# SUBSIDIARIES, JOINTLY CONTROLLED ENTITIES AND ASSOCIATES

The companies listed below are indirectly held by Rolls-Royce Holdings plc except Rolls-Royce Group plc which is directly held. Each company's principal place of business is its country of incorporation and the effective group interest is 100%.

In accordance with Section 410 of the Companies Act 2006, the subsidiaries, jointly controlled entities and associates are those where the results or financial position, in the opinion of the directors, principally affect the financial statements. A list of all related undertakings will be included in the Company's annual return to Companies House.

| | Country of incorporation | Principal activity |
|---|---|---|
| Rolls-Royce Brasil Limitada | Brazil | Aero engine repair and overhaul and marine aftermarket support services |
| Rolls-Royce Canada Limited | Canada | Aero engine sales, service and overhaul |
| MTU Engineering (Suzhou) Company Limited | China | Service and spare parts centre |
| Rolls-Royce Marine Manufacturing (Shanghai) Limited | China | Manufacture and supply of marine equipment and marine aftermarket support services |
| Composite Technology and Applications Limited | England | Development of aero engine fan blades and fan cases |
| MTU UK Limited | England | Sale and services of off-highway diesel engines |
| Rolls-Royce Controls and Data Services Limited | England | Development and manufacture of aero engine controls and monitoring systems |
| Rolls-Royce Group plc | England | Holding company |
| Rolls-Royce International Limited | England | International support and commercial information services |
| Rolls-Royce Leasing Limited | England | Engine leasing |
| Rolls-Royce Marine Electrical Systems Limited | England | Marine electrical systems |
| Rolls-Royce Marine Power Operations Limited | England | Nuclear submarine propulsion systems |
| Rolls-Royce plc | England | Principal UK trading company |
| Rolls-Royce Power Development Limited | England | Generation of electricity from independent power projects |
| Rolls-Royce Power Engineering plc | England | Marine systems |
| Rolls-Royce Total Care Services Limited | England | Aero engine aftermarket support services |
| Vinters Engineering Limited | England | Production, repair and overhaul of power generation, transmission and conversion equipment for military and commercial activities |
| Rolls-Royce OY AB | Finland | Manufacture of marine winches and propeller systems |
| Rolls-Royce Civil Nuclear SAS | France | Instrumentation and control systems and life-cycle management for nuclear power plants |
| Rolls-Royce Technical Support SARL | France | Aero engine project support |
| L'Orange GmbH | Germany | Development and production of high-pressure injection systems for diesel engines |
| MTU Friedrichshafen GmbH | Germany | Development, production and distribution of gas turbines and engines |
| MTU Onsite Energy GmbH | Germany | Sales and service of gas engines |
| MTU Onsite Energy Systems GmbH | Germany | Manufacture and distributor of diesel-powered generating sets |
| Rolls-Royce Deutschland Ltd & Co KG | Germany | Aero engine design, development and manufacture |
| Rolls-Royce Power Systems AG | Germany | Supplier of engines and power trains for marine propulsion, distributed power generation and industrial off-highway sectors |
| Nightingale Insurance Limited | Guernsey | Insurance services |
| MTU Hong Kong Limited | Hong Kong | Distributor for off-highway products and after-sales service |
| Rolls-Royce India Private Limited | India | Diesel engine project management and customer support |
| Rolls-Royce Marine India Private Limited | India | Provision of marine support services |
| Rolls-Royce Operations (India) Private Limited | India | Engineering support services |
| Europea Microfusioni Aerospaziali S.p.A. | Italy | Manufacture of gas turbine engine castings |
| MTU Italia S.r.l. | Italy | Distributor for off-highway products and after-sales service |
| MTU Benelux B.V. | Netherlands | Sales and after-sales support for diesel engines |
| Bergen Engines AS | Norway | Design and manufacture of medium-speed diesel engines |
| Rolls-Royce Marine AS | Norway | Design and manufacture of ship equipment |
| MTU Asia Pte. Limited | Singapore | Distributor of diesel engines and spare parts |
| Rolls-Royce Singapore Pte. Limited | Singapore | Aero engine parts manufacturing and engine assembly and marine aftermarket support services |
| MTU South Africa (Pty.) Limited | South Africa | Distributor of off-highway products and after-sales service |
| MTU Ibérica Propulsión y Energía S.L. | Spain | Sales and service of transmission equipment with diesel and gas engines |
| Rolls-Royce AB | Sweden | Manufacture of marine propeller systems |
| MTU Motor Türbin Sanayi ve Tic. A.S. | Turkey | Production of diesel engines and manufacturer of control systems |
| Data Systems & Solutions LLC | US | Instrumentation and control systems and life-cycle management for nuclear power plants |
| MTU America Inc. | US | Sales and service of engines and systems |
| Optimized Systems and Solutions Inc. | US | Equipment health management and advanced data management services |
| PKMJ Technical Services Inc. | US | Civil nuclear engineering services and software solutions |
| R. Brooks Associates Inc. | US | Specialist civil nuclear reactor services |
| Rolls-Royce Corporation | US | Design, development and manufacture of gas turbine engines |

| | Country of incorporation | Principal activity |
|---|---|---|
| Rolls-Royce Crosspointe LLC | US | Manufacturing facility for aero engine parts |
| Rolls-Royce Defense Services Inc. | US | Aero engine repair and overhaul |
| Rolls-Royce Energy Systems Inc. | US | Energy turbine generator packages |
| Rolls-Royce Engine Services – Oakland Inc. | US | Aero engine repair and overhaul |
| Rolls-Royce High Temperature Composites Inc. | US | Production of state-of-the-art composite materials |
| Rolls-Royce Marine North America Inc. | US | Design and manufacture of marine equipment and aftermarket support services |

The companies listed below are indirectly held by Rolls-Royce Holdings plc. Each company's principal place of business is its country of incorporation.

| | Country of incorporation | | Class of shares | % of class held | Group interest held % |
|---|---|---|---|---|---|
| Shanxi North MTU Diesel Co. Ltd | China | Manufacturer of aero engine parts | Ordinary | 49 | 49 |
| Xian XR Aero Components Co Limited | China | Manufacturer of aero engine parts | Ordinary | 49 | 49 |
| Airtanker Holdings Limited | England | Strategic tanker aircraft PFI project | Ordinary | 20 | 20 |
| Airtanker Services Limited | England | Provision of aftermarket services for strategic tanker aircraft | Ordinary | 22 | 22 |
| Alpha Partners Leasing Limited | England | Aero engine leasing | A ordinary | 100 | 50 |
| Genistics Holdings Limited | England | Trailer-mounted field mobile generator sets | A ordinary | 100 | 50 |
| Rolls-Royce Snecma Limited | England | Aero engine collaboration | B shares | 100 | 50 |
| TRT Limited | England | Aero engine turbine blade repair services | B ordinary | 100 | 49.5 |
| Turbine Surface Technologies Limited | England | Aero engine turbine surface coatings | B ordinary | 100 | 50 |
| Turbo-Union Limited | England | RB199 engine collaboration | Ordinary<br>A shares | 40<br>37.5 | 40 |
| EPI Europrop International GmbH (effective group interest held 35.5%) | Germany | A400M engine collaboration | Ordinary | 28 | 28 |
| EUROJET Turbo GmbH (effective group interest held 39%) | Germany | EJ200 engine collaboration | Ordinary | 33 | 33 |
| MTU, Turbomeca, Rolls-Royce GmbH | Germany | MTR390 engine collaboration | Ordinary | 33.3 | 33.3 |
| N3 Engine Overhaul Services GmbH & Co KG | Germany | Aero engine repair and overhaul | Ordinary | 50 | 50 |
| Hong Kong Aero Engine Services Limited | Hong Kong | Aero engine repair and overhaul | Ordinary | 45 | 45 |
| International Aerospace Manufacturing Private Limited | India | Manufacturer of aero engine parts | Ordinary | 50 | 50 |
| Techjet Aerofoils Limited | Israel | Manufacturer of aero engine parts | A ordinary<br>B ordinary | 50<br>50 | 50 |
| International Engine Component Overhaul Pte Limited | Singapore | Aero engine repair and overhaul | Ordinary | 50 | 50 |
| Singapore Aero Engine Services Private Limited (effective group interest 39%) | Singapore | Aero engine repair and overhaul | Ordinary | 30 | 30 |
| Industria de Turbo Propulsores SA | Spain | Aero engine component manufacture and maintenance | Ordinary | 46.9 | 46.9 |
| Alpha Leasing (US) LLC, Alpha Leasing (US) (No.2) LLC, Alpha Leasing (US) (No.4) LLC, Alpha Leasing (US) (No.5) LLC, Alpha Leasing (US) (No.6) LLC, Alpha Leasing (US) (No.7) LLC, Alpha Leasing (US) (No.8) LLC, Rolls-Royce & Partners Finance (US) LLC, Rolls-Royce & Partners Finance (US) (No.2) LLC | US | Aero engine leasing | Partnerships (no equity held) | – | 50 |
| Exostar LLC | US | Business to business internet exchange | Partnership (no equity held) | – | 18.5 |
| LG Fuel Cell Systems Inc. | US | Development of fuel cells | Common Stock | 32 | 32 |
| Texas Aero Engine Services, LLC | US | Aero engine repair and overhaul | Partnership (no equity held) | – | 50 |

