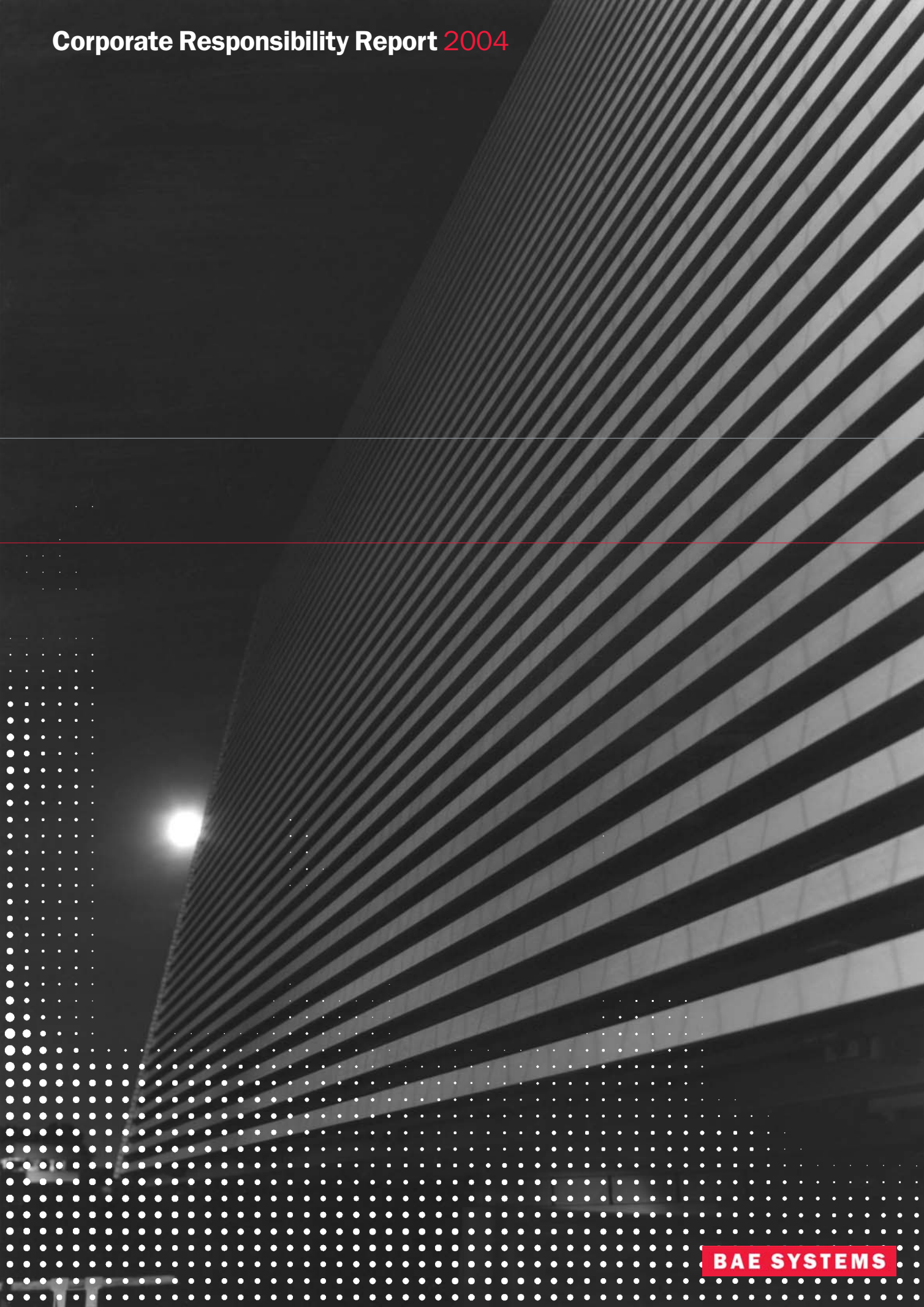


Corporate Responsibility Report 2004



Contents

Message from the Chief Executive	1
Objectives and progress	2
Stakeholder engagement	4
Corporate responsibility at BAE Systems	9
Does the defence industry really benefit the economy? A debate	10
Business ethics	12
Workplace	14
Education and community	18
Supply chain	22
Safety, health and environment	24
Assurance	28
CR on the web	30
Feedback – tell us your views	Inside cover

Front cover picture

The AR327 Commander long-range land-based radar is manufactured in the UK. It is at the forefront of communication technology. Communication systems are a key part of our business and we recognise the value of communication in all that we do. We do not claim to be at the forefront of communication in corporate responsibility but we strive for continuous improvement to equal the high standards of our products.

About this report

This report describes our corporate responsibility (CR) performance in 2004.

The theme is debate. In previous years we have asked contributors to give their views on issues around defence exports and CR in the defence sector. This year we focus on the debate about our contribution to the economy.

We value the views of our stakeholders and throughout the report we have included perspectives and opinions on many of the key issues associated with our business.

The report covers all BAE Systems' wholly owned businesses. Data is for calendar year 2004.

About BAE Systems

BAE Systems is an international company engaged in the development, delivery and support of advanced defence and aerospace systems in the air, on land, at sea and in space. The company designs, manufactures and supports military aircraft, surface ships, submarines, radar, avionics, communications, electronics and guided weapon systems. It is a pioneer in technology with a heritage stretching back hundreds of years. It is at the forefront of innovation, working to develop the next generation of intelligent defence systems.

BAE Systems has major operations across five continents and customers in some 130 countries. The company has more than 90,000 people and generates annual sales of approximately £1.2 billion through its wholly owned and joint venture operations.

Corporate Responsibility Report on the web

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

We welcome your views. Email any comments to crfeedback@baesystems.com



“Defence is a serious business and we recognise it is one that often provokes differing views. This is why we have focused on ‘debate’ as this year’s reporting theme.”

Corporate responsibility (CR) in BAE Systems is about good business practice and continual improvement. Our performance in 2004 underlines this as we delivered significant value across our worldwide activities. We also achieved reductions in accidents across our operations and our ongoing investment in training and development is contributing to delivering improved performance across our company.

Defence is a serious business and we recognise it is one that often provokes differing views. This is why we have chosen to focus on ‘debate’ as this year’s reporting theme. Debate means many things. It’s not just about understanding the concerns of others but also about communication, building relationships and challenging opinions around those issues that are fundamental to our business now and in the future. We consider it to be one of our responsibilities to help external stakeholders understand the value of defence, both in terms of national and global security and also as a sovereign capability and wealth generator in our home markets. We have engaged with BASIC

(British American Security Information Council), an independent research organisation, on this issue previously and are pleased they accepted our invitation to debate it in this report.

Our CR agenda is based on potential risk to our business. When evaluating risk it is essential that we engage with stakeholders and understand their views and perception of our business and do not rely solely on our own assessment. Accordingly, we invited recognised opinion leaders on CR to provide their views on our progress to date. We are pleased that our efforts and commitment are being recognised and have taken on board their comments and views on areas for improvement.

This year we have introduced formal reporting on CR issues to the Board of Directors and have expressed public commitment in our Annual Report & Accounts to conformance with the Association of British Insurers (ABI) Guidelines. The Board has decided to establish a CR Committee to be chaired by a non-executive director to provide focus on CR issues. We also

commissioned a third-party assurance group, csrnetwork, to carry out an independent review of accountability processes within our business. This review, coupled with ongoing stakeholder feedback and our own commitment to progress, led to us expanding reporting in several key areas. First, we have included more detailed information about who our main stakeholders are and how we engage with them. Secondly, we have increased the amount of information on business ethics and our operating principles and finally we have taken steps internally to strengthen the way corporate responsibility is managed to ensure it is fully embedded into all levels of our business.

To deliver products at the leading edge of technology in line with the needs of our customers requires a high-performance culture. It is a specific objective in 2005 for all employees to deliver high performance across all aspects of our business. On this basis, I anticipate being able to report continued progress on our CR agenda in future.



Mike Turner

Chief Executive
BAE Systems

We regularly review and update our CR activities to ensure we make progress on key issues and establish objectives for the coming year.

Progress in 2004 – How did we do?

Conduct a worldwide survey of employees to review progress on CR since 2002.

Conducted a worldwide employee survey covering a range of CR related questions, see page 6.

The survey showed positive feedback on employee engagement, and support and respect in the workplace. It also identified areas for improvement including management of poor performance, business change and trust in leadership.

Action plans developed in each Business Unit to respond to the survey findings.

Commissioned a survey of key CR opinion leaders to get feedback on our CR performance and reporting, see page 8. Feedback showed we have made some progress since 2002 but stakeholders still have concerns regarding our communication on ethical issues and transparency which we have begun to address in this report.

Extend our ethics hotline to operations in Australia.

Extended the ethics hotline to all our Australian sites.

Introduced an ethics email address that can be used by employees worldwide.

42 calls were made to the ethics hotline in the UK and 574 in the US, see page 12.

Held our first Ethics Officer Conference in North America to share best practice.

Benchmarked our whistleblowing arrangements against the Institute of Chartered Accountants Guidance on Effective Whistleblowing Arrangements.

Participated in the Economic Co-operation and Development (OECD) Phase 2 review to help assess implementation of the OECD Anti-Bribery Convention in the UK.

Partner with the UK Health & Safety Executive to address key areas of safety performance.

Partnered with the UK Health and Safety Executive to develop a best practice approach to managing five key risks. These are confined space working, hand-arm vibration syndrome (HAVS), working at height, contractor management and slips, trips & falls.

Agreed a three-year audit programme of our manufacturing sites to develop and extend best practice in the five key areas. In 2004, our sites at Samesbury and Barrow were audited as part of this programme.

Held our annual Safety, Health & Environment (SHE) conference in November 2004 to provide a networking and learning opportunity for safety professionals across our operations.

Improved our SHE performance in a number of areas, see data on page 24.

Introduce an external verification programme for safety and environment data.

Began working with CSR Network (an independent consultancy specialising in CR assurance) on an assurance process for our CR reporting, as a first step towards full verification. Their assessment of our CR processes is provided on page 28.

Reviewed our SHE data collection systems and commissioned a new database which will improve the quality of SHE data.

Reporting framework for SHE performance data formally agreed by the Executive Committee.

Assessment of SHE management systems across our Customer Support & Solutions (CS&S) operations carried out by our internal audit group.

Objectives 2005

Our objectives for 2005 are:

- 1 Establish a board committee on corporate responsibility
- 2 Improve our rating against Accountability standard AA1000
- 3 Improve safety, health & environmental performance
- 4 Develop a formal stakeholder engagement plan
- 5 Upgrade our CR website to provide real-time information on our CR activities

Review energy management and establish a strategy to improve energy efficiency and reduce consumption.

Established a Carbon Club for our UK manufacturing sites and joint venture and partner companies in the UK to address compliance with the EU Emissions Trading Scheme.

Strategy for the reduction of carbon emissions developed by the Carbon Club.

Other highlights.

The BAE Systems Board decided to disclose in our Annual Report our approach to managing corporate responsibility risks in compliance with the Association of British Insurers (ABI) Guidelines.

Appointed a new director for Diversity and Equal Employment Opportunities for our North American businesses.

A diversity case identifying key objectives and actions across our operations was agreed with our Executive Committee, see page 14.

Gave £1.1million in charitable donations.

Employees and the company raised £6 million for Charity Challenge and recorded 5,700 volunteer days.

Undertook research with schools and partners to help us strengthen our education partnerships.

Completed certification to ISO 14001, the international environmental management standard, at all our major manufacturing sites.

BAE Systems continued to be included on the Dow Jones Sustainability Index.

Joined the UK Dignity at Work partnership to combat workplace bullying.

Achieved Investors in People accreditation in our Avionics Systems business.

Engaging with our stakeholders

“BAE Systems goes beyond many other companies in the defence industry as it commits to responding to the specific challenges of defence exporters with respect to the nature of products and its impact.”

Dow Jones Sustainability Index assessment



Perspectives on Corporate responsibility

Corporate responsibility is about how we do business, so it involves everyone who works at BAE Systems. Here, several people from across the company explain its relevance to their job.

