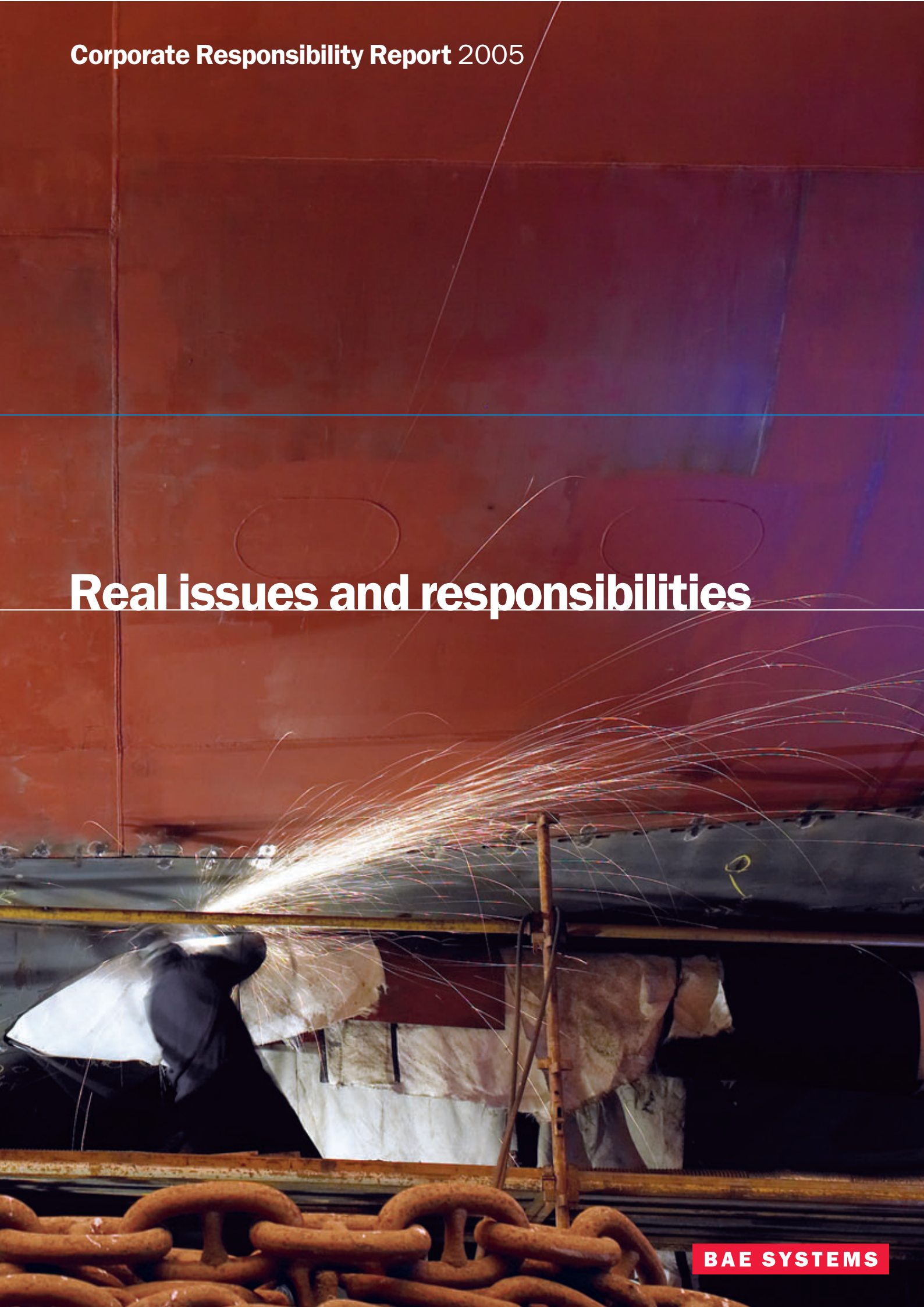
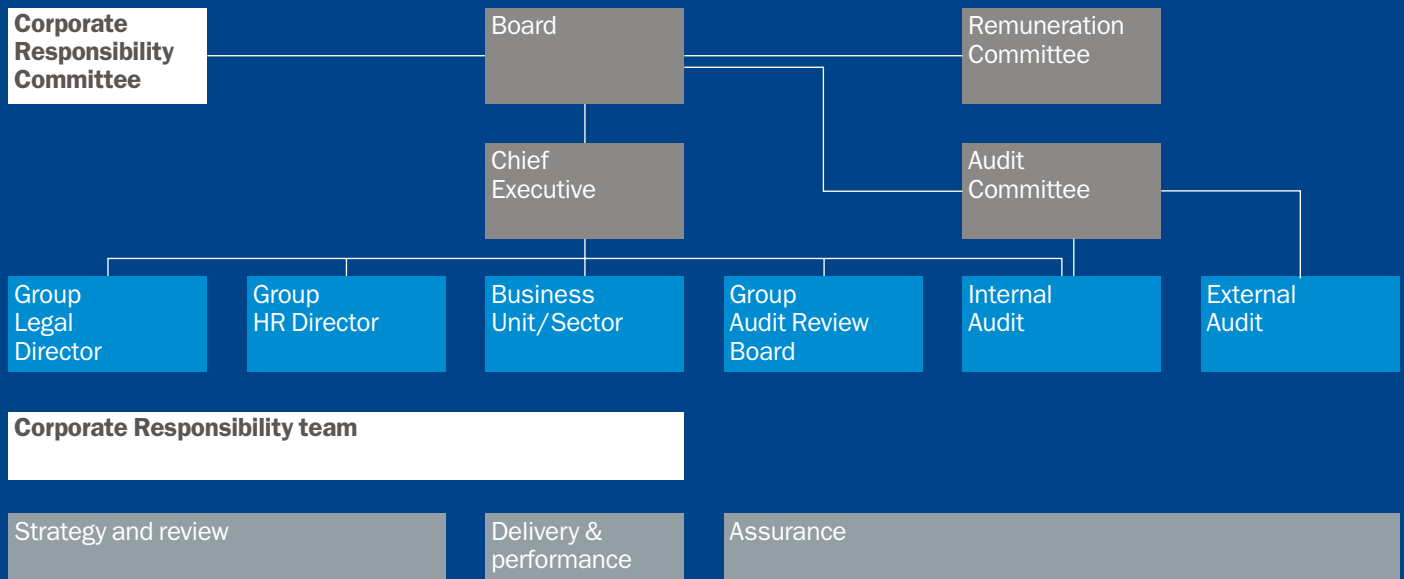


Real issues and responsibilities



Management of corporate responsibility



We committed to establishing a Board level committee with responsibility for corporate responsibility (CR) issues during 2005. This committee was duly formed and held its first meeting in November 2005. The membership is non-executive directors of the Company. Peter Weinberg, Chairman of the Corporate Responsibility Committee, provides his view of their role.

In establishing the Corporate Responsibility Committee BAE Systems is demonstrating the Board's commitment to delivering real improvements against its CR agenda. The Committee now forms an important aspect of the corporate governance of the Company and part of its remit will be to review and confirm that the appropriate policies and practices are in place to manage non-financial issues. I do, however, believe our role goes beyond that of assurance and to deliver real value we should be challenging the Company constantly to push forward its CR agenda. BAE Systems should not only aim to be the best in our sector for our CR performance but also strive to be counted amongst the world's top companies.

Specific areas of focus for the Committee during 2006 will include ethical policies and practices and health and safety performance. These are key issues for

BAE Systems and it is important that we as a Committee are confident that we have the policies and processes in place which when applied consistently will ensure that we manage them effectively.

BAE Systems is making real progress in terms of its social, environmental and ethical activities. I and my fellow committee members, look forward to being able to report back next year on the progress both we as a committee have made, but also the value we have added to the Company.

Peter Weinberg
Chairman of Corporate Responsibility Committee

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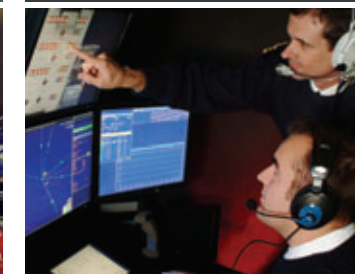

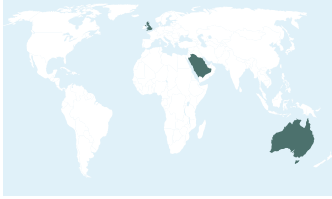
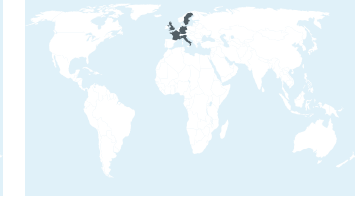
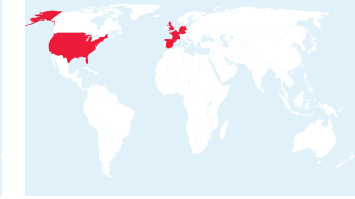
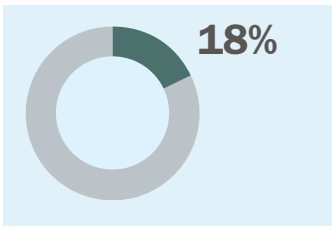
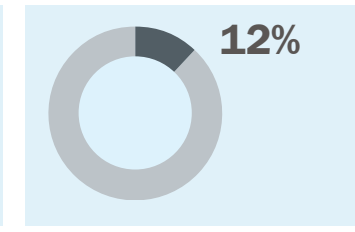
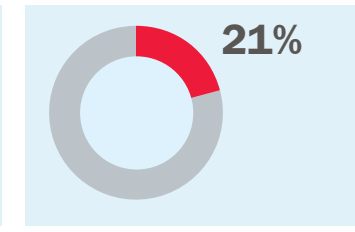
More information about BAE Systems and CR can be found on our website:
www.baesystems.com/corporateresponsibility

Who we are and what we do

BAE Systems is the premier transatlantic defence and aerospace company delivering a full range of products and services for air, land and naval forces as well as advanced electronics, information technology solutions and customer support services. We have major operations across five continents and customers in some 130 countries.

	Electronics, Intelligence & Support 	Land & Armaments 	Programmes 
Business overview	Electronics, Intelligence & Support comprises the former activities of BAE Systems North America together with those UK based displays and inertial systems activities and the marine repair activities of the former United Defense business.	Land & Armaments comprises the former RO Defence and Alvis businesses in the UK, Sweden and South Africa and the former United Defense land and armaments activities in the US and Sweden.	Programmes continues to comprise the Company's air systems, naval ships and submarines activities together with the Company's participation in the future Carrier Programme.
What we do	E&IS provides intelligent electronic products, systems and integration services, such as the F-35 Joint Strike Fighter (JSF) and F22, electronic warfare suite, to military and commercial customers.	Delivers the widest range of integrated battlefield systems, military vehicles, naval armaments and missile launchers, most notably the Bradley family of vehicles.	Design, development and production of military aircraft, ships and submarines including Eurofighter Typhoon and Nimrod MRA4 aircraft, Astute Class submarines, and the Type 45 destroyer.
Main operating regions	US and UK. 	US, UK, Sweden and South Africa. 	UK. 
Number of employees	32,900	10,600	16,200
Contribution to 2005 Group sales	 23%	 8%	 18%
Corporate responsibility focus	Increase the age range and diversity of employees, business ethics, support the local community, promote continued education in the workplace, improve the study of science and technology in secondary schools, safety, health and environment.	Business ethics, promotion of safe and healthy working practices. Manage environmental impacts associated with heavy manufacturing. Support local communities. Integrate new businesses and their people.	Promote safe and healthy working practices. Manage environmental impacts associated with heavy manufacturing. Ensure good relations with trade unions and local communities. Support for education. Business ethics.

This report addresses our corporate responsibility issues and priorities at a group level. The key issues identified by our stakeholders include business ethics, lobbying, political influence and workplace issues. Below we lay out how our business is organised and the specific CR issues faced at business group level.

Customer Solutions & Support	Integrated Systems & Partnerships	Commercial Aerospace	
			
<p>Customer Solutions & Support continues to comprise the partnered support activities with the UK MoD's Defence Logistics Organisation (DLO), together with the Company's support activities in the Kingdom of Saudi Arabia.</p>	<p>Integrated Systems & Partnerships comprises the wholly-owned UK-based Integrated System Technologies business and our underwater systems activity.</p>	<p>Commercial Aerospace comprises the Company's 20% interest in Airbus together with the Aerostructures business (now agreed to be sold) and the Regional Aircraft asset management and support activities.</p>	<p>Business overview</p>
<p>Support solutions for current and future capability including upgrade; integration and delivery of effective supply chain and logistics management; maintenance and facilities management and manpower services.</p>	<p>Design, development and production of communications infrastructure programmes and intelligence, surveillance, target acquisition and reconnaissance systems.</p>	<p>Design, development, production and support of commercial and regional aircraft.</p>	<p>What we do</p>
<p>UK, Australia, Saudi Arabia.</p> 	<p>UK, Sweden, France, Germany and Italy.</p> 	<p>UK, France, Germany, Spain and the US.</p> 	<p>Main operating regions</p>
<p>14,300</p>	<p>12,000</p>	<p>12,500</p>	<p>Number of employees</p>
 <p>18%</p>	 <p>12%</p>	 <p>21%</p>	<p>Contribution to 2005 Group sales</p>
<p>Business ethics, improving the age range of employees and providing guidance to help young people advance. Ensure managers understand the wide cultural diversity. Support for education, safety, health and environment.</p>	<p>Promote cultural and gender diversity. Business ethics, ensuring good relations with local communities, safety, health and environment.</p>	<p>Work closely with colleagues at Airbus on a range of common issues, including health, safety and environment.</p>	<p>Corporate responsibility focus</p>

Setting new standards in CR

“I believe that the leadership of a company plays a key role in driving performance improvement.”

