CONSOLIDATED FINANCIAL STATEMENTS

COMPANY FINANCIAL STATEMENTS

CONSOLIDATED INCOME STATEMENT

For the year ended 31 December 2014

	Notes	2014 £m	Re-presented * 2013 £m
Continuing operations			
Revenue	2	**13,736**	14,642
Cost of sales		**(10,533)**	(11,482)
Gross profit		**3,203**	3,160
Other operating income	3	**10**	65
Commercial and administrative costs		**(1,124)**	(1,237)
Research and development costs	3	**(793)**	(658)
Share of results of joint ventures and associates	11	**94**	149
Operating profit		**1,390**	1,479
Profit on acquisition/reclassification of joint ventures		**2**	119
Profit on disposal of businesses	25	**6**	216
Profit before financing and taxation	2	**1,398**	1,814
Financing income	4	**121**	327
Financing costs	4	**(1,452)**	(441)
Net financing		**(1,331)**	(114)
Profit before taxation [1]		**67**	1,700
Taxation	5	**(151)**	(377)
Profit for the year from continuing operations		**(84)**	1,323
Discontinued operations			
Profit for the year from ordinary activities	2	**4**	56
Profit on disposal	25	**138**	–
Profit for the year from discontinued operations		**142**	56
Profit for the year		**58**	1,379
Attributable to:			
Ordinary shareholders		**69**	1,367
Non-controlling interests		**(11)**	12
Profit for the year		**58**	1,379
Earnings per ordinary share attributable to ordinary shareholders:	6		
From continuing operations			
Basic		**(3.90)p**	70.26p
Diluted		**(3.90)p**	69.48p
From continuing and discontinued operations			
Basic		**3.68p**	73.26p
Diluted		**3.68p**	72.44p
Payments to ordinary shareholders in respect of the year	17		
Per share		**23.1p**	22.0p
Total		**435**	414
[1] Underlying profit before taxation	2	**1,617**	1,759

* Re-presented to reflect the Energy business as a discontinued operation. The relevant notes have also been re-presented.

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

For the year ended 31 December 2014

	Notes	2014 £m	2013 £m
Profit for the year		**58**	1,379
Other comprehensive income			
Items that will not be reclassified to profit or loss			
Movements in post-retirement schemes	19	**1,192**	48
Related tax movements	5	**(431)**	10
		761	58
Items that may be reclassified to profit or loss			
Foreign exchange translation differences on foreign operations		**(158)**	(64)
Reclassified to income statement on disposal of businesses		**(29)**	–
Share of other comprehensive income of joint ventures and associates	11	**(13)**	(6)
Related tax movements	5	**(2)**	1
		(202)	(69)
Total comprehensive income for the year		**617**	1,368
Attributable to:			
Ordinary shareholders		**650**	1,356
Non-controlling interests		**(33)**	12
Total comprehensive income for the year		**617**	1,368

CONSOLIDATED BALANCE SHEET

At 31 December 2014

	Notes	2014 £m	2013 £m
ASSETS			
Non-current assets			
Intangible assets	9	**4,804**	4,987
Property, plant and equipment	10	**3,446**	3,392
Investments – joint ventures and associates	11	**539**	601
Investments – other	11	**31**	27
Other financial assets	17	**107**	674
Deferred tax assets	5	**369**	316
Post-retirement scheme surpluses	19	**1,740**	248
		11,036	10,245
Current assets			
Inventories	12	**2,768**	3,319
Trade and other receivables	13	**5,509**	5,092
Taxation recoverable		**19**	16
Other financial assets	17	**22**	74
Short-term investments		**7**	321
Cash and cash equivalents	14	**2,862**	3,990
Assets held for sale		**1**	6
		11,188	12,818
Total assets		**22,224**	23,063
LIABILITIES			
Current liabilities			
Borrowings	15	**(68)**	(207)
Other financial liabilities	17	**(209)**	(1,976)
Trade and other payables	16	**(6,791)**	(7,045)
Current tax liabilities		**(184)**	(204)
Provisions for liabilities and charges	18	**(433)**	(348)
		(7,685)	(9,780)
Non-current liabilities			
Borrowings	15	**(2,193)**	(2,164)
Other financial liabilities	17	**(717)**	(360)
Trade and other payables	16	**(2,445)**	(2,138)
Non-current tax liabilities		**(10)**	(10)
Deferred tax liabilities	5	**(1,228)**	(882)
Provisions for liabilities and charges	18	**(374)**	(385)
Post-retirement scheme deficits	19	**(1,185)**	(1,041)
		(8,152)	(6,980)
Total liabilities		**(15,837)**	(16,760)
Net assets		**6,387**	6,303
EQUITY			
Equity attributable to ordinary shareholders			
Called-up share capital	20	**376**	376
Share premium account		**179**	80
Capital redemption reserve		**159**	163
Cash flow hedging reserve		**(81)**	(68)
Other reserves		**78**	250
Retained earnings		**5,671**	4,804
		6,382	5,605
Non-controlling interests	11	**5**	698
Total equity		**6,387**	6,303

The financial statements on pages 95 to 148 were approved by the Board on 12 February 2015 and signed on its behalf by:

JOHN RISHTON Chief Executive

DAVID SMITH Chief Financial Officer

CONSOLIDATED CASH FLOW STATEMENT

For the year ended 31 December 2014

	Notes	2014 £m	2013 £m
Reconciliation of cash flows from operating activities			
Operating profit from continuing operations		**1,390**	1,479
Operating (loss)/profit from discontinued operations		**(1)**	56
Operating profit		**1,389**	1,535
(Profit)/loss on disposal of property, plant and equipment		**(3)**	7
Share of results of joint ventures and associates	11	**(94)**	(160)
Dividends received from joint ventures and associates	11	**73**	99
Return of capital from joint ventures	11	**3**	–
Gain on consolidation of previously non-consolidated subsidiary		**(3)**	–
Amortisation and impairment of intangible assets	9	**367**	428
Depreciation and impairment of property, plant and equipment	10	**375**	372
Increase/(decrease) in provisions		**129**	(17)
Decrease in inventories		**166**	119
Increase in trade and other receivables		**(878)**	(533)
Increase in trade and other payables		**214**	376
Cash flows on other financial assets and liabilities held for operating purposes		**(30)**	9
Net defined benefit post-retirement cost recognised in profit before financing		**170**	279
Cash funding of defined benefit post retirement schemes		**(322)**	(315)
Share-based payments	21	**21**	79
Net cash inflow from operating activities before taxation		**1,577**	2,278
Taxation paid		**(276)**	(238)
Net cash inflow from operating activities		**1,301**	2,040
Cash flows from investing activities			
Additions of unlisted investments		**(11)**	(1)
Disposals of unlisted investments		**–**	1
Additions of intangible assets		**(477)**	(503)
Purchases of property, plant and equipment		**(648)**	(669)
Government grants received		**11**	21
Disposals of property, plant and equipment		**65**	7
Acquisitions of businesses	25	**(3)**	(37)
Acquisition of non-controlling interest		**(1,937)**	–
Reclassification of joint ventures to subsidiaries		**–**	245
Acquisition of preference shares in subsidiary		**–**	(34)
Disposal of discontinued operations	25	**1,027**	–
Disposals of other businesses	25	**24**	273
Investments in joint ventures and associates		**(17)**	(43)
Net cash outflow from investing activities		**(1,966)**	(740)
Cash flows from financing activities			
Repayment of loans		**(233)**	(133)
Proceeds from increase in loans and finance leases		**49**	1,013
Net cash flow from decrease in borrowings and finance leases		**(184)**	880
Interest received		**18**	15
Interest paid		**(63)**	(58)
Decrease/(increase) in short-term investments		**313**	(313)
Issue of ordinary shares (net of expenses)		**1**	32
Purchase of ordinary shares – share buyback		**(69)**	–
Purchase of ordinary shares – other		**(2)**	(3)
Dividend paid to non-controlling interest		**(76)**	(60)
Redemption of C Shares		**(406)**	(357)
Net cash (outflow)/inflow from financing activities		**(468)**	136
Change in cash and cash equivalents		**(1,133)**	1,436
Cash and cash equivalents at 1 January		**3,987**	2,585
Exchange gains/(losses) on cash and cash equivalents		**8**	(34)
Cash and cash equivalents at 31 December		**2,862**	3,987

	2014 £m	2013 £m
Reconciliation of movements in cash and cash equivalents to movements in net funds		
Change in cash and cash equivalents	**(1,133)**	1,436
Cash flow from decrease/(increase) in borrowings and finance leases	**184**	(880)
Cash flow from (decrease)/increase in short-term investments	**(313)**	313
Change in net funds resulting from cash flows	**(1,262)**	869
Net funds (excluding cash and cash equivalents) of businesses acquired	**(30)**	(204)
Exchange gains/(losses) on net funds	**19**	(43)
Fair value adjustments	**(59)**	105
Movement in net funds	**(1,332)**	727
Net funds at 1 January excluding the fair value of swaps	**1,940**	1,213
Net funds at 31 December excluding the fair value of swaps	**608**	1,940
Fair value of swaps hedging fixed rate borrowings	**58**	(1)
Net funds at 31 December	**666**	1,939

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

	At 1 January 2014 £m	Funds flow £m	Net funds of businesses acquired £m	Exchange differences £m	Fair value adjustments £m	Reclassifications £m	At 31 December 2014 £m
Cash at bank and in hand	**982**	(228)		(15)	–	–	**739**
Money market funds	**1,157**	(470)		5	–	–	**692**
Short-term deposits	**1,851**	(438)		18	–	–	**1,431**
Overdrafts	**(3)**	3		–	–	–	**–**
Cash and cash equivalents	**3,987**	(1,133)		8	–	–	**2,862**
Short-term investments	**321**	(313)	–	(1)	–	–	**7**
Other current borrowings	**(204)**	229	(30)	–	(2)	(60)	**(67)**
Non-current borrowings	**(2,163)**	(3)	–	14	(57)	60	**(2,149)**
Finance leases	**(1)**	(42)	–	(2)	–	–	**(45)**
Net funds excluding fair value of swaps	**1,940**	(1,262)	(30)	19	(59)	–	**608**
Fair value of swaps hedging fixed rate borrowings	**(1)**				59		**58**
Net funds	**1,939**	(1,262)	(30)	19	–	–	**666**

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December 2014

		Attributable to ordinary shareholders								
	Notes	Share capital £m	Share premium £m	Capital redemption reserve £m	Cash flow hedging reserve[1] £m	Other reserves[2] £m	Retained earnings[3] £m	Total £m	Non-controlling interests (NCI) £m	Total equity £m
At 1 January 2013		374	–	169	(63)	314	5,185	5,979	17	5,996
Profit for the year		–	–	–	–	–	1,367	1,367	12	1,379
Foreign exchange translation differences on foreign operations		–	–	–	–	(64)	–	(64)	–	(64)
Movement on post-retirement schemes	19	–	–	–	–	–	48	48	–	48
Share of other comprehensive income of joint ventures and associates	11	–	–	–	(5)	(1)	–	(6)	–	(6)
Related tax movements	5	–	–	–	–	1	10	11	–	11
Total comprehensive income for the year		–	–	–	(5)	(64)	1,425	1,356	12	1,368
Arising on issues of ordinary shares	20	2	80	–	–	–	(81)	1	–	1
Issue of C Shares	17	–	–	(366)	–	–	3	(363)	–	(363)
Redemption of C Shares	17	–	–	360	–	–	(360)	–	–	–
Ordinary shares purchased		–	–	–	–	–	(3)	(3)	–	(3)
Share-based payments – direct to equity [4]		–	–	–	–	–	99	99	–	99
Reclassification of Rolls-Royce Power Systems AG [5]		–	–	–	–	–	–	–	669	669
Transactions with NCI (including dividend of £60m)		–	–	–	–	–	–	–	(45)	(45)
Initial recognition of put option on NCI [6]		–	–	–	–	–	(1,477)	(1,477)	45	(1,432)
Related tax movements	5	–	–	–	–	–	13	13	–	13
Other changes in equity in the year		2	80	(6)	–	–	(1,806)	(1,730)	669	(1,061)
At 1 January 2014		**376**	**80**	**163**	**(68)**	**250**	**4,804**	**5,605**	**698**	**6,303**
Profit for the year		–	–	–	–	–	69	69	(11)	58
Foreign exchange translation differences on foreign operations		–	–	–	–	(141)	–	(141)	(17)	(158)
Reclassified to income statement on disposal of businesses	25	–	–	–	–	(29)	–	(29)	–	(29)
Movement on post-retirement schemes	19	–	–	–	–	–	1,199	1,199	(7)	1,192
Share of other comprehensive income of joint ventures and associates	11	–	–	–	(13)	–	–	(13)	–	(13)
Related tax movements	5	–	–	–	–	(2)	(433)	(435)	2	(433)
Total comprehensive income for the year		**–**	**–**	**–**	**(13)**	**(172)**	**835**	**650**	**(33)**	**617**
Arising on issues of ordinary shares	20	2	99	–	–	–	(100)	1	–	1
Issue of C Shares	17	–	–	(414)	–	–	2	(412)	–	(412)
Redemption of C Shares	17	–	–	408	–	–	(408)	–	–	–
Ordinary shares purchased – share buyback [7]		–	–	–	–	–	(69)	(69)	–	(69)
Ordinary shares cancelled [7]	20	(2)	–	2	–	–	–	–	–	–
Ordinary shares purchased – other		–	–	–	–	–	(2)	(2)	–	(2)
Share-based payments – direct to equity [4]		–	–	–	–	–	29	29	–	29
Transactions with NCI – acquisition of NCI shares		–	–	–	–	–	584	584	(584)	–
Dividend paid to NCI		–	–	–	–	–	–	–	(76)	(76)
Related tax movements	5	–	–	–	–	–	(4)	(4)	–	(4)
Other changes in equity in the year		**–**	**99**	**(4)**	**–**	**–**	**32**	**127**	**(660)**	**(533)**
At 31 December 2014		**376**	**179**	**159**	**(81)**	**78**	**5,671**	**6,382**	**5**	**6,387**

[1] See accounting policies note 1.
[2] Other reserves include a merger reserve of **£3m** (2013 £3m, 2012 £3m) and a translation reserve of **£75m** (2013 £247m, 2012 £311m).
[3] At 31 December 2014, **14,561,097** ordinary shares with a net book value of **£129m** (2013 11,960,535, 2012 20,365,787 ordinary shares with net book values of £91m and £125m respectively) were held for the purpose of share-based payment plans and included in retained earnings. During the year, **7,770,113** ordinary shares with a net book value of **£64m** (2013 16,603,840 shares with a net book value of £118m) vested in share-based payment plans. During the year the Company acquired **169,404** (2013 298,588) of its ordinary shares via reinvestment of dividends received on its own shares. In addition, the Company issued **10,200,000** (2013 7,900,000) new ordinary shares to the Group's share trust for its employees share-based payment plans with a net book value of **£100m** (2013 £81m).
[4] Share-based payments – direct to equity is the net of the credit to equity in respect of the share-based payment charge to the income statement and the actual cost of shares vesting, excluding those vesting from own shares.
[5] On 1 January 2013, the Group exercised rights that resulted in Rolls-Royce Power Systems AG (RRPS) being classified as a subsidiary and consolidated.
[6] As part of the Rolls-Royce Power Systems Holding GmbH (RRPSH) shareholders' agreement, Daimler had the option to sell its shares in RRPSH to Rolls-Royce for a period of six years from 1 January 2013. The initial fair value of the exercise price of this option in respect of Bergen Engines AS (£166m) was recognised in 2012 and the amount in respect of RRPS was recognised in 2013 and charged to retained earnings. In addition, £45m of the initial recognition of the put option on NCI relating to Bergen Engines AS, recognised in 2012, was reclassified from NCI to retained earnings. Subsequent movements in the value of the liability are included in the income statement but excluded from the underlying results.
[7] Following the completion of the sale of the Energy business to Siemens on 1 December 2014 and further to the announcement on 19 June 2014 of a £1bn share buyback, on 10 December 2014 the Company put in place a £250m programme to enable the purchase of its ordinary shares. The aim of the buyback is to reduce the issued share capital of the Company, helping enhance returns for shareholders. In the period to 31 December 2014, 8,215,000 shares were purchased at an average price of 840p. These shares were cancelled.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

1 ACCOUNTING POLICIES

THE COMPANY

Rolls-Royce Holdings plc (the 'Company') is a company domiciled in the United Kingdom. The consolidated financial statements of the Company for the year ended 31 December 2014 consist of the consolidation of the financial statements of the Company and its subsidiaries (together referred to as the 'Group') and include the Group's interest in jointly controlled and associated entities.

BASIS OF PREPARATION AND STATEMENT OF COMPLIANCE

In accordance with European Union (EU) regulations, these financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB), as adopted for use in the EU effective at 31 December 2014 (Adopted IFRS).

The Company has elected to prepare its parent company financial statements under UK Generally Accepted Accounting Practices. These are set out on pages 149 to 151 and the accounting policies in respect of Company financial statements are set out on page 150.

These consolidated financial statements have been prepared on the historical cost basis except where Adopted IFRS requires the revaluation of financial instruments to fair value and certain other assets and liabilities on an alternative basis – most significantly post-retirement scheme obligations are valued on the basis required by IAS 19 *Employee Benefits* – and on a going concern basis as described on page 164.

The consolidated financial statements are presented in sterling which is the Company's functional currency.

The preparation of financial statements in conformity with Adopted IFRS requires management to make judgements and estimates that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

KEY AREAS OF JUDGEMENT

INTRODUCTION

The Group generates a significant portion of its revenues and profit on aftermarket arrangements arising from the installed original equipment (OE) fleet. As a consequence, the Group will often agree contractual prices for OE deliveries that take into account the anticipated aftermarket arrangements. Accounting policies reflect this aspect of the business model, in particular the policies for the recognition of contractual aftermarket rights and the linkage of OE and aftermarket arrangements.

When a civil large engine is sold, the economic benefits received usually far exceed the cash receivable under the contract, due to the rights to valuable aftermarket spare parts business. However, because the value of this right cannot be estimated with enough precision, accounting standards require that the revenue recognised in the accounts on sale of the engine is restricted to a total amount that results in a break even position. The amount of the revenue recognised in excess of cash receivable is recognised as an intangible asset, which is called a 'contractual aftermarket right' (previously referred to as a 'recoverable engine cost'; this change has been made to reflect better the nature of the asset).

There is only one circumstance where accounting standards require the recognition of more of the value of the aftermarket rights when an engine is sold. This occurs where a long-term aftermarket contract (generally a TotalCare agreement — TCA) and an engine sale contract have been negotiated together. In this circumstance, the part of the aftermarket rights covered by the TCA can be valued much more precisely and is recognised at the time of the engine sale through accounting for the engine sale and TCA as a single contract. Nevertheless, the accounting profit recognised is still less than the economic benefits on the sale as there will be other valuable aftermarket rights (for instance for the period beyond the TCA term or for the sale of parts which are outside the scope of the TCA) which cannot be recognised.

The Group enters into arrangements with long-term suppliers to share the risks and rewards of major programmes – risk and revenue sharing arrangements (RRSAs). The accounting policy for these arrangements has been chosen, consistent with Adopted IFRS, to reflect their commercial effect.

The key judgements in determining these accounting policies are described below.

CONTRACTUAL AFTERMARKET RIGHTS (CARs)

On delivery of Civil aerospace engines, the Group has contractual rights to supply aftermarket parts to the customers and its intellectual rights, warranty arrangements and, where relevant, statutory airworthiness or other regulatory requirements provide reasonable control over this supply. The directors consider that these rights meet the definition of an intangible asset in IAS 38 *Intangible Assets*. However, the directors do not consider that it is possible to determine a reliable fair value for this intangible asset. Accordingly, an intangible asset (CAR) is only recognised on the occasions where the contractual price of the engine is below the cost of manufacture and then only to the extent of this deficit, as this amount is reliably measureable. An equal amount of revenue is recognised at the same point. Where a long-term aftermarket contract is linked to the OE contract (see below), the contractual price of the engine (including amounts allocated from the aftermarket contract) is above its cost of manufacture; consequently no CAR is recognised.

MEASURE OF PERFORMANCE ON LONG-TERM AFTERMARKET CONTRACTS

A large proportion of the Group's activities relate to long-term aftermarket contracts, in particular TotalCare and similar arrangements in the Aerospace Division. Under these contracts, the Group's primary obligation is to maintain customers' equipment in an operational condition and achieves this by undertaking various activities, such as engine monitoring, line maintenance and repair and overhaul, over

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
CONTINUED

1 ACCOUNTING POLICIES CONTINUED

the period of the contract. In general, the directors consider that the stage of performance of the contract should be by reference to the obligation to maintain an operational fleet and that this is best measured by the operation of the fleet. Accordingly, stage of performance is measured by reference to flying hours of each fleet under contract.

