

BAE Systems Applied Intelligence Limited

Annual Report and Financial Statements

31 December 2023

Registered number: 01337451

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Strategic Report
for the year ended 31 December 2023

Review of business and principal activities

BAE Systems Applied Intelligence Limited (the "Company") is a member of the BAE Systems plc Group ("BAE Systems Group" or "Group") of companies, its principal activities are the provision of data intelligence solutions which enable their customers, principally governments and government bodies, to defend against national scale threats, protect their networks and data against sophisticated attacks and operate successfully in cyber space.

The business performed strongly in 2023 delivering revenue growth despite the sale of the financial crime detection business in 2022. We have continued to see strong levels of demand for our products and services, as our core customers continue to invest in building cyber, data, digital and analytical capabilities. Operating profit was lower in the year due to an increase in company funded Research and Development expenditure, some cost inflation impact and some one-off profits in the previous year.

Key performance indicators

Key financial performance indicators are shown below:

	2023	2022
	£000	£000
Revenue	464,562	458,348
Operating profit	10,854	41,834

Revenue represents the amounts derived from the provision of goods and services. Revenue in the core government business grew strongly in the year which more than offset the impact of the sale of the financial crime detection business in the prior year.

Operating profit is used for internal performance analysis as a measure of operating profitability that is comparable over time. Operating profit has fallen despite revenue growth predominantly due to increased investment in the year, including in Research and Development, and due to the one off profit achieved last year on the sale of the SOCOS investment.

Strategic Report (continued)
for the year ended 31 December 2023

Principal risks and uncertainties

The Company's principal risks are identified below, along with their potential impact on the Company and how these are currently being managed:

The Company's largest customers are governments. The Company is dependent on government defence spending, and the timing and terms of trade of government contracts

Government spending

Description: The Company's core business is the sale of products and services directly and indirectly to departments and agencies of UK government. Levels of spending by governments are difficult to predict and can fluctuate depending on change of government policy, other political considerations, budgetary constraints, specific threats to national security and macro-economic conditions (including movements in oil prices). From time to time, there have been constraints on government expenditure in a number of the Company's principal markets.

Impact: Lower spending by the Company's major customers could have a material adverse effect on the Company's business, results of operations, financial condition and prospects.

Mitigation: The Directors believe that the diversified markets covered by the business and, in particular, the Company's focus on intellectual property led solutions to provide clients with greater value for money, provide some mitigation against this risk. In addition, the Company maintains flexibility in its employee base, enabling it to move resources to those areas where demand is greatest.

Government contracting

Description: The Company has long-standing relationships and security arrangements with the UK government and its agencies. It is important that these relationships and arrangements are maintained. In the defence and security industries, governments can typically modify contracts for their convenience or terminate them at short notice. Furthermore, governments also from time to time review their terms of trade and underlying policies and seek to impose such new terms and policies when entering into new contracts.

Impact: Deterioration in the Company's principal government relationships resulting in the failure to obtain contracts, adverse changes in the terms of its arrangements with those customers or their agencies, or the termination of contracts could have a material adverse effect on the Company's business, results of operations, financial condition and prospects.

Mitigation: Government customers have sophisticated procurement and security organisations with which the Company can have long-standing relationships with well-established and understood terms of business. In the event of a customer terminating a contract for convenience, the Company would typically be paid for work done and commitments made at the time of termination.

Contract timing and milestones

Description: The Company's profits and cash flows are dependent, to a significant extent, on the receipt and timing of the award of government contracts and the profile of cash receipts thereunder.

Impact: Amounts receivable under the Company's contracts can be substantial and therefore, the timing of, or failure to receive, awards and associated cash advances and milestone payments could materially affect the Company's profits and cash flows for the periods affected, thereby reducing cash available to meet the Company's cash allocation priorities. This in turn could have a material adverse effect on the Company's business, results of operations, financial condition and prospects.

Mitigation: The Company monitors a rolling forecast of its liquidity requirements to ensure that there is sufficient cash to meet its operational needs and maintain adequate headroom.

Strategic Report (continued)
for the year ended 31 December 2023

Principal risks and uncertainties (continued)

Delivery risk and supply chain

Contract risk and execution

Description: The Company executes high-value contracts for the provision of complex, strategically important products and services for its customers. It is important that the Company delivers on its projects within tight tolerances of quality, time and cost performance in a reliable, predictable and repeatable manner.

Impact: The failure by the Company to anticipate technical problems or deliver on its contractual commitments could result in (among other things) the loss, expiration, suspension, cancellation or termination of any one of its large contracts, which could have a material adverse effect on the Company's business, results of operations, financial condition, prospects or reputation.

Mitigation: All of the Company's major programmes are managed under the Company's mandated Lifecycle Management process, which includes contract-related risks. Robust bid preparation and approvals processes are well established within the Company, with decisions required to be taken at the appropriate level in line with clear delegations of authority. A leadership development programme for project directors is in place within the Company, covering the leadership competencies required to manage complex projects containing significant levels of risk and uncertainty.

Supply chain

Description: The Company is dependent upon the delivery of services and materials by suppliers and the assembly of components and subsystems by subcontractors used in its products in a timely and satisfactory manner, on satisfactory commercial terms and in full compliance with applicable terms and conditions. This can be exacerbated where the Company is dependent on either one or a limited number of suppliers. Some of the Company's suppliers or subcontractors may be impacted by the economic environment (including inflationary pressures and material shortages) which could impair their ability to meet their obligations to the Company and to supply on satisfactory commercial terms.

Impact: A failure by one or more of the Company's suppliers to provide the agreed-upon materials, components or products or perform the agreed-upon services, on a timely basis, at the agreed price, according to specifications (including compliance with regulatory requirements) or at all may adversely affect the Company's ability to perform its obligations, result in additional costs or delays, require the Company to transition work to other companies (resulting in further additional costs and delay) and/or result in penalties under, or the termination of, customer contracts. This impact is heightened where a supplier is a sole supplier or one of a small number of suppliers. Additionally, the Company could be adversely affected by actions, or issues experienced by, the Company's suppliers which are outside its control, such as misconduct and reputational issues involving the Company's suppliers, which could subject the Company to liability or adversely affect its ability to compete for contracts. Any of the foregoing could have a material adverse effect on the Company's business, results of operations, financial condition, prospects and reputation.

Mitigation: The Company's supply chain function establishes and manages enduring end-to-end integrated supplier arrangements, in partnership with the programmes it supports. In many cases, the Company benefits from long-term programme positions and incumbencies with more stable forward visibility for long-lead items allowing the Company to better manage supplier deliverables against programme requirements. Supply chain management starts with the BAE Systems Group's Global Procurement Policy which defines the requirements to be implemented by each of its sectors for the establishment of procurement controls and the management of supplier-related risk. Risk-based due diligence and audit activity is undertaken for each supplier whom the BAE System Group engages. Once a supplier has been approved, and a contract has been executed, the supply chain function continues to monitor that supplier. The supply chain risk management programme is working toward providing an enterprise-wide view of supplier risk, contributing to the continuity of supply and enabling better intelligence of sub-tier supply chain risk. Regular global supply chain meetings are held with senior procurement leaders to ensure that the latest risk data is appropriately shared. The Company seeks to manage inflation risk through its customer contracting arrangements on many of its major programmes, supplier cost management activity and through its long-term supplier agreements.

Strategic Report (continued)
for the year ended 31 December 2023

Principal risks and uncertainties (continued)

The Company could be negatively impacted by threats to the security of its information technology and operational technology systems

Description: As much of the Company's work relies on its reputation for strong security, in particular the services it provides for the national security community, which are subject to particularly stringent security requirements, it is critical that the Company's information technology and operational technology ("IT & OT") infrastructure, as well as the products and services it sells, are cyber resilient and the proprietary, classified, confidential or otherwise protected information, intellectual property and personal data held and processed on them are appropriately secured. Cyber security threats are continuous and evolving, and vary from attacks common to most industries, including those originating both externally and internally, to those from more advanced and persistent, highly organised adversaries, including nation states. The war in Ukraine has also increased Russian-aligned hacktivist activity against pro-Ukraine nations and their defence and national security industries. The cyber security threats faced by the Company include (but are not limited to): an attack impacting the availability of the Company's IT & OT infrastructure and systems and/or those of its customers, partners and suppliers; unlawful attempts to gain access to the Company's proprietary, classified, confidential or otherwise protected information, intellectual property and personal data, and that held or generated by the Company on behalf of its customers, partners and suppliers; and compromise of products and services for the purposes of sabotage or to disable or deny their use and/or alter their performance characteristics. The Company might also be exposed to cyber security risks through an attack on the Company's supply chain.

Impact: Given the nature and scope of cyber attacks, it is possible that the Company is unable to defend itself against all cyber-attacks, that unknown vulnerabilities could be exploited or that the Company may otherwise be unable to mitigate customer losses and other potential liabilities (including potential liabilities related to privacy and intellectual property). The Company could potentially be subject to: (a) production downtimes; (b) operational delays; (c) other detrimental impacts to its operations or ability to provide products and services to customers; (d) the compromise, misappropriation, destruction or corruption of the Company's proprietary, classified, confidential or otherwise protected information, intellectual property and personal data, and that held or generated by the Company on behalf of its customers, partners and suppliers; (e) security breaches; (f) other manipulation or improper use of the Company's or third-party systems, networks or products; and/or (g) financial losses from remedial actions, loss of business, or potential liability, penalties, fines and/or damages. Any of these could have a material adverse effect on the Company's business, results of operations, financial condition, prospects and reputation.

