Governance
Chairman’s introduction

The actions we have taken in 2012 should leave no doubt that the Board of Rolls-Royce will pursue the Code’s principles in the spirit in which they are intended.

Sir Simon Robertson
Chairman

In this report on governance, we will review the framework of rules and practices by which the Board of Rolls-Royce directed and controlled its business during 2012.

In 2012, the Association of British Insurers whose members account for a significant proportion of our shareholder base, issued a report on board effectiveness, which pinpointed three areas that it believed were essential to improving board effectiveness namely: board diversity, succession planning, and board evaluation.

The issues of diversity and the related topic of succession planning are high on our agenda and are covered in more detail in the nomination committee report on page 49.

With regard to board evaluation, we undertook an extensive external process in 2011 which provoked a good deal of debate and ushered in significant change. In 2012, I personally led a formal internal evaluation of the effectiveness of the Board. The general consensus from the confidential survey was that the Board continued to work well together and that Board interaction was effective. Further details of the process used and the outcome can be found on page 44.

Business ethics
The ethics committee spent a good deal of its time in 2012 dealing with concerns about bribery and corruption involving intermediaries in overseas markets which resulted in the Group handing over information to the Serious Fraud Office (SFO) in December 2012. This action, together with our appointment of Lord Gold to lead an independent review of our current compliance procedures, should make it clear to all who do business with us, or on our behalf, that the Board is united in its resolve not to accept any behaviour that undermines this Group’s future success. More information on the work of the ethics committee can be found on pages 50 to 51.

The International Advisory Board (IAB)
Rolls-Royce is a global company and whilst that brings with it many exciting opportunities it also presents significant challenges. We have an International Advisory Board, which has been in place for some six years. Its membership, which is listed on page 42, comprises senior business and political leaders from all the areas in which we are building and developing our business and where we have a substantial presence, such as the US, China, India and Australia. The IAB meets once a year and in 2012, it was held in Derby. Its remit is to discuss the high-level issues and their potential impact on the Group. This type of big picture discussion is vital for a company such as ours where our continued success depends on making very long-term investments.

Principal risks
In 2012, the risk committee reconsidered and redefined the principal risks which we face in our business. The resulting list on pages 18 to 19 has therefore been condensed to fit under just eight broad headings. We believe this should provide a much clearer picture of the major areas of risk which our business faces. A report from the chairman of the risk committee can be found on page 52.

Remuneration
In June 2012, the Government published a consultation on what companies must disclose in pay reports. The directors’ remuneration report on pages 57 to 67 must necessarily address existing legislation. However, we have anticipated some of the new requirements as described in the remuneration committee report on page 54.

UK Corporate Governance Code
The Financial Reporting Council (FRC) recently issued a revised UK Corporate Governance Code (the 2012 Code) and revised Guidance to Audit Committees. The audit committee has scheduled time in 2013 to discuss how the Company can best comply with these. This year’s audit committee report can be found on pages 47 to 48.

Safety committee
The new safety committee met for the first time in 2012. The committee has made a good start in gaining an understanding of the Group’s safety governance and disciplines and in developing a suitable reporting regime to enable the committee to provide the Board with an appropriate level of assurance. We hope this additional Board level scrutiny will tighten further the already stringent controls in place in this most critical area. The report of the safety committee is on page 53.

This is my final governance report as Chairman of Rolls-Royce. I firmly believe that the Company’s values, its reputation and its ability to achieve its objectives depend to a large extent on the effectiveness of its approach to corporate governance. However, rules alone are not enough. The Code is based on principles and not just rules and the actions we have taken in the past and in 2012 should leave no doubt that the Board of Rolls-Royce will pursue those principles in the spirit in which they are intended.

Sir Simon Robertson
Chairman
Sir Simon Robertson (71) 7
Non-executive Chairman, appointed January 2005

Skills and experience: Sir Simon brings to the Board an international corporate advisory background with a wealth of experience in mergers and acquisitions, merchant banking, investment banking and financial markets. During his career he has worked in France, Germany, the UK and the US. He is the former Managing Director of Goldman Sachs International and former Chairman of Dresdner Kleinwort Benson. In June 2010, he was honoured with a knighthood in recognition of his services to business.

External appointments: Sir Simon is the founder member of Robertson Robey Associates LLP and Deputy Chairman and Senior Independent Director of HSBC Holdings plc. He is a non-executive director of Berry Bros & Rudd Limited, The Economist Newspaper Limited and Troy Asset Management. He is a Trustee of The Eden Project and of the Royal Opera House Endowment Fund.

John Rishton (54) 2,14
Chief Executive, appointed March 2011

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

External appointments: Unilever have announced that John will be proposed to join the boards of Unilever NV and Unilever plc at the AGMs of those companies in May 2013.

Iain Conn (50) 1,2,6
Senior Independent Director, appointed January 2005

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

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

Dame Helen Alexander (56) 2,14,4
Non-executive director, appointed September 2007

Skills and experience: Dame Helen was Chief Executive of the Economist Group until 2008, having joined the company in 1985. She was President of the CBI until 2011 and Deputy President until June 2012; she has also been a non-executive director of Northern Foods plc, BT plc and Centrica plc. Dame Helen was awarded a CBE for services to publishing in 2004 and was made a Dame Commander of the Order of the British Empire for her services to business in June 2011.

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

Lewis Booth CBE (64) 2,4
Non-executive director, appointed May 2011

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

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

Peter Byrom (68) 1,4
Non-executive director, appointed January 1997

Skills and experience: Peter was a director of AMEC plc from 2005 to 2011 and of NM Rothschild & Sons Limited from 1977 to 1996. He is a Fellow of the Royal Aeronautical Society.

External appointments: Peter is Chairman of Domino Printing Sciences plc.

Sir Frank Chapman (59) 2,3,4
Non-executive director, appointed November 2011

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

John McAdam (64) 2,3,6
Non-executive director, appointed February 2008

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

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

**John Neill CBE (65) 1,2**
Non-executive director, appointed November 2008

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

**External appointments:** John is the Chairman and Group Chief Executive of the Unipart Group of Companies.

**Jasmin Staiblin (42) 2,4**
Non-executive director, appointed May 2012

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

**External appointments:** Jasmin is a non-executive director of Georg Fischer AG, ETH Domain and Neue Aargauer Bank (a member of the Credit Suisse Group).

**Ian Strachan (69) 1,2,4**
Non-executive director, appointed September 2003

**Skills and experience:** Ian is the former Chief Executive of BTR plc, former Deputy Chief Executive and Chief Financial Officer of Rio Tinto plc, former non-executive Chairman of Instinet Group Inc and a former non-executive director of Johnson Matthey plc, Commercial Union and Reuters Group plc.

**External appointments:** Ian is a non-executive director of Xstrata plc, Transocean Inc and Caithness Petroleum Limited.

**James Guyette (67) 5**
President and Chief Executive Officer of Rolls-Royce North America Inc. appointed January 1998

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

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

**Mark Morris Age (49) 5**
Chief Financial Officer, appointed January 2012

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

**Colin Smith CBE (57) 5**
Director – Engineering and Technology, appointed July 2005

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

**Nigel Goldsworthy (47)**
Company Secretary & Head of Legal appointed December 2012

**Skills and experience:** A solicitor, Nigel has held a number of senior legal and company secretary roles within the Company and, before his appointment as Company Secretary & Head of Legal, was Deputy General Counsel from 2008. Before joining Rolls-Royce in 2004, Nigel was a partner in the banking group of Lovells (now Hogan Lovells).
The IAB, formed in 2006, advises the Board on emerging worldwide trends. Membership is as follows:

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

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

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

**Carla Hills**
Chair and CEO, Hills & Company, International Consultants, former US Trade Representative, former US Secretary of Housing and Urban Development, former US Assistant Attorney General

**General Sir Mike Jackson**
Former Chief of the General Staff, UK Ministry of Defence

**Mustafa Koç**
Chairman of Koç Holding, A.Ş.

**Dr Henrique Meirelles**
Chairman of J&F, the holding company of JBS, Flora, Eldorado, non-executive Chairman of Brazil’s Olympic Public Committee (the 2016 Olympic Games – Rio de Janeiro) and former President of Brazil’s Central Bank from 2003 to 2010

**Akio Mimura**
Director, Board member and Senior Advisor Nippon Steel & Sumitomo Metal Corporation

**Lubna Olayan**
CEO and Deputy Chairperson of the Olayan Financing Company

**Rair Simonyan**
Advisor to the President OAO NK Rosneft, former Chairman, Morgan Stanley, Russia, former first vice president of Russian State oil company, Rosneft

**Ratan Tata**
Former Chairman of Tata Sons Limited

**Matthias Wissmann**
President of the German Association of the Automotive Industry, Vice-Chairman of the Federation of German Industries and Senior Counsel at WilmerHale, former Federal Minister of Research and Technology and of Transport of Germany

**Lee Hsien Yang**
Chairman, Fraser and Neave Limited, Chairman Civil Aviation Authority Singapore, Chairman Islamic Bank of Asia Private Limited

**Ernesto Zedillo**
Former President of Mexico, Director, Yale Center for the Study of Globalization

**Ambassador Robert B Zoellick**
Senior Fellow at the Belfer Center for Science and International Affairs at Harvard University’s Kennedy School of Government, former President of World Bank Group, former US Deputy Secretary of State and former US Trade Representative

During 2012, John Rishton chaired meetings of the GLT which acted as an important communications channel between the senior management team and the Group’s executive directors. In addition to John Rishton, its other members were:

**Andrew Heath**
President – Energy

**Mark King**
President – Aerospace

**Alain Michaelis**
Operations Director

**Mark Morris**
Chief Financial Officer

**Miles Cowdry**
Corporate Development Director

**Kath Durrant**
Human Resources Director

**James Guyette**
President – Rolls-Royce North America Inc.

**Lawrie Haynes**
President – Nuclear

**Peter Morgan**
Director – Corporate Affairs

**John Paterson**
President – Marine and Industrial Power Systems

**Colin Smith**
Director – Engineering and Technology

**Robert Webb**
General Counsel & Head of Risk

**Tony Wood**
President – Marine

Other members who served were: Mike Terrett, former Chief Operating Officer, who retired on 31 December 2012; Harry Holt who took up a post as Director, Business Development in our Civil aerospace business on 1 July 2012; Michael Haidinger who joined the board of Tognum as Chief Sales Officer on 1 July 2012; and Dan Korte, President – Defence aerospace who resigned in September 2012.
This report, which includes the directors’ remuneration report on pages 57 to 67, explains how the Company discharges its corporate governance responsibilities.

In the year to 31 December 2012, the revised principles and provisions of the Code (published in May 2010 by the Financial Reporting Council (FRC)) applied to the Company. A printed copy of the Code can be obtained free of charge from FRC Publications, 145 London Road, Kingston upon Thames, Surrey KT2 6SR – telephone: +44 (0)20 8247 1264 and online at: www.frcpublications.com.

The Board confirms that throughout 2012, the Company complied with the provisions of the Code, with the following exception:

<table>
<thead>
<tr>
<th>Code provision</th>
<th>Explanation</th>
</tr>
</thead>
<tbody>
<tr>
<td>C.3.4 – The audit committee should review arrangements by which staff of the company may, in confidence, raise concerns about possible improprieties in matters of financial reporting or other matters.</td>
<td>The Board considered it appropriate that this provision of the Code be the primary responsibility of the ethics committee although that committee is required to refer concerns about possible improprieties in matters of financial reporting to the audit committee.</td>
</tr>
</tbody>
</table>

**Board membership**

There are currently 14 directors on the Board comprising the non-executive Chairman, the Chief Executive, three other executive directors and nine non-executive directors. During the year, Mark Morris took up the post of Chief Financial Officer on 1 January 2012 and Jasmin Staiblin was appointed as an additional non-executive director on 21 May 2012. Two directors retired in the year, Sir Peter Gregson did not seek re-election at the annual general meeting (AGM) on 4 May 2012 and Mike Terrett retired on 31 December 2012.

On 14 February 2013, the Board announced Sir Simon Robertson’s intention to retire as Chairman and as a non-executive director at the conclusion of the AGM on 2 May 2013. In addition, Ian Strachan and Peter Byrom will not be seeking re-election as non-executive directors at that meeting. Under Article 112 of the Company’s Articles of Association, all directors (with the exception of Sir Simon Robertson, Peter Byrom and Ian Strachan) will offer themselves for re-election at the 2013 AGM. Ian Davis will be appointed as an additional non-executive director on 1 March 2013 and will take over as Chairman at the conclusion of the 2013 AGM.

The process for Board succession is discussed in the nomination committee report on page 49.

**Roles and responsibilities**

The Board has a written remit for the Chairman, Sir Simon Robertson, who has responsibility for the running of the Board and ensuring its effectiveness. The Chief Executive, John Rishton, has responsibility for running the business. This division of responsibility ensures that no one individual has unfettered powers of decision. In addition, the Board has agreed a set of guiding principles to govern the relationship between the Chairman and Chief Executive which, for example, requires that the two roles are structured in a complementary manner and demands that the relationship between the two be based on mutual respect and trust and be frank and open.

The Senior Independent Director, Iain Conn, acts as a sounding board for the Chairman and can act as an intermediary for other directors. Each year, he leads a separate meeting of the Board excluding the Chairman to review the Chairman’s performance. In 2012, the meeting expressed its unanimous support for Sir Simon Robertson, noting the enormous amount of time, effort and energy he contributed outside of the boardroom. During the year, Iain Conn also led the process to seek a replacement for Sir Simon, taking the chair when appropriate at meetings of the nomination committee.