Defence companies play an important and legitimate role in society. We are proud that our products help countries to defend themselves and enable peacekeepers to do their jobs.

However, we recognise that for some defence is a controversial industry. No matter how necessary, the manufacture and sale of equipment that is designed to kill inevitably evokes strong feelings.

We believe it is important to understand the views of others and explain our approach. Good communication helps us develop and improve our CR programmes.

We encourage dialogue and open communication with our stakeholders including employees and their families, trade unions, shareholders, customers, business partners, suppliers, competitors, governments, NGOs and local communities.

Much of this discussion takes place as part of normal business. We also communicate specifically on our CR performance through this report, our website and individual meetings.

These are some examples of our interactions during 2004.

Investors

We meet regularly with investors, including those representing socially responsible investment funds (SRI) to discuss CR issues.

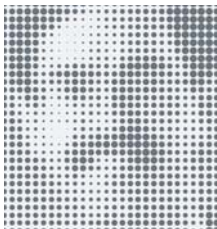
We met with over 30 SRI investors during 2004, in the UK, Benelux and France, to discuss a range of issues relating to our CR performance and reporting. Several SRI analysts also took part in our opinion leader survey.

BAE Systems is listed in the Dow Jones Sustainability World Index and Dow Jones STOXX Sustainability Index. Our inclusion in these indices is based on an annual assessment by

Sustainable Asset Management (SAM) Research. In 2004 this assessment rated BAE Systems strongly in several areas including our code of conduct, and risk and crisis management systems. BAE Systems was also rated above the industry average on environmental management and among the best for human resources management and community activities. The assessment gave BAE Systems a strong score for its willingness to enter into dialogue with stakeholders on controversial issues. Areas that received lower scores include transparency and strategic planning.

We participated in the Business in the Community Corporate Responsibility Index in 2004. Results will be available in 2005.

We also seek feedback from our shareholders through our Annual General Meeting, a feedback questionnaire included in our Annual Report and via our corporate responsibility email address crfeedback@baesystems.com.

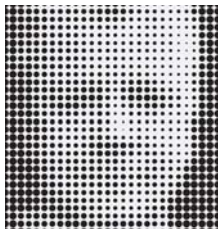


A sincere and vibrant 'corporate responsibility' culture positively influences attitudes about our company. It ensures that employees know that the company cares about the community and environment.

Employees get involved in lots of ways, from Charity Challenge to recycling or donating items instead of throwing them into the trash. Our ethics policies are communicated through newsletter articles, training and most of all by managers setting a positive example.

Ed Langmaid

Director of Public Affairs and Communications, US

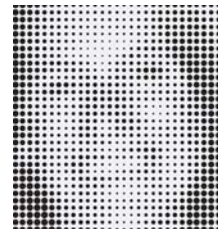


To my mind corporate responsibility is mainly about how the business affects the people that work inside it. You have to get things right for them.

For the people I represent, the major issue is job security. This can be enhanced by training and by the company having good CR policies that would hopefully help us to win more government contracts. Other important issues are pensions, fair treatment in the workplace and safety at work. We have trade union representatives who deal specifically with health and safety issues.

Mark Allen

Amicus (Professional Staff) Secretary, Warton Unit Secretary of BAE Systems Trade Union Delegates Conference



Corporate responsibility is about taking an active role in the community. It's also about appropriate governance and ethical behaviour.

The most important element of CR for me is our charity work. Most of our employees come from the local area and want to give something back. We encourage employees to get involved in Charity Challenge. This allows people to balance their interests outside work with their jobs.

Shelley Mearns

Communications and Corporate Affairs Manager, BAE Systems Australia

BAE Systems has 50 locations in Australia, often in remote areas. Our CR programmes aim to create a sense of community across the company.

Employees

Regular surveys are an important way for employees to give confidential feedback. They help us to understand employee views, monitor progress and improve our performance.

We conducted our second global Employee Opinion Survey in April 2004. All employees were invited to participate and over 37,000 people (56% of employees) from across BAE Systems took part.

The survey tracked our progress against our first global survey in 2001 and our snapshot survey in 2002. It also compared our results with those from other major companies and our peers in the aerospace and electronics industry.

Many of the questions help us to review our progress on CR.

Areas that scored well include employee engagement, and support and respect in the workplace. For example, 81% agreed with the statement, 'My immediate manager/team leader consistently treats me with fairness and respect'; 71% agreed that BAE Systems creates a climate of mutual respect among employees of different backgrounds.

The most notable improvements since our survey in 2002 were in the areas of management action and feedback.

Some Business Units included additional questions on business ethics. These received high scores. For example, in our North American business 93% of employees confirmed that they understand BAE Systems' rules of business conduct and ethics.

The survey also identified areas for improvement, such as management of poor performance, business change and trust in leadership.

It is important that we act on the feedback given. Each Business Unit has assessed the survey findings and developed action plans to address the issues identified. Action Teams have been appointed in each Business Unit to recommend improvements.

Employee Opinion Survey : **Improvements since 2002**

Notes

* Comparable data for the aerospace and electronics industry are not available for these two areas

My business unit leadership team is taking positive steps to improve business performance.



My immediate manager/team leader lets me know how I am doing on an ongoing basis.*



I believe my Business Unit will act on the results of the survey.*



% of employees who agree

“BAE Systems need to keep pursuing an open relationship and to encourage its people to be innovative in how they meet the customer’s requirements.” Mary O’Gorman, Director Strategy, Defence Logistics Organisation

Action plans have also been developed at corporate level to address issues of relevance across the company. These include measures to increase confidence and trust in leadership by improving communication with employees. The survey results show different trends between male and female employees at different levels of seniority. Specific actions are being planned by our diversity team and human resources department to address this.

Progress will be communicated to employees through regular business reviews, newsletters and via the company intranet.

Suppliers

Good communication and two-way feedback are important elements of our supplier management programme. We meet with key suppliers quarterly to review progress against targets, get feedback and identify ways we can better support them. See page 22.

Customers

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.



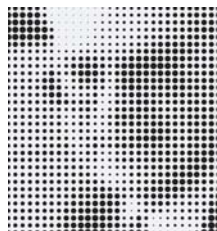
CR is about what the company puts into the community. BAE Systems has had a successful 30 years in Saudi Arabia so it is good policy for us to give something back.

This means helping Saudis to become more self-sufficient and prosperous – by employing Saudi nationals, sharing technology and supporting education and local charities.

As head of PR, CR is extremely important to my job. I regularly talk to the press and public about the good things we’re doing. As a foreign company this is vital to maintaining public support.

Walid Abukhaled

Head of PR & Communications – Middle East



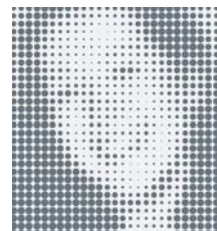
CR is about being ‘a good neighbour’. In my day-to-day work health and safety, product safety and care for the environment are crucial.

My goal is to create a forthright environment where employees can raise concerns. We also employ an independent consultancy which employees can call for advice or help.

We have a high-profile involvement in the community. This is not just about charity. Our grounds maintenance is done by the Blendworth Centre, for adults with learning difficulties. They do a super job at a competitive price. It’s a real win-win.

Andy Williams

Managing Director, Underwater Systems



To me corporate responsibility means that BAE Systems is cognisant of environmental and social issues and is trying to behave responsibly as a business. From a business perspective CR helps to improve public perceptions and is popular with investors.

CR is relevant to my day-to-day work; my current job involves a study into lead-free soldering, which has environmental benefits. Health and safety and the treatment of employees are also important aspects of CR.

Heather Anderson

Project management graduate, Avionics, Edinburgh

“You should engage positively and create a dialogue with critics as part of being transparent.” Trade union representative

CR opinion leaders

In 2004, we commissioned a small survey of 25 CR opinion leaders in the UK, Europe and the US. Participants included journalists, analysts, non-governmental organisations (NGOs), trade unions and industry representatives. Ten of these also participated in our first survey in 2002.

The survey gives us qualitative feedback and provides a snapshot of views. In general, participants welcomed our efforts to address CR issues and felt that CR is important to the defence sector.

Survey findings

Ethics and transparency were viewed as the most significant areas for improvement. Participants were keen to see more information on our policy regarding defence sales and some expressed concern that we do not do enough to address ethical issues in this area.

Bribery and corruption continued to generate most comment, with participants requiring further clarity on the steps we have taken to address these issues. Product stewardship and the environment, particularly climate change, were also considered to be significant issues for our company.

We specifically sought views on the quality of our previous CR reports. Many participants felt that our report should say more on how we comply with our policies and with the law. In particular there was a desire to see clearer information on corporate governance, including lines of responsibility throughout the company and at executive and board level.

There was also a request for more information on our approach to defence sales and human rights.

Interviewees felt that future reports should have more information on ethics with less emphasis given to community and charity work.

The report also received some positive feedback. In particular, participants felt that our objectives and progress were clearly presented and liked the inclusion of positive and negative feedback from stakeholders outside the company.

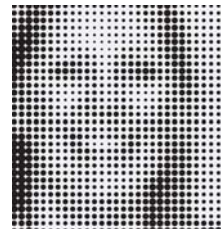
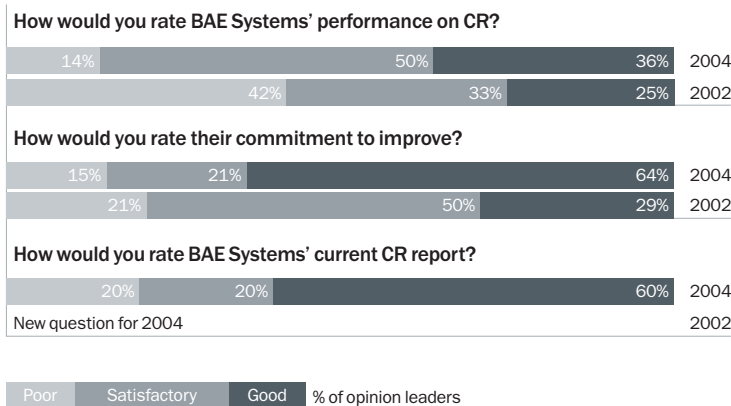
We value this feedback and have endeavoured to address as many issues as possible in this report. We will continue our efforts to improve communication on these issues.

Local communities

We have good relations with the communities around our sites and enjoy frequent and open communication with this stakeholder group. Our site managers address any complaints on issues such as noise or traffic congestion if they arise.

Many of our employees interact with their local communities through our community investment and education programmes, see page 18.

Opinion leader survey results 2002 and 2004



Corporate responsibility means being aware that what we do affects the outside world. In the Middle East our work for charities is the most visible aspect of CR. But CR is more than what we do for charity – that is the easy bit. It's also about ethics, safety and the environment.

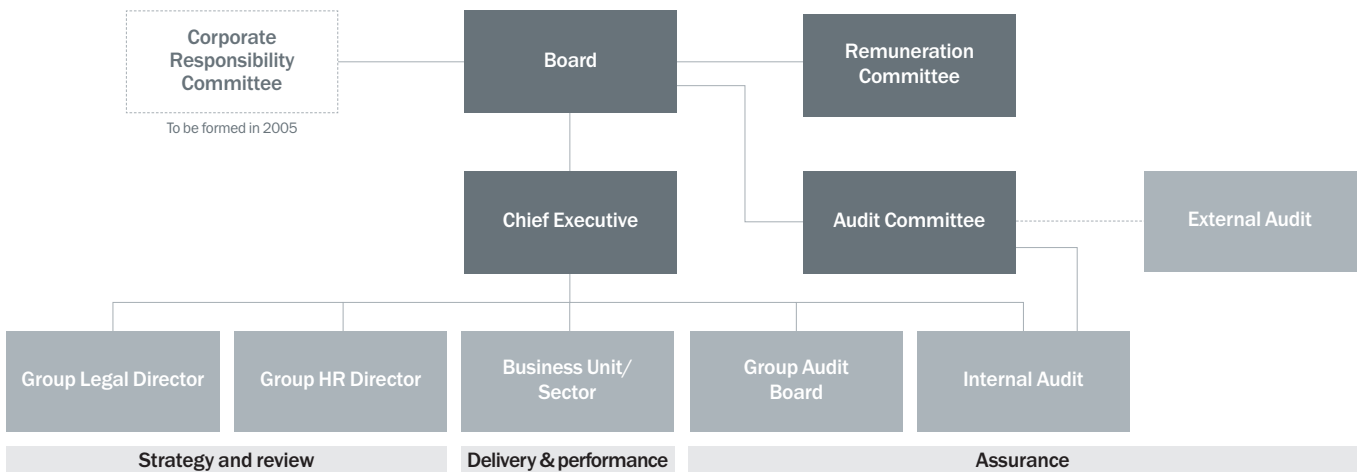
Jayne Thomson

Director of PR & Communications – Middle East

I would like us to be more proactive on CR in our export markets and make our work on ethics, safety and environment more visible. This shows the countries where we work that we're not just interested in selling to them, we're also working with them to benefit the community.