The fundamental role of the defence industry is providing national security and protection and we are proud to be a part of such an important and unique industry. But as with all industries we must continually demonstrate to all our stakeholders why we are the best company to provide this necessary capability. Operationally this means ensuring our customers receive the best value, highest product quality and complete reliability of product performance. But we also need to be able to demonstrate the highest standards of integrity and responsible management of our key issues.

We believe we are a responsible company but recognise that it is important to understand the views and perceptions of others. Over the four years of reporting on our Corporate Responsibility (CR) activities we have welcomed contributions from key stakeholders and believe this engagement has played a key role in developing our CR agenda. During 2005 we worked with PricewaterhouseCoopers (PwC) formally to identify the key CR issues to our stakeholders. These included business ethics, lobbying and political influence and workplace issues. Accordingly, we invited recognised authorities in each area to provide their view on what a responsible company should be doing and their opinion on how BAE Systems performs against this. These views along with our response are a key feature of this year's report.

I believe that the leadership of a company plays a key role in driving performance improvement and accordingly I accepted a number of personal objectives in 2005 relating to our safety performance and to ensuring a workplace where all employees are treated with dignity and respect.

Progress against these objectives is reported on page 6 along with the objectives agreed for 2006.

Whilst we again demonstrated real improvements in our safety management, I, and the rest of the Company, deeply regret the tragic accident at our Chorley site in the UK which resulted in the death of one of our employees. There is no acceptable number of fatalities or serious accidents and I am personally committed to ensuring that we continue to drive improvements in safety performance.

We can demonstrate progress across all areas of our CR agenda in 2005 but also acknowledge that there are certain areas where we must continue to focus in order to deliver the level of openness and transparency our stakeholders expect. The formation of the Corporate Responsibility Committee during 2005 underlines our commitment to driving these improvements at the most senior level. I look forward to the challenge that the Committee will no doubt bring to the Company and am sure we will deliver on expectation.

We are a long-term business and CR is fundamental to our sustainability as a responsible defence company. During 2006, we shall build on our progress and continue to address the real issues and responsibilities for our business.



Mike Turner
Chief Executive



BAE Systems recognises its responsibilities to the people it employs, its customers and suppliers, its shareholders, the wider community and to the environment. We are a well-managed, responsible and ethical company and are determined to be widely recognised for our world-class technology, the skills of our people and the seriousness with which we take our **corporate responsibilities.**

Corporate responsibility (CR) in BAE Systems is about good business practice and continual improvement. Our CR framework has been developed through analysis of key stakeholder interest and feedback, potential risk to our business and the extension and evaluation of existing practices.

Corporate responsibility supports delivery of the business strategy and values by:

- Helping us get the most from our workforce by providing workplace training and good industrial relations.
- Forming trusting relationships with our stakeholders, including customers, investors, local communities and suppliers – the people who influence our business.
- Ensuring we attract talented people in the future through our support for education in engineering and science.

“BAE Systems shows high management capabilities and awareness for the relevant challenges.” SAM Group

Sector Benchmarking

In 2005 BAE Systems maintained its position in both the Dow Jones Sustainability World Index and the pan European Dow Jones STOXX Sustainability Index. Our total score for 2005 was 81%. This was the highest score reached by a company in our specific industry sector and considerably higher than the average within the sector group of 50%.

The total score is an average of the three dimension scores for economic, environmental and social for which we scored:

Economic Dimension	77%
Environmental Dimension	88%
Social Dimension	79%

In all three areas we are again considerably above the industry sector average and are the highest scoring company for each dimension within our sector. The 2005 score is an improvement on where we were a year ago. Our overall total score increased by 13% (68% in 2004) and improvements were seen across all three dimensions. We recently met with the SAM Group to discuss the benchmarking, their concerns and areas in which we can improve in 2006.



CR risk management

We see social, ethical and environmental issues as important to our business performance, posing both risks and opportunities. It is essential that we manage these issues well. Our principles, code of behaviour and detailed corporate governance policies are included within the BAE Systems Operational Framework.

This document sets out our expectation of all employees to maintain the highest standards of personal conduct and integrity at all times in the carrying out of the Company's affairs. The senior executives of each business unit or operating group are held accountable for ensuring that the Framework is available to all personnel, together with appropriate education and training to support its deployment.

In 2005, we established a Corporate Responsibility Committee chaired by Peter Weinberg, a non-executive director. The Corporate Responsibility Committee reviews and monitors how we manage CR risks and assists the Board to develop strategy and policy in this area. For more on our governance process for CR issues see page 33.

Identifying key CR issues and stakeholders

It is important that our CR reporting addresses issues that are material to our business and reflect stakeholder concerns. In 2005 we worked with PricewaterhouseCoopers LLP (PwC) to obtain an independent analysis of the issues relevant to our CR reporting and an understanding of our priority CR stakeholders and their key concerns. We have used the findings from this work to help shape our CR reporting and stakeholder engagement. PwC considered and analysed information on our business strategy and the documented views of a range of stakeholders and interviewed BAE Systems executives who manage key stakeholder relationships. The work helped to show us that BAE Systems currently provides information on the issues identified as important for our business and its impacts on society and for over half these issues we are reporting at a level consistent with stakeholder expectations. The key areas our stakeholders consider material to our business are anti-bribery and corruption practices, health and safety, government relations and political influence and product responsibility.

We are committed to improving our reporting. This year we have strengthened our CR Report to include more detailed information on those areas highlighted as below expectations. For example we have included new information on lobbying and government relations (see page 18) as well as improved reporting on ethics and CR governance. It is important that we listen to what others say about us and not base our agenda purely on what we think is important. We will continue to work with both internal and external stakeholders to improve our reporting.

CR strategy for 2006

Our CR strategy must underline and support our business strategy. Over the last four years we have progressed from communicating existing processes to using the external reporting process and stakeholder feedback to evaluate the effectiveness and extent of these processes. A sustainable CR agenda must continue to evolve both the communication and effective deployment of our policies and practices but should also be a means of challenging the Company to ensure we are delivering on our commitment to high performance and continual improvement. Our long-term strategic objectives are provided on page 7.

More information about BAE Systems and CR can be found on our website: www.baesystems.com/corporateresponsibility

Q&A

These are some of the questions on issues relating to corporate responsibility that we received from stakeholders during 2005.

“What’s happening with the SFO enquiry?”

During 2005 the Serious Fraud Office and Ministry of Defence Police continued their investigation into the Company and certain employees in relation to allegations of false accounting and corruption. The Company continues to co-operate with the investigation.

“Why do you always say ‘no comment’ in response to media allegations of unethical practices?”

It is not always appropriate to comment on media allegations. We believe we meet the highest ethical standards in our dealings with others and that we have the processes in place to ensure our employees comply with these standards and the law in all the countries where we operate. We are aware that we have been criticised for not providing sufficient information on our processes for ensuring ethical behaviour in business. This year we have provided more information on ethics in this report including our statement on ethical business principles and practices. This statement can be found on page 25 and is also published on our website.

“Does BAE Systems make or sell cluster weapons?”

We do not make or sell cluster weapons.

“Does your CR reporting merely cover up what you really do?”

We take our corporate responsibilities extremely seriously. The more serious your products, the more important it is to have values and principles governing your business. Our Corporate Responsibility Report clearly states what we do and reflects actual progress and challenges in the business. We use stakeholder feedback to help determine the information we include in our report.





“Why do you hide behind the Government when explaining your decisions on defence exports?”

BAE Systems works closely with and maintains a regular dialogue with both the UK and US Governments in relation to all our export sales of defence equipment.

All export licence applications are considered on a case-by-case basis and take into account the proposed customer country, the type of equipment to be exported and its future use. All our applications comply with trade regulations and the requirements for end-user certificates. Every application we make for an export licence takes into account all the facts at our disposal before consideration by the government.

The decision to allow or refuse an application for a defence export licence can only be made by governments. Only governments are in a position to make a judgement and balance the political, economic, and strategic considerations and the human rights issues that are part of the licence process.

Further information on export licence applications can be found on page 33.

“Why was BAE Systems singled out by the media among UK defence sector companies for not engaging with Transparency International?”

We often gain increased media attention due to our size and position as the UK’s leading defence company. Our policies on business ethics address Transparency International’s Business Principles for Countering Bribery and equivalent models from other groups (see page 10). We have engaged with Transparency International and continue to work with them and other interested parties.

“If an employee broke the law or breached your own ethical principles would you fire them?”

Any action which is unlawful, dishonest, harmful to others or which is otherwise against our policies is unacceptable. We will take disciplinary action against anyone whose behaviour does not meet our ethical principles and standards (see page 10).

If an employee breaks the law or seriously breaches our policies this disciplinary action may lead to dismissal. During 2005 there were a number of dismissals due to employees breaching our UK Respect at Work policy.

“What difference will the Corporate Responsibility Committee make to your CR performance?”

The Corporate Responsibility Committee is an important aspect of our corporate governance and will help ensure that CR issues are appropriately managed at the most senior level. The Committee is comprised of independent non-executive directors and will provide an impartial, objective and informed viewpoint on key strategic decisions.

“Recently there have been bribery allegations made against BAE Systems. How can you claim to be a responsible company?”

There have been several media reports relating to allegations made against our Company. None of these allegations has been substantiated.

We will not tolerate bribery or other attempts to influence improperly the decisions of customers and suppliers. The intent of our policies is to establish compliance with the law as the minimum standard and to aim for higher standards where possible.

We have an anti-corruption compliance programme in place throughout the Company. This is monitored by our Operational Assurance Statement process which includes sign-off by all Managing Directors and is subject to internal audit (see page 10).

“Do you make nuclear weapons?”

Our submarines business in Barrow is responsible for the design and manufacture of nuclear-powered submarines on behalf of the Royal Navy. These submarines carry the UK’s strategic nuclear deterrent.






We also retain a non-controlling 37.5% shareholding in MBDA which manufactures (in France) the air-launched missile which forms part of the French nuclear deterrent.

Progress and objectives

We regularly review and update our CR programmes to ensure we make progress and set yearly objectives.

2005 objectives

Progress What we achieved

<p>1 Establish a board committee on corporate responsibility</p>		<p>We established a Corporate Responsibility Committee chaired by a non-executive director. The Corporate Responsibility Committee reviews our CR risk management processes and assists the Board to develop CR strategy and policies. The Committee's terms of reference are published on our website, www.baesystems.com. The Corporate Responsibility Committee held its first meeting in November 2005 and has agreed CR objectives for 2006, supported by a new CR strategy (see opposite).</p>
<p>2 Improve our rating against Accountability Standard AA1000</p>		<p>Our 2004 Corporate Responsibility Report was reviewed by csrnetwork, using the Accountability Rating. Key recommendations included: mapping our major stakeholder groups; strengthening our CR governance processes; and embedding CR at all levels of the organisation.</p> <p>In 2005 we commissioned PwC to help us analyse our key stakeholder groups and identify the material CR issues for our business (see page 2). We established a Corporate Responsibility Committee and have reviewed and updated our Operational Framework to make reference to the Committee and to further embed CR principles, for example on business ethics and workplace behaviours.</p>
<p>3 Improve Safety, Health and Environment (SHE) performance</p>		<p>Overall SHE performance improved but we have marked the progress level down on account of the fatality at Chorley, UK. No serious accident or fatality is acceptable and we continue to work towards reducing the risk of our operations.</p> <p>Our Internal Audit department confirmed our SHE framework is being implemented consistently. We have agreed a consistent approach to setting and reporting SHE targets and have set SHE targets for each business unit. These will be available on our website. SHE performance improvement targets are now included in the personal objectives for each member of the Executive Committee.</p>
<p>4 Develop a formal stakeholder engagement plan</p>		<p>We completed a stakeholder and issue mapping exercise with PwC. We have established a plan to engage with the stakeholders prioritised by this work, focusing on the issues identified as material to our business and to its impacts on society. The relationship pieces in this report are part of this engagement process.</p>
<p>5 Upgrade our CR website to provide real-time information on CR activities</p>		<p>We reviewed best practice in this area and audited our CR website to highlight areas where improvements and real-time information is needed.</p> <p>We will upgrade the CR website in 2006 and add real-time information on benchmarking and key performance indicators.</p>

2006 objectives

Strategic objectives

The overall CR strategic objective is to contribute to the sustainability of the Company's performance through ensuring continual improvement of application, communication and evolution of non-financial processes.

Specific objectives for 2006

- Through monitoring and review, ensure consistency and effective deployment of policies and processes related to key CR risk areas.
- Support the individual businesses in embedding CR action plans to increase employee awareness of the value and role of CR within BAE Systems.
- Review external best CR practice and evaluate for applicability and value to BAE Systems.
- Continue to improve external opinion of BAE Systems' CR performance.

Chief Executive objectives

Each year the Board agree a set of performance objectives for delivery by the Chief Executive and his senior team. Those objectives relating to CR are shown below. These are rolled out across the entire company.

Leadership

- Resolve 75% of employee grievances in the UK at local level.
- Reflect gender diversity on leading university courses in choice of graduate trainees through a focused recruitment plan.

Safety Health and Environment (SHE)

- Exceed safety performance commitments made to the UK Health and Safety Executive (see page 31).
- Meet SHE targets (see page 15).

Ethics

- Meet standards defined in our internal assurance statement (see page 10).
- Develop, pilot and roll out ethics training to all employees in the UK and Australia (see page 10).



ethics

Ethical business behaviour is critically important to the defence industry and our stakeholders consider it a priority issue. We invited Philippa Foster Back of the Institute of Business Ethics (IBE) to comment on how the defence industry should ensure it acts ethically, and to review our progress. Our response is on page 10*.

* This commentary does not imply an endorsement of this report by the IBE.

Stakeholder position

Philippa Foster Back,
Director, Institute of
Business Ethics (IBE).

The IBE encourages high standards of business behaviour based on ethical values. It is funded by donations from companies, associations and individuals.

“Bribery and corruption are bad for business. Bribery is illegal in most countries and is a form of ‘stealing’ from shareholders. Being caught making bribes or engaging in corrupt behaviour can seriously damage a company’s reputation and lead to loss of business.