**Role and operation of the Board**

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

To achieve its long-term success, the Board must:

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

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

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

**The work of the Board in 2012**

During 2012, the Board held 11 meetings, seven of which were scheduled and a further four called at short notice. At each scheduled meeting, executive directors supplied reports on business and financial performance including the usual approval of financial statements and budgets. The Board also received regular updates on HS&E issues, employee issues and legal issues including a review of its governance arrangements. In addition, the chairman of each of the board committees provided verbal reports on matters discussed by that committee since the previous Board meeting.
On 18 September 2012, the Board held its annual day-long strategy meeting, which included discussions on each of the business segments and presentations on the ten-year financial plan and the development of the Group’s overall strategy, vision, brand promise and values. The September meeting was held in the Group’s offices in Reston, US, and was followed by a visit to its Crosspointe facility, which included a tour of the newly established Commonwealth Centre for Advanced Manufacturing nearby.

In addition to its routine business, matters considered by the Board in 2012 included:

- the Eurozone crisis;
- defence strategy;
- concerns about bribery and corruption involving intermediaries in overseas markets;
- potential new and re-core engine developments;
- potential new facilities such as the new indoor test bed for Dahlewitz and a facility in Brazil;
- the acquisition of the remaining shares in the Aero Engine Controls joint venture from the Goodrich Corporation;
- the future of the tidal engineering and fuel cells businesses;
- potential acquisitions particularly in the nuclear sector;
- a presentation from Dr Hamid Mughal describing the global network of Advanced Manufacturing Research Centres;
- a review of the Group’s tax affairs which included the renewal of taxation policy a statement of which can be found on page 37;
- IT infrastructure update; and
- an investor relations presentation which included the results of the 2012 investor audit.

### Board and committee attendance

The attendance by individual directors at meetings of the Board and its committees in 2012 is shown in the table below:

<table>
<thead>
<tr>
<th>Director</th>
<th>Board</th>
<th>Audit</th>
<th>Remuneration</th>
<th>Nomination</th>
<th>Ethics</th>
<th>Risk</th>
<th>Safety</th>
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<tbody>
<tr>
<td>Sir Simon Robertson (Chairman)</td>
<td>11(11)</td>
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<td>4(4)</td>
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<tr>
<td>Dame Helen Alexander</td>
<td>10(11)</td>
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<tr>
<td>Lewis Booth CBE</td>
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<tr>
<td>Peter Byrom</td>
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<tr>
<td>Sir Frank Chapman ¹</td>
<td>8(11)</td>
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<tr>
<td>Iain Conn</td>
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<td>2(2)</td>
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<tr>
<td>Sir Peter Gregson ²</td>
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<td>James Guyette</td>
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<td>John McAdam</td>
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<tr>
<td>Mark Morris</td>
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<tr>
<td>John Neill CBE</td>
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<tr>
<td>John Rishton</td>
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<tr>
<td>Colin Smith CBE</td>
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<tr>
<td>Jasmin Staiblin ³</td>
<td>8(8)</td>
<td></td>
<td>3(3)</td>
<td>2(2)</td>
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<td></td>
<td></td>
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<tr>
<td>Ian Strachan</td>
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<td>4(4)</td>
<td>4(4)</td>
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<td>5(5)</td>
<td></td>
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<tr>
<td>Mike Terrett CBE</td>
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<td>2(2)</td>
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Figures in brackets denote the maximum numbers of meetings that could have been attended (seven Board meetings were scheduled and four called at short notice).

¹ Sir Frank Chapman was unable to attend two Board meetings and three committee meetings held in December 2012 due to illness.

² Sir Peter Gregson retired as a non-executive director at the AGM on 4 May 2012.

³ Jasmin Staiblin was appointed as a non-executive director on 21 May 2012.

⁴ Mike Terrett, Chief Operating Officer, retired on 31 December 2012.

### Board evaluation

The UK Corporate Governance Code requires that the Board undertakes an annual evaluation of its own performance and that of its committees and individual directors and to do so externally at least every three years. In 2012, the evaluation process was conducted internally, a full external review having been carried out by Jan Hall Associates in 2011.

Initially, directors were asked to complete a confidential survey covering the areas set out as best practice in the Financial Reporting Council’s ‘Guidance on Board Effectiveness – March 2011’. The Company Secretary then produced a report which consolidated the responses in such a way that individual contributions were not attributable. Following the circulation of the report to the Board, the Chairman conducted one-to-one interviews with each of them and reported to the next board meeting on the findings and agreed actions to be taken.

The general consensus from the process was that the Board was working well under the leadership of Sir Simon Robertson and John Rishton. It was considered appropriate that succession planning and the provision of information to the Board should be areas of focus for 2013. Also some directors expressed the view that the Board should maintain a continual watch on principal risks to avoid being solely reliant on the work of the audit and risk committees.

### Directors’ terms of appointment

Executive directors are employees who have day-to-day responsibilities as executives of the Group in addition to their duties as directors. Each executive director receives a service contract on appointment (see page 60 for further information).
Non-executive directors are generally independent of the Company, are not employees and do not participate in the daily business management of the Group. On appointment, each non-executive director receives a letter setting out the conditions of his or her appointment. Non-executive directors are appointed for an initial term of three years, which may be extended with the agreement of the Board, although reappointment is not automatic. Their term of office is also subject to annual re-election by shareholders at the AGM and will terminate without compensation if they fail to be re-elected (see page 67 for further information).

**Director training**

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

<table>
<thead>
<tr>
<th>Issues</th>
<th>Facilitated by</th>
</tr>
</thead>
<tbody>
<tr>
<td>Operation of the Board and governance</td>
<td>Chairman and Company Secretary</td>
</tr>
<tr>
<td>Group strategy development and current issues</td>
<td>Chief Executive</td>
</tr>
<tr>
<td>Financial structure</td>
<td>Chief Financial Officer</td>
</tr>
<tr>
<td>Risk strategy</td>
<td>General Counsel &amp; Head of Risk</td>
</tr>
<tr>
<td>Operational strategy</td>
<td>Operations Director</td>
</tr>
<tr>
<td>Technology and engineering issues</td>
<td>Director – Engineering and Technology</td>
</tr>
<tr>
<td>Key site visits</td>
<td>Company Secretary</td>
</tr>
<tr>
<td>Committee technical requirements</td>
<td>Committee chairmen, internal or external experts</td>
</tr>
</tbody>
</table>

Further training is available for all the directors, including presentations by the executive team on particular aspects of the business. In 2012, our lawyers, Freshfields Bruckhaus Deringer, held a seminar immediately following the November Board meeting updating the Board on developments in corporate law and regulation. In addition, there is a procedure for directors to take independent professional advice at the Company’s expense and every director has access to the General Counsel & Head of Risk and the Company Secretary. In-house training is also provided to directors of the Company’s subsidiaries and joint ventures.

**Shareholder relations**

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

The two primary written sources of information about the Group for shareholders are the website (www.rolls-royce.com) and the published annual report, an online version of which is also available on the website. The website also carries a wealth of financial and other information about the Group that includes current business strategy, historical financial data, recent presentation materials as well as factual data about the Group’s businesses, products and services.

The Group conducts a dedicated investor relations programme with institutional investors which includes various formal events during the year, as well as a regular series of one-to-one and group meetings. The purpose of these events is to highlight a particular issue, theme or announcement that the Group believes warrants further explanation or clarification. The events also provide opportunities for shareholders to meet members of the senior management team to discuss topics of interest. Examples of these events in 2012 were: the preliminary and half-yearly results announcements; the AGM; the update given at the Farnborough International Airshow on trends in the Civil and Defence aerospace businesses; visits to the Group’s sites; and industry conferences. The one-to-one and group meetings provide additional context around the Group’s business strategy and financial performance such that shareholders are able to consistently and fairly value the Group’s businesses.

In 2012, around 340 meetings took place with over 320 separately identifiable institutional investors. Of those meetings, the Chief Executive attended 25 meetings and the Chief Financial Officer 50 meetings. From a regional perspective, the majority of meetings took place in the UK (approximately 200). Sixty meetings occurred in the US and Canada, and a further 35 meetings took place in Europe. The Chairman also meets institutional investors from time to time when requested.

**AGM**

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

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

This year’s AGM will be held at 11.00am on Thursday, 2 May 2013 at the QEII Conference Centre, Broad Sanctuary, Westminster, London SW1P 3EE. The AGM notice and the annual report will be available to view on the Group’s website. Shareholders unable to attend the AGM can vote on the business of the meeting either by post or online.

**Independence of the non-executive directors**

The Board conducts a rigorous review of the independence of the non-executive directors every year, based on the criteria in the Code. This review was undertaken in November 2012 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, Sir Simon Robertson did meet the Code’s independence criteria upon his appointment as Chairman in January 2005. His other external commitments are described on page 40.
Conflicts of interest
Directors have a duty to avoid a situation in which they have, or can have, a direct or indirect interest which conflicts, or possibly may conflict, with the interests of the Company unless that situational conflict has been authorised by the Board. The nomination committee has reviewed and authorised all directors' situational conflicts and has agreed that while directors are required to keep confidential all Company information, they shall not be required to share with the Company confidential information received by them from a third party which is the subject of the situational conflict.

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

Board committees
The Board has established a number of committees, the principal ones being audit, remuneration, nomination, ethics and risk. A safety committee was established in 2012. Terms of reference for each committee are available on the Group's website at www.rolls-royce.com. The membership, responsibilities and activities of these committees are described on pages 47 to 56.

Executive committees
In 2012, the Executive Board, the senior decision-making committee, was made up of the executive directors. It worked with the Board to develop Group strategy and policy, established corporate priorities, decided on senior succession. It made recommendations to the nominations committee in relation to membership of the Executive Board and the Group Leadership Team (GLT). The membership of the GLT is described on page 42.

The GLT's responsibilities were:
• to provide input and advice to the Executive Board on policy and strategy;
• to agree priorities and objectives in management of the Group;
• to drive performance.

The GLT regularly considered HSE, customer relations, financial and operational performance. In addition the committee discussed a range of topics of business relevance. This included employee engagement, sustainability and the Global Code of Business Ethics.

In January 2013, the Executive Board and GLT were combined into the Executive Leadership Team (ELT). This new body simplifies the senior management structure, it will establish clear accountability and improve decision making.
Audit committee report

I would like to thank committee members, the executive management team and our auditor for the open discussions that take place at our meetings.

Lewis Booth CBE
Chairman of the audit committee

The audit committee, which consists exclusively of independent non-executive directors, met four times in 2012 and attendance by the members is shown in the table on page 44. During the year, the external auditors (KPMG Audit Plc), the Head of Internal Audit, the General Counsel & Head of Risk and the Acting Company Secretary attended the meetings, together with the Chairman of the Board, the Chief Executive and the Chief Financial Officer. Other Board members and/or senior executives may also attend meetings at the invitation of the committee chairman. The General Counsel & Head of Risk and the Head of Internal Audit have direct access to the committee.

I am pleased to present the report of the audit committee for the year. I would like to thank committee members, the executive management team and our auditor for the open discussions that take place at our meetings and the importance they all attach to its work. During 2012, the committee sought to enhance the clarity and focus of all the reports it receives.

A key task for 2013 will be to consider the implications of the revised UK Corporate Governance Code. In particular, we will assess the implications of the requirement for regular audit tendering and the procedures supporting the directors’ responsibility report statement that: “the report and accounts, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the Company’s performance, business model and strategy”.

Responsibilities
In summary, the committee recommends the financial statements to the Board and reviews the Group’s financial reporting and accounting policies, including formal announcements and trading statements relating to the Company’s financial performance. It oversees the relationship with KPMG, and the role and effectiveness of the internal audit function (previously termed Business Assurance). The committee reviews the Group’s procedures for detecting, monitoring and managing the risk of fraud and the Group’s internal controls and systems for assessing and mitigating risk.

The Board’s review of the risk management process and its statement on internal control as required by ‘Internal Control: Guidance for Directors’ published by the FRC is on pages 70 to 71.

Work of the committee in 2012
The focus at the meetings in February and July 2012 was the 2011 annual report and financial statements and 2012 half-yearly results announcement respectively, including an evaluation of the going concern statements therein. The May and November meetings reviewed the interim management statements, considered matters which were expected to require consideration at the following half year and full year and forthcoming changes to reporting and accounting requirements.

Since the year end, the committee has reviewed the form and content of the Group’s 2012 annual report and financial statements. In conducting its review, the committee considered reports prepared by management and the external auditors. These reports covered analyses of the judgements and sources of estimation uncertainty involved in applying the accounting policies as described in note 1 to the financial statements. The committee also considered the going concern statement on page 72. The committee recommended the 2012 annual report to the Board.

Internal Audit
In May and November, the Head of Internal Audit presented a summary of the reviews performed in the previous six months. The committee reviewed the effectiveness of the internal control environment and the structure in place to resolve identified weaknesses. It also agreed an improved structure for internal audit reports to the committee, with an increased focus on significant issues and trends evident in the reports and the speed of their resolution. During the year, the committee approved a revised charter for the internal audit function, reviewed and agreed the work plan for 2013 and reviewed compliance with the Group’s policies in respect of expenses incurred by the directors and other senior executives.

Auditors
During the year, the committee considered the independence and objectivity of KPMG and agreed the audit strategy and the audit fee.

Non-audit services provided by KPMG
In order to safeguard auditors’ independence and objectivity, the following policy is applied in relation to services provided by the auditors:

- audit related services — the auditors undertake these services as it is work that they must, or are best suited to, perform. It includes formalities relating to borrowings, grants, shareholder and other circulars, risk management services, various regulatory reports and work in respect of acquisitions and disposals;
- tax, accounting and mergers and acquisitions — the auditors are used for this work where they are best suited to undertake it. All other significant consulting work in these areas is put out to tender; and
- other advisory or consultancy services — the auditors are generally prohibited from providing these services.

Pre-approval of non-audit fees is required for non-audit fees exceeding pre-determined thresholds which vary according to the nature of the service being proposed.
The committee reviews non-audit fees charged by KPMG at each meeting and annually reviews the limits for pre-approval of non-audit fees. In particular the committee pre-approved: an engagement for KPMG to provide specialist support to internal audit during the Group's IT modernisation project while the department recruited its own personnel; and the continuation of specialist support to the IT modernisation programme that was being performed by a consultancy which was acquired by KPMG after the engagement had commenced. Expenditure on audit and non-audit services is set out in note 7 to the financial statements.

