DIRECTORS' REPORT

CHAIRMAN'S INTRODUCTION

> We will regularly review and develop our governance arrangements to ensure that the right decisions are made by the right people.
>
> **Ian Davis**
> Chairman

As Chairman, I am responsible for leading the Board and for ensuring its effectiveness in all aspects of its role. Strong governance is vital to this and I was reassured, when I joined Rolls-Royce, to find a robust governance foundation already in place. The challenge ahead is to build upon this foundation and ensure that the Group's values 'trusted to deliver excellence' apply not just to our products but also to the way that we conduct and govern our business.

Governance structure

In November, I led a discussion on governance with the non-executive directors. We will regularly review and develop our governance arrangements to ensure that the right decisions are made by the right people.

My instinct from my discussions to date is to allow as much time as possible at Board meetings for discussion on strategic and operational issues. With regard to committees, I have concluded that merging the work of the separate safety and ethics committees into one broader-based safety and ethics committee will give greater focus to our sustainability agenda.

I agree with the Association of British Insurers (ABI) that good governance enhances a company's sustainable performance and so helps underpin long-term economic growth. Sustainability has to be part of everything we do if our business is to endure in the long term. Further details on sustainability are on pages 26 to 29. We must provide excellent products which are safe, reliable, kinder to the environment and provide the right solutions for our customers at the right price. We can only endure if we are trusted by the world to deliver excellence in everything we do.

Board changes

During the year, Sir Simon Robertson retired as Chairman and Peter Byrom and Ian Strachan retired as non-executive directors at the conclusion of the AGM on 2 May 2013. I was appointed as a non-executive director on 1 March 2013 and was appointed Chairman on 2 May 2013. Lee Hsien Yang and Warren East were appointed as non-executive directors on 1 January 2014. Having served for nine years as a non-executive director, Iain Conn has decided to retire and will not be standing for re-election at the AGM on 1 May 2014.

Business ethics

In January 2013, we appointed Lord Gold to lead a review of our compliance procedures. Lord Gold presented an interim report to the Board in July 2013, having spent time immersing himself in the culture and systems of the Company.

We require high standards of ethical behaviour wherever we do business and for that behaviour to be second nature for every employee. With over 55,000 employees operating in many business sectors, regions and cultures across the world, we are well aware that this is not something that can be achieved overnight but only by relentless pursuit over time. Further details on ethics related matters can be found in the ethics committee report on pages 49 and 50.

Remuneration

Our remuneration report reflects the new reporting regulations. At the 2014 AGM shareholders shall, for the first time, have the right to vote on the policy section of the remuneration report separately and that vote is binding. The remuneration report can be found on pages 53 to 69.

At the 2014 AGM, we will be proposing to renew our long-term incentive plan, the Performance Share Plan (PSP). We are also taking the opportunity to ask shareholders to approve our Deferred Share Bonus Plan. Further details are set out in the remuneration report.

I believe that Rolls-Royce benefits from a strong Board though we will continue to look for opportunities to further strengthen and diversify, as discussed in the nomination committee report on page 47. I look forward to continuing to work with and support my colleagues at Rolls-Royce as we face the challenges and opportunities ahead.

Ian Davis
Chairman

BOARD OF DIRECTORS


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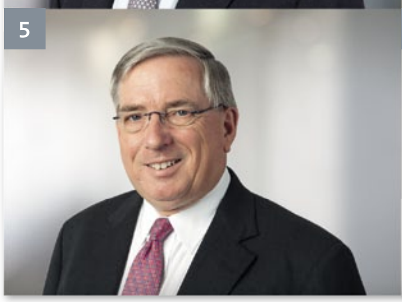
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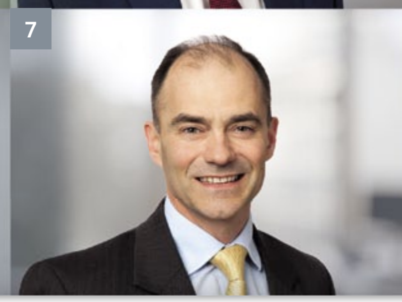
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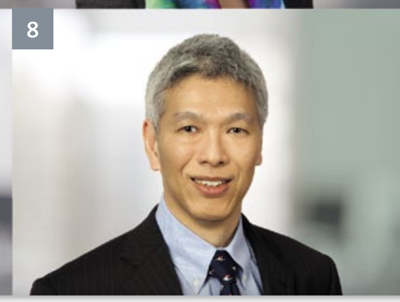
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1. Ian Davis [2*]
Chairman, appointed March 2013

Skills and experience: Ian spent his early career at Bowater, moving to McKinsey & Company in 1979. He was managing partner of McKinsey's practice in the UK and Ireland from 1996 to 2003. In 2003, he was appointed as Chairman and worldwide Managing Director of McKinsey, serving in this capacity until 2009. During his career with McKinsey, Ian served as a consultant to a range of global organisations across the private, public and not-for-profit sectors. He retired as senior partner of McKinsey & Company on 30 July 2010.

External appointments: Ian serves as a non-executive director on the boards of Johnson & Johnson Inc, BP p.l.c. and as a non-executive member of the Cabinet Office Board. He is also senior adviser to Apax Partners LLP.

2. John Rishton [5*]
Chief Executive, appointed March 2011

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

External appointments: John was appointed as a non-executive director of Unilever NV and Unilever plc in May 2013.

3. Iain Conn [1,2,4*,6]
Senior Independent Director, appointed January 2005

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

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

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

Skills and experience: Dame Helen was Chief Executive of the Economist Group until 2008 which she joined in 1985. She was President of the CBI until 2011; she has also been a non-executive director of Northern Foods plc, BT Group plc and Centrica plc. She was awarded a DBE in 2011 for services to business.

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

5. Lewis Booth CBE [1*,2,4]
Non-executive director, appointed May 2011

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

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

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

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

7. Warren East CBE [1,2]
Non-executive director, appointed January 2014

Skills and experience: Warren joined ARM Holdings in 1994 and was appointed Chief Executive in 2001. Under his leadership the company became the world's leading semiconductor IP licensing company. He retired from ARM Holdings in 2013. He is a Fellow of the Institute of Engineering and Technology, a Fellow of the Royal Academy of Engineering and a Distinguished Fellow of the BCS. He was awarded a CBE in 2014 for services to the technology industry.

External appointments: Warren is a non-executive director and chairman of the audit committee of De La Rue plc, and a non-executive director of Dyson Ltd, BT Group plc and Micron Technology Inc.

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

8. Lee Hsien Yang [2,4,6]
Non-executive director, appointed January 2014

Skills and experience: Hsien Yang was Chief Executive of Singapore Telecommunications Limited for 11 years. He served as Chairman and non-executive director of Fraser and Neave Limited from 2007 until February 2013.

External appointments: Hsien Yang serves as a Special Advisor of General Atlantic LLC. He is Chairman of the Civil Aviation Authority of Singapore, General Atlantic Singapore Fund Pte Ltd. and The Islamic Bank of Asia Private Limited, The Australian and New Zealand Banking Group Ltd. and the Lee Kuan Yew School of Public Policy. He is also President of the INSEAD South East Asia Council.

9. John McAdam [2,3,6]
Non-executive director, appointed February 2008

Skills and experience: John was the Chief Executive of ICI plc until ICI's acquisition by Akzo Nobel. He has held a number of positions at Unilever, within its Birds Eye Walls and Unichema International businesses and is a former non-executive director of Severn Trent plc and Sara Lee Corporation.

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

10. John Neill CBE [1,2]
Non-executive director, appointed November 2008

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

External appointments: John is the Chairman and Group Chief Executive of the Unipart Group of Companies Limited and was appointed Chairman of Atlantis Resources Limited in December 2013.

11. Jasmin Staiblin [2,4]
Non-executive director, appointed May 2012

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

External appointments: Jasmin is a non-executive director of Georg Fischer AG and a member of the board of the Federal Institute of Technology, the ETH Domain.

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

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

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

13. Mark Morris [5]
Chief Financial Officer, appointed January 2012

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

14. Colin Smith CBE [5]
Director – Engineering and Technology, appointed July 2005

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

15. Nigel T Goldsworthy
Company Secretary & Head of Legal, appointed December 2012

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

INTERNATIONAL ADVISORY BOARD (IAB)

The IAB, formed in 2006, advises the Board on political and economic developments around the world and alerts the Company to possible long-term opportunities, threats and risks. Its members are:

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

Vladimír Dlouhý
International advisor to Goldman Sachs for Central and Eastern Europe, European deputy chairman of the Trilateral Commission and a former member of the Czech Government

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

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

Mustafa Koç
Chairman of Koç Holding, A.Ş.

Akio Mimura
Senior Advisor, Honorary Chairman Nippon Steel & Sumitomo Metal Corporation

Lubna Olayan
CEO and Deputy Chairperson of the Olayan Financing Company

Ratan Tata
Former Chairman of Tata Sons Limited

Ambassador Robert B. Zoellick
Chairman of Goldman Sachs International Advisors, Senior Fellow at the Belfer Center at Harvard University, former President of World Bank Group, US Deputy Secretary of State and US Trade Representative

THE EXECUTIVE LEADERSHIP TEAM (ELT)

During 2013, John Rishton chaired meetings of the ELT, an executive forum at which his first line reports (the Group's most senior business and functional leaders) review, communicate and agree on issues and actions of group-wide significance. In addition to John Rishton, its other members are:

Miles Cowdry
Corporate Development Director

Kath Durrant
Human Resources Director

James Guyette
President and Chief Executive Officer – Rolls-Royce North America Inc.

Lawrie Haynes
President – Marine and Nuclear

Andrew Heath
President – Energy

Alain Michaelis
Operations Director

Mark Morris
Chief Financial Officer

John Paterson
President – Marine and Industrial Power Systems

Colin Smith
Director – Engineering and Technology

Robert Webb
General Counsel

Tony Wood
President – Aerospace

CORPORATE GOVERNANCE REPORT

Board members and attendance

There are currently 14 directors on the Board comprising the non-executive Chairman, the Chief Executive, three other executive directors and nine non-executive directors.

	Attendance in 2013
Ian Davis (Chairman) (appointed 1 March 2013)	7/7
Dame Helen Alexander	8/9
Lewis Booth CBE	9/9
Peter Byrom (retired 2 May 2013)	4/4
Sir Frank Chapman	8/9
Iain Conn	8/9
Warren East CBE (appointed 1 January 2014)	n/a
James Guyette	9/9
Lee Hsien Yang (appointed 1 January 2014)	n/a
John McAdam	8/9
Mark Morris	9/9
John Neill CBE	9/9
Sir Simon Robertson (retired 2 May 2013)	3/4
John Rishton	9/9
Colin Smith CBE	9/9
Jasmin Staiblin	4/9
Ian Strachan (retired 2 May 2013)	4/4

The General Counsel and the Company Secretary are also invited to attend meetings. Jasmin Staiblin who is based in Switzerland was unable to attend two scheduled meetings during pregnancy and three due to unavoidable diary clashes in respect of commitments entered into before her appointment to the Board.

Key objective:

- create long-term success for the Group within an acceptable risk profile and provide value for the long-term investor.

Responsibilities:

- ensure the safety of its products and people;
- ensure the development of strategy;
- monitor implementation of the strategy;
- ensure necessary resources are in place;
- ensure controls exist to manage risk;
- safeguard values, brand and reputation;
- oversee performance of management;
- ensure effective succession planning;
- agree remuneration policy; and
- maintain effective governance.

Governance principle: leadership

Board membership

The directors biographical details are on pages 36 and 37 which demonstrate the skills and experience of the Board. The experience and knowledge of each of the directors gives them the ability to constructively challenge strategy and scrutinise performance.

On 12 February 2014, the Board noted that Iain Conn intended to retire as the Senior Independent Director and as a non-executive director and would therefore not seek re-election at the AGM on 1 May 2014. The Board has resolved that Lewis Booth, subject to re-election at the AGM, will succeed Iain Conn as the Senior Independent Director at the conclusion of the AGM.

UK Corporate Governance Code (the Code)

This report explains how the Company discharges its corporate governance responsibilities. In the year to 31 December 2013, the revised principles and provisions of the Code (published in September 2012 by the Financial Reporting Council (FRC) applied to the Company.

Throughout the 2013 financial year, the Company did not fully comply with the provisions of the Code for the following reasons:

Code provision	Explanation
C.3.5 – The audit committee should review arrangements by which staff of the company may, in confidence, raise concerns about possible improprieties in matters of financial reporting or other matters.	The Board considered it appropriate that this provision of the Code be the primary responsibility of the ethics committee. The ethics committee is, however, required to refer concerns about possible improprieties in matters of financial reporting to the audit committee.
C.3.7 – The audit committee should have primary responsibility for making a recommendation on the appointment, reappointment and removal of the external auditors. FTSE 350 companies should put the external audit contract out to tender at least every ten years.	The audit committee has considered the requirement to put the audit out to tender every ten years. In line with the FRC's transitional arrangements, the committee will do so during the tenure of the current lead partner which expires in 2017. The committee concluded that, in order to ensure that a potential change in auditor is managed effectively, it would not be in the Company's interests to put the audit out to tender in 2013. More detail can be found in the audit committee report on page 46.

CORPORATE GOVERNANCE REPORT

In accordance with the Code and the Company's Articles of Association, all directors will retire and put themselves forward for election or re-election at the AGM in 2014 with the exception of Iain Conn who is not seeking re-election and will retire from the Board at the conclusion of that meeting.

The process for succession planning is discussed in the nomination committee report on page 47.

The work of the Board in 2013
During 2013, the Board held nine meetings, eight of which were scheduled and a further one called at short notice. In addition, two formal resolutions were passed by consent of all directors using electronic means. Non-executive directors communicate directly with executive directors and senior management between formal Board meetings. At each scheduled meeting, executive directors supplied reports on business and financial performance including the usual approval of financial statements and budgets. The Board also received regular updates on health, safety and environment (HS&E) and employee and legal issues, including a review of its governance arrangements. In addition, the chairman of each of the Board committees provided reports on matters discussed by that committee since the previous Board meeting.

The Board holds an annual day-long strategy meeting, which provides a forum for directors to challenge strategy and help develop it for the future. The strategy meeting held in September 2013 included discussions on the ten-year financial plan and the strategic context including market structure, competitor positioning, cost challenges, technology and with a focus on the Civil aerospace and the Marine and Industrial Power Systems businesses.

In addition to its routine business, matters considered by the Board in 2013 included:

- Marine strategy focused on markets, costs, supply chain, product development and alignment with the Rolls-Royce Power Systems and Bergen engines businesses;
- the closure of the proposed joint venture with Pratt & Whitney;
- updates on the referral to the Serious Fraud Office;
- discussion on Lord Gold's interim findings, the adoption of a new Global Code of Conduct and the roll-out of a comprehensive ethics training programme to all employees;
- relocation to new Group headquarters;
- the effect of sequestration on US defence spending;
- Civil Nuclear business strategy;
- investors' view on our AGM business;
- restructuring of the Aerospace business;
- liquidity and additional funding;
- the renewal of the Euro Medium Term Note programme;
- preliminary discussions with Wärtsilä regarding a possible offer for the company; and
- cyber security.