**UNINCORPORATED**

| | | | | | |
|---|---|---|---|---|---|
| Light Helicopter Turbine Engine Company (LHTEC) | US | T800 engine development and market | Partnership (no equity held) | – | 50 |

# INDEPENDENT AUDITOR'S REPORT

to the members of Rolls-Royce Holdings plc only

**OPINIONS AND CONCLUSIONS ARISING FROM OUR AUDIT**

1 OUR OPINION ON THE FINANCIAL STATEMENTS IS UNMODIFIED

We have audited the Financial Statements of Rolls-Royce Holdings plc for the year ended 31 December 2014 set out on pages 95 to 151. In our opinion:

- the Financial Statements give a true and fair view of the state of the Group's and of the parent company's affairs as at 31 December 2014 and of the Group's profit for the year then ended;
- the Group Financial Statements have been properly prepared in accordance with International Financial Reporting Standards as adopted by the European Union (Adopted IFRS);
- the parent company Financial Statements have been properly prepared in accordance with UK Accounting Standards; and
- the Financial Statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the Group Financial Statements, Article 4 of the IAS Regulation.

2 OUR ASSESSMENT OF RISKS OF MATERIAL MISSTATEMENT

We summarise below the risks of material misstatement that had the greatest effect on our audit, our key audit procedures to address those risks and our findings from those procedures in order that the Company's members as a body may better understand the process by which we arrived at our audit opinion. Our findings are the result of procedures undertaken in the context of and solely for the purpose of our statutory audit opinion on the Financial Statements as a whole and consequently are incidental to that opinion, and we do not express discrete opinions on separate elements of the Financial Statements.

Given the long-term nature of the Group's business, it is inevitable that the risks that had the greatest effect on our audit change little from year to year. Nevertheless, there have been a number of changes from 2013, the most significant being:

- for the 2014 audit, due to a number of revisions to the Group's published guidance on revenue and profit, we significantly increased our focus and work on the risk relating to *The pressure on and incentives for management to meet revised revenue and profit guidance*;
- the audit work in connection with the risk relating to *Accounting for risk and revenue sharing arrangements* was substantially less than that required in the 2013 audit as the Financial Reporting Council's enquiry was concluded during the 2013 audit, there have been no changes to relevant accounting standards and only a small number of new agreements have been entered into this year; and
- the risks relating to *Accounting for the consolidation of Rolls-Royce Power Systems Holding GmbH and the valuation of Daimler AG's put option* required substantially less audit effort than in earlier years when the transactions took place, in part due to the exercise of the put option by Daimler AG during 2014.

**The pressure on and incentives for management to meet revised revenue and profit guidance**

*Refer to pages 32 to 41 (Business reviews) and pages 69 to 71 (Audit Committee report – Financial reporting)*

**The risk** – The Group published a number of revisions to its revenue and profit guidance during the year with a generally decreasing trend in profit and revenue and there have been significant associated decreases in the Group's share price. The Chief Executive clearly instructed the Executive Leadership Team and the senior finance executives on more than one occasion not to take any account of the pressure to meet forecasts in preparing the financial results and to be alert to how this might affect personnel across the wider Group. Nevertheless, the heightened pressure on and incentives for management to meet the latest guidance increased the inherent risk of manipulation of the Financial Statements. The financial results are sensitive to significant estimates and judgements, particularly in respect of revenues and costs associated with long-term contracts, and there is a broad range of acceptable outcomes of these that could lead to different profit and revenue reported in the Financial Statements. Relatively small changes in the basis of those judgements and estimates could result in the Group meeting, exceeding or falling short of guidance.

**Our response** – We have: (i) extended our enquiries designed to assess whether management had applied unconscious bias or had taken systematic actions to manipulate the reported results; (ii) compared the results to forecasts and challenged variances at a much more granular level than we would otherwise have done based on our understanding of factors affecting business performance with corroboration using external data where possible; (iii) applied an increased level of scepticism throughout the audit by increasing the involvement of the senior audit team personnel, with particular focus on audit procedures designed to assess whether revenues and costs have been recognised in the correct accounting period and whether central adjustments were appropriate; and (iv) challenged our entire audit approach based on an independent review by personnel with no other involvement in the audit.

In particular:

- when considering the risk relating to *The measurement of revenue and profit in the Civil aerospace business*, we challenged the basis for changes in the estimated revenues and costs in long-term contracts with a heightened awareness of the possibility of unconscious or systematic bias; and
- when considering the risk relating to *The presentation of underlying profit*, we sought to identify items that affected profit (and/or the trend in profit) unevenly in frequency or amount at a much lower level than we would otherwise have done and to assess the transparency of disclosure of these items.

**Our findings** – Aside from one transaction which had a very small impact on the Group's profit and which was subsequently corrected by management, our testing did not identify any indication of manipulation of results. We found the degree of caution/optimism adopted in estimates to be broadly consistent with that adopted in the previous year with no indication of conscious or unconscious bias.

**The basis of accounting for revenue and profit in the Civil aerospace business**
*Refer to page 101 and 102 (Key areas of judgement – Introduction, Contractual aftermarket rights, Linkage of original and long-term aftermarket contracts), pages 104 and 105 (Significant accounting policies – Revenue recognition) and pages 69 to 71 (Audit Committee report – Financial reporting)*

**The risk** – The amount of revenue and profit recognised in a year on the sale of engines and aftermarket services is dependent, inter alia, on the appropriate assessment of whether or not each long-term aftermarket contract for services is linked to or separate from the contract for sale of the related engines as this drives the accounting basis to be applied. As the commercial arrangements can be complex, significant judgement is applied in selecting the accounting basis in each case. The most significant risk is that the Group might inappropriately account for sales of engines and long-term service agreements as a single arrangement for accounting purposes as this would usually lead to revenue and profit being recognised too early because the margin in the long-term service agreement is usually higher than the margin in the engine sale agreement.

**Our response** – We re-evaluated the appropriateness of the accounting bases the Group applies in the Civil aerospace business by reference to accounting standards, including examining correspondence and attending meetings between the Group and the Financial Reporting Council and re-examining historical long-term aftermarket contracts. We considered whether the enhanced disclosure included in the Financial Statements following this dialogue enables shareholders to understand how the accounting policies represent the commercial substance of the Group's contracts with its customers. We made our own independent assessment, with reference to the relevant accounting standards, of the accounting basis that should be applied to each long-term aftermarket contract entered into during the year and compared this to the accounting basis applied by the Group.

**Our findings** – We found that the Group has developed a framework for selecting the accounting bases which is consistent with a balanced interpretation of accounting standards *(2013 audit finding: balanced)* and has applied this consistently. We found that the enhanced disclosure was ample. For the agreements entered into during this year, it was clear which accounting basis should apply.

