

## **OUR RESPONSE TO THE WOOLF COMMITTEE RECOMMENDATIONS**

In 2007, we appointed Lord Woolf, the former Lord Chief Justice of England and Wales, and an independent expert review committee to advise on standards of best ethical business practice and what we needed to do to achieve them. The Woolf Committee Report was published in May 2008. It made 23 recommendations for further improvement.

These provided a route map for the Company to establish a global reputation for high standards of business conduct. We committed to act on all the Report's recommendations and put in place a comprehensive three-year implementation programme to achieve this.

This report explains the steps we have taken since 2008 to implement the recommendations and the changes we have made to our policies and processes. It shows how we have embedded responsible behaviour as a core component of our culture of Total Performance, our platform for ensuring a sustainable and profitable business in the future.

Our progress against the 23 recommendations has been assessed by the Ethical Leadership Group and our reporting of 2011 progress against the recommendations has also been assured by Deloitte (see their statement).

# **PROGRESS AGAINST RECOMMENDATIONS 2009**

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# STRATEGY

## Applicable Woolf Recommendations

**4** The Board should develop its increasingly proactive role in ensuring high standards of ethical business conduct in all the Company's activities. It should be a standing item on its agenda. There should be an explicit assessment of ethical and reputational risks in all business decisions taken by the Board. Board members should themselves be exemplars of the standards set out in the global code and receive regular briefings on emerging issues in business ethics.

**5** The Board Corporate Responsibility Committee (CRC) should have primary responsibility for oversight and reporting on standards of ethical business conduct and the management of reputational risk. This role should be performed as the Audit Committee performs its task of managing financial risk.

**6** The Company's Internal Audit function should ensure that ethical business conduct and the management of reputational risk is specifically assessed in all audit reports and the results, and progress made against recommendations, provided to the CRC. The additional skills and resources required for Internal Audit should be provided to achieve this. The CR and Audit Committees should hold at least one joint meeting a year to decide on the preparation of the annual internal audit programme.

**7** Members of the senior executive team and heads of business units have both a personal and collective responsibility to demonstrate high standards of ethical business conduct and to achieve effective implementation of the global code. Both should be reflected in their performance appraisals and in the variable element of their remuneration.

**8** There should be a senior executive, supported by a sufficiently resourced team, reporting to the CEO and with direct access to the Chair of the CRC, who has responsibility for the programme to ensure and assure there are high standards of ethical business conduct across the Company.

**10** Policies and procedures in areas of potential ethical risks should be regularly reviewed, with particular attention to the areas of greatest risks. The planned programme of reviews by the Company should ensure a consolidated and comprehensive suite of policies consistent with the global code, providing employees with a clear pathway to understanding how the Company's standards of ethical conduct can be applied in day-to-day business situations.

## 2009 Progress

Key performance indicators on our CR priorities (including objectives on responsible business conduct) are reported to the Executive Committee on a quarterly basis and reviewed alongside financial and programme data as part of our Quarterly Business Review process.

Progress against CR objectives is reviewed quarterly by the CR Committee. Raj Rajagopal, Managing Director Corporate Responsibility attends CRC meetings and has direct access to the CRC Chairman.

Our Executive Committee is visibly leading the CR agenda, personally undertaking safety audits and briefing employees on business conduct and our Code of Conduct. For 2009, an average of 12.3% of the potential annual incentive was paid to Executive Committee members based on the achievement of key performance objectives for responsible business conduct and safety.

The Managing Director Corporate Responsibility, Raj Rajagopal supports line leaders in driving the CR agenda. He reports directly to the Chief Executive. This year the global CR team, under Raj's direction, has supported Operating Groups in implementing our 2009 CR objectives. The team has also supported the work of the Woolf Implementation programme.

Responsible business conduct activities moved to the CR team in January 2010. We strengthened the capability of the CR team by recruiting new senior team members, focusing in particular on business conduct, diversity and inclusion, and environment.

We have reviewed our Operational Framework to enhance policies to address the Woolf Committee recommendations.

We have developed a set of Responsible Trading Principles:

1. We understand and support our customers' national security and other requirements
2. We assess carefully our products and services with the objective that neither BAE Systems nor our customers are exposed to significant reputational risk
3. We work to BAE Systems' Values in all that we do
4. We are as open as practicable about the nature of our business.

