Rolls-Royce

Delivering today, investing for the future

Rolls-Royce plc

Annual report 2009

Contents and Financial highlights

Business review

01 Introduction
02 Chief Executive's review
05 Global activity
06 Our strategy
08 Market outlook
09 Key performance indicators
14 Principal risks and uncertainties
17 Review of operations
- 17 Civil aerospace
- 19 Defence aerospace
- 21 Marine
- 23 Energy
- 25 Engineering and technology
- 27 Operations
- 29 Services

31 Corporate responsibility
41 Finance Director's review

Other matters

49 Board of directors
51 Internal control and risk management
52 Shareholders and share capital
52 Other statutory information
53 Annual report and financial statements

Financial statements

54 Independent Auditors' report
55 Financial statement contents

	2009	2008	2007	2006	2005	2004	2003	2002	2001	2000
Order book – firm and announced (£bn)	**58.3**	55.5	45.9	26.1	24.4	21.3	18.7	17.1	16.7	14.5
Underlying revenue (£m)	**10,108**	9,147	7,817	7,353	6,458	5,947	5,645	5,788	6,328	5,864
Profit before financing (£m)	**1,172**	862	512	700	855	417	270	212	311	289
Underlying profit before tax (£m)	**915**	883	845	851	579	364	285	255	475	436
Underlying EBITDA (£m)	**1,300**	1,244	1,065	986	911	715	661	672	849	837
Return on capital employed (%)	**17.4**	17.1	17.2	16.0	14.5	8.5	7.7	7.2	11.8	11.2

Cautionary statement regarding forward-looking statements

This Annual report has been prepared for the members of the Company only. The Company, its directors, employees or agents do not accept or assume responsibility to any other person in connection with this document and any such responsibility or liability is expressly disclaimed. This Annual report contains certain forward-looking statements. These forward-looking statements can be identified by the fact that they do not relate only to historical or current facts. In particular, all statements that express forecasts, expectations and projections with respect to future matters, including trends in results of operations, margins, growth rates, overall market trends, the impact of interest or exchange rates, the availability of financing to the Group, anticipated cost savings or synergies and the completion of the Group's strategic transactions, are forward-looking statements. By their nature, these statements and forecasts involve risk and uncertainty because they relate to events and depend on circumstances that may or may not occur in the future. There are a number of factors that could cause actual results or developments to differ materially from those expressed or implied by these forward-looking statements and forecasts. The forward-looking statements reflect the knowledge and information available at the date of preparation of this Annual report, and will not be updated during the year. Nothing in this Annual report should be construed as a profit forecast.

Note: The reconciliation of underlying revenues and results is provided in note 2 and on page 68 of the consolidated financial statements.

Directors' report

The Directors present the Annual report for the year ended December 31, 2009 which includes the business review and audited financial statements for the year. References to 'Rolls-Royce', the 'Group', the 'Company', 'we', or 'our' are to Rolls-Royce plc and/or its subsidiaries, or any of them as the context may require. Pages 01 to 53, inclusive, of this Annual report comprise a Directors' report that has been drawn up and presented in accordance with English company law and the liabilities of the Directors in connection with that report shall be subject to the limitations and restrictions provided by such law. Rolls-Royce plc is incorporated as a public limited company and is registered in England under the UK Companies Act 1985 with the registered number 1003142. Rolls-Royce plc's registered office is 65 Buckingham Gate, London SW1E 6AT.

Introduction

We have followed a consistent strategy for 20 years and our investment in technology, together with our strong order book, positions us well for future growth.

Civil aerospace

Powering more than 30 civil aircraft types from small executive jets to the largest airliners.

£47.0bn Order book

£4,481m Underlying revenue

Defence aerospace

An engine portfolio that covers all major sectors including transport, combat, trainers, helicopters, tactical and unmanned aircraft.

£6.5bn Order book

£2,010m Underlying revenue

Marine

A world-class range of capabilities in ship design and in the supply and support of power and propulsion systems.

£3.5bn Order book

£2,589m Underlying revenue

Energy

An established and leading position in power for onshore and offshore oil and gas applications, together with a growing presence in power generation.

£1.3bn Order book

£1,028m Underlying revenue

Chief Executive's review

"Our resilience, coupled with the inherent strength of our business model, will enable us to manage short-term uncertainties and deliver future growth."

In 2009, Rolls-Royce has delivered solid results despite the severity of the economic downturn, a performance which has again demonstrated the benefits of pursuing a consistent strategy over a long period. This approach has created a broadly-based business with deep customer knowledge, outstanding technology and world-class people.

Our financial results demonstrate the resilience of our business. The Group's order book increased to a record £58.3 billion, with underlying revenue growing 11 per cent to £10.1 billion and underlying profit before tax improving four per cent to £915 million.

The Group has a strong financial position with average cash balances increasing by £259 million to £633 million. The triennial valuation of the Group's largest pension scheme has just been completed and confirms that 2010's cash funding will be maintained at a level similar to that in 2009. This demonstrates the benefits of the early action taken to amend the terms of the scheme and to adopt an investment strategy that reduces volatility.

The economic environment remains challenging and it seems likely that world growth will be slower in the years ahead than it has been in the past decade. In these circumstances, we will benefit from our ability to access the world's faster growing markets where there continues to be demand for investment in transport and infrastructure.

We will maintain our focus on cost reduction and improving our operational efficiency. At the same time we will continue to invest in technology, in our product and service portfolio, in the capital assets required to deliver growth, in our international footprint and in our people.

A long-term business

It is important to recognise that ours is a long-term business. Typically, our product and service lifecycles span 40-50 years and we invest in technology programmes that look five, ten, 20 years and more into the future.

A good example of this is the Avon engine. In its latest version – modified to produce significant improvements in power and efficiency – it is meeting the demands of customers in the oil and gas sector. Yet the Avon first entered the industrial gas turbine market 40 years ago. That engine in turn was derived from the original aero version, which powered a Canberra aeroplane on the first non-stop, non-refuelling, jet flight across the Atlantic in 1951.

Examples like this show why it is so important to set our Group's progress into a broad context. This review will chart our progress over the past ten years, during which we more than doubled our revenues and our underlying profits. This has provided us with a platform from which we are confident we can grow our revenues by at least as much again in the decade ahead.

A very different company

We are now a very different company than we were ten years ago. This can be measured in terms of our scale and geography, in terms of the range of things we do and in terms of operational efficiency. All this has made us a more resilient business and has established a far broader foundation from which to build revenues in the future. A few facts and figures comparing the Rolls-Royce of 1999 with today's Group illustrate the point.

Today, at any one time around 200,000 people are flying in aircraft powered by Rolls-Royce engines. Our ability to keep those aircraft in the sky is a powerful illustration of the 'mission critical' nature of what we do. At peak times that figure can double, which means that the equivalent of the population of Bristol is being kept aloft by Rolls-Royce engines. That is considerably more than double the number of people we were flying a decade ago.

We have become much more than a civil aerospace company. The revenues from our marine, defence aerospace and energy businesses have grown from £2.1 billion in 1999 to £5.6 billion in 2009. In 2009, revenues from outside our civil aerospace business accounted for more than half of Group revenues.

We are becoming less dependent on our traditional markets of Europe and North America. These geographies, which accounted for around 70 per cent of our revenues in 1999, represent around 66 per cent of our revenues now and that trend is set to continue, as more than half our current order book comes from Asia, South America and the Middle East.

Around half our revenues come from services today compared to 40 per cent a decade ago. This represents an annual compound growth in services of ten per cent.

Throughout this period we have maintained our focus on costs and improving operational efficiency. Every year for the past ten years, revenue per employee has increased, showing a 16 per cent improvement in the year to £271,000 in 2009. We are now selling more than twice as much as we were ten years ago, with 2,000 fewer people.

Taken together, the pipeline of orders we have already signed, our increased market share, the growth and scale of our services business and our focus on costs, underpin our confidence that we will double our annual revenues in the decade ahead by organic growth alone.

The Company is proposing to pay an interim dividend of £550 million.

A consistent strategy

The disciplined application of a consistent strategy over many years has delivered a strong, resilient company, which is well positioned for the long-term growth we expect.

Our strategy has five elements and 2009 saw us make progress against each of these.

1. Addressing four global markets

Rolls-Royce has become a truly global Group, providing 'mission critical' power and propulsion systems to a wide range of customers in over 120 countries. The scale of the progress that has been made is illustrated by the fact that the size of our order book in Asia and the Middle East today is around double the Group's entire order book in 1999.

During 2009 we won new customers in Asia, Africa, Europe, the Middle East and North and South America.

Our global reach, coupled with the fact that very few companies offer the highly sophisticated range of products and services that we do, positions us well to take advantage of opportunities in early recovering and emerging economies.

2. Investing in technology, infrastructure and capability

We have managed our balance sheet cautiously and for the long term so that we can continue to invest in manufacturing capability and technology. These investments are targeted specifically to support anticipated growth and meet our customers' future needs.

Technology is a critical differentiator in our four markets, all of which demand increased fuel efficiency, reduced environmental impact and higher levels of reliability and durability. We have invested £7 billion in R&D over the past ten years to maintain our technological advantage, with a particular emphasis on collaborative research involving a network of universities around the world.

This focus continued in 2009, as we championed the development of a network of Advanced Manufacturing Research Centres – four in the UK and one each in the US and Singapore – bringing business and academia together to undertake research relevant to industry.

In 2009, the Group announced a £300 million investment in four new factories in the UK: a casting facility for single crystal turbine blades; an advanced disc facility; a wide-chord fan blade facility for defence engines and; a civil nuclear facility to assemble and test components. This represents the latest phase in a programme of capital replacement which has seen Rolls-Royce invest £1.8 billion in UK infrastructure over the past decade, creating world-class manufacturing facilities in multiple locations and providing skilled jobs in state-of-the-art environments.

To address our global market opportunities, in 2009 we began work on a manufacturing and assembly facility at Crosspointe in the United States. We also confirmed a large engine assembly plant and announced a new wide-chord fan blade factory in Seletar, Singapore, our first outside the UK. This will bring the total investment in the Seletar campus to around £300 million by the time it is completed in 2012.

We now manufacture in 20 countries and have service centres in over 50.

3. Developing a competitive portfolio of products and services

We invest continually in developing proprietary technology which will meet our customers' present and future needs. We currently have 39 'live' major engineering programmes, compared to 25 a decade ago.

2009 was a remarkable year in which we celebrated the first flight of six of our customers' aircraft: the Boeing 787; Gulfstream G650; Airbus A400M; Embraer Legacy 650, the BAE Systems Mantis UAV and the AgustaWestland Lynx Wildcat helicopter. Early in 2010, the short take-off and vertical landing (STOVL) version of the F-35 Joint Strike Fighter deployed the unique Rolls-Royce LiftSystem® for the first time.

These are unprecedented achievements, with more entirely new aircraft taking to the skies in a period of three months than in the previous five years. The capability to meet these requirements is the direct consequence of a decade of investment and innovation.

In the marine market in 2009, we saw the US Navy's Littoral Combat Ship go on active duty, the first sailing of the Royal Navy's Astute class submarine and the commissioning of the Royal Navy's first Type 45 Destroyer, HMS Daring.

All these aircraft and vessels are powered by Rolls-Royce and will enter active service in the next two to three years. The lives of each of these programmes is expected to span 40 years or more, giving us exceptional clarity of future original equipment and service revenues.

4. Growing market share and our installed product base

We have successfully grown our market share in each of our businesses, generating revenues today and establishing a platform for future growth.

Our share of the civil aerospace market has expanded from 27 per cent in 1999 to 34 per cent today and our future order book will ensure that our market share continues to grow, driven by the strong position Rolls-Royce has established on the new generation of wide-bodied aircraft. On the new Boeing 787 and the Airbus A350 XWB families, Rolls-Royce has achieved a market share of 64 per cent.

In the defence aerospace sector we are the world's number two and Europe's number one producer of aero engines, with an extensive engine portfolio for all key sectors of the market.

Revenues in our marine business have more than doubled since 2005. We now design, supply and support power and propulsion systems for naval and commercial applications, with over 30,000 vessels worldwide using our equipment.

In 2009, our energy business recorded its highest ever underlying revenue and profit. We serve energy customers in over 120 countries. Our position in providing power for the oil and gas sector remains strong and the industrial Trent engine continues to establish its presence in the power generation market.

5. Adding value for customers through product-related services

We have unrivalled knowledge of the complex technologies within our products and a deep understanding of our customers' needs. We have used these to develop services that improve our customers' operations.

Our aerospace operations centres are a good illustration of this capability. In dedicated facilities serving airline, corporate and defence customers, these Rolls-Royce centres collect real-time data from our engines as they are operating around the world, 24 hours a day, 365 days a year. By analysing, sharing and acting upon this information we can optimise the performance of our engines in service. The centres are a focal point for service delivery, assessing the condition of the fleet and directing logistics and field maintenance.

We have transferred service best practice across all our businesses so that each now offers a through-life service capability. We continue to strengthen our global services network and in the past year opened, or expanded, marine services facilities in Niteroi in Brazil, Galveston and Seattle in the US and Newfoundland in Canada. We opened an On-Wing Care facility for corporate and regional aircraft in Indianapolis, in the US, and continue to invest in our civil aerospace overhaul bases in Hong Kong and Singapore.

Our people

To execute this strategy effectively and on a worldwide basis, the skills, diversity and dedication of our people are key. The global nature of our customers and our operations means that our people have to be capable of teamwork across geographies. They need to be flexible and open minded, to have world-class capabilities and shared values. Of the 38,500 people we employ, 45 per cent are now based outside the UK.

Today we run a civil aerospace business from the UK with emerging capabilities in Germany and the US. The Presidents of both our defence and energy businesses are based in North America. The US is our biggest defence market and in our energy business, gas turbines are produced in Canada and packaged in the US. We have transferred our marine headquarters to Singapore, reflecting the significance of the Asia region for shipbuilding.

Effective communication that enables the organisation to work well across time zones and borders is crucial. We invest time and effort in communication, using a combination of modern technology and traditional formats to help us to stay connected. In 2009, we shared our strategy storyboard with every employee. The programme was conducted in groups of around ten with a presenter and a record keeper. This amounts to more than 4,000 presentations over 6,000 hours, with a record of the conversation kept to make sure that we benefit from local insights.

In 2009, Rolls-Royce recruited more than 250 new apprentices and 334 graduates, more than ever before, young men and women of over 30 nationalities who have the potential to become leaders of the future.

We are able to attract exceptional people because of the range of world-class skills we require to deliver high value-added manufacturing and services. These range from expertise in marketing and law, through to specialist engineering and logistics, all of which need to be practised internationally and at the highest level.

While we have continued to invest, economic conditions have forced us to take some difficult decisions as well. We have had to reduce our staff in parts of the business where demand has been weak, leading to a net reduction in headcount across the Group of around 500 people in the past year.

Taking these difficult decisions early, investing where the business case is strong and continually looking for ways to improve, have enabled us to respond to the difficult economic environment. Our employees have again demonstrated their capability and commitment and I would like to thank them for playing an integral part in our Group's continuing success.

Prospects

I have described how Rolls-Royce has transformed itself in the past ten years and how, in doing so, it has established a platform for the doubling of revenues in the decade ahead.

In 1999, Rolls-Royce had an order book of £13.2 billion. Today our order book stands at £58.3 billion, with a record number of major global programmes balanced across our four business sectors. These include the Trent XWB, which is not due to enter service until 2013, yet has already achieved more than 1,000 orders – a powerful demonstration of the confidence our customers have in our ability to deliver.

The market share we have gained, the investments in new products we have made and the balance of the business we have achieved, affords us access to a global market for products and services we assess to be worth more than US$2 trillion over the next 20 years, made up of US$1,400 billion for civil aerospace, US$450 billion for defence aerospace, US$320 billion for marine and US$120 billion for energy.

In the short term, the Group expects the trading environment to remain difficult, with the implications of delayed airframe programmes and launch costs adding to demand and operational uncertainty. The Group expects underlying revenues and profits in the current year to be broadly similar to those achieved in 2009. We anticipate a modest cash outflow in 2010 with average cash balances remaining above £500 million.

Our resilience, coupled with the inherent strengths of our business model will enable us to manage these short-term difficulties and deliver future growth.

Sir John Rose
Chief Executive
February 10, 2010

Reliable power is *'mission critical'* for our customers

The power systems we deliver are critical to the operations of our customers. On land, at sea and in the air we deploy the world's most advanced technologies for those who depend upon us.

Rolls-Royce is a global company producing *'mission critical'* power solutions for customers in aerospace, marine and energy markets.

Civil aerospace

Airlines and their customers rely on Rolls-Royce. We recognise the responsibility that is placed on us to produce the most reliable engines with the highest engineering integrity.

1,000,000

Aircraft powered by Rolls-Royce fly one million miles every hour, keeping society and the global economy on the move.

67,000

Airlines look to us to deliver safe, reliable power on behalf of their customers – to ensure this, we monitor 67,000 hours of engine data every day, in real time.

650

650 airline, freight and lease customers are Rolls-Royce powered and they fly the equivalent of six million flights around the world each year.

Marine

There are 30,000 commercial and naval vessels operating with Rolls-Royce equipment, ensuring that sea trade of all types keeps on the move and that coasts, national and international waters are safe for all. Rolls-Royce has a wider range of marine products than any other single supplier.

3,000

Our design of specialist vessels can secure an offshore platform at depths of up to 3,000 metres with pinpoint accuracy – helping access the world's deep water oil and gas reserves.

The latest Rolls-Royce nuclear plant, that powers the Royal Navy's Astute class submarines, can circumnavigate the globe without surfacing and will never need to be refuelled in its life.

40

The Littoral Combat Ship, USS Freedom, is one of the fastest warships afloat. Powered by two Rolls-Royce MT30 gas turbines it has a top speed of well over 40 knots.

Defence aerospace

Pilots of 160 armed forces need to know that they can depend on the power from Rolls-Royce engines instantly, whenever they call for it. Our engines are employed in all the key sectors of this market.

103

Rolls-Royce products provide the defence power systems for 103 countries.

15

Rolls-Royce is powering 15 different aircraft types in Afghanistan, supporting combat, transport, medical evacuation, tactical and surveillance operations.

85

Rolls-Royce powers 85 per cent of the UK MoD's aircraft in frontline operations. The UK military on average performs over 2,000 search and rescue missions annually, many are powered by Rolls-Royce.

Energy

Society's energy demands continue to grow. We are providing essential power for the oil and gas industries to meet these needs and increasingly our clean and efficient gas turbines are providing local electricity. Rolls-Royce is also at the forefront of low carbon and renewable energy products.

500

Over 500 of our gas turbines are operating in hostile weather environments, offshore of 25 countries, delivering the critical power needed on oil and gas platforms.

60

Over 60 major pipelines in 26 countries depend on Rolls-Royce gas turbines to transport oil and gas – essential arteries in the world's energy network.

16

Our new Trent 60 gas turbine has been sold to 16 countries and the fleet can generate enough power for three million homes.

Directors' report
Financial statements

Our consistent strategy

Our consistent strategy is based on five key elements

Address four global markets
We are a leading producer of mission critical, integrated, power systems for the civil and defence aerospace, marine and energy markets.

Invest in technology, infrastructure and capability
Over the past five years, we have invested £4 billion in R&D. We invest substantially in employee development and invest around £300 million a year in capital projects.

