Rolls-Royce Holdings plc
annual report 2012

Rolls-Royce

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Directors' report
The directors' report which includes the Business review is set out on pages 1 to 72.

Forward-looking statements
This annual report contains forward-looking statements. Any statements that express forecasts, expectations and projections are not guarantees of future performance and will not be updated. By their nature, these statements involve risk and uncertainty, and a number of factors could cause material differences to the actual results or developments.

This report is intended to provide information to shareholders, is not designed to be relied upon by any other party, or for any other purpose and the Company and its directors accept no liability to any other person other than under English law.

Cover: In February 2012, we celebrated the opening of our new manufacturing and assembly facility in Singapore for large civil aero engines.

Image courtesy of: Bob Lee Keng Siang

Introduction

"In the full year, underlying profits increased for the tenth consecutive year. We have established this record of consistent delivery while continuing to invest in people, technology and facilities."

John Rishton, Chief Executive

Rolls-Royce is a global company, providing integrated power solutions for customers in civil and defence aerospace, marine and energy markets. We support our customers through a worldwide network of offices, manufacturing and service facilities.

	2012	2011	% change
Order book – firm and announced	**£60,146m**	£57,630m**	**+4%**
Underlying revenue*	**£12,209m**	£11,277m	**+8%**
Profit before financing	**£2,072m**	£1,189m	**+74%**
Underlying profit before tax*	**£1,429m**	£1,157m	**+24%**
Underlying earnings per ordinary share*	**59.27p**	48.54p	**+22%**
Payments to shareholders	**19.5p**	17.50p	**+11%**

* See explanation in note 2 on page 86
** Restated 2011 year-end data excluding International Aero Engines (IAE) order book of £4,571 million

Group at a glance

The priorities of the Group remain: deliver on the promises we have made; decide where to grow and where not to; and improve financial performance.

Civil aerospace

£6,437m
Underlying revenue 2012

£727m
Underlying profit 2012

Trent XWB achieved certification

Trent 1000-TEN introduced

BR725 enters service and IAE restructure completed

The Civil aerospace business is a major manufacturer of aero engines for the airline and corporate jet market. Rolls-Royce powers more than 30 types of commercial aircraft and over 12,500 engines are in service with customers around the world.

Revenue mix

46% OE revenue
54% Services revenue

Defence aerospace

£2,417m
Underlying revenue 2012

£404m
Underlying profit 2012

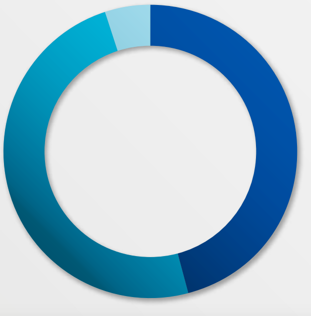
Over US$1 billion in contracts from US DoD and UK MoD

US$315 million contract for F-35B STOVL LiftSystems™

Adour engines ordered by Royal Saudi Air Force for Hawks

Rolls-Royce is the second largest provider of defence aero-engine products and services globally with 18,000 engines in service with 160 customers in 103 countries.

Revenue mix



46% OE revenue
49% Services revenue
5% Development

Group overview 2012

- The order book increased to £60.1 billion, up four per cent, adjusted for the IAE disposal. Order intake was £16.1 billion in the year.
- Underlying revenue increased eight per cent to £12.2 billion, including 12 per cent growth in original equipment (OE) revenue and five per cent growth in underlying services revenue.
- Underlying services revenue increased in all four business segments: Civil, Defence, Marine and Energy and, in Engine Holding.
- Underlying profit before tax increased 24 per cent to £1,429 million reflecting revenue growth, revenue mix, unit cost reduction, a contribution from Tognum and IAE restructuring.

2012 revenue by business segment

Marine

£2,249m
Underlying revenue 2012

£294m
Underlying profit 2012

£147 million orders from Brazil for drill ships and offshore vessels

MT7 chosen to power US Navy future hovercraft

£1.1 billion order for UK naval nuclear reactor core programme

Rolls-Royce has a world-leading range of capabilities in the marine market, encompassing the design, supply and support of power and propulsion systems. We provide comprehensive through-life support from a global network of service facilities.

Revenue mix

Energy

£962m
Underlying revenue 2012

£21m
Underlying profit 2012

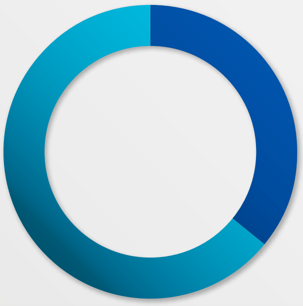
Six RB211s ordered by PetroChina for pipeline project

Services grew and investment 24/7 support desk completed

Nuclear agreements signed with AREVA and Hitachi

With over 4,800 gas turbines sold, and more than 130 million hours of operating experience gained, our Energy business plays a critical role in supporting global infrastructure. Our technology powers offshore platforms, transports oil and gas through pipelines and generates dependable electricity.

Revenue mix



Chairman's statement

Sir Simon Robertson
Chairman

In 2012, Rolls-Royce continued to grow underlying profits as it has done every year for the past decade. During that time the Group has doubled its revenues, trebled its order book and more than quadrupled its profits.

During 2012, the order book rose by four per cent, underlying revenues increased by eight per cent and underlying profits grew by 24 per cent. The Group's performance in 2012 is a testament to the strength of our strategy, the quality of our technology and the ability and determination of our people. We are proposing a final payment to shareholders of 11.9 pence per share bringing the full year payment to 19.5 pence per share, an increase of 11 per cent.

Many of the markets in which we operate remain challenging. European economies are stagnant or contracting. In North America, recovery is fragile and, in the emerging economies of South America and Asia, growth is relatively subdued. Government spending in the developed world remains under intense pressure, whilst political tensions in the Middle East further undermine confidence.

Nonetheless, Rolls-Royce remains well positioned. Millions of people in developing nations continue to join the real economy, which drives the requirement for power on land, sea and air. In addition, all of our customers demand increasingly fuel efficient and environmentally friendly power systems. Rolls-Royce continues to invest for future growth throughout the business cycle. This includes over £900 million a year in research and development (R&D), with two thirds of this total devoted to improving the environmental performance of our products. The result of these investments can be seen across our portfolio.

The Trent 1000 aero engine, which powers the Boeing 787 Dreamliner, has enabled this new composite aircraft to achieve fuel efficiency improvements of 20 per cent compared with the aircraft it is replacing. Looking ahead, the Trent XWB that will power the new Airbus A350 XWB is proving itself to be the most efficient jet engine in the world. In our Marine business, the introduction of Liquefied Natural Gas (LNG) engines and radical hull designs have enabled our newest vessels to reduce CO_2 emissions by up to 40 per cent and practically eliminate emissions of sulphur and nitrogen oxides. In our Energy business, the latest variant of our industrial Trent engine offers significant efficiency improvements. We continue to invest in our Civil Nuclear business in order to support the development of non-fossil fuel power generation.

In order to fulfil our substantial order book and to increase our productivity, Rolls-Royce has continued to develop new state-of-the-art facilities around the world. This investment creates a demand for highly-skilled labour and generates economic activity. In the US, we were pleased to welcome President Obama to our new facility at Crosspointe in Virginia where we are manufacturing discs for our latest Trent engines. It was a particular pleasure for me to welcome the Prime Minister of Singapore, Lee Hsien Loong, to the official opening of our new campus at Seletar in Singapore, where later in 2012 the Duke and Duchess of Cambridge unveiled the first Trent 900 engine to be assembled at the site. We also made substantial investments in the UK. These include our new apprentice academy in Derby, which was opened by the Chancellor of the Exchequer, George Osborne. This facility enables us to double the number of apprentices we can train, providing a supply of highly-trained young men and women for companies in our supply chain.

In 2012, 318 apprentices joined the Group, along with 312 graduates from 89 universities and 36 nations. We provide these young men and women with opportunities to gather experience across the Group by working on different projects and in various locations before settling on a career path within the Group.

We encourage all employees to undertake training throughout their careers. We invested £39 million in training and development during 2012 with major teaching facilities operating in the UK, US and Singapore. We also have a comprehensive online resource that this year delivered nearly 250,000 hours of training in subjects as wide ranging as export control legislation to health and safety.

We have an outstanding community of new recruits who give me tremendous confidence about the future of the Group. Among the many awards accumulated by our young men and women, Patrick Reimann came top in a national ranking of apprentices in Germany, having completed his final exams with a mark of 98 per cent. Neeraj Sunger, Oliver Jukes and Laura Gray all won 'Outstanding Achievement' awards from the Engineering Employers Federation in the UK. For the first time in 2012, one of our own graduates, Philippa Davies, acted as master of ceremonies at the Rolls-Royce Science Prize award, an annual event that celebrates the very best science teaching in the UK. These diverse young people show that engineering can attract the brightest and best by offering stimulating, varied and rewarding careers.

Chairman's statement

Rolls-Royce has a significant requirement for educated young people to support our future growth. Therefore we invest time, energy and financial resource in encouraging Science, Technology, Engineering and Mathematics (STEM) education. This includes our participation in 'Project Enthuse', an industry and government initiative that provides professional development of STEM teachers in the UK; a partnership to raise the skills of science teachers in primary schools in Germany; sponsorship of a 'Rocket Challenge' in the US; and a technology laboratory in Dubai, where teachers and pupils can learn about the practical applications of physics.

Rolls-Royce is dedicated to improving the environmental performance of its products and to bring better power to a changing world. The Group provides world-class training and its people give their time and energy to support educational projects. We donate around £8 million a year to charitable causes. In all of these ways Rolls-Royce demonstrates its commitment to sustainability and to investing in the communities in which it operates.

As previously reported, the Serious Fraud Office (SFO) asked us, early in 2012, to investigate allegations of bribery and corruption in Indonesia and China. In response to its request we asked a leading law firm to conduct a wide review which has raised matters of concern in these and in other markets. We have now referred a file to the SFO.

Rolls-Royce has significantly strengthened its compliance procedures in recent years. We established an ethics committee in 2008 and subsequently introduced a new Global Code of Business Ethics in 2009 and an Intermediaries Policy. We have also expanded our compliance function. In January 2013, we appointed Lord Gold to lead a review of our current procedures and to report to the ethics committee. Lord Gold is one of the UK's most respected litigators and has extensive experience working at the most senior levels with corporations, governments and regulators around the world. As we have made clear, the Board will not tolerate improper business conduct of any sort and will take all necessary action to ensure compliance.

I would like to thank my fellow directors for their great support and hard work in the last year. In particular, I would pay tribute to Mike Terrett, who retired from the Board and from his role as Chief Operating Officer at the end of 2012. Mike joined Rolls-Royce as a graduate trainee and over the course of 34 years played a significant role in the Group's transformation, as Chief Engineer on the Trent 700 and the Trent 800, President of International Aero Engines, President of Civil Aerospace and, since 2007, as Chief Operating Officer.

We bid farewell to Peter Byrom, our longest serving non-executive director and to Ian Strachan. Both retire at the 2013 annual general meeting (AGM). Their wise counsel, constructive challenge and support has been of enormous value to me and the Board. Iain Conn will replace Ian Strachan as Chairman of the ethics committee.

As well as thanking departing colleagues, it has been a great pleasure to welcome onto the Board, Jasmin Staiblin, who is Chief Executive of the Swiss energy group, Alpiq, and previously worked for many years for ABB. Jasmin brings engineering expertise and international experience to the Board.

Four executives at Rolls-Royce and one non-executive director were recognised this year by Her Majesty the Queen as Commanders of the Most Excellent Order of the British Empire (CBEs). I congratulate Colin Smith, Mike Terrett, Professor Ric Parker, Richard Thornley and Lewis Booth.

I would like to thank the members of our International Advisory Board (IAB) who continue to provide great insight into our global markets. The IAB is led by Lord Powell of Bayswater and its members are distinguished political and business leaders. We are fortunate to have their support, and I am grateful for the time and energy they devote on our behalf.

This will be the final review I write as Chairman of Rolls-Royce, as I will be retiring at the AGM after eight years with this great company.

It has been an honour to lead Rolls-Royce through a period of growth and transformation. I am proud of what has been achieved and believe strongly that the best is still to come. Rolls-Royce has earned itself an enviable position from which it can see abundant opportunities for profitable growth. The talent of its management team ably led by John Rishton, the strength of its order book, the quality and range of its technology and its access to global markets augur well for an outstanding future.

I have met extraordinary people at every level of the Group and have enjoyed my tenure as Chairman. I am in no doubt that my successor, Ian Davis, who will join the Board on 1 March 2013 and who will succeed me as Chairman at the conclusion of the AGM on 2 May, will shepherd Rolls-Royce to even greater success. He brings to the Group a wealth of international and Board level experience.

Lastly I wish the Board, John Rishton and the management team every success. I am grateful to my fellow directors, Rolls-Royce employees, customers, suppliers, partners and our long-term shareholders for their loyal support.

Sir Simon Robertson
Chairman

13 February 2013

Chief Executive's review

John Rishton
Chief Executive

In 2012, Rolls-Royce continued to build the capacity required to deliver our £60 billion order book. Among these investments, we opened a new engine test and assembly facility at Seletar in Singapore that is now producing Trent 900 engines. We announced an expansion of our facilities at Crosspointe in Virginia, US, where we will produce turbine blades and nozzle guide vanes. In South America, construction of a new assembly plant to support our Energy and Marine businesses is well advanced and will open later this year. In the UK, as well as having opened our new apprentice academy in Derby, we are developing a new turbine blade facility in Rotherham and a new disc factory in Washington, Tyne and Wear.

In the past decade, Rolls-Royce has transformed its business. Today we are more global, with over half our order book from the Middle East and Asia. Our portfolio has become more diversified, both through organic growth and acquisition, and we have significantly increased the revenues generated from servicing the power systems we produce. During 2012, we changed the way we describe our vision, values and strategy to reflect better the Group we have become, to set clear direction for the future and to reinforce standards in the way we conduct business:

Values –	**trusted to deliver excellence**
Vision –	**better power for a changing world**
Strategy –	**understanding our customers, innovation, profitable growth**

These are described on pages 8-9.

As well as looking at the expression of our vision, values and strategy, we have made an important structural change, bringing together our Civil and Defence businesses to create one Aerospace division with an integrated supply chain. This change, effective from 1 January 2013, will improve accountability and align our business more closely with our customers' requirements.

The priorities for the business remain the same as last year:
1. deliver on the promises we have made
2. decide where to grow and where not to
3. improve financial performance.

In 2012, we have made progress towards these objectives.

1. Deliver on the promises we have made

The quality of the products and services we supply is measured across the Group and has shown steady improvement. Increased focus on delivery has led to significant improvement in widebody engines in Civil aerospace and in our Marine products. Across the Group, we are investing in a wide range of projects that will improve operational performance and reduce cost. This includes continuing investment in modernising our IT infrastructure that is a key enabler for our business.

Significant milestones have been achieved in our major programmes.

These include: in Civil aerospace, the certification of the Trent XWB engine (in February 2013) that will power the Airbus A350 XWB, the launch of the Trent 1000-TEN that will power Boeing 787s entering service from 2016 and, the entry into service of the BR725 engine powering the new Gulfstream G650 corporate jet. In Defence aerospace, the short take-off and vertical landing (STOVL) variant of the F-35B Lightning II Joint Strike Fighter entered service with the US Marine Corps and deliveries were made to the UK MoD.

In Marine, gas turbine power and propulsion equipment was delivered for the US Navy's Littoral Combat Ship and the UK's Queen Elizabeth class aircraft carriers. And, in Energy, we expanded our fleet of gas turbine compressor units through contracts for China's West-East Pipeline Project (WEPP) and the Uzbekistan section of the Asia Trans Gas (ATG) pipeline.

2. Decide where to grow and where not to

We continue to invest in capacity to fulfil our order book and in technology to expand our portfolio.

In Civil aerospace, we are committed to investing in the widebody, narrowbody and corporate market segments. In Defence aerospace, we continue to see opportunities both in developing economies and in our traditional markets, despite the pressure on government spending. In Marine, offshore oil and gas remains a fast growing market and, in Energy, we continue to invest in our Civil Nuclear business where we believe Rolls-Royce can play an important part supporting both existing and new build nuclear capacity. Our acquisition of Tognum, in a joint venture with Daimler, expands our Marine and Energy portfolios and brings significant opportunities for synergies.

Areas where we have decided not to invest include the sale of our tidal power generation business to Alstom in January 2013 and the sale of a 51 per cent stake in our fuel cell business to LG.

3. Improve financial performance

We continue to focus on margin progression. In 2012, margins at Group level improved to 12.2 per cent (2011 10.7 per cent). The Tognum and the IAE restructuring, together contributed 1.1 percentage points, with 0.4 percentage point improvement coming from the underlying business. Overall, profits grew by 24 per cent enabling us to raise our full year distribution to shareholders to 19.5 pence, an 11 per cent increase.

Cost and cash generation remain areas of intense focus for the Group, as we seek to improve quality, on-time delivery and working capital while continuing to invest to meet the rising load. Around £50 million of unit cost improvements were realised in 2012.

As noted in the Chairman's statement, we have passed information to the Serious Fraud Office (SFO) relating to concerns about bribery and corruption involving intermediaries in overseas markets. This follows a request for information from the SFO about allegations of malpractice in Indonesia and China. We have significantly strengthened our compliance procedures in recent years, including new policies for Global Ethics and Intermediaries. We have also expanded the Compliance function. As a further measure, we have appointed Lord Gold to lead a review of current procedures and report to the ethics committee of the Board.

In February 2013, we announced that Sir Simon Robertson will retire as Chairman at our AGM in May. Simon has made an exceptional contribution to Rolls-Royce over the past eight years. He has worked tirelessly on behalf of the Group and his energy and enthusiasm have been an example to us all. He has led the Board with distinction and has made the time to offer guidance and encouragement to colleagues all around the world and at every level of the business. Simon has been a great support to me during my first years as Chief Executive and I wish him every success in the future. I am delighted to welcome Ian Davis as our new Chairman and look forward to working closely with him.

During 2012, the Group has once again increased its profits, revenues and its order book, providing a solid foundation for further progress in the year ahead. Our cash inflow of £137 million, prior to acquisitions and disposals, was delivered after a heavy year of investment in technology, capability and infrastructure.

The achievements of Rolls-Royce are made possible by the more than 40,000 employees whose combined expertise and enthusiasm give us the ability to do extraordinary things. I am constantly impressed by their commitment and am grateful for their hard work and customer focus.

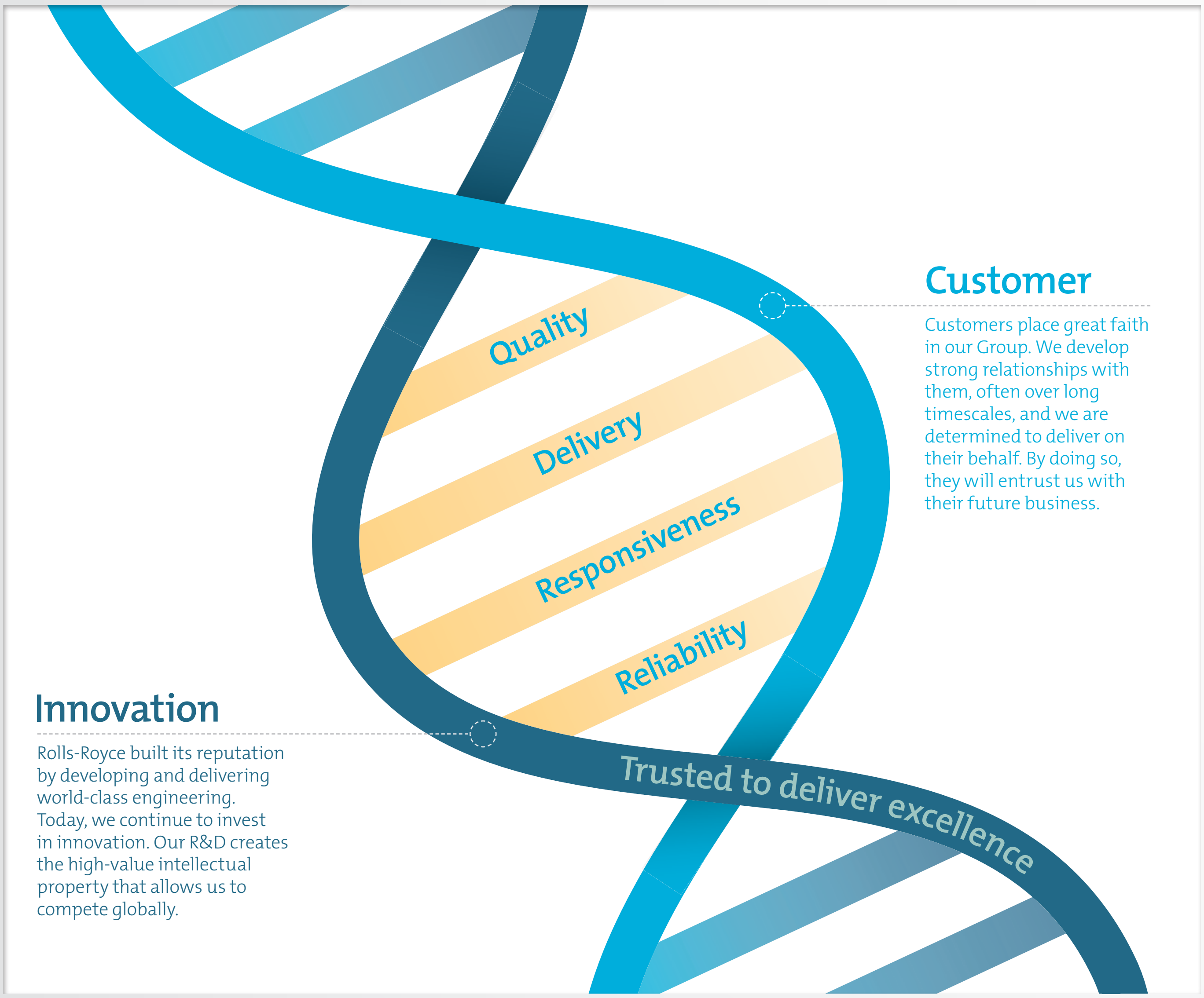
John Rishton
Chief Executive

13 February 2013

Values, vision and strategy

A customer-focused business

Our business model and strategy place the customer at the heart of our business. The DNA of the organisation is built around innovation and responding effectively to the needs of customers. Rolls-Royce will be relentless in the pursuit of quality, reliability and on-time delivery.



Customer

Customers place great faith in our Group. We develop strong relationships with them, often over long timescales, and we are determined to deliver on their behalf. By doing so, they will entrust us with their future business.

Innovation

Rolls-Royce built its reputation by developing and delivering world-class engineering. Today, we continue to invest in innovation. Our R&D creates the high-value intellectual property that allows us to compete globally.

Values

trusted to deliver excellence

Who we are and how we behave matter to our people and the many external groups that have an interest in our business. We have a proud heritage, one of the world's most powerful brands and a responsibility to hand on to future generations a business that is strong and successful.

Everyone at Rolls-Royce must be trusted to deliver excellence, this is a statement of values everyone can understand, take confidence from, be inspired by and always strive to achieve.

Vision

better power for a changing world

We are committed to innovation and a continuous pursuit of improvement. At the forefront of science and technology, and with a deep customer insight, we believe we are in a strong position to meet the demands of, and create opportunities in, our fast-changing world.

Strategy

understanding our customers, innovation, profitable growth

Our ambition is to be world class and competition-beating in our relationships with our customers, and in the delivery of world-class technologies and services. To achieve this, we apply lean and cost effective processes, simple and efficient operations, and a strong commitment always to operate to high ethical standards.

Future opportunity

A 20-year market outlook of US$3 trillion

The Group operates in four long-term global markets: Civil and Defence aerospace; Marine; and Energy. These markets contain a total business opportunity worth in excess of US$3 trillion over the next 20 years. The size of these markets is generally related to world Gross Domestic Product (GDP) growth, global security and defence budgets.

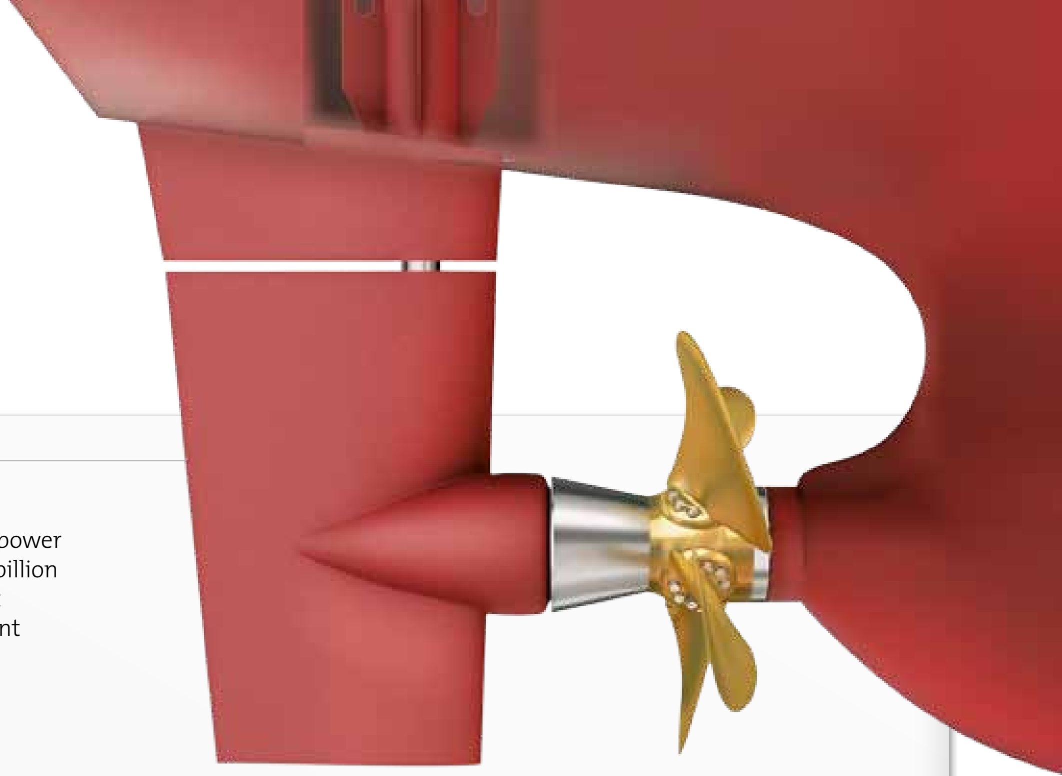
Civil aerospace

We predict emerging markets such as Asia, the Middle East and Africa will experience the fastest rates of growth. Factors affecting demand include GDP growth, aircraft productivity and retirements, operating costs and environmental issues. Civil engine demand over the next 20 years is forecast at US$975 billion, creating a services opportunity of US$700 billion over the same period.

US$975bn
Civil engine market

US$700bn
Civil engine services market

Future opportunity



Marine

The Group forecasts a demand for marine power and propulsion systems valued at US$215 billion over the next 20 years. Marine aftermarket services are expected to generate significant opportunities with demand forecast at US$125 billion over the same period.

US$215bn

Marine product market

US$125bn

Marine services market

Energy

The Group's 20-year forecast values the total aero-derivative gas turbine sales in the oil and gas and power generation sectors at more than US$70 billion. Over this period, demand for associated services is expected to be around US$50 billion.

Based on the International Energy Agency's latest World Energy Outlook we estimate that demand for nuclear mission-critical equipment, systems and engineering services could reach US$370 billion over the next 20 years, while demand for associated reactor support services could amount to US$240 billion.

US$120bn

Energy engine and services market

US$610bn

Civil nuclear market

Defence aerospace

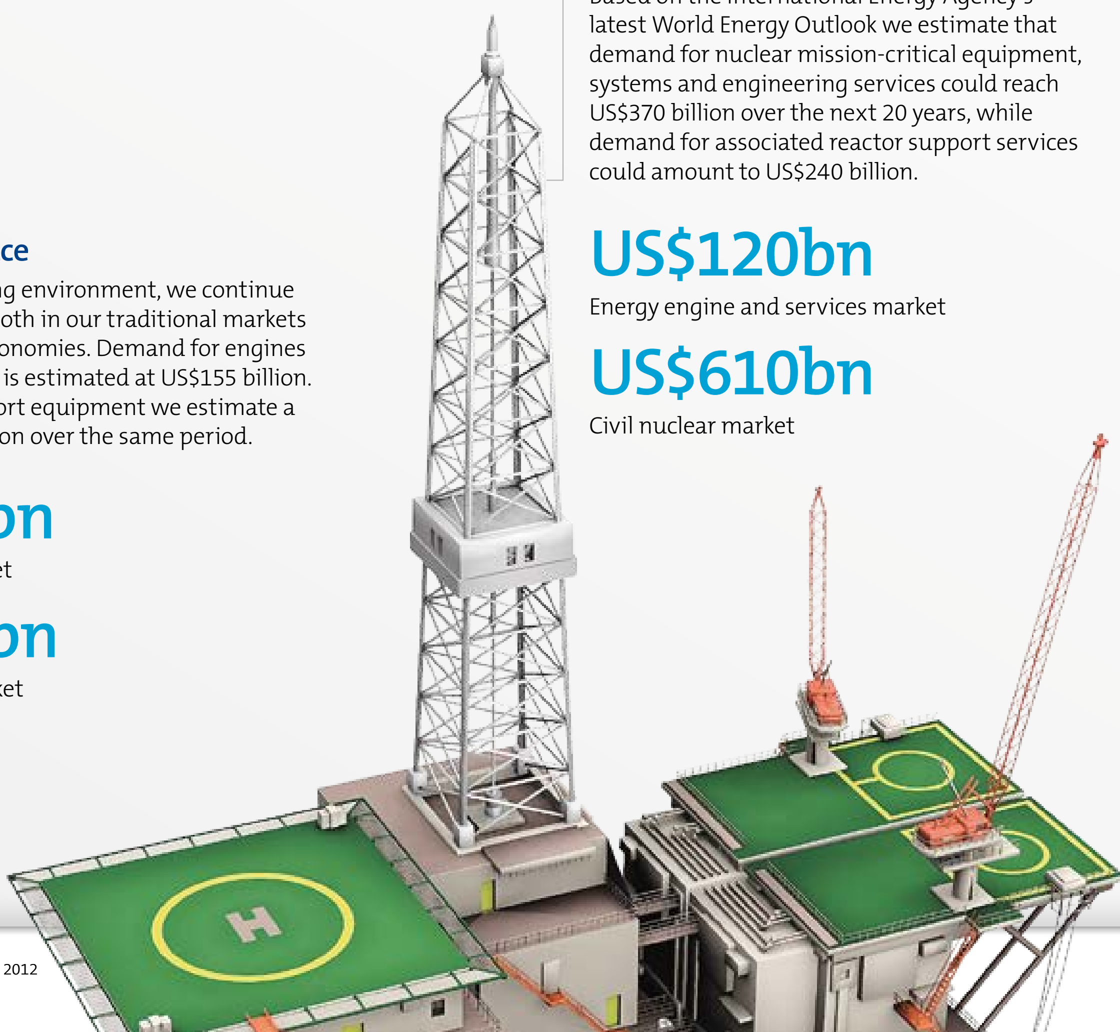
Despite the challenging environment, we continue to see opportunities both in our traditional markets and the developing economies. Demand for engines over the next 20 years is estimated at US$155 billion. For services and support equipment we estimate a market of US$260 billion over the same period.

US$155bn

Defence engine market

US$260bn

Defence services market



Chief Financial Officer's review

Our financial performance continues to improve and we are increasing investment to meet future commitments.

Mark Morris
Chief Financial Officer

Summary

	2012	2011	Change
Order book £m	60,146	57,630*	+4%
Underlying revenue** £m	12,209	11,277	+8%
Underlying profit before tax** £m	1,429	1,157	+24%
Underlying earnings per share	59.27p	48.54p	+22%
Full year payment to shareholders	19.5p	17.5p	+11%
Reported revenue £m	12,161	11,124	+9%
Reported profit before financing £m	2,072	1,189	+74%
Net cash £m	1,317	223	
Average net cash £m	(145)	320	

* Restated 2011 year-end data excluding IAE order book of £4,571 million
** See explanation opposite and on page 86

The pace of recovery of the global economy remains uncertain and some of our customers continue to operate in challenging budgetary environments. However, our customers operate across a broad range of businesses and markets and our relatively young and competitive installed portfolio of power systems and products will generate demand for aftermarket services for many years to come. Demand from existing customers remains strong, as it does from the new customers included in our growing order book.

Our investments in technology, operations and people are underpinned by the significant growth inherent in our order book. These investments will safeguard our competitive advantage, support our commitments to customers and improve our operational effectiveness.

The Group's 2012 performance was achieved after absorbing a 27 per cent increase in the net R&D charge to £589 million and a ten per cent increase in capital expenditure, including software, to £610 million.

Engine Holding (EH), our collaboration with Daimler, owns over 99 per cent of Tognum. We transferred Bergen Engines to EH on 2 January 2012, which resulted in a £167 million cash inflow to the Group. We continue to consolidate Bergen. We will consolidate the whole of EH, including Tognum, from 1 January 2013.

EH's contribution of £287 million to 2012 revenue came wholly from Bergen. EH's profit contribution of £109 million comprised £32 million from Bergen and £77 million from the equity accounted contribution from Tognum.

Chief Financial Officer's review

The Group's sale of its 32.5 per cent programme share and related goodwill in IAE in 2012, generated a profit before tax of £699 million and a cash inflow of £942 million. The profit is excluded from our underlying results. The Group continues to play an active role as a first tier supplier to IAE of high-pressure compressors and fan blades and remains responsible for the final assembly of 50 per cent of the production engines. The proposed joint venture with Pratt & Whitney to develop an engine to power the next mid-size aircraft is subject to regulatory approval and had no material effect on 2012's financial performance.

Underlying figures are considered more representative of the trading performance by excluding the impact of year end mark-to-market adjustments of outstanding financial instruments on the reported performance, principally relating to the GBP/USD hedge book. In addition, the net post-retirement financing and the effects of acquisition accounting are excluded. In 2011, adjustments were made to exclude one-off past-service credits on post-retirement schemes. The adjustments between the underlying income statement and the reported income statement are set out in more detail in note 2 of the financial statements. This basis of presentation has been applied consistently since the transition to IFRS in 2005.

Underlying income statement

Underlying income statement extracts

£ million	2012	2011	Change	
Revenue	**12,209**	11,277	932	+8%
Civil aerospace	**6,437**	5,572	865	+16%
Defence aerospace	**2,417**	2,235	182	+8%
Marine	**2,249**	2,271	(22)	-1%
Energy	**962**	1,083	(121)	-11%
Engine Holding	**287**	331	(44)	-13%
Intra-segment	**(143)**	(215)	72	
Profit before financing costs and taxation	**1,490**	1,206	284	+24%
Civil aerospace	**727**	499	228	+46%
Defence aerospace	**404**	376	28	+7%
Marine	**294**	287	7	+2%
Energy	**21**	16	5	+31%
Engine Holding	**109**	80	29	+36%
Intra-segment	**(11)**	–	(11)	
Central costs	**(54)**	(52)	(2)	+4%
Net financing costs	**(61)**	(49)	(12)	+24%
Profit before taxation	**1,429**	1,157	272	+24%
Taxation	**(318)**	(261)	(57)	+22%
Profit for the year	**1,111**	896	215	+24%
EPS	**59.27p**	48.54p	10.73p	+22%
Payment to shareholders	**19.5p**	17.5p	2.0p	+11%
Other items				
Other operating income	**33**	70	(37)	
Gross R&D investment	**919**	908	11	
Net R&D charged to the income statement	**589**	463	126	

Underlying revenue increased eight per cent to £12.2 billion. This includes a five per cent growth in services revenue to £6.3 billion and a 12 per cent increase in OE revenue to £5.9 billion. OE performance included strong 31 per cent growth in Civil aerospace and 12 per cent growth in Defence aerospace offset by reductions in each of Marine, Energy and EH. Underlying services revenue continues to represent more than half (52 per cent) of the Group's underlying revenue. In 2012, services revenue grew in all businesses as the installed base of products continued to grow and the services network expanded.

Underlying profit before financing costs and taxation increased 24 per cent to £1.49 billion. This was due to a number of factors: increased revenue; better mix; unit cost reduction; a full year's benefit from Tognum (compared to four months' contribution to Group results in 2011); and improved trading following the IAE restructuring settlement completed during the year. These improvements were partly offset by a significant increase in the R&D charge and lower other operating income.

Further discussion of trading is included in the business segment reports on pages 20 to 27.

Underlying financing costs increased 24 per cent to £61 million, including an increase in net interest charges reflecting lower average net funds after funding the Tognum acquisition in the second half of 2011.

Underlying taxation was £318 million, an underlying tax rate of 22.3 per cent compared with 22.6 per cent in 2011.

Underlying EPS increased 22 per cent to 59.27 pence, in line with the increase in the underlying profit after tax.

Payments to shareholders: at the AGM on 2 May 2013, the directors will recommend an issue of 119 C Shares with a total nominal value of 11.9 pence for each ordinary share. The final issue of C shares will be made on 1 July 2013 to shareholders on the register on 26 April 2013 and the final day of trading with entitlement to C Shares is 23 April 2013. Together with the interim issue on 2 January 2013 of 76 C Shares for each ordinary share with a total nominal value of 7.6 pence, this is the equivalent of a total annual payment to ordinary shareholders of 19.5 pence for each ordinary share.

The payment to shareholders will, as before, be made in the form of redeemable C Shares which shareholders may either choose to retain or redeem for a cash equivalent. The Registrar, on behalf of the Company, operates a C Share Reinvestment Plan (CRIP) and can, on behalf of shareholders, purchase ordinary shares from the market rather than delivering a cash payment. Shareholders wishing to redeem their C Shares or else redeem and participate in the CRIP must ensure that their instructions are lodged with the Registrar, Computershare Investor Services Plc, no later than 5.00pm on 3 June 2013. Redemption will take place on 3 July 2013.

Other operating income relates to programme receipts from Risk and Revenue Sharing Partnerships (RRSPs), which reimburse past expenditure. These receipts decreased by 53 per cent in 2012 due to the phasing of major programmes such as the Trent XWB.

Net R&D charged to the income statement increased by 27 per cent to £589 million reflecting a combination of increased spend of £56 million and lower net capitalisation of £69 million due to the phasing of major new programmes. This investment and the ten per cent increase in capital expenditure including software to £610 million will prepare our infrastructure and global supply chain for significant growth in the next decade. The Group continues to expect net R&D investment to remain within four to five per cent of Group underlying revenue.

Balance sheet

Summary data – £ million	2012	2011
Intangible assets	2,901	2,882
Property, plant and equipment	2,564	2,338
Net post-retirement scheme deficits	(545)	(397)
Net working capital	(1,100)	(1,098)
Net funds	1,317	223
Provisions	(461)	(502)
Net financial assets and liabilities	(127)	(718)
Joint ventures and associates	1,800	1,680
Assets held for sale	4	178
Other net assets and liabilities	(248)	(67)
Net assets	6,105	4,519
Other items		
USD hedge book (US$ million)	22,500	22,000
Net TotalCare assets	1,312	956
Gross customer finance contingent liabilities	569	612
Net customer finance contingent liabilities	70	124

Intangible assets relate to goodwill, certification costs, participation fees, development expenditure, recoverable engine costs, software and other costs that represent long-term assets of the Group. In aggregate, these assets remained broadly unchanged at £2.9 billion with additional development, certification and software costs being offset by annual amortisation charges. The carrying values of the intangible assets are assessed for impairment against the present value of forecast cash flows generated by the intangible asset. The principal risks remain: reductions in assumed market share; programme timings; increases in unit cost assumptions; and adverse movements in discount rates. There have been no significant impairments in 2012. Further details are given in note 8 of the financial statements.

Property, plant and equipment increased by ten per cent to £2.6 billion due to the ongoing development and refreshment of facilities and tooling as the Group prepares for increased production volumes.

Net post-retirement scheme deficits increased 37 per cent to £545 million. This was principally due to the movements in the assumptions used to value the underlying assets and liabilities in accordance with IAS 19 – in particular the discount rate which is derived from AA corporate bond yields. The impact of the revisions to IAS 19 is described in note 19 of the financial statements.

Overall funding across the schemes has improved in recent years as the Group has adopted a lower risk investment strategy that reduces volatility going forward and enables the funding position to remain stable: interest rate and inflation risks are largely hedged, and the exposure to equities has reduced to around 12 per cent of scheme asset. This has been achieved against the headwind of increasing life expectancy assumptions.

A modest reduction in the Group's cash contribution to the overall funding level of the schemes is expected in 2013.

Net funds increased by £1.1 billion to £1.3 billion largely due to the £0.9 billion proceeds received on the restructuring of IAE. Average net funds fell by £465 million to (£145) million due to the timing of the Tognum acquisition in the second half of 2011 and the restructuring of IAE in June 2012.

Investment – joint ventures and associates increased by seven per cent, largely as a result of the capitalisation of a loan to EH in respect of the acquisition of Tognum.

Provisions largely relate to warranties and guarantees provided to secure the sale of OE and services. These provisions reduced modestly during the year.

Net financial assets and liabilities relate to the fair value of foreign exchange, commodity and interest rate contracts, financial RRSPs and the put option on Bergen Engine AS, set out in detail in note 17 to the financial statements. The change largely reflects the impact of the change in the GBP/USD exchange rate on the valuation of foreign exchange contracts and the inclusion of the put option (£167 million) for the first time.

The USD hedge book increased two per cent to US$22.5 billion. This represents around five years of net exposure and has an average book rate of £1 to US$1.60. Current forward market exchange rates are similar to current average book rates.

Net TotalCare® assets relate to Long-Term Service Agreement (LTSA) contracts in the Civil aerospace business, including the flagship services product TotalCare. These assets represent the timing difference between the recognition of income and costs in the income statement and cash receipts and payments.

Customer financing facilitates the sale of OE and services by providing financing support to certain customers. Where such support is provided by the Group, it is generally to customers of the Civil aerospace business and takes the form of various types of credit and asset value guarantees. These exposures produce contingent liabilities that are outlined in note 23 to the financial statements. The contingent liabilities represent the maximum aggregate discounted gross and net exposure in respect of delivered aircraft, regardless of the point in time at which such exposures may arise.

During 2012, the Group's gross exposure remained stable at £569 million. On a net basis, exposure reduced by £54 million to £70 million predominantly due to an indemnity from United Technologies for all Airbus A320 commitments following the restructuring of IAE. Whilst some banks, particularly European institutions, continue to find circumstances challenging and offer limited participation in financing new aircraft deliveries, the Group expects that other providers of US dollar funding and ongoing support from the export credit agencies will largely fill the gap left by these banks.

Engine Holding

EH made progress towards achieving full ownership and management control of Tognum. At the end of 2012, EH owned over 99 per cent of the shares in Tognum. A squeeze-out process to acquire the remaining shares is ongoing, and is expected to conclude in 2013. During the year, EH registered a domination and profit and loss transfer agreement with Tognum, which provides a greater degree of management control and flexibility to pursue initiatives together. By bringing together Tognum and Bergen and leveraging the skills from Rolls-Royce and Daimler, we see significant opportunities for synergies.

In our Marine business, our design and integration skills will be further enhanced by the additional product range that Tognum's high-speed diesel engines will bring. And in the aftermarket, by combining the installed bases of equipment, we see good opportunities to leverage our customer support networks. Recently, we announced a contract to design and power four offshore supply vessels where, for the first time, we were able to incorporate Tognum's engines into our integrated design. Similarly, Tognum's high-speed diesels will add additional capabilities to our Energy portfolio, allowing us to offer both gas and diesel products as well as options for primary and stand-by power.

Group 2013 guidance excluding Engine Holding

For the full year 2013, we expect the Group to see modest growth in underlying revenue and good growth in underlying profit, with cash flow around breakeven as we continue to invest for future growth.

In Civil aerospace, we anticipate modest growth in revenue and strong growth in profit. In Defence aerospace we expect modest growth in revenue and a modest reduction in profit. In Marine, we expect modest growth in revenue and profit. And in Energy, we expect some improvement in revenue and profit.

This guidance excludes the impact of EH. The Group cannot provide financial guidance on EH while Tognum is still listed. Further information about Tognum's business and future prospects can be found on its website at www.tognum.de/investors.

Additional financial information can be found on pages 37 and 38.

Key performance indicators

The Board uses a range of financial and non-financial indicators to monitor Group and segmental performance in line with the strategy.

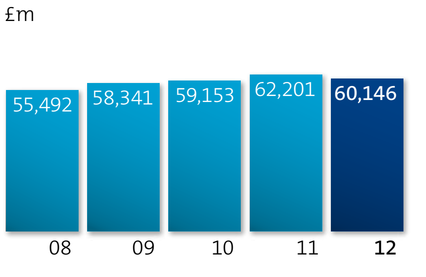
Financial indicators are shown below. The key objectives of board committees are described in the governance section of the annual report and other non-financial key performance indicators are shown in the sustainability section.

note: prior years are not restated for the 2012 IAE restructuring

Order book

-3%

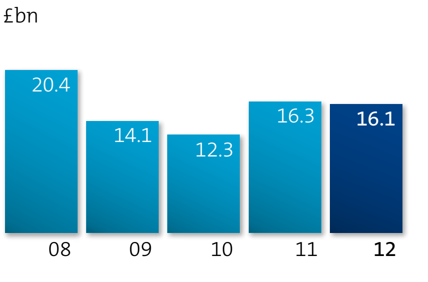
The order book provides an indicator of future business. It is measured at constant exchange rates and list prices and includes both firm and announced orders. In Civil aerospace, it is common for a customer to take options for future orders in addition to firm orders placed. Such options are excluded from the order book. In Defence aerospace, long-term programmes are often ordered for only one year at a time. In such circumstances, even though there may be no alternative engine choice available to the customer, only the contracted business is included in the order book. Only the first seven years' revenue of long-term aftermarket contracts is included.



Order intake

-1%

Order intake is a measure of new business secured during the year and represents new firm orders, net of the movement in the announced order book, between the start and end of the period. Any orders which were recorded in previous periods and which are subsequently cancelled, reducing the order book, are included as a reduction to intake. Order intake is measured at constant exchange rates and list prices and consistent with the order book policy of recording the first seven years' revenue of long-term aftermarket contracts, order intake for any given year includes the seventh year of revenue.

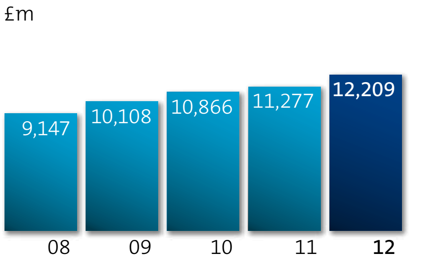


Underlying revenue

+8%

Monitoring of revenues provides a measure of business growth. Underlying revenue is used in order to eliminate the effect of the decision not to adopt hedge accounting and to provide a clearer year-on-year measure.

The Group measures foreign currency revenue at the actual exchange rate achieved as a result of settling foreign exchange contracts from forward cover.

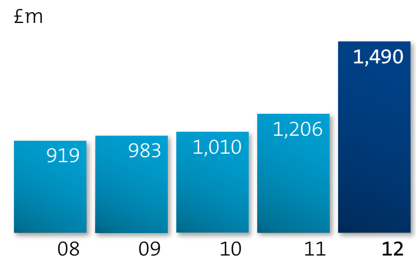


Key performance indicators

Underlying profit before financing

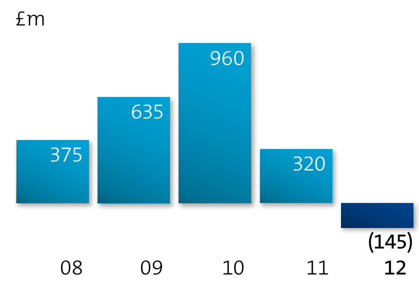
+24%

Underlying profit before financing is presented on a basis that shows the economic substance of the Group's hedging strategies in respect of the transactional exchange rate and commodity price movements. In particular: (a) revenues and costs denominated in US dollars and euros are presented on the basis of the exchange rates achieved during the year; (b) similar adjustments are made in respect of commodity derivatives; and (c) consequential adjustments are made to reflect the impact of exchange rates on trading assets and liabilities and long-term contracts on a consistent basis.



Average cash

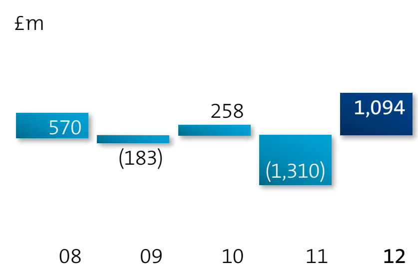
The Group reports the balance of net funds/debt on a weekly basis and average cash is therefore the average of these weekly net balances. These balances are reported at prevailing exchange rates and in recent periods, year-on-year movements in average cash balances reflect the significant acquisitions and disposals which have taken place, most notably Tognum in 2011 and IAE restructuring in 2012. The impact on average cash balances will depend on when these transactions took place during the year.



Cash flow

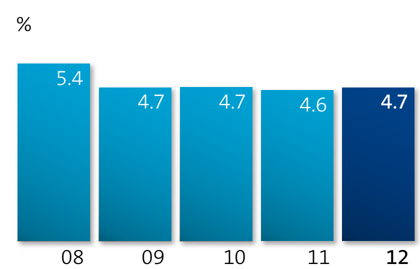
The figure for 2011 includes investment of £1,496 million in Tognum.

