

Our **governance** framework



“As Chairman, my principal duty is to ensure that BAE Systems is headed by an effective board that is accountable to shareholders for the Company’s performance.”

Dick Olver Chairman

This section of the report deals with how the Board and its committees discharge their duties and how we apply the principles in the UK’s Combined Code on Corporate Governance. Over the page you will find detailed statements concerning our compliance with the provisions of the Code. However, first I would like to highlight certain corporate governance matters and developments during the year.

At the end of last year the Financial Reporting Council issued the results of its review of the Combined Code. It reported that investors perceived that there had been a continued improvement in overall governance standards of UK companies since the introduction of the Code. I am pleased that the efforts made by companies such as ours in seeking to continually improve and stay at the forefront of corporate governance best practice are recognised.

Standards and values

As the Combined Code states, boards should set the values and standards for a company. To provide the BAE Systems Board with the best possible guidance on governance in this area, earlier this year we appointed an independent committee headed by a former Lord Chief Justice of England and Wales, Lord Woolf. In forming the committee to study and publicly report upon its policies and processes, the Company seeks to:

“garner and implement recommendations which enable the Company to maintain a leadership position in ethical business practice amongst comparable industry peers; and

further enhance the publicly available level of assurance regarding the accuracy of its assertions as to its policy, processes and conduct.”

The Woolf Committee is to publish its report in due course and the Board has agreed to act on its recommendations.

I see the formation of the Woolf Committee as positive affirmation of the Board seeking to continually improve, and in the area of business ethics not only achieve best practice but provide leadership.

Succession planning

Ensuring that we have the right people running the Company is one of the Board's core governance duties. Last year I reported on the new processes introduced by the Nominations Committee to identify and oversee the development of over 50 employees from across the Group. These individuals form the backbone of the Company's senior management resource and in the future candidates for appointment to the Board are likely to be drawn from amongst them. Overseeing the management of their development is a key responsibility for the Board and the Nominations Committee.

A review of management resources was completed in November last year and I am pleased to report that we have a good number of quality succession candidates across the current senior management roles in the Group. These individuals cover the range from 'ready now' to those candidates who we believe have the potential to take up the most senior positions in several years' time. In some areas we have identified a need in the succession plans for greater 'bench strength'. Where this is the case we are working at achieving full coverage. In addition, we have augmented our strategic management development activities to address certain common development requirements identified by our development and succession planning processes.

Naturally, the Chief Executive position is covered by these processes and with Mike Turner due to retire later this year the Nominations Committee has been actively engaged since last November on who should succeed him. As mentioned above, the Company has comprehensive succession planning and management evaluation processes and these have been of great assistance. In line with best practice, the Nominations Committee has also initiated an external search for suitable candidates for the Chief Executive position, with the aim of ensuring that the individual that the Board ultimately chooses to appoint is the best person available for the job. Progress is being made and we hope to be in a position to announce a successor later this year.

Board appointments

During the year Andy Inglis joined the Board in a non-executive capacity. As a director of BP p.l.c. he has excellent large global company experience as well as having considerable international project execution experience.

We have agreed that as a Board, in addition to the chairman, we should aim to have eight non-executive and four executive directors. With Ulrich Cartellieri having retired last September and Peter Weinberg due to retire from the Board at the Annual General Meeting (AGM) in May, the Nominations Committee has been active and I am pleased that Ravi Uppal will be joining the Board as a non-executive director in April. Search activity continues with a view to appointing an additional non-executive director later this year.

We need not only the right mix of knowledge, skills and experience around the Board table but also we have to be in a position to resource effectively the Board's committees. This is an important consideration because, as with the Audit and Remuneration committees, we believe the membership of the Corporate Responsibility Committee should be formed exclusively of independent non-executive directors.

Board committees

The role that board committees play in the UK's corporate governance structure should not be underestimated. As we seek to continually improve the effectiveness of our governance processes the demands on the committees have increased. The table on page 59 detailing the attendance of directors at board committee meetings during the year shows that a total of 26 meetings were held last year; this compares with 17 meetings five years ago – over a half more.