Corporate responsibility at BAE SYSTEMS

Management of corporate responsibility



Corporate responsibility (CR) is about good business practice and continuous improvement. It requires us to recognise and act on our responsibility to stakeholders. Everyone in the company has a role to play.

This section explains how we manage CR issues.

Managing corporate responsibility

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

The Remuneration Committee is responsible for agreeing the remuneration of the executive directors (including the Chief Executive).

The Audit Committee is responsible for reviewing the output from the group-wide process used to identify, evaluate and mitigate risk – including CR risks. It is also responsible for evaluating the performance of the external auditors and ensuring the processes are in place to ensure

that their objectivity and independence is not compromised.

The Board has recently agreed to form a Corporate Responsibility Committee that will be responsible for reviewing and monitoring the processes the company uses to manage social, environmental and ethical risk and to assist the Board in overseeing the development of strategy and policy in this area. It will be chaired by a non-executive director.

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 HR Director (Workplace, Community and Business Environment).

CR issues are managed day-to-day by our CR team. In 2004 we established a CR Forum, with representatives from each Business

Unit. This includes experts in communication, human resources, health and safety, community affairs, investor relations and the environment.

The Forum will meet regularly to coordinate CR activities and reporting, share best practice and promote internal communication and awareness-raising on CR issues across the business. Each Business Unit has developed a CR action plan reflecting its specific issues and stakeholder groups.

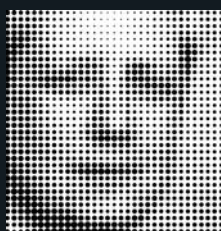
Assurance

It is important that our CR reporting addresses issues that are material to our business and reflects stakeholder concerns. In 2004 we worked with an independent consultancy to benchmark our CR reporting against other major companies and best practice standards, using the Accountability Rating, see page 28.

Does the defence industry really benefit the economy?

Julian Scopes

Head of UK
Government Affairs,
BAE Systems



London, December 2004

BASIC characterises UK Government purchasing from BAE Systems as a 'subsidy'. This argument is misplaced.

The UK operates the most openly competitive defence market. BAE Systems has to win on merit by demonstrating value for money. International comparisons demonstrate that BAE Systems delivers quality equipment at very cost-effective prices.

BASIC describes research and development (R&D) spending by the Government through BAE Systems as a subsidy. This is incorrect. Customers usually pay for R&D through pricing – in every sector from automotive to pharmaceuticals. The defence sector is different, because the customer (the Government) dictates in considerable detail specific requirements, often under

“The facts indicate that defence exports benefit the economy and national security.”

tight security rules. It is therefore more effective for the customer to pay for R&D direct. Buying 'off the shelf' sounds superficially attractive but ignores the sensitive uses to which defence equipment is put. The nation needs control of the technology to ensure that equipment can be upgraded and modified to meet UK requirements, often at very short notice, and can be supported throughout its 30-year plus life.

It is naive to think that without the pressure of home-grown competition, the UK customer would not end up paying for R&D on supposedly off the shelf equipment bought from overseas. The only effect of such purchasing would be to kill off one of the UK's few remaining centres of engineering and manufacturing excellence. In some cases it would mean buying off the shelf from a monopoly overseas provider at increased cost.

R&D spend also creates other significant economic benefits – new technologies, processes and skills typically spill over into the whole sector (eg as it is replicated by competitors), into other sectors and eventually throughout the whole UK economy.

The British Government's view is that the UK benefits from properly approved and targeted defence exports. Academic research also suggests a strong causal relationship between exports and economic benefits such as productivity, higher employment and sales. Increased

throughput in the British defence industry provides a pricing benefit to the Government and there are benefits from longer production runs and commonality of equipment with allies.

An Oxford Economic Forecasting (OEF) study, commissioned by Defence Industries Council, indicates that the cost to Government of supporting defence exports amounts to some £140 million at most (and some of this is attributable to broader defence diplomacy objectives, so would continue anyway). But the UK Government benefits from more efficiently priced defence equipment by £300 million a year. BASIC, and other NGOs, disagree in principle with defence exports. However the facts indicate that defence exports benefit the economy and national security.

BASIC argues that the economy would benefit if the resources applied to defence were invested in other industrial sectors. However the Government has to continue to spend money on equipping the armed forces in the interests of national security. As long as the UK defence industry continues to make good value, high-quality products the economy will benefit if this money is spent on equipment from the UK rather than off-the-shelf products from other countries.

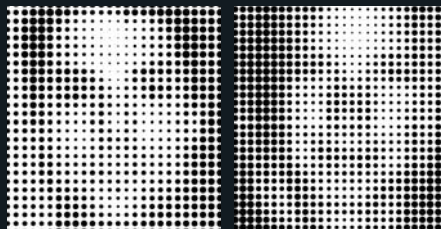
In 2003, we commissioned a report by Oxford Economic Forecasting (OEF) to measure the contribution that BAE Systems makes to the UK economy. Here we debate with the British American Security Information Council, an independent research organisation, the significance of the study's findings.

Paul Ingram

Senior Analyst, British American Security Information Council

Emma Mayhew

Project Analyst, British American Security Information Council



London, December 2004

Claims that arms production in general, and BAE Systems in particular, presents a special contribution to the UK economy deserving of public support need particular scrutiny.

Publishing a report (the Oxford Economic Forecasting study) that simply outlines the level of exports, investment, employment and contribution to the exchequer does not in itself settle the matter.

We can debate the level of taxpayers' money received by BAE Systems to facilitate its exports (we believe it to be hundreds of millions of pounds), but there can be no doubt that there is a significant subsidy from Defence Export Services Organisation support, contacts with (or promotion by) military attachés, official visits

and use of military personnel, cheap export credits and the influence of exports on Ministry of Defence (MoD) procurement.

There is also the significant government spend on military R&D. Since the 1980s transformation of the coal industry, mainstream economists have believed that industries generally should stand on their own two feet and that subsidies distort efficient allocation of resources. There are, of course, exceptions to this (such as correction for externalities, reallocation of wealth, public services), but employment and exports are not acceptable rationales under prevailing economic theory.

In any case, arms exports hardly amount to an essential element of the UK economy. We are now talking of little more than 60,000 jobs, 0.2% of the national labour force and fewer than the number finding new jobs in the average month. Even MoD economists agree that reduced arms exports would create more jobs elsewhere in the economy.

“Industries should stand on their own two feet ... subsidies distort efficient allocation of resources.”

BAE Systems' turnover is around a quarter of one per cent of the UK's total. The tax generated by BAE Systems reported in the Oxford Economic Forecasting study was made up of employee's income tax and NI contributions, as the company made a loss in 2002.

But what of BAE Systems' contribution to reducing MoD spend? The MoD claims that exports save their procurement budget £350 million a year. But how the department came to this figure and how these savings are actually made remains a mystery. These savings would not exist if MoD stuck by its Defence Industrial Policy and placed value for money (in the broadest sense) over the lifecycle of equipment as its prime objective. If it did, then it would buy more off the shelf.

Put simply, there is no doubt that BAE Systems makes contributions to the economy. But are those contributions more significant than those that would be made were the resources (skilled and unskilled workers and capital) applied elsewhere in the economy? The jury is still out, but the challenge is strong. This must call into doubt the basis upon which the government provides the company with such generous financial support.

Business ethics and operating principles

The nature of our business means it is particularly important that we have strong values and an awareness of public concerns.

BAE Systems is committed to comply with all laws governing defence sales and to meeting the highest ethical standards in our dealings with others.

We would never condone unethical or illegal conduct. It is not only wrong, it could also damage the national interests of the countries where we operate, harm the commercial prospects of the company and leave employees and directors liable to imprisonment.

Our Operational Framework sets out our policies and governance systems to ensure that all employees carry out our business in an ethical way. The Framework is reviewed and updated annually.

Ethical conduct

We are committed to conduct our business to the highest ethical standards. We comply with the law in all countries where we operate, including laws implementing the OECD Anti-Bribery Convention and the US Foreign Corrupt Practices Act.

All BAE Systems' employees are required to act with honesty, integrity and fairness. We will not tolerate bribery or other attempts to improperly influence the decisions of customers or suppliers.

Our Operational Framework sets out our expectations of employees. It is supported by more detailed policies to guide employees in their work. These cover a range of issues including ethical conduct, appointment and monitoring of marketing consultants and advisers, offset agreements, conflicts of interest and appropriate gifts and corporate hospitality.

More transparency from the company about our operating principles should help stakeholders understand the responsible nature in which we conduct our business. We are committed to providing this transparency.

Training and awareness

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

Our booklet *Ethics and You* explains in summary form our stance on ethical issues affecting our business and introduces our ethics hotline. It has been distributed to all employees in the UK, South Africa and Australia and a version is being prepared for use in Saudi Arabia. It is also available on our intranet site. Our US business has a similar booklet entitled *Code of Ethics and Standards of Conduct* which contains, in addition, material reflecting particular aspects of US law and practice relevant to doing business with the US government.

We provide awareness training on our anti-bribery programme to management and supervisory staff according to their business role. We have trained staff from commercial, procurement, finance, customer support and other functions, in addition to marketing staff and senior managers generally. On completing the training of the session employees are asked to sign a personal confirmation they have attended the course, and will comply with our policies and will report any issues of concern. Employees involved directly in sales and marketing must attend this training and must re-certify their compliance annually.

In the US all new employees are required to complete four mandatory online ethics training modules and all employees are required to view an ethics training video annually.

“Demonstrate compliance with your policies. Show how you are working with unions and governments to ensure you act ethically.” Investor

Monitoring and compliance

Employees are encouraged to seek advice on any concerns and are required to report suspected cases of unethical conduct.

They can do this through their line manager or confidentially through our independently managed ethics hotline. This toll-free telephone line is available in the UK and US and was launched in our operations in Australia in January 2005. Arrangements are in hand to provide local free telephone numbers in other countries in which we operate. We also have an ethics hotline email address that can be used by all our employees worldwide.

As well as support from their line manager, employees in Saudi Arabia can contact the managing director of our Saudi operations directly via a confidential post box with any concerns. We plan to extend the telephone hotline to our employees in Saudi Arabia during 2005.

In 2004 the UK hotline and worldwide e-mail address received a total of 42 enquiries. Of these 26 calls related to human resources issues, 11 were requests for further guidance or clarification, 2 were cases of suspected fraud and 3 were concerning our legal/environmental policies.

In the US there were 574 contacts with ethics officers through the hotline, by mail, email and visits to the ethics office. These included 248 requests for guidance and clarification, and 326 allegations

of misconduct in the workplace. The number of contacts in the US increased significantly this year. This is because of an increase in the size of our North American business, improvements in data collection and greater awareness of ethical issues.

We will be reviewing awareness of ethical issues across our UK businesses, including awareness of the UK hotline, during 2005.

Our UK Ethics Review Committee of senior executives reviews all calls to the UK hotline quarterly to ensure that reports are investigated and appropriate action taken. The Audit Director chairs the Committee and its members are the Director of Corporate Responsibility, the Director of Employee Relations, the Director of International Compliance and the Director of Security.