LINKAGE OF ORIGINAL AND LONG-TERM AFTERMARKET CONTRACTS

Where the key terms of a long-term aftermarket contract are substantively agreed (eg in a term sheet) at the same time as an OE contract with the operator, the directors consider these to be linked for accounting purposes and they are treated as a single contract, as this best reflects the overall commercial effect. Where the OE contract is not with the operator, eg where it is with an OE manufacturer or a lessor, the contracts are not linked as they were not negotiated on a unified basis.

RISK AND REVENUE SHARING ARRANGEMENTS (RRSAs)

RRSAs with key suppliers (workshare partners) are a feature of our Civil aerospace business. Under these contractual arrangements the key commercial objectives are that: (i) during the development phase the workshare partner shares in the risks of developing an engine by performing its own development work, providing development parts and paying a non-refundable cash entry fee; and (ii) during the production phase it supplies components in return for a share of the programme revenues as a 'life of type' supplier (ie as long as the engine remains in service). The share of development costs borne by the workshare partner and of the revenues it receives reflect the partner's proportionate cost of providing its production parts compared to the overall manufacturing cost of the engine. The share is based on a jointly agreed forecast at the commencement of the arrangement.

These arrangements are complex and have features that could be indicative of: a collaboration agreement, including sharing of risk and cost in a development programme; a long-term supply agreement; sharing of intellectual property; or a combination of these. In summary, and as described below, the directors' view is that the development and production phases of the contract should be considered separately in accounting for the RRSA, which results in the entry fee being matched against the non-recurring costs incurred by the Group.

Having considered the features above, the directors considered that there is no directly applicable IFRS to determine an accounting policy for the recognition of entry fees of this nature in the income statement. Consequently, in developing an accounting treatment for such entry fees that best reflects the commercial objectives of the contractual arrangement, the directors have analysed these features in the context of relevant accounting pronouncements (including those of other standard setters where these do not conflict with IFRS) and have weighed the importance of each feature in faithfully representing the overall commercial effect. The most important considerations that need to be balanced are: the transfer of development risk; the workshare partner receiving little standalone value from the payment of the entry fee; and the overall effect being collaboration between the parties which falls short of being a joint venture as the Group controls the programme. Also important in the analysis is the fact that, whilst the Group and the workshare partner share risks and rewards through the life of the contract, these risks and rewards are very different during the development and production phases.

In this context, the entry fee might be considered to represent: an amount paid as an equalisation of development costs; a payment to secure a long-term supply arrangement; a purchase of intellectual property; or some combination thereof. The accounting under these different scenarios could include: recognition of the entry fee to match the associated costs in the income statement; being spread over the life of the programme as a reduction in the cost of supply during production; or being spread over the time period of the access to the intellectual property by the workshare partner.

The directors consider that the most important features of the arrangement are the risk sharing and that the entry fee represents a contribution to the development costs that the Group incurs in excess of its proportionate programme share. The key judgements taken in reaching this view are: the entry fee is determined by the parties on that basis and the contract specifies that, in the event that a derivative engine is to be developed, additional entry fees will also be calculated on this basis; the workshare partners describe the entry fee in this way; although the workshare partner receives little stand-alone value from paying the entry fee, the entry fee together with its own development activities represent its aggregate investment in the collaboration; the amount of the entry fee does not include any amount in excess of that necessary to equalise forecast development costs; the Group is not 'on risk' for the full development costs it incurs but for that amount less the entry fees received; and, as far as can be determined, this appears to be common industry accounting for arrangements of this type, under both Adopted IFRS and US accounting standards (which the directors do not believe conflicts with IFRS in this regard).

The resulting accounting policy (described on page 105) represents the commercial effect of the contractual arrangements in that the Group recognises only those development costs to which it is exposed (and thus reflects the significant transfer of development risk to the workshare partner) and the costs of supply of parts during the production phase is measured at the workshare partner's share of programme revenues (which we consider to be a commercial fair value). The directors do not consider that accounting which would result in entry fees only being recognised in the production phase would appropriately reflect the sharing of development risk. Accordingly, the directors believe that the policy adopted best reflects the commercial objectives of the arrangements, the nature of the relationship with the workshare partner and is in accordance with Adopted IFRS.

As described in the 2013 Annual Report, an alternative view is that the RRSA contract cannot be divided into separate development and production phases, as the fees and development components received by the Group during the development phase are exchanged for the obligation to pay the supplier a predetermined share of any sales receipts during the production phase. On this basis the entry fees received would be deferred in their entirety and recognised over the period of production. The size of the difference between the two

1 ACCOUNTING POLICIES CONTINUED

approaches is monitored and is not currently expected to become material in the foreseeable future. The impact of the different approaches on profit before tax and net assets, which is not considered to be material, is as follows:

	2014			2013		
	Reported profit before tax £m	**Underlying profit before tax £m**	**Net assets £m**	Reported profit before tax £m	Underlying profit before tax £m	Net assets £m
Adopted policy	**67**	**1,617**	**6,387**	1,700	1,759	6,303
Difference	**(30)**[1]	**(30)**	**(402)**	(37)	(37)	(383)[2]
Alternative policy	**37**	**1,587**	**5,985**	1,663	1,722	5,920

1 If the alternative policy were adopted, the difference would be included in profit before financing, which would change from £1,398m as reported to £1,368m.
2 The 2013 adjustment includes a consequential adjustment to transactions with joint ventures, which was not reflected in the 2013 Annual Report.

INTERNALLY GENERATED DEVELOPMENT COSTS

IAS 38 requires that internally generated development costs should only be recognised if strict criteria are met, in particular relating to technical feasibility and generation of future economic benefits. The directors consider that, due to the complex nature of new equipment programmes, these criteria are not met until relatively late in the programme – Civil aerospace programmes represent around half of development costs recognised; for these, the criteria are generally satisfied around the time of the initial engine certification.

CUSTOMER FINANCING CONTINGENT LIABILITIES

The Group has contingent liabilities in respect of financing support provided to customers. In order to assess whether a provision should be recognised, judgement as to the likelihood of these crystallising is required. This judgement is based on an assessment on the knowledge of the customers' fleet plans, the underlying value of the security provided and, where appropriate, the customers' creditworthiness.

KEY SOURCES OF ESTIMATION UNCERTAINTY

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

FORECASTS AND DISCOUNT RATES

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

- The assessment of whether the goodwill and other intangible assets (carrying value at 31 December 2014 **£1,658 million**, 31 December 2013 £1,864 million) arising on the consolidation of RRPS is impaired is dependent of the present value of the future cash flows expected to be generated by the business.
- The assessment as to whether there are any indications of impairment of development, participation, certification and contractual aftermarket rights recognised as intangible assets (carrying values at 31 December 2014 **£2,533 million**, 31 December 2013 £2,499 million) is dependent on estimates of cash flows generated by the relevant assets and the discount rate used to calculate a present value. These estimates include the performance of long-term contractual arrangements as described below, as well as estimates for future market share, pricing and unit cost for uncontracted business. The risk of impairment is generally higher for newer programmes and for customer specific intangible assets (CARs) for launch customers.

ASSESSMENT OF LONG-TERM CONTRACTUAL ARRANGEMENTS

The Group has long-term contracts that fall into different accounting periods and which can extend over significant periods – the most significant of these are long-term service arrangements in the Civil aerospace business. The estimated revenues and costs are inherently imprecise and significant estimates are required to assess: engine flying hours, time on wing and other operating parameters; the pattern of future maintenance activity and the costs to be incurred; and life cycle cost improvements over the term of the contracts. The estimates take account of the inherent uncertainties and the risk of non-recovery of any resulting contract balances.

POST-RETIREMENT BENEFITS

The Group's defined benefit pension schemes and similar arrangements are assessed annually in accordance with IAS 19. The accounting valuation, which is based on assumptions determined with independent actuarial advice, resulted in a net surplus of **£555 million** before deferred taxation being recognised on the balance sheet at 31 December 2014 (31 December 2013 net deficit £793 million). The size of the net surplus/deficit is sensitive to the market value of the assets held by the schemes and to actuarial assumptions, which include price inflation, pension and salary increases, the discount rate used in assessing actuarial liabilities, mortality and other demographic assumptions and the levels of contributions. Further details are included in note 19.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
CONTINUED

1 ACCOUNTING POLICIES CONTINUED

PROVISIONS
As described in the accounting policy on page 108, the Group measures provisions (carrying value at 31 December 2014 **£807 million**, 31 December 2013 £733 million) at the directors' best estimate of the expenditure required to settle the obligation at the balance sheet date. These estimates take account of information available and different possible outcomes.

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

SIGNIFICANT ACCOUNTING POLICIES
The Group's significant accounting policies are set out below. These accounting policies have been applied consistently to all periods presented in these consolidated financial statements and by all Group entities.

BASIS OF CONSOLIDATION
The Group consolidated financial statements include the financial statements of the Company and its subsidiary undertakings together with the Group's share of the results of joint arrangements and associates made up to 31 December. In line with common practice in Germany, a small number of immaterial subsidiaries of Rolls-Royce Power Systems are not consolidated and are carried at cost in other investments. If such subsidiaries become material, they are consolidated. The difference between the net assets recognised and the investment cost eliminated is recognised in other operating income.

A subsidiary is an entity controlled by the Company. Control exists when the Company has power over an entity, exposure to variable returns from its involvement with an entity and the ability to use its power over an entity so as to affect the Company's returns.

A joint arrangement is an entity in which the Group holds a long-term interest and which is jointly controlled by the Group and one or more other venturers under a contractual arrangement. Joint arrangements may be either joint ventures or joint operations; all the Group's joint arrangements have been classified as joint ventures. An associate is an entity, being neither a subsidiary nor a joint arrangement, in which the Group holds a long-term interest and where the Group has a significant influence. The results of joint ventures and associates are accounted for using the equity method of accounting.

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

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

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

REVENUE RECOGNITION
Revenues comprise sales to outside customers after discounts, excluding value added taxes.

Sales of products (both original equipment and spare parts) are recognised when the significant risks and rewards of ownership of the goods are transferred to the customer, the sales price agreed and the receipt of payment can be assured – this is generally on delivery. On occasion, the Group may participate in the financing of OE, most commonly by the provision of guarantees as described in note 18. In such circumstances, the contingent obligations arising under these arrangements are taken into account in assessing when the significant risks and rewards of ownership have been transferred to the customer. As described on page 101, a sale of OE at a contractual price below its cost of manufacture is considered to give rise to revenue to the extent that an intangible asset, (contractual aftermarket right), is recognised at the same time.

Sales of services are recognised by reference to the stage of completion based on services performed to date. As described on page 103, the assessment of the stage of completion is dependent on the nature of the contract, but will generally be based on: flying hours or equivalent for long-term aftermarket arrangements where the service is provided on a continuous basis; costs incurred to the extent these relate to services performed up to the reporting date; or achievement of contractual milestones where relevant.

As described on page 102, **sales of products and services** are treated as though they are a single contract where these components have been negotiated as a single commercial package and are so closely interrelated that they do not operate independently of each other and are considered to form a single transaction with an overall profit margin. The total revenue is allocated between the two components such that the total agreed discount to list prices is allocated to revenue for each of the two components pro rata, based on list prices. The revenue is then recognised for each component on this basis as the products are delivered and services provided, as described above. Where the contractual price of the OE component is below the revenue allocated from the combined arrangement, this will give rise to an asset included in 'amounts recoverable on contracts'. This asset reduces as services are provided, increases as costs are incurred, and reduces to zero by the end of the contract. Where the balance is a liability, it is recognised in 'accruals and deferred income'.

1 ACCOUNTING POLICIES CONTINUED

Provided that the outcome of construction contracts can be assessed with reasonable certainty, the revenues and costs on such contracts are recognised based on stage of completion and the overall contract profitability. Full provision is made for any estimated losses to completion of contracts, having regard to the overall substance of the arrangements.

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

TOTALCARE ARRANGEMENTS

As described above, these are accounted for on a stage of completion basis, with the stage of completion based on the proportion of flying hours completed compared to the total estimated under the contract. In making the assessment of future revenues, costs and the level of profit recognised the Group takes account of: (i) the forecast utilisation of the engines by the operator; (ii) the forecast costs to maintain the engines in accordance with the contractual requirements – the principal variables being the time between shop visits and the cost of each shop visit; and (iii) the recoverability of any contract asset arising. The Group benchmarks the forecast costs against previous programmes, recognising that the reliability of the forecasts will improve as operational experience of the engine increases. To the extent that actual costs differ from forecast costs or that forecast costs change, the cumulative impact is recognised in the period. An allowance is made against contract assets arising, based on both the customer's creditworthiness and an assessment of the importance of the particular engine fleet to the customer. Again, changes in this allowance are recognised in the period.

RISK AND REVENUE SHARING ARRANGEMENTS (RRSAs)

As described on page 102, the Group enters into arrangements with certain workshare partners under which these suppliers: (i) contribute to the forecast costs of developing an engine by performing their own development work, providing development parts and paying a non-refundable cash entry fee; and (ii) supply components for the production phase for which they receive consideration, which is an agreed proportion of the total programme revenues. Both the suppliers' contributions to the forecast non-recurring development costs and their consideration are determined by reference to their proportionate forecast scopes of supply relative to that of the engine overall. Once the forecast costs and the scopes of supply have been agreed at the inception of the contract, each party is then accountable for its own incurred costs. No accounting entries are recorded when the suppliers undertake development work or when development components are supplied. Cash sums received are recognised in the income statement, as a reduction in research and development costs incurred, to match the expensing of the Group's related costs – where the cash sums are received in advance of the related costs being expensed or where the related costs are capitalised as intangible assets, the recognition of the cash received is deferred (in accruals and deferred income) to match the recognition of the related expense or the amortisation of the related intangible asset respectively. The payments to suppliers of their shares of the programme revenues for their production components are charged to cost of sales as programme revenues arise.

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

GOVERNMENT INVESTMENT

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

GOVERNMENT GRANTS

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

INTEREST

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

TAXATION

The tax charge/credit on the profit or loss for the year comprises current and deferred tax:

- Current tax is the expected tax payable for the year, using tax rates enacted or substantively enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.
- Deferred tax is provided using the balance sheet liability method, providing for temporary differences between the carrying amounts of the assets and liabilities for financial reporting purposes and the amounts used for taxation purposes and is calculated using the enacted or substantively enacted rates that are expected to apply when the asset or liability is settled.

Tax is charged or credited in the income statement or other comprehensive income (OCI) as appropriate, except when it relates to items credited or charged directly to equity in which case the tax is also dealt with in equity.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

CONTINUED

1 ACCOUNTING POLICIES CONTINUED

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

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

Accruals for tax contingencies require management to make judgements and estimates of exposures in relation to tax audit issues. Tax benefits are not recognised unless the tax positions will probably be sustained. Once considered to be probable, management reviews each material tax benefit to assess whether a provision should be taken against full recognition of that benefit on the basis of potential settlement through negotiation and/or litigation. All provisions are included in current liabilities. Any liability relating to interest on tax liabilities is provided for in the tax charge.

FOREIGN CURRENCY TRANSLATION

Transactions denominated in currencies other than the functional currency of the transacting Group undertaking are translated into the functional currency at the exchange rates ruling on the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated into the relevant functional currency at the rate ruling at the year end. Exchange differences arising on foreign exchange transactions and the retranslation of assets and liabilities into functional currencies at the rate ruling at the year end are taken into account in determining profit before taxation.

The trading results of Group undertakings are translated into sterling at the average exchange rates for the year. The assets and liabilities of overseas undertakings, including goodwill and fair value adjustments arising on acquisition, are translated at the exchange rates ruling at the year end. Exchange adjustments arising from the retranslation of the opening net investments, and from the translation of the profits or losses at average rates, are recognised in OCI. The cumulative amount of exchange adjustments was, on transition to IFRS in 2004, deemed to nil.

FINANCIAL INSTRUMENTS

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

- short-term investments are generally classified as **available for sale**;
- short-term deposits (principally comprising funds held with banks and other financial institutions), trade receivables and short-term investments not designated as available for sale are classified as **loans and receivables**;
- borrowings, trade payables, financial RRSAs, put options on NCI, and C Shares are classified as **other liabilities**; and
- derivatives, comprising foreign exchange contracts, interest rate swaps and commodity swaps are classified as **fair value through profit or loss**.

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

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

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

HEDGE ACCOUNTING

The Group does not generally apply hedge accounting in respect of forward foreign exchange contracts or commodity swaps held to manage the cash flow exposures of forecast transactions denominated in foreign currencies or in commodities respectively.

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

1 ACCOUNTING POLICIES CONTINUED

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

Changes in the fair values of derivatives that are designated as cash flow hedges and are effective are recognised directly in equity. Any ineffectiveness in the hedging relationships is included in the income statement. The amounts deferred in equity are recognised in the income statement to match the recognition of the hedged item.

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

The portion of a gain or loss on an instrument used to hedge a net investment in a foreign operation that is determined to be an effective hedge is recognised directly in equity. The ineffective portion is recognised immediately in the income statement. Gains and losses accumulated in the translation reserve will be recycled to profit when the foreign operation is sold.

BUSINESS COMBINATIONS AND GOODWILL

On the acquisition of a business, fair values are attributed to the identifiable assets and liabilities and contingent liabilities unless the fair value cannot be measured reliably, in which case the value is subsumed into goodwill. Where fair values of acquired contingent liabilities cannot be measured reliably, the assumed contingent liability is not recognised but is disclosed in the same manner as other contingent liabilities.

Goodwill recognised represents the excess of the fair value of the purchase consideration over the fair value to the Group of the net of the identifiable assets acquired and the liabilities assumed. On transition to IFRS on 1 January 2004, business combinations were not retrospectively adjusted to comply with Adopted IFRS and goodwill was recognised based on the carrying value under the previous accounting policies. Goodwill in respect of the acquisition of a subsidiary is recognised as an intangible asset. Goodwill arising on the acquisition of joint ventures and associates is included in the carrying value of the investment.

CERTIFICATION COSTS AND PARTICIPATION FEES

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

RESEARCH AND DEVELOPMENT

In accordance with IAS 38 *Intangible Assets*, expenditure incurred on research and development is distinguished as relating either to a research phase or to a development phase.

All research phase expenditure is charged to the income statement. Development expenditure is capitalised as an internally generated intangible asset only if it meets strict criteria, relating in particular to technical feasibility and generation of future economic benefits. As described on page 103, the Group considers that it is not possible to distinguish reliably between research and development activities until relatively late in the programme.

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

CONTRACTUAL AFTERMARKET RIGHTS

As described under key judgements on page 101, the Group may sell OE to customers at a price below its cost, on the basis that it also receives valuable aftermarket rights. Such a sale is considered to give rise to an intangible asset which is recognised, in accordance with IAS 38, at the same time as the revenue at an amount equal to the cash deficit and is amortised on a straight-line basis over the period that highly probable aftermarket sales are expected to be earned.

CUSTOMER RELATIONSHIPS

The fair value of customer relationships recognised as a result of a business combination relate to the acquired company's established relationships with its existing customers that result in repeat purchases and customer loyalty. Amortisation occurs on a straight-line basis over its useful economic life, up to a maximum of 15 years.

SOFTWARE

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

PROPERTY, PLANT AND EQUIPMENT

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
CONTINUED

1 ACCOUNTING POLICIES CONTINUED

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

i) land and buildings, as advised by the Group's professional advisers:
   a) freehold buildings – five to 45 years (average 25 years);
   b) leasehold buildings – lower of adviser's estimates or period of lease;
   c) no depreciation is provided on freehold land;
ii) plant and equipment – five to 25 years (average 13 years);
iii) aircraft and engines – five to 20 years (average 14 years).

OPERATING LEASES

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

IMPAIRMENT OF NON-CURRENT ASSETS

Impairment of non-current assets is considered in accordance with IAS 36 *Impairment of Assets*. Where the asset does not generate cash flows that are independent of other assets, impairment is considered for the cash-generating unit to which the asset belongs. Goodwill and intangible assets not yet available for use are tested for impairment annually. Other intangible assets, property, plant and equipment and investments are assessed for any indications of impairment annually. If any indication of impairment is identified, an impairment test is performed to estimate the recoverable amount.

If the recoverable amount of an asset (or cash-generating unit) is estimated to be below the carrying value, the carrying value is reduced to the recoverable amount and the impairment loss recognised as an expense. The recoverable amount is the higher of value in use or fair value less costs to sell, if this is readily available. The value in use is the present value of future cash flows using a pre-tax discount rate that reflects the time value of money and the risk specific to the asset.

INVENTORIES

Inventories and work in progress are valued at the lower of cost and net realisable value on a first-in, first-out basis. Cost comprises direct materials and, where applicable, direct labour costs and those overheads, including depreciation of property, plant and equipment, that have been incurred in bringing the inventories to their present location and condition. Net realisable value represents the estimated selling prices less all estimated costs of completion and costs to be incurred in marketing, selling and distribution.

