BOARD OF DIRECTORS

Ian Davis
Chairman

NG

Appointment to the Board
Appointed to the Board in March 2013 and as Chairman in May 2013

Current directorships and business interests
- Johnson & Johnson Inc, non-executive director
- BP p.l.c., non-executive director
- UK Cabinet Office Board non-executive member (stepping down in March 2016)
- Apax Partners LLP, senior adviser
- Temasek, European Advisory Panel member
- Teach for All Inc, director
- Majid Al Futtaim Holdings LLC, director

Career, skills and experience
Ian spent his early career at Bowater, moving to McKinsey & Company in 1979. He was managing partner of McKinsey's practice in the UK and Ireland from 1996 to 2003. In 2003, he was appointed as chairman and worldwide managing director of McKinsey, serving in this capacity until 2009 and retiring as senior partner in 2010. During his career with McKinsey, Ian served as a consultant to a range of global organisations across the private, public and not-for-profit sectors. He is now senior partner emeritus of McKinsey.

Warren East CBE
Chief Executive

Appointment to the Board
Appointed as an independent Non-executive Director in January 2014 and as Chief Executive in July 2015

Current directorships and business interests
- Dyson Ltd, non-executive director
- A member of the UK Government's Business Advisory Group
- Trustee of the Institute of Engineering and Technology

Career, skills and experience
Warren held various senior appointments at ARM Holdings plc from 1994 including CEO from 2001 to 2013. He is a fellow of the Institute of Engineering and Technology, a fellow of the Royal Academy of Engineering and a distinguished fellow of the BCS, the Chartered Institute for IT. He was awarded a CBE in 2014 for services to the technology industry.

Prior to his appointment as Chief Executive, Warren was Chairman of the Science & Technology Committee and a member of the Audit Committee and the Nominations & Governance Committee.

David Smith
Chief Financial Officer

Appointment to the Board
Appointed as an Executive Director in November 2014

Current directorships and business interests
- Motability Operations Group plc, non-executive director
- Warwick Business School, advisory board member
- Chartered Institute of Management Accountants, member of Advisory Panel

Career, skills and experience
David joined Rolls-Royce in January 2014 as Chief Financial Officer for the Aerospace Division. Before joining Rolls-Royce he was chief financial officer for technology group, Edwards.

He has spent over 25 years in the automotive industry at Ford and Jaguar Land Rover.

Colin Smith CBE
Group President

Appointment to the Board
Appointed as an Executive Director in July 2005

Current directorships and business interests
- Council for Science and Technology, member

Career, skills and experience
Colin joined Rolls-Royce in 1974. He has held a variety of key positions within the Group, including: Director – Research & Technology; Director of Engineering & Technology – Civil Aerospace; and, Group Director – Engineering & Technology, before being appointed as Group President in January 2016. Colin is a fellow of the Royal Society, the Royal Academy of Engineering, the Royal Aeronautical Society and the Institution of Mechanical Engineers. In June 2012 he was awarded a CBE for services to UK engineering.

Dame Helen Alexander
Independent
Non-executive Director

R NG SE

Appointment to the Board
Appointed as an independent Non-executive Director in September 2007

Current directorships and business interests
- UBM plc, chairman
- Huawei Technologies (UK) Co. Limited, non-executive director
- Bain Capital, senior adviser
- EDF Energy's Stakeholder Advisory Panel, member
- University of Southampton, chancellor
- She is also involved in not-for-profit organisations in media and the arts

Career, skills and experience
Dame Helen was chief executive of the Economist Group until 2008, having joined the company in 1985, and was managing director of the Economist Intelligence Unit from 1993 to 1997. She was president of the CBI from 2009 to 2011; she has also been chairman of Incisive Media and Port of London Authority, and a non-executive director of Northern Foods plc, BT Group plc and Centrica plc. She was awarded a DBE in 2011 for services to business.

Lewis Booth CBE
Senior Independent
Non-executive Director

A NG ST

Appointment to the Board
Appointed as an independent Non-executive Director in May 2011

Current directorships and business interests
- Mondelez International Inc, non-executive director
- Gentherm Inc., non-executive director

Career, skills and experience
Lewis is the former executive vice president and chief financial officer of Ford Motor Company, a position he held for over three years until his retirement from the company in April 2012. During his 34-year career at Ford he held a series of senior positions in Europe, Asia, Africa and the US. Lewis began his career with British Leyland, before joining Ford in 1978. He was awarded a CBE in June 2012 for services to the UK automotive and manufacturing industries.

Ruth Cairnie
Independent
Non-executive Director

NG R ST

Appointment to the Board
Appointed as an independent Non-executive Director in September 2014

Current directorships and business interests
- Associated British Foods plc, non-executive director
- Keller Group plc, non-executive director
- Rotterdam School of Management, member of the advisory board
- Cambridge University, finance committee member

Career, skills and experience
Ruth was executive vice president strategy and planning at Royal Dutch Shell Plc until 2014, before which she held a number of other senior international roles at Shell, including managing its global commercial fuels business from 2005 to 2011.

Ruth served on the boards of Shell Pakistan Ltd and joint venture companies in Germany and Thailand.

She also chairs the POWERful women initiative, supporting the progression of women to senior positions in the energy sector.

Sir Frank Chapman
Independent
Non-executive Director

SE NG R

Appointment to the Board
Appointed as an independent Non-executive Director in November 2011

Current directorships and business interests
- Myeloma UK, vice chairman

Career, skills and experience
Sir Frank has worked in the oil & gas industry for 38 years including appointments within Royal Dutch Shell plc and BP p.l.c. He was chief executive of BG Group plc for 12 years until December 2012 and chairman of Golar LNG Ltd from 2014 to 2015. Sir Frank is a fellow of the Royal Academy of Engineering, the Institution of Mechanical Engineers and the Energy Institute. He was knighted in 2011 for services to the oil & gas industry.

Committee membership

A	Audit Committee
NG	Nominations & Governance Committee
R	Remuneration Committee
SE	Safety & Ethics Committee
ST	Science & Technology Committee
■	Denotes Chairman

Alan Davies
Independent
Non-executive Director

NG A

Appointment to the Board
Appointed as an independent Non-executive Director in November 2015

Current directorships and business interests
- Rio Tinto Diamonds and Minerals division, chief executive

Career, skills and experience
Alan joined Rio Tinto in 1997 and has held a number of senior positions in Australia, London and the US, predominantly in Rio Tinto's iron ore product group where he has served as CFO, managing director global development and as president international operations. Alan is a fellow of the Institute of Chartered Accountants in Australia.

Irene Dorner
Independent
Non-executive Director

NG A SE

Appointment to the Board
Appointed as an independent Non-executive Director in July 2015

Current directorships and business interests
- OUTleadership Advisory Board, member
- South East Asia Rainforest Research Partnership, trustee

Career, skills and experience
Irene was CEO and president of HSBC, US, until December 2014 where she was responsible for all of HSBC's operations in the US and played a key role in strengthening the financial institution's risk processes. During a 29-year career at HSBC, she held a number of international roles including as the first woman to lead HSBC in Malaysia and launching its Islamic banking unit.

Irene was a consultant at PwC until February 2016. She is a fellow of St. Anne's College, Oxford.

Lee Hsien Yang
Independent
Non-executive Director

NG A SE

Appointment to the Board
Appointed as an independent Non-executive Director in January 2014

Current directorships and business interests
- General Atlantic LLC and associated funds, special adviser
- Civil Aviation Authority of Singapore, chairman
- The Islamic Bank of Asia Private Limited, chairman
- The Australian and New Zealand Banking Group Ltd, director
- Lee Kuan Yew School of Public Policy, member of the Board of governors
- INSEAD SE Asia Council, president
- Singapore Exchange Ltd, director
- Capital International Inc, consultant to advisory board

Career, skills and experience
Hsien Yang was chief executive of Singapore Telecommunications Limited for 12 years until 2007. He served as chairman and non-executive director of Fraser and Neave Limited from 2007 until February 2013.

John McAdam
Independent
Non-executive Director

NG R SE

Appointment to the Board
Appointed as an independent Non-executive Director in February 2008

Current directorships and business interests
- J. Sainsbury plc, senior independent director
- Rentokil Initial plc, chairman
- United Utilities Group PLC, chairman

Career, skills and experience
John was the chief executive of ICI plc until ICI's acquisition by Akzo Nobel in 2008. He held a number of positions at Unilever, within its Birds Eye Walls, Quest International and Unichema International businesses and is a former non-executive director of Severn Trent plc and Sara Lee Corporation.

Board members by gender

Male	10
Female	4

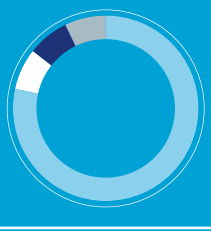
Balance of the Board

Executive Directors	3
Non-executive Directors	11

Tenure of Non-executive Directors

0 - 3 years	6
3 - 6 years	3
6 - 9 years	2

Nationalities of Directors*



British	11
German	1
Singaporean	1
Australian	1

* According to the Company's Articles of Association, at least 50% of all Directors must be British citizens

Sir Kevin Smith CBE
Independent
Non-executive Director

ST NG R

Appointment to the Board
Appointed as an independent Non-executive Director in November 2015

Current directorships and business interests
- Unitas Capital, senior adviser

Career, skills and experience
Sir Kevin joined Unitas Capital in 2012 and served as partner and chairman of its operating advisor group until October 2015. He was chief executive officer of GKN plc until 31 December 2011, having led GKN's Aerospace division from 1999 to 2003. Before joining GKN, he spent nearly 20 years with British Aerospace (BAe plc), becoming group managing director of BAe's New Business division. Sir Kevin served as a non-executive director of Scottish and Southern Energy plc between June 2004 and July 2008.

He was knighted in 2006 for services to industry and is a fellow of the University of Central Lancashire, The Royal Aeronautical Society and The Chartered Institute of Management.

Jasmin Staiblin
Independent
Non-executive Director

NG ST

Appointment to the Board
Appointed as an independent Non-executive Director in May 2012

Current directorships and business interests
- Alpiq Holding AG, CEO
- Georg Fischer AG, non-executive director
- Federal Institute of Technology, the ETH Domain, board member

Career, skills and experience
Jasmin is the CEO of Alpiq Holding AG. She held a number of senior positions at ABB Switzerland Ltd, a subsidiary of the ABB Group, culminating in her serving as CEO of ABB Switzerland Ltd until December 2012. She has lived and worked in Switzerland, Sweden and Australia.

Pamela Coles
Company Secretary

Appointment
Appointed as Company Secretary in October 2014

Career, skills and experience
Pamela has been a fellow of the Institute of Chartered Secretaries and Administrators since 1997, and is an expert in governance and company law. She has held a variety of company secretary roles throughout her career. She joined Rolls-Royce from Centrica plc, where she was head of secretariat. Pamela's previous roles also include group company secretary and a member of the executive committee at The Rank Group plc and company secretary & head of legal at RAC plc.

EXECUTIVE LEADERSHIP TEAM

The Executive Leadership Team is the executive forum in which the Group's senior leaders come together to communicate, review and agree on issues and actions of Group-wide significance, and assist the Chief Executive in the performance of his duties.

Warren East CBE
Chief Executive

Colin Smith CBE
Group President

David Smith
Chief Financial Officer

Chris Barkey
Group Director – Engineering & Technology

Marion Blakey
President & CEO Rolls-Royce North America

Chris Cholerton
President – Defence Aerospace

Miles Cowdry
Corporate Development Director

Dr Ulrich Döhle
CEO – Power Systems

Mark Gregory
General Counsel

Harry Holt
Group Operations Strategy Director (Transitional support)
President – Nuclear

Mary Humiston
Group Human Resources Director

Mikael Makinen
President – Marine

Eric Schulz
President – Civil Aerospace

Lawrie Haynes
Executive (Transitional support)

Tony Wood
Executive (Transitional support)

CHAIRMAN'S INTRODUCTION

"Strong corporate governance sets the right tone to drive appropriate conduct and behaviour across all that we do."

Ian Davis
Chairman

In its stewardship of Rolls-Royce, the Board recognises that excellence in corporate governance is essential in order to generate and protect value for our investors. This requires continuous focus but is particularly important in times of change and transformation. It is not just a matter of ensuring compliance with the latest regulatory guidance; strong corporate governance is the over-arching principle which gives management the confidence to run a sustainable business within an agreed framework of strategic direction and risk appetite. It sets the right tone to drive appropriate conduct and behaviour across all that we do.

This year we have taken steps to improve the frequency and quality of our interactions with major shareholders and will continue to work on this. You can read more about this activity on page 68.

READ BOARD GOVERNANCE DOCUMENT AT ROLLS-ROYCE.COM

Early in the year we adopted and published on our website a new Board governance document that recognises the requirements of the UK Corporate Governance Code 2014 (the Code). It contains the terms of reference of our principal Board committees and the matters reserved to the Board, and was further updated by the Board to reflect best practice in December 2015.

However, we did not stop at Code compliance. Our governance improvement work went much deeper this year by steering and supporting an update of internal governance arrangements at executive and operational levels. As a result, a new internal governance framework document is being rolled out to employees in 2016 to provide a clear and common understanding about how Rolls-Royce works and what is expected across the key governance areas. You can read about this important milestone project in the Nominations & Governance Committee report on page 73.

The following Board committees met for the first time under their new mandates:

- the Nominations & Governance Committee, with an expanded remit to provide more dedicated time and focus on corporate governance in addition to traditional nominations matters;
- our combined Safety & Ethics Committee, created as a dedicated and focused oversight forum in acknowledgement of the critical emphasis we place on:
  - promoting the highest standards of ethical behaviours throughout our organisation and with our partners,
  - the safety of our products and our workforce which can be jeopardised by inappropriate behaviours as well as other factors, and
  - the continuing development of a sustainable, socially and environmentally responsible business;
- the new Science & Technology Committee, formed to provide greater oversight of the Group's innovation strategy and the direction of research, technology and development activities taking into account scientific and technological trends.

I led a review that resulted in some changes to the composition of our committees during 2015. The changes reflected the diversity of skills and experience amongst our Non-executive Directors (including those who joined the Board during 2015) and the value that they could each bring to the particular work of the committees. More information on the experience of our Directors is contained in the Nominations & Governance Committee report on page 71. Our current committee memberships are set out on pages 58 to 61 and on page 65, and you can read about the remit and work of each committee during the year in the reports which follow on pages 69 to 104.

The Board is satisfied that all committees are working effectively to deliver strong oversight and governance over their respective areas of responsibility, and are reporting appropriately to the Board, in accordance with their terms of reference.

The Board and each of its committees have also worked during the year to implement the recommendations made by Independent Audit in its 2014 Board effectiveness review. Independent Audit returned to conduct a follow-on survey and review in 2015 of how this work had progressed. You can read more about this on page 66. This was a useful independent assessment of improvements made throughout the year and also served to identify further areas for our continued focus into 2016.

CORPORATE GOVERNANCE

The Board

The role of the Board	→ providing leadership, knowledge and experience to support and guide the Executive Leadership Team → setting Group strategy and objectives, considering recommendations from the Executive Leadership Team	→ overseeing and monitoring business performance, internal controls, governance and risk management → shareholder engagement
Chairman* Ian Davis	→ effective running of the Board and its committees in accordance with the highest standards of corporate governance → setting the Board agenda	→ managing the Board to ensure adequate time for discussion of all agenda items → ensuring the Board receives accurate, timely and clear information
Senior Independent Director* Lewis Booth	→ being available to major shareholders if they have concerns which have not been resolved through the normal channels of the Chairman, Chief Executive or other Executive Directors	→ conducting an annual review of the performance of the Chairman → providing a sounding board for the Chairman
Other Non-executive Directors	→ providing skills and external experience to support the Chairman and management	
Chief Executive* Warren East	→ overseeing the day-to-day operation of the Group's business → developing and implementing the Group's strategy as approved by the Board	→ establishing and maintaining formal and appropriate delegations of authority → maintaining a close working relationship with the Chairman
Other Executive Directors	→ providing management perspective to support the Board's decision making	
Company Secretary* Pamela Coles	→ providing governance, advisory and administrative support to all Directors → acting as Secretary to the Board and its committees → ensuring compliance with Board procedures and corporate governance requirements	→ administering the process for Directors to access external independent advice at the Company's expense → assisting the Nominations & Governance Committee with plans for Directors' induction and ongoing training

* These roles are set out in writing and have been agreed by the Board.

The Board committees

Nominations & Governance Committee	Remuneration Committee	Audit Committee	Safety & Ethics Committee	Science & Technology Committee
Board composition	Remuneration policy	Financial reporting	S&E governance framework	R&T/R&D strategy
Succession planning	Incentive design and setting of targets	Internal controls	S&E policies and practices	E&T processes
Board nominations	Executive remuneration review	Risk management	S&E training	Technology capabilities and skills
Board evaluation		Internal audit	S&E risk management	R&D investments
Corporate governance		External auditor	S&E investigations	Technology trends and risks
		Cyber security	Sustainability	

CORPORATE GOVERNANCE CONTINUED

The UK Corporate Governance Code 2014 (the Code)

The Board considered the Company's compliance with the Code during the year. Please see our compliance statement on page 67.

The Board

The Board is ultimately responsible to shareholders for the direction, management and performance of the Company.

Details of the Board are set out on pages 58 to 61 and on page 63. Details of the Executive Directors' service contracts and the Non-executive Directors' letters of appointment are on page 85. Details of their remuneration and share interests are set out in the Directors' Remuneration Report on pages 77 and 86.

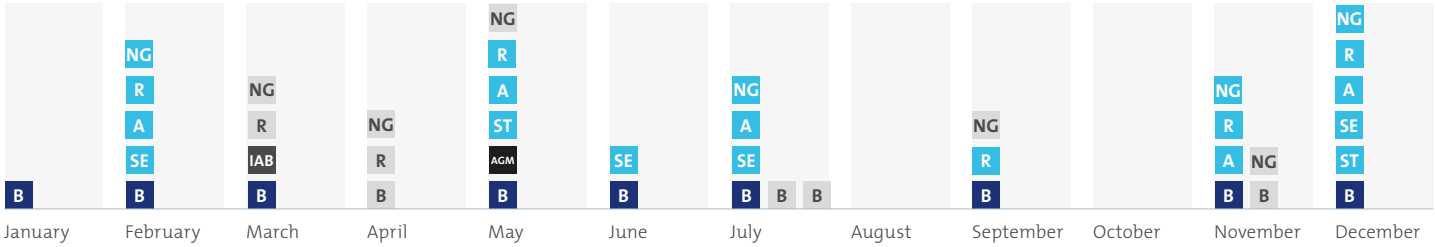
The Board has a schedule of matters reserved for its approval, generally being those items which affect the shape, risk profile or strategic direction of the Group, as well as key financial items. The schedule of reserved matters was reviewed during the year and is contained within our Board governance document available on the Group's website.