In North America, our ethics programmes are run by an Ethics Steering Committee with representatives from each Business Unit, and an Executive Ethics Oversight Committee, of senior executives chaired by the Senior Vice President Legal and General Counsel. We have an Ethics Officer in each North American Business Unit who is responsible for investigating any allegations of unethical conduct. We held our

“Honesty and transparency are key issues. The money used to buy products comes from taxpayers so there is a duty of accountability to them.” Journalist

first North American Ethics Officer Conference in 2004 for officers to meet, share best practice, hear from external experts, and attend a one-day training programme on conducting internal investigations.

Improving our ethics programmes

Our compliance policies and processes have been reviewed by legal experts in the UK and US to ensure they accord fully with the relevant laws. They are also in accordance with the anti-corruption rules of the International Chamber of Commerce (ICC) and are aligned with Transparency International's Business Principles for Countering Bribery. In early 2003, a review was completed by our Internal Audit team to ensure that they were being implemented properly within the business and some additional guidance was provided following their recommendations. A further review in late 2004 highlighted a small number of further improvements in specific areas, which have been implemented.

Also in 2004 we carried out a review of our whistleblowing arrangements and benchmarked our policies against the Institute of Chartered Accountants in England and Wales (ICAEW) Guidance on Effective Whistleblowing Arrangements.

The review found that our arrangements compare well with the ICAEW recommendations but that we need to do more to raise employee awareness. An indicator of this need may be that the number of calls to our ethics hotline is low compared with other companies of our size. We are looking at ways to increase awareness of the hotline among employees and to promote its use. A review of awareness programmes is due

to be undertaken early in 2005 and the results reported to the Audit Committee.

BAE Systems is committed to contribute to the debate on anti-corruption measures.

We were one of the companies to participate in the industrial interviews held as part of the UK's OECD Phase 2 review in July 2004 which assessed how effectively the UK had implemented the OECD anti-bribery convention. In the UK we participate in the Confederation of British Industry (CBI) and ICC (UK) anti-bribery forums and regularly attend seminars on these issues.

We also maintain contact with other major companies, which face the same challenges, to share learning. In North America BAE Systems is a signatory to the Defense Industry Initiative on Ethics and Business Conduct (DII). Members of this industry organisation agree to six principles of ethical conduct and to share best practice. We report annually to the DII on compliance with its standards for ethical conduct and public accountability. BAE Systems North America is also a sponsoring partner in the Ethics Officers Association.

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. A formal fraud response plan has been developed.

The plan requires our Internal Audit department to investigate all 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 made available to all employees on a dedicated intranet site.

Statutory controls on defence exports

The sale of defence equipment is highly regulated. In the UK the Export Control Act requires us to obtain a licence for all defence sales. 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 US we are subject to regulatory controls including the Arms Export Control Act, the Export Administration Act and Treasury embargoes.

Michael Lester, our Group Legal Director, is the board member responsible for ensuring that we comply with 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.

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. This provision of benefits may take many forms. These include:

Direct Offsets:

Platform/Product related

Indirect Offsets:

Defence, but not platform/product related

Unrelated Offsets:

Non-defence related.

Offsets, or industrial participation agreements, are a customer-driven requirement. Currently 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 engagement

It is our policy not to make any political donations.

We lobby governments to ensure they are well informed about BAE Systems, our products and services, and our economic and social contribution, when taking decisions and formulating policies that affect our business.

Often lobbying is undertaken indirectly through trade organisations. In the UK these include the CBI and the Society of British Aerospace Companies. We also engage directly with governments as part of our marketing activities.

Our Corporate Consultative Committee of senior trade union representatives and managers from our wholly owned UK businesses have developed a joint process for lobbying government on job security.

Workplace

“Everyone agrees that people are an organisation’s greatest asset, and we all know that for an organisation to succeed everyone has to perform well.” Investors in People

Our People Policy

We seek to:

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

Operate fair and transparent recruitment and resourcing policies that are based solely on merit and actively encourage career development within the organisation.

Ensure that our reward framework is fair and aligns the interests of employees with those of the business and the shareholders and facilitates a 'high-performance' culture.

Actively seek and act upon employees' views and feedback, using surveys, focus groups and any other appropriate means of promoting communication and dialogue.

Conduct regular dialogue on performance and development so that all employees have an opportunity for constructive feedback with their manager about their performance, their roles and responsibilities and development needs.

Create an environment in which employee relations, both individually and collectively, are managed in a spirit of openness and trust.

Provide employees with timely business information particularly at times of organisational change to ensure adequate employee consultation, involvement and support.

Ensure employees know what is expected of them and that they have the capability, resources and support to enable them to meet the demands of their job and deliver the performance required by the company.

Provide learning and development opportunities to ensure that people have the professional and personal skills to achieve their potential.

Data : Diversity

Diversity data: Ethnicity

	UK		US	
	2003	2004	2003	2004
White	36,296*	36,560	19,162 (82%)	20,470 (82%)
Non-white	383 (1%)*	412 (1%)	4,207 (18%)	9,522 (38%)

Ethnic minorities in the US

	2003	2004
Total employees	23,369	24,992
Ethnic minorities	4,207 (18%)	9,522 (38%)
Caucasian	19,162 (82%)	20,470 (82%)
African American	1,636 (7%)	1,928 (7.7%)
Hispanic	935 (4%)	939 (3.7%)
Asian	1,402 (6%)	1,537 (6.1%)
American Indian	234 (1%)	118 (0.47%)

Notes

* Data for 2003 corrected after improvements in our data collection system

North America Functional Leadership Development Programme

The North America Functional Leadership Development Programme (NA-FLDP) is an initiative based on building leadership strength, sustaining competitive advantage and leveraging resources across the North America organisation.

During 2004 a North America-wide team completed an internal and external benchmark study to assess current graduate level leadership development programmes in BAE Systems North America. Results indicated the North America business would benefit from a consistent approach to identifying

and developing talent through expanded functional leadership development programmes. This will significantly improve our ability to recruit, develop and retain an increased number of high potential employees. This will help to mitigate the pending shortage of skilled leaders and expand the pipeline of future leaders for BAE Systems North America.

During 2005, a Functional Leadership Development Programme Best Practice Model will be established. It will be based on industry best practices and sponsored by Vice Presidents who will communicate

and sponsor the model within their specific area. By implementing Functional Leadership Development Programmes, BAE Systems North America will have a consistent approach to the development of new talent, improve the ability to transfer high potential employees across the organisation, significantly improve succession planning within the functional areas, and prepare future leaders to assume leadership roles.

We employ over 90,000¹ people across five continents. Most of our employees are based in the UK, US, Saudi Arabia and Australia.

To achieve our business objectives we depend 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 are working with trade unions and employee representatives to review continually employment practices.

In 2004 we introduced a new People Policy, see page 14, to define our principles for people management across BAE Systems. The policy is addressed to all employees but is particularly important for managers and human resources professionals. The policy will be incorporated into our Operational Framework during 2005.

Diversity

BAE Systems is committed to equality of opportunity for all employees and to creating a workplace where everyone is treated with respect.

We collect data on gender diversity in Australia, the UK and US, and on ethnic diversity in the US and UK to monitor our progress.

A diverse mixture of cultures, backgrounds and thoughts helps to drive innovation and performance. Our Corporate Diversity Steering Group is working with diversity co-ordinators in our Business Units to help us recruit and retain a diverse workforce. This is a challenge in our traditionally white male-dominated sector.

In 2004 the Executive Committee agreed a new diversity case for the business. This outlines a more proactive approach to diversity on the part of our senior leadership. It aims to ensure we maintain a competitive business advantage by attracting and retaining a disproportionate share of the world's most talented people. The diversity case includes specific actions to help us:

- Demonstrate equality of opportunity and prevent direct or indirect discrimination
- Drive diversity and inclusion through selection and development processes
- Ensure we create a culture that attracts and retains the best
- Leverage maximum advantage from our geographical footprint
- Integrate diversity and inclusion into our existing business practices.

During 2004 several Business Units carried out employee surveys to assess perceptions on

diversity and are developing action plans to respond to the findings. We also appointed a new Director for Diversity and Equal Employment Opportunities for our North American businesses and reviewed and updated our UK Respect at Work policy and procedures.

Dignity at Work

In 2004 BAE Systems was invited to become a founding member of Dignity at Work, a new anti-bullying partnership between the UK Government, Amicus (the UK's largest private sector trade union) and several major companies. Workplace bullying is a serious problem that can affect employee health and performance.

Dignity at Work is researching the causes of bullying and developing guidance to help companies tackle this problem. The partnership is still in its early stages but is expected to include training for human resources professionals on how to deal with bullying, awareness programmes and employee harassment counsellors to help employees who are victims of bullying.

¹ Includes share of joint ventures

Diversity data: Gender

	UK		US		Australia	
	2003	2004	2003	2004	2003	2004
Total employees	36,679	36,974	23,369	24,992	2,658	2566
Male	31,668 (86%)	31,953 (86.5%)	16,739 (72%)	17,731 (71%)	2,215 (83%)	2,132 (83%)
Female	5,011 (14%)	5,021 (13.5%)	6,630 (28%)	7,261 (29%)	443 (17%)	433 (17%)
Undeclared	0	0	0	0	0	1

UK employee type by gender 2004*

	Male	Female	Total
Executive	4,854 (90.5%)	508 (9.5%)	5,362
Manual	8,698 (94%)	552 (6%)	9,250
Professional	17,260 (82%)	3,805 (18%)	21,065
Undisclosed	1,141	156	1,297
Total	31,953	5,021	36,974

Age (percentage)

	UK		US		Australia	
	2003	2004	2003	2004	2003	2004
Under 25	10	9.3%	5	3%	26.2	8.8%
26-35	19.3	18.6%	16	13.4%	43.8	25%
36-49	45.6	45.6%	45	48.6%	18.5	43.3%
50-59	21.9	23.1%	25	25.2%	3.2	19.1%
60+	2.9	3.5%	9	9.8%	8.3	3.8%

Notes

* Transfer from individual business unit legacy systems to a common people reporting system allows us to collect and report this data from 2004



Ian Madeley

**Technical Apprentice,
Naval Ships, UK**

I am in my second year of a technical apprenticeship to become a draughtsman. I applied for the apprenticeship to gain more qualifications, learn a trade and earn money at the same time.

In the first year of the apprenticeship I was based full time at college, studying maths, electrical fundamentals and technical drawing by hand and on the computer. So far in my second year I have been working on the shop floor to gain hands-on experience. Some of the skills we've covered are reading working

drawings and learning to operate different kinds of machinery and tools such as buffs, grinders and welding torches.

There is a training officer we can talk to for advice or to discuss any issues.

Through the apprenticeship I have gained qualifications, new skills and new friends. Once I finish, I hope BAE Systems will sponsor me to attend university to expand on the skills I have learned.

Training and development

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.

In 2004 employees in our UK businesses completed 1,222,658 training days (around three days per employee). Training was focused on areas of particular need such as retraining for employees at risk of redundancy (see case study, page 17).

We have a range of global training programmes to cater for employees at all levels of the business. These include:

- **E-learning courses.** Employees can access over 550 e-learning courses from their desktop, at home or in our Learning Resource Centres. During 2004, around 28,000 courses were taken, covering subjects from IT to presentation skills and managing budgets.
- **Future talent development.** Our apprentice and graduate training programmes offer practical on-the-job training, coaching and mentoring.

BAE Systems currently employs 1,100 apprentices, of whom 300 joined the company during 2004. All our UK graduate recruits complete our two-year development programme. Around 180 were recruited in 2004.

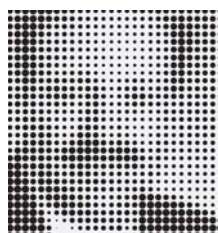
- **Professional development.** Our Developing You training programmes cover engineering, project management, quality, manufacturing, procurement, business winning, finance and human resources. Hundreds of employees take part in these courses each year. For example, in 2004 398 employees took part in our Manufacturing Developing You courses and 91 were enrolled on Procurement Developing You. During the year employees in Australia, North America, the UK and Saudi Arabia completed 7,500 training days on our Project Management Developing You programme (compared with 3,300 in 2003).
- **Leadership development.** Senior employees develop their leadership skills through the Performance Centred Leadership development framework. This includes a new Behavioural Performance Feedback (BPF) tool, through

which participants receive feedback from peers, managers and team members. Nearly 3,500 employees participated in BPF in 2004, 93% of those eligible.