Board committees
The Board has established a number of committees, the principal ones being audit, remuneration, nomination, ethics, risk and safety. Terms of reference for each committee are available on the Group's website at www.rolls-royce.com. Reports by committee chairmen on the activities of each of the principal committees are on pages 44 to 54. The Chairman's introduction provides more detail on page 35 of changes to the committee structures.

Senior management and advisers are invited to attend Board and committee meetings where appropriate to contribute to discussions and advise members of the Board and committees on relevant matters. The involvement of senior management additionally helps strengthen the relationship between the Board and senior management and helps to provide the Board with a greater understanding of operations and strategy.

Internal control
The directors are responsible for the Group's system of internal control and for maintaining and reviewing its effectiveness from both a financial and an operational perspective. Our risk management process is a key element of the Group's internal control system. This system of internal control is designed to identify and manage, rather than eliminate, the risk of failure to achieve business objectives and to provide reasonable but not absolute assurance against material misstatement or loss. The processes we use to identify and manage risk are set out in the risk committee report on page 51. The Board's report on the Group's principal risks and actions taken to mitigate them is on pages 32 to 34.

Turnover from joint ventures constitutes an increasingly large part of our reported group activity. Responsibility for internal control procedures in joint ventures where we do not have a control agreement lies with the managers of those operations. We seek to exert influence over such ventures by board representation and regularly review the activities of these ventures.

The audit committee has reviewed the effectiveness of the systems of internal control for the year under review. Further information can be found in the audit committee report on page 45. The Board confirms that the processes and systems currently in place ensure that the Group continues to be compliant with the 'Turnbull guidance' as contained in 'Internal Control: Revised Guidance for Directors on the Combined Code' issued by the Financial Reporting Council in 2005.

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

Financial managers are required to acknowledge in writing that their routine financial reporting is based on reliable data and that results are properly stated in accordance with Group requirements. In addition, for annual reporting, business presidents and finance directors are required to confirm that their business has complied with the Group's Finance Manual.

Roles and responsibilities

The Board has a written remit for the Chairman, Ian Davis, who has responsibility for the running of the Board and ensuring its effectiveness, and the Chief Executive, John Rishton, who has responsibility for running the business. This division of responsibility ensures that no one individual has unfettered powers of decision.

In addition, the Board has agreed a set of guiding principles to govern the relationship between the Chairman and Chief Executive which, for example, requires that the two roles are structured in a complementary manner and demands that the relationship between the two be based on mutual respect and trust and be frank and open.

The Senior Independent Director, Iain Conn, acts as a sounding board for the Chairman and can act as an intermediary for other directors. He led the nomination committee in the process which resulted in the appointment of Ian Davis as Chairman in May 2013.

Each year, the Senior Independent Director leads a separate meeting of the Board excluding the Chairman to review the Chairman's performance.

Role and operation of the Board

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

To achieve its long-term success the Board must:

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

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

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

Information is supplied to directors in a manner which enables them to fulfil their responsibilities. This includes the circulation of papers to be discussed, generally one week before meetings. Presentations are made by senior management at Board meetings on business, financial and operating issues. Directors are expected to attend all meetings of the Board and the committees on which they sit and to devote sufficient time to the Company's affairs to enable them to fulfil their duties as directors. If directors are unable to attend a meeting, their comments on the papers to be considered are discussed in advance with the Chairman so that their contribution can be included in the wider Board discussion.

Executive Leadership Team (ELT)

The ELT is the senior decision-making executive committee and met 26 times during the year. Its membership is described on page 38. It developed detailed strategic options for the Group culminating in approval of strategy by the Board in September. It reviewed HS&E performance, customer relations, governance, financial and operational performance. It also reviewed acquisitions and disposals and recommended them to the Board where required.

Each business segment holds executive meetings to review operational performance of its business, assisting the business president in taking such decisions as fall within his remit and reviewing proposals before presentation to the ELT or the Board for approval as appropriate.

Governance principle: effectiveness

Board evaluation

The Code requires that the Board undertakes an annual evaluation of its own performance and that of its committees and individual directors and to do so externally at least every three years. In 2013, the evaluation process was again conducted internally, full external reviews having been carried out by Jan Hall Associates in 2010 and 2011.

Initially, directors were asked to complete a confidential survey covering the areas set out as best practice published by the Financial Reporting Council's 'Guidance on Board Effectiveness'. The Company Secretary then produced a report which consolidated the responses following which the Chairman conducted one-to-one interviews with each director and the Senior Independent Director interviewed the Chairman. The findings were considered by the Board and actions to be taken were agreed.

The evaluation concluded that the Board was proving to be effective under the leadership of Ian Davis and John Rishton and that relationships and Board discussions work well. The principal recommendation was that succession planning for senior executive positions could be improved. Other areas for improvement identified included risk processes, mitigation plans, Board papers and governance.

Directors' terms of appointment

Executive directors are employees who have day-to-day responsibilities as executives of the Group in addition to their duties as directors. Each executive director receives a service contract on appointment (see pages 60 and 61 for further information).

Non-executive directors are generally independent of the Company, are not employees and do not participate in the daily business management of the Group. On appointment, each non-executive director receives a letter setting out the conditions of his or her appointment. Non-executive directors are appointed for an initial term of three years, which may be extended with the agreement of the Board, although reappointment is not automatic. Their term of office is also subject to annual re-election by shareholders at the AGM and will terminate without compensation if they fail to be re-elected (see page 60 for further information).

CORPORATE GOVERNANCE REPORT

Director training

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

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

Further training is available for directors, including presentations by the executive team on particular aspects of the business. In 2013, the Board received training in ethics conducted by our Head of Business Ethics. In December 2013, our corporate lawyers, Slaughter and May, held a seminar immediately following the Board meeting to update the Board on developments in corporate law and regulation. In addition, there is a procedure for directors to take independent professional advice at the Company's expense and every director has access to the General Counsel and to the Company Secretary who is responsible to the Board on corporate governance. All directors are advised of changes in legislation, regulation and changing risks with the assistance of the Company's advisers where necessary. In-house training is provided to directors of the Company's subsidiaries and joint ventures.

Independence of the non-executive directors

The Board conducts a rigorous review of the independence of the non-executive directors every year, based on the criteria in the Code. This review was undertaken in November 2013 and the Board concluded that all the non-executive directors remained independent in character and judgement. The Chairman met the Code's independence criteria upon his election as Chairman in May 2013. His other external commitments are described on page 36.

Non-executive directors are advised of the time required to fulfil the role and are asked to confirm that they can make the required commitment before the appointment is made. The Board is satisfied that each of the non-executive directors is able to devote sufficient time to the Company's business.

The Board believes it can be appropriate for executive directors to take non-executive positions in other companies and organisations, as such appointments should broaden their experience. The appointment to such positions is subject to the approval of the Chairman and the Board and must not conflict with a director's duties and commitments to the Company.

Conflicts of interest

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

Governance principle: accountability

The directors consider the annual report and accounts, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the Company's performance, business model and strategy.

Investor relations

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

The Group conducts a dedicated investor relations programme with institutional investors which includes various formal events during the year, as well as a regular series of one-to-one and group meetings. The purpose of these events is to highlight a particular issue, theme or announcement that the Group believes warrants further explanation or clarification. The events also provide opportunities for shareholders to meet members of the senior management team. Examples of these events in 2013 were: the preliminary and half-year results announcements; the AGM; the update given at the Paris Air Show on trends in the Civil and Defence aerospace businesses; visits to certain of the Group's sites; and industry conferences. The one-to-one and group meetings provide additional context around the Group's business strategy and financial performance.

In 2013, over 380 meetings took place with over 340 separately identifiable institutional investors. The majority of meetings took place in the UK (273), 81 meetings were in the USA and Canada, and a further 26 meetings took place in Europe. The Chairman also meets institutional investors from time-to-time.

Shareholder communications

Information about the Group is available on the Group's website (www.rolls-royce.com) and in the published annual report, an online version of which is also available on the website. The website contains financial and other information about the Group including current business strategy, historical financial data, and recent presentation materials together with information on the Group's businesses, products and services.

Over 20,000 Rolls-Royce shareholders have registered their email addresses with etree so that they benefit from immediate communication of the posting of our preliminary results and of the publication of our notice of meetings and our online annual report. This reduces our printing and mailing costs as well as our carbon footprint. We would encourage other shareholders to register for this service by following the instructions on the etree website at www.etreeuk.com/rolls-royce.

Annual general meeting (AGM)

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

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

This year's AGM will be held at 11.00am on Thursday, 1 May 2014 at the QEII Conference Centre, Broad Sanctuary, Westminster, London SW1P 3EE. The AGM notice and the annual report will be available to view on the Group's website. Shareholders unable to attend the AGM can vote on the business of the meeting either by post or online.

Shareholders and share capital

Information on shareholders and share capital, which also forms part of the Corporate Governance report, is detailed on pages 70 and 71.

Change of control

Contracts and joint venture agreements

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

Borrowings and other financial instruments

The Group has a number of borrowing facilities provided by various banks. These facilities generally include provisions which may require any outstanding borrowings to be repaid or the alteration or termination of the facility upon the occurrence of a change of control of the Company. At 31 December 2013 these facilities were less than 35 per cent drawn (2012 30 per cent).

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

Employee share plans

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

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

Payment to shareholders

At the AGM on 1 May 2014, the directors will recommend an issue of 134 C Shares with a total nominal value of 13.4 pence for each ordinary share. The final issue of C Shares will be made on 1 July 2014 to shareholders on the register on 25 April 2014 and the final day of trading with entitlement to C Shares is 22 April 2014. Together with the interim issue on 2 January 2014 of 86 C Shares for each ordinary share with a total nominal value of 8.6 pence, this is the equivalent of a total annual payment to ordinary shareholders of 22 pence for each ordinary share.

The payment to shareholders will, as before, be made in the form of redeemable C Shares which shareholders may either choose to retain or redeem for a cash equivalent. The Registrar, on behalf of the Company, operates a C Share Reinvestment Plan (CRIP) and can, on behalf of shareholders, purchase ordinary shares from the market rather than delivering a cash payment. Shareholders wishing to redeem their C Shares or else redeem and participate in the CRIP must ensure that their instructions are lodged with the Registrar, Computershare Investor Services PLC, no later than 5.00pm on 2 June 2014. Redemption will take place on 3 July 2014.

AUDIT COMMITTEE REPORT

Our committee is focused on ensuring the integrity of the Group's financial reporting and improving the financial controls framework.

Lewis Booth CBE
Chairman of the audit committee

Committee members and attendance

The audit committee consists exclusively of independent non-executive directors and met four times in 2013.

	Attendance in 2013
Lewis Booth CBE (Chairman)	4/4
Iain Conn	4/4
Warren East CBE (appointed 1 January 2014)	n/a
John Neill CBE	4/4
Ian Strachan (retired 2 May 2013)	2/2

The external auditors KPMG Audit Plc (KPMG), the Director of Internal Audit, the General Counsel, the Director of Risk, the Company Secretary, the Chairman of the Board, the Chief Executive and the Chief Financial Officer are also invited to attend meetings. Other Board members, including the remuneration committee chairman and senior executives attended meetings during the year at the invitation of the committee chairman.

Key objective:

- to assist the Board in ensuring the integrity of its financial statements.

Responsibilities:

- to review the financial results announcements and financial statements, monitoring compliance with relevant regulations;
- to review the appropriateness of accounting policies and the supporting key judgements and estimates;
- to assess the scope and effectiveness of the systems to identify, manage and monitor financial and non-financial risks;
- to review the procedures for detecting, monitoring and managing the risk of fraud;
- to oversee the relationship with the external auditor and make recommendations to the Board regarding the external auditor's appointment; and
- to review the scope, resources, results and effectiveness of Internal Audit.

I am pleased to present the report of the audit committee for the year. I would like to thank committee members, the executive management team and KPMG for the open discussions that take place at our meetings and the importance they all attach to its work.

Work of the committee in 2013

At our meetings during 2013, we focused on financial reporting, internal control, internal audit and external audit. We received presentations from senior executives from the Civil aerospace, Defence aerospace and Civil Nuclear businesses. These presentations covered key accounting judgements and estimates, internal control and risk management.

We also reviewed the committee's own terms of reference.

Financial reporting

In addressing our key objective, which is to assist the Board in ensuring the integrity of its financial statements, we reviewed financial announcements and financial statements with both management and the external auditor, concentrating on:

- compliance with financial reporting standards and governance reporting requirements;
- areas requiring significant judgements to be made in applying accounting policies;
- the appropriateness of accounting policies;
- the procedures and controls around estimates that are key in applying accounting policies;
- whether the annual report and accounts, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group's business model, strategy and performance; and
- any relevant correspondence from regulators.

Our committee is focused on ensuring integrity of the Group's financial reporting and improving the financial controls framework, including the restructuring of business audit committees which now report directly to this committee. During the year, we encouraged and supported the development of an enhanced business audit committee process. Under this process, management of each of the Group's businesses consider the appropriateness and related governance of accounting policies, judgements and estimates and the control environment relating to their businesses including internal audit findings and the robustness of the processes used to execute their risk management responsibilities. We receive reports on the results of these reviews.

Our business is complex; in particular the development of gas turbines for use in civil aircraft applications requires large upfront investments, a long period of sale of original equipment, and a very long period over which we generate profits and cash flows from the aftermarket by the sale of spare parts and engine maintenance work. The in-service period could be longer than 25 years for any engine, and the total life cycle of an engine could be more than 40 years from initial concept, through production, and then through the in-service life. Much of the aftermarket repair and overhaul is provided through long-term service agreements. Given this long exposure, the amount of revenue and profit recognised during any period requires a significant number of accounting judgements and estimates, supported by engineering and business assessments. Consequently, one of our primary responsibilities is to ensure that the bases for these judgements and estimates are robust.