CASH AND CASH EQUIVALENTS

Cash and cash equivalents includes cash at bank and in hand, investments in money-market funds and short-term deposits with a maturity of three months or less on inception. The Group considers overdrafts (repayable on demand) to be an integral part of its cash management activities and these are included in cash and cash equivalents for the purposes of the cash flow statement.

PROVISIONS

Provisions are recognised when the Group has a present obligation as a result of a past event, and it is probable that the Group will be required to settle that obligation. Provisions are measured at the directors' best estimate of the expenditure required to settle the obligation at the balance sheet date, and are discounted to present value where the effect is material.

POST-RETIREMENT BENEFITS

Pensions and similar benefits (principally healthcare) are accounted for under IAS 19 *Employee Benefits*.

For defined benefit plans, obligations are measured at discounted present value, using a discount rate derived from high-quality corporate bonds denominated in the currency of the plan, whilst plan assets are recorded at fair value. Surpluses in schemes are recognised as assets only if they represent economic benefits available to the Group in the future. A liability is recognised to the extent that the minimum funding requirements in respect of past service will give rise to an unrecognisable surplus.

The service and financing costs of such plans are recognised separately in the income statement:

- current service costs are spread systematically over the lives of employees;
- past-service costs are recognised immediately; and
- financing costs are recognised in the periods in which they arise.

Actuarial gains and losses and movements in unrecognised surpluses and minimum funding liabilities are recognised immediately in OCI.

Payments to defined contribution schemes are charged as an expense as they fall due.

1 ACCOUNTING POLICIES CONTINUED

SHARE-BASED PAYMENTS

The Group provides share-based payment arrangements to certain employees. These are principally equity-settled arrangements and are measured at fair value (excluding the effect of non-market based vesting conditions) at the date of grant. The fair value is expensed on a straight-line basis over the vesting period. The amount recognised as an expense is adjusted to reflect the actual number of shares or options that will vest, except where additional shares vest as a result of the total shareholder return (TSR) performance condition in the Performance Share Plan (PSP).

Cash-settled share options (grants in the International ShareSave plan) are measured at fair value at the balance sheet date. The Group recognises a liability at the balance sheet date based on these fair values, taking into account the estimated number of options that will actually vest and the relative completion of the vesting period. Changes in the value of this liability are recognised in the income statement for the year.

The cost of shares of Rolls-Royce Holdings plc held by the Group for the purpose of fulfilling obligations in respect of employee share plans is deducted from equity in the consolidated balance sheet. See note 21 for a further description of the share-based payment plans.

SALES FINANCING SUPPORT

In connection with the sale of its products, the Group will, on occasion, provide financing support for its customers. These arrangements fall into two categories: credit-based guarantees and asset-value guarantees. In accordance with the requirements of IAS 39 and IFRS 4 *Insurance Contracts*, credit-based guarantees are treated as insurance contracts. The Group considers asset-value guarantees to be non-financial liabilities and accordingly these are also treated as insurance contracts. As described on page 103, the directors consider the likelihood of crystallisation in assessing whether provision is required for any contingent liabilities.

The Group's contingent liabilities relating to financing arrangements are spread over many years and relate to a number of customers and a broad product portfolio, and are reported on a discounted basis.

REVISIONS TO ADOPTED IFRS IN 2014

With effect from 1 January 2014, the Group has adopted IFRS 10 *Consolidated Financial statements*, IFRS 11 *Joint Arrangements* and IFRS 12 *Disclosure of Interests in Other Entities*. The principal potential effect was that certain entities previously classified as joint ventures might be classified as joint operations, requiring the Group's share of the individual assets and liabilities of these entities to be included in the financial statements rather than the equity accounting method previously applied. The Group has reviewed its material joint ventures and has concluded that none are to be classified as joint operations under the requirements of IFRS 11. Disclosures required by IFRS 12 are included in note 11.

REVISIONS TO IFRS NOT APPLICABLE IN 2014

Standards and interpretations issued by the IASB are only applicable if endorsed by the EU.

Once endorsed, IFRS 9 *Financial Instruments* will simplify the classification of financial assets for measurement purposes, but is not anticipated to have a significant impact on the financial statements.

IFRS 15 *Revenue from Contracts with Customers* (effective for the year ending 31 December 2017, not yet endorsed by the EU) provides a single, principles-based five-step model to be applied to all sales contracts, based on the transfer of control of goods and services to customers. It replaces the separate models for goods, services and construction contracts currently included in IAS 11 *Construction Contracts* and IAS 18 *Revenue*. Given the nature of the Group's long-term contracts, it is likely that the adoption of IFRS 15 will require significant judgement.

Based on an initial assessment, IFRS 15 may have a significant impact on the timing of recognition of revenue on individual long-term contracts, although this impact is likely to be significantly reduced at a Group level when all long-term contracts (with different start and end dates) are combined. The Group will continue to assess the impact during 2015.

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
CONTINUED

2 SEGMENTAL ANALYSIS

The analysis by Division (business segment) is presented in accordance with IFRS 8 *Operating Segments*, on the basis of those segments whose operating results are regularly reviewed by the Board (the Chief Operating Decision Maker as defined by IFRS 8), as follows:

AEROSPACE DIVISION:

Civil – development, manufacture, marketing and sales of commercial aero engines and aftermarket services.
Defence – development, manufacture, marketing and sales of military aero engines and aftermarket services.

LAND & SEA DIVISION:

Power Systems – development, manufacture, marketing and sales of diesel engines and power systems.
Marine – development, manufacture, marketing and sales of marine-power propulsion systems and aftermarket services.
Nuclear & Energy – development, manufacture, marketing and sales of nuclear systems for civil power generation and naval propulsion systems (Nuclear) and power systems for the offshore oil & gas industry and electrical power generation (Energy) and aftermarket services. The Energy business was sold on 1 December 2014 – see note 25.

The operating results reviewed by the Board are prepared on an underlying basis, which the Board consider reflects better the economic substance of the Group's trading during the year. Additional disclosure of the two segments is also provided. The principles adopted to determine underlying results are:

Underlying revenues – Where revenues are denominated in a currency other than the functional currency of the Group undertaking, these reflect the achieved exchange rates arising on settled derivative contracts.

Underlying profit before financing – Where transactions are denominated in a currency other than the functional currency of the Group undertaking, this reflects the transactions at the achieved exchange rates on settled derivative contracts. In addition, adjustments have been made to exclude one-off past-service credits on post-retirement schemes, exceptional restructuring costs and the effect of acquisition accounting.

Underlying profit before taxation – In addition to those adjustments in underlying profit before financing:

- includes amounts realised from settled derivative contracts and revaluation of relevant assets and liabilities to exchange rates forecast to be achieved from future settlement of derivative contracts; and
- excludes unrealised amounts arising from revaluations required by IAS 39 *Financial Instruments: Recognition and Measurement*, changes in value of financial RRSA contracts arising from changes in forecast payments, changes in the value of put options on NCI and the net impact of financing costs related to post-retirement scheme benefits.

Taxation – the tax effect of the adjustments above are excluded from the underlying tax charge. In addition, changes in the amount of recoverable advance corporation tax recognised that arise from the above adjustments are also excluded.

This analysis also includes a reconciliation of the underlying results to those reported in the consolidated income statement.

2 SEGMENTAL ANALYSIS CONTINUED

	Aerospace			Land & Sea						
Year ended 31 December 2014	Civil £m	Defence £m	Total £m	Power Systems £m	Marine £m	Nuclear & Energy £m	Intra-segment £m	Total £m	Inter-segment £m	Total reportable segments £m
Underlying revenue from sale of original equipment	**3,265**	**816**	**4,081**	**1,893**	**1,070**	**556**	**(78)**	**3,441**	**–**	**7,522**
Underlying revenue from aftermarket services	**3,572**	**1,253**	**4,825**	**827**	**639**	**852**	**(77)**	**2,241**	**–**	**7,066**
Total underlying revenue	**6,837**	**2,069**	**8,906**	**2,720**	**1,709**	**1,408**	**(155)**	**5,682**	**–**	**14,588**
Underlying operating profit excluding share of results of joint ventures and associates	**849**	**350**	**1,199**	**256**	**138**	**42**	**(13)**	**423**	**–**	**1,622**
Share of results of joint ventures and associates	**93**	**16**	**109**	**(3)**	**–**	**3**	**–**	**–**	**–**	**109**
Underlying profit before financing and taxation	**942**	**366**	**1,308**	**253**	**138**	**45**	**(13)**	**423**	**–**	**1,731**
Segment assets	**10,268**	**1,460**	**11,728**	**3,581**	**1,636**	**954**	**(22)**	**6,149**	**(1,269)**	**16,608**
Investments in joint ventures and associates	**507**	**13**	**520**	**7**	**5**	**7**	**–**	**19**	**–**	**539**
Segment liabilities	**(7,418)**	**(1,743)**	**(9,161)**	**(1,100)**	**(1,075)**	**(880)**	**–**	**(3,055)**	**1,269**	**(10,947)**
Net assets/(liabilities)	**3,357**	**(270)**	**3,087**	**2,488**	**566**	**81**	**(22)**	**3,113**	**–**	**6,200**
Investment in intangible assets, property, plant and equipment and joint ventures and associates	**836**	**78**	**914**	**144**	**36**	**62**	**–**	**242**	**–**	**1,156**
Depreciation, amortisation and impairment	**381**	**49**	**430**	**221**	**38**	**53**	**–**	**312**	**–**	**742**
Year ended 31 December 2013[1]										
Underlying revenue from sale of original equipment	3,035	1,385	4,420	2,004	1,288	565	(72)	3,785	–	8,205
Underlying revenue from aftermarket services	3,620	1,206	4,826	827	749	973	(75)	2,474	–	7,300
Total underlying revenue	6,655	2,591	9,246	2,831	2,037	1,538	(147)	6,259	–	15,505
Underlying operating profit excluding share of results of joint ventures and associates	708	424	1,132	296	233	63	2	594	–	1,726
Share of results of joint ventures and associates	136	14	150	(2)	–	11	–	9	–	159
Underlying profit before financing and taxation	844	438	1,282	294	233	74	2	603	–	1,885
Segment assets	9,587	1,437	11,024	3,927	1,701	1,616	(10)	7,234	(734)	17,524
Investments in joint ventures and associates	495	17	512	29	5	55	–	89	–	601
Segment liabilities	(6,243)	(1,660)	(7,903)	(3,034)	(985)	(1,015)	–	(5,034)	733	(12,204)
Net assets/(liabilities)	3,839	(206)	3,633	922	721	656	(10)	2,289	(1)	5,921
Investment in intangible assets, property, plant and equipment and joint ventures and associates	891	103	994	142	23	80	–	245	–	1,239
Depreciation and amortisation and impairment	349	53	402	272	63	63	–	398	–	800

[1] The split between OE and aftermarket revenue for the year ended 31 December 2013 in Marine and Nuclear & Energy has been amended compared with that included on page 123 of the 2013 Annual Report.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
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2 SEGMENTAL ANALYSIS CONTINUED

RECONCILIATION TO REPORTED RESULTS

Year ended 31 December 2014	Total reportable segments £m	Underlying central items £m	Total underlying £m	Underlying adjustments £m	Discontinued business £m	Group £m
Revenue from sale of original equipment	**7,522**	**–**	**7,522**	**61**	**(283)**	**7,300**
Revenue from aftermarket services	**7,066**	**–**	**7,066**	**(200)**	**(430)**	**6,436**
Total revenue	**14,588**	**–**	**14,588**	**(139)**	**(713)**	**13,736**
Operating profit excluding share of results of joint ventures and associates	**1,622**	**(53)**[1]	**1,569**	**(274)**	**1**	**1,296**
Share of results of joint ventures and associates	**109**	**–**	**109**	**(13)**	**(2)**	**94**
Profit on transfer of joint ventures to subsidiaries	**–**	**–**	**–**	**2**	**–**	**2**
Profit on disposal of businesses	**–**	**–**	**–**	**6**	**–**	**6**
Profit before financing and taxation	**1,731**	**(53)**	**1,678**	**(279)**	**(1)**	**1,398**
Net financing		**(61)**	**(61)**	**(1,270)**	**–**	**(1,331)**
Profit before taxation		**(114)**	**1,617**	**(1,549)**	**(1)**	**67**
Taxation		**(387)**	**(387)**	**239**	**(3)**	**(151)**
Profit for the year from continuing operations			**1,226**	**(1,310)**	**–**	**(84)**
Profit for the year from discontinued operations			**4**	**–**	**138**	**142**
Profit for the year			**1,230**	**(1,310)**	**138**	**58**
Attributable to:						
Ordinary shareholders			**1,224**	**(1,293)**	**138**	**69**
Non-controlling interests			**6**	**(17)**	**–**	**(11)**

Year ended 31 December 2013	Total reportable segments £m	Underlying central items £m	Total underlying £m	Underlying adjustments £m	Discontinued business £m	Group £m
Revenue from sale of original equipment	8,205	–	8,205	70	(328)	7,947
Revenue from aftermarket services	7,300	–	7,300	(62)	(543)	6,695
Total revenue	15,505	–	15,505	8	(871)	14,642
Operating profit excluding share of results of joint ventures and associates	1,726	(54)[1]	1,672	(297)	(45)	1,330
Share of results of joint ventures and associates	159	–	159	1	(11)	149
Profit on transfer of joint ventures to subsidiaries	–	–	–	119	–	119
Profit on disposal of businesses	–	–	–	216	–	216
Profit before financing and taxation	1,885	(54)	1,831	39	(56)	1,814
Net financing		(72)	(72)	(39)	(3)	(114)
Profit before taxation		(126)	1,759	–	(59)	1,700
Taxation		(434)	(434)	54	3	(377)
Profit for the year from continuing operations			1,269	54	–	1,323
Profit for the year from discontinued operations			56	–	–	56
Profit for the year			1,325	54	–	1,379
Attributable to:						
Ordinary shareholders			1,224	143	–	1,367
Non-controlling interests			101	(89)	–	12

[1] Central corporate costs

DISCONTINUED OPERATIONS

	2014 £m	2013 £m
Revenue	**713**	871
Profit before taxation	**1**	59
Tax on ordinary activities	**3**	(3)
Profit for the year from ordinary activities	**4**	56
Profit on disposal	**136**	–
Tax on profit on disposal	**2**	–
Profit for the year from discontinued operations	**142**	56
Net cash (outflow)/inflow from operating activities	**(127)**	51
Net cash outflow from investing activities	**(35)**	(51)
Net cash flow from financing activities	**–**	–
Net change in cash and cash equivalents	**(162)**	–

2 SEGMENTAL ANALYSIS CONTINUED

UNDERLYING ADJUSTMENTS

	2014				2013			
	Revenue £m	**Profit before financing £m**	**Net financing £m**	**Taxation £m**	Revenue £m	Profit before financing £m	Net financing £m	Taxation £m
Underlying performance	**14,588**	**1,678**	**(61)**	**(387)**	15,505	1,831	(72)	(434)
Revenue recognised at exchange rate on date of transaction	**(139)**	**–**	**–**	**–**	8	–	–	–
Realised gains on settled derivative contracts[1]	**–**	**(87)**	**(5)**	**–**	–	(10)	(5)	–
Net unrealised fair value changes to derivative contracts[2]	**–**	**(15)**	**(1,141)**	**–**	–	–	250	–
Effect of currency on contract accounting	**–**	**13**	**–**	**–**	–	(18)	–	–
Revaluation of trading assets and liabilities	**–**	**(11)**	**(8)**	**–**	–	–	–	–
Put option on NCI and financial RRSAs – foreign exchange differences and other unrealised changes in value	**–**	**–**	**(87)**	**–**	–	–	(251)	–
Effect of acquisition accounting[3]	**–**	**(142)**	**–**	**–**	–	(265)	–	–
Pensions discretionary increase		**–**	**–**	**–**	–	(64)	–	–
Net post-retirement scheme financing	**–**	**–**	**(29)**	**–**	–	–	(26)	–
Profit on acquisition/reclassification of joint ventures	**–**	**2**	**–**	**–**	–	119	–	–
Profit on disposal of businesses	**–**	**6**	**–**	**–**	–	216	–	–
Exceptional restructuring[4]	**–**	**(39)**	**–**	**–**	–	–	–	–
Other[5]	**–**	**(6)**	**–**	**–**	–	61	(7)	–
Related tax effect	**–**	**–**	**–**	**239**	–	–	–	54
Total underlying adjustments	**(139)**	**(279)**	**(1,270)**	**239**	8	39	(39)	54
Discontinued operations	**(713)**	**(1)**	**–**	**(3)**	(871)	(56)	(3)	3
Reported per consolidated income statement	**13,736**	**1,398**	**(1,331)**	**(151)**	14,642	1,814	(114)	(377)

1 Realised gains on settled derivative contracts include adjustments to reflect the gains in the same period as the related trading cash flows.
2 Unrealised fair value changes to derivative contracts: (i) include those included in equity accounted joint ventures, which are included in profit before financing; and (ii) exclude those for which the related trading contracts have been cancelled when the fair value changes are recognised immediately in underlying profit.
3 The adjustment eliminates charges recognised as a result of recognising assets in acquired businesses at fair value.
4 Restructuring is excluded from the underlying performance when it relates to the closure of a significant business or a site.
5 In 2013, other included the exclusion of other operating income £63m and the revaluation of preference shares in RRPS AG, which were acquired.

The reconciliation of underlying earnings per ordinary share is shown in note 6.

RECONCILIATION TO THE BALANCE SHEET

	2014 £m	2013 £m
Reportable segment assets	**16,608**	17,524
Investments in joint ventures and associates	**539**	601
Cash and cash equivalents and short-term investments	**2,869**	4,311
Fair value of swaps hedging fixed rate borrowings	**80**	47
Income tax assets	**388**	332
Post-retirement scheme surpluses	**1,740**	248
Total assets	**22,224**	23,063
Reportable segment liabilities	**(10,947)**	(12,204)
Borrowings	**(2,261)**	(2,371)
Fair value of swaps hedging fixed rate borrowings	**(22)**	(48)
Income tax liabilities	**(1,422)**	(1,096)
Post-retirement scheme deficits	**(1,185)**	(1,041)
Total liabilities	**(15,837)**	(16,760)
Net assets	**6,387**	6,303

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
CONTINUED

2 SEGMENTAL ANALYSIS CONTINUED

GEOGRAPHICAL SEGMENTS

The Group's revenue by destination from continuing operations is shown below:

	2014 £m	2013 £m
United Kingdom	**1,599**	1,677
Norway	**322**	520
Germany	**734**	972
Switzerland	**670**	868
Spain	**113**	174
Italy	**201**	233
France	**292**	259
Russia	**86**	111
Rest of Europe	**575**	637
United States of America	**3,751**	3,910
Canada	**472**	474
South America	**407**	302
Saudi Arabia	**327**	544
Rest of Middle East	**418**	339
India	**161**	230
China	**1,290**	1,038
South Korea	**485**	452
Japan	**272**	235
Malaysia	**280**	235
Singapore	**396**	544
Rest of Asia	**493**	596
Africa	**115**	87
Australasia	**207**	143
Other	**70**	62
	13,736	14,642

No single customer represented 10% or more of the Group's revenue.

The carrying amounts of the Group's non-current assets, excluding financial instruments, deferred tax assets and post-retirement benefit surpluses, by the geographical area in which the assets are located, are as follows:

	£m	£m
United Kingdom	**3,864**	3,649
United States of America	**827**	872
Nordic countries	**724**	823
Germany	**2,493**	2,739
Other	**912**	924
	8,820	9,007

3 RESEARCH AND DEVELOPMENT AND OTHER INCOME

RESEARCH AND DEVELOPMENT

	2014 £m	2013 £m
Expenditure in the year	(818)	(725)
Capitalised as intangible assets	83	110
Amortisation of capitalised costs	(125)	(130)
Net research and development cost	(860)	(745)
Entry fees received	51	126
Entry fees deferred in respect of charges in future years	(38)	(50)
Recognition of previously deferred entry fees	54	11
Net cost recognised in the income statement	(793)	(658)
Underlying adjustments relating to effects of acquisition accounting and foreign exchange	63	59
Discontinued operations	(25)	(25)
Net underlying cost recognised in the income statement	(755)	(624)

OTHER INCOME

In October 2011, Rolls-Royce and United Technologies Corp. (UTC) announced their intention to form a new joint venture to develop an engine to power future mid-size aircraft (120-230 passenger aircraft). In September 2013, the parties agreed not to proceed with the partnership. Other operating income in 2013 includes £63 million as a result of this.

