

Financial statements



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Group accounting policies

Accounting policies are included within the relevant note to the Group accounts.

Group accounts

Preparation

Basis of preparation

The consolidated financial statements of BAE Systems plc have been prepared on a going concern basis, as discussed in the Directors' report on page 71, and in accordance with EU-endorsed International Financial Reporting Standards (IFRS) and the Companies Act 2006 applicable to companies reporting under IFRS.

The consolidated financial statements are presented in pounds sterling and, unless stated otherwise, rounded to the nearest million. They have been prepared under the historical cost convention, as modified by the revaluation of available-for-sale financial assets, and other relevant financial assets and financial liabilities (including derivative instruments).

Transactions in foreign currencies are translated at the exchange rates ruling at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies are retranslated at the exchange rates ruling at the balance sheet date, with the resulting exchange differences recognised in the income statement.

Significant accounting policies

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

Critical accounting policies

Certain of the Group's significant accounting policies are considered by the directors to be critical because of the level of complexity, judgement or estimation involved in their application and their impact on the consolidated financial statements. The critical accounting policies are listed below and explained in more detail in the relevant notes to the Group accounts:

Critical accounting policy	Description	Notes
Revenue and profit recognition – The recognition of revenue and profit on long-term contracts.	<p>The majority of long-term contracts are accounted for under IAS 11, Construction Contracts. Revenue on long-term contracts is recognised when performance milestones have been completed. Profit is recognised progressively as risks have been mitigated or retired.</p> <p>The ultimate profitability of long-term contracts is estimated based on estimates of revenue and costs, including allowances for technical and other risks, which are reliant on the knowledge and experience of the Group's project managers, engineers, and finance and commercial professionals. Material changes in these estimates could affect the profitability of individual contracts.</p> <p>Revenue and cost estimates are reviewed and updated at least quarterly, and more frequently as determined by events or circumstances.</p>	1
Carrying value of intangible assets – The valuation of acquired intangible assets; and – the determination of assumptions underpinning goodwill impairment testing.	<p>Acquired intangible assets, excluding goodwill, are valued in line with internationally used models, which require the use of estimates that may differ from actual outcomes. These assets are amortised over their estimated useful lives. Future results are impacted by the amortisation periods adopted and, potentially, any differences between estimated and actual circumstances related to individual intangible assets.</p> <p>Goodwill is not amortised, but is tested annually for impairment and carried at cost less accumulated impairment losses. For the purposes of impairment testing, goodwill is allocated to Cash-Generating Units on a consistent basis. The impairment review calculations require the use of estimates of the future profitability and cash-generating ability of the acquired businesses based on the Group's five-year Integrated Business Plan and the pre-tax discount rate used in discounting these projected cash flows.</p>	8
Valuation of retirement benefit obligations – The determination of assumptions underpinning the valuation of retirement benefit obligations for defined benefit pension schemes; and – the determination of the share of the pension deficit allocated to the Group's equity accounted investments.	<p>Pension scheme accounting valuations are prepared by independent actuaries. For each of the actuarial assumptions used to measure the Group's pension scheme liabilities, there is a range of possible values and management estimates the point within that range that most appropriately reflects the Group's circumstances. Small changes in these assumptions can have a significant impact on the size of the deficit.</p> <p>The Group operates a number of multi-employer defined benefit pension schemes and allocates a share of the surpluses and deficits in those schemes to the equity accounted investments that participate in them.</p> <p>On 1 April 2016, a separate Airbus section of the BAE Systems Pension Scheme (Main Scheme) was created, reducing the total IAS 19, Employee Benefits, deficit, with a corresponding reduction in the allocation to equity accounted investments.</p> <p>The deficit allocation methodology for the remaining employers of the Main Scheme and for all other schemes 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.</p>	20

Preparation continued

Other significant accounting policy judgements

In addition to the critical accounting policies, management exercises judgement in applying the Group's accounting policies in respect of the following principal items:

Tax provisions

Management exercises judgement to determine the amount of tax provisions. Provision is made for known issues based on management's interpretation of country-specific legislation and the likely outcome of negotiations or litigation. The Group's approach is to consider each uncertain tax position separately. Where management considers it is probable (defined as more likely than not) that there will be a future outflow of funds to a tax authority, a provision is recognised. The position is reviewed on an ongoing basis. Provisions are measured using management's best estimate of the most likely amount, being the single most likely amount in a range of possible outcomes. The Group discloses any significant uncertainties in relation to tax matters to the relevant tax authority. The resolution of tax positions taken by the Group can take a considerable period of time to conclude and, in some cases, it is difficult to predict the outcome. The directors believe that adequate provision is made for each known tax risk.

Included within the Consolidated balance sheet as at 31 December 2016 are current tax liabilities of £311m (2015 £315m), which comprise a provision of £365m (2015 £353m) and other tax creditors of £51m (2015 £35m), offset by a debtor of £105m (2015 £73m) in respect of research and development expenditure credits. The provision of £365m (2015 £353m) is in respect of known tax issues, of which £325m (2015 £287m) relates to non-UK jurisdictions. Whilst there is inherent uncertainty regarding the timing of any resolution of tax positions, the Group does not consider that there is a significant risk of material change in 2017.

Deferred tax assets

Included within the net deferred tax asset of £1,241m at 31 December 2016 is £1,212m in respect of the deficits in the Group's pension/retirement schemes (see note 14). It is management's judgement that the Group will generate sufficient taxable profits to recover the net deferred tax asset recognised. This judgement requires the use of estimates of future taxable profits based on the Group's Integrated Business Plan.

Changes in accounting policies

IFRS 9, Financial Instruments, issued in July 2014 with an effective date of 1 January 2018, was EU endorsed in November 2016. It is not expected to have a material impact on the Group.

IFRS 15, Revenue from Contracts with Customers, issued in May 2014 with an effective date of 1 January 2018, was EU endorsed in October 2016. The standard requires the identification of performance obligations in contracts with customers and allocation of the total contractual value to each of the performance obligations identified. Revenue is recognised as each performance obligation is satisfied either at a point in time or over time. The standard will replace IAS 11, Constructions Contracts, and IAS 18, Revenue.

An initial impact assessment has been undertaken which involved the review of all contract types across the Group. The assessment indicates that revenue on the Group's long-term contracts currently being recognised based on the completion of separately identifiable phases (milestones) will cumulatively be recognised earlier under IFRS 15, which reflects the continual transfer of the benefits of the Group's performance to the customer. It is expected that profit will continue to be recognised progressively as risks have been mitigated and retired and, accordingly, it is not expected that there will be a material impact on the timing of profit recognition. There is no impact on the timing of cash receipts, which are determined by the terms and conditions of contracts with the customers. The assessment has not indicated any significant changes will be required to the Group's revenue recognition policy in respect of revenue from the sale of goods not under long-term contract, services or licences.

IFRS 16, Leases, issued in January 2016 with an effective date of 1 January 2019, is not yet EU endorsed. Currently, leases classified as operating leases are not recognised on the balance sheet. The impact of this standard will be to recognise a lease liability and corresponding asset on the Group's balance sheet in respect of the majority of leases currently classified as operating leases.

Consolidation

The financial statements of the Group consolidate the results of the Company and its subsidiary entities, and include its share of its joint ventures' results accounted for under the equity method.

A subsidiary is an entity controlled by the Group. The Group controls a subsidiary when it is exposed, or has the rights, to variable returns from its involvement with the subsidiary and has the ability to affect those returns through its power over the subsidiary.

The results of subsidiaries are included in the income statement from the date of acquisition.

Intra-group balances and transactions, and any unrealised income and expenses arising from intra-group transactions, are eliminated in preparing the consolidated financial statements.

Joint ventures are accounted for under the equity method where the Consolidated income statement includes the Group's share of their profits and losses, and the Consolidated balance sheet includes its share of their net assets within equity accounted investments.

The assets and liabilities of overseas subsidiaries and equity accounted investments are translated at the exchange rates ruling at the balance sheet date. The income statements of such entities are translated at average rates of exchange during the year. All resulting exchange differences are recognised directly in a separate component of equity.

Translation differences that arose before the transition date to IFRS (1 January 2004) are presented in equity, but not as a separate component. When a foreign operation is sold, the cumulative exchange differences recognised in equity since 1 January 2004 are recognised in the income statement as part of the profit or loss on sale.

Consolidated income statement for the year ended 31 December

	Notes	2016		2015	
		£m	Total £m	£m	Total £m
Continuing operations					
Sales	1	19,020		17,904	
Deduct Share of sales by equity accounted investments	1	(2,427)		(2,719)	
Add Sales to equity accounted investments	1	1,197		1,602	
Revenue	1		17,790		16,787
Operating costs	2		(16,274)		(15,622)
Other income	4		136		227
Group operating profit			1,652		1,392
Share of results of equity accounted investments	1		90		110
<i>Underlying EBITA</i>	1	1,905		1,683	
<i>Non-recurring items</i>	1	(12)		26	
<i>EBITA</i>		1,893		1,709	
<i>Amortisation of intangible assets</i>	1	(87)		(108)	
<i>Impairment of intangible assets</i>	1	–		(78)	
<i>Financial (expense)/income of equity accounted investments</i>	5	(28)		3	
<i>Taxation expense of equity accounted investments</i>	6	(36)		(24)	
Operating profit	1		1,742		1,502
<i>Financial income</i>		713		241	
<i>Financial expense</i>		(1,304)		(653)	
Net finance costs	5		(591)		(412)
Profit before taxation			1,151		1,090
Taxation expense	6		(213)		(147)
Profit for the year			938		943
Attributable to:					
Equity shareholders			913		918
Non-controlling interests			25		25
			938		943
Earnings per share					
	7				
Basic earnings per share			28.8p		29.0p
Diluted earnings per share			28.7p		28.9p

Consolidated statement of comprehensive income for the year ended 31 December

	Notes	2016			2015 ¹		
		Other reserves ² £m	Retained earnings £m	Total £m	Other reserves ² £m	Retained earnings £m	Total £m
Profit for the year		–	938	938	–	943	943
Other comprehensive income							
Items that will not be reclassified to the income statement:							
Subsidiaries:							
Remeasurements on retirement benefit schemes		–	(1,468)	(1,468)	–	864	864
Tax on items that will not be reclassified to the income statement	6	–	260	260	–	(258)	(258)
Equity accounted investments (net of tax)		–	(53)	(53)	–	18	18
Items that may be reclassified to the income statement:							
Subsidiaries:							
Currency translation on foreign currency net investments		1,287	–	1,287	260	–	260
Reclassification of cumulative currency translation reserve on disposal		–	–	–	20	–	20
Fair value loss on available-for-sale financial assets		–	–	–	–	(1)	(1)
Amounts credited to hedging reserve		96	–	96	11	–	11
Tax on items that may be reclassified to the income statement	6	(17)	–	(17)	(2)	–	(2)
Equity accounted investments (net of tax)		45	–	45	(74)	–	(74)
Total other comprehensive income for the year (net of tax)		1,411	(1,261)	150	215	623	838
Total comprehensive income for the year		1,411	(323)	1,088	215	1,566	1,781
Attributable to:							
Equity shareholders		1,408	(348)	1,060	216	1,541	1,757
Non-controlling interests		3	25	28	(1)	25	24
		1,411	(323)	1,088	215	1,566	1,781

1. Re-presented in accordance with Amendments to IAS 1: Disclosure Initiative.

2. An analysis of other reserves is provided in note 22.

Consolidated statement of changes in equity for the year ended 31 December

	Attributable to equity holders of the parent						Non-controlling interests £m	Total equity £m
	Issued share capital £m	Share premium £m	Other reserves ¹ £m	Retained earnings £m	Total £m			
At 1 January 2016	87	1,249	5,277	(3,624)	2,989	13	3,002	
Profit for the year	–	–	–	913	913	25	938	
Total other comprehensive income for the year	–	–	1,408	(1,261)	147	3	150	
Share-based payments (inclusive of tax)	–	–	–	59	59	–	59	
Net sale of own shares	–	–	–	3	3	–	3	
Ordinary share dividends	–	–	–	(670)	(670)	(24)	(694)	
Partial disposal of shareholding in subsidiary undertaking	–	–	–	(3)	(3)	9	6	
At 31 December 2016	87	1,249	6,685	(4,583)	3,438	26	3,464	
At 1 January 2015	87	1,249	5,061	(4,555)	1,842	35	1,877	
Profit for the year	–	–	–	918	918	25	943	
Total other comprehensive income for the year	–	–	216	623	839	(1)	838	
Share-based payments	–	–	–	44	44	–	44	
Net sale of own shares	–	–	–	1	1	–	1	
Ordinary share dividends	–	–	–	(655)	(655)	(40)	(695)	
Disposal of non-controlling interest	–	–	–	–	–	(6)	(6)	
At 31 December 2015	87	1,249	5,277	(3,624)	2,989	13	3,002	

1. An analysis of other reserves is provided in note 22.

Consolidated balance sheet as at 31 December

	Notes	2016 £m	2015 £m
Non-current assets			
Intangible assets	8	11,264	10,117
Property, plant and equipment	9	2,098	1,698
Investment property	10	110	120
Equity accounted investments	11	299	250
Other investments		6	6
Other receivables	12	351	275
Retirement benefit surpluses	20	223	193
Other financial assets	13	345	107
Deferred tax assets	14	1,251	985
		15,947	13,751
Current assets			
Inventories	15	744	726
Trade and other receivables including amounts due from customers for contract work	12	3,305	2,940
Current tax		5	4
Other financial assets	13	204	105
Cash and cash equivalents	16	2,769	2,537
Assets held for sale		2	20
		7,029	6,332
Total assets	17	22,976	20,083
Non-current liabilities			
Loans	18	(4,425)	(3,775)
Other payables	19	(1,027)	(1,020)
Retirement benefit obligations	20	(6,277)	(4,694)
Other financial liabilities	13	(102)	(72)
Deferred tax liabilities	14	(10)	(13)
Provisions	21	(372)	(354)
		(12,213)	(9,928)
Current liabilities			
Loans and overdrafts	18	–	(237)
Trade and other payables	19	(6,540)	(6,162)
Other financial liabilities	13	(212)	(130)
Current tax		(311)	(315)
Provisions	21	(234)	(301)
Liabilities held for sale		(2)	(8)
		(7,299)	(7,153)
Total liabilities		(19,512)	(17,081)
Net assets		3,464	3,002
Capital and reserves			
Issued share capital	22	87	87
Share premium		1,249	1,249
Other reserves	22	6,685	5,277
Retained earnings – deficit		(4,583)	(3,624)
Total equity attributable to equity holders of the parent		3,438	2,989
Non-controlling interests		26	13
Total equity		3,464	3,002

Approved by the Board on 22 February 2017 and signed on its behalf by:

I G King
Chief Executive

P J Lynas
Group Finance Director

Consolidated cash flow statement

for the year ended 31 December

	Notes	2016 £m	2015 ¹ £m
Profit for the year		938	943
Taxation expense	6	213	147
Research and development expenditure credits	4	(22)	(65)
Share of results of equity accounted investments	1	(90)	(110)
Net finance costs	5	591	412
Depreciation, amortisation and impairment	2	345	460
Profit on disposal of property, plant and equipment	2,4	(5)	(28)
Profit on disposal of investment property	2,4	(12)	(41)
Profit on disposal of non-current other investments		–	(1)
Loss on disposal of businesses	2	–	24
Cost of equity-settled employee share schemes		55	44
Movements in provisions		(122)	(139)
Decrease in liabilities for retirement benefit obligations		(214)	(234)
Decrease/(increase) in working capital:			
Inventories		95	(6)
Trade and other receivables		(93)	60
Trade and other payables		(263)	(542)
Taxation paid		(187)	(116)
Net cash flow from operating activities		1,229	808
Dividends received from equity accounted investments	11	38	41
Net interest paid		(200)	(173)
Purchase of property, plant and equipment, and investment property		(408)	(359)
Purchase of intangible assets		(82)	(54)
Proceeds from sale of property, plant and equipment, and investment property		45	136
Proceeds from sale of non-current other investments		–	1
Purchase of subsidiary undertakings		–	(5)
Equity accounted investment funding	11	(5)	(8)
Proceeds from sale of subsidiary undertakings		6	34
Cash and cash equivalents disposed of with subsidiary undertakings		–	(13)
Net cash flow from investing activities		(606)	(400)
Net sale of own shares		3	1
Equity dividends paid	22	(670)	(655)
Dividends paid to non-controlling interests		(24)	(40)
Cash inflow from matured derivative financial instruments		480	12
Cash inflow from movement in cash collateral		32	3
Cash inflow from loans		–	1,625
Cash outflow from repayment of loans		(286)	(1,135)
Net cash flow from financing activities		(465)	(189)
Net increase in cash and cash equivalents		158	219
Cash and cash equivalents at 1 January		2,537	2,313
Effect of foreign exchange rate changes on cash and cash equivalents		76	5
Cash and cash equivalents at 31 December	16	2,771	2,537
Comprising:			
Cash and cash equivalents		2,769	2,537
Cash classified as held for sale		2	–
Cash and cash equivalents at 31 December	16	2,771	2,537

1. Re-presented to reclassify interest paid from operating to investing activities.

Notes to the Group accounts

1. Segmental analysis

Revenue and profit recognition

Revenue represents income derived from the provision of goods and services by the Company and its subsidiary undertakings.

Long-term contracts

The majority of the Group's long-term contract arrangements are accounted for under IAS 11, Construction Contracts. Revenue is recognised when the Group has obtained the right to consideration in exchange for its performance, which is when a separately identifiable phase (milestone) of a contract or development has been completed.

Profit is calculated by reference to reliable estimates of contract revenue and forecast costs after making suitable allowances for technical and other risks related to performance milestones yet to be achieved. No profit is recognised until the outcome of a contract can be reliably estimated. Profit is recognised progressively as risks have been mitigated or retired.

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

Goods sold and services rendered

Revenue is measured at the fair value of the consideration received or receivable, net of returns, rebates and other similar allowances.

Revenue from the sale of goods not under long-term contract is recognised in the income statement when the significant risks and rewards of ownership have been transferred to the buyer, recovery of the consideration is probable, there is no continuing management involvement with the goods, and the amount of revenue and costs can be measured reliably. Profit is recognised at the time of sale.

Revenue from the provision of services not under long-term contract is recognised in the income statement in proportion to the stage of completion of the contract at the reporting date. The stage of completion is measured on the basis of direct expenses incurred as a percentage of total expenses to be incurred for material contracts and labour hours delivered as a percentage of total labour hours to be delivered for time contracts.

Revenue from the sale of software licences is recognised on delivery to the customer when the Group has no remaining obligations to perform and collection of the consideration is considered probable. In circumstances where the Group has future obligations to perform as part of a software licence and related services contract, revenue is recognised over the contract term.

Revenue and profits on intercompany trading are determined on an arm's-length basis.

Research and development

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

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 Group's revenue recognition policy on long-term contracts.

Reporting segments

The Group has six reporting segments, which align with the Group's strategic direction, determined with reference to the products and services they provide, and the markets in which they operate:

- **Electronic Systems** comprises the US and UK-based electronics activities, including electronic warfare systems, electro-optical sensors, military and commercial digital engine and flight controls, next-generation military communications systems and data links, persistent surveillance capabilities, and hybrid electric drive systems;
- **Cyber & Intelligence** comprises the US-based Intelligence & Security business and UK-headquartered Applied Intelligence business, and covers the Group's cyber security, secure government, and commercial and financial security activities;
- **Platforms & Services (US)** has operations in the US, UK and Sweden. It produces combat vehicles, weapons and munitions, and delivers services and sustainment activities, including ship repair and the management of government-owned munitions facilities;
- **Platforms & Services (UK)** comprises the Group's UK-based air, maritime, land and shared services activities;
- **Platforms & Services (International)** comprises the Group's businesses in Saudi Arabia, Australia and Oman, together with its 37.5% interest in the pan-European MBDA joint venture; and
- **HQ** comprises the Group's head office activities, together with a 49% interest in Air Astana.

The Board (the chief operating decision maker as defined by IFRS 8, Operating Segments) monitors the results of these reporting segments to assess performance and make decisions about the allocation of resources. Segmental performance is evaluated based on Key Performance Indicators – sales (see page 129) and underlying EBITA (see page 130). Finance costs and taxation expense are managed on a Group basis.

1. Segmental analysis continued**Key Performance Indicator – Sales**

Definition Revenue including the Group's share of revenue of equity accounted investments.

Purpose Allows management to monitor the sales performance of subsidiaries and equity accounted investments.

Sales and revenue by reporting segment

	Sales		Deduct Share of sales by equity accounted investments		Add Sales to equity accounted investments		Revenue	
	2016 £m	2015 ¹ £m	2016 £m	2015 £m	2016 £m	2015 £m	2016 £m	2015 ¹ £m
Electronic Systems	3,282	2,922	(79)	(72)	79	72	3,282	2,922
Cyber & Intelligence	1,778	1,564	–	–	–	–	1,778	1,564
Platforms & Services (US)	2,874	2,779	(91)	(101)	–	–	2,783	2,678
Platforms & Services (UK)	7,806	7,405	(1,118)	(1,524)	1,011	1,438	7,699	7,319
Platforms & Services (International)	3,943	3,742	(906)	(785)	–	–	3,037	2,957
HQ	233	237	(233)	(237)	–	–	–	–
	19,916	18,649	(2,427)	(2,719)	1,090	1,510	18,579	17,440
Intra-group sales/revenue	(896)	(745)	–	–	107	92	(789)	(653)
	19,020	17,904	(2,427)	(2,719)	1,197	1,602	17,790	16,787

	Intra-group revenue		Revenue from external customers	
	2016 £m	2015 £m	2016 £m	2015 ¹ £m
Electronic Systems	92	91	3,190	2,831
Cyber & Intelligence	58	55	1,720	1,509
Platforms & Services (US)	43	22	2,740	2,656
Platforms & Services (UK)	592	480	7,107	6,839
Platforms & Services (International)	4	5	3,033	2,952
	789	653	17,790	16,787

1. Re-presented for the transfer of the GEOINT-ISR (Geospatial Intelligence – Intelligence, Surveillance and Reconnaissance) business from Cyber & Intelligence to Electronic Systems.