In 2013, our work focused on:

- carrying values of the principal intangible assets in Civil aerospace – we considered the business plans for the relevant engine programmes, including the key assumptions on which they are based, and which support the value in use assessments for the intangible assets. We were satisfied that no impairments were required;
- long-term contractual arrangements in Civil aerospace – we reviewed the forecasts of future contract performance on which the accounting is based. We also considered performance to date against these forecasts and the results of a detailed review of certain aspects of the processes supporting these forecasts. Where the accounting results in a contract asset, we assessed the recoverability of the asset against agreed criteria. We were satisfied that the forecasts have been prepared on an appropriate and consistent basis;
- risk and revenue sharing arrangements (RRSAs) in Civil aerospace – (as described in the Chief Financial Officer's review on page 11), during the year and following discussions with the Conduct Committee of the Financial Reporting Council (FRC), the Group has reassessed its accounting policy for entry fees received from workshare partners. Adopted IFRS does not contain requirements that are specific to arrangements of this type and we assessed possible alternative policies developed by management. We reviewed the revised policy, considered the FRC's and KPMG's views and I attended a meeting with the FRC. On balance, we agreed with management's view that the revised policy fairly reflects the nature of the transaction and that it should be adopted retrospectively;
- we reviewed the contractual arrangements that resulted in the Group consolidating Rolls-Royce Power Systems AG from 1 January 2013. We also reviewed the accounting for the business combination, based on a third-party valuation of the intangible assets acquired, and the valuation of the Daimler put option on the non-controlling interest. We were satisfied that appropriate judgements and estimates have been made;
- customer financing liabilities in Civil aerospace – we considered the adequacy of provisions for these liabilities. We considered the likelihood of the liabilities crystallising, based on an assessment of customers' fleet plans and their creditworthiness. We also considered the value of any security held, based on third-party valuations. We were satisfied that provisions have been made on an appropriate basis;
- contingent liabilities – we considered the adequacy of the disclosures. In particular, we considered legal advice in respect of the possible outcome of the SFO enquiries. We were satisfied that the disclosures appropriately reflect the current position; and
- segmental reporting – we considered the changes in management structure and internal reporting described on page 10 and the implications for reporting in accordance with IFRS 8. We were satisfied with the appropriateness of the revised segmental reporting from 1 January 2014.

Since the year end, we have reviewed the form and content of the Group's 2013 annual report. The committee has reported to the Board that it considers the annual report, taken as a whole, to be fair, balanced and understandable.

Internal control

The Director of Internal Audit provided a report setting out an overview of the Group's control environment and we reviewed the processes by which the control environment is assessed and any identified weaknesses resolved. We considered control weaknesses identified by the auditors in accounting for Civil aerospace long-term aftermarket contracts, and management's plans to address these. We also received reports of any identified frauds that are significant or demonstrate significant weakness in internal control.

We also reviewed a report on compliance with the Group's policies in respect of expenses incurred by the directors and other senior executives, which did not identify any significant issues.

Internal Audit

The Director of Internal Audit presented two updates on audit activities and findings covering six-month periods, the resolution of control weaknesses, progress against the agreed plan and the resourcing of the department. We are continuing to develop with him a simplified metrics-driven approach to the reporting, focusing on the closure of open items on a timely basis and the identification of recurring themes. We were satisfied that the scope, extent and effectiveness of Internal Audit are appropriate for the Group.

I meet the Director of Internal Audit in private before each meeting and the committee as a whole has a private meeting with him at least once a year.

External auditor

The external audit is a continuous process. At the start of the audit cycle, KPMG presented their audit strategy, identifying their assessment of the key risks for the purposes of the audit and the scope of their work.

For 2013, these risks were: the implementation of a new consolidation system; the business combination and Daimler's put option in respect of Rolls-Royce Power Systems Holding GmbH; impairment of intangible assets; long-term contractual arrangements; warranties and guarantees; RRSAs; customer financing arrangements; contingent liabilities; valuation of derivatives; valuation of pension liabilities; recoverability of tax assets and adequacy of tax provisions; the adjustments between the reported results and the Group's underlying performance; and the form and content of the annual report. More detail is set out in KPMG's report on pages 130 to 135.

AUDIT COMMITTEE REPORT

KPMG reports to the committee at both the half and full-year setting out their assessment of the Group's judgements and estimates in respect of these risks and the adequacy of the reporting. I meet the lead audit partner in private before each meeting and the whole committee meets with KPMG in private at least once a year.

Non-audit services provided by KPMG
In order to safeguard auditors' independence and objectivity, we do not engage KPMG for any non-audit services, except where it is work that they must, or are clearly best suited to perform. Fees paid to KPMG for audit, audit related and other services are set out in note 8 to the financial statements.

Excluding Rolls-Royce Power Systems (see below), the main non-audit related services provided by KPMG during the year were in respect of grant claims and tax compliance and were 11 per cent of the audit fee. The nature and level of all services provided by the external auditor is a factor taken into account by the audit committee in its annual review of the external auditor.

All proposed services must be pre-approved in accordance with an agreed policy. We review the non-audit fees charged by KPMG at each meeting and annually review the approval limits.

Following the consolidation of Rolls-Royce Power Systems on 1 January 2013, we took the decision to allow the completion of engagements already in progress. As a result, Rolls-Royce Power Systems incurred fees on non-audit services provided by KPMG in 2013 of £2.1 million, 210 per cent of its audit fee. This will reduce in 2014.

Reappointment of auditor
Following the completion of the audit, we reviewed the effectiveness and performance of KPMG with feedback from committee members, senior finance personnel and Internal Audit, covering overall quality, independence and objectivity, business understanding, technical knowledge, quality and continuity of personnel, responsiveness and cost effectiveness. We also considered the reports on KPMG by the FRC's Audit Quality Review Team. The audit of Rolls-Royce was not subject to their review in 2013. KPMG were appointed as auditors in 1990 and this appointment has not been subject to a tender process since that date.

The lead audit partner is required to rotate every five years and other key audit partners are required to rotate every seven years. Jimmy Daboo took over as lead audit partner in 2013 and has had no previous involvement with Rolls-Royce in any capacity. No contractual obligations restrict our choice of external auditors. We concluded that KPMG provides an effective audit and the committee and the Board have recommended their reappointment at the 2014 AGM.

Audit tendering
The Group is a complex and technologically advanced business with a long cycle from the development of an engine to its eventual retirement. We believe that KPMG's knowledge of this, built up over a number of years, enhances the effectiveness of the audit and that the existing professional requirements, such as the rotation of audit personnel, maintain independence. However, the UK Corporate Governance Code now requires the external audit contract be tendered at least every ten years. The FRC has proposed non-binding transitional arrangements with respect to audit tendering, including a suggestion that tendering should normally fit the five-yearly cycle with respect to the lead partner.

We plan to recommend a tender of the audit during the tenure of the current lead partner which, subject to KPMG's annual reappointment, is due to end following the 2017 audit. This will also satisfy the requirements proposed by the Competition Commission. However, before we make such a recommendation, we will satisfy ourselves that, if the tender resulted in a change of auditor: (i) it would not be unnecessarily disruptive, taking account of any other activities; and (ii) appropriate plans are in place to ensure audit effectiveness is maintained. During the year, we approved a tender plan prepared by management to be used when the audit is tendered but we do not plan to tender the audit during 2014. The EU is also finalising requirements which would require mandatory rotation of auditors. the draft proposals would require us to appoint a different firm by 2020 at the latest. Once finalised, we will take account of the EU requirements in our assessment of when to recommend an audit tender.

Lewis Booth CBE
Chairman of the audit committee

NOMINATION COMMITTEE REPORT

We must continue to appoint the best candidates but we will show an increasing emphasis on recruiting candidates from more diverse backgrounds.

Ian Davis
Chairman of the nomination committee

Committee members and attendance

The nomination committee consists of all of the non-executive directors and met six times in 2013.

	Attendance in 2013
Ian Davis (Chairman) (appointed 1 March 2013)	4/4
Dame Helen Alexander	6/6
Lewis Booth CBE	5/5
Peter Byrom (retired 2 May 2013)	2/2
Sir Frank Chapman	4/6
Iain Conn	5/6
Warren East CBE (appointed 1 January 2014)	n/a
Lee Hsien Yang (appointed 1 January 2014)	n/a
John McAdam	6/6
John Neill CBE	6/6
John Rishton	2/2
Sir Simon Robertson (retired 2 May 2013)	2/2
Jasmin Staiblin	4/6
Ian Strachan (retired 2 May 2013)	2/2

The committee decided on July 2013 that the committee should only consist of non-executive directors and John Rishton therefore ceased to be a member.

Key objective:

- to lead the process for appointments to the Rolls-Royce Board.

Responsibilities:

- monitor the composition and performance of the Board and its committees;
- evaluate the balance of skills and experience on the Board and the diversity of its members;
- consider and recommend the appointment and removal of directors;
- monitor executive development and succession planning;
- evaluate any conflicts of interest that directors might have; and
- evaluate the independence of the non-executive directors and their time commitments.

I am pleased to present my first report as chairman of the nomination committee.

During the year, the committee continued to develop its succession plans for new non-executive directors taking into account their respective tenures of office, analysing the skills which were either missing or could be missing in future and how different personalities would fit around the Board table. We are very clear that we must continue to appoint the best candidates but we will show an increasing emphasis on recruiting candidates from more diverse backgrounds and with international experience.

We are pleased that Lee Hsien Yang has joined the Board as a non-executive director. Hsien Yang was already known to the Board as a valued member of the IAB (a role that he has relinquished upon his appointment to the Board). The committee did not therefore engage search consultants in connection with his appointment.

Hsien Yang will bring to our Board a wealth of business experience in the Asian marketplace. His biography can be found on page 37.

The Board has been further bolstered by the appointment of Warren East as a non-executive director. Warren has extensive experience in the global technology sector and an outstanding record of business achievement that will be of great value to Rolls-Royce. His biography can be found on page 36. Both Warren and Hsien Yang took up their posts from 1 January 2014. Sciteb was engaged as search consultant for Warren's appointment. The firm has no other connection with the Company.

The topic of boardroom diversity has received much attention over the past two years. In September 2011, we issued our response to the Davies Report on women on boards stating that we expected to make demonstrable progress in this area by 2015. Maintaining the right balance on the Board and getting the succession policy right is high on my agenda and the Board is clear that purposeful diversity is a valuable goal. Gender diversity is an important part of that although we do not consider it appropriate to fix a specific target.

We continue to participate in the FTSE 100 Cross-Company Mentoring Programme, the objective of which is to increase the pool of eligible senior female candidates for UK board positions and we have comprehensive programmes in place to increase the diversity of our internal pipeline of future leaders. We have also issued guidance to executive search companies outlining the importance of diverse candidate short lists. Further details of our gender representation can be found in sustainability on page 27.

NOMINATION COMMITTEE REPORT

During the year, the committee reviewed the use of executive search consultants and concluded that the existing agency relationships were working well and should continue. The overarching brief is to find candidates of international stature, with international mindsets and relevant experience who could demonstrate sound judgement and board skills with an emphasis towards greater diversity.

MWM Consulting was engaged in the search for the vacant chairman's post earlier in 2013. A detailed brief was approved by the Board covering both the responsibilities of the role and the desired profile which formed the blueprint against which candidates were identified and assessed. The search was broad and global in outlook, constrained only by the requirements of the brief. Seventy candidates from ten different countries were actively considered. MWM Consulting has no other connection with the Company.

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

- considered time commitments and potential conflicts faced by directors who wished to take up non-executive positions on the boards of other companies;
- authorised John Rishton's acceptance of a non-executive role at Unilever;
- reviewed its own terms of reference;
- considered the independence of the non-executive directors;
- considered the standing schedule of directors' conflicts of interest and recommended to the Board that the schedule be approved;
- recommended the appointment of a new Chairman and two new non-executive directors and renewed terms of office for Dame Helen Alexander, John McAdam and Iain Conn;
- discussed governance arrangements for the Group and the Board evaluation process;
- reviewed the Board's diversity policy; and
- since the year end, the committee has reviewed and approved the form of this report.

Ian Davis
Chairman of the nomination committee

ETHICS COMMITTEE REPORT

The Board has a firm belief that the only way we can succeed as a Group is by applying sound and ethical business practices wherever we operate.

Iain Conn
Chairman of the ethics committee

Committee members and attendance

The ethics committee consists exclusively of independent non-executive directors and met four times in 2013.

	Attendance in 2013
Iain Conn (Chairman)	3/3
Dame Helen Alexander	4/4
Lewis Booth CBE	4/4
Peter Byrom (retired 2 May 2013)	1/1
Lee Hsien Yang (appointed 1 January 2014)	n/a
Jasmin Staiblin	3/4
Ian Strachan (retired 2 May 2013)	1/1

The Chairman of the Board, the Chief Executive, the General Counsel, the Director of Risk and the Head of Business Ethics are also invited to attend meetings on a regular basis.

Key objective:

- review compliance with Rolls-Royce ethics policies.

Responsibilities:

- review compliance with and recommend changes to the Global Code of Conduct;
- monitor evolving practice and requirements of regulatory bodies and recommend how they should be applied in the Group;
- establish bribery prevention policies and procedures;
- review arrangements by which staff may raise concerns and ensure such concerns are handled effectively; and
- ensure that ethical policies and practices are subject to an appropriate level of independent internal scrutiny.

The ethics committee was formed in 2008 in response to the publication of the Woolf Committee report. It is responsible, on behalf of the Board, for reviewing compliance with the Group's Global Code of Conduct, for improving bribery and corruption prevention policies and for reviewing arrangements by which staff may raise ethical concerns in confidence. It considers recommendations on ethical matters made by external regulatory authorities or other bodies and makes recommendations to the Board on how they should be applied in Rolls-Royce. I would like to thank Ian Strachan for his chairmanship of this committee from November 2008 to May 2013.

Referral to Serious Fraud Office (SFO)

On 6 December 2012, we announced that we had passed information to the SFO relating to concerns in overseas markets. Since that date we have continued our investigations and are engaging with the SFO and other authorities in the UK, the USA and elsewhere. In December 2013, we announced that we had been informed by the SFO that it had commenced a formal investigation. The consequence of these disclosures will be decided by the regulatory authorities. It remains too early to predict the outcomes, but these could include the prosecution of individuals and of the Group. Accordingly, the potential for fines, penalties or other consequences (including debarment from government contracts, suspension of export privileges and reputational damage) cannot currently be assessed. As the investigation is ongoing, it is not yet possible to identify the timescale in which these issues might be resolved. We continue to demand the highest standards of behaviour from our people. John Rishton has stated unequivocally that neither he nor the Board will tolerate improper business conduct of any sort and all necessary action will be taken to ensure compliance.

Lord Gold's review

The Group has taken significant further action to strengthen and enhance its ethics and compliance programme. In January 2013, the Group appointed Lord Gold to review its ethical and compliance procedures and make recommendations. Lord Gold began his work in 2013 reporting directly to the ethics committee and attending its meetings. In July 2013, he presented an interim report, having interviewed over 80 senior managers across the Group. In addition to a number of detailed recommendations, the report drew attention to the need for further strengthening of the Group's ethics and compliance function in the following three areas: develop and implement an integrity and values communication strategy; provide integrity and values training for all employees; and reorganise the compliance function. The ethics committee, the Board and the ELT have all reviewed and accepted Lord Gold's interim report and the recommendations made in it and the Group has started to implement those recommendations. The Group has

ETHICS COMMITTEE REPORT

developed an holistic ethics and compliance improvement programme, overseen by a newly appointed Director of Risk, clarifying, with a new Global Code of Conduct, what is expected from all individuals in the Group, defining processes to combat bribery and corruption and strengthening oversight and review of the Group's performance in these areas. The following is a summary of some of the Group's major activities undertaken in 2013:

Global Code of Conduct (Global Code)

In July 2013, the Board and the ELT approved a revised version of the Group's Global Code of Conduct which is a condensed, updated and more readable version of the previous Global Code of Business Ethics. The Global Code is being used as a platform for the Group's enhanced ethics and compliance programme and its rollout is being supported by manager-led face-to-face awareness briefings for all employees and a detailed programme of training which will continue. The Board and the ELT received the awareness briefing and supporting ethics training in July 2013 and provided feedback and input into the materials. The Board agreed that the training programme would be compulsory for all employees.