In a business requiring significant investment, the Board monitors cash flow to ensure that profitability is converted into cash generation, both for future investment and as a reward for shareholders. The Group measures cash flow as the movement in net funds/debt during the year, after taking into account the value of derivatives held to hedge the value of balances denominated in foreign currencies.



Net R&D expenditure as a proportion of underlying revenue

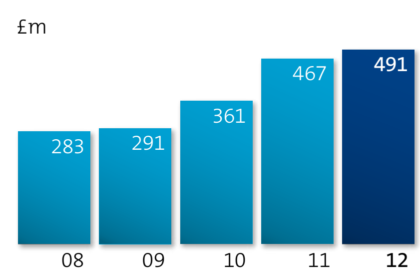
R&D is measured as the self-funded expenditure both before amounts capitalised in the year and amortisation of previously capitalised balances. The Group expects to spend approximately five per cent of revenues on R&D although this proportion will fluctuate depending on the stage of development of current programmes. This measure reflects the need to generate current returns as well as to invest for the future.



Capital expenditure

+5%

To deliver on its commitments to customers, the Group invests significant amounts in its infrastructure. All proposed investments are subject to rigorous review to ensure that they are consistent with forecast activity and will provide value for money. Annual capital expenditure is measured as the cost of property, plant and equipment acquired during the period.



Principal risks and uncertainties

Effectively managing our risks helps us to deliver our objectives and maximise the returns of the Group while managing our reputation.

The following table describes the risks that the risk committee, with endorsement from the Board, considers would have the most material potential impact on the Group and are specific to the nature of our business notwithstanding that there are other risks that may occur and may impact on the achievement of the Group's objectives.

The risk committee's discussions have been focused on the nature of these risks and the actions that are being taken to manage them.

Risk or uncertainty and potential impact	How we manage it
Product failure Product not meeting safety expectations, or causing significant impact to customers or the environment through failure in quality control.	• Operating a 'safety first' culture • Our engineering design and validation process is applied from initial design, through production and into service • A safety management system has been established by a dedicated team, which is subject to continual improvement based on experience and industry best practice • Plan to accelerate quality improvements launched, including involvement from our suppliers • Crisis management team chaired by the Director – Engineering and Technology or General Counsel as appropriate
Business continuity Complete breakdown of external supply chain or internal facilities that could be caused by destruction of key facilities, natural disaster, regional conflict, financial insolvency of a critical supplier or scarcity of materials which would reduce the ability to meet customer commitments, win future business or achieve operational results.	• Continued investment in adequate capacity and modern equipment and facilities • Identifying and reducing single points of failure • Selection of stronger suppliers, developing dual sources or dual capability • Developing and testing site level incident management and business recovery plans • Customer excellence centres provide improved response to supply chain disruption
Competitor action The presence of large, financially strong competitors in the majority of our markets means that the Group is susceptible to significant price pressure even where our markets are mature or the competitors are few. Our main competitors have access to significant government funding programmes as well as the ability to invest heavily in capability.	• Accessing and developing key capabilities in technology and service offerings which differentiate us competitively • Focusing on our customers and partnering with others effectively • Driving down cost and improving margins • Protecting credit lines • Investing in innovation, manufacturing and production • Understanding our competitors
International trade friction Geopolitical factors that lead to significant tensions between major trading parties or blocs which could impact the Group's operations. For example: explicit trade protectionism; differing tax or regulatory regimes; potential for conflict; or broader political issues.	• Where possible, locating our domestic facilities in politically stable countries and/or ensuring that we retain dual capability • Diversifying global operations to avoid excessive concentration of risks in particular areas • Regional director network proactively monitors local situations • Maintaining a balanced business portfolio with high barriers to entry and a diverse customer base • Understanding our supply chain risks • Proactively influencing regulation where it affects us

Principal risks and uncertainties

Risk or uncertainty and potential impact	How we manage it
Major product programme delivery Failure to deliver a major product programme on time, to specification or technical performance falling significantly short of customer expectations would have potentially significant adverse financial and reputational consequences, including the risk of impairment of the carrying value of the Group's intangible assets and the impact of potential litigation.	• Major programmes are subject to Board approval • Major programmes are reviewed at levels and frequencies appropriate to their performance against key financial and non-financial deliverables and potential risks • Technical audits are conducted at pre-defined points performed by a team that is independent from the programme • Formal independent gated reviews are conducted throughout a programme's lifecycle to review non-technical risks • Programmes are required to address the actions arising from reviews and audits and progress is monitored and controlled through to closure • Knowledge management principles are applied to provide benefit to current and future programmes
Compliance Non-compliance by the Group with legislation or other regulatory requirements in the heavily regulated environment in which it operates (for example: export controls; use of controlled chemicals and substances; and anti-bribery and corruption legislation) compromising the ability to conduct business in certain jurisdictions and exposing the Group to potential: reputational damage; financial penalties; debarment from government contracts for a period of time; and/or suspension of export privileges (including export credit financing), each of which could have a material adverse effect.	• An uncompromising approach to compliance is now, and should always be, the only way to do business • The Group has an extensive compliance programme as separately described in the ethics and risk committee reports. These programmes and the Global Code of Business Ethics are promulgated throughout the Group and are updated and reinforced from time to time, to ensure their continued relevance and, to ensure that they are complied with both in spirit and to the letter • A legal and compliance team has been put in place to manage the current specific issue through to a conclusion • The appointment of Lord Gold to lead a review of the Group's current compliance procedures and report to the ethics committee
Market shock The Group is exposed to a number of market risks: some of which are of a macro-economic nature, for example, foreign currency exchange rates, and some which are more specific to the Group, for example, liquidity and credit risks or disruption to aircraft or other operations. Significant extraneous market events could also materially damage the Group's competitiveness and/or credit worthiness. This would affect operational results or the outcomes of financial transactions.	• Maintaining a strong balance sheet, through healthy cash balances and a continuing low level of debt • Providing financial flexibility by maintaining high levels of liquidity and an investment grade 'A' credit rating • The portfolio effect from our business interests, both in terms of original equipment to aftermarket split and our different segments provide a natural shock absorber since the portfolios are not correlated • Deciding where and what currencies to source in, where and how much credit risk is extended or taken and hedging residual risk through the financial derivatives markets (foreign exchange, interest rates and commodity price risk)
IT vulnerability Breach of IT security causing controlled data to be lost, made inaccessible, corrupted or accessed by unauthorised users, impacting the Group's reputation.	• Establishing 'defence in depth' through deployment of multiple layers of software and processes including web gateways, filtering, firewalls, intrusion and advanced persistent threat detectors • Establishment of security and network operations centres • Active sharing of information through industry, government and security forums

Civil aerospace

The order book increased by five per cent* including new orders of £10.3 billion (2011 £11.0 billion). We continue to grow our widebody market share, with Trent engines making up around 75 per cent of our order book. We remain committed to the mid-size market both as a supplier to IAE and via our planned new joint venture with the IAE partners to develop the next generation of engines for this market segment. Our continued success in the corporate market is being driven primarily by our BR700 series of engines for large cabin Gulfstream and Bombardier aircraft.

*when compared to the 2011 Civil order book of £47,370 with IAE orders of £4,571 million excluded

Mark King
President – Aerospace

Revenue increased by 16 per cent. There was a 31 per cent growth in OE revenue, primarily reflecting higher deliveries of Trent and corporate engines. Services revenue grew by five per cent, consistent with growth in the installed base of thrust.

Profit increased by 46 per cent, including £92 million related to the restructured trading arrangements with IAE. Excluding these, profit increased by 27 per cent due to increased OE volume, better OE mix, services growth and unit cost improvements. This growth was tempered by a higher R&D charge due to higher spend and lower capitalisation related to major new programme activity and by lower entry fees related to the Trent XWB.

Key financial data

	2008	2009	2010	2011	2012
Order book £m*	43,524 +21%	47,102 +8%	48,490 +3%	51,942 +7%	**49,608** **-4%**
Engine deliveries*	987	844	846	962	**888**
Underlying revenue £m	4,502 +11%	4,481 0%	4,919 +10%	5,572 +13%	**6,437** **+16%**
Underlying OE revenue £m	1,776	1,855	1,892	2,232	**2,934**
Underlying service revenue £m	2,726	2,626	3,027	3,340	**3,503**
Underlying profit before financing £m	566 0%	493 -13%	392 -20%	499 +27%	**727** **+46%**

*all years prior to 2012 include IAE order book and engine deliveries include IAE V2500

Highlights

- Order book now stands at £49.6 billion
- Trent XWB gained certification
- Trent 1000-TEN launched
- Major new Trent XWB orders from Cathay Pacific and Singapore Airlines
- BR725 enters service on new Gulfstream G650 business jet
- IAE restructuring completed

Revenue mix

- 46% OE revenue
- 54% Services revenue

Revenue by market sector

- 58% Widebody
- 6% Narrowbody
- 36% Corporate and regional

The Civil aerospace business is a major manufacturer of aero engines for all sectors of the airliner and corporate jet market. Rolls-Royce powers more than 30 types of commercial aircraft and has 12,500 engines in service with customers around the world. Demand for our products remains robust and underpins strong performance.

In 2012, the airline industry saw overall passenger traffic growth at around five per cent. Airlines were careful to match capacity to demand and the industry as a whole will record a profit on passenger business despite the rising price of oil. The air cargo sector faced a tougher year as shippers moved away from air freight due to the impact of increasing fuel prices on shipment costs.

The large-cabin business aircraft market, which is characterised by a diverse customer base of large global corporations and high net worth individuals, remained resilient. The demand for small and medium-sized business aircraft continued to be subdued in 2012 but our exposure to this sector is relatively small.

Widebody

The Trent XWB engine flew for the first time in February 2012, on an Airbus A380 test aircraft in Toulouse, France. It went on to complete a successful flight-test programme and gained certification on 7 February 2013. This is the fastest selling Trent engine ever, with more than 1,200 engines sold to 35 customers.

During 2012, Singapore Airlines ordered 20 Trent XWB-powered Airbus A350-900s, while Cathay Pacific ordered ten A350-1000s and converted previously announced orders for 16 A350-900s to A350-1000s.

The Trent 1000 completed one year in service powering Boeing 787 Dreamliners with Japan's All Nippon Airways (ANA). The engine also entered service with South American airline LAN (the first Boeing 787s in the Americas), and with Polish flag-carrier LOT, the first in Europe. During the year, Trent 1000 orders were received from Avianca and Air New Zealand.

In July, we launched the Trent 1000-TEN (Thrust, Efficiency and New technology) that is due to enter service in 2016. This engine, which incorporates proven next generation technology from the Trent XWB, will be capable of powering all versions of the Boeing 787.

Trent 900-powered Airbus A380s entered service with two of Asia's leading airlines, Malaysia Airlines in July and Thai Airways in September. Skymark of Japan ordered the engine and Singapore Airlines, who launched the engine in service five years ago, ordered five more Trent 900-powered aircraft to add to the 19 A380s it already has in service.

The first Trent 900 engine to be completed at our new Seletar campus in Singapore was delivered in September. The engine was unveiled to an audience of VIPs and international media by Their Royal Highnesses The Duke and Duchess of Cambridge during their visit to Seletar.

The Trent 700 continues to be popular, winning orders in 2012 to power 54 Airbus A330 aircraft for China Eastern, Etihad, Avianca, Synergy, Garuda Indonesia, Air Pacific and Skymark. We announced plans to make performance improvements to the Trent 700 by incorporating proven technologies from the Trent 1000, Trent XWB and BR725 engines to deliver further increased efficiency. These enhancements will complement the improvements to the A330 aircraft that Airbus announced in 2012.

Narrowbody

In June 2012, we completed the restructuring of our participation in IAE, which produces the V2500 engine for the Airbus A320 family of aircraft selling our equity and programme shares to Pratt & Whitney.

We remain committed to the mid-size market through our new joint venture with the IAE partners. We will also continue to be responsible for the manufacture of high-pressure compressors, fan blades and discs as well as providing engineering support and final assembly for 50 per cent of IAE V2500 engines.

Corporate and regional

The flight-test programmes for two new Rolls-Royce powered business jets continued through the year. The BR725-powered Gulfstream G650 entered service in December 2012. The AE 3007C-powered Cessna Citation TEN is due to enter service in 2013.

Services

Revenue from services increased by five per cent in 2012, reflecting growth in the fleet of wide-bodied engines, 92 per cent of Trent engines are sold with TotalCare agreements.

Over 1,200 aircraft are covered by CorporateCare® and more than 70 per cent of customers for new Rolls-Royce powered business jets enrol in CorporateCare.

The Trent XWB successfully completed its flight-test programme on an A380 flying test bed.

Defence aerospace

The order book contracted by 15 per cent reflecting the budgetary pressures on our major customers in Europe and North America. The net order intake of £1.6 billion (2011 £1.8 billion) includes cancellations of £0.4 billion, principally the proposed cancellations of a number of contracts for C-27J aircraft, including those by the US Department of Defense. Despite the challenging environment, we continue to see opportunities both in our traditional markets and the developing economies.

Tom Bell
President – Defence aerospace

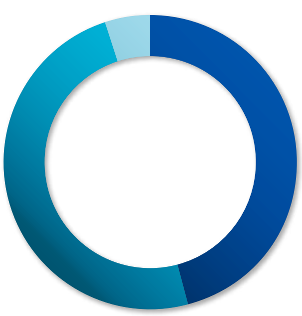
Revenue increased by eight per cent, reflecting a 12 per cent increase in OE revenue and a five per cent increase in services revenue. However, adjusted for the non-recurrence of the £60 million Strategic Defence and Security Review (SDSR) benefit in 2011, services revenue increased by 11 per cent. This highlights how our large installed base continues to provide services opportunities, as customers seek to optimise the efficiency of their aircraft.

Profit increased by seven per cent. Adjusted for the SDSR benefit in 2011, profit increased by 28 per cent due to increased OE volumes and mix, growth in services, unit cost improvements and a lower R&D charge.

Key financial data

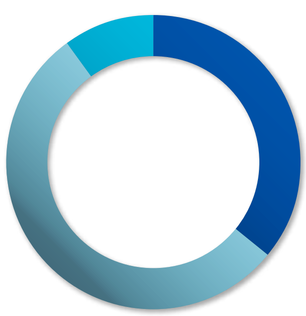
	2008	2009	2010	2011	**2012**
Order book £m	5,527 +23%	6,451 +17%	6,506 +1%	6,035 -7%	**5,157** **-15%**
Engine deliveries	517	662	710	814	**864**
Underlying revenue £m	1,686 +1%	2,010 +19%	2,123 +6%	2,235 +5%	**2,417** **+8%**
Underlying OE revenue £m	739	964	1,020	1,102	**1,231**
Underlying service revenue £m	947	1,046	1,103	1,133	**1,186**
Underlying profit before financing £m	223 +12%	253 +13%	309 +22%	376 +22%	**404** **+7%**

Revenue mix



- 46% OE revenue
- 49% Services revenue
- 5% Development

Revenue by market sector



- 36% Combat
- 54% Transport
- 10% UAV/trainer

Highlights

- US$1 billion of contracts for OE and services for military transport, trainer and helicopter engines for the US Army, US Air Force, US Marine Corps and US Navy
- A US$315 million contract for LiftSystems for the F-35B STOVL variant of the Lightning II aircraft
- Launch of fuel-saving initiative with the Royal Australian Air Force on C-130 operations and a £100 million contract extension to maintain engines for C-130 and VC-10 aircraft from the UK MoD
- An order for new Adour engines to power Hawk trainers for the Royal Saudi Air Force

Rolls-Royce remains the second largest provider of defence aero-engine products and services globally with 18,000 engines in the service of 160 customers in 103 countries. Our engines power aircraft in every major sector, including: transport; combat; patrol; trainers; helicopters; and unmanned aerial vehicles (UAVs).

Transport/Patrol

We are a world leader in the military transport/patrol market with over 8,000 engines in service. The AE 2100 engine fleet for the Lockheed Martin C-130J, the Alenia C-27J, and other transport/patrol aircraft, expanded in 2012.

The TP400 engine for the Airbus A400M military transport aircraft has amassed over 16,000 engine flying hours in its flight-test programme. Engine deliveries for the first production aircraft began in 2012, with entry into service planned for 2013.

Flight-tests of a technology upgrade for the T56 engine were successfully concluded by the US Air Force. Our '3.5 upgrade' kit will provide operators of legacy variants of the C-130 and P-3 aircraft with significant fuel savings and, therefore, reduced operating costs.

Combat

2012 was a significant year for the Rolls-Royce LiftSystem® which provides the STOVL capability for Lockheed Martin's F-35B Lightning II Joint Strike Fighter. The US Marine Corps and the UK MoD received their first deliveries of their STOVL aircraft. The F-35B exceeded the 500th short take-off milestone early in the year and the US Marine Corps commissioned its first operational squadron of F-35Bs in Yuma, US.

We delivered the 300th EJ200 engine built by Rolls-Royce for the Eurofighter Typhoon programme, which has significant export opportunities in the Middle East and Asia. The Kingdom of Saudi Arabia is already a major export customer and at the end of 2012 Oman announced its intention to purchase 12 Typhoon aircraft.

In the US, we initiated testing on a new, advanced technology engine compressor, focusing on reducing fuel consumption as part of our involvement in the Highly Energy Efficient Turbine Engine (HEETE) programme for the US Air Force.

Together with Snecma, we signed a contract to study the architecture and characteristics required for the next generation of UK and French combat aircraft engines.

Unmanned vehicles

The fleet of AE 3007H engines which power the Northrop Grumman Global Hawk high-altitude long-endurance and Triton platforms continues to grow, with 67 engines delivered and about 50 additional engines projected.

Rolls-Royce is to power the US Navy's Broad Area Maritime Surveillance (BAMS) aircraft and we also see opportunities in the US Navy's Unmanned Carrier Launched Airborne Surveillance and Strike (UCLASS) aircraft programme.

The first flight of the Adour-powered nEUROn, an unmanned combat air vehicle developed by six European partners, took place. The stealth technology demonstrator will undergo testing in France before moving to Sweden, in 2014 for operational trials, and also to Italy to measure stealth characteristics and undergo live-firing tests.

Small engines

We delivered the first production M250 engines to Grob for its new G120TP trainer aircraft, while in helicopters the RR300 achieved its first 30,000 hours flight time on the Robinson R66 and the CTS800 engine surpassed 100,000 in-service flight hours. The M250, which has now amassed over 200 million flight hours, powered the first flight of the GippsAero GA10, while the CTS800 achieved FAA certification for the Turkish T129 ATAK helicopter.

Services

The provision of engine support through MissionCare™ continues to generate significant revenues across a wide range of engines. The US Armed Forces placed contracts to support engines powering C-130, V-22, T-45 Goshawk aircraft and Kiowa Warrior helicopters totalling over US$560 million.

The Royal Australian Air Force became the first military customer to implement fuel usage analysis and modelling techniques, to help improve the fuel efficiency of its C-130 transport fleet. The techniques were first developed by Rolls-Royce for civil airline customers.

We opened our first US Operations Centre in Indianapolis, US. The US$2 million investment will offer technical support from a 50-strong team of technical and engineering experts. We also opened the first Defence Service Delivery Centre at RAF Marham in the UK.

During the year we delivered the 300th EJ200 engine built by Rolls-Royce for the Eurofighter programme.

Marine

The order book increased 44 per cent including new orders of £3.3 billion (2011 £2.1 billion). This includes the £1.1 billion order by the UK MoD to deliver reactor cores for its future fleet of nuclear-powered submarines. Offshore orders reflected improved demand in the oil and gas sector, especially for drill ships and support vessels in Brazil. This was partially offset by continued weak order flow in the merchant sector.

Tony Wood
President – Marine

Revenue reduced by one per cent, reflecting increased pricing pressure and adverse foreign exchange movements. Both OE and services revenue improved in the second half, reflecting improvement in the offshore sector and a better capture of the services market resulting from the recent expansion of our global network of services centres.

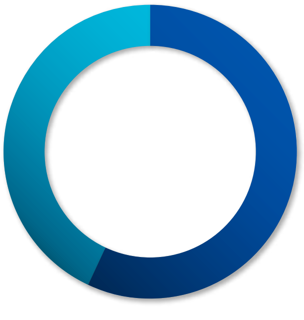
Profit increased by two per cent due to better revenue mix and cost reduction, partially offset by pricing pressures and adverse foreign exchange movement.

Key financial data

	2008	2009	2010	2011*	**2012**
Order book £m	5,190 +10%	3,526 -32%	2,977 -16%	2,737 -8%	**3,954** **+44%**
Underlying revenue £m	2,204 +42%	2,589 +17%	2,591 +0%	2,271 -12%	**2,249** **-1%**
Underlying OE revenue £m	1,492	1,804	1,719	1,322	**1,288**
Underlying service revenue £m	712	785	872	949	**961**
Underlying profit before financing £m	183 +62%	263 +44%	332 +26%	287* -14%	**294** **+2%**

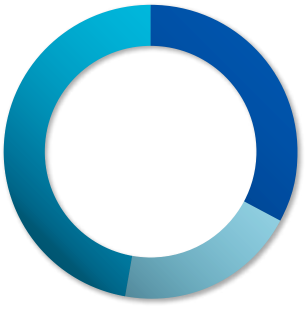
* 2011 figures restated due to transfer of Bergen to new Engine Holding segment

Revenue mix



57% OE revenue
43% Services revenue

Revenue by market sector



33% Naval
20% Merchant
47% Offshore

Highlights

- £147 million in new orders from Brazil for drill ships and highly complex offshore vessels
- £119 million of contracts to design and equip ten offshore supply vessels for COSCO, Farstad and Hyundai
- First contract for MT30 gas turbine outside of US and UK home markets – chosen by Republic of Korea Navy for future frigate
- US Navy contract to power the two latest Littoral Combat Ships
- MT7 gas turbines chosen for US Navy's future hovercraft fleet
- World's first gas-powered tug commissioned and world's first gas-powered cargo vessel entered service
- £1.1 billion order for naval nuclear reactor core programmes

Rolls-Royce has a world-leading range of capabilities in the marine market, encompassing the design, supply and support of power and propulsion systems.

We are leaders in the integration of technologically complex systems for offshore oil and gas, merchant and naval surface and submarine vessels. Comprehensive through-life support for our customers is provided through an expanding global network of service facilities.

Increased price pressure had an effect on trading, there was a reduced order flow in some merchant sectors and challenges to naval budgets in developed economies. Despite these headwinds, the Marine business continued to perform well in 2012.

We remain well positioned to capitalise on opportunities in the highly specialised offshore oil and gas sector. In addition, we are leveraging our global support network to service an increasing proportion of the installed base of equipment.

We continue to strengthen our position in new markets, including Brazil and Korea.

Offshore

We further consolidated our strong position in the oil and gas sector with encouraging growth in order intake, revenues and profitability. This was largely based on the success of our specialist UT vessel design capabilities, which now includes highly efficient wave-piercing vessels.

As the industry continues to explore deeper and more challenging environments, like those in the South Atlantic off the coast of Brazil and in the Arctic region, our core product and systems capabilities enable us to be a strong partner for our offshore customers.

Merchant

We continue to invest in technology that addresses the need for cleaner, more efficient and environmentally sustainable power and propulsion systems. Our market leading LNG-fuelled C engine positions us well for opportunities that arise from stricter environmental standards from 2016. Ship design enhances our ability to offer integrated solutions.

Naval

In our surface naval activities, we are developing greater design capabilities for auxiliary craft. Our innovative commercial ship design capability was extended with a new team to design ships for navies, coastguards and other maritime agencies.

In 2012, we delivered gas turbine-based power and propulsion equipment for the US Navy's Littoral Combat Ship and the Royal Navy's Queen Elizabeth class aircraft carriers. The MT30 gas turbine's success on both of these programmes has generated strong interest from navies in Europe, South America and in Asia where the Republic of Korea Navy chose the MT30 to power its next generation frigate programme.

The MT7 gas turbine was selected to power the US Navy's future fleet of up to 73 hovercraft.

Underlining the high level of confidence that the MoD has in our technology and our people, the Submarines business secured a contract worth £1.1 billion for the regeneration of the reactor core manufacturing facility at Derby and the continued delivery of reactor cores for the UK's nuclear powered submarine fleet.

Rolls-Royce continued to deliver against key milestones in the programme to replace the current Vanguard class of nuclear submarines, ensuring further long-term stability for the naval reactor business.

The opening of the new Primary Components Operations facility in the UK during the year, allowed the Group to rationalise its component manufacturing capability, delivering improved efficiencies for our customer.

Services

In 2012, we enhanced our capacity to realise better the significant opportunity that our large installed base of equipment represents. We expanded our service centre network through the opening of new facilities in China, and introduced a streamlined global spare parts distribution network and 24/7 service desks to improve customer delivery and responsiveness. In addition, we also opened a state-of-the-art technology and training centre to provide closer customer support.

Our new wave-piercing design of offshore support vessel entered service with Farstad.

Energy

The order book reduced by nine per cent, with new orders of £0.8 billion (2011 £1.3 billion). In the oil and gas market, high oil prices and global growth continue to sustain bid activity, albeit with pricing pressures and order deferrals by some customers. While the power generation market in mature economies remains suppressed, we are seeing growth in developing countries. We continue to invest for future growth in Civil Nuclear.

Andrew Heath
President – Energy

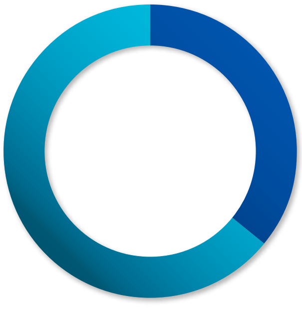
Revenue fell by 11 per cent due to a significant reduction in OE revenue and adverse revenue mix in oil and gas, and in power generation. The OE reduction was partially offset by an 11 per cent increase in services revenue. Services revenue, particularly in oil and gas, benefited from a better penetration of the aftermarket from the installed base across all sectors.

Key financial data

	2008	2009	2010	2011*	2012
Order book £m	1,250 +45%	1,262 +1%	1,180 -6%	1,420 +20%	**1,290** **-9%**
Engine deliveries	106	87	95	48	**49**
Underlying revenue £m	755 +35%	1,028 +36%	1,233 +20%	1,083 -12%	**962** **-11%**
Underlying OE revenue £m	385	558	691	527	**344**
Underlying service revenue £m	370	470	542	556	**618**
Underlying profit before financing £m	(2) -140%	24 +1300%	27 +13%	16 -41%	**21** **+31%**

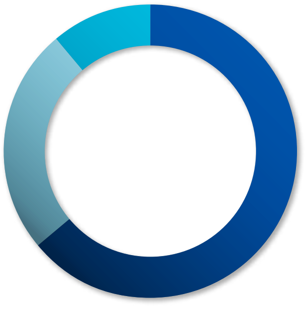
* 2011 figures restated due to transfer of Bergen to new Engine Holding segment

Revenue mix



- 36% OE revenue
- 64% Services revenue

Revenue by market sector



- 64% Oil and gas
- 25% Power generation
- 11% Civil Nuclear/other

Highlights

- Six RB211 gas turbine packages ordered by PetroChina
- Service revenue up 11 per cent, 333 engines under management
- LG acquired 51 per cent of Rolls-Royce Fuel Cell Systems (US) Inc.
- Tidal Generation Ltd sold to Alstom in January 2013
- RB211-Gzero launched
- £1.5 million investment 24/7 global Operational Service Desk completed
- Enhanced agreement with AREVA for UK civil nuclear new build
- Collaboration agreement with Hitachi following its acquisition of Horizon Nuclear Power
- Expanded global footprint with acquisition of US-based nuclear services business

With over 4,600 industrial gas turbines sold, recording over 180 million hours of operating experience, our Energy business plays a critical role in supporting global infrastructure.

Our technology powers offshore oil platforms around the world and transports oil and gas through 35 pipelines in 24 countries. Our power generation technology solutions ensure that reliable, dependable and flexible electricity supplies are efficiently met, without comprising emissions performance. We have also established a strong position in the civil nuclear sector.

Oil and gas

In total, ten RB211 gas turbines were ordered for oil and gas applications, nine of which are for pipeline compression projects. We secured a US$75 million contract to supply PetroChina with an additional six RB211-driven pipeline compressor units and related services to power the flow of natural gas through Line 3 of the West-East Pipeline Project (WEPP), the world's longest pipeline and a crucial element of China's drive towards cleaner energy consumption. When completed in 2015, the 7,000km WEPP Line 3 will link China's western Xinjiang autonomous region to Fuijan province in the south-east, transporting up to 30 billion cubic metres of gas per year. The contract significantly increases our supply to the WEPP network, bringing the total number of RB211 units sold for this huge infrastructure project to 37.

In addition, we secured a £24 million contract to supply three RB211 units for duty on the Uzbekistan section of the Asia Trans Gas (ATG) pipeline, and a contract to supply PTT's Ethane Separation Plant in Rayong, Thailand, with an additional unit to extend our scope at the site.

Construction of our new purpose-built packaging, assembly and test facility at Santa Cruz outside Rio de Janeiro, Brazil, is on track. The facility will open in 2013, positioning us for long-term growth from within Brazil. The first units to be delivered from Santa Cruz will be in fulfilment of the US$650 million contract awarded by Petrobras in 2011 which requires 32 RB211 gas turbine units to support its offshore production activities in the pre-salt, ultra-deepwater oil fields.

Power generation

Despite subdued demand for new power generation capacity in mature economies, £62 million in orders were received for four industrial Trent 60 gas turbines. Two units will support production expansion of LUKOIL's Stavrolen petrochemicals plant in Russia, and single units will respectively support Empresa Nacional de Electricidad's El Alto power plant in Bolivia, and textile and chemicals conglomerate CYDSA's processing plants at Coatzacoalcos Veracruz, México. We successfully completed several landmark installation and commissioning projects, including eight Trents for the Bayonne Energy Centre electric power plant in Bayonne, NJ, US, which supplies electricity to 400,000 homes in New York City at peak times.

Service

Our strategy to strengthen our aftermarket products and services capability delivered solid revenue growth. Excluding the land-based reciprocating engines that are now reported in Engine Holding, there are a total of 333 units, or 19 per cent of the core engine fleet, under long-term service agreements. We launched the RB211-Gzero, a retrofit upgrade product for the RB211-G gas generator, which provides many existing users of industrial RB211 aero-derivative gas turbine engines with a nominal power increase of ten per cent depending on ambient temperature and engine type.

Our new Operational Service Desk provides 24/7 technical support to customers, considerably enhancing our global service and parts delivery capabilities.

Civil Nuclear

During 2012, Rolls-Royce maintained its focus on the global and strategic growth of its Nuclear business and made solid progress in strengthening its position in this market.

We signed a strategic collaboration agreement in support of AREVA's plans to build new nuclear reactors and continued our collaboration with Rosatom on the development of global civil nuclear programmes. We have an agreement to support Hitachi, with its plans to build nuclear power stations at two sites in the UK.

The Group is modernising safety-critical instrumentation and control (I&C) systems on EDF's 1,300MW nuclear fleet in France and we are delivering I&C solutions to eight new nuclear power stations being built in China.

Our Nuclear Services business delivered a multi-million dollar package of automated handling, transportation and storage technology to Atomic Energy of Canada Ltd and secured a contract to provide specialist inspection solutions to Canadian nuclear utility, Bruce Power. At the end of 2012, we acquired PKMJ Technical Services, a specialist US-based software and nuclear engineering services company.

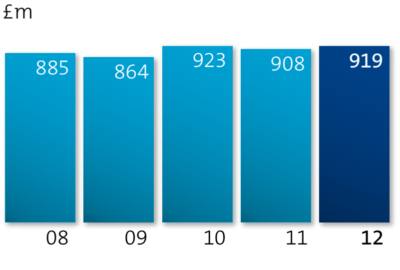
Industrial Trents power New York City from this Bayonne Energy plant in New Jersey.

Excellence in technology

In 2012, Rolls-Royce invested £919 million in gross research and development of which £577 million was funded from the Group's own resources. We create intellectual property which is then embedded in our products and services. This year, 475 patents were filed.

Colin Smith CBE
Director – Engineering and Technology

Gross research and development



Rolls-Royce has a track record of innovative products and services founded on a robust investment in technology. During 2012, we launched an Innovation Strategy which put in place a number of mechanisms to encourage our people to share and develop new ideas, ensuring that the flow of future technology remains strong. Through 'open innovation' we also invited other organisations to contribute to our technical challenges.

This year we invested significantly on our high-performance computing (HPC) capability and on several Design Key Systems which automate much of the design and make process for components, freeing up engineers to apply their skills to more complex and critical tasks.

Research and technology

We have an engineering resource inside the Group of 14,700 engineers. Many work as integrated teams across international borders on our major programmes and a number of our top engineers, or Rolls-Royce Fellows, are recognised as world-renowned experts in their fields.

In addition to our in-house R&D capability, Rolls-Royce undertakes advanced research via a global network of 28 university technology centres. Each centre is funded by the Group and undertakes specialist work in a particular engineering field, led by world-class academics. In 2012, we celebrated the 21st anniversary of this network.

In 2012, we invested £139 million in research and technology in addition to the significant government funding. In October 2012, together with the University of Birmingham, we announced a new £60 million centre for research into high-temperature metallurgy. This is the latest in a series of seven new research and advanced manufacturing centres the Group has helped to establish in the past four years. We believe our leading position in these centres will deliver significant benefit for the future in technologies and advanced manufacturing processes.

Civil aerospace

Our newest large engine programme, the Trent XWB for the Airbus A350 XWB family was successfully certificated on 7 February 2013. It began its flight-test programme in February 2012 on a modified A380 and completed over 150 flying hours. The initial engine entering service will be rated at 84,000lb thrust. The more powerful 97,000lb thrust engine for the later A350-1000 aircraft programme is progressing into the design and definition phase.

The new Trent 1000 engine was the first to enter service on the Boeing 787 Dreamliner and completed its first year in service with launch customer ANA, in October 2012.

Gulfstream's ultra-large-cabin, ultra-long-range G650 business jet aircraft with the BR725 engine, has received its final certification from Federal Aviation Administration and entered into service.

We successfully completed the E3E programme in 2012 which demonstrated core technology for our future two-shaft engine portfolio. Offering significant improvements in fuel consumption, unit cost, weight and emissions, it provides technologies for our BR700-NextGen and into our wider portfolio.

Defence aerospace

Since the T56 entered production in 1954, over 18,000 T56/501-D turboprops have been installed on a wide variety of propeller-driven aircraft. We recently successfully created a technology insertion package to significantly improve fuel efficiency on the US Air Force's C-130H Hercules transporter. In tests, our T56 Series 3.5 Enhancement Package demonstrated an eight per cent fuel consumption improvement. Once certified, the T56 Series 3.5 will help extend the life of this ageing fleet.

Our T56-A427A engine, with a modern electronic engine control and fuel pump metering unit replacing the previous hydro-mechanical control, is now ready for full production after receiving US Navy military qualification and successfully completing the initial operational test and evaluation. Two of these engines power the US Navy's E-2D Advanced Hawkeye airborne early warning and electronic warfare systems aircraft.

The Rolls-Royce LiftSystem for the F-35B Lightning II STOVL fighter aircraft entered service with the US Marine Corps in late 2012.

Marine

The Far Solitaire, a Rolls-Royce designed platform supply vessel for the offshore oil and gas industry, was named ship of the year at the Shipbuilding, Machinery and Marine Technology exhibition, the leading international maritime trade fair. This is the third time in five years a Rolls-Royce designed vessel has won the award.

We have delivered our first permanent magnet tunnel thruster. This new design reduces noise and vibration and increases power by 25 per cent, compared to traditional models of the same size.

Design of the PWR3 nuclear power plant for the UK Trident Successor Programme is progressing well. The new reactor plant design was selected by the UK MoD to provide easier operation, longer service life and lower through-life costs. A UK Government decision on the successor to Trident is planned for 2016.

Energy

The successful industrial version of the RB211 gas turbine is used all over the world in oil and gas and power generation markets. Over 700 industrial RB211s have been sold, achieving more than 30 million operating hours. In 2012, we announced the launch of the RB211-Gzero a retrofit upgrade product that provides the engine with a nominal power increase of ten per cent.

The distinctive power and efficiency of the industrial Trent were strengthened in 2012, together with its capability on low emissions and its operational flexibility for oil and gas applications.

The Trent XWB undergoing tests at the Group's outdoor facility in Mississippi, US.

Excellence in operations

We continue to invest globally in capacity and capability that will help our customers and our business succeed.

Alain Michaelis
Operations Director

£491 million

Capital expenditure on new and improved facilities

Manufacturing technology and infrastructure
Through the year, good progress has been made on the introduction of a broad spectrum of technology projects that will reduce operational costs, increase output and improve product performance.

Manufacturing capacity
We have added significant manufacturing capacity to meet our customers' needs and to successfully deliver our substantial order book.

Rolls-Royce has opened 19 new facilities in the past three years in locations including the UK, Germany, Norway, US, Singapore, China and Brazil.

In 2012, we opened our largest facility in Asia, at Seletar Aerospace Park in Singapore, and delivered our first Trent 900 engine from the site. At full capacity, this facility will be capable of producing a Trent engine every working day and 6,000 fan blades each year.

Other major projects include: construction of an advanced blade casting facility in Rotherham, UK, and our advanced blade and vane machining facility at our Crosspointe campus in Virginia, US. We also made a significant extension to our engine testing facility in Dahlewitz, Germany and developed a major facility for assembly and test in Rio de Janeiro, Brazil, that will support our Marine and Energy businesses.

Advanced centres
Five advanced manufacturing research centres are now all fully operational in the UK with the number of research projects doubling over the past 12 months to more than 160.

The sixth centre of the network, in Virginia, US, opened its doors in September and building work has started in Singapore on an advanced remanufacturing and technology centre.

These centres, which are the result of collaboration between governments, universities and industrial partners, form a vital bridge between the creation of a concept and industrial application. This allows us to work with suppliers, university research teams and technology providers to develop and prove manufacturing processes before making major investment decisions.

Suppliers

As an increasingly global business, we continue to develop our supply base in emerging markets, whilst also deepening our relationship with existing suppliers.

In the UK, we are taking a leading role in the UK Government's 'Sharing in Growth' initiative which will provide around 30 UK suppliers with a tailored, in-depth training and development programme. The aim is to create a competitive group of UK suppliers to help achieve sustainable, competitive performance as the industry continues to grow.

As we work alongside our suppliers, we also have to make sure we strike the right balance between what we choose to do ourselves and what we buy. We have acquired the Aero Engine Controls (AEC) business, in order to strengthen our offering in the increasingly important engine control systems market.

Information technology

In 2012, we invested over £100 million in IT as part of our ongoing investment programme. This programme is addressing the need to modernise data centres, improve networks, and upgrade personal computers and software across more than 265 sites in 39 countries.

Continuous improvement

We continually apply technology and operational improvements to drive productivity and the efficiency of the power systems we produce.

We apply lean techniques to our design, manufacture and our suppliers so that the actions of everyone involved will drive efficiency, quality and safety in all we do.

The production flow of our LiftFan™ assembly facility in the US is mapped on an interactive screen.

The Chairman and employees at Seletar celebrating delivery of the first production engine from the facility.

Sustainability – better power for a changing world

As a leader in technology, we believe that advanced engineering has a critical role to play in achieving a sustainable future. We are committed to developing the most efficient power systems in the world. This helps the environment and our customers by enabling them to do more, using less. Focusing on the environmental performance of our products and operations, investing in our people and, engaging with our communities helps grow our business.

Innovative new gas-powered ferry design for Lauro Shipping.

CARBON DISCLOSURE PROJECT

Carbon Disclosure Project (CDP)
We continue to be one of the leading companies in the CDP Index. Our 2012 carbon disclosure score was 72 and our performance band 'B'. We led the Global 500 industrials in governance and strategy, emissions management and reporting.

Dow Jones Sustainability Indexes
Member 2012/13

Dow Jones Sustainability World and European Indexes (DJSI)
We have retained our position in the DJSI for the eleventh consecutive year, with an overall score of 74 per cent, well above the average of 42 per cent in the aviation and defence sector.

Environment

We apply our knowledge and technology to develop the best solutions for the environment and our customers. Our environmental strategy has been revised in 2012 to reflect the main focus of investment and effort applied by the Group, concentrating on three areas:

1. support customers by further reducing the environmental impact of our products and services;
2. develop new technology for future low-emission products; and
3. maintain our drive to reduce the environmental impact of our business activities.

1. Support customers by further reducing the environmental impact of our products and services
We have a strong track record of reducing the emissions of our products through significant investment in R&D. In 2012, we invested £919 million in R&D, of which around two thirds is aimed at reducing the environmental impact of our products. Since the first jet airliners of around 50 years ago, on a per passenger-kilometre basis, aircraft burn 70 per cent less fuel and are 75 per cent quieter. An Environmental Advisory Board of distinguished academics and leading authorities in their respective fields, provides independent expert advice to inform business strategy and design processes.

The Advisory Council for Aviation Research and Innovation in Europe (ACARE) has set challenging goals for aviation to meet by 2050 (base year 2000). In 2012, we helped define the priorities for Strategic Research and Innovation in aviation to meet the ACARE goals:

- reducing aircraft CO_2 emissions by 75 per cent per passenger kilometre;
- reducing noise by 65 per cent; and
- reducing oxides of nitrogen (NO_X) by 90 per cent.

Innovation provides increasingly efficient products worldwide

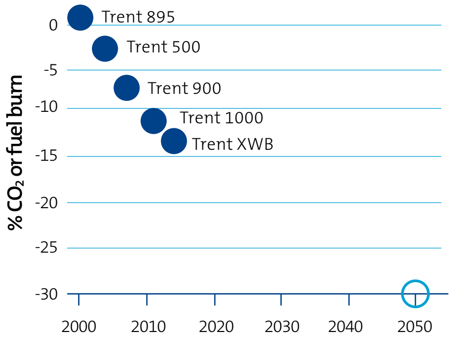
The Trent XWB – due to enter service in 2014 – is proving to be the most efficient large civil aero engine ever produced, burning 16 per cent less fuel per passenger kilometre than our first Trent engine which entered service in 1995.

CO_2 (Engine)

ACARE Target:
75% overall reduction in CO_2 per passenger kilometre 30% engine contribution (Rolls-Royce engine long-term goals).

Trent family

ACARE flightpath 2050 target



We are investing in technology to provide more efficient marine power and propulsion systems as well as 'whole ship' integrated designs. In 2012, we delivered our first lean-burn gas-powered platform supply vessel cargo ship and announced orders for our first gas-powered tugs. We introduced new propulsor technologies, including our first permanent magnet tunnel thruster and our first thruster to make extensive use of composite materials.

Innovative vessel designs use the Environship concept, incorporating wave-piercing hull features. A liquefied natural gas engine and an integrated rudder and propeller system combination can reduce fuel consumption, and cut CO_2 emissions by up to 40 per cent compared to conventional vessels.

In energy markets, our Trent 60 is the most advanced aero-derivative gas turbine available today, establishing a new benchmark for fuel economy and cost savings. Our RFA36 and RFA24 are the most efficient pipeline compressors available today with field-proven efficiencies of up to 91 per cent, saving energy costs for our customers.

2. Develop new technology for future low emission products

Nuclear power can make a significant contribution to future low carbon electricity generation.

As a key player in the industry for 50 years, we have extensive knowledge of nuclear technology, its safety and control. Our nuclear capabilities span the reactor life-cycle, from concept design through to obsolescence management and plant life extension.

Our expertise including component manufacturing, licensing, project and supply chain management as well as world-class engineering, positions us well to support nuclear power growth.

We are also working with customers and fuel companies to ensure that future biofuels, which will be part of the solution for aviation towards 2050, meet our requirements, with the important caveats that they are sustainable, do not compete with the growth of food crops and are used in the most effective way to maximise the reduction in greenhouse gas (GHG) emissions.

3. Maintain our drive to reduce the environmental impact of our business activities

Greenhouse gas emissions

In 2009, we set three year GHG reduction targets for our facilities and can now report that we have exceeded these (see table below).

2012 final target achievement

Target area	Targeted reduction by end 2012 [1]	Actual [2]
Facility GHG emissions (absolute) excluding product test and development	5%	6.5%
Total Group GHG emissions (normalised by turnover) including product test and development	10%	16%

[1] Based on 2009 GHG emissions
[2] Energy/GHG data has been forecast based on data collected during January to October 2012. The 'Basis of Reporting' is available at www.rolls-royce.com

Our total GHG emissions (including product test and development) was 550 $ktCO_2e$ in 2012, a reduction of four per cent compared with 572 $ktCO_2e$ in 2009 (see table below). This reduction has been achieved, despite a growth in our global facilities footprint, through a sustained investment in new and more efficient manufacturing facilities. In 2012, we invested over £3 million in energy reduction projects such as the upgrade of compressed air plant, furnace controls and, lighting systems and controls within our existing facilities.

GHG emissions breakdown

Total $ktCO_2e$ (includes emissions associated with product development and testing)	2009	2010	2011	**2012**
Direct emissions	215	236	229	**213**
Indirect emissions	357	365	346	**337**
Total	**572**	**601**	**575**	**550**

We continue to recognise the need to reduce the emissions of our operations and we are reducing our reliance on fossil fuels. We are seeking to make wider use of more sustainable energy sources, like renewable and other low carbon technologies, where cost effective and practical.

New energy and GHG reduction targets aimed at sustaining our improvement will be set for the next three years.

Certification

Our business segments have certification to the environmental management systems standard ISO 14001.

Global supply chain

During 2012, we expanded the application of lean techniques across the supply chain. Our suppliers increased their metal recycling and further engaged in paperless purchasing practices. We continue to request key suppliers are ISO 14001 certificated and support them to meet their obligations under the European REACH (Registration, Evaluation and Authorisation of Chemicals) legislation.

Our people

We support business growth by creating an inclusive working environment that attracts and retains the best people.

We employ 42,800 people in more than 50 countries across our four global market sectors:

Average number of employees	2012	2011
By region		
United Kingdom	**22,800**	21,600
Rest of the world	**20,000**	18,800
Total	**42,800**	40,400
By sector		
Civil aerospace	**21,500**	19,800
Defence aerospace	**7,800**	7,600
Marine	**8,800**	8,600
Energy	**3,700**	3,500
Engine Holding	**1,000**	900
Total	**42,800**	40,400

Rolls-Royce is committed to creating a working environment which helps people to perform at their best. Great value is placed on giving a voice to our workforce and we engage and involve people in improving the business and welcome their feedback. Information on business and work issues is shared with our employees and their representatives through established communication channels. We reward and recognise high performance and encourage our employees to become investors in the Company.

Human rights are reflected in our policies and standards covering Business Ethics, Health and Safety, the Environment, Employees, and Community Investment. We oppose any form of child labour or practices which inhibit the development of children. We believe employment should be freely chosen and commit to refrain from using forced or involuntary labour.

Encouraging diversity

Our Global Diversity and Inclusion Steering Group is comprised of main board directors and senior executives. It promotes an inclusive workplace in which individuals feel they are respected, valued and have an equal opportunity to progress.

The Group's global workforce is 15 per cent female with eight per cent female senior executives. About two thirds of our workforce is in engineering or manufacturing with historically low female representation. We actively work with schools and universities to increase interest and encourage diversity amongst those taking STEM subjects, and to broaden the career aspirations of individuals from under-represented groups.

Our female and international graduate recruitment has increased steadily over recent years, 26 per cent of overall graduate development programme participants are female and 38 per cent are non-British. Around 50 per cent of participants are female in our non-engineering and non-manufacturing programmes.

The Group is committed to developing a diverse workforce and equal opportunities for all. Our policy is to provide employment training and development opportunities for disabled people wherever possible. We are committed to supporting employees who become disabled during employment and helping disabled employees make the best use of their skills and potential.

Resourcing and development

In 2012, we recruited over 2,800 experienced professionals to support the growth of our business, nine per cent higher than in 2011. We recruited 318 apprentices. We engage with universities globally, and in 2012 recruited 312 graduates on to our corporate graduate programme from 89 universities and 36 nations. To support long-term growth objectives, we plan to further increase our graduate programme in 2013.

In 2012, we supported 47,500 employees and sub-contract personnel through our learning management system, MyLearning. A total of 249,000 training courses were completed during the year. Learning investment for 2012 was £39 million.

In November, the Chancellor of the Exchequer, George Osborne, opened the new apprentice academy in Derby. The £6 million investment, supported by the Skills Funding Agency, provides capacity for Rolls-Royce to double the number of apprentices it trains. They will provide an additional source of skilled employees to our supply chain. In the UK, the academy won the Gen II Macro Employer of the Year category of the National Apprenticeship Awards.

Our regional training centre strategy places product training close to our customers. A new training centre in Ålesund, opened by the Crown Prince of Norway in November, complements the existing facilities in Derby, Bristol, Singapore and Indianapolis.

Demand for customer training continues to increase with a 35 per cent growth in 2012. On-line learning is available to all our customers through the Group's website at www.rolls-royce.com.

In July, the launch at the Farnborough International Airshow of a Lego working replica of a Trent engine fuelled ten million Tweets – including one from The White House Office of Science and Technology Policy.

Health and safety
Rolls-Royce is committed to continual improvement in the standards of health and safety in the workplace. A main board director has responsibility for this. The Board receives regular reports on progress against targets and improvement programmes.