The defence industry is one of three sectors most at risk from bribery and corruption, according to analysis by the NGO Transparency International. So it is particularly important for BAE Systems to have strong policies on business ethics. They must be open and transparent and demonstrate that they meet high ethical standards.

Business ethics is the application of ethical values to business behaviour – such as openness, transparency or responsibility. Companies can demonstrate these values through their policies and through their relationships with stakeholders.

An ethics policy or code is needed to set the tone and provide clear guidance to staff on the standards expected of them. This should include examples or Q&As to help employees handle ethical dilemmas or issues that might arise in their work. Companies should embed this policy with staff at all levels of the organisation. It is vital that the code is distributed to all staff and translated into local languages. It must be supported by face to face or e-learning training sessions, referred to in staff appraisals and written into contracts of employment.

BAE Systems has undertaken a survey of employee views on ethical issues and has a detailed code of ethics which was recently updated. This code includes details of how to raise an ethical concern and follows good practice. Ensuring good business ethics requires continual effort. BAE Systems needs always to keep their policy alive and in front of staff to ensure that standards are maintained. This includes induction programmes for new staff and regular refresher courses.

The best way to embed ethical behaviour is by example from those leading the Company. Business leaders must demonstrate in their relationships with staff, customers, suppliers and others that they practice what they preach. This sets the tone for how all employees behave.

To monitor performance and demonstrate progress, companies should track the number of calls to their ethics help lines; conduct staff surveys to find out if there are concerns about ethical behaviour; and report the number of staff disciplined for unethical conduct, as done by companies such as BP, Shell and BT.

Courage and collaboration are needed to eradicate bribery and corruption. Companies have to take a firm stand and not participate in making or taking bribes. Ultimately they must be prepared to walk away from a piece of business rather than engage in corrupt activities by explicitly supporting staff who take the right path yet lose business as a consequence. If businesses stand together on this issue and are prepared to be transparent in their transactions we will see fewer instances of bribery and corruption.”



Our response

We are committed to meeting the highest ethical standards in our dealings with others. The nature of our business means it is particularly important that we have strong values and an awareness of public concerns.

We do not condone unethical or illegal conduct. The consequences of such conduct may be far reaching and severe not only for the Company and its employees, but also for other stakeholders. Unethical behaviour is wrong, could lead to loss of business, could seriously damage our reputation and leave the Company and its employees open to criminal sanction.

We agree with the views expressed by Philippa Foster Back on behalf of the IBE. We recognise the importance of such institutions in furthering awareness and improving standards on business ethics and gain significantly from our subscription to and association with the IBE.

Our policies on business ethics

The intent of our policies is to establish compliance with the law as the minimum and to aim for higher standards where possible.

Our Operational Framework includes policies and governance systems on business ethics. It requires all BAE Systems employees to act with honesty, integrity, and fairness and states that we will not tolerate bribery or

other attempts to improperly influence the decisions of customers or suppliers.

The Operational Framework is reviewed annually. In 2005, it was updated to include our five ethical principles, see page 25.

The Operational Framework is supported by more detailed policies covering topics such as health and safety, employee relations and anti-corruption. Our anti-corruption programme has been established in alignment with international standards such as those developed by the International Chamber of Commerce (ICC) and Transparency International.

The heads of each of our businesses and functions are required to sign statements (Operational Assurance Statements) every six months confirming that their area of responsibility meets the requirements of the Operational Framework.

Transparency

In last year's report we made a commitment to be more transparent about our operating principles. We are confident that we meet the highest ethical standards in our dealings with others and have the processes in place to ensure our employees comply with our policies and the law in all the countries where we operate. We also recognise the importance of demonstrating this to our stakeholders.

This year we have published an external statement on our ethical business

principles and practices. A copy of the statement can be found on page 25.

Ethics management structure

Compliance with our ethical policies and principles is the specific responsibility of our Group Legal Director, Michael Lester, who performs this task on behalf of the Executive Committee and the Board of Directors. He is supported by a team of legal experts, human resources and our Internal Audit Group.

The heads of each business are responsible for ensuring that employees in their area are familiar with the requirements of our business ethics policies, know what is expected of them and know how to act if they suspect wrongdoing. We have established points of contact to address employees' ethical concerns; these can be contacted directly or through anonymous telephone helplines.

In the UK our Ethics Review Committee is chaired by the Group Audit Director; its members are the Director of Corporate Responsibility, the Director of Employee Relations, the Director of International Compliance and the Director of Security. The Committee reviews issues raised on the ethics helpline to ensure that these matters are investigated and that appropriate action is taken.

In the US our ethics programme is run by an Ethics Steering Committee with representatives from each operating group and our legal and human resources departments. This reports to an Executive Ethics Oversight Committee made up of senior executives and chaired by the Senior Vice President General Counsel of BAE Systems. An Ethics Officer in each North American business unit is responsible for investigating allegations of unethical conduct.

During 2005, the Group Audit Director reported on ethical issues raised through these groups to the Group Audit Review Board. From 2006, this report will be submitted to the Corporate Responsibility Committee.

Reports to the helpline from Saudi Arabia, Australia and other international locations outside the US are reviewed by the UK Ethics Review Committee.

“We expect all our employees to act with the highest standards of ethical behaviour and integrity. We should accept no compromise of our values in or out of the workplace.”

Dick Olver, Chairman

Embedding ethical behaviour

We have training and awareness programmes to ensure employees understand our policies and the standards expected of them.

Our booklet *Ethics and You* summarises our ethics policies and incorporates our five ethics principles. Copies are currently being distributed to all employees in Australia, the UK and South Africa. It will be available on our intranet and internet sites. We intend to issue a version in Arabic for our Saudi Arabian employees during 2006.

A similar booklet entitled *Code of Ethics and Standards of Conduct* is distributed to all US employees and contains additional information on regulations for US government contracts. In 2005 we revised and reissued the booklet completely after analysing similar publications from 15 other companies to establish best practice.

We provide training on our anti-bribery programme to managers from commercial, procurement, finance, customer support and other functions as well as to marketing staff and other senior managers. On completing the training, employees are required to sign a statement confirming that they will comply with our policies and will report any issues of concern. This training is mandatory for all senior employees and for those employees involved in dealings with marketing advisers.

In the US, all new employees must complete four online ethics training modules. All employees in the US are also required to view an ethics training video every year. Over 33,000 employees completed this annual training in 2005. Our video, *Ethical Leadership: Let's Talk*, features senior management discussing the significance of our ethics principles.

During 2006 we aim to develop, pilot and roll out a similar online ethics training package for our UK and Australian employees. This training will consist of an online module that all employees must complete.

All BAE Systems' marketing advisers are subject to rigorous due diligence under our compliance programme, are made aware of our anti-bribery policy and are expected to maintain our ethical standards.

Monitoring

We encourage employees to seek advice from an ethics officer, their line manager or the helpline if they have a concern or do not understand any aspect of our ethics policy.

Employees are required to report suspected cases of unethical conduct through their line manager, or confidentially through our independently-managed ethics helpline. The helpline number is listed in our ethics publications and on our internal websites. During 2005 we set up local toll-free helplines in most of the countries where we operate (23 in total). Our ethics helpline email address can be used by all employees worldwide: ethics.helpline@baesystems.com

In 2005, 31 enquiries were made to the UK helpline and to the worldwide email address from the UK, compared with 42 in 2004. These covered a variety of topics including HR practices and employee relations and conduct, conflicts of interest as well as requests for guidance on ethics policies and procedures.

In the US, there were 336 formal enquiries (including 196 requiring formal investigation) to ethics officers through the helpline, by mail, email and visits to the ethics office. These covered a variety of topics including conflicts of interest, misuse of Company assets, gifts and gratuities, intimidating or threatening conduct, hiring practices and overcharging for services given.

We observed no significant new trends in the type of enquiries received during 2005.

When we do find evidence of unethical conduct disciplinary action is taken. Disciplinary actions in the US and UK have ranged from formal reprimand to suspension without pay and termination of employment. During 2005 there were a number of dismissals due to employees breaching our UK Respect at Work policy.

Improving our ethics programmes

BAE Systems is committed to taking part in the debate on anti-corruption measures. In the UK, we participate in the Confederation of British Industry and ICC (UK) anti-bribery forums. In the US, BAE Systems is a signatory to the Defense Industry Initiative (DII) on Ethics and Business Conduct.

We report annually to the DII on compliance with its standards for ethical conduct and public accountability. BAE Systems is also a sponsoring partner in the Ethics Officer Association.

In 2005, BAE Systems in the US participated with other major US defence companies in the DII Ethics Environment Survey to assess the effectiveness of our ethics programmes. The survey was carried out by the Ethics Resource Center (ERC), an independent non-profit organisation. Over 25,000 employees from 14 companies (including 1,820 from BAE Systems) took part.

BAE Systems ranked among the top three companies in all seven categories that summarised the effectiveness of ethics programmes. Our scores for individual questions all exceeded the average of DII companies.

In 2005 we carried out an employee ethics awareness survey in the UK. More than 11,000 employees (around a third of UK employees) replied to the survey. The results showed that more than 80% of respondents would describe the Company as ethical and more than 98% would act if they suspected unethical behaviour.

However, the survey also highlighted that employees did not have enough information regarding the ethical standards expected of them, with less than 30% being familiar with the specific requirements of our ethics policies. Awareness of the ethics helpline was also shown to be poor, with less than a third of respondents having heard of it.

The results have led us to revise and re-issue our *Ethics and You* leaflet and distribute it to all UK-based employees. We have included articles on our helpline and ethics policy in BAE Systems' employee newsletters.

Our ethics intranet site has been more widely publicised and the content extended to include more information on expected behaviours. We have updated our Operational Framework to have a clearer focus on our ethical policies and the standards expected by the Company. We launched a new poster campaign featuring the five ethical principles early in 2006.

A close-up photograph of two men in a workshop setting. The man on the left is older, with grey hair and glasses, wearing a blue shirt. The man on the right is younger, with dark hair and glasses, wearing a dark jacket. They are both looking down at a small object, possibly a component or a tool, which the younger man is holding. The background is blurred, showing various colors and lights, suggesting an industrial or manufacturing environment.

employees

Our relationship with our people and their trade union representatives is key to business success. It is important that we treat our employees well and create a strong business so we can continue to provide employment in the future.

Here John Wall, General Secretary of the Confederation of Shipbuilding and Engineering Unions (CSEU) and Alison Wood, BAE Systems Group Strategic Development Director, give their thoughts on current and future workplace issues for our business. Our response to the issues they raise can be found on page 14*.

* This commentary does not imply approval or otherwise for the content of this report.

Stakeholder position

A Trade Union view: John Wall General Secretary, Confederation of Shipbuilding and Engineering Unions (CSEU)

“Stability and the long-term future of the business are the real issues for employees at BAE Systems. Over the next five years, the introduction of the Defence Industrial Strategy and the Company’s increasing growth in the US will both present significant challenges.

Redundancies can’t always be avoided. BAE Systems can reduce redundancies by being fully transparent in their approach and their Company strategy. If management work with unions, compulsory redundancies can often be avoided through retraining, relocation and voluntary redundancy. Chadderton is a good example. Here local management and unions worked together to reduce the workforce and relocate the business within a year without any compulsory redundancies.

Training is vital to equip employees with the skills they need to adapt to new roles. Both the Company and unions are responsible for this. Unions must encourage members to take part in training. They must also sit down with companies, see what is on offer for employees and look at how training schemes can be improved. BAE Systems is investing heavily in training and is committed to working with SEMTA, the sector skills council for science, engineering and manufacturing, but this programme is in its infancy. It needs to be developed and given more resources.

Good workers are not just those that are white, male, middle-aged – they can be any colour, any gender. We need the multicultural mix and must encourage ethnic minorities to come in. We must blow away completely the myth that manufacturing is a man’s job or that it is about making boys’ toys. Why can’t women get involved? BAE Systems is not yet doing enough in this area. They should make a specific effort to cast their net wider to find more young women and more ethnic minorities.

A Company pension is a vitally important part of any good compensation package from any good employer. We have been dealing with BAE Systems on current pension issues for over a year and have now recommended their latest offer to our members as the best which can be realistically achieved given the very difficult circumstances we find ourselves in. If these circumstances improve we will expect this to be reflected by management in future pension negotiations.

Partnership between companies and unions works best if the views and values of both sides are as visible as possible. The unions need to recognise that a successful Company is essential to create jobs and the Company needs to recognise that they can only be successful with the full support of the unions. We’ve made a lot of progress since 1990 but still have work to do.

I’ve been dealing with this Company since 1976. BAE Systems is hugely important to the economy and people of the UK. Unfortunately that’s not always recognised by the UK at large or UK governments of any political persuasion.”

A strategic view: Alison Wood Group Strategic Development Director, BAE Systems

“BAE Systems faces several challenges in the next decade relating to employment. The first is the long-term future of our UK business. As we recruit apprentices and young engineers we want to be able to show them that the defence industry offers a stable and rewarding career. This is an agenda we share with the UK Ministry of Defence (MOD). In the US, defence is a fast-growing business – we must ensure that we have the people and the talent to take advantage of this opportunity. As we strive to become a truly multinational company the third issue is finding the right people to expand our business overseas. Restructuring is also a challenge that will continue for at

least the next decade; it would be unfair to employees to suggest otherwise.

To meet these challenges we must adapt our capabilities to align with customer requirements. This means attracting a highly skilled workforce that can not only design and develop innovative products but also support them in service and sell them into the export market.

Training will give employees the new skill sets they need for these changing roles. We must motivate them to seek more training and take personal responsibility for developing their skills. To minimise redundancies we must also work with our supply chain and plan for fluctuations in demand. The new Defence Industrial Strategy will help us do this in the UK. Jobs will also be secured and created if we can increase our exports.

There are many other employment issues we need to manage as part of being a responsible employer, for example pensions and employee diversity. Performing well against a successful business strategy will give us the resources we need to meet our pension obligations. Achieving a diverse workforce is not easy given our history as an engineering and defence business, and will take time. National security places constraints on who can work for us which makes ethnic diversity more challenging.