The rollout programme started in September 2013 and will be delivered to all employees and all new starters. All employees are being asked to certify they have: received a copy of the Global Code; read and understood it; will comply with it; and have received a management briefing. In future years, periodic refresher training will continue and will also be compulsory.

Ethics Line

Since 2008, employees have been able to access a confidential reporting line to report any concerns they might have. In 2013, the Group has reviewed, updated and re-launched its confidential reporting line (now known as the Ethics Line). Today we have contact numbers in 48 countries in addition to a web-based reporting tool which enables employees to ask questions or raise concerns 24 hours a day wherever they are based in the world. The ethics committee receives reports and questions raised through the Ethics Line. In July 2013, it was agreed that an oversight committee would be established to monitor the detailed operation of the Ethics Line and ensure it remains effective and efficient.

Anti-bribery and corruption policies (ABC policies)

Much progress has been made in developing policies to govern the use of intermediaries since the formation of the ethics committee in 2008. The number of intermediaries used by our businesses has continued to fall dramatically during the year. Businesses now have greater ownership and direct responsibility for the marketing, sales and support of the Group's products and services. An updated and simpler version of the Global Gifts and Hospitality Policy was introduced in October 2012 and work has continued in the year to capture data, develop a reporting regime and develop key metrics.

In July 2013, following the issue of Lord Gold's interim report, the Director of Risk undertook to carry out a further thorough review of all ABC policies, taking account of Lord Gold's recommendations. This review is underway and the Group has started the process of updating and modifying its suite of anti-bribery and corruption policies so that they are robust, simpler, meet the current needs of the business and are embedded as a core part of the Group's processes for winning new business. All revised and enhanced ABC policies and procedures will meet the recommendations made by Lord Gold and will be supported by a training programme.

ABC compliance team

The ABC compliance organisation's remit is to embed the ABC policies in the businesses, take the ABC programme into a 'business as usual' mode and make compliance a central part of the Group's processes for winning new business. The ABC compliance team has been reorganised during the year to ensure team members remain independent of the businesses they are policing. The team has been strengthened with the creation of several new roles and broader areas of responsibility including offset compliance. A new role of Head of Risk Training has been created to ensure that there is a robust and effective training programme to support all risk policies including compliance and ethics. In response to Lord Gold's recommendations, a protocol is being developed which will ensure that the Group's Legal, HR, Compliance and Ethics functions work in a co-ordinated manner when investigating potential ethics and compliance breaches, ensuring that any proposed disciplinary action is reported to the Director of Risk.

Ethics team

The ethics team manages the Global Code and the reporting Helplines. It works closely with the compliance team. The team has been strengthened by the creation of the new role of Group Ethics Officer responsible for establishing and co-ordinating a network of trained ethics officers across all business sectors to act as a local point of contact for ethical issues.

Conclusion

When I took up the post of chairman of the ethics committee in 2013, I was well aware of the huge amount of effort and resource that this Group had already dedicated to improving the way our employees conduct our business. The Board has a firm belief that the only way we can succeed as a Group is by applying sound and ethical business practices wherever we operate. We are equally aware that there will always be more to do and we must always seek to improve.

Iain Conn
Chairman of the ethics committee

RISK COMMITTEE REPORT

We have benefited from the work we did in 2012 to concentrate our focus on a smaller number of risks.

John Rishton
Chairman of the risk committee

Committee members and attendance

The risk committee consists of all of the executive directors and met three times in 2013.

	Attendance in 2013
John Rishton (Chairman)	3/3
Jim Guyette	3/3
Mark Morris	3/3
Colin Smith CBE	2/3

Other members of the Executive Leadership Team, the Director of Risk, the Company Secretary and the Head of Enterprise Risk Management are also invited to attend meetings.

Key objective:

- to assist the Board in determining the nature and extent of the principal risks it is willing to take in achieving its strategic objectives.

Responsibilities:

- develop and implement the Company's Risk Management strategy and policy;
- review reports on key risks and monitor the total level of risk across the Group; and
- assess the adequacy of management plans to address the risks.

Introduction

Each of the Group's principal risks are owned by specific members of my executive team. We continually review and challenge ourselves as to whether these continue to be our principal risks and whether our management of those risks remains effective. This year, in addition to executive directors, all members of my executive team were invited to attend the meetings to ensure there was enhanced visibility of the principal risks affecting the business and good communication of the outcomes of our discussions to each of the businesses and functions.

Work of the committee in 2013

The committee discussed all of the key risks in depth in advance of the annual and half-year results process and produced a report on principal risks for the Board's approval. It also discussed the work of the Crisis Management Team and agreed to hold more frequent crisis management exercises. During the year, work continued on the development of meaningful indicators to measure the principal risks. More focus was given to our key business continuity risks and the committee considered and assessed each of the key business continuity risks identified by the businesses and their mitigation plans. Our discussion on IT vulnerability led us to have an in-depth review of our IT Operations Centre and give detailed consideration to how IT security risks, including the growing global threat of cyber attack, are managed. We also reviewed the committee's own terms of reference.

Risk process

The Director of Risk leads our risk team across the Group which is responsible for implementing risk policy and processes. Line ownership for risk management is devolved to our business units and functions, supported by a network of risk champions and risk managers.

Each business maintains a risk register which comprises those risks that it considers are material to its objectives and operations. The businesses regularly review the effectiveness and consistency of risk management activity via their assurance framework and the application of the risk management process, all of which are subject to review by the business audit committees. Each business formally reviews their risks at least twice yearly taking account of work carried out by the underlying business units, programmes and functions. Business continuity plans are put in place by the businesses to mitigate continuity risks.

Every six months, as part of the full- and half-year results process, the risk committee reviews the key risks that the businesses and functions report in accordance with our enterprise-wide risk management system. The committee cross-checks the risks identified by the business with those risks it has identified from its own assessments and concludes a list of principal risks. During the year, the committee discusses how the risks have changed and how each risk is managed, identifying where further action is required.

We have benefited from the work we did in 2012 to concentrate our focus on a smaller number of risks. I am particularly pleased with the way the quality of discussion at these meetings has improved as a result of this focus. The attendance of business presidents at meetings has provided greater visibility across the Group of the principal risks and has enabled the Group to better manage and mitigate such risks.

John Rishton
Chairman of the risk committee

SAFETY COMMITTEE REPORT

The safety of our products and our people will always remain a central pillar of our business.

Sir Frank Chapman
Chairman of the safety committee

Committee members and attendance

The safety committee consists exclusively of independent non-executive directors and met twice in 2013.

	Attendance in 2013
Sir Frank Chapman (Chairman)	2/2
Iain Conn	2/2
Lee Hsien Yang (appointed 1 January 2014)	n/a
John McAdam	2/2

The Chairman of the Board, the Chief Executive, the General Counsel, the Director – Engineering and Technology, the Company Secretary, the Technical and Quality Director and the Head of Product Safety Assurance are also invited to attend meetings.

Key objective:

- review and assure the Board on all safety policies, practices and procedures and ensure that these operate reliably and to appropriate industry standards.

Responsibilities:

- keep product safety, HS&E, and personnel security policies under review;
- make recommendations as to content and communication of those policies;
- measure and review safety performance; and
- review external issues which relate to safety policies and practices.

Product safety

In all sectors, the Group supplies high value capital products that are strictly regulated with regard to safety. Civil aerospace products are required to meet relevant airworthiness authority standards, whilst defence operators define their own standards for military aerospace and naval products. Our Marine and Energy businesses need to meet industry specific standards with our Nuclear business being particularly highly regulated.

In June 2013, the committee reviewed a Trent case study which demonstrated how the Company's product safety process operates in practice both in the design stage and during the operational life of an engine. The committee found this product safety process to be very thorough and of a very high standard.

At its meeting in July 2013, the committee considered how the Group applied judgements in product safety beyond the levels defined in legislation. It received an update on the product safety management system and on recent developments in safety in the aerospace industry. It also examined the findings of the Australian Transport Safety Bureau in respect of the Qantas QF32 event and the actions taken by the Group.

In September, the committee was briefed by senior manufacturing and quality managers from the supply chain units (SCUs), the Technical and Quality Director and the Head of Product Safety Assurance on the Rolls-Royce Management System as it applies to safety. This was followed by an in-depth look at the compressor SCU and the design to manufacture process for wide-chord fan blades as well as the process for monitoring on-going blade production.

At our meeting in December, the committee reviewed how the Director – Engineering and Technology executes his accountability for product safety on behalf of the Chief Executive through the Company Product Safety Review Board and the Quality System. The committee also reviewed its own terms of reference.

Health, safety and environment

In July, the committee considered how the As Low as Reasonably Practical (ALARP) approach is applied to HS&E risks, and received updates on the global improvement programmes being implemented in relation to process safety management and electrical safety.

In December, we received an update on 2013 HS&E activity, including briefings on the global improvement programmes related to process safety, electrical safety and occupational health.

Further information on our HS&E performance can be found in sustainability on pages 28 and 29.

Overall the committee made good progress in 2013, particularly in relation to examining the processes that manage product safety. Alongside this central theme, the areas of asset integrity, occupational safety, occupational health, environmental performance and personnel security arrangements for staff working in difficult environments were reviewed. In 2014, we intend to establish a framework for a structured cyclical review of all HS&E and personnel security matters.

This is a Company built on a brand promise of being 'trusted to deliver excellence' and the safety of our products and our people will always remain a central pillar of our business.

Sir Frank Chapman
Chairman of the safety committee

REMUNERATION COMMITTEE REPORT

We believe that our remuneration policy is aligned with our strategy to enhance long-term value for our stakeholders.

Dame Helen Alexander
Chairman of the remuneration committee

Committee members and attendance

The remuneration committee consists exclusively of independent non-executive directors and met five times in 2013.

	Attendance in 2013
Dame Helen Alexander	5/5
Sir Frank Chapman	4/5
John McAdam	5/5

The Chairman, the Chief Executive, the Director – Human Resources, the HR Director – Reward & Pensions, the Company Secretary and the Chief Financial Officer are also invited to attend meetings. None of these executives were present during any discussion of their own remuneration packages.

Key objective:

- to develop a remuneration policy capable of attracting and retaining individuals necessary for business success.

Responsibilities:

- to consider and make recommendations to the Board on the policy for the remuneration of the executive directors, members of the Executive Leadership Team and other direct reportees to the Chief Executive (collectively the Senior Executives) and the Chairman;
- to determine the whole remuneration package for Senior Executives and recommend to the Board the whole remuneration package for the Chairman;
- to determine the terms and conditions of service contracts for Senior Executives;
- to determine the design, conditions and coverage of any annual and long-term incentive schemes for Senior Executives and to approve total and individual payments under these schemes;
- to determine targets for any annual and long-term incentive schemes;
- to determine the issue and terms of all share-based plans available to all employees;
- to determine compensation (if any) in the event of termination of service contracts of any of the Senior Executives; and
- to approve the appointment of former executive directors by the Company as consultants.

On behalf of the Board, I am pleased to present our directors' remuneration report that has been prepared in accordance with the new reporting regulations which became effective on 1 October 2013.

The report is divided into two sections. A policy report which sets out the approach to remuneration, and a remuneration report which details what has been paid to the directors during 2013. Each report will be proposed as a separate resolution at the AGM. The vote on the policy report is a binding vote.

The remuneration policy must be approved at least every three years if it remains unchanged, or sooner in the event the policy needs revising. The policy will become effective on 1 May 2014 subject to shareholder approval at the AGM.

We have a clearly defined strategy to win in competitive markets through our focus on the customer, innovation and profitable growth. Our remuneration policy supports the delivery of this strategy and aligns the interests of our directors with that of our shareholders. This is achieved by short-term and long-term incentive plans which focus on delivering business objectives, profitable growth and strong shareholder returns. Annual incentives are also based on personal performance which will include the progress made on longer-term strategic objectives. An important principle of the annual bonus plan is that no bonus can be paid unless the entire Group has achieved a base level of business performance.

For the first time, the bonus and PSP targets we set in 2014 will include both profit and cash contributions from Rolls-Royce Power Systems. We believe this is appropriate now that Rolls-Royce Power Systems is being integrated into the Rolls-Royce business.

Our overall remuneration policy remains relatively conservative which has served us well in recent years. There will be no increase in basic pay for most of the senior leadership team in 2014. We remain satisfied that the existing remuneration arrangements continue to align with the Group's strategy and there are no plans to change the current arrangements significantly. The committee will continue to monitor our market competitiveness in order to ensure we are able to attract and retain the best talent.

Annual bonus

For executive directors and all senior managers, a proportion of any annual bonus is made in deferred shares. The committee has agreed to allow flexibility to allot new shares to satisfy awards and this provision will be part of the new Rolls-Royce plc Deferred Share Bonus Plan which will be proposed at this year's AGM.

REMUNERATION COMMITTEE REPORT

Performance Share Plan

The current Performance Share Plan (PSP), approved by shareholders ten years ago, expires in 2014. A new PSP will be put forward for approval at the AGM. This will be broadly unchanged with the following two exceptions which we believe increase the link to shareholder interests:

- the new plan will contain malus and clawback provisions to enable the withdrawal or amendment of share grants before vesting and the right to reclaim awards that have vested or their proceeds in the case of serious non-compliance with the Group's Global Code of Conduct, reputational damage or gross misconduct; and
- the directors will be obliged to retain half of all PSP shares released to them until a multiple of salary is reached. The shareholding requirement has been increased to 250 per cent of salary for the Chief Executive and 200 per cent of salary for the other executive directors. The share retention policy is explained on page 66.

Annual bonus outcome

This year's bonus reflects on-target performance. Group underlying profit was £1,500 million which met the base level performance, and there was a net cash inflow of £312 million which resulted in an annual bonus outcome of 60 per cent. The targets and results exclude Rolls-Royce Power Systems AG (previously named Tognum AG).

PSP outcome

Over the three-year performance period for the 2011 PSP grant, earnings per share growth was 60 per cent, which exceeded the OECD index of consumer prices of six per cent, and cash flow per share was 86p. This resulted in 100 per cent of the shares conditionally granted being released. The Company's Total Shareholder Return (TSR) performance was ninth in the FTSE 100 over the three-year performance period which resulted in a 50 per cent increase in the number of shares released to executive directors.