Reappointment of auditor
Each year, the committee reviews the effectiveness and performance of the external auditors with feedback from committee members, senior finance personnel and internal audit. KPMG were appointed as auditors in 1990 and this appointment has not been subject to a tender process since that date. The lead audit partner is required to rotate every five years and other key audit partners are required to rotate every seven years. The current lead audit partner completed his term in 2012. His replacement as lead audit partner has had no previous involvement with Rolls-Royce in any capacity. No contractual obligations restrict the committee's choice of external auditors. The committee concluded that KPMG provides an effective audit and the committee and the Board have recommended their reappointment.

Resolutions to reappoint the external auditor, KPMG Audit Plc, and to authorise the directors to determine the auditor’s remuneration, will be proposed at the AGM on 2 May 2013.

I hope that you will vote in favour of the resolutions as the directors intend to do in respect of their own shareholdings.

Other matters
During the year, the committee reviewed risk management in the Marine and Civil businesses. The committee reviewed its own terms of reference.

Private meetings
During the year, the committee met privately with the Chief Financial Officer, KPMG and the Head of Internal Audit. I also met the lead audit partner in private in advance of each meeting.

Lewis Booth CBE
Chairman of the audit committee
Nomination committee report

I have absolutely no doubt that Ian Davis has all the required attributes to lead the Company to even greater success in the future

Sir Simon Robertson
Chairman of the nomination committee

However, diversity means much more than gender and we recognise that appointments should reflect the increasing range and geographical spread of activities carried out by the Group. In May 2012, we were pleased to announce the appointment of Jasmin Staiblin, a German national and currently Chief Executive of Alpiq, one of Europe’s leading energy companies. Jasmin’s appointment brings to the Board an exceptionally talented individual with broad and relevant international engineering experience.

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

• received papers on senior executive development and leadership team success and a detailed assessment of current diversity across the Group;
• considered time commitments and potential conflicts faced by directors who wished to take up non-executive positions on the boards of other companies;
• reviewed its own terms of reference;
• considered the independence of the non-executive directors;
• considered the standing schedule of directors’ conflicts of interest and recommended to the Board that such conflicts be duly re-authorised; and
• recommended the appointment of a new company secretary.

During the latter part of the year, Iain Conn ably led the committee in its search for a suitable replacement for myself as Chairman of the Board. An independent consultant, MWM Boardroom Consulting LLP, was again appointed to conduct the search having assisted in the process which led to Jasmin’s appointment earlier in the year. I am pleased to report that this process has resulted in the announcement on 14 February 2013 of the appointment of Ian Davis to the Board, effective 1 March 2013. He will succeed me as Chairman at the conclusion of the AGM. I have absolutely no doubt that Ian Davis has all the required attributes to lead the Group to even greater success in the future.

Sir Simon Robertson
Chairman of the nomination committee

The nomination committee, which comprises the Chairman, the Chief Executive and the independent non-executive directors met four times in 2012. Attendance by the members is shown in the table on page 44.

The principal role of the nomination committee is to consider, and recommend for approval to the Board, the appointment of suitable persons as directors of the Company and to lead the process for such appointments. The committee is also responsible for reviewing and overseeing senior management development to ensure orderly succession planning at and immediately below Board level.

During the year, the committee continued to develop its succession plans for new non-executive directors taking into account their respective tenures of office as far forward as 2020, analysing the skills which were either missing or could be missing in future and how different personalities would fit around the board table.

The committee continues to be mindful of the diversity agenda in its candidate selection process. In September 2011, we issued our response to the Davies Report on women on boards stating that we expected to make demonstrable progress in this area by 2015. We are committed to improving diversity at all levels of leadership in Rolls-Royce and to making appointments based on merit at the most senior levels of our organisation. We recognise the importance of gender diversity in the boardroom and the valuable contribution that women make in achieving the right mix of skills, knowledge and experience that enables us to maximise our corporate potential.

We continue to participate in the FTSE 100 Cross Company Mentoring Programme, the objective of which is to increase the pool of eligible senior female candidates for UK Board positions and have comprehensive programmes in place to increase the diversity of our internal pipeline of future leaders. We have also issued guidance to executive search companies outlining the importance of diverse candidate short lists. Further details of our gender representation can be found on page 34.
The Board will not tolerate improper business conduct of any sort and will take all necessary action to ensure compliance.

Ian Strachan  
Chairman of the ethics committee  

The ethics committee consists exclusively of independent non-executive directors. In 2012, the committee met five times and details of its membership and attendance can be found on page 44. During the year, the General Counsel & Head of Risk, Robert Webb, took executive responsibility for ethics and attended the meetings. The Chairman of the Board, the Chief Executive, the Head of Business Ethics and the Chief Compliance Officer were also invited to attend meetings on a regular basis.

The ethics committee was formed in 2008. It is responsible for reviewing compliance with the Group’s Global Code of Business Ethics, for establishing bribery prevention policies and for reviewing arrangements by which staff may raise concerns about improprieties in confidence. It considers recommendations on ethical matters made by external regulatory authorities or other bodies and makes recommendations to the Board on how they should be applied in Rolls-Royce. The committee’s full terms of reference are available on the Group’s website at www.rolls-royce.com.

Referral to Serious Fraud Office (SFO)  
During the last year, much of the discussion at the ethics committee has centred on specific concerns about bribery and corruption involving intermediaries in overseas markets. This followed a request for information from the SFO about allegations of malpractice in Indonesia and China. The review by our compliance team identified matters of sufficient concern to cause the committee to recommend to the Board that the law firm Debevoise & Plimpton LLP be instructed to conduct an independent investigation.

As a result of that investigation, on 6 December 2012 we announced that we were passing information to the SFO addressing their concerns in Indonesia and China and identifying further matters of concern in other overseas markets. The consequence of these disclosures will be decided by the regulatory authorities. It is too early to predict the outcomes but these could include the prosecution of individuals and of the Company. We are cooperating fully. John Rishton has stated unequivocally that neither he nor the Board will tolerate improper conduct of any sort and all necessary action will be taken to ensure compliance. The Board is committed to anti-bribery and corruption (ABC) compliance. Our Board Charter includes a commitment to ensure the Group meets ‘the highest legal and ethical standards’.

Global Code of Business Ethics (Global Code)  
In 2007, the Board supported the issue of a Global Code of Business Ethics which sets out the principles to be followed by employees when conducting business and makes it clear that the Board pursues a zero tolerance approach to bribery and corruption. The Global Code was revised in 2009 and was assessed as ‘best in class’ in 2011 by Radley Yeldar, a corporate communications company that reviewed 142 FTSE 350 Codes of Conduct against a set of 28 criteria. Work is currently underway to simplify the Global Code which we expect to roll-out with training and engagement activities in the first half of 2013. The revised Global Code will:

- provide increased clarity around the Company’s principles and the responsibility of individuals;
- focus on the guidance and support available to employees to help them apply the Global Code; and
- be more concise while focusing content on key topics.

ABC work programme  
After the publication of the Woolf Committee report in 2008, the Board undertook a systematic review of its ethics and compliance procedures that led to the creation of the ethics committee which first met under my chairmanship in November 2008. In 2009, with the assistance of an independent firm of auditors and at a cost of over £6 million, the Company conducted a thorough review to measure its ABC policies and procedures against the Woolf Committee report, the Aerospace & Defence Industries Association of Europe Common Industry Standards, the US Federal Sentencing Guidelines, the UK Bribery Bill then in draft and the OECD Guidelines. The first policies to be implemented arising from the work programme were the Global Gifts and Hospitality Policy and a new Global Intermediaries Policy both of which went into effect on 1 December 2010.

Policies, procedures and guidance notes on the remaining topic areas followed in the period from December 2010 to the implementation of the UK Bribery Act on 1 July 2011. These covered a number of topics including: sponsorships and donations; facilitation payments; raising concerns; conflicts of interest; competitive intelligence; sales and business evaluation; collaborative ventures; joint ventures; offset; human resources; financial monitoring and reporting; supply chain and purchasing; government interactions; and political lobbying. The ABC Programme team came to a close in July 2011, having delivered all of the necessary policies identified in the review.

Global Intermediaries Policy  
In 2009, the newly formed ethics committee enhanced and updated the Group’s Global Intermediaries Policy to require more exacting contractual warranties and safeguards in agreements with intermediaries. The current policy introduced in December 2010 represents a significant enhancement over the prior regime. A risk-based approach has been adopted, whereby the Company assigns a risk rating to each intermediary (lower, moderate, or higher) on the basis of a standardised risk assessment. Proportionate levels of review and due diligence are conducted on each intermediary depending on this risk rating. This has resulted in much more intense scrutiny of activities in high risk countries, covering matters such as the level of payments to intermediaries, their qualifications and the business case for their use.
Further work is underway to improve the process for appointment or renewal of intermediary advisers and consultants. The Company plans to introduce further enhanced controls targeting: the nature of the services the intermediary will provide; the value for money that represents; proposed and historical payment information; and disclosure of all relevant historical information about the intermediary.

**Global Gifts and Hospitality Policy**
This policy ensures that gifts and hospitality offered or accepted by the Group's employees do not appear to give or actually give a business advantage and are properly approved and documented. An updated and simpler version of the Global Gifts and Hospitality Policy was introduced in October 2012 along with a global internet-based reporting tool, ‘Rolls-Royce Compliance Online’.

**Confidential reporting lines**
In 2008, the Company established telephone contact numbers in 31 countries along with web-based reporting to enable employees, wherever they were based in the world, to report confidentially any concerns they might have with regard to business conduct. The committee receives reports on concerns raised through the confidential reporting line. Early this year, an improved service will be introduced combining both the internal ethics helpline and the confidential reporting line to provide a single route for individuals to ask questions or raise concerns 24 hours a day.

**Training and engagement**
Following the launch of the revised Global Code in 2009, a training and engagement programme was undertaken to ensure full awareness of the Global Code and the Group’s values and ethics across the organisation. This training programme ultimately reached more than 37,000 employees, starting with face-to-face workshops delivered to 4,600 managers across the Group.

The ABC work programme introduced a further comprehensive training programme to ensure that the new ABC policies and procedures were fully understood. Two training modules were created for gifts and hospitality – an e-learning module was completed by 23,000 employees and a facilitated online training module designed for employees was completed by the 4,000 employees responsible for approving gifts and hospitality. Two training modules also support the intermediaries process, both of which must be taken by any employees who interact with the Group’s intermediaries. By the time the UK Bribery Act came into effect on 1 July 2011, the Group had delivered more than 12,000 hours of training with an additional 9,000 hours planned.

Further training is always on our agenda. In 2012, the Group launched an online training module for employees in how to deal with conflicts of interest and also developed training for employees who are actively involved in the acquisition and use of competitive intelligence. Additional training on ABC policies will also be rolled out on a global basis in 2013.

**Central ethics and compliance team**
In 2011, the Board vested authority to administer and enforce our ABC policies in a newly-created compliance organisation, separate from but working closely with the business ethics team that remains in place to manage the Global Code and the reporting hotlines. The compliance organisation’s remit is to embed the ABC policies in the businesses and take the ABC programme into a ‘business as usual’ mode. The compliance organisation, with a total staff of 19, is headed by the Group’s first Chief Compliance Officer, who joined in May 2011.

**Conclusion**
As our actions in 2012 demonstrate, we aim to live up to the high ethical standards we have set ourselves. Despite the progress we have undoubtedly made, we constantly strive to improve our controls as indicated by our recent appointment of Lord Gold to lead an independent review of our current procedures.

We believe that everyone in our Group has a role to play in maintaining and building upon our reputation. This is at the heart of the way we do business and how we deliver our brand promise of ‘Trusted to deliver excellence’.

Ian Strachan
Chairman of the ethics committee
Risk committee report

Focusing our attention on a smaller number of risks has led to more comprehensive discussions about the nature of the risks that really matter to our business.

John Rishton
Chairman of the risk committee

The risk committee, which consists of the executive directors, met twice in 2012. Attendance by the members is shown in the table on page 44. During the year, the General Counsel & Head of Risk and the Head of Enterprise Risk Management also attended the meetings.

Summary
During the course of our meetings this year, the committee has spent time discussing and agreeing the most significant risks that the Group faces. We have condensed the 17 risks listed in our last annual report to the eight that can be found on pages 18 to 19. Each of these risks is owned by specific members of my executive team. We reviewed and challenged ourselves as to how these risks were managed.

Development of principal risks
At the June 2012 committee meeting, we performed our usual task of considering any potential changes to the full corporate risk register. The risk register comprises those risks that are escalated to the committee following reviews carried out by the underlying business units, programmes and functions.

These reviews take place at least twice a year. Following discussion, the committee decided that this bottom up process could be sense checked by a top down process; asking each member of the committee to identify the risks they considered would have a significant impact on the Group. The resulting list did overlap with the bottom up approach but helped stimulate debate which led us to redefine some of the risks and produce a new list of principal risks.

At the November meeting, we refined this new list of principal risks further, making changes to remove duplication and to define the risks more clearly. We discussed how the risks had changed and also reviewed how each risk was managed, identifying where further action was required.

In January 2013, the committee concluded this major review of the number and the nature of our risks and we believe that the list we have reported on pages 18 to 19 represents the most significant risks that would have an acute and traumatic impact on the Group were they to occur.

We also resolved to develop key risk indicators to measure each of the principal risks and use them to inform us where future action may be required. These will complement the key performance indicators shown on pages 16 to 17.

Group risk process
The risk process is part of our quality management system that all parts of the business must follow and it is shown below.

The General Counsel & Head of Risk now leads our enterprise wide risk team which is responsible for the risk policy and processes. Line ownership for risk management is devolved into our business units and functions, supported by a network of risk champions and risk managers.

