

# Governance summary

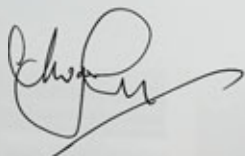
This section of the report details the arrangements the Board has put in place to help ensure that it fulfils the obligations it has for the good governance of the Company. The detail can be found in the following pages, but I would like to highlight briefly two important matters; diversity and our approach to board evaluation.

I'm pleased to report that we have exceeded the target set by the Board back in 2011, when it committed to an aspirational target of at least 25% of its membership being women by 2015 – the figure is currently 30%. The Company and I have always been supportive of the Women on Boards initiative led by Lord Davies, which has been successful in promoting greater diversity across UK listed company boardrooms. Diversity, in all its aspects, is an important element in the composition of any board and we will ensure that it continues to be an important part of our succession planning activity.

In pursuit of achieving the highest standards of governance, during the course of the year, the Board completed a formal and structured internal review of process and practice to determine areas for improvement. The review concluded that sound progress had been made in deepening the Board's understanding of the business and strengthening engagement in assessing both performance and strategic direction. Areas for improvement included the need to develop a better understanding of competitors, a more granular awareness of our offset policy and greater visibility of high-potential members of the management team. The dynamic and effectiveness of the Board were assessed to be good, and the contribution and enthusiasm of Board members was judged to be strong.

This year, the annual board evaluation is being undertaken by an external facilitator.

The following report details how the Board has applied the principles in the UK Corporate Governance Code (2014) and complied with its provisions. However, I and all Board members are very much aware of the need to ensure that our governance structure, and all that we do as a company, is underpinned by the right business culture. As I have emphasised elsewhere in these reports, from the Board downwards, it is not just what we do, but how we do it.



Sir Roger Carr Chairman

How the Company has applied the principles of the UK Corporate Governance Code (2014) (the Code)

The Company was compliant with the provisions of the Code throughout 2015 and the Board has applied its principles in its governance structure and operations.



The Code

"The Listing Rules require companies to apply the Main Principles and report to shareholders on how they have done so. The principles are the core of the Code and the way in which they are applied should be the central question for a board..."

The UK Corporate Governance Code

### Leadership

An effective board collectively responsible for the long-term success of the company.	Board of directors Board effectiveness	P60 P62
A clear division of responsibilities at the head of the company between the running of the board and the executive. No one individual should have unfettered powers of decision.	The Board and its responsibilities	P62
The chairman is responsible for leadership of the board and ensuring its effectiveness on all aspects of its role.	The Board and its responsibilities	P62
Non-executive directors should constructively challenge and help develop proposals on strategy.	How we manage risk The Board and its responsibilities	P52 P62

### Effectiveness

The board and its committees should have the appropriate balance of skills, experience, independence and knowledge of the company to enable them to discharge their respective duties and responsibilities effectively.	Nominations Committee report Board of directors	P70 P60
There should be a formal, rigorous and transparent procedure for the appointment of new directors to the board.	Nominations Committee report Governance summary	P70 P58
All directors should be able to allocate sufficient time to the company to discharge their responsibilities effectively.	Board attendance table Board effectiveness	P62 P62
All directors should receive induction on joining the board and should regularly update and refresh their skills and knowledge.	Board effectiveness	P62
The board should be supplied in a timely manner with information in a form and of a quality appropriate to enable it to discharge its duties.	Board effectiveness	P62
The board should undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual directors.	Board effectiveness Governance summary	P62 P58
All directors should be submitted for re-election at regular intervals, subject to continued satisfactory performance.	The Board and its responsibilities Board effectiveness	P62 P62

### Accountability

The board should present a fair, balanced and understandable assessment of the company's position and prospects.	Strategic report Risk management, viability assessment and going concern	P(i) P64
The board is responsible for determining the nature and extent of the principal risks it is willing to take in achieving its strategic objectives. The board should maintain sound risk management and internal control systems.	How we manage risk	P52
The board should establish formal and transparent arrangements for considering how they should apply the corporate reporting, risk management and internal control principles, and for maintaining an appropriate relationship with the company's auditors.	Audit Committee report	P65