Summary of activity during 2013

During 2013, amongst other things, the committee:

- endorsed the out-turn of the 2012 annual bonus and 2010 PSP;
- reviewed executive directors' base salary levels;
- set 2013 annual bonus targets and performance targets for the PSP 2013 – 2015;
- recommended the approval of the 2012 remuneration report to the Board;
- approved PSP grants to certain senior management;
- considered the structure of the annual bonus for 2014;
- considered the new BIS regulations in respect of drafting the remuneration report;
- considered the projected out-turns for the 2013 annual bonus, All-Employee Bonus Scheme and the 2011 PSP;
- considered a benchmarking report for the executive salary review in 2014; and
- reviewed its own terms of reference.

We believe our current remuneration practices are in line with the new reporting regulations and we welcome the structure and transparency introduced by the new requirements. Overall, we believe that our remuneration policy is aligned with our strategy to enhance long-term value for our stakeholders.

Dame Helen Alexander
Chairman of the remuneration committee

DIRECTORS' REMUNERATION POLICY

Remuneration policy framework

The Group is committed to achieving sustained improvements in performance and this depends crucially on the individual contributions made by the executive team and by employees at all levels. The Board believes that an effective remuneration strategy plays an essential part in the future success of the Group.

Accordingly, the remuneration policy will continue to reflect the following broad principles:

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

Policy report

The policy will start on 1 May 2014, subject to shareholder approval at the AGM.

Executive directors' remuneration policy

Element	Purpose and link to strategy	Operation	Maximum opportunity	Performance measures
Salary	It is essential that the Company provides competitive salaries, suitable to attract and retain individuals of the right calibre to develop and execute the business strategy.	Salary levels are set using careful judgement, taking into account the scope of the role and responsibilities, performance, experience, potential, retention issues and salaries elsewhere in the Group. Judgement will be informed, but not led, by reference to companies of a similar size, complexity and internationality. Salaries are reviewed annually and normally fixed for 12 months from 1 March each year. However, salary increases are not automatic. Exceptionally, salaries may be increased on other dates in the year. Executive directors may be appointed at salaries below the target level to enable pay progression commensurate with growth in the new role.	Annual salary increases will not normally exceed average increases for employees in other appropriate parts of the Group. On occasion, increases may be larger where the committee considers this to be necessary. Circumstances where this may apply include: growth into a role; to reflect a change in scope of role and responsibilities; where market conditions indicate a level of under competitiveness and the committee judges that there is a risk in relation to attracting or retaining executives. Where the committee exercises its discretion to award increases above the average for other employees, the resulting salary will not exceed the competitive market range.	None, although individual performance is the primary consideration in setting salary alongside overall Company affordability and market competitiveness.

DIRECTORS' REMUNERATION POLICY

Executive directors' remuneration policy

Element	Purpose and link to strategy	Operation	Maximum opportunity	Performance measures
Benefits	To provide market-competitive benefits sufficient to recruit and retain, and to support the executive to give maximum attention to their role.	Benefits provided include a car or car allowance, contribution to the cost of fuel, use of a driver, financial planning assistance, life assurance and medical insurance. Other appropriate benefits may be provided from time-to-time at the discretion of the committee. Certain benefits, such as accommodation or use of a driver, are to enable an executive to devote maximum time and attention to their role. Club membership fees may also be provided. The Group may pay any tax due on these benefits. The Group offers relocation for executives to be located within reasonable reach of their place of work. Where relocation is not practical or a preferred option, or where work is mainly split between two locations, support for accommodation and travel may be provided. Relocation support may include items such as transaction and legal fees, removals, disturbance allowance and temporary travel and subsistence costs. International relocation support may include items such as school fees, tax equalisation and home visits.	Benefits will be market competitive taking into account the role and the local market. Benefits excluding any accommodation, relocation and associated tax costs will not exceed £100,000 per annum. The value of benefits provided for international and domestic relocation and any ongoing accommodation and travel support will be appropriate to the individual circumstances of the executive and only expenses that the committee considers necessary and appropriate will be supported.	None.
Pension	To provide market-competitive pensions sufficient to recruit and retain.	New executives to the Company are offered membership of a defined contribution pension plan. Pension contributions are based on base salary only. There are a number of legacy pension arrangements, including defined benefit plans, which were in place before 27 June 2012 and have not changed since. Commitments to these arrangements will be honoured. Executives may opt to receive a cash allowance in lieu of pension.	The maximum employer contribution to defined contribution pension arrangements is 38% of base salary. Under the Group's legacy defined benefit arrangements, the pension due is the higher of a pension based on the executive's final salary, with a maximum annual accrual rate of 2.5%, or based on career average salary with a maximum annual accrual rate of 3.3%. The resulting pension is limited so that the maximum pension at normal retirement age is two thirds of the executive's final remuneration. The benefits under these arrangements include a lump sum payable on death in service and pensions for surviving spouses, civil partners and certain dependants.	None.

Executive directors' remuneration policy

Element	Purpose and link to strategy	Operation	Maximum opportunity	Performance measures
Pension continued			Executives may opt to receive a cash allowance in lieu of pension. The cash allowance is calculated to be equivalent to the employer's defined contribution pension contributions, reduced to allow for the additional National Insurance cost incurred by the employer. James Guyette participates in qualified and non-qualified defined benefit and defined contribution pension arrangements in the US. Under these various arrangements combined it is expected that the benefits provided by the Company will be equivalent in value to a pension of two thirds of salary, with post retirement increases similar to those required by statute in the UK.	
Annual bonus	To incentivise and reward execution of the business strategy, delivery of financial performance targets and achievement of personal objectives. Compulsory deferral of part of any bonus encourages retention and provides alignment with shareholders.	The committee sets Group financial targets and agrees personal objectives for each executive director at the start of the financial year. At the end of the year, business performance determines the Company bonus payout level and the committee considers whether any adjustment to the payout level is appropriate. Each executive director's bonus is also dependent on the achievement of their personal objectives and wider contribution to the Group. The committee may apply an uplift of up to 20% or a reduction, potentially to zero, as appropriate. A portion of the bonus paid, in a range 30% to 50%, is compulsorily deferred into the Company's shares for a period of two years and is subject to continued employment (with early release in certain circumstances). There are no further performance conditions. Deferred shares may receive a bonus issue of C Shares or equivalent during the deferral period. The bonus plan is non-contractual and may be offered on a year-by-year basis. The committee has the right to apply the malus provision on an individual or group basis and amend or withdraw the bonus before payment. From 2014, the same right over deferred shares will apply as will the right to clawback bonuses paid or vested shares on an individual basis if it can be demonstrated that individuals have acted in an improper manner. Malus and/or clawback provisions may apply in exceptional cases such as: material misstatement of results; a material failure of risk management; serious reputational damage; serious individual wrongdoing such as non-compliance with the Company's Code of Conduct; or gross misconduct.	The current maximum annual bonus, linked to business performance, is 135% of salary for the Chief Executive and 125% for other executive directors. This is based on achieving the highest targets set for business performance. However, the committee may adjust the bonus to reflect personal performance as described in the previous column, giving an overall maximum of 162% and 150% respectively. The committee has the discretion to increase the overall maximum bonus level to 200% of salary for the Chief Executive and 175% for other executive directors, subject to this not being above the competitive market range.	The bonus payout level is determined primarily by Group financial performance but the committee may introduce non-financial metrics and/or adjust the payout level to reflect other factors as appropriate. The final bonus awarded to each director is also linked to their personal performance. Any non-financial metrics used in the annual bonus plan will be linked to the Group's strategy and will not be weighted more than 50% of the whole bonus. A principle applies that no bonus is payable unless the base financial targets are achieved and this also applies if non-financial measures are introduced. Based on the current bonus opportunity: **Chief Executive:** Bonus generated by business performance is 40% of salary for achieving the base level targets and 135% of salary for achieving the highest level of targets. Bonus may then be adjusted for personal performance in a range 0-120% at committee discretion with 100% typically applying for good performance and a 20% uplift available for outstanding personal performance. **Other executive directors:** Bonus generated by business performance is 37% of salary for achieving the base level targets and 125% of salary for achieving the highest level of targets. Bonus may then be adjusted for personal performance as above.

DIRECTORS' REMUNERATION POLICY

Executive directors' remuneration policy

Element	Purpose and link to strategy	Operation	Maximum opportunity	Performance measures
Performance Share Plan (PSP) **Post 2014 AGM onwards**	To incentivise and reward development and execution of the business strategy over the longer term. The plan provides alignment with shareholder interests through the performance measures chosen and a retention element through the plan timescale. A shareholding requirement is linked to the PSP in order to further provide alignment with shareholders. The link between the performance measures and the Company's strategy is explained in the notes to this table on page 59.	Executive directors are granted awards over shares annually at the start of a three-year performance period. The proportion of the those awards that vest is determined at the end of the period according to a set of Company performance measures. Vesting of awards is subject to continued employment until vesting date with the exception of certain leaver circumstances, in which case vesting is subject to Company performance and pro-rating for service. The plan rules contain malus and clawback provisions. The committee has the right to amend and withdraw share grants before vesting for individuals and groups and the right to reclaim vested shares or their proceeds from individuals where it has been demonstrated that they acted in an improper manner. Situations where the provisions will apply are as described in the bonus section on page 57. Executive directors are required to hold a level of shareholding as described on page 66.	The Chief Executive is granted awards each year over shares to the value of 120% of salary. Other executive directors are granted 100% of salary. Subject to the earnings per share (EPS) condition being met, these shares vest at the end of the performance period if the Company has achieved the maximum target set for cash flow per share (CPS). The number of shares vesting can be increased by 25% for above median TSR ranking rising to 50% increase for upper quartile TSR ranking. Maximum face values of annual awards are therefore 180% of salary for the Chief Executive and 150% of salary for other executive directors.	The three corporate performance measures are: 1. EPS – condition. The increase in EPS over the three-year period must exceed an appropriate index of consumer prices for the same period. If this condition is not met share vesting is zero. 2. CPS – prime measure. The aggregate CPS over the performance period will determine the number of shares which vest. Achieving a base target of CPS will result in 30% of the shares vesting and achieving a maximum CPS target will cause 100% of the shares to vest. The number of shares which may vest is determined on a straight-line basis between the 30% and 100% level. 3. Total Shareholder Return (TSR) relative to FTSE 100 or other appropriate index. The number of shares vesting will be increased by 25% if the Company's TSR is ranked above the median of the FTSE 100, or other appropriate index, over the same periods and by 50% if ranked at or above the upper quartile of the same group. Intermediate TSR ranking will increase the number of shares released on a straight-line basis.
Performance Share Plan (PSP) **Legacy awards – 2004 plan**	The purpose of the 2004 share plan is fully consistent with the purpose of the 2014 plan described above.	The operation of the 2004 plan is as described above with the exception of malus and clawback elements which will apply for 2014 grants.	As above.	As above.
ShareSave Plan	This savings-related share option plan provides all employees worldwide an interest in the performance of Rolls-Royce shares.	Executive directors may participate on the same terms as other employees. The option price may be discounted by up to 20%. Accumulated savings may be used to exercise an option to acquire shares.	The maximum savings amount is currently £250 per month over a three- or five-year period. This may be increased in accordance with changes to UK legislation.	No performance measures are permitted by UK legislation applicable to this type of plan.
Share Incentive Plan (SIP)	UK employees may elect to receive part of any annual bonus in shares. UK employees may elect to make regular monthly purchases of shares from pre-tax income.	UK-based executive directors may participate on the same terms as all other UK employees. Shares held in the SIP for five years will vest free from income tax and National Insurance contributions.	Currently, up to £3,000 of the annual cash bonus can be applied to purchase shares. The maximum monthly amount of £125 may be used to purchase shares. The above limits may be increased in accordance with changes to UK legislation.	The award of any bonus will depend on performance conditions (see page 57) but no further conditions apply once the employee elects to participate in the SIP.

Non-executive directors' remuneration policy

Element	Purpose and link to strategy	Operation	Maximum opportunity	Performance measures
Fees	To reward individuals for fulfilling the relevant role and to attract individuals of the skills and calibre required.	The committee makes recommendations to the Board on the remuneration of the Chairman. The Chairman and the executive directors determine the remuneration for the non-executive directors. The level of remuneration is set within a limit approved from time-to-time by shareholders. The Chairman is paid a single consolidated fee. Other non-executive directors are paid a base fee covering Board and committee membership. Committee chairmen and the Senior Independent Director receive an additional fee.	The Articles of Association require the Company to set a maximum ceiling on the total remuneration payable to non-executive directors including the non-executive Chairman. A resolution to increase this to £1,400,000 will be proposed at the 2014 AGM. Fees are set at a level appropriate for the role and are reviewed regularly, taking in to account fees payable to non-executive directors of companies of a similar size and complexity.	None
Benefits	To devote maximum time and attention to the requirements of the role.	The Chairman has occasional use of chauffeur services. Travel, hotel and subsistence expenses incurred in attending Board meetings and committee meetings or otherwise required to attend the Company's offices are reimbursed by the Company. The Group may pay any tax due on such benefits. Where a non-executive director is based outside the UK and has to file a UK tax return, the Company may pay towards tax advice and filing.	The maximum value for chauffeur services will not exceed £25,000 per annum. The maximum contribution towards tax advice and filing is £5,000 per annum.	None

Performance measures and targets

The annual bonus measures are primarily based on Group financial performance but may contain non-financial measures as detailed in the above table.

The committee will set the Group financial targets with reference to the prior year and to the budgets and business plans for the coming year, ensuring the levels to achieve base, on-target and maximum bonus payout are appropriately challenging.

The PSP performance measures set out in the policy table support the Group's strategy as follows:

- the EPS growth hurdle ensures any payout is supported by sound profitability;
- the aggregate CPS measure incentivises the generation of cash flow in line with the Group's strategy. This measure is set in line with the principles described for the annual bonus; and
- the TSR performance measure aligns interests with shareholders by rewarding TSR out-performance. The TSR is measured with reference to constituents of an appropriate index such as the FTSE 100.

In accordance with the rules of the PSP, the performance condition may be replaced or varied if an event occurs or circumstances arise which cause the committee to determine that the performance conditions have ceased to be appropriate. If the performance condition is varied or replaced, the amended performance conditions must, in the opinion of the committee, be fair, reasonable and materially no more or less difficult than the original condition when set.

Shareholders' views

This statement of remuneration policy is largely a consolidation of policies which have enjoyed the support of shareholders for many years. We have considered the guidance provided by the GC 100 and shareholder advisory groups in preparing this policy and have followed this insofar as it is appropriate in the context of our business. Prior to finalising the policy, we have shared it with a selection of major shareholders. Looking ahead, we welcome an open dialogue with shareholders and intend to continue to consult with major shareholders before implementing any significant change.

Group employee considerations

When setting remuneration for executive directors the committee takes into account contextual information about pay and conditions within the Group, including the following:

- salary increases for the all-employee population;
- bonus awards for the all-employee population; and
- pay ratios between executive directors and other employees.