Working with the trade unions is important for the Company. A testament to this is the role that the trade unions took in the development of the Defence Industrial Strategy. We need to continue sharing views on what skills and support the workforce needs. We could both do more on reaching out to the supply chain. By working together we can demonstrate that defence is a major contributor to the economy and national security, creating highly skilled and value-added jobs.”

Our response

The success of our business depends on the skills, innovation and contribution of all our employees. We aim to get the best from our employees by treating them with respect, creating a supportive work environment, and providing opportunities for training and development.

We employ over 100,000* employees across five continents. Most of our employees are based in the UK, the US, Saudi Arabia and Australia.

Our people policies are written into our Operational Framework and define our principles for managing employees across BAE Systems. We are continually working with trade unions and employee representatives to review employment practices.

Our people policies cover the following areas:

Diversity and inclusion

We are committed to equality of opportunity for all employees and to creating a workplace where everyone is treated with respect. Diversity supports our objective to maintain competitive advantage by attracting and retaining a disproportionate share of the world's most talented people. In 2004, our Executive Committee agreed five diversity and inclusion objectives for

2005 and key actions for achieving these. Our objectives were to:

- Demonstrate equality of opportunity and non-discrimination.
- Drive diversity through selection and development processes.
- Create a Company culture that helps us attract and retain the best people.
- Leverage maximum advantage from our geographical footprint.
- Integrate diversity and inclusion into existing business practices.

In 2005 we:

- Reviewed our recruitment processes to ensure there is no direct or indirect discrimination against any candidate.
- Established diversity training for line managers involved in recruitment.
- Set a target to increase the number of female apprentices by 1% each year. We met this target in 2005.
- Revised and rolled out our Respect at Work policy across our UK operations. A target relating to the implementation of Respect at Work was included in the 2005 personal objectives for our Chief Executive.
- Established plans for senior managers to raise the profile of diversity initiatives.

Diversity plans for 2006

Gender will be the key focus for our diversity and inclusion efforts during 2006. We have also set objectives for ethnic diversity and are looking for opportunities to partner with the UK Ministry of Defence (MoD) on

diversity issues. These objectives have been agreed with our Executive Committee.

During 2006 we will:

- Develop a communications plan to raise awareness of our gender diversity programmes and promote BAE Systems as a good place for women to work.
- Establish a senior women's network to mentor younger female employees.
- Identify a senior 'Gender Champion' on our Executive Committee.
- Increase involvement of ethnic graduates in university recruitment fairs.
- Continue to target inner city schools, which have a higher percentage of pupils from ethnic minorities, through our Education Liaison scheme.
- Continue networking and relationship building with the UK MoD diversity team.
- Identify partnering opportunities (e.g. inter-Company peer group mentoring of minorities).

We will provide updates on progress against these objectives on our website and in our next report.

See page 26 for gender and ethnic diversity data.

Training and development

BAE Systems invests in the training and development of employees at all levels of the Company. Training helps our people develop their skills and capabilities. It enables us to keep pace with changing technologies and continue to improve our customer service.

We have a range of global training programmes including e-learning courses, graduate training programmes, apprenticeships and professional and leadership development. 40,000 e-learning courses were taken in 2005 (equating to 17,000 hours of online training time), compared with 26,000 in 2004. Our Virtual University allows employees and their families to access 3,000 courses, many of which are developed and run in partnership with colleges and universities.

We employ over 1,000 apprentices in the UK, of whom 276 joined the Company in 2005. During the year, 148 graduates joined our graduate programme as full time employees and 44 students took part in industrial placements.

In 2005, we extended our Performance Centred Leadership (PCL) programme to 5,200 managers. PCL includes a Behavioural Performance Feedback (BPF) tool, through which managers receive feedback from peers, managers and team members. In 2005, 95% of those eligible took part in BPF.

BAE Systems is a partner in the marine and aerospace sector groups of the Science, Engineering, Manufacturing Technologies Alliance (SEMTEA), a UK Sector Skills Council. Initial research has identified several areas where these sectors would benefit from greater investment in skills training – these include leadership, productivity/business improvement and technical skills. We are advising SEMTEA on how to channel the Learning and Skills Council funding to bring maximum benefit.

Our Chairman's Awards recognise BAE Systems employees and industry partners for excellence and innovation. Over 3,000 nominations were received for 2005. Winners included a team from Air Systems which developed a low-cost system to transmit battlefield imagery at high speed and a team from our Customer Solutions & Support business which established an upgrade and maintenance facility to improve the availability of Harrier aircraft to the front line at significantly reduced cost. A team from BAE Systems' Electronics & Integrated Solutions also won a Gold Award for the development of new labour-saving technology for the production of printed circuit boards and for making sure that it was shared across the Company.

Industrial relations

Good industrial relationships with employees and their trade unions are strategically important, helping us to remain productive, motivated and competitive. We consult and partner with trade unions to develop our employment policies and to compete for new contracts.

In the UK, the Chief Executive meets with senior union representatives twice a year. We also hold quarterly Corporate Consultative Committee meetings for union representatives to meet with senior managers. In 2005, topics discussed at these meetings included pensions, job loss mitigation, diversity, health, safety and environment, lobbying and government relations, apprentice training and education partnerships.

Pensions

In common with many other Companies, we are addressing significant shortfalls in our UK pension funds due to lower than expected returns on investment and increased life expectancy. We have announced funding shortfalls in our UK pension schemes which will require changes to future service benefits and in some cases contribution increases. We continue to consult or negotiate, where appropriate, with our trade unions, pension representatives and employees to achieve mutually acceptable solutions to the funding shortfalls, with the objective of retaining affordable and sustainable pension schemes for our employees.

Redundancies

We continue to grow and restructure our business. During 2005 we recruited 8,789 new employees worldwide. Restructuring also led to 1,992 job losses. We work with trade unions in the UK to minimise involuntary job losses. In 2005, 66% of employees who lost their jobs left the Company or changed jobs voluntarily through voluntary redundancy, retraining, re-deployment elsewhere at BAE Systems or early retirement. Redundancy programmes announced late in the year account for a further 21% of potential job losses and work is ongoing to minimise the amount of job losses that have to be achieved through involuntary means.

Health and safety

Our employees and contractors are exposed to a range of safety risks. At our manufacturing sites these include risks from manual handling, working at height, noise, hand-arm vibration syndrome (HAVS) and respiratory and skin irritation. Employees in office-based jobs are exposed to different types of risks including potential ergonomic issues associated with working with computers.

The health and safety of our employees and the communities around our facilities is very important. During 2005, a tragic incident at our Chorley site in the UK resulted in the death of one of our employees. No fatality or injury is acceptable to us. We are rigorously investigating this event internally and working with the authorities to understand and address the causes of this accident.

In April 2005, Mike Turner, our Chief Executive, met with the Director General of the UK Health & Safety Executive (HSE),

Timothy Walker, to reaffirm the commitment of both organisations to working in partnership to improve our safety performance. A copy of the joint statement can be found on page 31.

In 2005 we reduced the overall number of incidents resulting in injuries as well as the number of people that are exposed to environmental risk or occupational health hazards.

We have a health and safety team and management system within each business to identify, manage and control risks, and to ensure that employees understand health and safety risks and how to reduce them. Targets are set for each business unit to monitor and reduce the number of accidents, injuries and work-related diseases. Additional safety processes, risk assessments and emergency plans are in place for our sites in the UK and the US that handle explosives.

In 2005, the senior director for each of our Business Units and operating groups agreed a consistent approach to setting and reporting health and safety targets. This will enable us to report our health and safety performance in greater detail in future years. Health and safety improvement targets are now included in the performance objectives for our Chief Executive and other members of the Executive Committee.

In the UK we established a Trade Union Communication and Information Forum to strengthen our relationship with trade union health and safety representatives. In 2005, the Environment, Safety & Health Council for our North American operations was formally given a higher profile at the most senior level. We also recognise that the line managers play a key role in ensuring that high safety standards are maintained in our sites. Accordingly, in the UK our Manufacturing Council has accepted responsibility for improving health and safety through operational and line management across the business.

See page 28 for details of our Health and Safety performance in 2005.

A stack of colorful papers and folders is visible on the right side of the page, set against a dark blue background. The papers are in various colors including yellow, green, orange, and red. The stack is slightly out of focus, creating a sense of depth.

lobbying

Lobbying of governments and political influence are subjects on which we – along with all industries – are receiving increasing attention. We invited Robert Barrington of F&C Asset Management, a recognised expert in this area, to provide an outline of stakeholder expectations on disclosure and approach to such issues. Our response and a description of our activities can be found on page 18*.

** This commentary does not imply approval or otherwise for the content of this report.*

Stakeholder position

Robert Barrington
Director of Governance
& Socially Responsible
Investment
F&C Asset
Management plc

“In recent months, a spotlight has shone in both Washington and London on the issue of political influence exercised by companies. It is a subject that presents particular difficulties for defence companies. They have a relationship with government unlike any other sector, since most of their clients are governments: diplomacy and confidentiality have been part of their DNA – as has the special skill of cultivating government contacts when aiming to win contracts or gain support for export sales.

As a shareholder, F&C believes that it is entirely legitimate for companies to participate in the political process. More than that, we regard it as necessary, as so much regulation and legislation affects companies that their voices need to be heard alongside others when issues are debated within government. Likewise, when a government is your client, you need to engage it in a sales and marketing process.

However, it is also the case that legitimate influence can relatively easily veer from wholesome to dubious, when proper controls are not exercised. This starts to damage shareholder value. Allegations of misconduct, bribery or corruption are a distraction for management, can bring a halt to M&A activity, depress share prices and displease clients. Proven instances can generate fines, de-bar a company from bidding for contracts in the US, the world’s largest equipment defence buyer, and taint the company’s reputation when bidding elsewhere – not to mention land key staff in prison.

Transparency about political lobbying and donations are one of the safeguards against this. F&C’s concern has grown to the extent that it has recently published guidelines outlining the standards it expects of companies in which it invests. For the defence sector, as with other sectors involving government dealings, there is

an additional problem in trying to move beyond the opaque dealings of the past. If any individual company wishes to operate to higher standards, it may find these are commercially disadvantageous – which is unlikely to command the support of shareholders. Clearly, an industry-wide initiative is necessary to create higher standards and more transparency across the sector. That is why I welcome BAE Systems’ participation in discussion of an International Defence Industry Anti-Corruption Initiative, which is a good example of how companies can engage pro-actively to address such issues.

However, even within BAE Systems, there are occasional throwbacks to a less cooperative and transparent age. The debate on revising the Export Credit Guarantee Department’s (ECGD) anti-corruption provisions was an example of where BAE Systems has encountered problems. Although confident it had formed a sensible and pragmatic stance, the Company appeared to many others to be lobbying strongly against provisions that anti-corruption experts were citing as reasonable, and at the same time did not engage pro-actively with other parties in the debate to explain its position. This stimulated opponents, shortly followed by the press, to be highly critical of the Company’s approach to anti-corruption initiatives.

What would we like to see as a shareholder? First of all, I should note that BAE Systems has made good progress in transparency and corporate responsibility over the past three years. I particularly welcome the creation of a board-level Corporate Responsibility committee. But the company does need to tackle head on its residual reputation as being a laggard in corporate transparency, an opponent of NGOs and an abrasive partner in discussions about its business practices. Becoming a leader in transparency over political influence would be a good first step: including full disclosure of political donations made worldwide and publishing details of trade association memberships and lobbying positions – such as the submissions to the ECGD. Becoming a champion for stronger anti-bribery positions in international defence procurement would be another. As shareholders, we fully respect commercial confidentiality: but we also live in a transparent and information-rich age, which requires companies to be accountable. We look forward to accompanying BAE Systems on this journey.”

Our response

The defence industry has national governments as its customers. It is, therefore inevitable that we will have significant contact with different facets of, in particular, the UK and the US governments – our principal customers. It is imperative that we operate ethically and with integrity in all our business dealings, both for the sake of our own reputation and that of our customers.

We must also rigidly observe requirements of confidentiality and national security which means we are not always able to be as open on issues as our stakeholders would like.

We do, however, recognise the validity of Robert Barrington's comments on the issue of transparency and are working towards improvements both on our own behalf and across our industry.

Our policies on ethical business conduct and the management and monitoring systems for ensuring compliance are outlined on page 10.

Specific policies and practices related to issues of lobbying and political influence are outlined below.

Political activity

It is our policy to comply with all laws governing political activity of the Company and its employees. Employees are not allowed to engage in lobbying activities on behalf of the Company unless they have complied with all requirements of law, regulation and internal policy regarding such activities. All lobbying activity is regulated and co-ordinated through our Government Relations departments.

A primary objective of our government relations activities is to ensure that politicians, various parliamentary groups and government organisations are equipped with the necessary facts about our business and our industry to make knowledgeable decisions. We consider it a key responsibility both for our Company and our employees as well as the wider defence sector to provide this information and respond promptly and comprehensively to queries from decision makers.

Action in support of projects/capability in the UK

BAE Systems plays an important role both in the delivery and on-going support of military capability for the UK Armed Forces. We are also a key manufacturer and major employer in the UK, and therefore have a significant impact in our local communities both through the supply chain and our support of local activities. It is part of our responsibility to represent the case for sustaining and modernising key defence industrial capabilities, both to ensure

the UK retains the capability to make and support those products which deliver the basis of national security and in recognition of the impact our facilities have on the economy and local communities.

To ensure we act in a responsible and coordinated manner, we have a joint lobbying model with our Trade Union members in the UK, who obviously have particular focus on sustaining skills and jobs. This model contains the following typical activities:

- Company briefings to trade union representatives on key issues;
- Agreement on campaign strategy and tactics;
- Contact with unions from supplier companies;
- Production of trade union lobby booklet;
- Letters to MPs;
- Site visits for MPs and Ministers; and
- Lobby of Parliament.

Working for effective regulation

All aspects of our operations are subject to local, national and sometimes international regulation. We respect and obey the law in all countries in which we operate. During the development of new legislation we will aim to work with the relevant groups to ensure that they have the information they require of our industry and activities to make informed decisions. We also participate actively in a number of trade associations to ensure the wider industry view is presented on key issues.