Mitigation: The security of the BAE Systems Group's products and services, data, facilities and IT & OT infrastructure is regularly considered by the BAE Systems Group's Board and senior management and underpins the BAE Systems Group's strategy and influences its engineering, technology and digital strategies. Education and awareness to embed a strong cyber security culture across the Company is another vital part of its preventative activities. Employees are subject to mandatory training which, depending on role, covers cyber security, physical security, document marking, security of export-controlled information, and personal data protection. As many cyber-attacks involve email, the Company runs a programme of phishing exercises for all email users across the enterprise. To further increase cyber resilience, the BAE Systems Group's Security Operations Centres perform continual protective monitoring of activity on core networks. The Cyber Incident Response plan feeds into the BAE Systems Group's crisis management plan and regular exercises are conducted across the business to test the Cyber Incident Response plan, including up to the BAE Systems Group's Executive Committee. The BAE Systems Group purchases cyber insurance; however, as with all insurance, it does not provide full cover against all potential loss scenarios. To mitigate the cyber security risk posed by suppliers, the Company includes cyber security-related obligations in its contracts where relevant. Cyber security risk is constantly reviewed and an agile, proactive, approach to mitigating the risk is taken. The BAE Systems Group does this by efficiently leveraging its core internal capabilities in cyber security, including its specialist threat intelligence service, to maintain a managed risk position as it digitally transforms and the threat landscape evolves.

Strategic Report (continued)
for the year ended 31 December 2023

Principal risks and uncertainties (continued)

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

Description: Competition for the people the Company needs to deliver its strategy, including those with innovative technological capabilities, is high. Competition may be intensified by nationality and regulatory restrictions (including the requirement for security clearances for certain roles), and exacerbated by macroeconomic, industry and labour market conditions more generally.

Impact: The loss of key employees or inability to attract the appropriate people on a timely basis could adversely impact the Company's ability to deliver its strategy, meet its business plan and deliver on its contractual commitments, which accordingly could have a material adverse effect on the Company's business, results of operations, financial condition and prospects.

Mitigation: The Company recognises that its employees are key to delivering its strategy and business plan, and focuses on developing the existing workforce and hiring talented people to meet current and future requirements. The Company has well-established graduate recruitment and apprenticeship programmes and, to maximise the contribution that its workforce can make to the performance of the business, has an effective through career capability development programme. In order to seek to maximise its talent pool, the Company is committed to creating a diverse and inclusive environment for its employees.

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.

Decision making

The BAE Systems Group Operational Framework (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

The safety, wellbeing, skills, capabilities and commitment of the Company's people are critical to ensuring the long-term sustainability of the Company's business and delivering the innovation needed to solve the Company's customers' complex challenges.

Effective engagement enables our employees to contribute to improving business performance and helps the Company to create an environment in which everyone is safe, valued and can fulfil their potential.

Strategic Report (continued)
for the year ended 31 December 2023

Section 172(1) statement (continued)
Employees (continued)

The Company used a range of channels to engage with employees throughout the year, as well as keeping employees informed about the performance, developments and prospects of the business and the BAE Systems Group. This included surveys and insight sessions; in-person and virtual meetings, briefings, conferences, events and listening forums at all levels; regular leadership updates through videos and events throughout the year (including in relation to financial and business performance); and engagement through the BAE Systems Group's Employee App, intranet, email and TV systems.

The Company operates an Employee Incentive Scheme which entitles all employees to a financial benefit against the achievement of a set of business and programme milestones. This ensures that all employees feel connected with, and are invested in, the Company's achievements.

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 24 and 56 of BAE Systems plc's 2023 Annual Report (available at: www.baesystems.com/investors).

Pursuant to the BAE Systems Group's People Policy, directors and employees are required to contribute to creating an engaged and inclusive working environment, where individuals are respected and where the value of a diverse workforce is recognised. Also, pursuant to the Policy, employees are to be provided with the means to give their views and feedback.

Through the implementation by the Company of these processes and policies, the directors have regard to the interests of the Company's employees.

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 it to create best-in-class, cost-effective equipment, goods, services and solutions.

Our largest customers are government and government bodies. Strong and collaborative relationships with our principal customers help us to identify their requirements and to position the Company as a trusted provider. The Directors and their delegates are in regular contact with the principal customers of the Company.

The Company, through its supply chain function, works with its suppliers to provide goods and services that meet its customers' requirements. The Company's supplier relationships are often long-term and meetings are held with key suppliers to foster deeper relationships with business in the supply chain and develop strategic relationships with key suppliers. The Group's supply chain function continues to actively manage supply lead times against demand requirements.

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. The Company implements the requirements of the BAE Systems Group's Community Investment Policy, which is mandated through the Operational Framework and 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.

The Company recognises that its operations have an impact on the environment – from the energy and resources it uses, to the products and services it supplies and the waste that it generates. 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,

Strategic Report (continued)
for the year ended 31 December 2023

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.

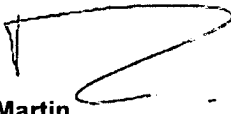
All the above activities form part of the Company's implementation of the BAE Systems Group-wide community and environment processes and policies and the BAE Systems Group's impacts thereon which are described on pages 59 to 60 and pages 48 to 55, respectively, of BAE Systems plc's 2023 Annual Report (available at: www.baesystems.com/investors).

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 the Company in attracting and retaining high-calibre employees.

Detailed information on the BAE Systems Group-wide business conduct processes and policies is described on pages 62 to 65 in BAE Systems plc's 2023 Annual Report (available at: www.baesystems.com/investors).

Approved by the Board and signed on its behalf by:


B Martin
Director

Date: 25 July 2024

Directors' Report

Company registration

BAE Systems Applied Intelligence Limited is a private company, limited by shares and registered in England and Wales with the registered number 01337451.

Results and dividends

The Company's profit for the financial year is £7,420k (2022: £34,848k). The Directors propose a dividend of £7,420k (2022: £34,848k).

The dividend proposed per share is £59.34 (2022: £278.68).

Directors and their interests

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

D J Lawton (resigned 09 October 2023)
D I Armstrong (resigned 31 December 2023)
B Martin (appointed 09 October 2023)
A J Thompson (appointed 01 January 2024)

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.

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 has net assets of £131,645k, made a profit of £7,420k and order intake continues to be positive. 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 on pages 48 to 55 and pages 232 to 235 of BAE Systems plc's 2023 Annual Report (available at www.baesystems.com/investors).

Looking forward

The services and products we offer in our Government businesses ensure that we are well placed to deliver growth as UK cyber, data and digital budgets increase and cyber security and information advantage continue to be an important part of a nation's security and economic prosperity.

During 2024 the Company continues to work within the BAE Systems Digital Intelligence group of companies, which brings together many of the Group's world-leading digital transformation, cyber security, complex data analysis and communication and information capabilities from across the BAE Systems Group.

Directors' Report (continued)

Financial instruments

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

Credit risk and liquidity

The applicable financial risk management policies and exposure to financial risks including price, credit, liquidity and cash flow risks are discussed in detail within the BAE Systems plc Group accounts.

Engagement with suppliers, customers and others

Engagement with suppliers, customers and others has been considered within the Strategic Report on page 6.

Research and development

The Company is focused on technology innovation and engineering excellence and invests in next-generation research and technology programmes to improve the manufacturing and service of products, generating substantial intellectual property. Total research and development expenditure in the year was £22,105k (2022: £13,300k), of which £22,105k (2022: £13,300k) was funded by the Company.

Employees

The Company is committed to giving full and fair consideration to applications for employment from disabled people who meet the requirements for roles, and making available training opportunities and appropriate accommodation to disabled people employed by the Company. In the event of members of staff becoming disabled every effort is made to ensure that their employment with the Company continues and that appropriate training is arranged.

Employee engagement enables our employees to contribute to improving business performance and helps us to gauge our performance in creating an environment in which everyone can fulfil their potential. Engagement with employees has been considered within the Strategic Report on page 6.

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

Qualifying indemnity provisions

The Directors of BAE Systems Pension Funds Trustees Limited, BAE Systems 2000 Pension Plan Trustees Limited and Alvis Pension Scheme Trustees Limited benefit from indemnities in the governing documentation of the BAE Systems Pension Scheme, the BAE Systems 2000 Pension Plan and the Alvis Pension Scheme, respectively, given by the Company, which are qualifying indemnity provisions for the purpose of the Companies Act 2006. All such indemnity provisions are in force at the date of this Directors' Report.

Directors' Report (continued)

Corporate governance statement

BAE Systems plc, the ultimate parent company of the Company, adheres to the UK Corporate Governance Code. The UK Corporate Governance Code's principles are embedded in the BAE Systems Group Operational Framework, which sets out the principles of good governance and encapsulates the BAE Systems Group's values, policies and processes. Each company in the BAE Systems Group is required to adhere to the Operational Framework, which enables the Group to deliver operational excellence in a clear, accountable and consistent way.

The policies and processes in the Operational Framework are enacted at a local level by each of the businesses in the BAE Systems Group. The Operational Framework is underpinned by an Operational Assurance Statement which is a six-monthly process used to monitor compliance with the Operational Framework and policies.

Accordingly, the Company has not applied any separate corporate governance code for the financial year as it believes the corporate arrangements described in this statement are appropriate for the Company.

Set out below is a summary of how principles of good corporate governance, as set out in the Operational Framework, apply to the Company:

Purpose, strategy, values and culture

The BAE Systems Group has a strategic framework that sets out the Group's vision, mission and strategy and sets out three strategic priorities which are embedded throughout each business in the Group. This provides the link between the Group's long-term strategy and the near-term business objectives for all employees in the Company. The Company produces a strategic plan, a financial forecast for the current year and financial projections for the next five years, aligning resources with the delivery of forecast financial performance and the BAE Systems Group's strategic objectives. 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.