4 NET FINANCING

		2014		2013	
	Note	Per consolidated income statement £m	*Underlying financing[1]* £m	Per consolidated income statement £m	*Underlying financing[1]* £m
Financing income					
Interest receivable		17	*17*	15	*15*
Fair value gains on foreign currency contracts[2]	17	2	–	287	–
Put option on NCI and financial RRSAs – foreign exchange differences and other unrealised changes in value	17	89	–	8	–
Finance income on post-retirement scheme surpluses	19	13	–	17	–
		121	*17*	327	*15*
Financing costs					
Interest payable		(63)	*(63)*	(58)	*(58)*
Fair value losses on foreign currency contracts[2]	17	(1,127)	–	(3)	–
Financial RRSAs – financing	17	(7)	*(5)*	(9)	*(9)*
Put option on NCI and financial RRSAs – foreign exchange differences and other unrealised changes in value	17	(174)	–	(259)	–
Fair value losses on commodity derivatives[2]	17	(15)	–	(34)	–
Finance cost on post-retirement scheme deficits	19	(42)	–	(43)	–
Net foreign exchange losses		(13)	–	(5)	–
Other financing charges		(11)	*(10)*	(30)	*(20)*
		(1,452)	*(78)*	(441)	*(87)*
Net financing		(1,331)	*(61)*	(114)	*(72)*
Analysed as:					
Net interest payable		(46)	*(46)*	(43)	*(43)*
Net post-retirement scheme financing		(29)	–	(26)	–
Net other financing		(1,256)	*(15)*	(45)	*(29)*
Net financing		(1,331)	*(61)*	(114)	*(72)*
[1] See note 2					
[2] Net (loss)/gain on fair value items through profit or loss	17	(1,140)	–	250	–

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
CONTINUED

5 TAXATION

	UK		Overseas		Total	
	2014 £m	2013 £m	**2014 £m**	2013 £m	**2014 £m**	2013 £m
Current tax						
Current tax charge for the year	**8**	7	**240**	301	**248**	308
Less double tax relief	**–**	(1)	**–**	–	**–**	(1)
	8	6	**240**	301	**248**	307
Adjustments in respect of prior years	**1**	2	**12**	29	**13**	31
	9	8	**252**	330	**261**	338
Deferred tax						
Deferred tax (credit)/charge for the year	**(72)**	212	**(77)**	(68)	**(149)**	144
Adjustments in respect of prior years	**(14)**	(8)	**(11)**	(37)	**(25)**	(45)
Derecognition of advance corporation tax	**64**	–	**–**	–	**64**	–
Credit resulting from reduction in tax rates	**–**	(59)	**–**	(1)	**–**	(60)
	(22)	145	**(88)**	(106)	**(110)**	39
Recognised in the income statement	**(13)**	153	**164**	224	**151**	377

OTHER TAX (CHARGES)/CREDITS

	OCI				Equity	
	Items that will not be reclassified		Items that may be reclassified			
	2014 £m	2013 £m	**2014 £m**	2013 £m	**2014 £m**	2013 £m
Current tax:						
Share-based payments – direct to equity					**3**	5
Deferred tax:						
Movement in post-retirement schemes	**(431)**	10				
Share-based payments – direct to equity					**(7)**	8
Net investment hedge			**(2)**	1		
	(431)	10	**(2)**	1	**(4)**	13

TAX RECONCILIATION ON CONTINUING OPERATIONS

	2014 £m	2013 £m
Profit before taxation	**67**	1,700
Less share of results of joint ventures and associates (note 11)	**(94)**	(149)
(Loss)/profit before taxation excluding joint ventures and associates	**(27)**	1,551
Nominal tax (credit)/charge at UK corporation tax rate 21.5% (2013 23.25%)	**(6)**	361
UK R&D credit	**(6)**	(13)
Rate differences	**71**	59
Profit on reclassification of joint ventures to subsidiaries	**–**	(27)
Change in value of put option on NCI	**17**	60
Other permanent differences	**22**	12
Benefit to deferred tax from previously unrecognised tax losses and temporary differences	**(3)**	(7)
Tax losses in year not recognised in deferred tax	**4**	6
Adjustments in respect of prior years	**(12)**	(14)
Derecognition of advance corporation tax	**64**	–
Reduction in closing deferred taxes resulting from decrease in tax rates	**–**	(60)
	151	377
Underlying items (note 2)	**390**	431
Non-underlying items	**(239)**	(54)
	151	377

5 TAXATION CONTINUED

TAX ON DISCONTINUED OPERATIONS

	2014 £m	2013 £m
Tax (credit)/charge on profit/loss on ordinary activities	**(3)**	3
Tax credit on disposal of discontinued operations	**(2)**	–
	(5)	3

DEFERRED TAXATION ASSETS AND LIABILITIES

	2014 £m	2013 £m
At 1 January	**(566)**	(242)
Amount credited/(charged) to income statement	**120**	(53)
Amount (charged)/credited to other comprehensive income	**(433)**	11
Amount (charged)/credited to equity	**(7)**	8
Acquisition of businesses	**(3)**	(282)
Exchange differences	**30**	(8)
At 31 December	**(859)**	(566)
Deferred tax assets	**369**	316
Deferred tax liabilities	**(1,228)**	(882)
	(859)	(566)

The analysis of the deferred tax position is as follows:

		At 1 January 2014 £m	Recognised in income statement £m	Recognised in OCI £m	Recognised in equity £m	Disposal of businesses £m	Exchange differences £m	At 31 December 2014 £m
Intangible assets		**(511)**	41	–	–	–	15	**(455)**
Property, plant and equipment		**(210)**	20	–	–	(6)	1	**(195)**
Other temporary differences		**80**	23	(2)	(10)	(1)	7	**97**
Amounts recoverable on contracts		**(380)**	(146)	–	–	–	–	**(526)**
Pensions and other post-retirement scheme benefits		**153**	(54)	(431)	–	–	8	**(324)**
Foreign exchange and commodity financial assets and liabilities		**(92)**	226	–	–	–	1	**135**
Losses		**323**	65	–	3	4	(2)	**393**
R&D expenditure credit		**7**	9	–	–	–	–	**16**
Advance corporation tax		**64**	(64)	–	–	–	–	**–**
		(566)	120	(433)	(7)	(3)	30	**(859)**
Included in:	Taxation		110					
	Discontinued operations		10					

		At 1 January 2013 £m	Recognised in income statement £m	Recognised in OCI £m	Recognised in equity £m	Acquisition of businesses £m	Exchange differences £m	At 31 December 2013 £m
Intangible assets		(232)	34	–	–	(311)	(2)	(511)
Property, plant and equipment		(158)	17	–	–	(70)	1	(210)
Other temporary differences		12	9	1	3	60	(5)	80
Amounts recoverable on contracts		(351)	(29)	–	–	–	–	(380)
Pensions and other post-retirement scheme benefits		110	–	10	–	36	(3)	153
Foreign exchange and commodity financial assets and liabilities		(56)	(36)	–	–	–	–	(92)
Losses		369	(55)	–	5	3	1	323
R&D expenditure credit		–	7	–	–	–	–	7
Advance corporation tax		64	–	–	–	–	–	64
		(242)	(53)	11	8	(282)	(8)	(566)
Included in:	Taxation		(39)					
	Discontinued operations		(14)					

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
CONTINUED

5 TAXATION CONTINUED

UNRECOGNISED DEFERRED TAX ASSETS

	2014 £m	2013 £m
Advance corporation tax	**182**	118
Losses and other unrecognised deferred tax assets	**35**	39
Deferred tax not recognised on unused tax losses and other items on the basis that future economic benefit is uncertain	**217**	157

DEFERRED TAXATION ASSETS AND LIABILITIES

The UK corporation tax rate reduced to 21% from 1 April 2014 and will reduce further to 20% from 1 April 2015. As the reduction was substantively enacted prior to the year end, the closing deferred tax assets and liabilities have been calculated at this rate.

The deferred tax asset recognised relating to advance corporation tax has reduced during the year due to a decrease in the net deferred tax liabilities against which the asset can be offset. The main reasons for this are the additional shadow advance corporation tax arising on the share buyback and the unrealised fair value change on derivative contracts.

The temporary differences associated with investments in subsidiaries, joint ventures and associates, for which a deferred tax liability has not been recognised, aggregate to **£512 million** (2013 £573 million). No deferred tax liability has been recognised on the potential withholding tax due on the remittance of undistributed profits as the Group is able to control the timing of such remittances and it is probable that consent will not be given in the foreseeable future.

6 EARNINGS PER ORDINARY SHARE

Basic earnings per ordinary share (EPS) are calculated by dividing the profit attributable to ordinary shareholders by the weighted average number of ordinary shares in issue during the year, excluding ordinary shares held under trust, which have been treated as if they had been cancelled.

Diluted EPS are calculated by adjusting the weighted average number of ordinary shares in issue during the year for the bonus element of share options.

	2014			2013		
	Basic	Potentially dilutive share options	Diluted[1]	Basic	Potentially dilutive share options	Diluted
Profit attributable to ordinary shareholders (£m)						
Continuing operations	**(73)**		**(73)**	1,311		1,311
Discontinued operations	**142**		**142**	56		56
	69		**69**	1,367		1,367
Weighted average number of ordinary shares (millions)	**1,874**	**18**	**1,892**	1,866	21	1,887
EPS (pence)						
Continuing operations	**(3.90)**	**–**	**(3.90)**	70.26	(0.78)	69.48
Discontinued operations	**7.58**	**–**	**7.58**	3.00	(0.04)	2.96
	3.68	**–**	**3.68**	73.26	(0.82)	72.44

[1] As there is a loss on continuing operations, the effect of potential dilutive ordinary shares is anti-dilutive.

The reconciliation between underlying EPS and basic EPS is as follows:

	2014		2013	
	Pence	£m	Pence	£m
Underlying EPS/Underlying profit attributable to ordinary shareholders	**65.31**	**1,224**	65.59	1,224
Total underlying adjustments to profit before tax (note 2)	**(82.65)**	**(1,549)**	–	–
Related tax effects	**12.75**	**239**	2.89	54
Profit on disposal of discontinued operations	**7.36**	**138**	–	–
Related NCI effects	**0.91**	**17**	4.78	89
EPS/Profit attributable to ordinary shareholders	**3.68**	**69**	73.26	1,367
Diluted underlying EPS	**64.69**		64.86	

7 EMPLOYEE INFORMATION

	2014 Number	2013 Number
Average number of employees[1]		
United Kingdom	**24,500**	24,800
United States of America	**7,900**	8,500
Canada	**1,500**	1,600
Germany	**10,500**	10,500
Nordic countries	**4,000**	4,100
Rest of world	**5,700**	5,700
Group	**54,100**	55,200
Civil	**23,900**	23,400
Defence	**7,000**	7,900
Aerospace Division	**30,900**	31,300
Power Systems	**10,700**	10,700
Marine	**6,400**	6,900
Nuclear & Energy[2]	**6,100**	6,300
Land & Sea Division	**23,200**	23,900
Group	**54,100**	55,200

	£m	£m
Group employment costs[3]		
Wages and salaries	**2,646**	2,843
Social security costs	**362**	374
Share-based payments (note 21)	**21**	79
Pensions and other post-retirement scheme benefits (note 19)	**328**	421
	3,357	3,717

[1] See page 44.
[2] The disposal of the Energy business on 1 December 2014 reduced employees by 2,000, (average 2,200).
[3] Remuneration of key management personnel is shown in note 24.

8 AUDITORS' REMUNERATION

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

	2014 £m	2013 £m
Fees payable to the Company's auditors for the audit of the Company's annual financial statements[1]	**0.2**	0.2
Fees payable to the Company's auditors and its associates for the audit of the Company's subsidiaries pursuant to legislation	**5.5**	5.6
Total fees payable for audit services	**5.7**	5.8
Fees payable to the Company's auditors and its associates for other services[2]:		
Audit related assurance services[3]	**1.1**	0.8
Taxation compliance services	**0.7**	0.8
Taxation advisory services	**–**	0.1
Internal audit services	**–**	0.2
All other services	**0.4**	1.0
	7.9	8.7
Fees payable in respect of the Group's pension schemes:		
Audit	**0.2**	0.2
Taxation compliance services	**–**	0.1

[1] The level of fees payable to the Company's auditors for the audit of the Company's annual financial statements reflects the fact that limited incremental work is required in respect of the audit of these financial statements. Rolls-Royce plc, a subsidiary of the Company, is also required to prepare consolidated financial statements and the fees payable to the Company's auditors for the audit of those financial statements, including the audit of the sub-consolidation, is included in the audit of the Company's subsidiaries pursuant to legislation.
[2] As described on pages 72 and 73, in 2014, fees for other services to KPMG in respect of Rolls-Royce Power Systems (RRPS) were **£0.9m** (2013 £2.1m). Following the consolidation of RRPS on 1 January 2013, the Audit Committee approved the continuation of engagements already in progress at that date.
[3] This includes **£0.3m** (2013 £0.3m) for the review of the half-year report.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
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9 INTANGIBLE ASSETS

	Goodwill £m	Certification costs and participation fees £m	Development expenditure £m	Contractual aftermarket rights[1] £m	Customer relationships £m	Software £m	Other £m	Total £m
Cost:								
At 1 January 2013	1,111	740	1,028	499	45	385	142	3,950
Exchange differences	(18)	3	5	–	(3)	(1)	17	3
Additions	–	185	110	52	–	69	87	503
Acquisitions of businesses	773	–	508	–	433	–	286	2,000
Disposals	(5)	–	(5)	–	–	–	–	(10)
At 1 January 2014	**1,861**	**928**	**1,646**	**551**	**475**	**453**	**532**	**6,446**
Reclassifications[2]	(8)	–	4	–	11	19	(28)	(2)
Exchange differences	(112)	(8)	(43)	–	(17)	(1)	(28)	(209)
Additions	–	159	100	93	–	83	42	477
Acquisitions of businesses	1	–	–	–	–	–	–	1
Disposal of business	(67)	–	–	(35)	–	(11)	–	(113)
At 31 December 2014	**1,675**	**1,079**	**1,707**	**609**	**469**	**543**	**518**	**6,600**
Accumulated amortisation:								
At 1 January 2013	9	225	323	295	12	144	41	1,049
Exchange differences	(1)	–	(7)	–	(8)	–	5	(11)
Charge for the year[3]	–	40	130	28	61	54	91	404
Impairment	17	–	3	–	4	–	–	24
Disposals	(2)	–	(5)	–	–	–	–	(7)
At 1 January 2014	**23**	**265**	**444**	**323**	**69**	**198**	**137**	**1,459**
Reclassifications[2]	(8)	–	4	–	(11)	5	6	(4)
Exchange differences	–	–	(9)	–	(4)	–	(6)	(19)
Charge for the year[3]	–	46	125	37	42	63	53	366
Impairment	1	–	–	–	–	–	–	1
Disposal of business	–	–	–	–	–	(7)	–	(7)
At 31 December 2014	**16**	**311**	**564**	**360**	**96**	**259**	**190**	**1,796**
Net book value:								
At 31 December 2014	**1,659**	**768**	**1,143**	**249**	**373**	**284**	**328**	**4,804**
At 31 December 2013	1,838	663	1,202	228	406	255	395	4,987
At 1 January 2013	1,102	515	705	204	33	241	101	2,901

1 Previously referred to as 'recoverable engine costs'.
2 In 2013, following the acquisition of RRPS, the Group revised the classification of intangible assets. During 2014, a number of minor inconsistencies in these classifications have been identified and amended. The net movement of £2m relates to software previously included in property, plant and equipment.
3 Charged to cost of sales except development costs, which are charged to research and development costs.

GOODWILL

In accordance with the requirements of IAS 36 *Impairment of Assets*, goodwill is allocated to the Group's cash-generating units, or groups of cash-generating units, that are expected to benefit from the synergies of the business combination that gave rise to the goodwill as follows:

CASH-GENERATING UNIT (CGU) OR GROUP OF CGUs

	Primary reporting segment	2014 £m	2013 £m
Rolls-Royce Deutschland Ltd & Co KG	Aerospace	**215**	230
Commercial marine – arising from the acquisitions of Vinters Limited and Scandinavian Electric Holdings AS	Land & Sea	**552**	620
Commercial marine – arising from the acquisition of ODIM ASA	Land & Sea	**77**	88
Rolls-Royce Power Systems AG	Land & Sea	**760**	785
Other	Various	**55**	115
		1,659	1,838

9 INTANGIBLE ASSETS CONTINUED

Goodwill has been tested for impairment during 2014 on the following basis:

- The carrying values of goodwill have been assessed by reference to value in use. These have been estimated using cash flows from the most recent forecasts prepared by management, which are consistent with past experience and external sources of information on market conditions. Given the long-term and established nature of many of the Group's products (product lives are often measured in decades), these forecasts generally cover the next ten years. Growth rates for the period not covered by the forecasts are based on a range of growth rates (2.0 – 2.75%) that reflect the products, industries and countries in which the relevant CGU or group of CGUs operate.
- The key assumptions for the impairment tests are the discount rate and, in the cash flow projections, the programme assumptions, the growth rates and the impact of foreign exchange rates on the relationship between selling prices and costs. Impairment tests are performed using prevailing exchange rates.
- The pre-tax cash flow projections have been discounted at **13%** (2013 13%), based on the Group's weighted average cost of capital, adjusted for specific risk where appropriate. The rate used for Rolls-Royce Power Systems AG takes account of the discount rate used for the agreement of the put option exercise price.

The principal value in use assumptions for goodwill balances considered to be individually significant are:

- **Rolls-Royce Power Systems AG** – Volume of equipment deliveries, pricing achieved and cost escalation. These are based on current and known future programmes, estimates of capture of market share and long-term economic forecasts. The principal foreign exchange exposures are on translating income in a variety of non-functional currencies into euros. For the purposes of the impairment only, cash flows from recent management forecasts for a five-year period have been included. Cash flows beyond five years are assumed to grow at **2%** (2013 management forecast for ten years; thereafter 2% growth). Following the recognition of RRPS at fair value on 1 January 2013, reasonably possible changes in the key assumptions would cause the value in use of the goodwill to fall below its carrying value. Such changes include: a reduction in the level of cash generation of 14%; or an increase in the assumed discount rate of 4%.
- **Rolls-Royce Deutschland Ltd & Co KG** – Volume of engine deliveries, flying hours of installed fleet and cost escalation. These are based on current and known future programmes, estimates of customers' fleet requirements and long-term economic forecasts. The principal foreign exchange exposure is on translating US dollar income into euros. For the purposes of the impairment test only, cash flows beyond the ten-year forecasts are assumed to grow at **2.5%** (2013 2.5%). The directors do not consider that any reasonably possible change in the key assumptions would cause the value in use of the goodwill to fall below its carrying value. The overall level of business would need to reduce by more than 81% to cause an impairment of this balance.
- **Vinters Limited** – Volume of equipment deliveries, capture of aftermarket and cost escalation. These are based on current and known future programmes, estimates of customers' fleet requirements and long-term economic forecasts. The principal foreign exchange exposures are on translating income in a variety of non-functional currencies into Norwegian kroner. For the purposes of the impairment test only, cash flows beyond the ten-year forecasts are assumed to grow at **2.5%** (2013 2.5%). The directors do not consider that any reasonably possible change in the key assumptions would cause the value in use of the goodwill to fall below its carrying value. The overall level of business would need to reduce by more than 75% to cause an impairment of this balance.

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CONTINUED

9 INTANGIBLE ASSETS CONTINUED

OTHER INTANGIBLE ASSETS

Certification costs and participation fees, development costs and contractual aftermarket rights have been reviewed for impairment in accordance with the requirements of IAS 36 *Impairment of Assets*. Where an impairment test was considered necessary, it has been performed on the following basis:

- The carrying values have been assessed by reference to value in use. These have been estimated using cash flows from the most recent forecasts prepared by management, which are consistent with past experience and external sources of information on market conditions over the lives of the respective programmes.
- The key assumptions underlying cash flow projections are assumed market share, programme timings, unit cost assumptions, discount rates, and foreign exchange rates.
- The pre-tax cash flow projections have been discounted at **11%** (2013 11%), based on the Group's weighted average cost of capital, reduced where relevant to take account of the lower risk associated with contracted aftermarket flows.
- No impairment is required on this basis. However, a combination of changes in assumptions and adverse movements in variables that are outside the Group's control (discount rate, exchange rate and airframe delays), could result in impairment in future years.
- As described in the Strategic Report, the Group is currently engaged in a number of Trent 900 sales campaigns. The carrying value of intangible assets relating to the Trent 900 programme assumes that a proportion of these campaigns are successful. If no further orders are obtained, the carrying value of these intangible assets (£142 million) may be impaired.