**The measurement of revenue and profit in the Civil aerospace business**
*Refer to pages 101 and 102 (Key areas of judgement – Measurement of performance on long-term aftermarket contracts), pages 104 and 105 (Significant accounting policies – Revenue recognition and TotalCare arrangements) and pages 69 to 71 (Audit Committee report – Financial reporting)*

**The risk** – The amount of revenue and profit recognised in a year on the sale of engines and aftermarket services is dependent, inter alia, on the assessment of the percentage of completion of long-term aftermarket contracts and the forecast cost profile of each arrangement. As long-term aftermarket contracts can extend over significant periods and the profitability of these arrangements typically assumes significant life-cycle cost improvement over the term of the contracts, the estimated outturn requires significant judgement to be applied in assessing engine flying hours, time on wing and other operating parameters, the pattern of future maintenance activity and the costs to be incurred. The inherent nature of these estimates means that their continual refinement can have an impact on the profits of the Civil aerospace business that can be significant in an individual financial year. The assessment of the estimated outturn for each arrangement involves detailed calculations using large and complex databases with a significant level of manual intervention.

**Our response** – We tested the controls designed and applied by the Group to provide assurance that the estimates used in assessing revenue and cost profiles are appropriate and that the resulting estimated cumulative profit on such contracts is accurately reflected in the Financial Statements; these controls operated over both the inputs and the outputs of the calculations. We challenged the appropriateness of these estimates for each programme and assessed whether or not the estimates showed any evidence of conscious or unconscious management bias in the context of the heightened pressure on and incentives for management to meet the latest guidance discussed above. Our challenge was based on our assessment of the historical accuracy of the Group's estimates in previous periods, identification and analysis of changes in assumptions from prior periods and an assessment of the consistency of assumptions across programmes, detailed assessments of the achievability of the Group's plans to reduce life-cycle costs and an analysis of the impact of these plans on forecast cost profiles taking account of contingencies and analysis of the impact of known technical issues on cost forecasts. Our analysis considered each significant airframe that is powered by the Group's engines and was based on our own experience supplemented by discussions with an aircraft valuation specialist engaged by the Group. We assessed whether the valuer was objective and suitably qualified. We also checked the mathematical accuracy of the revenue and profit for each arrangement and considered the implications of identified errors and changes in estimates.

**Our findings** – In 2013, our testing identified weaknesses in the design and operation of controls and we assessed the effectiveness of the Group's plans for addressing these weaknesses. In planning the 2014 audit, we anticipated that the control weaknesses identified in 2013 audit would be remediated. However, our testing identified continuing, albeit reduced, control weaknesses in some areas and so, as in 2013, we increased the scope and depth of our detailed testing and analysis from that originally planned. Overall, our assessment is that the assumptions and resulting estimates

# INDEPENDENT AUDITOR'S REPORT
CONTINUED

(including appropriate contingencies) resulted in mildly cautious *(2013 audit finding: mildly cautious)* profit recognition and we found no indication of conscious or unconscious bias.

**Recoverability of intangible assets (certification costs and participation fees, development expenditure and contractual aftermarket rights) and amounts recoverable on contracts primarily in the Civil aerospace business**
*Refer to page 103 (Key sources of estimation uncertainty – Forecasts and discount rates), pages 107 and 108 (Significant accounting policies – Certification costs and participation fees, Research and development, Contractual aftermarket rights and Impairment of non-current assets), page 122 (Note 9 to the Financial Statements – Intangible assets) and pages 69 to 71 (Audit Committee report – Financial reporting)*

**The risk** – The recovery of these assets depends on a combination of achieving sufficiently profitable business in the future as well as the ability of customers to pay amounts due under contracts often over a long period of time. Assets relating to a particular engine programme are more prone to the risk of impairment in the early years of a programme as the engine's market position is established. In addition, the pricing of business with launch customers makes assets relating to these engines more prone to the risk of impairment.

**Our response** – We tested the controls designed and applied by the Group to provide assurance that the assumptions used in preparing the impairment calculations are regularly updated, that changes are monitored, scrutinised and approved by appropriate personnel and that the final assumptions used in impairment testing have been appropriately approved. We challenged the appropriateness of the key assumptions in the impairment test (including market size, market share, pricing, engine and aftermarket unit costs, individual programme assumptions, price and cost escalation, discount rate and exchange rates) focusing particularly on those assets with a higher risk of impairment (those relating to the Trent 900 programme and launch customers on the Trent 900 and Trent 1000 programmes). Our challenge was based on our assessment of the historical accuracy of the Group's estimates in previous periods, our understanding of the commercial prospects of key engine programmes, identification and analysis of changes in assumptions from prior periods and an assessment of the consistency of assumptions across programmes and customers and comparison of assumptions with publicly available data where this was available. We tested the mathematical accuracy of the impairment calculations. We considered whether the disclosures in note 9 to the Financial Statements describe the inherent degree of subjectivity in the estimates and the potential impact on future periods of revisions to these estimates.

**Our findings** – Our testing did not identify weaknesses in the design and operation of controls that would have required us to expand the nature or scope of our planned detailed test work. We found that the assumptions and resulting estimates were balanced *(2013 audit finding: balanced)* and that the disclosures were proportionate *(2013 audit finding: proportionate)*. We found no errors in calculations *(2013 audit finding: none)*.

**Liabilities arising from sales financing arrangements**
*Refer to page 103 (Key areas of judgement – Customer financing contingent liabilities), page 109 (Significant accounting policies – Sales financing support), pages 137 and 138 (Note 18 to the Financial Statements – Provisions for liabilities and charges) and pages 69 to 71 (Audit Committee report – Financial reporting)*

**The risk** – The Group has contingent liabilities in respect of financing and asset value support provided to customers. This support typically takes the form of a guarantee with respect to the value of an aircraft at a future date, a commitment to buy used aircraft or a guarantee of a customer's future payments under an aircraft financing arrangement. Judgement is required to assess the likelihood of these liabilities crystallising, in order to assess whether a provision should be recognised and, if so, the amount of that provision. The total potential liability is significant and can be affected by the assessment of the residual value of the aircraft and the creditworthiness of the customers.

**Our response** – We analysed the terms of guarantees on aircraft delivered during the year in detail and obtained aircraft values from and held discussions with aircraft valuation specialists engaged by the Group. We assessed whether the valuer was objective and suitably qualified, had been appropriately instructed and had been provided with complete, accurate data on which to base its evaluation. For all contracts on delivered aircraft, we assessed the commercial factors relevant to the likelihood of the guarantees being called, including the credit ratings and recent financial performance of the relevant customers and their fleet plans, and critically assessed the Group's estimate of the required provisions for those liabilities. We considered movements in aircraft values and potential changes in the assessed probability of a liability crystallising since the previous year end and considered whether the evidence supported the Group's assessment as to whether or not a liability needs to be recognised and the amount of the liability recognised or contingent liability disclosed. We considered whether the related disclosure in note 18 to the Financial Statements appropriately explains the potential liability in excess of the amount provided for in the Financial Statements for delivered aircraft and highlights the significant but unquantifiable contingent liability in respect of aircraft which will be delivered in the future.

**Our findings** – We found that the assumptions and estimates were balanced *(2013 audit finding: balanced)* and that the disclosures were proportionate *(2013 audit finding: proportionate)*.

**Bribery and corruption**

*Refer to page 147 (Note 23 to the Financial Statements – Contingent liabilities) and pages 69 to 71 (Audit Committee report – Financial reporting)*

**The risk** – A large part of the Group's business is characterised by competition for individually significant contracts with customers, which are often directly or indirectly associated with governments, and the award of individually significant contracts to suppliers. The procurement processes associated with these activities are highly susceptible to the risk of corruption. In addition the Group operates in a number of territories where the use of commercial intermediaries is either required by the government or is normal practice. In December 2013, the Group announced that it had been informed by the Serious Fraud Office in the UK that it had commenced a formal investigation into bribery and corruption in overseas markets. The Group is cooperating with the Serious Fraud Office and other agencies, including the US Department of Justice. Breaches of laws and regulations in this area can lead to fines, penalties, criminal prosecution, commercial litigation and restrictions on future business.