Develop a competitive portfolio of products and services
We have 39 major engineering programmes and we are involved in many of the future projects in the markets we serve. These key projects will define the power systems market for many years.

Grow market share and installed product base
Across the Group, the installed base of engines in service is expected to generate attractive returns over many decades.

Add value for our customers through the provision of product-related services
We seek to add value for our customers with aftermarket services that will enhance the performance and reliability of our products.

Underpinned by core characteristics

Closeness to our customers
We recognise that our customers determine our strategy and organisation.

Domain knowledge
A deep understanding of our customers and the way in which our products and services are used.

Integrated systems
Integrating our products into systems that deliver increased value for our customers.

Technological superiority
Gaining competitive advantage through continuous investment in technology.

Operational excellence
Working constantly to meet and exceed customer expectations.

Organisational capability
Attracting and retaining the best people globally.

Brand
Recognised globally, our brand embodies qualities that create a common focus for all our people worldwide.

Across four key markets

Civil aerospace
Broadest engine range in the world

£4,481m
Underlying revenue 2009

Defence aerospace
Europe's biggest engine maker

£2,010m
Underlying revenue 2009

Marine
World-leading systems provider and integrator

£2,589m
Underlying revenue 2009

Energy
World leader in oil and gas and a growing power generation presence

£1,028m
Underlying revenue 2009

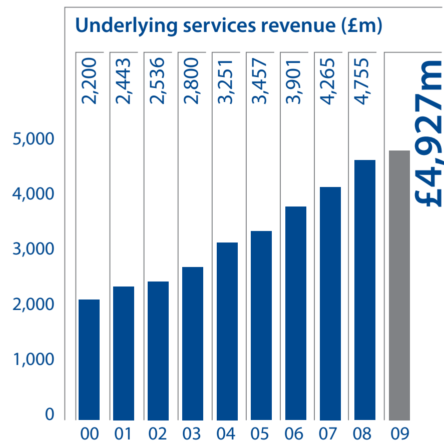
An increasing contribution from services

The increasing contribution from services

We have grown our service revenues ten per cent compound over the past ten years. Services now account for around 50 per cent of total underlying revenue.

Underlying services revenue 2009

£4,927m



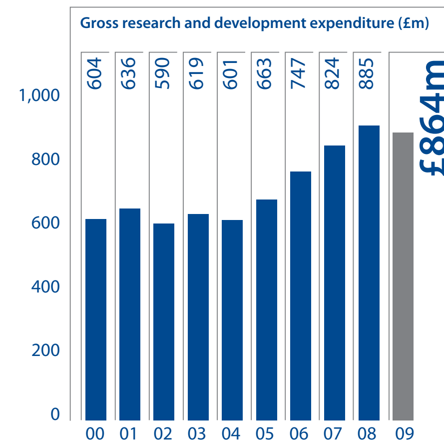
A commitment to R&D creating high barriers to entry

A strong record of investment in research and development

We invest in world-class, cost-effective technology in order to develop products that add value for our customers, improve efficiency and reduce environmental impact.

Investment in research and development during 2009

£864m



Delivering a 20-year track record of continued growth

Organic growth

Our broad product range and expanding service provision have delivered growth globally.

Partnerships

We increasingly develop products with risk and revenue sharing partners and through strategic long-term relationships.

Acquisition

Major acquisitions such as Allison and Vickers have enabled growth in key sectors.

Our growth during the past 20 years has been achieved organically and through partnerships and acquisitions.

Market outlook

The Group operates in four long-term global markets – civil and defence aerospace, marine and energy. These markets create a total opportunity worth in excess of US$2 trillion over the next 20 years and:

- have very high barriers to entry;
- offer the opportunity for organic growth;
- feature extraordinarily long programme lives, usually measured in decades;
- can only be addressed through significant investments in technology, infrastructure and capability; and
- create a significant opportunity for extended customer relationships, with revenues from aftermarket services similar in size to original equipment revenues.

The size of these markets is generally related to world Gross Domestic Product (GDP) growth, or in the case of the defence markets, global security and the scale of defence budgets.

Civil aerospace

The Group publishes a 20-year global market outlook, which covers passenger and cargo jets, corporate and regional aircraft. We predict that over the next 20 years 141,000 engines, worth over US$800 billion, will be required for more than 65,000 commercial aircraft and business jets. The forecast predicts faster growth rates for long-haul markets and those markets to, from and within Asia. These markets will continue to benefit from more liberal air service agreements, which boost demand. Factors affecting demand include GDP growth, aircraft productivity, operating costs, environmental issues and the number of aircraft retirements. While the market can be temporarily disrupted by external events, such as war, acts of terrorism, or economic downturns, it has, in the past, always returned to its long-term growth trend. In addition to the demand for engines, the Group forecasts a market opportunity worth US$600 billion for the provision of product-related aftermarket services.

Defence aerospace

The Group forecasts that demand for military engines will be worth US$170 billion over the next 20 years. The largest single market is expected to be the US, followed by Europe and the Far East. Within Asia, demand will be dominated by Japan, South Korea and India. Trends are driven by the scale of defence budgets and geopolitical developments around the world.

As in the Group's other business sectors, programme lives are long and there is a significant opportunity to support equipment with aftermarket services estimated at US$280 billion over the same period. Customers' budget constraints and their need to increase the value they derive from their assets have accelerated the move in this direction.

Marine

The Group forecasts a demand for marine power and propulsion systems valued at more than US$200 billion over the next 20 years. Demand will be greatest in the commercial sector, where the shipping of raw materials, finished goods and people, in addition to oil and gas exploration and production activity, play crucial roles in the world economy. These activities require large fleets of specialised and increasingly sophisticated ships, which have to be continually renewed and supported to remain operationally efficient.

Merchant and offshore markets are rarely at the same stage of the business cycle, which helps to reduce overall volatility. Whilst naval markets are driven by different considerations, customers are similarly seeking to get more from their budgets, leading to increasing demand for integrated systems and through-life support arrangements. As in the Group's other markets, marine aftermarket services are expected to generate significant opportunities, with demand forecasted at US$120 billion over the next 20 years.

Energy

The International Energy Agency has forecast that over the next 20 years, the worldwide demand for oil will grow by more than 20 per cent, for gas by 35 per cent and for power generation by more than 60 per cent. To satisfy this demand, there will be a growing requirement for aero derivative gas turbines.

The Group's 20-year forecast values the total aero-derivative gas turbine sales in the oil and gas and power generation sectors at more than US$70 billion. Over this period, demand for associated aftermarket services is expected to be around US$50 billion.

While the oil and gas market is large and growing, demand for aero-derivative gas turbines in the power generation segment is twice that of oil and gas.

Note: A long-term conversion rate has been used where necessary in order to present all figures in US$.

Key performance indicators

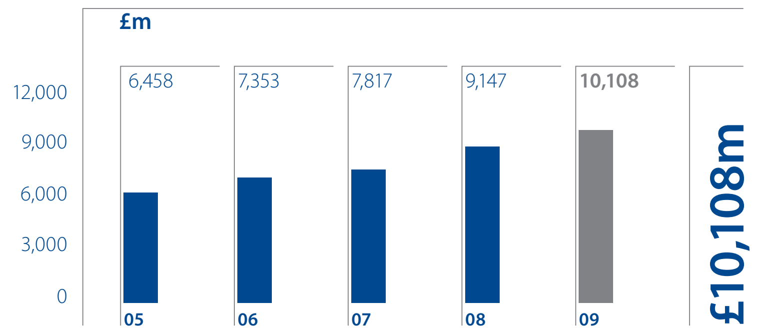
The Board uses a range of financial and non-financial indicators to monitor Group and segmental performance in line with the strategy described on pages 6-7. These indicators are chosen to monitor both current performance and the success of investments that will sustain and enhance future performance. Key performance indicators are included in the appropriate sections of the business review and are as follows:

Key performance indicators

- Underlying revenue
- Underlying profit before financing
- Cash flow
- Return on capital employed
- Net research and development charge
- Gross research and development expenditure
- Net research and development expenditure as a proportion of underlying revenue
- Capital expenditure
- Order book
- Training and development
- Employee engagement
- Underlying revenue per employee
- Product cost index
- Engine deliveries
- Installed thrust – civil aerospace
- Percentage of civil fleet under management
- Underlying services revenue
- Emissions

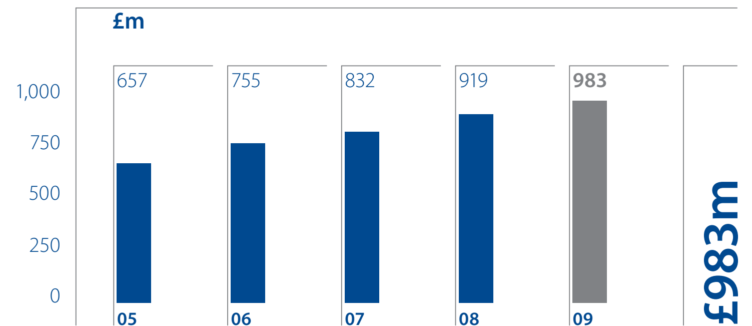
Underlying revenue

Monitoring of revenues provides a measure of business growth. Underlying revenues are used in order to eliminate the effect of the decision not to adopt hedge accounting and to provide a clearer year-on-year measure. The Group measures foreign currency sales at the actual exchange rate achieved as a result of settling foreign exchange contracts from forward cover.



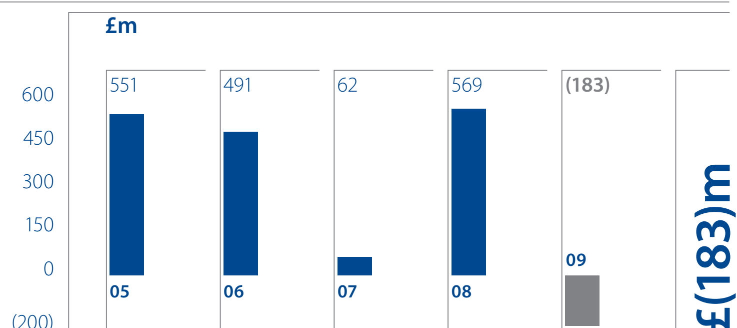
Underlying profit before financing

Underlying profit before financing is presented on a basis that shows the economic substance of the Group's hedging strategies in respect of the transactional exchange rate and commodity price movements. In particular: (a) revenues and costs denominated in US dollars and euros are presented on the basis of the exchange rates achieved during the year; (b) similar adjustments are made in respect of commodity derivatives; and (c) consequential adjustments are made to reflect the impact of exchange rates on trading assets and liabilities and long-term contracts on a consistent basis. The derivation of underlying profit before financing is shown in note 2 on page 68 of the consolidated financial statements.



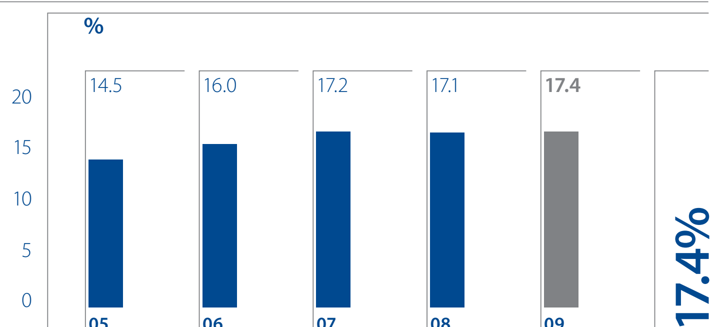
Cash flow

In a business requiring significant investment, the Board monitors cash flow to ensure that profitability is converted into cash generation, both for future investment and as a reward for shareholders. The Group measures cash flow as the movement in net funds/debt during the year, after taking into account the value of derivatives held to hedge the value of balances denominated in foreign currencies. The figure in 2007 includes a £500 million special contribution to the Group's UK pensions schemes, as part of the restructuring of its pension schemes.



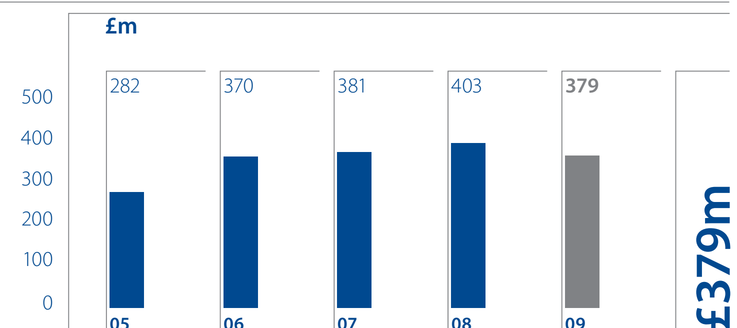
Return on capital employed

Return on capital employed is calculated as the after-tax underlying profit, divided by the average net assets during the year, adjusted for net cash, net post-retirement deficit and goodwill previously written off. It represents a measure of the return the Group is making on its investments.



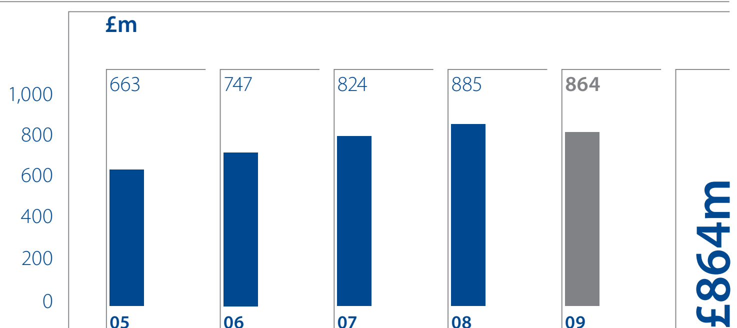
Net research and development charge

Investment in research and development underpins all the elements of the Group's strategy. Programme expenditure is monitored in conjunction with a gated review process on each programme and progress is reviewed at key milestones.



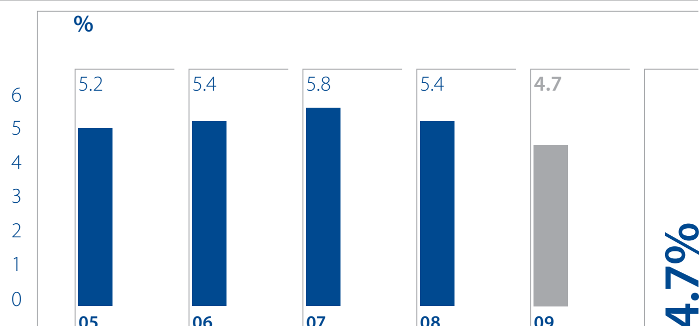
Gross research and development expenditure

The Group's research and development activities comprise both self-funded and customer funded programmes. Gross expenditure measures total research and development activity and is an indicator of the effectiveness of the actions taken to enhance the Group's intellectual property.



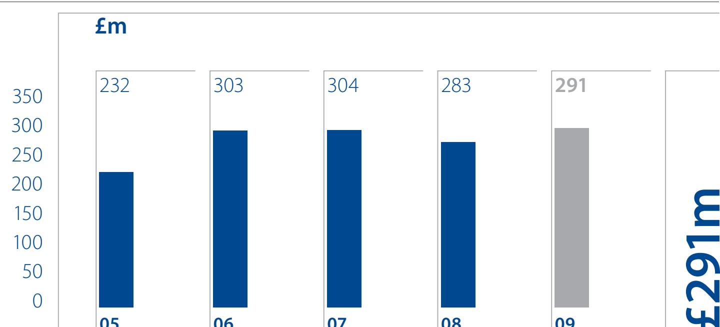
Net research and development expenditure as a proportion of underlying revenue

Research and development is measured as the self-funded expenditure before both amounts capitalised in the year and amortisation of previously capitalised balances. The Group expects to spend approximately five per cent of revenues on research and development although this proportion will fluctuate annually depending on the stage of development of current programmes. This measure reflects the need to generate current returns as well as to invest for the future.



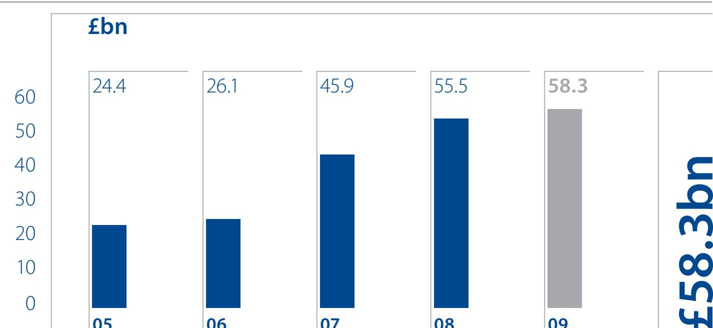
Capital expenditure

To deliver on its commitments to customers, the Group invests significant amounts in its infrastructure. All investments are subject to rigorous review to ensure that they are consistent with forecast activity and will provide value for money. Annual capital expenditure is measured as the cost of property, plant and equipment acquired during the period.



Order book

The order book provides an indicator of future business. It is measured at constant exchange rates and list prices and includes both firm and announced orders. In civil aerospace, it is common for a customer to take options for future orders in addition to firm orders placed. Such options are excluded from the order book. In defence aerospace, long-term programmes are often ordered for only one year at a time. In such circumstances, even though there may be no alternative engine choice available to the customer, only the contracted business is included in the order book. Only the first seven years' revenue of long-term aftermarket contracts is included.



Training and development

£24 million investment in 2009

Training is a core element of the Group's investment in its capability and is measured as the expenditure on the training and development of employees, customers and suppliers. Effectiveness is ensured by using a range of external and internal sources and by gathering user feedback.

£24m

Employee engagement

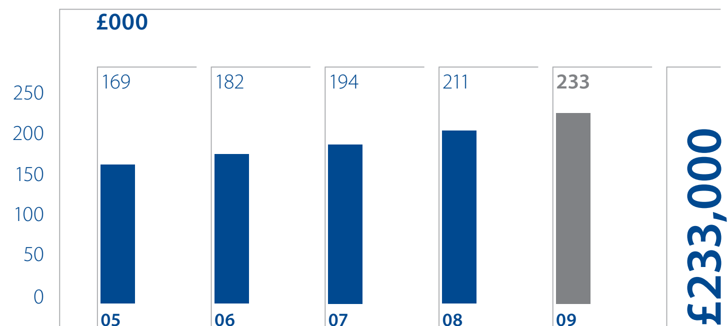
38,500 employees in 2009

Regular surveys are undertaken to identify and address emerging issues. A full employee engagement survey is run every two years with smaller pulse-check surveys in between. Training and employee engagement surveys are discussed further in the corporate responsibility section of this review.

38,500

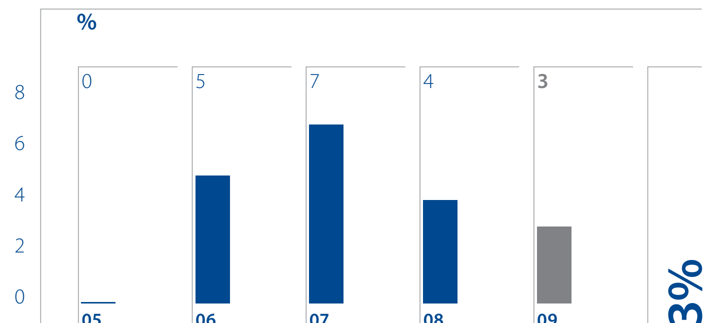
Underlying revenue per employee

A measure of personnel productivity, this indicator measures underlying revenue generated per employee on a three-year rolling basis. The basis of calculation has been amended to avoid short-term distortions caused by fluctuations in exchange rates.