DIRECTORS' REMUNERATION POLICY

Rolls-Royce employs over 55,000 people in more than 50 countries. Inevitably remuneration arrangements differ to reflect local markets, but some common themes apply to employees at all levels worldwide:

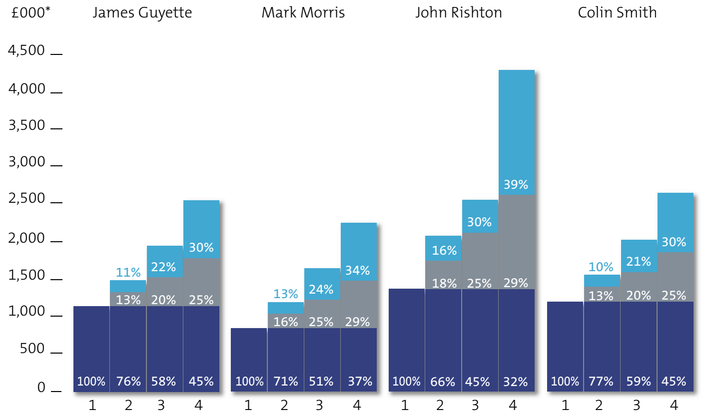
- we aim to offer competitive levels of remuneration, benefits and incentives to attract and retain employees;
- all employees participate in bonus arrangements where the bonus is determined by the same financial measures as that applicable to executive directors; and
- all employees have the opportunity to participate in a savings related share option plan.

At more senior levels, remuneration is increasingly long term and larger proportions are dependent on both Group and individual performance and paid in the form of shares.

Given the scale of the employee population, the committee considered that it would be impractical to consult all employees when drawing up the policy.

Illustrations of remuneration policy application

The bar chart below illustrates projected executive remuneration for 2014 at four different levels of performance showing payments from minimum to maximum. The table below the chart explains performance levels one to four and the associated remuneration.



* Salary values are as at 31 December 2013

- Salary, plus pension and benefits
- Potential value of bonus depending on the performance scenario
- Potential value of PSP depending on the performance scenario

Remuneration achieved for key levels of performance are:

1. Minimum	Fixed remuneration only. No bonus or PSP paid.
2. Base level	Bonus and PSP resulting from base level of business performance. Bonus at 30% of maximum payment assuming no adjustment for personal performance. PSP vesting at 30% of maximum from achieving base CPS target with no TSR multiplier.
3. On-target	Bonus and PSP resulting from performance in line with Company expectations. Bonus at 60% of maximum assuming no adjustment for personal performance. PSP vesting mid-way between base and maximum levels with 25% TSR multiplier.
4. Maximum	Maximum annual bonus based on achieving the highest targets set for business performance and outstanding individual performance: PSP vesting from achieving maximum CPS target and with maximum 50% TSR multiplier.

Service contracts

UK-based executive directors' contracts include the following provisions:

- 12 months' notice of termination from Rolls-Royce;
- 6 months' notice of termination from the executive; and
- reimbursement of reasonable business expenses.

The committee recognises that in the case of appointments to the Board from outside the Group, it may be necessary to offer a longer initial notice period, which would subsequently reduce to 12 months after that initial period.

The policy on exit payments is set out in the next section. The following table summarises the terms of the executive directors' service contracts:

	Date of contract	Notice period Company	Notice period individual
James Guyette	29 Sep 1997	30 days	30 days
Mark Morris	1 Jan 2012	12 months	6 months
John Rishton	10 Mar 2011	12 months	6 months
Colin Smith CBE	1 July 2005	12 months	6 months

James Guyette has a contract with Rolls-Royce North America Inc., drawn up under the laws of the State of Virginia, US. This provides that, on termination without cause, he is entitled to 12 months' severance pay without mitigation and, in addition, appropriate costs incurred in relocating household and personal effects. The contract also provides for the payment of club membership fees and for tax and financial planning up to a maximum of US$15,000 per annum and the Group will gross up any amounts to cover any applicable taxes arising.

All contracts also include the entitlement to paid holidays, sick pay and other standard employee terms.

The Chairman and the non-executive directors have letters of appointment rather than service contracts. No compensation is payable to the Chairman or to any non-executive director if the appointment is terminated early or if they fail to be re-elected at an AGM.

	Appointment date	Current letter of appointment end date
Dame Helen Alexander	1 Sep 2007	31 Aug 2016
Lewis Booth CBE	25 May 2011	24 May 2014
Sir Frank Chapman	10 Nov 2011	9 Nov 2014
Iain Conn	20 Jan 2005	19 Jan 2015
Ian Davis	1 Mar 2013	29 Feb 2016
Warren East CBE	1 Jan 2014	31 Dec 2016
Lee Hsien Yang	1 Jan 2014	31 Dec 2016
John McAdam	19 Jan 2008	18 Feb 2017
John Neill CBE	13 Nov 2008	12 Nov 2014
Jasmin Staiblin	21 May 2012	20 May 2015

Policy on exit payments

The notice period the Company is required to give to executive directors under their contracts of employment is 12 months. Payment in lieu of notice will not exceed the value of 12 months' salary, benefits and pension contributions. Both mitigation and the staggering of payments through the notice period will be considered by the committee where appropriate, as will the funding of reasonable outplacement and other professional fees. Should additional compensation matters arise, such as a settlement or compromise agreement, the committee will exercise judgement and will take into account the specific commercial circumstances.

Pension benefits on early retirement should be payable in accordance with the normal rules of the relevant pension plan. Under legacy UK defined benefit pension arrangements, accrued pension is reduced to reflect early receipt in accordance with factors set by the trustees from time-to-time and is limited to a maximum pension of two thirds of the executive's final remuneration, pro-rated by actual service to potential service.

The committee has the discretion to preserve incentive awards pro-rated to service and to release deferred shares. In exercising this discretion, the committee will have regard to performance and the circumstances of leaving. For deferred shares these are usually released in cases such as retirement, death, injury, ill-health and redundancy.

For PSP, the rules state that unvested awards may be preserved at the committee's discretion according to the circumstances. In such cases vesting will be at the normal date, subject to the established performance conditions, and pro rata to employment in the performance period. In cases such as death and terminal illness, the committee also has the discretion to vest the awards immediately using an estimate of future out-turn.

The treatment of leavers in the Company's ShareSave and SIP plans is governed by the plan rules. The UK rules are HMRC approved. An executive director who has ShareSave options who retires or who leaves the Company through ill-health, disability or redundancy will be entitled to exercise their options, pro rata to the savings made, within six months of leaving the Company. An executive director who leaves in any other manner such as dismissal would only be entitled to have their savings returned to them. Participants in the SIP who leave the Company for the same reasons listed above will have their shares released to them free of tax and National Insurance contributions.

In the event of a change of control of the Company, PSP awards will vest based on the extent to which the committee determines the performance conditions have been or would have been met. Pro-rating for service in the performance period will apply. Deferred shares earned under APRA would vest in full. ShareSave options would immediately be exercisable pro rata to savings made. Consideration received as shares would be held in the SIP, if possible, otherwise the consideration would be treated as a disposal from the SIP.

If awards are made on recruitment (such as buy-outs) the treatment on leaving would be determined at the time at the committee's discretion.

Policy on new appointments

The committee will normally award newly appointed executive directors with a remuneration package which is consistent with the policy and principles as set out in this report. Base salary may be set at a level higher or lower than previous incumbents and in certain circumstances, to facilitate the recruitment of individuals of the required calibre, the committee may use its discretion to make individual additional incentive awards up to a maximum of 100 per cent of annual salary. Incentive levels may also be increased by up to 30 per cent of salary per annum for incentives commencing within two years of joining. This level of discretion is considered appropriate given the current conservative market positioning of Rolls-Royce and our potential need to recruit from other market sectors or countries outside of the UK.

In addition, remuneration forfeited on resignation from a previous employer may be compensated. The form of this compensation would be considered on a case-by-case basis and may comprise either cash or shares. Generally:

- if such remuneration was in the form of shares, compensation will be in the Company's shares;
- if remuneration was subject to achievement of performance conditions, compensation will be subject to Rolls-Royce performance conditions; and
- the timing of any compensation will, where practicable, match the vesting schedule of the remuneration forfeited.

A newly appointed executive director may be provided with reasonable relocation support as set out in the policy table. Internal appointments would receive a remuneration package that is consistent with the remuneration policy. Legacy terms and conditions would be honoured, including pension entitlements and any outstanding incentive awards.

If an executive director is appointed following a merger or an acquisition of a company by Rolls-Royce, of which the executive director was employed, legacy terms and conditions may be honoured.

Legacy commitments

Contractual commitments made before 27 June 2012 and before the policy comes into effect will be honoured. This will include grants made under the old PSP arrangement which will vest, subject to the performance criteria being achieved after the adoption of this policy, as well as previous contractual provisions relating to the defined benefit pension scheme.

The committee may make minor amendments to the policy set out above (for regulatory, exchange control, tax, administrative purposes or to take account of a change in legislation) without obtaining shareholder approval for that amendment.

The remuneration policy report was approved by the Board on 12 February 2014 and signed on its behalf.

Dame Helen Alexander
Chairman of the remuneration committee

DIRECTORS' REMUNERATION REPORT

Single figure of remuneration (subject to audit)

The total remuneration for the directors of the Company for the financial year ending 31 December 2013 is detailed below:

	Salary/fees (a) £000		Benefits (b) £000		Bonus (c) £000		LTIP (d) £000		Other (e) £000		Sub-total £000		Pension (f) £000		Total £000	
	2013	2012	2013	2012	2013	2012	2013	2012	2013	2012	2013	2012	2013	2012	2013	2012
James Guyette	**535**	517	**107**	100	**423**	663	**1,464**	1,399	**–**	–	**2,529**	2,679	**532**	472	**3,061**	3,151
Mark Morris	**506**	482	**159**	189	**383**	464	**445**	333	**6**	–	**1,499**	1,468	**162**	719	**1,661**	2,187
John Rishton	**921**	896	**125**	126	**824**	1,239	**4,055**	1,998	**–**	–	**5,925**	4,259	**303**	318	**6,228**	4,577
Colin Smith CBE	**523**	506	**128**	23	**394**	596	**1,329**	1,194	**–**	–	**2,374**	2,319	**531**	1,034	**2,905**	3,353
Dame Helen Alexander	**75**	75	**–**	–	**–**	–	**–**	–	**–**	–	**75**	75	**–**	–	**75**	75
Lewis Booth CBE	**80**	80	**10**	4	**–**	–	**–**	–	**–**	–	**90**	84	**–**	–	**90**	84
Peter Byrom	**20**	60	**–**	–	**–**	–	**–**	–	**–**	–	**20**	60	**–**	–	**20**	60
Sir Frank Chapman	**75**	75	**3**	–	**–**	–	**–**	–	**–**	–	**78**	75	**–**	–	**78**	75
Iain Conn	**82**	72	**–**	–	**–**	–	**–**	–	**–**	–	**82**	72	**–**	–	**82**	72
Ian Davis	**292**	–	**2**	–	**–**	–	**–**	–	**–**	–	**294**	–	**–**	–	**294**	–
John McAdam	**60**	60	**–**	–	**–**	–	**–**	–	**–**	–	**60**	60	**–**	–	**60**	60
John Neill CBE	**60**	60	**2**	2	**–**	–	**–**	–	**–**	–	**62**	62	**–**	–	**62**	62
Sir Simon Robertson	**126**	370	**2**	7	**–**	–	**–**	–	**–**	–	**128**	377	**–**	–	**128**	377
Jasmin Staiblin	**60**	37	**2**	–	**–**	–	**–**	–	**–**	–	**62**	37	**–**	–	**62**	37
Ian Strachan	**26**	75	**–**	–	**–**	–	**–**	–	**–**	–	**26**	75	**–**	–	**26**	75
Total	**3,441**	3,365	**540**	451	**2,024**	2,962	**7,293**	4,924	**6**	–	**13,304**	11,702	**1,528**	2,543	**14,832**	14,245

Notes to the table

(a) Salary/fees – cash paid in the year. James Guyette was paid in US dollars translated at £1 = US$1.565 (2012 US$1.585).

(b) Benefits – taxable value of all benefits paid in the year. The benefits for the non-executive directors relate to travel and subsistence associated with attending board meetings with the exception of Sir Simon Robertson which was related to the use of a chauffeur.

	James Guyette £000		Mark Morris £000		John Rishton £000		Colin Smith CBE £000	
Benefits	2013	2012	2013	2012	2013	2012	2013	2012
Car or car allowance including fuel allowance	**11**	11	**24**	24	**18**	18	**21**	22
Chauffeur services	**–**	–	**–**	–	**13**	8	**–**	–
Financial planning	**19**	16	**–**	–	**–**	–	**–**	–
Medical insurance	**–**	–	**1**	1	**1**	1	**1**	1
Life assurance	**38**	37	**–**	–	**–**	–	**–**	–
Club membership fees	**23**	20	**–**	–	**–**	–	**–**	–
Travel and subsistence	**–**	–	**30**	36	**–**	–	**3**	–
Housing costs	**16**	16	**104**	128	**93**	99	**103**	–
Total	**107**	100	**159**	189	**125**	126	**128**	23

(c) Bonus. This is the total APRA bonus earned in 2013. The bonus, based on Group profit and cash performance, was 60 per cent of the maximum as detailed on page 57. Personal performance is taken into account in determining individual bonuses payable. The awards made to John Rishton and James Guyette included a modification for personal performance of 110 per cent and 105 per cent respectively. 60 per cent of the bonus is paid as cash and 40 per cent is deferred into shares for two years subject to continuous employment with the Group.

(d) Long-term incentives. This is the estimated value of the PSP shares that are due to vest in March 2014 (2013 being the final year of the performance period) and for John Rishton, as well as his PSP shares, the performance related shares he received on joining the Company. It is based on the number of shares that will vest multiplied by the average share price of 1184.52p over the quarter ending 31 December 2013 (as the vesting price is not known at the date of approval of the remuneration report). Performance has already been determined for these awards as detailed on page 64 and 150 per cent of the original award will vest, based on achievement of the EPS growth hurdle, the maximum CPS target and TSR performance in the upper quartile of FTSE 100 companies. The share price at the date of vesting for the PSP in 2013 was 1020.52p. The vesting price for John Rishton's release of the performance related and restricted shares in 2013 was 1048p.

(e) Value of the gain made on the exercise of ShareSave options is the difference between the exercise price of 387p and the mid-market price of 1062p on the date of exercise. ShareSave is not subject to performance conditions and the UK plan rules are HMRC approved.

(f) Pensions. For defined benefit plans, this is the increase in pension benefit net of inflation for the current year and applying the HMRC methodology multiplier of 20. Cash in lieu of pension accrual is also included.

Implementation of remuneration policy

Information on the elements of remuneration and how the Company intends to implement the remuneration policy in 2014 are set out below and on pages 64 to 66.

