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Consolidated income statement

For the year ended December 31, 2008

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	Notes	2008 £m	2007 £m
Revenue	2	9,082	7,435
Cost of sales		(7,311)	(6,003)
Gross profit		1,771	1,432
Other operating income		79	50
Commercial and administrative costs		(666)	(653)
Research and development costs		(403)	(381)
Share of profit of joint ventures	10	74	66
Operating profit		855	514
Profit/(loss) on sale or termination of businesses	25	7	(2)
Profit before financing	2	862	512
Financing income	3	432	718
Financing costs	3	(3,186)	(497)
Net financing		(2,754)	221
(Loss)/profit before taxation ¹		(1,892)	733
Taxation	4	547	(133)
(Loss)/profit for the year		(1,345)	600
Attributable to:			
Equity holders of the parent		(1,340)	606
Minority interests	20	(5)	(6)
(Loss)/profit for the year		(1,345)	600
Earnings per ordinary share:			
Basic	5	(73.63)p	33.67p
Diluted	5	(73.63)p	32.97p
Payments to shareholders in respect of the year	16	(263)	(237)
¹ Underlying profit before taxation	2	880	800

Consolidated balance sheet

At December 31, 2008

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	Notes	2008 £m	2007 £m
ASSETS			
Non-current assets			
Intangible assets	8	2,286	1,761
Property, plant and equipment	9	1,995	1,813
Investments – joint ventures	10	345	284
Other investments	10	53	57
Deferred tax assets	4	685	81
Post-retirement scheme surpluses	18	453	210
		5,817	4,206
Current assets			
Inventory	11	2,600	2,203
Trade and other receivables	12	3,929	2,585
Taxation recoverable		9	7
Other financial assets	16	390	514
Short-term investments		1	40
Cash and cash equivalents	13	2,471	1,897
Assets held for sale		12	7
		9,412	7,253
Total assets		15,229	11,459
LIABILITIES			
Current liabilities			
Borrowings	14	(23)	(34)
Other financial liabilities	16	(2,450)	(85)
Trade and other payables	15	(5,735)	(4,326)
Current tax liabilities		(184)	(188)
Provisions	17	(181)	(121)
		(8,573)	(4,754)
Non-current liabilities			
Borrowings	14	(1,325)	(1,030)
Other financial liabilities	16	(391)	(303)
Trade and other payables	15	(1,318)	(965)
Non-current tax liabilities		(1)	—
Deferred tax liabilities	4	(307)	(345)
Provisions	17	(188)	(180)
Post-retirement scheme deficits	18	(595)	(333)
		(4,125)	(3,156)
Total liabilities		(12,698)	(7,910)
Net assets		2,531	3,549
EQUITY			
Capital and reserves			
Called-up share capital	19	369	364
Share premium account	20	82	67
Capital redemption reserves	20	204	191
Hedging reserves	20	(22)	77
Other reserves	20	663	62
Retained earnings	20	1,226	2,776
Equity attributable to equity holders of the parent		2,522	3,537
Minority interests	20	9	12
Total equity		2,531	3,549

The financial statements on pages 86 to 137 were approved by the Board on February 11, 2009 and signed on its behalf by:

Simon Robertson
Chairman

Andrew Shilston
Finance Director

Consolidated cash flow statement

For the year ended December 31, 2008

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	Notes	2008 £m	2007 £m
Reconciliation of cash flows from operating activities			
(Loss)/profit before taxation		(1,892)	733
Share of profit of joint ventures	10	(74)	(66)
(Profit)/loss on sale or termination of businesses	25	(7)	2
(Profit)/loss on sale of property, plant and equipment		(11)	1
Net interest payable	3	10	6
Net post-retirement scheme financing	3	22	(30)
Net other financing	3	2,722	(197)
Taxation paid		(117)	(71)
Amortisation of intangible assets	8	107	63
Depreciation of property, plant and equipment	9	208	170
Increase/(decrease) in provisions		39	(42)
Increase in inventories		(208)	(359)
Increase in trade and other receivables		(1,072)	(128)
Increase in trade and other payables		1,242	778
Decrease in other financial assets and liabilities		144	357
Additional cash funding of post-retirement schemes		(117)	(441)
Share-based payments charge	21	40	36
Transfers of hedge reserves to income statement	16	(80)	(149)
Dividends received from joint ventures	10	59	42
Net cash inflow from operating activities		1,015	705
Cash flows from investing activities			
Additions of unlisted investments		(1)	(5)
Disposals of unlisted investments		6	—
Additions to intangible assets		(389)	(294)
Purchases of property, plant and equipment		(286)	(304)
Disposals of property, plant and equipment		68	47
Acquisitions of businesses	25	(50)	(6)
Disposals of businesses	25	6	3
Investments in joint ventures		(32)	(13)
Disposals of joint ventures		30	—
Net cash outflow from investing activities		(648)	(572)
Cash flows from financing activities			
Borrowings due within one year – repayment of loans		(1)	(350)
Borrowings due after one year – repayment of loans		(22)	—
Capital element of finance lease payments		(4)	(5)
Net cash outflow from decrease in borrowings		(27)	(355)
Interest received		52	95
Interest paid		(53)	(93)
Interest element of finance lease payments		(1)	(3)
Decrease/(increase) in government securities and corporate bonds		39	(6)
Issue of ordinary shares		17	29
Purchase of ordinary shares		(44)	(77)
Other transactions in ordinary shares		(4)	34
Redemption of B Shares		(200)	(97)
Net cash outflow from financing activities		(221)	(473)
Increase/(decrease) in cash and cash equivalents		146	(340)
Cash and cash equivalents at January 1		1,872	2,171
Foreign exchange		441	41
Net cash of businesses acquired/disposed		3	—
Cash and cash equivalents at December 31		2,462	1,872

	2008 £m	2007 £m
Reconciliation of movements in cash and cash equivalents to movements in net funds		
Increase/(decrease) in cash and cash equivalents	146	(340)
Net cash outflow from decrease in borrowings	27	355
Cash (inflow)/outflow from (decrease)/increase in government securities and corporate bonds	(39)	6
Change in net funds resulting from cash flows	134	21
Net funds of businesses acquired	(3)	—
Exchange adjustments	439	41
Fair value adjustments	(319)	(18)
Movement in net funds	251	44
Net funds at January 1 excluding the fair value of swaps	873	829
Net funds at December 31 excluding the fair value of swaps	1,124	873
Fair value of swaps hedging fixed rate borrowings	334	15
Net funds at December 31	1,458	888

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

	At January 1, 2008 £m	Funds flow £m	Net funds of businesses acquired/ disposed £m	Exchange adjustments £m	Fair value adjustments £m	Reclassi- fications £m	At December 31, 2008 £m
Cash at bank and in hand	1,265	(550)	1	224	—	—	940
Overdrafts	(25)	18	—	(2)	—	—	(9)
Short-term deposits	632	678	2	219	—	—	1,531
Cash and cash equivalents	1,872	146	3	441	—	—	2,462
Investments	40	(39)	—	—	—	—	1
Other borrowings due within one year	(4)	1	(6)	—	—	(2)	(11)
Borrowings due after one year	(1,026)	22	—	(3)	(319)	2	(1,324)
Finance leases	(9)	4	—	1	—	—	(4)
	873	134	(3)	439	(319)	—	1,124
Fair value of swaps hedging fixed rate borrowings	15	—	—	—	319	—	334
	888	134	(3)	439	—	—	1,458

Consolidated statement of recognised income and expense

For the year ended December 31, 2008

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	Notes	2008 £m	2007 £m
Foreign exchange translation differences from foreign operations		603	117
Net actuarial gains	18	944	511
Movement in unrecognised post-retirement surplus	18	(928)	(112)
Transfers from transition hedging reserve	16	(80)	(149)
Transfers to cash flow hedging reserve	10	(41)	—
Related tax movements	4	15	(86)
Change in rates of corporation tax	4	—	(9)
Net income recognised directly in equity		513	272
(Loss)/profit for the year		(1,345)	600
Total recognised income and expense for the year		(832)	872
Attributable to:			
Equity holders of the parent		(829)	878
Minority interests		(3)	(6)
Total recognised income and expense for the year		(832)	872

1 Significant accounting policies

The Company

Rolls-Royce Group plc (the 'Company') is a company domiciled in the United Kingdom. The consolidated financial statements of the Company for the year ended December 31, 2008 comprise the Company and its subsidiaries (together referred to as the 'Group') and the Group's interest in jointly controlled entities. The financial statements were authorised for issue by the directors on February 11, 2009.

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 December 31, 2008 (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 require an alternative treatment. The principal variations from the historical cost basis relate to pensions (IAS 19), monetary items (IAS 21), financial instruments (IAS 39) and share-based payments (IFRS 2).

The Group's significant accounting policies are set out below, together with the judgements made by management in applying these policies that have the most significant effect on the amounts recognised in the financial statements, apart from those involving estimations, which are dealt with separately below. These accounting policies have been applied consistently to all periods presented in these consolidated financial statements and by all Group entities.

Basis of consolidation

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

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.

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. The results of joint ventures are accounted for using the equity method of accounting.

Any subsidiary undertakings and joint ventures sold or acquired during the year are included up to, or from, the dates of change of control.

All intra-group transactions, balances, income and expenses are eliminated on consolidation.

Significant accounting policies and judgements applied

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. 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. Where it is judged that sufficient risks and rewards are not transferred, the transaction is treated as a leasing transaction, resulting in an operating lease between the Group and the customer. No deliveries of engines were treated as operating leases during 2008. Depending on the specific circumstances, where applicable, the financing arrangements may result in the consolidation of the entity established to facilitate the financing. Such special purpose entities will be consolidated as required by IAS 27 *Consolidated and Separate Financial Statements* if it is considered that the Group controls the entity. No such entities were consolidated at December 31, 2008.

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, in return for a share in future programme revenues or profits, make cash payments that are not refundable (except under certain remote circumstances). Cash sums received, which reimburse the Group for past expenditure, 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, payments to partners for their share in the programme 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 invests in a development programme, the Group treats such receipts as the sale of an interest in the programme. Subsequent payments are royalty payments and 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. The Group does not capitalise any borrowing costs.

Taxation

The tax charge 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.

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 recognised income and expense 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.

Segmental reporting

A segment is a distinguishable component of the Group that is engaged in providing products and services. As the risks and rates of return are predominantly affected by differences in these products and services, the primary format for reporting segment information is based on business segments.

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:

- Fixed deposits, principally comprising funds held with banks and other financial institutions and trade receivables, are classified as loans and receivables.
- Investments (other than interests in joint ventures and fixed deposits) and short-term deposits (other than fixed deposits) are classified as available for sale.
- Borrowings, trade payables, financial RRSPs and B 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:

- 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. If instruments held at amortised cost are hedged, generally by interest rate swaps, and the hedges are effective, the carrying values are adjusted for changes in fair value, which are included in the income statement.
- 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.
- 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 apply hedge accounting in respect of forward foreign exchange contracts held to manage the cash flow exposures of forecast transactions denominated in foreign currencies.

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.

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.

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.

Until December 31, 2004, and as allowed by IFRS 1 *First-time Adoption of International Financial Reporting Standards*, the Group applied hedge accounting for forecast foreign exchange transactions and commodity exposures in accordance with UK GAAP. On January 1, 2005, the fair values of derivatives used for hedging these exposures were included in the transition hedging reserve. This reserve is released to the income statement based on the designation of the hedges on January 1, 2005.

Purchased goodwill

Goodwill represents the excess of the fair value of the purchase consideration for shares in subsidiary undertakings and joint ventures over the fair value to the Group of the net of the identifiable assets acquired and the liabilities assumed.

- i) To December 31, 1997: Goodwill was written off to reserves in the year of acquisition.
- ii) From January 1, 1998: Goodwill was recognised within intangible assets in the year in which it arose and amortised on a straight line basis over its useful economic life, up to a maximum of 20 years.
- iii) From January 1, 2004, in accordance with IFRS 3 *Business Combinations*, goodwill is recognised as per (ii) above but is no longer amortised.

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 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.

Property, plant and equipment

Property, plant and equipment assets are stated at cost less accumulated depreciation and any provision for impairments 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 advisors' estimates or period of lease.
 - c) No depreciation is provided on freehold land.
- ii) Plant and equipment – five to 25 years (average 14 years).
- iii) Aircraft and engines – five to 20 years (average 17 years).

Leases

- i) As Lessee
Assets financed by leasing agreements that give rights approximating to ownership (finance leases) are capitalised at their fair value and depreciation is provided on the basis of the Group depreciation policy. The capital elements of future obligations under finance leases are included as liabilities in the balance sheet and the current year's interest element, having been allocated to accounting periods to give a constant periodic rate of charge on the outstanding liability, is charged to the income statement.

The annual payments under all other lease arrangements, known as operating leases, are charged to the income statement on a straight-line basis.

- ii) As Lessor
Amounts receivable under finance leases are included within receivables and represent the total amount outstanding under the lease agreements less unearned income. Finance lease income, having been allocated to accounting periods to give a constant periodic rate of return on the net investment, is included in revenue.

Rentals receivable under operating leases are included in revenue 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 and property, plant and equipment 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.

Inventory

Inventory 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 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. 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 and financing costs are recognised in the periods in which they arise. Actuarial gains and losses are recognised immediately in the statement of recognised income and expense.

Surpluses in schemes are recognised as assets only if they represent economic benefits available to the Group in the future. Movements in unrecognised surpluses are included in the statement of recognised income and expense.

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 performance condition in the Performance Share Plan.

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, and 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) Performance Share Plan – using a pricing model adjusted to reflect non-entitlement to dividends (or equivalent) and the Total Shareholder Return market-based performance condition;
- iii) Annual Performance Related Award plan deferred shares and free shares under the Share Incentive Plan – share price on the date of the award.

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 above.

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.

Key sources of estimation uncertainty

In applying the above 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 below. These matters are discussed in more detail in the Finance Director's review.

Forecasts and discount rates

The carrying value of a number of items on the balance sheet are dependent on the estimates of future cash flows arising from the Group's operations:

- The impairment tests for goodwill are dependent on forecasts of the cash flows of the cash generating units that give rise to the goodwill and the discount rate applied. (Carrying values at December 31, 2008 £1,008m, December 31, 2007 £801m).
- If the assessment of development, participation, certification and recoverable engine costs recognised as intangible assets indicates the possibility of impairment, a detailed impairment test is undertaken. (Carrying values at December 31, 2008 £1,072m, December 31, 2007 £880m).
- 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 December 31, 2008 £455m, December 31, 2007 £315m). 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 value at December 31, 2008 £685m, December 31, 2007 £81m) 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 under revenue recognition above.

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 £142m before deferred taxation being recognised on the balance sheet at December 31, 2008 (December 31, 2007 £123m). 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 18.