Sales and revenue by customer location

	Sales		Revenue	
	2016 £m	2015 £m	2016 £m	2015 £m
UK	4,033	4,006	3,869	3,812
Rest of Europe ¹	2,174	2,506	1,645	1,971
US	6,920	6,380	6,920	6,377
Canada	92	74	92	74
Saudi Arabia	4,043	3,839	3,808	3,653
Rest of Middle East	720	102	693	63
Australia	535	559	534	558
Rest of Asia and Pacific	369	347	167	234
Africa, and Central and South America	134	91	62	45
	19,020	17,904	17,790	16,787

1. Includes £1.0bn (2015 £1.4bn) generated under the Typhoon workshare agreement with Eurofighter Jagdflugzeug GmbH.

Notes to the Group accounts

continued

1. Segmental analysis continued

Revenue by category

	2016 £m	2015 ¹ £m
Long-term contracts	11,659	11,139
Sale of goods	3,223	2,974
Provision of services	2,903	2,669
Royalty income	5	5
	17,790	16,787

1. Restated.

Revenue by major customer

Revenue from the Group's three principal customers, which individually represent over 10% of total revenue, is as follows:

	2016 £m	2015 £m
UK Ministry of Defence ¹	4,402	4,838
US Department of Defense	4,319	3,838
Kingdom of Saudi Arabia Ministry of Defence and Aviation	3,726	3,582

1. Includes £1.0bn (2015 £1.4bn) generated under the Typhoon workshare agreement with Eurofighter Jagdflugzeug GmbH.

Revenue from the UK Ministry of Defence and the US Department of Defense was generated by the five principal reporting segments. Revenue from the Kingdom of Saudi Arabia Ministry of Defence and Aviation was generated by the Platforms & Services (UK) and Platforms & Services (International) reporting segments.

Key Performance Indicator – Underlying EBITA

Definition Profit for the year before amortisation and impairment of intangible assets, finance costs and taxation expense (EBITA) excluding non-recurring items.

Non-recurring items are defined as items that are relevant to an understanding of the Group's performance with reference to their materiality and nature:

- **Loss on business transactions:** Non-recurring items in 2016 represents an impairment of £12m against the carrying value of the BAE Systems San Francisco Ship Repair business sold in January 2017. A loss on the disposal of the Group's 75% holding in BAE Systems Land Systems South Africa (Pty) Limited of £24m was included in non-recurring items in 2015.
- **Research and development expenditure credits relating to prior years:** In 2013, UK legislation changed so that UK government credits for research and development spend are now accounted for as part of operating profit rather than as part of taxation expense. This treatment was optional for the first three years. During 2015, the Group exercised that option, effective from 2013, and reflected the change in the 2015 accounts. Credits relating to 2013 and 2014, totalling £50m, were included in non-recurring items in 2015.

Purpose Provides a measure of operating profitability that is comparable over time.

1. Segmental analysis continued**Operating profit/(loss) by reporting segment**

	Underlying EBITA		Non-recurring items		Amortisation and impairment of intangible assets		Financial and taxation (expense)/income of equity accounted investments		Operating profit/(loss)	
	2016 £m	2015 ¹ £m	2016 £m	2015 £m	2016 £m	2015 £m	2016 £m	2015 £m	2016 £m	2015 ¹ £m
Electronic Systems	494	437	–	–	(20)	(18)	–	–	474	419
Cyber & Intelligence	90	104	–	–	(31)	(135)	–	–	59	(31)
Platforms & Services (US)	211	177	(12)	(24)	(15)	(13)	(2)	2	182	142
Platforms & Services (UK)	810	721	–	50	(15)	(11)	(15)	(4)	780	756
Platforms & Services (International)	400	335	–	–	(6)	(9)	(29)	(27)	365	299
HQ	(100)	(91)	–	–	–	–	(18)	8	(118)	(83)
	1,905	1,683	(12)	26	(87)	(186)	(64)	(21)	1,742	1,502
Net finance costs									(591)	(412)
Profit before taxation									1,151	1,090
Taxation expense									(213)	(147)
Profit for the year									938	943

1. Re-presented for the transfer of the GEoint-ISR (Geospatial Intelligence – Intelligence, Surveillance and Reconnaissance) business from Cyber & Intelligence to Electronic Systems.

Share of results of equity accounted investments within reporting segments

	Underlying EBITA		Amortisation of intangible assets		Financial (expense)/income		Taxation (expense)/income		Share of results of equity accounted investments	
	2016 £m	2015 £m	2016 £m	2015 £m	2016 £m	2015 £m	2016 £m	2015 £m	2016 £m	2015 £m
Electronic Systems	5	7	–	–	–	–	–	–	5	7
Platforms & Services (US)	12	12	–	–	(2)	(1)	–	3	10	14
Platforms & Services (UK)	15	15	–	–	(5)	(2)	(10)	(2)	–	11
Platforms & Services (International)	107	96	(4)	(4)	(6)	(5)	(23)	(22)	74	65
HQ	19	5	–	–	(15)	11	(3)	(3)	1	13
	158	135	(4)	(4)	(28)	3	(36)	(24)	90	110

Notes to the Group accounts

continued

2. Operating costs

Leases

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

Research and development

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

Group-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.

Customer-funded expenditure on research and development activities is held in long-term contract balances as a contract cost within trade and other receivables and recognised in the income statement in accordance with the Group's revenue recognition policy on long-term contracts.

	2016 £m	2015 £m
Raw materials, subcontracts and other bought-in items	5,742	6,030
Change in inventories of finished goods and work-in-progress	1,415	1,027
Cost of inventories expensed	7,157	7,057
Staff costs (note 3)	5,440	5,052
Depreciation, amortisation and impairment	345	460
Loss on disposal of property, plant and equipment, and investment property	2	4
Loss on disposal of businesses	–	24
Other operating charges	3,330	3,025
Operating costs	16,274	15,622

Included within the analysis of operating costs are the following expenses:

Lease and sublease expense	284	257
Research and development expense including amounts funded under contract	1,416	1,263

Fees payable to the Company's auditor and its associates included in operating costs

	2016			2015		
	UK £'000	Overseas £'000	Total £'000	UK £'000	Overseas £'000	Total £'000
Fees payable to the Company's auditor for the audit of the Company's annual accounts*	1,776	–	1,776	1,759	–	1,759
Fees payable to the Company's auditor and its associates for other services pursuant to legislation:						
The audit of the Company's subsidiaries*	2,663	4,143 ¹	6,806	2,612	3,659	6,271
Interim review*	497	–	497	490	–	490
Other	112	3	115	164	19	183
Audit-related assurance services:						
Advice on accounting matters	–	–	–	–	6	6
Tax compliance services	17	576	593	22	457	479
Tax advisory services	9	122	131	30	125	155
Other assurance services:						
Non-statutory financial statements audit	–	7	7	–	1,806 ²	1,806 ²
Other non-audit services:						
Investor relations	200	–	200	220	–	220
Other	83	31	114	184	47	231
Total fees payable to the Company's auditor and its associates	5,357	4,882	10,239	5,481	6,119	11,600
*Total fees payable to the Company's auditor and its associates for audit services and interim review			9,079			8,520
Fees in respect of BAE Systems pension schemes:						
Audit	–	278	278	140	241	381
Tax compliance	–	2	2	–	4	4
Tax advisory	23	–	23	19	–	19
	23	280	303	159	245	404

1. After excluding the impact of foreign exchange translation, the fees for the audit of the Company's subsidiaries have increased by 2%.

2. Previously categorised as M&A services.

3. Employees

The weekly average and year-end numbers of employees, excluding those in equity accounted investments, were as follows:

	Weekly average		At year end	
	2016 Number '000	2015 ¹ Number '000	2016 Number '000	2015 ¹ Number '000
Electronic Systems	14	13	14	14
Cyber & Intelligence	12	12	12	11
Platforms & Services (US)	11	11	11	11
Platforms & Services (UK)	29	29	29	29
Platforms & Services (International)	9	10	9	9
HQ	1	1	1	1
	76	76	76	75

1. Re-presented for the transfer of the GEOINT-ISR (Geospatial Intelligence – Intelligence, Surveillance and Reconnaissance) business from Cyber & Intelligence to Electronic Systems.

The aggregate staff costs of Group employees, excluding employees of equity accounted investments, were as follows:

	2016 £m	2015 ¹ £m
Wages and salaries ²	4,672	4,339
Social security costs	365	333
Share-based payments (note 27)	55	44
Pension costs – defined contribution plans (note 20)	163	140
Pension costs – defined benefit plans (note 20)	183	194
US healthcare costs (note 20)	2	2
	5,440	5,052

1. Re-presented to include the charge in respect of the equity-settled all-employee Free Shares and Matching Partnership Shares elements of the Share Incentive Plan in share-based payments rather than wages and salaries.
2. After excluding the impact of exchange translation, wages and salaries increased by 2% per employee on 2015.

4. Other income

Leases

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

	2016 £m	2015 £m
Research and development expenditure credits ¹	22	65
Rental income from operating leases – investment property	24	23
Rental income from operating leases – other	18	19
Profit on disposal of property, plant and equipment	7	28
Profit on disposal of investment property	12	45
Profit on disposal of non-current other investments	–	1
Management recharges to equity accounted investments (note 28)	16	17
Royalties	8	3
Other ²	29	26
Other income	136	227

1. In 2013, UK legislation changed so that UK government credits for research and development spend are now accounted for as part of operating profit rather than as part of taxation expense. This treatment was optional for the first three years. During 2015, the Group exercised that option, effective from 2013, and reflected the change in the 2015 accounts. Credits relating to 2013 and 2014, totalling £50m, were included in 2015.
2. There are no individual amounts in excess of £10m.

Notes to the Group accounts

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5. Net finance costs

Interest income and borrowing costs

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

	2016 £m	2015 £m
Interest income	10	17
Gain on remeasurement of financial instruments at fair value through profit or loss ^{1,2}	665	167
Foreign exchange gains	38	57
Financial income	713	241
Interest expense on bonds and other financial instruments	(208)	(175)
Facility fees	(4)	(4)
Net present value adjustments	(43)	(29)
Net interest expense on retirement benefit obligations (note 20)	(169)	(192)
Loss on remeasurement of financial instruments at fair value through profit or loss ¹	(55)	(72)
Foreign exchange losses ³	(825)	(181)
Financial expense	(1,304)	(653)
Net finance costs	(591)	(412)

1. Comprises gains and losses on derivative financial instruments, including derivative instruments to manage the Group's exposure to interest rate fluctuations on external borrowings and exchange rate fluctuations on balances with the Group's subsidiaries and equity accounted investments.
2. The increase in the gain on remeasurement of financial instruments primarily reflects exchange rate movements on hedges relating to US dollar-denominated borrowings (2016 £446m; 2015 £98m). Loss on remeasurement of financial instruments includes £23m (2015 £nil) in respect of these exchange rate movements.
3. The increase in foreign exchange losses primarily reflects exchange rate movements on US dollar-denominated borrowings (2016 £592m; 2015 £144m).

Additional analysis

	2016 £m	2015 £m
Net finance costs:		
Group	(591)	(412)
Share of equity accounted investments	(28)	3
	(619)	(409)
Analysed as:		
Underlying net interest expense:		
Group	(245)	(191)
Share of equity accounted investments	(12)	(3)
	(257)	(194)
Other:		
Group:		
Net interest expense on retirement benefit obligations	(169)	(192)
Fair value and foreign exchange adjustments on financial instruments and investments ¹	(177)	(29)
Share of equity accounted investments:		
Net interest expense on retirement benefit obligations	(8)	(8)
Fair value and foreign exchange adjustments on financial instruments and investments	(8)	14
	(619)	(409)

1. The net cost primarily reflects foreign exchange translational losses on US dollar-denominated bonds held by BAE Systems plc.

6. Taxation expense

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

Current tax

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

Deferred tax

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

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

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

Taxation expense

	2016 £m	2015 £m
Current taxation		
UK:		
Current tax	(74)	(109)
Adjustments in respect of prior years ¹	29	17
	(45)	(92)
Overseas:		
Current year	(164)	(105)
Adjustments in respect of prior years ²	(5)	99
	(169)	(6)
	(214)	(98)
Deferred taxation		
UK:		
Origination and reversal of temporary differences	14	8
Adjustments in respect of prior years	4	8
Tax rate adjustment	–	(5)
	18	11
Overseas:		
Origination and reversal of temporary differences	(28)	(51)
Adjustments in respect of prior years	13	(9)
Tax rate adjustment	(2)	–
	(17)	(60)
	1	(49)
Taxation expense	(213)	(147)
UK	(27)	(81)
Overseas	(186)	(66)
Taxation expense	(213)	(147)

1. 2015 included a £52m credit in respect of the adjustment of certain UK tax provisions in the light of clarification received.

2. 2015 included an £82m credit in respect of the adjustment of certain overseas tax provisions in the light of rulings received.

Notes to the Group accounts

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6. Taxation expense continued

Reconciliation of taxation expense

The following table reconciles the theoretical income tax expense, using the UK corporation tax rate, to the reported tax expense. The reconciling items represent, besides the impact of tax rate differentials and changes, non-taxable benefits or non-deductible expenses arising from differences between the local tax base and the reported financial statements.

	2016 £m	2015 £m
Profit before taxation	1,151	1,090
UK corporation tax rate	20.0%	20.25%
Expected income tax expense	(230)	(221)
Effect of tax rates in foreign jurisdictions, including US state taxes	(81)	(69)
Effect of intra-group financing	15	13
Expenses not tax effected	(15)	(13)
Income not subject to tax	37	41
Research and development tax credits and patent box benefits	12	7
Non-deductible goodwill impairment	–	(15)
Chargeable gains and non-taxable gains/non-deductible losses on disposal of businesses	(3)	(7)
Utilisation of previously unrecognised tax losses	3	4
Adjustments in respect of prior years ¹	41	115
Adjustments in respect of equity accounted investments	18	22
Tax rate adjustment	(2)	(5)
Other	(8)	(19)
Taxation expense	(213)	(147)

Calculation of the underlying effective tax rate

	2016 £m	2015 £m
Profit before taxation	1,151	1,090
Add back:		
Taxation expense of equity accounted investments (note 1)	36	24
Loss on disposal of businesses (note 1)	–	24
Goodwill impairment (note 8)	–	75
Adjusted profit before taxation	1,187	1,213
Taxation expense	(213)	(147)
Taxation expense of equity accounted investments (note 1)	(36)	(24)
Taxation expense (including equity accounted investments)	(249)	(171)
Adjusted profit before taxation (above)		1,213
Exclude: Research and development expenditure credits ²		(77)
		1,136
Taxation expense (including equity accounted investments) (above)		(171)
Exclude: Adjustments relating to research and development expenditure credits ²		68
Exclude: Adjustment of tax provisions ¹		(134)
		(237)
Underlying effective tax rate	21%	21%

- 2016 comprises a number of separate items, individually less than £20m, in relation to which either resolution was reached in the year or new information enabled the Group to re-assess the related tax provisions. 2015 included credits totalling £134m in respect of the adjustment of certain UK and overseas tax provisions in the light of clarification and rulings received.
- In 2013, UK legislation changed so that UK government credits for research and development spend are now accounted for as part of operating profit rather than as part of taxation expense. This treatment was optional for the first three years. During 2015, the Group exercised that option, effective from 2013, and reflected the change in the 2015 accounts. The adjustment reversed this treatment to show an underlying effective tax rate that was comparable with the prior year. The £77m excluded from profit before taxation comprised £50m included in non-recurring items relating to 2013 and 2014 (see note 1) and £27m included in underlying EBITA relating to 2015, of which £12m related to the Group's share of equity accounted investments. The £68m adjustment included £45m relating to the £50m included in non-recurring items.

6. Taxation expense continued**Tax recognised in other comprehensive income**

	2016			2015 ¹		
	Before tax £m	Tax benefit/ (expense) £m	Net of tax £m	Before tax £m	Tax (expense)/ benefit £m	Net of tax £m
Items that will not be reclassified to the income statement:						
Subsidiaries:						
Remeasurements on retirement benefit schemes	(1,468)	246	(1,222)	864	(173)	691
Tax rate adjustment	–	14	14	–	(74)	(74)
Other	–	–	–	–	(11)	(11)
Equity accounted investments	(66)	13	(53)	21	(3)	18
Items that may be reclassified to the income statement:						
Subsidiaries:						
Currency translation on foreign currency net investments	1,287	–	1,287	260	–	260
Reclassification of cumulative currency translation reserve on disposal	–	–	–	20	–	20
Fair value loss on available-for-sale financial assets	–	–	–	(1)	–	(1)
Amounts credited/(charged) to hedging reserve	96	(17)	79	11	(2)	9
Equity accounted investments	43	2	45	(81)	7	(74)
	(108)	258	150	1,094	(256)	838

	2016			2015 ¹		
	Other reserves £m	Retained earnings £m	Total £m	Other reserves £m	Retained earnings £m	Total £m
Current tax						
Subsidiaries:						
Remeasurements on retirement benefit schemes	–	27	27	–	42	42
Other	–	–	–	–	(8)	(8)
	–	27	27	–	34	34
Deferred tax						
Subsidiaries:						
Remeasurements on retirement benefit schemes	–	219	219	–	(213)	(213)
Tax rate adjustment	–	14	14	–	(74)	(74)
Amounts charged to hedging reserve	(17)	–	(17)	(2)	–	(2)
Other	–	–	–	–	(5)	(5)
Equity accounted investments	2	13	15	7	(3)	4
	(15)	246	231	5	(295)	(290)
Tax on other comprehensive income	(15)	273	258	5	(261)	(256)

1. Re-presented in accordance with Amendments to IAS 1: Disclosure Initiative.

Notes to the Group accounts

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7. Earnings per share

Key Performance Indicator – Underlying earnings per share

Definition Basic earnings per share excluding amortisation and impairment of intangible assets, non-cash finance movements on pensions and financial derivatives, and non-recurring items.

Purpose Provides a measure of underlying performance that is comparable over time.

	2016			2015		
	£m	Basic pence per share	Diluted pence per share	£m	Basic pence per share	Diluted pence per share
Profit for the year attributable to equity shareholders	913	28.8	28.7	918	29.0	28.9
Add back:						
Non-recurring items, post tax ¹	9			19		
Amortisation and impairment of intangible assets, post tax ¹	69			88		
Impairment of goodwill	–			75		
Net interest expense on retirement benefit obligations, post tax ¹	140			158		
Fair value and foreign exchange adjustments on financial instruments and investments, post tax ¹	146			12		
Underlying earnings, post tax	1,277	40.3	40.1	1,270	40.2	40.1
		Millions	Millions		Millions	Millions
Weighted average number of shares used in calculating basic earnings per share		3,171	3,171		3,161	3,161
Incremental shares in respect of employee share schemes			14			10
Weighted average number of shares used in calculating diluted earnings per share			3,185			3,171

1. The tax impact is calculated using the underlying effective tax rate of 21% (2015 21%).

8. Intangible assets

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

Cost or valuation

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 subsidiaries is included in intangible assets. Goodwill on acquisitions of joint ventures and associates is included in the carrying value of equity accounted investments. Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold.

Programme and customer-related

Intangible assets recognised by the Group include those relating to ongoing programmes within businesses acquired, mainly in respect of customer relationships and order backlog.

Other intangible assets

Other intangible assets include:

- **Computer software licences acquired** for use within the Group are capitalised as an intangible asset on the basis of the costs incurred to acquire and bring to use the specific software;
- **Software development costs** that are directly associated with the production of identifiable and unique software products controlled by the Group, and that will probably generate economic benefits exceeding costs beyond one year, are recognised as intangible assets. Group-funded expenditure associated with enhancing or maintaining computer software programs for sale is recognised as an expense as incurred;
- **Research and development expenditure** funded by the Group on development activities applied to a plan or design for the production of new or substantially improved products is capitalised as an internally generated intangible asset if certain conditions are met. The expenditure capitalised includes the cost of materials, direct labour and related overheads; and
- **Patents, trademarks and licences.**

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.

For programme-related intangibles, amortisation is set on a programme-by-programme basis over the life of the individual programme. Amortisation for customer-related intangibles is also set on an individual basis.

The estimated useful lives are as follows:

Programme and customer-related	up to 15 years
Other intangible assets:	
Computer software licences acquired	2 to 5 years
Software development costs	2 to 5 years
Research and development expenditure	up to 10 years
Patents, trademarks and licences	up to 20 years
Other intangibles	up to 10 years

The Group has no indefinite-life intangible assets other than goodwill.

Impairment of intangible assets, property, plant and equipment, investment property and equity accounted investments

The carrying amounts of the Group's intangible assets (excluding goodwill), property, plant and equipment, investment property and equity accounted investments are reviewed at each balance sheet date to determine whether there is any indication of impairment as required by IAS 36, Impairment of Assets. If any such indication exists, the asset's recoverable amount is estimated. For goodwill and intangible assets that are not yet available for use, impairment testing is performed annually.

An impairment loss is recognised whenever the carrying amount of an asset or its Cash-Generating Unit exceeds its recoverable amount.

The recoverable amount is the greater of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using an appropriate pre-tax discount rate. For an asset that does not generate largely independent cash flows, the recoverable amount is determined for the Cash-Generating Unit to which the asset belongs.

Impairment losses are recognised in the income statement.

An impairment loss in respect of goodwill is not reversed. An impairment loss in respect of other intangible assets, property, plant and equipment, investment property and equity accounted investments is reversed if the subsequent increase in recoverable amount can be related objectively to an event occurring after the impairment loss was recognised or if there has been a change in the estimate used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

Notes to the Group accounts

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8. Intangible assets continued

	Goodwill £m	Programme and customer- related £m	Other £m	Total £m
Cost or valuation				
At 1 January 2015	13,708	739	533	14,980
Additions:				
Acquired separately	–	–	42	42
Internally developed	–	–	12	12
Disposals ¹	–	(147)	(33)	(180)
Transfer from property, plant and equipment	–	–	5	5
Foreign exchange adjustments	333	12	8	353
At 31 December 2015	14,041	604	567	15,212
Additions:				
Acquired separately	–	–	81	81
Internally developed	–	–	1	1
Disposals ¹	–	(122)	(23)	(145)
Reclassification from held for sale	–	–	3	3
Transfer from property, plant and equipment	–	–	57	57
Foreign exchange adjustments	1,362	62	72	1,496
At 31 December 2016	15,403	544	758	16,705
Amortisation and impairment				
At 1 January 2015	4,044	609	344	4,997
Amortisation charge	–	61	43	104
Impairment charge	75	3	–	78
Disposals ¹	–	(147)	(33)	(180)
Foreign exchange adjustments	82	8	6	96
At 31 December 2015	4,201	534	360	5,095
Amortisation charge	–	32	51	83
Disposals ¹	–	(122)	(23)	(145)
Reclassification from held for sale	–	–	3	3
Foreign exchange adjustments	300	52	53	405
At 31 December 2016	4,501	496	444	5,441
Net book value				
At 31 December 2016	10,902	48	314	11,264
At 31 December 2015	9,840	70	207	10,117
At 1 January 2015	9,664	130	189	9,983

1. Includes intangible assets with nil net book value no longer used by the Group.

Impairment testing

The recoverable amount of the Group's goodwill is based on value in use estimated using risk-adjusted future cash flow projections from the five-year Integrated Business Plan (IBP) and 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 historical experience, available government spending data and the Group's order backlog. Pre-tax discount rates, derived from the Group's post-tax weighted average cost of capital of 7.01% (2015 7.47%) (adjusted for risks specific to the market in which the Cash-Generating Unit (CGU) operates), have been used in discounting these projected risk-adjusted cash flows.