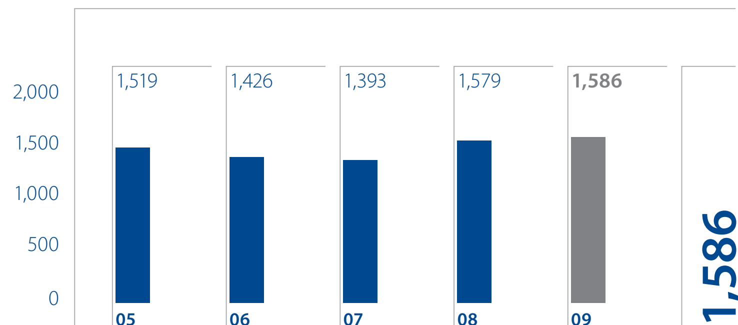
Product cost index

Unit costs are a key determinant of the Group's ability to deliver its commitments on a profitable basis. The Group monitors the year-on-year change in the average unit product cost of its gas turbine operations and seeks over time to improve productivity in all owned facilities and those of its suppliers.



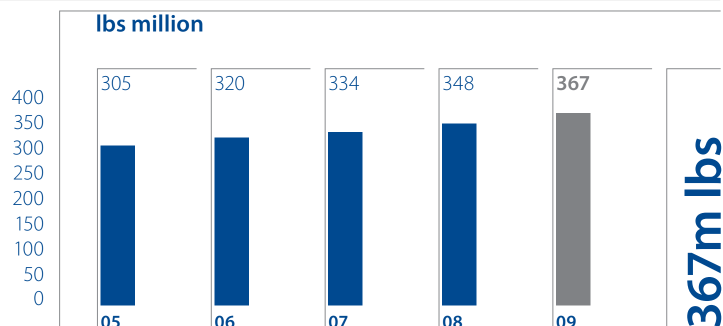
Engine deliveries

The Group's installed engine base represents an opportunity to generate future aftermarket business. This is measured as the number of Group products delivered during the year within each business except for marine, as its products do not lend themselves to this measure due to their diversity.



Installed thrust – civil aerospace

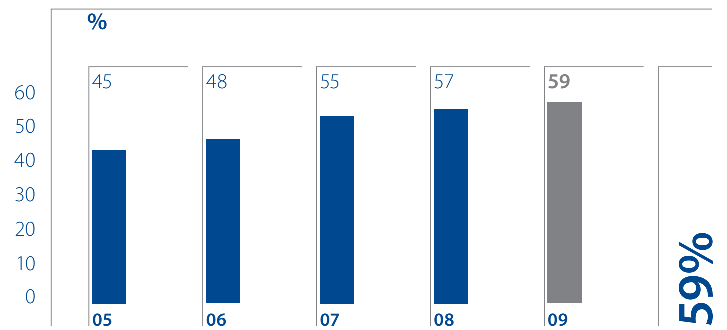
Installed thrust is the indicator of the amount of product in use by our customers and therefore the scale of opportunity this presents for our services business.



Percentage of civil fleet under management

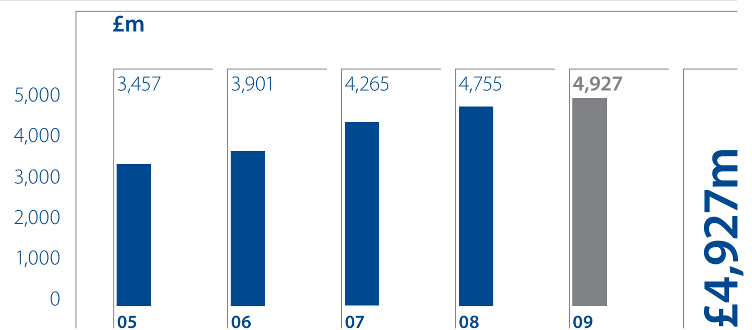
Long-term contracts are an important way of generating value for customers. The percentage of fleet under management gives a measure of the proportion of the installed base where the future aftermarket arrangements are agreed under long-term contracts.

The corresponding indicators for the other segments are shown in the respective sections of the business review of operations.



Underlying services revenue

Underlying services revenue shows the amount of business during the year that has been generated from the installed engine base. This is measured as the revenue derived from spare parts, overhaul services and long-term service arrangements.



Emissions

Much of the research and development expenditure is focused on reducing emissions of the Group's products. The Group measures both the emissions of its products and the emissions of its manufacturing operations. These measures are described in detail in the environment report, 'Powering a better world', which is available on the Group's website at www.rolls-royce.com/cr/reports.

Principal risks and uncertainties

The Group continues to be exposed to a number of risks and has an established, structured approach to identifying, assessing and managing these.

The risk committee has accountability for the system of risk management and reports regularly to the Board on the key risks facing the business and the mitigating actions taken in order to manage them. The Group's consistent strategy and long-term programmes require that key sources of risk are identified and are kept under continuous review.

Risk profile

Over the past year the risk profile of the Group, in common with many other large companies, has changed to reflect the underlying global economic uncertainties. The Group continues to experience the negative effects of the recent economic downturn through a decline in the civil aviation sector, shipbuilding and other capital-intensive industries, which are prime markets for its products and services.

In the absence of a sustained and general return to growth, uncertainty remains across financial and industrial markets. This is reflected in the Group's risk profile.

The risks described below are among those that may have an impact on the Group's performance. This is notwithstanding other risks and uncertainties that are currently unknown to the Group, or which the Group does not presently consider to be material. The principal risks reflect the global nature of the business and the competitive and challenging business environment in which it operates. Risks, including those to the Group's reputation, are considered under four broad headings:

- Business environment risks
- Strategic risks
- Financial risks
- Operational risks

Business environment risks

Cyclical downturn – global recession

The Group's largest market, civil aerospace, is cyclical by nature, although services activity and revenue, which now represents 59 per cent of annual revenue, have historically been less volatile in economic slowdowns and are considered more predictable and robust than the sales of engines for new aircraft.

The willingness of passengers to travel by air is influenced by a range of factors, including economic conditions, as well as health and security issues. Any prolonged reduction in air travel would impact airlines' revenues and cash flows and potentially reduce their need for new engines, spare parts or aftermarket support services.

The strategy of growing revenues in other sectors with steady and substantial long-term growth, will help offset this risk. Access to global markets with greater diversification by sector, customer and geography and an improved balance between original equipment and services revenue, are expected to help mitigate the effects of the slowing global economy in any one sector.

Tight control of the underlying cost base, the cost of managing operations and the unit cost of products, is essential to protect margins and maintain profitability. Even as the economy begins to recover, there will be continued pressure to reduce costs and improve the use of resources. The Group is focusing on identifying the principal drivers of unit costs and identifying actions to achieve sustainable cost reductions.

Environmental impact of products and operations

The Group recognises that its products and business operations have an impact on the environment, particularly in relation to climate change. Rolls-Royce is determined to be part of the solution to these environmental challenges and continues to make significant investment in innovative solutions for the aviation, marine and energy markets. The challenge is being addressed through the enhancement of current product ranges and affordable research and development into low carbon technologies such as nuclear power, fuel cells and tidal energy. The Group continues to work closely with its customers, industry partners and other stakeholders to implement these development opportunities.

A robust governance structure headed by the Environment Council directs and monitors improvements in the environmental performance of the Group's products, and the Environmental Advisory Board reviews and makes recommendations on the environmental aspects of the Group's products and business operations.

Strategic risks

Competitive pressures

The markets in which Rolls-Royce operates are highly competitive and this competitiveness is increasing as a result of the global economic uncertainties. The majority of product programmes are long term in nature and access to key customer platforms is critical to the success of the business. This requires sustained investment in technology, capability and infrastructure by the Group, all creating high barriers to entry. However, these factors alone do not protect the Group from competition such as pricing and technical advances made by competitors.

The Group has developed a balanced business portfolio and continues to maintain a steady focus on improvement in operational performance, for example through the modernisation of its facilities and an increased focus on managing the costs of operations and products. Sustained investment in technology acquisition and robust protection of intellectual property, together with the establishment of long-term customer relationships, allow the Group to differentiate its products and services and protect margins in the face of competitive pressures.

Export controls

Rolls-Royce designs and supplies a number of products and services for the defence market. Many countries in which the Group conducts its business have legislation controlling the export of specified goods and technology intended or adaptable for military application. The Group is committed to complying with the requirements of national governments in all jurisdictions when exporting goods, parts, technologies or information, although globalisation of the Group's operations brings with it complexities of concurrent but differing national export control legislation. Non-compliance with export controls is recognised as a principal risk to both programme performance and the Group's reputation.

The exports committee, chaired by the Chief Operating Officer, directs the Group's strategy and policy on exports. Export control managers are embedded throughout the business and export controls awareness training is provided to employees. The Group will continue to implement any necessary changes to ensure that it maintains the capability to monitor and comply with requirements.

Financial risks

Principal risks are:

- movements in foreign currency exchange rates;
- interest rates;
- commodity prices;
- counterparty credit risk; and
- regulatory developments.

A description of these risks and details of the Group's risk mitigation actions in this area are provided in the Finance Director's review.

Operational risks

Performance of supply chain

The Group's products and services are delivered through the effective operation of its facilities and key capabilities, including its supply chain. The Group's success in strengthening its market position and its presence on a number of high profile civil and defence aerospace programmes places increased demands on the performance of the supply chain. The Group manufactures approximately 30 per cent by value of its gas turbine products, the remainder being provided through external suppliers, including risk and revenue sharing partners. Meeting delivery commitments on schedule, cost and quality are critical to the achievement of business goals. Investment in developing world-class manufacturing processes is continuing in Asia, North America and Europe.

Global supply chains are complex with multiple inter-relationships across a wide network of organisations. While the Group's strategy is to improve integration and simplify the internal and external elements of its supply chain by building long-term strategic links with fewer, stronger suppliers, it remains at risk of disruption from financial or physical causes such as bankruptcy, natural disaster, armed conflict or pandemic. A significant disruption in any of these elements could adversely affect the Group's ability to deliver its operational commitments and would have the potential to affect financial returns.

The planning for, and management of, any such interruption is addressed through the Group's business continuity management process, which is well established and focused on critical facilities, activities, processes, skills and suppliers. The Group's crisis management plan and framework were significantly revised and exercised in 2009. In addition to the Group's comprehensive programme of business interruption insurance, significant investment is being undertaken to establish, where possible, dual sourcing of key components or processes. Increased focus is also being applied to understanding and addressing sources of risk arising in the external supply chain, particularly those associated with financial instability. Procedures are in place to monitor, assess and respond to such risks.

IT security
The continuing globalisation of the business and advances in technology have resulted in more data being transmitted internationally, posing an increased security risk. There is also the possibility of unintentional loss of controlled data by authorised users. In either case, adverse impacts upon operational effectiveness, the value of intellectual property, legislative compliance or the reputation of the Group might arise. The active sharing of information through industry and government forums, commitment of additional specialist resources and the continual upgrading of security equipment and software mitigate these risks.

Ethics
The Group recognises the benefit that is derived from conducting business in an ethical and socially responsible manner. This approach extends from the sourcing of raw materials and components to the manufacture and delivery of products and services in all of its global locations and markets. It applies to the provision of a safe and healthy place of work and investment in technologies to reduce the environmental impact of the Group's products and operations. Shortcomings in any of these areas could damage the Group's reputation, expose it to financial penalties and disrupt its business.

The Group is committed to maintaining high ethical standards. A Global Code of Business Ethics, available in 16 languages, has been issued to all employees supported by a training and engagement programme to improve awareness of the Group's values. A programme of technical training for specialist roles is underway. The Group's ethical standards are also communicated to the Group's first-tier supply base through a supplier code of conduct. Concerns regarding potentially unethical behaviours can be reported in confidence via dedicated global telephone and internet channels. All such reports are followed up and are monitored by the ethics committee.

Programme risk
The Group manages complex product programmes with demanding technical requirements against stringent, and sometimes fluctuating, customer schedules. This requires co-ordination of the engineering function, manufacturing operations, the external supply chain and other partners. Failure to achieve programme goals would have significant financial and reputational implications for the Group. These implications include the risk of impairment of the carrying value of the Group's intangible assets and the impact of potential litigation. Impairment is discussed further in the Finance Director's review on page 41.

The Group seeks continuous improvement of all its processes and employs project management controls to ensure that both technical and business objectives are achieved. All major programmes are subject to Board approval and are reviewed regularly by the Board with a particular focus on the nature and potential impact of emerging risks and the effective mitigation of previously identified threats.

Review of operations

Overview

Rolls-Royce is a technology leader with a global customer base. We are developing our presence across the world to meet increasing demand for the advanced products and services that we take to market.

As well as introducing new technologies we also place emphasis on continuously developing the through-life performance of our products for the benefit of customers.

Civil aerospace

The civil aerospace business powers over 30 types of commercial aircraft and has a strong position in all sectors of the market: wide-body, narrow-body and corporate and regional aircraft. Over 13,000 engines are currently in service with 650 airlines, freight operators and lessors and 4,000 corporate operators.

Despite a decline in air traffic, the market is beginning to recover, albeit slowly. 2010 traffic will see a return to growth but from suppressed levels. We remain cautious but optimistic of seeing the historic traffic growth level of approximately five per cent per annum achieved over a 20-year period.

The economic situation also saw the retirement across the industry of some 500 aircraft, notably older models. The Rolls-Royce powered fleet is, by contrast, relatively young and more fuel efficient. The better performance and increased aftermarket potential in this younger fleet underlined the value of our balanced services and products business model. The corporate and regional aircraft market has been sensitive in the downturn but the twin-aisle, large airliner market, has been more robust.

Order intake was reduced due to the poor market conditions but there were some significant orders, notably from AirAsia X, Air China and United Airlines. New orders also included first-time customers for the Trent family: Turkish Airlines; Ethiopian Airlines and, the US lessor Aviation Capital Group. Trent engines continue to win business across the range of wide-body aircraft and now hold a 50 per cent market share.

£4,481m
Underlying revenue

US$1,400bn
Market opportunity over 20 years

Highlights

- Record year for Trent delivery with 224 engines shipped
- Trent 700 and Trent XWB each exceeded orders for 1,000 engines
- Trent 1000 powered the Boeing 787 Dreamliner first flight
- BR725 powered the Gulfstream G650 long range business jet first flight

Key financial data

	2005	2006	2007	2008	**2009**
Underlying revenue £m	3,406 +11%	3,907 +15%	4,038 +3%	4,502 +11%	**4,481** **0%**
Underlying profit before financing £m	441 +112%	523 +19%	564 +8%	566 0%	**493** **-13%**
Net assets £m	1,315	1,889	2,260	246	**2,733**

Other key performance indicators

	2005	2006	2007	2008	**2009**
Order book £bn	19.0 +17%	20.0 +5%	35.9 +80%	43.5 +21%	**47.0** **+8%**
Engine deliveries	881	856	851	987	**844**
Underlying services revenues £m	2,016	2,310	2,554	2,726	**2,626**
Underlying services revenues %	59	59	63	61	**59**
Percentage of fleet under management	45	48	55	57	**59**

The first flight of the Boeing 787 in December 2009, powered by Rolls-Royce Trent 1000 engines, was a significant and important milestone for this programme. The majority of the Boeing 787 flight test and certification programme planned to be completed in 2010 will use Trent 1000 engines.

The Trent family philosophy continues to demonstrate significant advantages with the introduction of new technology for established engines. Upgrades for the Trent 700 have enhanced its performance and fuel efficiency and a similar package is planned for the Trent 900. Technology being developed for new engines such as the Trent 1000 and Trent XWB will continue to provide operational, performance and environmental advantages across our product range. Orders for the Trent 700 and the Trent XWB now exceed 1,000 engines for each programme. For the Trent XWB this marks a significant demonstration of customer confidence as the programme is still three years away from entry into service.

In the narrow-body market the V2500 engine, produced by International Aero Engines (IAE) in which Rolls-Royce is a major partner, continues to win orders. IAE delivered 347 engines in 2009. IAE also gained significant contract awards from Air China, Qatar Airlines and Dubai Aerospace. There are now more than 4,000 V2500 engines flying with 190 customers worldwide.

In the corporate and regional market, the latest addition to the Group's corporate engine family is the BR725 engine. It flew for the first time on the Gulfstream G650 ultra-long-range business jet in November 2009, and remains on schedule for entry into service in 2012. In September 2009, the first flight of an Embraer Legacy 650, powered by the new AE 3007A2 engine, took place. The AE 3007A2 will deliver significant performance and reliability improvements over previous engine marks. It is currently undergoing flight testing ahead of certification and entry into service in the second half of 2010.

The majority of orders in the civil aerospace business are now contracted under TotalCare® or CorporateCare® long-term support contracts. These overarching service contracts provide an important and sustainable revenue stream for the business. They also allow our customers to plan their business more effectively both financially and in the use of engine assets. Services revenue has been affected by the current economic environment with fewer flying hours and airlines deferring non-essential maintenance. As more engines enter service in line with order commitments we expect to see flying hours increase. The TotalCare service structure has been particularly robust and the model we have in place is designed to be responsive to this change and match the market and customer demand. Hours flown under TotalCare agreements continue to grow.

Defence aerospace

Rolls-Royce is a global provider of defence aero-engine products and services, with 18,000 engines in service for 160 customers in 103 countries. Our engines power aircraft in all key defence market sectors: transport; combat; reconnaissance; training; helicopters and unmanned aerial vehicles.

The downturn in the global economy has put pressure on public spending in our key markets in Europe and the US. However, our position on new and established programmes continues to provide growth opportunities in these markets. In addition, we are well positioned to secure growth from emerging economies in Asia, the Middle East and South America.

During 2009, key orders were secured in both the combat and transport sectors and we saw new programmes emerge in the helicopter and unmanned aerial vehicles (UAVs) sectors.

The US Government approved 2010 funding for development of the F136 engine for the F-35 Joint Strike Fighter. This engine, being developed jointly by Rolls-Royce and General Electric, is designed to power all variants of the F-35 aircraft.

We also received the second contract, worth US$171 million, for the production of the LiftSystem for the short take-off and vertical landing (STOVL) or 'B' version of the F-35 Joint Strike Fighter. This programme reached a significant milestone in early 2010, when the Rolls-Royce designed LiftSystem was engaged successfully in flight for the first time.

Tranche three of the Eurofighter Typhoon aircraft was ordered, which provided Rolls-Royce with a 37 per cent production share of 241 Eurojet engines. The EJ200's reliability and support effectiveness was highlighted during the year, with a Royal Air Force engine reaching 1,200 flying hours with no requirement for unscheduled maintenance.

At the end of the year the Airbus A400M airlifter, powered by the TP400 turboprop engine, flew for the first time. Rolls-Royce is a major partner in the European consortium producing the TP400. There is continuing uncertainty about the A400M programme. However, the TP400 engine has made good progress, with engine flight testing to date being encouraging. We believe that our estimated costs to completion adequately consider the remaining testing and delivery phases.

There were four additional successful Rolls-Royce powered first flights during 2009 in the defence sector: the AgustaWestland Lynx AH Mk.9A; the AgustaWestland AW159 Wildcat; and the AgustaWestland T129 Attack Helicopter, all powered by the CTS800 engine. The BAE Systems Mantis UAV powered by the Model 250 engine, also flew and demonstrated our capability to design and deliver an integrated power system.