Key matters reserved to the Board:

- the Group's long-term objectives, strategy and risk appetite
- shareholder engagement and general meetings
- overall corporate governance arrangements including Board composition, committee terms of reference and Directors' independence and conflicts of interest
- internal controls, governance and risk management frameworks
- changes to the corporate or capital structure of the Company
- annual report and accounts, and financial and regulatory announcements
- significant changes in accounting policies or practices
- policy on, and declarations of, payments to shareholders
- annual budgets and financial expenditure and commitments above levels set by the Board
- remuneration policy and remuneration of Directors and senior executives
- new share incentive or pension plans or major changes to existing plans

Area of focus	Matters considered	Outcome	Key areas of focus for 2016
Strategy and risk	Merits of maintaining a balanced portfolio of power systems businesses; markets, technology and product strategy; risks to the strategy; effectiveness of risk management system and review of principal risks with detailed review of export control compliance, business continuity, competitive position, talent and capability, and major programme delivery principal risks.	Strategic priorities endorsed and re-set; considered approach to risk appetite; enhanced risk management system and principal risks approved. Individual principal risks considered in detail and the Board was assured that they are managed appropriately.	Driving new strategic priorities towards future return to growth. Enhanced internal controls and assurance framework.
Shareholder engagement	Need to improve shareholder communications; ValueAct's acquisition of significant shareholding.	More detail provided in investor presentations; greater level of engagement with investors; constructive dialogue with ValueAct.	Continued engagement to rebuild investor confidence.
Financial and operational performance	Financial performance and outlook; product incidents in service; health, safety and the environment.	Updates to trading outlook; oversight of management information project.	Driving operational performance improvements and better forecasting.
Changes to capital structure	Share buyback; levels of access to debt capital; ADR programme; new US bond programme; new EIB loan; update of EMTN programme and refinancing of revolving credit facility (RCF).	Share buyback halted. Approved revised ADR programme, US bond, EIB loan, update to EMTN programme and refinancing of RCF.	New share plans and updated remuneration policy for adoption in 2017.
Payments to shareholders	Progressive payment policy and level of payment declared in February 2015.	Approved final payment to shareholders in respect of financial year 2014 and interim payment for 2015.	Review of policy on payments to shareholders.
Board composition	Succession planning for Chief Executive and Non-executive Directors. Appointment of a representative of ValueAct as a director.	Appointments of Warren East as Chief Executive, and Irene Dorner, Alan Davies and Sir Kevin Smith as Non-executive Directors approved. Considered appointing a representative of ValueAct under usual nomination process, which continued into 2016.	Executive succession and retention planning. Further consideration of balance of Board and its committees in light of Directors' terms of office.
Corporate governance	Committee terms of reference, Directors' independence, Chairman's evaluation. New internal governance framework.	Changes to composition of committees and updates to committee terms of reference approved. Internal governance framework approved subject to reflecting changes to organisational design.	Embedding new internal governance framework into the businesses. Further implementation of Board evaluation recommendations.
Annual budgets	2016 budget in light of 2015 financial performance and headwinds.	Budget approved.	Delivering competitively to our customers' needs.
Capital investments	Investment in new facilities in Indianapolis.	Investment approved subject to State funding.	Continuing transformation of our infrastructure.

Board and committee meetings held in 2015



Committee meetings

- NG Nominations & Governance Committee
- R Remuneration Committee
- A Audit Committee
- SE Safety & Ethics Committee
- ST Science & Technology Committee

Other meetings

- B Board
- IAB International Advisory Board
- AGM Annual General Meeting
- Denotes unscheduled meeting

The unscheduled meetings were held to consider:

- Warren East's selection and appointment as Chief Executive (March and April)
- Board committee composition arising from director changes (May)
- the Group's trading outlook and market updates (July and November)
- ValueAct's acquisition of a major shareholding in the Company (September and November)
- Sir Kevin Smith's appointment as a Non-executive Director (September)

Some of the Directors were unable to participate in the unscheduled meetings of the Nominations & Governance Committee held in April and November and the unscheduled Board meetings in July and November as these meetings were called on short notice.

Board and committee attendance at scheduled meetings

Current Directors / Number of meetings	Board (9)	Audit (5)	Nominations & Governance (4)	Remuneration (5)	Safety & Ethics (4)	Science & Technology (2)
Ian Davis	9/9	–	4/4	–	–	–
Warren East [1] (appointed Chief Executive on 3 July 2015)	9/9	2/2	1/1	–	–	1/1
Dame Helen Alexander [2]	6/9	–	3/4	5/5	1/4	–
Lewis Booth	9/9	5/5	4/4	–	–	2/2
Ruth Cairnie	9/9	–	4/4	5/5	–	2/2
Sir Frank Chapman	8/9	–	4/4	5/5	4/4	–
Alan Davies (appointed 1 November 2015)	2/2	2/2	2/2	–	–	–
Irene Dorner (appointed 27 July 2015)	4/4	3/3	2/2	–	2/2	–
Lee Hsien Yang (joined Audit Committee 2 March 2015)	9/9	4/4	4/4	–	4/4	–
John McAdam [3]	8/9	–	4/4	5/5	2/4	–
Colin Smith	9/9	–	–	–	–	–
David Smith	9/9	–	–	–	–	–
Sir Kevin Smith (appointed 1 November 2015)	2/2	–	2/2	–	–	1/1
Jasmin Staiblin	8/9	–	4/4	–	–	2/2
Former Directors						
James Guyette (left 8 May 2015)	4/4	–	–	–	–	–
John Neill (left 8 May 2015)	4/4	2/2	–	–	–	–
John Rishton (left 2 July 2015)	5/5	–	–	–	–	–

[1] Warren East stepped down from the Nominations & Governance, Audit and Science & Technology Committees upon his appointment as Chief Executive on 3 July 2015.

[2] Dame Helen Alexander missed the scheduled Board meetings in January, March and July, the scheduled Nominations & Governance Committee meeting in July and the Safety & Ethics Committee meetings in February and July for medical reasons. She also missed the Safety & Ethics Committee meeting in December due to an unavoidable diary clash with a board meeting of UBM plc, of which she is chairman.

[3] John McAdam missed the scheduled meetings of the Board and Safety & Ethics Committee in June and the Safety & Ethics Committee meeting in July due to unavoidable diary clashes with board meetings of J. Sainsbury plc, of which he is the senior independent director. The clashes in June were caused by the Company needing to reschedule to an alternative date at short notice.

CORPORATE GOVERNANCE CONTINUED

Appointments and re-appointments

We refreshed the composition of the Board with the appointment of three new Non-executive Directors; Irene Dorner, Alan Davies and Sir Kevin Smith. Warren East, who was previously a Non-executive Director, became the Chief Executive in July. Details of the appointment process are set out in the Nominations & Governance Committee report on pages 70 and 71.

Board induction and development

Newly appointed Directors follow a tailored induction programme, facilitated by the Company Secretary, which includes dedicated time with Group executives and scheduled trips to a variety of business sites. All Directors are encouraged to visit the Group's facilities and to undertake additional training. Details are set out in the Nominations & Governance Committee report on page 72, which includes information on Warren East's induction into the role of Chief Executive.

Independence of the Non-executive Directors

The Board conducts a review of the independence of the Non-executive Directors every year, based on the criteria in the Code and following consideration by the Nominations & Governance Committee as detailed on page 73. This review was undertaken in December 2015 and the Board concluded that all the Non-executive Directors remained independent in character and judgement.

The Code does not consider the test of independence to be appropriate to the chairman of a company. However, Ian Davis did meet the Code's independence criteria upon his appointment as Chairman in May 2013. His other external commitments are described on page 58.

We are satisfied that, based on the Directors' current declared interests, the Board will comply with the Financial Reporting Council's (FRC) forthcoming independence requirements on the maximum number of external directorships.

Board evaluation

The Board and its committees undertake an annual evaluation of their performance. At least once every three years this is conducted by external consultants. In 2014, the evaluation was conducted by Independent Audit who returned in 2015 to conduct a follow-up review of progress made. During the year, the Company subscribed to an online service from Independent Audit which was used to support the Board's review. Independent Audit also acted as an external sounding board in support of the Company's review of its internal governance, risk management, controls and assurance frameworks and in supporting an online survey of the effectiveness of the external audit process. Independent Audit does not have any other connection to the Company.

The original Board evaluation included; a review of Board and committee papers; interviews with Directors and others who have significant interaction with the Board or its committees including external auditors and remuneration advisors; and observations of a number of the meetings. In 2015, Independent Audit were engaged to conduct a follow-up review of progress towards the 2014 recommendations. This was not a full independent board evaluation assessment but, as an externally-facilitated review, it involved the Directors completing an online, tailored, self-assessment questionnaire and Independent Audit speaking with the Chairman, the Chief Executive and each of the Board committee chairs. Independent Audit also observed the November Board and Audit Committee meetings with a review of the papers for those meetings. The meetings observed were heavily focused on the Company's revised financial outlook, resulting in the market update given on 12 November 2015.

Independent Audit presented the results of the 2015 follow-up review to the Board in December 2015. In the context of 2015 having been a particularly challenging year for the Company and its shareholders, Independent Audit noted that progress had been made in certain areas, including the Board's overall composition and clearer risk management processes.

There were several areas identified as needing further attention. These were generally related to making the most effective use of the Board's time, and included:

- making sure the Board's discussions and agenda focus on and align to the transformation agenda and near-term priorities;
- ensuring that the Board devotes sufficient time to support this focus through discussion, and minimises lengthy management presentations;
- drawing out clear conclusions from Board discussions more effectively to guide management activity;
- giving due time and attention to people development, talent and succession; and
- better use of metrics and risk reporting in Board papers.

Having gone through the effectiveness review described above, and acknowledging the disappointing and difficult financial position that dominated discussions at the November Board and Audit Committee meetings, with the consequential market update, the Directors are satisfied that the Board and each of its committees operated effectively during 2015. Nonetheless, based on Independent Audit's observations, the Board is continuing to work on actions to improve its effectiveness for the future.

Lewis Booth, as the Senior Independent Director, led the Board's annual review of the Chairman's performance. Lewis obtained input from each of the Directors individually and then led a review at the Board meeting in December (without the Chairman present). The Board unanimously agreed that the Chairman's performance continued to be very strong through a difficult year for the Group, with him showing particular leadership and commitment in the process to select and appoint a new Chief Executive and further Non-executive Directors. The Board noted the Chairman's exceptional level of dedication to his role and to his engagement with the other Directors in keeping them informed and soliciting their views.

Executive Leadership Team (ELT)

The ELT is an executive-level forum of the Group's most senior leaders, chaired by the Chief Executive. It helps to develop, implement and monitor strategic and operational plans, considers the continuing applicability, appropriateness and impact of risks, leads the Group's culture and aids the decision making of the Chief Executive in managing the business. Following the initial results of the Chief Executive's operational review announced in November, the ELT membership was restructured under the oversight of the Nominations & Governance Committee to reflect the transformation agenda. The current ELT composition is set out on page 61.

Directors' indemnities and insurance

In accordance with the Articles, and to the extent permitted by law, the Company has entered into separate deeds of indemnity with its Directors, which were in force during the financial year and remain in force at the date of this report. The Company also maintains directors' and officers' liability insurance cover for its Directors and officers. This cover also extends to directors of subsidiary companies.

Internal control and risk management

In developing our internal governance framework we looked at how the Company's risk management and internal control systems work together. You can read about our risk management system on page 54 and details of our internal control system are in the Audit Committee report on page 95. As noted on page 54, these systems are designed to manage, rather than eliminate, the risk of failure to achieve objectives and so can only provide reasonable and not absolute assurance against material misstatement or loss. The Board, with the advice of the Audit Committee, has reviewed the effectiveness of the risk management and internal control systems, including controls in relation to the financial reporting process, for the year under review and to the date of this report. The Board confirms that the Group continues to be compliant with the standards in the Code and with the Financial Conduct Authority's (FCA) Disclosure Rules and Transparency Rules in this regard.

Financial reporting

The Group has a comprehensive budgeting system with an annual budget approved by the Board. Revised forecasts for the year are reported at least quarterly. Actual results, at both a business and Group level, are reported monthly against budget and variances are kept under scrutiny. Since his appointment in November 2014, the Chief Financial Officer has undertaken an in-depth review of our management reporting and budgeting processes to ensure that they fully provide what we need, taking into account the size and shape of the Group and the structure of our operations.

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

International Advisory Board (IAB)

The IAB meets annually with the Board in order to provide perspective and to guide strategy development through discussions on the geo-political and global economic landscape that may present risks or opportunities to the Group's current or future activities. The members of the IAB during the year were as follows:

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

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

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

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

***Mustafa Koç**
Chairman of Koç Holding, A.Ş., Turkey
*Mr Koç passed away on 21 January 2016

Dr Pedro Sampaio Malan
Chairman of Itaú Unibanco's international advisory board and a member of the boards of EDP – Energias do Brasil, Souza Cruz, Brazil, Mills Engenharia, a director of Thomson Reuters Founders Share Company and a member of the Temasek international panel

Akio Mimura
Senior advisor, honorary chairman Nippon Steel & Sumitomo Metal Corporation, Japan, chairman of The Japan Chamber of Commerce and Industry

Lubna Olayan
CEO and deputy chairperson of the Olayan Financing Company, Saudi Arabia

Ratan Tata
Chairman Emeritus of Tata Sons Limited, India

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

Compliance with the UK Corporate Governance Code 2014 (the Code)

The Company is subject to the provisions of the Code, a copy of which is available from the FRC's website.

The Board considers that the Company complied in all material respects with the Code for the whole of the year to 31 December 2015. The Board has agreed that arrangements by which staff may raise concerns in confidence are considered and reviewed by the Safety & Ethics Committee. Matters relating to financial reporting, the integrity of financial management or fraud are also reported to the Audit Committee.

The Audit Committee has again considered the requirement to put the audit out to tender every ten years and in line with the FRC's transitional arrangements will do so during the tenure of the current lead partner which expires in 2017. The current auditors will not be invited to tender. More detail is in the Audit Committee report on page 96.

CORPORATE GOVERNANCE CONTINUED

Shareholder engagement

The Board recognises and values the importance of building strong investor relations through a proactive communication programme. During 2015, various steps have been taken to improve performance in this area. These have included strengthening our investor relations function with the addition of experienced professionals and enhancing our disclosure and transparency through improved reporting. In addition, the frequency of meetings with investors has significantly increased under the new management team. As a result, we have also been proactive in obtaining an understanding of shareholder views on key matters affecting the Group and have incorporated these into our Board deliberations around strategy, performance improvement and governance. In addition, we have benefited from a review of investor opinion undertaken by an independent investor representative body towards the end of the year.

Our Investor Relations department plays a key role in building stronger, clearer discussions with current and potential investors and the sell-side analysts that help inform them. During the year, the team have undertaken an extensive investor relations programme involving formal events, smaller group and one-on-one investor meetings. The purpose of the larger events is to highlight particular issues, themes or announcements that the Group believes develop a better understanding of the business or which warrant further explanation or clarification. The events also provide opportunities for shareholders to meet members of the senior management team. The one-to-one and group meetings provide an opportunity for investors to ask more detailed questions that can improve individual knowledge or clarify areas of misunderstanding. This is a critical process in ensuring market participants make decisions based on a consistent understanding of the information available. In this way, shareholders should be able to consistently and fairly value the Group's businesses.

As a matter of best practice, the Chairman and Senior Independent Director, together with other members of the Board, make themselves available to meet with investors at their request and regularly attend key investor relations events.

During the year, it has been necessary to provide material updates on performance and expectations to the market alongside regular results communications. This included a capital markets presentation in London on 24 November 2015, attended by over 200 investors and analysts. At the same time, the team have held over 500 one-to-one and group meetings, led by the Chief Executive, Chief Financial Officer, the Director of Investor Relations or members of the Investor Relations team. In addition, the Chairman has undertaken 20 meetings or detailed discussions with investors, five at their request. Lewis Booth, our Senior Independent Director, has met with a further six investors, two at their request. Both the Chairman and Senior Independent Director, together with other members of the Board, attended various formal meetings, including the capital markets presentation on 24 November 2015.

In early 2016, Dame Helen Alexander, as chair of the Remuneration Committee, consulted with a number of investors on proposed changes to the 2016 annual bonus and Performance Share Plan (PSP). You can read more about this in the Remuneration Committee report on pages 74 to 76.

The Group's website rolls-royce.com contains up-to-date information for shareholders, including an online version of the Annual Report, share price information, news releases, presentations to the investment community and information on shareholder services. It also contains factual data about the Group's businesses, products and services.

Annual General Meeting (AGM)

All holders of ordinary shares may attend the Company's AGM at which the Chairman and Chief Executive present a review of the key business developments during the year. This year's AGM will be held at 11.00am on 5 May 2016 at the East Midlands Conference Centre, University Park, Nottingham NG7 2RJ.

Shareholders can ask questions of the Board on the matters put to the meeting, including the Annual Report and the running of the Company generally. All Directors are invited to attend each AGM. Unless unforeseen circumstances arise, all committee chairmen will be present to take questions at the AGM.

The Company intends to send the AGM notice and any relevant related papers to shareholders at least 20 working days before the meeting. The AGM notice will be available to view on the Group's website.

A poll is conducted on each resolution at the AGM and at all other Company general meetings. Shareholders have the opportunity to cast their votes in respect of proposed resolutions either in person at the general meeting, or by appointing a proxy to vote on their behalf. Proxy appointments can be made either electronically or by post. Following the AGM, the voting results for each resolution are published and made available on our website.

Information included in the Directors' report

Certain additional information can be found in the section headed 'Other statutory information' on pages 178 to 181 and is incorporated into and forms part of this Corporate Governance report by reference.

NOMINATIONS & GOVERNANCE COMMITTEE

Highlights

- Warren East appointed as Chief Executive
- Three new independent Non-executive Directors appointed
- Board governance document adopted and published
- Development of internal governance framework

2015 overview

Introduction

In January 2015, the Nominations Committee's remit was widened to include governance issues and was renamed the Nominations & Governance Committee. This committee is now responsible for advising the Board on governance best practice, ensuring that the Group policies are appropriate and for keeping the composition and balance of the Board and senior executive team under review. The committee also has responsibility for the identification of the future composition needs of the Board in light of the business strategy and for maintaining the Group's position on diversity and inclusion. The committee reports to the Board on Directors' conflicts and regularly reviews the Non-executive Directors' independence.

The committee has been allocated responsibility on behalf of the Board for overseeing the Group's principle risk relating to talent and capability.

Principal responsibilities

The key areas of responsibility of the committee are:

- to review the structure, size and composition (including skills, knowledge, experience and diversity) of the Board and its committees, to ensure that it remains appropriate, and to make recommendations to the Board of any changes;
- to consider and formulate succession plans for Directors and senior executives;
- to evaluate any conflicts of interest that the Directors may have;
- to review the Board's diversity policy and its implementation;
- to report to the Board on the Company's corporate governance practices and procedures to ensure that they remain appropriate for a group of the size and complexity of Rolls-Royce, taking account of best practice principles;
- to oversee the induction plans for Directors;
- to review the results of the annual Board performance evaluation;
- to review the independence of the Non-executive Directors; and
- to conduct an annual evaluation of the Chief Executive.

Committee members and attendance

The members of the committee are shown on pages 58 to 61 and their attendance is shown on page 65. The Chief Executive may attend meetings of the committee by invitation.

The committee met nine times during 2015 and focused in particular on the composition of the Board resulting in the appointments of three new Non-executive Directors and the appointment of a new Chief Executive. The committee also oversaw the restructuring of the ELT.