- **Virtual university.** BAE Systems' Virtual University allows employees to access 3,000 courses covering leadership, professional competencies and personal effectiveness. Many of these are developed and run in partnership with colleges and universities and can be identified through the Integrated Development Portfolio, see below.

The 2004 employee opinion survey sought feedback on training at BAE Systems. It showed that 56% of employees feel they have access to the training they need to be productive in their current position. We are introducing an Integrated Development Portfolio (IDP) to improve awareness and take-up of training and development opportunities. IDP is an online library of training modules, available via the intranet. The IDP will include details of training programmes and opportunities for placements, coaching and mentoring.

Perspectives on diversity



Curtis L Gray

Senior Vice President,
Human Resources,
BAE Systems
North America

Diversity refers both to the characteristics of our people (from gender and ethnicity to background and experiences) and to the internal culture of our company. We try to maintain an inclusive culture where each individual's contribution is valued.

The US is a multicultural country. Our customers, particularly the US military, are becoming increasingly diverse. We need to mirror that diversity to partner with them effectively. There is also a severe competition for qualified people in our industry so we need to actively seek candidates from all communities.

As a US government contractor, we comply with a variety of laws and regulations which require not only non-discrimination but also effective outreach. These require us to take action to match the

demographic of our workforce to that of the areas from which we hire. Each of our various sites has its own Affirmative Action Plan with annual targets. Our approach is to be co-ordinated but with a strong emphasis on local efforts.

In our recruitment processes we target schools with high percentages of minorities and women graduates. We run Women in Technology programmes and are piloting a minority scholarship at one of our sites. We also focus on hiring and developing a diverse leadership population.

We have recently created a new position, Director of Equal Employment Opportunity and Diversity, North America, to lead our diversity efforts and help us develop our long-term strategy in this area.

Retraining at Air Systems, UK

As technology develops and customer needs change we inevitably require different skills from our workforce. This creates new opportunities in some areas but means other jobs will be lost.

Air Systems has developed a strategy to anticipate the future needs of the business and prepare employees for this challenge. Retraining for employees at risk of redundancy is an important element.

Debbie Sallis, HR Director for Air Systems, explains: "It is crucial that we address what that means now and define the

steps that will have to be taken to reduce the impact on employees."

To do this the company carried out a review of its existing training programmes, looking in detail at their effectiveness. Training resources were then reallocated from non-essential areas to focus on important skills training and the New Start retraining programme. A Management Development Programme has also been introduced to help managers recognise and implement the most appropriate training solutions. The trade unions were

kept involved and informed throughout this process.

Results are starting to show. Barrie Mason-Lister is one of 70 employees at Air Systems' Warton site enrolled on the New Start training programme. A fitter at Air Systems for 16 years, Barrie is now retraining to be a qualified electrician. "Not only has it given me the chance to do something I've always wanted to do, now I have a future to look forward to with the company."

The Avionic Systems and Platform Solutions businesses have been awarded the Investors in People accreditation. This quality standard recognises companies that invest in training and development of their people.

Industrial relations

A constructive relationship with the trade unions that represent our employees is key to managing change. Good industrial relations are strategically important, helping us to remain productive, motivated and competitive. We partner with trade unions to develop our employment policies and compete for new contracts.

In the UK the Chief Executive meets with senior union representatives from across the UK business twice a year. We also hold quarterly Corporate Consultative Committee meetings for union representatives to meet with senior managers. In 2004, topics discussed at these meetings included company strategy, investor feedback, the employee opinion survey and government relations.

Redundancies

We continue to both grow and restructure our business and during 2004 took on over 6,400 new employees across our world-wide sites. Unfortunately restructuring also led to the announcement of 1,519 job losses in the UK and 321 in North America and 19 in Saudi Arabia.

We work with trade unions in the UK to minimise involuntary job losses. In 2004, 60% 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.

Pensions

In common with many other companies, we are facing shortfalls in our pension funds due to lower than expected investment returns and increased life expectancy.

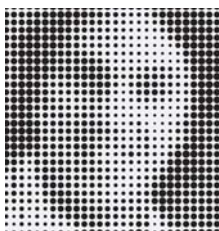
The changes to our main UK pension scheme announced in 2003 have been fully implemented with both the company and employees paying

increased contributions. We continue to consult with trade unions, pension representatives and employees in relation to two of our other pension schemes that have recently announced a funding shortfall.

Chairman's Awards for Innovation

Our Chairman's Awards for Innovation recognise employees and teams who have found new ways to make BAE Systems a more innovative company, and helped us to live up to our values and benefit the community.

Over 3,000 nominations were received in 2004 and awards were given in two categories – innovation and implementation. Winners included a 'smart imaging' targeting tool developed by our engineers in San Diego, California. This significantly reduces the time needed to generate highly accurate co-ordinates from imagery.



Wayne Achurch

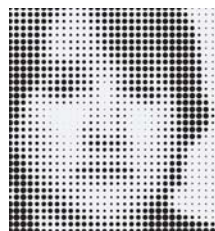
Human Resources
Director,
BAE Systems Australia

A mixture of people from different backgrounds helps to generate new ideas. That's why diversity is important for a company like ours which relies on innovation.

In Australia the cultural environment is very relaxed and the country prides itself on multiculturalism and acceptance of diversity. The Government does not take a prescriptive approach to diversity. However we are required to produce an

annual report to the Australian Government on equal opportunities and gender diversity in our workforce.

We have initiatives in place to encourage more women to become engineers. This is helping to increase the number of women at BAE Systems but we still have a long way to go, particularly at senior levels of the organisation. This is the same for many companies in Australia.



Dee Blackmore

Head of Human
Resources, CS&S and
Land Systems Group
Office, UK

"The management of diversity seeks to fully develop the potential of each employee and turn their unique skills into a business advantage." This quotation by Peter Herriot, the Occupational Psychologist, sums up the importance of diversity in business.

In delivering our strategy we are increasingly working more closely with our customers to enhance their military capability. Diversity not only brings creativity and challenge to the solutions we offer to our customers, it is also critical for the future sustainability of our business. Current demographic trends highlight the need to attract a more diverse pool of future employees. Statistics such as 'by the year 2010 only 20% of the labour market will be white, non-disabled men under the age of 45' (Institute of Employment Studies) clearly makes the point. Diversity can often

be seen as a soft issue, but it is not. It is fundamentally about business advantage and sustainability.

Within CS&S and Land Systems, each of the Business Units has a nominated lead who is developing local plans to address diversity.

Diversity is a key element of our corporate responsibility activities, which is championed within the CS&S business by Kevin Taylor, Managing Director, CS&S MASS.

During 2005 we aim to raise awareness further through trade union consultative forums and regular in-house newsletters. We are also investigating the value of pursuing external accreditation, such as Framework for Excellence in Equality and Diversity (FEED), to give visibility and pace to our diversity activities.

Education and community

We donate money, time and expertise to promote science and engineering education and to support charities and good causes. This community investment is not just a good thing to do – it is a core issue for our business.

Education

The number of students enrolled in engineering and technology courses around the world has fallen considerably in recent years. This has serious implications for our industry and our ability to recruit and retain the best people.

As a leading science and technology company, we need to ensure that talented young people continue to pursue careers in engineering and we are in a good position to achieve this. Our key government customers across the globe want business to be an active partner in improving education.

Our education partnerships are a key element of our community investment. We partner with schools, colleges and universities to interest young people in engineering and technology, improve teaching in these areas and ensure that young people have the skills our business needs.

UK

In 2004 we invested £213,000 directly on our education partnerships in the UK. We also make a contribution indirectly through our expenditure on apprenticeships and university research (worth £26 million in 2004). The money we spend in these areas enables colleges and universities to develop their capabilities and improve their facilities, raising standards and improving engineering education.

Our education programme has two main components:

1. In-school activity

We support engineering education in schools close to our main sites. In total over 1,500 schools have joined our Schools Network. This gives them access to specially developed teaching materials and opportunities to work with our people.

2. Online resources

Our website www.baesystems.com/education provides schools with a wealth of resources about engineering, to support teaching and provide guidance on engineering careers. These are supported by the work of our Ambassadors, over 400 BAE Systems employees who visit local schools to help with engineering projects and

give careers advice. As well as giving children an insight into engineering, the Ambassador programme helps our employees build their communication, coaching and project management skills and confidence. BAE Systems allows Ambassadors up to three days a year off work for these activities.

Our Ambassadors and employees also provide work experience placements for young people. Over 160 young people completed work experience placements during 2004, giving them a unique insight into engineering in the workplace.

The company has strategic partnerships with 20 colleges and universities, to build engineering research capabilities and improve our undergraduate recruitment. BAE Systems has partnered with the East Midlands Development Agency (EMDA) and Loughborough University to set up the Systems Engineering Innovation Centre (SEIC), a national centre for systems engineering research, training and education. SEIC was formally opened by Lord Sainsbury in July 2004. The company is also the largest employer of engineering apprentices in the UK, see page 16.

Strengthening our school programmes

In 2004 we undertook research to assess the impact of our school partnerships in the UK and identify ways to strengthen and improve them.

We spoke to 81 schools close to our sites, as well as key education partners such as the Department for Education and Skills and the Science, Engineering, Manufacturing Technologies Alliance. These included schools that have strong connections with BAE Systems as well as those who belong to our Schools Network but have had little direct contact. The research showed that there is an opportunity for us to do more in

local schools. Around 50% had no BAE Systems activities in their schools. More positively, around 60% had heard of www.baesystems.com or www.engineeringourfuture.co.uk and of these half had used these websites, feeling they were relevant and useful.

Half of the schools had heard of or used BAE Systems curriculum materials and our Ambassadors had visited 40% of the schools. They spoke positively about business participation and the contribution that they had made. Almost all said that they would like more involvement from Ambassadors.

Feedback from the survey showed the importance of constantly marketing, and reviewing our materials and websites to ensure they remain useful and provide support to our education partnerships.

During 2005 we will develop new website materials (on a new website www.baesystems.com/education) and drama and workshop activities. BAE Systems Ambassadors will be closely involved. We will test these with the schools that participated in the survey to ensure they inspire and motivate the pupils.

“The high school students have really gained from the experience of solving challenges and working as teams with a real engineer.”

Teacher, Robert Smyth School, Harborough, commenting on the help received from BAE Systems

United States

Girls Understanding Engineering, Science and Technology (GUEST)

BAE Systems is partnering with the American Association of University Women to encourage young women to take an interest in science and engineering. Female engineers from our site at Lansdale, Pennsylvania took part in the GUEST programme helping local students complete an engineering and team-building project.

For Inspiration and Recognition of Science and Technology (FIRST)

This international engineering contest immerses high school students in an engineering competition to design a remote-control robot. In the 2004 school year, 175 BAE Systems volunteers spent 8,969 hours working with students on their entries.

Engineering career days

Members of BAE Systems' Engineering Leadership Development Programme sponsored several engineering career days. These provide groups of students and teachers with a comprehensive overview of careers in engineering.

Tutoring and mentoring

Employees at Information & Electronic Warfare Systems mentor elementary and middle school students through the Nashua School District mentoring initiative. The objective is to reverse the high dropout rate, reduce substance abuse and juvenile delinquency, and increase academic achievement in the Nashua school system. In the 2003–2004 school year 35 employees gave 1,140 hours to mentor 60 students.

Saudi Arabia

Chevening Scholarships

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. Two students are currently being sponsored directly by BAE Systems to complete scholarships in the UK. We also sponsor the British Council's Post Doctoral Research Programme which gives Saudi academics grants to conduct research in British universities.

Training and skills transfer

During 2004 we agreed phase 2 of the National Occupational Skill Standards and Curriculum Development Project with the Saudi government. BAE Systems will provide administrative support, funding and resources to develop standard qualifications and training curriculum for technical trades and vocational qualifications. This builds on the success of the project's first phase which saw the development of 125 skills standards and 300 training packages matched to workplace needs.