£2,010m
Underlying revenue

US$450bn
Market opportunity over 20 years

Highlights

- £325 million contract secured for EJ200 engine production
- US$200 million production contract for AE 1107C V-22 engines
- F136 engine development funded for 2010
- US$184 million worth of US Army helicopter contracts secured for the Model 250 fleet
- £865 million contract secured for long-term EJ200 engine support
- US$500 million MissionCare contract signed for AE 1107C fleet

Key financial data

	2005	2006	2007	2008	**2009**
Underlying revenue £m	1,420 +3%	1,601 +13%	1,673 +4%	1,686 +1%	**2,010** **+19%**
Underlying profit before financing £m	175 -2%	195 +11%	199 +2%	223 +12%	**253** **+13%**
Net assets £m	(56)	(83)	(247)	(228)	**(329)**

Other key performance indicators

	2005	2006	2007	2008	**2009**
Order book £bn	3.3 0%	3.2 -3%	4.4 +38%	5.5 +25%	**6.5** **+18%**
Engine deliveries	565	514	495	517	**662**
Underlying services revenues £m	787	853	877	947	**1,046**
Underlying services revenues %	55	53	52	56	**52**
Percentage of fleet under management	8	11	11	12	**16**

Directors' report
Financial statements

Conversion work began on the first Airbus A330 aircraft for the Future Strategic Tanker Aircraft programme. The A330M multi-role tanker is powered by the Trent 700 engine and is expected to enter service in 2012.

Service business under long-term contract programmes, such as MissionCare™, continues to be attractive to defence customers. The US Department of Defense awarded us a US$90 million contract to support the engines for the US Navy's T-45 trainer aircraft. We agreed a US$200 million production contract and a US$500 million service contract, through to 2014, with the US Marine Corps to provide support for the AE 1107C Liberty engine in the Bell-Boeing V-22 Osprey vertical lift aircraft.

An £865 million contract to service the EJ200 engines for the UK Eurofighter Typhoon fleet through to 2019 was also secured. Rolls-Royce is a major partner in the Eurojet consortium which produces the EJ200.

Over £1 billion worth of orders for services were signed in 2009, presenting significant opportunities for Rolls-Royce to leverage its innovative service solutions.

The defence sector has continued to invest successfully in new technology as demonstrated by the Phase 2 award of the US Air Force ADVENT technology programme. Phase 2 will include the integration of a variety of advanced technologies, component testing and culminates with the development of a new technology demonstrator engine. The demonstrator is designed to reduce fuel consumption significantly, enabling extended mission ranges and loiter times. This advanced engine is targeted for future US military aerospace platforms. In the UK, we signed a jointly funded research and technology contract for ENTAPS (Engine Technologies for Aircraft Persistence and Survivability) with the UK Ministry of Defence.

Marine

Rolls-Royce has a world-class range of capabilities and expertise in the design, supply and support of power and propulsion systems for offshore oil and gas, merchant and naval vessels. Our marine business has more than 2,000 customers and equipment installed on over 30,000 vessels worldwide, including those of 70 navies.

£2,589m
Underlying revenue

US$320bn
Market opportunity over 20 years

Highlights

- Continued strong growth despite challenging market environment
- Far Samson, the world's most powerful offshore vessel, entered service
- Service capabilities expanded across North America, South America, Europe and Middle East
- Queen Elizabeth class aircraft carrier equipment deliveries commenced

The marine business has enjoyed another year of strong growth, despite macroeconomic challenges and a slowdown in orders. Although the demand for original equipment has reduced, service opportunities have increased as a result of the large number of ships introduced to the market in recent years. As a systems integrator, Rolls-Royce has an advantage in being able to provide a wide range of services for the sophisticated vessels that utilise our systems.

Since 2005, our revenues have more than doubled and increased by 17 per cent on 2008, driven primarily by the continued growth in our offshore business. Marine profit increased 44 per cent in 2009 as a result of strong revenue growth, the increasing importance of support services and improved operational performance.

The offshore sector has been central to our continued strong performance, based on the success of our specialist UT-Design and integrated systems capability. 2009 saw the launch of the Rolls-Royce designed Far Samson, the world's most powerful offshore vessel, and the introduction of an innovative wave-piercing design that improves stability and crew safety while minimising environmental impact.

During 2009, we acquired a 33 per cent holding in ODIM ASA, a leading provider of specialist marine handling systems. This investment increases our already strong presence in the offshore oil and gas sector.

Our naval business had a good year, with significant activity in the UK, the US, France, India and Korea. We began delivering power and propulsion equipment for the UK's new, Queen Elizabeth class, aircraft carriers. Stabilisers have already been delivered for the first carrier and our MT30 gas turbine has successfully completed trials. MT30 gas turbines installed in the US Navy Littoral Combat Ship, USS Freedom, also completed sea trials during the year.

As our installed base of equipment continues to grow, we are actively expanding our support capacity and capability to realise the significant opportunity that this represents. Six marine service centres across North America, South America, Europe and the Middle East were opened in 2009. Marine customers seek to have their ships serviced close to where they primarily operate and we are continuing to develop our extensive, global network to meet customer requirements.

Key financial data

	2005	2006	2007	2008	**2009**
Underlying revenue £m	1,097 +14%	1,299 +18%	1,548 +19%	2,204 +42%	**2,589** **+17%**
Underlying profit before financing £m	87 +12%	102 +17%	113 +11%	183 +62%	**263** **+44%**
Net assets £m	595	543	508	453	**661**

Other key performance indicators

	2005	2006	2007	2008	**2009**
Order book £bn	1.7 +21%	2.4 +41%	4.7 +96%	5.2 +11%	**3.5** **-33%**
Underlying services revenues £m	435	487	545	712	**785**
Underlying services revenues %	40	37	35	32	**30**
Percentage of fleet under management	3	3	33	35	**26**

A significant and growing proportion of our customers, manufacturing capability and supply chain are based in the Asia region. As a result, and recognising the importance of being closer to where more of our activity is located, we established the global headquarters of our marine business in Singapore.

We continue to invest in technology that can address the need for more efficient and environmentally sustainable power and propulsion systems. This is primarily through the reduction of exhaust gas emissions and improvements in ship design. Our Bergen gas engines already surpass International Maritime Organization limits for NO_x emissions, while research in propulsor/hull interactions deliver improvements in fuel consumption, stability and general performance, as demonstrated by our Promas integrated rudder/propeller system.

Rolls-Royce and Royal Caribbean Cruises have settled the lawsuit regarding the Mermaid podded-propulsion system, which experienced technical issues that have now been resolved. By working together, Rolls-Royce and Royal Caribbean have been successful in improving the reliability of the design.

As anticipated, there were some order cancellations in 2009 as customers reviewed their requirements given the economic downturn. However, our strong market-leading position in the offshore sector and demand for high-specification vessels in support of oil and gas exploration, provide good visibility of revenues in 2010.

Energy

The energy business is a world-leading supplier of power systems for onshore and offshore oil and gas applications and has a growing presence in the electric power generation sector. It has supplied products to customers in over 120 countries.

Energy had a strong performance in 2009, with revenues up by 36 per cent to over £1 billion for the first time and profits growing by £26 million.

The number of orders secured by the business reduced by 16 per cent compared to the previous year. Despite the challenging market conditions, the size of the order book was broadly maintained in 2009. The year also saw high original equipment volume deliveries. The modest profit increase in the year was achieved as a result of the continued growth in demand for aftermarket products and services.

In the main, oil and gas customers took a long-term view from the outset of the global recession and continued to invest, albeit at a reduced level. Market confidence has begun to return as a result of the strengthening in oil prices, with both offshore and pipeline customers now persisting with previous expansion plans.

Pipeline bid activity continued in the year, with a total of 24 gas turbine units ordered, comprising 11 units for Kazakhstan, nine for China and four for India. In other oil and gas markets, orders for five gas turbine units were received for installation offshore of Azerbaijan and Malaysia.

The power generation market remained depressed due to the high cost and restricted availability of finance, coupled with reduced demand for electricity. However, market interest in the Trent 60 continued to grow and contracted projects proceeded as planned. Sales growth continued to advance on the back of high order levels in recent years and the increasing aftermarket business. In the power generation market, successful commercial operation of the Trent 60 began in the US, Israel, Germany, China and Australia. Orders for 15 Trent 60 packages were secured in 2009.

Demand for aftermarket products and services grew strongly with another record year resulting in revenues of £470 million, an increase of 27 per cent. The growth of the installed fleet has resulted in an increase in demand for services and product upgrades which incorporate the latest gas turbine technology. Operators are benefiting from the additional power and efficiency that these upgrades provide. Units under long-term service agreements increased to approximately 300 units from 250 units the previous year.

£1,028m
Underlying revenue

US$120bn
Market opportunity over 20 years

Highlights

- Order book maintained despite difficult market conditions
- Revenues increased to over £1 billion for the first time
- Service business growth of 27 per cent to £470 million sales
- Civil nuclear business memorandum of understanding with EDF Energy

Key financial data

	2005	2006	2007	2008	**2009**
Underlying revenue £m	535 -1%	546 +2%	558 +2%	755 +35%	**1,028** **+36%**
Underlying profit before financing £m	(1) +86%	(18) -1700%	5 +128%	(2) -140%	**24** **+1300%**
Net assets £m	353	355	346	377	**542**

Other key performance indicators

	2005	2006	2007	2008	**2009**
Order book £bn	0.4 0%	0.5 +25%	0.9 +80%	1.3 +44%	**1.3** **0%**
Engine deliveries	61	44	32	64	**73**
Underlying service revenues £m	219	251	289	370	**470**
Underlying service revenues %	41	46	52	49	**46**
Percentage of fleet under management	5	6	7	9	**10**

The energy business strategy to consolidate its gas turbine packaging operations into the Mount Vernon, Ohio, US facility progressed with the latest site improvements becoming fully operational in the middle of 2009. While the energy business currently centres its product portfolio on the gas turbine, the skills and technical knowledge within the Group allow the business to identify and explore new growth opportunities in the energy market.

During 2009, good progress was made on the establishment of the new Rolls-Royce civil nuclear business unit. The business announced plans to build a new factory in the UK to assemble and test systems and components for nuclear power stations. This facility will have strong links with the UK Government-funded Nuclear Advanced Manufacturing Research Centre, in which Rolls-Royce is a lead partner. The Rolls-Royce position in the nuclear market was further strengthened with the signing of a memorandum of understanding in 2009 with EDF Energy to support the UK facility.

Rolls-Royce is already a global leader in the supply of digital instrumentation and control systems for nuclear power plants, with products installed in over 184 nuclear reactors worldwide.

Investment in fuel cell development technology continued, although at a reduced cost to the Group as planned. Other energy research included tidal power, where preparations for sea trials got underway during the year, following the Group taking full ownership of Tidal Generation Limited.

Engineering and technology

In 2009, Rolls-Royce invested a total of £864 million in research and development, of which £471 million was funded from Group resources.

The Group believes that its ongoing commitment to research and development is fundamental to its future success, providing technologies and intellectual property that allow us to compete on a global basis in highly competitive markets.

During 2009, we created a new advanced research centre in Singapore to develop manufacturing, electrical systems and high-power computing capabilities. Our new Mechanical Test Operations Centre in Dahlewitz, Germany, neared completion during the year. This centre will provide mechanical testing capability for all areas of the Group.

Building on the success of our membership of the Advanced Manufacturing Research Centre, we have increased our focus on advanced manufacturing. In the UK, we announced our partnership in the new National Composites Centre, the Advanced Fabrication Research Centre, the Advanced Nuclear Research Centre and became the inaugural industrial partner in the Manufacturing Technology Centre. Additionally, we became a partner of the US Commonwealth of Virginia in two new centres studying advanced aerospace propulsion systems and advanced manufacturing.

We continue to invest in our worldwide network of 27 Rolls-Royce University Technology Centres, which undertake advanced research for the Group across a range of specialist subject areas such as materials, noise, vibration and combustion. During the year we filed 440 patent applications.

Improving the environmental performance of our products and operations continues to be a key driver for research and development in Rolls-Royce. We have completed the first build of the Environmentally Friendly Engine and the second build of our mid-size technology demonstrator engine. These will begin testing in early 2010, delivering technology for the next generation of civil gas turbine engines. We also continue to invest in several other large-scale demonstrator programmes to reduce carbon emissions, which focus both on future gas turbine technology and advanced manufacturing.

We completed wind tunnel testing of our open rotor aero-engine concept. This concept uses large unducted fan blades to secure a significant reduction in fuel burn when compared with modern turbofans. Our results demonstrated efficient performance and low-noise characteristics in line with our expectations.

£864m
Investment

440
Patent applications

Highlights

- Award of the second phase of the ADVENT programme
- First flight of the Trent 1000-powered Boeing 787
- First flight of the BR725-powered Gulfstream G650
- First flight of the TP400-powered Airbus A400M
- First in-flight engagement of the F-35 LiftSystem
- Initial trials of the first Astute class submarine

Key performance indicators

	2005	2006	2007	2008	**2009**
Gross research and development expenditure £m	663	747	824	885	**864**
Net research and development expenditure £m	339	395	454	490	**471**
Net research and development charge £m	282	370	381	403	**379**
Net research and development expenditure % of underlying revenue	5.2	5.4	5.8	5.4	**4.7**

Our work for the US Air Force on the Adaptive Versatile Engine Technology (ADVENT) programme has led to us being awarded the second phase of funding, which will include the incorporation of Phase 1 technologies in a demonstrator engine. ADVENT focuses on the variable cycle and geometry to meet demanding US defence requirements for the next generation of military engines.

We achieved notable engineering successes in each of our key business sectors.

In the civil aerospace business, the Trent 1000 successfully completed its Extended Twin Operations (ETOPS) testing and, at the end of the year, powered the Boeing 787 on its first flight. The BR725 engine was certified and delivered on time and powered the new Gulfstream G650 corporate jet on its maiden flight. The AE 3007A2 engine for the Embraer Legacy 650 completed the majority of its certification testing and started flight testing.

Our marine business has designed a radical wave-piercing hull concept for applications in the offshore marine market. For the second year running Rolls-Royce won the coveted 'Ship of the year award', this time for the 'Far Samson' – the most powerful offshore vessel ever built. The Littoral Combat Ship, USS Freedom, completed US Navy acceptance trials in preparation for entering service. The first Type 45 Destroyer, HMS Daring, has entered service with the Royal Navy powered by the WR-21 and work on her sister ships is progressing well. The first Astute class nuclear-powered attack submarine with the Rolls-Royce designed, full-life, PWR2 power system has sailed for initial trials.

In defence aerospace, the Airbus A400M powered by the Europrop TP400 turboprop engine made a successful first flight in 2009 and the BAE Systems Mantis unmanned aerial vehicle, powered by Rolls-Royce, also operated flawlessly during its flight trials. In the F-35 Joint Strike Fighter programme, the first development F136 engine was delivered one month ahead of schedule. The Rolls-Royce LiftSystem, for the short take-off and vertical landing variant, completed ground testing and aircraft taxi trials ahead of its first engagement in-flight, which was achieved early in 2010.

In energy, the latest industrial Trent combustion system entered service during the year and the design of the high efficiency RB211-H63 has progressed significantly. We continue our work on low carbon energy solutions. During 2009, we began installation of a 500kW tidal power generator in the waters off the coast of Scotland and the Group continues to invest in engineering capability to support its move into the civil nuclear energy market.

Operations

2009 proved to be a challenging year but also one of notable achievement for our operations. We improved our revenue per employee significantly from £211,000 in 2008 to £233,000 in 2009.

The Group managed the disruptive effects of the recession and changes to programmes, we reduced our inventory levels and, although gas turbine product costs increased slightly, these were held at a level of three per cent above those of 2008.

Our operational activity in 2009 centred around two prime objectives: managing our own activities and those of the supply chain in a weak global economic climate, while at the same time continuing with our programme of investment for the future.

The Group's operations and its supply chain faced the challenges of uncertain market conditions, depressed financing markets and volatility in major programmes such as the Boeing 787 Dreamliner, Airbus A380 airliner and the A400M military airlifter.

Weaker demand in the corporate and regional jet market and for civil engine overhauls and spare parts in the large engine market, reduced levels of activity and impacted on productivity and unit costs.

Our marine business had a record year, placing additional demand on operations. Although certain product areas saw a slowdown in production, we also introduced an unprecedented number of new products in this sector. Nevertheless, the supply chain coped well by using our production planning and management tools and we were able to successfully match capacity to demand.

Across the Group we sought to ensure that we maintained the correct balance of employees to meet current and anticipated demand. This did involve some difficult decisions and, regrettably, some redundancies. Our employees remain understanding, loyal and co-operative, working with us to help mitigate the effects wherever possible and I would like to thank them for their support.

Our process excellence and improvement journeys continued throughout 2009. Our joint venture engine overhaul facilities, Hong Kong Aero Engine Services Limited (HAESL) and Singapore Aero Engine Services Limited (SAESL), were the latest to benefit from the rollout of the enterprise resource planning and SAP process systems.

Around 500 engineers based at our engineering support services business in India, also became connected to our design network,

£291m
Capital expenditure

Highlights

- Recession and delays to major programmes managed successfully
- Announced investment in Singapore facilities now at £300 million
- £300 million investment in UK facilities announced in 2009
- Building of new US facility commenced
- Global integration of people and systems continues

Key performance indicators

	2005	2006	2007	2008	**2009**
Capital expenditure £m	232	303	304	283	**291**
Product cost index – year-on-year (increase)/decrease %	–	(5)	(7)	(4)	**(3)**
Underlying revenue per employee £000 [1]	169	182	194	211	**233**

[1] Calculated on a three-year rolling basis

Product Life-cycle Management, and are now able to work concurrently on design models with colleagues around the world.

Continuing with our investment plan is important, as the Group must increase its operational capability in order to deliver the inevitable growth over the next decade that we will experience. This growth is as a result of the Group's improved market position and current order book commitments.

We announced further new investments in facilities in 2009 and work commenced on facilities that had already been announced. Construction of our new US-based disc manufacturing centre in Crosspointe, Virginia, began during the year.

Our plans progressed on the building of the new assembly and test facility for Trent engines at the Seletar Aerospace Park, Singapore. We also announced that we will build an additional wide-chord fan blade facility on an adjacent site at Seletar, bringing the total investment on the site to £300 million and creating 500 jobs over the next few years.

A further £300 million of significant capital investment in the UK was also announced, creating or securing 800 jobs. The Group is to build a new single crystal turbine blade facility at a location yet to be determined and in Sunderland we are to build a new discs facility. We are also extending our wide-chord fan blade facility at Barnoldswick to support our defence business. These gas turbine facilities are addressing the planned increase in the manufacturing of components that the Group sees as necessary over the next five years and they will help provide improved productivity benefits on our current product range.

In addition, we announced in 2009 our intention to create a new facility in the UK to support our emerging civil nuclear business.

Despite the planned increases in our own capability, the proportion of parts that the Group buys, including through our partnerships, will also continue to increase as we move towards having fewer, larger and more capable suppliers to support our global operations.

The increasing globalisation of our own operations and of our supply chain will, over time, bring together world-class capabilities while also helping to reduce the Group's US dollar exposure.

Our focus continues to be on operational excellence, strong partnerships and technological superiority, as we manage the current economic situation alongside continuing with our investments to provide the increased operational capacity we require for future growth.