One of many examples of this is our involvement with the Society of British Aerospace Companies (SBAC) on agreeing carbon emission limits for the aerospace sector. Another example is the partnership we have with the UK Health and Safety Executive (HSE) along with our trade union safety representatives to develop and deliver high standards of safety practice. This partnership helps the HSE better understand our operations and facilitates the sharing of expertise while still respecting the role of the HSE as the regulatory authority.

We acknowledge Robert Barrington's view that we could have better communicated our stance on the debate with ECGD and are constantly seeking to improve our communication to our stakeholders or to at least explain the process we are undertaking.

Political influence and affiliation

Our Operational Framework states:

“We do not make donations on behalf of the Company to political parties or their representatives. We respect the right of individual employees to make personal contributions”.

In the US our eligible employees are allowed to participate in the BAE Systems USA Inc Political Action Committee (PAC). PACs exist legally as a means for employees of corporations to make donations to candidates for Federal office – something that corporations cannot do directly. PACs work by raising money from eligible people employed by a corporation or in a trade union. The PAC is governed by and complies with US laws under the auspices of the Federal Election Commission.

We participate openly with trade associations.

Integrity in business dealings

Our anti-corruption awareness and compliance programme is entitled ‘Integrity in Business Dealings’.

It incorporates our two main anti-corruption policies, namely:

- giving and receiving hospitality, gifts and managing personal interests;
- how we handle the appointment of advisers to assist in marketing and other business activities.

We want to make sure that all employees know:

- that the Company rejects totally, and prohibits, bribery and other improper conduct in its business;
- what the Company expects of its employees in complying with the law and Company policy; and
- how to obtain help and advice about, and report, instances of possible corruption.

Our basic rule is:

We do not, and will not, offer, give or receive bribes or inducements of any sort.

Charitable donations

We have an important role to play in the communities in which we operate and trade and as part of this support the work of charities and other good causes. This support should not be motivated by the need to achieve any direct return other than general recognition of the contribution that the Company makes as a good ‘corporate citizen’.

Two internal committees exist to govern all donations. The Subscriptions and Donations Committee chaired by our Chief Operating Officer meets four times a year and oversees the Company’s charitable donations in accordance with the Company’s Operational Framework.

The Committee also oversees the sponsorship priorities for the Company which are recommended to the Committee by a sub-committee, the Sponsorship Committee, chaired by the Group Communications Director. The Sponsorship Committee is also responsible for the corporate sponsorship budget, which is held by Group Communications.

We monitor where donations are made using the London Benchmarking Group (LBG) model (see page 24).





education

We support the teaching of science and technology in schools, colleges and universities worldwide. This encourages young people to take an interest in these important subjects and helps us ensure a supply of talent in the future. We asked Jamie Zona and Tyler Forbes who are directly involved in FIRST, a US education initiative we support, for their views on its benefits* .

* Their commentary does not imply an endorsement of this report which they have not reviewed.

Stakeholder position

Jamie Zona, Senior Principal Mechanical Engineer, BAE Systems

FIRST (For Inspiration and Recognition of Science and Technology) is an international engineering competition where high school students design a remote-control robot. BAE Systems contributes funding to FIRST and our employees volunteer to mentor student teams.

“I have been a mentor on the Merrimack High School FIRST Robotics Team for three years. I assist the students with the mechanical design of the robot and help them build design models that are turned into drawings. The BAE Systems prototype shop builds the robot. I work alongside a team of dedicated parents and engineers to offer support and advice and to coordinate activities, but this really is the student’s project. They design the robot, they build some of it, they assemble it and when it breaks, they fix it.

I have learned a great deal from this programme – and not just about robotics. I have learned about teamwork, scheduling and project coordination. I have also come to understand a lot about high school students – what motivates them and how they interact.

Most who sign up for the project already have a propensity towards science, math and technology, although some join to be with their friends on the programme. Either way, FIRST gets them even more interested in these subjects. The process of building the robot and talking to other teams gives the students an incredible knowledge base and boosts their confidence.

They also learn the benefit of being part of the community. My team hosts summer science and robotics camps for elementary and middle school students, as well as doing many other activities in the community.

The FIRST programme is great for BAE Systems too. We are able to interact with some of the brightest and most motivated high school students, many of whom we offer internships. It is highly likely that these students will get technical degrees and have an immediate interest in BAE Systems as the employer of choice – several former FIRST students are now working as engineers at the Company. BAE Systems also benefits by being recognised for its involvement with the local community. What we need to do now is expand our funding of the FIRST project to include more schools.”

Tyler Forbes, US FIRST mentor and former FIRST participant

“I discovered the FIRST competition as a middle school student on a trip to a local high school. I was interested straight away and joined the team at the first opportunity.

Over the last six years I have worked in almost every area of a FIRST team. When I joined I just tried to absorb as much information as possible; through my high school years I became a team co-leader and then a student head of robot design. I am now at university and have started mentoring local high school teams.

I have always been good at science and math but you don’t have to have these skills to take part. FIRST Robotics teams are so varied that all you really need is a little determination and the will to learn. Students all bring different experiences and skills to the programme, they teach each other and solve problems together. FIRST can be beneficial to just about any student. It doesn’t just teach engineering skills, you get management and business experience too.

The FIRST programme has strengthened my interest in science in technology and has focused my career path towards mechanical and manufacturing engineering. The leadership, technical and creative skills that I have learned as a FIRST student and mentor will help me become a successful engineer. Real-world job skills only come with experience, they cannot be taught in a classroom – that is why project experience is so valuable.

By supporting programmes like US FIRST, BAE Systems is nurturing the engineers of the future. The more BAE Systems invests in these young people the more they will be worth to the Company in the future as successful, productive engineers. Through internships and educational programmes, BAE Systems later attracts many US FIRST students back as employees. I fully intend to aim for a career at BAE Systems considering what they have invested in me.”

Our response

The number of students enrolled in engineering and technology courses has fallen considerably in recent years. This means that there will be fewer future candidates for technical positions and this could affect our competitiveness and the future capability of the engineering industry.

To help address this we run a worldwide education programme aimed at encouraging young people throughout their academic careers to take an interest in science and technology. We support education in Australia, Saudi Arabia, the UK and the US.

FIRST is just one example. We partner with many schools, colleges and universities to equip young people with the skills they need for an engineering career.

In 2005, we invested £7 million directly in our global support for education and young people. We invested an additional £28.5 million in the UK through our indirect support for education in the form of apprenticeships, work placements and university research.

UK Schools programme

Over 350 employees (called ambassadors) from BAE Systems visit schools in the UK to help with engineering projects and to give careers advice.

Our UK Education Programme primarily targets 10 to 13-year-olds. In 2005, we launched the Schools Roadshow that includes a theatre performance. This is designed to interest the pupils in science and maths and get them thinking about a career in engineering, before they make subject choices at 14.

The Roadshow was launched by Dick Olver, our Chairman, and Dr Kim Howells, the UK education minister. The show visited 134 schools near our major sites, involving over 17,000 young people. The team from BAE Systems was accompanied by three actors who performed a specially designed play about building a vehicle that can fly, float and work on land.

After the performance the actors divided the students into groups for a workshop. The students were challenged to build the highest structure they could, using only newspapers and sticky tape. The structure had to support the weight of an iPod. BAE Systems employees were on hand to help the young people brainstorm ideas and give personal insights on how engineers approach such tasks.

The schools were challenged to devise an environmentally-friendly vehicle for the year 2050. The aim was for the students to develop an engineering design proposal whilst having fun. Our employees returned to the schools twice: half way through the project to check on progress and to help develop ideas; and once more near completion to comment on the work. Every school that submitted a completed project received a certificate from BAE Systems. The best designs are showcased on www.baesystems.com/education. The website also contains resources for teachers and pupils.

The programme has had a big impact. All the children were asked to complete a questionnaire about the experience and over 70% of boys and 40% of girls said they would now consider a career in engineering.

After the completion of the Roadshow we offered work experience to 14 to 16-year-olds to try and maintain their interest. In 2005, 495 young people completed one-day or one-/two-week placements with the Company. BAE Systems won the 2005 Edge Employer Award for its education activity. This award recognises employers in the UK that are dedicated to helping young people learn in the workplace. We are using the prize money to create a new virtual work experience area on our education website for those pupils who were unable to attend our work experience placements.

Higher education strategic partnerships

In the UK, we have strategic partnerships with 20 colleges and universities to build engineering research capabilities and improve graduate recruitment. In 2005, BAE Systems became the first corporate sponsor of the new National Science Learning Centre at York University. This is the first dedicated centre of excellence for the teaching of science to all age groups in the UK.

We also fund the Systems Engineering Innovation Centre (SEIC) at Loughborough University. The SEIC is a state-of-the-art centre for excellence in all areas of research and technology development, teaching and training.

“Before I thought engineering was just about cars, but now I know engineering is about lots of different things. Engineering is very important in our working lives.”

Pupil, St George's School for Girls, Edinburgh



Apprenticeships

BAE Systems is the largest employer of engineering apprentices in the UK, with more than 1,000 apprentices in training. Apprenticeships give young people the opportunity to gain qualifications through on-the-job training. This benefits us by ensuring a strong skills set in the future. In 2005, Vic Emery, Managing Director, Naval Ships presented the business benefits of apprenticeships to EU education policy makers at a conference organised during the UK EU Presidency.

Apprentices train in a wide range of skills, from engineering, steelwork and joinery to business administration and information technology. Overall the programme has an 87% completion and retention rate. This is high compared with other apprenticeship programmes where the rates are as low as 24%. Our Chief Executive, Mike Turner, was part of the Apprenticeship Task Force which advised the Government on how to expand and improve apprenticeships in the UK. In 2005, we received the Employer of the Year Award at the Apprenticeship Awards 2005.

The Company also made formal responses to the Leitch Review of Skills and the Foster Review of Further Education. These reviews were commissioned by the Government to improve the skills base in the UK.



US

We sponsor a number of programmes to support science and technology across the US. Our scholarships to colleges and universities have enabled hundreds of students to take courses in technical fields. For example in 2005:

- We helped the Rensselaer Polytechnic Institute in Troy, New York to develop an advanced version of the curriculum for the Laboratory Introduction to Embedded Controls (LITEC) course. A team made up of juniors, seniors, graduate teaching assistants and faculty advisers is developing lab exercises for the course. Currently the team is integrating hardware and software systems to pilot blimps autonomously. When it is fully developed, 250-300 students will take this course each semester.
- We sponsored engineering students at Purdue University, Indiana. BAE Systems supported a team studying the effects of spatial disorientation in zero-g environments as part of the NASA Reduced Gravity Student Flight Opportunities Programme. The team's research paper was accepted by the World Haptics Conference in Pisa, Italy. Haptics is the science of applying touch sensation and control to interaction with computer applications. Haptics technology is used to train people for tasks requiring hand-eye coordination.
- We partnered with the San Diego Science Alliance, a not-for-profit consortium of leaders from business, education, and scientific institutions. The Alliance aims to improve science literacy in primary and secondary education in San Diego County. The organisation provides educational resources and supports and runs educational programmes for students and teachers. These include a robotics programme called Bott Ball and the Expand Your Horizons science programme aimed at girls. The Alliance also organises High Tech Fairs which give students the chance to meet people from business and to see how their school work might be used in the future.

Australia

In Australia BAE Systems supports a wide range of school and university programmes. The company works with these institutions, offering sponsorship and mentoring programmes, to inspire young people to get involved in engineering.

These projects include:

- Sponsorship of South Australia's Engineering Week.
- Sponsorship of Super Science Sunday – a community open day, supported by local and federal government that celebrates science and technology.
- The Doxa Youth Foundation – a mentoring programme which enables talented young people from disadvantaged backgrounds to go to university.
- The Young Achievement Australia Business Skills Program through which BAE Systems employees act as mentors in business skills to students.
- Endeavour 2005 at the University of Melbourne – sponsorship of a public exhibition, showcasing final year student projects across engineering disciplines, with an awards ceremony. The Endeavour Excellence Awards brought representatives from industry and government together with academics and students to celebrate the achievements in technology, research and innovation of the student's projects.

Saudi Arabia

In Saudi Arabia BAE Systems supports the Chevening Scholarships, run by the British Council to give young people the opportunity to study in the UK and return with skills that will contribute to the development of their home country. We also sponsor the British Council's post-doctoral research programme which gives Saudi academics grants to conduct research in British universities.

We are partnering with the Government of the Kingdom of Saudi Arabia to develop standard qualifications and training curriculum for technical trades and vocational qualifications. This four-year programme is funded by BAE Systems, and a full-time, seconded BAE Systems specialist helps to run the programme. Apart from the provision of funding and specialist help, we also provide information about national vocational programmes in other countries.

Community

We support communities and charities in the countries where we operate.

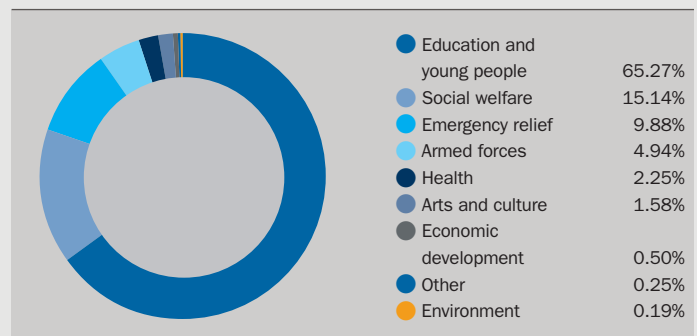
Data file

This section includes performance data for community investment, diversity, environment and health and safety as well as key documents referenced throughout this report.