NOMINATIONS & GOVERNANCE COMMITTEE CONTINUED

At a glance

Area of focus	Matters considered	Outcome
Succession planning and talent management	The selection and appointment of a new Chief Executive following John Rishton's decision to retire. Identifying the need for, and leading the process to select and recruit, additional Non-executive Directors. Succession planning below Board level, including the composition of the current ELT.	The committee recommended the appointment of Warren East as Chief Executive and the appointments of Irene Dorner, Alan Davies and Sir Kevin Smith as Non-executive Directors during 2015. Pages 58 to 61 set out their biographies. Changes to the ELT were agreed during 2015, resulting in the composition shown on page 61.
Committee membership	Committee refreshment arising from the retirement of one Non-executive Director and from the appointment of Warren East as Chief Executive.	The Board committees were restructured, and care was taken during the recruitment process to ensure the skills and experience of the new Non-executive Directors were closely matched to the needs of the committees. The revised committee membership is shown on pages 58 to 61 and on page 65.
Governance framework	The implementation of the revised governance framework and the extension of the framework below Board level.	Approval of the new framework, including new delegated authorities, and a process for rolling out the framework across the business.
Security clearance	Management of sensitive information to ensure good oversight and control.	The committee established a sub-committee of Non-executive Directors who have received appropriate clearance to enable them to review highly sensitive and secure data. The committee agreed appropriate levels of engagement with the board of Rolls-Royce North America following the departure of James Guyette.
Shareholder engagement	Liaison with ValueAct, a major shareholder, and consideration of its request for a seat on the Board.	A constructive dialogue was established with ValueAct and the committee initiated a nomination process to consider the proposed candidacy. This process continued into 2016.
Conflicts of interest	Directors are required to declare any potential or actual conflicts of interest that could interfere with their ability to act in the best interests of the Group.	The committee considered the schedule of Directors' conflicts of interests and recommended that the schedule be approved by the Board.
Reviewed its own terms of reference	Evaluation of how well the members and the committee operated during the year.	The committee reviewed and updated its terms of reference. In November 2015, it reviewed whether it had undertaken all the work required under its terms of reference and concluded that it had done so.

Principal risk

A principal risk to the business is the inability to attract, retain and incentivise sufficiently talented individuals to deliver our strategy. The committee is responsible for reviewing talent and capability management and it held two sessions during 2015 which looked at the processes to develop and maintain talent. These discussions focused around the need to reconfigure the ELT and resulted in its new composition to deliver business transformation, as shown on page 61.

Board composition

The committee reviews the balance and composition of the Board, its committees and the senior executive team on a regular basis. This review is not just to identify current needs, but also to consider longer term succession planning. To this end a sub-committee of the Nominations & Governance Committee was formed in February 2015 to look specifically at contingency planning for senior positions. This sub-committee reported back to the committee in February 2015 and in April 2015, when the committee considered the appointment of a new Chief Executive.

At the start of the year, the committee discussed James Guyette's wish to retire and recommended to the Board that he step down at the end of the 2015 Annual General Meeting. As part of the Board evaluation carried out in 2014, the current Board mix was discussed and it had been agreed that, subsequent to James leaving the Board, his role as CEO & President of Rolls-Royce North America would no longer be a Board position, although his successor would still be a member of the Executive Leadership Team.

In early 2014, the committee had carried out work with Korn Ferry on succession planning. Korn Ferry provides services of this nature, including the recruitment of senior executives, for the Group but does not have any other relationship with the Group. When, in 2015, John Rishton indicated his desire to retire as Chief Executive, Korn Ferry's work was revisited by a sub-committee of the Nominations & Governance Committee. This sub-committee comprised the Chairman, the Senior Independent Director and three other independent Non-executive Directors. Specific criteria for the role were drawn up and approved by the full committee and a comprehensive international search was undertaken with assistance from Korn Ferry. This search identified a small number of suitable candidates, each of whom was assessed against the objective criteria. The members of the Nominations & Governance Committee met each of the candidates on the shortlist and, as a result of this process and following formal meetings with the remaining Board members, Warren East was confirmed as the preferred candidate.

Warren has been a Non-executive Director of Rolls-Royce since January 2014 and he was CEO of ARM Holdings from 2001 to 2013. On becoming Chief Executive of Rolls-Royce on 3 July 2015, Warren stepped down from the Audit, Nominations & Governance and Science & Technology Committees.

The Chairman led the evaluation of Warren's performance as Chief Executive, including obtaining the individual views of the other Directors and certain members of the ELT, before a discussion at the committee's meeting in December 2015. It was recognised that in his first few months in the role Warren had made a strong start. He very quickly identified the need for improvements in operational performance and cost reduction, set the priorities and communicated these effectively both internally and with investors, and is reshaping the leadership team to support the transformation agenda.

The committee started the process for recruiting additional Non-executive Directors during 2014 by considering the areas of expertise that should be added to the Board. An external search consultant was appointed and a wide range of high calibre independent candidates was considered and a number of interviews were carried out.

As a result of this process, Irene Dorner joined the Board as a Non-executive Director in July 2015 and joined the Audit Committee, the Safety & Ethics Committee and the Nominations & Governance Committee. Irene has considerable international and risk management experience and is a powerful advocate for diversity and inclusion in the workplace.

The committee considered that strengthening the level of financial and technical accounting knowledge on the Board would be beneficial and, again following the process outlined above, Alan Davies joined the Board as Non-executive Director with effect from 1 November 2015 and joined the Audit and Nominations & Governance Committees. Alan is a fellow of the Institute of Chartered Accountants in Australia. As well as his strong financial background which includes serving as CFO of Rio Tinto's iron ore division, Alan brings with him a wealth of leadership experience, including transforming operational performance and driving cultural change through a complex global organisation. He has deep knowledge of China and key emerging markets. Alan's appointment also adds further expertise in safety and operations to the Rolls-Royce Board.

Dame Helen Alexander will be stepping down from the Board after the AGM in May 2016, having served on the Board for nine years. At that time, she will be succeeded as Chairman of the Remuneration Committee by Ruth Cairnie. Being mindful of the need for progressive refreshing of the Board and committees, the committee recommended to the Board the appointment of a further Non-executive Director in 2015 to ensure that there was scope for an orderly hand over.

Sir Kevin Smith was appointed on 1 November 2015 as a Non-executive Director, joining the Remuneration, Nominations & Governance and Science & Technology committees. Sir Kevin was a full-time partner at Unitas Capital, a leading Asian private equity firm, having served for nine years as CEO of GKN plc, the global engineering and manufacturing company. Before then, Sir Kevin spent nearly 20 years with British Aerospace (BAE plc). In February 2016, Sir Kevin was appointed as chairman of the Science & Technology Committee. Kevin's knowledge of Asia and of complex technological and engineering companies is extremely relevant to Rolls-Royce and we look forward to his contribution.

In February 2016, Lewis Booth indicated his intention to relinquish his responsibility as Senior Independent Director once a successor has been appointed. Lewis will continue as Chairman of the Audit Committee.

Details of the Non-executive Directors' experience are on pages 58 to 61.

MWM Consulting was engaged as the search consultant for the new Non-executive Directors. The committee set out the particular skills required in its brief, and this resulted in the appointment of Irene, Alan and Sir Kevin. MWM does not provide any other services to, and is not otherwise connected with, the Company.

Each of the Directors continues to be effective and able to devote sufficient time to the business of the Company and the Board will continue to keep its composition under review.

Succession planning and diversity

The Board fully recognises and embraces the benefits of diversity throughout the Group as it brings a broader and more rounded perspective to decision making. Increasing diversity influences our approach to succession planning and training and development. The percentage of women on the Board has increased to 29% (2014: 21%).

We believe a wide range of people and experiences is beneficial to achieving a high performance culture and enables innovation helping us to deliver excellence. Rolls-Royce is a founder patron of the FTSE 100 Cross-Company Mentoring Programme which aims to widen the pool of eligible female board candidates.

NOMINATIONS & GOVERNANCE COMMITTEE CONTINUED

We will continue to consider candidates for future Board appointments from the widest possible pool and will only engage executive search firms that have signed up to the Voluntary Code of Conduct for Executive Search Firms in relation to gender diversity on corporate boards.

We acknowledge the challenges of increasing diversity within our industry, and during 2015 we have introduced a refreshed global diversity and inclusion policy and a revised anti-discrimination policy. These policies aim to ensure that all employees are treated with respect and are empowered to deliver without fear of bullying or harassment.

We recognise that succession planning includes nurturing our own talent pool and giving opportunities to those who are capable of growing into more senior roles. We give full and fair consideration to all employment applications from people with disabilities, and support disabled employees, helping them to make the best use of their skills and potential. We have continued to roll out High Performance Culture training across the globe to help employees increase their personal effectiveness.

We have established several Employee Resource Groups (ERGs) to support our diversity and inclusion strategy. These include Women's ERGs in Germany, US and the UK, a Lesbian, Gay, Bisexual and Transgender ERG and an African Caribbean ERG, both in the UK.

The committee held two focused sessions during the year to consider succession planning at a senior level including the re-organisation of the ELT announced in December 2015.

Board induction and development

The Company Secretary is responsible for ensuring that new Directors have a thorough and appropriate induction. Each of the newly appointed Non-executive Directors has participated in a structured induction programme and received a comprehensive data pack providing detailed information on the Group. Each induction has been based on the individual Director's requirements and included meetings with relevant employees, committee members and external advisers to ensure that each new Director understands the Group's governance structure.

Warren East received a comprehensive induction when he was appointed as Chief Executive. Before he took over as Chief Executive, Warren met with a number of key customers, suppliers and partners. He also spent several weeks visiting Rolls-Royce sites and meeting the senior personnel as well as Board members. In gaining an understanding of the business challenges, he listened to feedback from most areas of the business. Since joining, Warren has conducted town hall meetings at sites he has visited and introduced a blog on the Group's intranet which has been well received as it opens up a constructive dialogue with employees on the issues that affect the businesses.

In 2015, the training programme was improved to ensure that all Directors had the opportunity to visit our operations. We regard visits by Board members to our operating sites as an important part of continuing education as well as an essential part of the induction process. They help Directors understand the business through direct experience of operating processes with employees at different levels. This also gives the Non-executive Directors the chance to spend time with their fellow Directors in a less formal setting, which helps them to understand the concerns of their colleagues.

In 2015, Irene Dorner and Sir Kevin Smith visited operational sites in Derby, UK and Irene visited production sites in the US (Indianapolis and Crosspointe); Ian Davis spent time with the supply chain team in Derby, UK and visited customers and suppliers in Japan, Singapore, Dubai and Washington, DC. Ruth Cairnie visited Friedrichshafen, Germany and Singapore, and Dame Helen Alexander visited our operations in Alesund, Norway. The members of the Audit Committee visited the Company's IT security operations centre to better understand the Group's preventative and reactive cyber security measures. Metrics to support cyber security assurance have since been developed and are periodically reviewed by the Audit Committee.

Further training is available for all Directors, as appropriate, including presentations by the executive team on particular aspects of the business. For example, all Non-executive Directors undertook the Group's ethics training programme during the year.

Board members by gender

Female	4 (29%)
Male	10 (71%)

Senior managers by gender

Female	14 (7%)
Male	177 (93%)

Employee headcount by gender

Female	7,700 (15%)
Male	42,800 (85%)

There is a procedure for Directors to take independent professional advice at the Company's expense and every Director has independent access to the Company Secretary.

Governance

The committee has taken on responsibility for corporate governance. Early in the year, we adopted the Company's Board governance document which sets out the roles and responsibilities of the Board members, the matters reserved to the Board and the terms of reference of the Board committees. This was revised for best practice in December 2015.

We also oversaw the development of the Company's internal governance framework, which documents how the Group is run, and recommended its adoption by the Board. It sets out the mandatory policies, processes and procedures that must be observed by all employees, clarifies the way in which we take decisions, and sets out our system of internal controls, risk management and assurance. Greater clarification around these issues is important in strengthening our governance and ensuring that all employees know what is expected of them.

We reviewed an updated schedule of delegated authorities and recommended it to the Board for adoption. The revised authority levels are better aligned with business needs, helping the Group to eliminate unnecessary bureaucracy whilst still providing sufficient control to manage the business responsibly at appropriate levels.

The committee reviewed the process through which sensitive information is handled and recommended the formation of a sub-committee, comprising only Directors who have received security clearance, to ensure proper oversight and control of classified information. This sub-committee will meet whenever necessary.

During 2015, an executive-level Disclosure Committee was established to review all significant market announcements and to oversee the process for handling any price-sensitive information. At its first meeting in October 2015, the committee members agreed its terms of reference, and received a refresher training session on inside information from the Company's external legal counsel. The committee met in November 2015 to consider the operating review update and interim management statement before their release to the market, and again in February 2016 to review at executive level this Annual Report (including as to whether it is fair, balanced and understandable) and our draft preliminary results announcement.

A key challenge has been to improve the quality and timeliness of information going to the Board and its committees. The Company has worked to develop better information systems, creating a more consistent and thoughtful approach to presenting technical materials. This has included the creation of templates and the introduction of a new board portal for easier and more timely access to key information. As recommended in the 2014 Board evaluation, we have encouraged more frequent conversations between senior management and the Directors, resulting in greater and more constructive challenge, although the latest Board evaluation indicated that we can do more in this area, see page 66.

We reviewed Board committee membership during the year, following Warren East's appointment as Chief Executive, John Neill's departure from the Board and the appointments of Irene Dorner, Alan Davies and Sir Kevin Smith. The committee took care to ensure that the skills and experience of the new Board members were closely aligned with the needs of the Board committees. Committee membership is set out on pages 58 to 61 and on page 65. The Nominations & Governance Committee is satisfied with the composition of the committees and confident that they are appropriately resourced to carry out their work.

The committee also reviewed and recommended to the Board that Jasmin Staiblin, who has served on the Board for three years, be reappointed for a further three-year term, subject to shareholder support at the AGM.

As part of its consideration of Board governance, the committee discussed the implications of ValueAct increasing its shareholding in the Company and encouraged engagement with ValueAct to better understand its views.

Conflicts of interest and independence

The Nominations & Governance Committee reviews the Non-executive Directors' external interests every year to determine whether each Non-executive Director continues to be independent. In undertaking this evaluation, the committee considers among other things the criteria set out in the UK Corporate Governance Code.

It also reviews any potential conflicts of interest as they arise and recommends to the Board whether these should be authorised and whether any conditions should be attached to any such authorisation. Additionally, an annual review of conflicts of interest is undertaken to ensure that any previously authorised conflicting situations are still being dealt with appropriately.

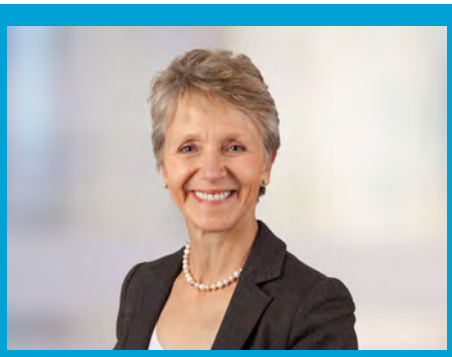
Having carried out a rigorous review, the committee advised the Board that it considered that each of the Non-executive Directors, with the exception of the Chairman for whom the test is not appropriate, continued to be independent and recommended to the Board that each of the Directors' potential conflicts of interest be authorised, without attaching any conditions.

Looking forward

Good progress has been made on governance during the year. For 2016, the key focus for the committee will be the development of succession plans to ensure that the transformation of the business is adequately supported below Board level and underpinned by the internal governance framework.

Ian Davis
Chairman of the Nominations & Governance Committee

REMUNERATION COMMITTEE REPORT



Highlights

- No salary increases in 2016
- No annual bonus payout for 2015
- Amended 2016 Performance Share Plan (PSP) awards, including reduction in value
- New operational measures for annual bonus

2015 overview

Introduction

On behalf of the Board, I am pleased to introduce our 2015 Directors' Remuneration Report, for which we seek your support at our forthcoming AGM, in May 2016. This report is designed to demonstrate the link between the Group's strategy, its performance, and the remuneration outcomes for our executives, in particular the Executive Directors. 2015 has been a challenging year for the Group and this is reflected in the performance outcomes for Executive Directors under the annual bonus and Performance Share Plan (PSP).

At the beginning of 2016, we consulted with shareholders on proposed changes to the 2016 annual bonus and PSP. These changes are within the terms of the approved policy, but we nevertheless considered it important to receive input from shareholders to maintain an open dialogue on remuneration and inform our judgement. The changes were driven by our desire to ensure we properly motivate our Executive Directors to deliver the transformation of the business, whilst balancing the interests of shareholders and other stakeholders.

Following Warren East's appointment as Chief Executive and the changes he is introducing to the business, we will be reviewing our Group-wide remuneration policies in the second half of 2016.

Principal responsibilities

The key areas of responsibility of the committee are:

- to set and monitor the strategy and policy for the remuneration of the Executive Directors, the Chairman and members of the ELT;
- to determine the design, conditions and coverage of annual and long-term incentive plans for senior executives and approve total and individual payments under the plans;
- to determine targets for any performance-related pay plans;
- to determine the issue and terms of all share-based plans available to all employees; and
- to oversee any major changes in remuneration.

Committee members and attendance

The committee membership and attendance throughout 2015 is shown on page 65. In addition to the committee members, the Chief Executive, the Chief Financial Officer and any of the Non-executive Directors may attend one or more meetings at the committee's invitation, although none was present during any discussions of his or her own remuneration package. The committee is supported by the Company Secretary, the Senior Reward Consultant, the Group Human Resources Director, and the Global Performance, Reward & Pensions Director. The committee is advised by Deloitte LLP, an independent reward adviser.

At a glance

Area of focus	Matters considered	Outcome
Base salaries	Base salaries, in accordance with the remuneration policy.	Increases to salaries for Colin Smith and David Smith March 2015. There will be no salary increases for Executive Directors in 2016.
Bonus outcome	Performance against bonus targets under the Annual Performance Related Award (APRA).	No bonus was paid in 2015 for 2014 performance and there will be no awards for 2015 performance. The maximum bonus opportunity for the Chief Executive was 180% of salary, and for the other Executive Directors 150% of salary.
Performance Share Plan award	Performance under the 2012 and 2013 PSP.	The 2012 PSP awards vested at 67% of the maximum award. The 2013 PSP awards will lapse in their entirety in March 2016 based on performance to 31 December 2015.
Leadership team changes	The terms of appointment for Warren East, who was appointed as Chief Executive on 3 July 2015. James Guyette retired from the Board on 8 May 2015 and John Rishton retired as Chief Executive on 2 July 2015.	The committee agreed the terms for Warren East's appointment. His base salary on appointment was £925,000 (equivalent to his predecessor) with a maximum annual bonus opportunity of 180% of salary, a maximum PSP opportunity of 180% of salary and a pension allowance of 25% of salary. Neither James Guyette nor John Rishton participated in the 2015 annual bonus. No bonus was paid in respect of 2014 and therefore no entitlement to shares arose on retirement. The deferred portion of their 2013 APRA awards was released following retirement. PSP awards made in 2013 and 2014 remained subject to performance targets with any vesting time-apportioned for the period that they were employed by the Group. The 2013 award has now lapsed in full based on Company performance.
2016 Annual Performance Related Award	Performance measures for the APRA to align better with the operational strategy for 2016. As Rolls-Royce enters a year of transformation it is important that the Group does not lose focus on the customer, and that employees are fully engaged in the transformation.	The committee agreed that for 2016, the weightings of the bonus performance measures will be: • 37.5% Profit and 37.5% Cash performance • 12.5% Customer performance (measured through on-time delivery percentage) • 12.5% People engagement (measured through our Employee Opinion Survey) Any bonus payments in relation to non-financial measures will be subject to achieving a PBT threshold. Awards earned based on the above measures will continue to be subject to the personal performance assessment which allows an uplift of up to 20% or a reduction, potentially to zero. The maximum opportunities will remain 180% of salary for the Chief Executive and 150% of salary for other Executive Directors.
2016 PSP award	Performance conditions for the 2016 PSP award.	For 2016 our PSP will continue to be based on CPS and TSR measures with an EPS hurdle. The EPS hurdle will be measured over the period 2017-2018. This change reflects the current business circumstances and the intended level of stretch of the EPS hurdle which is used as an underpin rather than as a primary performance measure. In recognition of the change, the maximum 2016 PSP award level will be reduced from 180% to 150% of salary for the Chief Executive and from 150% to 130% for other Executive Directors.
Governance matters	Terms of reference to ensure their adequacy and we assessed whether all the requirements of the terms of reference had been satisfied during the year.	The terms of reference for the committee were reviewed and minor amendments made. The committee was satisfied that it had covered all the requirements of the terms of reference during the year.