8. Intangible assets continued

Significant CGUs

Goodwill allocated to CGUs, which are largely dependent on US government spending on defence, aerospace and security, represents £8.4bn (2015 £7.4bn) of the Group's total goodwill balance. The Group monitors changes in defence budgets on an ongoing basis.

Cash-Generating Unit	Key assumptions	Allocated goodwill		Pre-tax discount rate	
		2016 £bn	2015 ¹ £bn	2016 %	2015 %
Electronic Systems	Continued demand from the US government for electronic warfare systems (where the business has a leadership position), other technology-based solutions and growth in the commercial avionics market	4.0	3.7	9	10
Intelligence & Security (within Cyber & Intelligence)	Continued demand in the US for the Group's services in the areas of homeland security, law enforcement and counter-intelligence	0.7	0.6	9	10
Platforms & Services (US)	Continued demand in the Group's principal markets for existing and successor military tracked vehicles, naval guns, missile launchers, artillery systems, munitions, upgrade programmes and support, and in the US for complex infrastructure, maritime and aviation services	3.7	3.1	9	10

1. Re-presented for the transfer of the GEOINT-ISR (Geospatial Intelligence – Intelligence, Surveillance and Reconnaissance) business from Cyber & Intelligence to Electronic Systems.

The headroom, calculated as the difference between net assets including allocated goodwill as at 31 December 2016 and the value-in-use calculations, for the CGUs listed above, is shown below. The table also shows the headroom assuming a 1% reduction in the terminal value growth rate assumption and a 1% increase in the discount rate used in the value-in-use calculations.

Cash-Generating Unit	Headroom as at 31 December		Headroom assuming a 1% reduction in the terminal value growth rate assumption		Headroom assuming a 1% increase in the discount rate	
	2016 £bn	2015 £bn	2016 £bn	2015 £bn	2016 £bn	2015 £bn
Electronic Systems	3.5	1.7	2.2	1.0	2.0	0.8
Intelligence & Security	0.3	–	0.2	(0.1)	0.1	(0.1)
Platforms & Services (US)	1.6	0.4	0.7	(0.1)	0.5	(0.3)

Other CGUs

The remaining goodwill balance of £2.5bn (2015 £2.4bn) is allocated across multiple CGUs, including £0.6bn (2015 £0.6bn) in the Applied Intelligence CGU, with no individual CGU exceeding 10% of the Group's total goodwill balance. The majority of the projected cash flows within these CGUs are underpinned by expected levels of primarily UK government spending on defence, aerospace and security, and the Group's ability to capture a broadly consistent market share. In the case of Applied Intelligence, the future cash flow projections are based on the expectation of growth in cyber and intelligence, in the UK and overseas government markets, together with increasing demand for products and services in commercial markets.

Impairment – goodwill

In 2015, the impairment charge of £75m in the Intelligence & Security CGU reflected lower business growth assumptions.

Impairment – intangible assets

In 2015, the impairment charge of £3m related to the Cyber & Intelligence reporting segment.

Notes to the Group accounts

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9. Property, plant and equipment

Cost

Items of property, plant and equipment are stated at cost less accumulated depreciation and impairment losses. The cost of self-constructed assets includes the cost of materials, direct labour and an appropriate proportion of production overheads. The cost of demonstration assets is written off as incurred. The reimbursement of the cost of an item of property, plant and equipment by a customer is presented as deferred income and recognised in the income statement on a basis consistent with the depreciation of the asset over its estimated useful life.

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

Depreciation

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

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

For certain items of plant and equipment in the Group's US businesses, depreciation is normally provided on a basis consistent with cost reimbursement profiles under US government contracts. Typically, this provides for a faster rate of depreciation than would otherwise arise on a straight-line basis.

No depreciation is provided on freehold land and assets in the course of construction.

The assets' residual values, useful lives and depreciation methods are reviewed, and adjusted if appropriate, at each balance sheet date.

Impairment

The carrying amounts of the Group's property, plant and equipment are reviewed at each balance sheet date to determine whether there is any indication of impairment in accordance with the policy shown in note 8.

9. Property, plant and equipment continued

	Land and buildings £m	Plant and machinery £m	Total £m
Cost			
At 1 January 2015	1,722	2,753	4,475
Additions ¹	108	284	392
Transfer to other intangible assets	–	(5)	(5)
Reclassification between categories	17	(17)	–
Disposals	(113)	(266)	(379)
Foreign exchange adjustments	36	57	93
At 31 December 2015	1,770	2,806	4,576
Additions ¹	235	326	561
Reclassification as held for sale	(20)	(2)	(22)
Transfer to investment properties	(9)	–	(9)
Transfer to other intangible assets	–	(57)	(57)
Reclassification between categories	28	(28)	–
Disposals	(22)	(72)	(94)
Foreign exchange adjustments	194	256	450
At 31 December 2016	2,176	3,229	5,405
Depreciation and impairment			
At 1 January 2015	963	1,923	2,886
Depreciation charge for the year	80	163	243
Impairment charge for the year	21	8	29
Reclassification between categories	2	(2)	–
Disposals	(80)	(261)	(341)
Foreign exchange adjustments	19	42	61
At 31 December 2015	1,005	1,873	2,878
Depreciation charge for the year	73	178	251
Impairment charge for the year	8	1	9
Reclassification as held for sale	(20)	(2)	(22)
Transfer to investment properties	(9)	–	(9)
Disposals	(13)	(70)	(83)
Foreign exchange adjustments	104	179	283
At 31 December 2016	1,148	2,159	3,307
Net book value			
At 31 December 2016	1,028	1,070	2,098
At 31 December 2015	765	933	1,698
At 1 January 2015	759	830	1,589
Net book value			
	Land and buildings £m	Plant and machinery £m	Total £m
Freehold property	869	–	869
Long leasehold property	18	–	18
Short leasehold property	141	–	141
Plant and machinery	–	998	998
Fixtures, fittings and equipment	–	72	72
At 31 December 2016	1,028	1,070	2,098

1. Includes £143m (2015 £44m) of land and buildings, and £25m (2015 £5m) of plant and machinery at Barrow-in-Furness, UK, relating to the Dreadnought submarine programme funded by the UK government.

Notes to the Group accounts continued

9. Property, plant and equipment continued

Impairment

	2016 £m	2015 £m
Cyber & Intelligence	–	1
Platforms & Services (US)	9	2
Platforms & Services (UK)	–	1
Platforms & Services (International)	–	25
	9	29

2016

The impairment in Platforms & Services (US) represents a charge against the carrying value of the BAE Systems San Francisco Ship Repair business sold in January 2017.

2015

The impairment in Platforms & Services (International) included a £24m charge against the carrying value of the Williamstown shipyard in Australia due to a reduction in workload.

Assets in the course of construction

	Land and buildings ¹ £m	Plant and machinery ² £m	Total £m
At 31 December 2016	246	352	598
At 31 December 2015	98	194	292

1. Includes £161m (2015 £42m) at Barrow-in-Furness, UK, relating to the Dreadnought submarine programme funded by the UK government.

2. 2016 includes £106m in support of industrialisation in Saudi Arabia and £78m in respect of a new dry dock in San Diego, US, to support the US Navy's re-balance to the Asia-Pacific region.

Operating leases

The future aggregate minimum lease income from the non-cancellable elements of operating leases for assets capitalised (including investment property – see note 10) are as follows:

	2016 £m	2015 £m
Receipts due:		
Not later than one year	25	25
Later than one year and not later than five years	90	93
Later than five years	72	94
	187	212

Under the terms of the lease agreements, no contingent rents are receivable. The leases have varying terms including escalation clauses and renewal rights. None of these terms represent unusual arrangements or create material onerous or beneficial rights or obligations.

10. Investment property

Cost

Land and buildings that are leased to non-Group entities are classified as investment property. The Group measures investment property at its cost less accumulated depreciation and impairment losses.

Depreciation

Depreciation is provided, on a straight-line basis, to write off the cost of investment property over its estimated useful life of up to 50 years.

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.

Impairment

The carrying amounts of the Group's investment property are reviewed at each balance sheet date to determine whether there is any indication of impairment in accordance with the policy shown in note 8.

	£m
Cost	
At 1 January 2015	186
Additions	13
Disposals	(23)
At 31 December 2015	176
Additions	9
Transfer from property, plant and equipment	9
Disposals	(24)
At 31 December 2016	170
Depreciation and impairment	
At 1 January 2015	57
Depreciation charge for the year	4
Impairment charge for the year	2
Disposals	(7)
At 31 December 2015	56
Depreciation charge for the year	2
Transfer from property, plant and equipment	9
Disposals	(7)
At 31 December 2016	60
Net book value	
At 31 December 2016	110
At 31 December 2015	120
At 1 January 2015	129
Fair value	
At 31 December 2016	167
At 31 December 2015	178

The fair values above are based on and reflect current market values as prepared by in-house professionals who have the appropriate professional qualifications and recent experience of valuing properties in the location and of the type being valued.

Notes to the Group accounts

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11. Equity accounted investments

A joint venture is a joint arrangement whereby the parties that have joint control have rights to the net assets of the arrangement.

Carrying value

The carrying value of an equity accounted investment comprises the Group's share of net assets and purchased goodwill, and is assessed for impairment as a single asset. The carrying amounts of the Group's equity accounted investments are reviewed at each balance sheet date to determine whether there is any indication of impairment in accordance with the policy shown in note 8.

Principal equity accounted investments

Joint venture	Principal activities	Shareholding	Principally operates in
Eurofighter Jagdflugzeug	Management and control of the European Typhoon programme	33%	Germany
MBDA	Development and manufacture of guided weapons	37.5%	Europe

The Group's 49% shareholding in Air Astana was previously classified as a principal equity accounted investment. The Group no longer considers Air Astana to be a principal equity accounted investment based on its share of Air Astana's revenue and profit, and its carrying value.

The following tables summarise the financial information of the Group's principal equity accounted investments included in their own financial statements, as adjusted for fair value adjustments at acquisition and differences in accounting policies, and reconcile this to the Group's interest in those equity accounted investments.

	2016		2015	
	Eurofighter Jagdflugzeug £m	MBDA £m	Eurofighter Jagdflugzeug £m	MBDA £m
Revenue (100%)	2,986	2,416	4,239	2,087
Underlying EBITA ¹ excluding depreciation	18	320	24	282
Depreciation and amortisation	(2)	(74)	–	(60)
Financial income	2	60	2	59
Financial expense	(9)	(77)	(1)	(70)
Taxation expense	(26)	(56)	(7)	(53)
(Loss)/profit for the year (100%)	(17)	173	18	158
Remeasurements on retirement benefit schemes, net of tax	–	(139)	–	47
Amounts charged to hedging reserve, net of tax	–	(30)	–	–
Foreign exchange adjustments	–	31	–	1
Total comprehensive income for the year (100%)	(17)	35	18	206
Group's share of total comprehensive income for the year	(5)	13	6	77
Non-current assets	11	1,996	9	1,498
Cash and cash equivalents	26	1,613	4	1,047
Current assets excluding cash and cash equivalents	1,746	3,870	1,048	2,921
Current assets	1,772	5,483	1,052	3,968
Non-current financial liabilities excluding trade and other payables, and provisions	–	(101)	–	(7)
Other non-current liabilities	(26)	(937)	(19)	(742)
Non-current liabilities	(26)	(1,038)	(19)	(749)
Current financial liabilities excluding trade and other payables, and provisions	–	(32)	–	–
Other current liabilities	(1,740)	(6,100)	(1,011)	(4,421)
Current liabilities	(1,740)	(6,132)	(1,011)	(4,421)
Net assets (100%)	17	309	31	296

1. Profit for the year before amortisation and impairment of intangible assets, finance costs and taxation expense (EBITA) excluding non-recurring items.

11. Equity accounted investments continued

	2016			2015		
	Eurofighter Jagdflugzeug £m	MBDA £m	Total £m	Eurofighter Jagdflugzeug £m	MBDA £m	Total £m
Group's share of net assets	5	116	121	10	111	121
Elimination of unrealised profit	–	–	–	–	(4)	(4)
Goodwill	–	5	5	–	4	4
Carrying value	5	121	126	10	111	121

	2016			2015		
	Eurofighter Jagdflugzeug £m	MBDA £m	Total £m	Eurofighter Jagdflugzeug £m	MBDA £m	Total £m
Dividends received	–	13	13	6	17	23

Group summary

The Group also has a number of individually immaterial joint ventures, the carrying values of which at 31 December 2016 are as follows: Advanced Electronics Company (£47m), FADEC International (£37m), Air Astana (£31m) and Panavia Aircraft (£21m). The following table shows a reconciliation of opening to closing carrying value for both the Group's principal and immaterial joint ventures in aggregate.

	Principal equity accounted investments £m	Other £m	Total £m
At 1 January 2015	65	164	229
<i>Group's share of profit for the year</i>	65	45	110
<i>Group's share of remeasurements on retirement benefit schemes</i>	21	–	21
<i>Tax on items that will not be reclassified to the income statement</i>	(3)	–	(3)
<i>Foreign exchange adjustments</i>	–	(43)	(43)
<i>Amounts charged to hedging reserve</i>	–	(36)	(36)
<i>Tax on items that may be reclassified to the income statement</i>	–	7	7
Group's share of total comprehensive income for the year	83	(27)	56
Equity accounted investment funding	–	8	8
Dividends received from equity accounted investments	(23)	(18)	(41)
Foreign exchange adjustments	(4)	2	(2)
At 31 December 2015	121	129	250
<i>Group's share of profit for the year</i>	59	31	90
<i>Group's share of remeasurements on retirement benefit schemes</i>	(66)	–	(66)
<i>Tax on items that will not be reclassified to the income statement</i>	13	–	13
<i>Foreign exchange adjustments</i>	13	20	33
<i>Amounts charged to hedging reserve</i>	(14)	5	(9)
<i>Tax on items that may be reclassified to the income statement</i>	3	(1)	2
Group's share of total comprehensive income for the year	8	55	63
Equity accounted investment funding	–	5	5
Dividends received from equity accounted investments	(13)	(25)	(38)
Foreign exchange adjustments	10	9	19
At 31 December 2016	126	173	299

Contingent liabilities

The Group is not aware of any material contingent liabilities in respect of its equity accounted investments.

Notes to the Group accounts

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12. Trade and other receivables

Trade and other receivables are stated at their cost less provision for bad debts. A provision for bad debt is established when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of the receivables. Significant financial difficulties of the debtor, probability that the debtor will enter bankruptcy or financial reorganisation, and default or delinquency in payments are considered indicators that the trade receivable is impaired. Receivables with a short-term duration are not discounted.

A loss on provision for bad debt is reversed if the subsequent increase in recoverable amount can be related objectively to an event occurring after the impairment loss was recognised.

Amounts due from customers for contract work includes long-term contract balances and amounts due from contract customers, less attributable progress payments.

Long-term contract balances are stated at cost less provision for any anticipated losses. Provisions for losses on contracts are recorded when it becomes probable that total estimated contract costs will exceed total contract revenues. Such provisions are recorded as write downs of long-term contract balances for that portion of the work which has already been completed, and the remainder is included as amounts due to long-term contract customers within trade and other payables. Losses are determined on the basis of estimated results on completion of contracts and are updated regularly.

Progress payments are amounts received from customers in accordance with the terms of contracts which specify payments in advance of delivery and are credited, as progress payments, against any expenditure incurred for the particular contract. Any unexpended balance in respect of progress payments is held in trade and other payables as customer stage payments or, if the amounts are subject to advance payment guarantees unrelated to Group performance, as cash received on customers' account.

Amounts due from contract customers represent unbilled income and are stated at cost, plus attributable profit.

	2016 £m	2015 £m
Non-current		
Prepayments and accrued income	35	23
US deferred compensation plan assets	296	234
Other receivables	20	18
	351	275
Current		
Long-term contract balances	3,128	4,407
Deduct Attributable progress payments	(2,282)	(3,762)
Amounts due from contract customers	435	413
Amounts due from customers for contract work	1,281	1,058
Trade receivables	1,437	1,284
Amounts owed by equity accounted investments (note 28)	69	75
Prepayments and accrued income	256	254
Other receivables	262	269
	3,305	2,940

The aggregate amount of costs incurred and recognised profits (less recognised losses) to date in respect of contracts in progress at 31 December 2016 is estimated to be £27.5bn (2015 £26.4bn).

Trade receivables are disclosed net of a provision for bad debts. Disclosures relating to the ageing of trade receivables and movements in the provision for bad debts are provided in note 26.

13. Other financial assets and liabilities

Derivative financial instruments and hedging activities

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

The Group uses interest rate derivative instruments to manage the Group's exposure to interest rate fluctuations on its borrowings and deposits by varying the proportion of fixed rate debt relative to floating rate debt over the forward time horizon.

The Group uses foreign exchange derivative instruments to manage the Group's exposure to currency fluctuations on its borrowings and deposits with the Group's subsidiaries and equity accounted investments.

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

The Group aims to achieve hedge accounting treatment for all derivatives that hedge material foreign currency exposures and those interest rate exposures where hedge accounting can be achieved.

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. The fair values are estimated by discounting expected future cash flows.

Fair value through profit or loss

Gains and losses on derivative financial instruments that do not qualify for hedge accounting are recognised in the income statement for the period.

Cash flow hedges

Where a derivative financial instrument is designated as a hedge of cash flows relating to a highly probable forecast transaction (income or expense), the effective portion of any change in the fair value of the instrument is recognised in other comprehensive income and presented in the hedging reserve in equity. Amounts recognised in equity are reclassified from reserves into the cost of the underlying transaction and recognised in the income statement when the underlying transaction affects profit or loss. The ineffective portion of any change in the fair value of the instrument is recognised in the income statement immediately.

Fair value hedges

Where a derivative financial instrument is designated as a fair value hedge, changes in the fair value of the underlying asset or liability attributable to the hedged risk, and gains and losses on the derivative instrument, are recognised in the income statement for the period.

	2016		2015	
	Assets £m	Liabilities £m	Assets £m	Liabilities £m
Non-current				
Cash flow hedges – foreign exchange contracts	138	(102)	52	(72)
Other foreign exchange/interest rate contracts	93	–	2	–
Debt-related derivative financial instruments – assets ¹	114	–	53	–
	345	(102)	107	(72)
Current				
Cash flow hedges – foreign exchange contracts	151	(184)	47	(123)
Other foreign exchange/interest rate contracts	53	(28)	58	(7)
	204	(212)	105	(130)

1. Includes fair value hedges of £4m (2015 £7m).

Cash flow hedges

The hedged, highly probable forecast transactions denominated in foreign currency are predominantly expected to occur at various stages during the next 12 months. The majority of those extending beyond 12 months are expected to have been transacted within five years of the balance sheet date.

Amounts credited to the hedging reserve in respect of cash flow hedges were £87m (2015 £25m charge), including £74m (2015 £54m) on reclassification to profit and loss and £13m (2015 £79m charge) on contracts held at 31 December 2016.

Fair value hedges

The loss arising in the income statement on fair value hedging instruments was £3m (2015 gain £3m). The gain arising in the income statement on the fair value of the underlying hedged items was £1m (2015 loss £2m). The ineffective portion recognised as a loss in the income statement arising from fair value hedges was £2m (2015 gain £1m).

Debt-related derivative financial instruments

The debt-related derivative financial instruments represent the fair value of cross-currency and interest rate derivatives relating to the US\$500m 7.5% bond, repayable 2027, and the US\$800m 3.8% bond, repayable 2024, respectively (see note 18). These derivatives have been entered into specifically to manage the Group's exposure to foreign exchange or interest rate risk.