Base salary

The committee reviewed the salary levels of executive directors and decided not to award any increases for 2014.

Name	Base salary
James Guyette	$840,000
Mark Morris	£510,000
John Rishton	£925,000
Colin Smith CBE	£525,000

Annual bonus

The annual bonus pool is delivered under APRA.

In 2013, executive directors were eligible for award levels as detailed in the policy report on page 57.

APRA 2013 performance measures

The APRA bonus is determined by Group financial performance and personal performance.

For 2013, the Group financial measures were cash-flow performance and profit. Targets for both measures were set as follows:

	% of maximum bonus
Base	15%
Target	30%
Maximum	50%

The Group financial performance is the addition of the cash and profit out-turns, provided a specified minimum level is achieved on both, after deduction of the cost of bonus from profit, otherwise no bonus is payable.

The 2013 financial performance which resulted in the APRA bonus out-turn of 60 per cent was as follows:

Group underlying profit	Group underlying profit* was £1,500 million which matched the base level but fell short of the on-target level of £1,530 million. The profit performance resulted in achievement of 15%.
Cash flow	Cash flow* for the year was £312 million which exceeded both the on-target level of break-even and the maximum target of £200 million. The cash flow performance resulted in the achievement of 50%.
Overall award	The minimum level of profit after the cost of bonus, necessary to enable payment of bonus was £1,500 million. To ensure this was achieved the bonus earned through the separate profit and cash elements was limited to 60% of the maximum.

* Group underlying profit and cash flow excludes the results of Rolls-Royce Power Systems AG (previously named Tognum AG), the impact of acquisitions and disposals in the year and unbudgeted foreign exchange translation effects where material.

The extent of this disclosure reflects the Board's view that APRA profit and cash targets are commercially sensitive. This will be kept under review.

Deferred APRA awards in March 2013 (subject to audit)

For executive directors and other senior executives, 40 per cent of APRA was delivered in deferred shares. As detailed on page 57, ordinary shares held as deferred shares may receive a bonus issue of C Shares during the deferral period.

Name	Number of shares	Face value £000	Vesting date
James Guyette	25,770	264	01/03/2015
Mark Morris	18,057	185	01/03/2015
John Rishton	48,250	494	01/03/2015
Colin Smith CBE	23,207	237	01/03/2015

APRA 2014

The committee have determined that the bonus in respect of 2014 will be operated on similar terms to 2013. There will be no change to the maximum bonus opportunities for executive directors. As described above, bonus targets are not disclosed.

Long-term incentives – PSP

The PSP is designed to reward and incentivise selected senior executives who can influence the long-term performance of the Group.

PSP 2013

In 2013, executive directors received PSP grants in line with the policy report on page 58.

PSP awards made in March 2013 (subject to audit)

The targets were as follows:

Aggregate CPS over the three-year period	% of maximum award released
Less than 56p	0%
56p	30%
94p	100%

Straight line vesting will apply between these points.

	Number of shares awarded	% of salary	Face value (at maximum vesting) £000	Minimum % vesting (as a % of maximum)	Performance period end date
James Guyette	51,714	100	794	20	31/12/2015
Mark Morris	49,838	100	765	20	31/12/2015
John Rishton	108,470	120	1,665	20	31/12/2015
Colin Smith CBE	51,304	100	788	20	31/12/2015

All awards are made as performance shares based on a percentage of salary and the value is divided by the average share price over a three-day period which was 1023.33p before to the date of grant. The face value is the maximum number of shares that would vest (150 per cent of the award) multiplied by the share price at the date of grant. If the base EPS or CPS targets are not achieved, no shares vest.

DIRECTORS' REMUNERATION REPORT

PSP awards vesting in March 2014

The following sets out details in respect of the March 2011 PSP award, for which the final year of performance was the 2013 financial year.

	Targets for 2011 – 2013 period	Performance against targets
EPS growth (hurdle)	Awards may vest if EPS growth exceeds the OECD index of consumer prices. Awards will lapse if hurdle not met.	EPS growth of 60% over the three-year period exceeded the hurdle which was 6%.
Aggregate CPS (100% of award)	Aggregate CPS over three-year period of less than 56p – zero vesting. Aggregate CPS over three-year period of 56p – 30% vesting. Aggregate CPS over three-year period of 83p – 100% vesting. Straight-line vesting between these points.	Aggregate CPS performance over three years of 86p. 100% vesting.
TSR performance (multiplier of up to 50%)	TSR below median of FTSE 100 – no additional vesting. TSR above median of FTSE 100 – 25% increase. TSR at upper quartile of FTSE 100 – 50% increase. Straight-line basis between these points.	TSR performance was ninth best amongst the FTSE 100. 50% increase.
Total		150% of shares will vest during March 2014.

PSP awards to be made in March 2014

The performance targets in respect of the 2014 to 2016 performance period under the Aggregate CPS measure will be as follows:

Aggregate CPS over the three-year period	% of maximum award released
Less than 125p	0%
125p	30%
155p	100%

CPS is calculated as reported cash flow before the cost of business acquisitions or proceeds of disposals, foreign exchange translation effects, special payments into pension schemes and payments to shareholders, divided by the weighted average number of shares in issue.

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

Non-executive directors' fees paid

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

Non-executive directors' base fees

	2014[1] £000	2013 £000	2012 £000
Chairman[2]	425	425	370
Other non-executive directors	70	60	60
Chairman of audit committee	25	20	20
Chairman of ethics committee	20	15	15
Chairman of remuneration committee	20	15	15
Chairman of safety committee	20	15	15
Senior Independent Director	15	12	12

[1] Subject to approval at the AGM, the base fees will be increased with effect from 1 May 2014.

[2] Sir Simon Robertson retired as Chairman on 2 May 2013. The fee was increased on the appointment of the new Chairman, Ian Davis.

Payments to past directors (not subject to audit)

John Cheffins retired from the Board on 30 September 2007. He continued in his role as Chairman of Rolls-Royce Fuel Cell Systems Limited and provided non-executive advice to the Energy business until 28 September 2013. He was paid £35,811 and benefits totalling £2,051 in 2013 (paid in Canadian dollars and translated at £1=CAD$1.612).

Dr Mike Howse retired from the Board on 30 June 2005. Following his retirement, he has continued to be retained by the Company for his expertise in engineering and was paid £23,310 in 2013.

Payments to past directors (subject to audit)

Mike Terrett retired from the Board on 31 December 2012. The PSP award, granted to him on 1 March 2010, for the performance period 1 January 2010 to 31 December 2012 vested on 1 March 2013 at a vesting price of 1020.52p. The value of the PSP released to him was £1.4 million (2012 £2.4 million) before tax and National Insurance contributions. PSP awards that will vest in 2014 and may vest in 2015, subject to meeting the performance criteria, will be pro-rated to the length of service during the performance period.

Loss of office payments (subject to audit)

There were no payments in respect of loss of office during the year.

External directorships

The directors retained the payments detailed below from serving on the boards of these companies:

	Directorships held	Payments received £000
James Guyette [1,2]	PrivateBancorp Inc. and priceline.com	128
John Rishton [3]	Unilever PLC and Unilever N.V.	56

[1] James Guyette was paid in US dollars translated at £1=US$1.565.
[2] James Guyette received 2,548 Restricted Stock Units (RSUs) at US$19.63 per share in PrivateBank, in addition to an annual fee. He also received 359 shares of restricted stock at US$695.62 per share in priceline.com.
[3] John Rishton was appointed as a director of Unilever PLC and Unilever N.V. on 15 May 2013. Part of his fee was paid in Euro's translated at £1 = EUR 1.178.

Pension entitlements (subject to audit)

The Group's UK pension schemes are funded, registered schemes and were approved under the regime applying until 6 April 2006. They include both defined contribution and defined benefit pension schemes. In the defined benefit pension schemes normal retirement age is 62.

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

Mark Morris opted out of future pension accrual and salary linkage with effect from 16 August 2012 and receives a cash allowance in lieu of future pension accrual.

Colin Smith CBE opted out of future pension accrual with effect from 1 April 2006 and receives a cash allowance in lieu of future pension accrual.

James Guyette participates in pension plans sponsored by Rolls-Royce North America Inc. He is a member of two defined benefit plans in the US, one qualified and one non-qualified. He accrues a retirement lump sum benefit in both of these plans. In addition, James Guyette is a member of two 401(k) Savings Plans in the US, one qualified and one non-qualified, to which both he and his employer, Rolls-Royce North America Inc., contribute. He is also a member of an unfunded non-qualified deferred compensation plan in the US, to which his employer makes notional contributions. Under the defined benefit plans, the earliest age at which benefits can be taken without consent and without actuarial reduction by James Guyette is age 65.

Details of the pension benefits of the executive directors as at 31 December 2013, in the Group's UK and US pensions schemes are given below:

	Total accrued annual pension entitlement at 31 December 2013 £000
Mark Morris	167
Colin Smith	391

	Total accrued retirement lump sum entitlement at 31 December 2013 £000
James Guyette [1]	1,181

[1] Benefits are translated at £1 = US$1.6542.

Details of the defined contribution pension contributions paid by the Group on behalf of the following executive directors are given below:

	2013 £000	2012 £000
James Guyette [1]	395	394
John Rishton	50	123

[1] Benefits are translated at £1=US$1.565 (2012 US$1.585).

DIRECTORS' REMUNERATION REPORT

Share retention policy (subject to audit)

We believe it is important that the interests of the executive directors should be closely aligned with those of shareholders. The deferred APRA award and the PSP provide considerable alignment. However, participants in the PSP are also required to retain at least one half of the number of after-tax shares released from the PSP, until the value of their shareholding reaches the percentage of salary shown in the table below. When this level is reached it must be maintained until retirement or departure from the Group. The director's total shareholding, for the purposes of comparing it with the minimum shareholding requirement, includes shares held: by their connected persons; in the SIP; APRA deferred shares that have not vested; and PSP shares that have vested but does not included unvested PSP awards. The shareholding requirement will increase in 2014 to 250 per cent of salary for the Chief Executive and 200 per cent of salary for the other executive directors. APRA deferred shares will no longer count towards their minimum shareholding requirement.

As at 31 December 2013, the executive directors each complied with the 2013 minimum shareholding requirement as detailed in the table below:

	Base salary £000	Total shareholding	Minimum shareholding requirement as % of salary	Minimum shareholding requirement[1]	Actual shareholding as % of minimum requirement
James Guyette[2]	508	447,868	150	74,462	601
Mark Morris	510	86,954	150	74,756	116
John Rishton	925	293,947	200	180,782	163
Colin Smith CBE	525	346,466	150	76,954	450

[1] Salary divided by the March 2013 PSP grant price of 1023.33p multiplied by percentage of salary.
[2] Translated at £1 = US$1.6542.

Directors' interests in shares (subject to audit)

The directors and their connected persons had the following interests in the ordinary shares and C Shares[1] of the Company at 31 December 2013, or at date of retirement if earlier, are shown in the table below:

			Unvested awards			Vested awards
	Ordinary shares	C Shares	Conditional shares not subject to performance conditions (APRA)	Conditional shares subject to performance conditions (PSP)	Options over shares subject to savings contracts (ShareSave)	Vested shares and options exercised in year
James Guyette	393,937	–	53,931	198,503	–	174,265
Mark Morris	62,752	12,676,120	24,202	134,776	541	41,713
John Rishton	201,297	–	92,650	510,681	1,450	190,691
Colin Smith CBE	296,274	–	50,192	189,104	–	150,678
Dame Helen Alexander	2,442	605,377	–	–	–	–
Lewis Booth CBE	12,500	950,000	–	–	–	–
Peter Byrom (retired 2 May 2013)	229,910	–	–	–	–	–
Sir Frank Chapman	4,832	358,759	–	–	–	–
Iain Conn	27,353	11,178	–	–	–	–
Ian Davis	6,595	–	–	–	–	–
Dr John McAdam	2,174	–	–	–	–	–
John Neill CBE	41,426	12,722,692	–	–	–	–
Sir Simon Robertson (retired 2 May 2013)	43,072	–	–	–	–	–
Jasmin Staiblin	–	–	–	–	–	–
Ian Strachan (retired 2 May 2013)	11,500	–	–	–	–	–

[1] Non-cumulative redeemable preference shares of 0.1p each.

Changes in interests (subject to audit)

	Ordinary shares		C Shares	
	31 December 2013	Changes from 31 December 2013 to 12 February 2014	31 December 2013	Changes from 31 December 2013 to 12 February 2014
James Guyette	393,937	2,609	–	–
Mark Morris	62,752	6	12,676,120	2,362,936
John Rishton	201,297	1,335	–	–
Colin Smith CBE	296,274	1,951	–	–
Dame Helen Alexander	2,442	204	605,377	(605,377)
Lewis Booth CBE	12,500	–	950,000	(950,000)
Sir Frank Chapman	4,832	534	358,759	354,062
Iain Conn	27,353	580	11,178	–
Ian Davis	6,595	361	–	–
Dr John McAdam	2,174	39	–	–
John Neill CBE	41,426	442	12,722,692	(12,722,692)

Directors' interests in unvested and vested awards

James Guyette

	31 December 2012	Granted during year	TSR uplift at vesting/ dividend enhancement	Vested awards	31 December 2013	Market price at date of award (p)	Date of grant	Date of vesting	Market price at vesting (p)
PSP 2010	91,383	–	45,692	137,075	–	544.70	01/03/2010	01/03/2013	1020.52
PSP 2011	82,404	–	–	–	82,404	601.50	09/03/2011	09/03/2014	–
PSP 2012	64,385	–	–	–	64,385	809.70	01/03/2012	01/03/2015	–
PSP 2013	–	51,714	–	–	51,714	1023.33	01/03/2013	01/03/2016	–
	238,172	51,714	45,692	137,075	198,503				
APRA 2010	35,595	–	1,595	37,190	–	601.00	11/03/2011	11/03/2013	1048.00
APRA 2011	28,161	–	–	–	28,161	808.80	01/03/2012	01/03/2014	–
APRA 2012	–	25,770	–	–	25,770	1023.33	01/03/2013	01/03/2015	–
	63,756	25,770	1,595	37,190	53,931				

Mark Morris

	31 December 2012	Granted during year	TSR uplift at vesting/ dividend enhancement	Vested awards	31 December 2013	Market price at date of award (p)	Date of grant	Date of vesting	Market price at vesting/ exercise (p)
PSP 2010	26,085	–	6,522	32,607	–	544.70	01/03/2010	01/03/2013	1020.52
PSP 2011	25,039	–	–	–	25,039	601.50	09/03/2011	09/03/2014	–
PSP 2012	59,899	–	–	–	59,899	809.70	01/03/2012	01/03/2015	–
PSP 2013	–	49,838	–	–	49,838	1023.33	01/03/2013	01/03/2016	–
	111,023	49,838	6,522	32,607	134,776				
APRA 2010	7,881	–	353	8,234	–	601.00	11/03/2011	11/03/2013	1048.00
APRA 2011	6,145	–	–	–	6,145	808.80	01/03/2012	01/03/2014	–
APRA 2012	–	18,057	–	–	18,057	1023.33	01/03/2013	01/03/2015	–
	14,026	18,057	353	8,234	24,202				
ShareSave (options)	872	–	–	872	–	387.00*	01/02/2010	01/02/2013	1062.00
ShareSave (options)	541	–	–	–	541	525.00	01/02/2012	01/02/2015	–
	1,413	–	–	872	541				

* For ShareSave, the share price shown is the exercise price which was 85 per cent of the market price at the date of award.