A unitary board containing a good number of both executive and non-executive directors is an excellent forum within which to develop and challenge strategy and provide entrepreneurial leadership for a company. However, certain responsibilities can only be undertaken effectively by directors who are independent of the activities they are required to oversee. The Audit and Remuneration committees are obvious examples of this, but this applies equally to the Corporate Responsibility Committee. You will find a report from this committee on page 63, but I would like to highlight in particular the role it has in overseeing compliance with the highest standards of ethical behaviour by all Group employees and also in overseeing our performance in keeping our employees safe and healthy in the workplace. With Peter Weinberg retiring from the Board, Andy Inglis has been appointed to succeed him as chairman of the Corporate Responsibility Committee, having first been nominated for appointment to this position by the Nominations Committee.

Board performance evaluation

I mentioned earlier the recent report on the Combined Code by the Financial Reporting Council. Reporting on its consultative exercise, it had the following to say on the subject of board performance evaluation:

"A number of respondents singled out the Code's recommendation that boards should carry out regular evaluations of their performance as having been particularly beneficial. This view was endorsed by the chairmen of the FTSE 350 companies surveyed by Independent Audit, of whom over 90% had found the exercise to be useful."

I am a big believer in performance evaluation, as this is a fundamental part of performance improvement. As a Board we have just completed our fourth such performance evaluation. This exercise covered the performance of the Board, its committees and that of the individual directors.

The Board evaluation includes a review of the Board's effectiveness, the effectiveness of each board committee, and an assessment of each board director. One-on-one feedback discussions between the Chairman and each director occur in the first quarter of the year. The table overleaf details some of the objectives that the Board has agreed as a result of the evaluation process.

Corporate governance (continued)

Board performance evaluation – objectives

2007 Objectives	2007 Achievements	2008 Objectives
<ul style="list-style-type: none"> – Continue the work started in 2006 on succession planning, with a focus on the support and development of the next generation of senior executives and also the identification and enhancement of the Group's management bench strength. – Develop further the work the Board has initiated on financial performance monitoring and looking at project and programme KPIs in more detail. – Build on current non-financial performance monitoring, including the Corporate Responsibility Committee's focus on corporate reputation issues. – Provide additional opportunities for non-executive directors to meet to discuss issues independently and with the Chief Executive. 	<ul style="list-style-type: none"> – Good progress made on succession planning with greater coverage across all senior executive succession plans. New senior management programme rolled out to address the common development needs identified during succession planning activities. – The Board reviewed programme and project KPIs regularly and uses these alongside standard financial measures to monitor the Company's performance. – The Board and Corporate Responsibility Committee have overseen the development of new non-financial risk processes. More work will be done in this area in 2008, aligning with Woolf Committee recommendations. – Additional opportunities were made available for the non-executive directors to meet to discuss issues informally as a group and with the Chief Executive present. 	<ul style="list-style-type: none"> – Engage non-executive and executive directors in dialogue to ensure smooth and transparent selection and transition of the new Chief Executive. – Board to conduct additional site visits as part of its meeting programmes. Use the visits as an opportunity to meet with senior management to support succession planning. – Understand and review the competencies, processes and culture required to support the Company's increasingly global position. – Ensure that ethical and reputational implications of strategic growth options are explored and understood. Plan for and commence embedding the Woolf Committee recommendations. – Keep attention focused on programme KPIs.

When we started the evaluation process in 2004 I was keen to use an external facilitator to conduct individual interviews with each director. No evaluation process is perfect but I believe our approach does allow us to deal effectively with not only the procedural or administrative aspects of how we operate but also some of the behavioural aspects of performance. As Chairman, it is important I receive full and frank feedback on my own performance and I receive this each year from our Senior Independent Director after he has met with the facilitator.

Shareholder communication

Finally, I would like to highlight the importance I place on communications with our shareholders and the central role the AGM plays in this. I want attendance at our AGM to be an interesting and worthwhile experience, allowing directors to report on their stewardship of the Company and to answer shareholders' questions on this. I hope as many shareholders as possible are able to attend and participate in the meeting on 7 May.