### Remuneration

Executive directors' remuneration should be designed to promote the long-term success of the company. Performance-related elements should be transparent, stretching and rigorously applied.	Remuneration Committee report	P71
There should be a formal and transparent procedure for developing policy on executive remuneration and for fixing the remuneration packages of individual directors. No director should be involved in deciding his or her own remuneration.	Remuneration Committee report	P71

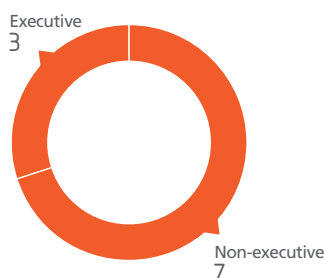
### Relations with shareholders

There should be a dialogue with shareholders based on the mutual understanding of objectives. The board as a whole is responsible for ensuring that a satisfactory dialogue with shareholders takes place.	Shareholder engagement	P64
The board should use general meetings to communicate with investors and to encourage their participation.	Shareholder engagement	P64

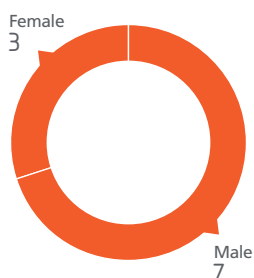
# Board of directors

Our business is led by our board of directors (the Board) whose biographical details can be found below.

## Board composition



## Board diversity



P62 Board members' attendance at scheduled meetings

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## Chairman



**Sir Roger Carr**  
Chairman

**Appointed to the Board:** 2013 **Nationality:** UK

### Skills and experience

Having joined the Board on 1 October 2013 as Chairman designate, Sir Roger was appointed Chairman on 1 February 2014. He was chairman of the board of Centrica plc from 2004 until 31 December 2013. Previous senior appointments include chairman of Cadbury plc, President of the Confederation of British Industry and Deputy Chairman of the Court of the Bank of England. Throughout his career, he has served on a number of external committees, including the Higgs Committee on Corporate Governance, Business for New Europe and the Prime Minister's Business Advisory Group.

### Other appointments

Vice Chairman of the BBC Trust, a senior adviser to Kohlberg Kravis Roberts, a fellow of the Royal Society for the encouragement of Arts, Manufactures and Commerce, an honorary fellow of the Institute of Chartered Secretaries and Administrators, and a visiting fellow to the Said Business School, Oxford.

### Other past appointments

Chairman of Thames Water plc and Mitchells & Butlers plc.

### Committee membership

Chairman of the Nominations Committee and the Non-Executive Directors' Fees Committee.

## Executive directors



**Ian King**  
Chief Executive

**Appointed to the Board:** 2007 **Nationality:** UK

### Skills and experience

Appointed as Chief Executive in 2008 having been originally appointed to the Board as Chief Operating Officer, UK and Rest of the World. He was previously Group Managing Director of the Company's Customer Solutions & Support business and, prior to that, Group Strategy and Planning Director. Prior to the BAe/MES merger, he was Chief Executive of Alenia Marconi Systems, having previously served as Finance Director of Marconi Electronic Systems.

### Other past appointments

Non-executive director and senior independent director of Rotork plc.

### Committee membership

Non-Executive Directors' Fees Committee.



**Jerry DeMuro**  
President and Chief Executive Officer of BAE Systems, Inc.

**Appointed to the Board:** 2014 **Nationality:** US

### Skills and experience

Appointed to the Board on 1 February 2014 as President and Chief Executive Officer of BAE Systems, Inc., Jerry DeMuro is an experienced US executive who has worked in the national security, technology and aerospace industry for over 30 years. Most recently, he served as executive vice president and corporate vice president of General Dynamics' Information Systems and Technology Group. Earlier in his career, he spent almost a decade as an acquisition official at the US Department of Defense.

### Other appointments

Non-executive director of Aero Communications, Inc.

### Committee membership

Non-Executive Directors' Fees Committee.