The BAE Systems Group's strategy is supported by the Group's values of trusted, innovative and bold. The Group has a Code of Conduct which lays out the standards that are expected of each employee in the Company, to support the employees in doing the right thing. All employees in the Company receive annual training designed to stimulate conversations about ethical decision making.

Board and directors' accountability

The directors of the Company consist of the Managing Director and Finance Director of the main business of the Company. The Managing Director is responsible for ensuring local policies, processes and charters are in place in the businesses of the Company to implement the requirements of the Operational Framework and for ensuring those requirements are met.

Those requirements ensure that internal controls are in place and documented that are designed to provide effective and measurable management of operational risk and performance, in line with BAE Systems Group requirements. These controls provide assurance regarding:

- the reliability and integrity of information;
- compliance with policies, processes, laws, regulations and contracts;
- the safeguarding of assets and protection against fraud; and
- the economical and efficient use of resources.

The requirements also regulate how the BAE Systems Group expects the employees of the businesses of the Company to be managed and the obligations placed on all employees concerning avoiding conflicts of interest, anti-bribery, and managing the security of employees, information and other assets.

Directors' Report (continued)

Corporate governance statement (continued)

Board and directors' accountability (continued)

As part of a robust system of internal controls, the authority of the Managing Director of the business of the Company is subject to financial limits and other restrictions, above which matters must be referred upwards and ultimately to the Board of BAE Systems plc.

Risk

Responsibility for identifying, analysing, evaluating and managing principal and emerging risks in the businesses lies with the managing directors of the businesses for which they are responsible. As mentioned the Managing Director of the main business of the Company is a director of the Company. The Managing Director is also responsible for the reporting and monitoring of key risks in accordance with established processes under the BAE Systems Group's Operational Framework.

The BAE Systems plc's risk management process is set out in the Risk Management Policy, a mandated policy under the Operational Framework, and, in respect of projects, in the Lifecycle Management Framework, a core business process under the Operational Framework. The Lifecycle Management Policy sets out how the Company must plan and manage the execution of projects above a certain minimum level, providing decision gate reviews at key stages from initial opportunity to final closure.

Further guidance is provided by a Risk Management Maturity self-assessment tool. Identified risks are documented in risk registers showing: the risks that have been identified; characteristics of the risk; the basis for determining mitigation strategy; and what reviews and monitoring are necessary. Each risk is allocated an owner who has authority and responsibility for assessing and managing it.

The Board of BAE Systems plc has overall responsibility for determining the nature and extent of the risk the BAE Systems Group is willing to take and ensuring that risks are managed effectively across the Group.

Remuneration

The BAE Systems Group's Performance Leadership framework is a core business process designed to support the development of a diverse and inclusive culture that delivers the Group's strategy. The framework provides a principled approach to performance, assessment, development and reward for employees and is required to be implemented within the businesses of the Company.

The BAE Systems plc Remuneration Committee is responsible for reviewing the BAE Systems Group's workforce remuneration and related policies and the alignment of incentives and rewards with culture, and take these into account when setting the policy for executive remuneration.

Stakeholders

As regards employees, the Operational Framework includes a People Policy, pursuant to which the directors and employees are required to contribute to creating an engaged and inclusive work environment, where individuals are respected and where the value of a diverse workforce is recognised. The policy also requires employees to be provided with the means to give their views and feedback, and for the feedback to be responded to appropriately.

As regards customers, the Operational Framework makes it a priority of each business to understand their customers' evolving needs and expectations, and deliver on their commitments throughout the life of the business's products and services. The Operational Framework requires businesses to measure the delivery of such customer focus through reviews with customers and measurement of schedule adherence.

Directors' Report (continued)

Corporate governance statement (continued)

Stakeholders (continued)

As regards suppliers, the BAE Systems Group's policy is to identify and select suppliers which meet the Group's standards and to support them by managing risks throughout the lifecycle of any commercial arrangement. The businesses manage risk with their suppliers in accordance with the BAE Systems Group's Procurement Policy, Lifecycle Management Framework and Supplier Principles. The Directors of the businesses of the Company are required to oversee compliance with these policies and principles for the businesses for which they are responsible.

The BAE Systems Group's Environmental Policy outlines the Group's commitment to improving standards of environmental management, and compliance with the Policy is directed by environmental teams across the Group.

Pursuant to the BAE Systems Group's Community Investment Policy, the Global Community Investment Strategy aims to build and nurture mutually beneficial relationships between the Group's businesses and local stakeholders, including employee involvement in charitable activities and donations to local, national and international charities.

Climate-related financial disclosures

The Company has taken advantage of the exemption granted under The Companies (Strategic Report) (Climate-related Financial Disclosure) Regulations 2022 as this information is disclosed on pages 48 to 55 of BAE Systems plc's 2023 Annual Report (available at www.baesystems.com/investors).

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.

Post balance sheet events

There have been no significant events affecting the Company since the year end.

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.

Directors' Report (continued)

Approved by the Board and signed on its behalf by:



B Martin
Director

Date: 25 July 2024

Registered office:
BAE Systems Applied Intelligence Limited
Surrey Research Park
Guildford
Surrey
GU2 7RQ

Directors' Responsibilities Statement

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.

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

Report on the audit of the financial statements

Opinion

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

- give a true and fair view of the state of the company's affairs as at 31st December 2023 and of its profit for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice, including Financial Reporting Standard 101 "Reduced Disclosure Framework"; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

We have audited the financial statements which comprise:

- the Income Statement;
- the Statement of Comprehensive Income;
- the Balance Sheet;
- the Statement of Changes in Equity; and
- the related notes 1 to 26.

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.

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.

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

Other information (continued)

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. 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 and the directors about their own identification and assessment of the risks of irregularities, including those that are specific to the company's business sector.

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, which included the UK Companies Act, pension legislation and taxation legislation; 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, including in respect of export controls, defence contracting and anti-bribery and corruption legislation.

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

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

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.

As a result of performing the above, we identified the area with the greatest potential risk of fraud to be in relation to revenue recognition on certain (significant) contracts. The specific procedures we performed to respond to this risk are described below.

- We assessed whether revenue recognised to date is based on the current best estimates of the degree of work performed under the contract, which included reviewing the evidence for the progress made against the contract.
- We reviewed contract risk registers to provide evidence over the judgement taken when providing for the cost of mitigating technical risk and meeting future milestones.
- We assessed the reliability of management estimates through consideration of the historical accuracy of prior period management estimates, and through challenge of project managers.

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 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, and reviewing internal audit reports.

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.

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

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.



Jamie Mander ACA (Senior Statutory Auditor)

For and on behalf of Deloitte LLP
Statutory Auditor

Reading, United Kingdom

25 July 2024

Income Statement
for the year ended 31 December 2023

	Note	2023 £000	2022 £000
Revenue	3	464,562	458,348
Operating costs	4	(463,089)	(423,405)
Other income	5	9,381	6,891
Operating profit		10,854	41,834
Financial income	6	600	-
Financial expense	7	(509)	(722)
Profit before tax		10,945	41,112
Tax	10	(3,525)	(6,264)
Profit for the financial year		7,420	34,848

The notes on pages (21-64) form part of these financial statements.

Statement of Comprehensive Income
for the year ended 31 December 2023

	Note	2023 £000	2022 £000
Profit for the financial year		7,420	34,848
Other comprehensive income:			
Items that will not be reclassified to the Income Statement			
Remeasurements on defined benefit pension schemes	10	(4,100)	21,500
Tax on items that will not be reclassified to the income statement		-	(3,600)
Items that may be reclassified to the Income Statement:			
Fair value loss arising on hedging instruments during the year		(149)	(63)
Cumulative fair value gain on hedging instruments reclassified to the income statement		(295)	(173)
Tax on items that may be reclassified to the income statement		111	59
Other comprehensive (expense)/income for the year (net of tax)		(4,433)	17,723
Total comprehensive income for the year		2,987	52,571

The notes on pages 24 to 67 form part of these financial statements.

The results for 2023 and 2022 arise from continuing activities.

Balance Sheet
as at 31 December 2023

	Note	2023 £000	2022 £000
Non-current assets			
Property, plant and equipment	12	31,720	16,131
Right-of-use assets	13	19,113	19,955
Intangible assets	11	101	53
Investments	14	180	180
Other financial assets	15	208	-
Trade, other and contract receivables	16	1,170	1,170
Retirement benefit surpluses	19	4,700	7,300
Deferred tax assets	17	5,061	5,998
		62,253	50,787
Current assets			
Inventories	18	10,046	8,659
Trade, other and contract receivables	16	243,887	299,327
Other financial assets	15	5	508
Current tax		6,093	3,072
		260,031	311,566
Total assets		322,284	362,353

Balance Sheet (continued)
as at 31 December 2023

	Note	2023 £000	2022 £000
Non-current liabilities			
Lease liabilities	13	(17,554)	(18,414)
Other financial liabilities	15	(329)	-
Retirement benefit obligations	19	(400)	(500)
Provisions	20	(800)	(1,132)
		<u>(19,083)</u>	<u>(20,046)</u>
Current liabilities			
Trade, other and contract payables	21	(161,551)	(159,612)
Lease liabilities	13	(4,010)	(3,555)
Other financial liabilities	15	(33)	(232)
Provisions	20	(5,962)	(19,087)
		<u>(171,556)</u>	<u>(182,486)</u>
Total liabilities		<u>(190,639)</u>	<u>(202,532)</u>
Net assets		<u>131,645</u>	<u>159,821</u>
Capital and reserves			
Issued share capital	23	125	125
Other reserves	23	32,292	28,940
Retained earnings		99,228	130,756
Total equity		<u>131,645</u>	<u>159,821</u>

Approved by the Board on 25 July 2024 and signed on its behalf by:



B Martin
Director

Registered number: 01337451

Statement of Changes in Equity
for the year ended 31 December 2023

	Issued share capital	Other reserves	Retained earnings	Total equity
	£000	£000	£000	£000
At 1 January 2022	125	26,033	78,008	104,166
Profit for the year	-	-	34,848	34,848
Other comprehensive income for the year	-	(177)	17,900	17,723
Cumulative fair value gain on hedging instruments reclassified to the balance sheet (net of tax)	-	(130)	-	(130)
Share-based payments (inclusive of tax)	-	3,214	-	3,214
At 31 December 2022	125	28,940	130,756	159,821
Profit for the year	-	-	7,420	7,420
Other comprehensive expense for the year	-	(333)	(4,100)	(4,433)
Dividends (note 22)	-	-	(34,848)	(34,848)
Cumulative fair value loss on hedging instruments reclassified to the balance sheet (net of tax)	-	27	-	27
Share-based payments (inclusive of tax)	-	3,658	-	3,658
At 31 December 2023	125	32,292	99,228	131,645

The notes on pages 24 to 67 form part of these financial statements.