Dick Oliver
Chairman

Applying the principles of the Combined Code on Corporate Governance

The Board has structured its activities so as to incorporate the main and supporting principles in the UK's Combined Code, recognising these to be a sound statement of accepted good practice for a company such as BAE Systems. The core activities of the Board and its committees are documented and planned on an annual basis but this only forms the basic structure within which the Board operates. The directors are required to provide entrepreneurial leadership for the Company, relying on the business skills and judgement that each director possesses. The governance structure recognises this essential human element and the role of the Chairman in ensuring that decisions are made by the directors within a framework of prudent and effective controls.

The Board has adopted a document, the Board Charter, in which there is a statement of governance principles that guide the activities of the Board and also details of the roles of the Chairman, Chief Executive and the Senior Independent Director. The governance principles reflect the main and supporting principles contained in the Combined Code and cover the following:

- Strategy – reviewing and agreeing strategy;
- Performance – monitoring the performance of the Group and also evaluating its own performance;
- Standards and Values – setting standards and values to guide the affairs of the Group;
- Oversight – ensuring an effective system of internal controls is in place, ensuring that the Board receives timely and accurate information on the performance of the Group and the proper delegation of authority; and
- People – ensuring the Group is managed by individuals with the necessary skills and experience and that appointments to the Board are managed effectively.

The Board Charter states that the Chief Executive is responsible for the leadership and operational management of the Company within the strategy and business plan agreed by the Board. Included within the Charter is a schedule of matters that have been reserved for the Board's decision. These include approving the vision, values, principles of ethical conduct, overall governance structure of the Company and its strategy and business plans. Within the Board's delegated authorities it has reserved for itself, amongst other things, certain decisions concerning contract bids and tenders, acquisitions and disposals of businesses, capital expenditure and Company-funded product development expenditure.

A copy of the Board Charter can be found on the Company's website, or alternatively, can be obtained from the Company Secretary.

Compliance with the provisions of the Combined Code

Compliance statement

The Company was compliant with the provisions of the Combined Code on Corporate Governance throughout 2007.

The Board

The Board comprises a non-executive chairman, seven non-executive directors and four executive directors.

The Board considers all of the non-executive directors, with the exception of the Chairman, to be independent for the purposes of the Combined Code. Each of these directors have been identified on pages 54 and 55 of this report.

Peter Weinberg was appointed to the Board in 2005. As Mr Weinberg was a senior director of Goldman Sachs Inc. (an investment bank that provides services to BAE Systems) the Board addressed the issue of his independence prior to his appointment in light of provision A.3.1 of the Combined Code concerning the possible existence of a 'material business relationship' between the director and the Company or between the Company and a party with which the director is a major shareholder, senior employee, partner or director. It determined that he was independent for the purposes of the Combined Code, notwithstanding the relationship with Goldman Sachs. The reasons for reaching this conclusion were:

- Goldman Sachs is a very large organisation with many clients. BAE Systems is therefore just one of many clients it has worldwide and the fees earned from its relationship with the Company represent a very small part of its total revenues. As a consequence, the Board believes that the relationship between the Company and Goldman Sachs does not represent 'a material business relationship'; and
- prior to his appointment to the Board, Mr Weinberg had no involvement with BAE Systems and none of the executive directors or the Chairman had had any business dealings with him.

Mr Weinberg ceased to be associated with Goldman Sachs in 2006.

In 2007 the Board was scheduled to meet eight times and in addition one day was spent reviewing strategy. Additional Board meetings are called as required and in total the Board met 12 times during the year.

The Board has appointed Sir Peter Mason as the Senior Independent Director. Amongst the duties undertaken by Sir Peter during the year was to meet with the non-executive directors without the Chairman present to appraise the Chairman's performance.

