Notes to the Company accounts

1. Accounting policies

Basis of preparation
The financial statements have been prepared under the historical cost convention, as modified by the revaluation of available-for-sale financial assets, and financial assets and financial liabilities (including derivative instruments) at fair value through profit or loss, and in accordance with applicable accounting standards in the United Kingdom (UK GAAP). The going concern basis has been applied in these accounts.

In the Company's accounts, all fixed asset investments (including subsidiary undertakings and joint ventures) are stated at cost (or valuation in respect of certain listed investments) less provisions for impairments. Dividends received and receivable are credited to the Company's profit and loss account. In accordance with Section 230(4) of the Companies Act 1985 the Company is exempt from the requirement to present its own profit and loss account. The amount of profit for the financial year of the Company is disclosed in note 14 to these accounts.

Relief under Sections 131 and 133 of the Companies Act 1985 is taken wherever possible. Accordingly, where such relief is available, the difference between the fair value and aggregate nominal value of shares is not recognised in either shareholders' funds or cost of investment.

Changes in accounting policies
Financial Reporting Standard 29 Financial Instruments: Disclosures (FRS 29) is applicable to the Company for the year ended 31 December 2007. The Company is exempt from presenting FRS 29 disclosures as full equivalent disclosures are presented on a Group basis within the consolidated financial statements.

Urgent Issues Task Force (UITF) Abstract 41 Scope of FRS 20 is applicable to the Company for the year ended 31 December 2007. This does not have any significant impact on the Company's accounts.

UITF Abstract 44 FRS 20, Group and treasury share transactions will be applicable for the year ending 31 December 2008. It is not expected to have any significant impact on the Company's accounts.

Cash flow statement
The Company is exempt under the terms of Financial Reporting Standard 1 from the requirement to publish its own cash flow statement, as its cash flows are included within the consolidated cash flow statement of the Group.

Foreign currencies
Transactions in foreign currencies are translated at the exchange rates ruling at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies are retranslated at the exchange rates ruling at the balance sheet date. These exchange differences are recognised in the profit and loss account unless they qualify for hedge accounting treatment, in which case the effective portion is recognised directly in a separate component of equity.

Tangible fixed assets
Depreciation is provided, normally on a straight-line basis, to write off the cost or valuation of tangible fixed assets over their estimated useful economic lives to any estimated residual value using the following rates:

Buildings	up to 50 years, or the lease term if shorter
Computing equipment, motor vehicles and short life works equipment	3 to 5 years

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

Impairment reviews are undertaken if there are indications that the carrying values may not be recoverable.

Leases
Assets obtained under finance leases are included in tangible fixed assets at cost and are depreciated over their useful economic lives, or the term of their lease, whichever is shorter. Future instalments under such leases, net of finance charges, are included within loans. Rental payments are apportioned between the finance element, which is charged as interest to the profit and loss account, and the capital element, which reduces the outstanding obligation for future instalments, so as to give a constant rate of charge on the outstanding obligation.

Rental payments under operating leases are charged to the profit and loss account on a straight-line basis in arriving at operating profit.

Investments
The Company's investment in shares in group companies are stated at cost less provision for impairment.

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

Tax
The charge for taxation is based on the profit for the year and takes account of taxation deferred because of timing differences between the treatment of certain items for taxation and accounting purposes. Deferred tax is recognised on an undiscounted basis in respect of all timing differences between the treatment of certain items for taxation and accounting purposes which have arisen but not reversed by the balance sheet date where there is an obligation to pay more tax, or a right to pay less tax, in the future.

Pensions and other post-retirement benefits
The Company contributes to Group pension plans operated in the UK. Details of the principal plans and the financial assumptions used are contained in the consolidated accounts of BAE Systems plc. As permitted by Financial Reporting Standard 17 Retirement Benefits, the plans are accounted for as defined contribution plans, as the employer cannot identify its share of the underlying assets and liabilities of the plans. The employer's contributions are set in relation to the current service period and also to fund a series of agreed measures to address the pension scheme deficits.

1. Accounting policies (continued)

Share options and own shares held

The Company issues equity-settled share options to Group employees. In accordance with the requirements of FRS 20 Share-based payment (FRS 20), the Company has applied FRS 20 to all equity-share options granted after 7 November 2002 that were unvested as of 1 January 2005. Equity-settled share options are measured at fair value at the date of grant using an option pricing model. The fair value is expensed on a straight-line basis over the vesting period, based on the Company's estimate of the number of shares that will actually vest.

In accordance with UITF Abstract 25 National insurance contributions on share option gains the Company provides in full for the employer's national insurance liability estimated to arise on the future exercise of share options granted, except where the employee has agreed to settle the employer's national insurance liability as a condition of the grant of the options.

As required under UITF Abstract 38 Accounting for ESOP trusts the cost to the Company of own shares held is shown as a deduction from shareholders' funds within the profit and loss account. Consideration paid or received for the purchase or sale of the Company's own shares in the ESOP trust is shown separately in the reconciliation of movements in shareholders' funds.

Preference share capital

During the year, the Company's 7.75p (net) cumulative preference shares of 25p each were converted into the Company's ordinary shares of 2.5p each on the basis of 0.47904 ordinary shares for every preference share.

In accordance with FRS 25 Financial Instruments: Disclosure and Presentation the preference shares were considered a compound financial instrument and, accordingly, split into an underlying debt instrument, classified within loans and overdrafts, and an equity conversion option, classified within equity.

The underlying debt instrument was presented on an amortised cost basis until extinguished on conversion.

The equity conversion option was presented at its historic fair value, based on the date of original issue of the preference shares. On conversion of the preference shares into ordinary shares, the equity component was reclassified to share capital and share premium.

Dividends thereon are recognised in the profit and loss account as finance costs.

Dividends

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