Notes to the Financial Statements

1. General information

BAE Systems Applied Intelligence Limited is a private company, limited by shares, and registered in England and Wales and incorporated in the United Kingdom. Its ultimate controlling party is disclosed in note 26. The address of the Company's registered office is shown on page 13.

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 (the Company's functional currency) and, unless otherwise stated, rounded to the nearest thousand.

2. Accounting policies

2.1 Basis of preparation

These financial statements have been prepared in accordance with FRS 101. The Company applies the recognition, measurement and disclosure requirements of International Financial Reporting Standards ("IFRS") and International Accounting Standards ("IAS"), 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 91-99 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 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 IAS 1 Presentation of Financial Statements to present comparative information in respect of:
 - paragraph 79(a)(iv) of IAS 1 Presentation of Financial Statements;
 - paragraph 73(e) of IAS 16 Property, Plant and Equipment; and
 - paragraph 118(e) of IAS 38 Intangible Assets; and
- 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;
- 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)-134(f) and 135(c)-135(e) of IAS 36 Impairment of Assets.

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

Notes to the Financial Statements

2. Accounting policies (continued)

2.1 Basis of preparation (continued)

The Company is exempt under Section 400 of the Companies Act 2006 from the requirement to prepare consolidated financial statements as it and its subsidiary undertakings are included by full consolidation in the consolidated financial statements of its ultimate parent, BAE Systems plc, a company registered in England and Wales. Accordingly, these financial statements present information about the Company as an individual undertaking and not as a group

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, as discussed in the Director's Report (page 8).

Key sources of estimation uncertainty

The application of the Company's accounting policies requires the use of estimates. In the event that these estimates or assumptions prove to be incorrect, there may be an adjustment to the carrying values of assets and liabilities within the next year. Potential areas of the Company's financial statements which could be materially impacted may include, but are not limited to:

Accounting policy	Description
Valuation of retirement benefit obligations	<p>A number of actuarial assumptions are made in assessing the value of post-employment benefit obligations, including discount rate, inflation rate, and mortality assumptions. For each of the actuarial assumptions used there is a wide range of possible values and management estimates a point within that range that most appropriately reflects the Company's circumstances.</p> <p>If estimates relating to these actuarial assumptions are no longer valid or change due to changing economic and social conditions, then the potential obligations due under these schemes could change significantly.</p> <p>Discount and inflation rates could change significantly as a result of a prolonged economic downturn, monetary policy decisions and interventions or other macroeconomic issues. The impact of estimates made with regard to mortality projections may also change.</p>

Notes to the Financial Statements

2. Accounting policies (continued)

2.1 Basis of preparation (continued)

Valuation of retirement benefit obligations
(continued)

Similarly, the values of many assets are subject to estimates and assumptions, in particular those which are held in unquoted pooled investment vehicles. The associated fair value of these unquoted pooled investments is estimated with consideration of the most recently available valuations provided by the investment or fund managers. These valuations inherently incorporate a number of assumptions including the impact of climate change on the underlying investments. The overall level of estimation uncertainty in valuing these assets could therefore give rise to a material change in valuation within the next 12 months.

Furthermore, estimates are required around the Group's ability to access its defined benefit surpluses, and on what basis, which then determines the associated rate of tax to apply. Depending on the outcome, judgment is then required to determine the presentation of any tax payable in recovering the surplus.

Note 19 provides information on the key assumptions and analysis of their sensitivities.

Critical accounting judgments

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.

Changes in accounting policies

The following standards, interpretations and amendments to existing standards became effective on 1 January 2023 and have not had a material impact on the Company:

- IFRS 17 Insurance Contracts, effective from 1 January 2023;
- Amendments to IAS 1: Presentation of Financial Statements, effective from 1 January 2023;
- Amendments to IFRS Practice Statement 2: Disclosure of Accounting Policies, effective from 1 January 2023;
- Amendments to IAS 8: Accounting Policies, Changes in Accounting Estimates and Errors, effective from 1 January 2023; and
- Amendments to IAS 12: Income Taxes, effective from 1 January 2023.

Notes to the Financial Statements

2. Accounting policies (continued)

2.1 Basis of preparation (continued)

The following other standards, interpretations and amendments to existing standards have been issued but were not mandatory for accounting periods beginning on 1 January 2023. These either have been, or are expected to be endorsed by the UK Endorsement Board and are not expected to have a material impact on the Company:

- Amendments to IAS 1: Classification of Liabilities as Current or Non-current, effective from 1 January 2024;
- Amendments to IAS 1: Non-Current Liabilities with Covenants, effective from 1 January 2024;
- Amendments to IAS 7 and IFRS 7: Supplier Finance Arrangements, effective from 1 January 2024;
- Amendments to IFRS 10 and IAS 28: Sale or Contribution of Assets between an Investor and its Associate or Joint Venture;
- Amendments to IFRS 16: Lease Liability in a Sale and Leaseback, effective from 1 January 2024; and
- IFRS 18 Presentation and Disclosure in Financial Statements, effective from 1 January 2027.

Material accounting policies

The material 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 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.

The Company accounts for revenue in accordance with IFRS 15 Revenue from Contracts with Customers. For most of the Company's contracts, revenue and associated margin are recognised progressively over time as costs are incurred, and as risks have been mitigated or retired.

The ultimate profitability of contracts is based on estimates of revenue and costs, including allowances for technical and other risks, which are reliant on the knowledge and experience of the Company's project managers, engineers, and finance and commercial professionals. Material changes in these estimates could affect the profitability of individual contracts. Revenue and cost estimates are reviewed and updated at least quarterly, and more frequently as determined by events or circumstances.

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

2. Accounting policies (continued)

2.2 Revenue and profit recognition (continued)

Transaction price

At the start of the contract, the total transaction price is estimated as the amount of consideration to which the Company expects to be entitled in exchange for transferring the promised goods and services to the customer, excluding sales taxes. Variable consideration, such as price escalation, is included based on the expected value or most likely amount only to the extent that it is highly probable that there will not be a reversal in the amount of cumulative revenue recognised. The transaction price does not include estimates of consideration resulting from contract modifications, such as change orders, until they have been approved by the parties to the contract. The total transaction price is allocated to the performance obligations identified in the contract in proportion to their relative stand-alone selling prices. Given the bespoke nature of many of the Company's products and services, which are designed and/or manufactured under contract to the customer's individual specifications, there are typically no observable stand-alone selling prices. Instead, stand-alone selling prices are typically estimated based on expected costs plus contract margin consistent with the Company's pricing principles. The Company therefore has significant contract liabilities.

Revenue and profit recognition

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

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

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

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

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

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

Notes to the Financial Statements

2. Accounting policies (continued)

2.2 Revenue and profit recognition (continued)

Software licences

The Company sells software licences either separately or together with other goods and services, including computer hardware and implementation, hosting and support. Revenue recognition in respect of software licences sold as part of a bundle of goods and services is considered separately when the licence is determined to be a separate performance obligation. Software licences either represent a right-to-access the Company's intellectual property as it exists throughout the licence period or a right to use the Company's intellectual property as it exists at the point in time at which the licence is granted. Revenue in respect of right-to-access licences is recognised over the licence term or, in relation to perpetual licences, over the related customer relationship, and revenue in respect of right-to-use licences is recognised up front on delivery to the customer. A software licence is considered to be a right-to-access the Company's intellectual property as it exists throughout the licence period if all of the following criteria are satisfied:

- the contract requires, or the customer reasonably expects, that the Company will undertake activities that significantly affect the intellectual property; and
- the licence directly exposes the customer to the effects of those activities; and
- those activities do not result in the transfer of a good or service to the customer.

If one or more of the above criteria is not met then the licence revenue is recognised at the point in time control of the licence passes to the customer

Outstanding commitments

The Company regularly reviews outstanding commitment for purchases in its supply chain in order to inform revenue recognition under IFRS 15 trading principles. Where the Company has received notification that the supplier has completed the manufacture of goods, but has not yet delivered and invoiced for them and the ultimate customer controls the asset, i.e. neither the subcontractor or the Company have an alternative use for the asset, the Company will accrue for these costs and recognise revenue in line with overtime trading principles under IFRS 15.

Contract modifications

The Company's contracts are often amended for changes in customers' requirements and specifications. A contract modification exists when the parties to the contract approve a modification that either changes existing or creates new enforceable rights and obligations. The effect of a contract modification on the transaction price and the Company's measure of progress towards the satisfaction of the performance obligation to which it relates is recognised in one of the following ways:

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

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

Costs to obtain a contract

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

Notes to the Financial Statements

2. Accounting policies (continued)

2.2 Revenue and profit recognition (continued)

Costs to fulfil a contract

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

2.3 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.