Employees receive mandatory health and safety training. As a result of this focus, health and safety performance has shown steady improvement over many years. However, tragically, in 2012 we suffered two employee fatalities. In the first incident, an employee was fatally injured whilst working on electrical equipment at a customer site. In the second, an employee drowned in a river during a company organised event. Thorough investigations for both incidents were carried out. These are the first fatalities since 2008.

We continued to make progress on our major global improvement programmes. We reviewed machinery guarding and lifting programmes at 30 sites as part of our review of process safety management.

Business segments have global certification to OSHAS 18001, confirming our commitment to globally consistent health and safety standards.

Exposure monitoring confirmed that existing controls should meet the new exposure and release standards under the EU Registration, REACH regulations.

We further engaged our employees in improving health and safety with focused activities during HS&E Week and over 5,000 employees taking part in a global wellness programme.

Our total reportable injury (TRI) rate continues to decline – a 23.5 per cent drop in 2012 gives a 28 per cent reduction over the past three years from 0.72 TRI per 100 employees to 0.52. This fell short of our target of a 50 per cent reduction by the end of 2012. Our primary focus has been on high potential incidents which could lead to significant injury or harm, rather than the broader measure of TRI which also includes minor incidents.

Engaging with governments and communities

Working with governments
We engage in dialogue to align our business needs with the political, social, and commercial requirements of host governments in our key markets. Where we achieve such alignment, for example in Singapore, the benefits for both the Group and the country can be considerable.

In the UK, the Government has made strategic investments in the aerospace industry through the Aerospace Growth Partnership. In 2012, they announced a £40 million investment, matched by industry, in the Rolls-Royce led SILOET II programme (Strategic Investment in Low-carbon Engine Technology). We expect this programme to deliver improvements in engine fuel economy for both widebody and narrowbody civil aircraft.

A further Government investment of £25 million was added to the £40 million from industry to support a series of research and technology projects including SAMULET II (Strategic Affordable Manufacturing in the UK through Leading Environmental Technologies). This Rolls-Royce led collaborative programme aims to accelerate the development of manufacturing and product technologies.

This year the Business Secretary, Vince Cable, performed the groundbreaking ceremonies for our new factories at Rotherham and Washington, Tyne and Wear, UK.

In view of the importance of EU regulation and funding for the Group's activities, Rolls-Royce enlarged its EU Affairs team in Brussels. Our main EU affairs activities in 2012 focused on two areas: financial regulation and the future framework for EU R&D funding.

We continued to monitor EU legislation on financial regulatory reform for its impact on non-financial companies like Rolls-Royce. Throughout the year, we provided input to the decision-making procedure on Horizon 2020 – the EU Research and Innovation funding framework for 2014-2020. Other policy areas have also required our attention, such as: REACH; the future monitoring, reporting and verification system for maritime emissions; revised noise rules in the field of aviation; alternative fuel policies; and international free trade agreement negotiations. We organised high-level meetings with relevant EU Commissioners during the year; gave evidence to the 'Liikanen group', the EU's high-level group on reforming the structure of the EU banking sector; and submitted responses to a number of Commission consultations. Rolls-Royce is registered in the EU's Transparency register where more information about our activities and involvement in associations can be found.

In North America, our relationships with a variety of domestic industry and government bodies provide an essential platform to communicate on a broad array of issues from aviation emissions to energy-related appropriations.

We engage with Congress (in both the House of Representatives and the Senate) at the Committee, District and State level. Our Political Action Committee (PAC) operates in accordance with all legal and ethical requirements.

We have hosted a number of Congressional visits including President Obama's visit to our new Crosspointe facility, Virginia, US.

Our membership of North American major trade associations (including the Aerospace Industries Association, Organization for International Investment and the US Chamber of Commerce), enables us to support broader coalition efforts. This guards against any potential protectionist measures which may be detrimental to Group interests.

Sustainability

The Group encourages the interest of young people in Science, Technology, Engineering and Mathematics.

Community investment

We have a long-standing commitment to the communities we operate in around the world and during 2012 the Group's total contribution (including money, employee time and gifts in kind) was £8 million.

Our community investment activities support the Group's strategy and future success, particularly in the areas of: recruitment and retention; employee engagement and development; and the Group's reputation in the wider community.

The main areas of support defined in our global charitable contributions and social sponsorships policy are:

- education and skills, particularly Science, Technology, Engineering and Mathematics (STEM) which are key to our future success;
- environment activities linking into our environment strategy;
- social investment, making a positive difference to the communities in which we operate; and
- arts, culture and heritage, contributing to the cultural vibrancy in the areas we operate.

A clear governance structure ensures a consistent approach and visibility of our contributions globally.

2012 charitable contributions, sponsorship and payroll giving

	£ million
Charitable contributions and social sponsorships:	
UK	2.3
Asia and Middle East £0.1m, Americas £0.8m, Europe £0.3m	1.2
Total	**3.5**
Commercial sponsorship – global total, including: UK £0.3m, Asia and Middle East £0.3m, Americas £1.3m, Europe 0.2m	2.1
Employee time	2.2
Gifts in kind	0.2
Total	**8.0**
Payroll giving UK £0.5m, North America £0.2m	0.7

Additional financial information

Foreign exchange

Foreign exchange rate movements influence the reported income statement, the cash flow and closing net cash balance. The average and spot rates for the principal trading currencies of the Group are shown in the table below:

		2012	2011	Change
USD per GBP	Year end spot rate	**1.63**	1.55	+5%
	Average spot rate	**1.59**	1.60	-1%
EUR per GBP	Year end spot rate	**1.23**	1.20	+3%
	Average spot rate	**1.23**	1.15	+7%

Taxation

The Group believes that it has a duty to shareholders to seek to minimise its tax burden but to do so in a manner which is consistent with its commercial objectives and meets its legal obligations and ethical standards. Every effort is made to maximise the tax efficiency of business transactions and this includes taking advantage of available tax incentives and exemptions. However, the Group has regard for the intention of the legislation concerned rather than just the wording itself.

The Group is committed to building open relationships with tax authorities and to following a policy of full disclosure in order to effect the timely settlement of its tax affairs and to remove uncertainty in its business transactions. Where appropriate, the Group enters into consultation with tax authorities to help shape proposed legislation and future tax policy.

Transactions between Rolls-Royce subsidiaries and associates in different jurisdictions are conducted on an arms-length basis and priced as if the transactions were between unrelated entities, in compliance with the OECD Model Tax Convention and the laws of the relevant jurisdictions.

Investments and capital expenditure

The Group subjects all major investments and capital expenditure to a rigorous examination of risks and future cash flows to ensure that they create shareholder value. All major investments require Board approval.

The Group has a portfolio of projects at different stages of their life cycles. Discounted cash flow analysis of the remaining life of projects is performed on a regular basis.

Sales of engines in production are assessed against criteria in the original development programme to ensure that overall value is enhanced.

Financial risk management

The Board has an established and structured approach to financial risk management. The Financial risk committee (Frc) is accountable for managing, reporting and mitigating the Group's financial risks and exposures. These risks include the Group's principal counterparty, currency, interest rate, commodity price, liquidity and credit rating risks outlined in more depth in note 17 to the financial statements. The Frc is chaired by the Chief Financial Officer.
The Group has a comprehensive financial risk policy that advocates the use of financial instruments to manage and hedge business operations risks that arise from movements in financial, commodities, credit or money markets. The Group's policy is not to engage in speculative financial transactions. The Frc sits quarterly to review and assess the key risks and agree any mitigating actions required.

Capital structure

£ million	2012	2011
Total equity	**6,105**	4,519
Cash flow hedges	**63**	52
Group capital	**6,168**	4,571
Net funds	**1,317**	223

Operations are funded through various shareholders' funds, bank debt, bonds and notes. The capital structure of the Group reflects the judgement of the Board as to the appropriate balance of funding required.

Funding is secured by the Group's continued access to the global debt markets. Borrowings are funded in various currencies using derivatives where appropriate to achieve a required currency and interest rate profile. The Board's objective is to retain sufficient financial investments and undrawn facilities to ensure that the Group can both meet its medium-term operational commitments and cope with unforeseen obligations and opportunities.

The Group holds cash and short-term investments which, together with the undrawn committed facilities, enable it to manage its liquidity risk.

During the year, the Group drew down a further £200 million loan from the European Investment Bank. Following the acquisition of the 50 per cent of AEC that we did not already own (see note 25 of the financial statements), the Group repaid AEC's external bank funding of £78 million.

At year end, the Group retained aggregate liquidity of £3.6 billion. This liquidity comprised net funds of £1.3 billion and aggregate borrowing facilities of £2.3 billion, of which £1.0 billion remained undrawn.

The maturity profile of the borrowing facilities is regularly reviewed to ensure that refinancing levels are manageable in the context of the business and market conditions. The only facility to mature in 2013 is the US$230 million private placement. There are no rating triggers in any borrowing facility that would require the facility to be accelerated or repaid due to an adverse movement in the Group's credit rating.

Additional financial information

During 2012, the maturity date on the £1.0 billion revolving credit facility was extended from 2016 to 2017.

The Group conducts some of its business through a number of joint ventures. A major proportion of the debt of these joint ventures is secured on the assets of the respective companies and is non-recourse to the Group. This debt is further outlined in note 10 to the financial statements.

Credit rating

	Rating	Outlook	Grade
Moody's Investor Service	A3	Stable	Investment
Standard & Poor's	A	Stable	Investment

The Group subscribes to both Moody's Investors Service and Standard & Poor's for independent long-term credit ratings. At 31 December 2012, the Group maintained investment grade ratings from both agencies.

As a capital-intensive business making long-term commitments to our customers, the Group attaches significant importance to maintaining or improving the current investment grade credit ratings.

Accounting and regulatory

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS), as adopted by the EU.

In 2012, the Group has adopted revisions to IAS 1 *Presentation of Financial Statements* that require items of other comprehensive income to be classified depending on whether they may be potentially reclassified to the income statement. There is no net impact. There were no other revisions to IFRS that became applicable in 2012 which had a significant impact on the Group's financial statements.

A summary of changes which have not been adopted in 2012 is included within the accounting policies in note 1 to the financial statements.

Governments and regulators around the world continue to implement reforms to the financial markets with the aim of improving transparency and reducing systemic risk. Although the reforms are predominantly directed at financial institutions, they will also affect non-financial institutions such as the Group. The primary concern has been the reform of the over-the-counter (OTC) derivatives market, and in particular a proposal in the EU European Market Infrastructure Regulation (EMIR) that parties to future OTC derivative transactions would be required to use an exchange to clear the transactions and post cash collateral to reduce counterparty risk. The proposal could adversely affect the Group's future funding requirements and make cash flow more volatile. The final EMIR rules have now been released, which exempt non-financial institutions engaged in hedging activity from this requirement.

Share price

During the year, the share price increased by 17 per cent from 746.5 pence to 873.5 pence, in line with a 17 per cent increase in the FTSE aerospace and defence sector and compared to a six per cent increase in the FTSE 100. The Company's share price ranged from 733 pence in January to 913.5 pence in December.

Governance
Chairman's introduction

The actions we have taken in 2012 should leave no doubt that the Board of Rolls-Royce will pursue the Code's principles in the spirit in which they are intended.

Sir Simon Robertson
Chairman

In this report on governance, we will review the framework of rules and practices by which the Board of Rolls-Royce directed and controlled its business during 2012.

In 2012, the Association of British Insurers whose members account for a significant proportion of our shareholder base, issued a report on board effectiveness, which pinpointed three areas that it believed were essential to improving board effectiveness namely: board diversity; succession planning; and board evaluation.

The issues of diversity and the related topic of succession planning are high on our agenda and are covered in more detail in the nomination committee report on page 49.

With regard to board evaluation, we undertook an extensive external process in 2011 which provoked a good deal of debate and ushered in significant change. In 2012, I personally led a formal internal evaluation of the effectiveness of the Board. The general consensus from the confidential survey was that the Board continued to work well together and that Board interaction was effective. Further details of the process used and the outcome can be found on page 44.

Business ethics

The ethics committee spent a good deal of its time in 2012 dealing with concerns about bribery and corruption involving intermediaries in overseas markets which resulted in the Group handing over information to the Serious Fraud Office (SFO) in December 2012. This action, together with our appointment of Lord Gold to lead an independent review of our current compliance procedures, should make it clear to all who do business with us, or on our behalf, that the Board is united in its resolve not to accept any behaviour that undermines this Group's future success. More information on the work of the ethics committee can be found on pages 50 to 51.

The International Advisory Board (IAB)

Rolls-Royce is a global company and whilst that brings with it many exciting opportunities it also presents significant challenges. We have an International Advisory Board, which has been in place for some six years. Its membership, which is listed on page 42, comprises senior business and political leaders from all the areas in which we are building and developing our business and where we have a substantial presence, such as the US, China, India and Australia. The IAB meets once a year and in 2012, it was held in Derby. Its remit is to discuss the high-level issues and their potential impact on the Group. This type of big picture discussion is vital for a company such as ours where our continued success depends on making very long-term investments.

Principal risks

In 2012, the risk committee reconsidered and redefined the principal risks which we face in our business. The resulting list on pages 18 to 19 has therefore been condensed to fit under just eight broad headings. We believe this should provide a much clearer picture of the major areas of risk which our business faces. A report from the chairman of the risk committee can be found on page 52.

Remuneration

In June 2012, the Government published a consultation on what companies must disclose in pay reports. The directors' remuneration report on pages 57 to 67 must necessarily address existing legislation. However, we have anticipated some of the new requirements as described in the remuneration committee report on page 54.

UK Corporate Governance Code

The Financial Reporting Council (FRC) recently issued a revised UK Corporate Governance Code (the 2012 Code) and revised Guidance to Audit Committees. The audit committee has scheduled time in 2013 to discuss how the Company can best comply with these. This year's audit committee report can be found on pages 47 to 48.

Safety committee

The new safety committee met for the first time in 2012. The committee has made a good start in gaining an understanding of the Group's safety governance and disciplines and in developing a suitable reporting regime to enable the committee to provide the Board with an appropriate level of assurance. We hope this additional Board level scrutiny will tighten further the already stringent controls in place in this most critical area. The report of the safety committee is on page 53.

This is my final governance report as Chairman of Rolls-Royce. I firmly believe that the Company's values, its reputation and its ability to achieve its objectives depend to a large extent on the effectiveness of its approach to corporate governance. However, rules alone are not enough. The Code is based on principles and not just rules and the actions we have taken in the past and in 2012 should leave no doubt that the Board of Rolls-Royce will pursue those principles in the spirit in which they are intended.

Sir Simon Robertson
Chairman

Board of directors


Sir Simon Robertson


John Rishton


Iain Conn


Dame Helen Alexander


Lewis Booth CBE


Peter Byrom


Sir Frank Chapman


John McAdam

Sir Simon Robertson (71) [2*]
Non-executive Chairman, appointed January 2005

Skills and experience: Sir Simon brings to the Board an international corporate advisory background with a wealth of experience in mergers and acquisitions, merchant banking, investment banking and financial markets. During his career he has worked in France, Germany, the UK and the US. He is the former Managing Director of Goldman Sachs International and former Chairman of Dresdner Kleinwort Benson. In June 2010, he was honoured with a knighthood in recognition of his services to business.

External appointments: Sir Simon is the founder member of Robertson Robey Associates LLP and Deputy Chairman and Senior Independent Director of HSBC Holdings plc. He is a non-executive director of Berry Bros & Rudd Limited, The Economist Newspaper Limited and Troy Asset Management. He is a Trustee of The Eden Project and of the Royal Opera House Endowment Fund.

John Rishton (54) [2,5*]
Chief Executive, appointed March 2011

Skills and experience: John began his career in 1979 at Ford Motor Company and held a variety of positions in the UK and in Europe. In 1994 he joined British Airways Plc, where he was Chief Financial Officer from 2001 to 2005. In 2006, he was appointed CFO at Royal Ahold and became CEO in 2007. John was appointed as a non-executive director of Rolls-Royce in 2007 and served as chairman of the audit committee and a member of the ethics and nomination committees. He is a former non-executive director of Allied Domecq.

External appointments: Unilever have announced that John will be proposed to join the boards of Unilever NV and Unilever plc at the AGMs of those companies in May 2013.

Iain Conn (50) [1,2,6]
Senior Independent Director, appointed January 2005

Skills and experience: Iain joined the BP group in 1986 and has held a number of executive positions within the BP group worldwide.

External appointments: Iain is Group Managing Director and Chief Executive of Refining and Marketing, BP p.l.c. He is Chairman of the Advisory Board of The Imperial College Business School and a member of the Imperial College Council. Iain is also a member of the Energy and Climate Change Board, CBI and a member of the advisory boards of the Centre for European Reform and of the Centre for China in the World Economy at Tsinghua University.

Dame Helen Alexander (56) [2,3*,4]
Non-executive director, appointed September 2007

Skills and experience:
Dame Helen was Chief Executive of the Economist Group until 2008, having joined the company in 1985. She was President of the CBI until 2011 and Deputy President until June 2012; she has also been a non-executive director of Northern Foods plc, BT plc and Centrica plc. Dame Helen was awarded a CBE for services to publishing in 2004 and was made a Dame Commander of the Order of the British Empire for her services to business in June 2011.

External appointments: Dame Helen is Chairman of UBM plc, the Port of London Authority (PLA) and Incisive Media. She is also deputy chairman of esure Group Holdings, senior adviser to Bain Capital and a Director of the CBI. Dame Helen is Chancellor of the University of Southampton and she is currently involved with a number of other not-for-profit organisations in media, the internet, the arts and education.

Lewis Booth CBE (64) [1*,2,4]
Non-executive director, appointed May 2011

Skills and experience: Lewis is the former Executive Vice President and Chief Financial Officer (CFO) of Ford Motor Company, a position he held for over three years until his retirement from the company in April 2012. During his 34-year career at Ford he held a series of senior positions in Europe, Asia, Africa and the United States. Lewis began his career with British Leyland, before joining Ford in 1978. He was awarded a CBE in June 2012 for services to the UK automotive and manufacturing industries.

External appointments: Lewis is a director of Mondelez International, Inc., Gentherm Inc. and of University of Liverpool in America Inc.

Peter Byrom (68) [2,4]
Non-executive director, appointed January 1997

Skills and experience: Peter was a director of AMEC plc from 2005 to 2011 and of NM Rothschild & Sons Limited from 1977 to 1996. He is a Fellow of the Royal Aeronautical Society.

External appointments: Peter is Chairman of Domino Printing Sciences plc.

Sir Frank Chapman (59) [2,3,6*]
Non-executive director, appointed November 2011

Skills and experience: Sir Frank has worked in the oil and gas industry for 38 years including appointments within Royal Dutch Shell plc and BP p.l.c. He was Chief Executive of BG Group plc for 12 years until December 2012. Sir Frank graduated with first class honours in Mechanical Engineering from Queen Mary College, London University and is a Fellow of the Royal Academy of Engineering, the Institution of Mechanical Engineers and the Energy Institute.

John McAdam (64) [2,3,6]
Non-executive director, appointed February 2008

Skills and experience: John was the Chief Executive of ICI plc until ICI's acquisition by Akzo Nobel. He has held a number of positions at Unilever, within its Birds Eye Walls,

Board of directors


John Neill CBE


Jasmin Staiblin


Ian Strachan


James Guyette


Mark Morris


Colin Smith CBE


Nigel Goldsworthy

Quest International and Unichema International businesses and is a former non-executive director of Severn Trent plc and Sara Lee Corporation.

External appointments: John is Chairman of United Utilities Group PLC and Rentokil Initial plc and the Senior Independent Director of J Sainsbury plc.

John Neill CBE (65) [1,2]
Non-executive director, appointed November 2008

Skills and experience: John is a member of the Council and Board of Business in the Community, is Vice President of the Society of Motor Manufacturers and Traders, BEN, the automotive industry charity and The Institute of the Motor Industry. He was formerly a Director of the Bank of England and a non-executive Director of the Royal Mail and Charter International plc. He was awarded a CBE in June 1994.

External appointments: John is the Chairman and Group Chief Executive of the Unipart Group of Companies.

Jasmin Staiblin (42) [2,4]
Non-executive director, appointed May 2012

Skills and experience: Jasmin is the CEO of Alpiq Holding AG and was CEO of ABB Switzerland Ltd until December 2012. She has lived and worked in Switzerland, Sweden and Australia.

External appointments: Jasmin is a non-executive director of Georg Fischer AG, ETH Domain and Neue Aarguer Bank (a member of the Credit Suisse Group).

Ian Strachan (69) [1,2,4*]
Non-executive director, appointed September 2003

Skills and experience: Ian is the former Chief Executive of BTR plc, former Deputy Chief Executive and Chief Financial Officer of Rio Tinto plc, former non-executive Chairman of Instinet Group Inc and a former non-executive director of Johnson Matthey plc, Commercial Union and Reuters Group plc.

External appointments: Ian is a non-executive director of Xstrata plc, Transocean Inc and Caithness Petroleum Limited.

James Guyette (67) [5]
President and Chief Executive Officer of Rolls-Royce North America Inc. appointed January 1998

Skills and experience: Before joining the Company, Jim was Executive Vice President, Marketing and Planning of United Airlines.

External appointments: Jim is Chairman of PrivateBancorp Inc., of Chicago, Illinois and he is lead independent director of priceline.com Inc of Norwalk, Connecticut. He is also Chairman of the Smithsonian National Air & Space Museum, Washington DC.

Mark Morris Age (49) [5]
Chief Financial Officer, appointed January 2012

Mark joined Rolls-Royce in 1986. He has held a number of senior positions throughout the Company and prior to his appointment as Chief Financial Officer was Group Treasurer from 2001.

Colin Smith CBE (57) [5]
Director – Engineering and Technology, appointed July 2005

Skills and experience: Colin joined Rolls-Royce in 1974. He has held a variety of key positions within the Company, including Director – Research and Technology and Director of Engineering and Technology – Civil Aerospace. Colin is a Fellow of the Royal Academy of Engineering, the Royal Aeronautical Society and the Institution of Mechanical Engineers. He is also a Member of the Council for Science and Technology. In June 2012 he was awarded a CBE for services to UK engineering.

Nigel Goldsworthy (47)
Company Secretary & Head of Legal appointed December 2012

Skills and experience: A solicitor, Nigel has held a number of senior legal and company secretary roles within the Company and, before his appointment as Company Secretary & Head of Legal, was Deputy General Counsel from 2008. Before joining Rolls-Royce in 2004, Nigel was a partner in the banking group of Lovells (now Hogan Lovells).

Committee membership
1 Audit committee
2 Nomination committee
3 Remuneration committee
4 Ethics committee
5 Risk committee
6 Safety committee
* Denotes chairman of committee

Non-executive directors

Executive directors

Company Secretary

International Advisory Board (IAB)

The IAB, formed in 2006, advises the Board on emerging worldwide trends. Membership is as follows:

Lord Powell of Bayswater (Chairman of the IAB)
Former Foreign Affairs and Defence Adviser to Prime Ministers Baroness Margaret Thatcher and Sir John Major

Sir Rod Eddington
Chairman JP Morgan (Australia & New Zealand) and former Chief Executive, British Airways Plc

Dr Fan Gang
Professor at China's Academy of Social Sciences and Director of National Economic Research Institute

Carla Hills
Chair and CEO, Hills & Company, International Consultants, former US Trade Representative, former US Secretary of Housing and Urban Development, former US Assistant Attorney General

General Sir Mike Jackson
Former Chief of the General Staff, UK Ministry of Defence

Mustafa Koç
Chairman of Koç Holding, A.Ş.

Dr Henrique Meirelles
Chairman of J&F, the holding company of JBS, Flora, Eldorado, non-executive Chairman of Brazil's Olympic Public Committee (the 2016 Olympic Games – Rio de Janeiro) and former President of Brazil's Central Bank from 2003 to 2010

Akio Mimura
Director, Board member and Senior Advisor Nippon Steel & Sumitomo Metal Corporation

Lubna Olayan
CEO and Deputy Chairperson of the Olayan Financing Company

Rair Simonyan
Advisor to the President OAO NK Rosneft, former Chairman, Morgan Stanley, Russia, former first vice president of Russian State oil company, Rosneft

Ratan Tata
Former Chairman of Tata Sons Limited

Matthias Wissmann
President of the German Association of the Automotive Industry, Vice-Chairman of the Federation of German Industries and Senior International Counsel at WilmerHale, former Federal Minister of Research and Technology and of Transport of Germany

Lee Hsien Yang
Chairman, Fraser and Neave Limited, Chairman Civil Aviation Authority Singapore, Chairman Islamic Bank of Asia Private Limited

Ernesto Zedillo
Former President of Mexico, Director, Yale Center for the Study of Globalization

Ambassador Robert B Zoellick
Senior Fellow at the Belfer Center for Science and International Affairs at Harvard University's Kennedy School of Government, former President of World Bank Group, former US Deputy Secretary of State and former US Trade Representative

The Group Leadership Team (GLT)

During 2012, John Rishton chaired meetings of the GLT which acted as an important communications channel between the senior management team and the Group's executive directors. In addition to John Rishton, its other members were:

Andrew Heath
President – Energy

Mark King
President – Aerospace

Alain Michaelis
Operations Director

Mark Morris
Chief Financial Officer

Miles Cowdry
Corporate Development Director

Kath Durrant
Human Resources Director

James Guyette
President – Rolls-Royce North America Inc.

Lawrie Haynes
President – Nuclear

Peter Morgan
Director – Corporate Affairs

John Paterson
President – Marine and Industrial Power Systems

Colin Smith
Director – Engineering and Technology

Robert Webb
General Counsel & Head of Risk

Tony Wood
President – Marine

Other members who served were: Mike Terrett, former Chief Operating Officer, who retired on 31 December 2012; Harry Holt who took up a post as Director, Business Development in our Civil aerospace business on 1 July 2012; Michael Haidinger who joined the board of Tognum as Chief Sales Officer on 1 July 2012; and Dan Korte, President – Defence aerospace who resigned in September 2012.

Corporate governance report

This report, which includes the directors' remuneration report on pages 57 to 67, explains how the Company discharges its corporate governance responsibilities.

In the year to 31 December 2012, the revised principles and provisions of the Code (published in May 2010 by the Financial Reporting Council (FRC)) applied to the Company. A printed copy of the Code can be obtained free of charge from FRC Publications, 145 London Road, Kingston upon Thames, Surrey KT2 6SR – telephone: +44 (0)20 8247 1264 and online at: www.frcpublications.com. The Board confirms that throughout 2012, the Company complied with the provisions of the Code, with the following exception:

Code provision	Explanation
C.3.4 – The audit committee should review arrangements by which staff of the company may, in confidence, raise concerns about possible improprieties in matters of financial reporting or other matters.	The Board considered it appropriate that this provision of the Code be the primary responsibility of the ethics committee although that committee is required to refer concerns about possible improprieties in matters of financial reporting to the audit committee.

Board membership

There are currently 14 directors on the Board comprising the non-executive Chairman, the Chief Executive, three other executive directors and nine non-executive directors. During the year, Mark Morris took up the post of Chief Financial Officer on 1 January 2012 and Jasmin Staiblin was appointed as an additional non-executive director on 21 May 2012. Two directors retired in the year, Sir Peter Gregson did not seek re-election at the annual general meeting (AGM) on 4 May 2012 and Mike Terrett retired on 31 December 2012.

On 14 February 2013, the Board announced Sir Simon Robertson's intention to retire as Chairman and as a non-executive director at the conclusion of the AGM on 2 May 2013. In addition, Ian Strachan and Peter Byrom will not be seeking re-election as non-executive directors at that meeting. Under Article 112 of the Company's Articles of Association, all directors (with the exception of Sir Simon Robertson, Peter Byrom and Ian Strachan) will offer themselves for re-election at the 2013 AGM. Ian Davis will be appointed as an additional non-executive director on 1 March 2013 and will take over as Chairman at the conclusion of the 2013 AGM.

The process for Board succession is discussed in the nomination committee report on page 49.

Roles and responsibilities

The Board has a written remit for the Chairman, Sir Simon Robertson, who has responsibility for the running of the Board and ensuring its effectiveness. The Chief Executive, John Rishton, has responsibility for running the business. This division of responsibility ensures that no one individual has unfettered powers of decision. In addition, the Board has agreed a set of guiding principles to govern the relationship between the Chairman and Chief Executive which, for example, requires that the two roles are structured in a complementary manner and demands that the relationship between the two be based on mutual respect and trust and be frank and open.

The Senior Independent Director, Iain Conn, acts as a sounding board for the Chairman and can act as an intermediary for other directors. Each year, he leads a separate meeting of the Board excluding the Chairman to review the Chairman's performance. In 2012, the meeting expressed its unanimous support for Sir Simon Robertson, noting the enormous amount of time, effort and energy he contributed outside of the boardroom. During the year, Iain Conn also led the process to seek a replacement for Sir Simon, taking the chair when appropriate at meetings of the nomination committee.

Role and operation of the Board

The principal role of the Board is to ensure that the Group's strategy creates long-term success for the Group within an acceptable risk profile and providing value for the long-term investor.

To achieve its long-term success, the Board must:

- ensure the safety of its products and its people;
- oversee and approve the development of the Group's strategy, monitoring both its achievement and the Group's risk appetite;
- uphold the values of the Group, including its brand and corporate reputation;
- oversee the quality and performance of management and ensure it is maintained at world-class standards, through effective succession planning and remuneration policies; and
- maintain an effective corporate governance framework, with transparent reporting.

The Board has established a formal schedule of matters reserved for its approval, generally being those items which affect the shape and risk profile of the Group, as well as items such as the annual budget and performance targets, the financial statements, payments to shareholders, major capital investments, substantial changes to balance sheet management policy and the strategic plan.

John Rishton, as the Chief Executive, is responsible for the day-to-day leadership, operational and performance management of the Group within the confines of the strategic and business plans and budgets agreed by the Board. The delegation of responsibilities to the executive team is set out in a detailed schedule approved by the Chief Executive.

The work of the Board in 2012

During 2012, the Board held 11 meetings, seven of which were scheduled and a further four called at short notice. At each scheduled meeting, executive directors supplied reports on business and financial performance including the usual approval of financial statements and budgets. The Board also received regular updates on HS&E issues, employee issues and legal issues including a review of its governance arrangements. In addition, the chairman of each of the board committees provided verbal reports on matters discussed by that committee since the previous Board meeting.

On 18 September 2012, the Board held its annual day-long strategy meeting, which included discussions on each of the business segments and presentations on the ten-year financial plan and the development of the Group's overall strategy, vision, brand promise and values. The September meeting was held in the Group's offices in Reston, US, and was followed by a visit to its Crosspointe facility, which included a tour of the newly established Commonwealth Centre for Advanced Manufacturing nearby.

In addition to its routine business, matters considered by the Board in 2012 included:

- the Eurozone crisis;
- defence strategy;
- concerns about bribery and corruption involving intermediaries in overseas markets;
- potential new and re-core engine developments;
- potential new facilities such as the new indoor test bed for Dahlewitz and a facility in Brazil;
- the acquisition of the remaining shares in the Aero Engine Controls joint venture from the Goodrich Corporation;
- the future of the tidal engineering and fuel cells businesses;
- potential acquisitions particularly in the nuclear sector;
- a presentation from Dr Hamid Mughal describing the global network of Advanced Manufacturing Research Centres;
- a review of the Group's tax affairs which included the renewal of taxation policy a statement of which can be found on page 37;
- IT infrastructure update; and
- an investor relations presentation which included the results of the 2012 investor audit.

Board and committee attendance

The attendance by individual directors at meetings of the Board and its committees in 2012 is shown in the table below:

	Board	Audit	Remuneration	Nomination	Ethics	Risk	Safety
Sir Simon Robertson (Chairman)	11(11)			4(4)			
Dame Helen Alexander	10(11)		3(3)	3(4)	5(5)		
Lewis Booth CBE	11(11)	4(4)		4(4)	5(5)		
Peter Byrom	11(11)			4(4)	5(5)		
Sir Frank Chapman [1]	8(11)		2(3)	3(4)			1(2)
Iain Conn	10(11)	4(4)		4(4)			2(2)
Sir Peter Gregson [2]	2 (3)		1(1)	0(1)			
James Guyette	11(11)					2(2)	
John McAdam	10(11)		3(3)	4(4)			2(2)
Mark Morris	11(11)					2(2)	
John Neill CBE	11(11)	4(4)		4(4)			
John Rishton	11(11)			3(4)		2(2)	
Colin Smith CBE	11(11)					2(2)	
Jasmin Staiblin [3]	8(8)			3(3)	2(2)		
Ian Strachan	11(11)	4(4)		4(4)	5(5)		
Mike Terrett CBE [4]	11(11)					2(2)	

Figures in brackets denote the maximum numbers of meetings that could have been attended (seven Board meetings were scheduled and four called at short notice).
[1] Sir Frank Chapman was unable to attend two Board meetings and three committee meetings held in December 2012 due to illness.
[2] Sir Peter Gregson retired as a non-executive director at the AGM on 4 May 2012.
[3] Jasmin Staiblin was appointed as a non-executive director on 21 May 2012.
[4] Mike Terrett, Chief Operating Officer, retired on 31 December 2012.

Board evaluation

The UK Corporate Governance Code requires that the Board undertakes an annual evaluation of its own performance and that of its committees and individual directors and to do so externally at least every three years. In 2012, the evaluation process was conducted internally, a full external review having been carried out by Jan Hall Associates in 2011.

Initially, directors were asked to complete a confidential survey covering the areas set out as best practice in the Financial Reporting Council's 'Guidance on Board Effectiveness – March 2011'. The Company Secretary then produced a report which consolidated the responses in such a way that individual contributions were not attributable. Following the circulation of the report to the Board, the Chairman conducted one-to-one interviews with each of them and reported to the next board meeting on the findings and agreed actions to be taken.

The general consensus from the process was that the Board was working well under the leadership of Sir Simon Robertson and John Rishton. It was considered appropriate that succession planning and the provision of information to the Board should be areas of focus for 2013. Also some directors expressed the view that the Board should maintain a continual watch on principal risks to avoid being solely reliant on the work of the audit and risk committees.

Directors' terms of appointment

Executive directors are employees who have day-to-day responsibilities as executives of the Group in addition to their duties as directors. Each executive director receives a service contract on appointment (see page 60 for further information).

Non-executive directors are generally independent of the Company, are not employees and do not participate in the daily business management of the Group. On appointment, each non-executive director receives a letter setting out the conditions of his or her appointment. Non-executive directors are appointed for an initial term of three years, which may be extended with the agreement of the Board, although reappointment is not automatic. Their term of office is also subject to annual re-election by shareholders at the AGM and will terminate without compensation if they fail to be re-elected (see page 67 for further information).

Director training

Newly appointed directors participate in a structured induction programme and receive a comprehensive data pack providing detailed information on the Group. An existing executive director acts as a mentor to each newly appointed non-executive director, giving guidance and advice as required.

Issues	Facilitated by
Operation of the Board and governance	Chairman and Company Secretary
Group strategy development and current issues	Chief Executive
Financial structure	Chief Financial Officer
Risk strategy	General Counsel & Head of Risk
Operational strategy	Operations Director
Technology and engineering issues	Director – Engineering and Technology
Key site visits	Company Secretary
Committee technical requirements	Committee chairmen, internal or external experts

Further training is available for all the directors, including presentations by the executive team on particular aspects of the business. In 2012, our lawyers, Freshfields Bruckhaus Deringer, held a seminar immediately following the November Board meeting updating the Board on developments in corporate law and regulation. In addition, there is a procedure for directors to take independent professional advice at the Company's expense and every director has access to the General Counsel & Head of Risk and the Company Secretary. In-house training is also provided to directors of the Company's subsidiaries and joint ventures.

Shareholder relations

Communications with shareholders regarding business strategy and financial performance are coordinated by a dedicated Investor Relations department that reports to the Chief Financial Officer. Communications regarding the general administration of shareholdings are coordinated by Company Secretariat, reporting to the Company Secretary.

The two primary written sources of information about the Group for shareholders are the website (www.rolls-royce.com) and the published annual report, an online version of which is also available on the website. The website also carries a wealth of financial and other information about the Group that includes current business strategy, historical financial data, recent presentation materials as well as factual data about the Group's businesses, products and services.

The Group conducts a dedicated investor relations programme with institutional investors which includes various formal events during the year, as well as a regular series of one-to-one and group meetings. The purpose of these events is to highlight a particular issue, theme or announcement that the Group believes warrants further explanation or clarification. The events also provide opportunities for shareholders to meet members of the senior management team to discuss topics of interest. Examples of these events in 2012 were: the preliminary and half-yearly results announcements; the AGM; the update given at the Farnborough International Airshow on trends in the Civil and Defence aerospace businesses; visits to the Group's sites; and industry conferences. The one-to-one and group meetings provide additional context around the Group's business strategy and financial performance such that shareholders are able to consistently and fairly value the Group's businesses.

In 2012, around 340 meetings took place with over 320 separately identifiable institutional investors. Of those meetings, the Chief Executive attended 25 meetings and the Chief Financial Officer 50 meetings. From a regional perspective, the majority of meetings took place in the UK (approximately 200). Sixty meetings occurred in the US and Canada, and a further 35 meetings took place in Europe. The Chairman also meets institutional investors from time to time when requested.

AGM

Holders of ordinary shares may attend the Company's AGM. The Chief Executive gives a presentation highlighting key business developments during the year and shareholders have an opportunity to ask questions. The chairmen of the audit, nomination, remuneration, ethics, safety and risk committees are available to answer any questions from shareholders on the work of their committees.

The Company confirms that it sends the AGM notice and relevant documentation to all shareholders at least 20 working days before the date of the AGM. For those shareholders who have consented to receive communications electronically, notice is given by email or by written notice of the availability of documents on the Group's website.

This year's AGM will be held at 11.00am on Thursday, 2 May 2013 at the QEII Conference Centre, Broad Sanctuary, Westminster, London SW1P 3EE. The AGM notice and the annual report will be available to view on the Group's website. Shareholders unable to attend the AGM can vote on the business of the meeting either by post or online.

Independence of the non-executive directors

The Board conducts a rigorous review of the independence of the non-executive directors every year, based on the criteria in the Code. This review was undertaken in November 2012 and the Board concluded that all the non-executive directors remained independent in character and judgement.

The Code does not consider the test of independence to be appropriate to the chairman of a company. However, Sir Simon Robertson did meet the Code's independence criteria upon his appointment as Chairman in January 2005. His other external commitments are described on page 40.

Conflicts of interest

Directors have a duty to avoid a situation in which they have, or can have, a direct or indirect interest which conflicts, or possibly may conflict, with the interests of the Company unless that situational conflict has been authorised by the Board. The nomination committee has reviewed and authorised all directors' situational conflicts and has agreed that while directors are required to keep confidential all Company information, they shall not be required to share with the Company confidential information received by them from a third party which is the subject of the situational conflict.

Indemnity

The Company has entered into separate Deeds of Indemnity in favour of its directors which were in force during the financial year and remained in force at the date of this report. The deeds provide substantially the same protection as that already provided to directors under the indemnity in Article 216 of the Company's Articles of Association. The Company has also reviewed, arranged and maintains appropriate insurance cover for any legal action taken against its directors and officers.

Board committees

The Board has established a number of committees, the principal ones being audit, remuneration, nomination, ethics and risk. A safety committee was established in 2012. Terms of reference for each committee are available on the Group's website at www.rolls-royce.com. The membership, responsibilities and activities of these committees are described on pages 47 to 56.

Executive committees

In 2012, the Executive Board, the senior decision-making committee, was made up of the executive directors. It worked with the Board to develop Group strategy and policy, established corporate priorities, decided on senior succession. It made recommendations to the nominations committee in relation to membership of the Executive Board and the Group Leadership Team (GLT). The membership of the GLT is described on page 42.

The Executive Board reviewed HS&E performance, customer relations, governance, financial and operational performance as well as receiving regular updates on potential acquisitions and disposals.

The GLT's responsibilities were:

- to provide input and advice to the Executive Board on policy and strategy;
- to agree priorities and objectives in management of the Group; and
- to drive performance.

The GLT regularly considered HS&E, customer relations, financial and operational performance. In addition the committee discussed a range of topics of business relevance. This included employee engagement, sustainability and the Global Code of Business Ethics.

In January 2013, the Executive Board and GLT were combined into the Executive Leadership Team (ELT). This new body simplifies the senior management structure, it will establish clear accountability and improve decision making.

Audit committee report

I would like to thank committee members, the executive management team and our auditor for the open discussions that take place at our meetings

Lewis Booth CBE
Chairman of the audit committee

The audit committee, which consists exclusively of independent non-executive directors, met four times in 2012 and attendance by the members is shown in the table on page 44. During the year, the external auditors (KPMG Audit Plc), the Head of Internal Audit, the General Counsel & Head of Risk and the Acting Company Secretary attended the meetings, together with the Chairman of the Board, the Chief Executive and the Chief Financial Officer. Other Board members and/or senior executives may also attend meetings at the invitation of the committee chairman. The General Counsel & Head of Risk and the Head of Internal Audit have direct access to the committee.

I am pleased to present the report of the audit committee for the year. I would like to thank committee members, the executive management team and our auditor for the open discussions that take place at our meetings and the importance they all attach to its work. During 2012, the committee sought to enhance the clarity and focus of all the reports it receives.

A key task for 2013 will be to consider the implications of the revised UK Corporate Governance Code. In particular, we will assess the implications of the requirement for regular audit tendering and the procedures supporting the directors' responsibility report statement that: "the report and accounts, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the Company's performance, business model and strategy".

Responsibilities

In summary, the committee recommends the financial statements to the Board and reviews the Group's financial reporting and accounting policies, including formal announcements and trading statements relating to the Company's financial performance. It oversees the relationship with KPMG, and the role and effectiveness of the internal audit function (previously termed Business Assurance). The committee reviews the Group's procedures for detecting, monitoring and managing the risk of fraud and the Group's internal controls and systems for assessing and mitigating risk.

The Board's review of the risk management process and its statement on internal control as required by 'Internal Control: Guidance for Directors' published by the FRC is on pages 70 to 71.

Work of the committee in 2012

The focus at the meetings in February and July 2012 was the 2011 annual report and financial statements and 2012 half-yearly results announcement respectively, including an evaluation of the going concern statements therein. The May and November meetings reviewed the interim management statements, considered matters which were expected to require consideration at the following half year and full year and forthcoming changes to reporting and accounting requirements.

Since the year end, the committee has reviewed the form and content of the Group's 2012 annual report and financial statements. In conducting its review, the committee considered reports prepared by management and the external auditors. These reports covered analyses of the judgements and sources of estimation uncertainty involved in applying the accounting policies as described in note 1 to the financial statements. The committee also considered the going concern statement on page 72. The committee recommended the 2012 annual report to the Board.

Internal Audit

In May and November, the Head of Internal Audit presented a summary of the reviews performed in the previous six months. The committee reviewed the effectiveness of the internal control environment and the structure in place to resolve identified weaknesses. It also agreed an improved structure for internal audit reports to the committee, with an increased focus on significant issues and trends evident in the reports and the speed of their resolution. During the year, the committee approved a revised charter for the internal audit function, reviewed and agreed the work plan for 2013 and reviewed compliance with the Group's policies in respect of expenses incurred by the directors and other senior executives.

Auditors

During the year, the committee considered the independence and objectivity of KPMG and agreed the audit strategy and the audit fee.

Non-audit services provided by KPMG

In order to safeguard auditors' independence and objectivity, the following policy is applied in relation to services provided by the auditors:

- audit related services – the auditors undertake these services as it is work that they must, or are best suited to, perform. It includes formalities relating to borrowings, grants, shareholder and other circulars, risk management services, various regulatory reports and work in respect of acquisitions and disposals;
- tax, accounting and mergers and acquisitions – the auditors are used for this work where they are best suited to undertake it. All other significant consulting work in these areas is put out to tender; and
- other advisory or consultancy services – the auditors are generally prohibited from providing these services.

Pre-approval of non-audit fees is required for non-audit fees exceeding pre-determined thresholds which vary according to the nature of the service being proposed.

The committee reviews non-audit fees charged by KPMG at each meeting and annually reviews the limits for pre-approval of non-audit fees. In particular the committee pre-approved: an engagement for KPMG to provide specialist support to internal audit during the Group's IT modernisation project while the department recruited its own personnel; and the continuation of specialist support to the IT modernisation programme that was being performed by a consultancy which was acquired by KPMG after the engagement had commenced. Expenditure on audit and non-audit services is set out in note 7 to the financial statements.

Reappointment of auditor

Each year, the committee reviews the effectiveness and performance of the external auditors with feedback from committee members, senior finance personnel and internal audit. KPMG were appointed as auditors in 1990 and this appointment has not been subject to a tender process since that date. The lead audit partner is required to rotate every five years and other key audit partners are required to rotate every seven years. The current lead audit partner completed his term in 2012. His replacement as lead audit partner has had no previous involvement with Rolls-Royce in any capacity. No contractual obligations restrict the committee's choice of external auditors. The committee concluded that KPMG provides an effective audit and the committee and the Board have recommended their reappointment.

Resolutions to reappoint the external auditor, KPMG Audit Plc, and to authorise the directors to determine the auditor's remuneration, will be proposed at the AGM on 2 May 2013.

I hope that you will vote in favour of the resolutions as the directors intend to do in respect of their own shareholdings.

Other matters

During the year, the committee reviewed risk management in the Marine and Civil businesses. The committee reviewed its own terms of reference.

Private meetings

During the year, the committee met privately with the Chief Financial Officer, KPMG and the Head of Internal Audit. I also met the lead audit partner in private in advance of each meeting.

Lewis Booth CBE
Chairman of the audit committee

Nomination committee report

I have absolutely no doubt that Ian Davis has all the required attributes to lead the Company to even greater success in the future

Sir Simon Robertson
Chairman of the nomination committee

The nomination committee, which comprises the Chairman, the Chief Executive and the independent non-executive directors met four times in 2012. Attendance by the members is shown in the table on page 44.

The principal role of the nomination committee is to consider, and recommend for approval to the Board, the appointment of suitable persons as directors of the Company and to lead the process for such appointments. The committee is also responsible for reviewing and overseeing senior management development to ensure orderly succession planning at and immediately below Board level.

During the year, the committee continued to develop its succession plans for new non-executive directors taking into account their respective tenures of office as far forward as 2020, analysing the skills which were either missing or could be missing in future and how different personalities would fit around the board table.

The committee continues to be mindful of the diversity agenda in its candidate selection process. In September 2011, we issued our response to the Davies Report on women on boards stating that we expected to make demonstrable progress in this area by 2015. We are committed to improving diversity at all levels of leadership in Rolls-Royce and to making appointments based on merit at the most senior levels of our organisation. We recognise the importance of gender diversity in the boardroom and the valuable contribution that women make in achieving the right mix of skills, knowledge and experience that enables us to maximise our corporate potential.

We continue to participate in the FTSE 100 Cross Company Mentoring Programme, the objective of which is to increase the pool of eligible senior female candidates for UK Board positions and have comprehensive programmes in place to increase the diversity of our internal pipeline of future leaders. We have also issued guidance to executive search companies outlining the importance of diverse candidate short lists. Further details of our gender representation can be found on page 34.

However, diversity means much more than gender and we recognise that appointments should reflect the increasing range and geographical spread of activities carried out by the Group. In May 2012, we were pleased to announce the appointment of Jasmin Staiblin, a German national and currently Chief Executive of Alpiq, one of Europe's leading energy companies. Jasmin's appointment brings to the Board an exceptionally talented individual with broad and relevant international engineering experience.

In addition to the work described above, the committee also carried out the following tasks during the year:

- received papers on senior executive development and leadership team success and a detailed assessment of current diversity across the Group;
- considered time commitments and potential conflicts faced by directors who wished to take up non-executive positions on the boards of other companies;
- reviewed its own terms of reference;
- considered the independence of the non-executive directors;
- considered the standing schedule of directors' conflicts of interest and recommended to the Board that such conflicts be duly re-authorised; and
- recommended the appointment of a new company secretary.

During the latter part of the year, Iain Conn ably led the committee in its search for a suitable replacement for myself as Chairman of the Board. An independent consultant, MWM Boardroom Consulting LLP, was again appointed to conduct the search having assisted in the process which led to Jasmin's appointment earlier in the year. I am pleased to report that this process has resulted in the announcement on 14 February 2013 of the appointment of Ian Davis to the Board, effective 1 March 2013. He will succeed me as Chairman at the conclusion of the AGM. I have absolutely no doubt that Ian Davis has all the required attributes to lead the Group to even greater success in the future.

Sir Simon Robertson
Chairman of the nomination committee

Governance

Ethics committee report

The Board will not tolerate improper business conduct of any sort and will take all necessary action to ensure compliance

Ian Strachan
Chairman of the ethics committee

The ethics committee consists exclusively of independent non-executive directors. In 2012, the committee met five times and details of its membership and attendance can be found on page 44. During the year, the General Counsel & Head of Risk, Robert Webb, took executive responsibility for ethics and attended the meetings. The Chairman of the Board, the Chief Executive, the Head of Business Ethics and the Chief Compliance Officer were also invited to attend meetings on a regular basis.

The ethics committee was formed in 2008. It is responsible for reviewing compliance with the Group's Global Code of Business Ethics, for establishing bribery prevention policies and for reviewing arrangements by which staff may raise concerns about improprieties in confidence. It considers recommendations on ethical matters made by external regulatory authorities or other bodies and makes recommendations to the Board on how they should be applied in Rolls-Royce. The committee's full terms of reference are available on the Group's website at www.rolls-royce.com.

