BAE Systems Applied Intelligence (Integration) Limited

Annual Report and Financial Statements

31 December 2018

Registered Number: 03361831

Contents

Directors' Report

Company registration

BAE Systems Applied Intelligence (Integration) Limited (the 'Company') is a private company, limited by shares and registered in England and Wales with the registered number 03361831.

Business review

Financial results

The Company's profit for the financial year is £50k (2017: £198k). The fall in profit has been as a result of the declined revenue of £772k in the year. Revenue is fully achieved though intercompany recharges. Due to the reduced workforce following the reorganisation in 2017, a reduction in revenue has followed.

The directors do not propose a dividend for 2018 (2017: £nil).

Looking forward

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

Going concern

The Company's directors have a reasonable expectation that the Company will be able to continue in operational existence for at least 12 months from the date of approval of the financial statements, thus they have adopted the going concern basis of accounting.

Small companies exemption

The Directors' Report has been prepared in accordance with the special provisions relating to small companies within Part 15 of the Companies Act 2006, and consequently a Strategic Report has not been prepared.

Directors and their interests

The directors who served throughout the year and up to the date of this report, unless otherwise stated, were as follows:

S Duncan	Resigned: 18 June 2018
A D Leggetter	Resigned: 30 June 2018
D R Jones	Appointed: 18 June 2018
A G Jordan	Appointed: 18 June 2018

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.

Indemnity insurance

The directors of the Company have been indemnified against liability in respect of proceedings brought by third parties, subject to the conditions set out in the Companies Act 2006. Such qualifying third party indemnity provision was in force during the year and continues to be in force as at the date of this report. Directors' and Officers' liability insurance has been purchased in order to minimise the potential impact of such proceedings.

Disclosure of information to auditor

The directors who held office at the date of approval of this Directors' Report confirm that, so far as they are each aware, there is no relevant audit information of which the Company's auditor is unaware; and each director has taken all the steps that he/she ought to have taken to make himself/herself aware of any relevant audit information and to establish that the Company's auditor is aware of that information. This confirmation is given and should be interpreted in accordance with the provisions of S418 of the Companies Act 2006.

Directors' Report *(continued)*

Auditor

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

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

Approved by the Board and signed on its behalf by:

A G Jordan
Director

17 June 2019

Registered office:
BAE Systems Applied intelligence (Integration) Limited
Surrey Research Park
Guildford
Surrey
GU2 7YP

Directors' Responsibilities Statement

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

Company law requires the directors to prepare financial statements for each financial year. Under that law they have elected to prepare the financial statements in accordance with UK accounting standards and applicable law (UK Generally Accepted Accounting Practice), including Financial Reporting Standards "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;
- assess the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern;
- make judgements and estimates that are reasonable and prudent and;
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

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

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

Report on the audit of the financial statements.

Opinion

In our opinion the financial statements of BAE Systems Applied Intelligence (Integration) Limited (the "Company"):

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

We have audited the financial statements which comprise:

- the Income Statement and Statement of Comprehensive Income;
- the Balance Sheet;
- the Statement of Changes in Equity; and
- the related notes 1 to 10.

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

Basis for opinion

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

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

Conclusions relating to going concern

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

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

We have nothing to report in respect of these matters.

Other information

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

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

We have nothing to report in respect of these matters.

Responsibilities of directors

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

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

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

Auditor's responsibilities for the audit of the financial statements

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

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

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 Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the Directors' Report has 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 Directors' Report.

Matters on which we are required to report by exception

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

- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit; or
- the directors were not entitled to take advantage of the small companies' exemption in preparing the director's report and from the requirement to prepare a strategic report

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.

Thomas Murray

Thomas Murray ACA (Senior Statutory Auditor)

For and on behalf of Deloitte LLP

Statutory Auditor

Reading, UK

17 June 2019

Income Statement and Statement of Comprehensive Income

for the year ended 31 December 2018

	Notes	**2018**	2017
		£'000	£'000
Revenue		**2,561**	3,333
Operating costs	2	**(2,511)**	(3,135)
Operating profit and profit before tax		**50**	198
Tax	4	**-**	-
Profit for the year		**50**	198
Total comprehensive income		**50**	198

The notes on pages 10 to 16 form part of the financial statements.

The results for 2018 and 2017 arise from continuing activities.