The attendance by individual directors at meetings of the Board and its committees in 2007 was as follows:

Director	Board	Audit Committee	Corporate Responsibility Committee	Nominations Committee	Remuneration Committee	Non-Executive Directors' Fees Committee
Professor S Birley ¹	3 (5)	–	1 (1)	–	3 (3)	–
Mr P Carroll	11 (12)	–	5 (5)	7 (8)	–	–
Dr U Cartellieri ²	8 (9)	3 (3)	–	–	–	–
Mr C V Geoghegan	10 (12)	–	–	–	–	–
Mr M J Hartnall	12 (12)	4 (4)	–	–	–	–
Mr W Havenstein	11 (12)	–	–	–	–	1 (1)
Mr A G Inglis ³	6 (6)	–	2 (2)	–	–	–
Mr I G King	11 (12)	–	–	–	–	–
Sir Peter Mason	10 (12)	3 (4)	–	7 (8)	–	–
Mr S L Mogford ¹	3 (5)	–	–	–	–	–
Mr R L Olver	12 (12)	–	–	8 (8)	–	1 (1)
Mr R Quarta	9 (12)	1 (1) ⁴	–	–	8 (8)	–
Mr G W Rose	12 (12)	–	–	–	–	–
Sir Nigel Rudd	11 (12)	–	5 (5)	–	8 (8)	–
Mr M J Turner	12 (12)	–	–	–	–	1 (1)
Mr P A Weinberg	10 (12)	–	5 (5)	–	7 (8)	–

Figures in brackets denote the maximum number of meetings that could have been attended.

1 retired from the Board on 9 May 2007

2 retired from the Board on 26 September 2007

3 appointed to the Board on 13 June 2007

4 in attendance at three additional meetings when not a member of the Committee

Corporate governance (continued)

The Company's Articles of Association require that all new directors seek re-election to the Board at the following AGM. In addition, all directors are required to stand down and seek re-election to the Board at least once every three years.

The Board has set out in the Notice of Annual General Meeting (enclosed with this report) their reasons for supporting the re-election of those directors seeking re-election at the forthcoming AGM.

Internal control

The Board has conducted a review of the effectiveness of the Group's system of internal controls, including financial, operational and compliance controls and risk management systems, in accordance with the Combined Code and the Turnbull guidance (as revised).

BAE Systems has developed a system of internal control that was in place throughout 2007 and to the date of this report, that encompasses, amongst other things, the policies, processes, tasks and behaviours that taken together, seek to:

- facilitate the effective and efficient operation of the Company by enabling it to respond appropriately to significant operational, financial, compliance and other risks that it faces in carrying out its business;
- assist in ensuring that internal and external reporting is accurate and timely and based on the maintenance of proper records supported by robust information gathering processes; and
- assist in ensuring that the Company complies with applicable laws and regulations at all times and also internal policies in respect of the standards of behaviour and conduct mandated by the Board.

Reporting within the Company is structured so that key issues are escalated through the management team ultimately to the Board if appropriate. The Operational Framework provides a common framework across the Company for operational and financial controls and is reviewed on a regular basis by the Board. The business policies and processes detailed within the Operational Framework draw on global best practice and their application is mandated across the organisation. Lifecycle Management (LCM) is such a process and promotes the application of best practice programme execution and facilitates continuous improvement across the Group. It considers the whole life of projects from inception to delivery into service and eventual disposal, and its application is critical to our capability in delivering projects to schedule and cost.

Further key processes are Integrated Business Planning (IBP), Quarterly Business Reviews (QBR) and Performance Centred Leadership (PCL). The IBP, approved annually by the Board, results in an agreed long-term strategy for each business group, together with detailed near-term budgets. The QBRs, chaired by the Chief Operating Officers, evaluate progress against the IBP and business performance against objectives, measures and milestones. PCL drives business success by linking individual goals to those of the organisation enabling employees to understand how their own success contributes to the success of the whole business.

Whilst the quality of the control processes is fundamental to the overall control environment, the consistent application of these processes is equally important. The consistent application of world-class control processes is a key management objective.

The Company is committed to the protection of its assets, which include human, property and financial resources, through an effective risk management process, underpinned where appropriate by insurance.

The Internal Audit team independently reviews the risk identification procedures and control processes implemented by management. It provides objective assurance as to the operation and validity of the systems of internal control through a programme of cyclical reviews making recommendations for business and control improvements as required.

The Board has delegated to the Audit Committee responsibility for reviewing in detail the effectiveness of the Company's system of internal controls. Having undertaken such reviews, the Committee reports to the Board on its findings so that the Board as a whole can take a view on this matter. In order to assist the Audit Committee and the Board in this review, the Company has developed the Operational Assurance Statement (OAS) process. This has been subject to regular review over a number of years, which has resulted in a number of refinements being made.