The carrying amounts of the Company's right-of-use assets are reviewed at each Balance Sheet date to determine whether there is any indication of impairment.

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.

2.4 Research and development

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

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

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

2.5 Interest income and borrowing costs

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

Notes to the Financial Statements

2. Accounting policies (continued)

2.6 Intangible assets

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

Goodwill

Under the acquisition method for business combinations, goodwill is the acquisition-date fair value of the consideration transferred, less the net of the acquisition-date fair values of the identifiable assets acquired and liabilities assumed. Goodwill on acquisitions of businesses is included in intangible assets. Gains and losses on the disposal of a business include the carrying amount of goodwill relating to the business sold.

Software

Software includes:

- Computer software licences acquired for use within the Company which are capitalised as an intangible asset on the basis of the costs incurred to acquire and bring to use the specific software; and
- 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, which 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

Goodwill is not amortised. Amortisation on intangible assets, excluding goodwill, is charged to the Income Statement on a straight-line basis over their estimated useful lives.

The non-amortisation of goodwill can conflict with the Companies Act 2006 which requires goodwill to be written off over its useful economic life. As such the Company applies the 'true and fair' override available to entities.

The estimated useful lives are as follows:

Software	-	2 to 5 years
Other	-	Up to 10 years

2.7 Property, plant and equipment

Cost

Items of property, plant and equipment are stated at cost less accumulated depreciation and impairment losses. The cost of self-constructed assets includes the cost of materials, direct labour, testing costs 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.

Notes to the Financial Statements

2. Accounting policies (continued)

2.7 Property, plant and equipment (continued)

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:

Leasehold buildings	- the lease term
Office furniture and equipment	- 20%
Computer, ancillary equipment and electronic test equipment	- 20-33%

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.

2.8 Impairment

The carrying amounts of the Company's intangible assets, property, plant and equipment and right-of-use 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 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 intangible assets, property, plant and equipment and right-of-use assets 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.

2.9 Investments

Fixed asset investments in shares in subsidiary undertakings and in shares in participating interests are stated at cost less provision for impairment.

Notes to the Financial Statements

2. Accounting policies (continued)

2.10 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.

2.11 Inventories

Inventories are stated at the lower of cost, including all relevant overhead expenditure, and net realisable value. Inventory is valued using moving average unit cost method.

2.12 Trade, contract and other 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.

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.

The Company writes off a 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.

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.

2.13 Trade, other and contract payables

Trade and other payables are stated at amortised cost.

Contract liabilities represent the obligation to transfer goods or services to a customer for which consideration has been received, or consideration is due, from the customer.

Notes to the Financial Statements

2. Accounting policies (continued)

2.14 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.

Warranties and after-sales service

Warranties and after-sales service are provided in the normal course of business with provisions for associated costs being made based on an assessment of future claims with reference to past experience. A provision for warranties is recognised when the underlying products and services are sold. The provision is based on historical warranty data and a weighting of possible outcomes against their associated probabilities.

IT provisions

IT costs that will be incurred as a result of separating the Digital Intelligence networks from the Financial Crime business.

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.

2.15 Financial instruments

Derivative financial instruments and hedging activities

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

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

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 based on reputable third party forecast data, and then adjusting for credit risk, including the Company's own credit risk, and market risk.

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 year.

Notes to the Financial Statements

2. Accounting policies (continued)

2.15 Financial instruments (continued)

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 removed from the hedging reserve and included in the cost of the underlying transaction or reclassified to the Income Statement when the underlying transaction affects profit or loss. These amounts are presented within the same line item in the Income Statement as the underlying transaction, typically revenue or operating costs. 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.

2.16 Dividends

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

2.17 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.

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

IAS 19 Employee Benefits, limits the measurement of a defined benefit surplus to the lower of the surplus in the defined benefit scheme and the asset ceiling. The asset ceiling is the present value of any economic benefits available in the form of refunds from the scheme or reductions in future contributions to the scheme. IFRIC 14 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction, issued in 2007, provides an interpretation of the requirements of IAS 19, clarifying that a refund is available if the entity has an unconditional right to a refund in certain circumstances. The Company has applied IFRIC 14 and has determined that there is no limit on the recognition of the surpluses in its defined benefit pension schemes as at 31 December 2023. The surpluses have been recognised on the basis that the future economic benefits are unconditionally available to the Company,

Notes to the Financial Statements

2. Accounting policies (continued)

2.17 Retirement benefit obligations (continued)

which is assumed to be via a refund. These have been recognised after deducting a 35% withholding tax which would be levied prior to the future refunding of any surplus and have been presented on a net basis as this is not deemed to be an income tax of the Company.

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.

2.18 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 in 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 tax 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.

Notes to the Financial Statements

2. Accounting policies (continued)

2.18 Tax (continued)

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

2.19 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

3. Revenue

Revenue by class of business

	2023 £000	2022 £000
Fixed Price	237,382	204,245
Time and Materials	175,172	173,262
Intercompany Service Fees	21,928	32,135
Maintenance and Software Support	14,633	20,173
Licence	789	17,127
Other	14,658	11,406
	464,562	458,348

Revenue by customer location:

	2023 £000	2022 £000
United Kingdom	454,999	451,790
Rest of Europe	5,111	4,425
North America	1,498	1,437
Rest of World	2,954	696
	464,562	458,348

Notes to the Financial Statements

4. Operating costs

	2023	2022
	£000	£000
Inventory recognised as an expense	7,691	4,203
Staff costs (note 8)	248,991	227,740
Depreciation of fixed assets	2,745	3,627
Depreciation of right of use assets	3,531	3,485
Amortisation of intangible assets	86	106
Lease and sublease expense	849	1,055
Other operating charges	199,196	183,189
	463,089	423,405
	463,089	423,405

The remuneration of the auditor for the year ended 31 December 2023 for auditing of the financial statements was £257k (2022: £254k) and £nil (2022: £nil) in respect of non-audit work.

Total research and development expenditure was £22,105k (2022: £13,300k), of which £22,105k (2022: £13,300k) was funded by the Company.

5. Other income

	2023	2022
	£000	£000
Research and development expenditure credits	6,035	-
Transitional Services Agreement	3,346	-
Gain on sale of shares	-	6,891
	9,381	6,891
	9,381	6,891

6. Financial income

	2023	2022
	£000	£000
Net interest income on retirement benefit obligations (note 19)	600	-
	600	-
	600	-

Notes to the Financial Statements

7. Financial expense

	2023	2022
	£000	£000
Net interest expense on retirement benefit obligations (note 19)	-	200
Interest expense on lease liabilities (note 13)	509	522
	509	722
	509	722

8. Employees

The average monthly number of employees during the year was as follows:

	2023	2022
	No.	No.
Engineering	1,467	1,394
Consulting	511	498
Production & Product Management	298	304
Overhead	351	396
	2,627	2,592
	2,627	2,592

The aggregate staff costs of Company employees were as follows:

	2023	2022
	£000	£000
Wages and salaries	209,739	190,523
Social security costs	23,500	21,971
Cost of defined benefit pension scheme (note 19)	600	1,600
Cost of defined contribution pension scheme (note 19)	11,872	10,897
Share-based payments (note 24)	3,280	2,749
	248,991	227,740
	248,991	227,740

Notes to the Financial Statements

9. Directors' remuneration

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

	2023	2022
	£000	£000
Directors' remuneration	1,211	1,076
Amounts receivable under long-term incentive schemes	17	16
Company contributions to defined benefit pension schemes	-	50
	1,228	1,142

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

	2023	2022
	Number of directors	Number of directors
Defined contribution schemes	2	-
Defined benefit schemes	-	2

	2023	2022
	Number of directors	Number of directors
Number of directors who exercised share options	1	1
Number of directors in respect of whose qualifying services shares were received or receivable under long-term incentive schemes	2	1

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

	2023	2022
	£000	£000
Remuneration and amounts receivable under long-term incentive schemes	878	577
Company contributions to defined benefit pension schemes	-	25
	878	602

The highest paid director's defined benefit accrued pension and accrued lump sum at 31 December 2023 were £250k (2022: £240k) and £nil (2022: £nil), respectively.

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

Notes to the Financial Statements

10. Tax

Tax expense

	2023	2022
	£000	£000
Current tax		
UK:		
Current tax	1,805	4,680
Adjustments in respect of prior years	247	583
Overseas:		
Current tax expense	55	108
	2,107	5,371
Deferred tax		
Origination and reversal of temporary differences	436	893
Tax rate adjustment ¹	-	(189)
Adjustments in respect of prior years	982	189
	1,418	893
	3,525	6,264

Tax expense

Reconciliation of tax expense

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

	2023	2022
	£000	£000
Profit before tax	10,945	41,112
UK corporation tax rate	23.52%	19.00%
Expected tax expense	2,574	7,811
Expenses not tax effected	(459)	(110)
Research and development expenditure credits	(117)	(393)
Effect of tax rates in foreign jurisdictions	55	108
Property, plant and equipment	81	111
Provisions and accruals	(60)	-
Pensions	(384)	57
Share-based payments	(211)	(374)
Imputed interest expense	1,669	484
Losses received from group companies	(852)	(2,013)
Adjustments in respect of prior years	1,229	772
Tax rate adjustment ¹	-	(189)
	3,525	6,264

Tax expense

Notes to the Financial Statements

10. Tax (continued)

Pillar Two income taxes rules. The Company, as part of the wider BAE Group is within the scope of the rules and the first period for which a Pillar Two tax return will be required for the BAE Group is the accounting period ending on 31 December 2024.