I am pleased with the level of active debate that we have had about risk this year. Focusing our attention on a smaller number of risks has helped us to have more comprehensive discussions about the nature of the risks that really matter to our business and to communicate these throughout the Group.

Our attention next year will be on developing further measures by which the status of these risks can be assessed.

John Rishton
Chairman of the risk committee
The safety of our products is paramount

Sir Frank Chapman
Chairman of the safety committee

This was followed by a presentation from the Director – Engineering and Technology on the governance of HS&E issues in the Group. The committee considered assurance, key metrics, performance, global improvement plans in course of delivery and the mechanism by which the Group learned from incidents. The meeting also considered the Group’s environmental performance including emissions levels and targets and actions to improve the in-house energy footprint.

At our meeting in December, we had a presentation from the Director – Engineering and Technology supported by the Head of Product Safety Assurance who took us through the Group’s product safety processes in more detail and how the engineering function asserts control over critical safety issues throughout the manufacturing process. The meeting discussed risk management in HS&E and the Group’s risk profile. We also considered personal security arrangements for employees travelling to difficult territories or else working in high risk environments.

In November 2012, I spent a day at the Group’s facilities in Derby, UK and met the engineering teams. I was impressed by the depth of knowledge and diligence demonstrated by the team members. During the tour, the team showed me how the Trent 1000 design process had proactively addressed safety issues at the design stage. I also looked at the management of in-service safety issues and how safety was managed for the Royal Navy’s submarine reactors currently in service and the design-for-safety approach adopted for the next generation successor submarine. My colleagues on the committee are planning similar induction visits in the near future.

The safety committee has been in existence just eight months at the date of this report. I feel the committee has made a good start but clearly there is more to do and I expect to be able to report much more progress in 2013, as the committee’s understanding and reporting processes mature.

Sir Frank Chapman
Chairman of the safety committee
Remuneration committee report

This year’s remuneration again reflects a strong performance

Dame Helen Alexander
Chairman of the remuneration committee

Rolls-Royce has followed a consistent strategy towards executive remuneration over many years. We believe that a significant proportion of senior executives’ remuneration should be made up of performance-related incentives so that overall reward is closely aligned to the creation of long-term stakeholder value. These principles are well-established in Rolls-Royce. This year’s remuneration again reflects a strong performance. Rolls-Royce has achieved record underlying revenues, underlying profits, and has a £60 billion order book which should ensure that the business will remain strong for many years to come.

In June 2012, the Department for Business Innovation & Skills (BIS) issued remuneration reporting regulations. Although these will not become mandatory until next year’s report and some of the details have still to be finalised, we have gone some way to anticipating these new regulations. On page 58 we have presented a total figure for remuneration table which includes an estimate of the value of the long-term incentive plan that is due to vest in March 2013. On page 62 we have illustrated the value of executive director packages for 2013 under different performance scenarios.

In the commentary, we show how the annual bonus paid in 2013 aligned to performance achieved in the 2012 financial year and how the Performance Share Plan (PSP) 2010-2012 out-turn was aligned to performance achieved and shareholder value generated over the three-year performance period; from 1 January 2010 to 31 December 2012.

Annual bonus outcome

It is an important principle of the Rolls-Royce executive bonus arrangements that no bonus can be paid to anyone unless the entire Group has achieved the financial targets set by the committee. During 2012, the Group delivered 24 per cent growth in underlying profit before tax and, before the cost of acquisitions and foreign exchange translation effects, a net cash inflow of £137 million. This strong performance was achieved in challenging economic circumstances whilst maintaining the long-term investment programmes needed to deliver our existing order book and future growth.

The committee is satisfied that the annual bonus financial outcome of 85 per cent for the executive directors for 2012 appropriately reflects these results and the significant value delivered to all stakeholders. Individual bonuses for executive directors reflect personal performance against clear objectives and can therefore vary in the range zero per cent to 120 per cent of the 85 per cent bonus determined by the Group financial outcome. The aggregate of individual bonuses cannot exceed the 85 per cent financial outcome. For executive directors, 40 per cent of the bonus is delivered in deferred shares which must be held for a period of two years, to align further with shareholder interests.

<table>
<thead>
<tr>
<th>Underlying profit before tax (£m)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2011</td>
</tr>
<tr>
<td>1.157</td>
</tr>
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</table>

+24%
Performance Share Plan outcome

The long-term incentive plans at Rolls-Royce are designed to reward long-term value creation. They are measured over three years against Total Shareholder Return (TSR), earnings per share and cash generation. Against all these metrics Rolls-Royce has performed well. The share price, for example, increased by 60 per cent between 1 March 2010 (date of grant for the 2010 PSP award) and 31 December 2012, compared to an increase in the FTSE 100 index over the same period of nine per cent. The March 2010 PSP award was made on the basis of a share price of 544.70 pence. The graph below demonstrates that a large part of the performance share plan reward is due to the substantial increase in the Company’s share price from 544.70 pence per share at award date to 873.50 pence per share at the end of the three-year performance period – a strong alignment of executive reward to shareholder reward. The actual value released will depend on the share price when the award vests on 1 March 2013.

Long-term remuneration for 2012 (£000)

Rolls-Royce TSR of 818 per cent over the ten-year period to 31 December 2012 was better than any other FTSE 100 company. Only 71 of the companies which made up the FTSE 100 at the beginning of that period are still trading independently and the median TSR amongst these 71 companies over the same ten-year period is 92 per cent.

Total returns over the period to 31 December 2012

All TSR numbers on this page, for both Rolls-Royce and FTSE 100, are calculated based on start and end values averaged over the previous six months. This is consistent with the rules of the PSP.
Remuneration committee report

Remuneration and opportunities for our employees
All employees worldwide have the opportunity to benefit from our success through participation in our global bonus and share plans. All employees who were with us throughout 2012 will be receiving a bonus of at least two weeks’ pay as a result of our 2012 performance. Around a half of our employees currently participate in our global save-as-you-earn ShareSave plan which gives all employees the opportunity to benefit from share price growth. In February 2013, two of our ShareSave plans matured – a three-year plan granted in 2009 at an option price of 387 pence and a five-year plan granted in 2007 at an option price of 416.1 pence against a closing price on 1 February 2013 of 971 pence. In addition, more than 6,000 employees participate in our SharePurchase and ShareBonus plans which allow employees to purchase shares on a regular basis and to convert bonus payments into shares.

The work of the committee during 2012
In February 2012, the committee endorsed the out-turn for bonus and long-term incentive plans. It also considered a benchmarking report by Deloitte LLP and assessments of personal performance before approving salary increases for senior executives. The committee set bonus targets for 2012 and targets for the Performance Share Plan 2012-2014 and agreed the participation of senior executives in those plans. It also considered a draft of the directors’ remuneration report which it agreed to recommend to the Board for approval.

In November, the committee considered the way the bonus pool would be determined for 2013. The committee agreed revised terms of reference and considered the BIS consultation on remuneration reporting. It agreed that consideration would be given to early adoption of some of the disclosure requirements within the draft regulations in the 2012 annual report.

In December, the committee considered the potential out-turns for the 2012 bonus, the all-employee bonus scheme and the vesting of PSP 2010 – 2012.

In summary
We support the clear message on executive remuneration sent by BIS that: ‘generous rewards for leading executives are not an issue where executive remuneration is well-structured, clearly linked to the strategic objectives of a company, and which rewards executives that contribute to the long-term success of that company’. The committee is very pleased that once again we are disclosing and explaining the compensation arrangements for Rolls-Royce executives against a background of excellent business performance.

Dame Helen Alexander
Chairman of the remuneration committee
Directors’ remuneration report

Remuneration committee
The committee is responsible for making recommendations to the Board on the Group's policy regarding executive remuneration and determines, on the Board’s behalf, the specific remuneration packages of the Chairman, the executive directors and a number of senior executives. A copy of the committee’s terms of reference is available at www.rolls-royce.com/about/management/corporate_governance. The remuneration committee consists exclusively of independent non-executive directors. In 2012, the committee met three times and details of its membership and attendance can be found on page 44. Peter Byrom retired as a member of the remuneration committee in February 2011. He continued to attend meetings by invitation. During the year, the Chairman of the Board, the Chief Executive, the Group HR Director and the HR Director – Performance, Reward and Recognition also attended the meetings.

During 2012, the committee had access to advice from:
• Deloitte LLP 1; and
• Freshfields Bruckhaus Deringer LLP, the Company’s lawyers.

1 Deloitte LLP advised the Group on tax, assurance, pensions and corporate finance and Deloitte MCS Limited provided consulting services.

The remuneration policy framework
The Group operates in a highly competitive, international market. Its business is complex, technologically advanced and has long time horizons. The Group is committed to achieving sustained improvements in performance and this depends crucially on the individual contributions made by the executive team and by employees at all levels. The Board therefore believes that an effective remuneration strategy plays an essential part in the future success of the Group.

Accordingly, we remain committed to a remuneration policy which, whilst sufficiently flexible to take account of future changes in the Group’s business environment and in remuneration practice, will continue to reflect the following broad principles:

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

The committee reviews regularly both the competitiveness of the Group’s remuneration structure and its role in incentivising executives to enhance value for all stakeholders over the longer term.

The main components of remuneration
The main components of remuneration for all executives worldwide comprise base salary, annual incentive arrangements, long-term share-based incentives and benefits. Executives are also entitled to participate in all-employee share plans.

<table>
<thead>
<tr>
<th>Base salaries</th>
<th>• Set by the committee at levels required to recruit and retain high quality senior executives with reference to the marketplace for companies of similar size, internationality and complexity and taking account of pay elsewhere in the Group.</th>
<th>• Normally reviewed annually on 1 March. Increases must be justified on the basis of performance and are not automatic.</th>
</tr>
</thead>
</table>
| Annual Performance Related Award plan (APRA) | • Annual incentive. Measures set by the committee, to align with Group Strategy, based on underlying profit, cash flow and individual objectives and performance.  
• Strong link between performance and remuneration.  
• Promotes share ownership and encourages decisions in the long-term interest of shareholders.  
• Bonuses can be increased by up to 20 per cent to reflect exceptional personal performance.  
• Shares vest after two years subject to continued employment. | • Compulsory deferral of 40 per cent of bonus into shares.  
• Bonus potential:  
  – for on target performance, 75 per cent of salary for executive directors, and 81 per cent for Chief Executive.  
  – for maximum performance, 125 per cent of salary for executive directors, and 135 per cent for Chief Executive.  
• For UK participants, APRA awards do not form part of pensionable earnings. |
| Performance Share Plan (PSP) | • Share-based long-term incentive.  
• Conditional on corporate performance.  
• Measures based on Cash Flow Per Share (CPS), Total Shareholder Return (TSR) and an underlying earnings per ordinary share (EPS) hurdle to ensure alignment with Group strategy and with the interests of shareholders.  
• Shares vest after three years provided performance criteria are met. | • 50 per cent must be held until retirement or the minimum shareholding requirement is met.  
• Potential:  
  – for maximum CPS performance, 100 per cent of salary for executive directors, and 120 per cent for Chief Executive.  
  – for maximum CPS and TSR performance, 150 per cent of salary for executive directors, and 180 per cent for Chief Executive. |
| All-employee share plans | • ShareSave Plan – a savings-related share option plan available to all employees allowing purchase of shares at a discount to the share price at date of grant.  
• Free share element of the Share Incentive Plan (SIP) where UK employees receive shares as part of any bonus paid.  
• Partnership share element of the SIP under which UK employees may make regular purchases of shares from pre-tax income. | • ShareSave options may be exercised in three or five years from the date of grant.  
• Shares under the SIP vest after five years free from income tax and national insurance. |

In addition to the above, pension and other benefits, which are competitive in local markets, are provided.
**Total remuneration**

We have gone some way to applying the new BIS regulations by providing the following table which shows a total figure for salary, benefits, annual bonus and long-term incentives. Pension valuations are provided on page 63 using the methodology under the existing regulations.

<table>
<thead>
<tr>
<th>Name</th>
<th>Salary</th>
<th>Benefits</th>
<th>Bonus</th>
<th>PSP</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>James Guyette</td>
<td>517</td>
<td>100</td>
<td>663</td>
<td>1,198</td>
<td>2,478</td>
</tr>
<tr>
<td>Mark Morris</td>
<td>482</td>
<td>189</td>
<td>464</td>
<td>285</td>
<td>1,420</td>
</tr>
<tr>
<td>John Rishton</td>
<td>896</td>
<td>126</td>
<td>1,239</td>
<td>1,666</td>
<td>3,927</td>
</tr>
<tr>
<td>Colin Smith CBE</td>
<td>506</td>
<td>23</td>
<td>596</td>
<td>1,022</td>
<td>2,147</td>
</tr>
<tr>
<td>Mike Terrett CBE</td>
<td>567</td>
<td>125</td>
<td>303</td>
<td>1,227</td>
<td>2,222</td>
</tr>
</tbody>
</table>

- Salary is total base salary paid during 2012.
- Benefits include car or car allowance, use of a driver, housing costs, private medical insurance and financial counselling.
- Bonus is the total bonus award paid in cash and deferred shares for 2012 performance.
- Forty per cent of the bonus is in deferred shares which are released after two years.
- PSP is an estimate of the value of the PSP award, including the TSR multiplier, which is due to vest on 1 March 2013. The PSP award was originally granted on 1 March 2010 at 5.44470 pence. For John Rishton, the table shows the value of the shares that are due to vest on 1 March 2013 that were granted to him on joining the Company.

**Annual incentives – APRA bonus opportunity**

The committee considers that there should be a continuing emphasis on those at-risk elements of remuneration, such as annual and long-term incentives, which directly influence the performance of senior executives. For the Chief Executive, a 162 per cent maximum bonus opportunity means that 62 per cent of combined basic pay and bonus opportunity is directly related to annual financial and personal performance.