Notes to the Group accounts

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14. Deferred tax

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

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

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

Deferred tax assets/(liabilities)

	Deferred tax assets		Deferred tax liabilities		Net balance at 31 December	
	2016 £m	2015 £m	2016 £m	2015 £m	2016 £m	2015 £m
Property, plant and equipment	20	16	(119)	(101)	(99)	(85)
Intangible assets	18	13	(28)	(30)	(10)	(17)
Provisions and accruals	343	299	–	–	343	299
Goodwill	–	–	(428)	(326)	(428)	(326)
Pension/retirement schemes:						
Deficits	1,212	908	–	–	1,212	908
Additional contributions and other ¹	149	112	–	–	149	112
Share-based payments	23	15	–	–	23	15
Financial instruments	–	16	(5)	(6)	(5)	10
Other items	39	35	–	–	39	35
Rolled over capital gains	–	–	(11)	(12)	(11)	(12)
Capital losses carried forward	11	12	–	–	11	12
Trading losses carried forward	17	21	–	–	17	21
Deferred tax assets/(liabilities)	1,832	1,447	(591)	(475)	1,241	972
Set off of tax	(581)	(462)	581	462	–	–
Net deferred tax assets/(liabilities)	1,251	985	(10)	(13)	1,241	972

1. Includes deferred tax assets on US deferred compensation plans.

14. Deferred tax continued**Movement in temporary differences during the year**

	At 1 January 2016 £m	Foreign exchange adjustments £m	Recognised in income £m	Recognised in equity £m	At 31 December 2016 £m
Property, plant and equipment	(85)	(16)	2	–	(99)
Intangible assets	(17)	–	7	–	(10)
Provisions and accruals	299	54	(10)	–	343
Goodwill	(326)	(67)	(35)	–	(428)
Pension/retirement schemes:					
Deficits	908	45	26	233	1,212
Additional contributions and other ¹	112	24	13	–	149
Share-based payments	15	–	4	4	23
Financial instruments	10	1	1	(17)	(5)
Other items	35	6	(2)	–	39
Rolled over capital gains	(12)	–	1	–	(11)
Capital losses carried forward	12	–	(1)	–	11
Trading losses carried forward	21	1	(5)	–	17
	972	48	1	220	1,241
	At 1 January 2015 £m	Foreign exchange adjustments £m	Recognised in income £m	Recognised in equity £m	At 31 December 2015 £m
Property, plant and equipment	(78)	(6)	(1)	–	(85)
Intangible assets	(35)	(1)	19	–	(17)
Provisions and accruals	287	13	(1)	–	299
Goodwill	(273)	(17)	(36)	–	(326)
Pension/retirement schemes:					
Deficits	1,154	14	15	(275)	908
Additional contributions and other ¹	121	6	(3)	(12)	112
Share-based payments	21	–	(2)	(4)	15
Financial instruments	21	–	(8)	(3)	10
Other items	66	(1)	(30)	–	35
Rolled over capital gains	(13)	–	1	–	(12)
Capital losses carried forward	13	–	(1)	–	12
Trading losses carried forward	22	1	(2)	–	21
	1,306	9	(49)	(294)	972

1. Includes deferred tax assets on US deferred compensation plans.

Notes to the Group accounts continued

14. Deferred tax continued

Unrecognised deferred tax assets and liabilities

Deferred tax assets have not been recognised in respect of the following items:

	2016		2015	
	Gross amount £m	Unrecognised deferred tax asset £m	Gross amount £m	Unrecognised deferred tax asset £m
Deductible temporary differences, including tax credits	2	2	1	1
Capital losses carried forward	165	30	172	31
Trading and other losses carried forward	415	39	454	38
	582	71	627	70

These assets have not been recognised as the incidence of future profits in the relevant countries and legal entities cannot be accurately predicted at this time.

The Group has not recognised any deferred tax liability on temporary differences totalling £274m (2015 £243m) relating to potentially taxable unremitted earnings of overseas subsidiaries and equity accounted investments because any withholding tax due on the remittance of those earnings is expected to be insignificant.

Future changes in tax rates

The UK current tax rate reduced from 21% to 20% with effect from 1 April 2015 and will reduce to 19% with effect from 1 April 2017 and to 17% with effect from 1 April 2020. This will reduce future UK current tax charges accordingly.

Both recognised and unrecognised UK deferred tax balances as at 31 December 2016 have been calculated at a blended rate of 18%, which is the same rate used as at 31 December 2015.

15. Inventories

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

	2016 £m	2015 £m
Short-term work-in-progress	416	455
Raw materials and consumables	256	197
Finished goods and goods for resale	72	74
	744	726

The Group recognised £10m (2015 £16m) as a write down of inventories to net realisable value.

16. Cash and cash equivalents

Cash and cash equivalents includes cash in hand, call and term deposits, investments in money market funds and other short-term liquid investments with original maturities of three months or less and which are subject to an insignificant risk of change in value. For the purpose of the cash flow statement, cash and cash equivalents also includes bank overdrafts that are repayable on demand.

	2016 £m	2015 ¹ £m
Cash	419	339
Money market funds	869	197
Short-term deposits	1,483	2,001
	2,771	2,537
Deduct Cash and cash equivalents (included within assets held for sale)	(2)	–
	2,769	2,537

1. Re-presented to show money market funds separately from cash.

17. Geographical analysis of assets

Analysis of non-current assets by geographical location

Asset location	Notes	2016 £m	2015 £m
UK		2,755	2,537
Rest of Europe		586	538
US		9,864	8,635
Saudi Arabia		443	349
Australia		474	406
Rest of Asia and Pacific		6	1
Non-current segment assets		14,128	12,466
Retirement benefit surpluses	20	223	193
Other financial assets	13	549	212
Tax		1,256	989
Inventories	15	744	726
Current trade and other receivables	12	3,305	2,940
Cash and cash equivalents	16	2,769	2,537
Assets held for sale		2	20
Consolidated total assets		22,976	20,083

18. Loans and overdrafts

Loans and overdrafts are recognised initially at fair value, less attributable transaction costs. Subsequent to initial recognition, loans and overdrafts are stated at either amortised cost or, where hedge accounting has been adopted, fair value in respect of the hedged risk. Any difference between the amount initially recognised and the redemption value is recognised in the income statement over the period of the borrowings.

	2016 £m	2015 £m
Non-current		
Albertville Hangar bond, repayable 2018	8	6
US\$1bn 6.375% bond, repayable 2019	810	680
US\$500m 2.85% bond, repayable 2020	403	337
US\$500m 4.75% bond, repayable 2021	404	339
£400m 4.125% bond, repayable 2022	398	398
US\$800m 3.8% bond, repayable 2024	649	546
US\$750m 3.85% bond, repayable 2025	598	501
US\$500m 7.5% bond, repayable 2027	402	337
US\$400m 5.8% bond, repayable 2041	320	268
US\$550m 4.75% bond, repayable 2044	433	363
	4,425	3,775
Current		
US\$350m 3.5% bond, repayable 2016	–	237
	–	237

US\$500m of the US\$1bn 6.375% bond, repayable 2019, has been converted to a floating rate bond by utilising interest rate swaps that mature in June 2019 and give an effective rate during 2016 of 6.0%.

US\$500m of the US\$800m 3.8% bond, repayable 2024, has been converted to a floating rate bond by utilising interest rate swaps that mature in October 2019 and give an effective rate during 2016 of 3.1%. US\$500m of the US\$800m bond is measured at amortised cost as adjusted for the fair value of the interest rate risk.

The US\$500m 7.5% bond, repayable 2027, was converted at issue to a sterling fixed rate bond by utilising cross-currency swaps and has an effective interest rate of 7.7%.

Notes to the Group accounts continued

19. Trade and other payables

Trade and other payables are stated at their cost.

	2016 £m	2015 £m
Non-current		
Amounts due to long-term contract customers	173	456
Amounts due to other customers	10	8
Amounts owed to equity accounted investments (note 28)	24	32
Accruals and deferred income ¹	300	121
US deferred compensation plan liabilities	326	264
Other payables	194	139
	1,027	1,020
Current		
Amounts due to long-term contract customers	3,084	3,119
Amounts due to other customers	169	204
Trade payables	707	690
Amounts owed to equity accounted investments (note 28)	726	414
Other taxes and social security costs	206	155
Accruals and deferred income	1,406	1,371
Other payables	242	209
	6,540	6,162
Included above:		
Amounts due to long-term contract customers, including contract losses	3,257	3,575
Advances from long-term contract customers	3,133	3,416
Advances from other customers	179	212

1. Includes £209m (2015 £46m) of funding received from the UK government for property, plant and equipment at Barrow-in-Furness, UK, relating to the Dreadnought submarine programme.

20. Retirement benefits

Pension schemes

Defined contribution

Obligations for contributions are recognised as an expense in the income statement as incurred.

Defined benefit

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 Consolidated 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 Group's balance sheet represent 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 158. The bid values of scheme assets are not intended to be realised in the short term and may be subject to significant change before they are realised. The present values of scheme liabilities are derived from cash flow projections over long periods and are, therefore, inherently uncertain.

IAS 19, Employee Benefits, limits the measurement of a defined benefit surplus to the lower of the surplus in the defined benefit scheme and the asset ceiling. The asset ceiling is the present value of any economic benefits available in the form of refunds from the scheme or reductions in future contributions to the scheme. IFRIC 14, IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction, issued in 2007, provides an interpretation of the requirements of IAS 19, clarifying that a refund is available if the entity has an unconditional right to a refund in certain circumstances. The Group 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 2016.

Certain of the Group's equity accounted investments participate in the Group's defined benefit schemes and, as these are multi-employer schemes, the Group has allocated a share of the IAS 19 pension surpluses and deficits to its equity accounted investments.

On 1 April 2016, a separate Airbus section of the BAE Systems Pension Scheme (Main Scheme) was created, reducing the total net IAS 19 deficit, with a corresponding reduction in the allocation to equity accounted investments. There was no settlement gain or loss upon sectionalisation of the Main Scheme.

The deficit allocation methodology for the remaining employers of the Main Scheme and for all other schemes 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.

In the event that an employer who participates in the Group'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 Group considers the likelihood of this event arising as remote. However, following the creation of an Airbus section of the Main Scheme, the Group's obligation in respect of Airbus has been removed in respect of the Main Scheme.

The Group's share of the IAS 19 pension deficit allocated to the equity accounted investments is included in the balance sheet within equity accounted investments.

Pension schemes

Background

BAE Systems plc operates pension schemes for the Group's qualifying employees in the UK, US and other countries. The principal schemes in the UK and US are funded defined benefit schemes, and the assets are held in separate trustee-administered funds. The two largest funded defined benefit schemes are the Main Scheme and the BAE Systems 2000 Pension Plan (2000 Plan) which, in aggregate, represent 69% (2015 71%) of the total IAS 19 defined benefit obligation at 31 December 2016. The schemes in other countries are primarily defined contribution schemes.

At 31 December 2016, the weighted average durations of the UK and US defined benefit pension obligations were 19 years (2015 18 years) and 12 years (2015 12 years), respectively.

The split of the defined benefit pension liability on a funding basis between active, deferred and pensioner members for the Main Scheme, 2000 Plan and US schemes in aggregate is set out below:

	Active %	Deferred %	Pensioner %
Main Scheme ¹	32	19	49
2000 Plan ²	14	29	57
US schemes ³	32	17	51

1. Source: Main Scheme actuarial valuation report as at 31 March 2014.

2. Source: 2000 Plan actuarial valuation report as at 31 March 2014.

3. Source: Annual updates of the US schemes as at 1 January 2016.

Notes to the Group accounts

continued

20. Retirement benefits continued

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 the Group.

The funded US schemes are tax-qualified pension schemes regulated by the Pension Protection Act 2006 and insured by the Pension Benefit Guarantee Corporation (PBGC) up to certain limits. These schemes were established under and are governed by the US Employee Retirement Income Security Act 1974 and the BAE Systems Administrative Committee is a named fiduciary with the authority to manage their operation.

Benefits

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

The US defined benefit schemes ceased to be final salary schemes in January 2013. The benefits accrued based on the final salaries of members at that point will become payable on retirement. The Normal Retirement Age for the largest scheme in the US is 65.

Funding

The majority of the UK and US defined benefit pension schemes are funded by the Group'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, whilst the liabilities are determined based on prudent assumptions set by the trustees following consultation with scheme actuaries.

The separate actuarial valuations for funding purposes include assumptions which differ from the actuarial assumptions used for IAS 19 accounting purposes shown on page 158. The latest valuations of the Main Scheme and 2000 Plan were performed as at 31 March 2014 and showed a funding deficit of £2.6bn. The total net funding deficit in respect of all of the UK schemes was £2.7bn. Deficit recovery plans agreed with the trustees of the relevant schemes run until 2026.

The next UK triennial funding valuations, as at 31 March 2017, will commence in April 2017 and, in conjunction with the trustees of the schemes and other stakeholders, the Group will be looking at various options with a focus on the longer-term view. The results of future triennial valuations and associated funding requirements will be impacted by the future performance of investment markets, and interest and inflation rates.

The total Group contributions made to the defined benefit schemes in the year ended 31 December 2016 were £411m (2015 £438m) excluding those amounts allocated to equity accounted investments of £50m (2015 £98m). Equity accounted investments make regular contributions to the schemes in which they participate in line with the schedule of contributions and are allocated a share of deficit funding contributions.

In 2017, the Group expects to make contributions at a similar level to the recurring contributions and deficit funding as made in 2016.

The Group incurred a charge of £163m (2015 £140m) in relation to defined contribution schemes for employees.

20. Retirement benefits continued

Risk management

The defined benefit pension schemes expose the Group to actuarial risks, including market (investment) risk, interest rate risk, inflation risk and longevity risk.

Risk	Mitigation
<p>Market (investment) risk</p> <p>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 provide reasonable assurance that no single security or type of security could have a materially adverse impact on the total portfolio. 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 47% (2015 49%) of the Group's pension scheme assets are held in equities and pooled investment vehicles due to the higher expected level of return over the long term.</p> <p>Some of the Group's pension schemes use derivative financial instruments as part of their investment strategy to manage the level of market risk. In August 2013, the Main Scheme implemented a long-dated equity option strategy protecting £1.4bn of assets against a significant fall in equity markets.</p>
<p>Interest rate risk</p> <p>Liabilities are sensitive to movements in interest rates, with lower interest rates leading to an increase in the valuation of liabilities.</p>	<p>In addition to investing in bonds as part of the matching portfolio, some of the UK schemes invest in interest rate swaps to reduce the exposure to movements in interest rates. The swaps are held with several banks to reduce counterparty risk. The Group is hedged against approximately 35% of interest rate risk.</p>
<p>Inflation risk</p> <p>Liabilities are sensitive to movements in inflation, with higher inflation leading to an increase in the valuation of liabilities.</p>	<p>In addition to investing in index-linked bonds as part of the matching portfolio, the principal UK schemes invest in long-term inflation swaps to reduce the exposure to movements in inflation. The swaps are held with several banks to reduce counterparty risk. The Group is hedged against approximately 40% of inflation risk.</p> <p>Effective 1 May 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</p> <p>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 February 2013, with the agreement of the Company, the trustees of the 2000 Plan entered into an arrangement with Legal & General to insure against longevity risk for the current pensioner population, covering £2.7bn of pension scheme liabilities. In December 2013, similar arrangements were entered into, with Legal & General, by the trustees of the Royal Ordnance Pension Scheme and Shipbuilding Industries Pension Scheme, covering £0.9bn and £0.8bn of pension scheme liabilities, respectively. These arrangements reduce the funding volatility relating to increasing life expectancy.</p>

Notes to the Group accounts

continued

20. Retirement benefits continued

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.

	UK			US		
	2016	2015	2014	2016	2015	2014
Financial assumptions						
Discount rate (%)	2.7	3.9	3.6	4.2	4.5	4.1
Inflation (%)	3.2	3.2	3.2	n/a	n/a	n/a
Rate of increase in salaries (%)	3.2	3.2	3.2	n/a	n/a	n/a
Rate of increase in deferred pensions (%)	2.2/3.2	2.3/3.2	2.3/3.2	n/a	n/a	n/a
Rate of increase in pensions in payment (%)	1.7 – 3.7	1.8 – 3.6	1.8 – 3.6	n/a	n/a	n/a
Demographic assumptions						
Life expectancy of a male currently aged 65 (years)	86 – 89	87 – 89	87 – 89	87	87	87
Life expectancy of a female currently aged 65 (years)	89 – 90	89 – 90	89 – 90	89	89	89
Life expectancy of a male currently aged 45 (years)	88 – 91	89 – 91	89 – 91	87	87	87
Life expectancy of a female currently aged 45 (years)	91 – 92	91 – 92	91 – 92	89	89	89

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 for the UK and US territories. This inherently captures the maturity profile of the expected benefit payments. Further information on the duration of the schemes is detailed on page 155.

Inflation

In the UK, 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. In the US, inflation assumptions are not significant as the Group's US pension schemes are not indexed with inflation.

Rate of increase in salaries

The rate of increase in salaries for the UK schemes is assumed to be Retail Prices Index (RPI) inflation of 3.2% (2015 RPI inflation of 3.2%), plus a promotional scale. From 1 January 2013, employees in the US schemes no longer accrue salary-related benefits.

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 2.2% (2015 CPI inflation of 2.3%), with the exception of the 2000 Plan, which is based on RPI inflation of 3.2% (2015 RPI inflation of 3.2%). 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 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

For its UK pension schemes, the Group has used the Self-Administered Pension Schemes S2 mortality tables based on year of birth (as published by the Institute of Actuaries) for both pensioner and non-pensioner members in conjunction with the results of an investigation into the actual mortality experience of scheme members. In addition, to allow for future improvements in longevity, the Continuous Mortality Investigation 2015 tables (published by the Institute of Actuaries) have been used, with an assumed long-term rate of future annual mortality improvements of 1.25% (2015 1.25%), for both pensioner and non-pensioner members.

In October 2015, the Society of Actuaries in the US released updated mortality assumptions reflecting the results of its comprehensive mortality study. For the majority of the US schemes, the mortality tables used at 31 December 2016 are a blend of the fully generational RP-2014 Aggregate table and the RP-2014 White Collar table, both projected using Scale MP-2016. IRS approval of the mortality tables is expected in 2017, following which the tables are expected to be adopted for funding valuation purposes.

20. Retirement benefits continued

Retirement benefits other than pensions

Background

The Group operates a number of non-pension retirement benefit schemes, under which certain employees are eligible to receive benefits after retirement, the majority of which relate to the provision of medical benefits to retired employees of the Group's subsidiaries in the US. The latest valuations of the principal schemes, covering retiree medical and life insurance schemes in certain US subsidiaries, were performed by independent actuaries as at 1 January 2016. These valuations were rolled forward to reflect the information at 31 December 2016. The method of accounting for these is similar to that used for defined benefit pension schemes.

Principal actuarial assumptions

The assumption for long-term healthcare cost increases is 4.8% (2015 4.8%) based on the assumptions that the increases are 6.5% in 2016 reducing to 4.5% by 2024 and 4.5% each year thereafter for pre-retirement, and 5.5% in 2016 reducing to 4.5% by 2024 and 4.5% each year thereafter for post-retirement.

The disclosures below relate to post-retirement benefit schemes in the UK, US and other countries which are accounted for as defined benefit schemes in accordance with IAS 19.

Summary of movements in retirement benefit obligations

	UK £m	US and other £m	Total £m
Total net IAS 19 deficit at 1 January 2016	(4,824)	(730)	(5,554)
Impact of sectionalisation of the Main Scheme ¹	667	–	667
Actual return on assets excluding amounts included in net interest expense	(4,157)	(730)	(4,887)
Increase in liabilities due to changes in financial assumptions	2,649	180	2,829
Decrease in liabilities due to changes in demographic assumptions	(4,815)	(170)	(4,985)
Experience gains	250	40	290
Additional contributions in excess of service cost	242	10	252
Recurring contributions in excess of service cost	164	–	164
Past service cost – plan amendments	46	43	89
Net interest expense	(7)	(4)	(11)
Foreign exchange adjustments	(150)	(34)	(184)
Movement in US healthcare schemes	–	(135)	(135)
	–	8	8
Total net IAS 19 deficit at 31 December 2016	(5,778)	(792)	(6,570)
Allocated to equity accounted investments	516	–	516
Group's share of net IAS 19 deficit excluding Group's share of amounts allocated to equity accounted investments at 31 December 2016	(5,262)	(792)	(6,054)

1. The Main Scheme deficit allocated to Airbus at 31 December 2015 of £683m as adjusted for a £16m contribution into the scheme by Airbus in the first quarter of 2016.

The increase in liabilities due to changes in financial assumptions in the UK schemes reflects a 1.2 percentage point decrease in the real discount rate to –0.5%.

Notes to the Group accounts

continued

20. Retirement benefits continued

Amounts recognised on the balance sheet

The table below shows a reconciliation between the gross assets and liabilities of the Group's UK, US and other post-retirement benefit schemes and the amounts recognised on the Group's balance sheet after allocation to equity accounted investments.

	2016				2015			
	UK defined benefit pension schemes £m	US and other pension schemes £m	US healthcare schemes £m	Total £m	UK defined benefit pension schemes £m	US and other pension schemes £m	US healthcare schemes £m	Total £m
Present value of unfunded obligations	(74)	(153)	–	(227)	(59)	(131)	–	(190)
Present value of funded obligations	(27,099)	(4,981)	(169)	(32,249)	(24,974)	(4,072)	(145)	(29,191)
Fair value of scheme assets	21,395	4,313	198	25,906	20,209	3,452	166	23,827
Total net IAS 19 (deficit)/surplus	(5,778)	(821)	29	(6,570)	(4,824)	(751)	21	(5,554)
Allocated to equity accounted investments	516	–	–	516	1,053	–	–	1,053
Group's share of net IAS 19 (deficit)/surplus	(5,262)	(821)	29	(6,054)	(3,771)	(751)	21	(4,501)
Represented by:								
Retirement benefit surpluses	132	49	42	223	120	41	32	193
Retirement benefit obligations	(5,394)	(870)	(13)	(6,277)	(3,891)	(792)	(11)	(4,694)
	(5,262)	(821)	29	(6,054)	(3,771)	(751)	21	(4,501)
Group's share of net IAS 19 deficit of equity accounted investments	(193)	–	–	(193)	(139)	–	–	(139)

Total cumulative actuarial losses recognised in equity since the transition to IFRS are £6.7bn (2015 £5.2bn).