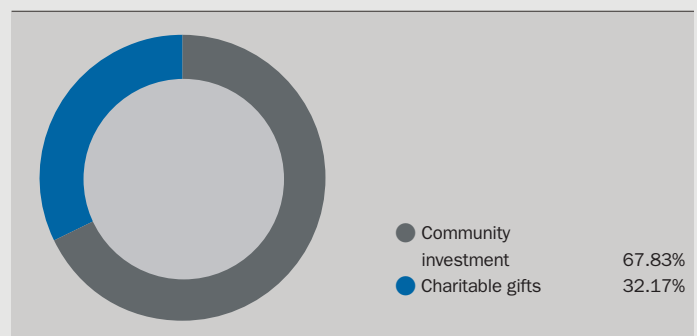
In 2005, our total global community investment was £10,525,731. This figure includes cash and in-kind donations to charity as well as our direct support for education. We are committed to the professional measurement of our contributions. In 2005 we became a member of the London Benchmarking Group (LBG) and use their agreed methodology to evaluate our annual community contribution across our global operations.

Our performance against the key LBG indicators can be found below:

What we contribute to



Focus of contribution



<http://www.lbg-online.net>

Ethics

We have summarised our five principles of ethical business conduct and policies and practice relating to how we do business into a single statement.

Statement of ethical business conduct

Ethical business conduct is fundamental to the success and reputation of our Company and we accept no compromise of our principles and policies.

Our five principles of ethical business conduct are:

Accountability – we are personally answerable for our conduct and actions.

Honesty – there is no substitute for the truth.

Integrity – we say what we do, we do what we say.

Openness – when questions are asked, we are frank and straightforward in our answers.

Respect – we value each individual and treat them with dignity and thoughtfulness.

These principles apply to everything we do.

Compliance with laws & regulations

We conduct ourselves in accordance with applicable laws and regulations of the countries within which we do business. Ignorance of the law and regulations is no excuse.

Political influence & affiliation

We do not make donations on behalf of the Company to political parties or their representatives. We respect the right of individual employees to make personal contributions.

Anti bribery & corruption

Bribery is a criminal offence. We do not, and will not, pay bribes or offer improper inducements to anyone for any purpose, nor do we or will we accept bribes or improper inducements. To use a third party as a conduit to channel bribes to others is a criminal offence. We do not, and will not, engage indirectly in or otherwise encourage bribery.

Workplace environment

We ensure an environment of respect and trust wherein each employee is valued as an individual.

We achieve high performance standards for safety, health and environmental management throughout our organisation.

Each employee has a responsibility to uphold BAE Systems, policies and identify areas of perceived wrongdoing.

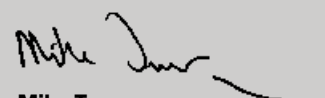
Security of information

We respect and preserve the confidentiality of personal data and proprietary information held by the Company.

We are committed to protecting Government controlled information and complying with national security requirements.

Any action which is unlawful, dishonest, and harmful to others or which is otherwise against our policies is unacceptable.

We will take disciplinary action against anyone whose behaviour does not meet our standards.



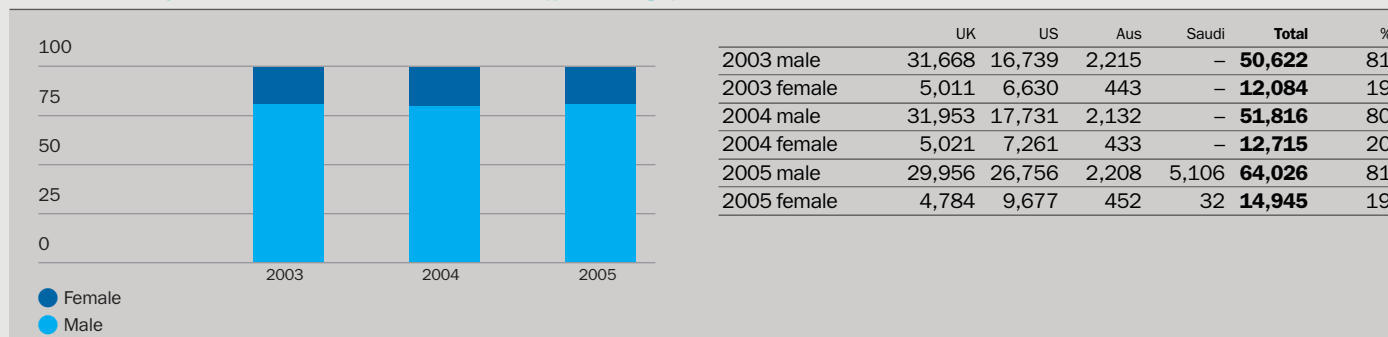
Mike Turner
Chief Executive

February 2006

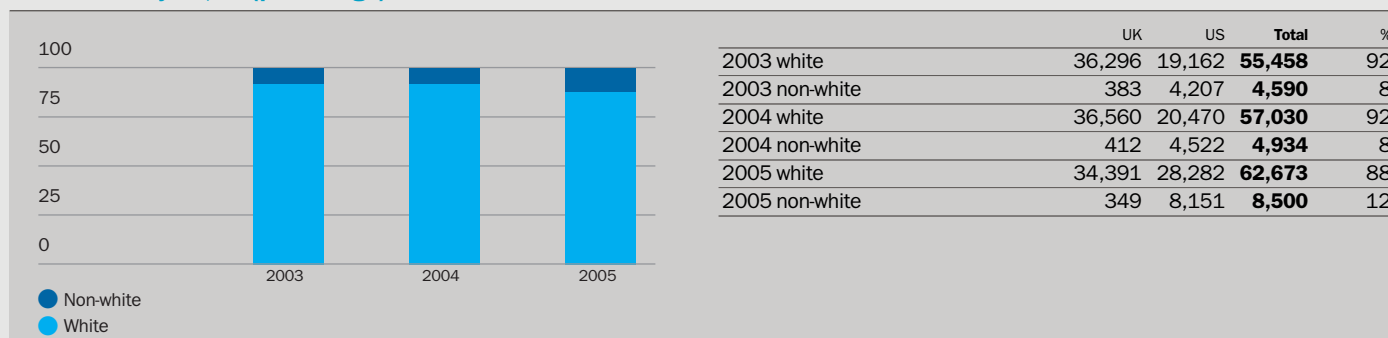
Diversity

A diverse mixture of cultures, backgrounds and views helps drive innovation and performance. We now collect data for gender, ethnicity and age diversity in the UK, the US, Australia and Saudi Arabia.

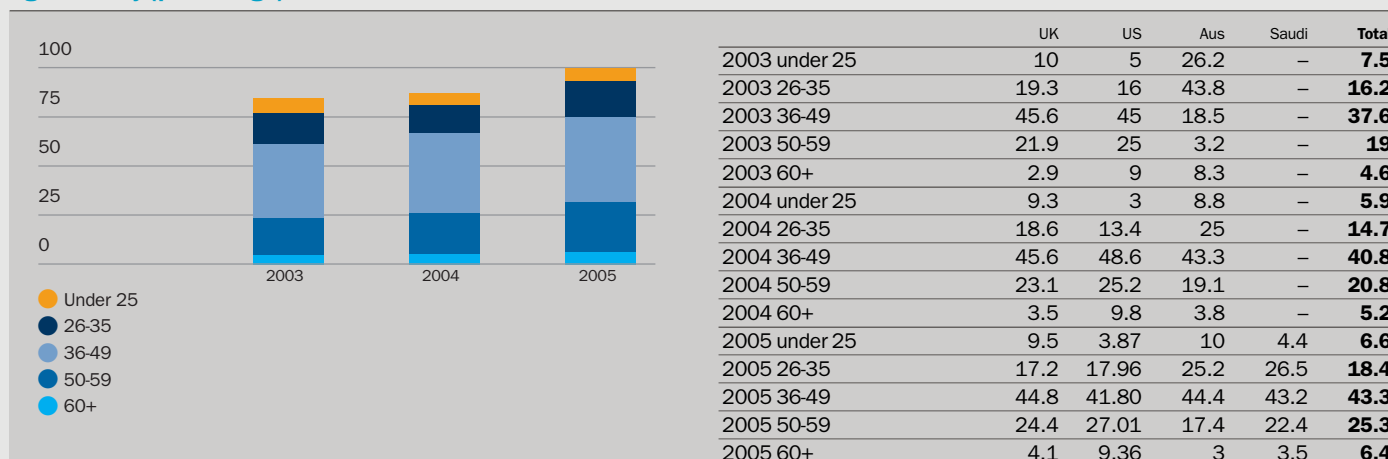
Gender diversity UK, US, Australia and Saudi Arabia (percentage)



Ethnic diversity UK, US (percentage)



Age diversity (percentage)



Comments on the 2005 data

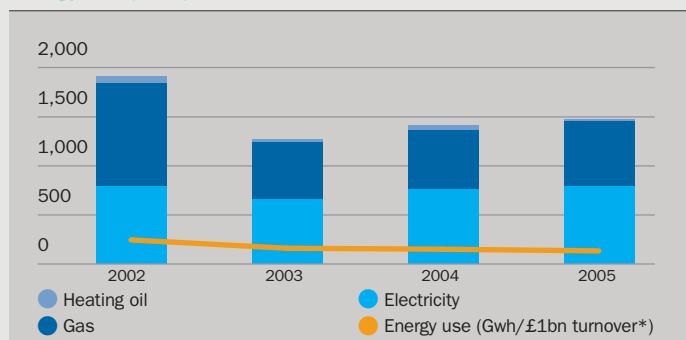
- In 2005 we started to collect gender and age diversity data in Saudi Arabia. 2003 and 2004 figures do not include data for Saudi Arabia.

- An increased focus on diversity, the broadening of the business into the IT sector and the acquisition of United Defense Industries in June 2005 all contributed to the increase in ethnic diversity in our US business during 2005.

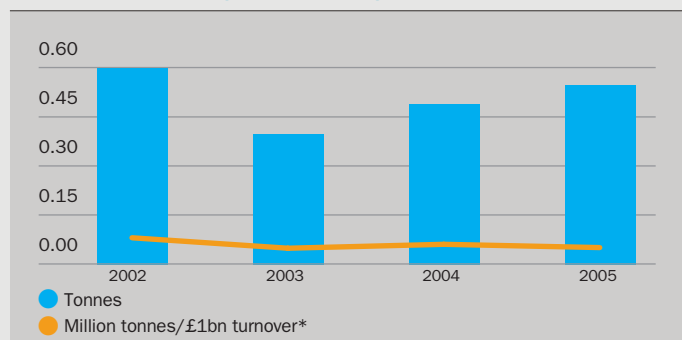
Environment

Our main environmental impacts are emissions of volatile organic compounds (VOCs) from painting and cleaning, production of waste, greenhouse gas emissions and water consumption.

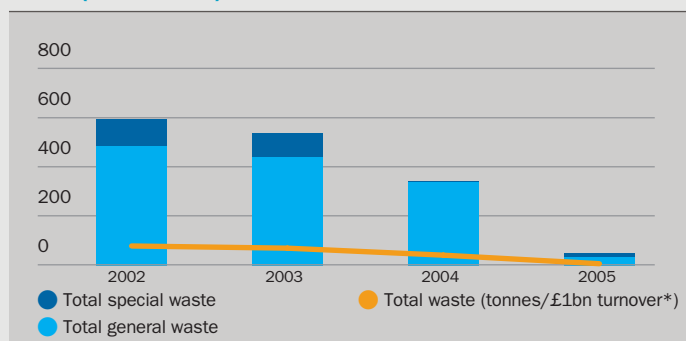
Energy use (Gwh)



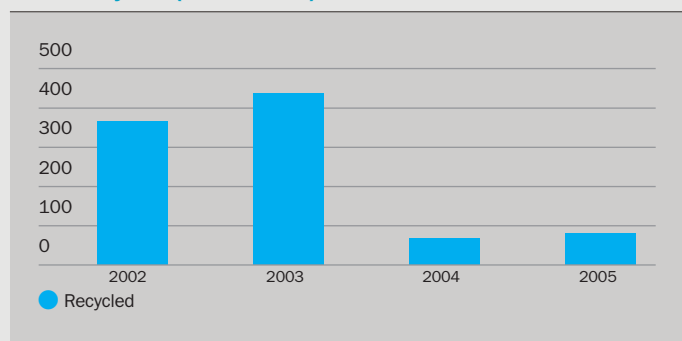
Total CO₂ emissions (million tonnes)



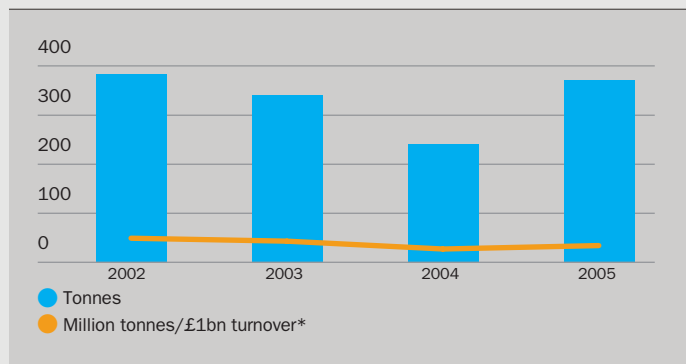
Waste ('000 tonnes)



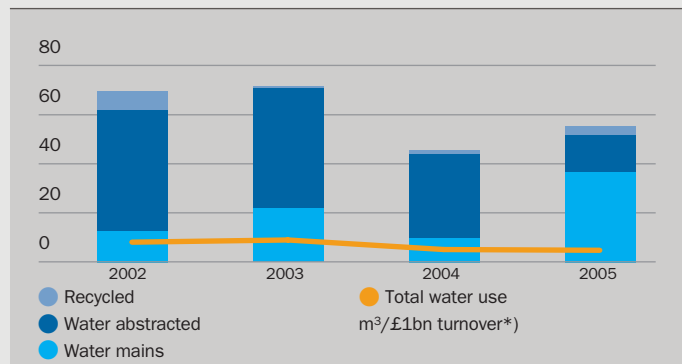
Waste recycled ('000 tonnes)



Volatile organic compound emissions to air (tonnes)



Water use (million m³)



Comments on the 2005 data

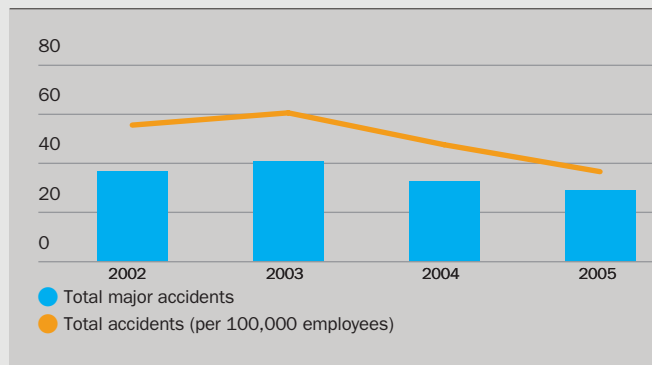
*Data for all years has been normalised using turnover figures excluding joint venture operations. Previous reports have reported inclusive of joint venture turnover. Data from previous years has been restated in this format to allow for comparison.