Alfaisal University

BAE Systems helped found this university in 2003, pledging funds and offering training expertise from our joint venture company, Saudi Development and Training. Alfaisal University offers courses in science, engineering and technology.

Australia

Australia's Engineering Week

BAE Systems is the major sponsor of South Australia's Engineering Week which encourages and inspires young people to get involved in engineering.

Harvey Knox Scholarships

We support the Harvey Knox Scholarships that give young people the opportunity to realise their goals and contribute to the Hunter region in New South Wales.

“BAE Systems’ CR Report gives too much importance to community and employment – these are not the core issues!”

Environmental non-governmental organisation

“Although the work was hard I wouldn’t have missed it for the world. In terms of my personal development I learned a great deal about teamwork and thinking problems through laterally.”

Sattam Al-Bukhari, BAE Systems Saudi Arabia, on his experiences as a volunteer

Community investment

We contribute to charities and good causes through donations of cash and materials and by encouraging our employees to give their time as volunteers.

Our support for charities and communities around our sites is important to our business. It improves knowledge and awareness of our company, enables our people to gain valuable experiences and helps create a sense of community.

In 2004 our community investment was worth £1.1 million. This includes cash and in-kind donations (such as furniture, computers and equipment). It does not include our education partnerships or the value of the time given by employees as volunteers during working hours.

We focus our support at corporate level on charities working in the areas of youth programmes, medical research and armed services. Some of the charities we supported in 2004 can be found on page 21. Our businesses and sites also make donations to charities in their local community.

We support several charities through our Relationship Charity Programme, giving £100,000 to each over three years. This guaranteed sum helps the charity to plan ahead and commit to a specific project. The charities we currently support in this way are: Leukaemia Research, St John Ambulance, the No Way Trust, Age Concern, and the US Juvenile Diabetes Research Foundation.

Charity Challenge

Charity Challenge is our company-wide fundraising and volunteering programme, operating at more than 100 sites across BAE Systems and our joint venture partners.

It encourages employees to give their time and money to good causes by matching funds raised and giving extra financial support to charities where employees are volunteers. Some Business Units also operate Pay As You Earn programmes to encourage employee giving.

Charity Challenge raised £6 million during its 2003/04 campaign (July 2003–December 2004) from employee fundraising and BAE Systems matched donations. It reported 5,700 volunteer days for charities worldwide. Much of the money was raised for four partnership charities: the American Cancer Society (North America), NCH (UK), Help the Hospices (Germany) and the Cancer Council Australia (Australia).

These are just a few examples of our activities in 2004:

- BAE Systems employees in the Washington, DC area raised more than US\$140,000 by participating in the American Cancer Society’s Relay For Life Program. Employees in the US have given more than 15,000 hours as total employees in North America raised more than US\$900,000 for the American Cancer Society during the 18-month campaign, breaking all previous records.

- Our Barrow Submarines site in the UK has helped more than 100 local charities through Charity Challenge. In 2004 employees raised £70,000 for local charities through the Keswick to Barrow sponsored walk.
- In Australia, employees raised Aus\$39,688 for the Cancer Council Australia, which will be matched by BAE Systems plc. In addition, employees also raised Aus\$19,925 for a number of other charities, including World Vision, Leukemia Foundation, Regency Park, Cranio-Maxillo Facial Foundation, Bali Orphanages and Indian charities.
- In March 2004, 70 Saudi employees took part in a BAE Systems sponsored Fun Run raising money for the Centennial Charity’s disabled children appeal. This was the first fundraising event of its kind organised by and for Saudi employees.

Employees vote for a new partnership charity every 18 months. New charities to be supported in 2005/06 are the Stroke Association in the UK, the National Heart Foundation in Australia and in North America, the American Cancer Society has been reselected for a second term. Employees also support local charities and community initiatives through the programme.

Charity Challenge in India – two personal accounts



In October 2004 a team of 15 employees from Australia, Germany, Saudi Arabia and the UK spent four weeks living and working with charities in Bangalore, India.

This initiative, organised by our joint venture in India, benefited five local charities. Here two of the volunteers describe their experiences during the trip.

“Hello India! These were two words I used during my amazing four-week trip, an experience that has been life changing and one I will never forget.

I worked on two projects – installing a new kitchen for the Cheshire Home for physically disabled women and girls and the construction of an outdoor stage at the School for the Deaf. Both these projects involved hard manual labour with limited tool resources. There were no local hardware stores down the road to pick up a wheelbarrow or powered garden tools. Instead we had gardening gloves, shovels, chisels, hammers and buckets to complete our projects.

I lived with a great host family of four who made me part of their family from the moment I stepped into their home.

Their hospitality was beyond anything I could imagine.”

Tina Brock, Edinburgh Parks Australia

“I spent most of my time working for the Centre for Learning, some 50 kilometres out of town. We lived in a small hostel, sleeping on bunk beds, washing our clothes on stone and rubbing them with a bar of soap.

The most challenging thing about the project was the fact that there were practically no tools or machinery, almost everything had to be done by hand. That included heaving large pipes that took 6–10 people to lift and positioning them with levers and spades.

Although the work was hard, I wouldn't have missed it for the world. In terms of my personal development I learned a great deal about teamwork, thinking problems through laterally and experiencing a culture that I will never forget.”

Sattam Al-Bukhari Riyadh, Saudi Arabia

Amazon Hope 2 – a floating medical centre for the Amazon

Amazon Hope is a floating medical centre bringing medical care and support to communities on the Amazon river.

BAE Systems at Barrow-in-Furness is helping to fit out and maintain the ship; and is now refitting a new sister ship – Amazon Hope 2 – to reach even more people. The work includes shot blasting, repainting, installing additional fuel tanks, bunks, cabins and safety equipment. When finished, the ship will include a dental surgery, minor operating theatre, pharmacy and accommodation for up to 24 people.

Perspectives from BAE Systems' Charity Partners

NCH, the children's charity



the children's charity

BAE Systems employees have given their time to help our projects through 3,760 involvement days since 2002.

A huge number of projects have benefited – from re-decoration programmes and garden makeovers, to fire safety training for all of NCH's projects in North Wales, trips to Euro Disney for some of the children at our projects, Christmas parties, mentoring and

befriending, and careers advice. In monetary terms those days translate into over £325,000 of support to NCH.

We've also received around £1.5 million in direct financial support from BAE Systems, making them one of our largest corporate supporters. The Charity Challenge programme is so well established it has taught us an enormous amount about how to make the most of our corporate supporters.

American Cancer Society



The American Cancer Society has benefited greatly from being a charity partner in BAE Systems' Charity Challenge.

BAE Systems employees have enthusiastically participated as volunteers in many of our events, including Relay for Life and Making Strides Against Breast Cancer. In addition, the employees held numerous creative in-house fundraising events, raising

an outstanding US\$900,000 which BAE Systems will generously match. Their support helps our mission to reduce the incidence of cancer, increase early detection, save lives and significantly improve the quality of life of those with cancer.

The Cancer Council Australia



BAE Systems has supported us since July 2003. Their fundraising efforts have helped our work with cancer patients and their families, and our awareness events educating people on how to reduce their risk of cancer.

We were delighted to have been the focus of the Charity Challenge fundraising commitment. Staff at BAE Systems have been passionate and active supporters involved in many

fundraising activities during our national events and raising significant amounts of money for us.

Charities donated to in 2004

Youth

- Children with Crohns and Colitis/Venture Trust
- Downs Syndrome Association
- Engineering Development Trust
- Outreach Army Cadet Force Association
- The Country Trust
- Wingate Special Children's Trust
- WISE

Medical Research

- Asthma UK
- British Council for Prevention of Blindness
- Motor Neurone Disease Association
- Pro Cancer Research Fund
- Research Into Ageing
- Sense
- Spencer Dayman Meningitis UK
- The Ear Foundation

Armed Services welfare

- Combat Stress
- SSAFA Forces HELP

Supply chain

“The company is committed to developing long-term relationships with its suppliers based on mutual trust and benefit.”

BAE Systems Operational Framework

Expenditure with suppliers accounts for about 70% of the cost of our products and services. This means it is vital that we work with the best suppliers and ensure that they maintain high standards of quality.

Our reputation can be affected by the suppliers we do business with. 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.

In this way we can improve our performance and ensure the timely delivery of high-quality, cost effective products and services to our customers. We have developed a supplier management programme to help us do this.

Our supply chain

In 2004 we spent £5.5 billion on goods and services from 15,000 suppliers.

Most of this is spent with key suppliers providing high tech components for our products. Expenditure on major equipment, systems and support capability accounted for £2.7 billion and we spent £0.7 billion on smaller equipment such as electronic and mechanical devices and raw materials.

We also buy a range of goods and services not related to our products from stationery to business travel. This accounted for £0.8 billion.

We have procedures in place to ensure we pay suppliers promptly. We review and audit any outstanding payments to ensure they are resolved as quickly as possible.

Supplychain Excellence

All our suppliers are required to meet high-quality standards. In addition we have developed a Supplychain Excellence (SCE) programme to help 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 working with 70 of our major suppliers through SCE. We aim to increase this to 80 over the next year which will account for 50% of expenditure on procurement directly related to our products.

As part of SCE, suppliers are assessed against our Business Excellence and Manufacturing Excellence standards. These are based on the internationally recognised business excellence model of the European Foundation for Quality Management (EFQM) and Lean Manufacturing, a best practice model based on the Kawasaki Production System.

The standards cover a range of criteria, such as leadership, people management, policies and processes. They include questions to assess performance on CR issues, such as ethics, employment practices, health and safety, and environmental management.

The assessment also identifies opportunities for improvement. We work with suppliers to develop a Continuous Improvement Plan and set targets for them to work towards world-class standards.

Assessments are carried out by trained BAE Systems employees. We have over 100

employees who are qualified to conduct supplier assessments. We also provide training on self-assessment for suppliers to help them understand the requirements and identify ways to improve. Suppliers are re-assessed every two or three years.

Our internal Supplier Development Working Group with representatives from each business unit meets every six weeks to review supply-chain performance and manage the SCE programme.

Suppliers achieving and maintaining high performance against our excellence standards receive formal recognition through our bronze, silver and gold Supplychain Excellence awards.

Good communication and two-way feedback are an important element of SCE. Each supplier is assigned a senior BAE Systems manager as their point of contact. We meet with each supplier quarterly to review progress against their improvement plans, get feedback and identify ways we can better support them. We also seek feedback through regular supplier surveys.

With such a large supply chain, it is difficult for us to meet and interact with all our suppliers individually. We work with many trade associations and regional development agencies to provide training and information on excellence standards to smaller companies in our supply chain.

BAE Systems also contributes to national supply-chain improvement programmes such as SCRIA (Supply Chain Relationships in Action) and the AeGIT (Aerospace Growth and Innovation Team). Both of these have been developed by the Society of British Aerospace Companies and the UK government to improve the competitiveness of the aerospace industry through good supply-chain relationships and better teamwork.

“Excellent organisations plan and manage external partnerships, suppliers and internal resources to support policy and strategy and CSR objectives.” European Foundation for Quality Management (EFQM) Framework for CSR

Supplier partnership improving quality, efficiency and EHS performance



Before



After

Dytecna Ltd, is a UK SME supplying BAE Systems company, C4ISR, with vehicle container installations. As a valued partner on the Falcon programme, Dytecna was invited to participate in BAE Systems' Supplychain Excellence (SCE) programme.

The SCE programme is designed to benefit both supplier and customer by checking that systems are in place to ensure consistent quality, security of supply and good EHS performance.

Working together, Dytecna was assessed by a multidisciplinary team from both

BAE Systems and Dytecna, the findings then being shared at workshops held at Dytecna's manufacturing site in Malvern. The initial assessment identified improvements that could be made to benefit both supplier and customer. Improvement targets were agreed between BAE Systems and Dytecna.