Referral to Serious Fraud Office (SFO)

During the last year, much of the discussion at the ethics committee has centred on specific concerns about bribery and corruption involving intermediaries in overseas markets. This followed a request for information from the SFO about allegations of malpractice in Indonesia and China. The review by our compliance team identified matters of sufficient concern to cause the committee to recommend to the Board that the law firm Debevoise & Plimpton LLP be instructed to conduct an independent investigation.

As a result of that investigation, on 6 December 2012 we announced that we were passing information to the SFO addressing their concerns in Indonesia and China and identifying further matters of concern in other overseas markets. The consequence of these disclosures will be decided by the regulatory authorities. It is too early to predict the outcomes but these could include the prosecution of individuals and of the Company. We are cooperating fully. John Rishton has stated unequivocally that neither he nor the Board will tolerate improper conduct of any sort and all necessary action will be taken to ensure compliance. The Board is committed to anti-bribery and corruption (ABC) compliance. Our Board Charter includes a commitment to ensure the Group meets 'the highest legal and ethical standards'.

Global Code of Business Ethics (Global Code)

In 2007, the Board supported the issue of a Global Code of Business Ethics which sets out the principles to be followed by employees when conducting business and makes it clear that the Board pursues a zero tolerance approach to bribery and corruption. The Global Code was revised in 2009 and was assessed as 'best in class' in 2011 by Radley Yeldar, a corporate communications company that reviewed 142 FTSE 350 Codes of Conduct against a set of 28 criteria.

Work is currently underway to simplify the Global Code which we expect to roll-out with training and engagement activities in the first half of 2013. The revised Global Code will:

- provide increased clarity around the Company's principles and the responsibility of individuals;
- focus on the guidance and support available to employees to help them apply the Global Code; and
- be more concise while focusing content on key topics.

ABC work programme

After the publication of the Woolf Committee report in 2008, the Board undertook a systematic review of its ethics and compliance procedures that led to the creation of the ethics committee which first met under my chairmanship in November 2008. In 2009, with the assistance of an independent firm of auditors and at a cost of over £6 million, the Company conducted a thorough review to measure its ABC policies and procedures against the Woolf Committee report, the Aerospace & Defence Industries Association of Europe Common Industry Standards, the US Federal Sentencing Guidelines, the UK Bribery Bill then in draft and the OECD Guidelines. The first policies to be implemented arising from the work programme were the Global Gifts and Hospitality Policy and a new Global Intermediaries Policy both of which went into effect on 1 December 2010.

Policies, procedures and guidance notes on the remaining topic areas followed in the period from December 2010 to the implementation of the UK Bribery Act on 1 July 2011. These covered a number of topics including: sponsorships and donations; facilitation payments; raising concerns; conflicts of interest; competitive intelligence; sales and business evaluation; collaborative ventures; joint ventures; offset; human resources; financial monitoring and reporting; supply chain and purchasing; government interactions; and political lobbying. The ABC Programme team came to a close in July 2011, having delivered all of the necessary policies identified in the review.

Global Intermediaries Policy

In 2009, the newly formed ethics committee enhanced and updated the Group's Global Intermediaries Policy to require more exacting contractual warranties and safeguards in agreements with intermediaries. The current policy introduced in December 2010 represents a significant enhancement over the prior regime. A risk-based approach has been adopted, whereby the Company assigns a risk rating to each intermediary (lower, moderate, or higher) on the basis of a standardised risk assessment. Proportionate levels of review and due diligence are conducted on each intermediary depending on this risk rating. This has resulted in much more intense scrutiny of activities in high risk countries, covering matters such as the level of payments to intermediaries, their qualifications and the business case for their use.

Further work is underway to improve the process for appointment or renewal of intermediary advisers and consultants. The Company plans to introduce further enhanced controls targeting: the nature of the services the intermediary will provide; the value for money that represents; proposed and historical payment information; and disclosure of all relevant historical information about the intermediary.

Global Gifts and Hospitality Policy

This policy ensures that gifts and hospitality offered or accepted by the Group's employees do not appear to give or actually give a business advantage and are properly approved and documented. An updated and simpler version of the Global Gifts and Hospitality Policy was introduced in October 2012 along with a global internet-based reporting tool, 'Rolls-Royce Compliance Online'.

Confidential reporting lines

In 2008, the Company established telephone contact numbers in 31 countries along with web-based reporting to enable employees, wherever they were based in the world, to report confidentially any concerns they might have with regard to business conduct. The committee receives reports on concerns raised through the confidential reporting line. Early this year, an improved service will be introduced combining both the internal ethics helpline and the confidential reporting line to provide a single route for individuals to ask questions or raise concerns 24 hours a day.

Training and engagement

Following the launch of the revised Global Code in 2009, a training and engagement programme was undertaken to ensure full awareness of the Global Code and the Group's values and ethics across the organisation. This training programme ultimately reached more than 37,000 employees, starting with face-to-face workshops delivered to 4,600 managers across the Group.

The ABC work programme introduced a further comprehensive training programme to ensure that the new ABC policies and procedures were fully understood. Two training modules were created for gifts and hospitality – an e-learning module was completed by 23,000 employees and a facilitated online training module designed for employees was completed by the 4,000 employees responsible for approving gifts and hospitality. Two training modules also support the intermediaries process, both of which must be taken by any employees who interact with the Group's intermediaries. By the time the UK Bribery Act came into effect on 1 July 2011, the Group had delivered more than 12,000 hours of training with an additional 9,000 hours planned.

Further training is always on our agenda. In 2012, the Group launched an online training module for employees in how to deal with conflicts of interest and also developed training for employees who are actively involved in the acquisition and use of competitive intelligence. Additional training on ABC policies will also be rolled out on a global basis in 2013.

Central ethics and compliance team

In 2011, the Board vested authority to administer and enforce our ABC policies in a newly-created compliance organisation, separate from but working closely with the business ethics team that remains in place to manage the Global Code and the reporting hotlines. The compliance organisation's remit is to embed the ABC policies in the businesses and take the ABC programme into a 'business as usual' mode. The compliance organisation, with a total staff of 19, is headed by the Group's first Chief Compliance Officer, who joined in May 2011.

Conclusion

As our actions in 2012 demonstrate, we aim to live up to the high ethical standards we have set ourselves. Despite the progress we have undoubtedly made, we constantly strive to improve our controls as indicated by our recent appointment of Lord Gold to lead an independent review of our current procedures.

We believe that everyone in our Group has a role to play in maintaining and building upon our reputation. This is at the heart of the way we do business and how we deliver our brand promise of 'Trusted to deliver excellence'.

Ian Strachan
Chairman of the ethics committee

Risk committee report

Focusing our attention on a smaller number of risks has led to more comprehensive discussions about the nature of the risks that really matter to our business

John Rishton
Chairman of the risk committee

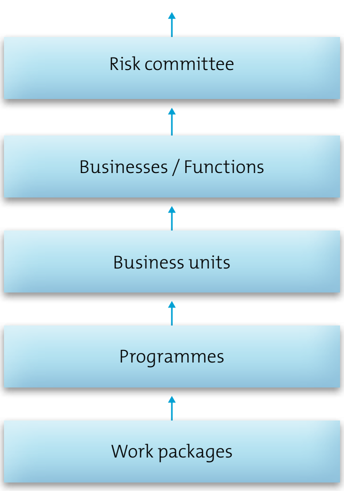
The risk committee, which consists of the executive directors, met twice in 2012. Attendance by the members is shown in the table on page 44. During the year, the General Counsel & Head of Risk and the Head of Enterprise Risk Management also attended the meetings.

Summary

During the course of our meetings this year, the committee has spent time discussing and agreeing the most significant risks that the Group faces. We have condensed the 17 risks listed in our last annual report to the eight that can be found on pages 18 to 19. Each of these risks is owned by specific members of my executive team. We reviewed and challenged ourselves as to how these risks were managed.

Development of principal risks

At the June 2012 committee meeting, we performed our usual task of considering any potential changes to the full corporate risk register. The risk register comprises those risks that are escalated to the committee following reviews carried out by the underlying business units, programmes and functions.



These reviews take place at least twice a year. Following discussion, the committee decided that this bottom up process could be sense checked by a top down process; asking each member of the committee to identify the risks they considered would have a significant impact on the Group. The resulting list did overlap with the bottom up approach but helped stimulate debate which led us to redefine some of the risks and produce a new list of principal risks.

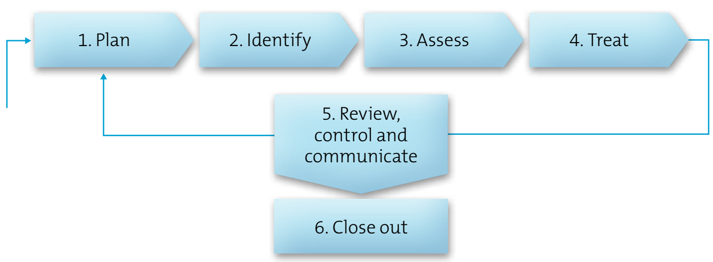
At the November meeting, we refined this new list of principal risks further, making changes to remove duplication and to define the risks more clearly. We discussed how the risks had changed and also reviewed how each risk was managed, identifying where further action was required.

In January 2013, the committee concluded this major review of the number and the nature of our risks and we believe that the list we have reported on pages 18 to 19 represents the most significant risks that would have an acute and traumatic impact on the Group were they to occur.

We also resolved to develop key risk indicators to measure each of the principal risks and use them to inform us where future action may be required. These will complement the key performance indicators shown on pages 16 to 17.

Group risk process

The risk process is part of our quality management system that all parts of the business must follow and it is shown below.



The General Counsel & Head of Risk now leads our enterprise wide risk team which is responsible for the risk policy and processes. Line ownership for risk management is devolved into our business units and functions, supported by a network of risk champions and risk managers.

I am pleased with the level of active debate that we have had about risk this year. Focusing our attention on a smaller number of risks has helped us to have more comprehensive discussions about the nature of the risks that really matter to our business and to communicate these throughout the Group.

Our attention next year will be on developing further measures by which the status of these risks can be assessed.

John Rishton
Chairman of the risk committee

Safety committee report

The safety of our products is paramount

Sir Frank Chapman
Chairman of the safety committee

The safety committee consists exclusively of independent non-executive directors. In 2012, the committee met twice and details of its membership and attendance can be found on page 44. During the year, the Chairman of the Board, the Chief Executive, the Director – Engineering and Technology and the General Counsel & Head of Risk were also invited to attend meetings.

I am pleased to present my first report as chairman of the newly formed Rolls-Royce safety committee. The committee held its first meeting in June 2012 having been tasked by the Board to keep under review the scope and effectiveness of the Group's Product Safety Policies and its Health, Safety and Environment (HS&E) Policies. The Group's performance in HS&E is described in more detail in the sustainability report on page 35.

The safety of our products is, of course, paramount. We supply high value capital products to customers that are strictly regulated with regard to safety. Civil aerospace products are required to meet relevant airworthiness authority standards, whilst defence operators define their own standards for military aerospace and naval products. Marine classification societies prescribe standards for product designs, working within the comprehensive regulatory framework for shipping developed by the International Maritime Organisation. Energy products, including those for the civil nuclear programme need to meet relevant standards and regulations.

The committee's first priority has been to familiarise the non-executive committee members with the Group's detailed safety protocols and procedures. At our first meeting, we received a presentation on product safety from the Technical and Quality Director which covered: the background to the Rolls-Royce Safety Management Process; the stringent risk levels the Group works to; the status of some key issues being managed across the Group's businesses; and safety assurance and safety in design.

This was followed by a presentation from the Director – Engineering and Technology on the governance of HS&E issues in the Group. The committee considered assurance, key metrics, performance, global improvement plans in course of delivery and the mechanism by which the Group learned from incidents. The meeting also considered the Group's environmental performance including emissions levels and targets and actions to improve the in-house energy footprint.

At our meeting in December, we had a presentation from the Director – Engineering and Technology supported by the Head of Product Safety Assurance who took us through the Group's product safety processes in more detail and how the engineering function asserts control over critical safety issues throughout the manufacturing process. The meeting discussed risk management in HS&E and the Group's risk profile. We also considered personal security arrangements for employees travelling to difficult territories or else working in high risk environments.

In November 2012, I spent a day at the Group's facilities in Derby, UK and met the engineering teams. I was impressed by the depth of knowledge and diligence demonstrated by the team members. During the tour, the team showed me how the Trent 1000 design process had proactively addressed safety issues at the design stage. I also looked at the management of in-service safety issues and how safety was managed for the Royal Navy's submarine reactors currently in service and the design-for-safety approach adopted for the next generation successor submarine. My colleagues on the committee are planning similar induction visits in the near future.

The safety committee has been in existence just eight months at the date of this report. I feel the committee has made a good start but clearly there is more to do and I expect to be able to report much more progress in 2013, as the committee's understanding and reporting processes mature.

Sir Frank Chapman
Chairman of the safety committee

Remuneration committee report

This year's remuneration again reflects a strong performance

Dame Helen Alexander
Chairman of the remuneration committee

Rolls-Royce has followed a consistent strategy towards executive remuneration over many years. We believe that a significant proportion of senior executives' remuneration should be made up of performance-related incentives so that overall reward is closely aligned to the creation of long-term stakeholder value. These principles are well-established in Rolls-Royce. This year's remuneration again reflects a strong performance. Rolls-Royce has achieved record underlying revenues, underlying profits, and has a £60 billion order book which should ensure that the business will remain strong for many years to come.

In June 2012, the Department for Business Innovation & Skills (BIS) issued remuneration reporting regulations. Although these will not become mandatory until next year's report and some of the details have still to be finalised, we have gone some way to anticipating these new regulations. On page 58 we have presented a total figure for remuneration table which includes an estimate of the value of the long-term incentive plan that is due to vest in March 2013. On page 62 we have illustrated the value of executive director packages for 2013 under different performance scenarios.

In the commentary, we show how the annual bonus paid in 2013 aligned to performance achieved in the 2012 financial year and how the Performance Share Plan (PSP) 2010-2012 out-turn was aligned to performance achieved and shareholder value generated over the three-year performance period; from 1 January 2010 to 31 December 2012.

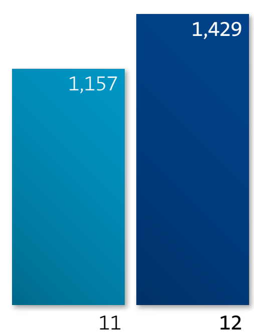
Annual bonus outcome

It is an important principle of the Rolls-Royce executive bonus arrangements that no bonus can be paid to anyone unless the entire Group has achieved the financial targets set by the committee. During 2012, the Group delivered 24 per cent growth in underlying profit before tax and, before the cost of acquisitions and foreign exchange translation effects, a net cash inflow of £137 million. This strong performance was achieved in challenging economic circumstances whilst maintaining the long-term investment programmes needed to deliver our existing order book and future growth.

The committee is satisfied that the annual bonus financial outcome of 85 per cent for the executive directors for 2012 appropriately reflects these results and the significant value delivered to all stakeholders. Individual bonuses for executive directors reflect personal performance against clear objectives and can therefore vary in the range zero per cent to 120 per cent of the 85 per cent bonus determined by the Group financial outcome. The aggregate of individual bonuses cannot exceed the 85 per cent financial outcome. For executive directors, 40 per cent of the bonus is delivered in deferred shares which must be held for a period of two years, to align further with shareholder interests.

Underlying profit before tax (£m)

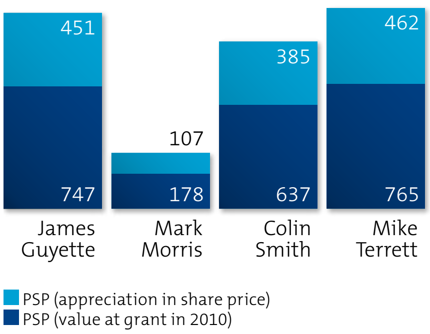
+24%



Performance Share Plan outcome

The long-term incentive plans at Rolls-Royce are designed to reward long-term value creation. They are measured over three years against Total Shareholder Return (TSR), earnings per share and cash generation. Against all these metrics Rolls-Royce has performed well. The share price, for example, increased by 60 per cent between 1 March 2010 (date of grant for the 2010 PSP award) and 31 December 2012, compared to an increase in the FTSE 100 index over the same period of nine per cent. The March 2010 PSP award was made on the basis of a share price of 544.70 pence. The graph below demonstrates that a large part of the performance share plan reward is due to the substantial increase in the Company's share price from 544.70 pence per share at award date to 873.50 pence per share at the end of the three-year performance period – a strong alignment of executive reward to shareholder reward. The actual value released will depend on the share price when the award vests on 1 March 2013.

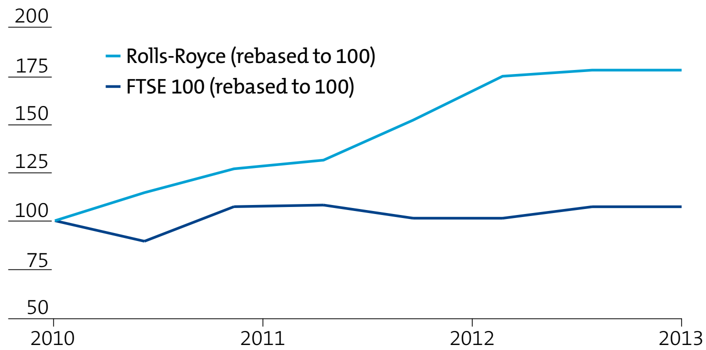
Long-term remuneration for 2012 (£000)



Over the three-year performance period for the 2010 PSP grant, our performance in terms of cash flow and earnings per share was sufficient to release 100 per cent of the conditional shares originally granted. The Company's TSR was 11th in the FTSE 100 over the three-year performance period. This TSR performance triggers an increase of 50 per cent in the shares released to executive directors and other members of the Group Leadership Team and an increase of 25 per cent for other executives. Executives must retain 50 per cent of the shares they receive under the scheme until they retire from the Company or achieve a minimum shareholding requirement which is 200 per cent of salary for the Chief Executive or 150 per cent for other executive directors. This ensures the directors have a personal financial interest in the long-term success of the business.

The following chart tracks the value of £100 invested in Rolls-Royce shares (to be clear, without taking account of dividends) compared to the FTSE 100 index from 1 January 2010 to 31 December 2012, to match with the performance period for the March 2010 PSP award.

Rolls-Royce – three year TSR data



Rolls-Royce TSR of 818 per cent over the ten-year period to 31 December 2012 was better than any other FTSE 100 company. Only 71 of the companies which made up the FTSE 100 at the beginning of that period are still trading independently and the median TSR amongst these 71 companies over the same ten-year period is 92 per cent.

Total returns over the period to 31 December 2012

	FTSE 100	Rolls-Royce
Last year	17%	37%
Last 3 years	35%	106%
Last 5 years	11%	90%
Last 7 years	43%	187%
Last 10 years	92%	818%

Rolls-Royce versus FTSE 100 TSR growth in each performance year

	FTSE 100	Rolls-Royce
2010	23%	+37%
2011	5%	+13%
2012	17%	+37%

All TSR numbers on this page, for both Rolls-Royce and FTSE 100, are calculated based on start and end values averaged over the previous six months. This is consistent with the rules of the PSP.

Remuneration and opportunities for our employees

All employees worldwide have the opportunity to benefit from our success through participation in our global bonus and share plans. All employees who were with us throughout 2012 will be receiving a bonus of at least two weeks' pay as a result of our 2012 performance. Around a half of our employees currently participate in our global save-as-you-earn ShareSave plan which gives all employees the opportunity to benefit from share price growth. In February 2013, two of our ShareSave plans matured – a three-year plan granted in 2009 at an option price of 387 pence and a five-year plan granted in 2007 at an option price of 416.1 pence against a closing price on 1 February 2013 of 971 pence. In addition, more than 6,000 employees participate in our SharePurchase and ShareBonus plans which allow employees to purchase shares on a regular basis and to convert bonus payments into shares.

The work of the committee during 2012

In February 2012, the committee endorsed the out-turn for bonus and long-term incentive plans. It also considered a benchmarking report by Deloitte LLP and assessments of personal performance before approving salary increases for senior executives.
The committee set bonus targets for 2012 and targets for the Performance Share Plan 2012-2014 and agreed the participation of senior executives in those plans. It also considered a draft of the directors' remuneration report which it agreed to recommend to the Board for approval.

In November, the committee considered the way the bonus pool would be determined for 2013. The committee agreed revised terms of reference and considered the BIS consultation on remuneration reporting. It agreed that consideration would be given to early adoption of some of the disclosure requirements within the draft regulations in the 2012 annual report.

In December, the committee considered the potential out-turns for the 2012 bonus, the all-employee bonus scheme and the vesting of PSP 2010 – 2012.

In summary

We support the clear message on executive remuneration sent by BIS that: 'generous rewards for leading executives are not an issue where executive remuneration is well-structured, clearly linked to the strategic objectives of a company, and which rewards executives that contribute to the long-term success of that company'.
The committee is very pleased that once again we are disclosing and explaining the compensation arrangements for Rolls-Royce executives against a background of excellent business performance.

Dame Helen Alexander
Chairman of the remuneration committee

Directors' remuneration report

Remuneration committee

The committee is responsible for making recommendations to the Board on the Group's policy regarding executive remuneration and determines, on the Board's behalf, the specific remuneration packages of the Chairman, the executive directors and a number of senior executives. A copy of the committee's terms of reference is available at www.rolls-royce.com/about/management/corporate_governance. The remuneration committee consists exclusively of independent non-executive directors. In 2012, the committee met three times and details of its membership and attendance can be found on page 44. Peter Byrom retired as a member of the remuneration committee in February 2011. He continued to attend meetings by invitation. During the year, the Chairman of the Board, the Chief Executive, the Group HR Director and the HR Director – Performance, Reward and Recognition also attended the meetings.

During 2012, the committee had access to advice from:

- Deloitte LLP [1]; and
- Freshfields Bruckhaus Deringer LLP, the Company's lawyers.

[1] Deloitte LLP advised the Group on tax, assurance, pensions and corporate finance and Deloitte MCS Limited provided consulting services.

The remuneration policy framework

The Group operates in a highly competitive, international market. Its business is complex, technologically advanced and has long time horizons. The Group is committed to achieving sustained improvements in performance and this depends crucially on the individual contributions made by the executive team and by employees at all levels. The Board therefore believes that an effective remuneration strategy plays an essential part in the future success of the Group.

Accordingly, we remain committed to a remuneration policy which, whilst sufficiently flexible to take account of future changes in the Group's business environment and in remuneration practice, will continue to reflect the following broad principles:

- the remuneration of executive directors and other senior executives should reflect their responsibilities and contain incentives to deliver the Group's performance objectives without encouraging excessive risk taking;
- remuneration must be capable of attracting and retaining the individuals necessary for business success;
- total remuneration should be based on Group and individual performance, both in the short and long term;
- the system of remuneration should establish a close identity of interest between senior executives and shareholders through measures such as encouraging the senior executives to acquire shares in the Company. Therefore, a significant proportion of senior executive remuneration will comprise share-based long-term incentives; and
- when determining remuneration, the remuneration committee should take into account pay and employment conditions elsewhere in the Group.

The committee reviews regularly both the competitiveness of the Group's remuneration structure and its role in incentivising executives to enhance value for all stakeholders over the longer term.

The main components of remuneration

The main components of remuneration for all executives worldwide comprise base salary, annual incentive arrangements, long-term share-based incentives and benefits. Executives are also entitled to participate in all-employee share plans.

Base salaries	• Set by the committee at levels required to recruit and retain high quality senior executives with reference to the marketplace for companies of similar size, internationality and complexity and taking account of pay elsewhere in the Group. • Set with reference to market practice.	• Normally reviewed annually on 1 March. Increases must be justified on the basis of performance and are not automatic.
Annual Performance Related Award plan (APRA)	• Annual incentive. • Measures set by the committee, to align with Group Strategy, based on underlying profit, cash flow and individual objectives and performance. • Strong link between performance and remuneration. • Promotes share ownership and encourages decisions in the long-term interest of shareholders. • Bonuses can be increased by up to 20 per cent to reflect exceptional personal performance. • Shares vest after two years subject to continued employment.	• Compulsory deferral of 40 per cent of bonus into shares. • Bonus potential: – for on target performance, 75 per cent of salary for executive directors, and 81 per cent for Chief Executive. – for maximum performance, 125 per cent of salary for executive directors, and 135 per cent for Chief Executive. • For UK participants, APRA awards do not form part of pensionable earnings.
Performance Share Plan (PSP)	• Share-based long-term incentive. • Conditional on corporate performance. • Measures based on Cash Flow Per Share (CPS), Total Shareholder Return (TSR) and an underlying earnings per ordinary share (EPS) hurdle to ensure alignment with Group strategy and with the interests of shareholders. • Shares vest after three years provided performance criteria are met.	• 50 per cent must be held until retirement or the minimum shareholding requirement is met. • Potential: – for maximum CPS performance, 100 per cent of salary for executive directors, and 120 per cent for Chief Executive. – for maximum CPS and TSR performance, 150 per cent of salary for executive directors, and 180 per cent for Chief Executive.
All-employee share plans	• ShareSave Plan – a savings-related share option plan available to all employees allowing purchase of shares at a discount to the share price at date of grant. • Free share element of the Share Incentive Plan (SIP) where UK employees receive shares as part of any bonus paid. • Partnership share element of the SIP under which UK employees may make regular purchases of shares from pre-tax income.	• ShareSave options may be exercised in three or five years from the date of grant. • Shares under the SIP vest after five years free from income tax and national insurance.

In addition to the above, pension and other benefits, which are competitive in local markets, are provided.

Total remuneration

We have gone some way to applying the new BIS regulations by providing the following table which shows a total figure for salary, benefits, annual bonus and long-term incentives. Pension valuations are provided on page 63 using the methodology under the existing regulations.

	Salary £000	Benefits £000	Bonus £000	PSP £000	Total £000
James Guyette	517	100	663	1,198	2,478
Mark Morris	482	189	464	285	1,420
John Rishton	896	126	1,239	1,666	3,927
Colin Smith CBE	506	23	596	1,022	2,147
Mike Terrett CBE	567	125	303	1,227	2,222

- Salary is total base salary paid during 2012.
- Benefits include car or car allowance, use of a driver, housing costs, private medical insurance and financial counselling.
- Bonus is the total bonus award paid in cash and deferred shares for 2012 performance. Forty per cent of the bonus is in deferred shares which are released after two years.
- PSP is an estimate of the value of the PSP award, including the TSR multiplier, which is due to vest on 1 March 2013. The PSP award was originally granted on 1 March 2010 at 544.70 pence. The share price as at 31 December 2012 was 873.50 pence. For John Rishton, the table shows the value of the shares that are due to vest on 1 March 2013 that were granted to him on joining the Company.

Annual incentives – APRA bonus opportunity

The committee considers that there should be a continuing emphasis on those at-risk elements of remuneration, such as annual and long-term incentives, which directly influence the performance of senior executives. For the Chief Executive, a 162 per cent maximum bonus opportunity means that 62 per cent of combined basic pay and bonus opportunity is directly related to annual financial and personal performance.

Under APRA, as operated in 2012, executive directors were eligible for awards in accordance with the table below:

	Target bonus (as a % of salary)[1]	Maximum bonus (as a % of salary)[1]
James Guyette	75	125
Mark Morris	75	125
John Rishton	81	135
Colin Smith CBE	75	125
Mike Terrett CBE	75	125

[1] It is possible for a bonus award to be increased by a further 20 per cent to reflect exceptional personal performance. Therefore the overall maximum was 162 per cent for the Chief Executive and 150 per cent for the other executive directors.

The committee has determined that the bonus in respect of 2013 will be operated on substantially similar terms to 2012. However, in 2013 separate bonus pools will be earned for profit and cash performance. Anything earned through one measure will be subject to a minimum level of acceptable performance against the other measure. The committee is mindful of corporate, environmental, social and governance risks when setting personal objectives. There will be no change to the maximum bonus opportunities for executive directors.

APRA performance measures

For 2012, the performance targets operated so that three Group underlying profit targets were set in respect of bonus levels as follows:

	(% of maximum)
Base	30
Stretch (1)	60
Stretch (2)	100

The bonus pool earned through profit performance was multiplied by a factor between zero per cent and 100 per cent as determined by cash flow performance.

For 2012, the performance out-turns which resulted in the APRA bonus out-turns were as follows:

Group underlying profit	Group underlying profit* was £1,292 million which exceeded the Base and the Stretch (1) target but was less than the Stretch (2) target. The performance resulted in achievement of 86 per cent of the maximum.
Cash flow hurdle	Cash flow* for the year was £92 million which resulted in the bonus pool earned through profit performance being reduced from 86 per cent to a final bonus pool of 85 per cent.

*Group underlying profit and cash flow exclude Tognum, the impact of acquisitions and disposals in the year and unbudgeted foreign exchange translation effects where material.

Individual bonuses for executive directors reflect personal performance against clear objectives and can therefore vary in the range zero per cent to 120 per cent of the 85 per cent bonus determined by the Group financial outcome. The aggregate of individual bonuses cannot exceed the 85 per cent financial outcome.

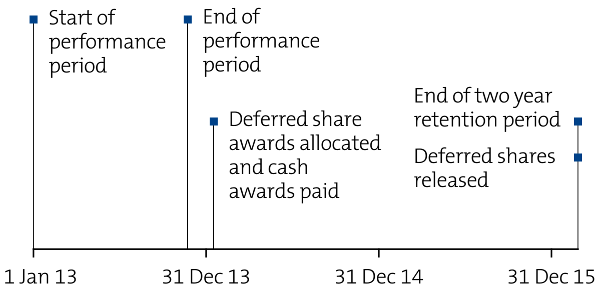
Deferred APRA

For executive directors and other senior executives, 40 per cent of APRA is delivered in the form of a deferred share award in the Company's shares. For other participants in APRA, 33 per cent is delivered in the form of deferred shares. Details of deferred shares held under the plan are shown in the table on page 65.

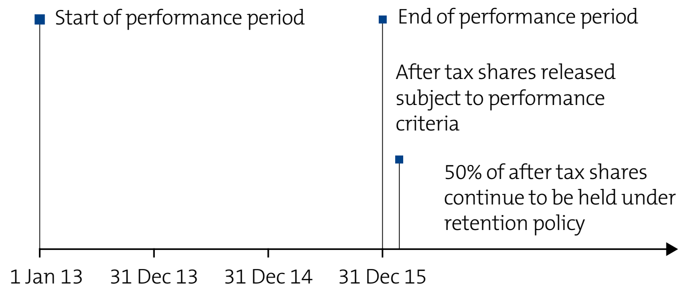
A participant who is granted a deferred share award under APRA must normally continue to remain an employee of the Group for two years from the date of the award in order for the shares to vest, although shares will be released early in certain circumstances including retirement or redundancy.

The value of any deferred share awards is derived from the annual bonus criteria and is therefore dependent on personal and business financial performance. This arrangement provides a strong link between performance and remuneration, promotes a culture of share ownership amongst the Group's senior management and encourages decisions in the long-term interest of shareholders.

APRA timeline – 2013 performance year



PSP timeline – 2013-2015 performance period



Other annual incentives

The same financial targets as set for APRA are used for the Managers' Bonus and the All-Employee Bonus Scheme (AEBS). The Managers' Bonus typically enables managers worldwide to receive a bonus of up to ten per cent of pay and the AEBS up to two weeks' pay, based on corporate and business performance. Participants in APRA or the Managers' Bonus do not participate in the AEBS.

Long-term incentives – PSP

The PSP is designed to reward and incentivise selected senior executives who can influence the long-term performance of the Group. The size of awards under the PSP take into account competitive levels within the marketplace for UK companies of a similar size and complexity to the Group. In 2012, John Rishton received a conditional award of shares with a market value at the time of grant of 120 per cent of his annual salary.

The 2012 grant for other executive directors was 100 per cent of their annual salary and 80 per cent for other members of the Group Leadership Team.

Under the rules of the PSP, selected senior executives are granted conditional share awards entitling them to a number of shares determined by reference to corporate performance over a three-year performance period. The measures of corporate performance are CPS, EPS and TSR. These measures are considered particularly important in generating shareholder value and are explained in more detail in the table opposite. There is no retesting of the performance criteria and no automatic vesting in the event of a takeover. In the three-year period to 31 December 2012, the Company's profit and cash flow performance generated 100 per cent of the number of shares conditionally granted in 2010. This was increased to 150 per cent for executive directors and other senior executives and to 125 per cent for other participants because the Company's TSR was ranked 11th in the FTSE 100 and therefore in the upper quartile, over the three-year performance period 2010-2012.

PSP performance measures

Vesting criteria	Purpose of the measure	Performance condition over three-year period
EPS growth	Hurdle to ensure any payouts are supported by sound profitability	• If EPS growth exceeds the hurdle, the number of shares vesting will be determined in accordance with the CPS targets. • If EPS growth does not exceed the hurdle – zero vesting.
Aggregate CPS	Incentivise generation of cash flow in line with the Group's strategy	• Below threshold cash flow target – zero vesting. • Threshold cash flow target – 30 per cent vesting. • Vesting will increase on a straight-line basis between 30 per cent and 100 per cent.
TSR performance against FTSE 100 index	Align interests with shareholders by rewarding out-performance of FTSE 100 returns	• 50th percentile (median) and below – no additional vesting. • Above 50th percentile (median) – vesting will be enhanced by 25 per cent. For executive directors and selected senior executives, a straight-line basis will operate from 25 per cent to 50 per cent enhancement for upper quartile TSR performance.

The profit hurdle for the 2013 grant will require EPS to show real growth by exceeding the OECD index of consumer prices.

The following CPS targets will apply to the grants to be made in 2013:

Aggregate CPS over three-year performance period	Percentage of maximum award released
56p	30
94p	100

The committee believes that these CPS targets are challenging and that the performance necessary to achieve awards towards the upper end of the range is stretching. They should not, therefore, be interpreted as providing guidance on the Group's performance over the relevant period.

PSP awards granted in 2013

For 2013, the size of awards under the PSP will be unchanged from 2012 and will be as follows:

	PSP award (as a % of salary)	PSP award overall maximum (as a % of salary)
James Guyette	100	150
Mark Morris	100	150
John Rishton	120	180
Colin Smith CBE	100	150

Share retention policy

The committee believes it is important that the interests of the executive directors should be closely aligned with those of shareholders. The deferred APRA award and the PSP provide considerable alignment. However, participants in the PSP are also required to retain at least one half of the number of after tax shares released from the PSP, until the value of their shareholding reaches 200 per cent of salary for the Chief Executive and 150 per cent for other executive directors. When this level is reached, it must be retained until retirement or departure from the Group. Details of the executive directors' share interests are set out on pages 64 to 67. The current executive directors have each complied with the minimum shareholding requirement.

All-employee share plans

The committee believes that share-based plans make a significant contribution to the close involvement and interest of all employees in the Group's performance. Executive directors are eligible to participate in the Group's all-employee share plans on the same terms as other employees:

i) the ShareSave Plan – a savings-related share option plan available to all employees. In the UK, this plan operates within UK tax legislation (including a requirement to finance the exercise of the option using the proceeds of a monthly savings contract) but the key principles are applied globally. The exercise of the option is not subject to the achievement of a performance target;

ii) the free share element of the Share Incentive Plan (SIP) under which UK employees may receive shares as part of the Company component of any bonus paid. The SIP attracts tax benefits for UK employees; and

iii) the partnership share element of the SIP under which UK employees may make regular purchases of shares from pre-tax income.

Benefits

Executive directors and senior executives are entitled to a company car or car allowance, private medical insurance and financial counselling. James Guyette is entitled to a housing allowance and the costs of additional housing are met for John Rishton, Mark Morris and Mike Terrett.

Service contracts

The committee's policy is that executive directors appointed to the Board are offered notice periods of 12 months. The committee recognises that in the case of appointments to the Board from outside the Group, it may be necessary to offer a longer initial notice period, which would subsequently reduce to 12 months after that initial period.

The committee has a defined policy on compensation and mitigation to be applied in the event of a UK director's contract being terminated prematurely. In these circumstances, steps are taken to ensure that poor performance is not rewarded. When calculating termination payments, the committee takes into account a range of factors including the director's obligation to mitigate their own loss.

The following table summarises the terms of the executive directors' service contracts:

	Date of contract	Unexpired term	Notice period Company	Notice period individual
James Guyette	29 September 1997	Indefinite	30 days [1]	30 days
Mark Morris	1 January 2012	12 months	12 months	6 months
John Rishton	10 March 2011	12 months	12 months	6 months
Colin Smith CBE	1 July 2005	12 months	12 months	6 months

[1] James Guyette has a contract with Rolls-Royce North America Inc., drawn up under the laws of the State of Virginia, US. It provides that, on termination without cause, he is entitled to 12 months' severance pay without mitigation and, in addition, appropriate relocation costs.

External directorships of executive directors

During 2012, James Guyette was chairman of PrivateBancorp Inc., and a director of priceline.com Inc. In each case he retained the relevant fees from serving on the boards of these companies, as shown in the table below:

	Payment received £000
James Guyette [1]	110

[1] James Guyette was paid in US dollars translated at £1=US$1.585.
In addition to an annual fee, James Guyette received 3,345 Restricted Stock Units (RSUs) at US$14.95 per share in PrivateBancorp. During 2012, 3,460 RSUs vested. He was granted 263 shares of restricted stock at US$645.86 per share in priceline.com. During 2012, 1,031 shares of restricted stock vested at US$645.86 per share.

Directors' aggregate emoluments (audited)

The individual directors' emoluments are analysed as follows:

		Annual Performance Related Award plan (APRA)					2012	2011
	Salary/fees £000	Cash bonus £000	Deferred shares [1] £000	Total APRA £000	Cash allowance [2] £000	Taxable benefits [3] £000	Aggregate emoluments excluding pensions contributions [4] £000	Aggregate emoluments excluding pensions contributions [4] £000
Executive directors								
James Guyette [5]	517	398	265	663	–	100	1,280	1,124
Mark Morris [6]	482	278	186	464	58	189	1,193	–
John Rishton	896	743	496	1,239	195	126	2,456	1,910
Colin Smith CBE	506	358	238	596	127	23	1,252	1,135
Mike Terrett CBE [7]	567	182	121	303	–	125	995	1,277
Former directors who served during 2011 but did not serve during 2012 [8]	–	–	–	–	–	–	–	1,481
	2,968	1,959	1,306	3,265	380	563	7,176	6,927
Non-executive directors								
Dame Helen Alexander	75	–	–	–	–	–	75	74
Lewis Booth CBE	80	–	–	–	–	–	80	44
Peter Byrom	60	–	–	–	–	–	60	60
Sir Frank Chapman	75	–	–	–	–	–	75	11
Iain Conn	72	–	–	–	–	–	72	72
Sir Peter Gregson [9]	21	–	–	–	–	–	21	60
John McAdam	60	–	–	–	–	–	60	60
John Neill CBE	60	–	–	–	–	–	60	60
Sir Simon Robertson	370	–	–	–	–	7	377	385
Jasmin Staiblin [10]	37	–	–	–	–	–	37	–
Ian Strachan	75	–	–	–	–	–	75	86
	3,953	1,959	1,306	3,265	380	570	8,168	7,839

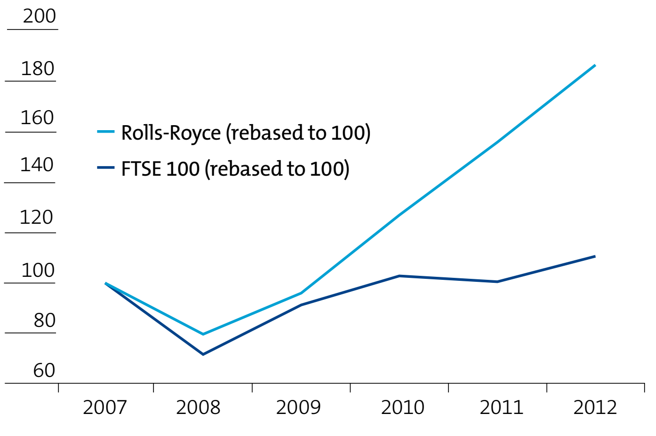
1 For executive directors, 60 per cent of APRA is delivered in cash and 40 per cent is delivered in the form of a deferred share award. Shares forming part of the bonus under APRA will be valued at the date of award which is likely to be 1 March 2013. The Trustee will acquire the required number of shares at the prevailing market price by 31 March 2013.
2 Colin Smith CBE received a cash allowance in lieu of future pension accrual. Mark Morris received a cash allowance in lieu of future pension accrual. John Rishton received employer contributions into the executive defined contribution pension arrangement restricted to the annual allowance limits with any excess paid as a cash allowance.
3 Taxable benefits may include the following: a car or car allowance; the use of a driver; private medical insurance and financial counselling; in the case of James Guyette, a housing allowance and club membership fees; and in the case of John Rishton, Mark Morris and Mike Terrett CBE, the figure in the above table includes additional housing costs paid on their behalf and the tax charge on that benefit paid by the Group.
4 Aggregate emoluments exclude pensions contributions. Details of the directors' pensions are set out on pages 63 and 64.
5 James Guyette was paid in US dollars translated at £1 = US$1.585.
6 Mark Morris was appointed as an executive director on 1 January 2012.
7 Mike Terrett CBE retired as an executive director on 31 December 2012.
8 Sir John Rose retired as an executive director on 31 March 2011 and Andrew Shilston retired as an executive director on 31 December 2011.
9 Sir Peter Gregson retired as a non-executive director on 4 May 2012.
10 Jasmin Staiblin was appointed as a non-executive director on 21 May 2012.

TSR over five years

The Company's TSR performance over the previous five years compared to a broad equity market index is shown in the graph below. The FTSE 100 has been chosen as the comparator index because it contains a broad range of other leading UK listed companies.

The graph shows the growth in value of a hypothetical £100 holding in Rolls-Royce Holdings plc ordinary shares over five years, relative to the FTSE 100 index. The values of the hypothetical £100 holdings at the end of the five-year period were £186.40 and £110.60 respectively.

Rolls-Royce – five year TSR data



The TSR calculations in the chart above are based on spot start and end values for both Rolls-Royce and the FTSE 100. The TSR data on page 55 is based on start and end values averaged over six months to be consistent with the rules of the PSP and does not therefore align to the values on which this chart is based. However, both spot and average methodologies confirm that Rolls-Royce TSR has outperformed the FTSE 100.

Payments made to former directors of the Company (audited)

John Cheffins retired from the Board on 30 September 2007. He has continued in his role as Chairman of Rolls-Royce Fuel Cell Systems Limited and provided non-executive advice to the Energy business. He was paid £47,890 and benefits totalling £3,642 in 2012 (paid in Canadian dollars translated at £1= CAD$1.5837).

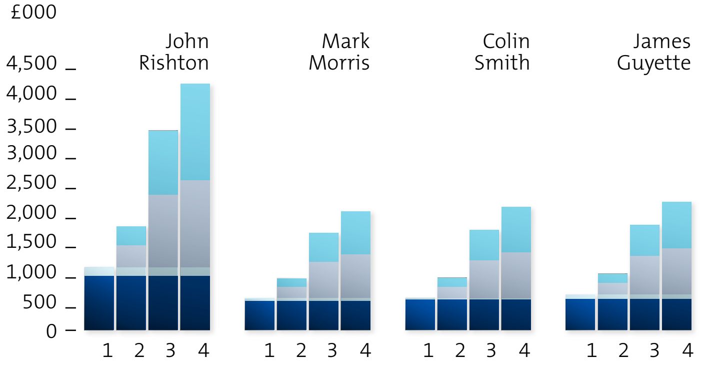
Dr Mike Howse retired from the Board on 30 June 2005. Following his retirement, he has continued to be retained by the Company for his expertise in engineering. He was paid £23,940 in 2012.

Looking ahead to 2013

The following chart illustrates the value of executive directors' packages in various scenarios.

Performance scenarios for annual bonus and PSP

Below threshold	Threshold	Maximum	Exceptional maximum
There is no bonus and no vesting under the PSP	Threshold bonus and threshold vesting under the PSP	Maximum bonus (based on financial performance) and maximum CPS vesting under the PSP	Maximum bonus (based on financial and exceptional individual performance) and maximum vesting under the PSP with maximum TSR multiplier



1. Below threshold
2. Threshold
3. Maximum
4. Exceptional maximum

- Salary for the year
- The taxable value of benefits
- The potential value of the APRA award depending on the performance scenario
- The potential value of the PSP awards, depending on the performance scenario

Pensions (audited)

The Group's UK pension schemes are funded, registered schemes and were approved under the regime applying until 6 April 2006. They include both defined contribution and defined benefit pension schemes.

John Rishton is a member of one of the Group's UK defined contribution pension schemes and received employer contributions restricted to the annual allowance limits with any excess paid as a cash allowance. The cash allowance is calculated as equivalent to the cost of the pension contributions allowing for national insurance costs.

Mark Morris opted out of future pension accrual and salary linkage with effect from 16 August 2012 and receives a cash allowance. Had he elected to continue to remain in the pension plan the estimated cost of accrual would be higher than the cash allowance being paid in lieu.

Mike Terrett CBE opted out of future pension accrual with effect from 1 April 2006 and started to receive his pension from 1 November 2009. Since starting to receive his pension, he does not accrue any further pension benefit or allowance in lieu of pension benefit from his ongoing employment with the Group.

Colin Smith CBE opted out of future pension accrual with effect from 1 April 2006. He receives a cash allowance in lieu of future pension accrual. Had he elected to continue to accrue pension the estimated cost of that accrual would be higher than the cash allowance being paid in lieu.

James Guyette participates in pension plans sponsored by Rolls-Royce North America Inc. He is a member of two defined benefit plans in the US, one qualified and one non-qualified. He accrues a retirement lump sum benefit in both of these plans. The aggregate value of the retirement lump sums accrued in these two plans, and the transfer values of these benefits, are shown in the second table below. In addition, James Guyette is a member of two 401(k) Savings Plans in the US, one qualified and one non-qualified, to which both he and his employer, Rolls-Royce North America Inc., contribute. He is also a member of an unfunded non-qualified deferred compensation plan in the US, to which his employer makes notional contributions. Employer contributions to these three plans during 2012 have been added to the increase in transfer value over 2012 for the defined benefit plans, and are therefore included in the figures shown in the final two columns of the second table below. The transfer values in the tables below have been calculated on the basis of actuarial advice.

Details of the pension benefits, which accrued over the year in the Group's registered UK defined benefit pension scheme [1], are given below:

	Increase in accrued pension during the year ended 31 Dec 2012 £000 pa	Increase/decrease in accrued pension during the year ended 31 Dec 2012 [2] £000 pa	Total accrued pension entitlement at the year ended 31 Dec 2012 [3] £000 pa	Transfer value of accrued pension as at 31 Dec 2012 [4] £000	Transfer value as at 31 Dec 2011 of accrued pension at that date [4] £000	Increase in transfer value over 2012 net of the member's own contributions £000	Transfer value of increase/decrease in accrued pension over 2012 net of the member's own contributions [5] £000
Mark Morris [6]	40	34	164	3,778	2,354	1,406	1,325
Colin Smith CBE	61	46	363	6,977	6,002	975	732
Mike Terrett CBE [7]	3	(10)	244	5,773	5,666	107	(202)

	Increase in accrued retirement lump sum during the year ended 31 Dec 2012 £000 pa	Increase in accrued retirement lump sum during the year ended 31 Dec 2012 [2] £000 pa	Total accrued retirement lump sum entitlement at the year ended 31 Dec 2012 [8] £000 pa	Transfer value of accrued retirement lump sum as at 31 Dec 2012 £000	Transfer value as at 31 Dec 2011 of accrued retirement lump sum at that date £000	Increase in transfer value over 2012 net of the member's own contributions £000	Transfer value of increase in accrued retirement lump sum over 2012 net of the member's own contributions [5] £000
James Guyette [9]	125	87	1,047	1,047	922	508	471

1 Members of the schemes have the option to pay Additional Voluntary Contributions. Neither the contributions nor the resulting benefits are included in the above table.
2 This column shows the increase/decrease in pension/retirement lump sum during the year ended 31 December 2012 but in this case excluding the effect of inflation.
3 The pension entitlement shown is that which would be paid annually on retirement at normal retirement age or to 1 April 2006 for Colin Smith CBE and to 16 August 2012 for Mark Morris. For Mike Terrett CBE, the pension shown is the annual pension in payment at 31 December 2012.
4 The transfer values stated represent liabilities of the Rolls-Royce sponsored pension schemes and are not sums paid to the individuals. The transfer values of the accrued pensions as at 31 December 2011 and 31 December 2012 have been calculated on the bases adopted by the trustees on 6 October 2008 and 16 October 2012 respectively, following receipt of actuarial advice.
5 This column shows the transfer value of the increase/decrease in pension/retirement lump sum during the year ended 31 December 2012 excluding the effect of inflation, and net of the member's own contributions.
6 Mark Morris was appointed as an executive director on 1 January 2012.
7 Mike Terrett CBE retired as an executive director on 31 December 2012.
8 The lump sum entitlement shown is that which would be paid on immediate retirement based on service to the end of the year.
9 Benefits are translated at £1 = US$1.6255.

Details of payments made by the Group to defined contribution pension plans on behalf of the following executive directors are given below:

	2012 £000	2011 £000
James Guyette [1,2]	**394**	381
John Rishton	**123**	115

[1] Employer contributions for the defined contribution plans during 2012, have been included in the increase in transfer value over 2012 for the defined benefit plans and shown in the final two columns of the table above for James Guyette.
[2] Benefits are translated at £1 = US$1.585.