**Peter Lynas**  
Group Finance Director

**Appointed to the Board:** 2011 **Nationality:** UK

### Skills and experience

Peter Lynas, a qualified accountant, was appointed to the Board as Group Finance Director in 2011. He previously served for a number of years as Director, Financial Control, Reporting & Treasury. He joined GEC-Marconi in 1985 having previously worked for other companies in the UK and Europe. After progressing through a number of positions, he was appointed Finance Director of GEC's Marconi Electronic Systems business, which was subsequently acquired by British Aerospace in 1999 to become BAE Systems.

### Other appointments

Non-executive director of SSE plc and chairman of its audit committee.

## Non-executive directors



**Elizabeth Corley CBE**  
Non-executive director

**Appointed to the Board:** 2016 **Nationality:** UK

**Skills and experience**

Elizabeth Corley was appointed to the Board on 1 February 2016. She has served as Chief Executive Officer of Allianz Global Investors since 2012 and will be stepping back from this role to take on a position with AllianzGI as vice chair on a part-time non-executive basis with effect from March 2016. Prior to joining Allianz in 2005, she spent 11 years working at Merrill Lynch Investment Managers (formerly Mercury Asset Management). She was previously a partner with Coopers & Lybrand.

**Other appointments**

Non-executive director of Pearson plc, the UK Financial Reporting Council and the supervisory board of Euler Hermes, a member of the European Securities and Markets Authority's stakeholder group, and an advisory council member of TheCityUK.

**Committee membership**

Nominations Committee and Remuneration Committee.



**Harriet Green OBE**  
Non-executive director

**Appointed to the Board:** 2010 **Nationality:** UK

**Skills and experience**

Harriet Green is Vice President and General Manager, Internet of Things, Commerce and Education at IBM. She previously served as Chief Executive Officer and executive director of Thomas Cook Group plc and, prior to that, was Chief Executive Officer and executive director of Premier Farnell plc. She is a member of the British Chambers of Commerce's International Advisory Council and has served as a member of the Prime Minister's Business Advisory Group.

**Other past appointments**

Non-executive director of Emerson Electric Co. and senior vice president of Arrow Electronics, Inc.

**Committee membership**

Corporate Responsibility Committee and Nominations Committee.



**Chris Grigg**  
Non-executive director

**Appointed to the Board:** 2013 **Nationality:** UK

**Skills and experience**

Chris Grigg is Chief Executive of The British Land Company PLC and has more than 30 years' experience in the financial and real estate industries in a range of leadership roles. Prior to joining British Land as its Chief Executive in 2009, he was an executive with Barclays Bank and previously spent over 20 years at Goldman Sachs where he rose to the position of partner.

**Committee membership**

Corporate Responsibility Committee and Nominations Committee.



**Paula Rosput Reynolds**  
Non-executive director

**Appointed to the Board:** 2011 **Nationality:** US

**Skills and experience**

Paula Rosput Reynolds is Chief Executive Officer and President of the business advisory group, PreferWest LLC. She had previously spent over 20 years in the energy sector, culminating in her appointment as President and Chief Executive Officer of AGL Resources in 2002. She subsequently served as President and Chief Executive Officer of Safeco Corporation, an insurance company located in Seattle. She was then appointed as Vice Chairman and Chief Restructuring Officer of American International Group, Inc. (AIG) from October 2008 to September 2009.

**Other appointments**

Non-executive director of BP p.l.c. and TransCanada Corporation.

**Other past appointments**

Non-executive director of Coca-Cola Enterprises, Inc., Anadarko Petroleum Corporation, Delta Air Lines, Inc. and Air Products and Chemicals, Inc.

**Committee membership**

Chairman of the Remuneration Committee, and member of the Audit Committee and Nominations Committee.