**Our response** – We evaluated and tested the Group's policies, procedures and controls over the selection and renewal of intermediaries, contracting arrangements, ongoing management, payments and responses to suspected breaches of policy. We sought to identify and tested payments made to intermediaries during the year, made enquiries of appropriate personnel and evaluated the tone set by the Board and the Executive Leadership Team and the Group's approach to managing this risk. Having enquired of management, the Audit Committee and the Board as to whether the Group is in compliance with laws and regulations relating to bribery and corruption, we made written enquiries of the Group's legal advisers to corroborate the results of those enquiries and maintained a high level of vigilance to possible indications of significant non-compliance with laws and regulations relating to bribery and corruption whilst carrying out our other audit procedures. We discussed the areas of potential or suspected breaches of law, including the ongoing investigation, with the Audit Committee and the Board as well as the Group's legal advisers and assessed related documentation. We assessed whether the disclosure in note 23 to the Financial Statements of the Group's exposure to the financial effects of potential or suspected breaches of law or regulation complies with accounting standards and in particular whether it is the case that the investigation remains at too early a stage to assess the consequences (if any), including in particular the size of any possible fines.

**Our findings** – We found that disclosure to be proportionate *(2013 audit finding: proportionate)*.

**Presentation and explanation of results**

*Refer to pages 32 to 41 (Business reviews), pages 28 to 31 (Financial Review), pages 112 and 113 (Note 2 to the Financial Statements – Segmental analysis) and pages 69 to 71 (Audit Committee report – Financial reporting)*

***The presentation of 'underlying profit'***

**The risk** – In addition to its Adopted IFRS Financial Statements, the Group presents an alternative income statement on an 'underlying' basis. The directors believe the 'underlying' income statement reflects better the Group's trading performance during the year. The basis of adjusting between the Adopted IFRS and 'underlying' income statements and a full reconciliation between them is set out in note 2 to the Financial Statements on pages 110 and 113. A significant recurring adjustment between the Adopted IFRS income statement and the 'underlying' income statement relates to the foreign exchange rates used to translate foreign currency transactions. The Group uses forward foreign exchange contracts to manage the cash flow exposures of forecast transactions denominated in foreign currencies but does not generally apply hedge accounting in its Adopted IFRS income statement. The 'underlying' income statement translates these amounts at the achieved foreign exchange rate on forward foreign exchange contracts settled in the period, retranslates assets and liabilities at exchange rates forecast to be achieved from future settlement of such contracts and excludes unrealised gains and losses on such contracts which are included in the Adopted IFRS income statement. The Group has discretion over which forward foreign exchange contracts are settled in each financial year, which could impact the achieved rate both for the period and in the future. In addition, adjustments are made to exclude one-off past-service costs on post-retirement schemes, restructuring activities that significantly change the shape of the Group's operations and the effect of acquisition accounting and a number of other items. Alternative performance measures can provide shareholders with appropriate additional information if properly used and presented. In such cases, measures such as these can assist shareholders in gaining a better understanding of a company's financial performance and strategy. However, when improperly used and presented, these kinds of measures might prevent the Annual Report being fair, balanced and understandable by hiding the real financial position and results or by making the profitability of the reporting entity seem more attractive.

**Our response** – We assessed the appropriateness of the basis for the adjustments between the Adopted IFRS income statement and the 'underlying' income statement and recalculated the adjustments with a particular focus on the impact of the foreign exchange rates used to translate foreign currency amounts in the 'underlying' income statement. We assessed whether or not the selection of forward foreign exchange contracts settled in the year showed any evidence of management bias. We also assessed: (i) the extent to which the prominence given to the 'underlying' financial information and related commentary in the Annual Report compared to the Adopted IFRS financial information and related commentary could be misleading; (ii) whether the Adopted IFRS and 'underlying' financial information are reconciled with sufficient prominence given to that reconciliation; (iii) whether the basis of the 'underlying' financial information is clearly and accurately described and consistently applied; and (iv) whether the 'underlying' financial information is not otherwise misleading in the form and context in which it appears in the Annual Report.

# INDEPENDENT AUDITOR'S REPORT
CONTINUED

**Our findings** – We found no concerns regarding the basis of the 'underlying' financial information or its calculation and no indication of management bias in the settlement of forward foreign exchange contracts. We consider that there is proportionate disclosure of the nature and amounts of the adjustments to allow shareholders to understand the implications of the two bases on the financial measures being presented *(2013 audit finding: proportionate)*. We found the overall presentation of the 'underlying' financial information to be balanced *(2013 audit finding: balanced)*.

***Disclosure of the effect on the trend in profit of items which are uneven in frequency or amount***
**The risk** – The Group's profits are significantly impacted by items such as cumulative adjustments to profit recognised on long-term contracts, sale and leasebacks of spare engines to joint ventures, research and development charges, reorganisation costs and foreign exchange translation which can be uneven in frequency and/or amount. If significant either to the profit for the year or to the trend in profit, appropriate disclosure of the effect of these items is necessary in the Annual Report and Financial Statements to provide the information necessary to enable shareholders to assess the Group's performance.

**Our response** – We sought to identify items that affect profit (and the trend in profit) which are uneven in frequency or amount at a much lower level than we would otherwise have done and to assess the transparency of disclosure of these items.

**Our findings** – We identified a number of significant items that had affected profit for the year or the prior year that required appropriate disclosure in the Annual Report to enable shareholders to assess the Group's performance. We found that proportionate disclosure of these items had been provided in the Annual Report and Financial Statements taken as a whole.

In reaching our audit opinion on the Financial Statements we took into account the findings that we describe above and those for other, lower risk areas. Overall the findings from across the whole audit are that the Financial Statements have been prepared on the basis of appropriate accounting policies, use mildly cautious estimates, which are consistent when comparing this year to last, and provide proportionate disclosure. Having assessed these findings and evaluated uncorrected misstatements in the context of materiality and considered the qualitative aspects of the Financial Statements as a whole we have not modified our opinion on the Financial Statements.

3 OUR APPLICATION OF MATERIALITY AND AN OVERVIEW OF THE SCOPE OF OUR AUDIT
The materiality for the Group Financial Statements as a whole was set at £70 million *(2013: £86 million)*, determined with reference to a benchmark of Group profit before taxation, normalised to exclude the volatility in reported profit due to gains and losses on revaluation of foreign currency and other derivative financial instruments which could otherwise result in an inappropriate materiality level being calculated. This materiality measure represents 4.6% of this benchmark and 34.3% of total reported profit before tax. We carry out full audit procedures to assess the accuracy of the gains and losses on these derivative financial instruments (which this year amounted to a £1.3 billion loss) as part of our audit of the Group's treasury operations.

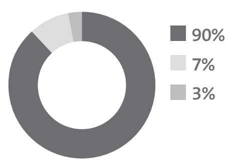
We report to the Audit Committee: (i) all material corrected identified misstatements; (ii) uncorrected identified misstatements exceeding £4 million for income statement items; and (iii) other identified misstatements that warranted reporting on qualitative grounds.

We subjected 33 of the Group's reporting components to audits for group reporting purposes and 14 to specified risk-focused audit procedures. The latter were not individually financially significant enough to require an audit for group reporting purposes, but did present specific individual risks that needed to be addressed. This work also provided further audit coverage. The remaining reporting units were subject to analytical procedures by the Group audit team.

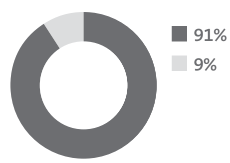
The Group operates shared service centres in Derby (UK) and Indianapolis (US), the outputs of which are included in the financial information of the reporting components they service and therefore they are not separate reporting components. Each of the service centres is subject to specified risk-focused audit procedures, predominantly the testing of transaction processing and review controls. Additional audit procedures are performed at certain reporting components to address the audit risks not covered by the work performed over the shared service centres.