10 PROPERTY, PLANT AND EQUIPMENT

	Land and buildings £m	Plant and equipment £m	Aircraft and engines £m	In course of construction £m	Total £m
Cost:					
At 1 January 2013	1,072	2,889	223	511	4,695
Exchange differences	(11)	(28)	(2)	(8)	(49)
Additions	17	150	83	437	687
Acquisitions of businesses	202	300	–	44	546
Disposals of businesses	–	(1)	–	–	(1)
Reclassifications	19	242	21	(282)	–
Disposals/write-offs	(2)	(62)	(1)	(2)	(67)
At 1 January 2014	**1,297**	**3,490**	**324**	**700**	**5,811**
Exchange differences	(23)	(42)	(1)	2	(64)
Additions	24	160	57	427	668
Acquisitions of businesses	–	–	38	–	38
Disposals of businesses	(88)	(94)	(77)	(28)	(287)
Reclassifications[1]	134	137	32	(305)	(2)
Disposals/write-offs	(10)	(51)	(52)	(1)	(114)
At 31 December 2014	**1,334**	**3,600**	**321**	**795**	**6,050**
Accumulated depreciation:					
At 1 January 2013	355	1,714	62	–	2,131
Exchange differences	(9)	(22)	(1)	–	(32)
Charge for the year[2]	48	301	23	–	372
Reclassifications	(8)	8	–	–	–
Disposals of businesses	–	(1)	–	–	(1)
Disposals/write-offs	–	(51)	–	–	(51)
At 1 January 2014	**386**	**1,949**	**84**	**–**	**2,419**
Exchange differences	(8)	(26)	–	–	(34)
Charge for the year[2]	49	294	31	–	374
Impairment	–	–	–	1	1
Disposals of businesses	(29)	(62)	(9)	–	(100)
Disposals/write-offs	(7)	(46)	(3)	–	(56)
At 31 December 2014	**391**	**2,109**	**103**	**1**	**2,604**
Net book value:					
At 31 December 2014	**943**	**1,491**	**218**	**794**	**3,446**
At 31 December 2013	911	1,541	240	700	3,392
At 1 January 2013	717	1,175	161	511	2,564

[1] The net reclassification of £2m relates to software now included in intangible assets.
[2] Depreciation charged during the year is presented in the income statement or included in the cost of inventory as appropriate.

10 PROPERTY, PLANT AND EQUIPMENT CONTINUED

Property, plant and equipment includes:

	2014 £m	2013 £m
Net book value of finance leased assets:		
Land and buildings	**6**	7
Plant and equipment	**9**	4
Aircraft and engines	**43**	–
Assets held for use in operating leases:		
Cost	**267**	320
Depreciation	**(64)**	(79)
Net book value	**203**	241
Capital expenditure commitments	**194**	317
Net book value of assets held as security for liabilities (excluding finance leased assets)	**–**	–
Cost of fully depreciated assets	**792**	899

The Group's share of equity accounted entities' capital commitments is **£82 million** (2013 £150 million).

11 INVESTMENTS

COMPOSITION OF THE GROUP

The principal entities contributing to the Group's financial results are listed on pages 152 and 153. These comprise 54 wholly-owned subsidiaries and 33 joint ventures which are located in the following countries.

	At 31 December 2014		At 31 December 2013		
	Wholly-owned subsidiaries	**Joint ventures**	Wholly-owned subsidiaries	Non-wholly-owned subsidiaries	Joint ventures
United Kingdom	**13**	**8**	13	1	9
Australia	**–**	**–**	–	–	1
Brazil	**1**	**–**	1	–	–
Canada	**1**	**–**	1	–	–
China	**2**	**2**	1	1	2
Finland	**1**	**–**	1	–	–
France	**2**	**–**	2	–	–
Germany	**6**	**4**	1	4	5
Guernsey	**1**	**–**	1	–	–
Hong Kong	**1**	**1**	–	1	1
India	**3**	**1**	3	–	1
Israel	**–**	**1**	–	–	1
Italy	**2**	**–**	1	1	–
Malaysia	**–**	**–**	–	–	1
Netherlands	**1**	**–**	–	1	–
Norway	**2**	**–**	1	1	–
Singapore	**2**	**2**	1	1	2
South Africa	**1**	**–**	–	–	–
Spain	**1**	**1**	–	1	1
Sweden	**1**	**–**	1	–	–
Turkey	**1**	**–**	–	1	–
United States of America	**12**	**13**	11	1	13

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
CONTINUED

11 INVESTMENTS CONTINUED

The non-wholly owned subsidiaries above comprise the Rolls-Royce Power Systems group. On 7 March 2014, Daimler AG announced its intention to exercise its put option on its 50% of Rolls-Royce Power Systems Holding GmbH (RRPSH). Formal notice of this intention was served on 24 March 2014. From this date, the Group has an effective economic interest in RRPSH of 100% and NCI of £584 million was transferred to retained earnings. The Group acquired the shares on 26 August 2014, giving it a 100% interest in RRPSH. Non-controlling interests are as follows:

	Proportion of ownership interests held by NCI		Comprehensive income allocated to NCI		Accumulated NCI	
	2014	2013	**2014 £m**	2013 £m	**2014 £m**	2013 £m
Rolls-Royce Power Systems GmbH	**–**	50%	**(12)**	11	**–**	694
Other subsidiaries with NCI			**1**	1	**5**	4
			(11)	12	**5**	698

Summarised financial information for RRPSH is as follows:

	At 24 March 2014[1] £m	At 31December 2013 £m
Current assets	**1,529**	1,776
Non-current assets	**2,511**	2,567
Current liabilities	**(974)**	(1,035)
Non-current liabilities	**(1,118)**	(1,134)
Equity attributable to Rolls-Royce shareholders	**1,364**	1,480
Non-controlling interests	**584**	694

1 Immediately prior to the exercise of the put option.

	Period to 24 March 2014 £m	Year to 31 December 2013 £m
Revenue	**551**	2,834
(Loss)/profit for the period	**(25)**	21
Attributable to ordinary shareholders	**(12)**	10
Non-controlling interests	**(12)**	10
Total comprehensive income for the period	**(69)**	21
Attributable to ordinary shareholders	**(35)**	11
Non-controlling interests	**(35)**	11
Dividends paid to non-controlling interests	**(76)**	(60)
Cash flow from operating activities	**33**	220
Cash flow from investing activities	**(17)**	(167)
Cash flow from financing activities	**(158)**	(97)
Net cash outflow	**(142)**	(44)

11 INVESTMENTS CONTINUED

EQUITY ACCOUNTED AND OTHER INVESTMENTS

	Equity accounted			Other
	Joint ventures £m	Associates £m	Total £m	Unlisted £m
At 1 January 2013	1,798	2	1,800	6
Exchange differences	(4)	–	(4)	1
Additions	43	–	43	1
Taxation paid by the Group	6	–	6	–
Transfer to subsidiary	(1,327)	–	(1,327)	–
Acquisition of business	30	–	30	20
Share of retained profit	61	–	61	–
Disposals	(2)	–	(2)	(1)
Share of OCI – may be reclassified to profit or loss	(6)	–	(6)	–
At 1 January 2014	**599**	**2**	**601**	**27**
Reclassification[1]	(25)	–	(25)	–
Exchange differences	7	–	7	(2)
Additions	15	2	17	11
Taxation paid by the Group	3	–	3	–
Transfer to subsidiary	(1)	–	(1)	–
Share of retained profit	23	–	23	–
Disposals	(70)	–	(70)	–
Consolidation of previously non-consolidated subsidiary	–	–	–	(5)
Return of capital	(3)	–	(3)	–
Share of OCI – may be reclassified to profit or loss	(13)	–	(13)	–
At 31 December 2014	**535**	**4**	**539**	**31**

[1] The reclassification relates to an adjustment in the prior year relating to transactions between the Group and a joint venture which was included in creditors. It has now been transferred to investments in joint ventures.

Reconciliation to the income statement and cash flow statement:

	Continuing operations		Discontinued operations		Total	
	2014 £m	2013 £m	2014 £m	2013 £m	2014 £m	2013 £m
Share of profit after tax	**94**	149	**2**	11	**96**	160
Dividends received	**(71)**	(94)	**(2)**	(5)	**(73)**	(99)
Share of retained profit	**23**	55	**–**	6	**23**	61

The following joint ventures are considered to be individually material to the Group:

	Principal location	Activity	Effective interest
Alpha Partners Leasing Limited (APL)	UK	Aero engine leasing	50.0%
Hong Kong Aero Engine Services Limited (HAESL)	Hong Kong	Aero engine repair and overhaul	45.0%
Singapore Aero Engine Services Pte Limited (SAESL)	Singapore	Aero engine repair and overhaul	39.0%
Industria de Turbo Propulsores SA (ITP)	Spain	Aero engine component manufacture and maintenance	46.9%

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
CONTINUED

11 INVESTMENTS CONTINUED

Summarised financial information of the Group's individually material joint ventures is as follows:

	APL		HAESL		SAESL		ITP	
	2014 £m	2013 £m	**2014 £m**	2013 £m	**2014 £m**	2013 £m	**2014 £m**	2013 £m
Revenue	**105**	89	**652**	898	**815**	1,150	**529**	528
Profit from continuing operations	**39**	45	**34**	67	**60**	88	**24**	57
Post-tax profit from discontinued operations	**–**	–	**–**	–	**–**	–	**–**	–
Profit for the year	**39**	45	**34**	67	**60**	88	**24**	57
Other comprehensive income	**–**	–	**–**	–	**–**	–	**–**	–
Total comprehensive income for the year	**39**	45	**34**	67	**60**	88	**24**	57
Dividends received during the year	**(13)**	(11)	**(30)**	(61)	**(56)**	(86)	**(19)**	(24)
Profit for the year included the following:								
Depreciation and amortisation	**(47)**	(40)	**(8)**	(8)	**(5)**	(6)	**(37)**	(37)
Interest income	**–**	–	**–**	–	**–**	–	**19**	12
Interest expense	**(15)**	(18)	**(1)**	(1)	**(1)**	(1)	**(12)**	(14)
Income tax expense	**(11)**	–	**(7)**	(13)	**–**	–	**4**	15
Current assets	**72**	85	**159**	222	**207**	217	**603**	672
Non-current assets	**1,171**	891	**86**	79	**102**	82	**525**	659
Current liabilities	**(62)**	(58)	**(61)**	(133)	**(88)**	(95)	**(415)**	(493)
Non-current liabilities	**(959)**	(757)	**(37)**	(34)	**(106)**	(99)	**(418)**	(461)
Net assets	**222**	161	**147**	134	**115**	105	**295**	377
Included in the above:								
Cash and cash equivalents	**11**	16	**8**	5	**11**	13	**94**	243
Current financial liabilities[1]	**(13)**	(8)	**–**	–	**–**	–	**(10)**	(3)
Non-current financial liabilities[1]	**(815)**	(633)	**(29)**	(27)	**(106)**	(99)	**(282)**	(353)

[1] Excluding trade and other payables

Reconciliation to the carrying amount recognised in the consolidated financial statements:

Effective interest	**50.0%**	50.0%	**45.0%**	45.0%	**39.0%**	39.0%	**46.9%**	46.9%
Group share of net assets above	**111**	81	**66**	60	**45**	41	**138**	177

At the option of the current owner, the Group has an agreement to purchase the shares in ITP that it does not own. If the option is exercised, the price payable would be fair value, determined on a basis agreed between the parties taking into account earnings multiples and discounted cash flows. As the exercise price would be at the fair value of the shares, the Group does not consider that this derivative has a significant fair value.

The summarised aggregated results of the Group's share of equity accounted investments is as follows:

	Joint ventures		Associates		Total	
	2014 £m	2013 £m	**2014 £m**	2013 £m	**2014 £m**	2013 £m
Profit from continuing operations	**94**	149	**–**	–	**94**	149
Profit from discontinued operations	**2**	11	**–**	–	**2**	11
Profit for the year	**96**	160	**–**	–	**96**	160
Other comprehensive income	**(13)**	(6)	**–**	–	**(13)**	(6)
Total comprehensive income for the year	**83**	154	**–**	–	**83**	154

12 INVENTORIES

	2014 £m	2013 £m
Raw materials	**553**	593
Work in progress	**984**	1,177
Long-term contracts work in progress	**22**	15
Finished goods	**1,149**	1,426
Payments on account	**60**	108
	2,768	3,319
Inventories stated at net realisable value	**265**	447
Amount of inventory write-down	**62**	89
Reversal of inventory write-down	**1**	5

13 TRADE AND OTHER RECEIVABLES

	2014 £m	2013 £m
Trade receivables	**1,531**	1,601
Amounts recoverable on contracts	**2,684**	2,239
Amounts owed by joint ventures and associates	**309**	380
Other receivables	**785**	637
Prepayments and accrued income	**200**	235
	5,509	5,092
Analysed as:		
Financial instruments (note 17):		
Trade receivables and similar items	**1,981**	2,118
Other non-derivative financial assets	**671**	527
Non-financial instruments	**2,857**	2,447
	5,509	5,092
Trade and other receivables expected to be recovered in more than one year:		
Trade receivables	**40**	51
Amounts recoverable on contracts	**2,444**	1,751
Other receivables	**61**	41
Prepayments and accrued income	**55**	84
	2,601	1,927

Amounts recoverable on contracts include **£2,492 million** (2013 £1,901 million) of TotalCare assets.

14 CASH AND CASH EQUIVALENTS

	2014 £m	2013 £m
Cash at bank and in hand	**739**	982
Money-market funds	**692**	1,157
Short-term deposits	**1,431**	1,851
	2,862	3,990
Overdrafts (note 15)	**–**	(3)
Cash and cash equivalents per cash flow statement (page 98)	**2,862**	3,987
Cash held as collateral against third party obligations (note 18)	**42**	50

Cash and cash equivalents at 31 December 2014 includes **£30 million** (2013 £286 million) that is not available for general use by the Group. This balance relates to cash held in the Group's captive insurance company and non-wholly owned subsidiaries. The principal reason for the significant decrease is that Power Systems is now a wholly owned subsidiary (2013 50% interest).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
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15 BORROWINGS

	Current		Non-current		Total	
	2014 £m	2013 £m	**2014 £m**	2013 £m	**2014 £m**	2013 £m
Unsecured						
Overdrafts	**–**	3	**–**	–	**–**	3
Bank loans	**12**	204	**392**	412	**404**	616
7⅜% Notes 2016 £200m	**–**	–	**200**	200	**200**	200
6.55% Notes 2015 US$83m[1]	**55**	–	**–**	55	**55**	55
6.75% Notes 2019 £500m[2]	**–**	–	**547**	535	**547**	535
2.125% Notes 2021 €750m[1]	**–**	–	**615**	611	**615**	611
3.375% Notes 2026 £375m[2]	**–**	–	**395**	350	**395**	350
Secured						
Obligations under finance leases[3]	**1**	–	**44**	1	**45**	1
	68	207	**2,193**	2,164	**2,261**	2,371

[1] These notes are the subject of interest rate swap agreements under which the Group has undertaken to pay floating rates of interest, and currency swaps which form a fair value hedge.
[2] These notes are the subject of interest rate swap agreements under which the Group has undertaken to pay floating rates of interest which form a fair value hedge.
[3] Obligations under finance leases are secured by related leased assets.

16 TRADE AND OTHER PAYABLES

	Current		Non-current		Total	
	2014 £m	2013 £m	**2014 £m**	2013 £m	**2014 £m**	2013 £m
Payments received on account[1]	**1,291**	1,594	**860**	750	**2,151**	2,344
Trade payables	**1,348**	1,370	**13**	16	**1,361**	1,386
Amounts owed to joint ventures and associates	**235**	191	**4**	–	**239**	191
Other taxation and social security	**109**	101	**1**	–	**110**	101
Other payables	**1,756**	1,820	**320**	143	**2,076**	1,963
Accruals and deferred income	**2,052**	1,969	**1,247**	1,229	**3,299**	3,198
	6,791	7,045	**2,445**	2,138	**9,236**	9,183
[1] Includes payments received on account from joint ventures and associates	**158**	180	**99**	151	**257**	331

Included within trade and other payables are government grants of **£80 million** (2013 £100 million). During the year, **£24 million** (2013 £26 million) of government grants were released to the income statement.

Included in accruals and deferred income are deferred receipts from RRSA workshare partners of **£244 million** (2013 £260 million) and **£687 million** (2013 £559 million) of TotalCare liabilities.

Trade and other payables are analysed as follows:

	2014 £m	2013 £m
Financial instruments (note 17):		
Trade payables and similar items	**3,049**	2,989
Other non-derivative financial liabilities	**831**	806
Non-financial instruments	**5,356**	5,388
	9,236	9,183

17 FINANCIAL INSTRUMENTS

CARRYING VALUES AND FAIR VALUES OF FINANCIAL INSTRUMENTS

			Assets				Liabilities		Total
	Notes	Basis for determining fair value	Fair value through profit or loss £m	Loans and receivables £m	Available for sale £m	Cash £m	Fair value through profit or loss £m	Other £m	£m
At 31 December 2014									
Unlisted non-current asset investments	11	**A**	**–**	**31**	**–**	**–**	**–**	**–**	**31**
Trade receivables and similar items	13	**B**	**–**	**1,981**	**–**	**–**	**–**	**–**	**1,981**
Other non-derivative financial assets	13	**B**	**–**	**671**	**–**	**–**	**–**	**–**	**671**
Derivative financial assets[1]		**C**	**129**	**–**	**–**	**–**	**–**	**–**	**129**
Short-term investments		**B**	**–**	**7**	**–**	**–**	**–**	**–**	**7**
Cash and cash equivalents	14	**B**	**–**	**1,431**	**692**	**739**	**–**	**–**	**2,862**
Borrowings	15	**D**	**–**	**–**	**–**	**–**	**–**	**(2,261)**	**(2,261)**
Derivative financial liabilities[1]		**C**	**–**	**–**	**–**	**–**	**(759)**	**–**	**(759)**
Financial RRSAs		**E**	**–**	**–**	**–**	**–**	**–**	**(145)**	**(145)**
C Shares		**B**	**–**	**–**	**–**	**–**	**–**	**(22)**	**(22)**
Trade payables and similar items	16	**B**	**–**	**–**	**–**	**–**	**–**	**(3,049)**	**(3,049)**
Other non-derivative financial liabilities	16	**B**	**–**	**–**	**–**	**–**	**–**	**(831)**	**(831)**
			129	**4,121**	**692**	**739**	**(759)**	**(6,308)**	**(1,386)**
At 31 December 2013									
Unlisted non-current asset investments	11	A	–	27	–	–	–	–	27
Trade receivables and similar items	13	B	–	2,118	–	–	–	–	2,118
Other non-derivative financial assets	13	B	–	527	–	–	–	–	527
Derivative financial assets		C	748	–	–	–	–	–	748
Short-term investments		B	–	321	–	–	–	–	321
Cash and cash equivalents	14	B	–	1,851	1,157	982	–	–	3,990
Borrowings	15	D	–	–	–	–	–	(2,371)	(2,371)
Derivative financial liabilities		C	–	–	–	–	(295)	–	(295)
Exercise price of put option on NCI		F	–	–	–	–	–	(1,858)	(1,858)
Financial RRSAs		E	–	–	–	–	–	(167)	(167)
C Shares		B	–	–	–	–	–	(16)	(16)
Trade payables and similar items	16	B	–	–	–	–	–	(2,989)	(2,989)
Other non-derivative financial liabilities	16	B	–	–	–	–	–	(806)	(806)
			748	4,844	1,157	982	(295)	(8,207)	(771)

[1] In the event of counterparty default relating to derivative financial assets and liabilities, off-setting would apply and financial assets and liabilities held with the same counterparty would net off. If this occurred with every counterparty, total financial assets would be £15m and liabilities £645m.

Fair values equate to book values for both 2014 and 2013, with the following exceptions:

	2014		2013	
	Book value £m	Fair value £m	Book value £m	Fair value £m
Borrowings	**(2,261)**	**(2,362)**	(2,371)	(2,495)
Financial RRSAs	**(145)**	**(152)**	(167)	(184)

The fair value of a financial instrument is the price at which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arms-length transaction. Fair values have been determined with reference to available market information at the balance sheet date, using the methodologies described below.