Directors' share interests (audited)

The directors who held office at 31 December 2012 and their connected persons, had the following interests in the ordinary shares and C Shares [1] of the Company in respect of which transactions are notifiable to the Company under DTR 3.1.2R of the Disclosure Rules and Transparency Rules:

	Ordinary shares			C Shares		
	1 January 2012#	Changes in 2012	31 December 2012§	1 January 2012#	Changes in 2012	31 December 2012§
James Guyette	**274,797**	211,646	**486,443**	**–**	51,562,968	**51,562,968**
Mark Morris [2]	**39,618**	32,254	**71,872**	**–**	4,314,497	**4,314,497**
John Rishton	**9,686**	97,179	**106,865**	**–**	–	**–**
Colin Smith CBE	**218,554**	64,308	**282,862**	**–**	–	**–**
Mike Terrett CBE [3]	**507,166**	10,659	**517,825**	**–**	–	**–**
Dame Helen Alexander	**1,071**	407	**1,478**	**102,816**	187,425	**290,241**
Peter Byrom	**223,321**	4,692	**228,013**	**–**	–	**–**
Lewis Booth CBE	**5,000**	7,500	**12,500**	**–**	–	**–**
Iain Conn	**20,210**	4,000	**24,210**	**–**	11,178	**11,178**
Sir Peter Gregson [4]	**4,218**	137	**4,355**	**–**	–	**–**
Dr John McAdam	**1,571**	341	**1,912**	**226,080**	(226,080)	**–**
John Neill CBE	**36,464**	2,101	**38,565**	**1,858,752**	5,138,350	**6,997,102**
Sir Simon Robertson	**41,839**	878	**42,717**	**–**	–	**–**
Jasmin Staiblin [5]	**–**	–	**–**	**–**	–	**–**
Ian Strachan	**11,500**	–	**11,500**	**–**	–	**–**

Or date of appointment if later
§ Or date of retirement if earlier
[1] Non-cumulative redeemable preference shares of 0.1p each.
[2] Mark Morris was appointed as an executive director on 1 January 2012.
[3] Mike Terrett CBE retired as an executive director on 31 December 2012.
[4] Sir Peter Gregson retired as a non-executive director on 4 May 2012.
[5] Jasmin Staiblin was appointed as a non-executive director on 21 May 2012.

Directors' interests in the Company's share plans are shown separately on pages 65, 66 and 67. No director had any other interests, beneficial or otherwise, in the share capital of the Company or any of its subsidiaries as at 31 December 2012.

Changes in the interests of the executive directors and non-executive directors between 31 December 2012 and 13 February 2013 are listed below.

	Ordinary shares	C Shares
Dame Helen Alexander	189	97,128
Lewis Booth CBE	–	950,000
Peter Byrom	1,897	–
Iain Conn	724	–
James Guyette	9,693	–
John McAdam	51	–
Mark Morris	–	2,953,208
John Neill CBE	528	2,231,512
John Rishton	890	–
Sir Simon Robertson	355	–
Colin Smith CBE	2,380	–

Partnership shares held in trust under the SIP[1]

	Ordinary shares			C Shares		
	1 January 2012	Changes in 2012	31 December 2012	1 January 2012	Changes in 2012	31 December 2012
Colin Smith CBE[2]	**1,610**	(125)	**1,485**	**–**	224,965	**224,965**
Mike Terrett CBE	**1,609**	(124)	**1,485**	**–**	224,965	**224,965**

Free shares held in trust under the SIP[1]

	Ordinary shares			C Shares		
	1 January 2012	Changes in 2012	31 December 2012	1 January 2012	Changes in 2012	31 December 2012
Colin Smith CBE	**3,179**	(249)	**2,930**	**–**	487,427	**487,427**

Unrestricted shares held under the SIP[1]

	Ordinary shares			C Shares		
	1 January 2012	Changes in 2012	31 December 2012	1 January 2012	Changes in 2012	31 December 2012
Colin Smith CBE[2]	**5,018**	(4,946)	**72**	**–**	40,423	**40,423**
Mike Terrett CBE	**4,545**	303	**4,848**	**–**	40,354	**40,354**

1 Under the SIP, free shares and partnership shares held in trust for more than five years are classified as unrestricted and are no longer subject to income tax or national insurance contributions on withdrawal. Unrestricted shares can be held in Trust under the SIP for as long as the participant remains an employee of the Group.
2 On 15 January 2013 and 8 February 2013, 25 and 31 ordinary shares respectively, which were held as partnership shares, were classified as unrestricted shares.

Share options (audited)

The directors held the following options under the Rolls-Royce ShareSave plan.

	1 January 2012	Granted in 2012	Lapsed in 2012	Exercised in 2012	31 December 2012	Exercise price	Market price at date exercised	Aggregate gains 2012 £000	Aggregate gains 2011 £000	Exercisable dates
Mark Morris	**872**	–	–	–	**872**	387p	–	–	–	2013
Mark Morris	**541**	–	–	–	**541**	525p	–	–	–	2015
John Rishton	**1,450**	–	–	–	**1,450**	525p	–	–	–	2017

The market price of the Company's ordinary shares ranged between 733.00 pence and 913.50 pence during 2012. The closing price on 31 December 2012 was 873.50 pence.

Long-term incentive awards (audited)

The directors as at 31 December 2012 had the following share awards arising out of the operation of APRA[1]:

	1 January 2012	Dividend enhancement during 2012	Vested during 2012	Granted during 2012	31 December 2012	Value of shares vested in 2012 £000
James Guyette	**51,867**	826	(17,098)	28,161	**63,756**	140
Mark Morris	**10,794**	145	(3,058)	6,145	**14,026**	25
John Rishton	**–**	–	–	44,400	**44,400**	–
Colin Smith CBE	**44,677**	631	(13,111)	26,985	**59,182**	107
Mike Terrett CBE	**59,682**	789	(16,344)	30,601	**74,728**	133
Total value of shares vested						405

1 Under APRA, shares vest after two years. Shares went into trust in 2010, 2011 and 2012 at prices of 537.20 pence, 601.00 pence and 808.80 pence respectively. At 31 December 2012, the amounts stated in the emoluments table representing the 2012 APRA deferred shares had not yet been applied by the Trustee to purchase shares. An investment is expected to be made by 31 March 2013 when the Trustee will acquire the required number of shares at the prevailing market price. The market value per share which vested under APRA during 2012 was 816 pence.

Conditional awards, granted under the PSP to executive directors are shown on page 66. The number of shares released will be dependent upon the achievement of the EPS and CPS targets over the three-year performance period. If the Company's TSR is above the median of the FTSE 100 index, the number of shares due to be released to an executive will be increased by between 25 per cent and 50 per cent. This increase is on a straight-line basis between the median and upper-quartile TSR performance in the performance period.

PSP (audited)

	1 January 2012	Granted during 2012	TSR uplift at vesting [1]	Total vested during 2012	31 December 2012	Value of shares vested in 2012 £000	Performance period	Date of grant	Market price at date of grant
James Guyette	207,845	–	103,923	(311,768)	–	2,551	1 Jan 2009 to 31 Dec 2011	10 Mar 2009	260.42p
	91,383	–	–	–	91,383	–	1 Jan 2010 to 31 Dec 2012	1 Mar 2010	544.70p
	82,404	–	–	–	82,404	–	1 Jan 2011 to 31 Dec 2013	9 Mar 2011	601.50p
	–	64,385	–	–	64,385	–	1 Jan 2012 to 31 Dec 2014	1 Mar 2012	809.70p
	381,632	64,385	103,923	(311,768)	238,172	2,551			
Mark Morris	44,506	–	11,127	(55,633)	–	455	1 Jan 2009 to 31 Dec 2011	10 Mar 2009	260.42p
	26,085	–	–	–	26,085	–	1 Jan 2010 to 31 Dec 2012	1 Mar 2010	544.70p
	25,039	–	–	–	25,039	–	1 Jan 2011 to 31 Dec 2013	9 Mar 2011	601.50p
	–	59,899	–	–	59,899	–	1 Jan 2012 to 31 Dec 2014	1 Mar 2012	809.70p
	95,630	59,899	11,127	(55,633)	111,023	455			
John Rishton	164,866	–	–	–	164,866	–	1 Jan 2011 to 31 Dec 2013	9 Mar 2011	601.50p
	–	133,383	–	–	133,383	–	1 Jan 2012 to 31 Dec 2014	1 Mar 2012	809.70p
	164,866	133,383	–	–	298,249	–			
Colin Smith CBE	148,319	–	74,160	(222,479)	–	1,820	1 Jan 2009 to 31 Dec 2011	10 Mar 2009	260.42p
	78,025	–	–	–	78,025	–	1 Jan 2010 to 31 Dec 2012	1 Mar 2010	544.70p
	74,813	–	–	–	74,813	–	1 Jan 2011 to 31 Dec 2013	9 Mar 2011	601.50p
	–	62,987	–	–	62,987	–	1 Jan 2012 to 31 Dec 2014	1 Mar 2012	809.70p
	301,157	62,987	74,160	(222,479)	215,825	1,820			
Mike Terrett CBE	191,998	–	95,999	(287,997)	–	2,357	1 Jan 2009 to 31 Dec 2011	10 Mar 2009	260.42p
	93,630	–	–	–	93,630	–	1 Jan 2010 to 31 Dec 2012	1 Mar 2010	544.70p
	91,438	–	–	–	91,438	–	1 Jan 2011 to 31 Dec 2013	9 Mar 2011	601.50p
	–	70,397	–	–	70,397	–	1 Jan 2012 to 31 Dec 2014	1 Mar 2012	809.70p
	377,066	70,397	95,999	(287,997)	255,465	2,357			
Total value of shares vested						7,183			

[1] Under the rules of the PSP, the number of shares vesting in 2012 was increased by between 25 per cent and 50 per cent as the TSR exceeded the median of the FTSE 100 index during the three-year performance period to 31 December 2012. The market value per share, which vested under the PSP during 2012, was 818.25 pence.

Grant of shares (audited)

John Rishton received a special grant of shares on joining the Company intended to mirror the fair value and vesting profile of the incentives he forfeited on resigning from his previous employer as detailed below:

	1 January 2012	TSR uplift	Total vested during 2012	31 December 2012	Performance period	Vesting date	Value of shares vested in 2012 [1] £000	Market price at date of grant
Performance related	**49,099**	24,550	(73,649)	–	1 Jan 2009 to 31 Dec 2011	1 Mar 2012	609	601.50p
Restricted shares	**126,019**	–	(126,019)	–	n/a	1 Mar 2012	1,043	601.50p
Performance related	**76,365**	–	–	**76,365**	1 Jan 2010 to 31 Dec 2012	1 Mar 2013	–	601.50p
Restricted shares	**76,143**	–	–	**76,143**	n/a	1 Mar 2013	–	601.50p
Performance related	**63,397**	–	–	**63,397**	1 Jan 2011 to 31 Dec 2013	1 Mar 2014	–	601.50p
Performance related	**40,565**	–	–	**40,565**	1 Jan 2012 to 31 Dec 2014	1 Mar 2015	–	601.50p
	431,588	24,550	(199,668)	**256,470**			1,652	

[1] The market value per share for the performance related and restricted shares that vested was 827.50 pence.

Non-executive directors' remuneration policy

The committee determines, on the Board's behalf, the remuneration package of the Chairman. The Board determines the remuneration of the other non-executive directors.

The Chairman and the non-executive directors have letters of appointment rather than service contracts. No compensation is payable to the Chairman or to any non-executive director if the appointment is terminated early.

	Appointment date	Current letter of appointment start date	Current letter of appointment end date
Dame Helen Alexander	1 Sep 2007	23 May 2011	31 Aug 2013
Lewis Booth CBE	25 May 2011	25 May 2011	25 May 2014
Peter Byrom	1 Jan 1997	1 Jan 2013	31 Dec 2013
Sir Frank Chapman	10 Nov 2011	10 Nov 2011	9 Nov 2014
Iain Conn	20 Jan 2005	23 May 2011	19 Jan 2014
Dr John McAdam	19 Feb 2008	23 May 2011	18 Feb 2014
John Neill CBE	13 Nov 2008	13 Nov 2011	12 Nov 2014
Sir Simon Robertson	1 Jan 2005	23 May 2011	31 Dec 2013
Jasmin Staiblin	21 May 2012	21 May 2012	21 May 2015
Ian Strachan	19 Sep 2003	19 Sep 2012	18 Sep 2013

Non-executive directors' fees

The Board takes account of independent market surveys in determining the fees payable to the Chairman and the non-executive directors.

The fees payable to the non-executive directors are reviewed annually by the Board and are shown below:

	£000
Chairman	370
Other non-executive directors	60
Chairman of audit committee	20
Chairman of ethics committee	15
Chairman of remuneration committee	15
Chairman of safety committee	15
Senior Independent Director	12

The Chairman and the non-executive directors are not eligible to participate in any of the Group's share schemes, incentive arrangements or pension schemes. A facility is in place which enables non-executive directors to use some or all of their fees, after the appropriate statutory deductions, to make market purchases of shares in the Company on a monthly basis.

Statutory requirements

The remuneration report has been prepared on behalf of the Board by the remuneration committee.

The committee adopts the principles of good governance as set out in the Code and complies with the Listing Rules of the Financial Services Authority and the relevant schedules of the Companies Act 2006 and the Directors' Report Regulations in Schedule 8 of the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008.

The report is divided into audited and unaudited information. The Companies Act 2006 and the Listing Rules require the Company's auditor to report on the audited information in their report on page 129 and to state that this section has been properly prepared in accordance with these regulations. The report is subject to shareholder approval at the AGM on 2 May 2013.

The directors' remuneration report was approved by the Board on 13 February 2013 and signed on its behalf.

Dame Helen Alexander
Chairman of the remuneration committee

Shareholders and share capital

Share capital and voting rights

On 31 December 2012, there were 1,872,303,563 ordinary shares of 20 pence each, 10,417,658,475 C Shares of 0.1 pence each and one Special Share of £1 in issue. The ordinary shares are listed on the London Stock Exchange.

Payments to shareholders

At the AGM on 2 May 2013, the directors will recommend an issue of 119 C Shares with a total nominal value of 11.6 pence for each ordinary share. The C Shares will be issued on 1 July 2013. Together with the interim issue on 2 January 2013 of 76 C Shares for each ordinary share with a total nominal value of 7.6 pence, this is the equivalent of a total annual payment to ordinary shareholders of 19.5 pence for each ordinary share.

The payment to shareholders will, as before, be made in the form of redeemable C Shares which shareholders may either choose to retain or redeem for a cash equivalent. The Registrar, on behalf of the Company, operates a C Share Reinvestment Plan (CRIP) and can, on behalf of shareholders, purchase ordinary shares from the market rather than delivering a cash payment. Shareholders wishing to redeem their C Shares or else redeem and participate in the CRIP must ensure that their instructions are lodged with the Registrar no later than 5pm on 3 June 2013.

Share class rights

The rights and obligations attaching to the different classes of shares are summarised below. The full rights are set out in the Company's Articles of Association, the latest copy of which can be found on the Group's website at www.rolls-royce.com.

Ordinary shares

Holders of ordinary shares are entitled to receive the Company's annual report. They are also entitled: to attend and speak at general meetings of the Company; to appoint one or more proxies or, if they are corporations, corporate representatives; and to exercise voting rights. They have the right to ask questions at the AGM relating to the business of the meeting and for these to be answered, unless such answer would interfere unduly with the business of the meeting, involve the disclosure of confidential information, if the answer has already been published on the Group's website or if it is not in the interests of the Group or the good order of the meeting that the question be answered. Holders of ordinary shares may receive a bonus issue of C Shares or a dividend and on liquidation may share in the assets of the Company.

C Shares

The Company issues non-cumulative redeemable preference shares (C Shares) as an alternative to paying a cash dividend.

Shareholders can choose to:

- redeem all C Shares for cash;
- redeem all C Shares for cash and reinvest the proceeds in additional ordinary shares using the CRIP operated by the Registrar; or
- keep the C Shares.

Any C Shares retained have limited voting rights and attract a dividend of 75 per cent of LIBOR on the 0.1p nominal value of each share, paid on a twice-yearly basis. The Company has the option to redeem the C Shares compulsorily, at any time, if the aggregate number of C Shares in issue is less than ten per cent of the aggregate number of all C Shares issued, or on the acquisition or capital restructuring of the Company.

On a return of capital on a winding-up, the holders of C Shares shall be entitled, in priority to any payment to the holders of ordinary shares, to the repayment of the nominal capital paid-up or credited as paid-up on the C Shares held by them, together with a sum equal to the outstanding preferential dividend which will have been accrued but not been paid until the date of return of capital.

The holders of C Shares are entitled to attend, speak and vote at a general meeting only if a resolution to wind up the Company is to be considered, in which case they may vote only on such resolution.

Special Share

Certain rights attach to the special rights non-voting share (Special Share) issued to HM Government (Special Shareholder). Subject to the provisions of the Companies Act 2006, the Treasury Solicitor may redeem the Special Share at par at any time. The Special Share confers no rights to dividends but in the event of a winding-up it shall be repaid at its nominal value in priority to any other shares.

Certain Articles (in particular those relating to the foreign shareholding limit, disposals and the nationality of directors) that relate to the rights attached to the Special Share may only be altered with the consent of the Special Shareholder. The Special Shareholder is not entitled to vote at any general meeting or any other meeting of any class of shareholders.

Restrictions on transfer of shares and limitations on holdings

There are no restrictions on transfer or limitations on the holding of the ordinary shares or C Shares other than under the Articles of Association (as described here), under restrictions imposed by law or regulation (for example, insider trading laws) or pursuant to the Company's share dealing code. The Articles of Association provide that the Company should be and remain under United Kingdom control. As such, an individual foreign shareholding limit is set at 15 per cent of the aggregate votes attaching to the share capital of all classes (taken as a whole) and capable of being cast on a poll and to all other shares that the directors determine are to be included in the calculation of such holding. The Special Share may only be issued to, held by and transferred to the Special Shareholder or his successor or nominee.

Shareholder agreements and consent requirements

There are no known arrangements under which financial rights carried by any of the shares in the Company are held by a person other than the holder of the shares and no known agreements between the holders of shares with restrictions on the transfer of shares or exercise of voting rights. No disposal may be made to a non-Group member which, alone or when aggregated with the same or a connected transaction, constitutes a disposal of the whole or a material part of either the nuclear business or the assets of the Group as a whole, without consent of the Special Shareholder.

Authority to issue shares

At the AGM in 2012, authority was given to the directors to allot new ordinary shares up to a nominal value of £124,816,246, equivalent to one-third of the issued share capital of the Company. This is called the first section 551 amount. In addition, a special resolution was passed to effect a disapplication of pre-emption rights for a maximum of five per cent of the issued share capital of the Company. These authorities are valid until the AGM in 2013, and the directors propose to renew these authorities at that AGM. It is proposed to seek a further authority, at the AGM in 2013 to allot up to two thirds of the total issued share capital, but only in the case of a rights issue. This is called the second section 551 amount.
The Board believes that this additional authority will allow the Company to retain the maximum possible flexibility to respond to circumstances and opportunities as they arise; and to allot new C Shares up to a nominal value of £500 million as an alternative to a cash dividend. Such authority expires at the conclusion of the AGM in 2013. The directors propose to renew the authority to allot new C Shares at the AGM in 2013.

Authority to purchase own shares

Also at the AGM in 2012, the Company was authorised by shareholders to purchase up to 187,224,369 of its own ordinary shares representing ten per cent of its issued ordinary share capital. The Company did not make use of this authority during 2012. The authority for the Company to purchase its own shares expires at the conclusion of the AGM in 2013 or 18 months from 2 May 2012, whichever is the earlier. A resolution to renew it will be proposed at that meeting.

Voting rights

Deadlines for exercising voting rights

Electronic and paper proxy appointments, and voting instructions, must be received by the Company's Registrar not less than 48 hours before a general meeting.

Voting rights for employee share plan shares

Shares are held in various employee benefit trusts for the purpose of satisfying awards made under the various employee share plans. For shares held in a nominee capacity or if plan/trust rules provide the participant with the right to vote in respect of specifically allocated shares, the trustee votes in line with the participants' instructions. For shares that are not held absolutely on behalf of specific individuals, the general policy of the trustees, in accordance with investor protection guidelines, is to abstain from voting in respect of those shares.

Major shareholdings

At 8 February 2013, the following companies had notified an interest in the issued ordinary share capital of the Company in accordance with the Financial Services Authority's Disclosure and Transparency Rules:

Company	Date notified	% of issued ordinary share capital
AXA S.A.	11 January 2010	4.90
BlackRock Inc.	3 September 2010	5.02
Invesco Limited	4 February 2008	6.91
Legal & General Group plc	14 October 2009	3.96

Other statutory information

Political donations

In line with its established policy, the Group made no political donations pursuant to the authority granted at the 2012 AGM. Although the Company does not make, and does not intend to make, donations to political parties, within the normal meaning of that expression, the definition of political donations under the Companies Act 2006 is very broad and includes expenses legitimately incurred as part of the process of talking to members of parliament and opinion formers to ensure that the issues and concerns of the Group are considered and addressed. These activities are not intended to support any political party and the Group's policy is not to make any donations for political purposes in the normally accepted sense.

A resolution will therefore be proposed at the 2013 AGM seeking shareholder approval for the directors to be given authority to make donations and incur expenditure which might otherwise be caught by the terms of the Companies Act 2006. The authority sought will be limited to a maximum amount of £25,000 per Group company but so as not to exceed £50,000 for the entire Group in aggregate.

During the year, the business expenses incurred by Rolls-Royce North America Inc. towards the operation of the Rolls-Royce North America Political Action Committee (RRNAPAC) in the US was US$44,161 (2011: US$44,436). PACs are a common feature of the US political system and are governed by the Federal Election Campaign Act.

The PAC is independent of the Group and independent of any political party. The PAC funds are contributed voluntarily by employees and the Company cannot affect how they are applied, although under US Law, the business expenses are paid by the Company.

Such contributions do not require authorisation by shareholders under the Companies Act 2006 and therefore do not count towards the £25,000 and £50,000 limits for political donations and expenditure for which shareholder approval will be sought at the AGM.

Change of control

Contracts and joint venture agreements

There are a number of contracts and joint venture agreements which would allow the counterparties to terminate or alter those arrangements in the event of a change of control of the Company. These arrangements are commercially confidential and their disclosure could be seriously prejudicial to the Company.

Borrowings and other financial instruments

The Group has a number of borrowing facilities provided by various banks. These facilities generally include provisions which may require any outstanding borrowings to be repaid or the alteration or termination of the facility upon the occurrence of a change of control of the Company. At 31 December 2012 these facilities were less than 30 per cent drawn (2011 20 per cent).

The Group has entered into a series of financial instruments to hedge its currency, interest rate and commodity exposures. These contracts provide for termination or alteration in the event that a change of control of the Company materially weakens the creditworthiness of the Group.

Employee share plans

In the event of a change of control of the Company, the effect on the employee share plans would be as follows:

- PSP – awards would vest pro rata to service in the performance period, subject to remuneration committee judgement of Group performance;
- APRA deferred shares – the shares would be released from trust immediately;
- ShareSave – options would become exercisable immediately. The new company might offer an equivalent option in exchange for cancellation of the existing option; and
- Share Incentive Plan (SIP) – consideration received as shares would be held within the SIP, if possible, otherwise the consideration would be treated as a disposal from the SIP.

Essential commercial relationships

Supply chain

Certain suppliers to the Group contribute key components or services, the loss of which could cause disruption to the Group's deliveries. However, none are so vital that their loss would affect the viability of the business as a whole. When dealing with suppliers, the Group is guided by the Supply Chain Relationships in Aerospace (SCRIA) initiative. It seeks the best possible terms from suppliers and when entering into binding purchasing contracts, gives consideration to quality, delivery, price and the terms of payment. In the event of disputes, efforts are made to resolve them quickly.

Customers

The increasingly global nature of the business, balanced across the Civil aerospace, Defence aerospace, Marine and Energy segments, ensures that the Group is not overly dependent on any individual customer.

Creditor days

As the Company is a holding company and does not itself trade, it owed no amounts to trade creditors at 31 December 2012 and therefore the number of creditor days required to be shown in this report to comply with the provisions of the Companies Act 2006 is nil.

Internal control and risk management

The Board's responsibility for internal control and risk management

The directors are responsible for the Group's system of internal control and for maintaining and reviewing its effectiveness from both a financial and an operational perspective. The system of internal control is designed to manage, rather than eliminate, the risk of failure to achieve business objectives and to provide reasonable but not absolute assurance against material misstatement or loss.

The Group's approach to internal control is based on the underlying principle of line management's accountability for control and risk management. In reviewing the effectiveness of the system of internal control, the Board has taken account of the results of the work carried out to audit and review the activities of the Group.

The risk management process is a key element of the Group's internal control system and there is an ongoing process to identify, assess and manage risk, including those risks affecting the Group's reputation. This process is subject to continuous improvement and has been in place throughout the financial year to which these statements apply and up to the date of their approval. The businesses regularly review the effectiveness and consistency of risk management via their assurance framework and the application of the risk management process is subject to review by internal audit.

Responsibility for internal control procedures in joint ventures where we do not have a control agreement lies with the managers of those operations. We seek to exert influence over such ventures by board representation and regularly review the activities of these ventures.

The Board has established a risk committee. Every six months the risk committee reviews the key operational risks that the businesses and functions report in accordance with our enterprise-wide risk management policy. The risk committee also determines material external and strategic risks that exist at Group level. The principal risks are reported annually to the Board and are included on pages 18 and 19. In addition, reports and presentations are made to the Board on certain types of specialist risks eg treasury, insurable risks, pensions, health and safety as the risks evolve.

Following the closure of the 2012 financial year, the audit committee reported to the Board the results of a review of the risk management process at all levels of the organisation prepared by internal audit. The Board confirms that ongoing processes and systems ensure that the Group continues to be compliant with the 'Turnbull guidance' as contained in 'Internal Control: Guidance for Directors on the Combined Code'.

Financial reporting

The Group has a comprehensive budgeting system with an annual budget approved by the Board. Revised forecasts for the year are reported at least quarterly. Actual results, at both a business and Group level, are reported monthly against budget and variances reviewed.

Financial managers are required to acknowledge in writing that their routine financial reporting is based on reliable data and that results are properly stated in accordance with Group requirements.

In addition, for annual reporting, business presidents and finance directors are required to acknowledge that their business has complied with the Group's Finance Manual.

Annual report and financial statements

Statement of directors' responsibilities in respect of the annual report and the financial statements

The directors are responsible for preparing the annual report and the Group and parent company financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare Group and parent company financial statements for each financial year. Under that law they are required to prepare the Group financial statements in accordance with IFRS as adopted by the EU and applicable law and have elected to prepare the parent company financial statements in accordance with UK Accounting Standards and applicable law (UK Generally Accepted Accounting Practice).

Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Group and parent company and of their profit or loss for that period.

In preparing each of the Group and parent company financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- for the Group financial statements, state whether they have been prepared in accordance with IFRSs as adopted by the EU;
- for the parent company financial statements, state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the parent company financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Group and the parent company will continue in business.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the parent and Group's transactions and disclose with reasonable accuracy at any time the financial position of the parent company and enable them to ensure that its financial statements comply with the Companies Act 2006. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

Under applicable law and regulations, the directors are also responsible for preparing a directors' report, directors' remuneration report and corporate governance statement that complies with that law and those regulations.

The directors are responsible for the maintenance and integrity of the corporate and financial information included on the Group's website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Other statutory information

Going concern
The Group's business activities, together with the factors likely to affect its future development, performance and position are set out on pages 1 to 38 of the business review and a summary of the principal risks affecting the business are shown on pages 18 to 19.

The financial position of the Group, its cash flows, liquidity position, borrowing facilities and financial risks are described on pages 12 to 15 and pages 37 to 38 of the business review.

In addition, notes 1, 13, 15 and 17 of the consolidated financial statements include the Group's objectives, policies and processes for financial risk management, details of its cash and cash equivalents, indebtedness and borrowing facilities and its financial instruments, hedging activities and its exposure to counterparty credit risk, liquidity risk, currency risk, interest rate risk and commodity pricing risk.

As described on page 37, the Group meets its funding requirements through a mixture of shareholders' funds, bank borrowings, bonds, notes and finance leases. The Group has facilities of £2.3 billion of which £1.3 billion was drawn at the year end. US$230 million of these facilities mature in 2013.

The Group's forecasts and projections, taking into account reasonably possible changes in trading performance, show that the Group has sufficient financial resources. In the event that the put option on Engine Holding GmbH is exercised, (estimated cost £1.6 billion), the directors consider that the Group would be able to raise additional resources in the necessary timeframe to meet this commitment. As a consequence, the directors have reasonable expectation that the Company and the Group are well placed to manage their business risks and to continue in operational existence for the foreseeable future, despite the current uncertain global economic outlook.

Accordingly, the directors continue to adopt the going concern basis (in accordance with the guidance 'Going Concern and Liquidity Risk: Guidance for Directors of UK Companies 2009' issued by the FRC) in preparing the consolidated financial statements.

Disclosure of information to auditors
Each of the persons who is a director at the date of approval of this report confirms that:

i) so far as the director is aware, there is no relevant information of which the Company's auditor is unaware; and

ii) the director has taken all steps that he or she ought to have taken as a director in order to make himself or herself aware of any relevant audit information and to establish that the Company's auditor is aware of that information.

This confirmation is given, and should be interpreted, in accordance with the provisions of Section 418 of the Companies Act 2006.

Responsibility statements
Each of the persons who is a director at the date of approval of this report confirms that to the best of his or her knowledge:

i) each of the Group and parent company financial statements, prepared in accordance with IFRS and UK Accounting Standards respectively, gives a true and fair view of the assets, liabilities, financial position and profit or loss of the issuer and the undertakings included in the consolidation taken as a whole; and

ii) the directors' report on pages 1 to 72 includes a fair review of the development and performance of the business and the position of the Company and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face.

By order of the Board

Nigel Goldsworthy
Company Secretary

13 February 2013

Financial statements

Consolidated financial statements

Company financial statements

Consolidated income statement

For the year ended 31 December 2012

	Notes	2012 Excluding IAE restructuring £m	2012 IAE restructuring £m	2012 Total £m	2011 £m
Revenue	2	12,161	–	12,161	11,124
Cost of sales		(9,416)	–	(9,416)	(8,676)
Gross profit		2,745	–	2,745	2,448
Other operating income		33	–	33	69
Commercial and administrative costs		(989)	–	(989)	(984)
Research and development costs		(589)	–	(589)	(463)
Share of results of joint ventures and associates	10	173	–	173	116
Operating profit		1,373	–	1,373	1,186
Profit on disposal of businesses	25	–	699	699	3
Profit before financing and taxation	2	1,373	699	2,072	1,189
Financing income	3	1,112	–	1,112	456
Financing costs	3	(479)	–	(479)	(540)
Net financing		633	–	633	(84)
Profit before taxation [1]		2,006	699	2,705	1,105
Taxation	4	(447)	37	(410)	(257)
Profit for the year		1,559	736	2,295	848
Attributable to:					
Ordinary shareholders		1,545	736	2,281	850
Non-controlling interests (NCI)		14	–	14	(2)
Profit for the year		1,559	736	2,295	848
Earnings per ordinary share attributable to ordinary shareholders:	5				
Basic		83.47p	39.76p	123.23p	45.95p
Diluted				121.59p	45.33p
Payments to ordinary shareholders in respect of the year:	17				
Per share				19.5p	17.5p
Total				365	328
[1] Underlying profit before taxation	2	1,429	–	1,429	1,157

Consolidated statement of comprehensive income

For the year ended 31 December 2012

	Notes	2012 £m	2011 £m
Profit for the year		2,295	848
Other comprehensive income (OCI)			
Items that will not be reclassified to profit or loss			
Movements in post-retirement schemes	19	(259)	123
Share of other comprehensive income of joint ventures and associates	10	(46)	(3)
Related tax movements	4	91	(53)
		(214)	67
Items that may be reclassified to profit or loss			
Foreign exchange translation differences on foreign operations		(118)	(102)
Share of other comprehensive income of joint ventures and associates	10	(12)	(7)
Related tax movements	4	(1)	(1)
		(131)	(110)
Total comprehensive income for the year		1,950	805
Attributable to:			
Ordinary shareholders		1,937	808
Non-controlling interests		13	(3)
Total comprehensive income for the year		1,950	805

Consolidated balance sheet

At 31 December 2012

	Notes	2012 £m	2011 £m
ASSETS			
Non-current assets			
Intangible assets	8	**2,901**	2,882
Property, plant and equipment	9	**2,564**	2,338
Investments – joint ventures and associates	10	**1,800**	1,680
Investments – other	10	**6**	10
Other financial assets	17	**592**	327
Deferred tax assets	4	**330**	368
Post-retirement scheme surpluses	19	**329**	503
		8,522	8,108
Current assets			
Inventories	11	**2,726**	2,561
Trade and other receivables	12	**4,119**	4,009
Taxation recoverable		**33**	20
Other financial assets	17	**115**	91
Short-term investments		**11**	11
Cash and cash equivalents	13	**2,585**	1,310
Assets held for sale	14	**4**	313
		9,593	8,315
Total assets		**18,115**	16,423
LIABILITIES			
Current liabilities			
Borrowings	15	**(149)**	(20)
Other financial liabilities	17	**(312)**	(111)
Trade and other payables	16	**(6,387)**	(6,236)
Current tax liabilities		**(126)**	(138)
Provisions for liabilities and charges	18	**(220)**	(276)
Liabilities associated with assets held for sale	14	**–**	(135)
		(7,194)	(6,916)
Non-current liabilities			
Borrowings	15	**(1,234)**	(1,184)
Other financial liabilities	17	**(418)**	(919)
Trade and other payables	16	**(1,465)**	(1,314)
Deferred tax liabilities	4	**(584)**	(445)
Provisions for liabilities and charges	18	**(241)**	(226)
Post-retirement scheme deficits	19	**(874)**	(900)
		(4,816)	(4,988)
Total liabilities		**(12,010)**	(11,904)
Net assets		**6,105**	4,519
EQUITY			
Equity attributable to ordinary shareholders			
Called-up share capital	20	**374**	374
Share premium account		**–**	–
Capital redemption reserve		**169**	173
Cash flow hedging reserve		**(63)**	(52)
Other reserves		**314**	433
Retained earnings		**5,294**	3,590
		6,088	4,518
Non-controlling interests		**17**	1
Total equity		**6,105**	4,519

The financial statements on pages 74 to 122 were approved by the Board on 13 February 2013 and signed on its behalf by:

Sir Simon Robertson Chairman **Mark Morris** Chief Financial Officer

Financial statements

Consolidated cash flow statement

For the year ended 31 December 2012

	Notes	2012 £m	2011 £m
Reconciliation of cash flows from operating activities			
Operating profit		**1,373**	1,186
Profit on disposal of property, plant and equipment		**(9)**	(8)
Share of results of joint ventures and associates	10	**(173)**	(116)
Dividends received from joint ventures and associates	10	**129**	76
Amortisation and impairment of intangible assets		**231**	169
Depreciation and impairment of property, plant and equipment		**256**	241
Impairment of investments	10	**2**	–
Decrease in provisions		**(40)**	(28)
Increase in inventories		**(158)**	(140)
Increase in trade and other receivables		**(284)**	(62)
Increase in trade and other payables		**267**	416
Movement in other financial assets and liabilities		**(29)**	68
Net defined benefit post-retirement cost/(credit) recognised in profit before financing		**151**	(43)
Cash funding of defined benefit post-retirement schemes		**(297)**	(304)
Share-based payments	21	**55**	59
Net cash inflow from operating activities before taxation		**1,474**	1,514
Taxation paid		**(219)**	(208)
Net cash inflow from operating activities		**1,255**	1,306
Cash flows from investing activities			
Disposals of unlisted investments		**4**	1
Additions of intangible assets		**(250)**	(363)
Disposals of intangible assets		**1**	6
Purchases of property, plant and equipment		**(435)**	(412)
Government grants received		**10**	38
Disposals of property, plant and equipment		**30**	31
Acquisitions of businesses (net of cash acquired)	25	**(20)**	(19)
Proceeds from restructuring of IAE		**942**	–
Disposals of businesses		**–**	7
Investments in joint ventures and associates		**(24)**	(1,329)
Cash flows from loan to Engine Holding GmbH		**167**	(167)
Transfer of subsidiary to associate	25	**(1)**	–
Net cash inflow/(outflow) from investing activities		**424**	(2,207)
Cash flows from financing activities			
Repayment of loans		**(78)**	(567)
Proceeds from increase in loans		**200**	–
Net cash flow from increase/(decrease) in borrowings		**122**	(567)
Interest received		**11**	19
Interest paid		**(52)**	(50)
Decrease in short-term investments		**–**	316
Issue of ordinary shares (net of expenses)		**–**	(1)
Purchase of ordinary shares		**(94)**	(57)
Redemption of C Shares		**(318)**	(315)
Net cash outflow from financing activities		**(331)**	(655)
Net increase/(decrease) in cash and cash equivalents		**1,348**	(1,556)
Cash and cash equivalents at 1 January		**1,291**	2,851
Exchange losses on cash and cash equivalents		**(54)**	(4)
Cash and cash equivalents at 31 December		**2,585**	1,291

Consolidated cash flow statement

	2012 £m	2011 £m
Reconciliation of movements in cash and cash equivalents to movements in net funds		
Increase/(decrease) in cash and cash equivalents	**1,348**	(1,556)
Cash flow from (increase)/decrease in borrowings	**(122)**	567
Cash flow from decrease in short-term investments	**–**	(316)
Change in net funds resulting from cash flows	**1,226**	(1,305)
Net funds (excluding cash and cash equivalents) of businesses acquired	**(78)**	–
Exchange losses on net funds	**(54)**	(5)
Fair value adjustments	**2**	92
Movement in net funds	**1,096**	(1,218)
Net funds at 1 January excluding the fair value of swaps	**117**	1,335
Net funds at 31 December excluding the fair value of swaps	**1,213**	117
Fair value of swaps hedging fixed rate borrowings	**104**	106
Net funds at 31 December	**1,317**	223

The movement in net funds (defined by the Group as including the items shown below) is as follows:

	At 1 January 2012 £m	Funds flow £m	Net funds of businesses acquired £m	Exchange differences £m	Fair value adjustments £m	Reclassifications £m	At 31 December 2012 £m
Cash at bank and in hand	**1,285**	(578)		(33)	–	–	**674**
Money market funds	**11**	397		–	–	–	**408**
Short-term deposits	**14**	1,510		(21)	–	–	**1,503**
Overdrafts	**(19)**	19		–	–	–	**–**
Cash and cash equivalents	**1,291**	1,348		(54)	–	–	**2,585**
Short-term investments	**11**	–	–	–	–	–	**11**
Other current borrowings	**(1)**	78	(78)	–	–	(148)	**(149)**
Non-current borrowings	**(1,183)**	(200)	–	–	2	148	**(1,233)**
Finance leases	**(1)**	–	–	–	–	–	**(1)**
Net funds excluding fair value of swaps	**117**	1,226	(78)	(54)	2	–	**1,213**
Fair value of swaps hedging fixed rate borrowings	**106**				(2)		**104**
Net funds	**223**	1,226	(78)	(54)	–	–	**1,317**

Consolidated statement of changes in equity

For the year ended 31 December 2012

	Notes	Attributable to ordinary shareholders Share capital £m	Share premium £m	Capital redemption reserve £m	Cash flow hedging reserve [1] £m	Other reserves [2] £m	Retained earnings [3] £m	Total £m	Non-controlling interests £m	Total equity £m
At 1 January 2011		374	133	209	(37)	527	2,769	3,975	4	3,979
Profit for the year		–	–	–	–	–	850	850	(2)	848
Foreign exchange translation differences on foreign operations		–	–	–	–	(101)	–	(101)	(1)	(102)
Movement on post-retirement schemes	19	–	–	–	–	–	123	123	–	123
Share of OCI of joint ventures and associates	10	–	–	–	(15)	8	(3)	(10)	–	(10)
Related tax movements	4	–	–	–	–	(1)	(53)	(54)	–	(54)
Total comprehensive income for the year		–	–	–	(15)	(94)	917	808	(3)	805
Arising on issues of ordinary shares	20	–	1	–	–	–	–	1	–	1
Issue of C Shares	17	–	(120)	–	–	–	(176)	(296)	–	(296)
Redemption of C Shares	17	–	–	317	–	–	(317)	–	–	–
Ordinary shares purchased		–	–	–	–	–	(57)	(57)	–	(57)
Share-based payments – direct to equity [4]		–	–	–	–	–	77	77	–	77
Effect of scheme of arrangement [5]		2,434	(14)	(353)	–	–	(2,069)	(2)	–	(2)
Effect of capital reduction [5]		(2,434)	–	–	–	–	2,434	–	–	–
Related tax movements	4	–	–	–	–	–	12	12	–	12
Other changes in equity in the year		–	(133)	(36)	–	–	(96)	(265)	–	(265)
At 1 January 2012		**374**	**–**	**173**	**(52)**	**433**	**3,590**	**4,518**	**1**	**4,519**
Profit for the year		–	–	–	–	–	2,281	2,281	14	2,295
Foreign exchange translation differences on foreign operations		–	–	–	–	(117)	–	(117)	(1)	(118)
Movement on post-retirement schemes	19	–	–	–	–	–	(259)	(259)	–	(259)
Share of OCI of joint ventures and associates [5]	10	–	–	–	(11)	(1)	(46)	(58)	–	(58)
Related tax movements	4	–	–	–	–	(1)	91	90	–	90
Total comprehensive income for the year		**–**	**–**	**–**	**(11)**	**(119)**	**2,067**	**1,937**	**13**	**1,950**
Issue of C Shares	17	–	–	(328)	–	–	4	(324)	–	(324)
Redemption of C Shares	17	–	–	324	–	–	(324)	–	–	–
Ordinary shares purchased		–	–	–	–	–	(94)	(94)	–	(94)
Share-based payments – direct to equity [4]		–	–	–	–	–	47	47	–	47
Transactions with NCI [6]		–	–	–	–	–	116	116	48	164
Initial recognition of put option on NCI [6]		–	–	–	–	–	(121)	(121)	(45)	(166)
Related tax movements	4	–	–	–	–	–	9	9	–	9
Other changes in equity in the year		**–**	**–**	**(4)**	**–**	**–**	**(363)**	**(367)**	**3**	**(364)**
At 31 December 2012		**374**	**–**	**169**	**(63)**	**314**	**5,294**	**6,088**	**17**	**6,105**

[1] See accounting policies note 1.

[2] Other reserves include a merger reserve of **£3m** (2011 £3m, 2010 £3m) and a translation reserve of **£311m** (2011 £430m, 2010 £524m).

[3] At 31 December 2012, **20,365,787** ordinary shares with a net book value of **£125m** (2011 22,541,187, 2010 28,320,962 ordinary shares with net book values of £116m and £125m respectively) were held for the purpose of share-based payment plans and included in retained earnings. During the year, **13,533,646** ordinary shares with a net book value of **£85m** (2011 14,822,563 shares with a net book value of £66m) vested in share-based payment plans. During the year, the Group acquired **11,485,790** of its ordinary shares through purchases on the London Stock Exchange.

[4] Share-based payments – direct to equity is the net of the credit to equity in respect of the share-based payment charge to the income statement and the actual cost of shares vesting, excluding those vesting from own shares.

[5] On 23 May 2011, under a scheme of arrangement between Rolls-Royce Group plc, the former holding company of the Group, and its shareholders under Part 26 of the Companies Act 2006, and as sanctioned by the High Court, all the issued ordinary shares in that company were cancelled and the same number of new ordinary shares were issued to Rolls-Royce Holdings plc in consideration for the allotment to shareholders of one ordinary share in Rolls-Royce Holdings plc for each ordinary share in Rolls-Royce Group plc held on the record date (20 May 2011). Pursuant to the scheme of arrangement, 1,872,188,709 ordinary shares of 150 pence were issued. As required by Section 612 of the Companies Act 2006, no share premium was recognised.
On 24 May 2011, the share capital of Rolls-Royce Holdings plc was reduced by reducing the nominal value of the ordinary shares from 150 pence to 20 pence as sanctioned by the High Court.

[6] On 2 January 2012, the Group transferred its interest in Bergen Engines AS (Bergen) to Engine Holding GmbH, its joint vehicle with Daimler AG. As it retained rights to control Bergen, the transaction has been treated as a disposal of 50 per cent of Bergen to a non-controlling interest for €200m. Daimler AG has a put option to sell its interest in Bergen (see note 17).

Notes to the consolidated financial statements

1 Accounting policies

The Company
Rolls-Royce Holdings plc (the 'Company') is a company domiciled in the United Kingdom. The consolidated financial statements of the Company for the year ended 31 December 2012 comprise the Company and its subsidiaries (together referred to as the 'Group') and the Group's interest in jointly controlled and associated entities. The financial statements were authorised for issue by the directors on 13 February 2013.

Basis of preparation and statement of compliance
In accordance with European Union (EU) regulations, these financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB), as adopted for use in the EU effective at 31 December 2012 (Adopted IFRS). The Company has elected to prepare its parent company accounts under UK Generally Accepted Accounting Practices (GAAP).

The financial statements have been prepared on the historical cost basis except where Adopted IFRS requires the revaluation of financial instruments to fair value and certain other assets and liabilities on an alternative basis – most significantly post-retirement scheme liabilities are valued on the basis required by IAS 19 *Employee Benefits* – and on a going concern basis as described on page 72.

The preparation of financial statements in conformity with Adopted IFRS requires the use of certain critical accounting judgements and estimates, which are set out below.

The Group's significant accounting policies are set out on the following pages. These accounting policies have been applied consistently to all periods presented in these consolidated financial statements and by all Group entities.

Key areas of judgement
The directors consider the potential key areas of judgements required to be made in applying the Group's accounting policies to be:

- A large proportion of the Group's activities relate to long-term aftermarket contracts. The determination of appropriate accounting policies for recognising revenue and costs in respect of these contracts requires judgement, in particular (i) whether an aftermarket contract is linked, for accounting purposes, to the related sale of original equipment and (ii) the appropriate measure of stage of completion of the contract.
- As set out in note 8, the Group has significant intangible assets. The decision as to when to commence capitalisation of development costs and whether sales of original equipment give rise to recognisable recoverable engine costs is a key judgement.
- As noted in the risk and revenue sharing partnerships accounting policy on page 81, the Group enters into arrangements with partners who make non-refundable payments, which the directors consider represent a reimbursement to the Group for its past expenditure, including that in establishing the market to which the partners gain access, on the basis that the Group has satisfied the relevant performance obligations and the payments are not linked to the future supply arrangements between the partners and the Group. Under the arrangements, the partners share the programme costs and receive a share in future programme revenues or profits.
- As set out in note 23, the Group has contingent liabilities in respect of financing support provided to customers. Judgement is required to assess the likelihood of these crystallising, in order to assess whether a provision should be recognised.

Key sources of estimation uncertainty
In applying the accounting policies, management has made appropriate estimates in many areas, and the actual outcome may differ from those calculated. The key sources of estimation uncertainty at the balance sheet date, that have a significant risk of causing material adjustment to the carrying amounts of assets and liabilities within the next financial year are set out below. The estimation of the relevant assets and liabilities involves the combination of a number of assumptions. Where appropriate and practicable, sensitivities are disclosed in the relevant notes.

Current economic environment
The current economic environment could impact a number of estimates necessary to prepare the financial statements, in particular, the recoverable amount of assets and contingent liabilities. The Group has taken these factors into account in assessing the estimates set out overleaf.

1 Accounting policies (continued)

Forecasts and discount rates
The carrying values of a number of items on the balance sheet are dependent on the estimates of future cash flows arising from the Group's operations, in particular:

- The assessment as to whether there are any indications of impairment of development, participation, certification and recoverable engine costs recognised as intangible assets is dependent on forecasts of cash flows generated by the relevant assets (carrying values at 31 December 2012 **£1,388m,** 31 December 2011 £1,442m).
- The financial liabilities arising from financial risk and revenue sharing partnerships are valued at each reporting date using the amortised cost method (carrying values at 31 December 2012 **£193m**, 31 December 2011 £230m). This involves calculating the present value of the forecast cash flows of the arrangement using the internal rate of return at the inception of the arrangement as the discount rate.
- The realisation of the deferred tax assets (carrying values at 31 December 2012 **£330m**, 31 December 2011 £368m) recognised is dependent on the generation of sufficient future taxable profits. The Group recognises deferred tax assets where it is more likely than not that the benefit will be realised.

Assessment of long-term contractual arrangements
The Group has long-term contracts that fall into different accounting periods. In assessing the allocation of revenues and costs to individual accounting periods, and the consequential assets and liabilities, the Group estimates the total revenues and costs forecast to arise in respect of the contract and the stage of completion based on an appropriate measure of performance as described in the revenue recognition accounting policy below.

Post-retirement benefits
The Group's defined benefit pension schemes and similar arrangements are assessed annually in accordance with IAS 19. The accounting valuation, which was based on assumptions determined with independent actuarial advice, resulted in a net deficit of **£545m** before deferred taxation being recognised on the balance sheet at 31 December 2012 (31 December 2011 £397m). The size of the net deficit is sensitive to the market value of the assets held by the schemes and to actuarial assumptions, which include price inflation, pension and salary increases, the discount rate used in assessing actuarial liabilities, mortality and other demographic assumptions and the levels of contributions. Further details are included in note 19.