Remuneration policy

This year we have sought to improve the design and content of this report to include a summary of our remuneration policy, which remains unchanged. It is shown on page 90 and the full policy is available on the Group's website at rolls-royce.com.

The remuneration policy is designed to attract, retain and motivate executives of the highest quality, incentivising them to deliver exceptional business performance aligned with the interests of shareholders, and to deliver the Group's strategy and objectives. The committee has taken care to ensure any change or decision made around remuneration potential for Executive Directors remains consistent and in line with the policy as approved by shareholders.

We value shareholder comments on our remuneration policy and its implementation. We strive to ensure that the policy is aligned to our strategy to enable the Group to attract and keep the experts and expertise it needs to deliver business success. To this end, the committee will begin a review of the policy in 2016 and propose any changes necessary to ensure that it continues to support our strategy. We will consult with shareholders on any proposed changes before bringing a revised policy to the 2017 AGM for approval.

Committee composition

I was delighted to welcome Sir Kevin Smith as a new member to the committee when he joined the Company as a Non-executive Director in November 2015. With his operational experience, Sir Kevin is well placed to offer challenge and support in ensuring that our remuneration is aligned to our strategy and incentivises exceptional performance.

The committee composition is shown on page 65.

Activities

No substantial changes have been made to Directors' remuneration in 2015 and all payments made have been in line with the approved remuneration policy.

We reviewed the executive reward framework as a precursor to the review of the remuneration policy and considered the high-level assumptions that would be used for the review.

We set the package terms for the appointment of Warren East as Chief Executive and delegated authority to the Chairman to finalise the terms of his contract within the agreed parameters. Details of his terms of appointment are shown on page 75.

We also considered and agreed the overall remuneration proposals for the new members of the ELT who were appointed during the year.

John Rishton and James Guyette both retired during the year, and the committee considered the terms of their departures. The committee agreed that neither should participate in the 2015 APRA, and that the deferred shares under the 2013 APRA be released to them after retirement. Their existing PSP awards remained, subject to performance conditions and time apportionment for the period that they were employed by the Group, in accordance with the rules of the PSP.

We reviewed our annual bonus plan to ensure that it will support the transformation of the business. As a result, and following consultation with shareholders, we have introduced two new metrics into the APRA, relating to on-time delivery to customers and to employee engagement, that reflect the strategic priorities of the business over the next year. Underlying financial performance will still be required in order for the bonus to pay out. The introduction of the measures will support the work being carried out on business transformation and operational effectiveness.

In recognition that 2016 is set to be a challenging year, and to ensure that our incentives are motivating for the management team during the transformation of the business, the committee reviewed the PSP. Following consultations with shareholders, we agreed that, for awards made in 2016 only, the EPS condition which underpins the award would measure growth over two years (2017-2018) against a baseline set in 2016. In recognition of this, the 2016 awards will be scaled back so that the maximum PSP award for the Chief Executive will be reduced from 180% to 150% of salary, and from 150% to 130% of salary for other Executive Directors.

2015 outturn

Group underlying profit and cash flow were below the base level performance targets and therefore no bonus will be paid for 2015.

Over the three-year performance period for the 2013 PSP grant, earnings per share growth was -13.7% which was below the growth measured by the OECD index of consumer prices of 3.8%. Cash flow per share was 45p against a threshold of 53p. As EPS growth and CPS were below the performance targets the awards have not vested and have lapsed.

2016 salary review

The committee has reviewed the salary levels of the Executive Directors in accordance with the remuneration policy and concluded that no increases to Executive Directors' base salaries will be made in 2016.

2016 Annual General Meeting (AGM)

The main part of this report sets out the way in which our remuneration policy was implemented during the year ended 31 December 2015 and shows how we intend to apply it in 2016. This will be subject to an advisory shareholder vote at the AGM.

Having served for nine years, I will be stepping down from the Board after the AGM in May 2016 and Ruth Cairnie will become chairman of the Remuneration Committee at that point. We look forward to your continuing support.

Dame Helen Alexander
Chairman of the Remuneration Committee

DIRECTORS' REMUNERATION REPORT

The table below shows how we have applied the remuneration policy during the year. It discloses all the elements of remuneration received by the Executive and Non-executive Directors during 2015.

SINGLE FIGURE OF REMUNERATION (AUDITED)

	Salary/fees (A) £000		Benefits (B) £000		Bonus (C) £000		LTIP (D)[12] £000		Other (E) £000		Sub-total £000		Pension (F) £000		Total £000	
	2015	2014	**2015**	2014	**2015**	2014	**2015**	2014	**2015**	2014	**2015**	2014	**2015**	2014	**2015**	2014
Executive Directors																
Warren East[1]	**421**	–	**8**	–	**–**	–	**–**	–	**–**	–	**429**	–	**114**	–	**543**	–
Colin Smith	**546**	525	**140**	138	**–**	–	**–**	395	**–**	–	**686**	1,058	**140**	131	**826**	1,189
David Smith[2]	**535**	84	**35**	2	**–**	–	**–**	–	**–**	–	**570**	86	**171**	27	**741**	113
James Guyette[3]	**274**	510	**47**	108	**–**	–	**–**	404	**–**	–	**321**	1,022	**262**	504	**583**	1,526
Mark Morris[4]	**–**	429	**–**	149	**–**	–	**–**	–	**597**	–	**597**	578	**–**	137	**597**	715
John Rishton[5]	**519**	925	**82**	151	**–**	–	**–**	1,217	**–**	–	**601**	2,293	**153**	303	**754**	2,596
Sub-total	**2,295**	2,473	**312**	548	**–**	–	**–**	2,016	**597**	–	**3,204**	5,037	**840**	1,102	**4,044**	6,139
Chairman and Non-executive Directors																
Ian Davis	**425**	425	**1**	3	**–**	–	**–**	–	**–**	–	**426**	428	**–**	–	**426**	428
Dame Helen Alexander	**90**	85	**–**	1	**–**	–	**–**	–	**–**	–	**90**	86	**–**	–	**90**	86
Lewis Booth	**110**	100	**11**	6	**–**	–	**–**	–	**–**	–	**121**	106	**–**	–	**121**	106
Ruth Cairnie[6]	**70**	23	**3**	–	**–**	–	**–**	–	**–**	–	**73**	23	**–**	–	**73**	23
Sir Frank Chapman	**90**	85	**4**	3	**–**	–	**–**	–	**–**	–	**94**	88	**–**	–	**94**	88
Alan Davies[7]	**12**	–	**–**	–	**–**	–	**–**	–	**–**	–	**12**	–	**–**	–	**12**	–
Irene Dorner[8]	**30**	–	**–**	–	**–**	–	**–**	–	**–**	–	**30**	–	**–**	–	**30**	–
Warren East[1]	**45**	67	**–**	–	**–**	–	**–**	–	**–**	–	**45**	67	**–**	–	**45**	67
Lee Hsien Yang	**70**	67	**8**	2	**–**	–	**–**	–	**–**	–	**78**	69	**–**	–	**78**	69
John McAdam	**70**	67	**–**	–	**–**	–	**–**	–	**–**	–	**70**	67	**–**	–	**70**	67
Jasmin Staiblin	**70**	67	**7**	1	**–**	–	**–**	–	**–**	–	**77**	68	**–**	–	**77**	68
Sir Kevin Smith[9]	**12**	–	**–**	–	**–**	–	**–**	–	**–**	–	**12**	–	**–**	–	**12**	–
Iain Conn[10]	**–**	29	**–**	–	**–**	–	**–**	–	**–**	–	**–**	29	**–**	–	**–**	29
John Neill[11]	**25**	67	**3**	2	**–**	–	**–**	–	**–**	–	**28**	69	**–**	–	**28**	69
Sub-total	**1,119**	1,082	**37**	18	**–**	–	**–**	–	**–**	–	**1,156**	1,100	**–**	–	**1,156**	1,100
Total	**3,414**	3,555	**349**	566	**–**	–	**–**	2,016	**597**	–	**4,360**	6,137	**840**	1,102	**5,200**	7,239

[1] Warren East was appointed as Chief Executive on 3 July 2015, having served as a Non-executive Director since 1 January 2014
[2] David Smith was appointed on 4 November 2014
[3] James Guyette left the Board on 8 May 2015. His 2014 pension contributions have been restated to allow for the 2014 employer true up match contribution paid in March 2015 of £42,000
[4] Mark Morris left the Board on 4 November 2014
[5] John Rishton stepped down as Chief Executive, and left the Board, on 2 July 2015
[6] Ruth Cairnie was appointed on 1 September 2014
[7] Alan Davies was appointed as a Non-executive Director on 1 November 2015
[8] Irene Dorner was appointed as a Non-executive Director on 27 July 2015
[9] Sir Kevin Smith was appointed as a Non-executive Director on 1 November 2015
[10] Iain Conn left the Board on 1 May 2014
[11] John Neill left the Board on 8 May 2015
[12] The 2014 LTIP has been recalculated using the actual vesting prices of 935.19p per share for James Guyette and Colin Smith and 1042.00p per share for John Rishton. The original calculation used a share price of 863.65p per share, the average share price over the quarter ended 31 December 2014, as the vesting price was not known at the date of approval of the 2014 Directors' Remuneration Report.

DIRECTORS' REMUNERATION REPORT CONTINUED

Notes to the table

A. Salary and fees

BASE SALARY

The Executive Directors' salaries are normally reviewed, but not necessarily increased, with effect from 1 March each year.

The committee reviewed the salary levels of Executive Directors during the year and the result of the review is shown below.

David Smith's increase reflected that his salary on appointment was positioned to allow scope for progression in the role and the increase made in the year reflects that progression. The increase in March 2015 for Colin Smith reflected the importance of the role to the business along with the current modest positioning compared to the external market range. No salary increases will be made for any Executive Directors in 2016.

EXECUTIVE DIRECTORS' BASE SALARY

Name	Base salary as at 1 March 2016	Base salary as at 1 March 2015 or date of appointment if later	Base salary as at 1 March 2014 or date of appointment if later
Warren East[1]	£925,000	£925,000	n/a
Colin Smith	£550,000	£550,000	£525,000
David Smith[2]	£540,000	£540,000	£510,000

[1] Warren East's salary level was effective from the date of his appointment on 3 July 2015

[2] David Smith's salary level was effective from the date of his appointment on 4 November 2014

NON-EXECUTIVE DIRECTORS' FEES

The Chairman's fee is reviewed by the Board as a whole on the recommendation of the Remuneration Committee and the review of the Non-executive Directors' fees is reserved to the Executive Directors, who take recommendations from the Chairman. No individual may be involved in setting his or her own fee. The Non-executive Directors' fees were last increased with effect from 1 May 2014.

The Chairman and Non-executive Directors are not eligible to participate in any of the Group's share schemes, incentive arrangements or pension schemes. We have in place a facility to enable Non-executive Directors to use some or all of their fees, after the appropriate statutory deductions, to make market purchases of shares in the Company on a monthly basis. Dame Helen Alexander, Ruth Cairnie, Sir Frank Chapman, Ian Davis, Lee Hsien Yang and John McAdam participate in this facility.

NON-EXECUTIVE DIRECTORS' BASE FEES

	2015 £000	2014 £000
Chairman	**425**	425
Other Non-executive Directors	**70**	70
Chairman of the Audit Committee	**25**	25
Chairman of the Safety & Ethics Committee	**20**	20
Chairman of the Remuneration Committee	**20**	20
Chairman of the Science & Technology Committee	**20**	–
Senior Independent Director	**15**	15

OUR APPROACH TO SALARY AND FEES IN 2016

The committee reviewed Executive Directors' salaries in early 2016 and agreed that no increases would be made in 2016

No increases will be made to Non-executive Directors' fees in 2016

B. Benefits

Benefits are provided to ensure that remuneration packages remain sufficiently competitive to recruit and retain directors and to enable them to devote themselves fully to their roles. The benefits for the Non-executive Directors relate predominantly to travel and subsistence associated with attending Board meetings, although for Directors who are based outside the UK, the Company may pay towards tax advice and filing. Additionally, the Chairman has occasional use of a chauffeur service to enable him to undertake his duties. The taxable value of all benefits paid to Executive Directors in the year is shown below.

BENEFITS PAID TO EXECUTIVE DIRECTORS

	Car or car allowance including fuel allowance £000		Chauffeur services £000		Financial planning £000		Medical insurance £000		Life assurance £000		Club membership fees £000		Travel and subsistence £000		Housing costs £000		Total £000	
	2015	2014	**2015**	2014	**2015**	2014	**2015**	2014	**2015**	2014	**2015**	2014	**2015**	2014	**2015**	2014	**2015**	2014
Executive Directors																		
Warren East[1]	**7**	–	**–**	–	**–**	–	**1**	–	**–**	–	**–**	–	**–**	–	**–**	–	**8**	–
Colin Smith	**30**	24	**–**	–	**6**	5	**2**	2	**–**	–	**–**	–	**4**	3	**98**	104	**140**	138
David Smith[2]	**16**	2	**–**	–	**–**	–	**2**	–	**–**	–	**–**	–	**5**	–	**12**	–	**35**	2
James Guyette[3]	**5**	11	**–**	–	**20**	18	**–**	7	**–**	33	**6**	24	**–**	–	**16**	15	**47**	108
Mark Morris[4]	**–**	21	**–**	–	**–**	5	**–**	1	**–**	–	**–**	–	**–**	23	**–**	99	**–**	149
John Rishton[5]	**14**	21	**14**	14	**6**	5	**1**	2	**–**	–	**–**	–	**–**	3	**47**	106	**82**	151
Total	**72**	79	**14**	14	**32**	33	**6**	12	**–**	33	**6**	24	**9**	29	**173**	324	**312**	548

[1] Warren East was appointed as Chief Executive on 3 July 2015, having served as a Non-executive Director since 1 January 2014
[2] David Smith was appointed on 4 November 2014
[3] James Guyette left the Board on 8 May 2015
[4] Mark Morris left the Board on 4 November 2014
[5] John Rishton stepped down as Chief Executive, and left the Board, on 2 July 2015

OUR APPROACH TO BENEFITS IN 2016

There will be no change to our approach to benefits in 2016.

C. Annual bonus

Annual bonuses may be awarded under the Annual Performance Related Award plan (APRA).

Executive Directors receive any annual bonus awarded in March following the performance period. The bonus is paid partially in cash and partially in deferred shares. The deferred shares are held in trust for two years before being released, subject to the recipient being still employed by the Group. Ordinary shares held as deferred shares may receive a bonus issue of C Shares during the deferral period. Malus and clawback provisions apply from the date of deferral until three years after the release of shares where there is: a material misstatement of the audited results; failure of risk management; serious reputational damage to the Company as a result of misconduct; serious breach of the Company's global code of conduct; or gross misconduct.

APRA 2015

The Remuneration Committee reviewed the 2015 outturn against the performance measures, which are shown overleaf, and determined that bonuses would not be payable this year in respect of performance in 2015.

The APRA bonus is determined by Group financial performance and personal performance. The Group financial performance is based on the addition of the cash and profit outturns, with a specified minimum level to be achieved on both, after deduction of the cost of bonus from profit. For 2015, the Group financial measures were cash flow performance and group underlying profit. Levels for both of these measures and their outcome are shown overleaf.

DIRECTORS' REMUNERATION REPORT CONTINUED

APRA 2015 PERFORMANCE MEASURES

	2015 performance measures				2015 outcome		
	Profit[1]		Cash[1]		Profit	Cash	Total bonus
	%	£m	%	£m	£m	£m	£m
Base	15	1,526	15	250	1,339	123	–
Target	30	1,526	30	350			
Maximum	50	1,536	50	500			

[1] Group underlying profit and cash flow, after deduction of the cost of bonus, and excludes the impact of acquisitions and disposals in the year and unbudgeted foreign exchange translation effects where material. To reflect the disposal of the Energy business, the December 2014 forecast cash and profit were added back to the 11 month actual results for bonus purposes.

For 2015 the base level of profit was set to be equivalent to target profit. This was to take into account the cost of the all-employee bonus plan which was aligned to the base and target profit levels.

OUR APPROACH TO APRA IN 2016

Following consultation with shareholders at the start of 2016, the committee has determined that the bonus in respect of 2016 will be operated on similar terms to 2015, but with the introduction of two new measures relating to customer and employee engagement. Any bonus in relation to the non-financial targets will be subject to achieving the underlying profit threshold. The maximum bonus opportunities for Executive Directors will remain at 180% for the Chief Executive and 150% of salary for other Executive Directors.

2016 WEIGHTINGS OF ANNUAL BONUS MEASURES

	Profit %	Cash %	Customer %	Employee engagement %	Maximum business outturn %
Target	37.5	37.5	12.5	12.5	100

Base, target and maximum performance levels are set for all business measures and result in 30%, 60% and 100% outturns respectively. The individual performance multiplier can increase or decrease the business outturn in a range of 0-120%.

D. Long-term incentives – Performance Share Plan

The PSP is designed to attract, reward and incentivise selected senior executives who can influence the long-term performance of the Group and execute the business strategy. Under the PSP, awards of shares are made annually at the start of a three-year performance period. Vesting is subject to continued employment and achievement of Group performance conditions. The number of shares vesting will be determined by the growth in aggregate cash flow per share (CPS) over the performance period. CPS is calculated as reported cash flow before the cost of business acquisitions or proceeds of disposals, foreign exchange translation effects, special payments into pension schemes and payments to shareholders, divided by the weighted average number of shares in issue. CPS is cumulative over a three-year period.

A further performance measure is growth in TSR relative to the FTSE 100 or other appropriate index. Where the Company's TSR is ranked above median in the comparator group, the shares vesting will be increased by 25%. Where the ranking is at or within upper quartile, the vesting will be increased by 50%. Between these two points, the increase will be on a straight-line basis.

The above measures are underpinned by growth in earnings per share (EPS). Growth in EPS must exceed the growth in an appropriate consumer price index over the performance period for any shares to vest.

PSP awards are conditional share awards and are usually made in March with the release date being in March of the year following the completion of the three-year performance period, subject to the performance criteria being met. Malus and clawback provisions apply where: there has been a material misstatement of audited results; serious financial irregularity which invalidates the targets set; reputational damage; material failure of risk management; a serious breach of the Company's global code of conduct; or individual gross misconduct. Clawback will apply for three years after the vesting of an award.