A These primarily comprise unconsolidated companies where fair value approximates to the book value.
B Fair values are assumed to approximate to cost either due to the short-term maturity of the instruments or because the interest rate of the investments is reset after periods not exceeding six months.
C Fair values of derivative financial assets and liabilities are estimated by discounting expected future contractual cash flows using prevailing interest rate curves. Amounts denominated in foreign currencies are valued at the exchange rate prevailing at the balance sheet date. These financial instruments are included on the balance sheet at fair value, derived from observable market prices (Level 2 as defined by IFRS 13 *Fair Value Measurement*).
D Borrowings are carried at amortised cost. Amounts denominated in foreign currencies are valued at the exchange rate prevailing at the balance sheet date.
E The fair value of RRSAs is estimated by discounting expected future cash flows. The contractual cash flows are based on future trading activity, which is estimated based on latest forecasts (Level 3 as defined by IFRS 13).
F The fair value of the put option on NCI is determined in accordance with the contractual terms, which requires averaging three valuations, covering forecasts of the business performance and external metrics of comparable business and transactions (Level 3 as defined by IFRS 13).IFRS 13 defines a three level valuation hierarchy:
Level 1 – quoted prices for similar instruments;
Level 2 – directly observable market inputs other than Level 1 inputs; and
Level 3 – inputs not based on observable market data.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
CONTINUED

17 FINANCIAL INSTRUMENTS CONTINUED

CARRYING VALUES OF OTHER FINANCIAL ASSETS AND LIABILITIES

	Foreign exchange contracts £m	Commodity contracts £m	Interest rate contracts £m	Total derivatives £m	Exercise price of put option on NCI £m	Financial RRSAs £m	C Shares £m	Total £m
At 31 December 2014								
Non-current assets	**28**	**–**	**79**	**107**	**–**	**–**	**–**	**107**
Current assets	**22**	**–**	**–**	**22**	**–**	**–**	**–**	**22**
Assets	**50**	**–**	**79**	**129**	**–**	**–**	**–**	**129**
Current liabilities	**(144)**	**(21)**	**–**	**(165)**	**–**	**(22)**	**(22)**	**(209)**
Non-current liabilities	**(545)**	**(22)**	**(27)**	**(594)**	**–**	**(123)**	**–**	**(717)**
Liabilities	**(689)**	**(43)**	**(27)**	**(759)**	**–**	**(145)**	**(22)**	**(926)**
	(639)	**(43)**	**52**	**(630)**	**–**	**(145)**	**(22)**	**(797)**
At 31 December 2013								
Non-current assets	631	–	43	674	–	–	–	674
Current assets	72	2	–	74	–	–	–	74
Assets	703	2	43	748	–	–	–	748
Current liabilities	(63)	(16)	(1)	(80)	(1,858)	(22)	(16)	(1,976)
Non-current liabilities	(142)	(25)	(48)	(215)	–	(145)	–	(360)
Liabilities	(205)	(41)	(49)	(295)	(1,858)	(167)	(16)	(2,336)
	498	(39)	(6)	453	(1,858)	(167)	(16)	(1,588)

DERIVATIVE FINANCIAL INSTRUMENTS

The Group uses various financial instruments to manage its exposure to movements in foreign exchange rates. Where the effectiveness of a hedging relationship in a cash flow hedge is demonstrated, changes in the fair value that are deemed effective are included in the cash flow hedge reserve and released to match actual payments on the hedged item. The Group uses commodity swaps to manage its exposure to movements in the price of commodities (jet fuel and base metals). To hedge the currency risk associated with a borrowing denominated in US dollars, the Group has currency derivatives designated as part of fair value hedges. The Group uses interest rate swaps, forward rate agreements and interest rate caps to manage its exposure to movements in interest rates.

Movements in the fair values of derivative financial assets and liabilities were as follows:

	Foreign exchange instruments		Commodity instruments		Interest rate instruments		Total	
	2014 £m	2013 £m	**2014 £m**	2013 £m	**2014 £m**	2013 £m	**2014 £m**	2013 £m
At 1 January	**498**	272	**(39)**	(13)	**(6)**	88	**453**	347
Business acquisitions	**–**	4	**–**	(1)	**–**	–	**–**	3
Movements in fair value hedges[1]	**3**	3	**–**	–	**58**	(91)	**61**	(88)
Movements in other derivative contracts[2]	**(1,125)**	284	**(15)**	(34)	**–**	–	**(1,140)**	250
Contracts settled[3]	**(15)**	(65)	**11**	9	**–**	(3)	**(4)**	(59)
At 31 December	**(639)**	498	**(43)**	(39)	**52**	(6)	**(630)**	453

1 Loss on related hedged items **£61m** (2013 £88m gain).
2 Included in financing.
3 2013 included £17m contracts settled in fair value hedges. Contracts settled in 2014 include a loss of £76m in relation to contracts put in place to hedge the settlement of the put option on RRPS.

NON-DERIVATIVE OTHER FINANCIAL LIABILITIES

The Group had agreed a put option with Daimler AG, such that Daimler could sell its interest in Rolls-Royce Power Systems Holding GmbH to the Group. Daimler AG exercised this option on 24 March 2014 and the Group acquired Daimler's 50% share of RRPSH on 26 August 2014. Prior to this, the present value of the exercise value of this option was included as a financial liability.

The Group has financial liabilities arising from financial RRSAs. These financial liabilities are valued at each reporting date using the amortised cost method. This involves calculating the present value of the forecast cash flows of the arrangements using the internal rate of return at the inception of the arrangements as the discount rate.

17 FINANCIAL INSTRUMENTS CONTINUED

Movements in the carrying values were as follows:

	Put option on non-controlling interests		Financial RRSAs	
	2014 £m	2013 £m	**2014 £m**	2013 £m
At 1 January	**(1,858)**	(167)	**(167)**	(193)
Business acquisitions	**–**	(2)	**–**	–
Additions	**–**	(1,432)	**–**	–
Exchange adjustments included in OCI	**–**	–	**3**	(4)
Financing charge[1]	**–**	–	**(5)**	(9)
Excluded from underlying profit:				
Financing charge[1]	**(2)**	–	**–**	–
Changes in put option exercise price[1]	**(166)**	(212)	**–**	–
Changes in forecast payments[1]	**–**	–	**–**	2
Exchange adjustments[1]	**89**	(45)	**(8)**	4
Cash paid to partners	**–**	–	**32**	33
Settlement of put option	**1,937**	–	**–**	–
At 31 December	**–**	(1,858)	**(145)**	(167)

1 Included in financing.

RISK MANAGEMENT POLICIES AND HEDGING ACTIVITIES

The principal financial risks to which the Group is exposed are: foreign currency exchange rate risk; liquidity risk; credit risk; interest rate risk; and commodity price risk. The Board has approved policies for the management of these risks.

Foreign currency exchange rate risk – The Group has significant cash flows (most significantly US dollars, followed by the euro) denominated in currencies other than the functional currency of the relevant trading entity. To manage its exposures to changes in values of future foreign currency cash flows, so as to maintain relatively stable long-term foreign exchange rates on settled transactions, the Group enters into derivative forward foreign currency transactions. For accounting purposes, these derivative contracts are not designated as hedging instruments.

The Group also has exposures to the fair values of non-derivative financial instruments denominated in foreign currencies. To manage the risk of changes in these fair values, the Group enters into derivative forward foreign exchange contracts, which are designated as fair value hedges for accounting purposes.

The Group regards its interests in overseas subsidiary companies as long-term investments. The Group aims to match its translational exposures by matching the currencies of assets and liabilities. Where appropriate, foreign currency financial liabilities may be designated as hedges of the net investment.

Liquidity risk – The Group's policy is to hold financial investments and maintain undrawn committed facilities at a level sufficient to ensure that the Group has available funds to meet its medium-term capital and funding obligations and to meet any unforeseen obligations and opportunities. The Group holds cash and short-term investments, which together with the undrawn committed facilities, enable the Group to manage its liquidity risk.

Credit risk – The Group is exposed to credit risk to the extent of non-payment by either its customers or the counterparties of its financial instruments. The effective monitoring and controlling of credit risk is a key component of the Group's risk management activities. The Group has credit policies covering both trading and financial exposures. Credit risks arising from treasury activities are managed by a central treasury function in accordance with the Group credit policy. The objective of the policy is to diversify and minimise the Group's exposure to credit risk from its treasury activities by ensuring the Group transacts strictly with 'BBB+' or higher rated financial institutions based on pre-established limits per financial institution. At the balance sheet date, there were no significant concentrations of credit risk to individual customers or counterparties. The maximum exposure to credit risk at the balance sheet date is represented by the carrying value of each financial asset, including derivative financial instruments.

Interest rate risk – The Group's interest rate risk is primarily in relation to its fixed rate borrowings (fair value risk), floating rate borrowings and cash and cash equivalents (cash flow risk). Interest rate derivatives are used to manage the overall interest rate profile within the Group policy, which is to maintain a higher proportion of net debt at floating rates of interest as a natural hedge to the net cash position. These are designated as either fair value or cash flow hedges as appropriate.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
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17 FINANCIAL INSTRUMENTS CONTINUED

Commodity risk – The Group has exposures to the price of jet fuel and base metals arising from business operations. To minimise its cash flow exposures to changes in commodity prices, the Group enters into derivative commodity transactions. For accounting purposes, these derivative contracts are not designated as hedging instruments.

Other price risk – The Group's cash equivalent balances represent investments in money market instruments, with a term of up to three months. The Group does not consider that these are subject to significant price risk.

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

		Expected maturity				Fair value	
	Nominal amount £m	Within one year £m	Between one and five years £m	Between two and five years £m	After five years £m	Assets £m	Liabilities £m
At 31 December 2014							
Foreign exchange contracts:							
Fair value hedges	**46**	**46**	**–**	**–**	**–**	**6**	**–**
Non-hedge accounted	**20,889**	**5,431**	**4,793**	**10,665**	**–**	**44**	**(689)**
Interest rate contracts:							
Fair value hedges	**1,512**	**53**	**–**	**500**	**959**	**74**	**(22)**
Non-hedge accounted	**2**	**2**	**–**	**–**	**–**	**5**	**(5)**
Commodity contracts:							
Non-hedge accounted	**240**	**79**	**62**	**71**	**28**	**–**	**(43)**
	22,689	**5,611**	**4,855**	**11,236**	**987**	**129**	**(759)**
At 31 December 2013							
Foreign exchange contracts:							
Fair value hedges	46	–	46	–	–	3	–
Non-hedge accounted	19,654	4,759	4,530	9,493	872	700	(205)
Interest rate contracts:							
Fair value hedges	1,550	–	50	–	1,500	43	(48)
Non-hedge accounted	5	–	5	–	–	–	(1)
Commodity contracts:							
Non-hedge accounted	262	79	62	80	41	2	(41)
	21,517	4,838	4,693	9,573	2,413	748	(295)

As described above, all derivative financial instruments are entered into for risk management purposes, although these may not be designated into hedging relationships for accounting purposes.

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

	Currencies purchased forward				
	Sterling £m	US dollar £m	Euro £m	Other £m	Total £m
At 31 December 2014					
Currencies sold forward:					
Sterling	**–**	**429**	**–**	**199**	**628**
US dollar	**16,659**	**–**	**2,014**	**938**	**19,611**
Euro	**150**	**61**	**–**	**185**	**396**
Other	**167**	**9**	**114**	**10**	**300**
At 31 December 2013					
Currencies sold forward:					
Sterling	–	429	–	10	439
US dollar	15,936	–	2,036	913	18,885
Euro	4	–	–	249	253
Other	22	23	75	3	123

17 FINANCIAL INSTRUMENTS CONTINUED

Other derivative financial instruments are denominated in the following currencies:

	2014 £m	2013 £m
Sterling	**877**	880
US dollar	**292**	300
Euro	**584**	637

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

	Sterling £m	US dollar £m	Euro £m	Other £m	Total £m
At 31 December 2014					
Unlisted non-current investments	**–**	**–**	**30**	**1**	**31**
Trade receivables and similar items	**232**	**1,180**	**479**	**90**	**1,981**
Other non-derivative financial assets	**400**	**53**	**101**	**117**	**671**
Short-term investments	**–**	**–**	**–**	**7**	**7**
Cash and cash equivalents	**513**	**1,404**	**619**	**326**	**2,862**
Assets	**1,145**	**2,637**	**1,229**	**541**	**5,552**
Borrowings	**(1,341)**	**(101)**	**(819)**	**–**	**(2,261)**
Financial RRSAs	**–**	**(97)**	**(48)**	**–**	**(145)**
C Shares	**(22)**	**–**	**–**	**–**	**(22)**
Trade payables and similar items	**(1,489)**	**(887)**	**(545)**	**(128)**	**(3,049)**
Other non-derivative financial liabilities	**(248)**	**(333)**	**(161)**	**(89)**	**(831)**
Liabilities	**(3,100)**	**(1,418)**	**(1,573)**	**(217)**	**(6,308)**
	(1,955)	**1,219**	**(344)**	**324**	**(756)**
At 31 December 2013					
Unlisted non-current investments	–	–	26	1	27
Trade receivables and similar items	199	995	829	95	2,118
Other non-derivative financial assets	289	48	89	101	527
Short-term investments	282	–	4	35	321
Cash and cash equivalents	1,619	1,080	980	311	3,990
Assets	2,389	2,123	1,928	543	6,983
Borrowings	(1,490)	(55)	(826)	–	(2,371)
Exercise price of put option on NCI	–	–	(1,858)	–	(1,858)
Financial RRSAs	–	(114)	(53)	–	(167)
C Shares	(16)	–	–	–	(16)
Trade payables and similar items	(1,501)	(641)	(653)	(194)	(2,989)
Other non-derivative financial liabilities	(208)	(328)	(158)	(112)	(806)
Liabilities	(3,215)	(1,138)	(3,548)	(306)	(8,207)
	(826)	985	(1,620)	237	(1,224)

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
CONTINUED

17 FINANCIAL INSTRUMENTS CONTINUED

CURRENCY EXPOSURES

The Group's actual currency exposures after taking account of derivative foreign currency contracts, which are not designated as hedging instruments for accounting purposes, are as follows:

Functional currency of Group operations	Sterling £m	US dollar £m	Euro £m	Other £m	Total £m
At 31 December 2014					
Sterling	**–**	**28**	**2**	**35**	**65**
US dollar	**(2)**	**–**	**(1)**	**8**	**5**
Euro	**2**	**5**	**–**	**11**	**18**
Other	**5**	**19**	**6**	**1**	**31**
At 31 December 2013					
Sterling[1]	–	13	(1,855)	12	(1,830)
US dollar	8	–	–	7	15
Euro	(1)	(2)	–	–	(3)
Other	(5)	41	(11)	(4)	21

[1] Included in the 2013 £1,855m liability euro currency exposure was a liability of £1,858m relating to the put option on Daimler's interest in Rolls-Royce Power Systems Holding GmbH – see page 130.

AGEING BEYOND CONTRACTUAL DUE DATE OF FINANCIAL ASSETS

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

	Within terms £m	Up to three months overdue £m	Between three months and one year overdue £m	More than one year overdue £m	Total £m
At 31 December 2014					
Unlisted non-current asset investments	**31**	**–**	**–**	**–**	**31**
Trade receivables and similar items	**1,657**	**206**	**104**	**14**	**1,981**
Other non-derivative financial assets	**667**	**4**	**–**	**–**	**671**
Derivative financial assets	**129**	**–**	**–**	**–**	**129**
Short-term investments	**7**	**–**	**–**	**–**	**7**
Cash and cash equivalents	**2,862**	**–**	**–**	**–**	**2,862**
	5,353	**210**	**104**	**14**	**5,681**
At 31 December 2013					
Unlisted non-current asset investments	27	–	–	–	27
Trade receivables and similar items	1,769	240	90	19	2,118
Other non-derivative financial assets	523	1	1	2	527
Derivative financial assets	748	–	–	–	748
Short-term investments	321	–	–	–	321
Cash and cash equivalents	3,990	–	–	–	3,990
	7,378	241	91	21	7,731

17 FINANCIAL INSTRUMENTS CONTINUED

CONTRACTUAL MATURITY ANALYSIS OF FINANCIAL LIABILITIES

	Gross values					
	Within one year £m	Between one and two years £m	Between two and five years £m	After five years £m	Discounting £m	Carrying Value £m
At 31 December 2014						
Borrowings	**(148)**	**(385)**	**(214)**	**(1,880)**	**366**	**(2,261)**
Derivative financial liabilities	**(174)**	**(115)**	**(324)**	**(181)**	**35**	**(759)**
Financial RRSAs	**(17)**	**(19)**	**(72)**	**(52)**	**15**	**(145)**
C Shares	**(22)**	**–**	**–**	**–**	**–**	**(22)**
Trade payables and similar items	**(3,012)**	**(32)**	**(2)**	**(3)**	**–**	**(3,049)**
Other non-derivative financial liabilities	**(650)**	**(95)**	**(20)**	**(66)**	**–**	**(831)**
	(4,023)	**(646)**	**(632)**	**(2,182)**	**416**	**(7,067)**
At 31 December 2013						
Borrowings	(290)	(140)	(609)	(1,894)	562	(2,371)
Derivative financial liabilities	(87)	(76)	(146)	(90)	104	(295)
Exercise price of put option on NCI	(1,858)	–	–	–	–	(1,858)
Financial RRSAs	(33)	(34)	(65)	(75)	40	(167)
C Shares	(16)	–	–	–	–	(16)
Trade payables and similar items	(2,972)	(17)	–	–	–	(2,989)
Other non-derivative financial liabilities	(751)	(28)	(16)	(11)	–	(806)
	(6,007)	(295)	(836)	(2,070)	706	(8,502)

INTEREST RATE RISK

In respect of income earning financial assets and interest bearing financial liabilities, the following table indicates their effective interest rates and the periods in which they reprice. The value shown is the carrying amount.

			Period in which interest rate reprices	
At 31 December 2014	Effective interest rate	Total £m	6 months or less £m	6-12 months £m
Short-term investments[1]		**7**	**5**	**2**
Cash and cash equivalents[2]		**2,862**	**2,862**	**–**
Unsecured bank loans				
Other borrowings		**(12)**	**(1)**	**–**
Interest rate swaps	5.8156%	**–**	**2**	**(2)**
£200m floating rate loan	GBP LIBOR + 0.267	**–**	**–**	**–**
£200m floating rate loan	GBP LIBOR + 1.26	**(200)**	**(200)**	**–**
€125m fixed rate loan	2.6000%	**(97)**	**–**	**–**
€75m fixed rate loan	2.0600%	**(59)**	**–**	**–**
€50m fixed rate loan	2.3500%	**(36)**	**–**	**–**
Unsecured bond issues				
7 3/8% Notes 2016 £200m	7.3750%	**(200)**	**–**	**–**
6.55% Notes 2015 US$83m	6.5500%	**(55)**	**–**	**(55)**
Effect of interest rate swaps	USD LIBOR + 1.24	**–**	**(55)**	**55**
6.75% Notes 2019 £500m	6.7500%	**(547)**	**–**	**–**
Effect of interest rate swaps	GBP LIBOR + 2.9824	**–**	**(547)**	**–**
2.125% Notes 2021 €750m	2.1250%	**(615)**	**–**	**–**
Effect of interest rate swaps	GBP LIBOR + 0.7005	**–**	**(615)**	**–**
3.375% Notes 2026 £375m	3.3750%	**(395)**	**–**	**–**
Effect of interest rate swaps	GBP LIBOR + 0.8930	**–**	**(395)**	**–**
Other secured				
Obligations under finance leases	4.1089%	**(45)**	**(1)**	**(1)**
		608		

[1] Interest on the short-term investments are at fixed rates.
[2] Cash and cash equivalents comprises bank balances and demand deposits and earns interest at rates based on daily deposit rates.

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17 FINANCIAL INSTRUMENTS CONTINUED

At 31 December 2013	Effective interest rate	Total £m	Period in which interest rate reprices: 6 months or less £m	6-12 months £m
Short-term investments[1]		321	318	3
Cash and cash equivalents[2]		3,990	3,990	–
Unsecured bank loans				–
Other borrowings		(10)	(5)	–
Interest rate swaps	5.3225%	–	5	–
£200m floating rate loan	GBP LIBOR + 0.267	(200)	(200)	–
£200m floating rate loan	GBP LIBOR + 1.26	(200)	(200)	–
€125m fixed rate loan	2.6000%	(104)	–	–
€75m fixed rate loan	2.0600%	(63)	–	–
€50m fixed rate loan	2.3500%	(42)	–	–
Unsecured bond issues				
7³/₈% Notes 2016 £200m	7.3750%	(200)	–	–
6.55% Notes 2015 US$83m	6.5500%	(55)	–	–
Effect of interest rate swaps	USD LIBOR + 1.24	–	(55)	–
6.75% Notes 2019 £500m	6.7500%	(535)	–	–
Effect of interest rate swaps	GBP LIBOR + 2.9824	–	(535)	–
2.125% Notes 2021 €750m	2.1250%	(611)	–	–
Effect of interest rate swaps	GBP LIBOR + 0.7005	–	(611)	–
3.375% Notes 2026 £375m	3.3750%	(350)	–	–
Effect of interest rate swaps	GBP LIBOR + 0.8930	–	(350)	–
Other secured				
Obligations under finance leases	5.0000%	(1)	(1)	–
		1,940		

[1] Interest on the short-term investments are at fixed rates.
[2] Cash and cash equivalents comprises bank balances and demand deposits and earns interest at rates based on daily deposit rates.

Some of the Group's borrowings are subject to the Group meeting certain obligations, including customary financial covenants. If the Group fails to meet its obligations these arrangements give rights to the lenders, upon agreement, to accelerate repayment of the facilities. There are no rating triggers contained in any of the Group's facilities that could require the Group to accelerate or repay any facility for a given movement in the Group's credit rating.

In addition, the Group has **£1,277 million** of undrawn committed borrowing facilities (2013 £1,250 million) expiring after two years.