Provisions

As described in the accounting policy above, the Group measures provisions (carrying value at December 31, 2008 £369m, December 31, 2007 £301m) at the directors' best estimate of the expenditure required to settle the obligation at the balance sheet date. These estimates are made, taking 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. If the tax eventually payable or reclaimable differs from the amounts originally estimated then the difference will be charged or credited in the financial statements for the year in which it is determined.

Contingent liabilities

As described in note 23, the Group has significant long-term contingent obligations. The directors consider that, after allowing for provisions already made, the possibility that there will be any significant loss arising from these contingencies as remote. In reaching this opinion, the directors have considered the likelihood of the contingency crystallising and have taken account of forecast aircraft values that generally provide security against the contingent liability.

Revisions to IFRS adopted in 2008

No standards or interpretations that became effective during 2008 had a significant impact on the Group's financial statements.

Revisions to IFRS not applicable in 2008

IAS 8 *Operating Segments* is applicable for 2009. This standard amends the requirements for disclosure of segmental performance and will not have any effect on the Group's overall reported results.

IFRIC 14 *IAS 19 The Limit of a Defined Benefit Asset, Minimum Funding Requirements and their Interaction* is applicable for 2009. This interpretation applies where regulatory funding requirements will result in an unrecognisable surplus arising in the future. Had it been applicable in 2008 an additional pension deficit of approximately £425m would have been recognised.

Amendment to IAS 23 *Borrowing Costs* is applicable for 2009. The amendment generally eliminates the option to expense borrowing costs attributable to the acquisition, construction or production of a qualifying asset as incurred, and instead requires the capitalisation of such borrowing costs as part of the cost of the specific asset. The Group does not consider that the adoption of this amendment will result in the capitalisation of a significant level of borrowing costs.

Amendments to IFRS 2 *Share-based Payments: Vesting Conditions and Cancellations* are applicable for 2009. These amendments concern certain aspects of the valuation of share-based payments and the impact of a cancellation by a grantee. The Group does not consider that these amendments will have a significant impact on the charges recognised to date for share-based payments.

Amendments to IAS 1 *Presentation of Financial Statements* are applicable for 2010. These amendments revise requirements for the presentation of the financial statements and will not affect the Group's overall reported results.

Revised IFRS 3 *Business Combinations* and amendments to IAS 27 *Consolidated and Separate Financial Statements* are applicable for 2010, if endorsed by the EU. If endorsed, these standards will affect the future accounting for acquisitions and transactions with non-controlling interests. There will be no retrospective impact.

IFRIC 12 *Service Concession Arrangements* is applicable for 2009, if endorsed by the EU. If endorsed, this will apply to the Group's investments in the joint ventures operating the Future Strategic Tanker Aircraft contract with the UK Ministry of Defence.

The Group does not consider that any other standards or interpretations issued by the IASB, but not yet applicable, will have a significant impact on the financial statements.

2 Segmental analysis

The Group operates in four segments which reflect the internal organisation and management structure according to the nature of the products and services provided:

- 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 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.

Details for these primary reporting segments are shown below:

	Civil aerospace £m	Defence aerospace £m	Marine £m	Energy £m	Central items £m	Eliminations £m	Group £m
Analysis by business segments for the year ended December 31, 2008							
Revenue from sale of original equipment	1,761	738	1,488	390	—	—	4,377
Revenue from aftermarket services	2,676	950	712	367	—	—	4,705
Total revenue	4,437	1,688	2,200	757	—	—	9,082
Other operating income – RRSP receipts	79						79
Operating profit excluding share of profit of joint ventures	438	220	178	(4)	(51)	—	781
Share of profit of joint ventures	55	12	(2)	9	—	—	74
Profit/(loss) on sale or termination of businesses	8	—	—	(1)	—	—	7
Profit/(loss) before financing and taxation	501	232	176	4	(51)	—	862
Financing income					432		432
Financing costs					(3,186)		(3,186)
Taxation					547		547
Profit for the year							(1,345)
Other information							
Segment assets	7,223	1,044	2,334	807	—	(477)	10,931
Investments in joint ventures	320	(7)	5	27	—	—	345
Cash and short-term investments					2,472		2,472
Fair value of swaps hedging fixed rate borrowings					334		334
Income tax assets					694		694
Post-retirement scheme surpluses					453		453
Total assets	7,543	1,037	2,339	834	3,953	(477)	15,229
Segment liabilities	(7,213)	(1,234)	(1,851)	(442)	—	477	(10,263)
Borrowings					(1,348)		(1,348)
Income tax liabilities					(492)		(492)
Post-retirement scheme deficits					(595)		(595)
Total liabilities	(7,213)	(1,234)	(1,851)	(442)	(2,435)	477	(12,698)
Net assets/(liabilities)	330	(197)	488	392	1,518	—	2,531
Expenditure on intangible assets and property, plant and equipment	495	79	67	35			676
Depreciation and amortisation	212	42	32	29			315

2 Segmental analysis continued

	Civil aerospace £m	Defence aerospace £m	Marine £m	Energy £m	Central items £m	Eliminations £m	Group £m
Analysis by business segments for the year ended December 31, 2007							
Revenue from sale of original equipment	1,417	782	996	251	—	—	3,446
Revenue from aftermarket services	2,301	854	546	288	—	—	3,989
Total revenue	3,718	1,636	1,542	539	—	—	7,435
Other operating income – RRSP receipts	50	—	—	—	—	—	50
Operating profit excluding share of profit of joint ventures	263	159	90	(15)	(49)	—	448
Share of profit of joint ventures	45	11	1	9	—	—	66
Loss on sale or termination of businesses	—	—	—	(2)	—	—	(2)
Profit/(loss) before financing and taxation	308	170	91	(8)	(49)	—	512
Financing income					718		718
Financing costs					(497)		(497)
Taxation					(133)		(133)
Profit for the year							600
Other information							
Segment assets	6,032	992	1,693	642	—	(461)	8,898
Investments in joint ventures	214	34	5	31	—	—	284
Cash and short-term investments					1,937		1,937
Fair value of swaps hedging fixed rate borrowings					42		42
Income tax assets					88		88
Post-retirement scheme surpluses					210		210
Total assets	6,246	1,026	1,698	673	2,277	(461)	11,459
Segment liabilities	(3,778)	(1,198)	(1,135)	(303)	—	461	(5,953)
Borrowings					(1,064)		(1,064)
Fair value of swaps hedging fixed rate borrowings					(27)		(27)
Income tax liabilities					(533)		(533)
Post-retirement scheme deficits					(333)		(333)
Total liabilities	(3,778)	(1,198)	(1,135)	(303)	(1,957)	461	(7,910)
Net assets/(liabilities)	2,468	(172)	563	370	320	—	3,549
Expenditure on intangible assets and property, plant and equipment	479	73	33	15			600
Depreciation and amortisation	164	28	21	20			233

2 Segmental analysis continued

Geographical segments

The Group's revenue by destination is shown below:

	2008 £m	2007 £m
United Kingdom	1,462	1,185
Rest of Europe	1,890	1,478
USA	2,214	2,232
Canada	299	274
Asia	2,439	1,785
Africa	143	108
Australasia	255	137
Other	380	236
	9,082	7,435

The following analysis shows the carrying amounts of the Group's assets, and additions to intangible assets and property, plant and equipment, by the geographical area in which the assets are located:

	Assets		Additions to intangible assets and property, plant and equipment	
	2008 £m	2007 £m	2008 £m	2007 £m
United Kingdom	10,275	7,737	517	517
North America	1,764	1,465	78	39
Nordic countries	1,756	1,280	28	18
Germany	893	645	40	20
Other	662	394	13	6
Eliminations	(121)	(62)	—	—
	15,229	11,459	676	600

2 Segmental analysis continued

Underlying performance

As discussed in the Finance Director's review on pages 55 and 56, the Group seeks to present a measure of underlying performance that excludes items considered to be non-underlying in nature. The principles adopted are:

Underlying revenues – Where revenues are denominated in a currency other than the functional currency of the Group undertaking, these exclude the release of the foreign exchange transition hedging reserve and 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 excludes the release of the foreign exchange transition hedging reserve and reflects the transactions at the achieved exchange rates on settled derivative contracts. In 2007, this also excluded £130m of past service post-retirement costs.

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 and the net impact of financing costs related to post-retirement scheme benefits.

Underlying profit adjustments:

	2008		2007	
	Profit before financing £m	(Loss)/profit before tax £m	Profit before financing £m	Profit before tax £m
Profit/(loss) per consolidated income statement	862	(1,892)	512	733
Release of transition hedging reserve	(80)	(80)	(149)	(149)
Realised gains on settled derivative contracts ¹	185	292	415	420
Net unrealised fair value changes to derivative contracts ²	(4)	2,475	—	(251)
Effect of currency on contract accounting	(44)	(44)	(76)	(76)
Revaluation of trading assets and liabilities	—	(14)	—	10
Financial RRSPs – foreign exchange differences and changes in forecast payments	—	121	—	13
Net post-retirement scheme financing	—	22	—	(30)
Post-retirement schemes – past service costs ³	—	—	130	130
Total underlying adjustments	57	2,772	320	67
Underlying profit	919	880	832	800

¹ Loss before tax excludes £24m of realised losses (2007 nil) on derivative contracts settled in respect of trading cash flows that will occur after the year-end.

² Includes £4m of unrealised gains (2007 £nil) in respect of derivative contracts held by joint venture companies (included in profit before financing).

³ During 2007, as part of its ongoing discussions with the Trustees of its UK pension schemes, the Group agreed to reflect changes in HM Revenue & Customs practice and increase the size of the lump sum payment retirees are able to receive by commuting part of the pension. Like many other employers, the Group also increased the amount of the lump sum payment for the pension commuted. Updating the commutation arrangements to reflect these factors increased the post-retirement liability by £100m. The Group also agreed a 2 per cent discretionary increase applicable to pensions that do not benefit from any guaranteed increase, which increased the liability by £30m.

The reconciliation of underlying earnings per ordinary share is provided in note 5.

Underlying profit reconciliation:

	2008			2007		
	Results per consolidated income statement £m	Underlying adjustments £m	Underlying results £m	Results per consolidated income statement £m	Underlying adjustments £m	Underlying results £m
Profit before financing						
Civil aerospace	501	65	566	308	256	564
Defence aerospace	232	(9)	223	170	29	199
Marine	176	7	183	91	22	113
Energy	4	(6)	(2)	(8)	13	5
Central items	(51)	—	(51)	(49)	—	(49)
	862	57	919	512	320	832
Net financing	(2,754)	2,715	(39)	221	(253)	(32)
(Loss)/profit before taxation	(1,892)	2,772	880	733	67	800
Taxation	547	(764)	(217)	(133)	(60)	(193)
(Loss)/profit for the year	(1,345)	2,008	663	600	7	607

3 Net financing

	2008		2007	
	Per consolidated income statement £m	Underlying financing ¹ £m	Per consolidated income statement £m	Underlying financing ¹ £m
Financing income				
Interest receivable	59	59	83	83
Fair value gains on foreign currency contracts (note 16) ²	—	—	215	—
Fair value gains on commodity derivatives (note 16) ²	—	—	36	—
Expected return on post-retirement scheme assets (note 18)	373	—	384	—
	432	59	718	83
Financing costs				
Interest payable	(69)	(69)	(89)	(89)
Fair value losses on foreign currency contracts (note 16) ²	(2,383)	—	—	—
Financial RRSPs – foreign exchange differences and changes in forecast payments (note 16)	(121)	—	(13)	—
Financial charge relating to financial RRSPs (note 16)	(26)	(26)	(26)	(26)
Fair value losses on commodity derivatives (note 16) ²	(96)	—	—	—
Interest on post-retirement scheme liabilities (note 18)	(395)	—	(354)	—
Net foreign exchange losses	(91)	—	(15)	—
Other financing charges	(5)	(3)	—	—
	(3,186)	(98)	(497)	(115)
Net financing	(2,754)	(39)	221	(32)
Analysed as:				
Net interest payable	(10)	(10)	(6)	(6)
Net post-retirement scheme financing	(22)	—	30	—
Net other financing	(2,722)	(29)	197	(26)
Net financing	(2,754)	(39)	221	(32)
¹ See note 2				
² Net (loss)/gain on items held for trading	(2,479)	—	251	—

4 Taxation

	UK		Overseas		Total	
	2008 £m	2007 £m	2008 £m	2007 £m	2008 £m	2007 £m
Current tax						
Current tax charge for the year	7	47	88	72	95	119
Less double tax relief	(7)	(7)	—	—	(7)	(7)
	—	40	88	72	88	112
Adjustments in respect of prior years	(9)	(27)	14	21	5	(6)
	(9)	13	102	93	93	106
Deferred tax						
Deferred tax (credit)/charge for the year	(574)	65	(50)	13	(624)	78
Adjustments in respect of prior years	2	(8)	(18)	(8)	(16)	(16)
Deferred tax credit resulting from reduction in tax rates ¹	—	(23)	—	(12)	—	(35)
	(572)	34	(68)	(7)	(640)	27
Recognised in the income statement	(581)	47	34	86	(547)	133

Other tax charges/(credits)

	2008 £m	2007 £m
Recognised in the statement of recognised income and expense – deferred tax ¹	(15)	95
Recognised directly in equity – current tax	—	(43)
– deferred tax ¹	11	23
	(4)	75

¹ In 2007, the deferred tax assets and liabilities reflected the reductions in corporate tax rates in the UK and Germany which were enacted during that year. The resulting charges or credits were recognised in the income statement except to the extent that they related to items previously charged or credited to the statement of recognised income and expense or equity. Accordingly in 2007, £35m was credited to the income statement, £9m was charged to the statement of recognised income and expense, and £5m was charged directly to equity.