**Summary audit scope**

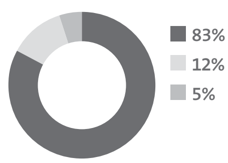
**REVENUE**




**UNDERLYING PROFIT BEFORE TAX**




**TOTAL ASSETS**




- Audits for group reporting purposes
- Specified risk-focused audit procedures
- Group-level procedures only

The Group audit team instructed component auditors, and the auditors of the shared service centres, as to the significant areas to be covered, including the relevant risks detailed above and the information to be reported back. The Group audit team approved the component materialities, which ranged from £0.3 million to £60 million, having regard to the mix of size and risk profile of the Group across the components. The work on 29 of the 47 components was performed by component auditors and the rest by the Group audit team. The Group audit team visited 25 component locations in the UK, the US, Germany and Norway, the purpose of which included an assessment of the audit risk and strategy. Telephone conference meetings were also held with these component auditors and with those of the higher risk components that were not physically visited. At these visits and meetings, the findings reported to the Group audit team were discussed in more detail, and any further work required by the Group audit team was then performed by the component auditor.

4 OUR OPINION ON OTHER MATTERS PRESCRIBED BY THE COMPANIES ACT 2006 IS UNMODIFIED

In our opinion:

- the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006; and
- the information given in the Strategic Report and Directors' Report for the financial year for which the Financial Statements are prepared is consistent with the Financial Statements.

5 WE HAVE NOTHING TO REPORT IN RESPECT OF THE MATTERS ON WHICH WE ARE REQUIRED TO REPORT BY EXCEPTION

Under ISA (UK and Ireland) we are required to report to you if, based on the knowledge we acquired during our audit, we have identified other information in the Annual Report that contains a material inconsistency with either that knowledge or the Financial Statements, a material misstatement of fact, or that is otherwise misleading. In particular, we are required to report to you if:

- we have identified material inconsistencies between the knowledge we acquired during our audit and the directors' statement that they consider that the Annual Report and Financial Statements taken as a whole is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group's performance, business model and strategy; or
- the Audit Committee report does not appropriately address matters communicated by us to the Audit Committee.

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- adequate accounting records have not been kept by the parent company, or returns adequate for our audit have not been received from branches not visited by us; or
- the parent company Financial Statements and the part of the Directors' Remuneration Report to be audited are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

Under the Listing Rules we are required to review:

- the directors' statement, set out on page 164, in relation to going concern; and
- the part of the corporate governance report on page 59 relating to the Company's compliance with the ten provisions of the UK Corporate Governance Code 2012 specified for our review.

We have nothing to report in respect of the above responsibilities.

**Scope of report and responsibilities**

As explained more fully in the directors' responsibilities statement set out on page 93, the directors are responsible for the preparation of the Financial Statements and for being satisfied that they give a true and fair view. A description of the scope of an audit of Financial Statements is provided on the Financial Reporting Council's website at www.frc.org.uk/auditscopeukprivate. This report is made solely to the Company's members as a body and is subject to important explanations and disclaimers regarding our responsibilities, published on our website at www.kpmg.com/uk/auditscopeukco2014b, which are incorporated into this report as if set out in full and should be read to provide an understanding of the purpose of this report, the work we have undertaken and the basis of our opinions.

JIMMY DABOO (SENIOR STATUTORY AUDITOR)
for and on behalf of KPMG LLP, Statutory Auditor

Chartered Accountants
15 Canada Square
London E14 5GL
12 February 2015

# ADDITIONAL FINANCIAL INFORMATION

### FOREIGN EXCHANGE

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

| | | 2014 | 2013 | Change |
|---|---|---|---|---|
| USD per GBP | Year end spot rate | **1.56** | 1.65 | -5% |
| | Average spot rate | **1.65** | 1.56 | +6% |
| EUR per GBP | Year end spot rate | **1.28** | 1.20 | +7% |
| | Average spot rate | **1.24** | 1.18 | +5% |

### THE GROUP'S APPROACH TO MANAGING ITS TAX AFFAIRS

The Board is involved in setting the Group's tax policies which govern the way its tax affairs are managed. In summary, this means:

i) the Group manages its tax costs through maximising the tax efficiency of business transactions. This includes taking advantage of available tax incentives and exemptions;
ii) this must be done in a way which is aligned with the Group's commercial objectives and meets its legal obligations and ethical standards;
iii) the Group also has regard for the intention of the legislation concerned rather than just the wording itself;
iv) the Group is committed to building constructive working relationships with tax authorities based on a policy of full disclosure in order to remove uncertainty in its business transactions and to allow the authorities to review possible risks;
v) where appropriate and possible, the Group enters into consultation with tax authorities to help shape proposed legislation and future tax policy; and
vi) the Group seeks to price transactions between Group companies as if they were between unrelated parties, in compliance with the OECD Transfer Pricing Guidelines and the laws of the relevant jurisdictions.

### THE GROUP'S GLOBAL CORPORATE INCOME TAX CONTRIBUTION

Around 95% of the Group's underlying profit before tax (excluding joint ventures) is generated in the UK, US, Germany, Norway, Finland and Singapore. The remaining profits are generated across more than 40 other countries. This reflects the fact that the majority of the Group's business is undertaken, and employees are based, in the above countries.

In common with most multinational groups, the total of all profits in respect of which corporate tax is paid is not the same as the consolidated profit before tax reported on page 95. The main reasons for this are:

i) the consolidated income statement is prepared under Adopted IFRS whereas tax is paid on the profits of each Group company, which are determined by local accounting rules;
ii) accounting rules require certain income and costs relating to our commercial activities to be eliminated from, or added to, the aggregate of all the profits of the Group companies when preparing the consolidated income statement ('consolidation adjustments'); and
iii) specific tax rules including exemptions or incentives as determined by the tax laws in each country.

The Group's total corporation tax payments in 2014 were £276 million. The level of tax paid in each country is impacted by the above. In most cases, (i) and (ii) are only a matter of timing and therefore tax will be paid in an earlier or later year. As a result they only have a negligible impact on the Group's underlying tax rate which, excluding joint ventures, would be 25.5% (the underlying tax rate including joint ventures can be found on page 29). This is due to deferred tax accounting, details of which can be found in note 5 to the Financial Statements. The impact of (iii) will often be permanent depending on the relevant tax law.

### INVESTMENTS AND CAPITAL EXPENDITURE

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

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

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

### FINANCIAL RISK MANAGEMENT

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

## CAPITAL STRUCTURE

| £ million | 2014 | 2013 |
|---|---|---|
| Total equity | **6,387** | 6,303 |
| Cash flow hedges | **81** | 68 |
| Group capital | **6,468** | 6,371 |
| Net funds | **666** | 1,939 |

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

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

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

During the year, the Group repaid a £200 million EIB loan.

At year end, the Group retained aggregate liquidity of £4.1 billion. This liquidity included net funds of £666 million and aggregate borrowing facilities of £3.5 billion, of which £1.3 billion remained undrawn.

The maturity profile of the borrowing facilities is regularly reviewed to ensure that refinancing levels are manageable in the context of the business and market conditions. The only facility to mature in 2015 is a US$83 million note. There are no rating triggers in any borrowing facility that would require the facility to be accelerated or repaid due to an adverse movement in the Group's credit rating.

The Group conducts some of its business through a number of joint ventures. A major proportion of the debt of these joint ventures is secured on the assets of the respective companies and is non-recourse to the Group. This debt is further outlined in note 11.

## CREDIT RATING

| | Rating | Outlook | Grade |
|---|---|---|---|
| Moody's Investors Service | A3 | Stable | Investment |
| Standard & Poor's | A | Stable | Investment |

The Group subscribes to both Moody's Investors Service and Standard & Poor's for independent long-term credit ratings. At 31 December 2014, the Group maintained investment grade ratings from both agencies.

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

## ACCOUNTING

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

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 impact of these and other changes to IFRS which have not been adopted in 2014 is included within the accounting policies in note 1.

## SHARE PRICE

During the year, the share price decreased by 32% from 1275 pence to 870 pence, compared to a 12% decrease in the FTSE aerospace and defence sector and 3% decrease in the FTSE 100. The Company's share price ranged from 1289 pence in January to 779.5 pence in October.