11. Intangible assets

	Goodwill £000	Software £000	Other £000	Total £000
Cost				
At 1 January 2023	27,531	738	4,742	33,011
Additions	-	134	-	134
On acquisition of subsidiaries	-	-	-	-
At 31 December 2023	27,531	872	4,742	33,145
Amortisation/impairment				
At 1 January 2023	27,531	685	4,742	32,958
Amortisation charge for the year	-	86	-	86
At 31 December 2023	27,531	771	4,742	33,044
Net book value				
At 31 December 2023	-	101	-	101
At 31 December 2022	-	53	-	53

Notes to the Financial Statements

12. Property, plant and equipment

	Short leasehold improvements £000	Office furniture and equipment £000	Computer and ancillary equipment £000	Electronic test equipment £000	Assets in the course of construction £000	Total £000
Cost or valuation						
At 1 January 2023	16,386	1,263	4,341	5,130	8,604	35,724
Additions	3,974	-	646	7	13,979	18,606
Disposals	(13)	(714)	-	-	(134)	(861)
Transfers between classes	(67)	-	117	54	(104)	-
At 31 December 2023	20,280	549	5,104	5,191	22,345	53,469
Depreciation						
At 1 January 2023	12,370	673	2,781	3,769	-	19,593
Depreciation charge for the year	1,092	136	544	973	-	2,745
Disposals	-	(589)	-	-	-	(589)
At 31 December 2023	13,462	220	3,325	4,742	-	21,749
Net book value						
At 31 December 2023	6,818	329	1,779	449	22,345	31,720
At 31 December 2022	4,016	590	1,560	1,361	8,604	16,131

Notes to the Financial Statements

13. Leases

The Company leases land, buildings, and vehicles under non-cancellable lease arrangements. There are no terms that represent unusual arrangements or create material onerous or beneficial rights or obligations.

	2023		
	Vehicles	Land and buildings	Total
	£000	£000	£000
Opening net book value as at 01 January	-	19,955	19,955
Additions during the year	68	-	68
Disposals during the year	-	(1,682)	(1,682)
Modifications	-	2,621	2,621
Depreciation expense for the year	(30)	(3,501)	(3,531)
Depreciation eliminated on disposal	-	1,682	1,682
Closing net book value as at 31 December	<u>38</u>	<u>19,075</u>	<u>19,113</u>
	2022		
	Vehicles	Land and buildings	Total
	£000	£000	£000
Opening net book value as at 01 January	-	15,937	15,937
Additions during the year	-	2,558	2,558
Disposals during the year	-	(547)	(547)
Modifications	-	5,267	5,267
Depreciation expense for the year	-	(3,485)	(3,485)
Depreciation eliminated on disposal	-	225	225
Closing net book value as at 31 December	<u>-</u>	<u>19,955</u>	<u>19,955</u>

Notes to the Financial Statements

13. Leases (continued)

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.

	2023	2022
	£000	£000
Payments due:		
Within one year	4,507	3,555
Between one and five years	11,743	13,054
Later than five years	7,538	7,170
	23,788	23,779
Impact of discounting	(2,174)	(1,810)
Total discounted lease liability	21,614	21,969

The total cash outflow for leases recognised on the Balance Sheet in the year ended 31 December 2023, amounted to £3,715k (2022: 694k).

Amounts recognised in the Income Statement

	2023	2022
	£000	£000
Included in operating costs:		
Depreciation on right-of-use assets	3,531	3,485
	3,346	-
Included in net finance costs:		
Interest expense on lease liabilities	509	522
	509	522

Notes to the Financial Statements

14. Investments

	Investments in subsidiary companies £000
Cost/net book value	
At 1 January 2023 and 31 December 2023	<u>180</u>

Impairment testing

During the year, management conducted an impairment review of the investments held by the Company. As a result of this review, no impairment charges were recognised.

The recoverable amount of the investments held by the Company has been calculated with reference to their value in use. The value-in-use calculations use risk-adjusted future cash flow projections based on the five-year Integrated Business Plan (IBP) and include a terminal value based on the projections for the final year of that plan, with growth rate assumptions in the range 0% to 2% applied. The IBP process includes the use of historic experience, available government spending data and the BAE Systems plc Group's order backlog. Pre-tax discount rates, derived from the Group's post-tax weighted average cost of capital of 8.0% (2022: 8.0%) (adjusted for risks specific to the market in which the cash-generating unit operates), have been used in discounting these projected risk-adjusted cash flows.

Subsidiary undertakings and participating interests at 31 December 2023

In accordance with Section 409 of the Companies Act 2006, a full list of subsidiary undertakings and significant holdings as at 31 December 2023 is disclosed below. The subsidiary undertaking is owned directly by the Company and has a financial year end of 31 December.

Company name	Class of shares held	Proportion of class (%)
BAE Systems Applied Intelligence Malaysia Sdn Bhd <i>Level 25, Menara Hong Leong, No 6 Jalan Damanlela,</i>	Ordinary	99.99%

Notes to the Financial Statements

15. Financial instruments

	2023 £000	2022 £000
Other financial assets		
Non-current		
Cash flow hedges – foreign exchange contracts	208	-
	<u>208</u>	<u>-</u>
Current		
Cash flow hedges – foreign exchange contracts	5	508
	<u>5</u>	<u>508</u>
Other financial liabilities		
Non-current		
Cash flow hedges – foreign exchange contracts	(329)	-
	<u>(329)</u>	<u>-</u>
Current		
Cash flow hedges – foreign exchange contracts	(33)	(232)
	<u>(33)</u>	<u>(232)</u>

Notes to the Financial Statements

16. Trade, other and contract receivables

	2023	2022
	£000	£000
Non current		
Amounts owed by BAE Systems plc subsidiaries	1,170	1,170
	1,170	1,170
Current		
Contract receivables	32,265	33,654
Trade debtors	45,387	31,525
Amounts owed by BAE Systems plc subsidiaries	24,541	31,289
Amounts owed by BAE Systems plc	126,289	184,885
Prepayments	14,043	12,819
Amounts owed by former related parties	-	2,533
Other receivables	1,362	2,622
	243,887	299,327

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

Amounts owed by former related parties are in connection with the disposal of the financial crime detection business.

The impact of discounting non-current amounts owed by BAE Systems plc and its subsidiaries is not material so has not been applied.

Notes to the Financial Statements

17. Deferred taxation

Deferred tax assets/(liabilities)

	Deferred tax assets		Deferred tax liabilities		Net balance at 31 December	
	2023 £000	2022 £000	2023 £000	2022 £000	2023 £000	2022 £000
Property, plant and equipment	1,874	4,606	-	-	1,874	4,606
Provisions and accruals	1,586	87	-	-	1,586	87
Retirement benefit schemes:						
Additional contributions and other	-	493	-	-	-	493
Share-based payments	1,567	881	-	-	1,567	881
Financial instruments	34	-	-	(69)	34	(69)
Deferred tax assets	5,061	6,067	-	(69)	5,061	5,998
Set off of tax	-	(69)	-	69	-	-
Deferred tax assets	5,061	5,998	-	-	5,061	5,998

Deferred tax assets

Movement in temporary differences during the year

	At 1 January 2023 £000	Recognised in income £000	Recognised in equity £000	At 31 December 2023 £000
Property, plant and equipment	4,606	(2,732)	-	1,874
Provisions and accruals	87	1,499	-	1,586
Additional contributions and other	493	(493)	-	-
Share-based payments	881	308	378	1,567
Financial instruments	(69)	-	103	34
	5,998	(1,418)	481	5,061

Notes to the Financial Statements

17. Deferred taxation (continued)

	At 1 January 2022 £000	Recognised in income £000	Recognised in equity £000	At 31 December 2022 £000
Property, plant and equipment	5,108	(502)	-	4,606
Provisions and accruals	431	(344)	-	87
Retirement benefit schemes:				
Deficits	3,600	-	(3,600)	-
Additional contributions and other	892	(399)	-	493
Share-based payments	64	352	465	881
Financial instruments	(171)	-	102	(69)
	<u>9,924</u>	<u>(893)</u>	<u>(3,033)</u>	<u>5,998</u>

The Government announced in 2021 that from 1 April 2023 the UK corporation tax rate would increase from 19% to 25%. The deferred tax asset has been calculated at the tax rates, enacted at each Balance Sheet date, expected to apply to the temporary differences when they reverse. The resulting tax rate adjustment has been recorded in the Income Statement and partly recorded in the Income Statement and partly in the Statement of Comprehensive Income and Statement of Changes in Equity.

The deferred tax assets continue to be recognised to the extent that there is evidence that future taxable profits will be available against which the temporary differences to which they relate will reverse. This conclusion is reached from an annual review of the Company's forecasts for the next five years.

18. Inventories

	2023 £000	2022 £000
Raw materials and consumables	1,452	863
Work in progress	5,960	5,663
Finished goods	2,634	2,133
	<u>10,046</u>	<u>8,659</u>

Notes to the Financial Statements

19. 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 35.

At 31 December 2023, the weighted average durations of the UK defined benefit pension obligations were 13 years (2022 13 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) ¹	28	21	51

1. Source: 31 March 2021 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.baesystems.com/en-pensions/home.

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 57 - 63.

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.

Notes to the Financial Statements

19. Retirement benefit obligations (continued)

Funding (continued)

Introduction (continued)

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 57. 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 accelerated payment in 2021 of the remaining sponsor deficit reduction contributions under the previously agreed deficit recovery plan, BAE Systems plc and the Trustees agreed to carry out an early triennial funding valuation for the Main Scheme as at 31 March 2021, this valuation was concluded and signed off on 30 June 2022.