Dytecna has begun implementing the recommendations and the impact on cost, quality and delivery has been immediately apparent. The shop floor was redesigned to provide an efficient

uncluttered layout and training and communication mechanisms were significantly improved. Benefits to the environment include reduced waste, better materials handling and storage and increased recycling. Health and safety has also improved as part of the new factory layout and investment in training.

Dytecna recognises it has embarked on a long process of continuous improvement and welcomes the regular SCE reviews that are planned for the future.

Safety, health and environment

We are committed to the highest standards of health and safety at work and an active concern for the environment. This is a specific area for which all employees have a personal responsibility in their day-to-day work.

We have management systems in place to reduce health and safety risks and our environmental impacts. This benefits our employees and the environment and helps to cut our costs.

Overall responsibility for safety, health and environment (SHE) is assumed by our Chief Executive, with the Group HR Director responsible for SHE policy and performance. In 2004 our Manufacturing Council, of senior operational directors from all Business Units, was assigned specific responsibility for driving improvements in SHE performance across all of our sites.

SHE performance issues are formally reviewed and starting in 2005 will be subject to formal annual review by the Board of Directors and every six months by the Executive Committee. Within our Business Units, SHE issues and performance are reviewed regularly at management committee meetings.

In 2004 we launched a new SHE framework which describes management responsibilities at each level of the organisation. This will help ensure that our SHE policy and Corporate Governance statement is implemented effectively throughout the business.

SHE management system

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 those from working with display-screen equipment.

We have a health and safety management system at each Business Unit to identify, manage and control risks, and to ensure that employees understand health and safety risks and how to reduce them. Each Business Unit has a dedicated SHE team providing the necessary expertise and advice. The Chief Executive signs the company SHE policy on behalf of the Board and Executive Committee. Operational responsibility and leadership for SHE performance is provided by the Managing Director and Management Committee of each Business Unit.

Targets are being 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 US that handle explosives.

Nuclear submarines are built at our marine yard in Barrow under a nuclear site licence, issued

by the UK government. This ensures the site is managed according to stringent safety requirements, employees are protected from exposure to radiation, and discharges to the environment are within strict limits set by the Environment Agency. The site is inspected through regular internal and external audits.

Environmental management

Our main environmental impacts are:

- Consumption of raw materials
- Emissions of volatile organic compounds (VOCs) from painting and cleaning
- Wastes produced at our sites
- Greenhouse gas emissions from energy use
- Water consumption and discharges
- Contaminated land.

In 2004, our shipyard in Barrow, UK achieved certification to ISO 14001, the international environmental management standard. This means we have met our target for all our major manufacturing sites to achieve ISO 14001 certification.

We use ISO 14001 to manage our environmental impacts and set improvement targets for each manufacturing site.

Data : Health and safety

Major accidents

	2002	2003	2004
UK major accidents	31	24	22
UK rate per 100,000 employees ¹	70	68	60
US major accidents	6	9	4
US rate per 100,000 employees	34	38	15
Aus. major accidents	0	0	2
Aus. rate per 100,000 employees	0	0	53
Saudi major accidents	*	8	3
Saudi rate per 100,000 employees	*	163	65
Total major accidents	37	41	31
Total rate per 100,000 employees	56	61	39

¹UK Health and Safety Executive (HSE) average (manufacturing sector) 190.6 per 100,000 – latest available date from HSE (2003)

Reportable accidents

We report all accidents defined as 'reportable' under the UK Reporting of Injuries, Diseases and Dangerous Occurrences Regulations (RIDDOR).

	2002	2003	2004
UK reportable accidents	302	325	244
UK rate per 100,000 employees ¹	686	925	668
US reportable accidents	111	62	105
US rate per 100,000 employees	634	258	387
Aus. reportable accidents	8	0	20
Aus. rate per 100,000 employees	178	0	534
Saudi reportable accidents	*	0	0
Saudi rate per 100,000 employees	*	0	0
Total reportable accidents	421	387	396
Total rate per 100,000 employees	638	577	498

¹UK Health and Safety Executive (HSE) average (manufacturing sector) 1156 per 100,000 – latest available date from HSE (2003)

Reportable diseases

We collect data on reportable diseases, which are those related to a particular activity at work and defined in law.

	2002	2003	2004
UK reportable diseases ¹	58	158	300
UK rate per 100,000 employees	132	450	822
US reportable diseases ²	33	5	50
US rate per 100,000 employees	189	21	185
Aus. reportable diseases ³	*	*	*
Aus. rate per 100,000 employees	*	*	*
Saudi reportable diseases	*	*	17
Saudi rate per 100,000 employees	*	*	435
Total reportable diseases	91	173	367
Total rate per 100,000 employees	138	243	517

¹ Hand-arm vibration syndrome (HAVS) is now required to be reported at an earlier stage

² An increased focus on ergonomics was made in 2004

³ The nature of operations does not require screening for reportable (defined under UK legislation) diseases.

Explanatory notes on safety, health and environment data

We currently standardise all safety data reporting against the UK Reporting of Injuries, Diseases and Dangerous Occurrences Regulations (RIDDOR) 1985. These regulations require notification of all fatal accidents, major injuries, accidents causing more than three days off work and specific dangerous occurrences at work.

In 2004, our Customer Support & Solutions (CS&S) business appointed a SHE manager to co-ordinate its SHE management and performance across all its operations (including Australia and Saudi Arabia). This has resulted in improved standardisation of approach, systems and reporting – e.g. reportable diseases and days lost due to injury. In addition the appointment of a central co-ordinator for SHE issues in Australia has resulted in improved collation and reporting of data – hence the apparent

increase in accident and days lost rates. We consider the 2004 data to be the most accurate reflection of data for Australia and will work against these values to manage performance. The major injuries reported in Saudi Arabia relate to incidents on the domestic compounds for which we are responsible and thus include the incidents in our accident reports. The SHE management systems in CS&S were subjected to an internal audit in 2004 and improvements are being implemented.

Progress in 2004 – Health and Safety

Implementing best practice

We are working in partnership with the UK's Health and Safety Executive (HSE) to develop a best practice approach to managing five key issues in our UK manufacturing operations. These are – confined space working, hand-arm vibration syndrome (HAVS), working at height, contractor management and slips, trips & falls. We have agreed a rolling audit programme with the HSE over a three-year period for our UK manufacturing sites.

Safety audits

Safety audits were conducted in our shipyards in Scotland to review progress since the last audit in 2002. An audit of SHE management systems and processes was also conducted throughout our entire CS&S business.

Health and well-being

Regular health checks are provided for all employees at risk from work-related illnesses. Employees attended 19,000 appointments to check for skin irritation, HAVS, respiratory conditions, or conditions relating to noise or ergonomic factors in 2004.

Many sites provide well-being initiatives to support employees in improving their health, reducing stress and getting fit. These include health screening programmes and providing medical check-ups, treatment and advice. Individual business units organise a range of programmes from confidential counselling services to awareness events on losing weight and giving up smoking.

Performance data

We collect and report data on major and reportable accidents, work-related injuries and reportable diseases (diseases related to a particular activity at work and defined in law).

We have agreed targets with the UK Health and Safety Executive (HSE) to reduce health and safety incidents on 2001 levels by 2010.

Interim targets were also set for 2005. We have significantly reduced major accidents and days lost to work-related injuries and illness and have exceeded our interim targets, see table below.

Safety compliance

We were fined £250,000 in respect of a fatality involving a contractor on our North Sea Range platform in 2001.



Our Aerostructures site at Prestwick, Scotland, has developed an innovative approach to reduce health risks to employees working with vibrating machinery.

The approach – developed in partnership with other Aerostructures sites, trade unions and occupational health teams – has two main elements. First, tools that produce lower vibrations are used where possible. In some cases the design of components or production techniques are changed to eliminate vibration risks altogether.

Second, a study of the risk factors and the way individual employees use tools has enabled managers to identify vibration risk areas in the factory. When allocating work, the managers can now ensure that those employees who are at especially high risk from vibration (because of a health condition) avoid those jobs.

The initiative has been recognised by the UK Health and Safety Executive as an example of best practice.

Total injuries

	2002	2003	2004
UK total injuries	5,785	5,862	4,135
UK rate per 100,000 employees	13,148	16,683	11,329
US total injuries	331	263	342
US rate per 100,000 employees	1,891	1,096	1,262
Aus. total injuries	58	51	123
Aus. rate per 100,000 employees	1,289	1,357	3,282
Saudi total injuries	*	263	129
Saudi rate per 100,000 employees	*	5,351	2,803
Total injuries	6,174	6,403	4,769
Total rate per 100,000 employees	9,355	9,550	5,999

Days lost to work-related injuries

	2002	2003	2004
UK total work-related injuries	6,652	6,870	4,124
UK rate per 100,000 employees	15,118	19,553	11,299
US total work-related injuries	1,328	1,603	1,462
US rate per 100,000 employees	7,589	6,679	3,782
Aus. total work-related injuries ¹	50	14	716
Aus. rate per 100,000 employees	1,111	467	19,103
Saudi total work-related injuries	*	*	115
Saudi rate per 100,000 employees	*	*	2,499
Total work-related injuries	8,030	8,487	6,084
Total rate per 100,000 employees	12,167	12,658	7,653

¹ Includes new site and first full year of reporting

Days lost work-related illnesses

	2003	2004
UK days lost work-related illness	784.5	602
UK rate per 100,000 employees	2,233	1,649
US days lost work-related illness	734	279
US rate per 100,000 employees	3,058	1,030
Aus. days lost work-related illness	0	259
Aus. rate per 100,000 employees	0	6,910
Saudi days lost work-related illness	*	20
Saudi rate per 100,000 employees	*	416
Total days lost work-related illness	1,518.5	1,160
Total rate per 100,000 employees	2,679	1,459

Progress against UK Health and Safety Executive (HSE) Revitalising Health and Safety targets for reduction in workplace injuries and illness

	2001 BAE Systems baseline	2004 BAE Systems actual	HSE 2005 target for reduction against baseline	BAE Systems actual reduction against 2001 baseline
Major accidents (rate per 100,000 employees)		68	5%	11%
Days lost to work-related injuries (rate per 100,000 employees)		21,079	15%	46%
Days lost to work-related illness (rate per 100,000 employees)		2,027	10%	18%

There were no work-related fatalities in 2004. Figures indicate that we are making noticeable progress against the HSE targets.

Radiation doses

	2002	2003	2004
Collective dose (man mSv) ¹	8.9	13.2	5.6
Average dose per person (mSv)	0.151	0.135	0.07
Number of employees engaged in radiation-related work	59	98	77

¹ Millisieverts – a unit of radiation received. The average annual amount received from background radiation is 2.2mSv

Progress in 2004 – Environment

Energy

Burning fossil fuels for energy use releases carbon dioxide that contributes to climate change.

We aim to use energy efficiently and are introducing energy-saving measures at our sites. In 2004 our UK manufacturing sites and joint venture and partner companies established a Carbon Club to address compliance with the EU Emissions Trading Scheme and share best practice on energy reduction.

Volatile Organic Compounds (VOCs)

VOCs are used in manufacturing to degrease and clean, and as a solvent in paint. They contribute to smog and can affect human health.

BAE Systems is working with Clariant to develop a new enzyme cleaner to replace solvents used in degreasing aircraft components. Trials of the new technology are in progress at our Samlesbury site. Initial results are promising and we hope to develop the product for widespread use within the next 12 months.

Waste

Our sites produce both special (hazardous) and general (non-hazardous) wastes. We aim to reduce the volume of waste produced and recycle wherever possible.

Waste reduction initiatives are managed by our Business Units. We also work with our waste management company, Cleanaway, in the UK to identify waste minimisation and recycling opportunities.

The significant reduction in our waste output in 2004 is due to the completion of a brownfield site redevelopment at our Land Systems site in Chorley, North West England.

Water consumption and effluent discharge

We use most water at our ammunition production and submarine manufacturing sites.

Contaminated land

Land may be contaminated by leaks, spills or incorrect disposal of chemicals and other hazardous materials. This is particularly serious if contamination enters groundwater and spreads beyond the site.