Tax reconciliation

	2008 £m	2007 £m
(Loss)/profit before taxation	(1,892)	733
Less share of profits of joint ventures (note 10)	(74)	(66)
(Loss)/profit before taxation excluding joint ventures	(1,966)	667
Nominal tax charge at UK corporation tax rate 28.5% (2007 30%)	(560)	200
UK R&D credit	(25)	(22)
Rate differences	16	12
Other permanent differences	15	(3)
Benefit to deferred tax from previously unrecognised tax losses and temporary differences	(3)	(6)
Tax losses in year not recognised in deferred tax	21	9
Adjustments in respect of prior years	(11)	(22)
Reduction in opening deferred taxes resulting from reduction in tax rate	—	(35)
	(547)	133
Analysis of taxation charge:		
Underlying items (note 2)	217	193
Non-underlying items	(764)	(60)
	(547)	133

4 Taxation continued

Deferred taxation assets and liabilities

	2008 £m	2007 £m
At January 1	(264)	(111)
Amount credited/(charged) to income statement	640	(27)
Amount credited/(charged) to statement of recognised income and expense (SORIE)	15	(95)
Amount charged to equity	(11)	(23)
On acquisition of business	(5)	—
Exchange movements	3	(8)
At December 31	378	(264)
Analysed as:		
Deferred tax assets	685	81
Deferred tax liabilities	(307)	(345)
	378	(264)

The analysis of the deferred tax position is as follows:

	At January 1, 2008 £m	Recognised in income statement £m	Recognised in SORIE £m	Recognised in equity £m	On acquisition £m	Exchange movements £m	At December 31, 2008 £m
Intangible assets	(140)	(50)	—	—	(4)	(6)	(200)
Property, plant and equipment	(143)	3	—	—	—	(6)	(146)
Other temporary differences	62	(40)	—	(20)	—	(33)	(31)
Amounts recoverable on contracts	(145)	(50)	—	—	—	—	(195)
Pensions and other post-retirement scheme benefits	35	(26)	(7)	—	(1)	48	49
Foreign exchange and commodity financial assets and liabilities	(121)	754	22	—	—	—	655
Losses	124	49	—	9	—	—	182
Advance corporation tax	64	—	—	—	—	—	64
	(264)	640	15	(11)	(5)	3	378

	2008 £m	2007 £m
Advance corporation tax	118	118
Losses and other unrecognised deferred tax assets	67	42
Deferred tax not recognised on unused tax losses and other items on the basis that future economic benefit is uncertain	185	160

In addition, there are temporary differences of **£946m** (2007 £943m) relating to investments in subsidiaries and joint ventures. No deferred tax has been provided in respect of these differences, since the timing of the reversals can be controlled and it is probable that the temporary differences will not reverse in the future.

5 Earnings per ordinary share

Basic earnings per ordinary share (EPS) are calculated by dividing the profit attributable to ordinary shareholders by 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 dividing the profit attributable to ordinary shareholders by the weighted average number of ordinary shares in issue during the year as above, adjusted by the bonus element of share options.

	2008			2007		
	Basic	Potentially dilutive share options	Diluted	Basic	Potentially dilutive share options	Diluted
(Loss)/profit (£m)	(1,340)	—	(1,340)	606	—	606
Weighted average number of shares (millions)	1,820	— ¹	1,820	1,800	38	1,838
EPS (pence)	(73.63)	—	(73.63)	33.67	(0.70)	32.97

¹ As the basic EPS is negative, in accordance with IAS 33 *Earnings per Share*, share options are not considered dilutive.

Underlying² EPS has been calculated as follows:

	2008		2007	
	Pence	£m	Pence	£m
EPS/(Loss)/profit attributable to equity holders of the parent	(73.63)	(1,340)	33.67	606
Release of transition hedging reserve	(4.40)	(80)	(8.28)	(149)
Realised gains on settled derivative contracts	16.05	292	23.33	420
Net unrealised fair value changes to derivative contracts	135.99	2,475	(13.94)	(251)
Effect of currency on contract accounting	(2.42)	(44)	(4.22)	(76)
Revaluation of trading assets and liabilities	(0.77)	(14)	0.56	10
Financial RRSPs – foreign exchange differences and changes in forecast payments	6.65	121	0.72	13
Net post-retirement scheme financing	1.21	22	(1.67)	(30)
Post-retirement schemes – past service costs (note 18)	—	—	7.22	130
Related tax effect	(41.98)	(764)	(1.39)	(25)
Change in rates of corporation tax (note 4)	—	—	(1.94)	(35)
Underlying EPS/Underlying profit attributable to equity holders of the parent	36.70	668	34.06	613

² See note 2.

6 Employee information

	2008 Number	2007 Number
Average weekly number of Group employees during the year		
United Kingdom	22,500	22,900
Overseas	16,500	15,700
	39,000	38,600
Civil aerospace	22,700	22,800
Defence aerospace	5,700	5,600
Marine	8,100	7,700
Energy	2,500	2,500
	39,000	38,600
	£m	£m
Group employment costs¹		
Wages and salaries	1,649	1,534
Social security costs	180	172
Share-based payments (note 21)	40	36
Pensions and other post-retirement scheme benefits (note 18)	218	248
	2,087	1,990

¹ Remuneration of key management personnel is shown in note 24.

7 Auditors' remuneration

Fees payable to the Company's auditors and its associates were as follows:

	2008 £m	2007 £m
Fees payable to the Company's auditors for the audit of the Company's annual financial statements ¹	0.1	0.1
Fees payable to the Company's auditors and its associates for the audit of the Company's subsidiaries pursuant to legislation	3.6	3.7
Total fees payable for the audit services	3.7	3.8
Fees payable to the Company's auditors and its associates for other services:		
Other services pursuant to legislation	0.5	0.1
Other services relating to taxation	0.4	0.3
	4.6	4.2
Fees payable in respect of the Group's pension schemes		
Audit	0.2	0.2
Other services relating to taxation	—	0.1

¹ The level of fees payable to the Company's auditors 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 auditors 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.

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 January 1, 2007	735	374	422	329	70	1,930
Exchange adjustments	59	1	—	—	—	60
Additions	—	129	91	37	39	296
On acquisitions of businesses	7	—	1	—	1	9
Disposals	—	—	—	—	(1)	(1)
At January 1, 2008	801	504	514	366	109	2,294
Exchange adjustments	173	9	5	—	7	194
Additions	—	55	113	97	128	393
On acquisitions of businesses	41	—	—	—	11	52
On disposals of businesses	(2)	—	—	—	—	(2)
Disposals	—	—	—	—	(1)	(1)
At December 31, 2008	1,013	568	632	463	254	2,930
Accumulated amortisation and impairment:						
At January 1, 2007	—	143	132	176	19	470
Provided during the year ¹	—	7	18	28	10	63
At January 1, 2008	—	150	150	204	29	533
Exchange adjustments	—	3	—	—	2	5
Provided during the year ¹	5	12	26	46	18	107
Disposals	—	—	—	—	(1)	(1)
At December 31, 2008	5	165	176	250	48	644
Net book value at December 31, 2008	1,008	403	456	213	206	2,286
Net book value at December 31, 2007	801	354	364	162	80	1,761
Net book value at January 1, 2007	735	231	290	153	51	1,460

¹ Charged to cost of sales except development costs, which are charged to research and development costs.

8 Intangible assets continued

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 group of CGUs.

	Primary reporting segment	2008 £m	2007 £m
Rolls-Royce Deutschland Ltd & Co KG	Civil aerospace	266	203
Commercial marine – arising from the acquisition of Vinters plc	Marine	599	514
Commercial marine – arising from the acquisition of Scandinavian Electric Holding AS	Marine	42	—
Energy – arising from the acquisition of Rolls-Royce Energy Systems Inc.	Energy	73	54
Other	Various	28	30
		1,008	801

Goodwill has been tested for impairment during 2008 on the following basis:

- The carrying value of goodwill has 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 typically forecast the next ten years. Growth rates for the period not covered by the forecasts are based on a range of growth rates that reflect the products, industries and countries in which the relevant CGU or group of CGUs operate.
- The key assumptions on which the cash flow projections for the most recent forecast are based are discount rates, growth rates and the impact of foreign exchange rates on the relationship between selling prices and costs.
- The pre-tax cash flow projections have been discounted at 12.75 per cent, based on the Group's weighted average cost of capital.

The principal value in use assumptions for significant goodwill balances are:

- Rolls-Royce Deutschland Ltd & Co KG – volume of engine deliveries, flying hours of installed fleet and cost escalation, based on current and known future programmes, estimates of customers' fleet requirements and long-term economic forecasts. For the purposes of the impairment test only, cash flows beyond the ten-year forecasts are assumed to grow at 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. A doubling of the discount rate would not lead to an impairment of this balance.
- Vinters plc – volume of equipment deliveries, capture of aftermarket and cost escalation, based on current and known future programmes, estimates of customers' fleet requirements and long-term economic forecasts. For the purposes of the impairment test only, cash flows beyond the ten-year forecasts are assumed to grow at 4 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. It would require a doubling of the discount rate to cause an impairment of this balance.

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 January 1, 2007	587	1,996	155	257	2,995
Exchange adjustments	19	39	—	2	60
Additions	22	88	92	102	304
On acquisitions of businesses	1	—	—	—	1
On disposals of businesses	—	(4)	—	—	(4)
Reclassifications	70	111	4	(185)	—
Transferred to assets held for sale	—	—	(12)	—	(12)
Disposals/write-offs	—	(120)	(65)	—	(185)
At January 1, 2008	699	2,110	174	176	3,159
Exchange adjustments	70	180	6	22	278
Additions	18	104	28	133	283
On acquisitions of businesses	18	—	—	—	18
On disposals of businesses	—	(13)	—	—	(13)
Reclassifications	17	69	—	(86)	—
Transferred to assets held for sale	(32)	(3)	—	—	(35)
Disposals/write-offs	(3)	(97)	(37)	—	(137)
At December 31, 2008	787	2,350	171	245	3,553
Accumulated depreciation and impairment:					
At January 1, 2007	150	1,096	43	—	1,289
Exchange adjustments	7	24	—	—	31
Provided during the year ¹	23	139	8	—	170
On disposals of businesses	—	(2)	—	—	(2)
Transferred to assets held for sale	—	—	(5)	—	(5)
Disposals/write-offs	—	(111)	(26)	—	(137)
At January 1, 2008	180	1,146	20	—	1,346
Exchange adjustments	18	106	3	—	127
Provided during the year ¹	44	155	9	—	208
On disposals of businesses	—	(11)	—	—	(11)
Transferred to assets held for sale	(22)	(3)	—	—	(25)
Disposals/write-offs	(2)	(85)	—	—	(87)
At December 31, 2008	218	1,308	32	—	1,558
Net book value at December 31, 2008	569	1,042	139	245	1,995
Net book value at December 31, 2007	519	964	154	176	1,813
Net book value at January 1, 2007	437	900	112	257	1,706

¹ Depreciation provided during the year is charged to the income statement or included in the cost of inventory as appropriate.

9 Property, plant and equipment continued

Property, plant and equipment includes:

	2008 £m	2007 £m
Net book value of finance leased assets:		
Land and buildings	9	9
Plant and equipment	9	14
Assets held for use in operating leases:		
Cost	141	141
Depreciation	(28)	(18)
Net book value	113	123
Non-depreciable land	113	94
Land and buildings at net book value comprise:		
Freehold	533	489
Long leasehold	12	13
Short leasehold	24	17
	569	519
Capital expenditure commitments – contracted but not provided for	122	82
Cost of fully depreciated assets	475	382

10 Investments

	Joint ventures			Other ¹
	Shares at cost £m	Share of post acquisition reserves £m	Loans £m	Unlisted £m
At January 1, 2007	110	116	14	240
Exchange adjustments	1	5	—	6
Additions	13	—	—	13
Taxation paid by the Group	—	2	—	2
Share of retained profit	—	24	—	24
Disposals	—	(1)	—	(1)
At January 1, 2008	124	146	14	284
Exchange adjustments	14	71	—	85
Additions	30	—	1	31
Taxation paid by the Group	—	3	—	3
Share of retained profit	—	25	—	25
Impairments	(8)	—	(2)	(10)
Transferred to 'Assets held for sale'	—	(2)	—	(2)
Disposals	(13)	(9)	(8)	(30)
Cash flow hedging reserve movement ²	—	(41)	—	(41)
At December 31, 2008	147	193	5	345

¹ These primarily comprise floating rate convertible loan stock.

² One of the Group's joint ventures, Airtanker Holdings Limited, holds interest rate and inflation swaps for which cash flow hedge accounting has been adopted.

Investments in joint ventures are represented by:

	2008 £m	2007 £m
Share of aggregate assets:		
Non-current assets ³	1,041	658
Current assets	940	635
Share of aggregate liabilities: ⁴		
Current liabilities	(841)	(523)
Non-current liabilities	(795)	(486)
	345	284
³ Non-current assets include goodwill of	10	7
⁴ Liabilities include borrowings of	(655)	(372)

	2008 £m	2007 £m
Share of income	104	94
Share of net financing	(16)	(21)
Share of taxation	(14)	(7)
Share of profit of joint ventures recognised in the income statement	74	66
Dividends received	(59)	(42)
Share of retained profit	15	24

The tax charge on joint venture profits represents an effective tax rate of **16 per cent** (2007 10 per cent), an increase of 6 per cent. This results from a change in profit mix between joint ventures taxed at different effective rates.

The principal joint ventures are listed on pages 143 and 144.

11 Inventory

	2008 £m	2007 £m
Raw materials	328	223
Work in progress	1,008	732
Long-term contracts work in progress	34	93
Finished goods	1,192	1,123
Payments on account	38	32
	2,600	2,203
Inventories stated at net realisable value	144	154
Amount of inventory write-down	81	79
Reversal of inventory write-down	15	6

12 Trade and other receivables

	2008 £m	2007 £m
Trade receivables	1,421	889
Amounts recoverable on contracts	1,448	904
Amounts owed by joint ventures	451	300
Other receivables	404	315
Prepayments and accrued income	205	177
	3,929¹	2,585¹
Analysed as (note 16):		
Financial instruments:		
Trade receivables and similar items	1,939	1,211
Other non-derivative financial assets	369	321
Non-financial instruments	1,621	1,053
	3,929	2,585

¹ Trade and other receivables expected to be recovered in more than one year:

Trade receivables	24	26
Amounts recoverable on contracts	1,222	704
Amounts owed by joint ventures	28	29
Other receivables	59	40
Prepayments and accrued income	38	28
	1,371	827

13 Cash and cash equivalents

	2008 £m	2007 £m
Cash at bank and in hand	940	1,265
Short-term deposits	1,531	632
	2,471	1,897
Overdrafts (note 14)	(9)	(25)
Cash and cash equivalents per cash flow statement (page 88)	2,462	1,872
Cash held as collateral against third party obligations	85	60

14 Borrowings

	Current		Non-current	
	2008 £m	2007 £m	2008 £m	2007 £m
Unsecured				
Overdrafts	9	25	—	—
Bank loans	11	3	5	2
7 ¾% Notes 2016 £200m	—	—	200	200
5.84% Notes 2010 US\$187m ¹	—	—	136	97
6.38% Notes 2013 US\$230m ¹	—	—	178	123
6.55% Notes 2015 US\$83m ¹	—	—	67	46
4 ½% Notes 2011 €750m ²	—	—	738	534
Other loan 2008 (interest rate nil)	—	1	—	—
Secured				
Bank loans ³	—	—	—	24
Obligations under finance leases: ⁴ (note 22)				
Less than one year	3	5	—	—
Between one and two years	—	—	—	3
Between two and five years	—	—	—	—
After five years	—	—	1	1
	23	34	1,325	1,030
Repayable				
Between one and two years – by instalments			2	4
– otherwise			136	—
Between two and five years – by instalments			1	1
– otherwise			916	655
After five years – by instalments			3	1
– otherwise			267	369
			1,325	1,030

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 swap agreements under which counterparties have undertaken to pay amounts at fixed rates of interest and exchange in consideration for amounts payable at variable rates of interest and at fixed exchange rates.

³ Secured on aircraft.

⁴ Obligations under finance leases are secured by related leased assets.