# OTHER STATUTORY INFORMATION

## SHARE CAPITAL

On 31 December 2014, 1,882,517,856 ordinary shares of 20 pence each, 22,005,007,762 C Shares of 0.1 pence each and one Special Share of £1 were in issue. The ordinary shares are listed on the London Stock Exchange.

## PAYMENT TO SHAREHOLDERS

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

Shareholders can choose to:
- redeem all C Shares for cash;
- redeem all C Shares for cash and reinvest the proceeds in the C Share Reinvestment Plan (CRIP); or
- keep the C Shares.

The CRIP is operated by Computershare Investor Services PLC (the Registrar). The Registrar will purchase ordinary shares in the market for shareholders electing to reinvest their C Share proceeds. Shareholders wishing to participate in the CRIP or redeem their C Shares must ensure that their instructions are lodged with the Registrar no later than 5.00pm on 1 June 2015. Redemption will take place on 3 July 2015.

At the AGM, the directors will recommend an issue of 141 C Shares with a total nominal value of 14.1 pence for each ordinary share. The C Shares will be issued on 1 July 2015 to shareholders on the register on 24 April 2015 and the final day of trading with entitlement to C Shares is 23 April 2015. Together with the interim issue on 2 January 2015 of 90 C Shares for each ordinary share with a total nominal value of 9.0 pence, this is the equivalent of a total annual payment to ordinary shareholders of 23.1 pence for each ordinary share.

Further information for shareholders is on page 166.

## SHARE CLASS RIGHTS

The full share class rights are set out in the Company's Articles of Association (Articles), which are available on the Group's website, and are summarised below.

## ORDINARY SHARES

Each member has one vote for each ordinary share held. Holders of ordinary shares are entitled to receive the Company's Annual Report; attend and speak at general meetings of the Company; to appoint one or more proxies or, if they are corporations, corporate representatives; and to exercise voting rights. Holders of ordinary shares may receive a bonus issue of C Shares or a dividend and on liquidation may share in the assets of the Company.

## C SHARES

C Shares have limited voting rights and attract a dividend of 75% of LIBOR on the 0.1p nominal value of each share, paid on a twice-yearly basis. The Company has the option to redeem the C Shares compulsorily, at any time, if the aggregate number of C Shares in issue is less than 10% of the aggregate number of all C Shares issued, or on the acquisition or capital restructuring of the Company.

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

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

## SPECIAL SHARE

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

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

## RESTRICTIONS ON TRANSFER OF SHARES AND LIMITATIONS ON HOLDINGS

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

## SHAREHOLDER AGREEMENTS AND CONSENT REQUIREMENTS

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

**AUTHORITY TO ISSUE SHARES**
At the AGM in 2014, authority was given to the directors to allot new ordinary shares up to a nominal value of £125,353,891 equivalent to one-third of the issued share capital of the Company.

In addition, a special resolution was passed to effect a disapplication of pre-emption rights for a maximum of 5% of the issued share capital of the Company. These authorities are valid until the AGM in 2015, and the directors propose to renew these authorities at that AGM. It is proposed to seek a further authority, at the AGM in 2015 to allot up to two thirds of the total issued share capital, but only in the case of a rights issue.

The Board believes that this additional authority will allow the Company to retain the maximum possible flexibility to respond to circumstances and opportunities as they arise; and to allot new C Shares up to a nominal value of £500 million as an alternative to a cash dividend. Such authority expires at the conclusion of the AGM in 2015. The directors propose to renew the authority to allot new C Shares at the AGM in 2015.

**AUTHORITY TO PURCHASE OWN SHARES**
At the AGM in 2014, the Company was authorised by shareholders to purchase up to 188,030,836 of its own ordinary shares representing 10% of its issued ordinary share capital.

The Company announced on 19 June 2014 that, as there were no material acquisitions planned, and reflecting the strength of the balance sheet, the Company would return the proceeds of the sale of the Energy gas turbines and compressor business to shareholders by way of a £1 billion share buyback. The buyback commenced on 10 December 2014.

As at 31 December 2014, 8,215,000 ordinary shares of 20p each had been purchased at a total aggregate consideration of £68.96 million representing 0.44% of the called-up share capital. The purchased shares have been cancelled.

The authority for the Company to purchase its own shares expires at the conclusion of the AGM in 2015 or 18 months from 1 May 2014, whichever is the earlier. A resolution to renew it will be proposed at that meeting.

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

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

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

BORROWINGS AND OTHER FINANCIAL INSTRUMENTS
The Group has a number of borrowing facilities provided by various banks. These facilities generally include provisions which may require any outstanding borrowings to be repaid or the alteration or termination of the facility upon the occurrence of a change of control of the Company. At 31 December 2014 these facilities were less than 24% drawn (2013 35%).

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

EMPLOYEE SHARE PLANS
In the event of a change of control of the Company, the effect on the employee share plans would be as follows:
- PSP – awards would vest pro rata to service in the performance period, subject to Remuneration Committee judgement of Group performance;
- APRA deferred shares – the shares would be released from trust immediately;
- ShareSave – options would become exercisable immediately. The new company might offer an equivalent option in exchange for cancellation of the existing option; and
- Share Incentive Plan (SIP) – consideration received as shares would be held within the SIP, if possible, otherwise the consideration would be treated as a disposal from the SIP.

**MAJOR SHAREHOLDINGS**
At 12 February 2015, the following companies had notified an interest in the issued ordinary share capital of the Company in accordance with the Financial Services Authority's Disclosure and Transparency Rules:

| Company | Date notified | % of issued ordinary share capital |
|---|---|---|
| Invesco Limited | 7 July 2014 | 4.99 |
| Harbor International Fund | 22 October 2014 | 4.02 |
| The Capital Group Companies, Inc. | 30 October 2014 | 4.99 |
| Aberdeen Asset Managers Limited | 7 November 2014 | 5.16 |

# OTHER STATUTORY INFORMATION
CONTINUED

## DIRECTORS
The names of the directors who held office during the year are set out on pages 54 and 55, with the exception of Iain Conn who retired on 1 May 2014, and Mark Morris who left the Company on 4 November 2014.

## DISCLOSURES IN THE STRATEGIC REPORT
The Board has taken advantage of Section 414C(11) of the Companies Act 2006 to include disclosures in the Strategic Report:

| | page(s) |
|---|---|
| • disabled people and employee involvement | 44 |
| • the future development, performance and position of the Group | 1 to 53 |
| • the financial position of the Group | 26 to 31 |
| • R&D activities | 20 and 21 |
| • the principal risks and uncertainties | 50 to 53 |

## GOING CONCERN
As described on page 161, the Group meets its funding requirements through a mixture of shareholders' funds, bank borrowings, bonds and notes. At 31 December 2014, the Group had borrowing facilities of £3.5 billion and total liquidity of £4.1 billion, including: cash and cash equivalents of £2.9 billion and undrawn facilities of £1.3 billion. £67 million of the facilities mature in 2015.

The Group's forecasts and projections, taking into account reasonably possible changes in trading performance, show that the Group has sufficient financial resources. The directors have reasonable expectation that the Company and the Group are well placed to manage their business risks and to continue in operational existence for the foreseeable future, despite the current uncertain global economic outlook.

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

## POLITICAL DONATIONS
The Group's policy is not to make political donations and therefore did not donate any money to any political party during the year.

However, it is possible that certain activities undertaken by the Group may unintentionally fall within the broad scope of the provisions contained in the Companies Act 2006 (the Act). The resolution to be proposed at the AGM is to ensure that the Group does not commit any technical breach of the Act.

During the year, expenses incurred by Rolls-Royce North America Inc. in providing administrative support for the Rolls-Royce North America Political Action Committee (RRNAPAC) was US$52,690 (2013: US$69,430). PACs are a common feature of the US political system and are governed by the Federal Election Campaign Act.

The PAC is independent of the Group and independent of any political party. The PAC funds are contributed voluntarily by employees and the Company cannot affect how they are applied, although under US Law, the business expenses are paid by the Company. Such contributions do not require authorisation by shareholders under the Companies Act 2006 and therefore do not count towards the limits for political donations and expenditure for which shareholder approval will be sought at this year's AGM to renew the authority given at the 2014 AGM.