The OAS requires that each part of the business completes a formal review of its compliance against the Operational Framework, including operational and financial controls and risk management processes. It is signed-off by the managing director of every line of business and relevant functional directors. The OAS is completed every six months and includes a formal assessment of business risk.

The overall responsibility for the system of internal control within BAE Systems rests with the directors of the Company. Responsibility for establishing and operating detailed control procedures lies with the line leaders of each operating business.

In line with any system of internal control, the policies and processes that are mandated in the Operational Framework are designed to manage rather than eliminate the risk of failure to achieve business objectives, and can only provide reasonable and not absolute assurance against material misstatement or loss.

The responsibility for internal control procedures with joint ventures and other collaborations rests, on the whole, with the senior management of those operations. The Company monitors its investments and exerts influence through Board representation.

Going concern

After making due enquiries, the directors have a reasonable expectation that the Group has adequate resources to continue operational existence for the foreseeable future. For this reason they continue to adopt the going concern basis in preparing the accounts.

Relations with shareholders

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

The Company maintains a comprehensive Investor Relations website that provides, amongst other things, information on investing in BAE Systems and copies of the presentation materials used for key shareholders presentations. This can be accessed via the Company's website, www.baesystems.com.

The AGM provides all shareholders with the opportunity to develop their understanding of the Company and ask questions on the matters put to the meeting including this Annual Report. All shareholders are entitled to vote on the resolutions put to the AGM and, to ensure that all votes are counted, the Company's Articles of Association requires that a poll is taken on all the resolutions in the Notice of Meeting. The results of the votes on the resolutions will be published on the Company's website.

Audit Committee report



Michael Hartnall
Audit Committee
Chairman

Members

Michael Hartnall (Chairman)
Sir Peter Mason
Roberto Quarta

During the year, Dr Ulrich Cartellieri was a member of the Committee until his retirement from the Board on 26 September 2007.

Responsibilities

- Reviewing the effectiveness of the Company's financial reporting, internal control policies and procedures for the identification, assessment and reporting of risk.
- Monitoring the role and effectiveness of the Internal Audit function including approving the appointment or removal of the Head of Internal Audit.
- Considering and making recommendations to the Board on the appointment of the Auditors.
- Keeping the relationship with the Auditors under review, including the terms of their engagement and fees, their independence and their expertise, resources and qualifications.
- Monitoring the integrity of the Company's financial statements.
- Reviewing significant financial reporting issues and judgements.

The full terms of reference of the Audit Committee can be found on the Company's website or can be obtained from the Company Secretary.

Governance

The Audit Committee was in place throughout 2007 during which all its members were non-executive directors deemed to be independent in accordance with provision A.3.1 of the Combined Code.

The Committee is chaired by Michael Hartnall who is a chartered accountant and has relevant experience of serving as a finance director of a large UK listed company.

The Committee normally asks that the Chief Executive, Group Finance Director and Head of Internal Audit attend its meetings. However, during the year the Committee held individual meetings without Company executives present, with only the Head of Internal Audit present and also with only the external auditors present.

The Committee met four times in 2007.

Activities

One of the Committee's principal duties is to review the effectiveness of the Group's internal control processes. Robust internal controls are essential. They ensure that the information on the performance of the Company is accurate and timely, thereby assisting management and directors in the effective management of the Group. They are also essential in ensuring that the Group complies with law and regulations including those that concern external reporting. As in previous years, the Committee received a report and presentation from the Auditors summarising the findings of their review of the Group's control environment. In addition, the Committee received reports on control matters from the Internal Audit function and, as explained on page 60, twice during the year it reviewed the findings from the Group's Operational Assurance Statement process.

One of the Committee's key responsibilities is monitoring the effectiveness of the Company's Auditors and Internal Audit function. Each year the Committee reviews the results of an internal evaluation of the performance of the Internal Audit function that looks at its effectiveness in terms of work planning, the skills and experience available to the function, quality of reporting, implementation of audit recommendations and its independence. In addition, last year the Committee commissioned an independent third party to provide the Committee with an external view of the effectiveness of the Internal Audit function – this being in line with best practice recommended by the Institute of Internal Auditors.