Provisions
As described in the accounting policy on page 84, the Group measures provisions (carrying value at 31 December 2012 **£461m**, 31 December 2011 £502m) at the directors' best estimate of the expenditure required to settle the obligation at the balance sheet date. These estimates take account of information available and different possible outcomes.

Taxation
The tax payable on profits is determined based on tax laws and regulations that apply in each of the numerous jurisdictions in which the Group operates. Where the precise impact of these laws and regulations is unclear then reasonable estimates may be used to determine the tax charge included in the financial statements.

Basis of consolidation
The Group financial statements include the financial statements of the Company and all of its subsidiary undertakings together with the Group's share of the results of joint ventures and associates made up to 31 December.

A subsidiary is an entity controlled by the Company. Control exists when the Company has the power, directly or indirectly, to govern the financial and operating policies of the entity so as to derive benefits from its activities. The Group has an indirect interest of 50 per cent in Bergen Engines AS. Under the terms of the shareholders' agreement with Daimler AG, the Group controls this company.

A joint venture is an entity in which the Group holds a long-term interest and which is jointly controlled by the Group and one or more other venturers under a contractual arrangement. An associate is an entity, being neither a subsidiary nor a joint venture, in which the Group holds a long-term interest and where the Group has a significant influence. The results of joint ventures and associates are accounted for using the equity method of accounting.

Any subsidiary undertakings, joint ventures or associates sold or acquired during the year are included up to, or from, the dates of change of control. Transactions with non-controlling interests are recorded directly in equity.

Where the Group has issued a put option over shares held by a non-controlling interest, the Group recognises a liability for the estimated exercise value of that option. Movements in the estimated liability after initial recognition are recognised in the income statement.

All intra-group transactions, balances, income and expenses are eliminated on consolidation. Adjustments are made to eliminate the profit or loss arising on transactions with joint ventures and associates to the extent of the Group's interest in the entity.

1 Accounting policies (continued)

Significant accounting policies

Revenue recognition

Revenues comprise sales to outside customers after discounts, excluding value added tax.

Sales of products are recognised when the significant risks and rewards of ownership of the goods are transferred to the customer, the sales price agreed and the receipt of payment can be assured. On occasion, the Group may participate in the financing of engines in conjunction with airframe manufacturers, most commonly by the provision of guarantees as described in note 23. In such circumstances, the contingent obligations arising under these arrangements are taken into account in assessing whether significant risks and rewards of ownership have been transferred to the customer.

Sales of services are recognised by reference to the stage of completion based on services performed to date. The assessment of the stage of completion is dependent on the nature of the contract, but will generally be based on: costs incurred to the extent these relate to services performed up to the reporting date; achievement of contractual milestones where appropriate; or flying hours or equivalent for long-term aftermarket arrangements.

Linked sales of products and services are treated as a single contract where these components have been negotiated as a single commercial package and are so closely interrelated that they do not operate independently of each other and are considered to form a single project with an overall profit margin. Revenue is recognised on the same basis as for other sales of products and services as described above.

Provided that the outcome of construction contracts can be assessed with reasonable certainty, the revenues and costs on such contracts are recognised based on stage of completion and the overall contract profitability.

Full provision is made for any estimated losses to completion of contracts, having regard to the overall substance of the arrangements.

Progress payments received, when greater than recorded revenue, are deducted from the value of work in progress except to the extent that payments on account exceed the value of work in progress on any contract where the excess is included in trade and other payables. The amount by which recorded revenue of long-term contracts is in excess of payments on account is classified as amounts recoverable on contracts and is separately disclosed within trade and other receivables.

Risk and revenue sharing partnerships (RRSPs)

From time to time, the Group enters into arrangements with partners who make cash payments that are not refundable. Cash sums received, which reimburse the Group for past expenditure, including that in establishing the market to which the partners gain access, are credited to other operating income. The arrangements also require partners to undertake development work and/or supply components for use in the programme at their own expense. No accounting entries are recorded where partners undertake such development work or where programme components are supplied by partners because no obligation arises unless and until programme sales are made. Instead, partners receive a share of the programme revenues or profits, which are charged to cost of sales as programme revenues arise.

The Group has arrangements with partners who do not undertake development work or supply parts. Such arrangements are considered to be financial instruments as defined by IAS 32 *Financial Instruments: Presentation* and are accounted for using the amortised cost method.

Government investment

Where a government or similar body has previously invested in a development programme, the Group treats payments to that body as royalty payments, which are matched to related sales.

Government grants

Government grants are recognised in the income statement so as to match them with the related expenses that they are intended to compensate. Where grants are received in advance of the related expenses, they are included in the balance sheet as deferred income. Non-monetary grants are recognised at fair value.

Interest

Interest receivable/payable is credited/charged to the income statement using the effective interest method. Where borrowing costs are attributable to the acquisition, construction or production of a qualifying asset, such costs are capitalised as part of the specific asset.

Taxation

The tax charge/credit on the profit or loss for the year comprises current and deferred tax. Current tax is the expected tax payable for the year, using tax rates enacted or substantively enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

Deferred tax is provided using the balance sheet liability method, providing for temporary differences between the carrying amounts of the assets and liabilities for financial reporting purposes and the amounts used for taxation purposes.

1 Accounting policies (continued)

Deferred tax liabilities are recognised for taxable temporary differences arising on investments in subsidiaries and joint ventures, except where the Group is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future. Deferred tax is not recognised on taxable temporary differences arising on the initial recognition of goodwill or for temporary differences arising from the initial recognition of assets and liabilities in a transaction that is not a business combination and that affects neither accounting nor taxable profit.

Deferred tax is calculated using the enacted or substantively enacted rates that are expected to apply when the asset or liability is settled. Deferred tax is charged or credited in the income statement or statement of comprehensive income as appropriate, except when it relates to items credited or charged directly to equity in which case the deferred tax is also dealt with in equity.

Deferred tax assets are recognised only to the extent that it is probable that future taxable profits will be available against which the assets can be utilised.

Foreign currency translation

Transactions in overseas currencies are translated into local currency at the exchange rates ruling on the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated into local currency at the rate ruling at the year end. Exchange differences arising on foreign exchange transactions and the retranslation of assets and liabilities into sterling at the rate ruling at the year-end are taken into account in determining profit before taxation.

The trading results of overseas undertakings are translated at the average exchange rates for the year. The assets and liabilities of overseas undertakings, including goodwill and fair value adjustments arising on acquisition, are translated at the exchange rates ruling at the year end. Exchange adjustments arising from the retranslation of the opening net investments, and from the translation of the profits or losses at average rates, are taken to equity.

Financial instruments

IAS 39 *Financial Instruments: Recognition and Measurement* requires the classification of financial instruments into separate categories for which the accounting requirement is different. The Group has classified its financial instruments as follows:

- Short-term investments are generally classified as available for sale.
- Short-term deposits (principally comprising funds held with banks and other financial institutions), trade receivables and short-term investments not designated as available for sale are classified as loans and receivables.
- Borrowings, trade payables, financial RRSPs and C Shares are classified as other liabilities.
- Derivatives, comprising foreign exchange contracts, interest rate swaps and commodity swaps are classified as held for trading.

Financial instruments are recognised at the contract date and initially measured at fair value. Their subsequent measurement depends on their classification:

- Available for sale assets are held at fair value. Changes in fair value arising from changes in exchange rates are included in the income statement. All other changes in fair value are taken to equity. On disposal, the accumulated changes in value recorded in equity are included in the gain or loss recorded in the income statement.
- Loans and receivables and other liabilities are held at amortised cost and not revalued (except for changes in exchange rates which are included in the income statement) unless they are included in a fair value hedge accounting relationship. Where such a relationship exists, the instruments are revalued in respect of the risk being hedged, with the change in value included in the income statement.
- Held for trading instruments are held at fair value. Changes in fair value are included in the income statement unless the instrument is included in a cash flow hedge. If the instruments are included in a cash flow hedging relationship, which is effective, changes in value are taken to equity. When the hedged forecast transaction occurs, amounts previously recorded in equity are recognised in the income statement.

Financial instruments are derecognised on expiry or when all contractual rights and obligations are transferred.

Hedge accounting

The Group does not generally apply hedge accounting in respect of forward foreign exchange contracts held to manage the cash flow exposures of forecast transactions denominated in foreign currencies. In 2011, the Group applied cash flow hedge accounting in respect of foreign exchange contracts entered into to hedge the cost of its investment in Engine Holding GmbH.

The Group does not apply hedge accounting in respect of commodity swaps held to manage the cash flow exposures of forecast transactions in those commodities.

1 Accounting policies (continued)

The Group applies hedge accounting in respect of transactions entered into to manage the fair value and cash flow exposures of its borrowings. Forward foreign exchange contracts are held to manage the fair value exposures of borrowings denominated in foreign currencies and are designated as fair value hedges. Interest rate swaps are held to manage the interest rate exposures and are designated as fair value or cash flow hedges of fixed and floating rate borrowings respectively.

Changes in the fair values of derivatives designated as fair value hedges and changes in fair value of the related hedged item are recognised directly in the income statement.

Changes in the fair values of derivatives that are designated as cash flow hedges and are effective are recognised directly in equity. Any ineffectiveness in the hedging relationships is included in the income statement. The amounts deferred in equity are recognised in the income statement to match the recognition of the hedged item or, in the case of the cash flow hedges of the investment in Engine Holding GmbH, included in the initial carrying value of the joint venture.

Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated, exercised, or no longer qualifies for hedge accounting. At that time, for cash flow hedges and if the forecast transaction remains probable, any cumulative gain or loss on the hedging instrument recognised in equity is retained in equity until the forecast transaction occurs. If a hedged transaction is no longer expected to occur, the net cumulative gain or loss previously recognised in equity is transferred to the income statement.

The portion of a gain or loss on an instrument used to hedge a net investment in a foreign operation that is determined to be an effective hedge is recognised directly in equity. The ineffective portion is recognised immediately in the income statement.

Purchased goodwill
Goodwill recognised represents the excess of the fair value of the purchase consideration over the fair value to the Group of the net of the identifiable assets acquired and the liabilities assumed. On transition to IFRS on 1 January 2004, goodwill was recognised based the carrying value under the previous accounting policies. Goodwill in respect of the acquisition of a subsidiary is recognised as an intangible asset. Goodwill arising on the acquisition of joint ventures and associates is included in the carrying value of the investment.

Certification costs and participation fees
Costs incurred in respect of meeting regulatory certification requirements for new civil aero-engine/aircraft combinations and payments made to airframe manufacturers for this, and participation fees, are carried forward in intangible assets to the extent that they can be recovered out of future sales and are charged to the income statement over the programme life, up to a maximum of 15 years from the entry into service of the product.

Research and development
In accordance with IAS 38 *Intangible Assets*, expenditure incurred on research and development, excluding known recoverable amounts on contracts, and contributions to shared engineering programmes, is distinguished as relating either to a research phase or to a development phase.

All research phase expenditure is charged to the income statement. For development expenditure, this is capitalised as an internally generated intangible asset only if it meets strict criteria, relating in particular to technical feasibility and generation of future economic benefits.

Expenditure that cannot be classified into these two categories is treated as being incurred in the research phase. The Group considers that, due to the complex nature of new equipment programmes, it is not possible to distinguish reliably between research and development activities until relatively late in the programme.

Expenditure capitalised is amortised over its useful economic life, up to a maximum of 15 years from the entry into service of the product.

Recoverable engine costs
On occasion, the Group may sell original equipment to customers at a price below its cost, on the basis that this deficit will be recovered from future aftermarket sales to the original customer. Where the Group has a contractual right to supply aftermarket parts to the customer and its intellectual rights, warranty arrangements and, where relevant, statutory airworthiness requirements provide reasonable control over this supply, these arrangements are considered to meet the definition of an intangible asset. Such intangible assets are recognised to the extent of the deficit and amortised on a straight-line basis over the expected period of utilisation by the original customer.

Software
The cost of acquiring software that is not specific to an item of property, plant and equipment is classified as an intangible asset and amortised over its useful economic life, up to a maximum of five years.

1 Accounting policies (continued)

Property, plant and equipment

Property, plant and equipment assets are stated at cost less accumulated depreciation and any provision for impairment in value.

Depreciation is provided on a straight-line basis to write off the cost, less the estimated residual value, of property, plant and equipment over their estimated useful lives. No depreciation is provided on assets in the course of construction. Estimated useful lives are as follows:

i) land and buildings, as advised by the Group's professional advisors:
   a) freehold buildings – five to 45 years (average 24 years)
   b) leasehold buildings – lower of advisor's estimates or period of lease
   c) no depreciation is provided on freehold land
ii) plant and equipment – five to 25 years (average 13 years)
iii) aircraft and engines – five to 20 years (average 16 years).

Operating leases

Payments made and rentals received under operating lease arrangements are charged/credited to the income statement on a straight-line basis.

Impairment of non-current assets

Impairment of non-current assets is considered in accordance with IAS 36 *Impairment of Assets*. Where the asset does not generate cash flows that are independent of other assets, impairment is considered for the cash-generating unit to which the asset belongs.

Goodwill and intangible assets not yet available for use are tested for impairment annually. Other intangible assets, property, plant and equipment and investments are assessed for any indications of impairment annually. If any indication of impairment is identified, an impairment test is performed to estimate the recoverable amount.

Recoverable amount is the higher of value in use or fair value less costs to sell, if this is readily available. The value in use is the present value of future cash flows using a pre-tax discount rate that reflects the time value of money and the risk specific to the asset.

If the recoverable amount of an asset (or cash-generating unit) is estimated to be below the carrying value, the carrying value is reduced to the recoverable amount and the impairment loss recognised as an expense.

Inventories

Inventories and work in progress are valued at the lower of cost and net realisable value on a first-in, first-out basis. Cost comprises direct materials and, where applicable, direct labour costs and those overheads, including depreciation of property, plant and equipment, that have been incurred in bringing the inventories to their present location and condition. Net realisable value represents the estimated selling prices less all estimated costs of completion and costs to be incurred in marketing, selling and distribution.

Cash and cash equivalents

Cash and cash equivalents include cash at bank and in hand, investments in money-market funds and short-term deposits with a maturity of three months or less on inception. The Group considers overdrafts (repayable on demand) to be an integral part of its cash management activities and these are included in cash and cash equivalents for the purposes of the cash flow statement.

Provisions

Provisions are recognised when the Group has a present obligation as a result of a past event, and it is probable that the Group will be required to settle that obligation. Provisions are measured at the directors' best estimate of the expenditure required to settle the obligation at the balance sheet date, and are discounted to present value where the effect is material.

Post-retirement benefits

Pensions and similar benefits (principally healthcare) are accounted for under IAS 19 *Employee Benefits*.

For defined benefit plans, obligations are measured at discounted present value whilst plan assets are recorded at fair value. Surpluses in schemes are recognised as assets only if they represent economic benefits available to the Group in the future. A liability is recognised to the extent that the minimum funding requirements in respect of past service will give rise to an unrecognisable surplus. Movements in unrecognised surpluses and minimum funding liabilities are included in the statement of comprehensive income.

1 Accounting policies (continued)

The service and financing costs of such plans are recognised separately in the income statement:

- current service costs are spread systematically over the lives of employees;
- past service costs are recognised immediately to the extent the benefits are already vested, or otherwise recognised on a straight-line basis over the average period until the benefits become vested; and
- financing costs are recognised in the periods in which they arise.

Actuarial gains and losses are recognised immediately in the statement of comprehensive income.

Payments to defined contribution schemes are charged as an expense as they fall due.

Share-based payments
The Group provides share-based payment arrangements to certain employees. These are principally equity-settled arrangements and are measured at fair value (excluding the effect of non-market based vesting conditions) at the date of grant. The fair value is expensed on a straight-line basis over the vesting period. The amount recognised as an expense is adjusted to reflect the actual number of shares or options that will vest, except where additional shares vest as a result of the Total Shareholder Return (TSR) performance condition in the Performance Share Plan (PSP).

Cash-settled share options (grants in the International ShareSave plan) are measured at fair value at the balance sheet date. The Group recognises a liability at the balance sheet date based on these fair values, taking into account the estimated number of options that will actually vest and the relative completion of the vesting period. Changes in the value of this liability are recognised in the income statement for the year.

The fair values of the share-based payment arrangements are measured as follows:

i) ShareSave plans – using the binomial pricing model;
ii) PSP – using a pricing model adjusted to reflect non-entitlement to dividends (or equivalent) and the TSR market-based performance condition; and
iii) Annual Performance Related Award plan deferred shares – share price on the date of the award.

The cost of shares of Rolls-Royce Holdings plc held by the Group for the purpose of fulfilling obligations in respect of employee share plans is deducted from equity in the consolidated balance sheet. See note 21 for a further description of the share-based payment plans.

Contingent liabilities
In connection with the sale of its products, the Group will, on occasion, provide financing support for its customers. These arrangements fall into two categories: credit-based guarantees and asset-value guarantees. In accordance with the requirements of IAS 39 and IFRS 4 *Insurance Contracts*, credit-based guarantees are treated as insurance contracts. The Group considers asset-value guarantees to be non-financial liabilities and accordingly these are also treated as insurance contracts. Provision is made as described on page 118.

The Group's contingent liabilities relating to financing arrangements are spread over many years and relate to a number of customers and a broad product portfolio, and are reported on a discounted basis.

Revisions to Adopted IFRS in 2012
The Group has adopted revisions to IAS 1 *Presentation of Financial Statements* that require items of other comprehensive income to be classified depending on whether they may be potentially reclassified to the income statement. There is no net impact.

There were no other revisions to Adopted IFRS that became applicable in 2012 which had a significant impact on the Group's financial statements.

1 Accounting policies (continued)

Revisions to IFRS not applicable in 2012

Standards and interpretations issued by the IASB are only applicable if endorsed by the EU. The following will or may be applicable in the future:

- Amendments to IAS 19 *Employee Benefits*: the principal change is that the financing on post-retirement benefits is calculated on the net surplus or deficit using an 'AA' corporate bond rate. This will be effective for 2013. If it had been effective in 2012, it would have increased the current service cost of defined benefit post-retirement schemes by £9 million, the past service cost by £5 million and reduced the net post-retirement scheme financing cost by £55 million. The net deficit at 31 December 2012 would have reduced by £100 million.
- IFRS 11 *Joint Arrangements*: the principal potential effect is certain entities currently classified as joint ventures may be classified as joint operations. This would result in the Group's share of the individual assets and liabilities of these entities being included in the financial statements rather than the equity method accounting adopted under the requirements of IAS 31. This would not affect the Group's net assets or profit after tax for the period. This will be effective for 2013. The Group has reviewed its joint ventures and has concluded that none of its material joint ventures fall to be classified as joint operations under the requirements of IFRS 11.
- IFRS 9 *Financial Instruments* will simplify the classification of financial assets for measurement purposes, but is not anticipated to have a significant impact on the financial statements. If endorsed, this will be effective for 2015.

The Group does not consider that any other standards, amendments or interpretations issued by the IASB, but not yet applicable, will have a significant impact on the financial statements.

2 Segmental analysis

The analysis by business segment is presented in accordance with IFRS 8 *Operating Segments*, on the basis of those segments whose operating results are regularly reviewed by the Board (the Chief Operating Decision Maker as defined by IFRS 8), as follows:

Civil aerospace	– development, manufacture, marketing and sales of commercial aero engines and aftermarket services.
Defence aerospace	– development, manufacture, marketing and sales of military aero engines and aftermarket services.
Marine	– development, manufacture, marketing and sales of marine-power propulsion systems and aftermarket services.
Energy	– development, manufacture, marketing and sales of power systems for the offshore oil and gas industry and electrical power generation and aftermarket services.
Engine Holding	– development, manufacture, marketing and sales of diesel engines, aftermarket services and the equity accounted share of Tognum AG.

Technology and Operations discussed in the business review operate on a Group-wide basis across all the above segments. Following the transfer of Bergen Engines AS to Engine Holding on 2 January 2012, the comparative figures for 2011 have been restated to put them on a consistent basis.

The operating results reviewed by the Board are prepared on an underlying basis, which the Board consider reflects better the economic substance of the Group's trading during the year. The principles adopted to determine underlying results are:

Underlying revenues – Where revenues are denominated in a currency other than the functional currency of the Group undertaking, these reflect the achieved exchange rates arising on settled derivative contracts.

Underlying profit before financing – Where transactions are denominated in a currency other than the functional currency of the Group undertaking, this reflects the transactions at the achieved exchange rates on settled derivative contracts. In addition, adjustments have been made to exclude one-off past-service credits on post-retirement schemes and the effect of acquisition accounting.

Underlying profit before taxation – In addition to those adjustments in underlying profit before financing:

- Includes amounts realised from settled derivative contracts and revaluation of relevant assets and liabilities to exchange rates forecast to be achieved from future settlement of derivative contracts.
- Excludes unrealised amounts arising from revaluations required by IAS 39 *Financial Instruments: Recognition and Measurement*, changes in value of financial RRSP contracts arising from changes in forecast payments, changes in the value of put options on NCI and the net impact of financing costs related to post-retirement scheme benefits.

This analysis also includes a reconciliation of the underlying results to those reported in the consolidated income statement.

2 Segmental analysis (continued)

Year ended 31 December 2012	Civil aerospace £m	Defence aerospace £m	Marine £m	Energy £m	Engine Holding £m	Intra-segment £m	Total reportable segments £m
Underlying revenue from sale of original equipment	**2,934**	**1,231**	**1,288**	**344**	**118**	**(22)**	**5,893**
Underlying revenue from aftermarket services	**3,503**	**1,186**	**961**	**618**	**169**	**(121)**	**6,316**
Total underlying revenue	**6,437**	**2,417**	**2,249**	**962**	**287**	**(143)**	**12,209**
Underlying operating profit excluding share of results of joint ventures and associates	**597**	**391**	**295**	**9**	**32**	**(11)**	**1,313**
Share of results of joint ventures and associates	**130**	**13**	**(1)**	**12**	**77**	**–**	**231**
Underlying profit before financing and taxation	**727**	**404**	**294**	**21**	**109**	**(11)**	**1,544**
Segment assets	**8,683**	**1,434**	**2,059**	**1,279**	**150**	**(682)**	**12,923**
Investments in joint ventures and associates	**440**	**(22)**	**4**	**50**	**1,328**	**–**	**1,800**
Segment liabilities	**(5,598)**	**(1,797)**	**(1,467)**	**(570)**	**(282)**	**671**	**(9,043)**
Net assets	**3,525**	**(385)**	**596**	**759**	**1,196**	**(11)**	**5,680**
Investment in intangible assets, property, plant and equipment and joint ventures and associates	**581**	**126**	**101**	**94**	**11**	**–**	**913**
Depreciation, amortisation and impairment	**322**	**46**	**55**	**42**	**4**	**–**	**469**
Year ended 31 December 2011							
Underlying revenue from sale of original equipment	2,232	1,102	1,322	527	185	(110)	5,258
Underlying revenue from aftermarket services	3,340	1,133	949	556	146	(105)	6,019
Total underlying revenue	5,572	2,235	2,271	1,083	331	(215)	11,277
Underlying operating profit excluding share of results of joint ventures and associates	384	367	282	6	44	–	1,083
Share of results of joint ventures and associates	115	9	2	10	36	–	172
Profit on disposal of businesses	–	–	3	–	–	–	3
Underlying profit before financing and taxation	499	376	287	16	80	–	1,258
Segment assets	8,218	1,333	2,023	1,192	405	(746)	12,425
Investments in joint ventures and associates	403	(22)	8	42	1,249	–	1,680
Segment liabilities	(5,982)	(1,831)	(1,440)	(546)	(164)	746	(9,217)
Net assets	2,639	(520)	591	688	1,490	–	4,888
Investment in intangible assets, property, plant and equipment and joint ventures and associates	620	70	75	83	1,318	–	2,166
Depreciation and amortisation	267	48	56	38	1	–	410

2 Segmental analysis (continued)

Reconciliation to reported results

Year ended 31 December 2012	Total reportable segments £m	Underlying central items £m	Total underlying £m	Underlying adjustments £m	Group £m
Revenue from sale of original equipment	5,893	–	5,893	41	5,934
Revenue from aftermarket services	6,316	–	6,316	(89)	6,227
Total revenue	12,209	–	12,209	(48)	12,161
Operating profit excluding share of results of joint ventures and associates	1,313	(54) [1]	1,259	(59)	1,200
Share of results of joint ventures and associates	231	–	231	(58)	173
Profit on disposal of businesses	–	–	–	699	699
Profit before financing and taxation	1,544	(54)	1,490	582	2,072
Net financing		(61)	(61)	694	633
Profit before taxation		(115)	1,429	1,276	2,705
Taxation		(318)	(318)	(92)	(410)
Profit for the year		(433)	1,111	1,184	2,295
Year ended 31 December 2011					
Revenue from sale of original equipment	5,258	–	5,258	(19)	5,239
Revenue from aftermarket services	6,019	–	6,019	(134)	5,885
Total revenue	11,277	–	11,277	(153)	11,124
Operating profit excluding share of results of joint ventures and associates	1,083	(52) [1]	1,031	39	1,070
Share of results of joint ventures and associates	172	–	172	(56)	116
Profit on disposal of businesses	3	–	3	–	3
Profit before financing and taxation	1,258	(52)	1,206	(17)	1,189
Net financing		(49)	(49)	(35)	(84)
Profit before taxation		(101)	1,157	(52)	1,105
Taxation		(261)	(261)	4	(257)
Profit for the year		(362)	896	(48)	848

[1] Central corporate costs

Underlying adjustments

	2012				2011			
	Revenue £m	Profit before financing £m	Net financing £m	Taxation £m	Revenue £m	Profit before financing £m	Net financing £m	Taxation £m
Underlying performance	12,209	1,490	(61)	(318)	11,277	1,206	(49)	(261)
Revenue recognised at exchange rate on date of transaction	(48)	–	–	–	(153)	–	–	–
Realised (gains)/losses on settled derivative contracts [1]	–	(25)	–	–	–	(116)	24	–
Net unrealised fair value changes to derivative contracts [2]	–	–	747	–	–	(5)	(49)	–
Effect of currency on contract accounting	–	(23)	–	–	–	4	–	–
Put option on NCI and financial RRSPs – foreign exchange differences and other unrealised changes in value	–	–	11	–	–	–	2	–
Effect of acquisition accounting [3]	–	(69)	–	–	–	(64)	–	–
Post-retirement scheme past-service credits [4, 5]	–	–	–	–	–	164	–	–
Net post-retirement scheme financing	–	–	(64)	–	–	–	(12)	–
Related tax effect	–	–	–	(129)	–	–	–	4
IAE restructuring	–	699	–	37	–	–	–	–
Total underlying adjustments	(48)	582	694	(92)	(153)	(17)	(35)	4
Reported per consolidated income statement	12,161	2,072	633	(410)	11,124	1,189	(84)	(257)

[1] Realised (gains)/losses on settled derivative contracts include adjustments to reflect the (gains)/losses in the same period as the related trading cash flows.
[2] Unrealised fair value changes to derivative contracts: (i) include those included in equity accounted joint ventures; and (ii) exclude those for which the related trading contracts have been cancelled when the fair value changes are recognised immediately in underlying profit.
[3] The adjustment eliminates charges recognised as a result of recognising assets in acquired businesses at fair value.
[4] In 2010, the UK Government announced changes to the basis of the statutory indexation for pension increases. As a result, the relevant arrangements have been amended, resulting in a gain in the income statement of £130m in 2011, which was excluded from underlying profit.
[5] In 2011, the Group agreed revised post-retirement healthcare arrangements on certain of its overseas schemes. This resulted in a net gain in the income statement of £34m which was excluded from underlying profit.

The reconciliation of underlying earnings per ordinary share is shown in note 5.

2 Segmental analysis (continued)

	2012 £m	2011 £m
Reportable segment assets	**12,923**	12,425
Investments in joint ventures and associates	**1,800**	1,680
Cash and cash equivalents and short-term investments	**2,596**	1,321
Fair value of swaps hedging fixed rate borrowings	**104**	106
Income tax assets	**363**	388
Post-retirement scheme surpluses	**329**	503
Total assets	**18,115**	16,423
Reportable segment liabilities	**(9,043)**	(9,217)
Borrowings	**(1,383)**	(1,204)
Income tax liabilities	**(710)**	(583)
Post-retirement scheme deficits	**(874)**	(900)
Total liabilities	**(12,010)**	(11,904)
Net assets	**6,105**	4,519

Geographical segments

The Group's revenue by destination is shown below:

	2012 £m	2011 £m
United Kingdom	**1,641**	1,361
Norway	**446**	374
Germany	**319**	409
Spain	**177**	189
Italy	**151**	183
France	**182**	143
Russia	**165**	143
Rest of Europe	**676**	547
USA	**3,999**	3,578
Canada	**351**	301
China	**1,117**	934
South Korea	**194**	210
Middle East and South East Asia	**1,729**	1,778
Rest of Asia	**306**	290
Africa	**123**	261
Australasia	**240**	228
Other	**345**	195
	12,161	11,124

In 2012, revenue (included in all reportable segments, other than Engine Holding) of **£1,203m** (2011 £1,143m) was received from a single customer.

The carrying amounts of the Group's non-current assets, excluding financial instruments, deferred tax assets and post-employment benefit surpluses, by the geographical area in which the assets are located, are as follows:

	2012 £m	2011 £m
United Kingdom	**3,139**	2,980
North America	**723**	670
Nordic countries	**883**	902
Germany	**2,023**	1,907
Other	**497**	441
	7,265	6,900

3 Net financing

		2012		2011	
	Notes	Per consolidated income statement £m	*Underlying financing* [1] *£m*	Per consolidated income statement £m	*Underlying financing* [1] *£m*
Financing income					
Interest receivable		10	*10*	20	*20*
Fair value gains on foreign currency contracts [2]	17	750	–	–	–
Put option on NCI and financial RRSPs – foreign exchange differences and other unrealised changes in value	17	11	–	2	–
Expected return on post-retirement scheme assets	19	341	–	410	–
Net foreign exchange gains		–	–	24	–
		1,112	*10*	456	*20*
Financing costs					
Interest payable		(51)	*(51)*	(51)	*(51)*
Fair value losses on foreign currency contracts [2]	17	–	–	(21)	–
Financial charge relating to financial RRSPs	17	(10)	*(10)*	(11)	*(11)*
Fair value losses on commodity derivatives [2]	17	(3)	–	(28)	–
Interest on post-retirement scheme liabilities	19	(405)	–	(422)	–
Other financing charges		(10)	*(10)*	(7)	*(7)*
		(479)	*(71)*	(540)	*(69)*
Net financing		633	*(61)*	(84)	*(49)*
Analysed as:					
Net interest payable		(41)	*(41)*	(31)	*(31)*
Net post-retirement scheme financing		(64)	–	(12)	–
Net other financing		738	*(20)*	(41)	*(18)*
Net financing		633	*(61)*	(84)	*(49)*
[1] See note 2					
[2] Net gain/(loss) on items held for trading		747	–	(49)	–

4 Taxation

	UK		Overseas		Total	
	2012 £m	2011 £m	2012 £m	2011 £m	2012 £m	2011 £m
Current tax						
Current tax (credit)/charge for the year	(3)	(1)	218	177	215	176
Less double tax relief	(1)	(2)	–	–	(1)	(2)
	(4)	(3)	218	177	214	174
Adjustments in respect of prior years	(7)	1	(18)	(8)	(25)	(7)
	(11)	(2)	200	169	189	167
Deferred tax						
Charge for the year	193	69	45	37	238	106
Adjustments in respect of prior years	1	2	6	(7)	7	(5)
Credit resulting from reduction in UK tax rate	(24)	(11)	–	–	(24)	(11)
	170	60	51	30	221	90
Recognised in the income statement	159	58	251	199	410	257

4 Taxation (continued)

Other tax (charges)/credits

	OCI				Equity	
	Items that will not be reclassified		Items that may be reclassified			
	2012 £m	2011 £m	2012 £m	2011 £m	2012 £m	2011 £m
Current tax:						
Share-based payments – direct to equity					3	6
Deferred tax:						
Net investment hedge	–	–	(1)	(1)		
Movement in post-retirement schemes	91	(53)	–	–		
Share-based payments – direct to equity					6	6
	91	(53)	(1)	(1)	9	12

Tax reconciliation

	2012 £m	2011 £m
Profit before taxation	2,705	1,105
Less share of results of joint ventures and associates (note 10)	(173)	(116)
Profit before taxation excluding joint ventures and associates	2,532	989
Nominal tax charge at UK corporation tax rate 24.5% (2011 26.5%)	620	262
UK R&D credit	(26)	(29)
Rate differences	58	40
Effect of restructuring of IAE [1]	(209)	–
Other permanent differences	9	8
Benefit to deferred tax from previously unrecognised tax losses and temporary differences	–	(1)
Adjustments in respect of prior years	(18)	(12)
Reduction in closing deferred taxes resulting from decrease in UK tax rate	(24)	(11)
	410	257
Underlying items (note 2)	318	261
Non-underlying items	92	(4)
	410	257

[1] Pursuant to the Substantial Shareholding Exemption, the majority of the upfront proceeds received on the IAE restructuring (see note 25) are not subject to tax.

Deferred taxation assets and liabilities

	2012 £m	2011 £m
At 1 January	(77)	13
Amount charged to income statement	(221)	(90)
Amount credited/(charged) to other comprehensive income	90	(54)
Amount credited to equity	6	6
Acquisition of businesses	(1)	(3)
Transferred (from)/to assets held for sale	(46)	46
Exchange differences	(5)	5
At 31 December	(254)	(77)
Deferred tax assets	330	368
Deferred tax liabilities	(584)	(445)
	(254)	(77)

4 Taxation (continued)

The analysis of the deferred tax position is as follows:

	At 1 January 2012 £m	Recognised in income statement £m	Recognised in OCI £m	Recognised in equity £m	Acquisition of businesses £m	Transferred from assets held for sale £m	Exchange differences £m	At 31 December 2012 £m
Intangible assets	**(243)**	58	–	–	–	(46)	(1)	**(232)**
Property, plant and equipment	**(135)**	(25)	–	–	1	–	1	**(158)**
Other temporary differences	**(61)**	21	(1)	–	–	–	2	**(39)**
Amounts recoverable on contracts	**(250)**	(101)	–	–	–	–	–	**(351)**
Pensions and other post-retirement scheme benefits	**99**	(31)	91	–	(2)	–	(8)	**149**
Foreign exchange and commodity financial assets and liabilities	**121**	(177)	–	–	–	–	–	**(56)**
Losses	**328**	34	–	6	–	–	1	**369**
Advance corporation tax	**64**	–	–	–	–	–	–	**64**
	(77)	(221)	90	6	(1)	(46)	(5)	**(254)**

	At 1 January 2011 £m	Recognised in income statement £m	Recognised in OCI £m	Recognised in equity £m	Acquisition of businesses £m	Transferred to assets held for sale £m	Exchange differences £m	At 31 December 2011 £m
Intangible assets	(282)	(9)	–	–	–	46	2	(243)
Property, plant and equipment	(150)	16	–	–	–	–	(1)	(135)
Other temporary differences	(64)	(3)	(1)	6	(3)	–	4	(61)
Amounts recoverable on contracts	(229)	(21)	–	–	–	–	–	(250)
Pensions and other post-retirement scheme benefits	263	(111)	(53)	–	–	–	–	99
Foreign exchange and commodity financial assets and liabilities	94	27	–	–	–	–	–	121
Losses	317	11	–	–	–	–	–	328
Advance corporation tax	64	–	–	–	–	–	–	64
	13	(90)	(54)	6	(3)	46	5	(77)

	2012 £m	2011 £m
Advance corporation tax	**118**	118
Losses and other unrecognised deferred tax assets	**39**	41
Deferred tax not recognised on unused tax losses and other items on the basis that future economic benefit is uncertain	**157**	159

The Autumn Statement 2012 announced that the UK corporation tax rate will reduce to 21 per cent by 2014. The reductions to 24 per cent effective from 1 April 2012 and 23 per cent effective from 1 April 2013 were substantively enacted on 26 March 2012 and 3 July 2012 respectively. As the rate change to 23 per cent was substantively enacted prior to the year end, the closing deferred tax assets and liabilities have been calculated at this rate. The resulting charges or credits have been recognised in the income statement except to the extent that they relate to items previously charged or credited to OCI or equity. Accordingly, in 2012, **£24m** has been credited to the income statement, **£3m** has been charged to the OCI and **£3m** has been charged directly to equity.

Had the further tax rate changes been substantively enacted on or before the balance sheet date it would have had the effect of reducing the deferred tax asset by **£15m** and reducing the deferred tax liability by **£33m**.

The temporary differences associated with investments in subsidiaries, joint ventures and associates, for which a deferred tax liability has not been recognised, aggregate to **£144m** (2011 £178m). No deferred tax liability has been recognised on the potential withholding tax due on the remittance of undistributed profits as the Group is able to control the timing of such remittances and it is probable that consent will not be given in the foreseeable future.

5 Earnings per ordinary share

Basic earnings per ordinary share (EPS) are calculated by dividing the profit attributable to ordinary shareholders by the weighted average number of ordinary shares in issue during the year, excluding ordinary shares held under trust, which have been treated as if they had been cancelled.

Diluted EPS are calculated by adjusting the weighted average number of ordinary shares in issue during the year for the bonus element of share options.

	2012			2011		
	Basic	Potentially dilutive share options	Diluted	Basic	Potentially dilutive share options	Diluted
Profit attributable to ordinary shareholders (£m)	2,281		2,281	850		850
Weighted average number of ordinary shares (millions)	1,851	25	1,876	1,850	25	1,875
EPS (pence)	123.23	(1.64)	121.59	45.95	(0.62)	45.33

The reconciliation between underlying EPS and basic EPS is as follows:

	2012		2011	
	Pence	£m	Pence	£m
Underlying EPS/Underlying profit attributable to ordinary shareholders	59.27	1,097	48.54	898
Total underlying adjustments to profit before tax (note 2)	68.93	1,276	(2.81)	(52)
Related tax effects	(4.97)	(92)	0.22	4
EPS/Profit attributable to ordinary shareholders	123.23	2,281	45.95	850
Excluding IAE restructuring	83.47	1,545	45.95	850
IAE restructuring	39.76	736	–	–
Diluted underlying EPS	58.48		47.89	

6 Employee information

	2012 Number	2011 Number
Average number of employees		
United Kingdom	22,800	21,600
Rest of world	20,000	18,800
	42,800	40,400
Civil aerospace	21,500	19,800
Defence aerospace	7,800	7,600
Marine	8,800	8,600
Energy	3,700	3,500
Engine Holding	1,000	900
	42,800	40,400

	£m	£m
Group employment costs [1]		
Wages and salaries	2,163	2,037
Social security costs	265	245
Share-based payments (note 21)	55	59
Pensions and other post-retirement scheme benefits (note 19)	279	23
	2,762	2,364

[1] Remuneration of key management personnel is shown in note 24.

7 Auditors' remuneration

Fees payable to the Company's auditor and its associates were as follows:

	2012 £m	2011 £m
Fees payable to the Company's auditor for the audit of the Company's annual financial statements [1]	**0.2**	0.2
Fees payable to the Company's auditor and its associates for the audit of the Company's subsidiaries pursuant to legislation	**4.5**	4.3
Total fees payable for audit services	**4.7**	4.5
Fees payable to the Company's auditor and its associates for other services:		
Audit related assurance services [2]	**0.6**	1.0
Taxation compliance services	**0.3**	0.3
Taxation advisory services	**0.2**	0.2
Internal audit services [3]	**0.6**	–
Information technology [4]	**0.4**	–
All other services	**0.1**	0.2
	6.9	6.2
Fees payable in respect of the Group's pension schemes:		
Audit	**0.2**	0.2
Taxation compliance services	**0.1**	–

1 The level of fees payable to the Company's auditor for the audit of the Company's annual financial statements reflects the fact that limited incremental work is required in respect of the audit of these financial statements. Rolls-Royce plc, a subsidiary of the Company, is also required to prepare consolidated financial statements and the fees payable to the Company's auditor for the audit of those financial statements, including the audit of the sub-consolidation, is included in the audit of the Company's subsidiaries pursuant to legislation.

2 This includes **£0.3m** (2011 £0.3m) for the review of the half-year report.

3 During the Group's IT modernisation programme, KPMG provided specialist internal audit support while the Group recruited its own personnel.

4 This relates to consulting services on the Group's IT modernisation programme. After being engaged by the Group, the consultancy was acquired by KPMG.

8 Intangible assets

	Goodwill £m	Certification costs and participation fees £m	Development expenditure £m	Recoverable engine costs £m	Software and other £m	Total £m
Cost:						
At 1 January 2011	1,115	686	862	697	413	3,773
Exchange differences	(20)	(2)	(1)	–	(2)	(25)
Additions	–	44	93	135	95	367
Acquisitions of businesses	11	–	–	–	8	19
Transferred to assets held for sale	–	–	–	(368)	–	(368)
Disposals	–	(8)	–	–	(24)	(32)
At 1 January 2012	**1,106**	**720**	**954**	**464**	**490**	**3,734**
Exchange differences	(4)	(2)	(4)	–	(1)	(11)
Additions	–	28	38	35	124	225
Acquisitions of businesses	10	–	–	–	9	19
Transferred from subsidiary to associate	–	–	(1)	–	–	(1)
Disposals	(1)	(6)	(6)	–	(3)	(16)
At 31 December 2012	**1,111**	**740**	**981**	**499**	**619**	**3,950**
Accumulated amortisation:						
At 1 January 2011	7	190	232	351	109	889
Charge for the year [1]	–	15	36	62	56	169
Transferred to assets held for sale	–	–	–	(182)	–	(182)
Disposals	–	(8)	–	–	(16)	(24)
At 1 January 2012	**7**	**197**	**268**	**231**	**149**	**852**
Charge for the year [1]	–	34	50	64	61	209
Impairment	3	–	–	–	–	3
Disposals	(1)	(6)	(6)	–	(2)	(15)
At 31 December 2012	**9**	**225**	**312**	**295**	**208**	**1,049**
Net book value:						
At 31 December 2012	**1,102**	**515**	**669**	**204**	**411**	**2,901**
At 31 December 2011	1,099	523	686	233	341	2,882
At 1 January 2011	1,108	496	630	346	304	2,884

[1] Charged to cost of sales except development costs, which are charged to research and development costs.

Goodwill

In accordance with the requirements of IAS 36 *Impairment of Assets*, goodwill is allocated to the Group's cash-generating units, or groups of cash-generating units, that are expected to benefit from the synergies of the business combination that gave rise to the goodwill as follows:

Cash-generating unit (CGU) or groups of CGUs

	Primary reporting segment	2012 £m	2011 £m
Rolls-Royce Deutschland Ltd & Co KG	Civil aerospace	**223**	230
Offshore marine – arising from the acquisitions of Vinters Limited and Scandinavian Electric Holdings AS	Marine	**649**	645
Offshore marine – arising from the acquisition of ODIM ASA	Marine	**115**	112
Other	Various	**115**	112
		1,102	1,099

8 **Intangible assets** (continued)

Goodwill has been tested for impairment during 2012 on the following basis:

- The carrying values of goodwill have been assessed by reference to value in use. These have been estimated using cash flows from the most recent forecasts prepared by management, which are consistent with past experience and external sources of information on market conditions. Given the long-term and established nature of many of the Group's products (product lives are often measured in decades), these forecast the next ten years. Growth rates for the period not covered by the forecasts are based on a range of growth rates (2.0 – 2.5 per cent) that reflect the products, industries and countries in which the relevant CGU or group of CGUs operate.
- The key assumptions for the impairment tests are the discount rate and, in the cash flow projections, the programme assumptions, the growth rates and the impact of foreign exchange rates on the relationship between selling prices and costs. Impairment tests are performed using prevailing exchange rates.
- The pre-tax cash flow projections have been discounted at **13** per cent (2011 13 per cent), based on the Group's weighted average cost of capital, adjusted for specific risks.

The principal value in use assumptions for goodwill balances considered to be individually significant are:

- Rolls-Royce Deutschland Ltd & Co KG – Volume of engine deliveries, flying hours of installed fleet and cost escalation. These are based on current and known future programmes, estimates of customers' fleet requirements and long-term economic forecasts. The principal foreign exchange exposure is on translating US dollar income into euros. For the purposes of the impairment test only, cash flows beyond the ten-year forecasts are assumed to grow at **2.5** per cent (2011 2.5 per cent). The directors do not consider that any reasonably possible change in the key assumptions would cause the value in use of the goodwill to fall below its carrying value. The overall level of business would need to reduce by more than **75** per cent to cause an impairment of this balance.
- Vinters Limited – Volume of equipment deliveries, capture of aftermarket and cost escalation. These are based on current and known future programmes, estimates of customers' fleet requirements and long-term economic forecasts. The principal foreign exchange exposures are on translating income in a variety of non-functional currencies into Norwegian kroner. For the purposes of the impairment test only, cash flows beyond the ten-year forecasts are assumed to grow at **2.5** per cent (2011 2.5 per cent). The directors do not consider that any reasonably possible change in the key assumptions would cause the value in use of the goodwill to fall below its carrying value. The overall level of business would need to reduce by more than **80** per cent to cause an impairment of this balance.

Other intangible assets

Certification costs and participation fees, development costs and recoverable engine costs have been reviewed for impairment in accordance with the requirements of IAS 36 *Impairment of Assets*. Where an impairment test was considered necessary, it has been performed on the following basis:

- The carrying values have been assessed by reference to value in use. These have been estimated using cash flows from the most recent forecasts prepared by management, which are consistent with past experience and external sources of information on market conditions over the lives of the respective programmes.
- The key assumptions underlying cash flow projections are assumed market share, programme timings, unit cost assumptions, discount rates, and foreign exchange rates.
- The pre-tax cash flow projections have been discounted at **11** per cent (2011 11 per cent), based on the Group's weighted average cost of capital, adjusted for specific risks.
- No impairment is required on this basis. However, a combination of changes in assumptions and adverse movements in variables that are outside the Group's control (discount rate, exchange rate and airframe delays), could result in impairment in future years.

9 Property, plant and equipment

	Land and buildings £m	Plant and equipment £m	Aircraft and engines £m	In course of construction £m	Total £m
Cost:					
At 1 January 2011	877	2,538	189	342	3,946
Exchange differences	(4)	(13)	–	1	(16)
Additions	17	80	52	318	467
Acquisitions of businesses	–	2	–	–	2
Reclassifications	78	123	5	(206)	–
Transferred to assets held for sale	15	–	(13)	–	2
Disposals	(2)	(84)	(17)	(1)	(104)
At 1 January 2012	**981**	**2,646**	**216**	**454**	**4,297**
Exchange differences	(14)	(25)	(1)	(9)	(49)
Additions	50	124	18	299	491
Acquisitions of businesses	–	45	–	–	45
Disposals of businesses	–	(4)	–	–	(4)
Reclassifications	60	168	4	(232)	–
Disposals	(5)	(65)	(14)	(1)	(85)
At 31 December 2012	**1,072**	**2,889**	**223**	**511**	**4,695**
Accumulated depreciation:					
At 1 January 2011	271	1,497	42	–	1,810
Exchange differences	(2)	(7)	–	–	(9)
Charge for the year [1]	39	185	15	–	239
Impairment	–	–	–	2	2
Reclassifications	3	(3)	–	–	–
Transferred to assets held for sale	6	–	(7)	–	(1)
Disposals	(2)	(74)	(6)	–	(82)
At 1 January 2012	**315**	**1,598**	**44**	**2**	**1,959**
Exchange differences	(3)	(13)	–	–	(16)
Charge for the year [1]	39	196	20	–	255
Reclassifications	7	(7)	–	–	–
Disposals of businesses	–	(2)	–	–	(2)
Disposals	(3)	(58)	(2)	(2)	(65)
At 31 December 2012	**355**	**1,714**	**62**	**–**	**2,131**
Net book value:					
At 31 December 2012	**717**	**1,175**	**161**	**511**	**2,564**
At 31 December 2011	666	1,048	172	452	2,338
At 1 January 2011	606	1,041	147	342	2,136

[1] Depreciation charged during the year is presented in the income statement or included in the cost of inventory as appropriate.

Property, plant and equipment includes:

	2012 £m	2011 £m
Net book value of finance leased assets:		
Land and buildings	**7**	7
Plant and equipment	**4**	5
Assets held for use in operating leases:		
Cost	**242**	235
Depreciation	**(65)**	(60)
Net book value	**177**	175
Capital expenditure commitments	**258**	196
Cost of fully depreciated assets	**721**	655

The Group's share of equity accounted entities' capital commitments is **£31m** (2011 £25m).