These, along with the Code of Conduct and our new Company Values, underpin all our business activities.

In 2009, the Internal Audit team worked with The GoodCorporation to devise a methodology to assess Responsible Business Conduct and Non-Financial Risk as part of all internal audits. We intend that the revised methodology will be implemented during 2010.

During the year the CRC monitored management's progress against the milestones set for the implementation of the recommendations in the Woolf Report. In addition, the Committee monitored the roll out of the Company's Code of Conduct across the Company.

We shall review all policies every three years to ensure they remain current and reflect the standards expected of a global company.

**We remain firmly committed to becoming recognised as a leader in responsible business conduct**

## DECISION MAKING

### Applicable Woolf Recommendations

**9** The Company should develop formal processes to ensure business decisions are only taken following an explicit consideration of ethical and reputational risks. Where such risks are identified, the process should ensure any decision to proceed is taken at the appropriate level, and should include ratification by the Board.

**11** The Company should ensure that the new process for selection, appointment and management of advisers is fully codified and integrated into the mandatory policy and procedures of the operational framework, and that appropriate guidance and training in the process is provided to all relevant employees. This should make explicit:

- a requirement to undertake face-to-face interviews, involving a company lawyer, as part of the due diligence process with all advisers whose activities require the interaction with potential customers;
- a general presumption that the identity of such advisers will be made known to potential customers; and
- endorsement by the Board of the adviser panel's recommendations and their explicit approval of any decision to make an appointment contrary to the panel's advice.

**12** Advisers engaged to assist in Offset arrangements in export contracts should be subjected to the same due diligence and approval process as Advisers on the principal export contract. Offset contracts should be subject to a due diligence process requiring an explicit assessment of ethical and reputational risks and be capable of being audited for this. The Company should also be proactive in encouraging greater scrutiny and transparency by governments of the Offset elements of defence contracts.

**13** The Company should continue to forbid facilitation payments as a matter of global policy. While it may not be possible to eliminate such payments immediately in some countries, management and employees in those countries need to be supported to ensure all such payments are reported to senior executives and to the Board, and the means developed to eliminate them completely over time.

**14** The Company should implement central registers (by individual country) to enable information to be collected and monitored on aggregate spend on gifts and hospitality to individuals and overall to each customer. Aggregate spend by individual country on gifts and hospitality should be reported annually to the CRC. The policy on gifts and hospitality should be circulated to customers, contractors and suppliers and the Company should agree and document acceptable standards and expectations of behaviour with each customer government. A global policy on corporate donations should be developed, consistent with the global code and the policy of openness and transparency.

**17** The Company should ensure an explicit assessment of proposed lobbying positions or campaigns against the values and standards in the global code, and that regular reports on this are submitted to the CRC.

**19** Any proposals for the appointment of third parties to provide the Company's Security Division with information should be subject to the same process (including Panel review) as for advisers. Regular reports on the activities of the Security Division, and compliance with ethical policies and procedures, should be provided to the CRC.

## 2009 Progress

Our new and revised policies, including our Product Trading and Pursuit of Export Opportunities policies, require us to make informed assessments and responsible decisions about the nature of our products and the business opportunities we choose to pursue. Products must be assessed against four criteria: the type of product, its intended use, the end user and, for exports, the country of sale.

The revised policy on offset (agreements with export customers to generate work or create capability in their country) requires us to ensure that robust procedures are in place for assessing and committing to such agreements.

In 2007 we created a Business Development Adviser Compliance Panel (the 'Panel') for the review and assessment of adviser appointments including for business development, security and offset advisers. All appointments of lobbyists are required to be reviewed by the Panel, other than certain domestic US appointments which are subject to separate legislative controls. The Panel, which is required to advise the Company as to whether it should proceed with an adviser appointment, is chaired by independent third parties who are partners from leading law firms.

All advisers added to the Company's adviser register in 2009 were appointed in accordance with a new global adviser policy introduced from 1 January 2009, with the exception of a limited number of US advisers who were already being assessed before the introduction of the new global adviser policy. However, this limited group of US advisers were also assessed by the panel which recommended their appointment.