While we expect 2010 to be no less volatile, it is pleasing to reflect on a year of strong progress. Our operations have proven to be robust and adaptable, giving us confidence in our ability to cope well with challenges and changes as we move ahead.

Services

Services activities provide around one half of the Group's revenues, having increased ten per cent compound over the past ten years. As the original equipment manufacturer, Rolls-Royce is best placed to provide 'mission critical' support, long-term product care and well planned maintenance on behalf of customers in each of the markets we serve.

£4,927m
Underlying revenue

US$1,050bn
Market opportunity over 20 years

Highlights

- Service revenues increased by four per cent to £4.9 billion
- 65 per cent of the civil large engine fleet now under TotalCare support
- OSyS expands service diagnostic and predictive capabilities
- Major defence contracts secured for Typhoon and C-130J airlifter engines
- New marine service centres opened around the world
- Over 300 long-term service contracts now signed by energy

Key performance indicators

	2005	2006	2007	2008	**2009**
Underlying services revenue £m	3,457	3,901	4,265	4,755	**4,927**
Underlying services as percentage of Group revenue	54	53	55	52	**49**

The Group's service business capabilities include field services, the sale of spare parts, equipment overhaul services, component repair, data management, field support, equipment leasing and inventory management. These are typically sold as packages such as our TotalCare suite. We work closely with customers to align these service packages to their operational needs, helping to maximise the efficient operation of the equipment on their behalf.

In civil aerospace, over 65 per cent of the total large-engine fleet and nearly 90 per cent of the in-service Trent fleet is now managed under TotalCare. We also have over 900 corporate and business jet aircraft enrolled in CorporateCare, the equivalent offering for this market sector. This year, significant TotalCare contracts were signed with airlines in Asia, the Middle East and the US.

Defence continued to develop its MissionCare provision worldwide and its service presence on military bases. A number of long-term engine service agreements were signed with customers of the C-130J airlifter worldwide and contracts were signed with the UK Ministry of Defence in support of frontline fighter aircraft engines. The US Department of Defense also signed major agreements for support of Rolls-Royce engines in service.

Energy secured 12 long-term service agreements which, together with the additional 35 new gas turbine units that will become operational during 2010, will take the number of gas turbines under long-term service agreement to over 300. In support of the Rolls-Royce fleet in China, a 22-year maintenance, repair and overhaul agreement was signed with PetroChina for the West to East Gas Pipeline Project. New service operations serving energy customers were opened in Angola, India, Israel, Kazakhstan and Qatar.

In the marine market our investment in capability and capacity continued to deliver benefits, with ten per cent services revenue growth in 2009. Marine customers require their service centres to be close to their operational base and therefore the expansion of our network to serve their needs continued. Six new centres were opened during the year in North America, South America, Europe and the Middle East. We have also developed underwater intervention capability, enabling Rolls-Royce to complete major propulsion overhauls without the need for time-consuming dry dockings.

The Group invested over £10 million this year in developing and restructuring our gas turbine repair and overhaul network, which will deliver significant improvements in performance and customer satisfaction. We also upgraded our service processes and continued to make progress in standardising our IT systems for global services.

Our SAESL joint venture celebrated its 1,000th Trent engine overhaul and a £25 million facility extension was opened. A similar investment in our HAESL joint venture is planned to open in 2010. N3, our Germany-based repair and overhaul joint venture with Lufthansa marked its 100th Trent engine overhaul this year and is now fully capable for Trent 500 and 700 overhaul, with Trent 900 capability development underway. 2009 also saw the celebration of 50 years of repair and overhaul operations in Brazil.

During 2009, we opened our sixth On-Wing Care facility in Indianapolis, US, and our field service capability supported over 4,000 aero engines globally. Good progress has been made in applying this capability across all sectors. Our focus on asset optimisation was further reinforced by the Optimized Systems and Solutions Inc. (OSyS) business, created in 2009. OSyS has further expanded our in-service diagnostic and predictive capabilities and signed contracts this year with Qatar Airways and easyJet for its fuel management system, enabling them both to realise substantial fuel savings. OSyS also expanded the health monitoring services and capabilities already applied successfully to aircraft engines and energy systems.

We expanded component repair coverage and capability across all sectors and delivered savings to Rolls-Royce of £120 million during 2009. Our International Engine Component Overhaul Limited (IECO) joint venture in Singapore completed its 11th year of operation and the repair of its one millionth component. Both SAESL and IECO were recognised with several prestigious awards, highlighting their contribution to the Asia Pacific region, process innovation, new technology introduction and service delivery.

Corporate responsibility

The business case for corporate responsibility

Corporate responsibility is a fundamental part of the Group's business strategy. It is not conducted as a separate and self-contained activity, but is integral to the business.

We see corporate responsibility as making a key contribution to the success of Rolls-Royce. We believe that conducting business in an ethical and responsible manner creates competitive advantage by enabling us to:

- attract and retain the best people;
- build goodwill and maintain successful working relationships with customers, suppliers and governments; and
- support the global communities in which our employees live and work.

The Group's values of reliability, integrity and innovation are embedded in our Global Code of Business Ethics. This provides a framework for our stakeholder relationships worldwide, the strength of which helps to shape the Group's reputation.

With around 38,500 employees in more than 50 countries, our strongest contribution to society is the wealth generated by the thousands of highly skilled jobs we provide worldwide.

Governance

Each area of corporate responsibility has its own governance process or managing committee. These include:

- the ethics committee, consisting exclusively of independent non-executive directors;
- the health, safety and environment committee, chaired by the Chief Executive;
- the Environment Council, chaired by the Director – Engineering and Technology;
- the Environmental Advisory Board, chaired by a senior academic from the Massachusetts Institute of Technology;
- the Global Council, chaired by the Director – Human Resources;
- the Global Diversity and Inclusion Steering Group, chaired by the Chief Operating Officer; and
- the Group community investment and sponsorship committee, chaired by the Chief Executive.

Individual subject matter expertise is reviewed by the Corporate Responsibility Steering Group, which reports to the Board. This group comprises the Director – Human Resources, Director – Public Affairs, Director of Risk and the General Counsel and Company Secretary. In addition, the corporate responsibility risk register uses the Group risk process to identify the potential risks and opportunities, as well as mitigation plans to address these risks. Additional information can be found in the Principal risks and uncertainties section on pages 14 to 16.

External recognition

Rolls-Royce is ranked in a number of external indices which benchmark corporate responsibility performance, see below:

Business in the Community Corporate Responsibility Index (BitC)
The BitC Index assesses the extent to which corporate strategy is integrated into business practice throughout an organisation. It provides a benchmark for companies to evaluate their management practices in key areas of corporate responsibility and performance in a range of environmental and social impact areas. In this year's BitC Index, Rolls-Royce retained its Gold status with an overall score of 93 per cent.

Dow Jones Sustainability World and European Indexes (DJSI)
Rolls-Royce has retained its position in the DJSI for the eighth consecutive year, thereby achieving international recognition of being amongst the best-in-class for addressing a range of sustainability issues. Our overall score of 80 per cent represented an improvement of one per cent on last year and we once again achieved first position in the Aerospace and Defence sector. The Group scored 100 per cent for environmental reporting, product impact and operational eco-efficiency and the best sector score for both climate strategy (91 per cent) and occupational health and safety (95 per cent).

CARBON DISCLOSURE PROJECT

Carbon Disclosure Project (CDP)
The CDP is an independent not-for-profit organisation holding the largest database of primary corporate climate change information in the world. Thousands of organisations from across the world's major economies measure and disclose their greenhouse gas emissions and climate change strategies through CDP.

For the second consecutive year, Rolls-Royce has been included within CDP's FTSE 350 Carbon Disclosure Leadership Index, in which the quality and depth of a company's response to the annual CDP questionnaire is scored.

Rolls-Royce has a long history of being a responsible business. We are committed to building on our track record and our obligation to behave responsibly.

Our approach

Our approach to corporate responsibility is concentrated on four areas of activity:

Business ethics
Rolls-Royce has a long history of conducting business responsibly and ethically. Our commitment to act with integrity is at the heart of the way we operate and we regard ethical behaviour as key to maintaining and strengthening our reputation for being trusted to deliver excellence.

Health, safety and the environment (HS&E)
With its heritage of technological and engineering excellence, Rolls-Royce is well placed to help society address the problems of climate change and energy security. We also believe that good HS&E performance in our operations is synonymous with good business. Our objective is to achieve world-class performance at every site and to be widely recognised for the excellence of our HS&E performance.

Employees
We aim to attract and retain the best people and create an inclusive working environment in which creativity, capability and motivation flourish. By continually improving levels of employee performance, we deliver on our commitments.

Society
Rolls-Royce has a firm, long-standing commitment to the communities in which we operate. Sustained investment in communities makes a positive difference and delivers tangible benefits to our business. Corporate responsibility is also a key enabler in delivering our global supply chain strategy.

Business ethics

Rolls-Royce has a long history of conducting business responsibly and ethically. Our commitment to act with integrity is at the heart of the way we operate and we regard ethical behaviour as key to maintaining and strengthening our reputation.

The Board strongly believes that the Group's business should be conducted in a way that reflects the highest ethical standards. The ethics committee was established in 2008 to oversee the implementation of the Group's global ethics strategy and the management of ethical and reputational risk. The committee consists exclusively of independent non-executive directors and met four times in 2009.

In 2009, as a demonstration of the Group's commitment to setting industry-leading standards of ethical business conduct, Rolls-Royce signed the statement of adherence to the Aerospace and Defence Industries Association of Europe Common Industry Standards.

Global Code of Business Ethics

In 2009, Rolls-Royce published an updated version of its Global Code of Business Ethics (the Global Code) and issued a personal copy to every employee. The revised Global Code sets out the principles for employees to follow when conducting business and provides practical guidance to help identify, resolve and report any ethical issues or dilemmas they may face. It sets standards of ethical behaviour for working together, conducting business with customers, suppliers and joint ventures, running our company, health safety and the environment, and working within our communities. Principles and guidance for managers and employees are provided in key areas such as diversity, discrimination and harassment, bribery and corruption, conflicts of interest and safe working. The Global Code encourages employees to ask for help and assures them that concerns can be raised without fear of reprisal. It is available in 16 languages and can be viewed on the Group's website at www.rolls-royce.com/cr/ethics.

Training and awareness programme

In 2009, the Group completed a programme of face-to-face training for all employees to strengthen awareness of the Group's values and embed the Global Code. The training programme included facilitated half-day leadership workshops for almost 4,600 managers across the Group. The aim of these workshops was to set the tone at the top, make managers aware of the content of the Global Code and equip them with the necessary tools to deal with ethics-related issues appropriately. Employee briefings were subsequently delivered by these managers to their teams using supporting materials including briefing guides, Global Code wall charts and a corporate values and ethics video. A tailored ethics e-learning course will be available in 2010 to reinforce the face-to-face training provided in 2009.

Confidential reporting line

An independently operated and confidential ethics reporting facility is available worldwide so employees can raise issues or concerns regarding business conduct independently of the normal management chain. This facility includes telephone lines and an external website. Rolls-Royce employees can call any one of over 30 telephone numbers in countries across the world to report any concerns they may have with regard to business conduct. Calls are made in total confidence, being handled independently by the partnership LRN – EthicsPoint. Reports are investigated by the business ethics and compliance team with support from the businesses, security, legal counsel and human resources as required. An ethics report steering group meets quarterly to review cases, identify trends and manage the associated ethical and reputational risks. The ethics committee monitors cases reported, the management of cases and the results for high risk investigations undertaken.

Health, safety and the environment (HS&E)

Rolls-Royce is well placed to help society address the problems of climate change and energy security.

We also believe that good HS&E performance in our operations is synonymous with good business. Our objective is to achieve world-class performance at every site.

HS&E management

We believe that all cases of work-related ill-health, injuries and environmental incidents are avoidable. Our vision is to have world-class levels of performance on every site and be recognised for the excellence of our HS&E performance. The Group's arrangements for HS&E governance and management systems implementation are detailed in our Policy & Management Arrangements booklet available on www.rolls-royce.com/cr. Performance improvement is delivered through the implementation of a focused strategy, the core elements of which cover: leadership, commitment and involvement; full implementation of the company HS&E management system and related standards; and implementation of best practice and reducing risks through the removal or minimisation of hazards in the workplace.

An underlying theme of our strategy is to continue to develop a strong HS&E culture. A team of HS&E professionals supports line management at the corporate, business and site levels. During 2009, we have made further progress to strengthen the capabilities of the HS&E function.

All the Group's businesses have third-party certification to the environmental management system standard ISO 14001. During 2009, we consolidated all of our third-party certification and surveillance activities into one provider – Bureau Veritas Certification. This is aimed at increasing the efficiency and effectiveness of the global programme. This also supports our drive to provide consistent standards across the Group and to focus our efforts on key issues. In this way we will derive greater benefit from the certification process.

The Group has recently committed to a programme of third-party certification to OHSAS 18001, the standard for Occupational Health and Safety management systems, across all businesses by 2012. This will provide independent assessment across all of the elements of our HS&E management system. Both the ISO 14001 and the OHSAS 18001 international standards are supported within the Group by a comprehensive range of Rolls-Royce standards and guidelines.

We operate three sites in the UK which together manufacture, test and support nuclear reactor cores for the Royal Navy's submarines. The Nuclear Propulsion Assurance Committee regularly monitors the performance of both the submarines and recently formed civil nuclear businesses and seeks evidence that the highest standards of HS&E are maintained and that fit-for-purpose processes are followed.

The Group's contribution to developing best practice through third-party collaboration continues. We are taking a leading industry role in Registration, Evaluation, Authorisation and restriction of Chemicals (REACH), the latest EU chemicals regulation and continue to work with other companies, trade bodies, sectors and regulators on implementation. During 2009, efforts have again focused on raising awareness within our supply chain, such that appropriate arrangements for compliance and business continuity are introduced well ahead of deadlines. We continue to support the development of international standards within aviation, for the phased declaration of substances supplied to us to facilitate future REACH compliance and, where required, industry-wide substitution programmes. We also continue to consult widely with the European Chemicals Agency (ECHA) on pertinent matters relating to implementation and compliance within our sectors.

We continue to participate in and meet our ongoing commitments under various climate change agreements such as the EU Emissions Trading Scheme and the US Chicago Climate Exchange greenhouse gas emissions trading scheme. The Group is also preparing for the latest carbon emissions reduction regulations in the UK under the Carbon Reduction Commitment Energy Efficiency Scheme. Such measures, alongside the underpinning science, are fully considered when setting Group greenhouse gas reduction targets.

Operational performance

Shaped by our HS&E strategy, we continue to implement prioritised work programmes across all our sites to meet the challenging objectives and targets that have been set. In the past year, we have made excellent progress against these targets. There were no fatalities in the Group during 2009 and no prosecutions against the Group for HS&E offences. Comprehensive improvement programmes, with an enhanced level of support from the Corporate HS&E team, were initiated at the poorer performing sites during 2009. A significant improvement in performance has been achieved at these target sites.

During 2009, we introduced a web-based, global reporting system, which now provides the facility to collect and review HS&E performance in our operations on a monthly basis. This provides improved tracking of performance at site, business and Group levels. Our latest progress report is available on the Group's website at www.rolls-royce.com/cr/reports. Our data collection and reporting is subject to independent assurance and recommendations for improvement by Deloitte LLP.

Our 2007-2009 objectives and targets were to:

Protect health
Reduce the incident rate of occupational diseases and other work-related ill health by ten per cent by the end of 2009

Prevent injury
Achieve a 15 per cent reduction in the lost-time injury rate (over one day) by the end of 2009

Reduce environmental impact
Achieve a ten per cent reduction in energy consumed (normalised by financial revenues) by the end of 2009

Achieve a ten per cent reduction in solid waste (normalised by financial revenues) by the end of 2009

Achieve a 58 per cent recycle rate of solid waste by the end of 2009

Detailed results will be published during 2010 on the Group's website at www.rolls-royce.com/cr/reports

A new set of objectives and targets for the period 2010-2012 have been agreed and are set out below:

Protect health
Reduce the Group incident rate of occupational diseases and other work related ill-health by ten per cent by end 2012

Prevent injury
Reduce Company Total Reportable Injury (TRI) rate by 50 per cent by end 2012

Reduce environmental impact
Five per cent reduction in company facility greenhouse gas emissions by end 2012 (absolute)

Ten per cent reduction in total Group greenhouse gas emissions by end 2012 (normalised by financial revenues)

Ten per cent reduction in total Group production waste (solid and liquid) by end 2012 (normalised by financial revenues)

70 per cent Group recycle rate of solid waste by end 2012.

Product environmental performance

Rolls-Royce is both committed and well placed to find solutions to the substantial challenges posed by climate change. The Group believes that technology must be applied on an industrial scale, through companies such as Rolls-Royce with global reach, to achieve significant reductions in emissions.

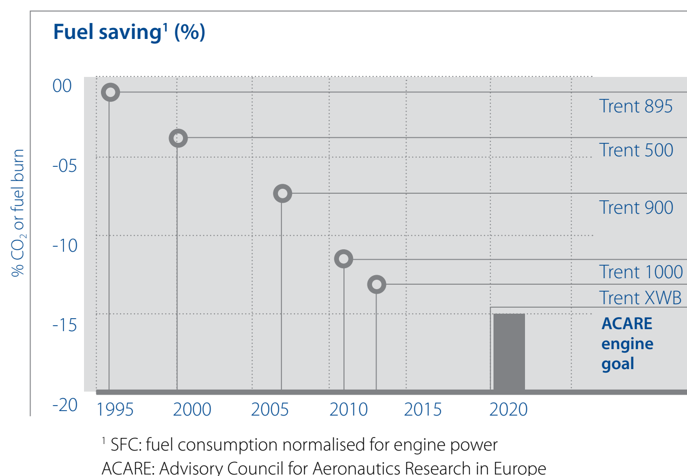
The Group closely monitors developments in the underpinning science to help steer the significant research and development programmes undertaken across all product ranges. Such knowledge, supplemented by independent expert advice from the Group's Environmental Advisory Board made up of distinguished academics who are leading authorities in their respective fields, is also vital to the overall business strategy and design process.

In civil aerospace we have used our technological expertise to reduce significantly the fuel consumption of our products and consequently carbon dioxide emissions, since the first jet aircraft entered service. For example, the Trent 1000 engine is 25 per cent more efficient than the first RB211 engine. The Trent 900 and 1000 engines, for the Airbus A380 and Boeing 787 respectively, and in future the Trent XWB for the Airbus A350 XWB, help us demonstrate progress towards meeting our Advisory Council for Aeronautics Research in Europe (ACARE) goal of a 15-20 per cent reduction in engine fuel burn by 2020 compared to 2000 levels. The Group also continues to drive for reductions in noise and improvements in air quality.

We are taking a leading role in research, including the Environmentally Friendly Engine (EFE), a combined UK Government, industry and university programme, as part of our continuing drive to improve the environmental performance of our aero engines. As part of the European Commission Clean Sky Joint Technology Initiative, we are leading a €400 million engine research programme, where our efforts are focused on demonstrators for low-weight advanced turbofans and ultra-low fuel burn geared open rotors. Rolls-Royce is also leading other joint Government/industry programmes, including:

- Strategic Investment in Low-carbon Engine Technology (SILOET);
- Strategic Affordable Manufacturing in the UK through Leading Environmental Technologies (SAMULET); and
- Environmental Lightweight Fan (ELF).