10 Investments

	Equity accounted			Other
	Joint ventures £m	Associates £m	Total £m	Unlisted £m
At 1 January 2011	393	–	393	11
Exchange differences	(62)	–	(62)	–
Additions	1,329	–	1,329	–
Taxation paid by the Group	3	–	3	–
Share of retained profit	40	–	40	–
Transferred to assets held for sale	(13)	–	(13)	–
Disposals	–	–	–	(1)
Share of OCI of joint ventures and associates – will not be reclassified to profit or loss	(3)	–	(3)	–
Share of OCI of joint ventures and associates – may be reclassified to profit or loss	(7)	–	(7)	–
At 1 January 2012	**1,680**	**–**	**1,680**	**10**
Exchange differences	(58)	–	(58)	–
Additions	191	–	191	–
Taxation paid by the Group	6	–	6	–
Transfer to subsidiary	(5)	–	(5)	–
Impairment	(2)	–	(2)	–
Share of retained profit	44	–	44	–
Transferred from subsidiary to associate	–	2	2	–
Disposals	–	–	–	(4)
Share of OCI of joint ventures and associates – will not be reclassified to profit or loss	(46)	–	(46)	–
Share of OCI of joint ventures and associates – may be reclassified to profit or loss	(12)	–	(12)	–
At 31 December 2012	**1,798**	**2**	**1,800**	**6**

	Joint ventures						Associates		Total	
	Engine Holding[1] £m	Other £m	2012 £m	Engine Holding[1] £m	Other £m	2011 £m	2012 £m	2011 £m	2012 £m	2011 £m
Assets:										
Non-current assets	**1,590**	**1,717**	**3,307**	1,687	1,529	3,216	**1**	–	**3,308**	3,216
Current assets	**718**	**818**	**1,536**	818	891	1,709	**2**	–	**1,538**	1,709
Liabilities:[2]										
Current liabilities	**(421)**	**(655)**	**(1,076)**	(477)	(793)	(1,270)	**(1)**	–	**(1,077)**	(1,270)
Non-current liabilities	**(559)**	**(1,410)**	**(1,969)**	(779)	(1,196)	(1,975)	**–**	–	**(1,969)**	(1,975)
	1,328	**470**	**1,798**	1,249	431	1,680	**2**	–	**1,800**	1,680
[2] Liabilities include borrowings of:	**(103)**	**(1,271)**	**(1,374)**	(176)	(1,176)	(1,352)	**–**	–	**(1,374)**	(1,352)
Revenue	**1,223**	**2,827**	**4,050**	491	3,055	3,546	**3**	–	**4,053**	3,546
Profit before financing and taxation	**33**	**189**	**222**	(13)	165	152	**–**	–	**222**	152
Net financing	**(10)**	**(22)**	**(32)**	(12)	(19)	(31)	**–**	–	**(32)**	(31)
Taxation	**(1)**	**(16)**	**(17)**	10	(15)	(5)	**–**	–	**(17)**	(5)
Results recognised in the consolidated income statement	**22**	**151**	**173**	(15)	131	116	**–**	–	**173**	116
Dividends received	**(28)**	**(101)**	**(129)**	–	(76)	(76)	**–**	–	**(129)**	(76)
Retained profit	**(6)**	**50**	**44**	(15)	55	40	**–**	–	**44**	40

[1] At 31 December 2012, Engine Holding (the 50:50 collaboration with Daimler AG) held 99 per cent of the Tognum shares. As part of the Engine Holding shareholders' agreement, certain conditions allow the Group to exercise rights and classify Tognum as a subsidiary and consolidate it. These conditions were fulfilled and the rights exercised on 1 January 2013. Daimler AG has the option to sell, for a period of six years, from 1 January 2013, at a specified price, its shares in Engine Holding to Rolls-Royce. The fair value of this option was not significant at 31 December 2012. Further detail is shown in note 26.

The principal joint ventures at 31 December 2012 are listed on pages 127 and 128.

11 Inventories

	2012 £m	2011 £m
Raw materials	**336**	319
Work in progress	**1,056**	921
Long-term contracts work in progress	**10**	12
Finished goods	**1,282**	1,267
Payments on account	**42**	42
	2,726	2,561
Inventories stated at net realisable value	**136**	169
Amount of inventory write-down	**64**	114
Reversal of inventory write-down	**1**	3

12 Trade and other receivables

	2012 £m	2011 £m
Trade receivables	**1,182**	1,123
Amounts recoverable on contracts [1]	**1,902**	1,665
Amounts owed by joint ventures and associates	**351**	421
Loan to Engine Holding GmbH	**–**	169
Other receivables	**479**	475
Prepayments and accrued income	**205**	156
	4,119	4,009
Analysed as:		
Financial instruments (note 17):		
Trade receivables and similar items	**1,662**	1,655
Other non-derivative financial assets	**364**	550
Non-financial instruments	**2,093**	1,804
	4,119	4,009
Trade and other receivables expected to be recovered in more than one year:		
Trade receivables	**40**	4
Amounts recoverable on contracts	**1,473**	1,314
Amounts owed by joint ventures and associates	**3**	20
Other receivables	**63**	60
Prepayments and accrued income	**32**	28
	1,611	1,426

[1] The balance at 31 December 2012 includes an allowance of **£80m** (2011 £63m), being the directors' best estimate of the loss that will occur from the Group's contract with EPI Europrop International GmbH to participate in the development of the TP400 engine for the A400M military transport aircraft.

13 Cash and cash equivalents

	2012 £m	2011 £m
Cash at bank and in hand	**674**	1,285
Money-market funds	**408**	11
Short-term deposits	**1,503**	14
	2,585	1,310
Overdrafts (note 15)	**–**	(19)
Cash and cash equivalents per cash flow statement (page 76)	**2,585**	1,291
Cash held as collateral against third party obligations (note 23)	**64**	67

14 Assets held for sale

	2012 £m	2011 £m
Intangible assets – recoverable engine costs	–	186
Property, plant and equipment	4	6
Investment in joint venture	–	13
Amounts recoverable on contracts	–	59
Amounts owed by joint ventures	–	49
Assets held for sale	4	313
Accruals and deferred income	–	(54)
Other payables	–	(26)
Provisions for liabilities and charges	–	(9)
Deferred tax liabilities	–	(46)
Liabilities associated with assets held for sale	–	(135)

On 12 October 2011, the Group announced an agreement to form a new partnership with Pratt & Whitney, a United Technologies Corporation company, to develop new engines for the next generation of mid-size aircraft (120-230 seats). As part of this agreement, on 29 June 2012, the Group and Pratt & Whitney restructured their participation in IAE, which produces the V2500 engine for the Airbus A320 family of aircraft. Rolls-Royce sold its equity, programme share and related goodwill in IAE to Pratt & Whitney for US$1.5 billion.

As Rolls-Royce continues to be responsible for the manufacture of high-pressure compressors, fan blades as well as the provision of engine support and final assembly of 50 per cent of V2500 engines, the transaction was not considered to give rise to a discontinued operation.

15 Borrowings

	Current		Non-current		Total	
	2012 £m	2011 £m	2012 £m	2011 £m	2012 £m	2011 £m
Unsecured						
Overdrafts	–	19	–	–	–	19
Bank loans	2	1	404	204	406	205
7$^{3}/_{8}$% Notes 2016 £200m	–	–	200	200	200	200
6.38% Notes 2013 US$230m [1]	147	–	–	160	147	160
6.55% Notes 2015 US$83m [1]	–	–	58	62	58	62
6.75% Notes 2019 £500m [2]	–	–	571	557	571	557
Secured						
Obligations under finance leases [3]:	–	–	1	1	1	1
	149	20	1,234	1,184	1,383	1,204

1 These notes are the subject of interest rate swap agreements under which the Group has undertaken to pay floating rates of interest, and currency swaps which form a fair value hedge.
2 These notes are the subject of interest rate swap agreements under which the Group has undertaken to pay floating rates of interest which form a fair value hedge.
3 Obligations under finance leases are secured by related leased assets.

16 Trade and other payables

	Current		Non-current		Total	
	2012 **£m**	2011 £m	**2012** **£m**	2011 £m	**2012** **£m**	2011 £m
Payments received on account [1]	**1,361**	1,396	**609**	487	**1,970**	1,883
Trade payables	**1,109**	1,028	**–**	–	**1,109**	1,028
Amounts owed to joint ventures and associates	**202**	215	**1**	1	**203**	216
Other taxation and social security	**107**	88	**–**	–	**107**	88
Other payables	**1,574**	1,623	**95**	58	**1,669**	1,681
Accruals and deferred income	**2,034**	1,886	**760**	768	**2,794**	2,654
	6,387	6,236	**1,465**	1,314	**7,852**	7,550
[1] Includes payments received on account from joint ventures and associates	**262**	358	**162**	147	**424**	505

Included within accruals and deferred income are government grants of **£89m** (2011 £104m). During the year, **£16m** (2011 £2m) of government grants were released to the income statement.

Trade and other payables are analysed as follows:

	2012 **£m**	2011 £m
Financial instruments (note 17):		
Trade payables and similar items	**2,571**	2,356
Other non-derivative financial liabilities	**704**	718
Non-financial instruments	**4,577**	4,476
	7,852	7,550

17 Financial instruments

Carrying values and fair values of financial instruments

	Notes	Basis for determining fair value	Assets: Held for trading £m	Assets: Loans and receivables £m	Assets: Available for sale £m	Assets: Cash £m	Liabilities: Held for trading £m	Liabilities: Other £m	Total £m
At 31 December 2012									
Unlisted non-current asset investments	10	A	**–**	**6**	**–**	**–**	**–**	**–**	**6**
Trade receivables and similar items	12	B	**–**	**1,662**	**–**	**–**	**–**	**–**	**1,662**
Other non-derivative financial assets	12	B	**–**	**364**	**–**	**–**	**–**	**–**	**364**
Derivative financial assets		C	**707**	**–**	**–**	**–**	**–**	**–**	**707**
Short-term investments		B	**–**	**11**	**–**	**–**	**–**	**–**	**11**
Cash and cash equivalents	13	B	**–**	**1,503**	**408**	**674**	**–**	**–**	**2,585**
Borrowings	15	D	**–**	**–**	**–**	**–**	**–**	**(1,383)**	**(1,383)**
Derivative financial liabilities		C	**–**	**–**	**–**	**–**	**(360)**	**–**	**(360)**
Put option on non-controlling interests		E	**–**	**–**	**–**	**–**	**–**	**(167)**	**(167)**
Financial RRSPs		D	**–**	**–**	**–**	**–**	**–**	**(193)**	**(193)**
C Shares		B	**–**	**–**	**–**	**–**	**–**	**(10)**	**(10)**
Trade payables and similar items	16	B	**–**	**–**	**–**	**–**	**–**	**(2,571)**	**(2,571)**
Other non-derivative financial liabilities	16	B	**–**	**–**	**–**	**–**	**–**	**(704)**	**(704)**
			707	**3,546**	**408**	**674**	**(360)**	**(5,028)**	**(53)**
At 31 December 2011									
Unlisted non-current asset investments	10	A	–	10	–	–	–	–	10
Trade receivables and similar items	12	B	–	1,655	–	–	–	–	1,655
Other non-derivative financial assets	12	B	–	550	–	–	–	–	550
Derivative financial assets		C	418	–	–	–	–	–	418
Short-term investments		B	–	11	–	–	–	–	11
Cash and cash equivalents	13	B	–	14	11	1,285	–	–	1,310
Borrowings	15	D	–	–	–	–	–	(1,204)	(1,204)
Derivative financial liabilities		C	–	–	–	–	(796)	–	(796)
Financial RRSPs		D	–	–	–	–	–	(230)	(230)
C Shares		B	–	–	–	–	–	(4)	(4)
Trade payables and similar items	16	B	–	–	–	–	–	(2,356)	(2,356)
Other non-derivative financial liabilities	16	B	–	–	–	–	–	(718)	(718)
			418	2,240	11	1,285	(796)	(4,512)	(1,354)

Fair values equate to book values for both 2012 and 2011, with the following exceptions:

	2012 Book value £m	2012 Fair value £m	2011 Book value £m	2011 Fair value £m
Borrowings	**(1,383)**	**(1,542)**	(1,204)	(1,371)
Financial RRSPs	**(193)**	**(215)**	(230)	(254)

The fair value of a financial instrument is the price at which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arms-length transaction. Fair values have been determined with reference to available market information at the balance sheet date, using the methodologies described below.

A These primarily comprise bank deposits where the fair value approximates to the book value.
B Fair values are assumed to approximate to cost either due to the short-term maturity of the instruments or because the interest rate of the investments is reset after periods not exceeding six months.
C Fair values of derivative financial assets and liabilities are estimated by discounting expected future contractual cash flows using prevailing interest rate curves. Amounts denominated in foreign currencies are valued at the exchange rate prevailing at the balance sheet date. These financial instruments are included on the balance sheet at fair value, derived from observable market prices (Level 2 as defined by IFRS 7 *Financial Instruments: Disclosures*).
D Borrowing and financial RRSPs are carried at amortised cost. Fair values are estimated by discounting expected future contractual cash flows using prevailing interest rate curves. Amounts denominated in foreign currencies are valued at the exchange rate prevailing at the balance sheet date. For financial RRSPs, the contractual cash flows are based on future trading activity, which is estimated based on latest forecasts.
E The fair value of the put option on NCI is determined in accordance with the contractual terms (Level 3 as defined by IFRS 7).

17 Financial instruments (continued)

Carrying values of other financial assets and liabilities

	Foreign exchange contracts £m	Commodity contracts £m	Interest rate contracts £m	Total derivatives £m	Put option on non-controlling interests £m	Financial RRSPs £m	C Shares £m	Total £m
At 31 December 2012								
Non-current assets	**498**	**4**	**90**	**592**	**–**	**–**	**–**	**592**
Current assets	**104**	**6**	**5**	**115**	**–**	**–**	**–**	**115**
	602	**10**	**95**	**707**	**–**	**–**	**–**	**707**
Current liabilities	**(97)**	**(8)**	**–**	**(105)**	**(167)**	**(30)**	**(10)**	**(312)**
Non-current liabilities	**(233)**	**(15)**	**(7)**	**(255)**	**–**	**(163)**	**–**	**(418)**
	(330)	**(23)**	**(7)**	**(360)**	**(167)**	**(193)**	**(10)**	**(730)**
	272	**(13)**	**88**	**347**	**(167)**	**(193)**	**(10)**	**(23)**
At 31 December 2011								
Non-current assets	237	7	83	327	–	–	–	327
Current assets	84	7	–	91	–	–	–	91
	321	14	83	418	–	–	–	418
Current liabilities	(85)	(7)	–	(92)	–	(15)	(4)	(111)
Non-current liabilities	(683)	(19)	(2)	(704)	–	(215)	–	(919)
	(768)	(26)	(2)	(796)	–	(230)	(4)	(1,030)
	(447)	(12)	81	(378)	–	(230)	(4)	(612)

Derivative financial instruments

The Group uses various financial instruments to manage its exposure to movements in foreign exchange rates. Where the effectiveness of a hedging relationship in a cash flow hedge is demonstrated, changes in the fair value that are deemed effective are included in the cash flow hedge reserve and released to match actual payments on the hedged item. The Group uses commodity swaps to manage its exposure to movements in the price of commodities (jet fuel and base metals). To hedge the currency risk associated with a borrowing denominated in US dollars, the Group has currency derivatives designated as part of fair value hedges. The Group uses interest rate swaps, forward rate agreements and interest rate caps to manage its exposure to movements in interest rates.

Movements in the fair values of derivative financial assets and liabilities were as follows:

	Foreign exchange instruments £m	Commodity instruments £m	Interest rate instruments £m	Total £m
At 1 January 2011	(336)	21	175	(140)
Movements in fair value hedges [1]	2	–	83	85
Movements in cash flow hedges	(1)	–	–	(1)
Movements in other derivative contracts [2]	(21)	(28)	1	(48)
Contracts settled [3]	(91)	(5)	(178)	(274)
At 1 January 2012	**(447)**	**(12)**	**81**	**(378)**
Movements in fair value hedges [1]	(8)	–	6	(2)
Movements in cash flow hedges	(4)	–	–	(4)
Movements in other derivative contracts [2]	750	(3)	1	748
Contracts settled [3]	(19)	2	–	(17)
At 31 December 2012	**272**	**(13)**	**88**	**347**

[1] Net gain on related hedged items **£2m** (2011 £85m net loss).
[2] Included in financing.
[3] Includes contracts settled in fair value hedges **£nil** (2011 £1m loss) and cash flow hedges **£4m** loss (2011: nil).

Put option on NCI and financial risk and revenue sharing partnerships (RRSPs)

The Group has agreed a put option with Daimler AG, such that Daimler can sell its interest in Engine Holding GmbH to the Group. The fair value of the exercise value of this option that relates to Bergen Engines AS is included as a financial liability (see also note 26). The Group has financial liabilities arising from financial RRSPs. These financial liabilities are valued at each reporting date using the amortised cost method. This involves calculating the present value of the forecast cash flows of the arrangements using the internal rate of return at the inception of the arrangements as the discount rate.

17 Financial instruments (continued)

Movements in the carrying values were as follows:

	Put option on NCI	Financial RRSPs	
	2012 £m	2012 £m	2011 £m
At 1 January	–	(230)	(266)
Cash paid to partners	–	35	46
Additions	(167)		–
Exchange adjustments included in OCI	–	1	(1)
Financing charge [1]		(10)	(11)
Excluded from underlying profit:			
Change in put option exercise price [1]	(5)		
Exchange adjustments [1]	5	9	1
Changes in forecast payments [1]		2	1
At 31 December	(167)	(193)	(230)

[1] Included in financing.

Risk management policies and hedging activities

The principal financial risks to which the Group is exposed are: foreign currency exchange rate risk; liquidity risk; credit risk; interest rate risk; and commodity price risk. The Board has approved policies for the management of these risks.

Foreign currency exchange rate risk – The Group has significant cash flows (most significantly US dollars, followed by the euro) denominated in currencies other than the functional currency of the relevant trading entity. To manage its exposures to changes in values of future foreign currency cash flows, so as to maintain relatively stable long-term foreign exchange rates on settled transactions, the Group enters into derivative forward foreign currency transactions. For accounting purposes, these derivative contracts are not designated as hedging instruments.

The Group also has exposures to the fair values of non-derivative financial instruments denominated in foreign currencies. To manage the risk of changes in these fair values, the Group enters into derivative forward foreign exchange contracts, which are designated as fair value hedges for accounting purposes.

The Group regards its interests in overseas subsidiary companies as long-term investments. The Group aims to match its translational exposures by matching the currencies of assets and liabilities. Where appropriate, foreign currency financial liabilities may be designated as hedges of the net investment.

Liquidity risk – The Group's policy is to hold financial investments and maintain undrawn committed facilities at a level sufficient to ensure that the Group has available funds to meet its medium-term capital and funding obligations and to meet any unforeseen obligations and opportunities. The Group holds cash and short-term investments, which together with the undrawn committed facilities, enable the Group to manage its liquidity risk. The profile of the maturity of the Group's committed facilities is discussed on page 37.

Credit risk – The Group is exposed to credit risk to the extent of non-payment by either its customers or the counterparties of its financial instruments. The effective monitoring and controlling of credit risk is a key component of the Group's risk management activities. The Group has credit policies covering both trading and financial exposures. Credit risks arising from treasury activities are managed by a central treasury function in accordance with the Group credit policy. The objective of the policy is to diversify and minimise the Group's exposure to credit risk from its treasury activities by ensuring the Group transacts strictly with 'BBB+' or higher rated financial institutions based on pre-established limits per financial institution. At the balance sheet date, there were no significant concentrations of credit risk to individual customers or counterparties. The maximum exposure to credit risk at the balance sheet date is represented by the carrying value of each financial asset, including derivative financial instruments.

Interest rate risk – The Group's interest rate risk is primarily in relation to its fixed rate borrowings (fair value risk), floating rate borrowings and cash and cash equivalents (cash flow risk). Interest rate derivatives are used to manage the overall interest rate profile within the Group policy, which is to maintain a higher proportion of net debt at floating rates of interest as a natural hedge to the net cash position. These are designated as either fair value or cash flow hedges as appropriate.

Commodity risk – The Group has exposures to the price of jet fuel and base metals arising from business operations. To minimise its cash flow exposures to changes in commodity prices, the Group enters into derivative commodity transactions. For accounting purposes, these derivative contracts are not designated as hedging instruments.

Other price risk – The Group's cash equivalent balances represent investments in money market instruments, with a term of up to three months. The Group does not consider that these are subject to significant price risk.

17 Financial instruments (continued)

Derivative financial instruments

The nominal amounts, analysed by year of expected maturity, and fair values of derivative financial instruments are as follows:

		Expected maturity				Fair value	
	Nominal amount £m	Within one year £m	Between one and two years £m	Between two and five years £m	After five years £m	Assets £m	Liabilities £m
At 31 December 2012							
Foreign exchange contracts:							
Fair value hedges	**175**	**129**	**–**	**46**	**–**	**15**	**–**
Non-hedge accounted	**17,701**	**4,585**	**3,542**	**9,029**	**545**	**587**	**(330)**
Interest rate contracts:							
Fair value hedges	**692**	**141**	**51**	**–**	**500**	**89**	**–**
Non-hedge accounted	**7**	**–**	**–**	**7**	**–**	**6**	**(7)**
Commodity contracts:							
Non-hedge accounted	**286**	**76**	**68**	**99**	**43**	**10**	**(23)**
	18,861	**4,931**	**3,661**	**9,181**	**1,088**	**707**	**(360)**
At 31 December 2011							
Foreign exchange contracts:							
Fair value hedges	175	–	129	46	–	23	–
Non-hedge accounted	17,563	5,438	3,625	7,568	932	298	(768)
Interest rate contracts:							
Fair value hedges	701	–	148	53	500	83	–
Non-hedge accounted	43	–	–	43	–	–	(2)
Commodity contracts:							
Non-hedge accounted	220	68	59	93	–	14	(26)
	18,702	5,506	3,961	7,803	1,432	418	(796)

As described above, all derivative financial instruments are entered into for risk management purposes, although these may not be designated into hedging relationships for accounting purposes.

Currency analysis

Derivative financial instruments related to foreign exchange risks are denominated in the following currencies:

	Currencies purchased forward				
	Sterling £m	US dollar £m	Euro £m	Other £m	Total £m
At 31 December 2012					
Currencies sold forward:					
Sterling	**–**	**495**	**–**	**23**	**518**
US dollar	**14,407**	**–**	**1,817**	**840**	**17,064**
Euro	**–**	**–**	**–**	**177**	**177**
Other	**21**	**11**	**70**	**15**	**117**
At 31 December 2011					
Currencies sold forward:					
Sterling	–	814	–	147	961
US dollar	14,401	–	1,193	834	16,428
Euro	–	–	–	197	197
Other	36	26	67	23	152

Other derivative financial instruments are denominated in the following currencies:

	2012 £m	2011 £m
Sterling	**506**	510
US dollar	**479**	421
Other	**–**	33

17 Financial instruments (continued)

Non-derivative financial instruments are denominated in the following currencies:

	Sterling £m	US dollar £m	Euro £m	Other £m	Total £m
At 31 December 2012					
Assets					
Unlisted non-current investments	**1**	**–**	**4**	**1**	**6**
Trade receivables and similar items	**234**	**1,176**	**169**	**83**	**1,662**
Other non-derivative financial assets	**121**	**75**	**40**	**128**	**364**
Short-term investments	**5**	**–**	**–**	**6**	**11**
Cash and cash equivalents	**495**	**1,038**	**606**	**446**	**2,585**
	856	**2,289**	**819**	**664**	**4,628**
Liabilities					
Borrowings	**(1,173)**	**(205)**	**(5)**	**–**	**(1,383)**
Put option on non-controlling interests	**–**	**–**	**(167)**	**–**	**(167)**
Financial RRSPs	**–**	**(139)**	**(54)**	**–**	**(193)**
C Shares	**(10)**	**–**	**–**	**–**	**(10)**
Trade payables and similar items	**(1,254)**	**(825)**	**(289)**	**(203)**	**(2,571)**
Other non-derivative financial liabilities	**(250)**	**(320)**	**(17)**	**(117)**	**(704)**
	(2,687)	**(1,489)**	**(532)**	**(320)**	**(5,028)**
	(1,831)	**800**	**287**	**344**	**(400)**
At 31 December 2011					
Assets					
Unlisted non-current investments	1	–	4	5	10
Trade receivables and similar items	204	1,201	133	117	1,655
Other non-derivative financial assets	112	87	217	134	550
Short-term investments	5	–	–	6	11
Cash and cash equivalents	50	657	367	236	1,310
	372	1,945	721	498	3,536
Liabilities					
Borrowings	(977)	(222)	(5)	–	(1,204)
Financial RRSPs	–	(173)	(57)	–	(230)
C Shares	(4)	–	–	–	(4)
Trade payables and similar items	(1,095)	(812)	(275)	(174)	(2,356)
Other non-derivative financial liabilities	(252)	(308)	(18)	(140)	(718)
	(2,328)	(1,515)	(355)	(314)	(4,512)
	(1,956)	430	366	184	(976)

Currency exposures

The Group's actual currency exposures after taking account of derivative foreign currency contracts, which are not designated as hedging instruments for accounting purposes are as follows:

Functional currency of Group operation	Sterling £m	US dollar £m	Euro £m	Other £m	Total £m
At 31 December 2012					
Sterling	**–**	**22**	**(166)**[1]	**4**	**(140)**
US dollar	**4**	**–**	**(6)**	**5**	**3**
Euro	**(1)**	**(2)**	**–**	**–**	**(3)**
Other	**6**	**1**	**(5)**	**1**	**3**
At 31 December 2011					
Sterling	–	1	–	3	4
US dollar	3	–	(2)	10	11
Euro	(1)	(1)	–	–	(2)
Other	1	4	1	3	9

[1] Includes £167m relating to the put option on Daimler's interest in Bergen Engines AS — see note 10.

17 Financial instruments (continued)

Ageing beyond contractual due date of financial assets

	Within terms £m	Up to three months overdue £m	Between three months and one year overdue £m	More than one year overdue £m	Total £m
At 31 December 2012					
Unlisted non-current asset investments	**6**	**–**	**–**	**–**	**6**
Trade receivables and similar items	**1,470**	**132**	**43**	**17**	**1,662**
Other non-derivative financial assets	**343**	**18**	**1**	**2**	**364**
Derivative financial assets	**707**	**–**	**–**	**–**	**707**
Short-term investments	**11**	**–**	**–**	**–**	**11**
Cash and cash equivalents	**2,585**	**–**	**–**	**–**	**2,585**
	5,122	**150**	**44**	**19**	**5,335**
At 31 December 2011					
Unlisted non-current asset investments	10	–	–	–	10
Trade receivables and similar items	1,377	184	68	26	1,655
Other non-derivative financial assets	532	15	–	3	550
Derivative financial assets	418	–	–	–	418
Short-term investments	11	–	–	–	11
Cash and cash equivalents	1,310	–	–	–	1,310
	3,658	199	68	29	3,954

Contractual maturity analysis of financial liabilities

	Gross values					
	Within one year £m	Between one and two years £m	Between two and five years £m	After five years £m	Discounting £m	Carrying value £m
At 31 December 2012						
Borrowings	**(210)**	**(257)**	**(403)**	**(778)**	**265**	**(1,383)**
Derivative financial liabilities	**(108)**	**(103)**	**(138)**	**(14)**	**3**	**(360)**
Put option on non-controlling interests	**(167)**	**–**	**–**	**–**	**–**	**(167)**
Financial RRSPs	**(35)**	**(32)**	**(75)**	**(100)**	**49**	**(193)**
C Shares	**(10)**	**–**	**–**	**–**	**–**	**(10)**
Trade payables and similar items	**(2,568)**	**(1)**	**(1)**	**(1)**	**–**	**(2,571)**
Other non-derivative financial liabilities	**(694)**	**(10)**	**–**	**–**	**–**	**(704)**
	(3,792)	**(403)**	**(617)**	**(893)**	**317**	**(5,388)**
At 31 December 2011						
Borrowings	(85)	(213)	(608)	(603)	305	(1,204)
Derivative financial liabilities	(92)	(199)	(419)	(48)	(38)	(796)
Financial RRSPs	(37)	(37)	(91)	(127)	62	(230)
C Shares	(4)	–	–	–	–	(4)
Trade payables and similar items	(2,353)	(1)	(1)	(1)	–	(2,356)
Other non-derivative financial liabilities	(715)	(2)	–	(1)	–	(718)
	(3,286)	(452)	(1,119)	(780)	329	(5,308)

17 Financial instruments (continued)

Interest rate risk

In respect of income earning financial assets and interest bearing financial liabilities, the following table indicates their effective interest rates and the periods in which they reprice. The value shown is the carrying amount.

			2012 Period in which interest rate reprices				
	Effective interest rate %	Total £m	6 months or less £m	6-12 months £m	1-2 years £m	2-5 years £m	More than 5 years £m
Short-term investments [1]	4.1927%	11	9	2	–	–	–
Cash and cash equivalents [2]		2,585	2,585	–	–	–	–
Unsecured bank loans							
€2m floating rate loan	0.5000%	(2)	–	–	–	–	(2)
€5m floating rate loan	EURIBOR + 0.75	(4)	(4)	–	–	–	–
Overdrafts [3]		–	–	–	–	–	–
Interest rate swaps	5.3225%	–	7	–	–	(7)	–
£200m floating rate loan	GBP LIBOR + 0.267	(200)	(200)	–	–	–	–
£200m floating rate loan	GBP LIBOR + 1.26	(200)	(200)	–	–	–	–
Unsecured bond issues							
7$^{3}/_{8}$% Notes 2016 £200m	7.3750%	(200)	–	–	–	(200)	–
6.38% Notes 2013 US$230m	6.3800%	(147)	–	(147)	–	–	–
Effect of interest rate swaps	USD LIBOR + 1.26	–	(147)	147	–	–	–
6.55% Notes 2015 US$83m	6.5500%	(58)	–	–	–	(58)	–
Effect of interest rate swaps	USD LIBOR + 1.24	–	(58)	–	–	58	–
6.75% Notes 2019 £500m	6.7500%	(571)	–	–	–	–	(571)
Effect of interest rate swaps	GBP LIBOR + 2.9824	–	(571)	–	–	–	571
Other secured							
Obligations under finance leases	5.0000%	(1)	–	–	–	–	(1)
		1,213	1,421	2	–	(207)	(3)

			2011 Period in which interest rate reprices				
	Effective interest rate %	Total £m	6 months or less £m	6-12 months £m	1-2 years £m	2-5 years £m	More than 5 years £m
Short-term investments [1]	4.3782%	11	9	2	–	–	–
Cash and cash equivalents [2]		1,310	1,310	–	–	–	–
Unsecured bank loans							
€2m floating rate loan	0.5000%	(2)	–	–	–	–	(2)
€5m floating rate loan	EURIBOR + 0.75	(3)	(3)	–	–	–	–
Overdrafts [3]		(19)	(19)	–	–	–	–
Interest rate swaps	10.8775%	–	10	–	–	(10)	–
£200m floating rate loan	GBP LIBOR + 0.267	(200)	(200)	–	–	–	–
Unsecured bond issues							
7$^{3}/_{8}$% Notes 2016 £200m	7.3750%	(200)	–	–	–	(200)	–
6.38% Notes 2013 US$230m	6.3800%	(160)	–	–	(160)	–	–
Effect of interest rate swaps	USD LIBOR + 1.26	–	(160)	–	160	–	–
6.55% Notes 2015 US$83m	6.5500%	(62)	–	–	–	(62)	–
Effect of interest rate swaps	USD LIBOR + 1.24	–	(62)	–	–	62	–
6.75% Notes 2019 £500m	6.7500%	(557)	–	–	–	–	(557)
Effect of interest rate swaps	GBP LIBOR + 2.9824	–	(557)	–	–	–	557
Other secured							
Obligations under finance leases	5.0000%	(1)	–	–	–	–	(1)
		117	328	2	–	(210)	(3)

1 Interest on the short-term investments is at fixed rates.
2 Cash and cash equivalents comprise bank balances and demand deposits and earns interest at rates based on daily deposit rates.
3 Overdrafts bear interest at rates linked to applicable LIBOR rates that fluctuate in accordance with local practice.

Some of the Group's borrowings are subject to the Group meeting certain obligations, including customary financial covenants. If the Group fails to meet its obligations these arrangements give rights to the lenders, upon agreement, to accelerate repayment of the facilities. There are no rating triggers contained in any of the Group's facilities that could require the Group to accelerate or repay any facility for a given movement in the Group's credit rating.

17 Financial instruments (continued)

In addition, the Group has undrawn committed borrowing facilities available as follows:

	2012 £m	2011 £m
Expiring after two years	**1,000**	1,200

Sensitivity analysis

Sensitivities at 31 December (all other variables held constant) – impact on profit after tax and equity	2012 £m	2011 £m
Sterling 10% weaker against the US dollar	**(1,073)**	(1,083)
Sterling 10% stronger against the US dollar	**878**	886
Euro 10% weaker against the US dollar	**(146)**	(93)
Euro 10% stronger against the US dollar	**118**	78
Commodity prices 10% lower	**(20)**	(15)
Commodity prices 10% higher	**20**	15

At 31 December 2012 the Group had no material sensitivity to changes in interest rates on that date. The main interest rate sensitivity for the Group arises as a result of the gross up of net funds and this is mitigated as described under the interest rate risk management policies on page 104.

C Shares and payments to shareholders

The Company (and previously Rolls-Royce Group plc, the former holding company) issues non-cumulative redeemable preference shares (C Shares) as an alternative to paying a cash dividend. C Shares in respect of a year are issued in the following year. Shareholders are able to redeem any number of their C Shares for cash. Any C Shares retained attract a dividend of 75 per cent of LIBOR on the 0.1p nominal value of each share, paid on a twice-yearly basis in arrears, and have limited voting rights. In certain circumstances the Company has the option to compulsorily redeem the C Shares, at any time, if the aggregate number of C Shares in issue is less than ten per cent of the aggregate number of C Shares issued, or on the acquisition or capital restructuring of the Company. As part of the scheme of arrangement described on page 78, all outstanding C Shares issued by Rolls-Royce Group plc were redeemed on 6 April 2011.

Movements in the C Shares during the year were as follows:

	2012		2011	
	Millions	Nominal value £m	Millions	Nominal value £m
Issued and fully paid				
At 1 January	**6,371**	**6**	23,380	23
Issued	327,643	328	299,522	300
Redeemed	(323,596)	(324)	(316,531)	(317)
C Shares in issue	**10,418**	**10**	6,371	6
Held in employee share trust	–	–	(1,999)	(2)
At 31 December	**10,418**	**10**	4,372	4

Payments to shareholders in respect of the year represent the value of C Shares to be issued in respect of the results for the year. Issues of C Shares were declared as follows:

	2012		2011	
	Pence per share	£m	Pence per share	£m
Interim	**7.6**	**142**	6.9	129
Final	**11.9**	**223**	10.6	199
	19.5	**365**	17.5	328

18 Provisions for liabilities and charges

	At 1 January 2012 £m	Exchange differences £m	Acquisitions of businesses £m	Disposals of businesses £m	Unused amounts reversed £m	Charged to income statement £m	Utilised £m	At 31 December 2012 £m
Warranty and guarantees	**285**	(3)	7	–	(18)	42	(66)	**247**
Contract loss	**52**	(1)	–	–	(8)	29	(18)	**54**
Restructuring	**6**	–	–	–	(1)	–	(1)	**4**
Customer financing	**81**	(1)	–	–	–	2	–	**82**
Insurance	**51**	–	–	–	(21)	31	(14)	**47**
Other	**27**	–	–	(3)	(4)	10	(3)	**27**
	502	(5)	7	(3)	(52)	114	(102)	**461**
Current liabilities	**276**							**220**
Non-current liabilities	**226**							**241**

Provisions for warranties and guarantees primarily relate to products sold and generally cover a period of up to three years.

Provisions for contract loss and restructuring are generally expected to be utilised within two years.

Customer financing provisions cover guarantees provided for asset value and/or financing. These guarantees are considered to be insurance contracts in nature and provision is made in accordance with IFRS 4 *Insurance Contracts* and IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. These guarantees, the risks arising and the process used to assess the extent of the risk are described under the heading 'Customer financing' in the Chief Financial Officer's review on page 14. The related contingent liabilities arising from these guarantees and the sensitivity to movements in the value of the underlying security are discussed in note 23. It is estimated that the provision will be utilised as follows:

	2012 £m	2011 £m
Potential claims with specific claim dates:		
In one year or less	**30**	12
In more than one year but less than five years	**43**	62
In more than five years	**8**	6
Potential claims that may arise at any time up to the date of expiry of the guarantee:		
Up to one year	**–**	–
Up to five years	**1**	1
Thereafter	**–**	–
	82	81

The Group's captive insurance company retains a portion of the exposures it insures on behalf of the remainder of the Group. Significant delays occur in the notification and settlement of claims and judgement is involved in assessing outstanding liabilities, the ultimate cost and timing of which cannot be known with certainty at the balance sheet date. The insurance provisions are based on information currently available, however it is inherent in the nature of the business that ultimate liabilities may vary. Provisions for outstanding claims are established to cover the outstanding expected liability as well as claims incurred but not yet reported.

Other provisions comprise a number of liabilities with varying expected utilisation rates.

19 Post-retirement benefits

The Group operates a number of defined benefit and defined contribution schemes.

For the UK defined benefit schemes, the assets are held in separate trustee administered funds and employees are entitled to retirement benefits based on either their final or career average salaries and length of service.

Overseas defined benefit schemes are a mixture of funded and unfunded plans. Additionally in the US, and to a lesser extent in some other countries, the Group's employment practices include the provision of healthcare and life insurance benefits for retired employees. These schemes are unfunded.

19 Post-retirement benefits (continued)

The valuations of the defined benefit schemes are based on the most recent funding valuations, updated by the scheme actuaries to 31 December 2012. The most recent funding valuations of the main UK schemes were:

Scheme	Valuation date
Rolls-Royce Pension Fund	31 March 2009
Rolls-Royce Group Pension Scheme	5 April 2010
Vickers Group Pension Scheme	31 March 2010

Amounts recognised in the income statement

	2012			2011		
	UK schemes £m	Overseas schemes £m	Total £m	UK schemes £m	Overseas schemes £m	Total £m
Defined benefit schemes:						
Current service cost	**123**	**38**	**161**	119	34	153
Past-service cost/(credit)	**2**	**(12)**	**(10)**	(126)	(68)	(194)
Curtailment	**–**	**–**	**–**	–	(2)	(2)
	125	**26**	**151**	(7)	(36)	(43)
Defined contribution schemes	**23**	**41**	**64**	16	38	54
Operating cost	**148**	**67**	**215**	9	2	11
Financing in respect of defined benefit schemes:						
Expected return on assets	**(315)**	**(26)**	**(341)**	(381)	(29)	(410)
Interest on liabilities	**356**	**49**	**405**	372	50	422
	41	**23**	**64**	(9)	21	12
Total income statement charge	**189**	**90**	**279**	–	23	23

The operating cost is charged as follows:

	Defined benefit		Defined contribution		Total	
	2012 £m	2011 £m	2012 £m	2011 £m	2012 £m	2011 £m
Cost of sales – included in underlying profit	**108**	114	**46**	38	**154**	152
Cost of sales – excluded from underlying profit	**–**	(204)	**–**	–	**–**	(204)
Commercial and administrative costs	**33**	36	**14**	12	**47**	48
Research and development	**10**	11	**4**	4	**14**	15
	151	(43)	**64**	54	**215**	11

The Group operates a PaySave scheme in the UK. This is a salary sacrifice scheme under which employees elect to stop making employee contributions and the Group makes additional contributions in return for a reduction in gross contractual pay. As a result, there is a decrease in wages and salaries and a corresponding increase in pension costs of **£36m** (2011 £35m) in the year.

Amounts recognised in other comprehensive income

	2012 £m	2011 £m
Actuarial (loss)/gain on scheme assets	**(10)**	1,426
Experience losses on scheme liabilities	**(777)**	(720)
Movement in unrecognised surplus	**465**	(683)
Movement in minimum funding liability	**63**	100
	(259)	123

19 Post-retirement benefits (continued)

Defined benefit schemes

Assumptions

The principal actuarial assumptions used at the balance sheet date were as follows:

	2012		2011	
	UK schemes %	Overseas schemes %	UK schemes %	Overseas schemes %
Rate of increase in salaries	**4.1**	**3.9**	4.2	4.0
Rate of increase of pensions in payment	**2.5**	**2.6**	1.7	1.7
Discount rate	**4.4**	**3.9**	4.7	4.5
Expected rate of return on scheme assets	**3.1**	**5.6**	3.4	5.6
Inflation assumption *	**3.0**	**2.4**	3.1	2.5

* For the UK schemes, this is the assumption for the Retail Price Index. The Consumer Price Index is assumed to be 0.6 per cent lower.

The discount rates are determined by reference to the market yields on AA rated corporate bonds. For the main schemes, the rate is determined by using the profile of forecast benefit payments to derive a weighted average discount rate from the yield curve. For other schemes, the rate is determined as the market yield at the average duration of the forecast benefit payments. The discount rates above are the weighted average of those for each scheme, based on the value of their respective liabilities.

The overall expected rate of return is calculated by weighting the individual returns expected from each asset class (see below) in accordance with the actual asset balance in the schemes' investment portfolios.

The mortality assumptions adopted for the UK pension schemes are derived from the SAP actuarial tables, with future improvements in line with the CMI 2011 core projections and long-term improvements of 1.25 per cent. Where appropriate, these are adjusted to take account of the relevant scheme's actual experience. The resulting range of life expectancies in the principal UK schemes are as follows:

Life expectancy from age 65	
Current pensioner	**20.8 years**
Future pensioner currently aged 45	**22.4 years**

Other demographic assumptions have been set on advice from the relevant actuary, having regard to the latest trends in scheme experience and other relevant data. The assumptions are reviewed and updated as necessary as part of the periodic actuarial valuation of the schemes.

Assumptions in respect of overseas schemes are also set in accordance with advice from local actuaries.

The future costs of healthcare benefits are based on an assumed healthcare costs trend rate of **7.9** per cent grading down to **5.0** per cent over **6.7** years.

Amounts recognised in the balance sheet

	2012			2011		
	UK schemes £m	Overseas schemes £m	Total £m	UK schemes £m	Overseas schemes £m	Total £m
Present value of funded obligations	**(8,588)**	**(609)**	**(9,197)**	(7,713)	(557)	(8,270)
Fair value of scheme assets	**9,794**	**534**	**10,328**	9,519	497	10,016
	1,206	**(75)**	**1,131**	1,806	(60)	1,746
Present value of unfunded obligations	**–**	**(568)**	**(568)**	–	(495)	(495)
Unrecognised past-service credit [1]	**–**	**(82)**	**(82)**	–	(94)	(94)
Unrecognised surplus [2]	**(853)**	**–**	**(853)**	(1,318)	–	(1,318)
Minimum funding liability [3]	**(173)**	**–**	**(173)**	(236)	–	(236)
Net asset/(liability) recognised in the balance sheet	**180**	**(725)**	**(545)**	252	(649)	(397)
Post-retirement scheme surpluses	**317**	**12**	**329**	495	8	503
Post-retirement scheme deficits	**(137)**	**(737)**	**(874)**	(243)	(657)	(900)

[1] The unrecognised past-service credit arose as a result of revisions to post-retirement healthcare schemes in 2011. It will be amortised over the remaining service lives of the participants (11.3 years).
[2] Where a surplus has arisen on a scheme, in accordance with IAS 19 and IFRIC 14, the surplus is recognised as an asset only if it represents an unconditional economic benefit available to the Group in the future. Any surplus in excess of this benefit is not recognised in the balance sheet.
[3] A minimum funding liability arises where the statutory funding requirements require future contributions in respect of past service that will result in a future unrecognisable surplus.

19 Post-retirement benefits (continued)

Changes in present value of defined benefit obligations

	2012			2011		
	UK schemes £m	Overseas schemes £m	Total £m	UK schemes £m	Overseas schemes £m	Total £m
At 1 January	**(7,713)**	**(1,052)**	**(8,765)**	(7,039)	(1,063)	(8,102)
Exchange differences	–	42	42	–	–	–
Current service cost	(123)	(38)	(161)	(119)	(34)	(153)
Past-service (cost)/credit	(2)	–	(2)	126	162	288
Finance cost	(356)	(49)	(405)	(372)	(50)	(422)
Contributions by employees	(4)	(2)	(6)	(4)	(3)	(7)
Benefits paid out	323	38	361	312	37	349
Acquisition of businesses	(54)	–	(54)	–	–	–
Actuarial losses	(659)	(118)	(777)	(617)	(103)	(720)
Settlement	–	2	2	–	2	2
At 31 December	**(8,588)**	**(1,177)**	**(9,765)**	(7,713)	(1,052)	(8,765)
Funded schemes	**(8,588)**	**(609)**	**(9,197)**	(7,713)	(557)	(8,270)
Unfunded schemes	**–**	**(568)**	**(568)**	–	(495)	(495)

Changes in fair value of scheme assets

	2012			2011		
	UK schemes £m	Overseas schemes £m	Total £m	UK schemes £m	Overseas schemes £m	Total £m
At 1 January	**9,519**	**497**	**10,016**	7,783	434	8,217
Exchange differences	–	(18)	(18)	–	1	1
Expected return on assets	315	26	341	381	29	410
Contributions by employer	250	47	297	256	48	304
Contributions by employees	4	2	6	4	3	7
Benefits paid out	(323)	(38)	(361)	(312)	(37)	(349)
Acquisition of businesses	59	–	59	–	–	–
Actuarial (losses)/gains	(30)	20	(10)	1,407	19	1,426
Settlement	–	(2)	(2)	–	–	–
At 31 December	**9,794**	**534**	**10,328**	9,519	497	10,016
Actual return on scheme assets	**285**	**46**	**331**	1,788	48	1,836

The fair value of the scheme assets in the schemes and the expected rates of return at 31 December, were as follows:

	2012				2011			
	UK		Overseas		UK		Overseas	
	Expected rate of return %	Market value £m	Expected rate of return %	Market value £m	Expected rate of return %	Market value £m	Expected rate of return %	Market value £m
UK schemes:								
Liability driven investment (LDI) portfolios [1]	**2.8**	**7,925**	**5.4**	**313**	3.1	8,330	5.3	291
Longevity swap [2]	**4.4**	**(126)**	**–**	**–**	4.7	(79)	–	–
Equities	**5.9**	**1,095**	**7.5**	**119**	6.0	1,004	7.9	118
Sovereign debt	**2.3**	**245**	**–**	**–**	2.8	159	–	–
Corporate bonds	**3.5**	**334**	**3.6**	**74**	4.0	13	4.0	83
Other	**2.7**	**321**	**4.3**	**28**	2.8	92	2.5	5
	3.1	**9,794**	**5.6**	**534**	3.4	9,519	5.6	497

[1] A portfolio of gilt and swap contracts, backed by LIBOR generating assets, that is designed to hedge the majority of the interest rate and inflation risks associated with the schemes' obligations.

[2] Under the longevity swap, the Rolls-Royce Pension Fund has agreed an average life expectancy of pensioners with a counterparty. If pensioners live longer than expected the counterparty will make payments to the Fund to offset the additional cost of paying pensioners. If the reverse applies, the cost of paying pensioners will be reduced but the scheme will be required to make payments to the counterparty.

The scheme assets do not include any of the Group's own financial instruments, nor any property occupied by, or other assets used by, the Group.

The expected rates of return for LDI portfolios are determined by the implicit yields on the portfolios at the balance sheet date and that for the longevity swap by the discount rate.

19 Post-retirement benefits (continued)

The expected rates of return on other individual categories of scheme assets are determined by reference to gilt yields. In the UK, equities and corporate bonds are assumed to generate returns that exceed the return from gilts by **3.25** per cent and **0.9** per cent per annum respectively.

The expected rates of return above are the weighted average of the rates for each scheme.

Future contributions

The Group expects to contribute approximately **£290m** to its defined benefit schemes in 2013.

Sensitivities

For the most significant schemes, the investment strategies are designed to hedge the risks from interest rates and inflation on an economic basis. The impacts of principal sensitivities are:

	2012 £m	2011 £m
UK defined benefit obligations – 0.25% reduction in the discount rate [1]	(319)	(298)
UK defined benefit assets – 0.25% reduction in interest rates [1]	458	463
UK defined benefit obligations – Age ratings increase by one year	(199)	(163)
UK defined benefit longevity swap – Age ratings increase by one year	68	62
UK defined benefit obligations – 0.5% increase in rate of increase in salaries	(197)	(127)
Post-retirement medical benefit obligations – 1% increase in healthcare trend rates	(49)	(45)
Post-retirement medical benefit obligations – 1% decrease in healthcare trend rates	41	56
Post-retirement medical benefit expense – 1% increase in healthcare trend rates	4	4
Post-retirement medical benefit expense – 1% decrease in healthcare trend rates	(3)	(5)

[1] The difference arises largely due to differences in the methods used to value the obligations for accounting and economic purposes. On an economic basis the correlation is approximately 97 per cent.