Changes in the fair value of scheme assets before allocation to equity accounted investments

	UK defined benefit pension schemes £m	US and other pension schemes £m	US healthcare schemes £m	Total £m
Value of scheme assets at 1 January 2015	20,170	3,505	165	23,840
<i>Interest income</i>	720	142	7	869
<i>Actual return on assets excluding amounts included in interest income</i>	(335)	(198)	(9)	(542)
Actual return on assets	385	(56)	(2)	327
<i>Contributions by employer</i>	460	76	2	538
<i>Contributions by employer in respect of employee salary sacrifice arrangements</i>	103	–	–	103
Total contributions by employer	563	76	2	641
Members' contributions	11	–	–	11
Administrative expenses	–	(12)	(1)	(13)
Settlements	–	(64)	–	(64)
Foreign exchange translation	–	190	9	199
Benefits paid	(920)	(187)	(7)	(1,114)
Value of scheme assets at 31 December 2015	20,209	3,452	166	23,827
Impact of sectionalisation of the Main Scheme	(1,779)	–	–	(1,779)
<i>Interest income</i>	710	166	8	884
<i>Actual return on assets excluding amounts included in interest income</i>	2,649	180	2	2,831
Actual return on assets	3,359	346	10	3,715
<i>Contributions by employer</i>	390	71	1	462
<i>Contributions by employer in respect of employee salary sacrifice arrangements</i>	86	–	–	86
Total contributions by employer	476	71	1	548
Members' contributions	9	–	–	9
Administrative expenses	–	(17)	–	(17)
Foreign exchange translation	–	679	33	712
Benefits paid	(879)	(218)	(12)	(1,109)
Value of scheme assets at 31 December 2016	21,395	4,313	198	25,906

20. Retirement benefits continued**Assets of defined benefit pension schemes**

	2016								
	UK			US and other			Total		
	Quoted £m	Unquoted £m	Total £m	Quoted £m	Unquoted £m	Total £m	Quoted £m	Unquoted £m	Total £m
Equities:									
UK ¹	4,030	–	4,030	–	–	–	4,030	–	4,030
Overseas	2,774	–	2,774	430	–	430	3,204	–	3,204
Pooled investment vehicles ²	1,503	2,428	3,931	988	–	988	2,491	2,428	4,919
Fixed interest securities:									
UK gilts	1,947	–	1,947	–	–	–	1,947	–	1,947
UK corporates	2,389	145	2,534	–	–	–	2,389	145	2,534
Overseas government	79	–	79	151	–	151	230	–	230
Overseas corporates	1,069	230	1,299	2,509	–	2,509	3,578	230	3,808
Index-linked securities:									
UK gilts	2,039	–	2,039	–	–	–	2,039	–	2,039
UK corporates	1,046	546	1,592	–	–	–	1,046	546	1,592
Property ³	–	1,460	1,460	–	147	147	–	1,607	1,607
Derivatives ⁴	–	(708)	(708)	–	–	–	–	(708)	(708)
Cash:									
Sterling	345	–	345	–	–	–	345	–	345
Foreign currency	32	26	58	79	–	79	111	26	137
Other	–	15	15	–	9	9	–	24	24
Total	17,253	4,142	21,395	4,157	156	4,313	21,410	4,298	25,708

	2015								
	UK ^{5,6}			US and other			Total ^{5,6}		
	Quoted £m	Unquoted £m	Total £m	Quoted £m	Unquoted £m	Total £m	Quoted £m	Unquoted £m	Total £m
Equities:									
UK ¹	4,133	–	4,133	–	–	–	4,133	–	4,133
Overseas	2,883	–	2,883	602	–	602	3,485	–	3,485
Pooled investment vehicles ²	1,172	2,247	3,419	480	–	480	1,652	2,247	3,899
Fixed interest securities:									
UK gilts	2,103	–	2,103	–	–	–	2,103	–	2,103
UK corporates	2,534	237	2,771	–	–	–	2,534	237	2,771
Overseas government	–	–	–	111	–	111	111	–	111
Overseas corporates	184	205	389	2,084	–	2,084	2,268	205	2,473
Index-linked securities:									
UK gilts	1,754	–	1,754	–	–	–	1,754	–	1,754
UK corporates	1,074	604	1,678	–	–	–	1,074	604	1,678
Property ³	–	1,433	1,433	–	146	146	–	1,579	1,579
Derivatives ⁴	–	(678)	(678)	–	–	–	–	(678)	(678)
Cash:									
Sterling	253	–	253	–	–	–	253	–	253
Foreign currency	44	13	57	23	–	23	67	13	80
Other	–	14	14	–	6	6	–	20	20
Total	16,134	4,075	20,209	3,300	152	3,452	19,434	4,227	23,661

1. Includes £32m (2015 £31m) of the Company's own ordinary shares.

2. Primarily invested in equities. The amounts classified as unquoted primarily comprise investments in private equity, valued in accordance with International Private Equity and Venture Capital Valuation Guidelines.

3. 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. Includes £229m (2015 £257m) of property occupied by Group companies.

4. Includes interest rate, inflation and longevity swaps. The valuations are based on valuation techniques using underlying market data and discounted cash flows.

5. 2015 assets are prior to sectionalisation of the Main Scheme.

6. Restated following reinterpretation of the classifications, including the allocation between quoted and unquoted assets.

Notes to the Group accounts

continued

20. Retirement benefits continued

Changes in the present value of the defined benefit obligations before allocation to equity accounted investments

	UK defined benefit pension schemes £m	US and other pension schemes £m	US healthcare schemes £m	Total £m
Defined benefit obligations at 1 January 2015	(26,236)	(4,270)	(146)	(30,652)
Current service cost	(239)	(11)	(2)	(252)
Contributions by employer in respect of employee salary sacrifice arrangements	(103)	–	–	(103)
Total current service cost	(342)	(11)	(2)	(355)
Members' contributions	(11)	–	–	(11)
Past service cost – plan amendments	(10)	–	–	(10)
Settlements	–	68	–	68
Actuarial gain due to changes in financial assumptions	1,348	202	7	1,557
Actuarial gain due to changes in demographic assumptions	–	29	2	31
Experience gains/(losses)	224	(4)	1	221
Interest expense	(926)	(174)	(6)	(1,106)
Foreign exchange translation	–	(230)	(8)	(238)
Benefits paid	920	187	7	1,114
Defined benefit obligations at 31 December 2015	(25,033)	(4,203)	(145)	(29,381)
Impact of sectionalisation of the Main Scheme	2,446	–	–	2,446
Current service cost	(180)	(11)	(1)	(192)
Contributions by employer in respect of employee salary sacrifice arrangements	(86)	–	–	(86)
Total current service cost	(266)	(11)	(1)	(278)
Members' contributions	(9)	–	–	(9)
Past service cost – plan amendments	(7)	(4)	(1)	(12)
Actuarial loss due to changes in financial assumptions	(4,815)	(170)	(5)	(4,990)
Actuarial gain due to changes in demographic assumptions	250	40	3	293
Experience gains	242	10	1	253
Interest expense	(860)	(200)	(7)	(1,067)
Foreign exchange translation	–	(814)	(26)	(840)
Benefits paid	879	218	12	1,109
Defined benefit obligations at 31 December 2016	(27,173)	(5,134)	(169)	(32,476)

Amounts recognised in the income statement after allocation to equity accounted investments

	2016				2015			
	UK defined benefit pension schemes £m	US and other pension schemes £m	US healthcare schemes £m	Total £m	UK defined benefit pension schemes £m	US and other pension schemes £m	US healthcare schemes £m	Total £m
Included in operating costs:								
Current service cost	(161)	(11)	(1)	(173)	(177)	(11)	(2)	(190)
Past service cost – plan amendments	(7)	(4)	(1)	(12)	(10)	–	–	(10)
Settlements	–	–	–	–	–	4	–	4
	(168)	(15)	(2)	(185)	(187)	(7)	(2)	(196)
Administrative expenses	–	(17)	–	(17)	–	(12)	(1)	(13)
	(168)	(32)	(2)	(202)	(187)	(19)	(3)	(209)
Included in net finance costs:								
Net interest (expense)/income on retirement benefit obligations	(136)	(34)	1	(169)	(161)	(32)	1	(192)
Group defined benefit schemes included in share of results of equity accounted investments:								
Group's share of equity accounted investments' operating costs	(10)	–	–	(10)	(10)	–	–	(10)
Group's share of equity accounted investments' finance costs	(5)	–	–	(5)	(6)	–	–	(6)

20. Retirement benefits continued

Sensitivity analysis

The sensitivity information has been derived using scenario analysis from the actuarial assumptions as at 31 December 2016 and keeping all other assumptions as set out on page 158.

Financial assumptions

Changes in the following financial assumptions would have the following effect on the defined benefit pension obligation before allocation to equity accounted investments:

	(Increase)/decrease in pension obligation £bn
Discount rate:	
0.1 percentage point increase	0.6
0.1 percentage point decrease	(0.6)
Inflation:	
0.1 percentage point increase	(0.5)
0.1 percentage point decrease	0.5

The sensitivity analysis does not allow for the impact of the Group's risk management activities in respect of interest rate and inflation risk (see page 157) on the valuation of the scheme assets. Across all of its pension schemes, the Group is hedged against approximately 35% and 40% of interest rate and inflation risk, respectively, measured relative to the funding liabilities. The Group's US schemes are not indexed with inflation. The table below shows the estimated impact of changes in the following financial assumptions allowing for the impact of the Group's risk management activities in respect of interest rate and inflation risk swaps, together with the impact on the matched asset portfolio. It does not reflect any natural matching that occurs in the wider asset portfolio:

	(Increase)/decrease in pension obligation £bn	(Increase)/decrease in scheme assets £bn
Discount rate:		
0.1 percentage point increase	0.6	(0.2)
0.1 percentage point decrease	(0.6)	0.2
Inflation:		
0.1 percentage point increase	(0.5)	0.2
0.1 percentage point decrease	0.5	(0.2)

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

	(Increase)/decrease in pension obligation £bn
Inflation:	
0.5 percentage point increase	(1.8)
0.5 percentage point decrease	1.6
1.0 percentage point increase	(3.5)
1.0 percentage point decrease	3.0

Demographic assumptions

Changes in the life expectancy assumption, including the benefit of longevity swap arrangements (see longevity risk on page 157), would have the following effect on the total net IAS 19 deficit:

	(Increase)/decrease in net deficit £bn
Life expectancy:	
One-year increase	(1.1)
One-year decrease	1.1

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21. Provisions

A provision is recognised in the balance sheet when the Group 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.

Reorganisations

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

Legal, contractual and environmental

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

	Warranties and after-sales service £m	Reorganisations £m	Legal, contractual and environmental £m	Other £m	Total £m
Non-current	48	–	278	28	354
Current	37	65	151	48	301
At 1 January 2016	85	65	429	76	655
Created	55	13	44	27	139
Utilised	(31)	(36)	(48)	(19)	(134)
Released ¹	(16)	(21)	(62)	(26)	(125)
Net present value adjustments	–	–	16	3	19
Foreign exchange adjustments	9	2	32	9	52
At 31 December 2016	102	23	411	70	606
Represented by:					
Non-current	59	1	280	32	372
Current	43	22	131	38	234
	102	23	411	70	606

1. There are no individual provision releases in excess of £10m.

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.

Reorganisations

Reorganisation costs are generally incurred within one to three years. There is limited volatility around the timing and amount of the ultimate outflows related to these provisions.

Legal, contractual and environmental

Reflecting the inherent uncertainty within many legal proceedings, the amount of the outflows could differ significantly from the amount provided.

Other

There are no individually significant provisions included within other provisions.

22. Share capital and other reserves

Share capital

	Equity		Non-equity		Total
	Ordinary shares of 2.5p each		Special Share of £1		Nominal value
	Number of shares m	Nominal value £m	Number of shares	Nominal value £	£m
Issued and fully paid					
At 1 January 2015	3,469	87	1	1	87
Repurchased and cancelled	(2)	–	–	–	–
At 31 December 2015 and 31 December 2016	3,467	87	1	1	87

Special Share

One Special Share of £1 in the Company is held on behalf of the Secretary of State for Business, Energy and Industrial Strategy (the Special Shareholder). Certain provisions of the Company's Articles of Association cannot be amended without the consent of the Special Shareholder. These provisions include the requirement that no foreign person, or foreign persons acting in concert, can have more than a 15% voting interest in the Company, the requirement that the majority of the directors are British, and the requirement that the Chief Executive and any executive Chairman are British citizens. The effect of these requirements can also be amended by regulations made by the directors and approved by the Special Shareholder.

The Special Shareholder may require the Company at any time to redeem the Special Share at par or to convert the Special Share into one ordinary voting share. The Special Shareholder is entitled to receive notice of and to attend general meetings and class meetings of the Company's shareholders, but has no voting right, nor other rights, other than to speak in relation to any business in respect of the Special Share.

Share buyback

In 2015, 1,450,000 ordinary shares of 2.5p were repurchased under the three-year buyback programme announced in February 2013 and such repurchased shares were cancelled.

Treasury shares

As at 31 December 2016, 291,449,361 (2015 301,808,103) ordinary shares of 2.5p each with an aggregate nominal value of £7,286,234 (2015 £7,545,203) were held in treasury. During 2016, 10,358,742 (2015 14,018,511) treasury shares were used to satisfy awards and options under the Share Incentive Plan, International Share Incentive Plan, Performance Share Plan, Restricted Share Plan and Executive Share Option Plan.

Own shares held

Own shares held, including treasury shares and shares held by BAE Systems Employee Share Option Plan (ESOP) Trust, are recognised as a deduction from retained earnings.

BAE Systems ESOP Trust

The Group has an ESOP discretionary trust to administer the share plans and to acquire Company shares, using funds loaned by the Group, to meet commitments to Group employees. Dividend waivers were in operation for shares within the ESOP Trust, other than those owned beneficially by the participants, for the dividends paid in June and November 2016.

At 31 December 2016, the ESOP held 1,327,731 (2015 897,873) ordinary shares of 2.5p each, with a market value of £8m (2015 £4m). The shares held by the ESOP are recorded at cost and deducted from retained earnings until such time as the shares vest unconditionally to employees.

A dividend waiver was also in operation for the dividends paid in June and November 2016 over shares within the Company's Share Incentive Plan Trust other than those shares owned beneficially by the participants.

Equity dividends

Equity dividends on ordinary share capital are recognised as a liability in the period in which they are declared. The interim dividend is recognised when it has been approved by the Board and the final dividend is recognised when it has been approved by the shareholders at the Annual General Meeting.

	2016 £m	2015 £m
Prior year final 12.5p dividend per ordinary share paid in the year (2015 12.3p)	397	389
Interim 8.6p dividend per ordinary share paid in the year (2015 8.4p)	273	266
	670	655

After the balance sheet date, the directors proposed a final dividend of 12.7p per ordinary share. The dividend, which is subject to shareholder approval, will be paid on 1 June 2017 to shareholders registered on 21 April 2017. The ex-dividend date is 20 April 2017.

Shareholders who do not at present participate in the Company's Dividend Reinvestment Plan and wish to receive the final dividend in shares rather than cash should complete a mandate form for the Dividend Reinvestment Plan and return it to the registrars no later than 10 May 2017.

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22. Share capital and other reserves continued

Other reserves

	Merger reserve £m	Statutory reserve £m	Revaluation reserve £m	Capital redemption reserve £m	Hedging reserve £m	Translation reserve £m	Total £m
At 1 January 2015	4,589	202	10	3	(42)	299	5,061
Subsidiaries:							
Currency translation on foreign currency net investments	–	–	–	–	–	261	261
Reclassification of cumulative currency translation reserve on disposal	–	–	–	–	–	20	20
Amounts credited to hedging reserve ¹	–	–	–	–	11	–	11
Tax on other comprehensive income ¹	–	–	–	–	(2)	–	(2)
Equity accounted investments (net of tax) ¹	–	–	–	–	(29)	(45)	(74)
At 31 December 2015	4,589	202	10	3	(62)	535	5,277
Subsidiaries:							
Currency translation on foreign currency net investments	–	–	–	–	–	1,284	1,284
Amounts credited to hedging reserve	–	–	–	–	96	–	96
Tax on other comprehensive income	–	–	–	–	(17)	–	(17)
Equity accounted investments (net of tax)	–	–	–	–	(7)	52	45
At 31 December 2016	4,589	202	10	3	10	1,871	6,685

1. Re-presented in accordance with Amendments to IAS 1: Disclosure Initiative.

Merger reserve

The merger reserve arose on the acquisition of the Marconi Electronic Systems (MES) business by British Aerospace in 1999 to form BAE Systems, and represents the amount by which the fair value of the shares issued by British Aerospace as consideration exceeded their nominal value.

Statutory reserve

Under Section 4 of the British Aerospace Act 1980, this reserve may only be applied in paying up unissued shares of the Company to be allotted to members of the Company as fully paid bonus shares.

Revaluation reserve

The revaluation reserve relates to the revaluation at fair value of the net assets of the BVT joint venture previously held as an equity accounted investment on the acquisition of the remaining 45% interest in 2009.

Capital redemption reserve

The capital redemption reserve represents the cumulative nominal value of the Company's ordinary shares repurchased and subsequently cancelled.

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.

Translation reserve

The translation reserve comprises all foreign currency differences arising from the translation of the financial statements of foreign operations.

Capital

The Group funds its operations through a mixture of equity funding and debt financing, including bank and capital market borrowings.

At 31 December 2016, the Group's capital was £3,454m (2015 £3,064m), which comprises total equity of £3,464m (2015 £3,002m), excluding amounts accumulated in equity relating to cash flow hedges of £10m (2015 liability £62m). Net debt was £1,542m (2015 £1,422m).

The capital structure of the Group reflects the judgement of the directors of an appropriate balance of funding required. The Group's policy is to maintain an investment grade credit rating and ensure operating flexibility, whilst:

- meeting its pension obligations;
- pursuing organic investment opportunities;
- paying dividends in line with the Group's policy of long-term sustainable cover of around two times underlying earnings (see note 7);
- making accelerated returns of capital to shareholders when the balance sheet allows and when the return from doing so is in excess of the Group's Weighted Average Cost of Capital; and
- investing in value-enhancing acquisitions, where market conditions are right and where they deliver on the Group's strategy.

23. Operating business cash flow

Key Performance Indicator – Operating business cash flow

Definition Net cash flow from operating activities excluding taxation after net capital expenditure, financial investment and dividends from equity accounted investments.

Purpose Allows management to monitor the operating cash generation of the Group.

Reconciliation of net cash flow from operating activities to operating business cash flow

	2016 £m	2015 £m
Net cash flow from operating activities	1,229	808
Add back Taxation paid	187	116
<i>Purchase of property, plant and equipment, and investment property</i>	(408)	(359)
<i>Purchase of intangible assets</i>	(82)	(54)
<i>Proceeds from sale of property, plant and equipment, and investment property</i>	45	136
<i>Proceeds from sale of non-current other investments</i>	–	1
<i>Equity accounted investment funding</i>	(5)	(8)
Net capital expenditure and financial investment	(450)	(284)
Dividends received from equity accounted investments	38	41
Operating business cash flow	1,004	681

Reconciliation of operating business cash flow to net cash flow from operating activities by reporting segment

	Operating business cash flow		Deduct Dividends received from equity accounted investments		Add back Net capital expenditure and financial investment		Net cash flow from operating activities	
	2016 £m	2015 ¹ £m	2016 £m	2015 £m	2016 £m	2015 ¹ £m	2016 £m	2015 ¹ £m
Electronic Systems	469	370	(2)	(1)	101	76	568	445
Cyber & Intelligence	83	46	–	–	23	24	106	70
Platforms & Services (US)	58	100	(9)	(6)	80	50	129	144
Platforms & Services (UK)	199	220	(3)	(6)	189	75	385	289
Platforms & Services (International)	435	164	(19)	(26)	57	55	473	193
HQ	(240)	(219)	(5)	(2)	–	4	(245)	(217)
	1,004	681	(38)	(41)	450	284	1,416	924
Taxation paid ²							(187)	(116)
Net cash flow from operating activities							1,229	808

1. Re-presented for the transfer of the GEOINT-ISR (Geospatial Intelligence – Intelligence, Surveillance and Reconnaissance) business from Cyber & Intelligence to Electronic Systems.

2. Taxation is managed on a Group basis.

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24. Net debt

Key Performance Indicator – Net debt

Definition Cash and cash equivalents, less loans and overdrafts (including debt-related derivative financial instruments).

Purpose Allows management to monitor the net cash generation of the Group.

Components of net debt

	Notes	2016 £m	2015 £m
Cash and cash equivalents	16	2,769	2,537
Debt-related derivative financial instrument assets – non-current	13	114	53
Loans – non-current	18	(4,425)	(3,775)
Loans and overdrafts – current	18	–	(237)
Net debt		(1,542)	(1,422)

25. Fair value measurement

Fair value of financial instruments

Certain of the Group's financial instruments are held at fair value.

The fair value of a financial instrument is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the balance sheet date.

The fair values of financial instruments held at fair value have been determined based on available market information at the balance sheet date, and the valuation methodologies listed below:

- the fair values of forward foreign exchange contracts are calculated by discounting the contracted forward values and translating at the appropriate balance sheet rates;
- the fair values of both interest rate and cross-currency swaps are calculated by discounting expected future principal and interest cash flows and translating at the appropriate balance sheet rates; and
- the fair values of loans and overdrafts have been estimated by discounting the future cash flows to net present values using appropriate market-based interest rates prevailing at 31 December.

Due to the variability of the valuation factors, the fair values presented at 31 December may not be indicative of the amounts the Group would expect to realise in the current market environment.

Fair value hierarchy

The fair value measurement hierarchy is as follows:

- Level 1 – Quoted prices (unadjusted) in active markets for identical assets or liabilities;
- Level 2 – Inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices); and
- Level 3 – Inputs for the asset or liability that are not based on observable market data (i.e. unobservable inputs).

25. Fair value measurement continued**Carrying amounts and fair values of certain financial instruments**

	Notes	2016		2015	
		Carrying amount £m	Fair value £m	Carrying amount £m	Fair value £m
Financial instruments measured at fair value:					
Non-current					
Available-for-sale financial assets		6	6	6	6
Other receivables ¹	12	296	296	234	234
Other financial assets	13	345	345	107	107
Other financial liabilities	13	(102)	(102)	(72)	(72)
Other payables ¹	19	(326)	(326)	(264)	(264)
Current					
Other financial assets	13	204	204	105	105
Other financial liabilities	13	(212)	(212)	(130)	(130)
Financial instruments not measured at fair value:					
Non-current					
Loans ²	18	(4,425)	(4,805)	(3,775)	(4,050)
Current					
Cash and cash equivalents	16	2,769	2,769	2,537	2,537
Loans and overdrafts	18	–	–	(237)	(241)

1. Represents US deferred compensation plan assets and liabilities.

2. US\$500m of the US\$800m 3.8% bond, repayable 2024, has been converted to a floating rate bond by utilising interest rate swaps. These derivatives have been designated as fair value hedges. Changes in the fair value of the interest rate risk on the bond, and gains and losses on the derivatives are recognised in the income statement. The bond has been included in financial instruments not measured at fair value because its carrying value has only been adjusted for the fair value of the interest rate risk on a portion of the bond.

All of the financial assets and liabilities measured at fair value are classified as level 2 using the fair value hierarchy. There were no transfers between levels during the year.

Financial assets and liabilities in the Group's Consolidated balance sheet are either held at fair value or their carrying value approximates to fair value, with the exception of loans, most of which are held at amortised cost.

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26. Financial risk management

Interest rate risk

The Group's objective is to manage its exposure to interest rate fluctuations on borrowings through varying the proportion of fixed rate debt relative to floating rate debt with derivative instruments, including interest rate and cross-currency swaps.

The Group's interest rate management policy is that a minimum of 50% (2015 50%) and a maximum of 90% (2015 90%) of gross debt is maintained at fixed interest rates. At 31 December 2016, the Group had 81% (2015 83%) of fixed rate debt and 19% (2015 17%) of floating rate debt based on a gross debt of £4.3bn, including debt-related derivative financial assets (2015 £4.0bn).