Rolls-Royce is an active member of the UK Sustainable Aviation Council, which comprises manufacturers, airlines, airports and air navigation service providers and is an industry body committed to building a sustainable future for aviation. Its second progress report, published in 2009, includes an emissions reduction 'Roadmap' detailing that significant abatement is feasible in the UK by 2050.



[1] SFC: fuel consumption normalised for engine power
ACARE: Advisory Council for Aeronautics Research in Europe

The aviation sector is closely examining the potential of bio-fuels to offer a sustainable lower-carbon alternative to kerosene. Rolls-Royce has supported a number of flight trials, whilst remaining conscious of the wider sustainability issues. Our position is that, to be acceptable, candidate alternative fuels must:

- be technically suitable;
- be deployable on a scale sufficient to displace a significant quantity of kerosene use;
- avoid harmful impacts on food availability and cost, water demand and ecosystems; and
- offer an overall lifecycle carbon footprint significantly lower than kerosene.

Environmental performance is fundamental across all of our businesses. For example, in the marine sector, our market leading Azipull thrusters use 16 per cent less energy than conventional thrusters, resulting in lower emissions. We are also extending our range of marine reciprocating engines capable of running on liquefied natural gas (LNG), which compared with diesel fuel in conventional engines, provide significantly lower CO_2, NO_x and SO_x emissions.

The Group continues to explore opportunities in low emission and alternative energy products and is working in partnership with the UK Energy Technologies Institute. As part of this work programme, a prototype tidal device has been developed and will be tested at the European Marine Energy Centre, in Orkney, Scotland.

Nuclear power is expected to represent an important component of future low-carbon electricity generation. Rolls-Royce has substantial capabilities in this area gained through supplying power systems for the UK nuclear-powered submarine fleet over many decades and, in response to the formidable challenge posed by climate change, has formed a civil nuclear business unit.

A new factory is planned to manufacture, assemble and test components for new civil nuclear power stations. These include pressure vessels, heat exchangers and other large and complex reactor parts, manufactured to exacting nuclear standards. The facility will have strong links with the Nuclear Advanced Manufacturing Research Centre, announced by the UK Government in July 2009, in which Rolls-Royce will be the leading industrial partner.

Employees

We aim to attract and retain the best people and create an inclusive working environment in which creativity, capability and motivation flourish. By continually improving levels of employee performance, we deliver on our commitments.

Engaging employees

At the end of 2009, Rolls-Royce employed 38,500 permanent staff in over 50 countries. The long lifecycle of the Group's products makes it imperative that we have a skilled workforce that is committed to delivering excellence to customers over the long term. To achieve this and help improve performance, we aim to create an inclusive working environment that attracts and retains the best people, enhances their flexibility, capability and motivation and encourages them to be involved in the ongoing success of the Group.

In 2005, we formed a Global Council to improve our consultation and employee engagement. The full council meets twice a year and involves 42 employee delegates and a selection of senior management representatives from each business and function. Employee delegates are elected to represent both employees that are members of unions and those who are not. An executive committee of eight elected delegates meets senior management an additional four times throughout the year to ensure regular dialogue and timely consultation between council meetings.

In 2009, our global election process saw 30 per cent of Global Council delegates take up the responsibility for the first time. Due to the changing shape of our global workforce and the need for delegates to have effective communication and interaction during and in between Global Council meetings, we ran cultural awareness training for all delegates in 2009.

Since 2008, we have conducted an annual strategy storyboard, an interactive Group-wide briefing on corporate direction and performance. The storyboard is delivered globally through small face-to-face briefings and ensures all our employees have a good understanding of the Group's key objectives and the contribution each individual can make towards meeting them.

Our Employee Engagement Survey was redesigned at the end of 2008 to give clearer and more comprehensive feedback and was incorporated into a two-year rolling global engagement programme. The first improved global employee survey was conducted in January 2009 with a participation rate of 80 per cent, a marked increase from the 46 per cent participation in 2006. The new reporting format has allowed us to develop improvement activities that are being implemented across each business and function. A pulse-check survey to gauge employees' perceptions of progress will be undertaken in early 2010.

Rolls-Royce provides competitive pay and benefits in all its locations and actively encourages share ownership by offering ShareSave plans to all employees. Our employees have currently committed around £106 million to these plans. In the UK, statutory arrangements enable employees to receive part of their annual bonus in shares and to make monthly share purchases from their salary.

Encouraging diversity

The Group is committed to developing a diverse workforce and equal opportunities for all. This includes encouraging more women and people from minority backgrounds to pursue engineering careers. Our global governance framework for diversity includes a senior executive Global Diversity Steering Group that provides leadership and shapes strategic direction.

During 2009, we recruited MBA students from 11 nations, graduates for our worldwide graduate programme from 34 nations, and apprentices in the UK and Germany from five nations.

In Asia, we continue to make good progress in attracting the highest quality leadership talent. Several key management roles have provided the opportunity to recruit new senior management locally. As the need for early career high potential talent strengthens in the region, we have also engaged with several universities to encourage students to apply for our graduate recruitment and development programmes.

Launched in 2006, our UK Women's Network focuses on personal and professional skills development as well as providing support through networking and mentoring frameworks. Participation continues to grow and, during 2009, we supported the launch of a Women's Network in Indianapolis, North America, and we are currently supporting the launch of a network in Germany.

Our policy is to provide, wherever possible, employment training and development opportunities for disabled people. We are committed to supporting employees who become disabled during employment and to helping disabled employees make the best possible use of their skills and potential.

Learning and development

In December 2008, we launched MyLearning, a global system providing access for all employees to both instructor-led and online learning. Through this web-based system, employees are now able to view the training available, book onto a course, undertake online learning and review their training history. By the end of December 2009, employees from 44 countries had accessed the system, with over 11,000 employees undertaking more than 65,000 hours of online training.

We have begun to roll out a programme of competency definitions that will align generic jobs to behavioural and technical competencies. These competencies will allow all our employees to assess their skills and knowledge against those required to carry out their job successfully. Through MyLearning, employees can run a self-assessment and are then offered training to ensure that they develop the skills needed to meet the required competency levels.

During 2009 our learning and development team provided 9,000 days of leadership training and delivered learning and development programmes that supported capability development for individuals and the business. We continue to use trained facilitators to deliver global training programmes such as business ethics and our annual strategy storyboard to all employees.

About 1,000 employees have benefited from financial support and time off work to attend further education programmes at local colleges and universities and we provided £1.7 million to finance this type of learning.

Overall, we invested £24 million in the education, training and professional development of employees during the year.

Resourcing and deployment

We continue to focus on the recruitment, development, and deployment of leadership and professional capability across all of our functions globally. Leadership succession and individual career development is managed through development meetings held on a regular basis with senior leadership teams throughout the Group. Discussions in these forums are directly linked to the development of resourcing plans which identify the need for specialist, managerial, MBA, graduate and apprentice employees. Development meetings operate at four different levels in the organisation, ensuring a balanced focus on the development and advancement of employees including, high potential employees, technical specialists and senior executives. This ultimately enables effective deployment of people throughout the business.

During 2009, we recruited 199 graduates onto Rolls-Royce graduate programmes and 254 apprentices and technicians worldwide and an additional 256 students were employed on short-term training projects in the UK and North America. We remain in the upper quartile of The Times' Top 100 Graduate Employers survey and are ranked in first position for engineering companies.

Health and wellbeing

The Group is committed to promoting best practice in occupational health and provides professional expertise through highly regarded service providers. The primary objective of the Group's occupational health strategy remains a culture of prevention rather than cure.

The strategy maintains four key areas of focus:

- screening and surveillance;
- rehabilitation;
- health promotion; and
- education.

We continue to demonstrate good progress against our screening and surveillance targets. These are detailed in the Responsible Operations report, published in April 2007 and subsequent updates available on the Group's website at www.rolls-royce.com/cr/reports.

The 'Know your body metrics' health promotion campaign designed to complement the 'Owners Handbook' on wellbeing rolled out in 2007 and 2008 has been continued in 2009 following popular demand. The programme is designed to raise awareness and understanding of cardiovascular risk factors.

An anonymous online questionnaire found that the 'Owners Handbook' and the 'Know your body metrics' booklet were rated as 'good to excellent' by more than 80 per cent of respondents. Some 45 per cent said they had made beneficial lifestyle changes as a result of the information.

A pilot programme in one of our business units took place with the Sainsbury Centre for Mental Health based on the successful Australian programme entitled 'beyondblue'. Further training and awareness are planned to help managers identify depression in the workplace.

Society

Rolls-Royce has a firm, long-standing commitment to the communities in which we operate around the world.

Sustained investment in communities makes a positive difference and delivers tangible benefits to our business. Corporate responsibility is also a key enabler in delivering our global supply chain strategy.

Society

The Group continues to foster productive supplier relationships which:

- deliver mutual business benefits;
- minimise the environmental impact of business operations;
- encourage the highest standards of ethical behaviour; and
- promote human rights.

We also set and manage rigorous performance standards for suppliers through our quality system, Supplier Advanced Business Relationships (SABRe). This includes a supplier code of conduct, which is complemented by the Group's purchasing code of conduct to ensure suppliers and employees work to the same standards.

We are an active member of the UK MoD/Industry Sustainable Procurement working group, and look to proactively engage suppliers in this topic. In 2010, we aim to address the integration of Sustainable Procurement into our sourcing decision process.

Over the last few years Rolls-Royce has voluntarily and publicly declared our carbon emissions by having our data analysed by the Carbon Disclosure Project (CDP). As part of our membership of the CDP we were able to extend this analysis into our external supply chain by inviting some of our suppliers from around the world to declare their carbon emissions. Due to the success of this analysis, we plan to extend this pilot programme in 2010.

We are committed to working with suppliers to eliminate waste. S uccess in recycling metals within our manufacturing facilities has been extended to support suppliers in recycling their waste metals. In 2009, we further extended our remit on metal recycling by engaging with selected customers to ensure that their time-expired engine parts enter the recycling process. In addition, in 2009 over 4,000 tonnes of high-value metals were returned from Rolls-Royce factories directly back to our own supply chain for re-use.

Local sourcing policies reflect government regulations, such as in the US where particular rules towards working with small and disadvantaged businesses apply.

Community investment

The Group has a long-standing commitment to support its local communities. Community investment is an intrinsic part of the way we do business, supporting the Group's strategy and future success, particularly in the areas of:

- recruitment and retention of employees, especially by investing in the science skills we need;
- employee engagement, by encouraging a sense of loyalty, pride and motivation in our organisation;
- development of professional and personal skills such as teamwork, leadership, adaptability and ethical behaviour; and
- reputation, by building proactive and mutually beneficial relationships in the communities in which we operate.

During 2009, we conducted our sixth global survey of community and sponsorship contributions, including cash, employee time and gifts in kind, using the London Benchmarking Group model. The Group's total contributions across all these areas amounted to approximately £6.7 million.

Donations and sponsorship

The Group's charitable donations policy is to 'directly support causes primarily relating to educational, engineering and scientific objectives, as well as social objectives connected with the Group's business and place in the wider community'.

The Group's charitable donations amounted to £2.3 million, of which £1.5 million were made in the UK. These included support for Community Foundations, Emmaus for homeless people, and the main armed service benevolent funds. Rolls-Royce made charitable donations of US$800,000 in North America, €135,000 in Germany and £200,000 in other regions. These donations included support for the work of United Way in North America and for the victims of natural disasters in Vietnam, India, Indonesia and Brazil.

A further £2.1 million was contributed in sponsorships and educational programmes, including the Smithsonian National Air and Space Museum in North America, the Brandenburg Summer Festival in Germany and sponsorship of The Big Bang fair for young scientists and engineers in the UK.

The Group has a stated policy of working closely with governments and institutions to highlight the many career opportunities that science and engineering can offer.

Our flagship education programme, the Rolls-Royce Science Prize, recognises excellent and innovative science teaching in the UK. This year's winner, Kells Lane Primary School in Gateshead, England, received a total of £20,000 for its project, in which teachers developed a wind tunnel to test pupil-designed wind turbines. In all, £120,000 was awarded, with the help of the UK Science Learning Centre network, to 59 schools to improve science teaching and learning. As part of the Science Prize, the Group sponsors Project ENTHUSE which provides free professional development courses to teachers in the UK through the National Science Learning Centre.

Employee time

Employee time contributed during 2009 is estimated at a value of at least £1.5 million, with more than 5,000 employees participating in activities such as community projects and team-building activities with societal benefits.

Over 200 employees in the UK, North America and Germany took part in 20 projects during the year as part of their personal development. These projects are recognised at the Group's Global Learning and Development Awards.

Employee giving

In addition to the Group's own contributions, Rolls-Royce finances the administration of a Payroll Giving Scheme for UK employees, enabling them to make tax-free donations to their chosen charities. In the UK during 2009, employees gave almost £430,000 to more than 350 charitable causes of their choice. The scheme is recognised as Gold Award standard by the UK Government's Payroll Giving Quality Mark, with approximately 14 per cent of UK employees participating in the scheme. In North America, employees have contributed over US$550,000 directly from payroll to good causes through the United Way scheme, a percentage of which is matched by the Group.

In-kind support

The Group also supports community and educational organisations with in-kind donations, including places on Group training courses and the loan of engines and components.

Finance Director's review

"In 2009, the Group delivered increases in revenue and profit. The order book also remained resilient in difficult market conditions."

The Group delivered another year of strong progress in the face of significant challenges in 2009. The global recession, together with industry specific issues, provided substantial challenges, including the continued delay of a number of major new aerospace programmes. However, a resilient financial performance provides clear evidence of the strength of the business and its ability to adjust quickly in a volatile environment.

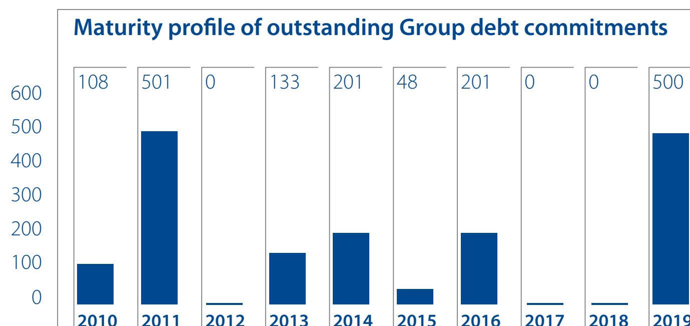
Our businesses are being affected by the same economic factors as many of our peers and competitors. However, the Group's breadth both by sector and geographical mix, the age of our installed fleet of products, the strong positions we hold on current and future major programmes, together with the Group's services revenues, provide us with significant advantages and have helped deliver a resilient overall result for the year.

The financial performance in 2009 met the expectations of the Board and the guidance provided at the start of the year, delivering an 11 per cent increase in underlying Group revenues with underlying profit before taxes up four per cent to £915 million.

As anticipated there was a cash outflow in the year of £183 million. This was as a consequence of the global economic downturn and programme delays impacting the working capital cycle which was exacerbated by year-end revaluation effects.

The published results were heavily influenced by the significant movements in foreign exchange rates in 2009, especially the GBP/USD and the GBP/EUR which are explained on pages 41 and 42.

The Group has maintained a strong financial position throughout the year and its parent company, Rolls-Royce Group plc, continues to hold strong credit ratings from both Standard & Poor's (A-, Stable) and Moody's (A3, Stable). At the year end, the Group held gross cash balances of £3.0 billion with £1.7 billion of outstanding debt commitments – a net cash position of £1.3 billion with the average net cash having also increased to £635 million over 2009. The redemptions on the Group's existing bond financing, at around £1.7 billion, are well spread with around US$187 million due in the second half of 2010 and a €750 million Eurobond due in 2011 as shown in the chart opposite. The Group had a further £450 million in term funding available to it that was undrawn at the year end. The Group has essentially completed the refinancing of the 2011 Eurobond via the successful £500 million GBP bond issued in the first half of 2009, the proceeds of which are now held on term deposit and will be available to settle the 2011 bond when it falls due. There are no other material maturities until 2013.



The changes made to the Group's UK pension schemes over the last few years have enabled the deficit to remain stable and modest and the schemes ended the year with a net deficit of £380 million on an accounting basis, as detailed in note 17 of the financial statements on page 94. The triennial actuarial valuation of the Rolls-Royce Pension Fund, representing 64 per cent of future liabilities, was completed in the year producing a pleasing result with no material changes in the scale of the deficit or future funding levels. The stability in ongoing funding is a direct result of changes made to the Group's pension schemes to reduce the volatility of the deficit, and to provide stability and visibility of cash funding requirements over the next three years.

Foreign exchange effects on published results

The pace and extent of currency movements have continued to have a significant effect on the Group's financial reporting in 2009, with the GBP/USD and GBP/EUR rates having the biggest impact. These movements have influenced both the reported income statement and the cash flow and closing net cash position (as set out in the cash flow statement and note 2 in the financial statements) in the following ways:

1. Income statement – the most important impact was the end of year mark to market of outstanding financial instruments (foreign exchange contracts, interest rate, commodity and jet fuel swaps). The principal adjustments related to the GBP/USD hedge book.

The principal movements in 2009 were as follows:

	Open	Close
GBP–USD	£1–$1.438	£1–$1.615
GBP–EUR	£1–€1.034	£1–€1.126
Oil–Spot Brent	$49/bbl	$77/bbl

The impact of this mark to market is included in net financing in the income statement and caused a net £1,835 million benefit, contributing to a published profit before tax of £2,957 million. These adjustments are non-cash, accounting adjustments required under IAS 39 *Financial Instruments: Recognition and Measurement*. As a result, reported earnings do not reflect the economic substance of derivatives that have been settled in the financial year, but do include the unrealised gains and losses on derivatives that will only affect cash flows when they are settled at some point in the future to match trading cash flows.

Underlying earnings are presented on a basis that shows the economic substance of the Group's hedging strategies in respect of transactional exchange rates and commodity price movements. Further details and information are included within the section on key performance indicators on page 9 and in note 2 of the financial statements.

Underlying profit before finance costs of £915 million benefited from £71 million of foreign exchange benefits compared to 2008. The achieved rate on selling US dollar income, around one and a half cents better in 2009 than 2008, contributed £16 million of transactional benefits. In addition, the improvement in the average GBP-USD and GBP-EUR exchange rates, 29 and 14 cents respectively, contributed translation benefits totalling £55 million to underlying profit before tax in the year.

The achieved rate on selling net US dollar income is expected to improve by six to nine cents in 2010 compared to 2009, as the Group is able to benefit from forward contracts at better rates. Revaluation effects, which are measured at a point in time, do not, therefore, represent additional currency headwinds or benefits.

2. Cash flow and balance sheet – the Group maintains a number of currency cash balances which vary throughout the financial year. Given the significant movements in foreign exchange rates in 2009, a number of these cash balances were reduced by the effects of retranslation at the year end, causing a reduction of £141 million in the 2009 cash flow and hence the closing balance sheet cash position.

Summary

The Group's revenues increased by 15 per cent in 2009 to £10,414 million with 86 per cent of revenues from customers outside the UK. Underlying revenues grew 11 per cent in 2009 with double-digit increases in defence aerospace, marine and energy and stable revenues in civil aerospace.