Our policy on lobbying governments and other bodies has been revised to require all those lobbying externally on BAE Systems' behalf to comply with our Code of Conduct. From 2010 a report on lobbying activities must be provided to the CR Committee.

Our updated Gifts and Hospitality Policy sets out clear requirements for employees including limits on the giving and receiving of gifts and hospitality, together with recording of these activities.

We have amended our Company Giving Policy to give clear guidance on all Company donations.

Our Facilitation Payments Policy states that employees are prohibited from making facilitation payments irrespective of whether or not they are permitted by local laws and requires employees to decline and report any request for such payment.

**We are required to make informed assessments and responsible decisions about the nature of our products and opportunities we pursue.**

## GOVERNANCE

### Applicable Woolf Recommendations

**1** The Board of Directors should decide and communicate the Company's strategic aspiration and intention to be a leader in standards of ethical business conduct among global companies.

**2** The Company should be an advocate of its own ethical standards and must adopt the principle of openness and transparency. All ethical business conduct policies and procedures must be publicly available and easily accessible. The Company should be open about the actions it has undertaken to investigate allegations of unethical behaviour and about the outcomes..

**23** The Board/CR Committee should commission and publish an independent external audit of ethical business conduct and the management of reputational risk in the Company within three years and at regular intervals thereafter.

## 2009 Progress

We remain firmly committed to becoming recognised as a leader in responsible business conduct and in January 2009 we launched a Code of Conduct.

Establishing a clear understanding and shared commitment to responsible business conduct is an important element in our commitment to developing a culture of Total Performance. To support this commitment, during 2009 we reviewed and updated many of our policies and governance procedures.

We believe visible leadership is essential to embed a culture of Total Performance and responsible business conduct among employees at all levels and wherever they work in the world. Our Values, Code of Conduct and Responsible Trading Principles are being communicated to employees through briefings, training and ongoing engagement by senior leaders.

Given the key role of our Executive Committee, 12.5% to 13% of their potential incentive allocation was based on achieving our business conduct and safety objectives in 2009.

All line leaders and functional directors are required to submit to the Chief Executive the level of implementation of core policies in their areas of responsibility through the twice yearly Operational Assurance Statement. In cases where a policy is judged not to be fully implemented a plan is required setting out the milestones to full compliance. The objective agreed for 2010 is that by December all of the milestones have been met and any future milestones are on track to be met.

We have embedded Responsible Trading Principles into the Company's central system of Governance and our Operational Framework has been updated to address the 23 Woolf Recommendations.

In 2009, the Internal Audit team worked with The GoodCorporation to devise a methodology to assess Responsible business Conduct and Non-Financial Risk as part of all internal audits. We intend that the revised methodology will be implemented during 2010.

**We have embedded Responsible Trading Principles into the Company's central system of Governance and our Operational Framework has been updated to address the 23 Woolf Recommendations.**



# CODE OF CONDUCT

## Applicable Woolf Recommendations

**3** The Company should develop, publish and implement a global code of ethical business conduct. The Board should ensure the proposed global code is comprehensive and reflects the high standards of ethical business conduct consistent with the aspiration and intention to become a leader among global companies.

**15** The Company should:

- for all new majority joint ventures require the adoption of its global code and associated policies and procedures, or equivalent standards;
- for all new minority joint ventures, mergers and acquisitions, undertake a due diligence assessment of standards of ethical business conduct compared to those of the Company, and ensure to the extent possible that equivalent standards are put in place;
- for all new key contractors, require the adoption of its global code and associated policies and procedures, or equivalent standards in all of its collaborative activities; and
- for all existing relationships, implement a programme to achieve the above.

**16** As part of the programme to ensure that equivalent standards are in place for joint ventures and with key contractors, the Company should extend to them appropriate access to its ethics helpline.

**18** The Company should make explicit its commitment to take a proactive approach to instigating internal investigations into allegations of unethical behaviour and to the disclosure of any material findings to the relevant authorities. Aggregate information on disciplinary actions for unethical behaviour should be included in internal and external publications.