**Nick Rose**  
Non-executive director and Senior Independent Director

**Appointed to the Board:** 2010 **Nationality:** UK

**Skills and experience**

Nick Rose held the position of Chief Financial Officer of Diageo plc for over ten years until October 2010 where, in addition to his finance responsibilities, he was also responsible for supply, procurement, strategy and IT on a global basis. His financial experience has encompassed a number of roles at Diageo, including group treasurer and group controller, having spent his earlier career with Ford Finance.

**Other appointments**

Chairman of Williams Grand Prix Holdings PLC, non-executive director and senior independent director of BT Group plc, and adviser to CCMP Capital Advisors, LLC.

**Other past appointments**

Chairman of Edwards Group Limited, and non-executive director of Moët Hennessy SNC and Scottish Power plc.

**Committee membership**

Chairman of the Audit Committee, and member of the Nominations Committee and Remuneration Committee.



**Ian Tyler**  
Non-executive director

**Appointed to the Board:** 2013 **Nationality:** UK

**Skills and experience**

Ian Tyler served as Chief Executive of Balfour Beatty plc for a period of eight years, stepping down from that position in 2013. A Chartered Accountant, he joined Balfour Beatty as Finance Director in 1996 having spent his earlier career in a variety of finance roles.

**Other appointments**

Chairman of Cairn Energy PLC and Bovis Homes Group PLC, and non-executive director of Medicinix International plc.

**Other past appointments**

Non-executive director of Cable & Wireless Communications Plc and VT Group plc.

**Committee membership**

Chairman of the Corporate Responsibility Committee, and member of the Audit Committee and Nominations Committee.

# Corporate governance report

## The Board and its responsibilities

The Board has adopted a governance structure based on the principles of the UK Corporate Governance Code (2014) (the Code), which includes the following governance principles:

**Strategy** – reviewing and agreeing strategy for the Company;

**Performance** – overseeing the performance of the Group and also evaluating its own performance;

**Standards and values** – setting standards and values to guide the affairs of the Group;

**Oversight** – monitoring the effectiveness of the Company's risk management and internal control systems; and

**People** – ensuring the Group is managed by individuals with the necessary skills and experience, and that appointments to the Board are managed effectively.

Pursuant to these principles, the Board has put in place a detailed governance framework, the Operational Framework, which includes the Company's Code of Conduct. It sets out how we do business across BAE Systems and encapsulates the Company's values, policies and processes, together with clear levels of delegated authority aimed at ensuring that all of its employees and businesses act in a clear, accountable and consistent manner.

There is a clear division of responsibility at the head of the Company and these are detailed in the Board Charter. The Chairman leads the Board and is responsible for ensuring that it discharges its duties effectively. The Chief Executive is responsible for the implementation and delivery of the strategy agreed by the Board.

The Senior Independent Director acts as a sounding board for the Chairman and acts as an intermediary for the other directors when necessary. He is also available to shareholders if they have concerns which cannot be addressed through the normal channels. The Company Secretary is responsible to the Board for ensuring that board procedures are complied with.

As required by the Code, the Company ensures that all non-executive directors have sufficient time to fulfil their obligations. This is assessed when a director is appointed and also in the event of there being a material change to an individual's circumstances. During the year, such an assessment was undertaken for Ian Tyler. Mr Tyler is currently chairman of Cairn Energy and Bovis Homes Group and a non-executive director of

Mediclinic International plc. During 2015, he retired as a non-executive director of Cable & Wireless Communications. With effect from 24 February 2016, he will be appointed Chairman of AWE, a non-listed company. Given the significant changes, the Chairman led an assessment of Mr Tyler's commitments and it was agreed that they would not impact his ability to fulfil his commitments to the Company. It was agreed that the matter would be further reviewed in 12 months' time.

The Board has adopted robust processes for dealing with potential conflicts of interest. All directors declare their interests on appointment and any subsequent changes are required to be notified to the Company and an assessment made as to any potential conflicts. All directors' interests are reviewed on an annual basis and formally noted by the Board.

In general, non-executive directors help constructively challenge and develop the Company's strategy, scrutinise the performance of management in meeting agreed goals and objectives, and monitor the reporting of performance. The Board considers all of the non-executive directors, with the exception of the Chairman, to be independent for the purposes of the Code.