Balance Sheet
as at 31 December 2018

	Notes	2018 £'000	2017 £'000
Current assets			
Trade and other receivables	6	**11,190**	11,143
Total assets		**11,190**	11,143
Current liabilities			
Trade and other payables	7	**(322)**	(325)
Total liabilities		**(322)**	(325)
Net assets		**10,868**	10,818
Equity			
Issued share capital	8	**71**	71
Share premium	8	**6,868**	6,868
Other reserves	8	**615**	615
Retained earnings		**3,314**	3,264
Total equity		**10,868**	10,818

Approved by the Board on 17 June 2019 and signed on its behalf by:

A G Jordan
Director

Registered number: 03361831

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

	Notes	Issued share capital	Share premium	Other reserves	Retained earnings	Total equity
		£'000	**£'000**	**£'000**	**£'000**	**£'000**
Total equity at 1 January 2018		71	6,868	615	3,264	10,818
Profit for the year		-	-	-	50	50
At 31 December 2018		71	6,868	615	3,314	10,868
Balance at 1 January 2017		71	6,868	615	3,066	10,620
Profit for the year		-	-	-	198	198
At 31 December 2017		71	6,868	615	3,264	10,818

Notes to the Financial Statements

1 Accounting policies

BAE Systems Applied Intelligence (Integration) 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 16. The principal activity of the Company is to solve complex and mission-critical problems through a combination of IT software, hardware and professional services.

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

Basis of preparation
These financial statements have been prepared in accordance with Financial Reporting Standard 101 "FRS 101" Reduced Disclosure Framework issued in September 2015. The amendments to FRS 101 (2015/16 cycle) issued in July 2016 and FRS 101 (2016/17 cycle) issued in July 2017 have no impact on the Company.

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

- the requirements of paragraphs 45(b) and 46 to 52 of IFRS 2 Share-based Payment;
- the requirements of IFRS 7 Financial Instruments: Disclosures;
- the requirements of paragraphs 91 to 99 of IFRS 13 Fair Value Measurement;
- the requirements of the second sentence of paragraph 110 and paragraphs 113(a), 114, 115, 118, 119(a) to (c), 120 to 127 and 129 of IFRS 15 Revenue from Contracts with Customers;
- the requirement in paragraph 38 of IAS 1 Presentation of Financial Statements, to present comparative information in respect of: paragraph 79(a)(iv) of IAS 1; paragraph 73(e) of IAS 16 Property, Plant and Equipment; paragraph 118(e) of IAS 38 Intangible Assets; and paragraphs 76 and 79(d) of IAS 40 Investment Property;
- the requirements of paragraphs 10(d), 10(f), 16, 38A, 38B, 38C, 38D, 40A, 40B, 40C, 40D, 111 and 134 to 136 of IAS 1 Presentation of Financial Statements;
- the requirements of IAS 7 Statement of Cash Flows;
- the requirements of paragraphs 30 and 31 of IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors;
- the requirements of paragraphs 17 and 18A of IAS 24 Related Party Disclosures;
- the requirements in IAS 24 Related Party Disclosures, to disclose related party transactions entered into between two or more members of a group, provided that any subsidiary which is a party to the transaction is wholly owned by such a member; and
- the requirements of paragraphs 130(f)(ii), 130(f)(iii), 134(d) to 134(f) and 135(c) to 135(e) of IAS 36 Impairment of Assets.

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

The following paragraphs summarise the main accounting policies of the Company and have, unless otherwise stated, been applied consistently to all periods presented in these financial statements.

The financial statements have been prepared under the historical cost convention, as modified by the revaluation of relevant financial assets and financial liabilities (including derivative instruments). These financial statements have been prepared using the going concern basis of accounting.

Judgements made in applying accounting policies
In the course of preparing the financial statements, no material 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.

Key sources of estimation uncertainty
No material estimates have been used in the creation of these financial statements

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.

Notes to the Financial Statements *(continued)*

1 Accounting policies *(continued)*

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.

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

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

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.

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.

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

Dividends
Equity dividends paid on ordinary share capital are recognised as a liability in the period in which they are declared.

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.

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.

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

Notes to the Financial Statements *(continued)*

1 Accounting policies *(continued)*

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

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

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

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

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

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

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

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

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

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

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

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

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

Share-based payments
BAE Systems plc, the Company's ultimate parent Company, issues equity-settled share options to employees of the Company. In accordance with the requirements of IFRS 2 Share-based Payment, the Company has recognised a charge for the equity-settled share options issued to its employees.

Equity-settled share options and long-term incentive plan arrangements are measured at fair value at the date of grant using an option pricing model.