## GREENHOUSE GAS EMISSIONS
Our greenhouse gas emissions reporting excludes data from our Power Systems business for 2013 and 2014, as detailed on page 46.

In 2014, our total greenhouse gas (GHG) emissions from our facilities, processes, and product test and development was 565 kilotonnes carbon dioxide equivalent (kt$CO_2$e). This represents an increase of 2% compared with 554 kt$CO_2$e in 2013 (see table below).

| Total GHG emissions (ktCO2e) | 2010 | 2011 | 2012 | 2013 | **2014*** |
|---|---|---|---|---|---|
| Direct emissions – facilities, processes, product test and development (Scope 1) | 221 | 218 | 219 | 241 | **231** |
| Indirect emissions – facilities, processes, product test and development (Scope 2) | 349 | 327 | 313 | 313 | **334** |
| **Total for facilities, processes, product test and development** | 570 | 545 | 532 | 554 | **565** |
| Direct emissions – power generation to grid (Scope 1) | | | | 153 | **155** |
| Indirect emissions – power generation to grid (Scope 2) | | | | 12 | **14** |
| **Total for facilities, processes, product test and development, and power generation to grid** | | | | 719 | **734** |
| **Normalised (by revenue) emissions ration for facilities, processes, product test and development (kt$CO_2$e/£m)** | 0.058 | 0.056 | 0.049 | 0.048 | **0.047** |

* We engaged KPMG LLP to undertake a limited assurance engagement, reporting to Rolls-Royce Holdings plc, using the assurance standards ISAE 3000 and ISAE 3410 over the GHG and TRI data that have been highlighted in this report with ☑ and as set out on page 46 and in the table above. Their full statement, as well as our methodology for reporting and the criteria used as set out in our Basis of Reporting document, is available on our website at www.rolls-royce.com/sustainability. The level of assurance provided for a limited assurance engagement is substantially lower than a reasonable assurance agreement. In order to reach their opinion they performed a range of procedures over the GHG and TRI data including: evaluating the work performed and conclusions reached by the Rolls-Royce Internal Audit team; agreeing a selection of the data to the corresponding source documentation; and reviewing the data collation and validation processes at the head office level, including formulae used and manual calculations performed. A summary of the work they performed is included within their assurance opinion. Non-financial performance information, greenhouse gas quantification in particular, is subject to more inherent limitations than financial information. It is important to read the energy, GHG and TRI data in the context of the full limited assurance statement provided by KPMG LLP and the reporting criteria as set out in the Rolls-Royce Basis of Reporting document.

The figures in the table do not include emissions associated with our Power Systems business. We are in the process of integrating our Power Systems business into our HS&E management system. The figures presented have been adjusted to reflect the disposal of our Energy gas turbines and compressor business in December 2014.

Entities that were part of the Energy business that were not part of the disposal have been included.

Power generation relates to the operation of commercial gas-fired power stations and the figures have been adjusted to include emissions associated with Trigno Energy S.r.l.

We have used the GHG Protocol Corporate Accounting and Reporting Standard (revised edition) as of 31 December 2014 data gathered to fulfil our requirements under the Carbon Reduction Commitment (CRC) Energy Efficiency scheme, the UK Government's GHG reporting guidance and Department for Environment, Food & Rural Affairs' (Defra) emissions factors for company reporting for 2014 as the basis of our methodology.

Through our active participation in the International Aerospace Environment Group we have helped to introduce new guidance on greenhouse gas emissions reporting in June to enable consistent communications and reporting for aerospace industry companies. The Guidance is a voluntary consensus standard designed to supplement the World Resources Institute's (WRI) GHG Protocol. It earned the WRI 'Built on GHG Protocol' mark after public comment consultation.

**BRANCHES**
We are a global company and our activities and interests are operated through subsidiaries, branches of subsidiaries, joint ventures and associates which are subject to the laws and regulations of many different jurisdictions. Our principal subsidiaries and joint ventures are listed on page 152 and 153.

**POST BALANCE SHEET EVENTS**
There have been no events affecting the Group since 31 December 2014 which need to be reflected in the 2014 Financial Statements.

**FINANCIAL INSTRUMENTS**
Details of the Group's financial instruments are set out in note 17 to the Financial Statements.

**RELATED PARTY TRANSACTIONS**
Related party transactions are set out in note 24 to the Financial Statements.

**INFORMATION REQUIRED BY UK LISTING RULE 9.8.4**
There are no disclosures to be made under the above listing rule.

**MANAGEMENT REPORT**
The Strategic Report and the Directors' Report together are the management report for the purposes of the Disclosure and Transparency Rules 4.1.8R.

**DISCLOSURE OF INFORMATION TO AUDITORS**
Each of the persons who is a director at the date of approval of this report confirms that:

i) so far as the director is aware, there is no relevant audit information of which the Company's auditor is unaware; and
ii) the director has taken all steps that he or she ought to have taken as a director in order to make himself or herself aware of any relevant audit information and to establish that the Company's auditor is aware of that information.

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

# SHAREHOLDER INFORMATION

## FINANCIAL CALENDAR 2015-2016

**APR 2015**

**23 APRIL**
Ex-entitlement to C Shares

**24 APRIL**
Record date for entitlement to C Shares

**MAY 2015**

**8 MAY 11.00AM**
AGM
QEII Centre London

**29 MAY**
Record date for C Share dividend

**JUN 2015**

**1 JUNE 5.00PM**
Deadline for receipt of C Share elections

**JUL 2015**

**1 JULY**
Payment of C Share dividend

**1 JULY**
Allotment of C Shares

**3 JULY**
Payment of C Share redemption monies

**10 JULY**
Purchase of ordinary shares for CRIP participants (at the latest)

**31 JULY**
Announcement of half-year results

**AUG 2015**

**SEP 2015**

**OCT 2015**

**22 OCTOBER**
Ex-entitlement to C Shares

**23 OCTOBER**
Record date for entitlement to C Shares

**NOV 2015**

**13 NOVEMBER**
Record date for C Share dividend

**DEC 2015**

**1 DECEMBER 5.00PM**
Deadline for receipt of C Share elections

**31 DECEMBER**
Financial year end

**JAN 2016**

**4 JANUARY**
Payment of C Share dividend

**4 JANUARY**
Allotment of C Shares

**6 JANUARY**
Payment of C Share redemption monies

**13 JANUARY**
Purchase of ordinary shares for CRIP participants (at the latest)

**FEB 2016**

**FEBRUARY**
Announcement of full year results

**MAR 2016**

**MARCH**
Annual Report published

### MANAGING YOUR SHAREHOLDING

Your shareholding is managed by Computershare Investor Services PLC (the Registrar). When making contact with the Registrar please quote your Shareholder Reference Number (SRN), an 11-digit number that can be found on the right-hand side of your share certificate or in any other shareholder correspondence. It is very important that you keep your shareholding account details up to date by notifying the Registrar of any changes in your circumstances.

You can manage your shareholding at www.investorcentre.co.uk, speak to the Registrar on +44 (0)870 703 0162 (8.30am to 5.30pm Monday to Friday) or you can write to them at Computershare Investor Services PLC, The Pavilions, Bridgwater Road, Bristol BS13 8AE.

### PAYMENTS TO SHAREHOLDERS

The Company makes payments to shareholders by issuing redeemable C Shares of 0.1 pence each. You can still receive cash or additional ordinary shares from the Company providing you complete a payment instruction form, which is available from the Registrar. Once you have submitted your payment instruction form, you will receive cash or additional ordinary shares each time the Company issues C Shares. If you choose to receive cash we strongly recommend that you include your bank details on the payment instruction form and have payments credited directly to your bank account. This removes the risk of a cheque going astray in the post and means that cleared payments will be credited to your bank account on the payment date.