Under APRA, as operated in 2012, executive directors were eligible for awards in accordance with the table below:

<table>
<thead>
<tr>
<th>Name</th>
<th>Target bonus (as a % of salary)</th>
<th>Maximum bonus (as a % of salary)</th>
</tr>
</thead>
<tbody>
<tr>
<td>James Guyette</td>
<td>75</td>
<td>125</td>
</tr>
<tr>
<td>Mark Morris</td>
<td>75</td>
<td>125</td>
</tr>
<tr>
<td>John Rishton</td>
<td>81</td>
<td>135</td>
</tr>
<tr>
<td>Colin Smith CBE</td>
<td>75</td>
<td>125</td>
</tr>
<tr>
<td>Mike Terrett CBE</td>
<td>75</td>
<td>125</td>
</tr>
</tbody>
</table>

1. It is possible for a bonus award to be increased by a further 20 per cent to reflect exceptional personal performance. Therefore the overall maximum was 162 per cent for the Chief Executive and 150 per cent for the other executive directors.

The committee has determined that the bonus in respect of 2013 will be operated on substantially similar terms to 2012. However, in 2013 separate bonus pools will be earned for profit and cash performance. Anything earned through one measure will be subject to a minimum level of acceptable performance against the other measure. The committee is mindful of corporate, environmental, social and governance risks when setting personal objectives. There will be no change to the maximum bonus opportunities for executive directors.

**APRA performance measures**

For 2012, the performance targets operated so that three Group underlying profit targets were set in respect of bonus levels as follows:

<table>
<thead>
<tr>
<th>Base</th>
<th>Stretch (1)</th>
<th>Stretch (2)</th>
</tr>
</thead>
<tbody>
<tr>
<td>30</td>
<td>60</td>
<td>100</td>
</tr>
</tbody>
</table>

The bonus pool earned through profit performance was multiplied by a factor between zero per cent and 100 per cent as determined by cash flow performance.

For 2012, the performance out-turns which resulted in the APRA bonus out-turns were as follows:

<table>
<thead>
<tr>
<th>Group underlying profit</th>
<th>Base</th>
<th>Stretch (1)</th>
<th>Stretch (2)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Group underlying profit*</td>
<td>£1,292 million</td>
<td>exceeded the Base and the Stretch (1) target but was less than the Stretch (2) target.</td>
<td>The performance resulted in achievement of 86 per cent of the maximum.</td>
</tr>
<tr>
<td>Cash flow hurdle</td>
<td>Cash flow* for the year was £92 million which resulted in the bonus pool earned through profit performance being reduced from 86 per cent to a final bonus pool of 85 per cent.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

*Group underlying profit and cash flow exclude Tognum, the impact of acquisitions and disposals in the year and unbudgeted foreign exchange translation effects where material.

Individual bonuses for executive directors reflect personal performance against clear objectives and can therefore vary in the range zero per cent to 120 per cent of the 85 per cent bonus determined by the Group financial outcome. The aggregate of individual bonuses cannot exceed the 85 per cent financial outcome.

**Deferred APRA**

For executive directors and other senior executives, 40 per cent of APRA is delivered in the form of a deferred share award in the Company’s shares. For other participants in APRA, 33 per cent is delivered in the form of deferred shares. Details of deferred shares held under the plan are shown in the table on page 65.

A participant who is granted a deferred share award under APRA must normally continue to remain an employee of the Group for two years from the date of the award in order for the shares to vest, although shares will be released early in certain circumstances including retirement or redundancy.

The value of any deferred share awards is derived from the annual bonus criteria and is therefore dependent on personal and business financial performance. This arrangement provides a strong link between performance and remuneration, promotes a culture of share ownership amongst the Group’s senior management and encourages decisions in the long-term interest of shareholders.
Governance

Directors’ remuneration report

APRA timeline – 2013 performance year

<table>
<thead>
<tr>
<th>Start of performance period</th>
<th>End of performance period</th>
<th>Deferred share awards allocated and cash awards paid</th>
<th>Deferred shares released</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Jan 13</td>
<td>31 Dec 13</td>
<td>31 Dec 14</td>
<td>31 Dec 15</td>
</tr>
</tbody>
</table>

PSP timeline – 2013-2015 performance period

<table>
<thead>
<tr>
<th>Start of performance period</th>
<th>End of performance period</th>
<th>After tax shares released subject to performance criteria</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Jan 13</td>
<td>31 Dec 13</td>
<td>50% of after tax shares continue to be held under retention policy</td>
</tr>
</tbody>
</table>

PSP performance measures

<table>
<thead>
<tr>
<th>Vesting criteria</th>
<th>Purpose of the measure</th>
<th>Performance condition over three-year period</th>
</tr>
</thead>
<tbody>
<tr>
<td>EPS growth</td>
<td>Hurdle to ensure any payouts are supported by sound profitability</td>
<td>IF EPS growth exceeds the hurdle, the number of shares vesting will be determined in accordance with the CPS targets. If EPS growth does not exceed the hurdle – zero vesting.</td>
</tr>
<tr>
<td>Aggregate CPS</td>
<td>Incentivise generation of cash flow in line with the Group’s strategy</td>
<td>Below threshold cash flow target – zero vesting. Threshold cash flow target – 30 per cent vesting. Vesting will increase on a straight-line basis between 30 per cent and 100 per cent.</td>
</tr>
<tr>
<td>TSR performance</td>
<td>Align interests with shareholders by rewarding out-performance of FTSE 100 returns</td>
<td>50th percentile (median) and below – no additional vesting. Above 50th percentile (median) – vesting will be enhanced by 25 per cent. For executive directors and selected senior executives, a straight-line basis will operate from 25 per cent to 50 per cent enhancement for upper quartile TSR performance.</td>
</tr>
</tbody>
</table>

Other annual incentives

The same financial targets as set for APRA are used for the Managers’ Bonus and the All-Employee Bonus Scheme (AEBS). The Managers’ Bonus typically enables managers worldwide to receive a bonus of up to ten per cent of pay and the AEBS up to two weeks’ pay, based on corporate and business performance. Participants in APRA or the Managers’ Bonus do not participate in the AEBS.

Long-term incentives – PSP

The PSP is designed to reward and incentivise selected senior executives who can influence the long-term performance of the Group. The size of awards under the PSP take into account competitive levels within the marketplace for UK companies of a similar size and complexity to the Group. In 2012, John Rishton received a conditional award of shares with a market value at the time of grant of 120 per cent of his annual salary.

The 2012 grant for other executive directors was 100 per cent of their annual salary and 80 per cent for other members of the Group Leadership Team.

Under the rules of the PSP, selected senior executives are granted conditional share awards entitling them to a number of shares determined by reference to corporate performance over a three-year performance period. The measures of corporate performance are CPS, EPS and TSR. These measures are considered particularly important in generating shareholder value and are explained in more detail in the table opposite. There is no retesting of the performance criteria and no automatic vesting in the event of a takeover. In the three-year period to 31 December 2012, the Company’s profit and cash flow performance generated 100 per cent of the number of shares conditionally granted in 2010. This was increased to 150 per cent for executive directors and other senior executives and to 125 per cent for other participants because the Company’s TSR was ranked 11th in the FTSE 100 and therefore in the upper quartile, over the three-year performance period 2010-2012.

The profit hurdle for the 2013 grant will require EPS to show real growth by exceeding the OECD index of consumer prices.

The following CPS targets will apply to the grants to be made in 2013:

<table>
<thead>
<tr>
<th>Aggregate CPS over three-year performance period</th>
<th>Percentage of maximum award released</th>
</tr>
</thead>
<tbody>
<tr>
<td>56p</td>
<td>30</td>
</tr>
<tr>
<td>94p</td>
<td>100</td>
</tr>
</tbody>
</table>

The committee believes that these CPS targets are challenging and that the performance necessary to achieve awards towards the upper end of the range is stretching. They should not, therefore, be interpreted as providing guidance on the Group’s performance over the relevant period.
PSP awards granted in 2013
For 2013, the size of awards under the PSP will be unchanged from 2012 and will be as follows:

<table>
<thead>
<tr>
<th>PSP award (as a % of salary)</th>
<th>PSP award overall maximum (as a % of salary)</th>
</tr>
</thead>
<tbody>
<tr>
<td>James Guyette</td>
<td>100</td>
</tr>
<tr>
<td>Mark Morris</td>
<td>100</td>
</tr>
<tr>
<td>John Rishton</td>
<td>120</td>
</tr>
<tr>
<td>Colin Smith CBE</td>
<td>100</td>
</tr>
</tbody>
</table>

Share retention policy
The committee believes 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 200 per cent of salary for the Chief Executive and 150 per cent for other executive directors. When this level is reached, it must be retained until retirement or departure from the Group. Details of the executive directors’ share interests are set out on pages 64 to 67. The current executive directors have each complied with the minimum shareholding requirement.

All-employee share plans
The committee believes that share-based plans make a significant contribution to the close involvement and interest of all employees in the Group’s performance. Executive directors are eligible to participate in the Group’s all-employee share plans on the same terms as other employees:

i) the ShareSave Plan – a savings-related share option plan available to all employees. In the UK, this plan operates within UK tax legislation (including a requirement to finance the exercise of the option using the proceeds of a monthly savings contract) but the key principles are applied globally. The exercise of the option is not subject to the achievement of a performance target;

ii) the free share element of the Share Incentive Plan (SIP) under which UK employees may receive shares as part of the Company component of any bonus paid. The SIP attracts tax benefits for UK employees; and

iii) the partnership share element of the SIP under which UK employees may make regular purchases of shares from pre-tax income.

Benefits
Executive directors and senior executives are entitled to a company car or car allowance, private medical insurance and financial counselling. James Guyette is entitled to a housing allowance and the costs of additional housing are met for John Rishton, Mark Morris and Mike Terrett.

Service contracts
The committee’s policy is that executive directors appointed to the Board are offered notice periods of 12 months. The committee recognises that in the case of appointments to the Board from outside the Group, it may be necessary to offer a longer initial notice period, which would subsequently reduce to 12 months after that initial period.

The committee has a defined policy on compensation and mitigation to be applied in the event of a UK director’s contract being terminated prematurely. In these circumstances, steps are taken to ensure that poor performance is not rewarded. When calculating termination payments, the committee takes into account a range of factors including the director’s obligation to mitigate their own loss.

The following table summarises the terms of the executive directors’ service contracts:

<table>
<thead>
<tr>
<th>Date of contract</th>
<th>Unexpired term</th>
<th>Notice period Company</th>
<th>Notice period individual</th>
</tr>
</thead>
<tbody>
<tr>
<td>James Guyette</td>
<td>29 September 1997</td>
<td>Indefinite</td>
<td>30 days 1</td>
</tr>
<tr>
<td>Mark Morris</td>
<td>1 January 2012</td>
<td>12 months</td>
<td>12 months</td>
</tr>
<tr>
<td>John Rishton</td>
<td>10 March 2011</td>
<td>12 months</td>
<td>12 months</td>
</tr>
<tr>
<td>Colin Smith CBE</td>
<td>1 July 2005</td>
<td>12 months</td>
<td>12 months</td>
</tr>
</tbody>
</table>

1 James Guyette has a contract with Rolls-Royce North America Inc., drawn up under the laws of the State of Virginia, US. It provides that, on termination without cause, he is entitled to 12 months’ severance pay without mitigation and, in addition, appropriate relocation costs.

External directorships of executive directors
During 2012, James Guyette was chairman of PrivateBancorp Inc., and a director of priceline.com Inc. In each case he retained the relevant fees from serving on the boards of these companies, as shown in the table below:

<table>
<thead>
<tr>
<th>Payment received</th>
<th>£000</th>
</tr>
</thead>
<tbody>
<tr>
<td>James Guyette</td>
<td>110</td>
</tr>
</tbody>
</table>

1 James Guyette was paid in US dollars translated at £1=US$1.585.
In addition to an annual fee, James Guyette received 3,345 Restricted Stock Units (RSUs) at US$14.95 per share in PrivateBancorp. During 2012, 3,460 RSUs vested. He was granted 263 shares of restricted stock at US$645.86 per share in priceline.com. During 2012, 1,031 shares of restricted stock vested at US$645.86 per share.
Directors’ aggregate emoluments (audited)
The individual directors’ emoluments are analysed as follows:

<table>
<thead>
<tr>
<th></th>
<th>Salary/fees £000</th>
<th>Cash bonus £000</th>
<th>Deferred shares 1 £000</th>
<th>Total APRA £000</th>
<th>Cash allowance 1 £000</th>
<th>Taxable benefits 1 £000</th>
<th>Aggregate emoluments excluding pensions contributions 4 £000</th>
<th>Aggregate emoluments excluding pensions contributions 4 £000</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Executive directors</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>James Guyette 3</td>
<td>517</td>
<td>398</td>
<td>265</td>
<td>663</td>
<td>–</td>
<td>100</td>
<td>1,280</td>
<td>1,124</td>
</tr>
<tr>
<td>Mark Morris 4</td>
<td>482</td>
<td>278</td>
<td>186</td>
<td>464</td>
<td>58</td>
<td>189</td>
<td>1,193</td>
<td>–</td>
</tr>
<tr>
<td>John Rishton</td>
<td>896</td>
<td>743</td>
<td>496</td>
<td>1,239</td>
<td>195</td>
<td>126</td>
<td>2,456</td>
<td>1,910</td>
</tr>
<tr>
<td>Colin Smith CBE</td>
<td>506</td>
<td>358</td>
<td>238</td>
<td>596</td>
<td>127</td>
<td>23</td>
<td>1,252</td>
<td>1,135</td>
</tr>
<tr>
<td>Mike Terrett CBE 7</td>
<td>567</td>
<td>182</td>
<td>121</td>
<td>303</td>
<td>–</td>
<td>125</td>
<td>995</td>
<td>1,277</td>
</tr>
<tr>
<td>Former directors who served during 2011 but did not serve during 2012 4</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>1,481</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>2,968</td>
<td>1,959</td>
<td>1,306</td>
<td>3,265</td>
<td>380</td>
<td>563</td>
<td>7,176</td>
<td>6,927</td>
</tr>
<tr>
<td><strong>Non-executive directors</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Dame Helen Alexander</td>
<td>75</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>75</td>
<td>74</td>
</tr>
<tr>
<td>Lewis Booth CBE</td>
<td>80</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>80</td>
<td>44</td>
</tr>
<tr>
<td>Peter Byrom</td>
<td>60</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>60</td>
<td>60</td>
</tr>
<tr>
<td>Sir Frank Chapman</td>
<td>75</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>75</td>
<td>11</td>
</tr>
<tr>
<td>Iain Conn</td>
<td>72</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>72</td>
<td>72</td>
</tr>
<tr>
<td>Sir Peter Gregson 9</td>
<td>21</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>21</td>
<td>60</td>
</tr>
<tr>
<td>John McAdam</td>
<td>60</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>60</td>
<td>60</td>
</tr>
<tr>
<td>JohnNeill CBE</td>
<td>60</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>60</td>
<td>60</td>
</tr>
<tr>
<td>Sir Simon Robertson</td>
<td>370</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>7</td>
<td>377</td>
<td>385</td>
<td></td>
</tr>
<tr>
<td>Jasmin Staiblin 10</td>
<td>37</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>37</td>
<td>–</td>
<td></td>
</tr>
<tr>
<td>Ian Strachan</td>
<td>75</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>75</td>
<td>86</td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>3,953</td>
<td>1,959</td>
<td>1,306</td>
<td>3,265</td>
<td>380</td>
<td>570</td>
<td>8,168</td>
<td>7,839</td>
</tr>
</tbody>
</table>