Based on contracted maturities and/or repricing dates, the following amounts are exposed to interest rate risk over the future as shown below:

	Less than one year £m	Between one and two years £m	More than two years £m
Cash and cash equivalents	2,769	–	–
Loans and overdrafts	(811)	(811)	–

The floating rate debt has been predominantly achieved by entering into interest rate swaps which swap the fixed rate US dollar interest payable on debt into either floating rate sterling or US dollars. At the end of 2016, the Group had a total of \$1.0bn (2015 \$1.0bn) of this type of swap outstanding with a weighted average duration of 2.6 years (2015 3.6 years). In respect of the fixed rate debt, the weighted average period in respect of which interest is fixed was 11.6 years (2015 11.5 years).

Given the level of short-term interest rates during the year, the average cost of the floating rate debt was 4.1% (2015 3.5%) on US dollars. The cost of the fixed rate debt was 4.8% (2015 4.9%).

A change of 100 basis points in short-term rates applied to the average fixed/floating mix and level of borrowings would vary the interest cost to the Group by £8m (2015 £7m).

In respect of cash deposits, given the fluctuation in the Group's working capital requirements, cash is generally invested for short-term periods based at floating interest rates. A change of 100 basis points in the average interest rates during the year applied to the average cash deposits would vary the interest receivable by £14m (2015 £7m).

Liquidity risk

Contractual cash flows on financial liabilities

The contracted cash flows on loans and overdrafts, and derivative financial instruments at the reporting date are shown below, classified by maturity. The cash flows are shown on a gross basis, are not discounted and include estimated interest payments where applicable.

	31 December 2016					31 December 2015				
	Carrying amount £m	Contracted cash flow				Carrying amount £m	Contracted cash flow			
		Less than one year £m	Between one and five years £m	More than five years £m	Total £m		Less than one year £m	Between one and five years £m	More than five years £m	Total £m
Loans and overdrafts	(4,425)	(217)	(2,354)	(4,055)	(6,626)	(4,012)	(431)	(1,698)	(3,939)	(6,068)
(Sale)/purchase contracts:										
US dollar		(396)	23	30	(343)		(299)	(217)	50	(466)
Euro		466	225	18	709		814	238	27	1,079
Sterling		(333)	(307)	(55)	(695)		(555)	(89)	(77)	(721)
Other		255	58	7	320		35	55	–	90
Cash flow hedges – foreign exchange contracts	3	(8)	(1)	–	(9)	(96)	(5)	(13)	–	(18)
Purchase/(sale) contracts:										
US dollar		1,809	–	–	1,809		2,133	(4)	–	2,129
Euro		620	–	–	620		441	–	–	441
Sterling		(2,624)	–	–	(2,624)		(2,672)	4	–	(2,668)
Other		195	–	–	195		98	–	–	98
Interest rate contracts		7	106	–	113		3	(1)	–	2
Other foreign exchange/interest rate contracts	118	7	106	–	113	53	3	(1)	–	2
Debt-related derivative financial instruments	114	10	29	147	186	53	6	11	55	72
Other financial assets and liabilities	235	9	134	147	290	10	4	(3)	55	56

Contractual cash flows in respect of all other financial liabilities are equal to the balance sheet carrying amount. Current contractual amounts relating to other financial liabilities, such as trade payables, are settled within the normal operating cycle of the business.

26. Financial risk management continued

Borrowing facilities

The Group's objective is to maintain adequate undrawn committed borrowing facilities.

At 31 December 2016, the Group had a committed Revolving Credit Facility (RCF) of £2bn (2015 £2bn). The RCF is contracted until 2018 at £2bn and from 2018 to 2020 at £1.9bn. The RCF was undrawn throughout the year. The RCF also acts as a back stop to Commercial Paper issued by the Group. At 31 December 2016, the Group had no Commercial Paper in issue (2015 £nil).

Cash management

Cash flow forecasting is performed by the businesses on a monthly basis. The Group monitors a rolling forecast of its liquidity requirements to ensure that there is sufficient cash to meet operational needs and maintain adequate headroom.

Surplus cash held by the businesses over and above balances required for working capital management is loaned to the Group's centralised treasury department. Surplus cash is invested in instant-access current accounts, short-term deposits and money market funds, choosing instruments with appropriate maturities or sufficient liquidity to provide adequate headroom as determined by cash forecasts.

The Group's objective is to monitor and control counterparty credit risk and credit limit utilisation. The Group adopts a conservative approach to the investment of its surplus cash which is deposited with financial institutions with the strongest credit ratings for short periods. The cash and cash equivalents balance at 31 December 2016 of £2,769m (2015 £2,537m) was invested with 33 (2015 35) financial institutions. A credit limit is allocated to each institution taking account of its market capitalisation, credit rating and credit default swap price.

The cash and cash equivalents of the Group are invested in non-speculative financial instruments which are usually highly liquid, such as short-term deposits. The Group, therefore, believes it has reduced its exposure to counterparty credit risk through this process.

Currency risk

The Group's objective is to reduce its exposure to transactional volatility in earnings and cash flows from movements in foreign currency exchange rates, mainly the US dollar, euro, Saudi riyal and Australian dollar.

The Group is exposed to movements in foreign currency exchange rates in respect of foreign currency denominated transactions. All material firm transactional exposures are hedged and the Group aims, where possible, to apply hedge accounting to these transactions.

The Group is exposed to movements in foreign currency exchange rates in respect of the translation of net assets and income statements of foreign subsidiaries and equity accounted investments. The Group does not hedge the translation effect of exchange rate movements on the income statements or balance sheets of foreign subsidiaries and equity accounted investments it regards as long-term investments.

The estimated impact on foreign exchange gains and losses in net finance costs of a ten cent movement in the closing US dollar exchange rate on the retranslation of US dollar-denominated bonds held by BAE Systems plc is approximately £59m (2015 £58m).

Credit risk

The Group has material receivables due from the UK, US and Saudi Arabian governments where credit risk is not considered an issue. For the remaining trade receivables, a provision for bad debts has been calculated taking into account individual assessments based on past credit history and prior knowledge of debtor insolvency or other credit risk, and no one counterparty constitutes more than 11% of the balance (2015 12%).

The ageing of trade receivables is detailed below:

	2016			2015 ¹		
	Gross £m	Provision £m	Net £m	Gross £m	Provision £m	Net £m
Not past due and not impaired	850	–	850	807	–	807
Up to 180 days overdue and not impaired	466	–	466	376	–	376
Past 180 days overdue and not impaired	76	–	76	59	–	59
Past 180 days overdue and impaired	85	(40)	45	76	(34)	42
	1,477	(40)	1,437	1,318	(34)	1,284

1. Restated.

Movements on the provision for bad debts are as follows:

	2016 £m	2015 ¹ £m
At 1 January	34	28
Created	15	17
Utilised	(2)	(3)
Released	(13)	(9)
Foreign exchange adjustments	6	1
At 31 December	40	34

1. Restated.

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27. Share-based payments

The Group has granted equity-settled share options and Long-Term Incentive Plan arrangements which 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 Group's estimate of the number of shares that will actually vest.

Details of the terms and conditions of each share-based payment plan are given in the Annual remuneration report on pages 84 to 98.

Expense in year

	2016 £m	2015 £m
Executive Share Option Plan	6	6
Performance Share Plan	11	6
Restricted Share Plan	5	4
	22	16

The Group also incurred a charge of £33m (2015 £28m) in respect of the equity-settled all-employee Free Shares and Matching Partnership Shares elements of the Share Incentive Plan.

Executive Share Option Plan

	2016		2015	
	Number of shares '000	Weighted average exercise price £	Number of shares '000	Weighted average exercise price £
Outstanding at the beginning of the year	32,165	4.26	35,594	3.70
Granted during the year	10,981	5.02	9,349	5.25
Exercised during the year	(6,255)	3.81	(9,838)	3.38
Expired during the year	(2,576)	4.28	(2,940)	3.52
Outstanding at the end of the year	34,315	4.59	32,165	4.26
Exercisable at the end of the year	5,961	3.56	4,307	3.30
			2016	2015
Range of exercise price of outstanding options (£)			3.01 – 5.56	3.01 – 5.43
Weighted average remaining contracted life (years)			8	8
Weighted average fair value of options granted (£)			0.65	0.76

27. Share-based payments continued

Performance Share Plan, Share Matching Plan and Restricted Share Plan

	Performance Share Plan		Share Matching Plan		Restricted Share Plan	
	2016 Number of shares '000	2015 Number of shares '000	2016 Number of shares '000	2015 Number of shares '000	2016 Number of shares '000	2015 Number of shares '000
Outstanding at the beginning of the year	19,662	18,868	2,252	5,618	2,847	3,760
Granted during the year	8,638	7,167	–	–	1,393	1,218
Exercised during the year	(361)	(335)	–	–	(699)	(1,876)
Expired during the year	(4,947)	(6,038)	(2,252)	(3,366)	(213)	(255)
Outstanding at the end of the year	22,992	19,662	–	2,252	3,328	2,847
Exercisable at the end of the year	81	204	–	–	–	–
	2016	2015	2016	2015	2016	2015
Weighted average remaining contracted life (years)	5	5	–	–	5	5
Weighted average fair value of awards granted (£)	4.09	4.49	–	–	5.01	5.12

The exercise price for the Performance Share Plan and Restricted Share Plan is £nil (2015 £nil).

Details of options/awards granted in the year

The fair value of equity-settled options/awards granted in the year has been measured using the weighted average inputs below and the following valuation models:

- Executive Share Option Plan – Binomial
- Performance Share Plan – Monte Carlo
- Restricted Share Plan – Dividend valuation

	2016	2015
Range of share price at date of grant (£)	4.99 – 5.56	4.38 – 5.43
Expected option/award life (years)	3 – 10	3 – 10
Volatility (%)	20	20 – 21
Risk free interest rate (%)	0.1 – 0.4	0.5 – 0.9

Volatility was calculated with reference to the Group's weekly share price volatility, after allowing for dividends and stock splits, for the greater of 30 weeks or for the period until vest date.

The average share price in the year was £5.24 (2015 £4.87).

Notes to the Group accounts

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28. Related party transactions

The Group has a related party relationship with its directors and key management personnel (see below), equity accounted investments (note 11) and pension schemes (note 20).

Transactions occur with the equity accounted investments in the normal course of business, are priced on an arm's-length basis and settled on normal trade terms. The more significant transactions are disclosed below:

Related party	Sales to related party		Purchases from related party		Amounts owed by related party		Amounts owed to related party ¹		Management recharges ¹	
	2016 £m	2015 £m	2016 £m	2015 £m	2016 £m	2015 £m	2016 £m	2015 £m	2016 £m	2015 £m
Advanced Electronics Company Limited	27	22	95	46	–	–	–	–	–	–
CTA International SAS	6	15	–	–	4	11	–	–	–	–
Eurofighter Jagdflugzeug GmbH	997	1,417	3	–	41	37	126	65	–	–
FADEC International LLC	79	72	–	–	–	–	–	–	–	–
Gripen International KB	–	–	–	–	18	19	16	14	–	–
MBDA SAS ²	24	23	199	286	2	6	608	367	16	17
Panavia Aircraft GmbH	64	53	79	47	4	2	–	–	–	–
	1,197	1,602	376	379	69	75	750	446	16	17

1. Also relates to disclosures under IAS 24, Related Party Disclosures, for the parent company, BAE Systems plc. At 31 December 2016, £631m (2015 £405m) was owed by BAE Systems plc and £119m (2015 £41m) by other Group subsidiaries.

2. Amounts owed to related party excludes £285m (2015 £217m) included within amounts due to long-term contract customers.

The Group considers key management personnel as defined under IAS 24, Related Party Disclosures, to be the members of the Group's Executive Committee and the Company's non-executive directors. Fuller disclosures on directors' remuneration are set out in the Annual remuneration report on pages 84 to 98. Total emoluments for directors and key management personnel charged to the Consolidated income statement were:

	2016 £'000	2015 £'000
Short-term employee benefits	19,389	14,831
Post-employment benefits	1,931	2,021
Share-based payments	5,744	4,144
	27,064	20,996

29. Contingent liabilities

Contingent liabilities are potential future cash outflows which are either not probable or cannot be measured reliably.

The Group has entered into a number of guarantee and performance bond arrangements in the normal course of business and regards these as insurance contracts. Various Group undertakings are parties to legal actions and claims which arise in the normal course of business. Provision is made for any amounts that the directors consider may become payable (see note 21).

The Group has no individually significant contingent liabilities.

30. Commitments

Operating lease commitments

The Group leases various offices, factories and shipyards under non-cancellable operating lease agreements. The leases have varying terms, including escalation clauses, renewal rights and purchase options. None of these terms represent unusual arrangements or create material onerous or beneficial rights or obligations.

The future aggregate minimum lease payments under non-cancellable operating leases and associated future minimum sublease income are as follows:

	2016 £m	2015 £m
Payments due:		
Not later than one year	255	222
Later than one year and not later than five years	699	710
Later than five years	802	779
	1,756	1,711
Total of future minimum sublease income under non-cancellable subleases	115	139

Capital commitments

Capital expenditure contracted for but not provided for in the accounts is as follows:

	2016 £m	2015 £m
Property, plant and equipment ¹	429	264
Intangible assets	19	8
	448	272

1. Includes £158m (2015 £99m) at Barrow-in-Furness, UK, relating to the Dreadnought submarine programme funded by the UK government.

Notes to the Group accounts

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31. Information about related undertakings

In accordance with Section 409 of the Companies Act 2006, a full list of subsidiaries and equity accounted investments as at 31 December 2016 is disclosed below. Unless otherwise stated, the Group's shareholding represents ordinary shares held indirectly by BAE Systems plc, the year end is 31 December and the address of the registered office is Warwick House, PO Box 87, Farnborough Aerospace Centre, Farnborough, Hampshire GU14 6YU, United Kingdom. No subsidiary undertakings have been excluded from the consolidation.

Subsidiaries – wholly-owned

4219 Lafayette, LLC ²² 4219-120 Lafayette Center Drive, Chantilly VA 20151, United States	BAE Systems (Oman) Limited	BAE Systems Applied Intelligence Malaysia Sdn Bhd 16th Floor, Wisma Sime Darby, Jalan Raja Laut, 50350 Kuala Lumpur, Malaysia
Aerosystems International Limited Lupin Way, Alvington, Yeovil, Somerset BA22 8UZ, United Kingdom	BAE Systems (Operations) Limited ¹⁰	BAE Systems Applied Intelligence New Zealand Limited c/o Russell McVeagh, Vero Centre, 48 Shortland Street, Auckland Central, 1140, New Zealand
Alabama Dry Dock and Shipbuilding, LLC ²² PO Box 3202, Main Gate, Dunlap Drive, Mobile AL 36652, United States	BAE Systems (Operations) Singapore Pte Limited One Marina Boulevard #28-00, Singapore 018989, Singapore	BAE Systems Applied Intelligence Pty Limited Level 12, 16-20 Bridge Street, Sydney NSW 2000, Australia
Alvis Pension Scheme Trustees Limited	BAE Systems (Overseas Holdings) Limited	BAE Systems Applied Intelligence US Corp ⁶ 440 Wheelers Farms Road, Suite 202, Milford CT 06461, United States
Alvis Limited	BAE Systems (Poland) Sp. z o.o. ul. Abp. A. Baraniaka 88, 61-131 Poznan, Poland	BAE Systems Australia Datagate Pty Limited Evans Building, Taranaki Road, Edinburg Parks, Edinburg SA 5111, Australia
Alvis Vickers Limited	BAE Systems (Projects) Limited	BAE Systems Australia Defence Holdings Pty Limited Evans Building, Taranaki Road, Edinburg Parks, Edinburg SA 5111, Australia
Armor Holdings Inc. ⁶ 2000 North 15th Street, 11th Floor, Arlington VA 22201, United States	BAE Systems (Property Investments) Limited	BAE Systems Australia Defence Pty Limited ¹⁴ Evans Building, Taranaki Road, Edinburg Parks, Edinburg SA 5111, Australia
Armstrong Whitworth Aircraft Limited ¹	BAE Systems (Sweden) AB ¹⁷ c/o Advokatfirman DLA Nordic KB, Box 7315, SE-103 90 Stockholm, Sweden	BAE Systems Australia (Electronic Systems) Pty Limited Evans Building, Taranaki Road, Edinburg Parks, Edinburg SA 5111, Australia
Atlantic-Alabama Holding Company, LLC ²² PO Box 3202, Main Gate, Dunlap Drive, Mobile AL 36652, United States	BAE Systems (Vehicles and Equipment) Limited	BAE Systems Australia (NSW) Holdings Pty Limited Evans Building, Taranaki Road, Edinburg Parks, Edinburg SA 5111, Australia
Australian Marine Engineering Corporation (Finance) Pty Limited Evans Building, Taranaki Road, Edinburg Parks, Edinburg SA 5111, Australia	BAE Systems 2000 Pension Plan Trustees Limited ¹	BAE Systems Australia (NSW) Pty Limited Evans Building, Taranaki Road, Edinburg Parks, Edinburg SA 5111, Australia
Avro International Aerospace Limited ¹	BAE Systems AB ¹³ Box 5676, SE-114 86 Stockholm, Sweden	BAE Systems Australia (Singapore) Pte Limited ²⁰ 60 Paya Lebar Road, #08-43 Paya Lebar Square, 409051, Singapore
BAE Systems (Aberdeen) Limited ^{13,16} Saltire Court, 20 Castle Terrace, Edinburgh EH1 2EG, United Kingdom	BAE Systems AI Diriyah Programme Limited ¹	BAE Systems Australia Holdings Limited ¹ Evans Building, Taranaki Road, Edinburg Parks, Edinburg SA 5111, Australia
BAE Systems (AI Diriyah C4i) Limited ¹	BAE Systems Applied Intelligence (Asia Pacific) Pte Limited United Square, 101 Thomson Road, #25-03/04, 307591, Singapore	BAE Systems Australia Limited Evans Building, Taranaki Road, Edinburg Parks, Edinburg SA 5111, Australia
BAE Systems (Aviation Services) Limited	BAE Systems Applied Intelligence (Australia) Pty Limited Level 12, 16-20 Bridge Street, Sydney NSW 2000, Australia	BAE Systems Australia Logistics Pty Limited ¹⁰ Evans Building, Taranaki Road, Edinburg Parks, Edinburg SA 5111, Australia
BAE Systems (Bristol House) Limited ^{1,11,16} 15 Canada Square, London E14 5GL, United Kingdom	BAE Systems Applied Intelligence (Belgium) NV Geldenaaksebaan 329, B-3001, Heverlee, Leuven, Belgium	BAE Systems Australia Sea Sentinel Project Pty Limited Evans Building, Taranaki Road, Edinburg Parks, Edinburg SA 5111, Australia
BAE Systems (Canada) Inc. 220 Laurier Avenue West, Suite 1200, Ottawa ON K1P 5Z9, Canada	BAE Systems Applied Intelligence Canada Inc. 1959 Upper Water Street, Suite 900, Halifax NS B3J 2X2, Canada	BAE Systems Avionics Singapore Pte Limited One Marina Boulevard, #28-00, Singapore 018989, Singapore
BAE Systems (Combat and Radar Systems) Limited PO Box 727, St. Paul's Gate, New Street, St. Helier JE4 8ZB, Jersey	BAE Systems Applied Intelligence (Connect) A/S Bouet Mollevej 3-5, 9400 Norresundby, Denmark	BAE Systems Bofors AB SE-691 80 Karlskoga, Sweden
BAE Systems (Consultancy Services) Limited	BAE Systems Applied Intelligence Inc. ⁵ 5th Floor, Suite 1920, 256 Franklin Street, Boston MA 02110, United States	BAE Systems Bofors Holdings Sdn Bhd Level 21, Suite 21.01, The Gardens South Tower, Mid Valley City, Lingkaran Syed Putra, 59200 Kuala Lumpur, Malaysia
BAE Systems (Corporate Air Travel) Limited	BAE Systems Applied Intelligence GCS Inc. ⁶ 1676 International Drive, 10th Floor, Suite 1000, McLean VA 22102, United States	BAE Systems China (Exports) Limited
BAE Systems (CS&SI – Qatar) Limited ¹	BAE Systems Applied Intelligence (GCS) Limited Surrey Research Park, Guildford, Surrey GU2 7YP, United Kingdom	BAE Systems C-ITS AB Box 5676, SE-114 86 Stockholm, Sweden
BAE Systems (Defence Systems) Limited	BAE Systems Applied Intelligence (Germany) GmbH Mainzer Landstrasse 50, 60325 Frankfurt am Main, Germany	BAE Systems Command and Control Limited ^{10,16} 15 Canada Square, London E14 5GL, United Kingdom
BAE Systems (Dynamics) Limited	BAE Systems Applied Intelligence (Integration) Limited Surrey Research Park, Guildford, Surrey GU2 7YP, United Kingdom	BAE Systems Communications Limited ¹
BAE Systems (Farnborough 1) Limited	BAE Systems Applied Intelligence (International) Limited Priestley Road, Surrey Research Park, Guildford, Surrey GU2 7YP, United Kingdom	BAE Systems Communications Solutions, LLC ²² Knowledge Oasis, Building 4, Second Floor, 0402-Z427, Knowledge Oasis Muscat, PO Box 16, Postal Code 135, Muscat, Oman
BAE Systems (Farnborough 2) Limited	BAE Systems Applied Intelligence (Ireland) Limited Level 5, Block 4, Dundrum Town Centre, Sandyford Road, Dundrum, Dublin 16, D16 A4W6, Ireland	BAE Systems Controls Inc. ⁵ 1098 Clark Street, Endicott NY 13760, United States
BAE Systems (Farnborough 3) Limited	BAE Systems Applied Intelligence (Japan) KK Ark Mori Building, Regus Serviced Office, Office #103, Akasaka, Minato-ku, Tokyo, Japan, 107-6012	BAE Systems Creole Inc. ⁷ 3701 Outlet Ctr. Drive, Suite 15, Sealy TX 77474-4904, United States
BAE Systems (Finance) Limited	BAE Systems Applied Intelligence (Luxembourg) SARL 1 Boulevard de la Foire, L-1528 Luxembourg, Luxembourg	BAE Systems Datagate Limited
BAE Systems (Funding Three) Limited	BAE Systems Applied Intelligence (Spain) S.A. Paseo de la Castellana, 141, Cuzco IV, 28046 Madrid, Spain	BAE Systems Datagate Holdings Limited
BAE Systems (Funding Two) Limited	BAE Systems Applied Intelligence (UK) Limited	BAE Systems Defence Limited ¹
BAE Systems (Gripen Overseas) Limited	BAE Systems Applied Intelligence A/S Bouet Mollevej 3, 9400 Norresundby, Denmark	BAE Systems Deployed Systems Limited ²
BAE Systems (Hawk Synthetic Training) Limited	BAE Systems Applied Intelligence France SAS 112 Avenue Kleber, 75016, Paris, France	
BAE Systems (Holdings) Limited ¹	BAE Systems Applied Intelligence Limited Surrey Research Park, Guildford, Surrey GU2 7YP, United Kingdom	
BAE Systems (Insurance) Limited	BAE Systems Applied Intelligence LLC ²² 8200 Greensboro Drive, 9th Floor, McLean VA 22102, United States	
BAE Systems (International) Limited		
BAE Systems (Kazakhstan) Limited		
BAE Systems (Land and Sea Systems) Limited ¹¹		
BAE Systems (Malaysia) Sdn Bhd 16th Floor, Wisma Sime Darby, Jalan Raja Laut, 50350 Kuala Lumpur, Malaysia		
BAE Systems (MEH) Limited		
BAE Systems (Military Air) Overseas Limited		
BAE Systems (Moose Jaw) Inc. ^{1,5} LeBlanc Nichols, The Chambers, 1000-300 Terry Fox Drive, Ottawa ON K2K 0E3, Canada		
BAE Systems (Nominees) Limited ¹		