DIRECTORS' REMUNERATION REPORT

John Rishton

	31 December 2012	Granted during year	TSR uplift at vesting/ dividend enhancement	Vested awards	31 December 2013	Market price at date of award (p)	Date of grant	Date of vesting	Market price at vesting/ exercise (p)
PSP 2011	164,866	–	–	–	164,866	601.50	09/03/2011	09/03/2014	–
PSP 2012	133,383	–	–	–	133,383	809.70	01/03/2012	01/03/2015	–
PSP 2013	–	108,470	–	–	108,470	1023.33	01/03/2013	01/03/2016	–
	298,249	108,470	–	–	406,719				
Performance related shares	76,365	–	38,183	114,548	–	601.50	09/03/2011	11/03/2013	1048
Performance related shares	63,397	–	–	–	63,397	601.50	09/03/2011	01/03/2014	–
Performance related shares	40,565	–	–	–	40,565	601.50	09/03/2011	01/03/2015	–
	180,327	–	38,183	114,548	103,962				
APRA 2011	44,400	–	–	–	44,400	808.80	01/03/2012	01/03/2014	–
APRA 2012	–	48,250	–	–	48,250	1023.33	01/03/2013	01/03/2015	–
	44,400	48,250	–	–	92,650				
Restricted shares	76,143	–	–	76,143	–	601.50	09/03/2011	01/03/2013	1048
ShareSave (options)	1,450	–	–	–	1,450	525.00*	01/02/2012	01/02/2017	–

* For ShareSave, the share price shown is the exercise price which was 85 per cent of the market price at the date of award.

Colin Smith CBE

	31 December 2012	Granted during year	TSR uplift at vesting/ dividend enhancement	Vested awards	31 December 2013	Market price at date of award (p)	Date of grant	Date of vesting	Market price at vesting (p)
PSP 2010	78,025	–	39,013	117,038	–	544.70	01/03/2010	01/03/2013	1020.52
PSP 2011	74,813	–	–	–	74,813	601.50	09/03/2011	09/03/2014	–
PSP 2012	62,987	–	–	–	62,987	809.70	01/03/2012	01/03/2015	–
PSP 2013	–	51,304	–	–	51,304	1023.33	01/03/2013	01/03/2016	–
	215,825	51,304	39,013	117,038	189,104				
APRA 2010	32,197	–	1,443	33,640	–	601.00	11/03/2011	11/03/2013	1048.00
APRA 2011	26,985	–	–	–	26,985	808.80	01/03/2012	01/03/2014	–
APRA 2012	–	23,207	–	–	23,207	1023.33	01/03/2013	01/03/2015	–
	59,182	23,207	1,443	33,640	50,192				

Chief Executive pay, TSR and all-employee pay

This section of the report enables our remuneration arrangements to be seen in context by providing:

- a five-year history of our Chief Executive's remuneration;
- our TSR performance over the same period;
- a comparison of the year-on-year change in our Chief Executive's remuneration with the change in average remuneration across the Group; and
- a year-on-year comparison of the total amount spent on pay across the Group with profit before tax and dividends paid.

Chief Executive pay

Year	Chief Executive[1,2]	Single figure of total remuneration £000	Annual bonus as a % of maximum	PSP as a % of maximum
2013	John Rishton	6,228	55	100
2012	John Rishton	4,577	85	–
2011	John Rishton	3,677	63	–
2011	Sir John Rose	3,832	–	75
2010	Sir John Rose	3,914	100	100
2009	Sir John Rose	2,409	29	93

1 On 31 March 2011, Sir John Rose retired as Chief Executive and John Rishton was appointed.

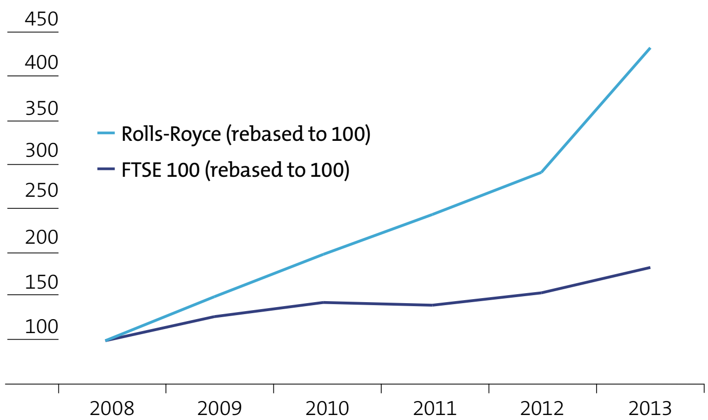
2 The remuneration for Sir John Rose does not include any pension accrual or contribution as he was receiving his pension from 1 February 2008. John Rishton received a special grant of shares on joining the Company on 1 March 2011 to mirror the shares he forfeited on resigning from his previous employer. The share price has increased from 483.50p at the time this grant was made to 1275p at the end of 2013. These are the main reasons why John Rishton's remuneration exceeds that of his predecessor.

Five-year TSR performance

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

The graph shows the growth in value of a hypothetical £100 holding in the Company's ordinary shares over five years, relative to the FTSE 100 index. The values of the hypothetical £100 holdings at the end of the five-year period were £432.40 and £183.10 respectively.

Rolls-Royce – five year TSR data



Percentage change in Chief Executive remuneration

The following table compares the percentage change in the Chief Executive's remuneration to the average percentage change in remuneration for all UK employees from 2012 to 2013.

	Salary	Benefits	Annual bonus
Chief Executive	2.8%	-0.8%	-33%
UK employees average	3.2%	0.6%	-12%

UK employees were chosen as a comparator group in order to avoid the impact of exchange rate movements over the year. UK employees make up approximately 45 per cent of the total employee population.

Relative spend on pay

The following table sets out the percentage change in payments to shareholders and overall expenditure on pay across the Group.

	2013 £m	2012 £m	Change %
Payments to shareholders (note 17 – financial statements)	**366**	328	11.6
Group employment costs (note 7 – financial statements)	**3,675**	2,762	34.7

Statement of shareholder voting

	For	Against	Votes withheld
Approval of 2012 remuneration report			
Percentage of votes (%)	98.41	1.59	0.58
Number of votes cast	1,297,319,180	20,981,975	7,611,187

We monitor carefully shareholder voting on our remuneration policy and implementation. We recognise the importance of ensuring that our shareholders continue to support our remuneration arrangements.

Advisers to the committee

During the year, the committee had access to advice from Deloitte LLP's executive compensation advisory practice. Total fees for advice provided to the committee during the year by Deloitte were £120,850. Deloitte also advised the Company on tax, assurance, pensions and corporate finance and Deloitte MCS Limited provides consulting services.

Deloitte is a founding member of the Remuneration Consultants Group and adheres to its code in relation to executive remuneration consulting. The committee requests Deloitte to attend meetings periodically during the year. The committee is satisfied that the advice it has received has been objective and independent.

Statutory requirements

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

We adopt the principles of good governance as set out in the UK Corporate Governance Code and comply with the regulations contained in the Schedule 8 of the Large and Medium-sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013, the Listing Rules of the Financial Conduct Authority and the relevant schedules of the Companies Act 2006.

The Companies Act 2006 and the Listing Rules require the Company's auditor to report on the audited information in their report on page 135 and to state that this section has been properly prepared in accordance with these regulations. The remuneration policy report and the annual remuneration report are subject to shareholder approval at the AGM on 1 May 2014.

The directors' remuneration report was approved by the Board on 12 February 2014 and signed on its behalf.

Dame Helen Alexander
Chairman of the remuneration committee

SHAREHOLDERS AND SHARE CAPITAL

Share capital and voting rights
On 31 December 2013, there were 1,880,301,654 ordinary shares of 20 pence each, 16,286,039,565 redeemable C Shares of 0.1 pence each and one Special Share of £1 in issue. The ordinary shares are listed on the London Stock Exchange.

Payments to shareholders
Payments to shareholders will, as before, be made in the form of redeemable C Shares and at the AGM on 1 May 2014, the directors will recommend an issue of 134 C Shares with a total nominal value of 13.4 pence for each ordinary share. The C Shares will be issued on 1 July 2014. Together with the interim issue on 2 January 2014 of 86 C Shares for each ordinary share with a total nominal value of 8.6 pence, this is the equivalent of a total annual payment to ordinary shareholders of 22 pence for each ordinary share.

You can find out more about payments to shareholders by going to the 'Shareholder information' section of this report on page 139 or by visiting the Group's website www.rolls-royce.com/investors/share_information.

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

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

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

Shareholders can choose to:

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

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

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

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

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

Certain Articles that relate to the rights attached to the Special Share may only be altered with the consent of the Special Shareholder. Such Articles include: (i) the foreign shareholding limit provisions whereby a foreign person cannot hold more than a 15 per cent voting interest in the Company; and (ii) the nationality of directors provisions whereby at least the Chairman or the Chief Executive must be a British citizen and at least half of the number of directors must be British citizens. The Special Shareholder is not entitled to vote at any general meeting or any other meeting of any class of shareholders.

Restrictions on transfer of shares and limitations on holdings

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

Shareholder agreements and consent requirements

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

Authority to issue shares

At the AGM in 2013, authority was given to the directors to allot new ordinary shares up to a nominal value of £124,821,118, equivalent to one-third of the issued share capital of the Company.

This is called the first section 551 amount. In addition, a special resolution was passed to effect a disapplication of pre-emption rights for a maximum of five per cent of the issued share capital of the Company. These authorities are valid until the AGM in 2014, and the directors propose to renew these authorities at that AGM. It is proposed to seek a further authority, at the AGM in 2014 to allot up to two thirds of the total issued share capital, but only in the case of a rights issue. This is called the second section 551 amount.

The Board believes that this additional authority will allow the Company to retain the maximum possible flexibility to respond to circumstances and opportunities as they arise; and to allot new C Shares up to a nominal value of £500 million as an alternative to a cash dividend. Such authority expires at the conclusion of the AGM. The directors propose to renew the authority to allot new C Shares at the AGM.

Authority to purchase own shares

At the 2013 AGM, the Company was authorised by shareholders to purchase up to 187,231,677 of its own ordinary shares representing ten per cent of its issued ordinary share capital.

The Company did not make use of this authority during 2013. The authority for the Company to purchase its own shares expires at the conclusion of the AGM or 18 months from 2 May 2013, whichever is the earlier. A resolution to renew it will be proposed at the AGM.

Voting rights

Deadlines for exercising voting rights

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

Voting rights for employee share plan shares

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

Major shareholdings

At 31 December 2013, the following companies had notified an interest in the issued ordinary share capital of the Company in accordance with the Financial Conduct Authority's Disclosure and Transparency Rules:

Company	Date notified	% of issued ordinary share capital
BlackRock Inc.	03 Sep 2010	5.02
Invesco Limited	04 Feb 2008	6.91
Capital Research and Management Company	16 May 2013	3.03

The Company had not received any further notifications from 31 December 2013 to 12 February 2014.

OTHER STATUTORY INFORMATION

Political donations

In line with its established policy, the Group made no political donations pursuant to the authority granted at the 2013 AGM. Although the Company does not make, and does not intend to make, donations to political parties within the normal meaning of that expression, the definition of political donations under the Companies Act 2006 is very broad and includes expenses legitimately incurred as part of the process of talking to members of parliament and opinion formers to ensure that the issues and concerns of the Group are considered and addressed. These activities are not intended to support any political party.

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

During the year, the business expenses incurred by Rolls-Royce North America Inc. towards the operation of the Rolls-Royce North America Political Action Committee (RRNAPAC) in the US was US$69,430 (2012 US$44,161). PACs are a common feature of the US political system and are governed by the Federal Election Campaign Act.

The RRNAPAC is independent of the Group and independent of any political party. The RRNAPAC funds are contributed voluntarily by employees and the Company cannot affect how they are applied, although under US Law, the business expenses are paid by the Company. Such contributions do not require authorisation by shareholders under the Companies Act 2006 and therefore do not count towards the £25,000 and £50,000 limits for political donations and expenditure for which shareholder approval will be sought at the AGM.

Indemnity

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

Disclosures in the strategic report

The Board has taken advantage of section 414C(11) of the Companies Act 2006 to include disclosures in the strategic report on:

- greenhouse gas emissions on page 29;
- disabled people and employee involvement on page 27;
- the future development, performance and position of the Group throughout pages 1 to 34;
- the financial position of the Group on pages 10 to 13;
- the R&D and net R&D expenditure as a proportion of underlying revenue on pages 24 and 31; and
- the summary of principal risks on pages 32 to 34.

In addition, notes 1, 14, 15 and 17 to the consolidated financial statements include the Group's objectives, policies and processes for financial risk management, details of its cash and cash equivalents, indebtedness and borrowing facilities and its financial instruments, hedging activities and its exposure to counterparty credit risk, liquidity risk, currency risk, interest rate risk and commodity pricing risk.

Going concern

As described on page 138, the Group meets its funding requirements through a mixture of shareholders' funds, bank borrowings, bonds and notes. The Group has facilities of £3.6 billion of which £2.4 billion was drawn at the year end. £200 million of these facilities mature in 2014.

The Group's forecasts and projections, taking into account reasonably possible changes in trading performance, show that the Group has sufficient financial resources. If the put option on Rolls-Royce Power Systems Holding GmbH (formerly named Engine Holding GmbH) is exercised by Daimler AG, (estimated cost £1.9 billion), the directors consider that the Group would be able to raise additional resources in the necessary timeframe to meet this commitment. As a consequence, the directors have a reasonable expectation that the Company and the Group are well placed to manage their business risks and to continue in operational existence for the foreseeable future, despite the current uncertain global economic outlook.

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

Responsibility statements

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

The directors as listed on pages 36 to 37 are responsible for preparing the annual report and the Group and parent company financial statements in accordance with applicable law and regulations.

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

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

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

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

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

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

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

Disclosure of information to auditors

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

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

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

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

Responsibility statements under the Disclosure and Transparency Rules and the UK Corporate Governance Code

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

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

ii) the strategic report on pages 1 to 34 and pages 137 to 138 of the directors' report include a fair review of the development and performance of the business and the position of the Company and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face; and

iii) the annual report, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the Company's performance, business model and strategy.

By order of the Board

Nigel T Goldsworthy
Company Secretary

12 February 2014