History of defined benefit schemes

The history of the schemes for the current and prior years is as follows:

	2012 £m	2011 £m	2010 £m	2009 £m	2008 £m
Balance sheet					
Present value of defined benefit obligations	(9,765)	(8,765)	(8,102)	(7,537)	(6,546)
Fair value of scheme assets	10,328	10,016	8,217	7,402	7,446
Unrecognised past-service credit	(82)	(94)	–	–	–
Unrecognised surpluses	(853)	(1,318)	(635)	(335)	(1,042)
Minimum funding liabilities	(173)	(236)	(336)	(385)	(425)
Deficit	(545)	(397)	(856)	(855)	(567)
Experience (losses)/gains					
Actuarial (losses)/gains on scheme assets	(10)	1,426	460	(270)	178
Experience (losses)/gains on scheme liabilities	(777)	(720)	(303)	(878)	766
Movement in unrecognised surpluses	465	(683)	(300)	707	(928)
Recognition of minimum funding liability on 1 January 2008	–	–	–	–	(491)
Movement in minimum funding liabilities	63	100	49	40	66
Total amount recognised in OCI	(259)	123	(94)	(401)	(409)
Cumulative amounts recognised in OCI since 1 January 2004	(328)	(69)	(192)	(98)	303

20 Share capital

	Non-equity			Equity	
	Special Share of £1	Preference shares of £1 each	Nominal value £m	Ordinary shares of 20p each [1] Millions	Nominal value £m
Issued and fully paid					
Rolls-Royce Group plc					
At 1 January 2011	**1**	**–**	**–**	**1,872**	**374**
Proceeds from shares issued for share option schemes				–	–
At 23 May 2011	**1**	**–**	**–**	**1,872**	**374**
Rolls-Royce Holdings plc					
On formation of Rolls-Royce Holdings plc	–	50,000	–	–	–
Scheme of arrangement – issue of ordinary shares of 150p each [2]	1	–	–	1,872	2,808
Capital reduction to ordinary shares of 20p each [2]				–	(2,434)
Proceeds from shares issued for share option schemes				–	–
Redemption of shares	–	(50,000)	–		
At 1 January 2012	**1**	**–**	**–**	**1,872**	**374**
Proceeds from shares issued for share option schemes				–	–
At 31 December 2012	**1**	**–**	**–**	**1,872**	**374**

[1] Unless otherwise stated.
[2] See page 78.

The rights attaching to each class of share are set out on page 68.

In accordance with IAS 32 *Financial Instruments: Presentation*, the Company's non-cumulative redeemable preference shares (C Shares) are classified as financial liabilities. Accordingly, movements in C Shares are included in note 17.

21 Share-based payments

Effect of share-based payment transactions on the Group's results and financial position

	2012 £m	2011 £m
Total expense recognised for equity-settled share-based payments transactions	**49**	52
Total expense recognised for cash-settled share-based payments transactions	**6**	7
Share-based payments recognised in the consolidated income statement	**55**	59
Liability for cash-settled share-based payment transactions	**18**	9

Share-based payment plans in operation during the year

Performance Share Plan (PSP)
This plan involves the award of shares to participants subject to performance conditions. Vesting of the performance shares is based on the achievement of both non-market based conditions (EPS and cash flow per share) and a market based performance condition (Total Shareholder Return – TSR) over a three-year period.

ShareSave share option plan (ShareSave)
Based on a three or five-year monthly savings contract, eligible employees are granted share options with an exercise price of up to 20 per cent below the share price when the contract is entered into. Vesting of the options is not subject to the achievement of a performance target. In the UK, the plan is HM Revenue & Customs approved. Overseas, employees in 33 countries participate in cash-settled ShareSave plans through arrangements which provide broadly comparable benefits to the UK plan.

Executive Share Option Plan (ESOP)
This plan involved the grant of market value share options to participants. It terminated in 2009 and no further grants may be made. Remaining options under the plan are subject to a non-market based performance condition (growth in EPS) and have a maximum contractual life of ten years.

Annual Performance Related Award (APRA) plan deferred shares
A proportion of the APRA annual incentive scheme is delivered in the form of a deferred share award. The release of deferred share awards is not dependent on the achievement of any further performance conditions other than that participants remain employed by the Group for two years from the date of the award in order to retain the full number of shares. During the two-year deferral period, participants are entitled to receive dividends, or equivalent, on the deferred shares.

Further information regarding the operation of the plans can be found on pages 57 to 60 of the directors' remuneration report.

21 Share-based payments (continued)

Movements in the Group's share-based payment plans during the year

	ShareSave		ESOP		PSP	APRA
	Number Millions	Weighted average exercise price Pence	Number Millions	Weighted average exercise price Pence	Number Millions	Number Millions
Outstanding at 1 January 2012	**27.5**	**447**	**0.5**	**100**	**19.5**	**3.3**
Granted	–	–	–	–	4.3	2.0
Additional entitlements arising from TSR performance	–	–	–	–	2.8	–
Forfeited	(0.6)	446	–	–	(0.8)	(0.1)
Exercised	(0.1)	409	(0.4)	103	(11.8)	(1.2)
Outstanding at 31 December 2012	**26.8**	**447**	**0.1**	**77**	**14.0**	**4.0**
Exercisable at 31 December 2012	–	–	0.1	77	–	–
Outstanding at 1 January 2011	26.5	384	0.7	125	19.5	3.1
Granted	10.6	525	–	–	5.3	2.6
Additional entitlements arising from TSR performance	–	–	–	–	1.1	–
Additional shares accrued from reinvestment of C Shares	–	–	–	–	–	0.1
Forfeited	(0.9)	387	–	–	(0.7)	(0.1)
Exercised	(8.7)	357	(0.2)	207	(5.7)	(2.4)
Outstanding at 31 December 2011	27.5	447	0.5	100	19.5	3.3
Exercisable at 31 December 2011	–	–	0.5	100	–	–

As share options are exercised throughout the year, the weighted average share price during the year of **836 pence** (2011 642 pence) is representative of the weighted average share price at the date of exercise. The closing price at 31 December 2012 was **873.5 pence** (2011 746.5 pence).

The average remaining contractual life of exercisable options is **0.2** years (2011 1.0 years).

Share options outstanding

	ShareSave		ESOP		Total	
Exercise prices (pence)	Number Millions	Weighted average remaining contractual life Years	Number Millions	Weighted average remaining contractual life Years	Number Millions	Weighted average remaining contractual life Years
At 31 December 2012						
0 – 99	**–**	**–**	**0.1**	**0.2**	**0.1**	**0.2**
300 – 399	**10.5**	**1.3**	**–**	**–**	**10.5**	**1.3**
400 – 499	**5.9**	**0.1**	**–**	**–**	**5.9**	**0.1**
500 – 599	**10.4**	**3.2**	**–**	**–**	**10.4**	**3.2**
	26.8	**1.8**	**0.1**	**0.2**	**26.9**	**1.8**
At 31 December 2011						
0 – 99	–	–	0.4	1.2	0.4	1.2
100 – 199	–	–	0.1	0.2	0.1	0.2
300 – 399	10.8	2.3	–	–	10.8	2.3
400 – 499	6.0	1.1	–	–	6.0	1.1
500 – 599	10.7	4.2	–	–	10.7	4.2
	27.5	2.7	0.5	1.0	28.0	2.7

The range of exercise prices of options outstanding at 31 December 2012 was: for ShareSave between **387 pence** and **525 pence** (2011 387 pence and 525 pence); and for ESOP it was **77 pence** (2011 77 pence and 188 pence).

Under the terms of the Rolls-Royce 1999 Executive Share Option Plan, options granted to **three** senior executives were outstanding at 31 December 2012.

21 Share-based payments (continued)

Fair values of share-based payments

The weighted average fair value per share of equity-settled share-based payment plans granted during the year, estimated at the date of grant, are as follows:

	2012	2011
PSP – 25% TSR uplift	**885p**	662p
PSP – 50% TSR uplift	**985p**	737p
ShareSave – 3 year grant	**n/a**	210p
ShareSave – 5 year grant	**n/a**	238p
APRA	**809p**	612p

In estimating these fair values, the following assumptions were used:

	PSP		ShareSave
	2012	2011	2011
Weighted average share price	**809p**	612p	691p
Exercise price	**n/a**	n/a	525p
Expected dividends	**16.5p**	15.4p	16.0p
Expected volatility	**31%**	32%	30%
Correlation	**39%**	36%	n/a
Expected life – PSP	**3 years**	3 years	n/a
Expected life – 3 year ShareSave	**n/a**	n/a	3.3 – 3.8 years
Expected life – 5 year ShareSave	**n/a**	n/a	5.3 – 5.8 years
Risk free interest rate	**0.6%**	1.9%	1.9%

Expected volatility is based on the historical volatility of the Company's share price over the seven years prior to the grant or award date. Expected dividends are based on the Company's payments to shareholders in respect of the previous year.

PSP

The fair value of shares awarded under the PSP is calculated using a pricing model that takes account of the non-entitlement to dividends (or equivalent) during the vesting period and the market-based performance condition based on expectations about volatility and the correlation of share price returns in the group of FTSE 100 companies and which incorporates into the valuation the interdependency between share price performance and TSR vesting. This adjustment increases the fair value of the award relative to the share price at the date of grant.

ShareSave

The fair value of the options granted under the ShareSave plan is calculated using a binomial pricing model that assumes that participants will exercise their options at the beginning of the six-month window if the share price is greater than the exercise price. Otherwise it assumes that options are held until the expiration of their contractual term. This results in an expected life that falls somewhere between the start and end of the exercise window.

APRA

The fair value of shares awarded under APRA is calculated as the share price on the date of the award, excluding expected dividends.

22 Operating leases

Leases as lessee

	2012 £m	2011 £m
Rentals paid – hire of plant and machinery	**94**	104
– hire of other assets	**34**	29
Non-cancellable operating lease rentals are payable as follows:		
Within one year	**147**	117
Between one and five years	**490**	401
After five years	**526**	479
	1,163	997

Leases as lessor

	2012 £m	2011 £m
Rentals received – credited within revenue from aftermarket services	**30**	36
Non-cancellable operating lease rentals are receivable as follows:		
Within one year	**2**	3
Between one and five years	**7**	8
After five years	**1**	2
	10	13

The Group acts as lessee and lessor for both land and buildings and gas turbine engines, and acts as lessee for some plant and equipment.

- Sublease payments of **£4m** (2011 £3m) and sublease receipts of **£17m** (2011 £23m) were recognised in the income statement in the year.
- Purchase options exist on aero engines, land and buildings and plant and equipment with the period to the purchase option date varying between one to eight years.
- Renewal options exist on aero engines, land and buildings and plant and equipment with the period to the renewal option varying between one to 29 years at terms to be negotiated upon renewal.
- Escalation clauses exist on some leases and are linked to LIBOR.
- The total future minimum sublease payments expected to be made is **£10m** (2011 £5m) and sublease receipts expected to be received is **£9m** (2011 £4m).

23 Contingent liabilities

In connection with the sale of its products the Group will, on some occasions, provide financing support for its customers. The Group's contingent liabilities relating to financing arrangements are spread over many years and relate to a number of customers and a broad product portfolio.

Contingent liabilities are disclosed on a discounted basis. As the directors consider the likelihood of these contingent liabilities crystallising to be remote, this amount does not represent a value that is expected to crystallise. However, the amounts are discounted at the Group's borrowing rate to reflect better the time span over which these exposures could arise. The contingent liabilities are denominated in US dollars. As the Group does not generally adopt cash flow hedge accounting for forecast foreign exchange transactions, this amount is reported, together with the sterling equivalent at the reporting date spot rate.

The discounted values of contingent liabilities relating to delivered aircraft and other arrangements where financing is in place, less insurance arrangements and relevant provisions, were:

	2012		2011	
	£m	*$m*	£m	*$m*
Gross contingent liabilities	**569**	***925***	612	*951*
Contingent liabilities net of relevant security [1]	**70**	***114***	124	*192*
Contingent liabilities net of relevant security reduced by 20% [2]	**133**	***216***	201	*312*
[1] Security includes unrestricted cash collateral of:	**64**	***104***	67	*104*

[2] Although sensitivity calculations are complex, the reduction of relevant security by 20 per cent illustrates the sensitivity of the contingent liability to changes in this assumption.

There are also net contingent liabilities in respect of undelivered aircraft, but it is not considered practicable to estimate these as deliveries can be many years in the future, and the relevant financing will only be put in place at the appropriate time.

23 Contingent liabilities (continued)

Following a request for information from the Serious Fraud Office (SFO) about allegations of malpractice in Indonesia and China, investigations by Rolls-Royce have identified matters of concern in these, and in other overseas markets. The Group has passed information to the SFO relating to these concerns and is cooperating fully.

The consequence of these disclosures will be decided by the regulatory authorities. It is too early to predict the outcomes, but these could include the prosecution of individuals and of the Company. Accordingly, the potential for fines or other penalties cannot currently be assessed. As the investigation is ongoing it is not possible to identify the timescale in which these issues might be resolved.

Contingent liabilities exist in respect of guarantees provided by the Group in the ordinary course of business for product delivery, performance and reliability. The Group has, in the normal course of business, entered into arrangements in respect of export finance, performance bonds, countertrade obligations and minor miscellaneous items. Various Group undertakings are parties to legal actions and claims which arise in the ordinary course of business, some of which are for substantial amounts. As a consequence of the insolvency of an insurer as previously reported, the Group is no longer fully insured against known and potential claims from employees who worked for certain of the Group's UK-based businesses for a period prior to the acquisition of those businesses by the Group. While the outcome of some of these matters cannot precisely be foreseen, the directors do not expect any of these arrangements, legal actions or claims, after allowing for provisions already made, to result in significant loss to the Group. The Group's share of equity accounted entities' contingent liabilities is **£48m** (2011 £68m).

24 Related party transactions

	2012 £m	2011 £m
Sales of goods and services to joint ventures and associates	**2,937**	2,864
Purchases of goods and services from joint ventures and associates	**(3,082)**	(2,380)
Operating lease payments to joint ventures and associates	**(57)**	(77)
Guarantees of joint ventures' and associates' borrowings	**12**	124
Dividends received from joint ventures and associates	**129**	76
RRSP receipts from joint ventures and associates	**13**	13
Other income received from joint ventures and associates	**2**	56

The aggregated balances with joint ventures are shown in notes 12 and 16. Transactions with Group pension schemes are shown in note 19.

In the course of normal operations, related party transactions entered into by the Group have been contracted on an arms-length basis.

Key management personnel are deemed to be the directors and the members of the GLT as set out on pages 40 to 42. Remuneration for key management personnel is shown below:

	2012 £m	2011 £m
Salaries and short-term benefits	**15**	18
Post-retirement schemes	**1**	1
Share-based payments	**8**	14
	24	33

More detailed information regarding the directors' remuneration, shareholdings, pension entitlements, share options and other long-term incentive plans is shown in the directors' remuneration report on pages 57 to 67.

25 Acquisitions and disposals

During the year, the Group made a number of acquisitions:

- on 19 June 2012, Superstructure Capital Limited, a business engaged in marketing and sale of safety and risk management software to the aerospace industry;
- on 13 July 2012, PFW Aerospace UK, a business engaged in the manufacture of precision components for the aerospace industry;
- on 13 December 2012, Rolls-Royce Goodrich Engine Controls Limited (AEC, acquisition of 50 per cent not already held), a business engaged in the development and manufacture of aero-engine controls; and
- on 27 December 2012, PKMJ Technical Services, Inc., a nuclear engineering services business in the US.

Recognised amounts of identifiable assets acquired and liabilities assumed

	£m
Intangible assets	9
Property, plant and equipment	45
Post-retirement scheme surpluses	5
Inventory	37
Trade and other receivables	61
Cash and cash equivalents	7
Trade and other payables	(52)
Borrowings	(78)
Deferred tax liabilities	(1)
Provisions	(7)
Total identifiable assets and liabilities	**26**
Goodwill arising	10
Bargain purchase [1]	(4)
Total consideration	**32**
Satisfied by:	
Cash consideration	27
Existing shareholding	5
	32
Net cash outflow arising on acquisition:	
Cash consideration	27
Less: cash and cash equivalents acquired	(7)
Cash outflow per cash flow statement	**20**
Identifiable intangible assets comprise:	
Technology, patents and licenses	2
Customer relationships	5
Other	2
	9

[1] Bargain purchase of £4m arising on the acquisition of AEC has been recognised as a gain within commercial and administrative costs, offset by a charge of £2m on revaluing the previous joint venture investment.

These acquisitions did not have a significant impact on the results for the year, and would not have done had they been acquired on 1 January 2012.

25 Acquisitions and disposals (continued)

During the year, the Group disposed of:

- on 27 June 2012, Rolls-Royce Fuel Cell Systems Inc. (dilution of existing shareholding to 49 per cent); and
- on 29 June 2012 for US$1.5 billion, the equity, programme share and related goodwill of International Aero Engines AG, which produces the V2500 engine for the Airbus A320 family of aircraft.

Assets and liabilities disposed

	IAE [1] £m	Other £m	Total £m
Intangible assets	193	1	194
Property, plant and equipment	–	2	2
Investment in joint venture	13	–	13
Trade and other receivables	76	1	77
Cash and cash equivalents	–	1	1
Trade and other payables	(31)	–	(31)
Provisions for liabilities and charges	(8)	(3)	(11)
Net assets	243	2	245
Profit on disposal of businesses	699	–	699
Transfer of subsidiary to associate	–	(2)	(2)
Disposal proceeds	942	–	942
Cash and cash equivalents disposed	–	(1)	(1)
Cash inflow/(outflow) per cash flow statement	942	(1)	941

[1] At 31 December 2011, the assets and liabilities associated with the IAE business were classified as 'Assets held for sale', as described in note 14.

Notes to the consolidated financial statements

26 Events after the reporting period – Consolidation of Tognum AG

On 1 January 2013, conditions were fulfilled which gave the Group certain rights that result in Tognum AG being classified as a subsidiary and consolidated. Rolls-Royce and Daimler AG each hold 50 per cent of the shares of Engine Holding GmbH, which itself holds approximately 99 per cent of the shares of Tognum AG. From 25 August 2011 to 31 December 2013 the Group's interest in Tognum was classified as a joint venture and equity accounted. Tognum is a premium supplier of engines, propulsion systems and components for marine, energy, defence, and other industrial applications (often described as 'off-highway' applications).

The table below sets out the illustrative effects of this business combination. These are based on: (i) a price of €26 per share (the offer price of the acquisition of Tognum by Engine Holding in 2011) and (ii) adjustments to reflect the fair values of Tognum's assets and liabilities on the acquisition of Tognum by Engine Holding on 25 August 2011, updated where appropriate. Both these bases will be updated during 2013.

As part of the Engine Holding shareholders' agreement, Daimler has the option to sell its shares in Engine Holding to Rolls-Royce for a period of six years from 1 January 2013. The fair value of the exercise price of this option will be recognised as a liability.

Provisional identifiable assets acquired and liabilities assumed

	£m
Intangible assets	1,134
Property, plant and equipment	572
Investments in joint ventures and associates	30
Inventory	764
Trade and other receivables	479
Taxation recoverable	46
Financial assets	29
Cash and cash equivalents	240
Trade and other payables	(520)
Current tax liabilities	(26)
Borrowings and other financial liabilities	(306)
Deferred tax	(263)
Provisions	(435)
Post-retirement schemes	(397)
Total identifiable assets and liabilities	1,347
Goodwill arising	735
Total consideration	2,082
Put option on NCI	(1,433)
	649
Consideration satisfied by:	
Existing shareholding	1,409
NCI	673
	2,082

The carrying value of the Group's interest in Tognum before the change in classification was **£1,328m**. On the basis of the illustrative valuation, the Group will recognise a gain of £81m in 2013 as a result of re-measuring this interest.

Company balance sheet
At 31 December 2012

	Notes	2012 £m	2011 £m
Fixed assets			
Investments – subsidiary undertakings	2	**11,954**	11,921
Creditors – amounts falling due within one year			
Financial liabilities	3	**(10)**	(6)
Amounts owed to subsidiary undertakings due within one year		**(595)**	(175)
		(605)	(181)
Net current assets		**(605)**	(181)
Total assets less current liabilities		**11,349**	11,740
Capital and reserves			
Called-up share capital	4	**374**	374
Share premium account		**–**	–
Merger reserve	5	**8,893**	8,897
Capital redemption reserve	5	**173**	173
Other reserve	5	**63**	31
Profit and loss account	5	**1,846**	2,265
Equity shareholders' funds		**11,349**	11,740

The financial statements on pages 123 to 125 were approved by the Board on 13 February 2013 and signed on its behalf by:

Sir Simon Robertson Chairman **Mark Morris** Chief Financial Officer

Company's registered number: 7524813

Reconciliation of movements in shareholders' funds
For the period ended 31 December 2012

	£m
At 1 January 2012	**11,740**
Profit for the year	–
Arising on issue of ordinary shares	–
Issue of C Shares	(328)
Share-based payments – direct to equity	(63)
At 31 December 2012	**11,349**

Financial statements

Notes to the Company financial statements

1 Accounting policies

Basis of accounting
The financial statements have been prepared in accordance with applicable UK Accounting Standards on the historical cost basis and on a going concern basis.

As permitted by Section 408 of the Companies Act 2006, a separate profit and loss account for the Company has not been included in these financial statements. As permitted by the audit fee disclosure regulations, disclosure of non-audit fees information is not included in respect of the Company. As permitted by FRS 1 *Cash flow statements*, no cash flow statement for the Company has been included. As permitted by FRS 8 *Related party disclosures*, no related party disclosures in respect of transactions between the Company and its wholly-owned subsidiaries have been included.

Investments in subsidiary undertakings
Investments in subsidiary undertakings are reported at cost less any amounts written off.

Share-based payments
As described in the directors' remuneration report on pages 57 to 67, the Company grants awards of its own shares to employees of its subsidiary undertakings, (see note 21 of the consolidated financial statements). The costs of share-based payments in respect of these awards are accounted for, by the Company, as an additional investment in its subsidiary undertakings. The costs are determined in accordance with FRS 20 *Share-based payment*. Any payments made by the subsidiary undertakings in respect of these arrangements are treated as a return of this investment.

Financial instruments
In accordance with FRS 25 *Financial instruments: Presentation*, the Company's C Shares are classified as financial liabilities and held at amortised cost from the date of issue until redeemed.

Taxation
Provision for taxation is made at the current rate and, in accordance with FRS 19 *Deferred tax*, for deferred taxation at the projected rate on timing differences that have originated, but not reversed at the balance sheet date.

2 Investments – subsidiary undertakings

	£m
Cost:	
At 1 January 2012	**11,921**
Cost of share-based payments in respect of employees of subsidiary undertakings less receipts from subsidiaries in respect of those payments	33
At 31 December 2012	**11,954**

3 Financial liabilities

C Shares
Movements in C Shares during the year were as follows:

	C Shares of 0.1p Millions	Nominal value £m
Issued and fully paid		
At 1 January 2012	**6,371**	**6**
Shares issued	327,643	328
Shares redeemed	(323,596)	(324)
At 31 December 2012	**10,418**	**10**

The rights attaching to C Shares are set out on page 68.

4 Share capital

	Special Share of £1	Non-equity: Preference shares of £1 each	Non-equity: Nominal value £m	Equity: Ordinary shares of 20p each Millions	Equity: Nominal value £m
Issued and fully paid					
At 1 January 2012	**1**	**–**	**–**	**1,872**	**374**
Proceeds from shares issued for share options schemes	–	–	–	–	–
At 31 December 2012	**1**	**–**	**–**	**1,872**	**374**

The rights attaching to each class of share are set out on page 68.

In accordance with FRS 25 *Financial instruments: Presentation*, the Company's non-cumulative redeemable preference shares (C Shares) are classified as financial liabilities. Accordingly, movements in C Shares are included in note 3.

5 Movements in capital and reserves

	Share capital £m	Non-distributable reserves: Merger reserve £m	Non-distributable reserves: Capital redemption reserve £m	Non-distributable reserves: Other reserve [1] £m	Profit and loss account £m	Total £m
At 1 January 2012	**374**	**8,897**	**173**	**31**	**2,265**	**11,740**
Profit for the year	–	–	–	–	–	–
Proceeds from shares issued for share options schemes	–	–	–	–	–	–
Issue of C Shares	–	(328)	–	–	–	(328)
Redemption of C Shares	–	324	–	–	(324)	–
Share-based payments – direct to equity	–	–	–	32	(95)	(63)
At 31 December 2012	**374**	**8,893**	**173**	**63**	**1,846**	**11,349**

[1] The 'Other reserve' represents the value of share-based payments in respect of employees of subsidiary undertakings for which payment has not been received.

6 Other information

Emoluments of directors
The remuneration of the directors of the Company is shown in the directors' remuneration report on pages 57 to 67.

Employees
The Company had no employees in 2012.

Share-based payments
Shares in the Company have been granted to employees of the Group as part of share-based payment plans, and are charged in the employing company.

Subsidiaries, jointly controlled entities and associates

At 31 December 2012

Subsidiaries incorporated within the UK – directly held

Rolls-Royce Group plc	Holding company

Subsidiaries incorporated within the UK – indirectly held

Optimized Systems and Solutions Limited	Equipment health management and advanced data management services
Rolls-Royce Engine Control Systems Limited	Development and manufacture of aero engine controls
Rolls-Royce International Limited	International support and commercial information services
Rolls-Royce Leasing Limited	Engine leasing
Rolls-Royce Marine Electrical Systems Limited	Marine electrical systems
Rolls-Royce Marine Power Operations Limited	Nuclear submarine propulsion systems
Rolls-Royce plc	Principal trading company
Rolls-Royce Power Development Limited	Generation of electricity from independent power projects
Rolls-Royce Power Engineering plc	Energy and marine systems
Rolls-Royce Total Care Services Limited	Aero engine aftermarket support services
Vinters Engineering Limited	Production, repair and overhaul of power generation, transmission and conversion equipment for military and commercial activities

The above companies operate principally in the UK and the effective Group interest is 100 per cent.

Subsidiaries incorporated overseas – indirectly held

Brazil	Rolls-Royce Brasil Limitada	Industrial gas turbines and aero engine repair and overhaul, energy and marine aftermarket support services
Canada	Rolls-Royce Canada Limited	Industrial gas turbines and aero engine sales, service and overhaul
China	Rolls-Royce Marine Manufacturing (Shanghai) Limited	Manufacture and supply of marine equipment and marine aftermarket support services
Finland	Rolls-Royce OY AB	Manufacture of marine winches and propeller systems
France	Rolls-Royce Civil Nuclear SAS	Instrumentation and control systems and life-cycle management for nuclear power plants
France	Rolls-Royce Technical Support SARL	Aero engine project support
Germany	Rolls-Royce Deutschland Ltd & Co KG	Aero engine design, development and manufacture
Guernsey	Nightingale Insurance Limited	Insurance services
India	Rolls-Royce India Private Limited	Diesel engine project management and customer support
India	Rolls-Royce Operations (India) Private Limited	Engineering support services
Italy	Europea Microfusioni Aerospaziali S.p.A.	Manufacture of gas turbine engine castings
Norway	Rolls-Royce Marine AS	Design and manufacture of ship equipment
Norway	Bergen Engines AS	Design and manufacture of medium-speed diesel engines (50%)
Singapore	Rolls-Royce Singapore Pte Limited	Aero engine parts manufacturing and engine assembly, energy and marine aftermarket support services
Sweden	Rolls-Royce AB	Manufacture of marine propeller systems
US	Data Systems & Solutions LLC	Instrumentation and control systems and life-cycle management for nuclear power plants
US	Optimized Systems and Solutions Inc.	Equipment health management and advanced data management services
US	PKMJ Technical Services, Inc.	Nuclear engineering services and software solutions
US	R. Brooks Associates Inc.	Specialist civil nuclear reactor services
US	Rolls-Royce Corporation	Design, development and manufacture of gas turbine engines
US	Rolls-Royce Crosspointe LLC	Manufacturing facility for aero engine parts
US	Rolls-Royce Energy Systems Inc.	Energy turbine generator packages
US	Rolls-Royce Engine Services – Oakland Inc.	Aero engine repair and overhaul
US	Rolls-Royce Defense Services Inc.	Aero engine repair and overhaul
US	Rolls-Royce Marine North America Inc.	Design and manufacture of marine equipment and marine aftermarket support services

The above companies operate principally in the country of their incorporation and the effective Group interest is 100 per cent unless otherwise stated.

Subsidiaries, jointly controlled entities and associates
At 31 December 2012

Jointly controlled entities and associates incorporated within the UK – indirectly held

	Class	% of class held	% of equity held
Airtanker Holdings Limited Strategic tanker aircraft PFI project	Ordinary	20	20
Airtanker Services Limited Provision of aftermarket services for strategic tanker aircraft	Ordinary	22	22
Alpha Partners Leasing Limited Aero engine leasing	A Ordinary B Ordinary	100 –	50
Composite Technology and Applications Limited Development of aero engine fan blades and fan cases	A Ordinary B Ordinary	100 –	51
Genistics Holdings Limited Trailer-mounted field mobile generator sets	A Ordinary B Ordinary	100 –	50
Rolls-Royce Snecma Limited (UK & France) Aero engine collaboration	A Shares B Shares	– 100	50
Rolls-Royce Turbomeca Limited (UK & France) Adour and RTM322 aero engine collaboration	A Shares B Shares	– 100	50
Rolls Wood Group (Repair and Overhauls) Limited Industrial gas turbine repair and overhaul	A Ordinary B Ordinary	100 –	50
TRT Limited Aero engine turbine blade repair services	A Ordinary B Ordinary	– 100	49.5
Turbine Surface Technologies Limited Aero engine turbine surface coatings	A Ordinary B Ordinary	– 100	50
Turbo-Union Limited (UK, Germany & Italy) RB199 engine collaboration	Ordinary A Shares	40 37.5	40

The above companies operate principally in the country of their incorporation. The countries of principal operations are stated in brackets after the name of the company, if not the country of their incorporation.

Subsidiaries, jointly controlled entities and associates
At 31 December 2012

Jointly controlled entities and associates incorporated overseas – indirectly held

		Class	% of class held	% of equity held
China	Xian XR Aero Components Co Limited Manufacturing facility for aero engine parts	Ordinary	49	49
Germany	EPI Europrop International GmbH (effective interest 35.5%) A400M engine collaboration	Ordinary	28	28
Germany	EUROJET Turbo GmbH (UK, Germany, Italy & Spain) (effective interest 39%) EJ200 engine collaboration	Ordinary	33	33
Germany	MTU, Turbomeca, Rolls-Royce GmbH (UK, France & Germany) MTR390 engine collaboration	Ordinary	33.3	33.3
Germany	N3 Engine Overhaul Services GmbH & Co KG Aero engine repair and overhaul	Ordinary	50	50
Germany	Tognum AG Supplier of engines and power trains for marine propulsion, distributed power generation and industrial 'off highway' sectors	Ordinary	49.5	49.5
Hong Kong	Hong Kong Aero Engine Services Limited Aero engine repair and overhaul	Ordinary	45	45
India	International Aerospace Manufacturing Private Limited Manufacture of compressor shrouds, compressor rings, turbine blades and nozzle guide vanes	Ordinary	50	50
Israel	Techjet Aerofoils Limited Manufacture of compressor aerofoils for gas turbines	A Ordinary B Ordinary	50 50	50
Malaysia	Advanced Gas Turbine Solutions Sdn Bhd Industrial gas turbine aftermarket services	Ordinary	49	49
Singapore	International Engine Component Overhaul Pte Limited Aero engine repair and overhaul	Ordinary	50	50
Singapore	Singapore Aero Engine Services Private Limited (effective interest 39%) Aero engine repair and overhaul	Ordinary	30	30
Spain	Industria de Turbo Propulsores SA Aero engine component manufacture and maintenance	Ordinary	46.9	46.9
US	Alpha Leasing (US) LLC, Alpha Leasing (US) (No.2) LLC, Alpha Leasing (US) (No.4) LLC, Alpha Leasing (US) (No.5) LLC, Alpha Leasing (US) (No.6) LLC, Alpha Leasing (US) (No.7) LLC, Alpha Leasing (US) (No.8) LLC, Rolls-Royce & Partners Finance (US) LLC, Rolls-Royce & Partners Finance (US) (No.2) LLC Aero engine leasing	Partnerships	50	–
US	Exostar LLC Business to business internet exchange	Partnership	18.5	–
US	LG Fuel Cell Systems Inc. Development of fuel cells	Common Stock	49	49
US	Texas Aero Engine Services, LLC Aero engine repair and overhaul	Partnership	50	–

Unincorporated overseas – indirectly held

US	Light Helicopter Turbine Engine Company (LHTEC) Rolls-Royce Corporation has a 50 per cent interest in this unincorporated partnership which was formed to develop and market jointly the T800 engine

The above companies operate principally in the country of their incorporation. The countries of principal operations are stated in brackets after the name of the company, if not the country of their incorporation.

In accordance with Section 410 of the Companies Act 2006, the subsidiaries, jointly controlled entities and associates listed on pages 126 to 128 is of those whose results or financial position, in the opinion of the directors, principally affect the financial statements. A list of all related undertakings will be included in the Company's annual return to Companies House.

Independent Auditor's report
to the Members of Rolls-Royce Holdings plc

We have audited the financial statements of Rolls-Royce Holdings plc for the year ended 31 December 2012, set out on pages 74 to 128. The financial reporting framework that has been applied in the preparation of the Group financial statements is applicable law and International Financial Reporting Standards (IFRS) as adopted by the EU. The financial reporting framework that has been applied in the preparation of the parent company financial statements is applicable law and UK Accounting Standards (UK Generally Accepted Accounting Practice).

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members, as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditor
As explained more fully in the directors' responsibilities statement set out on pages 71 and 72, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit, and express an opinion on, the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements
A description of the scope of an audit of financial statements is provided on the Financial Reporting Council's website at www.frc.org.uk/auditscopeukprivate.

Opinion on financial statements
In our opinion:

- the financial statements give a true and fair view of the state of the Group's and of the parent company's affairs as at 31 December 2012 and of the Group's profit for the year then ended;
- the Group financial statements have been properly prepared in accordance with IFRS as adopted by the EU;
- the parent company financial statements have been properly prepared in accordance with UK Generally Accepted Accounting Practice; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006; and, as regards the Group financial statements, Article 4 of the IAS Regulation.

Opinion on other matters prescribed by the Companies Act 2006
In our opinion:

- the part of the directors' remuneration report to be audited has been properly prepared in accordance with the Companies Act 2006; and
- the information given in the directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which we are required to report by exception
We have nothing to report in respect of the following:

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- adequate accounting records have not been kept by the parent company, or returns adequate for our audit have not been received from branches not visited by us; or
- the parent company financial statements and the part of the directors' remuneration report to be audited are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

Under the Listing Rules we are required to review:

- the directors' statement, set out on page 72 in relation to going concern;
- the part of the corporate governance statement on page 43 relating to the Company's compliance with the nine provisions of the UK Corporate Governance Code specified for our review; and
- certain elements of the report to shareholders by the Board on directors' remuneration.

A J Sykes (Senior Statutory Auditor)
for and on behalf of KPMG Audit Plc, Statutory Auditor
Chartered Accountants
15 Canada Square
London, E14 5GL

13 February 2013

Group five-year review

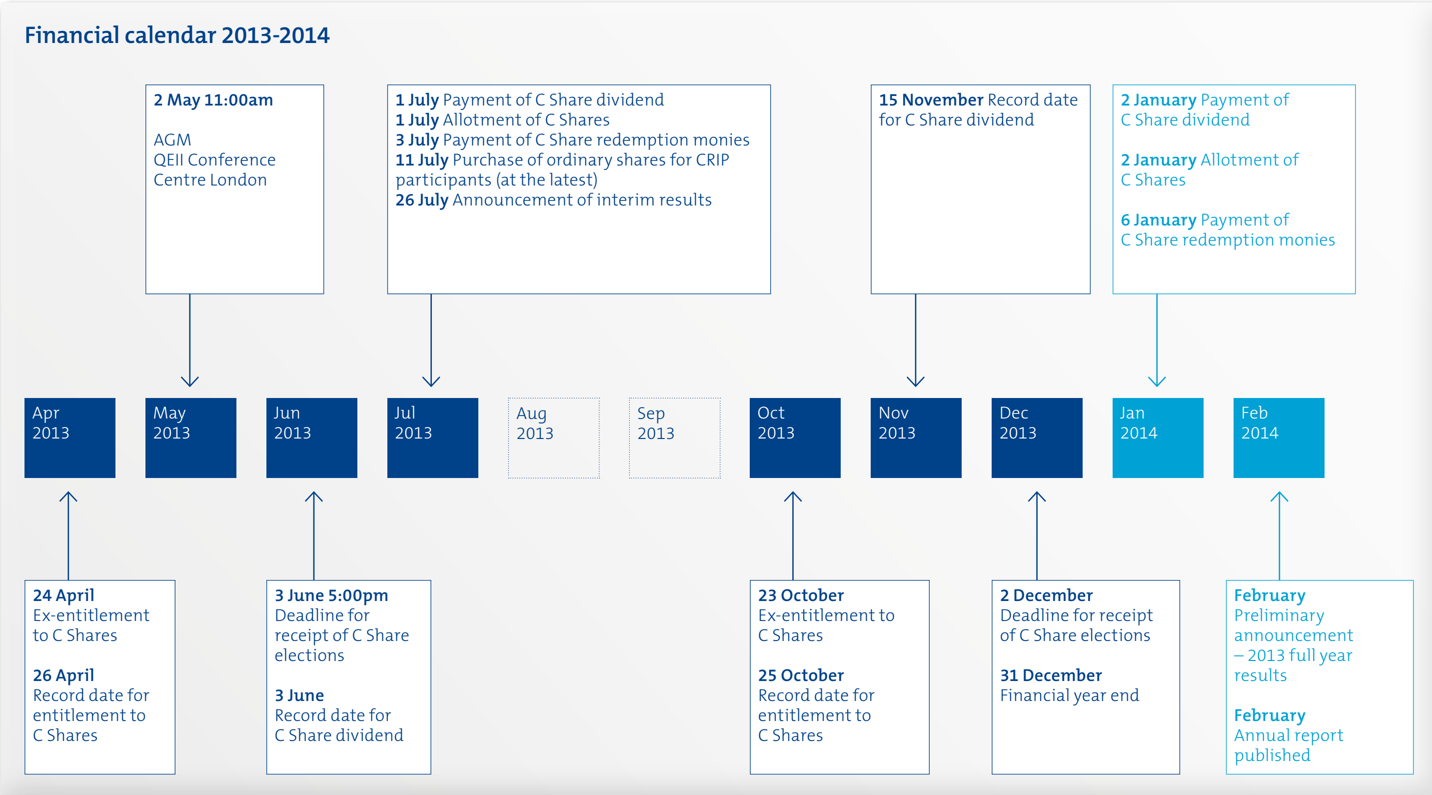
For the years ended 31 December

Income statement	2012 £m	2011 £m	2010 £m	2009 £m	2008 £m
Revenue	**12,161**	11,124	11,085	10,414	9,082
Profit before net research and development and share of results of joint ventures and associates	**2,488**	1,536	1,463	1,458	1,191
Research and development (net) [1]	**(589)**	(463)	(422)	(379)	(403)
Share of results of joint ventures and associates	**173**	116	93	93	74
Profit before financing	**2,072**	1,189	1,134	1,172	862
Net financing	**633**	(84)	(432)	1,785	(2,754)
Profit/(loss) before taxation [2]	**2,705**	1,105	702	2,957	(1,892)
Taxation	**(410)**	(257)	(159)	(740)	547
Profit/(loss) for the year	**2,295**	848	543	2,217	(1,345)
Attributable to:					
Equity shareholders of the parent	**2,281**	850	539	2,221	(1,340)
Non-controlling interests	**14**	(2)	4	(4)	(5)
Profit/(loss) for the year	**2,295**	848	543	2,217	(1,345)
[1] Research and development (gross)	**(919)**	(908)	(923)	(864)	(885)
[2] Underlying profit before taxation	**1,429**	1,157	955	915	880
Earnings per ordinary share:					
Underlying	**59.27p**	48.54p	38.73p	39.67p	36.70p
Basic	**123.23p**	45.95p	29.20p	120.38p	(73.63p)
Payments to shareholders per ordinary share	**19.50p**	17.50p	16.00p	15.00p	14.30p

Balance sheet	2012 £m	2011 £m	2010 £m	2009 £m	2008 £m
Assets	**18,115**	16,423	16,234	15,422	15,348
Liabilities	**(12,010)**	(11,904)	(12,255)	(11,640)	(13,123)
	6,105	4,519	3,979	3,782	2,225
Called-up share capital	**374**	374	374	371	369
Reserves	**5,714**	4,144	3,601	3,411	1,847
Equity attributable to equity holders of the parent	**6,088**	4,518	3,975	3,782	2,216
Non-controlling interests	**17**	1	4	–	9
	6,105	4,519	3,979	3,782	2,225

Cash flow	2012 £m	2011 £m	2010 £m	2009 £m	2008 £m
Cash inflow from operating activities	**1,255**	1,306	1,378	859	1,015
Cash inflow/(outflow) from investing activities	**424**	(2,207)	(759)	(606)	(645)
Cash (outflow)/inflow from financing activities	**(331)**	(655)	(743)	384	(221)
Increase/(decrease) in cash and cash equivalents	**1,348**	(1,556)	(124)	637	149
Net funds	**1,317**	223	1,533	1,275	1,458

Shareholder information



Managing your shareholding

Your shareholding is managed by Computershare Investor Services PLC (the Registrar). When making contact with the Registrar please quote your Shareholder Reference Number (SRN), an 11-digit number that can be found on the right-hand side of your share certificate or in any other shareholder correspondence. It is very important that you keep your shareholding account details up to date by notifying the Registrar of any changes in your circumstances.

You can manage your shareholding at www.investorcentre.co.uk, speak to the Registrar on +44 (0)870 703 0162 (8.30am to 5.30pm Monday to Friday) or you can write to them at Computershare Investor Services PLC, The Pavilions, Bridgwater Road, Bristol BS13 8AE.

Payments to shareholders

The Company makes payments to shareholders by issuing redeemable C Shares of 0.1 pence each. You can still receive cash or additional ordinary shares from the Company providing you complete a payment instruction form, which is available from the Registrar. Once you have submitted your payment instruction form, you will receive cash or additional ordinary shares each time the Company issues C Shares. If you choose to receive cash we recommend that you include your bank details on the payment instruction form and have payments credited directly to your bank account. This removes the risk of a cheque going astray in the post and means that cleared payments will be credited to your bank account on the payment date.

Share dealing

The Registrar offers existing shareholders an internet dealing service at www-uk.computershare.com/investor/sharedealing.asp and a telephone dealing service (+44 (0)870 703 0084). The service is available during market hours, 8.00am to 4.30pm, Monday to Friday excluding Bank holidays. The fee for internet dealing is 1 per cent of the transaction value subject to a minimum fee of £30. The fee for telephone dealing is 1 per cent of the transaction plus £35. Please note that, in addition to dealing fees, stamp duty of 0.5 per cent is payable on all purchases. Other share dealing facilities are available but we recommend that you only use a firm regulated by the Financial Services Authority (FSA). You can check the FSA register at www.fsa.gov.uk.

Your share certificate

If you sell or transfer your shares you must ensure that you have a valid share certificate in the name of Rolls-Royce Holdings plc. If you place an instruction to sell your shares and cannot provide a valid share certificate the transaction cannot be completed and you will be liable for any costs incurred by the broker. Share certificates previously issued by either Rolls-Royce Group plc or Rolls-Royce plc are invalid and should be destroyed. If you are unable to locate your share certificates please inform the Registrar immediately.

American Depositary Receipts (ADR)

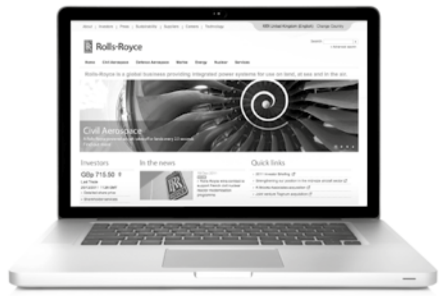
ADR holders should contact the depositary, The Bank of New York Mellon by calling +1 888 269 2377 (toll free within the US) or emailing shrrelations@bnymellon.com.

Shareholder information

Warning to shareholders – boiler room fraud

We are aware that some shareholders might have received unsolicited phone calls or correspondence concerning investment matters. These are typically from overseas based ‘brokers’ who offer to sell them what often turn out to be worthless or high risk shares in US or UK investments. Such operations are known as ‘boiler rooms’ and these ‘brokers’ can be very persistent and extremely persuasive. You should always check that any firm calling you about investment opportunities is properly authorised by the FSA using the following web link www.fsa.gov.uk/fsaregister or by calling their Consumer Helpline on 0845 606 1234 (overseas callers dial +44 20 7066 1000). If you deal with an unauthorised firm, you will not be eligible to receive payment under the Financial Services Compensation Scheme. You will find lots of advice and information about protecting yourself from investment scams on the FSA website www.fsa.gov.uk.

Remember the golden rule – IF IT SOUNDS TOO GOOD TO BE TRUE IT PROBABLY IS.



Available as a free download from the app store for iPad users

Visit Rolls-Royce online

Visit www.rolls-royce.com/investors to find out more about the latest financial results, the share price, payments to shareholders, the financial calendar and shareholder services.

Keeping up to date

You can sign up to receive the latest news to your phone or inbox. You can also download the Rolls-Royce Investor Relations iPad app which provides the latest media and financial information.

Dividends paid on C Shares held

C Share calculation period	C Share dividend rate (%)	Record date for C Share dividend	Payment date
1 July 2012 – 31 December 2012	0.441	16 November 2012	2 January 2013
1 January 2012 – 30 June 2012	0.516	27 April 2012	3 July 2012

Previous C Share issues

			Apportionment values			CGT apportionment				
Issue date	No of C Shares issued per ordinary share	Record date for entitlement to C Shares	Latest date for receipt of Payment Instruction Forms by Registrar	Price of ordinary shares on first day of trading (p)	Value of C Share issues per ordinary shares (p)	Ordinary shares (%)	C Shares (%)	Date of redemption of C Shares	CRIP purchase date	CRIP purchase price (p)
2 January 2013	76	26 November 2012	3 December 2012	903.288	7.6	99.17	0.83	4 January 2013	7 January 2013	906.210
2 July 2012	106	27 April 2012	1 June 2012	863.25	10.6	98.79	1.21	4 July 2012	5 July 2012	888.027

For earlier C Share issues, please refer to the Group’s website.

Analysis of ordinary shareholders at 31 December 2012

Type of holder:	Number of shareholders	% of total shareholders	Number of shares	% of total shares
Individuals	208,973	97.06	109,156,755	5.83
Institutional and other investors	6,322	2.94	1,763,146,808	94.17
Total	215,295	100.00	1,872,303,563	100.00
Size of holding:				
1 – 150	67,604	31.40	6,501,027	0.35
151 – 500	109,625	50.92	29,132,208	1.55
501 – 10,000	36,046	16.74	58,447,201	3.12
10,001 – 100,000	1,354	0.63	36,087,499	1.93
100,001 – 1,000,000	460	0.21	161,984,671	8.65
1,000,001 and over	206	0.10	1,580,150,957	84.40
Total	215,295	100.00	1,872,303,563	100.00

Glossary

ABC	Anti-bribery and corruption
ACARE	Advisory Council for Aviation Research and Innovation in Europe
ADR	American Depositary Receipts Programme
AEBS	All-Employee Bonus Scheme
AGM	Annual general meeting
ANA	All Nippon Airways
APB	Auditing Practices Board
APRA	Annual Performance Related Award plan
BIS	Department for Business, Innovation and Skills
CAD	Canadian dollar
CBE	Commander of the Most Excellent Order of the British Empire
CDP	Carbon Disclosure Project
CGU	Cash-generating unit
CO_2	Carbon dioxide
CO_2e	Carbon dioxide equivalent
CPS	Cash flow per share
CRIP	C Share Reinvestment Plan
DJSI	Dow Jones Sustainability World and European Indexes
DoD	US Department of Defense
EMIR	European Market Infrastructure Regulation
EPS	Earnings per ordinary share
ESOP	Executive Share Option Plan
EU	European Union
FAA	Federal Aviation Administration
Frc	Financial Risk Committee
FRC	Financial Reporting Council
FSA	Financial Services Authority
GBP	Great British pound or pound sterling
GDP	Gross Domestic Product
GHG	Greenhouse gas
GLT	Group Leadership Team
HS&E	Health, Safety and Environment
I&C	Instrumentation and control
IAB	International Advisory Board
IAE	IAE International Aero Engines AG
IAS	International Accounting Standards
IASB	International Accounting Standards Board
IFRIC	International Financial Reporting Interpretations Committee
IFRS	International Financial Reporting Standards
ISO	International Standards Organisation
LDI	Liability-driven investment
LIBOR	London Inter-Bank Offered Rate
LLP	Limited Liability Partnership
LTSA	Long-Term Service Agreement
LNG	Liquefied Natural Gas
MoD	UK Ministry of Defence
MW	Megawatt
NCI	Non-controlling interest
NO_x	Nitrogen oxides
OCI	Other comprehensive income
OE	Original Equipment
OECD	Organisation for Economic Cooperation and Development
OHSAS	Occupational Health and Safety Advisory Services
OTC	Over-the-counter
PAC	Political Action Committee
PLC	Public Limited Company
PSP	Performance Share Plan
R&D	Research and development
RCF	Revolving credit facility
REACH	Registration, Evaluation and Authorisation of Chemicals
Registrar	Computershare Investor Services PLC
RRNA	Rolls-Royce North America
RRSPs	Risk and Revenue Sharing Partnerships
RSUs	Restricted stock units
SCRIA	Supply Chain Relationships in Aerospace
SDSR	Strategic Defence and Security Review
SFO	Serious Fraud Office
SIP	Share Incentive Plan
SRN	Shareholder Reference Number
STEM	Science, Technology, Engineering and Mathematics
STOVL	Short take-off and vertical landing
TRI	Total reportable injuries
TSR	Total Shareholder Return
UAV	Unmanned aerial vehicle
UK GAAP	UK Generally Accepted Accounting Practices
USD	United States dollar

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