PSP 2015 AWARD CPS TARGETS (AUDITED)

The cash flow per share targets for awards made in 2015 were as follows and straight-line vesting will apply between these points.

Aggregate cash flow per share over the three-year period	Maximum award released %
Less than 60p	0
60p	30
100p	100

PSP AWARDS MADE IN MARCH AND SEPTEMBER 2015

In 2015, Executive Directors received PSP awards in line with the remuneration policy as follows:

	Date of award	Number of shares awarded	% of salary	Performance period end date
Warren East	01/09/2015	126,643	100	31/12/2017
Colin Smith	02/03/2015	58,263	100	31/12/2017
David Smith	02/03/2015	57,204	100	31/12/2017

All awards are made as performance shares based on a percentage of salary and the value is divided by the average share price over a three-day period before the date of grant, being 944p for the award on 2 March 2015 and 730p for the award on 1 September 2015. The face value is the maximum number of shares that would vest (150% of the award) multiplied by the share price at the date of grant. If the EPS and base CPS targets are not achieved, no shares vest.

PSP AWARDS VESTING IN MARCH 2016

The following sets out details in respect of the March 2013 PSP award, for which the final year of performance was the 2015 financial year. Subject to performance conditions, these shares would be due to vest in March 2016, three years after the award was made.

	Targets for 2013 – 2015 period	Performance against targets
EPS growth (hurdle)	Awards may vest if EPS growth exceeds the OECD index of consumer prices. Awards will lapse if hurdle not met.	EPS growth of -13.7% over the three-year period underperformed the hurdle which was 3.8%.
Aggregate CPS (100% of award)	Aggregate CPS over three-year period of less than 56p – zero vesting. Aggregate CPS over three-year period of 94p – 100% vesting.	Aggregate CPS performance over three years of 45p.
Outcome		None of the 2013 shares will vest in March 2016.

OUR APPROACH TO PSP IN 2016

Following consultation with shareholders in early 2016, the committee has confirmed that CPS and TSR measures will continue to determine the vesting level of PSP awards for 2016 as described on page 80. The EPS hurdle will also apply, although we have adjusted the calculation of the EPS hurdle to reflect the very significant changes in our business environment and our financial forecasts, so that the measurement will be based on two years' performance from 2016. Without such adjustments, the awards would have been inappropriate as they would be unlikely to vest. To balance this, we have reduced the PSP award levels from a maximum of 180% to 150% of salary for the Chief Executive and from a maximum of 150% to 130% of salary for other Executive Directors. These targets have been chosen to ensure that the participants maintain focus on people and customers during the transformation of our business. The performance targets in respect of the 2016 to 2018 performance period under the aggregate CPS measure will be as follows:

PSP AWARDS TO BE MADE IN MARCH 2016

Aggregate CPS over the three-year period	Maximum award released %
Less than 10p	0
10p	30
50p	100

The stretch of these targets reflects that, during this period, we will be investing in ramping up Trent production, IT, new product technology and aftermarket capability, while at the same time implementing cost reductions and inventory and working capital improvements. We believe that the combination of the EPS hurdle, CPS and TSR targets are challenging and that the performance necessary to achieve awards towards the upper end of the range is stretching. They should not, therefore, be interpreted as providing guidance on the Group's future performance.

DIRECTORS' REMUNERATION REPORT CONTINUED

E. Other items

As reported last year, loss of office payments were made to Mark Morris who left the Group on 4 November 2014. The contractual payments were made in accordance with his service agreement. The total amount paid to him in 2015 in respect of the termination of his employment was £597,000.

Dr Mike Howse retired from the Board on 30 June 2005. Following his retirement, he has continued to be retained by the Company for his expertise in engineering and was paid £21,420 in 2015 (2014: £27,720).

F. Pension entitlements (audited)

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

Warren East and David Smith receive a cash allowance in lieu of a defined contribution pension accrual. Colin Smith, who opted out of future pension accrual with effect from 1 April 2006 and opted out of salary linkage with effect from 30 November 2015, receives a cash allowance in lieu of future pension accrual.

John Rishton, who left the Group and started to receive his pension on 2 July 2015, was a member of one of the Group's UK defined contribution pension schemes and received employer contributions restricted to the annual allowance limits with any excess paid as a cash allowance. The cash allowance was calculated as equivalent to the cost of the pension contributions allowing for National Insurance costs.

James Guyette, who retired and started to receive his pension on 8 May 2015, participated in pension plans sponsored by Rolls-Royce North America Inc (RRNA). He was a member of two defined benefit plans in the US, one qualified and one non-qualified. He accrued a retirement lump sum in both of these plans. In addition, he was a member of two 401(k) Savings Plans in the US, one qualified and one non-qualified, to which both he and RRNA contributed. He was also a member of an unfunded non-qualified deferred compensation plan in the US, to which RRNA made notional contributions. Under the defined benefit plans, the earliest age at which benefits could be taken without consent and without actuarial reduction was 65.

Details of the defined benefits of the Executive Directors as at 31 December 2015 in the Group's UK and US pensions schemes are given below.

DEFINED BENEFITS SCHEMES

Year	**2015 £000**	2014 £000
Colin Smith (UK pension funds)	**385**	393
James Guyette[1] (US pension funds)	**–**	1,380

[1] James Guyette retired on 8 May 2015 and received his full accrued lump sum entitlement amounting to £1,577,000, translated at £1=US$1.4833

Details of defined contribution pension contributions paid by the Group on behalf of the following Executive Directors are given below.

DEFINED CONTRIBUTION SCHEMES

	2015 £000	2014 £000
James Guyette[1] (left 8 May 2015)	**183**	391
John Rishton (left 2 July 2015)	**20**	42

[1] Benefits are translated at £1=US$1.5292 (2014: US$1.6477). There has been an adjustment to the defined pension contributions over 2014 to allow for the 2014 employer true up match contribution paid in March 2015 of £42,000

OUR APPROACH TO PENSIONS IN 2016

We will continue to operate both defined benefit and defined contributions pension plans on the basis outlined above.

We will continue to allow Directors to receive a cash allowance in lieu of contributions to the defined contribution pension scheme. Where a Director has opted out of future accrual under the defined benefit pension scheme, we will continue to pay a cash allowance in lieu of that accrual.

OTHER INFORMATION

A. CHIEF EXECUTIVE PAY, TSR AND ALL-EMPLOYEE PAY

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

- a seven-year history of our Chief Executive's remuneration;
- our TSR performance over the same period;
- a comparison of the year-on-year change in our Chief Executive's remuneration with the change in average remuneration across the Group; and
- a year-on-year comparison of the total amount spent on employment costs across the Group and shareholder payments.

CHIEF EXECUTIVE PAY

Year	Chief Executive[1]	Single figure of total remuneration £000	Annual bonus as a % of maximum	PSP as a % of maximum
2015	Warren East	543	–	–
2015	John Rishton[2]	754	–	–
2014	John Rishton	2,596	–	45
2013	John Rishton	6,228	55	100
2012	John Rishton	4,577	85	–
2011	John Rishton	3,677	63	–
2011	Sir John Rose[3]	3,832	–	75
2010	Sir John Rose	3,914	100	100
2009	Sir John Rose	2,409	29	93

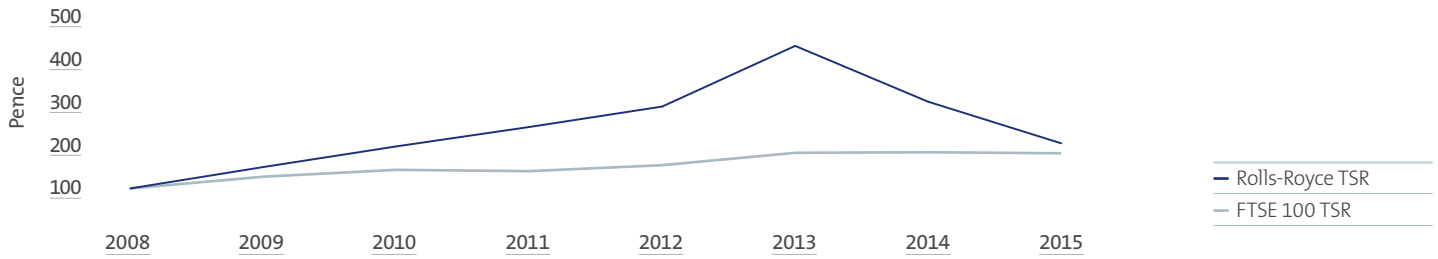
[1] On 31 March 2011, Sir John Rose retired and John Rishton was appointed. John Rishton retired on 2 July 2015 and Warren East was appointed on 3 July 2015.
[2] John Rishton received a special grant of shares on joining the Company on 1 March 2011 to mirror the shares he forfeited on resigning from his previous employer. The share price had increased from 483.50p at the time this grant was made to 870p at the end of 2014. These are the main reasons why John Rishton's remuneration in 2012 and 2013 exceeded that of his predecessor.
[3] The remuneration for Sir John Rose does not include any pension accrual or contribution as he received his pension from 1 February 2008.

DIRECTORS' REMUNERATION REPORT CONTINUED

TSR PERFORMANCE

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

The graph shows the growth in value of a hypothetical £100 holding in the Company's ordinary shares over seven years, relative to the FTSE 100 index.



PERCENTAGE CHANGE IN CHIEF EXECUTIVE REMUNERATION

The following table compares the percentage change in the Chief Executive's salary, bonus and benefits to the average percentage change in salary, bonus and benefits for all UK employees from 2014 to 2015.

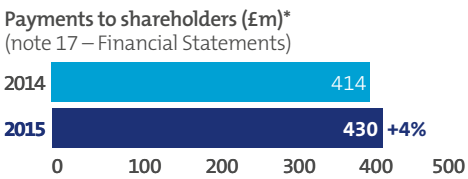
CHANGE IN REMUNERATION

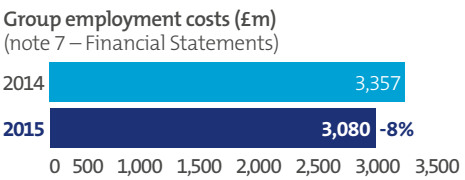
	Salary	Benefits	Annual bonus
Chief Executive	–%	(40)%	–%
UK employees average	3.2%	0.6%	–%

UK employees were chosen as a comparator group in order to avoid the impact of exchange rate movements over the year. UK employees make up 46% of the total employee population.

RELATIVE SPEND ON PAY

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





* Value of C Shares issued during the year

B. CONTRACTUAL ARRANGEMENTS

The Executive Directors have service agreements that set out the contract between each Executive Director and the Company. Executive Directors retain payments received from serving on the boards of external companies, the details of which are given below.

The Chairman and other Non-executive Directors have letters of appointment. Each Non-executive Director serves for a term of three years, which may be extended twice up to a total of nine years.

EXECUTIVE DIRECTORS' SERVICE CONTRACTS

	Date of contract	Notice period Company	Notice period individual
Warren East	21 April 2015	12 months	6 months
Colin Smith	1 July 2005	12 months	6 months
David Smith	19 November 2014	12 months	6 months

PAYMENTS RECEIVED FOR SERVING ON EXTERNAL BOARDS

	Directorships held	Payments Received £000
Warren East[1]	Dyson Limited, De La Rue	44
David Smith	Motability Operations Group plc	43

[1] Warren East stepped down from the board of De La Rue Holdings plc on 23 July 2015

NON-EXECUTIVE DIRECTORS' LETTERS OF APPOINTMENT

	Date of appointment letter	Current letter of appointment end date
Ian Davis	1 March 2013	29 February 2016
Dame Helen Alexander	1 September 2007	31 August 2016
Lewis Booth	25 May 2011	24 May 2017
Ruth Cairnie	1 September 2014	31 August 2017
Sir Frank Chapman	10 November 2011	9 November 2017
Alan Davies	29 July 2015	31 October 2018
Irene Dorner	12 February 2015	26 July 2018
Lee Hsien Yang	1 January 2014	31 December 2016
John McAdam	19 January 2008	18 February 2017
Jasmin Staiblin	21 May 2012	20 May 2018
Sir Kevin Smith	1 October 2015	31 October 2018

DIRECTORS' REMUNERATION REPORT CONTINUED

C. DIRECTORS' INTERESTS IN SHARES (AUDITED)

We believe it is important that the interests of the Executive Directors should be closely aligned with those of shareholders. The deferred APRA award and the PSP provide considerable alignment. However, participants in the PSP are also required to retain at least one half of the number of after-tax shares released from the PSP until the value of their shareholding reaches the percentage of salary shown in the table below. When this level is reached it must be maintained until retirement or departure from the Group. Each Executive Director's total shareholding, for the purposes of comparing it with the minimum shareholding requirement, includes shares held: by connected persons; in the all-employee Share Incentive Plan; and PSP shares that have vested, but does not include unvested PSP awards. The shareholding requirement is 250% of salary for the Chief Executive and 200% of salary for the other Executive Directors. APRA deferred shares do not count towards their minimum shareholding requirement.

Each Executive Director has built towards compliance with the minimum shareholding requirement as detailed in the table below.

MINIMUM SHAREHOLDINGS

Year	Base salary £000	Total shareholding	Minimum shareholding requirement as % of salary	Minimum shareholding requirement[1]	Actual shareholding as % of minimum requirement
Warren East	925	24,990	250	244,969	10
Colin Smith	550	208,105	200	116,526	179
David Smith	540	20,328	200	114,407	18

[1] Salary divided by the March 2015 PSP grant price of 944.00p multiplied by percentage of salary

The Directors and their connected persons had the following interests in the ordinary shares and C Shares of the Company at 31 December 2015, or at date of leaving or retirement if earlier, as shown in the table below.

DIRECTORS' SHARE INTERESTS

			Unvested awards			Vested awards
	Ordinary shares	C Shares[1]	Conditional shares not subject to performance conditions (APRA)	Conditional shares subject to performance conditions (PSP)	Options over shares subject to savings contracts (ShareSave)	Vested shares and options exercised in year
Executive Directors						
Warren East (appointed 3 July 2015)	24,990	–	–	126,643	1,264	–
Colin Smith	208,105	–	16,000	162,903	758	66,427
David Smith	20,328	–	–	75,491	758	–
James Guyette (left 8 May 2015)	388,846	–	16,307	103,484	–	–
John Rishton (left 2 July 2015)	503,807	–	33,490	221,238	1,745	–
Chairman and Non-executive Directors						
Ian Davis	37,476	–	–	–	–	–
Dame Helen Alexander	4,969	–	–	–	–	–
Lewis Booth	60,000	–	–	–	–	–
Ruth Cairnie	7,482	–	–	–	–	–
Sir Frank Chapman	14,948	1,515,481	–	–	–	–
Alan Davies	10,370	–	–	–	–	–
Irene Dorner	5,000	–	–	–	–	–
Lee Hsien Yang	2,170	–	–	–	–	–
John McAdam	2,803	–	–	–	–	–
Jasmin Staiblin	–	–	–	–	–	–
Sir Kevin Smith	20,000	–	–	–	–	–
John Neill (left 8 May 2015)	46,616	–	–	–	–	–

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

CHANGES IN INTERESTS (AUDITED)

	Ordinary shares		C Shares	
	31 December 2015	Changes from 31 December 2015 to February 2016	**31 December 2015**	Changes from 31 December 2015 to February 2016
Executive Directors				
Warren East	**24,990**	126	**–**	–
Colin Smith	**208,105**	3,403	**–**	–
David Smith	**20,328**	260	**–**	–
Chairman and Non-executive Directors				
Ian Davis	**37,476**	1,362	**–**	–
Dame Helen Alexander	**4,969**	413	**–**	–
Lewis Booth	**60,000**	–	**–**	–
Ruth Cairnie	**7,482**	782	**–**	–
Sir Frank Chapman	**14,948**	1,502	**1,515,481**	1,273,883
Alan Davies	**10,370**	–	**–**	–
Irene Dorner	**5,000**	83	**–**	–
Lee Hsien Yang	**2,170**	404	**–**	–
John McAdam	**2,803**	89	**–**	–
Jasmin Staiblin	**–**	–	**–**	–
Sir Kevin Smith	**20,000**	–	**–**	–

DIRECTORS' INTERESTS IN UNVESTED AND VESTED AWARDS

WARREN EAST

	31 December 2014	Granted during year	TSR uplift/ dividend enhancement	Vested awards	Lapsed	**31 December 2015**	Market price at date of award (p)	Date of grant	Date of vesting	Market price at vesting (p)
PSP 2015	–	126,643	–	–	–	126,643	730.00	01/09/2015	01/09/2018	–
Total	–	126,643	–	–	–	**126,463**				
ShareSave (options)[1]	–	1,264	–	–	–	1,264	616.80	12/10/2015	01/02/2021	–
Total	–	1,264	–	–	–	**1,264**				

[1] For ShareSave, the share price shown is the exercise price which was 85% of the market price at the date of the award

COLIN SMITH

	31 December 2014	Granted during year	TSR uplift/ dividend enhancement	Vested awards	Lapsed	**31 December 2015**	Market price at date of award (p)	Date of grant	Date of vesting	Market price at vesting (p)
PSP 2012	62,987	–	11,420	42,284	32,123	–	809.70	01/03/2012	02/03/2015	935.19
PSP 2013	51,304	–	–	–	–	51,304	1023.33	01/03/2013	01/03/2016	–
PSP 2014	53,336	–	–	–	–	53,336	984.33	07/05/2014	03/03/2017	–
PSP 2015	–	58,263	–	–	–	58,263	944.00	02/03/2015	02/03/2018	–
Total	167,627	58,263	11,420	42,284	32,123	**162,903**				
APRA 2012	23,207	–	936	24,143	–	–	1023.33	01/03/2013	02/03/2015	935.19
APRA 2013	16,000	–	–	–	–	16,000	984.40	07/05/2014	03/03/2016	–
Total	39,207	–	936	24,143	–	**16,000**				
ShareSave (options)[1]	–	758	–	–	–	758	616.80	12/10/2015	01/02/2019	–
Total	–	758	–	–	–	**758**				

[1] For ShareSave, the share price shown is the exercise price which was 85% of the market price at the date of the award

DIRECTORS' REMUNERATION REPORT CONTINUED

DAVID SMITH

	31 December 2014	Granted during year	TSR uplift/ dividend enhancement	Vested awards	Lapsed	**31 December 2015**	Market price at date of award (p)	Date of grant	Date of vesting	Market price at vesting (p)
PSP 2014	18,287	–	–	–	–	18,287	984.33	03/03/2014	03/03/2017	–
PSP 2015	–	57,204	–	–	–	57,204	944.00	02/03/2015	02/03/2018	–
Total	18,287	57,204	–	–	–	**75,491**				
ShareSave (options)[1]	–	758	–	–	–	758	616.80	12/10/2015	01/02/2019	–
Total	–	758	–	–	–	**758**				

[1] For ShareSave, the share price shown is the exercise price which was 85% of the market price at the date of the award

JAMES GUYETTE[1]

	31 December 2014	Granted during year	TSR uplift/ dividend enhancement	Vested awards	Lapsed	**8 May 2015**	Market price at date of award (p)	Date of grant	Date of vesting	Market price at vesting (p)
PSP 2012	64,385	–	11,674	43,223	32,836	–	809.70	01/03/2012	02/03/2015	935.19
PSP 2013	51,714	–	–	–	–	51,714	1023.33	01/03/2013	01/03/2016	–
PSP 2014	51,770	–	–	–	–	51,770	984.33	07/05/2014	03/03/2017	–
Total	167,869	–	11,674	43,223	32,836	**103,484**				
APRA 2012	25,770	–	1,039	26,809	–	–	1,023.33	01/03/2013	02/03/2015	935.19
APRA 2013	16,307	–	–	–	–	16,307	984.40	07/05/2014	01/03/2016	–
Total	42,077	–	1,039	26,809	–	**16,307**				

[1] James Guyette stepped down from the Board on 8 May 2015

JOHN RISHTON[1]

	31 December 2014	Granted during year	TSR uplift/ dividend enhancement	Vested awards	Lapsed	**02 July 2015**	Market price at date of award (p)	Date of grant	Date of vesting	Market price at vesting (p)
PSP 2012	133,383	–	24,183	89,541	68,025	–	809.70	01/03/2012	23/04/2015	1042.00
PSP 2013	108,470	–	–	–	–	108,470	1023.33	01/03/2013	01/03/2016	–
PSP 2014	112,768	–	–	–	–	112,768	984.33	07/05/2014	03/03/2017	–
Total	354,621	–	24,183	89,541	68,025	**221,238**				
Performance related shares[2]	40,565	–	7,355	27,232	20,688	–	601.50	09/03/2011	23/04/2015	1042.00
Total	40,565	–	7,355	27,232	20,688	**–**				
APRA 2012	48,250	–	1,946	50,196	–	–	1,023.33	01/03/2013	23/04/2015	1042.00
APRA 2013	33,490	–	–	–	–	33,490	984.40	07/05/2014	03/03/2016	–
Total	81,740	–	1,946	50,196	–	**33,490**				
ShareSave (options)[3]	1,450	–	–	–	–	1,450	525.00	01/02/2012	01/02/2017	–
ShareSave (options)[3]	295	–	–	–	–	295	961.60	01/02/2014	01/02/2017	–
Total	1,745	–	–	–	–	**1,745**				

[1] John Rishton stepped down as Chief Executive, and from the Board, on 2 July 2015
[2] The performance related shares were awarded as part of a special grant of shares to John Rishton on joining the Company and were intended to mirror the fair value and vesting profile of incentives he forfeited on leaving his previous employer
[3] For ShareSave, the share price shown is the exercise price which was 85% of the market price at the date of the award

D. ADDITIONAL INFORMATION

Advisers to the committee

During the year, the committee had access to advice from Deloitte LLP's executive compensation advisory practice. Total fees for advice provided to the committee during the year by Deloitte were £125,150 (2014: £81,432). Deloitte also advised the Company on tax, assurance, pensions and corporate finance and Deloitte MCS Limited provided consulting services. The committee is exclusively responsible for reviewing, selecting and appointing its advisers. The committee reviewed its appointment of Deloitte LLP during the year and confirmed its reappointment as adviser.