31. Information about related undertakings continued**Subsidiaries – wholly-owned** continued

BAE Systems Display Technologies Limited	BAE Systems Integrated System Technologies GmbH Hans-StieBberger-Str. 2b, 85540 Haar, Germany	BAE Systems RO Defense Inc. ⁶ 1801 Electronics Drive, Anniston AL 36207, United States
BAE Systems do Brasil Ltda SCN Quadra 5 Bloco A, Ed. Brasilia Shopping, Torre Norte, Sala 426, Brasilia, DF CEP:70715-900, Brazil	BAE Systems Integrated System Technologies Limited	BAE Systems Rokar International Limited PO Box 45059, 11 Hartom Street, Mount Hotzvim, 91450 Jerusalem, Israel
BAE Systems Electronic Systems (Overseas) Limited	BAE Systems International Inc. ⁵ 1101 Wilson Blvd, Ste 2000, Arlington VA 22209, United States	BAE Systems S&S Holdings Inc. ⁷ 3701 Outlet Ctr. Drive, Suite 15, Sealy TX 77474-4904, United States
BAE Systems Electronics Limited	BAE Systems Land & Armaments Holdings Inc. ⁶ 2000 North 15th Street, 11th Floor, Arlington VA 22201, United States	BAE Systems S&S Operations Inc. ⁶ 3701 Outlet Ctr. Drive, Suite 15, Sealy TX 77474-4904, United States
BAE Systems Enterprises Limited	BAE Systems Land & Armaments Inc. ⁶ 2000 North 15th Street, 11th Floor, Arlington VA 22201, United States	BAE Systems San Diego Ship Repair Inc. ⁶ 2205 East Belt Street, Foot of Sampson Street, San Diego CA 92113, United States
BAE Systems Executive Pension Scheme Trustees Limited ¹	BAE Systems Land & Armaments L.P. ²² 2000 North 15th Street, 11th Floor, Arlington VA 22201, United States	BAE Systems San Francisco Ship Repair Inc. ⁶ Foot of 20th Street at Illinois Street, San Francisco CA 94107-7644, United States
BAE Systems Finance (Ireland) Unlimited Company ²³ Level 5, Block 4, Dundrum Town Centre, Sandyford Road, Dundrum, Dublin 16, D16 A4W6, Ireland	BAE Systems Land Systems ATF Limited	BAE Systems Saudi Limited PO Box 1732, Riyadh 11441, Saudi Arabia
BAE Systems Finance B.V. c/o SGG Netherlands N.V., Hoogoorddreef 15, 1101 BA Amsterdam, Netherlands	BAE Systems Land Systems (Finance) Limited	BAE Systems Saudi Arabia (Maintenance and Equipment Services) Limited PO Box 1732, Riyadh 11441, Saudi Arabia
BAE Systems Finance Inc. ⁶ 1101 Wilson Blvd, Ste 2000, Arlington VA 22209, United States	BAE Systems Land Systems FMTV International Inc. ⁷ 1101 Wilson Blvd, Ste 2000, Arlington VA 22209, United States	BAE Systems Saudi Arabia (Vehicles and Equipment Holdings) Limited ¹
BAE Systems Flight Training (Australia) Pty Limited ¹⁰ Evans Building, Taranaki Road, Edinburgh Parks, Edinburgh SA 5111, Australia	BAE Systems Land Systems (Investments AVG) Limited ¹⁶ 15 Canada Square, London E14 5GL, United Kingdom	BAE Systems Saudi Arabia (Vehicles and Equipment Nominees) Limited ¹
BAE Systems Funds Management ^{1,23}	BAE Systems Land Systems (Investments South Africa) Limited	BAE Systems Serviços de Aviãoicos Ltda. Rua Boa Vista, No. 254, 13th Floor, Suite 15, Centro, São Paulo, São Paulo 01014-907, Brazil
BAE Systems Global Combat Systems Bridging Limited	BAE Systems Land Systems (Investments) Limited	BAE Systems Shared Services Inc. ⁶ 11215 Rushmore Drive, Charlotte NC 28277, United States
BAE Systems Global Combat Systems Limited	BAE Systems Land Systems (Logistics) Limited	BAE Systems Shared Services (Overseas) Limited
BAE Systems Global Combat Systems Munitions Limited	BAE Systems Land Systems Pinzgauer Limited	BAE Systems Share Plans Trustee Limited ¹
BAE Systems Global Mobility LLC ²² 1300 Wilson Blvd., Arlington VA 22209, United States	BAE Systems Land Systems Pinzgauer (Holdings) Limited	BAE Systems Ship Repair Inc. ⁶ 750 West Berkley Ave., Norfolk VA 23523, United States
BAE Systems Global Tactical Systems LLC ²² 3701 Outlet Ctr. Drive, Suite 15, Sealy TX 77474-4904, United States	BAE Systems Land Systems (Ranges) Limited	BAE Systems Southeast Shipyards Alabama LLC ²² PO Box 3202, Main Gate, Dunlap Drive, Mobile AL 36652, United States
BAE Systems Högglunds AB SE-691 80, Karlskoga, Sweden	BAE Systems Land Systems (Singapore Investments) Limited	BAE Systems Southeast Shipyards AMHC Inc. ^{6,22} 8500 Heckscher Drive, Jacksonville FL 32226, United States
BAE Systems Hawaii Shipyards Inc. ⁶ 3049 Ualena Street, Suite 915, Honolulu HI 96819, United States	BAE Systems Logistica Ltda SCN Quadra 5 Bloco A, Ed. Brasilia Shopping, Torre Norte, Sala 426, Brasilia, DF CEP:70715-900, Brazil	BAE Systems Southeast Shipyards Jacksonville LLC ²² 8500 Heckscher Drive, Jacksonville FL 32226, United States
BAE Systems Holdings (South Africa) (Pty) Limited Central Office Park No. 5, 257 Jean Avenue, Centurion, Gauteng, 0157, South Africa	BAE Systems MAI Turkey Hava Sistemleri A.Ş Kizilirmak Mahallesi, 1445. Sok No: 2, The Paragon B Blok K: 23, iç Kapi No: 113 Çukurambar, Çankaya, Ankara, Turkey	BAE Systems Southeast Shipyards Mayport LLC ²² 8500 Heckscher Drive, Jacksonville FL 32226, United States
BAE Systems Holdings B.V. c/o SGG Netherlands N.V., Hoogoorddreef 15, 1101 BA Amsterdam, Netherlands	BAE Systems Marine (Holdings) Limited	BAE Systems SSY Alabama Property Holdings LLC ²² PO Box 3202, Main Gate, Dunlap Drive, Mobile AL 36652, United States
BAE Systems Holding GmbH ¹⁷ Hauptstrasse 48, 82433 Bad Kohlgryn, Germany	BAE Systems Marine (YSL) Limited	BAE Systems SSY Floating Dry Dock Holdings LLC ²² 8500 Heckscher Drive, Jacksonville FL 32226, United States
BAE Systems Holdings Inc. ⁵ 1101 Wilson Blvd, Ste 2000, Arlington VA 22209, United States	BAE Systems Marine Limited	BAE Systems SSY Florida Property Holdings LLC ²² 8500 Heckscher Drive, Jacksonville FL 32226, United States
BAE Systems Holdings International LLC ²² 1101 Wilson Blvd, Ste 2000, Arlington VA 22209, United States	BAE Systems Maritime Engineering & Services Inc. ⁶ 7330 Engineer Road, Suite A, San Diego CA 92111, United States	BAE Systems Surface Ships (Holdings) Limited
BAE Systems Imaging Solutions Inc. ⁵ 1841 Zanker Road, Suite 50, San Jose CA 95112, United States	BAE Systems Norfolk Ship Repair Inc. ⁶ 750 West Berkley Avenue, Norfolk VA 23523, United States	BAE Systems Surface Ships Limited
BAE Systems, Inc. ⁶ 1101 Wilson Blvd, Ste 2000, Arlington VA 22209, United States	BAE Systems Oman LLC ²² PO Box 74, Postal Code 111, Seeb, Oman	BAE Systems Surface Ships (Projects) Limited
BAE Systems India (Services) Private Limited ¹⁸ 2nd Floor, Hotel Le-Meridien Commercial Tower, Raisina Road, New Delhi 110001, India	BAE Systems Ordnance Systems Inc. ⁶ 4509 West Stone Drive, Kingsport TN 37660-9982, United States	BAE Systems Surface Ships Intermediate Holdings Limited
BAE Systems India (Homeland Security) Private Limited ¹⁸ 2nd Floor, Hotel Le-Meridien Commercial Tower, Raisina Road, New Delhi 110001, India	BAE Systems Overseas Inc. ⁶ 1101 Wilson Blvd, Ste 2000, Arlington VA 22209, United States	BAE Systems Surface Ships Integrated Support Limited
BAE Systems India (Technology) Private Limited ¹⁸ 2nd Floor, Hotel Le-Meridien Commercial Tower, Raisina Road, New Delhi 110001, India	BAE Systems PAMCO Services International Inc. ⁷ 3701 Outlet Ctr. Drive, Suite 15, Sealy TX 77474-4904, United States	BAE Systems Surface Ships International Limited ¹³
BAE Systems India (Ventures) Private Limited ¹⁸ 2nd Floor, Hotel Le-Meridien Commercial Tower, Raisina Road, New Delhi 110001, India	BAE Systems Pension Funds CIF Trustees Limited ¹	BAE Systems Surface Ships Maritime Limited
BAE Systems Information and Electronic Systems Integration Inc. ⁶ 65 Spit Brook Road, Nashua NH 03061, United States	BAE Systems Pension Funds Investment Management Limited ^{1,19}	BAE Systems Surface Ships Portsmouth Limited ¹³
BAE Systems Insurance (Isle of Man) Limited Tower House, Loch Promenade, Douglas, IM1 2LZ, Isle of Man, United Kingdom	BAE Systems Pension Funds Trustees Limited ¹	BAE Systems Surface Ships Projects (Malaysia) Sdn Bhd Level 14, West Block, Wisma Selangor Dredging, 142-C, Jalan Ampang, 50450 Kuala Lumpur, Malaysia
BAE Systems Insyte Limited ¹⁶ 15 Canada Square, London E14 5GL, United Kingdom	BAE Systems Project Services Limited	BAE Systems Surface Ships Property Services Limited
BAE Systems Integrated System Technologies (KSA) Limited	BAE Systems Projects (Canada) Limited	BAE Systems Surface Ships Support Limited ¹⁰
BAE Systems Integrated System Technologies (Overseas) Limited	BAE Systems Properties Limited	BAE Systems Surface Ships (Overseas) Limited
	BAE Systems Protection Systems Inc. ⁷ 7822 South 46th Street, Phoenix AZ 85044, United States	BAE Systems SWS Defence AB SE-691 80 Karlskoga, Sweden
	BAE Systems Quest Limited ¹	BAE Systems Tactical Vehicle Systems LP ²² 3701 Outlet Ctr. Drive, Suite 15, Sealy TX 77474-4904, United States
	BAE Systems Regional Aircraft (Japan) KK ⁶ Minami Azabu T&F Building 8th Floor, 4-11-22 Minami Azabu, Minato-ku, Tokyo, Japan	
	BAE Systems Regional Aircraft Colombia SAS c/o Brigard & Urrutia, Calle 70 A No. 4-41, Bogota, Colombia	
	BAE Systems Resolution Inc. ⁷ 3701 Outlet Ctr. Drive, Suite 15, Sealy TX 77474-4904, United States	

Notes to the Group accounts

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31. Information about related undertakings continued

Subsidiaries – wholly-owned continued

BAE Systems Technology Solutions & Services Inc.⁶
520 Gaither Road, Rockville, MD 20850, United States

BAE Systems Training Services Limited

BAE Systems TVS Holdings Inc.⁶
3701 Outlet Ctr. Drive, Suite 15, Sealy TX 77474-4904, United States

BAE Systems TVS Holdings LLC²²
3701 Outlet Ctr. Drive, Suite 15, Sealy TX 77474-4904, United States

BAE Systems TVS Inc.⁷
3701 Outlet Ctr. Drive, Suite 15, Sealy TX 77474-4904, United States

BAE Systems Zephyr Corporation⁵
c/o The Corporation Trust Company, Corporation Trust Center, 1209 Orange Street, City of Wilmington, County of New Castle DE 19801, United States

BAE Systems Zephyr Fifth Corporation⁵
c/o The Corporation Trust Company, Corporation Trust Center, 1209 Orange Street, City of Wilmington, County of New Castle DE 19801, United States

BAE Systems Zephyr Fourth Corporation⁵
c/o The Corporation Trust Company, Corporation Trust Center, 1209 Orange Street, City of Wilmington, County of New Castle DE 19801, United States

BAE Systems Zephyr Second Corporation⁵
c/o The Corporation Trust Company, Corporation Trust Center, 1209 Orange Street, City of Wilmington, County of New Castle DE 19801, United States

BAE Systems Zephyr Third Corporation⁵
c/o The Corporation Trust Company, Corporation Trust Center, 1209 Orange Street, City of Wilmington, County of New Castle DE 19801, United States

Brabazon Limited

British Aerospace (Far East) Limited²¹
Level 54, Hopewell Centre, 183 Queen's Road East, Hong Kong

British Aerospace (Malaysia) Sdn Bhd²¹
Unit 30-01, Level 30, Tower A, Vertical Business Suite, Avenue 3, Bangsar South, No.8, Jalan Kerinchi, 59200 Kuala Lumpur, Malaysia

British Aircraft Corporation (Pension Fund Trustees) Limited¹

British Aircraft Corporation Limited¹

Buckfield Properties Limited

Cashhold Limited^{1,10}

CPS International, Inc.⁷
c/o Benedetti & Benedetti, Comosa Building, 21st Floor, Ave. Samuel Lewis, PO Box 850120, Panama 5, Panama

Creole (Nigeria) Limited¹⁰
Tapa House (2nd Floor), 45, Imman Dauda St (Abosede Kuboye Crescent Entrance) Surulere, Lagos, Nigeria

Detica B.V.
Luna ArenA, Herikerbergweg 238, 1101 CM Amsterdam, Netherlands

Detica Group Holdings (Ireland) Limited
Level 5, Block 4, Dundrum Town Centre, Sandyford Road, Dundrum, Dublin 16, D16 A4W6, Ireland

Detica Group Limited

Detica Ireland Limited¹³
Level 5, Block 4, Dundrum Town Centre, Sandyford Road, Dundrum, Dublin 16, D16 A4W6, Ireland

Detica Mexico S. de R.L. de C.V.
Torre Esmeralda II, Blvd Manuel Avila Camacho No. 36 Piso 18, Lomas de Chapultepec, 11000 D.F., Mexico

Detica Patent Limited
Level 5, Block 4, Dundrum Town Centre, Sandyford Road, Dundrum, Dublin 16, D16 A4W6, Ireland

Detica Services, Inc.
8200 Greensboro Drive, 9th Floor, McLean VA 22102, United States

ETI Engineering, Inc.⁶
1676 International Drive, 10th Floor, Suite 1000, McLean VA 22102, United States

Gloster Aircraft Limited¹

Granada Enterprises Limited
PO Box 1732, Riyadh 11441, Saudi Arabia

Hadrian Trustees Limited^{1,18}
2nd floor, Viables 3, Viables Business Park, Jays Close, Basingstoke, Hampshire RG22 4BS, United Kingdom

Hadrian Holdings, Inc.¹⁸
521 Fifth Avenue, New York NY 101075, United States

Hägglunds Vehicle GmbH
Ernst-Grote Strasse 13, 30916 Isernhagen, Germany

Hawker Siddeley Aviation Limited¹

Hawker Siddeley Dynamics Limited¹

H-B Utveckling, H-B Development AB
Nybergsgatan 7, SE-114 34 Stockholm, Sweden

Hertfordshire Estates Limited¹⁰

HSA/HSD Pension Fund Trustees Limited¹

Hunter Aerospace Corporation Pty Limited
Evans Building, Taranaki Road, Edinburg Parks, Edinburg SA 5111, Australia

International Military Sales Limited

Jetstream Aircraft Limited¹
Prestwick International Airport, Prestwick, Ayrshire KA9 2RW, United Kingdom

Kalamind Limited

Land Services Arabia Ltd.
Business Gate Building 7, Floor 1, Riyadh 11482, Saudi Arabia

Lemacrown Limited¹²

MES Holdco Limited
PO Box 727, St. Paul's Gate, New Street, St. Helier JE4 8ZB, Jersey

MES Interco²³

Meslink Limited

Muiden Chemie International B.V.
c/o SGG Netherlands N.V., Hoogoorddreef 15, 1101 BA Amsterdam, Netherlands

Newcombe Properties Limited

PAMCO Servicios Internacionales de Mexico, S. de R.L. de C.V.⁷
c/o Gonzalez Calvillo y Forastieri, S.C., Centro Empresarial Lomas, Monte Peloux No. 111, Piso 5, Lomas de Chapultepec, 11000 D.F., Mexico

Piper Group plc

Pitch Technologies AB
Repslagaregatan 25, SE-582 22 Linköping, Sweden

Pitch Technologies Limited
Sweden House, 5 Upper Montagu Street, London W1H 2AG, United Kingdom

Port Solent Limited

Port Solent Marina Limited

PT. BAE Systems Services⁶
Wisma 46, Kota BNI, 34th Floor, Suite 34.01.A, Jl. Jenderal Sudirman Kavling 71, Jakarta 10220, Indonesia

Reflectone UK Limited¹⁶
15 Canada Square, London E14 5GL, United Kingdom

Representaciones SSTs, CA⁷
Ave Francisco de Miranda, Centro Lido El Rosal Oficina 71B, Caracas, Venezuela

Royal Ordnance B.V.
c/o SGG Netherlands N.V., Hoogoorddreef 15, 1101 BA Amsterdam, Netherlands

Royal Ordnance (Crown Service) Pension Scheme Trustees Limited

Royal Ordnance Maschinen und Anlagenbau GmbH¹⁷
Heckler & Koch Straße 1, D-78727 Oberndorf a.N, Germany

Royal Ordnance Senior Staff Pension Scheme Trustees Limited

Royal Ordnance Speciality Metals Limited¹

RWT Limited¹

Salford Electrical Instruments Limited

Scentcivil Limited

Scottish Aviation Limited¹
Prestwick International Airport, Prestwick, Ayrshire KA9 2RW, United Kingdom

Sepia, LLC²²
4219-120 Lafayette Center Drive, Chantilly VA 20151, United States

Shipbuilding (MSF) Pty Limited
Evans Building, Taranaki Road, Edinburg Parks, Edinburg SA 5111, Australia

Shipbuilding (VIC) Pty Limited
Evans Building, Taranaki Road, Edinburg Parks, Edinburg SA 5111, Australia

Stephen Howe Systems Limited
Alvington, Yeovil, Somerset BA22 8UZ, United Kingdom

Stewart & Stevenson Operations (Nigeria) Limited⁷
Tapa House (2nd Floor), 45, Imman Dauda St (Abosede Kuboye Crescent Entrance), Surulere, Lagos, Nigeria

Stewart & Stevenson TVS UK Limited

Stratsec.net Sdn Bhd
Unit F-3-1, Blok F, Third Floor, CBD Perdana 3, Jalan Perdana, Cyber 12, 63000 Cyberjaya, Selangor Darul Ehsan, Malaysia

Support Solutions General Services and Contracting Company/Limited Liability company^{17,22}
House No. 145, Street No. 1, Qtr. 611, Al Andalous Area, Al Mansour, Baghdad, Iraq

TDS International Pty Limited
Evans Building, Taranaki Road, Edinburg Parks, Edinburg SA 5111, Australia

TDS International Holdings Pty Limited⁸
Evans Building, Taranaki Road, Edinburg Parks, Edinburg SA 5111, Australia

Tenix Philippines Inc.^{17,20}
1605 Tower One, Ayala Triangle, Ayala Avenue, Makati City, 1226, Philippines

The Blackburn Aeroplane & Motor Co Limited¹

The Bristol Aviation Company Limited¹

The British & Colonial Aeroplane Co. Limited¹

The Leeds Partnership Limited¹⁰

The Supermarine Aviation Works Limited^{1,11}

Thomas Sopwith Aviation Company Limited¹

VSEL Birkenhead Limited

Warship Design Services Limited

Westover Controls Incorporated⁶
1098 Clark Street, Endicott NY 13760, United States

31. Information about related undertakings continued**Subsidiaries – not wholly-owned**

Aircraft Accessories & Components Co Limited (85.7%)
PO Box 13532, Jeddah 21434, Saudi Arabia

Aircraft Research Association Limited (87.1%)¹
Manton Lane, Bedford MK41 7PF, United Kingdom

ARA Pension Fund Trustees Limited (87.1%)
Manton Lane, Bedford MK41 7PF, United Kingdom