- The increases in energy and water consumption are due to the growth in business and extra sites resulting from the acquisition of United Defense Industries in June 2005. These figures normalised against turnover show that we are continuing to reduce our relative environmental impact in these areas.
- The increase in emissions of volatile organic compounds is due to ship finishing and painting of the Type 45 vessels at our Scottish shipyards. The emissions of VOCs are linked to this stage of our programme build and are not a continuous emission.
- The reductions in quantities of waste generated and recycled are primarily due to the completion of the redevelopment of land at Chorley, UK.

Health and Safety

We are committed to the highest standards of health and safety at work. We use a number of indicators to monitor our progress in creating a safe work environment.

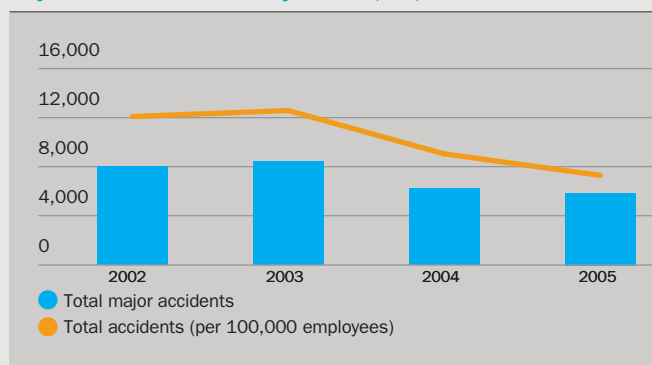
Major accidents*



	2002	2003	2004	2005
UK major accidents	31	24	24	15
UK rate per 100,000 employees	70	68	65	39
US major accidents	6	9	4	13
US rate per 100,000 employees	34	38	17	39
Aus. major accidents	0	0	2	0
Aus. rate per 100,000 employees	0	0	53	0
Saudi major accidents	-	8	3	1
Saudi rate per 100,000 employees	-	163	65	22
Total major accidents	37	41	33	29
Total rate per 100,000 employees	56	61	48	37

UK manufacturing industry average 2004-05 – 192.3 Per 100,000 employees

Days lost to work related injuries UK, US, Saudi Arabia and Australia



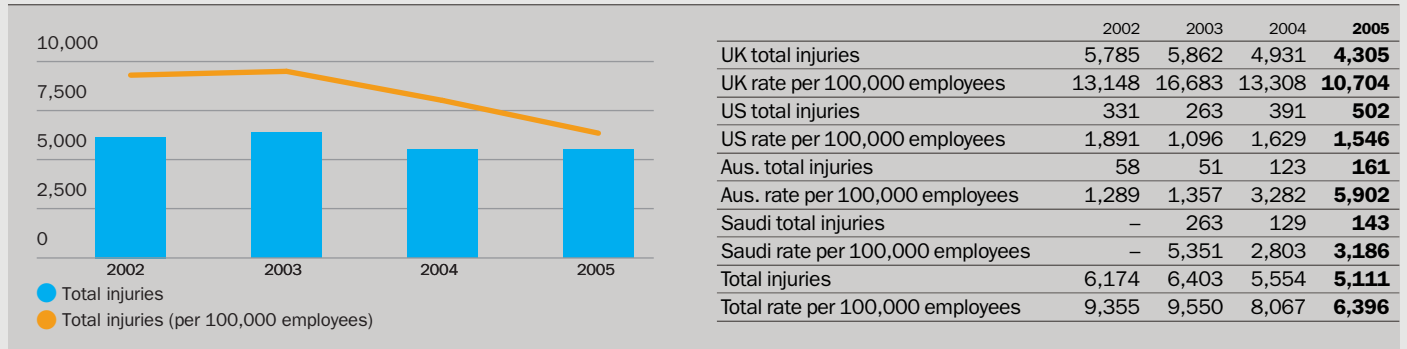
	2002	2003	2004	2005
UK days lost work-related injuries	6,652	6,870	4,529	3,532
UK rate per 100,000 employees	15,118	19,553	12,223	8,782
US days lost work-related injuries	1,328	1,603	1,130	1,914
US rate per 100,000 employees	7,589	6,679	4,708	5,893
Aus. days lost work-related injuries	50	14	716	176
Aus. rate per 100,000 employees	1,111	467	19,103	6,452
Saudi days lost work-related injuries	-	-	115	267
Saudi rate per 100,000 employees	-	-	2,499	5,948
Total days lost work-related injuries	8,030	8,487	6,283	5,889
Total rate per 100,000 employees	12,167	12,658	9,126	7,369

UK manufacturing industry average 2003-04 – 37,000 Per 100,000 employees

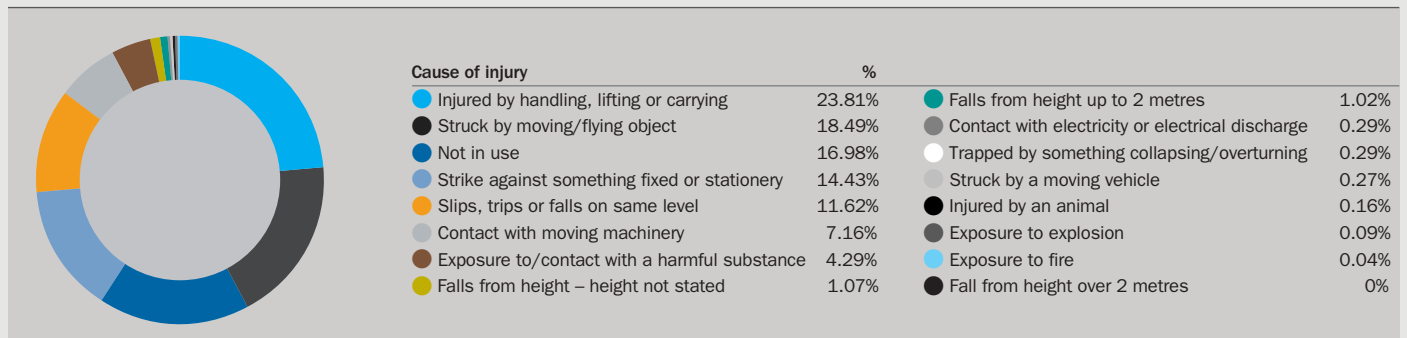
Comments on the 2005 data

- * As defined under the UK Reporting of Injuries, Diseases and Dangerous Occurrences Regulations (RIDDOR).
- Minor adjustments to previously stated 2004 figures reflect improved clarification and reporting definitions and do not alter overall trends.
- Overall the number of major accidents has decreased but we have seen an increase in the US numbers as a result of the higher risk profile of the business following the acquisition of United Defense Industries (UDI) in June 2005. The UDI sites account for more than 50% of the reported major accidents in the US.
- Days lost to work-related injuries indicates both the number of accidents, the severity of accidents and the time taken to rehabilitate an injured person. This has been a key focus at our marine sites during 2005 with significant improvements driving the overall figures down. The increase in the US numbers is as a result of the higher risk profile of the US business following the acquisition of UDI.
- The apparent increase in accidents in Saudi Arabia and Australia reflects increased accuracy of recording and reporting. A number of programmes are in place to ensure safety management in both these areas is as robust as across our other operations.

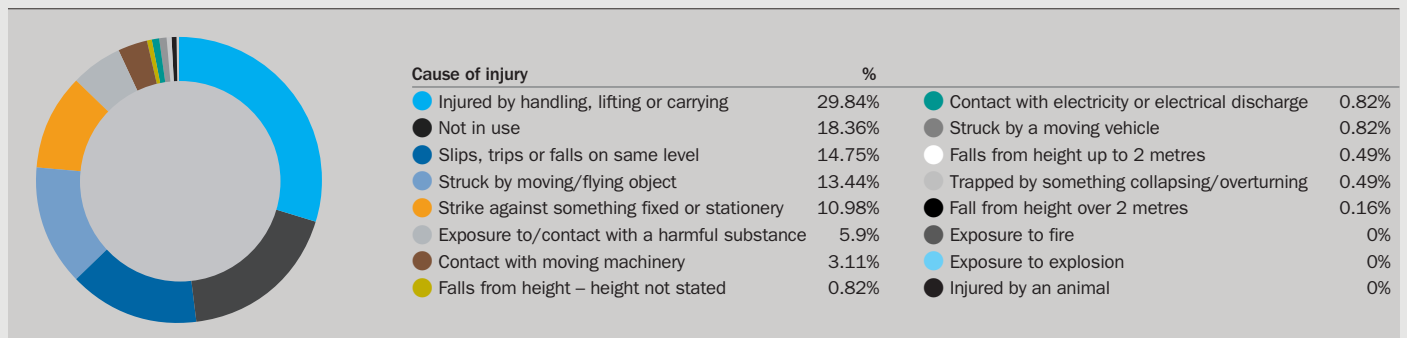
Total injuries to all employees (BAE and non-BAE)



Causation of total injuries to BAE Systems employees 2005



Causation of total injuries to Non BAE Systems employees 2005*



Comments on the 2005 data

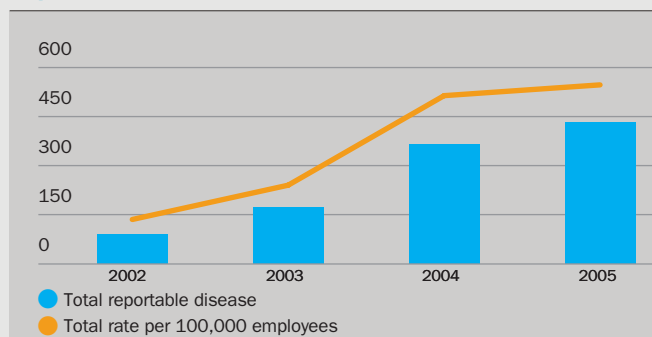
* contractors and temporary employees working at our sites

- Minor adjustments to previously stated 2004 figures reflect improved clarification and reporting definitions and do not alter overall trends.

- The total number of injuries continues to decrease. Our manufacturing sites in the UK are the highest risk sites due to the heavy manufacturing operations carried out. We review the causes of accidents, both at corporate and business level to identify risks and establish areas for improvement. The majority of accidents on our sites are related to the manufacturing environment. We are specifically focusing on manual handling and slips and trips through our partnership in the UK with the Health & Safety Executive (HSE).

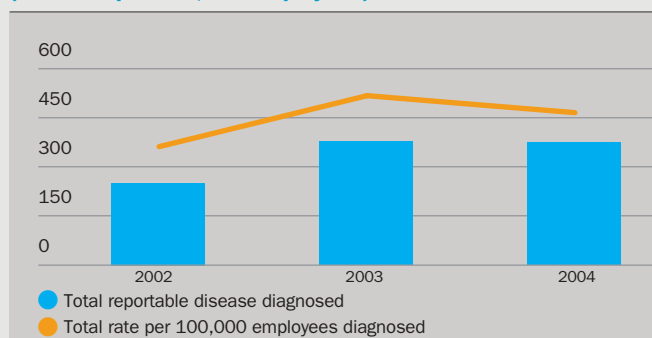
Health and Safety cont.

Reportable diseases



	2002	2003	2004	2005
UK reportable diseases	58	158	300	182
UK rate per 100,000 employees	132	450	822	453
US reportable diseases	33	5	50	219
US rate per 100,000 employees	189	21	185	674
Saudi reportable diseases	–	–	17	32
Saudi rate per 100,000 employees	–	–	435	713
Total reportable diseases	91	173	367	433
Total rate per 100,000 employees	138	243	517	550

Reportable diseases screened and diagnosed by disease type (total and per 100,000 employees)



Disease type	2003		2004		2005	
	Screened	Diagnosed	Screened	Diagnosed	Screened	Diagnosed
HAVS	2,607	136	3,393	296	3,686	78
HAVS per 100,000 employees	3,815	199	5,269	409	4,613	98
Skin irritation	3,596	15	3,950	14	5,006	17
Skin irritation per 100,000 employees	5,262	22	5,456	19	6,264	21
Noise	4,762	57	5,115	24	7,950	72
Noise per 100,000 employees	6,969	83	7,065	33	9,948	90
Respiratory illnesses	3,828	0	4,888	6	6,107	13
Respiratory illnesses per 100,000 employees	5,602	0	6,751	8	7,642	16
Musculoskeletal	4,465	43	5,181	39	3,044	196
Musculoskeletal per 100,000 employees	6,534	63	7,156	54	3,809	245
Total	19,258	251	22,527	379	25,793	376
Total per 100,000 employees	28,181	367	31,114	523	32,276	471

Comments on the 2005 data

- The incidence of new reportable diseases in the UK is beginning to decrease. This reflects the emphasis placed on eliminating the causes of Hand Arm Vibration Syndrome (HAVS) over the last 5 years.
- The incidence rate of reportable diseases in the US reflects the heavier manufacturing profile of the businesses since the acquisition of United Defense Industries in June 2005.
- We are continuously extending our screening of employees to ensure incidence of industrial diseases are diagnosed and treated.
- Overall the incidence of reportable diseases is decreasing. A key focus in 2006 will be to improve understanding of the causes of musculoskeletal injuries and set in place programmes to address these.