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 March 2021 £bn
Market value of assets	22.9
Present value of liabilities	(22.9)
Funding (deficit)/surplus	-
Percentage of accrued benefits covered by the assets at the valuation date	100%

The valuations 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)	88 – 90
Life expectancy of a male currently aged 45 (years)	88 – 91
Life expectancy of a female currently aged 45 (years)	90 – 93

As part of the process of the Main Scheme's 2021 valuation, the Trustees and BAE Systems plc agreed to update the methodology to use a cash flow matching strategy, such that assets are invested with the aim of the expected income directly matching the expected benefit payments of the Scheme. The cash flow matching strategy aims to manage risk through a defined amount of risk buffer assets, which equate to the agreed prudence margin in the valuation. The risk buffer assets are measured over time to assure the Scheme is sufficiently funded. The asset portfolio is currently invested in a selection of bonds designed to match the pension payments for current pensioners, as well as a mix of growth seeking assets aimed to generate returns for the pension payments for future pensioners. Over time, assets from the return seeking portfolio will be realised to purchase additional, lower risk assets to match the increasing current pensioner portfolio.

The inflation assumptions for each of the valuations were derived 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.

Notes to the Financial Statements

19. Retirement benefit obligations (continued)

Funding (continued)

Valuations (continued)

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.

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

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

Contributions

Under the terms of the trust deeds of the UK schemes, BAE Systems plc is required to have a funding plan determined at the conclusion of the triennial funding valuations.

The total Company contributions made to the defined benefit schemes in the year ended 31 December 2023 were £2,100k (2022 £1,900k). Contributions in 2024 are expected to be at a similar level to 2023.

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.

Notes to the Financial Statements

19. Retirement benefit obligations (continued)

Risk	Mitigation
<p>Market (investment) risk Asset returns may not move in line with the liabilities and may be subject to volatility.</p>	<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 38% (2022 46%) 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>The UK Main Scheme reduced its allocation to equities significantly over the course of 2023, and closed out its equity option strategy to reflect its limited resultant exposure to equity markets.</p> <p>Environmental (including exposure to climate related risks), Social and Governance (ESG) factors are incorporated into the investment analysis and decision-making process carried out by the Trustees of the UK schemes. There is alignment between the UK Main Scheme and Company's climate change objectives with consistent long-term net zero ambitions.</p>
<p>Interest rate risk Liabilities are sensitive to movements in interest rates, with lower interest rates leading to an increase in the valuation of liabilities.</p>	<p>As part of the funding valuation finalised during 2022, the main UK Scheme has adopted a cash flow matching strategy, whereby contractual income from assets is designed to directly match benefits paid to members each year. A portfolio of assets with contractual income has been structured to match benefits already in payment, representing around half of the liabilities. This inherently hedges the associated interest rate risk. As members retire and become pensioners, additional matching assets will be purchased to keep pace. Interest rate risk associated with the remaining purchase of matching assets is mitigated via a hedging strategy involving mainly physical assets rather than derivatives and only modest levels of leverage. The overall level of interest rate hedging on the funding basis has increased compared to 2022.</p>
<p>Inflation risk Liabilities are sensitive to movements in inflation, with higher inflation leading to an increase in the valuation of liabilities.</p>	<p>The main UK Scheme's cash flow matching strategy includes aligning asset income to the inflation-linked members' benefit payments. Inflation risk is mitigated by the presence of caps on most inflation linked benefits and via a hedging strategy, executed with several banks to reduce counterparty risk. The overall level of inflation hedging on the funding basis has increased compared 2022.</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>
<p>Longevity risk Liabilities are sensitive to life expectancy, with increases in life expectancies leading to an increase in the valuation of liabilities.</p>	<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 & 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 & General remains in place following the merger of the 2000 Plan and SIPS into the Main Scheme.</p>

Notes to the Financial Statements

19. Retirement benefit obligations (continued)

Funding (continued)

Risk management (continued)

Virgin Media case

The Company is aware of the ongoing 'Virgin Media v NTL Pension Trustees Ltd and others' case and that there is a potential for the outcome of the case to have an impact on the UK schemes. The case affects defined benefit schemes that provided contracted-out benefits before 6 April 2016 based on meeting the reference scheme test. Where scheme rules were amended, potentially impacting benefits accrued from 6 April 1997 to 6 April 2016, schemes needed the actuary to confirm that the reference scheme test was still being met by providing written confirmation under Section 37 of the Pension Schemes Act 1993. In the Virgin Media case the judge ruled that alterations to the scheme rules were void and ineffective because of the absence of written actuarial confirmation required under Section 37 of the Pension Schemes Act 1993. The case has been taken to The Court of Appeal, with the hearing set for June 2024. The potential impact on the UK schemes is not yet known but continues to be assessed.

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.

	2023	2022	2021
Financial assumptions			
Discount rate – past service (%)	4.5	4.8	1.9
Discount rate – future service (%)	4.6	4.8	1.9
Retail Prices Index (RPI) inflation (%)	2.8	3.0	3.1
Rate of increase in salaries (%)	2.8	3.0	3.1
Rate of increase in deferred pensions (%)	2.1/2.8	2.3/3.0	2.4/3.1
Rate of increase in pensions in payment (%)	1.6 – 3.6	1.7 – 3.6	1.7 – 3.7
Demographic assumptions			
Life expectancy of a male currently aged 65 (years)	85 – 89	86 – 89	86 – 89
Life expectancy of a female currently aged 65 (years)	88 – 89	88 – 90	88 – 90
Life expectancy of a male currently aged 45 (years)	86 – 89	87 – 90	86 – 90
Life expectancy of a female currently aged 45 (years)	89 – 90	89 – 91	89 – 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 53.

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.

Notes to the Financial Statements

19. Retirement benefit obligations (continued)

IAS 19 Accounting (continued)

Principal actuarial assumptions (continued)

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

The inflation risk premium deduction has been set at 0.55% per annum (2022 0.55%) and the CPI assumption has been set at 0.7% per annum (2022 0.7%) lower than RPI. The resulting RPI assumption is 2.8% per annum and the CPI assumption is 2.1% 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.

Rate of increase in salaries

The rate of increase in salaries for the UK schemes is assumed to be RPI inflation of 2.8% (2022 RPI inflation of 3.0%), plus a promotional scale.

Rate of increase in deferred pensions

The rate of increase in deferred pensions for the UK schemes is based on Consumer Prices Index (CPI) inflation of 2.1% (2022 CPI inflation of 2.3%), with the exception of the 2000 Plan, which is based on RPI inflation of 2.8% (2022 RPI inflation of 3.0%). For all UK schemes, 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' benefits 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 S3 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 2022 tables (published by the Institute of Actuaries) have been used (in 2022, the Continuous Mortality Investigation 2021 tables were used), with an assumed long-term rate of future annual mortality improvements of 1.0% per annum (2022 1.0%), an initial rate adjustment parameter ('A') of 0.2% (2022 0.25%) in conjunction with a smoothing parameter ('S_k') of 7 for all members (2022 7) and the following weighting ('W') parameters: W2022 35% (2022 n/a); W2021 0% (2022 7.5%); and W2020 0% (2022 7.5%).

The disclosures below are in respect of the Company's share of the IAS 19 deficit using the allocation methodology outlined on page 35.

Notes to the Financial Statements

19. Retirement benefit obligations (continued)

IAS 19 Accounting (continued)
Principal actuarial assumptions (continued)
Life expectancy (continued)

Summary of movements in retirement benefit obligations

	£000
Company's share of IAS 19 surplus at 1 January 2023 (net of withholding tax)	6,800
Add back: withholding tax on surpluses	4,000
Company's share of IAS 19 surplus at 1 January 2023 (net)	10,800
Actual return on assets excluding amounts included in net interest expense	(5,100)
Increase in liabilities due to changes in assumptions and experience	(600)
Contributions in excess of service cost	1,000
Net interest income	600
	6,700
Withholding tax on surpluses	(2,400)
Company's share of IAS 19 surplus at 31 December 2023	4,300

Surplus recognition

All UK schemes are in an accounting surplus position. The surpluses have been recognised on the basis that the future economic benefits are unconditionally available to the Company, which is assumed to be via a refund. On 22 November 2023, the UK government announced that the authorised surplus payments charge would be reduced from 35% to 25% from 6 April 2024. The Company considers this to be a non-adjusting post balance sheet event and the surplus has been recognised net of withholding tax of 35% at 31 December 2023 (2022: 35%) based on the enacted legislation at that date. Should the legislation have been enacted at year-end, this would have resulted in an £1m increase in the pension surplus. This tax would be levied prior to the future refunding of any surplus and therefore the surplus has been presented on a net basis as this is not deemed to be an income tax of the Group.