BAE Systems Saudi Development and Training Company Limited (99%)³
PO Box 67775, Riyadh 11517, Saudi Arabia

BAE Systems SDT (UK) Limited (99%)

Flight Control System Management GmbH (66.6%)⁴
PO Box 801109, 81663 Munich, Germany

Hadrian Properties, Inc. (95%)¹⁸
521 Fifth Avenue, New York NY 101075, United States

Häggglunds Foremost Inc. (66.7%)⁵
1616 Meridian Road N.E., Calgary AB T2A 2PL, Canada

International Systems Engineering Company Limited (90.6%)
PO Box 54002, Riyadh 11514, Saudi Arabia

Overhaul and Maintenance Company Limited (95.9%)
PO Box 1732, Riyadh 11441, Saudi Arabia

Saudi Maintenance & Supply Chain Management Company Limited (51%)
PO Box 1732, Riyadh 11441, Saudi Arabia

Saudi Technology & Logistics Services Limited (65%)¹
PO Box 1732, Riyadh 11441, Saudi Arabia

SMSCMC (UK) Limited (51%)

U.S. Munitions, LLC (51%)²²
1713 Burdette Crossing, Blue Springs MO 64015, United States

Equity accounted investments²⁴

Abercromby Property International (21.5%)

Advanced Electronics Company Limited (50%)
PO Box 90916, Riyadh 11623, Saudi Arabia

Air Astana (49%)⁵
Zakarpatskaya Str 4A, 050039 Almaty, Kazakhstan

AMSH B.V. (50%)⁹
Weena 210-212, 3012 NJ Rotterdam, Netherlands

BAeHAL Software Limited (40%)^{1,18}
Airport Lane, HAL Estate, Bangalore 560010, India

BHIC Bofors Defense Asia Sdn Bhd (49%)
Suite B, Menara Maxis, Kuala Lumpur City Centre, 50088 Kuala Lumpur, Malaysia

BAE (Consultancy Services) Malaysia Sdn Bhd (49%)
Tkt.11, Wisma Damansara, Damansara Heights, 50490 Kuala Lumpur, Malaysia

Canadian Naval Support Limited (50%)¹⁵
3099 Barrington Street, Halifax NS B3K 5M7, Canada

CTA International SAS (50%)
13 Route De La Miniere, 78000 Versailles, France

Data Link Solutions L.L.C. (50%)^{21,22}
400 Collins Ave, Cedar Rapids IA 52498, United States

Eurofighter Aircraft Management GmbH (33%)^{1,17}
Am Soldnermoos 17, 85399 Hallbergmoos, Germany

Eurofighter International Limited (33%)^{1,17}

Eurofighter Jagdflugzeug GmbH (33%)¹
Am Soldnermoos 17, 85399 Hallbergmoos, Germany

European Aerosystems Limited (50%)^{1,8}

FADEC International LLC (50%)²²
1098 Clark Street, Endicott NY 13760, United States

FAST Holdings Limited (50%)^{8,18}

FAST Training Services Limited (50%)¹⁸

FBV Designs Limited (50%)^{8,18}
33 Wigmore Street, London W1U 1QX, United Kingdom

FNSS Savunma Sistemleri A.S (49%)⁸
PK 37, Golbasi 06830, Ankara, Turkey

Gripen International KB (50%)²²
SE-581 88 Linköping, Sweden

MBDA Holdings SAS (25%)
1 Avenue Réaumur, 92350 Le Plessis-Robinson, France

Nobeli Business Support AB (34%)
SE-691 80 Karlskoga, Sweden

Nurol BAE Systems Hava Sistemleri Anonim Şirketi (49%)⁹
Arjantin Cad. No: 7 06700, Gaziosmanpaşa, Ankara, Turkey

Panavia Aircraft GmbH (42.5%)¹
Am Soldnermoos 17, 85399 Hallbergmoos, Germany

Patria Häggglunds Oy (50%)
Naulakatu 3, FI-33100 Tampere, Finland

Reaction Engines Limited (20%)⁹
Hill House, 1 Little New Street, London EC4A 3TR, United Kingdom

Saab-BAE Systems Gripen AB (50%)¹
SE-581 88 Linköping, Sweden

Saab Bofors Test Center AB (30%)
SE-691 80 Karlskoga, Sweden

Sandstone Integrated Operations, LLC (20%)²²
2016 Mt. Athos Road, Lynchburg VA 24504, United States

Seele-Alvis Fenestration Limited (43.5%)^{8,20}
Unit A33, Jack's Place, 6 Corbett Place, London E1 6NN, United Kingdom

SIKA International Limited (50%)⁸

Spectrum Technologies Public Limited Company (20%)^{1,18}
Western Avenue, Bridgend Industrial Estate, Bridgend, Mid Glamorgan CF31 3RT, United Kingdom

Tirs Mateen & Co LLC (50%)²²
PO Box 3369, Postal Code 111, Seeb, Oman

Winner Developments Limited (33.3%)

Notes

1. Directly owned by BAE Systems plc.
2. 40% owned by BAE Systems plc.
3. 1% owned by BAE Systems plc.
4. 33.3% owned by BAE Systems plc.
5. Ownership held in common stock.
6. Ownership held in common shares.
7. Ownership held in authorized shares.
8. Ownership held in class of A shares.
9. Ownership held in class of B shares.
10. Ownership held in class of A shares and B shares.
11. Ownership held in class of A shares, B shares and preference shares.
12. Ownership held in ordinary shares and class of A shares.
13. Ownership held in ordinary shares and preference shares.
14. Ownership held in ordinary shares and redeemable preference shares.
15. Ownership held in common shares and B Preferred shares.
16. In members' voluntary liquidation.
17. In liquidation.
18. Year end 31 March.
19. Year end 5 April.
20. Year end 30 June.
21. Year end 30 September.
22. Unincorporated entity for which the address given is the principal place of business.
23. Unlimited company.
24. For companies incorporated outside of the United Kingdom, the country of incorporation is shown in the address.

Company statement of comprehensive income for the year ended 31 December

	2016 £m	2015 £m
Profit for the year	560	94
Other comprehensive income		
Items that will not be reclassified to the income statement:		
Remeasurements on retirement benefit schemes	(56)	14
Items that may be reclassified to the income statement:		
Amounts (charged)/credited to hedging reserve	(13)	7
Total other comprehensive income for the year (net of tax)	(69)	21
Total comprehensive income for the year	491	115

Company statement of changes in equity for the year ended 31 December

	Issued share capital £m	Share premium £m	Other reserves £m	Retained earnings ¹ £m	Total equity £m
At 1 January 2015	87	1,249	278	2,429	4,043
Profit for the year	–	–	–	94	94
Total other comprehensive income for the year	–	–	7	14	21
Share-based payments	–	–	–	39	39
Net sale of own shares	–	–	–	1	1
Ordinary share dividends	–	–	–	(655)	(655)
Non-distributable reserve transfer	–	–	(67)	67	–
At 31 December 2015	87	1,249	218	1,989	3,543
Profit for the year	–	–	–	560	560
Total other comprehensive income for the year	–	–	(13)	(56)	(69)
Share-based payments	–	–	–	50	50
Net sale of own shares	–	–	–	3	3
Ordinary share dividends	–	–	–	(670)	(670)
At 31 December 2016	87	1,249	205	1,876	3,417

1. The non-distributable portion of retained earnings is £354m (2015 restated £343m).

Company balance sheet

as at 31 December

	Notes	2016 £m	2015 £m
Non-current assets			
Intangible assets		34	31
Property, plant and equipment		31	20
Investments in subsidiary undertakings and participating interests	2	8,149	8,138
Other receivables		4	5
Retirement benefit surpluses	8	8	6
Other financial assets	4	385	151
		8,611	8,351
Current assets			
Trade and other receivables	3	3,038	3,221
Current tax		14	14
Other financial assets	4	347	212
Cash and cash equivalents		2,168	2,061
		5,567	5,508
Total assets		14,178	13,859
Non-current liabilities			
Loans	5	(1,122)	(1,005)
Other payables		(33)	(5)
Retirement benefit obligations	8	(308)	(259)
Other financial liabilities	4	(182)	(98)
Provisions	7	(97)	(105)
		(1,742)	(1,472)
Current liabilities			
Loans and overdrafts	5	–	(237)
Trade and other payables	6	(8,664)	(8,430)
Other financial liabilities	4	(332)	(165)
Provisions	7	(23)	(12)
		(9,019)	(8,844)
Total liabilities		(10,761)	(10,316)
Net assets		3,417	3,543
Capital and reserves			
Issued share capital		87	87
Share premium		1,249	1,249
Other reserves	9	205	218
Retained earnings		1,876	1,989
Total equity		3,417	3,543

Approved by the Board on 22 February 2017 and signed on its behalf by:

I G King
Chief Executive

P J Lynas
Group Finance Director

Registered number: 1470151

Notes to the Company accounts

1. Preparation

Basis of preparation

These financial statements were prepared in accordance with Financial Reporting Standard (FRS) 101, Reduced Disclosure Framework. Amendments to FRS 101 (2014/15 cycle and other minor amendments), issued in July 2015, and Amendments to FRS 101 (2015/16 cycle), issued in July 2016, both effective for periods beginning on or after 1 January 2016, have been applied.

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

- the requirements of paragraphs 45(b) and 46 to 52 of IFRS 2, Share-based Payment;
- the requirements of paragraphs 62, B64(d), B64(e), B64(g), B64(h), B64(j), to B64(m), B64(n)(ii), B64(o)(ii), B64(p), B64(q)(ii), B66 and B67 of IFRS 3, Business Combinations;
- the requirements of paragraph 33(c) of IFRS 5, Non-current Assets Held for Sale and Discontinued Operations;
- the requirements of IFRS 7, Financial Instruments: Disclosures;
- the requirements of paragraphs 91 to 99 of IFRS 13, Fair Value Measurement;
- the requirement in paragraph 38 of IAS 1, Presentation of Financial Statements, to present comparative information in respect of: paragraph 79(a)(iv) of IAS 1; paragraph 73(e) of IAS 16, Property, Plant and Equipment; paragraph 118(e) of IAS 38, Intangible Assets; and paragraphs 76 and 79(d) of IAS 40, Investment Property;
- the requirements of paragraphs 10(d), 10(f), 16, 38A, 38B, 38C, 38D, 40A, 40B, 40C, 40D, 111 and 134 to 136 of IAS 1, Presentation of Financial Statements;
- the requirements of IAS 7, Statement of Cash Flows;
- the requirements of paragraphs 30 and 31 of IAS 8, Accounting Policies, Changes in Accounting Estimates and Errors;
- the requirements of paragraphs 17 and 18A of IAS 24, Related Party Disclosures;
- the requirements in IAS 24, Related Party Disclosures, to disclose related party transactions entered into between two or more members of a group, provided that any subsidiary which is a party to the transaction is wholly owned by such a member; and
- the requirements of paragraphs 130(f)(ii), 130(f)(iii), 134(d) to 134(f) and 135(c) to 135(e) of IAS 36, Impairment of Assets.

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

In accordance with Section 408(3) of the Companies Act 2006, the Company is exempt from the requirement to present its own income statement. The amount of profit for the year of the Company is disclosed in the Company statement of comprehensive income.

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).

Significant accounting policies

The significant accounting policies applied in the preparation of these individual financial statements are set out below. These policies have been applied consistently to all the years presented, unless otherwise stated.

Investments in subsidiary undertakings and participating interests

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

Other significant accounting policies

Other significant accounting policies are consistent with the Group accounts and the table below references where they are disclosed.

Significant accounting policy	Page
Loans and overdrafts	153
Retirement benefits	155
Provisions	164

2. Investments in subsidiary undertakings and participating interests

	£m
Cost	
At 1 January 2016	8,152
Additions	11
At 31 December 2016	8,163
Impairment provisions	
At 1 January and 31 December 2016	14
Net carrying value	
At 31 December 2016	8,149
At 31 December 2015	8,138

3. Trade and other receivables

	2016 £m	2015 £m
Current		
Amounts owed by subsidiary undertakings	2,954	3,159
Amounts owed by Group joint ventures	–	5
Prepayments and accrued income	37	45
Other receivables	47	12
	3,038	3,221

4. Other financial assets and liabilities

	2016		2015	
	Assets £m	Liabilities £m	Assets £m	Liabilities £m
Non-current				
Cash flow hedges – foreign exchange contracts	1	–	8	–
Other foreign exchange/interest rate contracts	274	(182)	97	(98)
Debt-related derivative financial instruments – assets	110	–	46	–
	385	(182)	151	(98)
Current				
Cash flow hedges – foreign exchange contracts	1	(2)	5	–
Other foreign exchange/interest rate contracts	346	(330)	207	(165)
	347	(332)	212	(165)

The contractual cash flows on derivative financial instruments at the reporting date are shown below, classified by maturity.

	2016 £m	2015 £m
Less than one year	11	2
Between one and five years	136	9
More than five years	147	55
	294	66

Full disclosures relating to the Group's other financial assets and liabilities, and financial risk management strategies are given in notes 13, 25 and 26 to the Group accounts.

Notes to the Company accounts continued

5. Loans and overdrafts

	2016 £m	2015 £m
Non-current		
US\$500m 4.75% bond, repayable 2021	404	339
£400m 4.125% bond, repayable 2022	398	398
US\$400m 5.8% bond, repayable 2041	320	268
	1,122	1,005
Current		
US\$350m 3.5% bond, repayable 2016	–	237
	–	237

6. Trade and other payables

	2016 £m	2015 £m
Current		
Amounts owed to subsidiary undertakings	7,830	7,824
Amounts owed to Group joint ventures	631	405
Accruals and deferred income	121	100
Other payables	82	101
	8,664	8,430

7. Provisions

	Contracts and other £m
Non-current	105
Current	12
At 1 January 2016	117
Created	14
Utilised	(16)
Net present value adjustments	5
At 31 December 2016	120
Represented by:	
Non-current	97
Current	23
	120

The Company holds provisions for contractual costs that it expects to incur over an extended period. These costs are based on past experience of similar items and represent management's best estimate of the likely outcome.

8. Retirement benefits

The Company participates in all of the Group's UK pension schemes. Regular contributions to the schemes are made in line with the schedule of contributions and a share of deficit funding is allocated to participating employers. The deficit allocation methodology is based on the relative payroll contributions of active members. Full disclosures relating to these schemes are given in note 20 to the Group accounts.

Amounts recognised on the balance sheet

The table below shows the Company's share of the Group's UK pension schemes after allocation to other participating employers.

	2016 £m	2015 £m
Present value of unfunded obligations	(39)	(41)
Present value of funded obligations	(1,429)	(1,302)
Fair value of scheme assets	1,168	1,090
Company's share of net IAS 19 deficit	(300)	(253)
Represented by:		
Retirement benefit surpluses	8	6
Retirement benefit obligations	(308)	(259)
	(300)	(253)

9. Share capital and other reserves

Share capital

Disclosures in respect of the Company's share capital are provided in note 22 to the Group accounts.

Other reserves

	Non- distributable reserve £m	Statutory reserve £m	Capital redemption reserve £m	Hedging reserve £m	Total £m
At 1 January 2015	67	202	3	6	278
Amounts credited to hedging reserve	–	–	–	7	7
Transfer to retained earnings	(67)	–	–	–	(67)
At 31 December 2015	–	202	3	13	218
Amounts charged to hedging reserve	–	–	–	(13)	(13)
At 31 December 2016	–	202	3	–	205

Statutory reserve

Under Section 4 of the British Aerospace Act 1980, this reserve may only be applied in paying up unissued shares of the Company to be allotted to members of the Company as fully paid bonus shares.

Capital redemption reserve

The capital redemption reserve represents the cumulative nominal value of the Company's ordinary shares repurchased and subsequently cancelled.

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.

Notes to the Company accounts continued

10. Share-based payments

Options over shares of the Company 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 on pages 84 to 98.

	2016		2015	
	Range of exercise price of outstanding options £	Weighted average remaining contracted life Years	Range of exercise price of outstanding options £	Weighted average remaining contracted life Years
Executive Share Option Plan	3.01 – 5.56	8	3.01 – 5.43	8
Performance Share Plan	–	5	–	5
Restricted Share Plan	–	–	–	5

The average share price in the year was £5.24 (2015 £4.87).

11. Other information

Company audit fee

Fees payable to the Company's auditor for the audit of the Company's annual accounts totalled £1,776,000 (2015 £1,759,000).

Employees

The total number of employees of the Company at 31 December 2016 was 1,101 (2015 1,030). Total staff costs, excluding charges for share-based payments, were £115m (2015 £98m).

Related party transactions

Disclosures in respect of related party transactions are provided in note 28 to the Group accounts.

The Company also has a related party relationship with its directors and key management personnel, and pension schemes.

Directors' emoluments

Under Schedule 5 of the Large and Medium-Sized Companies and Groups (Accounts and Reports) Regulations 2008 (Schedule 5), total directors' emoluments, excluding Company pension contributions, were £10,806,172 (2015 £6,949,237); these amounts are calculated on a different basis to emoluments in the Annual remuneration report which are calculated under Schedule 8 of the Large and Medium-Sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013 (Schedule 8 (2013)). These emoluments were paid for their services on behalf of the BAE Systems Group. No emoluments related specifically to their work for the Company. Under Schedule 5, the aggregate gains made by the directors from the exercise of share options in 2016 as at the date of exercise was £158,125 (2015 £992,252) and the net aggregate value of assets received by directors in 2016 from Long-Term Incentive Plans as calculated at the date of vesting was £nil (2015 £nil); these amounts are calculated on a different basis from the valuation of share plan benefits under Schedule 8 (2013) in the Annual remuneration report. Retirement benefits are accruing to two directors in respect of defined benefit schemes and to two directors in respect of defined contribution schemes.

Company guaranteed borrowings

Borrowings by subsidiary undertakings totalling £3,295m (2015 £2,764m), which are included in the Group's borrowings, have been guaranteed by the Company.

Information about related undertakings

In accordance with Section 409 of the Companies Act 2006, a full list of the Company's subsidiaries and significant holdings is included in note 31 to the Group accounts.

Shareholder information

Registered office

6 Carlton Gardens
London
SW1Y 5AD
United Kingdom
Telephone: +44 (0)1252 373232
Company website: baesystems.com
Registered in England and Wales, No. 1470151

Registrars

Equiniti Limited (0140)
Aspect House
Spencer Road
Lancing
West Sussex
BN99 6DA
United Kingdom

If you have any queries regarding your shareholding or need to notify any changes to your personal details, please contact Equiniti.

Equiniti's website (help.shareview.co.uk) includes a comprehensive set of answers to many frequently asked questions relating to managing a shareholding. If you cannot find the answer to your question, there is an online e-mail form, which will help to ensure your question is directed to the most appropriate team for a response. Alternatively, you can call the BAE Systems Helpline on 0371 384 2044 or, from outside the UK, +44 121 415 7058. Lines are open from 8.30am to 5.30pm Monday to Friday, excluding UK Bank holidays.

In addition, the following services are offered to shareholders:

- **Shareview** – online access to your shareholding, including balance movements, indicative share prices and information on recent payments
- **Dividend mandates** – have your dividends paid directly into either your UK bank/building society account or an overseas bank account
- **Dividend reinvestment plan (DRIP)** – have your dividend reinvested in shares purchased on the stock market

More information on all these services can be found on Equiniti's website (shareview.co.uk).

American Depositary Receipts

BAE Systems plc American Depositary Receipts (ADRs) are traded on the Over The Counter market (OTC) under the symbol BAESY. One ADR represents four BAE Systems plc ordinary shares.

JPMorgan Chase Bank, N.A. is the depository. If you should have any queries, please contact:

JPMorgan Chase & Co
PO Box 64504
St Paul
MN 55164-0854 USA

Email: jpmorgan.adr@wellsfargo.com

Telephone number for general queries: (800) 990 1135

Telephone number from outside the US: +1 651 453 2128

ShareGift

ShareGift, the share donation charity (registered charity number 1052686), accepts donations of small parcels of shares which may be uneconomic to sell. Details of the scheme are available from ShareGift at sharegift.org, by telephone on 020 7930 3737 or by e-mail: help@sharegift.org

Share price information

The middle market price of the Company's ordinary shares on 31 December 2016 was 591.5p and the range during the year was 459.7p to 612.0p.

For more information

Visit the Shareholder information section of our website:

investors.baesystems.com

FINANCIAL CALENDAR

Financial year end	31 December
Annual General Meeting	10 May 2017
2016 final ordinary dividend payable	1 June 2017
2017 half-yearly results announcement	2 August 2017
2017 interim ordinary dividend payable	30 November 2017
2017 full-year results:	
– preliminary announcement	February 2018
– Annual Report	March 2018
2017 final ordinary dividend payable	June 2018

BEWARE OF SHARE FRAUD

Fraudsters use persuasive and high-pressure tactics to lure investors into scams.

They may offer to sell shares that turn out to be worthless or non-existent, or to buy shares at an inflated price in return for an upfront payment. While high profits are promised, if you buy or sell shares in this way you will probably lose your money.

Victims of share fraud lose an average of £20,000 to these scams, with as much as £200m being lost in the UK each year.

How to avoid share fraud

1. Keep in mind that firms authorised by the FCA are unlikely to contact you out of the blue with an offer to buy or sell shares.
2. Do not get into a conversation, note the name of the person and firm contacting you and then end the call.
3. Check the Financial Services Register from fca.org.uk to see if the person and firm contacting you is authorised by the FCA.
4. Beware of fraudsters claiming to be from an authorised firm, copying its website or giving you false contact details.
5. Use the firm's contact details listed on the Register if you want to call it back.
6. Call the FCA on **0800 111 6768** if the firm does not have contact details on the Register or you are told they are out of date.
7. Search the list of unauthorised firms to avoid at scamsmart.fca.org.uk/warninglist
8. Consider that if you buy or sell shares from an unauthorised firm you will not have access to the Financial Ombudsman Service or Financial Services Compensation Scheme.
9. Think seriously about getting independent financial and professional advice before you hand over any money.
10. **Remember:** if it sounds too good to be true, it probably is!

Report a scam

If you are approached by fraudsters please tell the FCA using the FCA Consumer Helpline on **0800 111 6768**, or the share fraud reporting form at fca.org.uk/scams, where you can also find out more about investment scams.

If you have already paid money to share fraudsters you should contact Action Fraud on **0300 123 2040** or online at actionfraud.police.uk