### SHARE DEALING

The Registrar offers existing shareholders an internet dealing service at www-uk.computershare.com/investor/sharedealing.asp and a telephone dealing service (+44 (0)870 703 0084). The service is available during market hours, 8.00am to 4.30pm, Monday to Friday excluding bank holidays. The fee for internet dealing is 1% of the transaction value subject to a minimum fee of £30. The fee for telephone dealing is 1% of the transaction plus £35. Please note that, in addition to dealing fees, stamp duty of 0.5% is payable on all purchases. Other share dealing facilities are available but you should always use a firm regulated by the Financial Conduct Authority (FCA). You can check the FCA register at www.fca.org.uk/register.

### YOUR SHARE CERTIFICATE

If you sell or transfer your shares you must ensure that you have a valid share certificate in the name of Rolls-Royce Holdings plc. If you place an instruction to sell your shares and cannot provide a valid share certificate, the transaction cannot be completed and you will be liable for any costs incurred by the broker. Share certificates previously issued by either Rolls-Royce Group plc or Rolls-Royce plc are invalid and should be destroyed. If you are unable to locate your share certificates please inform the Registrar immediately.

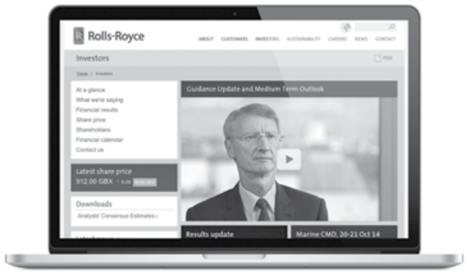
### AMERICAN DEPOSITARY RECEIPTS (ADR)

ADR holders should contact the depositary, The Bank of New York Mellon by calling +1 888 269 2377 (toll free within the US) or emailing shrrelations@cpushareownerservices.com.

## WARNING TO SHAREHOLDERS – BOILER ROOM FRAUD

We are aware that some shareholders might have received unsolicited phone calls or correspondence concerning investment matters. These are typically from overseas based 'brokers' who offer to sell them what often turn out to be worthless or high risk shares in US or UK investments. Such operations are known as 'boiler rooms' and these 'brokers' can be very persistent and extremely persuasive. You should always check that any firm calling you about investment opportunities is properly authorised by the FCA by checking their register at www.fca.org.uk/register. If you need to contact the FCA urgently you should call their Consumer Helpline on 0800 111 6768 (overseas callers dial +44 20 7066 1000). If you deal with an unauthorised firm, you will not be eligible to receive payment under the Financial Services Compensation Scheme. You will find lots of useful advice and information about protecting yourself from investment scams on the FCA website www.fca.org.uk/consumers.

Remember the golden rule – if it sounds too good to be true it probably is.




Available as a free download from the app store

## VISIT ROLLS-ROYCE ONLINE

Visit www.rolls-royce.com/investors to find out more about the latest financial results, the share price, payments to shareholders, the financial calendar and shareholder services.

## KEEPING UP TO DATE

You can sign up to receive the latest news to your phone or inbox. You can also download the Rolls-Royce Investor Relations app which provides the latest media and financial information.

## DIVIDENDS PAID ON C SHARES HELD

| C Share calculation period | C Share dividend rate (%) | Record date for C Share dividend | Payment date |
|---|---|---|---|
| 1 July 2014 – 31 December 2014 | 0.263 | 14 November 2014 | 2 January 2015 |
| 1 January 2014 – 30 June 2014 | 0.233 | 2 June 2014 | 1 July 2014 |

## PREVIOUS C SHARE ISSUES

| | | | | Apportionment values | | CGT apportionment | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Issue date | No. of C Shares issued per ordinary share | Record date for entitlement to C Shares | Latest date for receipt of Payment Instruction Forms by Registrar | Price of ordinary shares on first day of trading (p) | Value of C Share issues per ordinary shares (p) | Ordinary shares (%) | C Shares (%) | Date of redemption of C Shares | CRIP purchase date | CRIP purchase price (p) |
| 2 January 2015 | 90 | 24 October 2014 | 1 December 2014 | 864.250 | 9.0 | 98.97 | 1.03 | 6 January 2015 | 9 January 2015 | 863.372 |
| 2 July 2014 | 134 | 25 April 2014 | 2 June 2014 | 1066.685 | 13.4 | 98.76 | 1.24 | 3 July 2014 | 9 July 2014 | 1058.380 |

For earlier C Share issues, please refer to the Group's website.

## ANALYSIS OF ORDINARY SHAREHOLDERS AT 31 DECEMBER 2014

| Type of holder: | Number of shareholders | % of total shareholders | Number of shares | % of total shares |
|---|---|---|---|---|
| Individuals | 194,995 | 95.66 | 97,855,322 | 5.20 |
| Institutional and other investors | 8,857 | 4.34 | 1,784,695,534 | 94.80 |
| Total | 203,852 | 100.00 | 1,882,517,856 | 100.00 |
| Size of holding: | | | | |
| 1 – 150 | 64,561 | 31.67 | 6,116,140 | 0.32 |
| 151 – 500 | 101,779 | 49.93 | 27,532,323 | 1.46 |
| 501 – 10,000 | 35,567 | 17.45 | 57,568,059 | 3.06 |
| 10,001 – 100,000 | 1,290 | 0.63 | 35,524,258 | 1.89 |
| 100,001 – 1,000,000 | 439 | 0.21 | 152,132,412 | 8.08 |
| 1,000,001 and over | 216 | 0.11 | 1,603,644,664 | 85.19 |
| Total | 203,852 | 100.00 | 1,882,517,856 | 100.00 |

# GLOSSARY

| | |
|---|---|
| **ABC** | anti-bribery and corruption |
| **AGM** | Annual General Meeting |
| **ANA** | All Nippon Airways |
| **APRA** | Annual Performance Related Award plan |
| **Articles** | Articles of Association of Rolls-Royce Holdings plc |
| **C Shares** | non-cumulative redeemable preference shares |
| **C&A** | commercial and administrative |
| **CARs** | contractual aftermarket rights |
| **CEO** | chief executive officer |
| **CFO** | chief financial officer |
| **CGU** | cash-generating unit |
| **$CO_2$** | carbon dioxide |
| **Company** | Rolls-Royce Holdings plc |
| **CPS** | cash flow per share |
| **CRIP** | C Share Reinvestment Plan |
| **ELT** | Executive Leadership Team |
| **EPS** | earnings per ordinary share |
| **EU** | European Union |
| **EUR** | euro |
| **FRC** | Financial Reporting Council |
| **FX** | foreign exchange |
| **GBP** | Great British pound or pound sterling |
| **GHG** | greenhouse gas |
| **Global Code** | Global Code of Conduct |
| **Group** | Rolls-Royce Holdings plc and its subsidiaries |
| **HMRC** | HM Revenue & Customs |
| **HS&E** | health, safety and environment |
| **I&C** | instrumentation and control |
| **IAB** | International Advisory Board |
| **IAS** | International Accounting Standards |
| **IFRIC** | International Financial Reporting Interpretations Committee |
| **IFRS** | International Financial Reporting Standards |
| **KPIs** | key performance indicators |
| **$ktCO_2e$** | kilotonnes carbon dioxide equivalent |
| **LIBOR** | London Inter-Bank Offered Rate |
| **LTSA** | long-term service agreement |
| **LNG** | liquefied natural gas |
| **NCI** | non-controlling interest |
| **$NO_x$** | nitrogen oxides |
| **OCI** | other comprehensive income |
| **OE** | original equipment |
| **OECD** | Organisation for Economic Cooperation and Development |
| **PBT** | profit before tax |
| **PSP** | Performance Share Plan |
| **R&D** | research and development |
| **REACH** | Registration, Evaluation Authorisation and restriction of CHemicals |
| **Registrar** | Computershare Investor Services PLC |
| **RRPS** | Rolls-Royce Power Systems AG |
| **RRSAs** | risk and revenue sharing arrangements |
| **SFO** | Serious Fraud Office |
| **SIP** | Share Incentive Plan |
| **$SO_x$** | sulphur oxides |
| **STEM** | science, technology, engineering and mathematics |
| **TCA** | TotalCare agreement |
| **TRI** | total reportable injuries |
| **TSR** | total shareholder return |
| **UAV** | unmanned aerial vehicle |
| **USD/US$** | United States dollar |
| **UTCs** | University Technology Centres |