The fair value is expensed on a straight-line basis over the vesting period, based on the Company's estimate of the number of shares that will actually vest.

Notes to the Financial Statements *(continued)*

2 Operating costs

Included within operating costs are the following expenses:	**2018 £'000**	2017 £'000
Staff costs (note 3)	**2,366**	2,915

For the year ended 31 December 2018 the fee for the audit of the financial statements of the Company was £5k (2017: £15k) and £nil (2017: £nil) in respect of non-audit work.

As noted in the Directors' Report, Deloitte LLP was appointed as statutory auditor for 2018, replacing KPMG LLP, who resigned following the 2017 audit. Accordingly, references related to 2018 relate to Deloitte LLP and 2017 to KPMG LLP.

3 Employees

The monthly average number of Company employees was 21 (2017: 29).

The aggregate staff costs of Company employees were as follows:

	2018 £'000	2017 £'000
Wages and salaries	**1,930**	2,370
Social security costs	**239**	293
Pension costs – defined contribution plans	**197**	252
	2,366	2,915

None of the directors received any emoluments from the Company during the year. All directors who served during the year were employed by other BAE Systems entities and were remunerated through those companies.

The directors did not provide any material qualifying services to the Company.

4 Tax

The Company has not provided for corporation tax for the year as any profits will be covered by the surrender of losses from other Group companies, in respect of which no payment will be made.

Reconciliation of tax result

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

	2018 £'000	2017 £'000
Profit before tax	**50**	198
UK corporation tax rate	**19.00%**	19.25%
Expected tax expense on profit	**10**	38
Research and development tax credits	**(1)**	12
Provisions and accruals	**(1)**	(3)
Utilisation of previously unrecognised tax losses	**(8)**	(47)
Imputed interest income	**40**	36
Losses received from other group companies	**(40)**	(36)
Tax result	**-**	-

Notes to the Financial Statements *(continued)*

5 Deferred tax

Unrecognised deferred tax asset

The deferred tax asset, which has not been recognised in the accounts, is made up as follows:

	2018 £'000	2017 £'000
Property, plant and equipment	**109**	109
Trading losses	**798**	784
Provisions and accruals	**3**	3
Share-based payments	**-**	3
	910	899

The deferred tax asset has not been recognised because there is insufficient evidence of future taxable profits to support its recoverability.

The UK corporation tax rate will be reduced to 17% with effect from 1 April 2020. The rate applying to the unrecognised deferred tax asset is 17% (2017 - 17%).

6 Trade and other receivables

	2018 £'000	2017 £'000
Current		
Amounts owed by ultimate parent company	**9,558**	9,443
Amounts owed by immediate parent company	**-**	107
Amounts owed by group subsidiaries	**1,631**	1,586
Other taxes and social security costs	**1**	4
Other receivables	**-**	3
	11,190	11,143

7 Trade and other payables

	2018 £'000	2017 £'000
Current		
Other taxes and social security costs	**52**	74
Accruals and deferred income	**192**	195
Other payables	**78**	56
	322	325

Notes to the Financial Statements *(continued)*

8 Share capital and other reserves

Share capital

	£0.01 Ordinary shares	Nominal value £'000
Issued and fully paid		
At 1 January and 31 December 2018	**7,124,245**	**71**

Equity dividends

No dividends were paid in respect of the year ended 31 December 2018 or 31 December 2017.

The directors do not propose a final dividend for 2018 (2017: £nil).

Other reserves

	Share premium £'000	Share based payments reserve £'000
At 1 January 2017	6,868	615
Share-based payment	-	-
At 31 December 2017	6,868	615
Share-based payment	-	-
At 31 December 2018	**6,868**	**615**

9 Changes in accounting policies

IFRS 9 Financial instruments – impact of adoption

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

Classification and measurement

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

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

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

Impairment of financial assets

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

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

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

Notes to the Financial Statements *(continued)*

9 Changes in accounting policies *(continued)*

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

Amounts due from BAE Systems plc equity accounted investments primarily relate to trading balances with no significant financing element, in accordance with IFRS 9. The simplified approach is therefore used for these balances. The identified impairment loss was immaterial.

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

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

IFRS 15 Revenue from Contracts with Customers – impact of adoption

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

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

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

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

The impact of adoption on the Company's retained earnings at 31 December 2017 and 1 January 2017 is nil.

10 Controlling parties

The Company's immediate parent company is Detica Group Limited. The ultimate and controlling party is BAE Systems plc which is the smallest and largest 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