- Underlying revenues in the civil aerospace division were stable at £4,481 million (2008 £4,502 million) with a four per cent decline in service revenues being offset by a four per cent improvement in revenues from original equipment. Original equipment revenues were supported by a record year for the Trent family, with 224 engines delivered, helping to offset a 39 per cent reduction in deliveries for the corporate and regional sector. Overall 844 engines were delivered in the year, including 347 V2500 engines, and 273 engines for various corporate and regional applications. Revenues from services were held back by reduced discretionary spares and service activity as customers reduced overhaul activity given lower utilisation patterns on a number of large aircraft types.
- Underlying defence aerospace revenues grew by 19 per cent supported by strong growth in deliveries for the military transport sector. New equipment revenues grew 30 per cent and services revenues increased by ten per cent over 2008.
- The marine business continued to grow strongly in the year with underlying revenues increasing 17 per cent from 2008 to £2,589 million. Overall new equipment revenues increased by 21 per cent to £1,804 million with services revenues increasing ten per cent to £785 million supported by the expansion of the marine services network as six facilities were opened or expanded in the year.
- The energy business made strong progress in the year with underlying revenues up 36 per cent to £1,028 million, supported by good growth in both original equipment and services activities.

Overall underlying services revenues increased by four per cent in 2009 to £4,927 million and accounted for 49 per cent of Group revenues for the year.

Underlying profit margins before financing costs reduced slightly from 10.0 per cent in 2008 to 9.7 per cent in 2009. The reduction in margin reflected an increased mix of original equipment and increased unit costs. Underlying financing costs increased by £29 million to £68 million (2008 £39 million) including an increase in the net interest charge of £33 million as a consequence of the additional £500 million bond issue in April 2009, and finance costs associated with financial risk and revenue sharing partnerships.

Restructuring charges in 2009 totalled £55 million (2008 £82 million) as the Group continued its focus on operational improvements, including the reduction in the number of people working in support functions. These costs are included within operating costs.

The Company is proposing to pay an interim dividend of £550 million.

Order book

The order book at December 31, 2009, at constant exchange rates, has remained resilient at £58.3 billion (2008 £55.5 billion). This included firm business that had been announced but for which contracts had not yet been signed of £6.8 billion (2008 £6.1 billion).

In civil aerospace, it is common for a customer to take options for future orders in addition to firm orders placed. Such options are excluded from the order book.

In defence aerospace, long-term programmes are often ordered for only one year at a time. In such circumstances, even though there may be no alternative engine choice available to the customer, only the contracted business is included in the order book.

Aftermarket services agreements, including TotalCare packages, represented 28 per cent of the order book, having increased by £2 billion in the year. These are long-term contracts where only the first seven years' revenue is included in the order book.

Aftermarket services

The Group continues to be successful in developing its aftermarket services activities. These grew by four per cent on an underlying basis in 2009 and accounted for 49 per cent of the Group revenues.

In particular, TotalCare packages in the civil aerospace sector now cover 59 per cent, by value, of the installed fleet. TotalCare packages cover long-term management of the maintenance and associated logistics for our engines and systems, monitoring the equipment in service to deliver the system availability our customers require with predictable costs. The pricing of such contracts reflects their long-term nature. Revenues and costs are recognised based on the stage of completion of the contract, generally measured by reference to flying hours. The overall net position of assets and liabilities on the balance sheet for TotalCare packages was an asset of £970 million (2008 £848 million).

Cash

There was a cash outflow in the year of £183 million (2008 £569 million inflow) partly the consequence of revaluing year end non-GBP cash balances of £141 million (2008 £439 million inflow) but also reflecting £94 million of investments in acquisitions and joint ventures and associates during the period.

Working capital increased by £78 million during the year with increased financial working capital offsetting inventory which reduced by £119 million. Reduced inventory levels was a significant achievement given the volatility caused by the economic downturn, ongoing delays of major new programmes and the growth in the non-civil aerospace segments during 2009.

Cash investments of £597 million (2008 £675 million) in property, plant and equipment and intangible assets, and tax payments of £119 million (2008 £117 million) represented the major cash outflows in the period.

Despite a modest cash outflow in 2009, the average net cash was £633 million (2008 £374 million). The net cash balance at the year end was £1,273 million (2008 £1,456 million).

Taxation

The overall tax charge on the profit before tax was £740 million (2008 £547 million credit), a rate of 25.0 per cent (2008 28.9 per cent).

The tax charge on underlying profit was £187 million (2008 £217 million) a rate of 20.4 per cent (2008 24.7 per cent).

The overall tax charge was reduced by £26 million in respect of the expected benefit of the UK research and development tax credit. In addition, £35 million of prior years' tax provisions were released in the year. This was partly following settlement of a number of outstanding tax issues and partly as a result of a change in UK tax law generally exempting foreign dividends from UK taxation. These items also reduced the underlying tax charge by the same amounts. The underlying tax rate is expected to increase in 2010 to around 24 per cent.

The operation of most tax systems, including the availability of specific tax deductions, means that there is often a delay between the Group tax charge and the related tax payments, to the benefit of cash flow.

The Group operates internationally and is subject to tax in many differing jurisdictions. As a consequence, the Group is routinely subject to tax audits and examinations which, by their nature, can take a considerable period to conclude. Provision is made for known issues based on management's interpretation of country specific legislation and the likely outcome of negotiation or litigation. The Group believes that it has a duty to shareholders to seek to minimise its tax burden but to do so in a manner which is consistent with its commercial objectives and meets its legal obligations and ethical standards. While every effort is made to maximise the tax efficiency of its business transactions, the Group does not use artificial structures in its tax planning. The Group has regard for the intention of the legislation concerned rather than just the wording itself. The Group is committed to building open relationships with tax authorities and to following a policy of full disclosure in order to effect the timely settlement of its tax affairs and to remove uncertainty in its business transactions. Where appropriate, the Group enters into consultation with tax authorities to help shape proposed legislation and future tax policy.

Transactions between Rolls-Royce subsidiaries and associates in different jurisdictions are conducted on an arms-length basis and priced as if the transactions were between unrelated entities, in compliance with the OECD Model Tax Convention and the laws of the relevant jurisdictions.

Before entering into a transaction the Group makes every effort to determine the tax effect of that transaction with as much certainty as possible. To the extent that advance rulings and clearances are available from tax authorities, in areas of uncertainty, the Group will seek to obtain them and adhere to their terms.

Pensions

The charges for pensions are calculated in accordance with the requirements of IAS 19 *Employee Benefits*. During 2007 the Group's principal UK defined benefit schemes adopted a lower risk investment strategy in which the interest rate and inflation risks were largely hedged and the exposure to equities reduced to around 20 per cent of scheme assets. As reported last year, the primary objective of the revised investment strategy was to reduce the volatility of the pension schemes to enable greater stability in the funding requirements. The March 31, 2009 valuation of our largest pension fund has demonstrated the success of these measures. After increasing the allowance for life expectancy, the deficit has fallen slightly compared to the previous valuation in 2006. This means that the deficit reduction contributions which have been in place since 2003 will continue at their current level but are now projected to end slightly earlier than previously envisaged.

Further information and details of the pensions' charge and the defined benefit schemes' assets and liabilities are shown in note 17 to the financial statements. The net deficit, after taking account of deferred tax, was £590 million (2008 £399 million restated). Changes in this net position are affected by the assumptions made in valuing the liabilities and the market performance of the assets.

Investments

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

The Group has a portfolio of projects at different stages of their lifecycles. Discounted cash flow analysis of the remaining life of projects is performed on a regular basis. Sales of engines in production are assessed against criteria in the original development programme to ensure that overall value is enhanced.

Gross research and development (R&D) investment amounted to £864 million (2008 £885 million). Net research and development charged to the income statement was £379 million (2008 £403 million). The level of self-funded investment in research and development is expected to remain at approximately four to five per cent of Group revenues in the future. The impact of this investment on the income statement will reflect the mix and maturity of individual development programmes and will result in a modest increase in the level of net research and development charged within the income statement in 2010.

The continued development and replacement of operational facilities contributed to the total expenditure in property, plant and equipment of £291 million (2008 £283 million). Investment in 2010 is anticipated to be slightly increased compared to the 2009 level as the investments in new facilities in the US and Singapore commence.

Investment in training was £24 million (2008 £30 million).

Intangible assets

The Group carried forward £2,472 million (2008 £2,286 million) of intangible assets. This comprised purchased goodwill of £984 million, engine certification costs and participation fees of £454 million, development expenditure of £546 million, recoverable engine costs of £290 million and other intangible assets of £198 million. Expenditure on intangible assets is expected to increase modestly in 2010.

The carrying values of the intangible assets are assessed for impairment against the present value of forecast cash flows generated by the intangible asset. The principal risks remain reductions in assumed market share, programme timings, increases in unit cost assumptions and adverse movements in discount rates. There have been no impairments in 2009. Further details are given in note 7.

Partnerships

The development of effective partnerships continues to be a key feature of the Group's long-term strategy. Major partnerships are of two types: joint ventures and risk and revenue sharing partnerships.

Joint ventures

Joint ventures are an integral part of our business. They are involved in engineering, manufacturing, repair and overhaul, and financial services. They are also common business structures for companies participating in international, collaborative defence projects. They share risk and investment, bring expertise and access to markets and provide external objectivity. Some of our joint ventures have become substantial businesses. A major proportion of the debt of the joint ventures is secured on the assets of the respective companies and is non-recourse to the Group.

Risk and revenue sharing partnerships (RRSPs)

RRSPs have enabled the Group to build a broad portfolio of engines, thereby reducing the exposure of the business to individual product risk. The primary financial benefit is a reduction of the burden of R&D expenditure on new programmes.

The related R&D expenditure is expensed through the income statement and the initial programme receipts from partners, which reimburse the Group for past R&D expenditure, are also recorded in the income statement, as other operating income.

RRSP agreements are a standard form of co-operation in the civil aero-engine industry. They bring benefits to the engine manufacturer and the partner. Specifically, for the engine manufacturer they bring some or all of the following benefits: additional financial and engineering resource; sharing of risk; and initial programme contribution. As appropriate, the partner also supplies components and as consideration for these components, receives a share of the long-term revenues generated by the engine programme in proportion to its purchased programme share.

The sharing of risk is fundamental to RRSP agreements. Partners share financial investment in the programme, typically through:

- market risk as they receive their return from future sales;
- currency risk as their returns are denominated in US dollars;
- sales financing obligations;
- warranty costs; and
- where they are manufacturing or development partners, technical and cost risk.

Partners that do not undertake development work or supply components are referred to as financial RRSPs and are accounted for as financial instruments as described in the accounting policies on page 61.

In 2009, the Group received other operating income of £89 million (2008 £79 million).

Payments to RRSPs are recorded within cost of sales and increase as the related programme sales increase. These payments amounted to £231 million (2008 £268 million).

The classification of financial RRSPs as financial instruments has resulted in a liability of £363 million (2008 £455 million) being recorded in the balance sheet and an associated underlying financing cost of £25 million (2008 £26 million) recorded in the income statement.

In the past, the Group has also received government launch investment in respect of certain programmes. The treatment of this investment is similar to non-financial RRSPs.

Risk management

The Board has an established, structured approach to risk management. The risk committee has accountability for the system of risk management and reporting the key risks and associated mitigating actions. The Director of Risk reports to the Finance Director. The Group's policy is to preserve the resources upon which its continuing reputation, viability and profitability are built, to enable the corporate objectives to be achieved through the operation of the Rolls-Royce business processes. Risks are formally identified and recorded in a corporate risk register and its subsidiary registers within the businesses, which are reviewed and updated on a regular basis, with risk mitigation plans identified for key risks.

Financial risk

The Group uses various financial instruments in order to manage the exposures that arise from its business operations as a result of movements in financial markets. All treasury activities are focused on the management and hedging of risk. It is the Group's policy not to trade financial instruments or to engage in speculative financial transactions. There have been no significant changes in the Group's policies in the last year.

The principal economic and market risks continue to be movements in foreign currency exchange rates, interest rates and commodity prices. The Board regularly reviews the Group's exposures and financial risk management and a specialist committee also considers these in detail.

All such exposures are managed by the Group Treasury function, which reports to the Finance Director and which operates within written policies approved by the Board and within the internal control framework described on page 51.

Counterparty credit risk

The Group has an established policy for managing counterparty credit risk. A common framework exists to measure, report and control exposures to counterparties across the Group using value-at-risk and fair-value techniques. The Group assigns an internal credit rating to each counterparty, which is assessed with reference to publicly available credit information, such as that provided by Moody's, Standard & Poor's, and other recognised market sources, and is reviewed regularly.

Financial instruments are only transacted with counterparties that have a publicly assigned long-term credit rating from Standard & Poor's of 'A-' or better and from Moody's of 'A3' or better.

Funding and liquidity

The Group finances its operations through a mixture of shareholders' funds, bank borrowings, bonds, notes and finance leases. The Group borrows in the major global markets in a range of currencies and employs derivatives where appropriate to generate the desired currency and interest rate profile.

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

Short-term investments are generally held as bank deposits or in 'AAA' rated money market funds. The Group operates a conservative investment policy which limits investments to high quality instruments with a short-term credit rating of 'A-1' from Standard & Poor's or better and 'P-1' from Moody's. Counterparty diversification is achieved with suitable risk-adjusted concentration limits. Investment decisions are refined through a system of monitoring real-time equity and credit-default swap (CDS) price movements of potential investment counterparties which are compared to other relevant benchmark indices and then risk-weighted accordingly.

The Group's borrowing facilities increased during 2009 following the successful placement of a £500 million ten-year bond. As at December 31, 2009 the Group had total committed borrowing facilities of £2.15 billion (2008 £1.65 billion). Debt maturities in 2010 and 2011 are £108 million and £501 million respectively. The proceeds of the recent £500 million bond issue are anticipated to be used to pay down the £501 million of debt maturities in 2011. The maturity profile of the borrowing facilities is staggered to ensure that refinancing levels are manageable in the context of the business and market conditions.

There are no rating triggers contained in any of the Group's facilities that could require the Group to accelerate or repay any facility for a given movement in the Group's credit rating.

The Group's £250 million bank revolving credit facility contains a rating price grid, which determines the borrowing margin for a given credit rating. The Group's current borrowing margin would be 20 basis points (bp) over sterling LIBOR if drawn. The borrowing margin on this facility increases by approximately 5bp per one notch rating downgrade, up to a maximum borrowing margin of 55bp. The facility was not drawn during 2009.

There are no rating price grids contained in the Group's other borrowing facilities.

The Group continues to have access to all the major global debt markets.

Credit rating

The Group's parent company, Rolls-Royce Group plc, subscribes to both Moody's Investors Service and Standard & Poor's for its official publicised credit ratings. As at December 31, 2009 Rolls-Royce Group plc's assigned long-term credit ratings were:

Rating agency	Rating	Outlook	Category
Moody's	A3	Stable	Investment grade
Standard & Poor's	A-	Stable	Investment grade

As a long-term business, the Group attaches significant importance to maintaining this investment grade credit rating, which it views as necessary for the business to operate effectively.

The Group's objective is to maintain this 'A' category investment grade credit rating from both agencies.

Currency risk

The Group is exposed to movements in exchange rates for both foreign currency transactions and the translation of net assets and income statements of foreign subsidiaries.

The Group regards its interests in overseas subsidiary companies as long-term investments and manages its translational exposures through the currency matching of assets and liabilities where applicable. The matching is reviewed regularly, with appropriate risk mitigation performed where material mismatches arise.

The Group has exposure to a number of foreign currencies. The most significant transactional currency exposures are USD to GBP and USD to EUR.

The Group manages its exposure to movements in exchange rates at two levels:

i) Revenues and costs are currency matched where it is economic to do so. The Group actively seeks to source suppliers with the relevant currency cost base to avoid the risk or to flow down the risk to those suppliers that are capable of managing it. Currency risk is also a prime consideration when deciding where to locate new facilities. US dollar income converted into sterling represented 23 per cent of Group revenues in 2009 (2008 26 per cent). US dollar income converted into euros represented two per cent of Group revenues in 2009 (2008 four per cent).
ii) Residual currency exposure is hedged via the financial markets. The Group operates a hedging policy using a variety of financial instruments with the objective of minimising the impact of fluctuations in exchange rates on future transactions and cash flows.

Market exchange rates

	2008	2009
USD per GBP		
– Year-end spot rate	1.438	**1.615**
– Average spot rate	1.854	**1.566**
EUR per GBP		
– Year-end spot rate	1.034	**1.126**
– Average spot rate	1.258	**1.123**

The permitted range of the amount of cover taken is determined by the written policies set by the Board, based on known and forecast income levels.

The forward cover is managed within the parameters of these policies in order to achieve the Group's objectives, having regard to the Group's view of long-term exchange rates. Forward cover is in the form of standard foreign exchange contracts and instruments on which the exchange rates achieved are dependent on future interest rates.

The Group may also write currency options against a portion of the unhedged dollar income at a rate which is consistent with the Group's long-term target rate. At the end of 2009 the Group had US$18.8 billion of forward cover (2008 US$17.1 billion).

The consequence of this policy has been to maintain relatively stable long-term foreign exchange rates. Note 15 to the financial statements includes the impact of revaluing forward currency contracts at market values on December 31, 2009, showing a negative value of £144 million (2008 negative value of £2,181 million) which will fluctuate with exchange rates over time. The Group has entered into these forward contracts as part of the hedging policy, described above, in order to mitigate the impact of volatile exchange rates.

Interest rate risk

The Group uses fixed rate bonds and floating rate debt as funding sources. The Group's policy is to maintain a proportion of its debt at fixed rates of interest having regard to the prevailing interest rate outlook. To implement this policy the Group may utilise a combination of interest-rate swaps, forward-rate agreements and interest-rate caps to manage the exposure.

Commodity risk

The Group has an ongoing exposure to the price of jet fuel and base metals arising from business operations. The Group's objective is to minimise the impact of price fluctuations. The exposure is hedged, on a similar basis to that adopted for currency risks, in accordance with parameters contained in written policies set by the Board.

Sales financing

In connection with the sale of its products, the Group will, on some occasions, provide financing support for its customers. This may involve the Group guaranteeing financing for customers, providing asset-value guarantees (AVGs) on aircraft for a proportion of their expected future value, or entering into leasing transactions.

The Group manages and monitors its sales finance related exposures to customers and products within written policies approved by the Board and within the internal framework described in the corporate governance section. The contingent liabilities represent the maximum discounted aggregate gross and net exposure that the Group has in respect of delivered aircraft, regardless of the point in time at which such exposures may arise.

The Group uses Ascend Worldwide Limited as an independent appraiser to value its security portfolio at both the half year and year end. Ascend provides specific values (both current and forecast future values) for each asset in the security portfolio. These values are then used to assess the Group's net exposure.

The permitted levels of gross and net exposure are limited in aggregate, by counterparty, by product type and by calendar year. The Group's gross exposures were divided approximately 55:45 between AVGs and credit guarantees in 2009 (2008 55:45). They are spread over many years and relate to a number of customers and a broad product portfolio.

The Board regularly reviews the Group's sales finance related exposures and risk management activities. Each financing commitment is subject to a credit and asset review process and prior approval in accordance with Board delegations of authority.

The Group operates a sophisticated risk-pricing model to assess risk and exposure.

Costs and exposures associated with providing financing support are incorporated in any decision to secure new business.

The Group seeks to minimise the level of exposure from sales finance commitments by:

- the use of third-party non-recourse debt where appropriate;
- the transfer, sale, or reinsurance of risks; and
- ensuring the proportionate flow down of risk and exposure to relevant RRSPs.