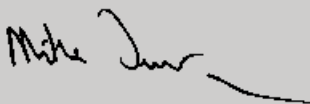
In 2005 we issued a joint statement with the UK Health and Safety Executive (HSE) reaffirming our commitment to work in partnership to improve safety performance.

Joint statement from the UK Health & Safety Executive (HSE) and BAE Systems

BAE Systems and the HSE have now completed one year of a three-year partnership to address specific safety issues in the manufacturing sector. The initiative was launched as part of the HSE's commitment to Revitalising Health & Safety and followed on from a previous partnership between the two organisations. The Company and experts from the HSE are working together to develop and deploy standards of best practice in five key areas of safety risk (contractor management, hand-arm vibration syndrome, working at heights, confined space working, and slips, trips and falls). Employee involvement is being delivered in partnership with trade union safety representatives at BAE Systems' UK sites.

Both organisations recognise the benefit the partnership is bringing in progressing safety standards in Great Britain.

BAE Systems is committed to achieving high performance standards for safety throughout the organisation. We are pleased to have this opportunity to work with the Health & Safety Executive on driving improvements in safety, not only in our own business but to establish standards of good practice which can be used across other sectors. We believe the partnership has many benefits both in access to expertise of the HSE and in improvements we've made to our own standards and processes. We look forward to continuing a positive and productive relationship over the next two years.



Mike Turner
Chief executive, BAE Systems

HSE welcomes the commitment of BAE Systems to meeting the challenges of the Revitalising Health & Safety agenda. HSE, through the joint initiative, is committed to the development of an effective professional relationship across the manufacturing units. HSE is committed to assisting BAE Systems meet the challenges by establishing productive partnerships at all levels of the Company and sharing expertise to reduce injuries and ill-health.

HSE recognises the positive approach and good offices of the Company, and the significant progress with the initiative. We want to build on this to realise our common goal of a safe and healthy workplace.



Timothy Walker
Director general, Health & Safety Executive



Issues index

Our policies and position statements on the CR issues addressed in this report have been brought together in this section to act as an easy reference guide to those issues material to our business.

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Acting responsibly and within the laws of the countries in which we operate.

Corporate governance

The responsibility for the governance of the Company rests primarily with the BAE Systems Board. Our statement on corporate governance, together with the remuneration report, describes the way in which the principles and practices detailed in the Combined Code are applied within BAE Systems and can be found at http://ir.baesystems.com/bae/comp_info/corp_gov

Corporate responsibility governance

Overall responsibility for CR lies with the Board of Directors. It has delegated certain matters to a number of Board Committees:

The Corporate Responsibility Committee is responsible for reviewing and monitoring the processes the Company uses to manage social, environmental and ethical risk and assists the Board in overseeing the development of strategy and policy in this area. It is chaired by a non-executive director.

The Audit Committee is responsible for reviewing the output from the Group-wide process used to identify, evaluate and mitigate risk. It is also responsible for evaluating the performance of the external auditors and ensuring processes are in place to prevent their objectivity and independence being compromised.

The Chief Executive is responsible for all normal operational matters and has delegated specific responsibilities to the Group Legal Director (Ethics, Compliance and Business Principles) and the Group Human Resources Director (Workplace, Community and Business Environment).

Stakeholder engagement

We believe that it is important to understand the views of others and explain our approach. We encourage dialogue and open communication with our stakeholders. For further information see page 2.

Business ethics/anti-bribery and corruption

We are committed to meeting the highest ethical standards in our dealings with others. For a full statement and our policies and further information see page 10.

Fraud

The Company regards any act of fraud committed by an employee against the Company as extremely serious and will investigate all instances of any such suspected fraud.

Our fraud prevention policy is stated in the Operational Framework and our Internal Audit function is responsible for investigating all suspected cases of fraud in the Company.

Our formal fraud response plan requires our Internal Audit department to investigate allegations of fraud and outlines the procedure by which this should be done, including setting up Fraud Investigation Boards where necessary. Fraud prevention and detection information is available to all employees on a dedicated intranet site.

Export licences

The sale of defence equipment is highly regulated. Licences will not be granted for countries where sales would be inconsistent with respect for human rights or regional stability, or where there are UN arms embargoes or trade sanctions in place.

In the UK the Export Control Act requires us to obtain a licence for all defence sales. Michael Lester, our Group Legal Director, is the Board member responsible for ensuring that we comply with UK export controls and the UK Government's Code of Practice. Twice a year the managing director from each Business Unit reports on compliance with export regulations to the Audit Committee and the Board. We maintain an active and open dialogue with relevant government departments to help us comply with export policies.

In the US we function under a Special Security Agreement (SSA) approved by the US Department of Defense. The SSA requires us to implement a Technology Control Plan (TCP) with oversight by the Corporation's Government Security Committee (GSC). The SSA and TCP are established to ensure compliance with all US regulatory controls, including the Arms Export Control Act, the Export Administration Act, Treasury embargoes and other applicable regulations.

Sheila Cheston, the Senior Vice President and General Counsel, is responsible for export compliance in the US. She is supported by a Director for International Trade Compliance and a Director for Export/Import Licensing. Our US Export Compliance Program includes an Export Compliance and Procedures Manual, an export database, regulation training programmes and internal and independent audits. Sheila Cheston reports annually to the GSC on the status of the Export Compliance Program.

Offset agreements

An offset is a requirement on a contractor to provide industrial, economic or other benefits to a country or government as compensation for the purchase of foreign defence equipment or services.

The need to undertake offset or industrial participation is a customer-driven requirement.

Offsets, or industrial participation agreements, are required by customers. Over 120 countries operate offset regulations. Consequently, bids directly to governments, and to primary contractors bidding for government contracts, increasingly require the inclusion of offset proposals.

We apply the same rigorous controls and assurance systems to development and delivery of our offset obligations as we do to all other areas of our operation. This is specifically included within our Operational Framework and Assurance process.

Political influence and affiliation

We do not make donations on behalf of the Company to political parties or their representatives. We respect the right of individual employees to make personal contributions. In the US our eligible employees are allowed to participate in the BAE Systems USA Inc Political Action Committee (PAC). See page 19.

We lobby governments directly as part of our marketing activities and also indirectly through trade organisations. For further information see page 18.

Employee, customer and supplier issues

We aim to get the best from our employees by providing a working environment that is safe, supportive, provides opportunities for training and development and where all employees are treated with dignity and respect.

Industrial relations

Good industrial relations are strategically important. We partner with trade unions to develop our employment policies and compete for new contracts. For further information see page 15.

Pensions

We are consulting with trade unions, pension representatives, trustees of the pension funds and employees to address the shortfall in some of our pension funds. For further information see page 15.

Diversity and inclusion

We are committed to equality of opportunity for all employees and to creating a workplace where everyone is treated with respect. For further information see page 14.

Health and Safety

We are committed to the highest standards of health and safety at work. For further information see page 15.

Employee well-being

Regular health checks are provided for all employees at risk from work-related illnesses. Many of our sites also provide well-being initiatives.

Customer relations

We seek feedback from our customers to help us better understand their requirements, identify new business opportunities and improve customer relationships.

Our customer relationship programme is known as Customer Voice in the UK and Customer Perception Survey in the US. It includes a customer feedback mechanism and a Company review process to ensure feedback is acted on.

Feedback is used by management in business planning to drive change throughout BAE Systems. Findings help us to understand the priorities of our customers and to reshape our services and behaviour to meet their needs.

Customers are invited to get involved in action planning. This enables us to work in partnership with them to identify and act on improvements.

Training and development

Training helps our people develop their skills and capabilities. We have a range of training programmes to cater for all employees at all levels of business. For further information see page 14.

Supplier standards and relations

Suppliers account for around 70% of the costs of our products and services. This means it is vital that we work with the best suppliers and ensure that they maintain high quality standards.

Our reputation can be affected by the suppliers with whom we do business. It is important that our suppliers act ethically, treat their employees fairly, maintain high health and safety standards and manage their impact on the environment.

In return we need to treat our suppliers fairly, pay them promptly, and communicate our requirements clearly. We believe we can get the most from our relationship with suppliers by working with them as a team.

Our Supplychain Excellence (SCE) programme helps us share best practice and work in partnership with our strategic suppliers. Through SCE we work with our key suppliers to improve delivery, quality, cost and management systems and reduce waste. This benefits BAE Systems by ensuring we do our most important business with high-performing suppliers. Suppliers benefit from increased competitiveness and lower internal costs.



We are committed to managing our impact on the environment and supporting communities near to our sites.

Community investment and education

BAE Systems supports charities, education activities and communities close to our facilities worldwide.

In 2005, our total community investment was £10.5 million.

This figure includes cash and in-kind donations to charity as well as our direct support for education. Charity Challenge, our Company-wide fundraising and volunteering programme, raised £2.7 million from employee fundraising and reported over 4,200 volunteer days for charities worldwide.

In 2005 we joined the London Benchmarking Group (LBG), which comprises 100 leading UK-based companies committed to rigorous evaluation of their community programmes. A detailed breakdown of our giving in line with the LBG methodology can be found in the data section of this report on page 24.

For further information on our education programmes see page 21.

Product stewardship

Notwithstanding the nature of what we make, ensuring that our products are safe to use is a key responsibility. We also need to make weapon systems as accurate as possible, and minimise the potential impact of our products on the environment.

Our Product Safety & Environmental Focus Group includes representatives from each major business. The group provides specialist advice on product safety management, raises awareness of product safety/environmental issues and regulation, and promotes the spread of good practice across the Company.

Environmental impacts

All our activities, manufacturing operations, offices and products have an impact on the environment. This includes the natural resources and raw materials that we use as well as wastes and emissions. We are committed to managing and minimising these impacts wherever possible.

We have an environment policy and framework to help us manage our environmental performance and minimise risks. This emphasises that everyone at BAE Systems – from individual employees to teams and managers – is accountable for the environmental impacts of our operations.

All of our major manufacturing sites are certified to the international environmental management systems standard ISO 14001.

We monitor and report publicly on our performance using environmental reporting indicators that apply across the Group. Improvement targets are set at site level.



External assurance statement and commentary

BAE Systems has commissioned The Corporate Citizenship Company to provide it with external assurance and commentary on its Corporate Responsibility Report 2005. BAE System's management has prepared the report and is responsible for its contents. Our objectives were to review its contents and presentation, to conduct selected checks to underlying corporate records, and to provide this statement for which we have sole responsibility.

A full statement of our external assurance and commentary is available at www.baesystems.com, including details about The Corporate Citizenship Company, our relationship with BAE Systems and the assurance process we have adopted. This statement summarises our principal findings.

Our opinion

In our opinion, the report provides a fair and balanced representation of the progress BAE Systems is making in living out its commitments to corporate responsibility (CR). Where gaps in available performance data and stakeholder views on material issues exist, they are identified below.

In forming our opinion and making our comments, we have had regard to the principles underlying the international assurance standard AA1000 (www.accountability.org.uk) notably concerning materiality, completeness and responsiveness. We have also had regard to the 11 reporting principles judged essential by the June 2002 GRI sustainability reporting guidelines (www.globalreporting.org).

Commentary

A corporate responsibility report should explain how the company impacts on society, looking at all the important economic, social and environmental concerns of its stakeholders. It should show how crucial decisions are made, and differing interests balanced. Honest about shortcomings, it should demonstrate how the organisation is responsive, by listening, learning and improving.

Against this goal, we believe BAE System's fifth corporate responsibility report marks a clear step forward on previous years. It responds to stakeholder research

conducted during the year, addressing issues people said were material to the company and their perceptions of it. In particular, business ethics, lobbying and political influence and workplace issues featured. BAE Systems deals with these and other challenging issues head on through a Q&A section and by inviting relevant experts to provide comments on these subjects, to which the Company has given responses with supporting information. The Issues Index at the back of the report, along with the Company's and Chief Executive's commitments for the year ahead, help to provide context and focus to BAE Systems' corporate responsibility efforts. The creation of the Board level Corporate Responsibility Committee, chaired by a non-executive director, underscores senior management's commitment to improving the Company's corporate responsibility practices. During interviews we conducted as part of our assurance, company representatives highlighted this as an important development.

Looking ahead

In our opinion, to account fully for all its material impacts on society, there are four areas that BAE Systems should address in future reports:

Firstly, reports should set out in more detail an account of BAE Systems' business, the agreements it has reached with governments and the products and services it has sold during the reporting period.

This would be supported by addressing a second area, BAE Systems' economic impacts. Future reports should set out who exactly benefits from the Company's roll in creating wealth, directly, and along the value chain, including shareholders, suppliers and their employees and governments. In relation to suppliers, BAE Systems has

some excellent supplier relationships and already supports the top suppliers through the Supplychain Excellence programme. However, more could be done to help suppliers advance their own corporate responsibility practices. Similarly, on joint ventures, BAE Systems could do more to encourage corporate responsibility activities and reporting, possibly making greater efforts itself to report on partners' performance.

Thirdly, future reports should set out explicitly where BAE Systems stands on critical global issues such as climate change, human rights and sustainable development.

Finally, they should also serve to direct readers to various sources of information, including the website, the updating of which as a reporting tool, remains to be completed. Additional topics should include: detailing trade association membership; tax contributions worldwide; any forms of non-compliance, internally, regarding breaches of Company policy and externally, in terms of overall corporate activity and information about defence sales that are in the public domain and more information about offset agreements. We believe that inclusion of these topics would help to provide a more complete understanding of the full range of the Company's activities and impacts.

10 February 2006



www.corporate-citizenship.com

We've had our say – now tell us what you think.

We welcome feedback, both positive and negative, on any aspect of our corporate responsibility performance and reporting.

E-mail us at
crfeedback@baesystems.com

More information about BAE Systems
and CR can be found on our website:
www.baesystems.com/corporateresponsibility

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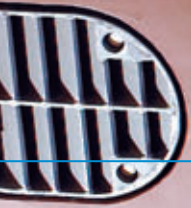
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