15 Trade and other payables

	Current		Non-current	
	2008 £m	2007 £m	2008 £m	2007 £m
Payments received on account ¹	1,635	1,226	549	332
Trade payables	1,042	778	—	—
Amounts owed to joint ventures	372	272	9	32
Other taxation and social security	55	64	—	—
Other payables	1,170	766	206	103
Accruals and deferred income	1,461	1,220	554	498
	5,735	4,326	1,318	965

¹ Includes payments received from joint ventures	209	195	107	25
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Total trade and other payables are analysed as (note 16):

	2008 £m	2007 £m
Financial instruments:		
Trade payables and similar items	2,264	1,872
Other non-derivative financial liabilities	430	315
Non-financial instruments	4,359	3,104
	7,053	5,291

16 Financial instruments

This note should be read in conjunction with the Finance Director's review on pages 54 to 63.

Carrying values and fair values of financial instruments

The carrying values of the Group's assets and liabilities are analysed as follows:

		2008				2007			
		Financial instruments				Financial instruments			
	Notes	Derivative £m	Non- derivative £m	Non-financial instruments £m	Total £m	Derivative £m	Non- derivative £m	Non-financial instruments £m	Total £m
Assets:									
Unlisted non-current asset investments ^{1,2}	10	—	53	—	53	—	57	—	57
Other non-current assets		—	—	5,764	5,764	—	—	4,149	4,149
Trade and other receivables: ³									
Trade receivables and similar items ¹	12	—	1,939	—	1,939	—	1,211	—	1,211
Other non-derivative financial assets ¹	12	—	369	—	369	—	321	—	321
Non-financial instruments	12	—	—	1,621	1,621	—	—	1,053	1,053
Other financial assets ⁴		390	—	—	390	514	—	—	514
Short-term investments ^{1,3}		—	1	—	1	—	40	—	40
Cash and cash equivalents: ³									
Cash at bank and in hand	13	—	940	—	940	—	1,265	—	1,265
Short-term deposits	13	—	1,531	—	1,531	—	632	—	632
Other current assets		—	—	2,621	2,621	—	—	2,217	2,217
		390	4,833	10,006	15,229	514	3,526	7,419	11,459
Liabilities:									
Borrowings – current ⁴	14	—	(23)	—	(23)	—	(34)	—	(34)
– non-current ⁴	14	—	(1,325)	—	(1,325)	—	(1,030)	—	(1,030)
Other financial liabilities: ⁴									
Financial RRSPs		—	(455)	—	(455)	—	(315)	—	(315)
B Shares		—	—	—	—	—	(16)	—	(16)
Other		(2,386)	—	—	(2,386)	(57)	—	—	(57)
Trade and other payables: ³									
Trade payables and similar items	15	—	(2,264)	—	(2,264)	—	(1,872)	—	(1,872)
Other non-derivative financial liabilities	15	—	(430)	—	(430)	—	(315)	—	(315)
Non-financial instruments	15	—	—	(4,359)	(4,359)	—	—	(3,104)	(3,104)
Other liabilities		—	—	(1,456)	(1,456)	—	—	(1,167)	(1,167)
		(2,386)	(4,497)	(5,815)	(12,698)	(57)	(3,582)	(4,271)	(7,910)
Net assets/(liabilities)		(1,996)	336	4,191	2,531	457	(56)	3,148	3,549

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 arm's length transaction. Fair values have been determined with reference to available market information at the balance sheet date, using the methodologies described below.

¹ Loans and receivables.

² These primarily comprise floating rate convertible loan stock. The conversion conditions are such that fair value approximates to the book value.

³ 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.

⁴ Where available, market values have been used to determine fair values. Where market values are not readily available (principally in respect of derivatives, borrowings and financial RRSPs), fair values have been estimated by discounting expected future cash flows using prevailing interest rate curves. Amounts denominated in foreign currencies are valued at the exchange rate prevailing at the balance sheet date.

16 Financial instruments continued

Fair values equate to book values for both 2008 and 2007, with the following exceptions:

	Book value £m	2008 Fair value £m	Book value £m	2007 Fair value £m
Borrowings – current	(23)	(23)	(34)	(34)
– non-current	(1,325)	(1,291)	(1,030)	(1,058)
Financials RRSPs	(455)	(487)	(315)	(340)

The carrying values of financial assets and liabilities by category, as defined by IAS 39 *Financial Instruments: Recognition and Measurement*, are as follows:

	2008 £m	2007 £m
Assets		
Held for trading ¹	390	514
Loans and receivables ²	3,892	2,221
Available for sale ²	1	40
Cash	940	1,265
Liabilities		
Held for trading ¹	(2,386)	(57)
Financial liabilities at amortised cost	(4,497)	(3,582)
	(1,660)	401

¹ All financial assets and liabilities classified as held for trading are treated as current.

² In the comparative figures, £592m has been reclassified from available for sale to loans and receivables.

Carrying values of other financial assets and liabilities

	Foreign exchange contracts £m	Commodity contracts £m	Interest rate contracts £m	Financial RRSPs £m	B Shares £m	Total £m
At December 31, 2008						
Assets	112	—	278	—	—	390
Liabilities	(2,293)	(89)	(4)	(455)	—	(2,841)
	(2,181)	(89)	274	(455)	—	(2,451)
At December 31, 2007						
Assets	433	39	42	—	—	514
Liabilities	(54)	—	(3)	(315)	(16)	(388)
	379	39	39	(315)	(16)	126

Other financial liabilities are analysed as follows:

	2008 £m	2007 £m
Current liabilities	(2,450)	(85)
Non-current liabilities	(391)	(303)
	(2,841)	(388)

16 Financial instruments continued

Foreign exchange and commodity financial instruments

The Group uses various financial instruments to manage its exposure to movements in foreign exchange rates. The Group uses commodity swaps to manage its exposure to movements in the price of commodities (jet fuel and base metals). From January 1, 2005, the Group has not included foreign exchange or commodity financial instruments in any cash flow hedging relationships for accounting purposes. 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.

Movements in the fair values of foreign exchange and commodity instruments were as follows:

	Foreign exchange instruments			Commodity instruments		
	Total £m	Included in transition hedging reserve £m	Included in income statement £m	Total £m	Included in transition hedging reserve £m	Included in income statement £m
At January 1, 2007	554	254	—	39	—	—
Fair value changes to derivative contracts not in accounting hedging relationships ¹	215	—	215	36	—	36
Fair value changes to fair value hedges ^{1,2}	(6)	—	(6)	—	—	—
Fair value of contracts settled	(384)	—	—	(36)	—	—
Transferred to revenue	—	(149)	149	—	—	—
At January 1, 2008	379	105	—	39	—	—
Fair value changes to derivative contracts not in accounting hedging relationships ¹	(2,383)	—	(2,383)	(96)	—	(96)
Fair value changes to fair value hedges ^{1,2}	83	—	83	—	—	—
Fair value of contracts settled	(236)	—	—	(32)	—	—
Fair value of derivative contracts assumed on formation of joint venture	(24)	—	—	—	—	—
Transferred to revenue	—	(80)	80	—	—	—
At December 31, 2008	(2,181)	25	—	(89)	—	—

¹ Included in financing.

² Loss on related hedged items **£83m** (2007 £6m gain).

Interest rate financial instruments

The Group uses interest rate swaps, forward rate agreements and interest rate caps to manage its exposure to movements in interest rates. Where the effectiveness of the hedge relationship in a cash flow hedge is demonstrated, changes in the fair value that are deemed effective are included in the hedging reserve and released to match actual payments on the hedged item.

Movements in the fair values of interest rate financial instruments were as follows:

	Total £m	Included in fair value hedging relationships £m	Other interest rate financial instruments £m	Included in income statement £m
At January 1, 2007	15	18	(3)	—
Fair value changes ^{1,2}	24	24	—	24
At January 1, 2008	39	42	(3)	—
Fair value changes ^{1,2}	235	236	(1)	235
At December 31, 2008	274	278	(4)	—

¹ Included in financing.

² Loss on related hedged items **£236m** (2007 £24m).

16 Financial instruments continued

Financial risk and revenue sharing partnerships (RRSPs)

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.

Movements in the amortised cost values of financial RRSPs were as follows:

	2008 £m	2007 £m
At January 1	315	324
Cash paid to partners	(53)	(55)
Addition	40	—
Exchange adjustments direct to reserves	6	7
Financing charge ¹	26	26
Excluded from underlying profit:		
Exchange adjustments ¹	118	(7)
Restructuring of financial RRSP agreements and changes in forecast payments ¹	3	20
At December 31	455	315

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; 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 in the Finance Director's review.

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 single A 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, 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 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 one month. The Group does not consider that these are subject to significant price risk.

16 Financial instruments continued

Derivative financial instruments

The nominal amounts and fair values of derivative financial instruments are as follows, analysed by year of expected maturity:

						2008	
	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
Foreign exchange contracts:							
Fair value hedges	(280)	—	(106)	(128)	(46)	56	—
Non-hedge accounted	9,653	1,760	2,080	5,711	102	56	(2,293)
Interest rate contracts:							
Fair value hedges	848	—	130	660	58	278	—
Non-hedge accounted	65	25	22	—	18	—	(4)
Commodity contracts:							
Non-hedge accounted	271	106	73	92	—	—	(89)
	10,557	1,891	2,199	6,335	132	390	(2,386)
						2007	
	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
Foreign exchange contracts:							
Fair value hedges	(280)	—	—	(105)	(175)	—	(27)
Non-hedge accounted	5,168	2,135	1,816	1,217	—	433	(27)
Interest rate contracts:							
Fair value hedges	751	—	—	594	157	42	—
Non-hedge accounted	74	20	18	16	20	—	(3)
Commodity contracts:							
Non-hedge accounted	166	91	55	20	—	39	—
	5,879	2,246	1,889	1,742	2	514	(57)

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.

16 Financial instruments continued

Derivative financial instruments related to foreign exchange risks are denominated in the following currencies:

	2008 Currencies purchased forward				Total £m
	Sterling £m	US dollar £m	Euro £m	Other £m	
Currencies sold forward:					
Sterling	—	280	—	43	323
US dollar	10,096	—	1,189	1,097	12,382
Euro	—	—	—	614	614
Other	2	44	166	91	303

	2007 Currencies purchased forward				Total £m
	Sterling £m	US dollar £m	Euro £m	Other £m	
Currencies sold forward:					
Sterling	—	280	—	30	310
US dollar	5,136	—	922	431	6,489
Euro	—	—	—	497	497
Other	3	12	151	98	264

Other derivative financial instruments are denominated in the following currencies:

	2008 £m	2007 £m
Sterling	18	20
US dollar	791	470
Euro	500	500

16 Financial instruments continued

Non-derivative financial instruments

Non-derivative financial instruments are denominated in the following currencies:

					2008
	Sterling £m	US dollar £m	Euro £m	Other £m	Total £m
Assets:					
Unlisted non-current investments	46	1	4	2	53
Trade receivables and similar items	249	1,228	211	251	1,939
Other non-derivative financial assets	91	110	85	83	369
Short-term investments	—	—	—	1	1
Cash at bank and in hand	99	552	129	160	940
Short-term deposits	479	287	744	21	1,531
	964	2,178	1,173	518	4,833
Liabilities:					
Borrowings – current	(3)	(4)	(2)	(14)	(23)
– non-current	(200)	(381)	(744)	—	(1,325)
Financial RRSPs	—	(455)	—	—	(455)
Trade payables and similar items	(763)	(979)	(250)	(272)	(2,264)
Other non-derivative financial liabilities	(144)	(151)	(58)	(77)	(430)
	(1,110)	(1,970)	(1,054)	(363)	(4,497)
	(146)	208	119	155	336
					2007
	Sterling £m	US dollar £m	Euro £m	Other £m	Total £m
Assets:					
Unlisted non-current investments	46	6	2	3	57
Trade receivables and similar items	233	720	133	125	1,211
Other non-derivative financial assets	150	68	40	63	321
Short-term investments	40	—	—	—	40
Cash at bank and in hand	161	376	608	120	1,265
Short-term deposits	319	293	3	17	632
	949	1,463	786	328	3,526
Liabilities:					
Borrowings – current	(5)	(3)	(1)	(25)	(34)
– non-current	(203)	(290)	(537)	—	(1,030)
Financial RRSPs	—	(315)	—	—	(315)
B Shares	(16)	—	—	—	(16)
Trade payables and similar items	(959)	(495)	(248)	(170)	(1,872)
Other non-derivative financial liabilities	(148)	(85)	(35)	(47)	(315)
	(1,331)	(1,188)	(821)	(242)	(3,582)
	(382)	275	(35)	86	(56)

16 Financial instruments continued

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:

	2008			
	Sterling £m	US dollar £m	Euro £m	Other £m
Functional currency of Group operation	—	11	(4)	1
Sterling	—	—	—	—
US dollar	6	—	—	8
Other	—	—	(2)	5
				3

	2007			
	Sterling £m	US dollar £m	Euro £m	Other £m
Functional currency of Group operation	—	3	—	2
Sterling	—	—	—	—
US dollar	6	—	—	6
Euro	—	5	—	—
Other	—	4	9	12
				25

Ageing beyond contractual due date

The ageing beyond contractual due date of the Group's financial assets is:

	2008			
	Within terms £m	Up to three months overdue £m	Between three months and one year overdue £m	More than one year overdue £m
Assets:				
Unlisted non-current asset investments	53	—	—	—
Trade receivables and similar items	1,516	322	93	8
Other non-derivative financial assets	354	9	4	2
Other financial assets	390	—	—	—
Short-term investments	1	—	—	—
Cash at bank and in hand	940	—	—	—
Short-term deposits	1,531	—	—	—
	4,785	331	97	10
				5,223

	2007			
	Within terms £m	Up to three months overdue £m	Between three months and one year overdue £m	More than one year overdue £m
Assets:				
Unlisted non-current asset investments	57	—	—	—
Trade receivables and similar items	973	186	52	—
Other non-derivative financial assets	296	8	17	—
Other financial assets	514	—	—	—
Short-term investments	40	—	—	—
Cash at bank and in hand	1,265	—	—	—
Short-term deposits	632	—	—	—
	3,777	194	69	—
				4,040

16 Financial instruments continued

Contractual maturity analysis

	Gross cash flows					2008
	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
Borrowings:						
Unsecured bank loans	(20)	(2)	(1)	(3)	1	(25)
Unsecured bond issues	(69)	(200)	(1,004)	(309)	263	(1,319)
Other secured	(3)	—	—	(1)	—	(4)
	(92)	(202)	(1,005)	(313)	264	(1,348)
Other:						
Trade payables and similar items	(2,255)	(5)	(4)	—	—	(2,264)
Derivative financial liabilities	(252)	(225)	(817)	(963)	(129)	(2,386)
Financial RRSPs	(56)	(177)	(127)	(198)	103	(455)
Other non-derivative financial liabilities	(408)	(21)	(1)	—	—	(430)
	(2,971)	(428)	(949)	(1,161)	(26)	(5,535)
	(3,063)	(630)	(1,954)	(1,474)	238	(6,883)
						2007
	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
Borrowings:						
Unsecured bank loans	(26)	(1)	(1)	—	—	(28)
Other unsecured	(3)	—	—	—	—	(3)
Unsecured bond issues	(56)	(56)	(773)	(432)	317	(1,000)
Secured bank loans	(1)	(1)	(26)	—	4	(24)
Other secured	(6)	(3)	—	(1)	1	(9)
	(92)	(61)	(800)	(433)	322	(1,064)
Other:						
Trade payables and similar items	(1,862)	(2)	(7)	(1)	—	(1,872)
Derivative financial liabilities	(13)	(2)	(4)	20	(58)	(57)
Financial RRSPs	(38)	(34)	(201)	(141)	99	(315)
B Shares	(16)	—	—	—	—	(16)
Other non-derivative financial liabilities	(271)	(1)	(29)	(14)	—	(315)
	(2,200)	(39)	(241)	(136)	41	(2,575)
	(2,292)	(100)	(1,041)	(569)	363	(3,639)

16 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.