All directors seek election on an annual basis at the Annual General Meeting.

Attendance by individual directors at meetings of the Board and its committees in 2015 is shown below.

## Board effectiveness

This section considers the effectiveness of the board of directors and the way in which the provisions of the Code have been addressed.

### Annual evaluation

The Board's evaluation in respect of performance in 2015 is being undertaken by an external facilitator, Independent Board Evaluation. The facilitator has no other connection with the Company.

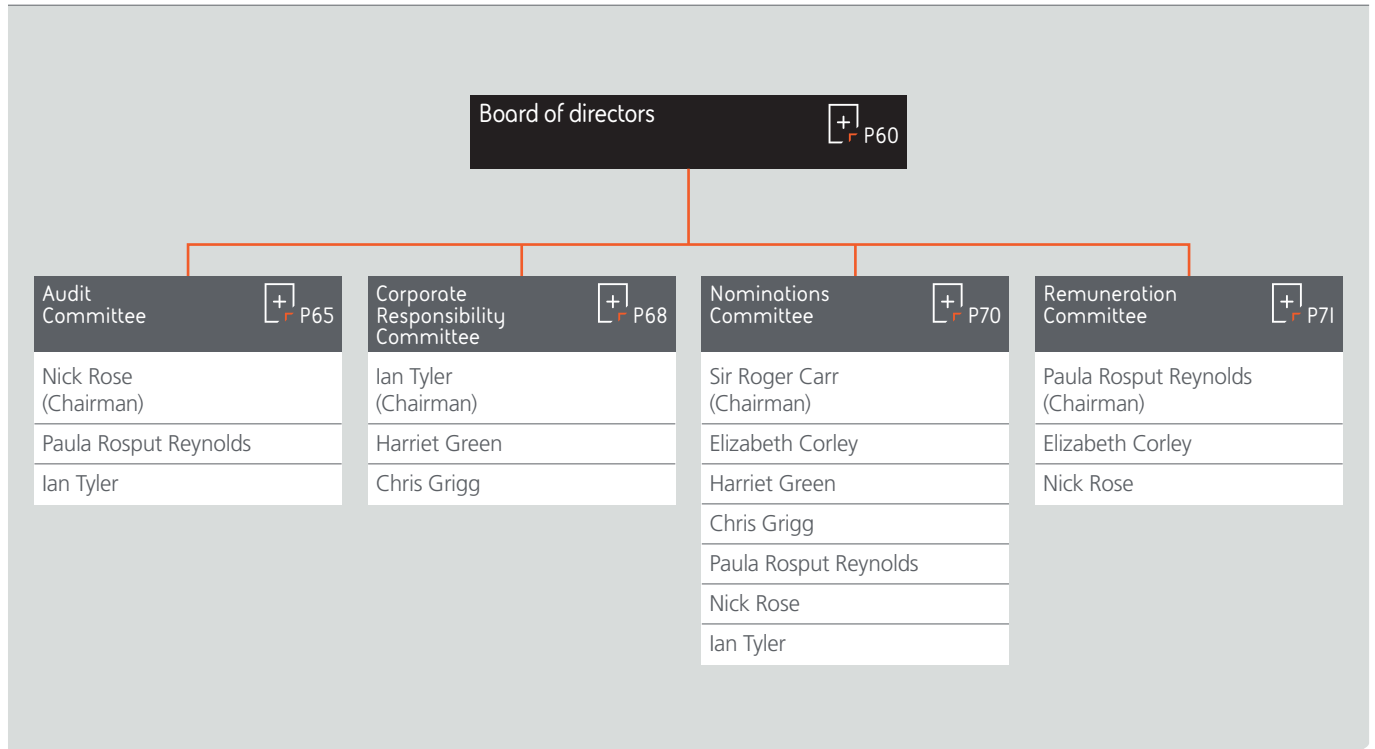
The 2015 evaluation is underway and is a full evaluation of the Board, its committees and individual Board members based on face-to-face interviews with directors and regular contributors to Board meetings. In addition, the facilitator has observed Board and committee meetings. The results of the assessment as they apply to the Board will be discussed collectively and objectives agreed for 2016. The Chairman will meet with each director to provide feedback on individual performance. Feedback on the Chairman's own performance will be provided by the Senior Independent Director, Nick Rose.