Amounts recognised in the Balance Sheet

	2023	2022
	£'000	£'000
Present value of unfunded obligations	(400)	(500)
Present value of funded obligations	(114,800)	(113,900)
Fair value of scheme assets	121,900	125,200
	6,700	10,800
Withholding tax on surpluses	(2,400)	(4,000)
Company's share of IAS 19 surplus, net	4,300	6,800
Represented by:		
Retirement benefit surpluses	4,700	7,300
Retirement benefit obligations	(400)	(500)
	4,300	6,800

Notes to the Financial Statements

19. Retirement benefit obligations (continued)

IAS 19 Accounting (continued)

Changes in the fair value of scheme assets

	£'000
Company's share of the value of scheme assets at 1 January 2022	156,900
<i>Interest income</i>	2,800
<i>Actual return on assets excluding amounts included in interest income</i>	(29,800)
Actual return on assets	(27,000)
<i>Contributions by employer</i>	1,500
<i>Contributions by employer in respect of employee salary sacrifice arrangements</i>	400
Total contributions by employer	1,900
Members' contributions	0
Benefits paid	(6,500)
Company's share of the value of scheme assets at 31 December 2022	125,200
<i>Interest income</i>	5,800
<i>Actual return on assets excluding amounts included in interest income</i>	(5,100)
Actual return on assets	700
<i>Contributions by employer</i>	1,600
<i>Contributions by employer in respect of employee salary sacrifice arrangements</i>	500
Total contributions by employer	2,100
Members' contributions	0
Administrative expenses	(100)
Benefits paid	(6,000)
Company's share of the value of scheme assets at 31 December 2023	121,900

Notes to the Financial Statements

19. Retirement benefit obligations (continued)

IAS 19 Accounting (continued)

Assets of defined benefit pension schemes

	2023			2022		
	Quoted £'000	Unquoted £'000	Total £'000	Quoted £'000	Unquoted £'000	Total £'000
Equities:						
UK	-	-	-	1,300	-	1,300
Overseas	1,000	-	1,000	3,600	-	3,600
Pooled investment vehicles ¹	-	46,100	46,100	-	53,300	53,300
Fixed interest securities:						
UK gilts	12,300	-	12,300	12,300	-	12,300
UK corporates	16,700	10,600	27,300	10,500	14,800	25,300
Overseas government	200	-	200	200	-	200
Overseas corporates	9,000	-	9,000	6,400	300	6,700
Index-linked securities:						
UK gilts	10,400	-	10,400	8,900	-	8,900
UK corporates	6,400	-	6,400	-	5,600	5,600
Overseas corporates	200	-	200	100	-	100
Property ²	-	8,700	8,700	-	10,700	10,700
Derivatives ³	-	(4,600)	(4,600)	-	(6,300)	(6,300)
Cash:						
Sterling	3,500	-	3,500	3,500	-	3,500
Foreign currency	1,500	-	1,500	100	-	100
Other	-	(100)	(100)	-	(100)	(100)
Company total	61,200	60,700	121,900	46,900	78,300	125,200

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 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.

Longevity swap

The Company holds longevity insurance contracts for some of its UK defined benefit pension schemes. These provide long-term protection and income to the underlying pension scheme in the event that insured members live longer than expected.

The value of the longevity insurance contracts held by the Company are calculated by an actuary. They are measured by discounting the difference between the projected fixed and floating cash flows payable under the contracts, excluding the value of future projected fees. The significant assumptions used for this valuation are the discount rate and mortality assumptions; fair values for these assumptions are advised by an actuary based on external data and characteristics of the insured member population.

Notes to the Financial Statements

19. Retirement benefit obligations (continued)

IAS 19 Accounting (continued)

Longevity swap (continued)

As at 31 December 2023, the longevity swap valuation leads to a negative adjustment to the assets which reflects that experience to date on the contracts has been higher than expected deaths.

Changes in the present value of the defined benefit obligations

	£'000
Company's share of the defined benefit obligations at 1 January 2022	(171,300)
<i>Current service cost</i>	(1,500)
<i>Contributions by employer in respect of employee salary sacrifice arrangements</i>	(400)
Total current service cost	(1,900)
Members' contributions	-
Actuarial gain due to changes in assumptions and experience	55,300
Interest expense	(3,000)
Benefits paid	6,500
Company's share of the defined benefit obligations at 31 December 2022	(114,400)
<i>Current service cost</i>	(500)
<i>Contributions by employer in respect of employee salary sacrifice arrangements</i>	(500)
Total current service cost	(1,000)
Members' contributions	0
Past service cost – plan amendments	
Actuarial loss due to changes in assumptions and experience	(600)
Interest expense	(5,200)
Benefits paid	6000
Company's share of the defined benefit obligations at 31 December 2023	(115,200)

Amounts recognised in the Income Statement

	2023 £'000	2022 £'000
Included in operating costs:		
Current service cost	(500)	(1,500)
Administrative expenses	(100)	(100)
	(600)	(1,600)
Included in finance costs:		
Net interest income/(expense) on retirement benefit obligations	600	(200)

The Company incurred a charge of £11,872k (2022 £10,897k) in relation to defined contribution schemes for employees.

Notes to the Financial Statements

19. Retirement benefit obligations (continued)

Sensitivity analysis

The sensitivity information has been derived using scenario analysis from the actuarial assumptions as at 31 December 2023 and keeping all other assumptions as set out on page 57.

The pension schemes hold a number of unquoted pooled investment vehicles, which are investments in private markets. These are valued based on latest available valuation reports, and as noted on page 25, these valuations are subject to estimation uncertainty as their valuation techniques incorporate a number of assumptions, including those associated with the impact of climate change.

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.

	Decrease/ (Increase) in pension obligation ¹ £m	(Decrease)/ Increase in scheme assets ¹ £m
Discount rate:		
0.5 percentage point increase/decrease	7/(8)	(7)/8
1.0 percentage point increase/decrease	13/(16)	(13)/17
2.0 percentage point increase/decrease	24/(36)	(23)/37
3.0 percentage point increase/decrease	32/(62)	(30)/64
	(Increase)/ Decrease in pension obligation ¹ £m	Increase/ (Decrease) in scheme assets ¹ £m
Inflation:		
0.1 percentage point increase/decrease	(1)/1	1/(1)
0.5 percentage point increase/decrease	(4)/4	5/(4)
1.0 percentage point increase/decrease	(8)/7	10/(8)

1. Before deduction of withholding tax

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 surplus:

	(Decrease)/ increase in net surplus ¹ £m
Life expectancy:	
One-year increase/decrease	(4)/4

1. Before deduction of withholding tax

Notes to the Financial Statements

20. Provisions

	IT provisions £000	Warranty £000	Other £000	Total £000
Non-current	1,132	-	-	1,132
Current	13,683	215	5,189	19,087
	<u>14,815</u>	<u>215</u>	<u>5,189</u>	<u>20,219</u>
At 1 January 2023	14,815	215	5,189	20,219
Released	-	-	(4,646)	(4,646)
Created	(899)	-	292	(607)
Utilised in year	(8,154)	-	(50)	(8,204)
	<u>5,762</u>	<u>215</u>	<u>785</u>	<u>6,762</u>
At 31 December 2023	<u>5,762</u>	<u>215</u>	<u>785</u>	<u>6,762</u>
Represented by:				
Non-current	800	-	-	800
Current	4,962	215	785	5,962
	<u>5,762</u>	<u>215</u>	<u>785</u>	<u>6,762</u>

IT Provisions

IT costs that will be incurred as a result of separating the Digital Intelligence networks from the Financial Crime business. The majority of costs are expected to be incurred within 1 year, with some licence costs to be incurred by December 2025.

Warranties and after-sales service

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

Other

There are no individually significant provisions included within other provisions.

Notes to the Financial Statements

21. Trade, other and contract payables

	2023 £000	2022 £000
Current		
Contract payables	28,149	23,746
Trade payables	12,702	13,764
Amounts owed to BAE Systems plc subsidiaries	18,313	28,014
Amounts owed to BAE Systems plc	14,569	15,448
Other taxation and social security costs	16,925	16,000
Other payables	7,662	2,087
Accruals	63,231	60,553
	161,551	159,612
	161,551	159,612

Included in the opening balance of contract payables is £17,842k (2022: £31,271k) which has been recognised as revenue in the current year.

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

22. Dividends

	2023 £000	2022 £000
Final dividend of £278.68 (2022: £nil) per ordinary share proposed and paid during the year relating to the previous year's results	34,848	-
	34,848	-
	34,848	-

The directors are proposing a final dividend of £59.34 (2022: £278.68) per share totalling £7,420k (2022: £34,848k)

This dividend has not been accrued in the balance sheet.

Notes to the Financial Statements

23. Share capital and other reserves

Share capital

	£1 Ordinary shares	Nominal value £000
Authorised, issued and fully paid		
At 1 January 2022, 31 December 2022 and 31 December 2023	<u>125,046</u>	<u>125</u>

Other reserves

	Capital redemption £000	Share- based payments £000	Hedging reserve £000	Total £000
At 1 January 2022	31	25,487	515	26,033
Amounts debited to hedging reserve	-	-	(307)	(307)
Share-based payments	-	3,214	-	3,214
At 31 December 2022	<u>31</u>	<u>28,701</u>	<u>208</u>	<u>28,940</u>
Amounts debited to hedging reserve	-	-	(306)	(306)
Share-based payments	-	3,658	-	3,658
At 31 December 2023	<u>31</u>	<u>32,359</u>	<u>(98)</u>	<u>32,292</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.

Share-based payments reserve

The share-based payment reserves represents the credit to reserves in relation to the share-based payments expense recognised in the Company's Income Statement.

Capital redemption reserve

The Capital redemption reserve represents the amount transferred following the purchase of the company's own shares out of distributable reserves.

Notes to the Financial Statements

24. Share based payments

Share-based payment awards in respect of shares in the ultimate parent company, BAE Systems plc, have been granted to employees of the Company under various plans. Details of the terms and conditions of each share-based payment plan are given in the Annual Remuneration Report of the BAE Systems plc Annual Report.

	Range of exercise price of outstanding options (£) 2023	Weighted average remaining contracted life (years) 2023	Range of exercise price of outstanding options (£) 2022	Weighted average remaining contracted life (years) 2022
Executive Share Option Plan	4.12 - 7.83	6	7.83-4.12	7
Restricted Share Plan		6		7
Performance Share Plan		5		5
Share Matching Plan		-		-

The average share price of BAE Systems plc in the year was £9.77 (2022: £7.53).

25. Events after the reporting period

There have been no significant events affecting the Company since the year end.

26. Controlling parties

The immediate parent company is Detica Group Limited and the ultimate controlling party is BAE Systems plc, which is both the smallest and largest parent company preparing consolidated 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