	Effective interest rate %	Total £m	Period in which interest rate reprices					2008
			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	9.6769%	1	1	—	—	—	—	
Cash at bank and in hand ²		940	940	—	—	—	—	
Short-term deposits ³		1,531	1,531	—	—	—	—	
Unsecured bank loans								
€2.5m floating rate loan	EURIBOR +1.2	(2)	(2)	—	—	—	—	
€5m floating rate loan	EURIBOR +0.5	(5)	(5)	—	—	—	—	
Overdrafts ⁴		(9)	(9)	—	—	—	—	
55m Indian Rupee Fixed Rate Loan	13.5455%	(1)	—	(1)	—	—	—	
79.4m Norwegian Kroner Floating Rate Loan	NIBOR + 1.1	(8)	(8)	—	—	—	—	
Effect of interest rate swaps	3.3521%	—	40	—	(22)	—	(18)	
Unsecured bond issues								
7 ¾% Notes 2016 £200m	7.3750%	(200)	—	—	—	—	(200)	
5.84% Notes 2010 US\$187m	5.8400%	(136)	—	—	(136)	—	—	
Effect of interest rate swaps	USD LIBOR +1.159	—	(136)	—	136	—	—	
6.38% Notes 2013 US\$230m	6.3800%	(178)	—	—	—	(178)	—	
Effect of interest rate swaps	USD LIBOR +1.26	—	(178)	—	—	178	—	
6.55% Notes 2015 US\$83m	6.5500%	(67)	—	—	—	—	(67)	
Effect of interest rate swaps	USD LIBOR +1.24	—	(67)	—	—	—	67	
4 ½% Notes 2011 €750m	4.5000%	(738)	—	—	—	(738)	—	
Effect of interest rate swaps	GBP LIBOR +0.911	—	(738)	—	—	738	—	
Other secured								
Obligations under finance leases	5.5226%	(4)	(3)	—	—	—	(1)	
		1,124	1,366	(1)	(22)	—	(219)	

16 Financial instruments continued

Interest rate risk continued

	Effective interest rate %	Total £m	Period in which interest rate reprices					2007
			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	5.5913%	40	14	6	—	12	8	
Cash at bank and in hand ²		1,265	1,265	—	—	—	—	
Short-term deposits ³		632	632	—	—	—	—	
Unsecured bank loans								
€4m floating rate loan	EURIBOR +1.2	(3)	(3)	—	—	—	—	
Overdrafts ⁴		(25)	(25)	—	—	—	—	
Effect of interest rate swaps	1.2277%	—	54	—	(18)	(16)	(20)	
Other unsecured								
South Korean Won floating rate loan	KRW LIBOR +0.9	(2)	(2)	—	—	—	—	
Other loan 2008 (interest rate nil)	0.0000%	(1)	(1)	—	—	—	—	
Unsecured bond issues								
7 ¾% Notes 2016 £200m	7.3750%	(200)	—	—	—	—	(200)	
5.84% Notes 2010 US\$187m	5.8400%	(97)	—	—	—	(97)	—	
Effect of interest rate swaps	USD LIBOR +1.159	—	(97)	—	—	97	—	
6.38% Notes 2013 US\$230m	6.3800%	(123)	—	—	—	—	(123)	
Effect of interest rate swaps	USD LIBOR +1.26	—	(123)	—	—	—	123	
6.55% Notes 2015 US\$83m	6.5500%	(46)	—	—	—	—	(46)	
Effect of interest rate swaps	USD LIBOR +1.24	—	(46)	—	—	—	46	
4 ½% Notes 2011 €750m	4.5000%	(534)	—	—	—	(534)	—	
Effect of interest rate swaps	GBP LIBOR +0.911	—	(534)	—	—	534	—	
Secured bank loans								
US\$ floating rate loan	USD LIBOR +0.53	(24)	(24)	—	—	—	—	
Other secured								
Obligations under finance leases	6.0183%	(9)	(2)	(3)	(3)	—	(1)	
		873	1,108	3	(21)	(4)	(213)	

¹ Interest on the short-term investments are at fixed rates.

² Cash at bank and in hand comprises bank balances and demand deposits and earns interest at rates based on daily bank deposit rates.

³ Short-term deposits are deposits placed on money markets for periods up to three months and earn interest at the respective short-term deposit rates.

⁴ 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.

In addition, the Group has undrawn committed borrowing facilities available as follows:

	2008 £m	2007 £m
Expiring within one year	—	—
Expiring in one to two years	—	—
Expiring thereafter	650	450
	650	450

16 Financial instruments continued

Sensitivity analysis

The Group is exposed to a number of foreign currencies. The most significant transactional currency exposures are US dollar with sterling and US dollar with euro.

At December 31, 2008 if sterling had weakened ten per cent against the US dollar with all other variables held constant, profit after tax for the year and equity would have been **£890m** lower (2007 £329m). If sterling had strengthened ten per cent against the US dollar with all other variables held constant, profit after tax for the year and equity would have been **£728m** higher (2007 £269m). There would have been no change to the underlying results that exclude unrealised gains and losses on foreign exchange derivatives.

At December 31, 2008 if the euro had weakened ten per cent against the US dollar with all other variables held constant, profit after tax and equity for the year would have been **£102m** lower (2007 £73m). If the euro had strengthened ten per cent against the US dollar with all other variables held constant, profit after tax for the year and equity would have been **£84m** higher (2007 £60m). There would have been no change to the underlying results that exclude unrealised gains and losses on foreign exchange derivatives.

At December 31, 2008 if the price of commodities had been ten per cent lower, with all other variables remaining constant, profit after tax for the year and equity would have been **£13m** lower (2007 £16m), arising mainly as the result of lower fair value gains on derivative contracts. If the price of commodities had been ten per cent higher, with all other variables remaining constant, profit after tax and equity would have been **£13m** higher (2007 £16m), arising mainly as the result of higher fair value gains on derivatives. There would have been no change to the underlying results that exclude unrealised gains and losses on commodity derivatives.

At December 31, 2008 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 cash and this is mitigated as described under the interest rate risk management policies on page 61 and 62.

B Shares and payments to shareholders

From July 2004 to July 2008, the Company issued non-cumulative redeemable convertible preference shares (B Shares) as an alternative to paying a cash dividend. B Shares in respect of a year are issued in the following year. Shareholders were able to redeem any number of their B Shares for cash or convert them into ordinary shares. Any B Shares retained attracted a dividend of 75 per cent of LIBOR on the 0.1p nominal value of each share, paid on a twice-yearly basis, and had limited voting rights. In certain circumstances the Company had the option to compulsorily redeem the B Shares, at any time, if the aggregate number of B Shares in issue was less than ten per cent of the aggregate number of B Shares issued, or on the acquisition or capital restructuring of the Company. The Company exercised this option in September 2008 and redeemed all B Shares then in issue.

Since January 2009, following approval by shareholders at the 2008 Annual General Meeting, the Company has issued non-cumulative redeemable preference shares (C Shares) as an alternative to paying a cash dividend. The only significant difference is that C Shares, unlike B Shares, will not carry the right to convert into ordinary shares.

Movements in the B Shares during the year were as follows:

	2008		2007	
	B Shares of 0.1p each Millions	Nominal value £m	B Shares of 0.1p each Millions	Nominal value £m
Authorised				
At January 1, and December 31	1,000,000	1,000	1,000,000	1,000
Issued and fully paid				
At January 1	15,859	16	12,616	13
Issued	236,740	237	172,006	172
Converted into ordinary shares	(52,524)	(53)	(71,819)	(72)
Redeemed	(200,075)	(200)	(96,944)	(97)
At December 31	—	—	15,859	16

Payments to shareholders in respect of the year represent the value of B Shares or C Shares to be issued in respect of the results for the year.

Issues of B Shares and C Shares were declared as follows:

	2008		2007	
	C Shares		B Shares	
	Pence per share	£m	Pence per share	£m
Interim	5.72	105	4.04	73
Final	8.58	158	8.96	164
	14.30	263	13.00	237

17 Provisions

	At December 31, 2007 £m	Exchange adjustments £m	Acquisitions/ disposals of businesses £m	Unused amounts reversed £m	Charged to income statement £m	Utilised £m	At December 31, 2008 £m
Warranties and guarantees	165	19	1	(6)	39	(36)	182
Contract loss	28	4	—	—	19	(13)	38
Customer financing	44	5	—	—	29	(5)	73
Insurance	40	—	—	(2)	4	(4)	38
Restructuring	11	—	—	(2)	16	(9)	16
Other	13	2	(2)	(1)	11	(1)	22
	301	30	(1)	(11)	118	(68)	369

Analysed as:

	2008 £m	2007 £m
Current liabilities	181	121
Non-current liabilities	188	180
	369	301

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.

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.

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 'Sales financing' in the Finance Director's review on page 62. 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. Based on the assumptions used to estimate the customer finance provision, it is estimated that the provision will be utilised as follows:

	2008 £m	2007 £m
Potential claims with specific claim dates:		
In one year or less	—	1
In more than one year but less than five years	6	3
In more than five years	27	14
Potential claims that may arise at any time by date of expiry of the guarantee:		
Up to one year	31	16
Up to five years	4	4
Thereafter	5	6
	73	44

18 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.

The valuations of the defined benefit schemes are based on the most recent funding valuations, updated by the scheme actuaries to December 31, 2008. The most recent funding valuations of the main UK schemes were:

Scheme	Valuation date
Rolls-Royce Pension Fund	March 31, 2006
Rolls-Royce Group Pension Scheme	April 5, 2007
Vickers Group Pension Scheme	March 31, 2007

Amounts recognised in the income statement

	2008			2007		
	UK schemes £m	Overseas schemes £m	Total £m	UK schemes £m	Overseas schemes £m	Total £m
Defined benefit schemes:						
Current service cost	127	27	154	100	25	125
Past service cost	5	3	8	131	2	133
Ex-gratia payment paid directly by the Group	8	—	8	—	—	—
	140	30	170	231	27	258
Defined contribution schemes	6	20	26	3	17	20
Operating cost	146	50	196	234	44	278
Financing (income)/costs in respect of defined benefit schemes:						
Expected return on assets	(352)	(21)	(373)	(367)	(17)	(384)
Interest on liabilities	358	37	395	323	31	354
	6	16	22	(44)	14	(30)
Total income statement charge	152	66	218	190	58	248

The operating cost is charged as follows:

	Defined benefit		Defined contribution		Total	
	2008 £m	2007 £m	2008 £m	2007 £m	2008 £m	2007 £m
Cost of sales	124	223	19	15	143	238
Commercial and administrative costs	33	26	5	4	38	30
Research and development	13	9	2	1	15	10
	170	258	26	20	196	278

Amounts recognised in the statement of recognised income and expense

	2008 £m	2007 £m
Actuarial gain on scheme assets	178	161
Experience gains on scheme liabilities	766	350
Movement in unrecognised surplus	(928)	(112)
	16	399

In December 2007, PaySave was introduced 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 has been a decrease in wages and salaries and a corresponding increase in pension costs of **£38m** (2007 £3m) in the year.

18 Post-retirement benefits continued

Defined benefit schemes

Assumptions

The principal actuarial assumptions used at the balance sheet date were as follows:

	2008		2007	
	UK schemes %	Overseas schemes %	UK schemes %	Overseas schemes %
Rate of increase in salaries	4.5	3.9	5.0	3.8
Rate of increase of pensions in payment ¹	2.9	0.5	3.5	0.4
Discount rate	6.4	6.1	5.8	6.0
Expected rate of return on scheme assets	4.1	6.9	5.4	7.5
Inflation assumption	3.0	2.6	3.5	2.5

¹ Benefits accruing after April 5, 2005 are assumed to increase in payment at a rate of 2.1 per cent.

The discount rates are determined by reference to the market yields on AA rated corporate bonds. For the main UK 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 less significant UK schemes and overseas 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 PA92 actuarial tables, with medium cohort, published by the Institute of Actuaries, projected forward and, where appropriate, 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	17.5 years to 22.2 years
Future pensioner	19.5 years to 23.9 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 8.9 per cent grading down to 5.0 per cent over seven years.

Amounts recognised in the balance sheet

	2008			2007		
	UK schemes £m	Overseas schemes £m	Total £m	UK schemes £m	Overseas schemes £m	Total £m
Present value of funded obligations	(5,719)	(390)	(6,109)	(6,335)	(293)	(6,628)
Fair value of scheme assets	7,163	283	7,446	6,626	277	6,903
	1,444	(107)	1,337	291	(16)	275
Present value of unfunded obligations	—	(437)	(437)	—	(284)	(284)
Unrecognised surplus ¹	(1,036)	(6)	(1,042)	(110)	(4)	(114)
Net asset/(liability) recognised in the balance sheet	408	(550)	(142)	181	(304)	(123)
Analysed as:						
Post-retirement scheme surpluses	453	—	453	210	—	210
Post-retirement scheme deficits	(45)	(550)	(595)	(29)	(304)	(333)
	408	(550)	(142)	181	(304)	(123)

¹ Where a surplus has arisen on a scheme, in accordance with IAS 19, the surplus is recognised as an asset only if it represents an economic benefit available to the Group in the future. Any surplus in excess of this benefit is not recognised in the balance sheet.