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

Statement of shareholder voting

	For	Against	Votes withheld
Results of the resolution approving the 2014 remuneration report at the AGM held on 8 May 2015			
Percentage of votes (%)	98.11	1.89	4.38
Number of votes cast	1,228,258,116	23,643,321	54,797,128

The remuneration policy was approved by shareholders at the 2014 AGM. We monitor carefully shareholder voting on our remuneration policy and implementation. We recognise the importance of ensuring that our shareholders continue to support our remuneration arrangements and have consulted with shareholders even on changes within the policy.

Statutory requirements

The Directors' Remuneration Report has been prepared on behalf of the Board by the Remuneration Committee.

We adopt the principles of good governance as set out in the UK Corporate Governance Code 2014 and comply with the regulations contained in Schedule 8 of the Large and Medium-sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013, the Listing Rules of the Financial Conduct Authority and the relevant schedules of the Companies Act 2006.

The Companies Act 2006 and the Listing Rules require the Company's auditor to report on the audited information in their report on page 173 and to state that this section has been properly prepared in accordance with these regulations. The Directors' Remuneration Report is subject to shareholder approval at the AGM on 5 May 2016.

The Directors' Remuneration Report was approved by the Board on 11 February 2016 and signed on its behalf.

Dame Helen Alexander
Chairman of the Remuneration Committee

A summary of the remuneration policy is shown on page 90 and the full policy is available on our website, rolls-royce.com.

REMUNERATION POLICY SUMMARY

Fixed remuneration	Purpose
Base salaries	The Company provides competitive salaries, suitable to attract and retain individuals of the right calibre to develop and execute the business strategy. Salaries are set using careful judgement taking into account a range of factors including experience, role and responsibilities, performance and salaries elsewhere in the Group. Decisions on salary are informed but not led by reference to companies of a similar size, complexity and international reach. Salaries are reviewed, although not necessarily increased, annually. Any salary increases will not normally exceed average increases for employees in other appropriate parts of the Group. The committee may exercise discretion to make larger increases in circumstances where it is necessary to address particular issues or risks, although in exercising such discretion the resulting salary will not exceed the competitive market range. Executive Directors may be appointed at salaries below the target level to enable pay progression commensurate with growth in the new role.
Benefits	Benefits include car or car allowance and related costs, financial planning assistance and certain insurances and other appropriate benefits at the discretion of the committee. Relocation support, or support for accommodation and travel, may be offered to executives where necessary. Benefits excluding any accommodation, relocation and associated tax costs will not exceed £100,000 per annum.
Pension	The maximum employer contribution to defined contribution pension arrangements is 38% of base salary. Pension contributions are based on base salary only. A cash allowance may be paid in lieu of pension contributions, reduced to allow for the additional NI incurred. A number of legacy plans are also in operation, including defined benefits plans which are closed to new members under which a maximum of two thirds of final salary may be accrued. A cash allowance may be paid in lieu of pension contributions.

At risk remuneration	Purpose
Annual bonus	The annual bonus is designed to incentivise execution of the business strategy, delivery of financial targets and the achievement of personal objectives. The bonus payout level is determined primarily by Group financial performance but the committee may introduce non-financial metrics and/or adjust the payout level to reflect other factors as appropriate. The final bonus awarded to each Director is also linked to personal performance. No bonus is payable unless the base financial targets are achieved and this also applies if non-financial measures are introduced. The committee also has discretion to increase the bonus to 200% for the Chief Executive and 175% for other Executive Directors respectively subject to this not being above the competitive market range. Between 30% and 50% of the bonus is compulsorily deferred into shares for a period of two years and released subject to continued employment.
Performance Share Plan	The PSP is designed to reward the development and execution of the business strategy over the longer term, providing alignment with shareholder interests through the performance conditions and a retention element through the plan timescale. Executive Directors are granted awards over shares annually at the start of a three-year performance period. The proportion of award that vests is determined at the end of the period according to a set of Company performance measures. The three corporate performance measures are CPS (the prime measure), TSR (relative to the FTSE 100 or other appropriate index) and EPS. Maximum face values of annual awards are 180% of salary for the Chief Executive and 150% for the other Executive Directors.
All employee share plans	The Executive Directors may participate in the ShareSave and Share Incentive plans on the same terms as other employees.

AUDIT COMMITTEE REPORT

Highlights

- Accounting policies and key judgements and estimates are appropriate
- Procedures in place to identify, manage and review principal risks
- Internal control system meets Code requirements
- KPMG recommended for re-appointment
- Audit will be tendered in 2016, in line with EU directive

2015 overview

Introduction

I am pleased to present the 2015 report of the Audit Committee which describes how the committee has carried out its responsibilities during the year. I would like to thank the members of the committee, the executive management team and KPMG for the open discussions that take place at our meetings and the importance they all attach to its work.

All members of the committee are independent Non-executive Directors. There have been a number of changes to the committee's composition during the year. Lee Hsien Yang joined the committee in March 2015. John Neill stood down from the Board in May and Warren East stepped down before taking on the role of Chief Executive in July 2015. Irene Dorner joined the committee on 27 July 2015. Irene's background in banking gives her a strong understanding of complex financial issues and risk management processes. Alan Davies joined the committee on 1 November 2015. Alan is a fellow of the Institute of Chartered Accountants in Australia and through his career at Rio Tinto has amassed considerable financial experience, including serving as CFO of its Iron Ore group.

Lewis Booth, Alan Davies and Irene Dorner are considered by the Board to have recent and relevant financial experience. Their biographies are on page 59 and 60.

Principal responsibilities

The key areas of responsibility of the committee are:

Financial reporting

- review financial results announcements and financial statements, focusing on:
  - the appropriateness of critical accounting policies, judgements and estimates and consistent application of those accounting policies;
  - inclusion of appropriate disclosures;
  - compliance with relevant regulations;
  - reporting to the Board as to whether the Annual Report, as a whole, is fair, balanced and understandable.

Risk and control environment

- assess the scope and effectiveness of the systems to identify, manage and monitor financial and non-financial risks;
- assess the management of principal risks allocated to the committee: business continuity, market and financial shock and IT vulnerability;
- review the procedures for detecting, monitoring and managing the risk of fraud;
- review the system of internal control over the business processes and the risks identified through the risk management process.

Internal audit

- review the scope, resources, results and effectiveness of internal audit.

External auditors

- oversee the relationship with the external auditor, reviewing the effectiveness of the external audit process and making recommendations to the Board for the external auditor's appointment and fees.

Areas of focus in 2015

- reviewing key accounting judgements and estimates and the consistent application of accounting policies which had the most significant impacts on the financial results in 2015;
- overseeing the activities undertaken to maintain compliance with the UK Corporate Governance Code 2014 (the Code) requirements, including enhancements to the risk management and internal control systems to improve oversight by the Board and its committees;
- assessing the effectiveness of internal control over financial reporting and agreeing an improvement plan;
- overseeing the development of the Group's approach to the viability statement;
- agreeing an audit tender plan, scheduled for 2016;
- monitoring the project to assess the impact of IFRS 15 and implement its requirements;
- detailed reviews of cyber security and business continuity risks;
- supporting the implementation of the new management information system.

AUDIT COMMITTEE REPORT CONTINUED

At a glance:

Area of focus	Matters considered	Outcome
Financial reporting	The appropriateness of accounting policies and key accounting judgements and estimates, including: • reversal of impairment on contractual aftermarket rights; • estimates used in accounting for long-term contractual arrangements, including the regular review of the methodologies for taking account of uncertainties in these estimates and the financial impact; • impairment of goodwill in Marine; • adequacy of warranty provisions in Marine; • carrying value of goodwill in Rolls-Royce Power Systems AG; and • disclosures of contingent liabilities. The form and content of the 2015 Annual Report. The requirements and necessary judgements of IFRS 15 *Revenue from Contracts with Customers*.	The accounting policies and key judgements and estimates are appropriate and key estimates used are balanced. The Annual Report, taken as a whole, is fair, balanced and understandable. Recommended that the Group should seek, as far as possible, to implement IFRS 15 in a way which appropriately reflects the underlying business drivers and the interpretations of other aerospace and defence companies.
Risk and control environment	Improvements to the risk management and internal controls systems to address new requirements of the Code. Management's assessment of the risk of a disruptive event. The procedures for monitoring and combatting breaches of the IT system. The processes for identifying and managing risks. The model for assessing the effectiveness of the Group's systems of internal control. The process and assumptions underlying the viability statement.	Appropriate procedures are in place to identify and manage principal risks and all of these have been subject to a review by the Board or an appropriate Board committee. Appropriate procedures are in place to manage business continuity and cyber-security risks. The internal control system is sufficient to meet the requirements of the Code. It will continue to be enhanced during 2016. Reported to the Board that an appropriate process is in place to make the viability statement.
Internal audit	The effectiveness of the internal audit function, its key findings and trends arising, and the resolution of these matters.	The scope, extent and effectiveness of internal audit are appropriate.
External audit	The approach and scope of external audit and the effectiveness and independence of the external auditor. Plans for the tendering of the external audit to meet the requirements of the EU directive. The extent of non-audit services provided by KPMG.	Assessed KPMG as effective and independent and recommended their re-appointment at the 2016 AGM. Agreed plan to tender the audit during 2016, with new auditor to be appointed to report in the 2018 Annual Report. No concerns over the nature and scale of the non-audit services provided.

Operation of the committee

The committee's responsibilities are outlined in its terms of reference which can be found in the Board governance document on the Group's website. We review these annually and refer them to the Board for approval. During 2015, we made revisions to clarify our interaction with other committees in meeting the requirements of the Code.

Following the changes agreed in 2014, which gave us additional responsibilities for the oversight of risk management, the committee has worked closely with the Director of Risk to enhance the Group's risk management system.

As described on page 66, the performance of the committee was independently assessed in 2014, with a follow-up in 2015.

Sector audit committees

In support of our work, each of the Group's businesses has its own sector audit committee, each of which comprises senior finance personnel and is attended by KPMG. These committees:

- allow the review of accounting policies and their consistent application, risk management, internal systems and issues arising at a more detailed level;
- give us further assurance as to the extent of management control and accountability;
- promote the governance culture within the Group; and
- inform areas for further consideration at our meetings.

In 2015, additional committees were established to cover central functions including group finance, treasury, tax, transaction processing shared-service centres, property, human resources, engineering and technology, information technology, and our regional offices. These additional committees provide assurance that all key areas are covered. In particular, they consider issues arising from the interactions between the businesses and central functions. All the committees meet twice a year to consider the accounting policies, judgements and estimates and the internal control environment. They are chaired by the Director of Internal Audit, who then reports to us.

In 2015, the sector audit committees have focused on internal control and risk management processes in support of the new requirements of the Code. We expect this to continue in 2016, as we seek to enhance these processes, making them as effective and efficient as possible.

Business and function presentations

We have a regular schedule of presentations from each of the Group's businesses and its key functions. During 2015, we received presentations from the following:

- **Civil Aerospace business** – key business risks (including major product failure, on-time and profitable delivery of new programmes, business continuity risks including supply chain disruption and market shock due to external events or factors reducing air travel); accounting policies; key accounting judgements, estimates and controls; credit risks associated with customers; and TotalCare and CorporateCare accounting.
- **Nuclear business** – key business risks (including the future of the UK submarine programme, government relations, new programmes, and product safety); growth in civil nuclear markets; accounting policies and key accounting estimates (which principally relate to accounting for long-term contracts); and controls.
- **Power Systems** – key business risks (including competitor actions, the low oil price, and warranties); new programme developments; accounting policies; key accounting estimates (largely relating to warranty provisions) and controls.
- **Director of Tax** – approach to managing the Group's tax affairs; key tax risks and how they are managed (with specific consideration of customs duties); effective tax rate; UK tax position; and key tax-related accounting policies and judgements.

Financial reporting

We place considerable emphasis on making sure that the accounting policies are appropriate and are consistently applied so that the financial statements faithfully represent the results and financial position of the Group and its underlying contractual arrangements. Given the long-term nature of the Group's businesses, most of the accounting policies subject to significant judgement do not change significantly year-on-year. However, the facts and circumstances on which those judgements are based do vary over time, with a consequential impact on the application of the policies. The key areas of focus in 2015 are set out in the table overleaf. In part, these reflect the current weak trading conditions in Marine. Overall, we are satisfied that the judgements and estimates made are balanced.

During the year, we discussed the requirements of IFRS 15 *Revenue from Contracts with Customers*, which will be applicable for 2018. This new standard will have a significant impact on our accounting policies for revenue recognition in our Civil Aerospace business. The Group is consulting with other companies in the aerospace and defence sector, and we will take account of other interpretations in our implementation of the new requirements. This is discussed further in the accounting policies on page 121.

Since the year end, we have reviewed the form and content of the Group's 2015 Annual Report together with the processes used to prepare and verify it. We have reported to the Board that, taken as a whole, we consider the Annual Report to be fair, balanced and understandable. We further believe the Annual Report provides the necessary information for shareholders to adequately assess the Company's performance, business model and strategy.

The Group is also implementing a new management information system covering both financial and non-financial information. The committee strongly supports this initiative and is reviewing the progress of this project to ensure that it provides improvements in the information used to manage the business.

AUDIT COMMITTEE REPORT CONTINUED

Key issues	Matters considered	Outcome
Reversal of impairment on contractual aftermarket rights	The background to the impairment charges originally made on certain Trent 1000 contractual aftermarket rights and the reasons and supporting evidence as to why it is considered that the circumstances have changed, requiring the reversal of these charges.	We are satisfied that this is an appropriate judgement. We paid particular attention to the requirements of accounting standards and to the engineering assessment of the improved outlook for the cost of maintaining these engines.
Indications of impairment of the carrying values of intangible assets in Civil Aerospace	The assessments of the value-in-use of the principal intangible assets, including the key assumptions and estimates on which they are based.	We are satisfied that there were no indications of impairment.
The estimates used in accounting for long-term contractual arrangements in Civil Aerospace are appropriate	The basis on which the estimates are prepared and, in particular, how the inherent uncertainties are reflected in these estimates. In 2015, as we had agreed in 2012, the methodologies to reflect risk, current experience and expected long-term performance were reviewed.	We are satisfied that the process produces balanced estimates, with appropriate consideration of the uncertainties. Refinements to the methodologies as a result of the review, resulted in a one-off profit benefit to the income statement of £189m.
The sale of engines to joint ventures	The basis for assessing the selling price.	We are satisfied that the price represents the fair value of the engines.
Impairment of goodwill in Marine	The forecasts for each of the relevant cash generating units, including the key assumptions on which they are based.	We are satisfied with the analysis and that impairments should be recognised where these did not support the carrying value of the goodwill.
Whether there is any impairment to the carrying value of the goodwill in Rolls-Royce Power Systems AG	The business plan, and the underlying assumptions on which it is based.	We are satisfied that, although the headroom has reduced as a result of the current trading environment, there is no indication of impairment.
Warranty and contractual provisions in Marine	The basis for specific warranty and contractual provisions, including those established in 2014 and 2015 for product quality issues.	We are satisfied that the estimates reflect a balanced assessment of the likely outcome.
The disclosures of contingent liabilities, in particular those in respect of the possible outcome of the SFO enquiries, are adequate	Legal advice received in respect of the SFO enquiries.	We are satisfied that the disclosures appropriately reflect the current position.

Risk and control environment

Assessment of principal risks

Risk management is fundamental and forms an integral part of how we work. All risks are managed through a risk management system (described on page 54) in accordance with policies and guidance established by the Director of Risk and his team and approved by the Board. The new requirements of the Code have provided a catalyst to review and enhance these, to improve Board oversight and to enable continuous monitoring within the businesses. On behalf of the Board, we monitored this system and the enhancements.

In addition, as described in last year's Annual Report, the Board allocated responsibility for reviewing certain principal risks to an appropriate committee.

This process and the principal risks arising then formed the basis for our assessment of the going concern and viability statements which are discussed later in this report. As described on page 54, the processes are designed to identify and manage, rather than eliminate, the risk of failure to achieve our business objectives.

We satisfied ourselves that the processes for identifying and managing the principal risks are appropriate and that all risks and mitigating actions had been subject, during the year, to a detailed review by the Board or an appropriate committee. Based on this and on our other activities including consideration of the work of internal and external audit and presentations from senior management of each business which include risk management, we reported to the Board that a robust assessment of the principal risks facing the Company had been undertaken.

We also considered in detail the principal risks that have been allocated to us by the Board.

Business continuity – we reviewed management's contingency plans in the event of a disruptive event, most particularly within the aero gas turbine supply chain, both external and internal. These take account of the likelihood of such an incident, its impact on the business and its likely duration, and the cost and availability of mitigating actions. The Group has an incident management framework in place, including a crisis management team to deal with any significant event.