An evaluation of the effectiveness of the Auditors, KPMG Audit Plc, was completed during the year.

The Committee accepts that certain work of a non-audit nature is best undertaken by the Auditors. The Audit Committee reviews the amount and nature of non-audit work undertaken by the Auditors during the year and has agreed that, whilst it believes it is not appropriate to manage such work by limiting it to a certain percentage of audit work, such work should be controlled to ensure that it does not compromise the independence of the Auditors. Consequently, the Committee has agreed the following rules to control the quantity and the nature of the work undertaken by the Auditors:

- any non-audit work to be undertaken by the Auditors in excess of £250,000 to be authorised by both the Chairman of the Audit Committee and the Group Finance Director;
- no partner/director of the Auditor's worldwide audit team is to be employed by the Company within two years of the conclusion of a relevant audit;
- no qualified member of the worldwide audit team at manager level or below is to be employed by the Company within two years of the conclusion of a relevant audit; and
- no partner/director of the Auditors not associated with the audit is to be employed by the Company without the approval of the Group Finance Director and the Chairman of the Audit Committee.

As part of the Committee's annual schedule of meetings, a meeting is held at one of the Company's operations so that members of the Committee can meet management and develop a greater understanding of various aspects of the Company. This year a meeting of the Committee was held at the Woodford site in the UK where the Regional Aircraft business and Nimrod MR4A programme were reviewed.

Corporate governance (continued)

The Audit Committee also undertook the following during 2007:

- reviewed the effectiveness of the Group's internal controls and the disclosures made in the Annual Report on this matter;
- reviewed the output from the Group-wide process used to identify, evaluate and mitigate risk;
- received a report from the Auditors on their review of the effectiveness of the controls across the Group;
- reviewed the financial statements in the 2006 and 2007 Annual Report and the Interim Report issued in August 2007, and received a report from the Auditors on the statements;
- reviewed and agreed the approach and scope of the audit work to be undertaken by the Auditors;
- agreed the fees to be paid to the Auditors in respect of the 2007 audit;
- received a report from the Head of Internal Audit on the work undertaken by the Internal Audit function;
- undertook an assessment of fraud risks;
- reviewed proposals concerning the Group's periodic financial reporting obligations;
- reviewed the Group's procedures for disclosing information to the Auditors and the statement concerning such disclosures in the Annual Report;
- reviewed the Committee's terms of reference; and
- reviewed the effectiveness of the Company's helpline procedures in respect of the reporting of possible accounting, financial control and other financial irregularities.

On behalf of the Audit Committee

Michael Hartnall

Audit Committee Chairman

Nominations Committee report



Dick Olver
Nominations Committee
Chairman

Members

- Dick Olver (Chairman)
- Phil Carroll
- Sir Peter Mason

Responsibilities

- Reviewing regularly the structure, size and composition of the Board and making recommendations to the Board on any desired changes.
- Identifying and nominating for the Board's approval suitable candidates to fill vacancies for non-executive and, with the assistance of the Chief Executive, executive directors.
- Planning for the orderly succession of new directors to the Board.
- Recommending to the Board the membership and chairmanship of the Audit and Remuneration committees.

The full terms of reference of the Nominations Committee can be found on the Company's website or can be obtained from the Company Secretary.

Governance

The Nominations Committee was in place throughout 2007. It is chaired by the Chairman of the Company. Whilst he is not deemed to be independent, the other two members of the Committee are independent non-executive directors in accordance with provision A.3.1 of the Combined Code.

The Committee normally asks the Chief Executive and Group Human Resources Director to attend its meetings. However, during the year the Committee did meet without Company executives present.

The Committee met eight times in 2007.

Activities

The Committee is responsible for nominating suitable candidates for appointment to the Board – in both executive and non-executive capacities. When the Committee identifies a need to recruit new non-executive directors, a profile of the ideal candidate is produced based on the skills and experience required. The Company is increasingly global and looks beyond both the UK and the US to identify the right people. Search consultants have an important role to play in identifying suitable candidates based on the Committee's requirements. In 2007, The Zygos Partnership was engaged to assist in such search activities.