We are inspecting all BAE Systems' sites in the UK to check for contamination as part of our Contaminated Land Strategy. During 2004 we inspected 1,027 hectares of land at 10 of our major sites.

No significant instances of land contamination were discovered, although some potential environmental risks have been identified, relating to historical site use. In these cases action plans

have been developed and further investigations and remediation will be carried out to mitigate the identified potential environmental risks where necessary.

Compliance

There were no environmental prosecutions in 2004.

Our Platform Solutions facility in Ontario, California was fined \$5,180 for operating equipment without California air permit applications.

There were no reportable environmental incidents at our sites. There were 23 complaints from the public relating to environmental matters.

Product Stewardship

We are committed to minimising the impact of our products on the environment, to ensuring that our products are safe to handle and transport, and to developing weapons systems that are as accurate as possible. Our Product Assurance Response Centre helps our Business Units reduce the environmental impact of our products during design, production, use and at disposal. It provides a range of information on environmental regulations and environmentally preferable materials and processing technologies. Two of the projects they are currently working on are the search for alternatives to cadmium and lead used in soldering.

Environmental improvements at IEWS

IEWS, BAE Systems' electronic warfare systems business in the US, is introducing a range of environmental improvements. These are helping to reduce environmental impacts and save money.

Energy efficiency is one area being addressed. All eight IEWS sites have introduced energy efficient lighting and air conditioning systems. Some sites have also added new roof insulation to reduce heat loss. These measures have reduced electricity use and IEWS has received a one-time rebate of \$106,000 from their power supplier as a result.

Recycling is also a priority at IEWS sites. A full-time Asset Recovery Team reviews all waste material to identify items that can be reused or recycled. Approximately 135 tonnes of material were recycled during 2004.

A new air conditioning system at the IEWS Canal Street facility in Nashua, New Hampshire has cut water consumption by 42 million gallons a year. Previously, water used in the site's cooling system was used once and then discharged into the local river. The new system operates on a 'closed loop' so water is continually

reused. This saves \$160,000 per year and means that no water is discharged into the river.

All new IEWS employees receive environmental training as part of their induction. This ensures they understand the company's environmental policy and can help to implement environmental improvement programmes.

“Environmental management systems (EMS) allow organizations to systematically manage their environmental and health safety matters. EMSs can result in both business and environmental benefits.”

Environmental Protection Agency, USA, website



Supporting environmental research

BAE Systems Regional Aircraft has converted a BAe 146-300 airliner, one of the quietest jets in existence, into an Atmospheric Research Aircraft to support environmental research in the UK.

The aircraft has been equipped with highly sophisticated atmospheric research instruments. It will be used by the Facility for Airborne Atmospheric Measurement to support research into climate change, prediction of extreme weather events and atmospheric chemistry and pollution.

The project is a result of a partnership between BAE Systems Regional Aircraft, the Met Office, the Natural Environment Research Council and several universities.

Data : Environment

Energy

	Energy use (Gwh)			Index (GWh/£1bn turnover)		
	2002	2003	2004	2002	2003	2004
Electricity	792	657	734	98	78	54
Gas	1,054	582	557	130	69	41
Heating oil	64	40	49	239	5	7
Total energy use	1,910	1,279	1,321	202	149	98
Total CO ₂ emissions (million tonnes)	0.6	0.4	0.49	0.07	0.048	0.036

Notes

1 The large remediation project at Chorley in the UK was completed in 2003, thus reducing quantities of waste generated and recycled

Volatile organic compounds

	Output (tonnes)			Index (tonnes/£1bn turnover)		
	2002	2003	2004	2002	2003	2004
VOCs to air	385	341	241	44	41	18

Waste¹

	Output (tonnes)			Index (tonnes/£bn turnover)		
	2002	2003	2004	2002	2003	2004
Total general waste	486,985	442,283	339,650	60,300	52,734	25,198
Total special waste	108,813	97,661	5,014	13,474	11,644	372
Recycled	365,130	436,899	67,042	45,212	52,092	4,974

Water and effluent

	Output (million m ³)			Index (million m ³ /£bn turnover)		
	2002	2003	2004	2002	2003	2004
Total water mains	13	22	10	1.6	2.6	0.7
Total water abstracted	49	49	34	6	6	3
Trade effluent	2	13	2	0.25	1.5	0.15
Recycled	8	1	2	1	0.11	0.15

Commentary – route to assurance

BAE Systems commissioned csrnetwork to carry out an independent review of accountability processes at BAE Systems using the Accountability Rating® methodology¹. The BAE Systems 2003 CR Report was used as the basis for the review – supplemented by a limited number of senior management interviews. The objective was to highlight any strengths and weaknesses and make recommendations for improvement to the company's accountability practices.

Although this work responds in part to BAE Systems' commitment to work towards external verification, csrnetwork is not offering independent assurance.

A summary of our review findings and recommendations are as follows. These comments follow the headings used in the Accountability Rating®.

Notes

1 The Accountability Rating 2004® was developed as a joint project between csrnetwork and AccountAbility. For more details see www.csrnetwork.com/accountabilityrating

Topic	Observations	Recommendations from csrnetwork	BAE Systems' response
Stakeholder Engagement	<p>BAE Systems undertakes a range of activities that contribute to its understanding of stakeholder issues and expectations. However, these processes are not yet systematic.</p> <p>Some challenging views were acknowledged in the 2003 CSR Report that help to identify some stakeholder issues.</p> <p>The 2003 report did not fully recognise positive developments such as the Supplychain Excellence Programme.</p> <p>The Virtual University provides a mechanism for effective dissemination of information on CSR issues.</p>	<p>Future reports should include mapping of major stakeholder groups, more complete reporting on the engagement processes in place, their core issues and describe BAE Systems' response.</p>	<p>The 2004 report has addressed stakeholder engagement with further information provided on stakeholder groups and an explanation of engagement processes. We intend to carry out a stakeholder mapping exercise during 2005.</p> <p>The 2004 report provides feedback from a wide range of stakeholders on those issues that matter to them as well as giving our response.</p> <p>The 2004 report features a detailed section on the Supplychain Excellence programme.</p> <p>The external CR website has been updated to improve transparency across all CR issues.</p>
Governance	<p>BAE Systems has recently taken significant steps to improve its governance arrangements by adding corporate responsibility explicitly onto the board agenda and assigning specific board responsibility for CR.</p> <p>Several non-financial policies already exist, e.g. safety, health and environment, ethics, arms export, employment and diversity.</p> <p>Although training on non-financial issues is not yet in place for board members, it has been recognised as something that may be necessary in the future.</p>	<p>In addition to the implementation activities of the new CR Forum, the board should specifically consider the merits of creating a senior CR committee tasked with driving Group CR strategy.</p> <p>There is a general need to review the corporate intent in terms of the relationship between setting Group policy and ensuring local implementation.</p> <p>Extension of Group CR policy to fully incorporate relationships with suppliers, joint ventures, partners and investments should be considered.</p> <p>The future CR strategy should address the organisational development issues arising from the need to achieve an appropriate balance internally between maintaining confidentiality and the benefit of greater transparency.</p>	<p>The Board has agreed to establish a Board Committee on CR. This will be implemented in 2005 and progress reported.</p> <p>The newly established CR Forum will be reviewing the relationship between group policy and local implementation and forming an action plan to drive CR initiatives locally.</p> <p>The 2004 report includes information on our relationship with our suppliers. We are investigating if and how this might be extended to influence joint ventures, partners and other investments where we hold a controlling share.</p> <p>The 2004 report has more information and transparency on key stakeholder issues including ethics, business conduct and supply chain.</p>
Strategic Intent	<p>Some non-financial impacts are described in the 2003 report, particularly economic and environmental impacts.</p> <p>Some explicit links have been made between core business strategy/objectives and CR issues, but overall the strategic intent with respect to CR remains unclear.</p>	<p>BAE Systems needs to provide evidence that CR has been fully embedded into all levels of the business and should review the business case for aligning with voluntary standards.</p>	<p>We intend to revise our Operational Framework during 2005 to explicitly embed our CR principles within our Code of Practice.</p>

“BAE Systems has recently taken significant steps to improve its governance arrangements by adding Corporate Responsibility explicitly onto the Board agenda...”

Topic	Observations	Recommendations from csnetwork	BAE Systems' response
Performance Management	<p>BAE Systems has the systems and management in place to manage most relevant CR impacts.</p> <p>Significant training programmes are in place for senior managers on several areas including corruption, bribery and equal opportunities.</p> <p>BAE Systems has a strong anti-bribery awareness programme in place (including an independent hot-line) that helps monitor compliance with company policy. This is a core component of the company's governance system which is not fully recognised in the CR Report.</p>	<p>Within this review we have not determined the extent to which CR management systems are interconnected between local and group level.</p> <p>The process for setting and monitoring objectives/targets should be clarified and made increasingly quantitative in the different areas of CR.</p> <p>There would be merit in assessing existing incentive and appraisal programmes to ensure support for achievement of non-financial policies and targets</p> <p>There are some uncertainties regarding the integrity of data collection at operating unit level. Different units may use different methods.</p>	<p>In 2004 we set up a CR Forum to improve the links between group and local levels.</p> <p>We set and monitor our safety, health and environment objectives and targets and executive management provides strong leadership. We are investigating how we can improve reporting in this area to increase transparency</p> <p>Behavioural Performance is already a key part of our incentive and appraisal programmes for senior managers.</p> <p>We are continually reviewing our data collection tools to ensure consistency and integrity of data.</p>
Assurance	<p>BAE Systems is committed to assurance over public disclosures; csnetwork are in discussion with the company regarding development of both internal and external assurance processes, however achieving progress will take time.</p>	<p>An early priority is to work with Internal Audit to develop internal assurance processes that address compliance with policy and data processes at a local level. This is an essential precursor for effective external assurance.</p>	<p>One of our 2005 objectives is to improve our rating against Accountability standard AA1000. We plan to work with our internal audit team early in 2005 to put in place the mechanisms necessary to achieve this.</p>
Public Disclosure	<p>BAE Systems is included in several external benchmarking studies e.g. the Business in the Community Corporate Responsibility Index and is listed on the Dow Jones Sustainability Index (DJSI).</p> <p>Compliance information has been disclosed for safety, health and environment, but not for other areas such as human resources.</p> <p>BAE Systems has acknowledged stakeholder views on corporate responsibility issues in the defence sector by commissioning specific articles from external observers. The company now needs to decide how it can better describe its own performance in relation to the issues raised.</p>	<p>Disclosing more details of improvement issues highlighted by benchmarking studies would increase the transparency of reporting.</p> <p>Reviewing the alignment and compatibility of human resources data collection systems so as to allow more complete reporting on other compliance areas such as discrimination and unlawful dismissal.</p> <p>Regulations requiring UK companies to produce an Operating and Financial Review (OFR) will come into effect in 2005. It will be important to ensure consistent mechanisms are used for determining material issues for public disclosure in both the OFR and CR report.</p> <p>Use of the Global Reporting Initiative Guidelines will facilitate selection of appropriate indicators for material and other relevant issues; allowing consistency/comparability with peers.</p> <p>BAE Systems should include commentary relating to alleged improprieties on specific transactions, thus providing more complete reporting.</p>	<p>In the 2004 report we have featured more detailed feedback from the DJSI including those areas where improvements can be made. We intend to meet with Sustainable Asset Management Research early in 2005 to formulate an action plan to address these areas.</p> <p>We are continually reviewing our data collection tools to improve reporting.</p> <p>Increased stakeholder engagement and the new Board Committee on CR will better allow us to determine the material issues for public disclosure.</p> <p>We continue to review all external benchmarks to assist us in selecting the appropriate indicators for our reporting.</p> <p>BAE Systems is working to increase transparency in our reporting and we will continue to improve in this area.</p>

Find out more . . .

This report summarises our corporate responsibility performance in 2004. More detailed information on our policies and programmes, and further case studies, are available on our website:

**Corporate
Responsibility
Report on the web**

[www.baesystems.com/
corporateresponsibility](http://www.baesystems.com/corporateresponsibility)



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. Email us at **crfeedback@baesystems.com**.

Credits

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