**20** A well-resourced training programme, in which every person in the Company participates, should be undertaken as part of the implementation of the global code and revised and repeated at regular intervals. Specific training modules should also be developed for senior executives and business unit leaders. Systems for monitoring these programmes should be developed so that they are able to provide the necessary assurance to the CRC as to their effectiveness.

## 2009 Progress

In January 2009 we launched a Code of Conduct. The Code encapsulates the principles and standards of business conduct we expect of employees wherever they work globally. As well as setting out our standards, the Code provides all our employees with practical guidance on how to deal with ethical dilemmas that may arise, and represents an unequivocal public statement of what we stand for, and how we do business.

The Code of Conduct was communicated to employees in 2009 through team briefings. The briefings were designed to cover how the Code of Conduct applies to employees in their daily work lives and aimed to create an environment where employees feel they can speak up, ask questions and raise any issues relating to responsible business conduct. Employees were required to undertake either online or classroom-based training on the Code of Conduct.

Our objective in 2009 was to ensure that our employees were aware of the Code of Conduct and understood how it applied to their day-to-day working lives. During 2009 we trained approximately 91,000 employees\* working in a wide range of roles in many countries around the world using a range of training materials.

Approximately 91,000 of our employees in our wholly-owned businesses were briefed and trained in 2009, representing approximately 95% of our workforce\*. These results include our Surface Ships business (approximately 7,000 employees) which joined the Company on 30 October 2009.

Employees were also asked to formally acknowledge that they understood and would comply with its requirements. By the end of 2009 approximately 86% of the workforce\* had provided their written acknowledgement. In addition to our wholly-owned businesses, as at 31 December 2009, we had 1,300 employees in joint ventures that are essentially under the control of BAE Systems ('controlled joint ventures'). We intend that those businesses are operating in alignment with our governance system. As at 31 December 2009 some 65% of employees in the businesses had been briefed and trained on the Code of Conduct, with 65% having signed their formal acknowledgements.

Activity continues to ensure that the remaining employees complete the Code of Conduct programme.

We intend that regular training will form part of our ongoing commitment to continuous improvement in responsible behaviour. refresher training will begin in 2010.

We intend that the Code will be reviewed regularly to ensure it continues to meet best practice, with the first review being conducted during 2010.

In 2010, we plan to provide our top 1,000 suppliers with a copy of our Code of Conduct and they will be encouraged to work to equivalent standards.

The Company is not in a position to require our non-controlled joint ventures or suppliers to adopt our specific standards (including operating an Ethics Helpline) in their business activity. However, it is our aim that there is clear understanding and a shared set of Values governing how we do business with our joint ventures. We intend to assess the approach taken by joint ventures and key suppliers as part of our programme.

\* As at 31 December 2009. Wholly owned subsidiaries only, excluding employees on long-term absence.

**Our global Code of Conduct defines the principles and standards of responsible business conduct we expect of employees.**

## WORKING TO IMPROVE INDUSTRY STANDARDS

### Applicable Woolf Recommendations

**21** The Company should take a more proactive leadership role in its engagement with the defence industry, governments, NGOs and other external interest parties to develop initiatives that will address the key ethical and reputational issues affecting the defence industry.

**22** The Company should be as open and transparent as possible in communicating all of its activities. Where this is not possible the Company should explain the reasons why.

## 2009 Progress

BAE Systems is a member of both the Aerospace Industries Association of America and the Aerospace and Defence Industries Association of Europe, which agreed common Global Principles of Business Ethics for the Aerospace and Defence Industry in October 2009.

We are actively working with the UK defence industry to promote the adoption of responsible business practices and we welcome the publication of a draft Bribery Bill. The Bill aims to provide a comprehensive scheme to deter bribery offences enabling courts and prosecutors to respond more effectively to bribery in the public and private sectors within the UK or abroad.

BAE Systems, together with other leading multinationals, is supporting a new Centre for Law and Ethics at University College London. The Centre, established in October 2009, aims to promote debate on business ethics and help companies promote an ethical corporate culture.

We have committed to being as open as practicable with external stakeholders.

We communicated our response to the Woolf recommendations internally during 2009. We shall now progressively communicate externally explaining our approach and the changes that we are making.

**We are actively supporting the promotion and adoption of responsible business practices**