Each year the Committee undertakes a detailed review of the Company's management resources and the succession plans for all senior executive positions. The Committee is interested in both the

quality of management resource and also its depth, looking at who is ready to take on specific management positions now, as well as who is likely to come through in the next couple of years and beyond. The Committee also monitors the development of senior management, ensuring that individual development plans are in place.

Overseeing the process for the appointment of executive directors is the most important task that the Committee has to perform. As reported on page 57, the Committee is undertaking the task of finding the right person to succeed Mike Turner when he retires later this year. This process was started last year and the Committee is committed to doing this in line with best practice, reviewing rigorously both external and internal candidates.

On behalf of the Nominations Committee

Dick Oliver

Nominations Committee Chairman

Corporate Responsibility Committee report



Peter Weinberg
Corporate Responsibility Committee Chairman

Members

- Peter Weinberg (Chairman)
- Phil Carroll
- Andy Inglis
- Sir Nigel Rudd

Responsibilities

- Assisting the Board on overseeing the development of strategy and policy on social, environmental and ethical matters.
- Monitoring and reviewing the Company's performance in managing social, environmental, ethical and reputational risk.
- Overseeing and supporting key stakeholder engagement on social, environmental and ethical issues.

The full terms of reference of the Corporate Responsibility Committee can be found on the Company's website or can be obtained from the Company Secretary.

Governance

The Corporate Responsibility Committee was in place throughout 2007 during which all its members were non-executive directors deemed to be independent in accordance with provision A.3.1 of the Combined Code.

The Committee normally asks the Head of Internal Audit, Group Human Resources Director, Group General Counsel and Corporate Responsibility Director to attend its meetings.

The Committee met five times in 2007.

Activities

Corporate responsibility concerns a company's economic, social and environmental impact. All companies are different when it comes to their impact in these areas and therefore it is important for the Corporate Responsibility Committee to focus on the areas of corporate responsibility that are of particular importance for BAE Systems. The Committee has therefore agreed that its prime focus should be ethics and health and safety. However, it also deals with a range of other areas, including matters such as workforce diversity and a range of environmental matters.

The Committee monitors and reviews compliance with the Company's standards of business behaviour and the work undertaken to ensure that all employees are aware and understand the application of these. The activities of the Committee during 2007 included reviewing the Company's Ethics Helpline and Group ethics awareness programmes, including the results of surveys assessing such awareness. As reported elsewhere in this report, the Board has formed the Woolf Committee to study and report on the Group's ethical policies and processes. During the year the Corporate Responsibility Committee met with members of the Woolf Committee to discuss ethics in general and its role in relation to the prospective implementation and assurance of activity that may be recommended. We look forward to the publication of the report later this year.

The health and safety of our employees is a key priority for the Company and also for the Corporate Responsibility Committee. We monitor safety performance and have reviewed various aspects of the management of health and safety within the Company. In addition, the Committee considered the output from a workshop held by management on corporate responsibility and was pleased to endorse the priority it is giving to health and safety in addition to ethics.

During the year the Company has been developing further its risk management processes, particularly in respect of the monitoring and mitigation of non-financial risks. The Committee reviews, on an annual basis, the relevant output from such processes as they relate to health and safety, workplace policies, environmental impact, business ethics and compliance with anti-corruption laws and regulation.

The Committee undertook the following activities in 2007:

- received reports on corporate responsibility matters including, amongst other things, engagement with shareholders and safety, health and environment performance information;
- received reports from the Internal Audit function on audits undertaken on ethical and environmental matters;
- reviewed and approved the proposed approach to progress the Company towards a 'best in class' position on safety performance;
- reviewed the Company Corporate Responsibility Report;
- reviewed its terms of reference; and
- liaised with the Remuneration Committee on the setting of corporate responsibility-related non-financial objectives to be included in the directors' annual bonus plan.

See pages 37 to 43 for more detail on the Group's corporate responsibility activities.

On behalf of the Corporate Responsibility Committee

Peter Weinberg

Corporate Responsibility Committee Chairman