1 For executive directors, 60 per cent of APRA is delivered in cash and 40 per cent is delivered in the form of a deferred share award. Shares forming part of the bonus under APRA will be valued at the date of award which is likely to be 1 March 2013. The Trustee will acquire the required number of shares at the prevailing market price by 31 March 2013.
2 Colin Smith CBE received a cash allowance in lieu of future pension accrual. Mark Morris received a cash allowance in lieu of future pension accrual. John Rishton received employer contributions into the executive defined contribution pension arrangement restricted to the annual allowance limits with any excess paid as a cash allowance.
3 Taxable benefits may include the following: a car or car allowance, the use of a driver, private medical insurance and financial counselling, in the case of James Guyette, a housing allowance and club membership fees, and in the case of John Rishton, Mark Morris and Mike Terrett CBE, the figure in the above table includes additional housing costs paid on their behalf and the tax charge on that benefit paid by the Group.
4 Aggregate emoluments exclude pensions contributions. Details of the directors’ pensions are set out on pages 63 and 64.
5 James Guyette was paid in US dollars translated at £1 = US$1.585.
6 Mark Morris was appointed as an executive director on 1 January 2012.
7 Mike Terrett CBE retired as an executive director on 31 December 2012.
8 Sir John Rose retired as an executive director on 31 March 2011 and Andrew Shilston retired as an executive director on 31 December 2011.
9 Sir Peter Gregson retired as a non-executive director on 4 May 2012.
10 Jasmin Staiblin was appointed as a non-executive director on 21 May 2012.
**Governance**

**Directors’ remuneration report**

**TSR over five years**

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

The graph shows the growth in value of a hypothetical £100 holding in Rolls-Royce Holdings plc ordinary shares over five years, relative to the FTSE 100 index. The values of the hypothetical £100 holdings at the end of the five-year period were £186.40 and £110.60 respectively.

![Rolls-Royce – five year TSR data](image)

The TSR calculations in the chart above are based on spot start and end values for both Rolls-Royce and the FTSE 100. The TSR data on page 55 is based on start and end values averaged over six months to be consistent with the rules of the PSP and does not therefore align to the values on which this chart is based. However, both spot and average methodologies confirm that Rolls-Royce TSR has outperformed the FTSE 100.

**Payments made to former directors of the Company (audited)**

John Cheffins retired from the Board on 30 September 2007. He has continued in his role as Chairman of Rolls-Royce Fuel Cell Systems Limited and provided non-executive advice to the Energy business. He was paid £47,890 and benefits totalling £3,642 in 2012 (paid in Canadian dollars translated at £1 = CAD$1.5837).

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. He was paid £23,940 in 2012.

**Looking ahead to 2013**

The following chart illustrates the value of executive directors’ packages in various scenarios.

**Performance scenarios for annual bonus and PSP**

<table>
<thead>
<tr>
<th>Below threshold</th>
<th>Threshold</th>
<th>Maximum</th>
<th>Exceptional maximum</th>
</tr>
</thead>
<tbody>
<tr>
<td>There is no bonus and no vesting under the PSP</td>
<td>Threshold bonus and threshold vesting under the PSP</td>
<td>Maximum bonus (based on financial performance) and maximum CPS vesting under the PSP</td>
<td>Maximum bonus (based on financial and exceptional individual performance) and maximum vesting under the PSP with maximum TSR multiplier</td>
</tr>
</tbody>
</table>

The TSR calculations in the chart above are based on spot start and end values for both Rolls-Royce and the FTSE 100. The TSR data on page 55 is based on start and end values averaged over six months to be consistent with the rules of the PSP and does not therefore align to the values on which this chart is based. However, both spot and average methodologies confirm that Rolls-Royce TSR has outperformed the FTSE 100.

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**Performance scenarios for annual bonus and PSP**

<table>
<thead>
<tr>
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<th>Exceptional maximum</th>
</tr>
</thead>
<tbody>
<tr>
<td>There is no bonus and no vesting under the PSP</td>
<td>Threshold bonus and threshold vesting under the PSP</td>
<td>Maximum bonus (based on financial performance) and maximum CPS vesting under the PSP</td>
<td>Maximum bonus (based on financial and exceptional individual performance) and maximum vesting under the PSP with maximum TSR multiplier</td>
</tr>
</tbody>
</table>

The TSR calculations in the chart above are based on spot start and end values for both Rolls-Royce and the FTSE 100. The TSR data on page 55 is based on start and end values averaged over six months to be consistent with the rules of the PSP and does not therefore align to the values on which this chart is based. However, both spot and average methodologies confirm that Rolls-Royce TSR has outperformed the FTSE 100.
**Pensions (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 pension schemes.

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

Mark Morris opted out of future pension accrual and salary linkage with effect from 16 August 2012 and receives a cash allowance. Had he elected to continue to remain in the pension plan the estimated cost of accrual would be higher than the cash allowance being paid in lieu.

Mike Terrett CBE opted out of future pension accrual with effect from 1 April 2006 and started to receive his pension from 1 November 2009. Since starting to receive his pension, he does not accrue any further pension benefit or allowance in lieu of pension benefit from his ongoing employment with the Group.

Colin Smith CBE opted out of future pension accrual with effect from 1 April 2006. He receives a cash allowance in lieu of future pension accrual. Had he elected to continue to accrue pension the estimated cost of that accrual would be higher than the cash allowance being paid in lieu.

James Guyette participates in pension plans sponsored by Rolls-Royce North America Inc. He is a member of two defined benefit plans in the US, one qualified and one non-qualified. He accrues a retirement lump sum benefit in both of these plans. The aggregate value of the retirement lump sums accrued in these two plans, and the transfer values of these benefits, are shown in the second table below. In addition, James Guyette is a member of two 401(k) Savings Plans in the US, one qualified and one non-qualified, to which both he and his employer, Rolls-Royce North America Inc., contribute. He is also a member of an unfunded non-qualified deferred compensation plan in the US, to which his employer makes notional contributions. Employer contributions to these three plans during 2012 have been added to the increase in transfer value over 2012 for the defined benefit plans, and are therefore included in the figures shown in the final two columns of the second table below. The transfer values in the tables below have been calculated on the basis of actuarial advice.

Details of the pension benefits, which accrued over the year in the Group’s registered UK defined benefit pension scheme 1, are given below:

<table>
<thead>
<tr>
<th></th>
<th>Increase in accrued pension during the year ended 31 Dec 2012</th>
<th>Increase/Decrease in accrued pension during the year ended 31 Dec 2012</th>
<th>Total accrued pension entitlement at 31 Dec 2012</th>
<th>Transfer value of accrued pension as at 31 Dec 2012</th>
<th>Transfer value as at 31 Dec 2011 of accrued pension at that date</th>
<th>Increase in transfer value over 2012 net of the member’s own contributions</th>
<th>Transfer value of increase/decrease in accrued pension over 2012 net of the member’s own contributions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mark Morris</td>
<td>40</td>
<td>34</td>
<td>164</td>
<td>3,778</td>
<td>2,354</td>
<td>1,406</td>
<td>1,325</td>
</tr>
<tr>
<td>Colin Smith CBE</td>
<td>61</td>
<td>46</td>
<td>363</td>
<td>6,977</td>
<td>6,002</td>
<td>975</td>
<td>732</td>
</tr>
<tr>
<td>Mike Terrett CBE</td>
<td>3</td>
<td>(10)</td>
<td>244</td>
<td>5,773</td>
<td>5,666</td>
<td>107</td>
<td>(202)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>Increase in accrued retirement lump sum during 31 Dec 2012</th>
<th>Increase in accrued retirement lump sum during the year ended 31 Dec 2012</th>
<th>Total accrued retirement lump sum entitlement at 31 Dec 2011</th>
<th>Transfer value of accrued retirement lump sum at 31 Dec 2011</th>
<th>Transfer value as at 31 Dec 2011 of accrued retirement lump sum at that date</th>
<th>Increase in transfer value over 2012 net of the member’s own contributions</th>
<th>Transfer value of increase/decrease in accrued retirement lump sum over 2012 net of the member’s own contributions</th>
</tr>
</thead>
<tbody>
<tr>
<td>James Guyette</td>
<td>125</td>
<td>87</td>
<td>1,047</td>
<td>922</td>
<td>508</td>
<td>471</td>
<td></td>
</tr>
</tbody>
</table>

1 Members of the schemes have the option to pay Additional Voluntary Contributions. Neither the contributions nor the resulting benefits are included in the above table.
2 This column shows the increase/decrease in pension/retirement lump sum during the year ended 31 December 2012 but in this case excluding the effect of inflation.
3 The pension entitlement shown is that which would be paid annually on retirement at normal retirement age or to 1 April 2006 for Colin Smith CBE and to 16 August 2012 for Mark Morris. For Mike Terrett CBE, the pension shown is the annual pension in payment at 31 December 2012.
4 The transfer values stated represent liabilities of the Rolls-Royce sponsored pension schemes and are not sums paid to the individuals. The transfer values of the accrued pensions as at 31 December 2011 and 31 December 2012 have been calculated on the bases adopted by the trustees on 6 October 2008 and 16 October 2012 respectively, following receipt of actuarial advice.
5 This column shows the transfer value of the increase/decrease in pension/retirement lump sum during the year ended 31 December 2012 excluding the effect of inflation, and net of the member’s own contributions.
6 Mark Morris was appointed as an executive director on 1 January 2012.
7 Mike Terrett CBE retired as an executive director on 31 December 2012.
8 The lump sum entitlement shown is that which would be paid on immediate retirement based on service to the end of the year.
9 Benefits are translated at £1 = US$1.6255.
Details of payments made by the Group to defined contribution pension plans on behalf of the following executive directors are given below:

<table>
<thead>
<tr>
<th></th>
<th>2012 £000</th>
<th>2011 £000</th>
</tr>
</thead>
<tbody>
<tr>
<td>James Guyette 1, 2</td>
<td>394</td>
<td>381</td>
</tr>
<tr>
<td>John Rishton</td>
<td>123</td>
<td>115</td>
</tr>
</tbody>
</table>

1 Employer contributions for the defined contribution plans during 2012, have been included in the increase in transfer value over 2012 for the defined benefit plans and shown in the final two columns of the table above for James Guyette.

2 Benefits are translated at £1 = US$1.585.

Directors’ share interests (audited)
The directors who held office at 31 December 2012 and their connected persons, had the following interests in the ordinary shares and C Shares 1 of the Company in respect of which transactions are notifiable to the Company under DTR 3.1.2R of the Disclosure Rules and Transparency Rules:

<table>
<thead>
<tr>
<th></th>
<th>Ordinary shares</th>
<th></th>
<th>C Shares</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1 January 2012</td>
<td>Changes in 2012</td>
<td>31 December 2012</td>
</tr>
<tr>
<td>James Guyette</td>
<td>274,797</td>
<td>211,646</td>
<td>486,443</td>
</tr>
<tr>
<td>Mark Morris 2</td>
<td>39,618</td>
<td>32,254</td>
<td>71,872</td>
</tr>
<tr>
<td>John Rishton</td>
<td>9,686</td>
<td>97,179</td>
<td>106,865</td>
</tr>
<tr>
<td>Colin Smith CBE</td>
<td>218,554</td>
<td>64,308</td>
<td>282,862</td>
</tr>
<tr>
<td>Mike Terrett CBE 3</td>
<td>507,166</td>
<td>10,659</td>
<td>517,825</td>
</tr>
<tr>
<td>Dame Helen Alexander</td>
<td>1,071</td>
<td>407</td>
<td>1,478</td>
</tr>
<tr>
<td>Peter Byrom</td>
<td>223,321</td>
<td>4,692</td>
<td>228,013</td>
</tr>
<tr>
<td>Lewis Booth CBE</td>
<td>5,000</td>
<td>7,500</td>
<td>12,500</td>
</tr>
<tr>
<td>Iain Conn</td>
<td>20,210</td>
<td>4,000</td>
<td>24,210</td>
</tr>
<tr>
<td>Sir Peter Gregson 4</td>
<td>4,218</td>
<td>137</td>
<td>4,355</td>
</tr>
<tr>
<td>Dr John McAdam</td>
<td>1,571</td>
<td>341</td>
<td>1,912</td>
</tr>
<tr>
<td>John Neill CBE</td>
<td>36,464</td>
<td>2,101</td>
<td>38,565</td>
</tr>
<tr>
<td>Sir Simon Robertson</td>
<td>41,839</td>
<td>878</td>
<td>42,717</td>
</tr>
<tr>
<td>Jasmin Staiblin 5</td>
<td>–</td>
<td>–</td>
<td>–</td>
</tr>
<tr>
<td>Ian Strachan</td>
<td>11,500</td>
<td>–</td>
<td>11,500</td>
</tr>
</tbody>
</table>

# Or date of appointment if later
§ Or date of retirement if earlier
1 Non-cumulative redeemable preference shares of 0.1p each.
2 Mark Morris was appointed as an executive director on 1 January 2012.
3 Mike Terrett CBE retired as an executive director on 31 December 2012.
4 Sir Peter Gregson retired as a non-executive director on 4 May 2012.
5 Jasmin Staiblin was appointed as a non-executive director on 21 May 2012.