18 Post-retirement benefits continued

Changes in present value of defined benefit obligations

	2008			2007		
	UK schemes £m	Overseas schemes £m	Total £m	UK schemes £m	Overseas schemes £m	Total £m
At January 1	(6,335)	(577)	(6,912)	(6,338)	(561)	(6,899)
Exchange adjustments	—	(196)	(196)	—	(15)	(15)
Current service cost	(127)	(27)	(154)	(100)	(25)	(125)
Past service cost	(5)	(3)	(8)	(131)	(2)	(133)
Finance cost	(358)	(37)	(395)	(323)	(31)	(354)
Contributions by employees	(4)	(2)	(6)	(38)	(2)	(40)
Net benefits paid out	331	25	356	286	18	304
Actuarial gains/(losses)	776	(10)	766	309	41	350
Transfers	3	—	3	—	—	—
At December 31	(5,719)	(827)	(6,546)	(6,335)	(577)	(6,912)
Funded schemes	(5,719)	(390)	(6,109)	(6,335)	(293)	(6,628)
Unfunded schemes	—	(437)	(437)	—	(284)	(284)

Changes in fair value of scheme assets

	2008			2007		
	UK schemes £m	Overseas schemes £m	Total £m	UK schemes £m	Overseas schemes £m	Total £m
At January 1	6,626	277	6,903	5,673	233	5,906
Exchange adjustments	—	63	63	—	9	9
Expected return on assets	352	21	373	367	17	384
Contributions by employer	248	31	279	677	30	707
Contributions by employees	4	2	6	38	2	40
Benefits paid out	(331)	(25)	(356)	(286)	(18)	(304)
Actuarial gains/(losses)	264	(86)	178	157	4	161
At December 31	7,163	283	7,446	6,626	277	6,903

Actual return on scheme assets	551	545
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The fair value of the scheme assets in the schemes and the expected rates of return at December 31, were as follows:

	2008		2007	
	Expected rate of return %	Market value £m	Expected rate of return %	Market value £m
UK schemes:				
LDI portfolio ¹	3.5	5,833	4.7	4,595
Equities	7.2	1,141	7.8	1,651
Sovereign debt	3.9	110	4.6	48
Corporate bonds	5.5	110	5.1	88
Other	1.9	(31)	4.9	244
	4.1	7,163	5.4	6,626
Overseas schemes:				
Equities	9.0	134	9.0	165
Corporate bonds	4.9	130	4.8	86
Other	5.9	19	6.4	26
	6.9	283	7.5	277

¹ A portfolio of swap contracts, backed by short-term money market deposits, that is designed to hedge, on an economic basis, the majority of the interest rate and inflation risks associated with the schemes' obligations.

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 rate of return for LDI portfolios is determined by the implicit yield on the portfolio at the balance sheet date.

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 1.75 per cent per annum respectively.

The expected rates of return above are the weighted average of the rates for each scheme.

18 Post-retirement benefits continued

Future contributions

The Group expects to contribute approximately £292m to its defined benefit schemes in 2009.

Sensitivities

The revised investment strategies are designed to hedge the risks from interest rates and inflation on an economic basis. A reduction of 0.25 per cent in the discount rate would increase the obligations of the principal UK defined benefit schemes by approximately £220m. An equivalent movement in interest rates would increase the fair value of the assets by approximately £320m. 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 in excess of 85 per cent. The principal remaining risks relate to the assumptions for mortality and increases in salaries. If the age ratings in respect of the principal UK defined benefit schemes were increased by one year, the scheme liabilities would increase by £118m. If the rate of increase in salaries were 0.5 per cent higher, scheme liabilities would increase by £100m.

The defined benefit obligation relating to post-retirement medical benefits would increase by £50m if the healthcare trend rate increases by one per cent, and reduce by £41m if it decreases by one per cent. The pension expense relating to post-retirement medical benefits, comprising service cost and interest cost, would increase by £5m if the healthcare trend increases by one per cent, and reduce by £4m if it decreases by one per cent.

History of defined benefit schemes

The history of the schemes for the current and prior years is as follows:

	2008 £m	2007 £m	2006 £m	2005 £m	2004 £m
<i>Balance sheet</i>					
Present value of defined benefit obligations	(6,546)	(6,912)	(6,899)	(7,220)	(6,107)
Fair value of scheme assets	7,446	6,903	5,906	5,563	4,698
Unrecognised surplus	(1,042)	(114)	(2)	(2)	—
Deficit	(142)	(123)	(995)	(1,659)	(1,409)
<i>Experience gains/losses</i>					
Actuarial gains on scheme assets	178	161	132	588	126
Experience gains/(losses) on scheme liabilities	766	350	470	(868)	(133)
Movement in unrecognised surplus	(928)	(112)	—	(2)	—
Total amount recognised in the statement of recognised income and expense	16	399	602	(282)	(7)
Cumulative since January 1, 2004	728	712	313	(289)	(7)

19 Share capital

	Non-equity			Equity
	Special Share of £1	Preference shares of £1 each	Nominal value £m	Ordinary shares of 20p each Millions Nominal value £m
Authorised				
At January 1, 2007 and December 31, 2008	1	50,000	—	2,500
Issued and fully paid				
At January 1, 2007	1	—	—	1,781
Exercise of share options	—	—	—	24
B Share conversion into ordinary shares	—	—	—	15
At January 1, 2008	1	—	—	1,820
Exercise of share options	—	—	—	12
B Share conversion into ordinary shares	—	—	—	12
At December 31, 2008	1	—	—	1,844

The rights attaching to each class of share are set out in the Directors' report on page 81.

In accordance with IAS 32 *Financial Instruments: Presentation*, the Company's non-cumulative redeemable convertible preference shares (B Shares) are classified as financial liabilities. Accordingly, movements in B Shares are included in note 16.

20 Movements in capital and reserves

	Attributable to equity holders of the parent							Minority interests £m	Total equity £m
	Share capital £m	Share premium £m	Capital redemption reserves £m	Hedging reserves ¹ £m	Other reserves ² £m	Retained earnings ³ £m	Total £m		
At January 1, 2007	356	43	197	177	(55)	2,000	2,718	7	2,725
Total recognised income and expense for the year	—	—	—	(100)	117	861	878	(6)	872
Arising on issues of ordinary shares	5	24	—	—	—	—	29	—	29
Issue of B Shares	—	—	(172)	—	—	—	(172)	—	(172)
Redemption of B Shares	—	—	97	—	—	(97)	—	—	—
Conversion of B Shares into ordinary shares ⁴	3	—	69	—	—	(1)	71	—	71
Ordinary shares purchased	—	—	—	—	—	(78)	(78)	—	(78)
Ordinary shares vesting in share-based payment plans	—	—	—	—	—	93	93	—	93
Share-based payments adjustment	—	—	—	—	—	(22)	(22)	—	(22)
Transactions with minority interests	—	—	—	—	—	—	—	11	11
Related tax movements – current tax	—	—	—	—	—	43	43	—	43
– deferred tax	—	—	—	—	—	(18)	(18)	—	(18)
Change in rate of UK corporation tax – deferred tax	—	—	—	—	—	(5)	(5)	—	(5)
At January 1, 2008	364	67	191	77	62	2,776	3,537	12	3,549
Total recognised income and expense for the year	—	—	—	(99)	601	(1,331)	(829)	(3)	(832)
Arising on issues of ordinary shares	2	15	—	—	—	—	17	—	17
Issue of B Shares	—	—	(237)	—	—	—	(237)	—	(237)
Redemption of B Shares	—	—	200	—	—	(200)	—	—	—
Conversion of B Shares into ordinary shares ⁴	3	—	50	—	—	—	53	—	53
Ordinary shares purchased	—	—	—	—	—	(44)	(44)	—	(44)
Ordinary shares vesting in share-based payment plans	—	—	—	—	—	37	37	—	37
Share-based payments adjustment	—	—	—	—	—	(1)	(1)	—	(1)
Transactions with minority interests	—	—	—	—	—	—	—	—	—
Related tax movements – current tax	—	—	—	—	—	—	—	—	—
– deferred tax	—	—	—	—	—	(11)	(11)	—	(11)
At December 31, 2008	369	82	204	(22)	663	1,226	2,522	9	2,531

¹ See accounting policies note 1 – hedge accounting. Hedging reserves include **£19m** (2007 £77m) in respect of the transition hedging reserve and **£(41)m** (2007 £nil) in respect of the cash flow hedging reserve.

² 'Other reserves' include a merger reserve of **£3m** (2007 £3m) and a translation reserve of **£660m** (2007 £59m).

³ At December 31, 2008, **8,017,635 shares** with a net book value of **£34m** (2007 5,838,501 shares with a net book value of £24m) were held and included in retained earnings.

⁴ On conversion of B Shares, the nominal value of ordinary shares issued is credited to share capital and the excess to a capital reserve.

21 Share-based payments

Share-based payment plans in operation during the year

The Group had the following 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).

ShareSave share option plan

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 ShareSave plans through arrangements which provide broadly comparable benefits to the UK plan. From 2007 onwards, the overseas plans are cash-settled schemes.

Executive Share Option Plan (ESOP)

This plan involves the grant of market value share options to participants. The options are subject to a non-market based performance condition (growth in EPS). The options have a maximum contractual life of ten years. Following the introduction of the PSP, it is not intended to grant any further executive share options. The plan terminates in 2009.

Annual Performance Related Award (APRA) plan deferred shares

Deferred shares are awarded as part of the APRA plan. One third of the value of any annual bonus 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.

Share Incentive Plan (SIP)

There is a 'Free Share' element of the UK Share Incentive Plan. Eligible employees may receive shares with a value of up to one and a half weeks' salary as part of any bonus paid. There are no conditions attached to the shares.

Further information regarding the operation of the plans can be found on pages 71 and 72 of the Directors' remuneration report.

In accordance with the transitional provisions of IFRS 2 *Share-based Payment*, the Group has recognised an expense in respect of all grants under these plans made after November 7, 2002 and unvested at January 1, 2005.

During the year the Group recognised a total expense of **£40m** (2007 £36m), of which **£0.4m** (2007 £0.1m) related to cash-settled arrangements. At December 31, 2008, the Group had a liability of **£0.6m** (2007 £0.2m) relating to cash-settled arrangements.

The movements in awards under the Group's various share plans are shown in the tables below.

	Number of shares awarded	
	2008 Millions	2007 Millions
PSP		
Outstanding at January 1	14.0	15.7
Awarded during the year	5.1	4.6
Forfeited during the year	(0.7)	(0.8)
Additional entitlements arising from TSR performance	1.3	1.3
Vested during the year	(6.5)	(6.8)
Outstanding at December 31	13.2	14.0

	2008		2007	
	Number of share options Millions	Weighted average exercise price Pence	Number of share options Millions	Weighted average exercise price Pence
ShareSave				
Outstanding at January 1	43.3	260p	54.7	160p
Granted during the year	—	—	13.0	416p
Forfeited during the year	(1.7)	333p	(0.8)	207p
Exercised during the year	(11.9)	144p	(23.6)	116p
Outstanding at December 31	29.7	303p	43.3	260p
Exercisable at December 31	1.6	141p	—	—

21 Share-based payments continued

	2008		2007	
	Number of share options Millions	Weighted average exercise price Pence	Number of share options Millions	Weighted average exercise price Pence
ESOP				
Outstanding at January 1	2.3	175p	19.0	188p
Exercised during the year	(0.2)	156p	(16.7)	189p
Outstanding at December 31	2.1	177p	2.3	175p
Exercisable at December 31	2.1	177p	2.3	175p

	Number of shares awarded	
	2008 Millions	2007 Millions
Deferred shares under APRA		
Outstanding at January 1	3.4	4.9
Awarded during the year	1.5	1.9
Forfeited during the year	(0.1)	(0.1)
Additional shares accrued from conversion of B Shares	0.1	0.2
Vested during the year	(2.1)	(3.5)
Outstanding at December 31	2.8	3.4

	Number of shares awarded	
	2008 Millions	2007 Millions
Free Shares under SIP		
Awarded during the year	1.2	0.7

Options were exercised on a regular basis during the year. The average share price during the year was **382p** (2007 510p).

Fair values

The weighted average fair values per share for PSP awards, ShareSave grants, APRA deferred share awards, and SIP Free Share awards included in the expense for the year were as follows:

	2008 Pence	2007 Pence	2006 Pence	2005 Pence	2004 Pence
PSP awards	458p	557p	494p	282p	249p
ShareSave – 3 year grants	—	230p	—	131p	—
ShareSave – 5 year grants	—	264p	—	154p	—
APRA deferred share awards	440p	502p	448p	260p	220p
SIP Free Share awards	439p	499p	462p	257p	231p

Details of the assumptions used in the calculation of these fair values are set out below. Expected volatility was based on the historical volatility of the Company's share price over the seven years prior to the grant or award date. Until 2007, expected dividends were based on the Company's payments to shareholders over the five years prior to the grant or award date. From 2008, expected dividends were based on the Company's payments to shareholders in respect of 2007.

21 Share-based payments continued

PSP awards

The fair value of shares awarded under the PSP are calculated using the market value of shares at the time of the award adjusted to take into account non-entitlement to dividends (or equivalent) during the vesting period and the TSR performance condition. The PSP fair values were calculated using the following assumptions:

	2008	2007	2006	2005	2004
Weighted average share price	430p	501p	444p	262p	233p
Expected dividends	13.00p	8.30p	7.92p	7.81p	7.61p
Volatility	29%	29%	32%	34%	35%
Correlation	29%	26%	19%	19%	22%
Expected life	3 years	3 years	3 years	3 years	3 years
Risk free interest rate	4.1%	5.2%	4.3%	4.9%	5.2%

As explained on page 71 of the Directors' remuneration report, the PSP has a TSR market-based performance condition, such that the Company's TSR over the performance period will be compared with the TSR of the companies constituting the FTSE 100 index on the date of grant. If the Company's TSR exceeds the median TSR of the FTSE 100, the number of shares that vest will be increased by 25 per cent. The fair value of an award of shares under the PSP has been adjusted to take into account this market-based performance condition using a pricing model 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 relative to the share price at the date of grant.

ShareSave awards

The fair value of options granted under the ShareSave plan are calculated using a binomial pricing model with the following assumptions:

	2007	2005	2003
Weighted average share price	553p	351p	173p
Exercise price	416p	298p	142p
Volatility	37%	40%	43%
Expected dividends	8.80p	7.86p	7.61p
Expected life ¹ – 3 year ShareSave	3.3-3.8 years	3.3-3.8 years	3.2-3.7 years
– 5 year ShareSave	5.3-5.8 years	5.3-5.8 years	5.2-5.7 years
Close periods:			
From January 1	6 weeks	6 weeks	6 weeks
From July 1	1 month	1 month	1 month
Risk free interest rate	5.0%	4.4%	4.6%

¹ The binomial pricing model 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.

Deferred shares under APRA and Free Shares under SIP

The fair value of shares awarded under these plans is calculated as the share price on the date of the award.

At December 31, 2008, the following ordinary shares were subject to options:

	Date of grant	Number	Exercise price	Exercisable dates
Executive Share Option Plan	1999	52,403	269p	2009
	2000	193,831	194p	2009-2010
	2001	1,069,069	216p	2009-2011
	2001	8,161	218p	2009-2012
	2002	239,544	188p	2009-2012
	2003	519,555	77p	2009-2013
ShareSave plans	2001	5,451,109	108p	2009
	2003	1,597,604	142p	2009
	2005	10,414,054	298p	2009/2011
	2007	12,206,498	416p	2011/2013

Under the terms of the Rolls-Royce 1999 Executive Share Option Plan, options granted to 54 directors and senior executives were outstanding at December 31, 2008.