Following the evaluation undertaken last year, the Board agreed a number of objectives aimed at further improving its effectiveness. These included objectives concerning Board succession planning, how Board members develop their understanding of the business and use this to develop future strategy, and the use of modern technology to improve the efficiency and effectiveness of reporting. Good progress was made against these objectives during the year.

### Attendance by individual directors at meetings of the Board and its committees in 2015

Director	Board	Audit Committee	Corporate Responsibility Committee	Nominations Committee	Remuneration Committee
Sir Roger Carr	8/8	–	–	5/5	–
Jerry DeMuro	7/8	–	–	–	–
Harriet Green	8/8	–	4/4	5/5	–
Chris Grigg	8/8	–	–	5/5	4/4
Ian King	8/8	–	–	–	–
Peter Lynas	8/8	–	–	–	–
Paula Rosput Reynolds	8/8	5/5	–	5/5	2/2
Nick Rose	8/8	5/5	–	5/5	4/4
Carl Symon	3/3	–	–	1/1	2/2
Ian Tyler	7/8	5/5	4/4	5/5	–

Board committees



**Board induction**

An induction programme is agreed for all new directors aimed at ensuring they are able to develop an understanding and awareness of the Company's core processes, its people and businesses. In addition, as part of the induction process, new directors will typically visit the Group's principal operations in order to meet employees, and gain an understanding of the Group's products and services. Ongoing training is provided for the Board and individual directors as required.

**Information for the Board**

The Chairman, with the assistance of the Company Secretary, is responsible for ensuring that directors are supplied with information in a timely manner that is in a form and of a quality appropriate to enable them to discharge their duties.

In the normal course of business, such information is provided by the Chief Executive in a regular report to the Board that includes information on operational matters, strategic developments, reports on the performance of Group operations, financial performance relative to the business plan, business development, corporate responsibility and investor relations.

**Risk management, internal control and viability assessment**

**Principal risks**

Details of how the Company manages risks can be found on pages 52 and 53 of the Strategic report. This section of the report includes details of how the Board and its committees maintain oversight of the key risks within the business and how these are being managed. It also describes the Company's approach to risk management and the processes used to identify, analyse, evaluate and mitigate risks. These processes are the basis of the Company's risk management and internal control systems, and the Board regularly reviews both the output from them and their effectiveness.

The Board has completed a robust assessment of the principal risks facing the Company and these are detailed on pages 54 to 57.

# Corporate governance report

## continued

### Viability assessment

As required by the provisions of the Code, the Board has undertaken an assessment of the future prospects of the Company taking account of the Company's current position and principal risks. This assessment was made using the Company's core business processes, including the following:

**Integrated Business Plan (IBP)** – the IBP represents a common process with standard outputs and requirements that produces an integrated strategic and business plan for the Group and also for each of its businesses. The plan is reviewed each year by the Board as part of its strategy review process. Once approved by the Board, the IBP is cascaded down across all the Company's businesses and provides the basis for setting all detailed financial budgets and strategic actions that are subsequently used by the Board to monitor performance.

**Risk management** – as detailed above, the Company has developed a structured approach to the management of risk and the principal risks identified are considered as part of the Board's annual review of the IBP.

**Liquidity analysis** – based on the financial output from the IBP, the Board regularly reviews an analysis looking at the forecast working capital requirements, cash flow, and committed borrowing and other funding facilities available to the Company over the five-year period covered by the IBP. This analysis includes 'stress testing' of the Company's liquidity under severe, but plausible, scenarios as developed from the IBP.

In addition to the above, the Board's review of the effectiveness of the Company's risk management and internal control systems (see below) is important to the viability statement. As such, systems are designed to ensure that the information used for business planning processes is accurate and robust. Directors have also reviewed the Company's insurance arrangements and the level of cover these provide.