SENSITIVITY ANALYSIS

Sensitivities at 31 December (all other variables held constant) – impact on profit after tax and equity	2014 £m	2013 £m
Sterling 10% weaker against the US dollar	**(1,336)**	(1,177)
Sterling 10% stronger against the US dollar	**1,093**	963
Euro 10% weaker against the US dollar	**(147)**	(128)
Euro 10% stronger against the US dollar	**123**	100
Sterling 10% weaker against the Euro	**15**	(95)
Sterling 10% stronger against the Euro	**(12)**	78
Commodity prices 10% lower	**(15)**	(16)
Commodity prices 10% higher	**15**	16

At 31 December 2014 the Group had no material sensitivity to changes in interest rates on that date. The main interest rate sensitivity for the Group arises as a result of the gross up of net cash and this is mitigated as described under the interest rate risk management policies on page 131.

17 FINANCIAL INSTRUMENTS CONTINUED

C SHARES AND PAYMENTS TO SHAREHOLDERS

The Company issues non-cumulative redeemable preference shares (C Shares) as an alternative to paying a cash dividend. C Shares in respect of a year are issued in the following year. Shareholders are able to redeem any number of their C Shares for cash. Any C Shares retained attract a dividend of 75% of LIBOR on the 0.1p nominal value of each share, paid on a twice-yearly basis, and have limited voting rights. The Company has the option to compulsorily redeem the C Shares, at any time, if the aggregate number of C Shares in issue is less than 10% of the aggregate number of C Shares issued, or on the acquisition or capital restructuring of the Company.

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

	2014		2013	
	Millions	**Nominal value £m**	Millions	Nominal value £m
Issued and fully paid				
At 1 January	**16,286**	**16**	10,418	10
Issued	**413,669**	**414**	366,041	366
Redeemed	**(407,950)**	**(408)**	(360,173)	(360)
At 31 December	**22,005**	**22**	16,286	16

Payments to shareholders in respect of the year represent the value of C Shares to be issued in respect of the results for the year. Issues of C Shares were declared as follows:

	2014		2013	
	Pence per share	**£m**	Pence per share	£m
Interim	**9.0**	**170**	8.6	162
Final	**14.1**	**265**	13.4	252
	23.1	**435**	22.0	414

18 PROVISIONS FOR LIABILITIES AND CHARGES

	At 1 January 2014 £m	Exchange differences £m	Disposals of businesses £m	Unused amounts reversed £m	Charged to income statement £m	Utilised £m	**At 31 December 2014 £m**
Warranty and guarantees	**419**	(18)	(14)	(27)	181	(115)	**426**
Contract loss	**67**	(1)	(11)	(9)	16	(21)	**41**
Restructuring	**25**	1	–	–	121	(25)	**122**
Customer financing	**73**	–	–	(34)	15	(7)	**47**
Insurance	**62**	–	–	(13)	35	(19)	**65**
Other	**87**	(3)	(9)	(13)	76	(32)	**106**
	733	(21)	(34)	(96)	444	(219)	**807**
Current liabilities	**348**						**433**
Non-current liabilities	**385**						**374**

Provisions for warranties and guarantees primarily relate to products sold and generally cover a period of up to three years.

Provisions for contract loss and restructuring are generally expected to be utilised within two years.

In connection with the sale of its products the Group will, on some occasions, provide financing support for its customers – generally in respect of civil aircraft. The Group's commitments relating to these financing arrangements are spread over many years, relate to a number of customers and a broad product portfolio and are generally secured on the asset subject to the financing. These include commitments of US$1.8 billion to provide borrowing facilities to enable customers to purchase aircraft (of which approximately US$300 million could be called in 2015). These facilities may only be used if the customer is unable to obtain financing elsewhere and are priced at a premium to the market rate. Consequently the directors do not consider that there is a significant exposure arising from the provision of these facilities.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
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18 PROVISIONS FOR LIABILITIES AND CHARGES CONTINUED

Customer financing provisions cover guarantees provided for asset value and/or financing. These guarantees, the risks arising and the process used to assess the extent of the risk are described under the heading 'Customer financing' in the Financial Review on page 31. It is estimated that the provision will be utilised as follows:

	2014 £m	2013 £m
Potential claims with specific claim dates:		
In one year or less	**32**	29
In more than one year but less than five years	**11**	38
In more than five years	**4**	5
Potential claims that may arise at any time up to the date of expiry of the guarantee:		
Up to one year	**–**	1
	47	73

Commitments on delivered aircraft in excess of the amounts provided are shown in the table below. These are reported on a discounted basis at the Group's borrowing rate to reflect better the time span over which these exposures could arise. These amounts do not represent values that are expected to crystallise. The commitments are denominated in US dollars. As the Group does not generally adopt cash flow hedge accounting for future foreign exchange transactions, this amount is reported, together with the sterling equivalent at the reporting date spot rate. The values of aircraft providing security are based on advice from a specialist aircraft appraiser.

	2014		2013	
	£m	*$m*	£m	*$m*
Gross commitments	**388**	***605***	356	*589*
Value of security[1]	**(245)**	***(382)***	(217)	*(360)*
Indemnities	**(84)**	***(132)***	(80)	*(132)*
Net commitments	**59**	***91***	59	*97*
Net commitments with security reduced by 20%[2]	**90**	***140***	78	*129*
[1] Security includes unrestricted cash collateral of:	**42**	***66***	50	*83*

[2] Although sensitivity calculations are complex, the reduction of relevant security by 20% illustrates the sensitivity to changes in this assumption.

There are also commitments in respect of undelivered aircraft, but it is not considered practicable to estimate these, as deliveries can be many years in the future, and the relevant financing will only be put in place at the appropriate time.

The Group's captive insurance company retains a portion of the exposures it insures on behalf of the remainder of the Group. Significant delays occur in the notification and settlement of claims and judgement is involved in assessing outstanding liabilities, the ultimate cost and timing of which cannot be known with certainty at the balance sheet date. The insurance provisions are based on information currently available, however it is inherent in the nature of the business that ultimate liabilities may vary. Provisions for outstanding claims are established to cover the outstanding expected liability as well as claims incurred but not yet reported.

Other provisions comprise a number of liabilities with varying expected utilisation rates.

19 POST-RETIREMENT BENEFITS

The Group operates a number of defined benefit and defined contribution schemes.

UK defined benefit schemes are funded, with the assets held in separate trustee administered funds. Employees are entitled to retirement benefits based on either their final or career average salaries and length of service.

Overseas defined benefit schemes are a mixture of funded and unfunded plans and provide benefits in line with local practice. Additionally in the US, and to a lesser extent in some other countries, the Group's employment practices include the provision of healthcare and life insurance benefits for retired employees. These schemes are unfunded.

The valuations of the defined benefit schemes are based on the most recent funding valuations, where relevant, updated by the scheme actuaries to 31 December 2014.

The defined benefit schemes expose the Group to actuarial risks such as longevity, interest rate, inflation and investment risks. In the UK, and in the principal US pension schemes, the Group has adopted investment policies to mitigate some of these risks. This involves investing a significant proportion of the schemes' assets in liability driven investment (LDI) portfolios, which hold investments designed to offset interest rate and inflation rate risks. In addition, in the UK, the Rolls-Royce Pension Fund has invested in a longevity swap, which is designed to offset longevity risks in respect of existing pensioners.

AMOUNTS RECOGNISED IN THE INCOME STATEMENT

	2014			2013		
	UK schemes £m	**Overseas schemes £m**	**Total £m**	UK schemes £m	Overseas schemes £m	Total £m
Defined benefit schemes:						
Current service cost and administrative expenses	**156**	**45**	**201**	153	55	208
Past-service (credit)/cost	**(18)**	**(13)**	**(31)**	66	5	71
	138	**32**	**170**	219	60	279
Defined contribution schemes[1]	**32**	**97**	**129**	30	86	116
Operating cost	**170**	**129**	**299**	249	146	395
Net financing (income)/charge in respect of defined benefit schemes	**(11)**	**40**	**29**	(12)	38	26
Total income statement charge	**159**	**169**	**328**	237	184	421

[1] The 2013 reported figures did not include defined contribution costs for Rolls-Royce Power Systems AG.

The operating cost is charged as follows:

	Defined benefit		**Defined contribution**		**Total**	
	2014 £m	2013 £m	**2014 £m**	2013 £m	**2014 £m**	2013 £m
Cost of sales – included in underlying profit	**117**	141	**84**	74	**201**	215
Commercial and administrative costs	**21**	104	**23**	23	**44**	127
Research and development	**27**	28	**17**	14	**44**	42
	165	273	**124**	111	**289**	384
Discontinued operations	**5**	6	**5**	5	**10**	11
	170	279	**129**	116	**299**	395

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
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19 POST-RETIREMENT BENEFITS CONTINUED

The Group operates a PaySave scheme in the UK. This is a salary sacrifice scheme under which employees elect to stop making employee contributions and the Group makes additional contributions in return for a reduction in gross contractual pay. As a result, there is a decrease in wages and salaries and a corresponding increase in pension costs of **£35 million** (2013 £37 million) in the year.

Net financing comprises:

	2014			2013		
	UK schemes £m	Overseas schemes £m	Total £m	UK schemes £m	Overseas schemes £m	Total £m
Financing on scheme obligations	390	64	454	371	59	430
Financing on scheme assets	(427)	(24)	(451)	(431)	(21)	(452)
Financing on unrecognised surpluses and minimum funding liability	26	–	26	48	–	48
Net financing (income)/charge in respect of defined benefit schemes	(11)	40	29	(12)	38	26
Financing income on scheme surpluses	(13)	–	(13)	(16)	(1)	(17)
Financing costs on scheme deficits	2	40	42	4	39	43

AMOUNTS RECOGNISED IN OCI IN RESPECT OF DEFINED BENEFIT SCHEMES

	2014			2013		
	UK schemes £m	Overseas schemes £m	Total £m	UK schemes £m	Overseas schemes £m	Total £m
Actuarial gains and losses arising from demographic assumptions	23	(17)	6	(87)	(12)	(99)
Actuarial gains and losses arising from financial assumptions	(1,099)	(228)	(1,327)	(200)	116	(84)
Actuarial gains and losses arising from experience adjustments	(343)	(17)	(360)	65	31	96
Return on scheme assets excluding financing income	2,258	55	2,313	(363)	(42)	(405)
Movement in unrecognised surplus and related finance cost	513	–	513	407	–	407
Movement in minimum funding liability and related finance cost	47	–	47	133	–	133
	1,399	(207)	1,192	(45)	93	48

AMOUNTS RECOGNISED IN THE BALANCE SHEET IN RESPECT OF DEFINED BENEFIT SCHEMES

	2014			2013		
	UK schemes £m	Overseas schemes £m	Total £m	UK schemes £m	Overseas schemes £m	Total £m
Present value of funded obligations	(10,606)	(664)	(11,270)	(9,046)	(558)	(9,604)
Fair value of scheme assets	12,341	593	12,934	9,776	504	10,280
Net asset/(liability) on funded schemes	1,735	(71)	1,664	730	(54)	676
Present value of unfunded obligations	–	(1,109)	(1,109)	–	(935)	(935)
Unrecognised surplus[1]	–	–	–	(488)	–	(488)
Minimum funding liability[2]	–	–	–	(46)	–	(46)
Net asset/(liability) recognised in the balance sheet	1,735	(1,180)	555	196	(989)	(793)
Post-retirement scheme surpluses	1,735	5	1,740	242	6	248
Post-retirement scheme deficits	–	(1,185)	(1,185)	(46)	(995)	(1,041)

[1] Where a surplus has arisen on a scheme, in accordance with IAS 19 and IFRIC 14, the surplus is recognised as an asset only if it represents an unconditional economic benefit available to the Group in the future. Any surplus in excess of this benefit is not recognised in the balance sheet. During 2014, the rules of one scheme were amended, which removed the restriction on recognising the surplus.

[2] A minimum funding liability arises where the statutory funding requirements require future contributions in respect of past service that will result in a future unrecognisable surplus.

Overseas schemes are located in the following countries:

	2014			2013		
	Assets £m	Obligations £m	Net £m	Assets £m	Obligations £m	Net £m
Canada	160	(208)	(48)	135	(181)	(46)
Germany	–	(592)	(592)	–	(500)	(500)
US pension schemes	414	(508)	(94)	347	(420)	(73)
US healthcare schemes	–	(423)	(423)	–	(352)	(352)
Other	19	(42)	(23)	22	(40)	(18)
Net asset/(liability) recognised in the balance sheet	593	(1,773)	(1,180)	504	(1,493)	(989)

19 POST-RETIREMENT BENEFITS CONTINUED

DEFINED BENEFIT SCHEMES

ASSUMPTIONS

Significant actuarial assumptions for UK schemes (weighted average by size of the obligation) used at the balance sheet date were as follows:

UK schemes	**2014**	2013
Discount rate	**3.6%**	4.4%
Inflation assumption (RPI)[1]	**3.2%**	3.5%
Rate of increase in salaries	**4.2%**	4.5%
Male life expectancy from age 65 – current pensioner	**22.5 years**	22.5 years
– future pensioner currently aged 45	**24.1 years**	24.2 years

1 The Consumer Price Index is assumed to be 1.1% lower.

Discount rates are determined by reference to the market yields on AA rated corporate bonds. The rate is determined by using the profile of forecast benefit payments to derive a weighted average discount rate from the yield curve. In prior years, only bonds with an average AA rating by the three main agencies were included. The population of such bonds has reduced and limited the reliability of the derived yield curve, consequently this has been changed so that bonds rated AA by at least one agency are included. The impact of this change is to increase the discount rate at 31 December 2014 by approximately 0.3%.

The inflation assumption is determined by the market implied assumption based on the yields on long-term indexed linked government securities and increases in salaries are based on actual experience, allowing for promotion, of the real increase above inflation.

The mortality assumptions adopted for the UK pension schemes are derived from the SAP actuarial tables, with future improvements in line with the CMI 2014 core projections and long-term improvements of 1.25%. Where appropriate, these are adjusted to take account of the relevant scheme's actual experience.

Other assumptions have been set on advice from the relevant actuary, having regard to the latest trends in scheme experience and the assumptions used in the most recent funding valuation. The rate of increase of pensions in payment is based on the rules of the relevant scheme, combined with the inflation assumption where the increase is capped.

Assumptions for overseas schemes are less significant and are based on advice from local actuaries. The principal assumptions are:

Overseas schemes	**2014**	2013
Discount rate	**3.3%**	4.5%
Inflation assumption	**2.2%**	2.3%
Long-term healthcare cost trend rate	**5.0%**	3.7%
Male life expectancy from age 65 – current pensioner	**21.1 years**	19.6 years
– future pensioner currently aged 45	**23.3 years**	20.7 years

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
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19 POST-RETIREMENT BENEFITS CONTINUED

CHANGES IN PRESENT VALUE OF DEFINED BENEFIT OBLIGATIONS

	2014			2013		
	UK schemes £m	Overseas schemes £m	Total £m	UK schemes £m	Overseas schemes £m	Total £m
At 1 January	**(9,046)**	**(1,493)**	**(10,539)**	(8,569)	(1,178)	(9,747)
Exchange differences	**–**	**(7)**	**(7)**	–	16	16
Current service cost	**(151)**	**(44)**	**(195)**	(147)	(53)	(200)
Past-service cost	**18**	**16**	**34**	(66)	(4)	(70)
Finance cost	**(390)**	**(63)**	**(453)**	(371)	(59)	(430)
Contributions by employees	**(4)**	**(5)**	**(9)**	(4)	(4)	(8)
Benefits paid out	**376**	**71**	**447**	334	63	397
Acquisition of businesses	**–**	**–**	**–**	(1)	(402)	(403)
Disposal of businesses	**10**	**16**	**26**	–	–	–
Actuarial (losses)/gains	**(1,419)**	**(266)**	**(1,685)**	(222)	134	(88)
Settlement curtailment	**–**	**6**	**6**	–	–	–
Other movements	**–**	**(4)**	**(4)**	–	(6)	(6)
At 31 December	**(10,606)**	**(1,773)**	**(12,379)**	(9,046)	(1,493)	(10,539)
Funded schemes	**(10,606)**	**(664)**	**(11,270)**	(9,046)	(558)	(9,604)
Unfunded schemes	**–**	**(1,109)**	**(1,109)**	–	(935)	(935)
The defined benefit obligations are in respect of:						
Active plan participants	**(4,170)**	**(974)**	**(5,144)**	(3,492)	(849)	(4,341)
Deferred plan participants	**(2,009)**	**(97)**	**(2,106)**	(1,647)	(74)	(1,721)
Pensioners	**(4,427)**	**(702)**	**(5,129)**	(3,907)	(570)	(4,477)
Weighted average duration of obligations (years)	**17**	**16**	**17**	16	13	16

CHANGES IN FAIR VALUE OF SCHEME ASSETS

	2014			2013		
	UK schemes £m	Overseas schemes £m	Total £m	UK schemes £m	Overseas schemes £m	Total £m
At 1 January	**9,776**	**504**	**10,280**	9,794	534	10,328
Exchange differences	**–**	**18**	**18**	–	(19)	(19)
Administrative expenses	**(5)**	**(1)**	**(6)**	(6)	(2)	(8)
Financing	**427**	**24**	**451**	431	21	452
Return on plan assets excluding financing	**2,258**	**55**	**2,313**	(363)	(42)	(405)
Contributions by employer	**257**	**65**	**322**	249	66	315
Contributions by employees	**4**	**5**	**9**	4	4	8
Benefits paid out	**(376)**	**(71)**	**(447)**	(334)	(63)	(397)
Acquisition of businesses	**–**	**–**	**–**	1	5	6
Settlements/curtailment	**–**	**(6)**	**(6)**	–	–	–
At 31 December	**12,341**	**593**	**12,934**	9,776	504	10,280
Total return on scheme assets	**2,685**	**79**	**2,764**	68	(21)	47

19 POST-RETIREMENT BENEFITS CONTINUED

FAIR VALUE OF SCHEME ASSETS AT 31 DECEMBER

	2014			2013		
	UK schemes £m	**Overseas schemes £m**	**Total £m**	UK schemes £m	Overseas schemes £m	Total £m
Sovereign debt	**7,282**	**167**	**7,449**	5,929	231	6,160
Derivatives on sovereign debt	**(2,622)**	**2**	**(2,620)**	(987)	2	(985)
Corporate debt instruments	**2,053**	**237**	**2,290**	1,045	190	1,235
Interest rate swaps	**4,218**	**–**	**4,218**	1,361	–	1,361
Inflation swaps	**(360)**	**–**	**(360)**	(13)	–	(13)
Cash and similar instruments	**193**	**127**	**320**	257	44	301
Liability driven investment (LDI) portfolios[1]	**10,764**	**533**	**11,297**	7,592	467	8,059
Longevity swap[2]	**10**	**–**	**10**	3	–	3
Listed equities	**787**	**3**	**790**	994	3	997
Unlisted equities	**216**	**–**	**216**	172	–	172
Sovereign debt	**105**	**4**	**109**	215	4	219
Corporate debt instruments	**15**	**–**	**15**	540	4	544
Cash	**166**	**32**	**198**	253	4	257
Other	**278**	**21**	**299**	7	22	29
At 31 December	**12,341**	**593**	**12,934**	9,776	504	10,280

1 A portfolio of gilt and swap contracts, backed by LIBOR generating assets, that is designed to hedge the majority of the interest rate and inflation risks associated with the schemes' obligations.

2 Under the longevity swap, the Rolls-Royce Pension Fund (RRPF) has agreed an average life expectancy of pensioners with a counterparty. If pensioners live longer than expected the counterparty will make payments to the RRPF to offset the additional cost of paying pensioners. If the reverse applies the cost of paying pensioners will be reduced but the scheme will be required to make payments to the counterparty. The longevity swap is valued on an external fair market basis, rather than using the same assumptions as used for the valuation of the scheme's liabilities.

The scheme assets do not include any of the Group's own financial instruments, nor any property occupied by, or other assets used by, the Group. The longevity swap is valued by the scheme actuaries based on the difference between the agreed longevity assumptions at inception and actual longevity experience. All other fair values are provided by the fund managers. Where available, the fair values are quoted prices (eg listed equity, sovereign debt and corporate bonds). Unlisted investments (private equity) are included at values provided by the fund manager in accordance with relevant guidance. Other significant assets are valued based on observable inputs such as yield curves.

MOVEMENTS IN UNRECOGNISED SURPLUS AND MINIMUM FUNDING LIABILITY

	2014			2013		
	UK schemes £m	**Overseas schemes £m**	**Total £m**	UK schemes £m	Overseas schemes £m	Total £m
At 1 January	**(534)**	**–**	**(534)**	(1,026)	–	(1,026)
Movements in unrecognised surplus through OCI	**513**	**–**	**513**	407	–	407
Movements in minimum funding liability through OCI	**47**	**–**	**47**	133	–	133
Related finance costs	**(26)**	**–**	**(26)**	(48)	–	(48)
At 31 December	**–**	**–**	**–**	(534)	–	(534)

FUTURE CONTRIBUTIONS

The Group expects to contribute approximately £250 million to its defined benefit schemes in 2015.