IT vulnerability – recent events make it clear that this is an increasing issue for all companies, and particularly for Rolls-Royce given the nature of the data held. During the year, we visited the Group's security centre where we met with the senior IT security team. During this visit, the Group's systems for preventing breaches of the IT system and procedures for monitoring and combatting those arising were demonstrated. We discussed with the team the evolving nature of cyber attacks and how its procedures are evolving in parallel. During the year, a dashboard was developed to monitor attacks and how they are dealt with.

Market and financial shock – as part of the decision to issue the US$1.5bn bond in October 2015, the Board considered the exposure of the Group to financial market risks including: foreign currency exchange rates; oil price; liquidity and credit risks; and reduction in air travel or other disruption to customer operations. The Board also reviewed the Group's management of these risks. As this area was subject to detailed review by the Board, we did not consider it necessary to repeat this.

Internal control

The Board has overall responsibility to the shareholders for the Group's system of internal control over its business and risk management processes and the risks identified through the risk management process. The committee has responsibility for reviewing the system's operation and effectiveness.

The Group has a long-standing process for identifying risks and planning mitigating actions and for assessing the effectiveness of internal control. In assessing the Code requirements, enhancements to the existing processes were identified. We approved an enhanced model for representing the system, comprising:

- entity-level controls covering leadership and direction from the top; and
- specific control activities, covering detailed process controls, and internal and external assurance activities.

This model was then populated and the operation and effectiveness of the controls rated. This commenced in 2015 and prioritised:

- entity-level controls;
- controls over principal risks as described on pages 55 and 56;
- controls over key risks and critical processes for each of the Group's business; and
- core financial controls.

We considered that the existing process, together with the enhancements implemented to date, are sufficient to meet the requirements of the Code and the FCA's Disclosure Rules and Transparency Rules and we concluded that the operation and monitoring of controls, including those relating to the financial reporting process, were effective during the year. Work will continue during 2016 to complete the definition and documentation of the controls in the enhanced model.

Judgement is required in evaluating the risks facing the Group in achieving its objectives, in determining the risks that are considered acceptable, in determining the likelihood of those risks materialising, in identifying the Group's ability to reduce the incidence and impact on the business of risks that do materialise, and in ensuring the costs of operating particular controls are proportionate to the benefit provided.

The enhanced control model has been reviewed by the sector audit committees and a summary by this committee. Going forward, this will be included in the presentations we receive from the Group's businesses and key functions, giving us the opportunity to discuss and challenge the assessments and judgements underlying the internal control systems.

The Group is also using this standardisation of the internal control framework as an opportunity to improve the consistency of reporting, in particular from the Group's smaller operations.

We paid particular attention to internal controls over financial reporting and, mindful of the current business challenges the Group is facing, have instigated, and will monitor progress in achieving, a wide-ranging plan to improve controls in this area.

The going concern and viability statements

We reviewed the processes and assumptions underlying the statements set out on page 57. In particular, we focused on the new viability statement and considered:

- the consistency of the analysis of risk impact with that reviewed by the Board as part of its strategy review;
- the assessment of the impact of individual risks, both in amount and timing;
- the analysis of multiple risk impacts; and
- the current financing in place and the availability of future financing.

As a result, we were satisfied that the viability statement had been prepared on an appropriate basis.

AUDIT COMMITTEE REPORT CONTINUED

Internal audit

We receive a quarterly dashboard from the Director of Internal Audit identifying key trends and findings of internal audit reports, and the resolution of actions agreed. Twice a year, we review detailed updates of significant findings. In particular, we review the nature and number of issues raised by internal audit and the time to complete the related actions, which during 2015 we considered to be reasonable.

Increasing focus has been put on identifying the root causes of unsatisfactory internal audit reports, both to consider whether there are any systemic areas of concern in the Group's control environment and to inform the development of future internal audit planning.

The committee considered and reviewed the effectiveness of the Group's internal audit function, including internal audit resources, plans and performance as well as the function's interaction with management. The outcome of the 2014 review of the audit function provided a number of improvements and changes which have been implemented during 2015. In particular, the recruitment process has been improved to ensure that the function maintains adequate resource to meet its objectives.

I meet the Director of Internal Audit privately before each meeting and on an ad-hoc basis throughout the year, and the committee as a whole has a private meeting with him at least once a year. These discussions cover the activities, findings, resolution of control weaknesses, progress against the agreed plan and the resourcing of the department.

We were satisfied that the scope, extent and effectiveness of internal audit work are appropriate for the Group and that there is a sound plan for ensuring that this continues to be the case as our business progresses and risks change.

External auditor

2015 audit

During the year, KPMG presented the audit strategy, which identified their assessment of the key audit risks and the proposed scope of audit work. We agreed the approach and scope of audit work to be undertaken. Key risks and the audit approach to these risks are discussed in the Independent Auditor's report (pages 167 to 174), which also highlights the other significant risks that KPMG drew to our attention.

We also undertook an assessment of KPMG's qualifications, expertise and resources, independence and the effectiveness of the external audit process. We reviewed the fees of the external auditor. Our conclusions were that the external audit was carried out effectively, efficiently and with the necessary objectivity and independence.

As part of the reporting of the half and full-year results, in July 2015 and February 2016, KPMG reported to the committee on their assessment of the Group's judgements and estimates in respect of these risks and the adequacy of the reporting. KPMG also report on their assessment of the Group's control environment.

We continue to be supportive of the extended auditor's report and KPMG's approach which goes beyond the minimum requirements, providing additional clarity on the key judgements and estimates.

I meet with the lead partner prior to each meeting and the whole committee has a private meeting with KPMG at least once a year. In 2015, upon their appointments to the committee, Lee Hsien Yan, Irene Dorner and Alan Davies had briefings with KPMG.

Reappointment of KPMG and audit tender process

The committee reviews and makes recommendations to the Board with regard to the reappointment of the external auditor. In doing so, we take into account auditor independence and audit partner rotation. KPMG were appointed as auditors in 1990 and we have not tendered the audit since. No contractual obligations restrict our choice of external auditor. The lead audit partner is required to rotate every five years and other key audit partners are required to rotate every seven years. Jimmy Daboo took over as lead audit partner in 2013, and will be required to rotate after the 2018 AGM. The committee and the Board have recommended KPMG's re-appointment at the 2016 AGM.

The new EU directive requires us to appoint a different auditor no later than 2020. During 2015, we have considered the plans for meeting these requirements. We believe that it is in the best interests of the Company and its shareholders to allow an appropriate period for the new auditor to build up a detailed knowledge of the business. A tender of the audit will be undertaken during 2016. The new auditor will then be appointed at the 2018 AGM and provide its first auditor's report in the 2018 Annual Report.

The Committee considers that the Company has, throughout the year ended 31 December 2015, complied with the provisions of the The Statutory Audit Services for Large Companies Market Investigation (Mandatory Use of Competitive Tender Processes and Audit Committee Responsibilities) Order 2014.

Non-audit services provided by KPMG

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

All proposed services must be pre-approved in accordance with the non-audit services policy which is reviewed and approved annually. Above defined levels, my pre-approval is required. The committee also reviews the non-audit fees charged by KPMG quarterly.

Non-audit related fees paid to KPMG during the year were 29% (2014: 39%) of the audit fee. Our annual review of the external auditor takes into account the nature and level of all services provided.

	2015		2014	
	£m	**%**	£m	%
Audit	**5.9**		5.7	
Audit-related	**1.3**	**22**	1.1	19
Tax compliance	**0.4**	**7**	0.7	12
Other	**–**	**–**	0.4	7
Non-audit	**1.7**	**29**	2.2	39

Based on our review of the services provided by KPMG and discussion with the lead audit partner, we concluded that neither the nature nor the scale of these services gave any concerns regarding the objectivity or independence of KPMG.

As part of the EU audit reform, further restrictions will be placed on auditors undertaking non-audit services from 2017. In the UK, these will be implemented by the Financial Reporting Council, which is expected to publish the final requirements in the first half of 2016. We will continue to monitor developments in this area and make amendments as necessary to the policy. We have also put in place additional procedures to monitor engagements with potential future auditors to ensure that, following the tender process, we can discontinue or transition any engagements as required.

Looking forward

The introduction of the recent changes to the Code has increased the focus of the committee on business risk, which continues to be a high profile topic in boardrooms. During 2015, we have made significant progress in developing further the existing processes for risk management and internal controls. However, we believe that that this is a continuous activity of improvement to the underlying processes, making them as effective and efficient as possible and ensuring that they are fully embedded as part of 'business-as-usual' activities. In championing this in 2016 and beyond, we will ensure that the Board, its committees and senior management have a sound basis for understanding the principal risks in the Group, assurance that they are being managed effectively and that the internal controls are appropriate and are operating effectively.

We will continue to monitor the key accounting judgements and estimates, focusing on ensuring consistent application across the Group. In particular, we will review the accounting impact of the transition in the Civil Aerospace business from mainly linked to mainly unlinked TotalCare contracts.

During 2016, we will also continue to review the development of the plans to implement IFRS 15 in 2018.

We will also continue to review the implementation of the improved management information system, ensuring that this will provide a robust basis for the management of the business and will support high quality analysis and will monitor progress on the internal financial control improvement programme.

As noted above, we plan to tender the audit in 2016 and this will be a significant activity for both the committee and management. We will ensure that the selection of the new auditor is based on a robust assessment, focusing on the qualities of the proposed audit team and their understanding of our business. As this process develops, our attention will also turn to ensuring that there is a seamless transition from KPMG to the new auditor.

Lewis Booth
Chairman of the Audit Committee

SAFETY & ETHICS COMMITTEE REPORT

Highlights

- Successful migration to a single Safety & Ethics Committee
- Product safety management system effective in responding to incidents in service
- Key HS&E global improvement programmes delivering results
- Good progress with the ethics and compliance improvement programme, including introduction of a global local ethics adviser network
- Aerospace and Defense industry leader in Dow Jones Sustainability Index 2015

2015 overview

Introduction

On 1 January 2015 the Group's separate Safety and Ethics Committees combined to become one committee.

The committee assists the Board in fulfilling its oversight responsibilities in respect of safety and ethics matters, which include: product safety; HS&E (occupational health, process safety, asset integrity, personal security and the environment); sustainability; and ethics (business ethics, anti-bribery and corruption and export controls compliance). It has been allocated responsibility on behalf of the Board for overseeing the Group's principal risks of product failure and compliance (see pages 54 to 56).

In addition to its oversight role for the Board, the committee supports management in its aim to create, promote and maintain an ethical, compliant, safety-conscious, environmentally-aware and socially-responsible culture across the Group as a means of delivering its safety and ethics goals.

Principal responsibilities

Under its wide remit, the committee's responsibilities include:

- to maintain an understanding of and keep under review the Group's frameworks for the effective governance of safety and ethics and the Group's culture in these areas;
- to oversee and review annually the Group's key safety and ethics policies, including: the Global Code of Conduct, anti-bribery and corruption and export controls, fraud, product safety, HS&E and sustainability policies, and ensuring appropriate independent scrutiny of policies and practices;
- to review the Group's compliance with relevant legislation, regulation and make recommendations in the key policy areas;
- to oversee training in respect of safety and ethics, including ensuring adequate arrangements exist to enable employees and contractors to raise concerns, in confidence;
- to review reports on issues raised through the Ethics Line and review the results of any investigations into ethical or compliance breaches or allegations of misconduct;
- to review reports on risks in relation to products not meeting safety expectations;
- to review reports on health and safety risk and proposed actions to manage such risks;
- to review remedial actions and lessons learned in relation to material investigations;
- to review disciplinary action taken following safety and ethics concerns; and
- to keep under review the key performance indicators in relation to safety and ethics.

The committee regularly reports to the Board and refers any concerns about possible financial improprieties to the Audit Committee.

The Director – Engineering & Technology, General Counsel, Director of Risk and other senior safety and risk executives attend committee meetings.

During the year the committee reviewed its terms of reference and recommended certain changes to reflect its oversight of the Company's strengthened commitment to sustainability. The terms of reference for the committee are available in the Board governance document available on the Group's website.

At a glance

Area of focus	Matters considered	Outcome
Product safety	Product safety incidents in service and the Group's response.	Satisfactory response to incidents and support to investigations.
	Review of product safety policy, assurance framework and safety management systems including in Marine and Power Systems.	The framework and systems are robust and provide appropriate governance and accountability.
	Review of product safety learning and development framework.	Widely deployed training across the Group, tailored to different categories of employees depending on role.
HS&E	Review of HS&E risk profile and learning from incidents.	Satisfactory process to contain and mitigate against future emergence of risks, including communication of learning points.
	Review of HS&E governance and accountability framework, learning and development programme and communications.	Model remains satisfactory and was strengthened in the non-aerospace businesses during the year. Training is being consolidated.
	Review of global HS&E improvement programmes.	Programmes are delivering improvements.
Sustainability	Plans to improve rating in Dow Jones Sustainability Index.	Target exceeded and achieved sector Industry Leader.
Ethics and compliance	Monitoring of ethics and compliance improvement programme.	Significant progress made in implementing the Group's plans, including Lord Gold's recommendations.
	Monitoring deployment of ABC policies and use of advisers.	Good progress and significant decrease in advisers.

Principal risks

The Board has allocated responsibility to the committee for reviewing the principal risks of product failure and compliance. These topics form a core part of discussions at our meetings, as described in more detail in the remainder of this committee report.

Product safety

The Group recognises that its products are mission critical to its customers, and the people its customers serve, all over the world. As Rolls-Royce products become increasingly technologically advanced, they are expected to always be reliable and safe whenever they are used, often in harsh operating environments. Our commitment to meet this expectation is essential to the Group's business, its reputation and its sustainability. As a committee we draw on our collective industry and regulatory experience to oversee the Group's work in achieving this.

Throughout the year, we were kept regularly updated on aviation product-related safety incidents in service and considered the potential impact on the Group and its products. We also oversaw the Group's response to a marine equipment product issue. Our work in reviewing incidents in service involved: monitoring management's progress in root cause identification; being briefed on the development and deployment of technical solutions required; testing the Group's approach in engaging with affected operators; and overseeing plans for the timely mitigation and retirement of any safety risk including through the application of lessons learned back into product design. The committee was satisfied with the Group's response in swiftly deploying its safety assessment process to mitigate, control and monitor any potential product safety risks as they emerged.

The committee considered the Group's product portfolio in offshore marine applications. We discussed with management the potential safety risk and associated liabilities were the Group in future to be requested to provide dynamic positioning equipment or systems for drill rigs and work-over vessels. The Group does not presently provide any such equipment for these specific applications. However this resulted in management reviewing its processes for ensuring that novel products, and novel applications of existing products, cannot be introduced without being the subject of a rigorous safety assessment and a suitability and performance review.

Throughout the year, the committee received detailed briefings in relation to elements of the product safety assurance framework and safety management system outlined on the following page. This included a review of how the Group is managing product safety assurance while major updates to the engineering processes in the Group's quality system are being implemented.

We spent time during 2015 gaining a more detailed understanding of product safety management in the Marine and Power Systems businesses. The committee was assured that progress is being made in deploying many of the rigorous safety methodologies used in aerospace to the Marine business in order to align the Group's global safety standards. Power Systems operates its own mature product safety assurance system to comparable standards. Further shared learning and closer alignment are planned for the future.

To maintain the highest standards of product safety requires that engineering tasks are carried out only by those with a suitable level of competence. During the year, the committee assessed the Group's product safety learning and development framework as it applies to different categories of employees depending upon their roles. To experience training first-hand, the committee members undertook an employee product safety training module.

SAFETY & ETHICS COMMITTEE REPORT CONTINUED

Product safety policy

The Group's product safety policy sets out the internal standards that we expect to be met across the Group, through the following five governing principles:

1. Leadership commitment and accountability	Our leaders champion product safety and prioritise it so that safety-related tasks receive the right level of attention, time and resource. We make accountability for product safety clear and ensure people understand what they are accountable for.
2. Level of product safety	We design our products to achieve a high level of safety consistent with their application, always ensuring that we meet or better the relevant Group, legal, regulatory and industry requirements. We assess what potentially could go wrong and put in place controls to meet the required safety levels, thereby reducing safety risks as far as is reasonably practicable.
3. Maintaining and improving product safety	We are committed to the continuous improvement of product safety and actively engage in setting industry standards and good practice. We continually measure our performance and rigorously investigate and resolve safety-related issues, systematically embedding the learning from these back into our practices and processes. Everyone is encouraged to report any product safety concerns.
4. Conforming product	Robust quality is an essential building block of product safety and by following our processes we can ensure that our products and those of our suppliers conform to specification.
5. Safety awareness and competence	Everyone who works in the Group shares responsibility for product safety and we are mindful of the safety implications of our actions. Training is provided to ensure a clear understanding of the product safety policy and processes. There is a collective and personal responsibility accepted by all. The product safety policy is subject to annual review by both the Group product safety review board and the committee. No significant policy weakness or omission was identified during the period of review.

Safety management system

In order to help the organisation to follow these five principles and meet the required standards through operational processes, the Group maintains a product safety management system (SMS). During 2015, it was agreed to develop the SMS manual further to clarify how accountability for product safety, in particular the conforming product element, flows through the organisation; and to define the role of Quality and Safety Assurance Boards in identifying and addressing causes of non-conformance.

The Group's engineering and safety processes must work together closely in order to ensure that we efficiently produce safe designs for our products. Safety assessments are undertaken in support of the design of all Rolls-Royce products and during in-service operation to support the response to arising safety issues. The test applied to all product safety risks is that they are both tolerable and as low as reasonably practicable. Tolerable risks are those that satisfy all relevant targets. The targets are set internally by the Group and externally by customers and regulators.

The safety assessment process that has been developed is based upon a standard industry approach as follows:

Safety assessment

Health, safety and the environment (HS&E)

During the year, we receive a number of briefings and presentations as part of an annual agreed cycle of HS&E topics. This enables oversight, discussion and year-on-year monitoring of the Group's progress on key aspects of its HS&E management and assurance.

At each meeting, the committee receives HS&E performance reports and a balanced scorecard showing performance trends against the objectives of protecting health, preventing injury and reducing environmental impact. Overall, in 2015, this showed improvement in all areas except personal safety. Areas for improvement were identified.

The committee also oversees the 'learning from incidents' process that examines root causes of significant and major incidents and defines measures to mitigate against the risk of similar incidents. In July 2015, we were saddened to learn that a contractor working in Italy had died from an electric shock at a customer site. A detailed investigation was conducted and a Group-wide HS&E bulletin was issued to share lessons learned and to stipulate actions needed to prevent any similar incident.

The Group also suffered two dust fires during the year at one of its facilities in Hucknall, UK. Whilst these were contained and no-one was injured, again the lessons learned were promptly shared and steps taken to mitigate against any re-occurrence at other Group sites.

We conducted an annual review of HS&E governance and concluded that this remained satisfactory, noting that it had been strengthened during the year to include a rolling calendar of executive level reviews. The committee also examined the HS&E Group risk profile which had been adapted during the year, and received assurance on the steps taken to contain known issues and to mitigate against the effects of future emerging risks. In December 2015, we endorsed the adoption of a revised Group HS&E policy.