22 Operating and finance leases

Operating leases

Leases as lessee

	2008 £m	2007 £m
Rentals paid – hire of plant and machinery	64	58
– hire of other assets	25	18
Non-cancellable operating lease rentals are payable as follows:		
Within one year	104	77
Between one and five years	163	179
After five years	205	99
	472	355

Leases as lessor

	2008 £m	2007 £m
Rentals received – credited within revenue from aftermarket services	26	27
Non-cancellable operating lease rentals are receivable as follows:		
Within one year	6	5
Between one and five years	13	13
After five years	3	3
	22	21

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 **£15m** (2007 £15m) and sublease receipts of **£11m** (2007 £8m) 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 five 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 21 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 **£88m** (2007 £13m) and sublease receipts expected to be received is **£6m** (2007 £3m).

Finance leases

Finance lease liabilities are payable as follows:

	2008			2007		
	Payments £m	Interest £m	Principal £m	Payments £m	Interest £m	Principal £m
Within one year	4	1	3	6	1	5
Between one and five years	—	—	—	3	—	3
After five years	1	—	1	1	—	1
	5	1	4	10	1	9

There were no contingent rents recognised as an expense in the year (2007 £nil) and no future minimum sublease receipts are expected under non-cancellable subleases (2007 £nil).

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 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:

	2008		2007	
	£m	US\$m	£m	US\$m
Gross contingent liabilities	755	1,086	616	1,227
Contingent liabilities net of relevant security ¹	155	222	140	279
Contingent liabilities net of relevant security reduced by 20% ²	246	354	218	434

¹ Security includes unrestricted cash collateral of:

85 **123** 60 120

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.

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.

24 Related party transactions

	2008 £m	2007 £m
Sales of goods and services to joint ventures	1,555	1,289
Purchases of goods and services from joint ventures	(1,482)	(1,100)
Operating lease payments to joint ventures	(36)	(41)
Guarantees of joint ventures' borrowings	13	11
Dividends received from joint ventures	59	42
RRSP receipts from joint ventures	19	29
Interest received from joint ventures	2	2
Other income received from joint ventures	102	25

The aggregated balances with joint ventures are shown in notes 12 and 15. Transactions with Group pension schemes are shown in note 18.

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 Group Executive as set out on pages 65 and 66. Remuneration for key management personnel is shown below:

	2008 £m	2007 £m
Salaries and short-term benefits	9	9
Post-retirement schemes	2	2
Share-based payments	6	5
	17	16

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 70 to 79.

25 Acquisitions and disposals

During the year the Group acquired a number of small businesses as summarised below.

	Total £m
Intangible assets – software and other	11
Property, plant and equipment	18
Inventory	16
Trade and other receivables	16
Short-term deposits	2
Cash at bank and in hand	1
Trade and other payables	(43)
Borrowings – current liabilities	(6)
Deferred tax liabilities	(5)
Provisions	(1)
Net assets acquired	9
Goodwill arising	41
	50
Additions to investments in joint ventures ¹	31
	81
Represented by:	
Net cash outflow per cash flow statement	82
Net non-cash consideration	(1)
	81

¹ As part of the transaction to conclude the joint venture with Goodrich Corporation to develop and manufacture engine controls, the Group also paid US\$100m in cash and assumed a liability of £24m in respect of foreign exchange contracts. These amounts, totalling £93m, have been included in intangible asset additions in the year (note 8).

There were no significant fair value adjustments in respect of the net assets acquired.

During the year the Group disposed of its interests in a number of small businesses, as summarised below.

	Total £m
Intangible assets – goodwill	2
Property, plant and equipment	2
Inventory	5
Trade and other receivables	11
Trade and other payables	(9)
Provisions	(2)
	9
Disposals of investments in joint ventures	30
Net assets	39
Profit on sale or termination of businesses	7
	46
Analysed as:	
Receipts outstanding at December 31, 2008	10
Net cash inflow per cash flow statement	36
	46

Company balance sheet

At December 31, 2008

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	Notes	2008 £m	2007 £m
Fixed assets			
Investments in shares in subsidiary undertakings at cost	2	2,230	2,212
Current assets			
Amounts owed by subsidiary undertakings due within one year		165	413
Cash at bank		2	1
		167	414
Creditors – amounts falling due within one year			
Financial liabilities	3	—	(16)
Accruals and deferred income		—	(3)
		—	(19)
Net current assets		167	395
Total assets less current liabilities		2,397	2,607
Net assets		2,397	2,607
Capital and reserves			
Called-up share capital	4	369	364
Share premium account	5	82	67
Merger reserve	5	214	451
Capital redemption reserves	5	767	517
Other reserve	5	77	59
Own shares reserve	5	(35)	—
Profit and loss account	5	923	1,149
Equity shareholders' funds		2,397	2,607

The financial statements on pages 138 to 141 were approved by the Board on February 11, 2009 and signed on its behalf by:

Simon Robertson
Chairman

Andrew Shilston
Finance Director

Reconciliation of movements in shareholders' funds

For the year ended December 31, 2008

	2008 £m	2007 £m
At January 1	2,607	2,755
Loss for the year	(1)	(1)
Arising on issue of ordinary shares	17	29
Issue of B Shares	(237)	(172)
Conversion of B Shares into ordinary shares	53	72
Ordinary shares purchased	(71)	—
Share-based payment adjustments	29	(76)
At December 31	2,397	2,607

1 Accounting policies

Basis of accounting

The financial statements have been prepared in accordance with applicable UK Accounting Standards on the historical cost basis.

As permitted by section 230 of the Companies Act 1985, 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 for the Company have been included.

Investments in subsidiary undertakings

Investments in subsidiary undertakings are reported at cost less amounts written off.

Share-based payments

As described in the Directors' remuneration report on pages 70 to 79, 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.

Own shares for settlement of share-based payment plans

Where the Company acquires its own shares for the purpose of satisfying share-based payment plans, the cost in excess of any exercise price payable by the plan participants is written off to the profit and loss reserve.

Current assets

Amounts are recognised at the lower of cost and net realisable value.

Financial instruments

In accordance with FRS 25 *Financial Instruments: Disclosure and Presentation*, the Company's B Shares are classified as financial liabilities and held at amortised cost from the date of issue until redeemed or converted.

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 January 1, 2008	2,212
Cost of share-based payments in respect of employees of subsidiary undertakings less receipts from subsidiaries in respect of those payments	18
At December 31, 2008	2,230

3 Financial liabilities

B Shares

Movements in the B Shares during the year were as follows:

	B Shares of 0.1p Millions	Nominal value £m
Authorised		
At January 1, and December 31, 2008	1,000,000	1,000
Issued and fully paid		
At January 1, 2008	15,859	16
Shares issued	236,740	237
Shares converted into ordinary shares	(52,524)	(53)
Shares redeemed	(200,075)	(200)
At December 31, 2008	—	—

Rights attaching to B Shares, and C Shares that the Company will issue from January 2009, are described in note 16 of the Company's consolidated financial statements.

4 Share capital

	Non-equity			Equity	
	Special Share of £1	Preference shares of £1 each	Nominal value £m	Ordinary shares of 20p each Millions	Nominal value £m
Authorised					
At January 1, 2007 and December 31, 2008	1	50,000	—	2,500	500
Issued and fully paid					
At January 1, 2007	1	—	—	1,781	356
Exercise of share options	—	—	—	24	5
B Share conversion into ordinary shares	—	—	—	15	3
At January 1, 2008	1	—	—	1,820	364
Exercise of share options	—	—	—	12	2
B Share conversion into ordinary shares	—	—	—	12	3
At December 31, 2008	1	—	—	1,844	369

The rights attaching to each class of share are set out in the Directors' report on page 81.

In accordance with FRS 25 *Financial instruments: Presentation*, the Company's non-cumulative redeemable convertible preference shares (B Shares) are classified as financial liabilities. Accordingly, movements in B Shares are included in note 3.

5 Movements in capital and reserves

	Non-distributable reserves						Profit and loss account £m	Total £m
	Share capital £m	Share premium £m	Merger reserve £m	Capital redemption reserves £m	Other reserve ¹ £m	Own shares reserve ² £m		
At January 1, 2008	364	67	451	517	59	—	1,149	2,607
Loss for the year	—	—	—	—	—	—	(1)	(1)
Arising on issue of ordinary shares	2	15	—	—	—	—	—	17
Issue of B Shares	—	—	(237)	—	—	—	—	(237)
Redemption of B Shares	—	—	—	200	—	—	(200)	—
Conversion of B Shares into ordinary shares ³	3	—	—	50	—	(2)	2	53
Own shares purchased	—	—	—	—	—	(71)	—	(71)
Own shares vesting in share-based payment plans	—	—	—	—	—	38	(38)	—
Share-based payment adjustments	—	—	—	—	18	—	11	29
At December 31, 2008	369	82	214	767	77	(35)	923	2,397

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.

² During 2008, ordinary shares were transferred from a trust sponsored by Rolls-Royce plc to an equivalent trust sponsored by Rolls-Royce Group plc. At December 31, 2008, **8,017,635 shares** (2007 nil) with a net book value of **£35m** (2007 nil) were held.

³ On conversion of B Shares, the nominal value of ordinary shares issued is credited to share capital and the excess to a capital reserve.

6 Contingent liabilities

Where the Company enters into financial guarantee contracts to guarantee the indebtedness of other companies within the Group, the Company considers these to be insurance arrangements, and accounts for them as such. In this respect, the Company treats the guarantee contract as a contingent liability until such time as it becomes probable that the Company will be required to make a payment under the guarantee.

At December 31, 2008 these guarantees amounted to **£1,273m** (2007 £1,035m).

7 Other information

Emoluments of directors

The remuneration of the directors of the Company is shown in the Directors' remuneration report on pages 70 to 79.

Employees

The Company had no employees in 2008 and 2007.

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.

Principal subsidiary undertakings

At December 31, 2008

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Incorporated within the UK – held by Rolls-Royce Group plc

Rolls-Royce plc	Principal trading company
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Incorporated within the UK – indirectly held

Optimized Systems and Solutions Limited	Advanced controls and predictive data management
Rolls-Royce Fuel Cell Systems Limited	Development of fuel cell systems
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 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

The above companies operate principally in the UK and the effective Group interest is 100 per cent, other than Rolls-Royce Fuel Cell Systems Limited in which it is 80 per cent.

Incorporated overseas – indirectly held

Brazil	Rolls-Royce Brasil Limitada	Aero engine repair and overhaul
Canada	Rolls-Royce Canada Limited	Industrial gas turbines and aero-engine sales, service and overhaul
China	Rolls-Royce Marine (Shanghai) Limited	Manufacture and supply of marine equipment
Finland	Rolls-Royce OY AB	Manufacture of marine winches and propeller systems
France	Data Systems & Solutions 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 Energy Systems 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	Scandinavian Electric Holding AS	Marine electrical systems
Singapore	Rolls-Royce Singapore Pte Limited	Energy and marine aftermarket support services
Sweden	Rolls-Royce AB	Manufacture of marine propeller systems
US	Data Systems & Solutions LLC	Advanced controls and predictive data management
US	Rolls-Royce Commercial Marine Inc.	Marine aftermarket support services
US	Rolls-Royce Corporation	Design, development and manufacture of gas turbine engines
US	Rolls-Royce Crosspointe LLC	Manufacture of 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 Naval Marine Inc.	Design and manufacture of marine equipment
US	Seaworthy Systems Inc.	Marine support services

The above companies operate principally in the country of their incorporation.

The effective Group interest is 100 per cent, other than Europea Microfusioni Aerospaziali S.p.A. in which it is 51 per cent.

A list of all subsidiary undertakings will be included in the Company's annual return to Companies House.

Incorporated within the UK – indirectly held

	Class	% of class held	% of total equity held
Airtanker Holdings Limited <i>Strategic tanker aircraft PFI project</i>	Ordinary	20	20
Airtanker Services Limited <i>Provision of aftermarket services for strategic tanker aircraft</i>	Ordinary	22	22
Alpha Partners Leasing Limited <i>Aero engine leasing</i>	A Ordinary B Ordinary	100 —	50
Composite Technology & Applications Limited <i>Development of aero-engine fan blades</i>	A Ordinary B Ordinary	100 —	51
Genistics Holdings Limited <i>Trailer-mounted field mobile generator sets</i>	A Ordinary B Ordinary	100 —	50
Rolls-Royce Goodrich Engine Control Systems Limited <i>Development and manufacture of aero-engine controls</i>	Ordinary	50	50
Rolls-Royce Snecma Limited (UK & France) <i>Aero engine collaboration</i>	A Shares B Shares	— 100	50
Rolls-Royce Turbomeca Limited (UK & France) <i>Aero engine collaboration</i>	A Shares B Shares	— 100	50
Rolls Wood Group (Repair and Overhauls) Limited <i>Industrial gas turbine repair and overhaul</i>	A Ordinary B Ordinary	100 —	50
Tidal Generation Limited <i>Development of tidal generation systems</i>	A Ordinary B Ordinary C Ordinary	— 100 —	42
TRT Limited <i>Aero-engine turbine blade repair services</i>	A Ordinary B Ordinary	— 100	49.5
Turbine Surface Technologies Limited <i>Aero-engine turbine surface coatings</i>	A Ordinary B Ordinary	— 100	50
Turbo-Union Limited (UK, Germany & Italy) <i>RB199 engine collaboration</i>	Ordinary A Shares	40 37.5	40

Incorporated overseas – indirectly held

		Class	% of class held	% of total equity held
China	Xian XR Aero Components Co Limited <i>Manufacturing facility for aero-engine parts</i>	Ordinary	49	49
Germany	EPI Europrop International GmbH (effective interest 35.5%) <i>A400M engine collaboration</i>	Ordinary	28	28
Germany	EUROJET Turbo GmbH (UK, Germany, Italy & Spain) (effective interest 39%) <i>EJ200 engine collaboration</i>	Ordinary	33	33
Germany	MTU, Turbomeca, Rolls-Royce GmbH (UK, France & Germany) <i>MTR390 engine collaboration</i>	Ordinary	33.3	33.3
Germany	N3 Engine Overhaul Services Verwaltungsgesellschaft mbh <i>Aero engine repair and overhaul</i>	Ordinary	50	50
Hong Kong	Hong Kong Aero Engine Services Limited <i>Aero engine repair and overhaul</i>	Ordinary	45	45
Israel	TechJet Aerofoils Limited <i>Manufacture of compressor aerofoils for gas turbines</i>	A Ordinary	50	50
		B Ordinary	50	
Malaysia	Advanced Gas Turbine Solutions Sdn Bhd <i>Industrial gas turbine aftermarket services</i>	Ordinary	49	49
Singapore	International Engine Component Overhaul Pte Limited <i>Aero engine repair and overhaul</i>	Ordinary	50	50
Singapore	Singapore Aero Engine Services Private Limited (effective interest 39%) <i>Aero engine repair and overhaul</i>	Ordinary	30	30
Spain	Industria de Turbo Propulsores SA <i>Aero engine component manufacture and maintenance</i>	Ordinary	46.9	46.9
Switzerland	IAE International Aero Engines AG (UK, Germany, Japan & US) <i>V2500 engine collaboration</i>	A Shares B Shares C Shares D Shares	100 — — —	32.5
US	Alpha Leasing (US) LLC, Alpha Leasing (US) (No. 2) LLC, Alpha Leasing (US) (No. 4) LLC, Alpha Leasing (US) (No. 5) LLC, Rolls-Royce & Partners Finance (US) LLC <i>Aero engine leasing</i>	Partnerships	50	
US	Exostar LLC <i>Business to business internet exchange</i>	Partnership	17.6	
US	GE Rolls-Royce Fighter Engine Team LLC <i>F136 development engine for the Joint Strike Fighter (JSF) Programme</i>	Partnership	40	
US	Texas Aero Engine Services, LLC <i>Aero engine repair and overhaul</i>	Partnership	50	—
US	Williams-Rolls Inc. (UK & US) <i>Small aero engine collaboration</i>	Common	15	15

Unincorporated overseas – held by subsidiary undertakings

US	Light Helicopter Turbine Engine Company (LHTEC) <i>Rolls-Royce Corporation has a 50 per cent interest in this unincorporated partnership which was formed to develop and market jointly the T800 engine</i>
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The countries of principal operations are stated in brackets after the name of the company, if not the country of incorporation.