In the UK, the funding is set on the basis of a triennial funding valuation by the actuaries for which the assumptions may differ from those above. In particular, the discount rate used to value the obligations takes account of the investment strategy, rather than being based on market yields of AA corporate bonds. As a result of these valuations, the Group and the scheme trustees agree a Schedule of Contributions (SoC), which sets out the required contributions from the employer and employees for current service. Where the scheme is in deficit, the SoC also includes required contributions from the employer to eliminate the deficit. The most recent agreed triennial valuations for the principal schemes are:

	Obligations at 31 December 2014 £m	Valuation date
Rolls-Royce Pension Fund	**7,330**	31 March 2012
Rolls-Royce Group Pension Scheme	**1,779**	5 April 2013
Vickers Group Pension Scheme	**696**	31 March 2013

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19 POST-RETIREMENT BENEFITS CONTINUED

SENSITIVITIES

The calculations of the defined benefit obligations are sensitive to the assumptions set out above. The following table summarises how the estimated impact of a change in a significant assumption would affect the UK defined benefit obligation at 31 December 2014, while holding all other assumptions constant. This sensitivity analysis may not be representative of the actual change in the defined benefit obligation as it is unlikely that the change in assumptions would occur in isolation of one another as some of the assumptions may be correlated.

For the most significant funded schemes, the investment strategies are designed to hedge the risks from interest rates, inflation on an economic basis and in the Rolls-Royce Pension Fund in the UK, the longevity of pensioners. Where appropriate, the table also includes the corresponding movement in the value of the plan assets.

		£m
Reduction in the discount rate of 0.25%[1]	Obligation	(473)
	Plan assets (LDI portfolio)	591
Increase in inflation of 0.25%	Obligation	(241)
	Plan assets (LDI portfolio)	209
Increase in real increase in salaries of 0.25%	Obligations	(95)
One year increase in life expectancy	Obligations	(250)

[1] The difference between the sensitivities on obligations and plan assets arises largely due to differences in the methods used to value the obligations for accounting and economic purposes. On an economic basis the correlation is approximately 96%.

20 SHARE CAPITAL

	Non-equity		Equity	
	Special Share of £1	Nominal value £m	Ordinary shares of 20p each Millions	Nominal value £m
Issued and fully paid				
At 1 January 2013	**1**	**–**	**1,872**	**374**
Proceeds from shares issued for share option schemes	–	–	8	2
At 31 December 2013	**1**	**–**	**1,880**	**376**
Shares issued to share trust	–	–	10	2
Purchase and cancellation of ordinary shares	–	–	(8)	(2)
At 31 December 2014	**1**	**–**	**1,882**	**376**

The rights attaching to each class of share are set out on page 162.

In accordance with IAS 32 *Financial Instruments: Presentation*, the Company's non-cumulative redeemable preference shares (C Shares) are classified as financial liabilities. Accordingly, movements in C Shares are included in note 17.

21 SHARE-BASED PAYMENTS

EFFECT OF SHARE-BASED PAYMENT TRANSACTIONS ON THE GROUP'S RESULTS AND FINANCIAL POSITION

	2014 £m	2013 £m
Total charge recognised for equity-settled share-based payments transactions	**26**	61
Total (credit)/charge recognised for cash-settled share-based payments transactions	**(5)**	18
Share-based payments recognised in the consolidated income statement	**21**	79
Liability for cash-settled share-based payment transactions	**13**	19

A description of the share-based payment plans is included in the Directors' Remuneration Report on pages 77 to 89.

MOVEMENTS IN THE GROUP'S SHARE-BASED PAYMENT PLANS DURING THE YEAR

	ShareSave		ESOP		PSP	APRA
	Number Millions	Weighted average exercise price Pence	Number Millions	Weighted average exercise price Pence	Number Millions	Number Millions
Outstanding at 1 January 2013	26.8	447	0.1	77	14.0	4.0
Granted	10.0	961	–	–	2.8	1.6
Additional entitlements arising from TSR performance	–	–	–	–	0.6	–
Additional shares accrued from reinvestment of C Shares	–	–	–	–	–	0.1
Forfeited	(0.6)	483	–	–	(0.6)	(0.1)
Exercised	(10.2)	404	(0.1)	77	(4.8)	(2.5)
Outstanding at 1 January 2014	**26.0**	**660**	**–**	**–**	**12.0**	**3.1**
Granted	–	–			2.9	1.1
Additional entitlements arising from TSR performance	–	–			0.5	–
Additional shares accrued from reinvestment of C Shares	–	–			–	0.1
Forfeited	(1.0)	775			(1.2)	(0.2)
Exercised	(0.5)	487			(4.4)	(1.7)
Outstanding at 31 December 2014	**24.5**	**660**			**9.8**	**2.4**
Exercisable at 31 December 2014	**–**	**–**			**–**	**–**
Exercisable at 31 December 2013	–	–			–	–

As share options are exercised throughout the year, the weighted average share price during the year of **1013p** (2013 1123p) is representative of the weighted average share price at the date of exercise. The closing price at 31 December 2014 was **870p** (2013 1275p).

FAIR VALUES OF SHARE-BASED PAYMENT PLANS

The weighted average fair value per share of equity-settled share-based payment plans granted during the year, estimated at the date of grant, are as follows:

	2014	2013
PSP – 25% TSR uplift	**1105p**	1128p
PSP – 50% TSR uplift	**1227p**	1254p
ShareSave – 3 year grant	**n/a**	287p
ShareSave – 5 year grant	**n/a**	349p
APRA	**984p**	1027p

PSP

The fair value of shares awarded under the PSP is calculated using a pricing model that takes account of the non-entitlement to dividends (or equivalent) during the vesting period and the market-based performance condition based on expectations about volatility and the correlation of share price returns in the group of FTSE 100 companies and which incorporates into the valuation the interdependency between share price performance and TSR vesting. This adjustment increases the fair value of the award relative to the share price at the date of grant.

SHARESAVE

The fair value of the options granted under the ShareSave plan is calculated using a binomial pricing model that assumes that participants will exercise their options at the beginning of the six-month window if the share price is greater than the exercise price. Otherwise it assumes that options are held until the expiration of their contractual term. This results in an expected life that falls somewhere between the start and end of the exercise window.

APRA

The fair value of shares awarded under APRA is calculated as the share price on the date of the award, excluding expected dividends (or equivalent).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
CONTINUED

22 LEASES

OPERATING LEASES

LEASES AS LESSEE

	2014 £m	2013 £m
Rentals paid – hire of plant and machinery	**123**	134
– hire of other assets	**75**	55
Non-cancellable operating lease rentals are payable as follows:		
Within one year	**182**	179
Between one and five years	**542**	545
After five years	**438**	507
	1,162	1,231

LEASES AS LESSOR

	2014 £m	2013 £m
Rentals received – credited within revenue from aftermarket services	**15**	56
Non-cancellable operating lease rentals are receivable as follows:		
Within one year	**16**	19
Between one and five years	**30**	48
After five years	**13**	23
	59	90

The Group acts as lessee and lessor for both land and buildings and gas turbine engines, and acts as lessee for some plant and equipment.

- Sublease payments of **£1 million** (2013 £1 million) and sublease receipts of **£12 million** (2013 £27 million) were recognised in the income statement in the year.
- Purchase options exist on aero engines, land and buildings and plant and equipment with the period to the purchase option date varying between one to eight years.
- Renewal options exist on aero engines, land and buildings and plant and equipment with the period to the renewal option varying between one to 42 years at terms to be negotiated upon renewal.
- Escalation clauses exist on some leases and are linked to LIBOR.
- The total future minimum sublease payments expected to be made are **£6 million** (2013 £8 million) and sublease receipts expected to be received are **£31 million** (2013 £42 million).

FINANCE LEASES

LEASES AS LESSEE

Finance lease liabilities are payable as follows:

	2014			2013		
	Payments £m	Interest £m	Principal £m	Payments £m	Interest £m	Principal £m
Within one year	**3**	**2**	**1**	–	–	–
Between one and five years	**13**	**7**	**6**	1	–	1
After five years	**47**	**9**	**38**	–	–	–
	63	**18**	**45**	1	–	1

23 CONTINGENT LIABILITIES

Contingent liabilities in respect of customer financing commitments are described in note 18.

On 6 December 2012, the Company announced that it had passed information to the Serious Fraud Office (SFO), following a request from the SFO for information about allegations of malpractice in overseas markets. On 23 December 2013, the Company announced that it had been informed by the SFO that it had commenced a formal investigation. Since the initial announcement, the Company has continued its investigations and is engaging with the SFO and other authorities in the UK, the USA and elsewhere in relation to the matters of concern.

The consequence of these disclosures will be decided by the regulatory authorities. It is too early to predict the outcomes, but these could include the prosecution of individuals and of the Group. Accordingly, the potential for fines, penalties or other consequences 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.

Contingent liabilities exist in respect of guarantees provided by the Group in the ordinary course of business for product delivery, performance and reliability. The Group has, in the normal course of business, entered into arrangements in respect of export finance, performance bonds, countertrade obligations and minor miscellaneous items. Various Group undertakings are parties to legal actions and claims which arise in the ordinary course of business, some of which are for substantial amounts. As a consequence of the insolvency of an insurer as previously reported, the Group is no longer fully insured against known and potential claims from employees who worked for certain of the Group's UK-based businesses for a period prior to the acquisition of those businesses by the Group. While the outcome of some of these matters cannot precisely be foreseen, the directors do not expect any of these arrangements, legal actions or claims, after allowing for provisions already made, to result in significant loss to the Group.

The Group's share of equity accounted entities' contingent liabilities is **£11 million** (2013 £13 million).

Following the sale of the Energy business to Siemens on 1 December 2014 and further to the announcement on 19 June 2014 of a £1 billion share buyback, on 10 December 2014, the Company put in place an initial £250 million programme for the purchase of its ordinary shares. The aim of the buyback is to reduce the share capital of the Company, helping enhance returns to shareholders. In the period to 31 December 2014, 8,215,000 shares were purchased at an average price of 840 pence, leaving a contracted commitment of £182 million.

24 RELATED PARTY TRANSACTIONS

	2014 £m	2013 £m
Sales of goods and services to joint ventures and associates	**2,138**	3,149
Purchases of goods and services from joint ventures and associates	**(2,544)**	(3,269)
Operating lease payments to joint ventures and associates	**(81)**	(69)
Guarantees of joint ventures' and associates' borrowings	**9**	7
Dividends received from joint ventures and associates	**73**	99
RRSA receipts from joint ventures and associates	**2**	4
Other income received from joint ventures and associates	**2**	1

The aggregated balances with joint ventures are shown in notes 13 and 16. Transactions with Group pension schemes are shown in note 19.

In the course of normal operations, related party transactions entered into by the Group have been contracted on an arms-length basis.

Key management personnel are deemed to be the directors and the members of the ELT as set out on pages 54 to 57. Remuneration for key management personnel is shown below:

	2014 £m	2013 £m
Salaries and short-term benefits	**9**	11
Post-retirement schemes	**1**	1
Share-based payments	**4**	7
	14	19

More detailed information regarding the directors' remuneration, shareholdings, pension entitlements, share options and other long-term incentive plans is shown in the Directors' Remuneration Report on pages 76 to 85.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
CONTINUED

25 ACQUISITIONS AND DISPOSALS

ACQUISITIONS
On 5 March 2014, the Group acquired the 50% of Gate Leasing Limited that it did not already own for US$5 million. The principal assets and liabilities acquired were aircraft engines (£37 million) and borrowings (£30 million).

DISPOSALS
On 1 December 2014, the Group sold its Energy business for £785 million which included a contribution to the costs of separating the Energy business from the Group's continuing activities, most significantly the creation of a stand-alone IT system. In addition, Rolls-Royce has received a further £200 million for a 25-year licensing agreement[1] granting Siemens access to relevant Rolls-Royce aero-derivative technology for use in the 4 to 85MW power output gas turbine range. The Energy business disposal gave rise to a cash inflow of £1,027 million. In accordance with IFRS 5 *Non-Current Assets Held for Sale and Discontinued Operations*, the disposal of the Energy business has been accounted for as a discontinued operation.

In addition, on 1 October 2014 the Group sold its interest in MTU Australia Pty. Limited for £24 million. The principal activity of this company was to hold the Group's joint venture interest in MTU Detroit Diesel Australia Pty. Limited.

	Energy (discontinued operation) £m	MTU Australia £m
PROCEEDS		
Cash consideration	985	24
Adjustments and future obligations to the purchaser	(28)	–
Total consideration before deferrals	**957**	**24**
Receipt of licensing agreement proceeds deferred as at 1 December 2014[1]	(58)	–
Total consideration after deferrals	**899**	**24**
ASSETS AND LIABILITIES DISPOSED		
Intangible assets	106	–
Property, plant and equipment	187	–
Investment in joint venture	56	14
Inventory	320	–
Deposits (payments received on account)	(11)	–
Trade and other receivables	337	–
Cash and cash equivalents	4	–
Trade and other payables	(253)	–
Provisions for liabilities and charges	(34)	–
Net assets disposed	**712**	**14**
PROFIT ON DISPOSAL		
Profit on disposal before disposal costs and continuing obligations	**187**	**10**
Cumulative currency translation gain/(loss)	32	(3)
Disposal costs and continuing obligations[2]	(98)	(1)
Post-retirement scheme net credit[3]	15	–
Profit on disposal of business before tax	**136**	**6**
Tax on disposal	2	–
Profit on disposal of business after tax	**138**	**6**
RECONCILIATION TO CASH FLOW STATEMENT		
Total consideration after deferrals	**899**	**24**
Adjustments, future obligations and receipt of licensing agreement proceeds deferred at 1 December 2014[4]	158	–
Cash and cash equivalents disposed	(4)	–
Disposal costs paid in the year	(26)	–
Cash inflow per cash flow statement	**1,027**	**24**

1 The £200m licensing agreement contained £142m to provide intellectual property which has been recognised in the period, whilst £58m relating to the provision of engineering services and supply of parts has been deferred over a period up to 25 years.
2 Disposal costs £98m (incurred and accrued), includes costs to separate the Energy business including IT, legal and transactional fees.
3 Profit on the sale of business includes pension and other post-retirement benefit plan curtailment gains of £26m (note 19) and an accrual to settle a pension deficit that is expected to transfer to Siemens during 2015.
4 £58m of costs relating to future obligations to Siemens not yet incurred have been accrued and £58m relating to the licensing agreement have been deferred. In addition, the Energy disposal is subject to customary post-closing adjustments that are estimated to be £42m, which may include adjustments for working capital. Such adjustments may result in the final amounts received from the purchaser differing from the disposal proceeds above.

COMPANY BALANCE SHEET

At 31 December 2014

	Notes	2014 £m	2013 £m
Fixed assets			
Investments – subsidiary undertakings	2	**12,015**	**12,000**
Debtors – amounts falling due with one year			
Amounts owed by subsidiary undertakings		**57**	–
Creditors – amounts falling due within one year			
Financial liabilities	3	**(22)**	(16)
Amounts owed to subsidiary undertakings		**–**	(995)
Net current assets/(liabilities)		**35**	(1,011)
Total assets less current liabilities		**12,050**	10,989
Capital and reserves			
Called-up share capital	4	**376**	376
Share premium account	5	**179**	80
Merger reserve	5	**7,789**	8,203
Capital redemption reserve	5	**1,267**	857
Other reserve	5	**124**	109
Profit and loss account	5	**2,315**	1,364
Equity shareholders' funds		**12,050**	10,989

The financial statements on pages 149 to 151 were approved by the Board on 12 February 2015 and signed on its behalf by:

JOHN RISHTON Chief Executive **DAVID SMITH** Chief Financial Officer

Company's registered number: 7524813

RECONCILIATION OF MOVEMENTS IN SHAREHOLDERS' FUNDS

For the year ended 31 December 2014

	£m
At 1 January 2014	**10,989**
Profit for the year	**1,500**
Arising on issue of ordinary shares	**101**
Purchase of ordinary shares	**(69)**
Issue of C Shares	**(414)**
Share-based payments – direct to equity	**(57)**
At 31 December 2014	**12,050**

NOTES TO THE COMPANY FINANCIAL STATEMENTS

1 ACCOUNTING POLICIES

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

As permitted by section 408 of the Companies Act 2006, a separate profit and loss account for the Company has not been included in these financial statements. As permitted by the audit fee disclosure regulations, disclosure of non-audit fees information is not included in respect of the Company. As permitted by FRS 1 *Cash flow statements*, no cash flow statement for the Company has been included. As permitted by FRS 8 *Related party disclosures*, no related party disclosures in respect of transactions between the Company and its wholly owned subsidiaries have been included.

INVESTMENTS IN SUBSIDIARY UNDERTAKINGS
Investments in subsidiary undertakings are reported at cost less any amounts written off.

SHARE-BASED PAYMENTS
As described in the remuneration report on pages 78 to 80, the Company grants awards of its own shares to employees of its subsidiary undertakings, (see note 21 of the consolidated financial statements). The costs of share-based payments in respect of these awards are accounted for, by the Company, as an additional investment in its subsidiary undertakings. The costs are determined in accordance with FRS 20 *Share-based payment*. Any payments made by the subsidiary undertakings in respect of these arrangements are treated as a return of this investment.

FINANCIAL INSTRUMENTS
In accordance with FRS 25 *Financial instruments*: *Presentation*, the Company's C Shares are classified as financial liabilities and held at amortised cost from the date of issue until redeemed.

2 INVESTMENTS – SUBSIDIARY UNDERTAKINGS

	£m
Cost:	
At 1 January 2014	**12,000**
Cost of share-based payments in respect of employees of subsidiary undertakings less receipts from subsidiaries in respect of those payments	15
At 31 December 2014	**12,015**

3 FINANCIAL LIABILITIES

C SHARES
Movements in C Shares during the year were as follows:

	C Shares of 0.1p Millions	Nominal value £m
Issued and fully paid		
At 1 January 2013	**16,286**	**16**
Shares issued	413,669	414
Shares redeemed	(407,950)	(408)
At 31 December 2014	**22,005**	**22**

The rights attaching to C Shares are set out on page 162.

4 SHARE CAPITAL

	Non-equity			Equity	
	Special Share of £1	Preference shares of £1 each	Nominal value £m	Ordinary shares of 20p each Millions	Nominal value £m
Issued and fully paid					
At 1 January 2014	**1**	**–**	**–**	**1,880**	**376**
Cancellation of ordinary shares	–	–	–	(8)	(2)
Shares issued to share trust	–	–	–	10	2
At 31 December 2014	**1**	**–**	**–**	**1,882**	**376**

The rights attaching to each class of share are set out on page 162.

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

5 MOVEMENTS IN CAPITAL AND RESERVES

	Non-distributable reserves						
	Share capital £m	Share premium £m	Merger reserve £m	Capital redemption reserve £m	Other reserve[1] £m	Profit and loss account £m	Total £m
At 1 January 2014	**376**	**80**	**8,203**	**857**	**109**	**1,364**	**10,989**
Profit for the year	–	–	–	–	–	1,500	1,500
Shares issued to share trust	2	99	–	–	–	–	101
Purchase of ordinary shares	–	–	–	–	–	(69)	(69)
Cancellation of ordinary shares	(2)	–	–	2	–	–	–
Issue of C Shares	–	–	(414)	–	–	–	(414)
Redemption of C Shares	–	–	–	408	–	(408)	-
Share-based payments – direct to equity	–	–	–	–	15	(72)	(57)
At 31 December 2014	**376**	**179**	**7,789**	**1,267**	**124**	**2,315**	**12,050**

[1] The 'Other reserve' represents the value of share-based payments in respect of employees of subsidiary undertakings for which payment has not been received.

6 CONTINGENT LIABILITIES

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

At 31 December 2014, these guarantees amounted to **£959 million** (2013 £1 billion).

Following the sale of the Energy business to Siemens on 1 December 2014 and further to the announcement on 19 June 2014 of a £1 billion share buyback, on 10 December 2014, the Company put in place an initial £250 million programme for the purchase of its ordinary shares. The aim of the buyback is to reduce the share capital of the Company, helping enhance returns to shareholders. In the period to 31 December 2014, 8,215,000 shares were purchased at an average price of 840 pence, leaving a contracted commitment of £182 million.

7 OTHER INFORMATION

EMOLUMENTS OF DIRECTORS

The remuneration of the directors of the Company is shown in the Directors' Remuneration Report on pages 76 to 85.

EMPLOYEES

The Company had no employees in 2014.

SHARE-BASED PAYMENTS

Shares in the Company have been granted to employees of the Group as part of share-based payment plans, and are charged in the employing company.