The Group's HS&E experts gave progress updates to the committee during the year on the key HS&E improvement programmes:

- the process safety management programme is driving improvements in the management of high hazard processes, including relating to chemicals;
- the electrical safety programme has successfully raised the level of electrical safety management and control across the Group;
- waste control standards and tools, innovation, multi-site solutions and the development of exemplar sites are being used to manage and further the Group's waste action programme; and
- development of an improved HS&E management system continued throughout 2015 and is starting to be deployed.

The committee was satisfied that these programmes will continue to deliver improvements.

We also learned about the Group's management of the integrity of its infrastructure and assets, in order that HS&E risk can be profiled to reflect age or environmental conditions.

This year, as part of its occupational health strategy, the Group has increased the level of focus and resources being applied in promoting health risk management, resilience and wellbeing among the workforce. This has included the launch of toolkits, workshops, videos and blogs from the Chief Medical Officer.

The committee reviewed the overall HS&E learning and development programme and discussed how HS&E culture can be promoted and strengthened. The HS&E communications plan and initiatives were discussed, including the regular inclusion of HS&E 'moments' at team meetings (including the ELT), promotion of HS&E walks and talks, and the HS&E Week held Group-wide in October 2015. In September 2015, the committee undertook an HS&E walk with members of management at operational facilities in Derby, UK.

The committee received a presentation on the Group's environmental strategy, centred around efficient products, advanced technology for future low emission products, and reducing the environmental impact of business operations.

The model for governance of environmental aspects of the Group's business, product and operational strategies was also reviewed. This includes support provided to the management by an Environmental Advisory Board whose members and supporting project teams are respected authorities in their fields drawn from academia and external organisations.

Sustainability

The committee oversees and helps guide the Group's approach to sustainability, as well as monitoring progress towards goals in this area. In 2015, we discussed how sustainability can be used as a driver of value creation. To support this, the Group has been focusing in the year on reducing what it uses, re-using waste material, and recycling end-of-life products.

We were delighted that, in September 2015, Rolls-Royce achieved Industry Leader for the Aerospace and Defense sector in the Dow Jones Sustainability Index. This marked a significant (17%) improvement since 2014 reflecting the Group's progress across sustainability and corporate responsibility disciplines. All scores were well above the industry average for all sections. Of particular note to the committee was that the Group achieved industry best scores for product stewardship, corporate citizenship and philanthropy, as well as the environmental and social dimensions as a whole. You can read more about the Group's approach to sustainability on pages 48 to 51.

Ethics and compliance

There is recognition that the Board and the ELT must continue to demonstrate leadership around ethical and behavioural standards. The Board is determined to ensure this is embedded into the culture of the business. The committee plays a vital role in providing dedicated focus and attention on behalf of the Board to this critical area, including reviewing the Group's 2015 ethics and compliance employee communications plan.

Regulatory investigations

We previously reported that the SFO had begun a formal investigation. The Group is continuing to co-operate with the authorities in the UK, US and elsewhere. The committee received regular updates on the regulatory investigations. As the investigations are still ongoing we are unable to give any further details or a timescale for when they will conclude.

Disciplinary proceedings under the Global Code of Conduct (Global Code)

If an employee is found to have acted in breach of the Company's Global Code, the Group takes appropriate action to address that breach. That action may include giving a disciplinary warning, imposing another penalty or, ultimately, terminating employment in the most serious of cases. In 2015, there were 33 employees whose employment ended for reasons relating to breaches of the Global Code.

Ethics and compliance improvement programme and Lord Gold's review

Lord Gold was engaged in 2013 to provide independent assessment and guidance to assist the Company in improving its ethics and compliance culture. In December 2014, Lord Gold issued a second interim report and recommendations on the results from his detailed review. The Group has been implementing these recommendations in 2015 through its ethics and compliance improvement programme under the committee's oversight, and has continued to make good progress. Lord Gold attended three meetings of the committee during the year. We discussed the results of his review and his observations, including insights from focus groups held with a mix of employees in different countries.

The size, structure and skills of the risk team were kept under review during the year with regard to required resourcing to deliver and maintain the appropriate level of focus.

Anti-bribery and corruption (ABC) policies

In 2014, the ABC compliance team completed a thorough and successful review and update of the Group's policies on ABC, advisers, confidential information, gifts and hospitality and facilitation payments. In 2015, this work expanded to the review and updating of policies on offset, conflicts of interest and lobbying and political donations together with guidance on managing the ABC risks of sponsorship and donations. All of these refreshed policies were fully operational by the end of 2015 and are being rolled out in the Power Systems business in 2016. Completion of this roll-out will mean that unified global ABC policies will be implemented across the entire Group. The committee, throughout the year, turned its focus to ensuring the effective monitoring of the suite of policies and their implementation.

During the year, the risk team also launched a due diligence toolkit, which enables managers across the Group to understand and manage ABC risks relating to lower risk third parties such as maintenance repair and overhaul centres, logistics providers and suppliers.

Following the introduction of the Group's new adviser policy, the number of advisers engaged has reduced dramatically for all businesses except Power Systems, which has a large network of distributors and is more reliant on the services of third parties to sell, distribute and support its products. However, the Group is applying its new adviser policies to all Power Systems' third parties and this review is expected to be completed during 2016. In addition, every new proposal to engage an adviser must go through rigorous review by the Group's advisers and offset panel, presently comprised of the Director of Risk, Lord Gold, and a partner from an external law firm.

Ethics Line and local ethics advisers

As part of the committee's responsibility, the Group's confidential reporting line, the Ethics Line, was discussed and reviewed. The Group continues to improve awareness of the 'speak-up' channels available to employees through training and ongoing engagement. Ethical questions and concerns that are raised by employees and other stakeholders are recorded as contacts in the Ethics Line system. Whilst the total number of Ethics Line contacts decreased in 2015 to 729 (2014: 850 contacts) this was largely driven by a reduction in the number of questions asked, with the number of ethical concerns raised remaining at a similar level to last year at 439 (2014: 434 concerns). The Ethics Line oversight group, which was originally formed in 2014, continued to review cases, analyse the contact trends and provide updates to the committee highlighting any high-risk cases. We share any concerns about possible improprieties in matters of financial reporting with the Audit Committee.

During 2015, the committee supported and welcomed the introduction of a global network of local ethics advisers appointed from the existing workforce who are trained in how to respond to ethical issues raised. The presence of these 76 local points of contact is designed to promote 'speaking-up' and tackling of ethical issues locally where appropriate to provide staff with an alternative to using other 'speak-up' channels including the Ethics Line.

Export control

During the year, the committee received briefings and a presentation on the export control compliance landscape, the key risks, and the Group's export control enhancement programme to address those risks. This included discussion of the Group's processes and systems for classification of parts, and the deployment of extra export control professionals into the business.

Training

The committee reviewed the proposal for an integrated ethics training and communications campaign to engage the Group's employees further, and to create the right environment for our employees to 'speak-up and ask' and 'think and act'. This built on the manager-led ethics toolkit discussions undertaken in 2014 whilst bringing a fresh approach for 2015, built around a series of filmed scenarios to prompt manager-led group discussions. Annual ethics training is mandatory for all employees across the Group, and the Board and the ELT undertook this ethics training in the year. Each member of the ELT also had a personal objective to lead an ethics session with their teams during 2015. A series of monthly dilemma-based stories drawn from real cases were also published on the Group's intranet during 2015, inviting employees to vote on what action they would take.

In 2015, a further mandated ABC training programme for employees was rolled out, as well as annual online export control training.

Conclusion

The committee is pleased with the progress made by the Group during the year promoting the safety and ethics agenda, and in particular in developing and undertaking detailed improvement plans. These plans are making a difference across the Group. The focus of the committee in 2016 is expected to turn to the challenge of ensuring that the improvement programmes transition into a sustainable 'steady-state' position that will provide a strong platform for achievement of the Group's safety, ethics, and wider objectives and targets over the years to come.

Sir Frank Chapman
Chairman of the Safety & Ethics Committee

SCIENCE & TECHNOLOGY COMMITTEE REPORT

Highlights

- Broad review of key technologies undertaken
- Technology acquisition process and relevant benchmarks reviewed
- Technology selection and funding outcomes for 2015 reviewed
- Deep reviews of selected key technologies for aerospace and marine
- Group's approach to digitisation as a disruptive enabler reviewed in detail

2015 overview

Introduction

I am pleased to present the inaugural report of the Science & Technology Committee, which the Board agreed to establish with effect from 1 January 2015.

The Group invests more than £1bn each year in R&D to enable us to conceive, design and deliver world-class technology that meets our customers' current and future requirements. The Board considers that this key area of the business will benefit from the dedicated focus and support of the committee especially in helping with the formulation of strategic direction. It is the aim of the committee to provide high level oversight and assurance of the Group's scientific and technological strategy, processes and investments.

Upon its creation, Warren East (then a Non-executive Director) assumed the chairmanship of the committee. In May 2015, he chaired the first of the two meetings of the committee held during the year (a planning session also having taken place in March 2015). Warren stepped down from the committee when he became Chief Executive in July 2015, and as an interim arrangement Ruth Cairnie chaired the second meeting of the committee in December 2015. I was appointed as the new chairman of the committee in February 2016. The membership of the committee presently comprises four independent Non-executive Directors.

Principal responsibilities

The remit of the committee is to:

- to review the strategic direction of the Company's research, technology and development activities;
- to provide assurance that significant trends in science, technology, software and data are identified and incorporated into management plans;
- to assist the Board in its oversight of major R&D investment and provide assurance on the competitiveness and adequacy of any R&D;
- to oversee the effectiveness of key engineering and technological processes and operations, including delivery of major product development and technology programmes, intellectual property management and interactions with institutions;
- to provide assurance on the identification and management of key technological risks;
- to oversee processes for ensuring effective resourcing and development of required technological capability and skills;
- to conduct visits to R&D facilities;
- to ensure dialogue with the Group's engineering and technology leaders and employees; and
- to review industry and scientific benchmark data and best practices.

The Director – Engineering & Technology, and other senior engineering and technology executives, attend the committee meetings.

SCIENCE & TECHNOLOGY COMMITTEE REPORT CONTINUED

At a glance

Area of focus	Matters considered	Outcome
Overview of technology	How the Group selects, develops and acquires new technology across all areas of the business; and the outcome of the process during 2015.	The technology process was appropriate and supported the development of the business.
Deep dives	Detailed technical briefings on certain key technologies for aerospace and marine applications.	The committee supported areas of innovation and the commercial application of new technologies.
Governance	The adequacy of the committee's terms of reference.	No changes were made to the terms of reference.

Overview and deep dive reviews

The first meeting of the committee served as an orientation session at which the members received detailed briefings and presentations from senior engineering and technology executives. This included a review of the Group's technology acquisition process, and a detailed walkthrough of each of the Group's identified key technologies in its businesses.

The committee learned about how the Group benchmarks its activities in R&D and research & technology providing measures to establish whether the Group is doing enough to capture its intellectual property.

In December 2015, a briefing was provided on technologies which could be potential disruptors (both as potential risks and opportunities).

A detailed discussion was held with the Group's Chief Scientific Officer and Chief Information Officer on steps taken in identifying and mitigating the risks and opportunities in emerging digital capabilities, and the Group's future plans for digital business. This included consideration of how digitisation could be applied to particular technologies reviewed in detail by the committee.

The committee reviewed the processes and outcomes of current technology selection and related funding, including a discussion of items that did not get funded and the reasons why.

The committee is continuing to review the Group's current and emerging technologies, as well as the measures that the Group deploys continually to assess the competitive and technological landscape. Maintaining technological advantage through leading-edge R&D, engineering and manufacturing techniques in the development of our products whilst ensuring they remain reliable, safe and compliant with regulatory standards is core to what the Group does. The committee will continue to support and guide management in its strategic decision-making on technology investments, and in assessing scientific and technology risks and opportunities for our business.

Sir Kevin Smith
Chairman of the Science & Technology Committee

University Technology Centres (UTCs)

We have established a global network of UTCs, with the first formal collaborations being signed in 1990. At first, UTCs were established mostly in the UK and more recently they have been founded in the US, Norway, Sweden, Italy, Germany and Korea. Additionally, Rolls-Royce has significant relationships with many other research centres around the world, including Japan, Singapore, China, Germany and the US.

Each UTC addresses a key technology; collectively they tackle a wide range of engineering disciplines from combustion and aerodynamics to noise and manufacturing technology. This consistent strategy of developing long-term relationships with selected universities has provided close contact with world-class academic institutions, and given access to a wealth of talent and creativity to help protect our capability into the future.

The aim is to satisfy the needs of the business and its customers whilst providing technical input that enhances the research reputation of the university. UTCs are long-term, funded collaborations that ensure continuity of work, offering high-quality technology for the Group and real-world challenges for academic partners. Each is led by a world-class academic and supported by a strong team of research fellows, associates, students, technicians, staff and facilities.

While the main focus of the UTC is long-term research, an additional advantage of the relationship is to provide the Group with access to highly capable people to support short-term needs. This can be beneficial to both parties, providing practical experience for the research team and valuable solutions for the Group.

RESPONSIBILITY STATEMENTS

STATEMENT OF DIRECTORS' RESPONSIBILITIES IN RESPECT OF THE ANNUAL REPORT AND THE FINANCIAL STATEMENTS

The Directors, as listed on pages 58 to 61, are responsible for preparing the Annual Report and the Group and parent company financial statements in accordance with applicable law and regulations.

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

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

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

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

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

Under applicable law and regulations, the Directors are also responsible for preparing a Directors' Report, Directors' Remuneration Report and Corporate Governance Statement that complies with that law and those regulations.

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

RESPONSIBILITY STATEMENTS UNDER THE DISCLOSURE RULES AND TRANSPARENCY RULES

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

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

ii) the Strategic Report on pages 2 to 57 and Directors' Report on pages 58 to 104 and pages 178 to 181 include a fair review of the development and performance of the business and the position of the Company and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face; and

iii) the Annual Report, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group's position and performance, business model and strategy.

By order of the Board

Pamela Coles
Company Secretary
11 February 2016

OTHER STATUTORY INFORMATION

Share capital

On 31 December 2015, 1,838,677,392 ordinary shares of 20p each, 28,959,754,116 C Shares of 0.1p 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 5pm BST on 1 June 2016 (CREST holders must submit their election in CREST before 3pm BST on 1 June 2016). Redemption will take place on 4 July 2016.

At the AGM, the Directors will recommend an issue of 71 C Shares with a total nominal value of 7.1p for each ordinary share. The C Shares will be issued on 1 July 2016 to shareholders on the register on 29 April 2016 and the final day of trading with entitlement to C Shares is 27 April 2016. Together with the interim issue on 4 January 2016 of 92.7 C Shares for each ordinary share with a total nominal value of 9.27p, this is the equivalent of a total annual payment to ordinary shareholders of 16.37p for each ordinary share.

Further information for shareholders is on pages 182 and 183.

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 at rolls-royce.com, 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; appoint one or more proxies or, if they are corporations, corporate representatives; and 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). These rights are set out in the Articles. 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 the Company's 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 UK 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 the consent of the Special Shareholder.

Authority to issue shares

At the AGM in 2015, authority was given to the Directors to allot new ordinary shares up to a nominal value of £124,333,948 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 2016, and the directors propose to renew these authorities at that AGM. It is proposed to seek a further authority, at the AGM in 2016 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 2016. The directors propose to renew the authority to allot new C Shares at the AGM in 2016.

Authority to purchase own shares

At the AGM in 2015, the Company was authorised by shareholders to purchase up to 186,500,921 of its own ordinary shares representing 10% of its issued ordinary share capital.

On 6 July 2015 the Company issued revised guidance for 2015 and announced that it would be cancelling its share buyback programme, having completed £500m of the planned £1bn programme during the first half of the year.

The authority for the Company to purchase its own shares expires at the conclusion of the AGM in 2016 or 18 months from 8 May 2015 whichever is the earlier. A resolution to renew it will be proposed at the 2016 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 2015 these facilities were less than 22% drawn (2014: 24%).

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.

OTHER STATUTORY INFORMATION CONTINUED

Major shareholdings

At 11 February 2016 the following companies had notified an interest in the issued ordinary share capital of the Company in accordance with the Financial Conduct Authority's Disclosure Rules and Transparency Rules.

Company	Date notified	% of issued ordinary sharecapital
ValueAct Capital Master Fund, L.P.	18 November 2015	10.01
Blackrock, Inc.	2 February 2016	5.00

Directors

The names of the Directors who held office during the year are set out on page 65.

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)
• employee involvement	49
• the future development, performance and position of the Group	2 to 57
• the financial position of the Group	42 to 47
• R&D activities	18
• the principal risks and uncertainties	54 to 57

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$45,021 (2014: US$52,690). 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 2015 AGM.

Greenhouse gas emissions

In 2015, our total greenhouse gas (GHG) emissions from our facilities and processes, including product test and development, was 602 kilotonnes carbon dioxide equivalent ($ktCO_2e$). This represents a decrease of 12% compared with 683 $ktCO_2e$ in 2014.

All figures exclude fugitive emissions of hydrofluorocarbons (HFCs) associated with air conditioning equipment. We are putting in place a system to be able to extract this data from records kept under the F-Gas regulations. We do not anticipate a material impact on our reported GHG emissions.

Total GHG emissions ($ktCO_2e$)	2011	2012	2013	2014*	**2015☑**
Direct emissions – facilities, processes, product test and development (Scope 1)	218	219	241	301	**242**
Indirect emissions – facilities, processes, product test and development (Scope 2)	327	313	313	382	**360**
Total for facilities, processes, product test and development	545	532	554	683	**602**
Direct emissions – power generation to grid (Scope 1)			153	155	**132**
Indirect emissions – power generation to grid (Scope 2)			12	14	**15**
Total for facilities, processes, product test and development, and power generation to grid			719	852	**749**
Intensity ratio (total emissions normalised by revenue) for facilities, processes, product test and development, and power generation to grid ($ktCO_2e$/£m)			0.048	0.062	**0.055**

* 2014 data has been restated to reflect the inclusion of greenhouse gas emissions data from Power Systems. Figures for prior years (2011 to 2013) do not include data from Power Systems and therefore are not directly comparable

☑ We engaged Bureau Veritas to undertake a limited assurance engagement, reporting to Rolls-Royce Holdings plc, using the assurance standards ISAE 3000 and ISAE 3410 over the energy, GHG and TRI data that has been highlighted with ☑ and as set out on page 51 and in the table above. The full statement is included on page 175

With the exceptions noted above, we have reported on all of the emission sources required under the Companies Act 2006 (Strategic Report and Directors Reports) Regulations 2013. These sources fall within our Consolidated Financial Statements. We do not have responsibility for any emission sources that are not included in our Consolidated Financial Statement.

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 and emission factors from the UK Government's GHG Conversion Factors for Company Reporting 2015.

Further details on our methodology for reporting and the criteria used can be found within our Basis of Reporting, available to download from our website at rolls-royce.com/sustainability.

Branches

Rolls-Royce is 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 subsidiaries, joint ventures and associates are listed on pages 160 to 166.

Post balance sheet events

There have been no events affecting the Group since 31 December 2015 which need to be reflected in the 2015 Consolidated 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 Consolidated Financial Statements.

Information required by UK Listing Rule (LR) 9.8.4

There are no disclosures to be made under LR 9.8.4.

Management report

The Strategic Report and the Directors' Report together are the management report for the purposes of Rule 4.1.8R of the Financial Conduct Authority's (FCA's) Disclosure Rules and Transparency Rules.

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.