We have audited the Group and parent Company financial statements (the 'financial statements') of Rolls-Royce Group plc for the year ended December 31, 2008 which comprise the Group consolidated income statement, the Group and parent Company balance sheets, the Group consolidated cash flow statement, the Group consolidated statement of recognised income and expense and the related notes. These financial statements have been prepared under the accounting policies set out therein. We have also audited the information in the Directors' remuneration report that is described as having been audited.

This report is made solely to the Company's members, as a body, in accordance with section 235 of the Companies Act 1985. 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 auditors

The directors' responsibilities for preparing the Annual report and the Group financial statements in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted by the EU, and for preparing the parent Company financial statements and the Directors' remuneration report in accordance with applicable law and UK Accounting Standards (UK Generally Accepted Accounting Practice) are set out in the Statement of directors' responsibilities on page 84.

Our responsibility is to audit the financial statements and the part of the Directors' remuneration report to be audited in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements and the part of the Directors' remuneration report to be audited have been properly prepared in accordance with the Companies Act 1985 and, as regards the Group financial statements, Article 4 of the IAS Regulation. We also report to you whether in our opinion the information given in the Directors' report is consistent with the financial statements.

In addition we report to you if, in our opinion, the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

We review whether the Corporate governance statement reflects the Company's compliance with the nine provisions of the 2006 Combined Code specified for our review by the Listing Rules of the Financial Services Authority, and we report if it does not. We are not required to consider whether the Board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the Group's corporate governance procedures or its risk and control procedures.

We read the other information contained in the Annual report and consider whether it is consistent with the audited financial statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements and the part of the Directors' remuneration report to be audited. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Group's and Company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements and the part of the Directors' remuneration report to be audited are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements and the part of the Directors' remuneration report to be audited.

Opinion

In our opinion:

- the Group financial statements give a true and fair view, in accordance with IFRSs as adopted by the EU, of the state of the Group's affairs as at December 31, 2008 and of its loss for the year then ended;
- the Group financial statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation;
- the parent Company financial statements give a true and fair view, in accordance with UK Generally Accepted Accounting Practice, of the state of the parent Company's affairs as at December 31, 2008;
- the parent Company financial statements and the part of the Directors' remuneration report to be audited have been properly prepared in accordance with the Companies Act 1985; and
- the information given in the Directors' report is consistent with the financial statements.

KPMG Audit Plc

Chartered Accountants, Registered Auditor

London

February 11, 2009

Group five-year review

For the years ended December 31

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	2008 £m	2007 £m	2006 £m	2005 £m	2004 £m
Income statement					
Revenue	9,082	7,435	7,156	6,603	5,947
Profit before net research and development and share of joint venture profit	1,191	827	1,016	1,113	686
Research and development (net) ¹	(403)	(381)	(370)	(282)	(288)
Share of profit of joint ventures	74	66	47	46	19
Profit before financing	862	512	693	877	417
Net financing	(2,754)	221	698	(400)	(53)
(Loss)/profit before taxation ²	(1,892)	733	1,391	477	364
Taxation	547	(133)	(397)	(130)	(100)
(Loss)/profit for the year	(1,345)	600	994	347	264

Attributable to:

Equity holders of the parent	(1,340)	606	998	350	263
Minority interests	(5)	(6)	(4)	(3)	1
(Loss)/profit for the year	(1,345)	600	994	347	264

¹ Research and development (gross) (885) (824) (747) (663) (601)

² Underlying profit before taxation 880 800 705 593 364

Earnings per ordinary share:

Underlying	36.70p	34.06p	29.81p	24.48p	15.62p
Basic	(73.63)p	33.67p	57.32p	20.11p	15.56p

Payments to shareholders per ordinary share 14.30p 13.00p 9.59p 8.72p 8.18p

	2008 £m	2007 £m	2006 £m	2005 £m	2004 £m
Balance sheet					
Assets	15,229	11,459	10,798	9,627	8,419
Liabilities	(12,698)	(7,910)	(8,073)	(8,122)	(6,973)
	2,531	3,549	2,725	1,505	1,446

Called-up share capital	369	364	356	352	346
Reserves	2,153	3,173	2,362	1,147	1,096
Equity attributable to equity holders of the parent	2,522	3,537	2,718	1,499	1,442
Minority interests	9	12	7	6	4
	2,531	3,549	2,725	1,505	1,446

	2008 £m	2007 £m	2006 £m	2005 £m	2004 £m
Cash flow					
Cash inflow from operating activities	1,015	705	1,072	1,060	610
Cash outflow from investing activities	(648)	(572)	(469)	(289)	(237)
Cash (outflow)/inflow from financing activities	(221)	(473)	(122)	(443)	189
Increase/(decrease) in cash and cash equivalents	146	(340)	481	328	562
Net funds/(debt)	1,458	888	826	335	(149)

Financial calendar 2009-2010

Ex entitlement to C Shares	April 22, 2009
Record date for entitlement to C Shares	April 24, 2009
Annual General Meeting, Queen Elizabeth II Conference Centre, London	11.00am April 30, 2009
Deadline for receipt of C Share elections	5.00pm June 5, 2009
Record date for dividend payable on C Shares	June 5, 2009
Allotment of C Shares	July 1, 2009
Payment of C Share redemption monies	July 2, 2009
Purchase of ordinary shares for CRIP participants	By July 8, 2009
Announcement of interim results	July 30, 2009
Ex entitlement to C Shares	October 28, 2009
Record date for entitlement to C Shares	October 30, 2009
Deadline for receipt of C Share elections	5.00pm December 4, 2009
2009 financial year end	December 31, 2009
Allotment of C Shares	January 4, 2010
Payment of C Share redemption monies	January 5, 2010
Purchase of ordinary shares for CRIP participants	By January 8, 2010
Preliminary announcement – 2009 full year results	February, 2010
2009 Annual report published	March, 2010

Registrar

Our Registrar is Computershare Investor Services PLC. When making contact with the Registrar please quote your Shareholder Reference Number (SRN). This is an 11-digit number, which usually starts with the letter 'C' and which can be found on the right hand side of your share certificate. You can speak to a member of the Registrar's Rolls-Royce team by calling +44 (0)870 703 0162 between 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.

Information available on the internet

You can access copies of the Annual report, Company announcements and much more at www.rolls-royce.com.

You can also visit our Registrar's website at

www-uk.computershare.com/investor/ to:

- view your account balance, values and history;
- view your payment history;
- update your bank details;
- register to receive electronic shareholder communications;
- download forms;
- deal in Rolls-Royce shares online;
- vote online for forthcoming general meetings;
- view your holdings in all companies registered with Computershare and create a portfolio; and
- track the market value of your portfolio.

Share dealing service

Our Registrar offers both internet and telephone dealing services. You can deal over the telephone or on the internet Monday to Friday from 8.00am to 4.30pm excluding Bank holidays. Real time trading is available on the internet during market hours and there is no need to open a trading account in order to deal. The fee for the service is 0.5 per cent of the value of each sale or purchase of shares subject to a minimum fee of £15. The maximum value of shares you can trade using the internet is £25,000 for purchases and £50,000 for sales. Please note that the internet dealing service is only available to existing shareholders. www-uk.computershare.com/investor/sharedealing.asp.

The fee for the Telephone Share Dealing Service is one per cent of the value of the transaction subject to a minimum fee of £15. If you would like to use this service please call +44 (0)870 703 0084. Stamp duty of 0.5 per cent is also payable on all purchases.

A low-cost, execution only share-dealing service for the purchase and sale of Rolls-Royce Group plc shares is also available from NatWest Stockbrokers. NatWest Stockbrokers is authorised and regulated by the Financial Services Authority and is a member of the London Stock Exchange and PLUS. For details please contact NatWest Stockbrokers, Waterhouse Square, 138-14 Holborn, London EC1N 2TH. Tel: +44 (0)870 600 3070

Share price

You can obtain the current market price of the Company's shares on our website at www.rolls-royce.com or from Teletext, Ceefax or similar services or on the London Stock Exchange website at www.londonstockexchange.com.

ADR programme

For further information about the US ADR programme, please contact your broker or write to:

The Bank of New York Mellon
Shareholder Relations
PO Box 11258
Church Street Station
New York, NY 10286

Toll free telephone for callers from the US: 1-888-BNY-ADRS (1-888-269-2377)

For callers outside the US: +1-201-680-6825

Website: www.adrbnymellon.com.

Unsolicited mail

The Company is legally obliged to make its share register publicly available. As a consequence, you may receive mail you have not asked for. If you want to limit the amount of personally addressed unsolicited mail you receive, and you have a UK registered address, please write to the Mailing Preference Service (MPS), DMA House, 70 Margaret Street, London W1W 8SS or register by telephoning +44 (0)845 703 4599 or online www.mpsonline.org.uk.

ShareGift

The Orr Mackintosh Foundation operates a charity donation scheme for shareholders with small numbers of shares which may be uneconomic to sell. Details of the scheme are available from ShareGift at www.sharegift.org or you can write to Orr Mackintosh Foundation, 17 Carlton House Terrace, London SW1Y 5AH. Tel: +44 (0)20 7930 3737.

Warning to shareholders

We are aware that some shareholders have received unsolicited phone calls or correspondence concerning investment matters. These are typically from overseas based 'brokers' who target UK shareholders, offering to sell them what often turn out to be worthless or high risk shares in US or UK investments. Shareholders are advised to be very wary of any unsolicited advice, offers to buy shares at a discount or offers of free company reports.

If you receive any unsolicited investment advice:

- Make sure you get the correct name of the person and organisation;
- Check that they are properly authorised by the FSA before getting involved by visiting www.fsa.gov.uk/register/.

If you deal with an unauthorised firm, you will not be eligible to receive payment under the Financial Services Compensation Scheme. You can report approaches made by unauthorised firms to the FSA either by calling +44 (0)845 606 1234 or by completing the online reporting form at www.fsa.gov.uk/pages/doing/regulated/law/alerts/overseas.shtml.

Details of any share dealing facilities that the Company endorses will be included in Company mailings. More detailed information can be found on the FSA website www.moneymadeclear.fsa.gov.uk.

Dividends paid on B Shares held

B Share dividends: calculation period	Dividend rate	Record date for B Share dividend	Payment date
July 1, 2008 to September 22, 2008	1.0485000%	September 22, 2008	September 29, 2008
January 1, 2008 to June 30, 2008	2.2275000%	June 6, 2008	July 1, 2008
July 1, 2007 to December 31, 2007	2.2973400%	November 23, 2007	January 2, 2008
January 1, 2007 to June 30, 2007	2.0362500%	June 8, 2007	July 2, 2007
July 1, 2006 to December 31, 2006	1.8063300%	November 24, 2006	January 2, 2007
January 1, 2006 to June 30, 2006	1.7205487%	June 9, 2006	July 3, 2006
July 1, 2005 to December 31, 2005	1.7353125%	November 25, 2005	January 3, 2006
January 1, 2005 to June 30, 2005	1.8433613%	June 10, 2005	July 1, 2005
July 1, 2004 to December 31, 2004	1.8890625%	November 26, 2004	January 4, 2005

Copies of the Scheme Circular and Summary of Terms of B Share Issue, which contain more detailed information on B Shares, are available in the Investors section on the Group's website at www.rolls-royce.com.

Previous B Shares issues

B Share issues	B Shares per ordinary share	Conversion Share Value	First day of trading	Share price on first day of trading		CGT apportionment	
				Ordinary shares	B Shares	Ordinary shares	B Shares
June 30, 2008	89.6	422p	June 30, 2008	335.875p	0.0950p	97.53%	2.47%
January 2, 2008	40.4	553p	January 2, 2008	546.750p	0.1000p	99.27%	0.73%
June 29, 2007	59.2	486p	June 29, 2007	534.500p	0.1010p	98.88%	1.12%
January 2, 2007	36.7	477p	January 2, 2007	450.750p	0.1000p	99.19%	0.81%
June 30, 2006	53.8	443p	June 30, 2006	413.875p	0.1005p	98.71%	1.29%
January 3, 2006	33.4	356p	January 3, 2006	433.045p	0.1015p	99.22%	0.78%
July 1, 2005	50.0	253p	July 1, 2005	291.000p	0.0995p	98.32%	1.68%
January 4, 2005	31.8	250p	January 4, 2005	244.625p	0.0955p	98.77%	1.23%
June 25, 2004	50.0	212p	July 5, 2004	241.875p	0.1130p	97.72%	2.28%

Analysis of ordinary shareholders at December 31, 2008

Type of holder:	Number of shareholders	% of total shareholders	Number of shares	% of total shares
Individuals	229,152	97.53	123,115,886	6.68
Institutional and other investors	5,810	2.47	1,720,624,250	93.32
Total	234,962	100.00	1,843,740,136	100.00
Size of holding:				
1 – 150	70,139	29.85	7,296,206	0.40
151 – 500	122,396	52.09	31,390,720	1.70
501 – 10,000	40,425	17.21	68,346,836	3.71
10,001 – 100,000	1,363	0.58	35,227,512	1.91
100,001 – 1,000,000	447	0.19	164,674,669	8.93
1,000,001 and over	192	0.08	1,536,804,193	83.35
Total	234,962	100.00	1,843,740,136	100.00