Directors’ interests in the Company’s share plans are shown separately on pages 65, 66 and 67. No director had any other interests, beneficial or otherwise, in the share capital of the Company or any of its subsidiaries as at 31 December 2012.

Changes in the interests of the executive directors and non-executive directors between 31 December 2012 and 13 February 2013 are listed below.

<table>
<thead>
<tr>
<th></th>
<th>Ordinary shares</th>
<th>C Shares</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dame Helen Alexander</td>
<td>189</td>
<td>97,128</td>
</tr>
<tr>
<td>Lewis Booth CBE</td>
<td>–</td>
<td>950,000</td>
</tr>
<tr>
<td>Peter Byrom</td>
<td>1,897</td>
<td>–</td>
</tr>
<tr>
<td>Iain Conn</td>
<td>724</td>
<td>–</td>
</tr>
<tr>
<td>James Guyette</td>
<td>9,693</td>
<td>–</td>
</tr>
<tr>
<td>John McAdam</td>
<td>51</td>
<td>–</td>
</tr>
<tr>
<td>Mark Morris</td>
<td>–</td>
<td>2,953,208</td>
</tr>
<tr>
<td>John Neill CBE</td>
<td>528</td>
<td>2,231,512</td>
</tr>
<tr>
<td>John Rishton</td>
<td>890</td>
<td>–</td>
</tr>
<tr>
<td>Sir Simon Robertson</td>
<td>355</td>
<td>–</td>
</tr>
<tr>
<td>Colin Smith CBE</td>
<td>2,380</td>
<td>–</td>
</tr>
</tbody>
</table>
### Partnership shares held in trust under the SIP

<table>
<thead>
<tr>
<th></th>
<th>Ordinary shares</th>
<th></th>
<th>C Shares</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Colin Smith CBE</td>
<td>1,610</td>
<td>(125)</td>
<td>1,485</td>
<td>–</td>
</tr>
<tr>
<td>Mike Terrett CBE</td>
<td>1,609</td>
<td>(124)</td>
<td>1,485</td>
<td>–</td>
</tr>
</tbody>
</table>

### Free shares held in trust under the SIP

<table>
<thead>
<tr>
<th></th>
<th>Ordinary shares</th>
<th></th>
<th>C Shares</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Colin Smith CBE</td>
<td>3,179</td>
<td>(249)</td>
<td>2,930</td>
<td>–</td>
</tr>
</tbody>
</table>

### Unrestricted shares held under the SIP

<table>
<thead>
<tr>
<th></th>
<th>Ordinary shares</th>
<th></th>
<th>C Shares</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Colin Smith CBE</td>
<td>5,018</td>
<td>(4,946)</td>
<td>72</td>
<td>–</td>
</tr>
<tr>
<td>Mike Terrett CBE</td>
<td>4,545</td>
<td>303</td>
<td>4,848</td>
<td>–</td>
</tr>
</tbody>
</table>

1 Under the SIP, free shares and partnership shares held in trust for more than five years are classified as unrestricted and are no longer subject to income tax or national insurance contributions on withdrawal. Unrestricted shares can be held in trust under the SIP for as long as the participant remains an employee of the Group.

2 On 15 January 2013 and 8 February 2013, 25 and 31 ordinary shares respectively, which were held as partnership shares, were classified as unrestricted shares.

### Share options (audited)

The directors held the following options under the Rolls-Royce ShareSave plan:

<table>
<thead>
<tr>
<th></th>
<th>1 January 2012</th>
<th>Granted in 2012</th>
<th>Lapsed in 2012</th>
<th>Exercised in 2012</th>
<th>31 December 2012</th>
<th>Exercise price</th>
<th>Market price at date exercised</th>
<th>Aggregate gains 2012 £000</th>
<th>Aggregate gains 2011 £000</th>
<th>Exercisable dates</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mark Morris</td>
<td>872</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>872</td>
<td>387p</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>2013</td>
</tr>
<tr>
<td>Mark Morris</td>
<td>541</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>541</td>
<td>525p</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>2015</td>
</tr>
<tr>
<td>John Rishton</td>
<td>1,450</td>
<td>–</td>
<td>–</td>
<td>1,450</td>
<td>–</td>
<td>525p</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>2017</td>
</tr>
</tbody>
</table>

The market price of the Company’s ordinary shares ranged between 733.00 pence and 913.50 pence during 2012. The closing price on 31 December 2012 was 873.50 pence.

### Long-term incentive awards (audited)

The directors as at 31 December 2012 had the following share awards arising out of the operation of APRA:

<table>
<thead>
<tr>
<th></th>
<th>1 January 2012</th>
<th>Dividend enhancement during 2012</th>
<th>Vested during 2012</th>
<th>Granted during 2012</th>
<th>31 December 2012</th>
<th>Value of shares vested in 2012 £000</th>
</tr>
</thead>
<tbody>
<tr>
<td>James Guyette</td>
<td>51,867</td>
<td>826</td>
<td>(17,098)</td>
<td>28,161</td>
<td>63,756</td>
<td>140</td>
</tr>
<tr>
<td>Mark Morris</td>
<td>10,794</td>
<td>145</td>
<td>(3,058)</td>
<td>6,145</td>
<td>14,026</td>
<td>25</td>
</tr>
<tr>
<td>John Rishton</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>44,400</td>
<td>44,400</td>
<td>–</td>
</tr>
<tr>
<td>Colin Smith CBE</td>
<td>44,677</td>
<td>631</td>
<td>(13,111)</td>
<td>26,985</td>
<td>49,182</td>
<td>107</td>
</tr>
<tr>
<td>Mike Terrett CBE</td>
<td>59,682</td>
<td>789</td>
<td>(16,344)</td>
<td>30,601</td>
<td>74,728</td>
<td>133</td>
</tr>
</tbody>
</table>

Total value of shares vested: 405

1 Under APRA, shares vest after two years. Shares went into trust in 2010, 2011 and 2012 at prices of 537.20 pence, 601.00 pence and 808.80 pence respectively. At 31 December 2012, the amounts stated in the emoluments table representing the 2012 APRA deferred shares had not yet been applied by the Trustee to purchase shares. An investment is expected to be made by 31 March 2013 when the Trustee will acquire the required number of shares at the prevailing market price. The market value per share which vested under APRA during 2012 was 816 pence.

Conditional awards, granted under the PSP to executive directors are shown on page 66. The number of shares released will be dependent upon the achievement of the EPS and CPS targets over the three-year performance period. If the Company’s TSR is above the median of the FTSE 100 index, the number of shares due to be released to an executive will be increased by between 25 per cent and 50 per cent. This increase is on a straight-line basis between the median and upper-quartile TSR performance in the performance period.
### PSP (audited)

<table>
<thead>
<tr>
<th>Name</th>
<th>1 January 2012</th>
<th>Granted during 2012</th>
<th>TSR uplift at vesting</th>
<th>Total vested during 2012</th>
<th>31 December 2012</th>
<th>Value of shares vested in 2012 £000</th>
<th>Performance period</th>
<th>Date of grant</th>
<th>Market price at date of grant</th>
</tr>
</thead>
<tbody>
<tr>
<td>James Guyette</td>
<td>207,845</td>
<td>–</td>
<td>103,923</td>
<td>(311,768)</td>
<td>–</td>
<td>2,551</td>
<td>1 Jan 2009 to 31 Dec 2011</td>
<td>10 Mar 2009</td>
<td>260.42p</td>
</tr>
<tr>
<td></td>
<td>91,383</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>91,383</td>
<td>–</td>
<td>1 Jan 2010 to 31 Dec 2012</td>
<td>1 Mar 2010</td>
<td>544.70p</td>
</tr>
<tr>
<td></td>
<td>82,404</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>82,404</td>
<td>–</td>
<td>1 Jan 2011 to 31 Dec 2013</td>
<td>9 Mar 2011</td>
<td>601.50p</td>
</tr>
<tr>
<td></td>
<td>–</td>
<td>64,385</td>
<td>–</td>
<td>–</td>
<td>64,385</td>
<td>–</td>
<td>1 Jan 2012 to 31 Dec 2014</td>
<td>1 Mar 2012</td>
<td>809.70p</td>
</tr>
<tr>
<td></td>
<td>381,632</td>
<td>64,385</td>
<td>103,923</td>
<td>(311,768)</td>
<td>238,172</td>
<td>2,551</td>
<td>1 Jan 2011 to 31 Dec 2013</td>
<td>1 Mar 2011</td>
<td>809.70p</td>
</tr>
<tr>
<td></td>
<td>26,085</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>26,085</td>
<td>–</td>
<td>1 Jan 2010 to 31 Dec 2012</td>
<td>1 Mar 2010</td>
<td>544.70p</td>
</tr>
<tr>
<td></td>
<td>25,039</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>25,039</td>
<td>–</td>
<td>1 Jan 2011 to 31 Dec 2013</td>
<td>9 Mar 2011</td>
<td>601.50p</td>
</tr>
<tr>
<td></td>
<td>–</td>
<td>59,899</td>
<td>–</td>
<td>–</td>
<td>59,899</td>
<td>–</td>
<td>1 Jan 2012 to 31 Dec 2014</td>
<td>1 Mar 2012</td>
<td>809.70p</td>
</tr>
<tr>
<td></td>
<td>95,630</td>
<td>59,899</td>
<td>11,127</td>
<td>(55,633)</td>
<td>111,023</td>
<td>455</td>
<td>1 Jan 2011 to 31 Dec 2013</td>
<td>9 Mar 2011</td>
<td>601.50p</td>
</tr>
<tr>
<td>John Rishton</td>
<td>164,866</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>164,866</td>
<td>–</td>
<td>1 Jan 2011 to 31 Dec 2013</td>
<td>1 Mar 2011</td>
<td>601.50p</td>
</tr>
<tr>
<td></td>
<td>164,866</td>
<td>133,383</td>
<td>–</td>
<td>–</td>
<td>133,383</td>
<td>–</td>
<td>1 Jan 2012 to 31 Dec 2014</td>
<td>1 Mar 2012</td>
<td>809.70p</td>
</tr>
<tr>
<td>CBE</td>
<td>78,025</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>78,025</td>
<td>–</td>
<td>1 Jan 2010 to 31 Dec 2012</td>
<td>1 Mar 2010</td>
<td>544.70p</td>
</tr>
<tr>
<td></td>
<td>74,813</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>74,813</td>
<td>–</td>
<td>1 Jan 2011 to 31 Dec 2013</td>
<td>9 Mar 2011</td>
<td>601.50p</td>
</tr>
<tr>
<td></td>
<td>301,157</td>
<td>62,987</td>
<td>74,160</td>
<td>(222,479)</td>
<td>215,825</td>
<td>1,820</td>
<td>1 Jan 2011 to 31 Dec 2013</td>
<td>9 Mar 2011</td>
<td>601.50p</td>
</tr>
<tr>
<td>Mike Terrett</td>
<td>191,998</td>
<td>–</td>
<td>95,999</td>
<td>(287,997)</td>
<td>–</td>
<td>2,357</td>
<td>1 Jan 2009 to 31 Dec 2011</td>
<td>10 Mar 2009</td>
<td>260.42p</td>
</tr>
<tr>
<td>CBE</td>
<td>93,630</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>93,630</td>
<td>–</td>
<td>1 Jan 2010 to 31 Dec 2012</td>
<td>1 Mar 2010</td>
<td>544.70p</td>
</tr>
<tr>
<td></td>
<td>91,438</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>91,438</td>
<td>–</td>
<td>1 Jan 2011 to 31 Dec 2013</td>
<td>9 Mar 2011</td>
<td>601.50p</td>
</tr>
<tr>
<td></td>
<td>–</td>
<td>70,397</td>
<td>–</td>
<td>–</td>
<td>70,397</td>
<td>–</td>
<td>1 Jan 2012 to 31 Dec 2014</td>
<td>1 Mar 2012</td>
<td>809.70p</td>
</tr>
<tr>
<td></td>
<td>377,066</td>
<td>70,397</td>
<td>95,999</td>
<td>(287,997)</td>
<td>255,465</td>
<td>2,357</td>
<td>1 Jan 2011 to 31 Dec 2013</td>
<td>9 Mar 2011</td>
<td>601.50p</td>
</tr>
</tbody>
</table>

**Total value of shares vested:** 7,183

*Under the rules of the PSP, the number of shares vesting in 2012 was increased by between 25 per cent and 50 per cent as the TSR exceeded the median of the FTSE 100 index during the three-year performance period to 31 December 2012. The market value per share, which vested under the PSP during 2012, was 818.25 pence.*
Grant of shares (audited)
John Rishton received a special grant of shares on joining the Company intended to mirror the fair value and vesting profile of the incentives he forfeited on resigning from his previous employer as detailed below:

<table>
<thead>
<tr>
<th></th>
<th>1 January 2012</th>
<th>TSR uplift</th>
<th>Total vested during 2012</th>
<th>31 December 2012</th>
<th>Performance period</th>
<th>Vesting date</th>
<th>Value of shares vested in 2012 £000</th>
<th>Market price at date of grant</th>
</tr>
</thead>
<tbody>
<tr>
<td>Performance related</td>
<td>49,099</td>
<td>24,550</td>
<td>(73,649)</td>
<td>–</td>
<td>1 Jan 2009 to 31 Dec 2011</td>
<td>1 Mar 2012</td>
<td>609</td>
<td>601.50p</td>
</tr>
<tr>
<td>Restricted shares</td>
<td>126,019</td>
<td>–</td>
<td>(126,019)</td>
<td>n/a</td>
<td>1 Jan 2010 to 31 Dec 2012</td>
<td>1 Mar 2012</td>
<td>1,043</td>
<td>601.50p</td>
</tr>
<tr>
<td>Performance related</td>
<td>76,365</td>
<td>–</td>
<td>–</td>
<td>76,365</td>
<td>n/a</td>
<td>1 Mar 2013</td>
<td>76,365</td>
<td>601.50p</td>
</tr>
<tr>
<td>Restricted shares</td>
<td>76,143</td>
<td>–</td>
<td>–</td>
<td>76,143</td>
<td>n/a</td>
<td>1 Mar 2013</td>
<td>76,143</td>
<td>601.50p</td>
</tr>
<tr>
<td>Performance related</td>
<td>63,397</td>
<td>–</td>
<td>–</td>
<td>63,397</td>
<td>n/a</td>
<td>1 Mar 2013</td>
<td>63,397</td>
<td>601.50p</td>
</tr>
<tr>
<td>Performance related</td>
<td>40,565</td>
<td>–</td>
<td>–</td>
<td>40,565</td>
<td>n/a</td>
<td>1 Mar 2013</td>
<td>40,565</td>
<td>601.50p</td>
</tr>
<tr>
<td>Performance related</td>
<td>431,588</td>
<td>24,550</td>
<td>(199,668)</td>
<td>256,470</td>
<td>1 Jan 2012 to 31 Dec 2014</td>
<td>1 Mar 2015</td>
<td>1,652</td>
<td>601.50p</td>
</tr>
</tbody>
</table>

1 The market value per share for the performance related and restricted shares that vested was 827.50 pence.

Non-executive directors’ remuneration policy
The committee determines, on the Board’s behalf, the remuneration package of the Chairman. The Board determines the remuneration of the other non-executive directors.

The Chairman and the non-executive directors have letters of appointment rather than service contracts. No compensation is payable to the Chairman or to any non-executive director if the appointment is terminated early.

Non-executive directors’ fees
The Board takes account of independent market surveys in determining the fees payable to the Chairman and the non-executive directors.

The fees payable to the non-executive directors are reviewed annually by the Board and are shown below:

<table>
<thead>
<tr>
<th>Position</th>
<th>£000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chairman</td>
<td>370</td>
</tr>
<tr>
<td>Other non-executive directors</td>
<td>60</td>
</tr>
<tr>
<td>Chairman of audit committee</td>
<td>20</td>
</tr>
<tr>
<td>Chairman of ethics committee</td>
<td>15</td>
</tr>
<tr>
<td>Chairman of remuneration committee</td>
<td>15</td>
</tr>
<tr>
<td>Chairman of safety committee</td>
<td>15</td>
</tr>
<tr>
<td>Senior Independent Director</td>
<td>12</td>
</tr>
</tbody>
</table>

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

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

The committee adopts the principles of good governance as set out in the Code and complies with the Listing Rules of the Financial Services Authority and the relevant schedules of the Companies Act 2006 and the Directors’ Report Regulations in Schedule 8 of the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008.

The report is divided into audited and unaudited information. The Companies Act 2006 and the Listing Rules require the Company’s auditor to report on the audited information in their report on page 129 and to state that this section has been properly prepared in accordance with these regulations. The report is subject to shareholder approval at the AGM on 2 May 2013.

The directors’ remuneration report was approved by the Board on 13 February 2013 and signed on its behalf.

Dame Helen Alexander
Chairman of the remuneration committee
Shareholders and share capital

Share capital and voting rights
On 31 December 2012, there were 1,872,303,563 ordinary shares of 20 pence each, 10,417,658,475 C Shares of 0.1 pence each and one Special Share of £1 in issue. The ordinary shares are listed on the London Stock Exchange.

Payments to shareholders
At the AGM on 2 May 2013, the directors will recommend an issue of 119 C Shares with a total nominal value of 11.6 pence for each ordinary share. The C Shares will be issued on 1 July 2013. Together with the interim issue on 2 January 2013 of 76 C Shares for each ordinary share with a total nominal value of 7.6 pence, this is the equivalent of a total annual payment to ordinary shareholders of 19.5 pence for each ordinary share.

The payment to shareholders will, as before, be made in the form of redeemable C Shares which shareholders may either choose to retain or redeem for a cash equivalent. The Registrar, on behalf of the Company, operates a C Share Reinvestment Plan (CRIP) and can, on behalf of shareholders, purchase ordinary shares from the market rather than delivering a cash payment. Shareholders wishing to redeem their C Shares or else redeem and participate in the CRIP must ensure that their instructions are lodged with the Registrar no later than 5pm on 3 June 2013.

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

Ordinary shares
Holders of ordinary shares are entitled to receive the Company’s annual report. They are also entitled: to attend and speak at general meetings of the Company; to appoint one or more proxies or, if they are corporations, corporate representatives; and to exercise voting rights. They have the right to ask questions at the AGM relating to the business of the meeting and for these to be answered, unless such answer would interfere unduly with the business of the meeting. The directors have discretion to refuse to entertain questions at the AGM that they consider inappropriate or which they consider the directors and/or their employees are not equipped to answer. The Interim Directors have discretion to refuse to entertain questions at the AGM that they consider inappropriate or which they consider the directors and/or their employees are not equipped to answer.

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

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

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

Authority to issue shares
At the AGM in 2012, authority was given to the directors to allot new ordinary shares up to a nominal value of £124,816,246, equivalent to one-third of the issued share capital of the Company. This is called the first section 551 amount. In addition, a special resolution was passed to effect a disapplication of pre-emption rights for a maximum of five per cent of the issued share capital of the Company. These authorities are valid until the AGM in 2013, and the directors propose to renew these authorities at that AGM. It is proposed to seek a further authority, at the AGM in 2013 to allot up to two thirds of the total issued share capital, but only in the case of a rights issue. This is called the second section 551 amount. The Board believes that this additional authority will allow the Company to retain the maximum possible flexibility to respond to circumstances and opportunities as they arise, and to allot new C Shares up to a nominal value of £500 million as an alternative to a cash dividend. Such authority expires at the conclusion of the AGM in 2013. The directors propose to renew the authority to allot new C Shares at the AGM in 2013.

Authority to purchase own shares
Also at the AGM in 2012, the Company was authorised by shareholders to purchase up to 187,224,369 of its own ordinary shares representing ten per cent of its issued ordinary share capital. The Company did not make use of this authority during 2012. The authority for the Company to purchase its own shares expires at the conclusion of the AGM in 2013 or 18 months from 2 May 2012, whichever is the earlier. A resolution to renew it will be proposed at that meeting.

Voting rights

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

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

Major shareholdings
At 8 February 2013, the following companies had notified an interest in the issued ordinary share capital of the Company in accordance with the Financial Services Authority’s Disclosure and Transparency Rules:

<table>
<thead>
<tr>
<th>Company</th>
<th>Date notified</th>
<th>% of issued ordinary share capital</th>
</tr>
</thead>
<tbody>
<tr>
<td>AXA S.A.</td>
<td>11 January 2010</td>
<td>4.90</td>
</tr>
<tr>
<td>BlackRock Inc.</td>
<td>3 September 2010</td>
<td>5.02</td>
</tr>
<tr>
<td>Invesco Limited</td>
<td>4 February 2008</td>
<td>6.91</td>
</tr>
<tr>
<td>Legal &amp; General Group plc</td>
<td>14 October 2009</td>
<td>3.96</td>
</tr>
</tbody>
</table>
Other statutory information

Political donations
In line with its established policy, the Group made no political donations pursuant to the authority granted at the 2012 AGM. Although the Company does not make, and does not intend to make, donations to political parties, within the normal meaning of that expression, the definition of political donations under the Companies Act 2006 is very broad and includes expenses legitimately incurred as part of the process of talking to members of parliament and opinion formers to ensure that the issues and concerns of the Group are considered and addressed. These activities are not intended to support any political party and the Group’s policy is not to make any donations for political purposes in the normally accepted sense.

A resolution will therefore be proposed at the 2013 AGM seeking shareholder approval for the directors to be given authority to make donations and incur expenditure which might otherwise be caught by the terms of the Companies Act 2006. The authority sought will be limited to a maximum amount of £25,000 per Group company but so as not to exceed £50,000 for the entire Group in aggregate.

During the year, the business expenses incurred by Rolls-Royce North America Inc. towards the operation of the Rolls-Royce North America Political Action Committee (RRNAPAC) in the US was US$44,161 (2011: US$44,436). 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 £25,000 and £50,000 limits for political donations and expenditure for which shareholder approval will be sought at the AGM.

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. As at 31 December 2012 these facilities were less than 30 per cent drawn (2011 20 per cent).

The Group has entered into a series of financial instruments to hedge its currency, interest rate and commodity exposures. These contracts provide for termination or alteration 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.

Essential commercial relationships
Supply chain
Certain suppliers to the Group contribute key components or services, the loss of which could cause disruption to the Group’s deliveries. However, none are so vital that their loss would affect the viability of the business as a whole. When dealing with suppliers, the Group is guided by the Supply Chain Relationships in Aerospace (SCRI/A) initiative. It seeks the best possible terms from suppliers and when entering into binding purchasing contracts, gives consideration to quality, delivery, price and the terms of payment. In the event of disputes, efforts are made to resolve them quickly.

Customers
The increasingly global nature of the business, balanced across the Civil aerospace, Defence aerospace, Marine and Energy segments, ensures that the Group is not overly dependent on any individual customer.

Creditor days
As the Company is a holding company and does not itself trade, it owed no amounts to trade creditors at 31 December 2012 and therefore the number of creditor days required to be shown in this report to comply with the provisions of the Companies Act 2006 is nil.

Internal control and risk management
The Board’s responsibility for internal control and risk management
The directors are responsible for the Group’s system of internal control and for maintaining and reviewing its effectiveness from both a financial and an operational perspective. The system of internal control is designed to manage, rather than eliminate, the risk of failure to achieve business objectives and to provide reasonable but not absolute assurance against material misstatement or loss.
The Group’s approach to internal control is based on the underlying principle of line management’s accountability for control and risk management. In reviewing the effectiveness of the system of internal control, the Board has taken account of the results of the work carried out to audit and review the activities of the Group.

The risk management process is a key element of the Group’s internal control system and there is an ongoing process to identify, assess and manage risk, including those risks affecting the Group’s reputation. This process is subject to continuous improvement and has been in place throughout the financial year to which these statements apply and up to the date of their approval. The businesses regularly review the effectiveness and consistency of risk management via their assurance framework and the application of the risk management process is subject to review by internal audit.

Responsibility for internal control procedures in joint ventures where we do not have a control agreement lies with the managers of those operations. We seek to exert influence over such ventures by board representation and regularly review the activities of these ventures.

The Board has established a risk committee. Every six months the risk committee reviews the key operational risks that the businesses and functions report in accordance with our enterprise-wide risk management policy. The risk committee also determines material external and strategic risks that exist at Group level. The principal risks are reported annually to the Board and are included on pages 18 and 19. In addition, reports and presentations are made to the Board on certain types of specialist risks eg treasury, insurable risks, pensions, health and safety as the risks evolve.

Following the closure of the 2012 financial year, the audit committee reported to the Board the results of a review of the risk management process at all levels of the organisation prepared by internal audit. The Board confirms that ongoing processes and systems ensure that the Group continues to be compliant with the ‘Turnbull guidance’ as contained in ‘Internal Control: Guidance for Directors on the Combined Code’.

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 reviewed.

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 acknowledge that their business has complied with the Group’s Finance Manual.

Annual report and financial statements
Statement of directors’ responsibilities in respect of the annual report and the financial statements
The directors are responsible for preparing the annual report and the Group and parent company financial statements in accordance with applicable law and regulations.

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

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

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

• select suitable accounting policies and then apply them consistently;
• make judgements and estimates that are reasonable and prudent;
• for the Group financial statements, state whether they have been prepared in accordance with IFRSs 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.
**Going concern**
The Group's business activities, together with the factors likely to affect its future development, performance and position are set out on pages 1 to 38 of the business review and a summary of the principal risks affecting the business are shown on pages 18 to 19.

The financial position of the Group, its cash flows, liquidity position, borrowing facilities and financial risks are described on pages 12 to 15 and pages 37 to 38 of the business review.

In addition, notes 1, 13, 15 and 17 of the consolidated financial statements include the Group's objectives, policies and processes for financial risk management, details of its cash and cash equivalents, indebtedness and borrowing facilities and its financial instruments, hedging activities and its exposure to counterparty credit risk, liquidity risk, currency risk, interest rate risk and commodity pricing risk.

As described on page 37, the Group meets its funding requirements through a mixture of shareholders' funds, bank borrowings, bonds, notes and finance leases. The Group has facilities of £2.3 billion of which £1.3 billion was drawn at the year end. US$230 million of these facilities mature in 2013.

The Group's forecasts and projections, taking into account reasonably possible changes in trading performance, show that the Group has sufficient financial resources. In the event that the put option on Engine Holding GmbH is exercised, (estimated cost £1.6 billion), the directors consider that the Group would be able to raise additional resources in the necessary timeframe to meet this commitment. As a consequence, the directors have reasonable expectation that the Company and the Group are well placed to manage their business risks and to continue in operational existence for the foreseeable future, despite the current uncertain global economic outlook.

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

**Disclosure of information to auditors**
Each of the persons who is a director at the date of approval of this report confirms that:

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

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

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

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

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

ii) the directors' report on pages 1 to 72 includes 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.

By order of the Board

**Nigel Goldsworthy**
Company Secretary

13 February 2013