In undertaking its review of the IBP in 2015, the Board considered the prospects of the Company over the one and five-year periods covered by the process. The one-year planning period has a greater level of certainty and is, therefore, used to set detailed budgetary targets at all levels across the Group – it is also used by the Remuneration Committee to set targets for the annual incentive. The five-year period provides less certainty of outcome, but provides a robust planning tool against which long-term decisions can be made concerning, among other things, strategic priorities, funding requirements, capital expenditure and resource planning. On the basis of this and

other matters considered and reviewed by the Board during the year, the Board has reasonable expectations that the Company will be able to continue in operation and meet its liabilities as they fall due over the periods used for the assessment. In doing so, it is recognised that such future assessments are subject to a level of uncertainty that increases with time and, therefore, future outcomes cannot be guaranteed or predicted with certainty. Also, this assessment was made recognising the principal risks that could have an impact on the future performance of the Company (see pages 54 to 57).

### Risk management and internal control

The Board is responsible for the Company's risk management and internal control systems. Details of these systems and how they operate can be found on pages 52 and 53 of the Strategic report. These include ongoing processes for identifying, analysing, evaluating and managing the principal risks faced by the Company, which have been in place throughout the year and up to the date of this report. The Board has reviewed the effectiveness of the Company's risk management and internal control systems, and believes that they accord with the Financial Reporting Council's Guidance on Risk Management, Internal Control and Related Financial and Business Reporting.

The Board has delegated to the Audit Committee responsibility for reviewing in detail the effectiveness of the Company's risk management and internal control systems. Having undertaken such reviews, the Audit Committee reports to the Board on its findings so that the Board as a whole can take a view on this matter. In order to assist the Board and the Audit Committee in this review, the Company has developed the Operational Assurance Statement (OAS) process (as detailed on page 52). Part of this requires that a return is completed every six months by each operational and functional business head, reporting their formal review against such matters as compliance with law and regulations, ethical business conduct, financial controls, risk management, compliance with business planning processes, health and safety, conflicts of interest, delegated authorities, appointment of advisers and product safety. Where simple yes/no answers are not appropriate, an assessment of compliance is required to be made against structured qualitative guidance.

The twice-yearly OAS assessment process is owned by the Company's Internal Audit function, which provides assurance as to the accuracy of returns relative to the findings of audit work undertaken during the year. The returns are also shared with the Company's auditors.

A separate OAS return is required to be completed by the most senior BAE Systems employee responsible for joint ventures and BAE Systems employees on the boards of these companies are required to exert such influence as the Company may have to encourage the adoption of a governance structure that is substantially equivalent to that mandated for the Group for wholly-owned or controlled parts of the Group.

### Going concern

Accounting standards require that directors satisfy themselves that it is reasonable for them to conclude whether it is appropriate to prepare financial statements on a going concern basis and the Code requires that, if appropriate, this report includes a statement to that effect. Following review, the directors have concluded that it is appropriate to adopt the going concern basis for these financial statements and have not identified any material uncertainties concerning the Company's ability to do so in the 12-month period from the date of approving them. For this reason, they continue to adopt the going concern basis in preparing the accounts.

### Shareholder engagement

The Company has a well-developed investor relations programme managed by the Chief Executive, Group Finance Director and Investor Relations Director. In addition, the Chairman is available to meet with major shareholders and is in regular contact with them so as to keep them informed of progress on corporate governance matters. In order to assist in developing an understanding of the views of major shareholders, each year the Company commissions a survey of investors undertaken by external consultants.

The results of the survey are presented to the Board.

The Board uses the Company's Annual General Meeting to communicate with investors. The meeting provides all shareholders with the opportunity to vote on the resolutions put to shareholders either electronically via the Company's website or by post. All resolutions detailed in the Notice of Meeting are voted on by way of a poll so as to ensure that all votes are counted on the basis of one vote for every share held. The results of the voting on all resolutions are published on the Company's website.