Each of the above forms an active part of the Group's exposure management process.

Where exposures arise, the strategy has been, and continues to be, to assume where possible liquid forms of financing commitment that may be sold or transferred to third parties when the opportunity arises. Note 21 to the financial statements describes the Group's contingent liabilities. There were no material changes to the Group's gross and net contingent liabilities during 2009.

Accounting standards

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS), as adopted by the EU. In 2009, the changes that have had the most significant effect on the Group's financial statements are:

- Amendments to IAS 1 *Presentation of Financial Statements*: this relates to presentation only and there is no impact on the reported results. The amendments require (i) a statement of comprehensive income in place of the statement of recognised income and expense; (ii) a balance sheet at the beginning of the comparative period when there has been a change in accounting policy; and (iii) the statement of changes in equity to be presented as a primary statement.
- IFRIC 14 *IAS 19 The Limit of a Defined Benefit Asset, Minimum Funding Requirements and their Interaction*: this interpretation applies where regulatory funding requirements for pension schemes will result in an unrecognisable surplus arising in the future. It has been adopted with effect from January 1, 2008. An additional liability of £491 million was recognised at that date. Further details are shown in note 17.
- IFRS 8 *Operating Segments*: this standard amends the requirements for disclosure of segmental performance and does not have any effect on the Group's overall reported results. Note 2 is presented in accordance with the new requirements. The key change is that the basis for reporting the segmental results is the same as that used internally, which is equivalent to the underlying results, reported as additional information in prior years.

A summary of other less significant changes, and those which have not been adopted in 2009, is included within the accounting policies in note 1 to the financial statements.

Regulatory developments

In response to the financial crisis, governments and regulators around the world are considering various regulatory reforms to the financial markets with the aim of improving transparency and reducing systemic risk. While the proposed reforms are predominantly directed at financial institutions, some of them may have implications for non-financial institutions.

In particular, proposals by both US and European regulators to reform the Over-the-Counter (OTC) derivatives market could have implications for the Group in terms of future funding requirements and increased cash flow volatility, if parties to future OTC derivative transactions are required to post collateral to reduce counterparty risk.

Andrew Shilston
Finance Director
February 10, 2010

Board of directors

Simon Robertson
Non-executive Chairman
Chairman of the nominations committee
Simon Robertson was appointed to the Board in 2004. He is the founder member of Simon Robertson Associates LLP and a non-executive director of HSBC Holdings plc, Berry Bros & Rudd Limited, and The Economist Newspaper Limited. He is a director of The Royal Opera House Covent Garden Limited and a Trustee of The Eden Project and the Royal Opera House Endowment Fund. He is the former President of Goldman Sachs Europe Limited. Age 68.

Sir John Rose
Chief Executive
A member of the nominations committee
Sir John Rose was appointed to the Board in 1992, having joined Rolls-Royce in 1984. He has been Chief Executive since 1996. He is a Trustee of The Eden Project. Age 57.

Helen Alexander CBE
Non-executive director
Chairman of the remuneration committee and a member of the ethics and nominations committees
Helen Alexander CBE was appointed to the Board in 2007. She is President of the CBI and Chairman of the Port of London Authority and of Incisive Media. She is a non-executive director and chair of the remuneration committee at Centrica plc and senior adviser to Bain Capital. She was CEO of the Economist Group from 1997 to 2008. Helen is also senior trustee of the Tate Gallery and a trustee of the World Wide Web Foundation. Age 53.

Peter Byrom BSc, FCA
Non-executive director
A member of the remuneration, ethics and nominations committees
Peter Byrom was appointed to the Board in 1997. He is Chairman of Domino Printing Sciences plc and a non-executive director of AMEC plc. He is a Fellow of the Royal Aeronautical Society. He was a director of NM Rothschild & Sons Limited from1977 to 1996. Age 65.

Iain Conn
Non-executive director, Senior Independent Director
A member of the audit and nominations committees
Iain Conn was appointed to the Board in 2005. He is an executive director of BP p.l.c. having held a range of executive positions within the BP Group worldwide. He is Chairman of the Advisory Board of The Imperial College Business School. Age 47.

Professor Peter Gregson
Non-executive director
A member of the remuneration and nominations committees
Peter Gregson was appointed to the Board in 2007. He is President and Vice-Chancellor of Queen's University Belfast and serves on the Northern Ireland Economic Development Forum, the Council of CBI Northern Ireland and the Steering Group of the US-Ireland Research and Development Partnership. He is a Fellow of the Royal Academy of Engineering, a Member of the Royal Irish Academy, and Deputy Lieutenant of Belfast. He was formerly Professor of Aerospace Materials and Deputy Vice-Chancellor of the University of Southampton and has served on the Councils of the Royal Academy of Engineering and the Central Laboratory of the Research Councils. Age 52.

James Guyette BSc
President and Chief Executive Officer of Rolls-Royce North America Inc.
Jim Guyette was appointed to the Board in 1998 having joined Rolls-Royce in 1997. He is a director of the PrivateBank and Trust Company of Chicago, Illinois and of priceline.com Inc. Until 1995 he was Executive Vice President, Marketing and Planning of United Airlines. Age 64.

Dr John McAdam
Non-executive director
A member of the remuneration and nominations committees
John McAdam was appointed to the Board in 2008. He is Chairman of United Utilities Group PLC and of Rentokil Initial plc, the Senior Independent Director of J Sainsbury plc and a non-executive director of Sara Lee Corporation. He was the Chief Executive of ICI plc until ICI's acquisition by Akzo Nobel. Age 61.

John Neill CBE
Non-executive director
A member of the audit and nominations committees
John Neill was appointed to the Board in 2008. He is the Chief Executive of the Unipart Group of Companies. He is a member of the Council and Board of Business in the Community and is a non-executive director of Charter International plc. He is Vice President of the Society of Motor Manufacturers and Traders, BEN, the automotive industry charity and The Institute of the Motor Industry. Age 62.

John Rishton
Non-executive director
Chairman of the audit committee and a member of the ethics and nominations committees
John Rishton was appointed to the Board in 2007. He is Chief Executive Officer of Royal Ahold. He began his career in 1979 at Ford Motor Company and held a variety of positions both in the UK and in Europe. In 1994 he joined British Airways Plc where he was Chief Financial Officer from 2001 to 2005. He is a former non-executive director of Allied Domecq. Age 51.

Andrew Shilston MA, ACA, MCT
Finance Director
Andrew Shilston was appointed to the Board in 2003 having joined Rolls-Royce in 2002. He was a non-executive director of Cairn Energy PLC until May 2008 and he was Finance Director of Enterprise Oil plc from 1993 until 2002. Age 54.

Colin Smith BSc Hons, FREng, FRAeS, FIMechE
Director – Engineering and Technology
Colin Smith was appointed to the Board in 2005 having joined Rolls-Royce in 1974. He has held a variety of key positions within Engineering, including Director – Research and Technology and Director of Engineering and Technology – Civil Aerospace. He is a Fellow of the Royal Academy of Engineering, the Royal Aeronautical Society and the Institution of Mechanical Engineers. Age 54.

Ian Strachan
Non-executive director
Chairman of the ethics committee and a member of the audit and nominations committees
Ian Strachan was appointed to the Board in 2003. He is a non-executive director of Xstrata plc, Transocean Inc and Caithness Petroleum Limited. He is the former Chief Executive of BTR plc, former Deputy Chief Executive (1991 to 1995) and Chief Financial Officer (1987 to 1991) of Rio Tinto plc, former non-executive Chairman of Instinet Group Inc and former non-executive director of Johnson Matthey plc, Commercial Union and Reuters Group plc. Age 66.

Mike Terrett
Chief Operating Officer
Mike Terrett was appointed to the Board in 2007, having joined Rolls-Royce in 1978. He has held a variety of senior positions in the development of new aero-engine programmes, including Managing Director of Airlines and President and Chief Executive Officer of International Aero Engines (IAE), based in the United States. Prior to his appointment as Chief Operating Officer he was President – Civil Aerospace. He is a Member of the Institute of Mechanical Engineers and a Fellow of the Royal Aeronautical Society. Age 53.

Tim Rayner
General Counsel and Company Secretary
Tim Rayner joined Rolls-Royce in 2007 having previously been General Counsel and Company Secretary at United Utilities PLC. Age 49.

At December 31, 2009, all the directors were also directors of Rolls-Royce Group plc, the ultimate parent company. As directors of the ultimate parent company, there is no requirement to disclose their individual remuneration or their interests in the shares of Rolls-Royce group companies in this Annual report, as they are included in the Annual report of Rolls-Royce Group plc.

Internal control and risk management

The Board – system of internal control and its effectiveness

The Board is 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.

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.

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 their 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 Finance Manual.

The audit committee – reviewing internal controls

The audit committee keeps under review the Group's internal controls and systems for assessing and mitigating financial and non-financial risk. In addition, the committee reviews the Group's procedures for detecting, monitoring and managing the risk of fraud.

The committee reviews and approves the business assurance work programmes and ensures that this function is adequately resourced and co-ordinated with the work of the external auditors. Twice a year, the committee receives a report on the reviews conducted throughout the Group by business assurance and a report from senior executives on the key risks and risk systems in selected customer facing businesses and key functions.

The business assurance function, working closely with external auditors, undertakes a programme of financial and operational audits or reviews agreed by the audit committee and covering all Group activities. The programme includes independent reviews of the systems of internal control, selected on the basis of risks material to the Group. The findings and status of corrective actions taken to address these are reported to the audit committee.

The risk committee – implementation of the Board's policies

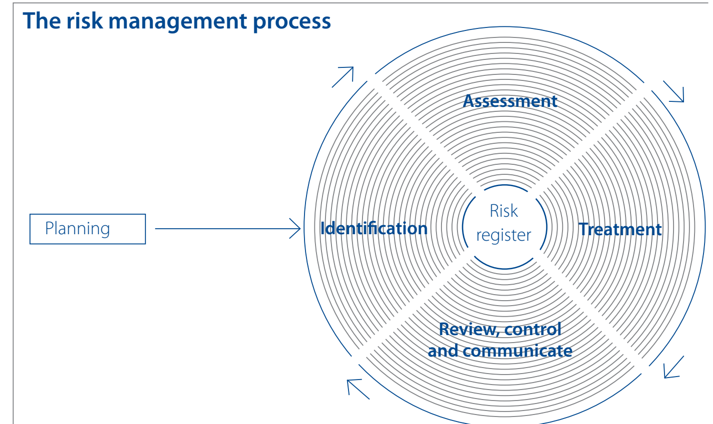
The risk committee has accountability for the system of risk management and for reporting the principal risks and associated mitigating actions, including those risks potentially affecting the Group's reputation. It has responsibility for implementing the Board's policies on risk and internal control and reviews the results of the risk management process, which operates at all levels in the Group. The risk committee has developed a risk policy which states that risk management is a part of every manager's responsibility and that risk management is to be embedded within the day-to-day management activity. The committee reports annually to the Board on the policy, process and operation of the risk management system and the principal risks facing the Group, identified through the risk management system.

Specific committees have accountability for reviewing certain categories of risk. The financial risk committee reviews credit, market or liquidity risks. The ethics committee reviews those risks with a significant ethical dimension, often identified as threats to reputation.

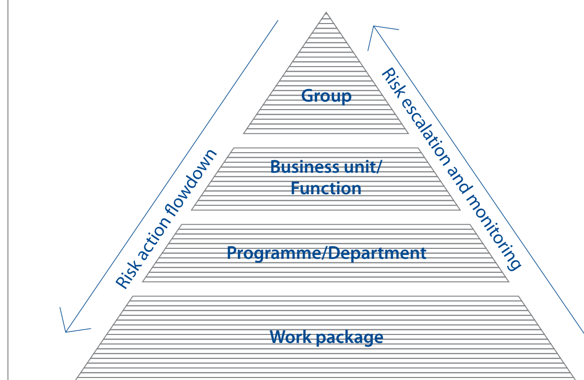
Risk management process – how risks are managed throughout the Group

Risks are defined as threats to the achievement of business objectives or to the continuing reputation of the Group. As part of the business cycle each part of the Group is required formally to identify and document key risks together with appropriate mitigating activities.

The risk management process



The risk escalation structure



The process provides methods for escalation and delegation to the appropriate levels within the organisation and ensures that actions are owned, defined, resourced and effective.

Risks may arise from a variety of internal and external sources. They may be associated with regulations, customer requirements, economic conditions or competitor actions. They could result from the capability of the processes used to execute the business or from external causes, such as war, terrorist activity or pandemics.

Management has continued to perform comprehensive risk reviews for all major programmes, including business change plans. Independent gated reviews are conducted where key risks and mitigating actions are identified and reported to management for incorporation into programme plans. The risk management process places significant emphasis on learning from and sharing prior experience.

Risks are documented in a framework of risk registers and are subject to regular review by management. The top-level corporate risk register is updated and reviewed by the risk committee twice per year and the Board also considers these risks in the context of the Group's business strategy. This ongoing process has been in place during 2009, up to and including the date of approval of the Annual report.

Implementation of the process

Development, implementation and maintenance of the standard global process are the responsibility of a dedicated enterprise risk management team. This team is part of the Department of Risk, which reports to the Finance Director. The team has created a comprehensive framework for the assessment of risk management process maturity that enables focused improvement actions and drives consistent application of the risk management process throughout the Group.

An integrated range of tools and training underpins the risk process. Implementation of an enterprise-wide software application enables the recording, analysis, communication and management of risks across the Group.

A global network of risk champions, mentors and facilitators drive the application of the standard process in their parts of the business and help to develop, embed and share best practice throughout the Group.

The risk management process is subject to continuous improvement. In 2009, training has been enhanced and a comprehensive curriculum of risk, reputation and ethics training has been developed for delivery at all levels of the organisation.

Shareholders and share capital

Share capital

Throughout 2009, the Company's authorised share capital was £400 million, comprising 2,000,000,000 ordinary shares of 20p. On December 31, 2009, there were 1,630,996,508 ordinary shares in issue. The ordinary shares are not listed.

Dividends

The directors have recommended an interim dividend of £550 million payable on February 11, 2010.

Other statutory information

Political donations

In line with its established policy, the Group made no political donations during 2009.

During the year, one of our US subsidiaries made a contribution towards the running expenses of a political action committee (PAC) organised by its employees in an amount of US$24,636 (2008: US$23,700). PACs are a common feature of the US political system and are governed by the Federal Election Campaign Act. The Rolls-Royce PAC is independent of the Company and independent of any political party. Its funds are contributed voluntarily by employees and the Company cannot affect how they are applied. Such contributions do not require authorisation by shareholders under the Companies Act 2006.

Payment to suppliers

The Company is guided by the Supply Chain Relationships in Aerospace (SCRIA) 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 the payment. In the event of disputes, efforts are made to resolve them quickly.

The Company had the equivalent of 62 days' purchases outstanding at December 31, 2008, based on the average daily amount invoiced by suppliers during the year.

Auditors

A resolution to reappoint the auditors, KPMG Audit Plc, and to authorise the directors to determine their remuneration, will also be proposed at the AGM.

Indemnity

The Company has entered into separate Deeds of Indemnity in favour of its directors. The deeds provide substantially the same protection as that already provided to directors under the indemnity in Article 170 of the Company's Articles of Association. The Company has also arranged appropriate insurance cover for any legal action taken against its directors and officers.

Annual report and the 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 company'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.

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 30 of the business review. The financial position of the Group, its cash flows, liquidity position, borrowing facilities and financial risks are described in pages 41 to 48 of the business review. In addition, notes 1, 12, 13 and 15 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 45, the Group meets its funding requirements through a mixture of shareholders' funds, bank borrowings, bonds, notes and finance leases. The chart on page 41 shows the maturity profile of the Group's outstanding debt facilities; a total of £108 million is due to expire in 2010. The Group has a further £450 million of term funding available that is currently undrawn.

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

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 auditors are 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 statement

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 53 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

Tim Rayner
General Counsel and Company Secretary
February 10, 2010

Independent Auditors' report

We have audited the financial statements of Rolls-Royce plc for the year ended December 31, 2009 set out on pages 55 to 129. The financial reporting framework that has been applied in the preparation of the group financial statements is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the EU. The Financial reporting framework that has been applied in the preparation of the parent company financial statements is applicable law and UK Accounting Standards (UK Generally Accepted Accounting Practice).

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members, as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditors

As explained more fully in the Directors' responsibilities statement set out on page 53, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's (APB) Ethical Standards for Auditors.

Scope of the audit of the financial statements

A description of the scope of an audit of financial statements is provided on the APB's web-site at www.frc.org.uk/apb/scope/UKNP.

Opinion on financial statements

In our opinion:

- the financial statements give a true and fair view of the sate of the Group's and of the parent company's affairs as at December 31, 2009 and of the Group's profit for the year then ended;
- the Group financial statement have been properly prepared in accordance with IFRSs as adopted by the EU;
- the parent company financial statements have been properly prepared in accordance with UK Generally Accepted Accounting Practice;
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matter prescribed by the Companies Act 2006

In our opinion the information given in the Directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

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

A J Sykes
Senior Statutory Auditor
for and on behalf of KPMG Audit Plc, Statutory Auditor

Chartered Accountants
8 Salisbury Square
London
EC4Y 8BB

February 10, 2010

Financial statements

Consolidated financial statements

56 Consolidated income statement
56 Consolidated statement of comprehensive income
57 Consolidated balance sheet
58 Consolidated cash flow statement
60 Consolidated statement of changes in equity

61 Notes to the consolidated financial statements
61 1 Significant accounting policies
68 2 Segmental analysis
72 3 Net financing
72 4 Taxation
75 5 Employee information
75 6 Auditors' remuneration
76 7 Intangible assets
78 8 Property, plant and equipment
79 9 Investments
80 10 Inventory
81 11 Trade and other receivables
81 12 Cash and cash equivalents
82 13 Borrowings
82 14 Trade and other payables
83 15 Financial instruments
93 16 Provisions
94 17 Post-retirement benefits
98 18 Share capital
99 19 Share-based payments
102 20 Operating and finance leases
103 21 Contingent liabilities
104 22 Related party transactions
105 23 Acquisitions and disposals

Company financial statements

107 Company balance sheet
108 Statement of total recognised gains and losses
108 Reconciliation of movements in shareholders' funds

109 Notes to the Company financial statements
109 1 Significant accounting policies
113 2 Emoluments of directors
113 3 Intangible assets
114 4 Tangible assets
115 5 Investments
115 6 Stocks
115 7 Debtors
116 8 Borrowings
116 9 Other creditors
117 10 Other financial assets and liabilities
118 11 Provisions for liabilities and charges
119 12 Deferred taxation
120 13 Post-retirement benefits
122 14 Share capital
123 15 Movements in capital and reserves
123 16 Operating lease annual commitments
123 17 Share-based payments
126 18 Contingent liabilities
126 19 Related party transactions
126 20 Ultimate holding company

Other matters

127 Principal subsidiary undertakings
128 Principal joint ventures and associates

Consolidated income statement

For the year ended December 31, 2009

	Notes	2009 £m	Restated* 2008 £m
Revenue	2	**10,414**	9,082
Cost of sales		**(8,303)**	(7,278)
Gross profit		**2,111**	1,804
Other operating income		**89**	79
Commercial and administrative costs		**(740)**	(699)
Research and development costs		**(379)**	(403)
Share of profit of joint ventures and associates	9	**93**	74
Operating profit		**1,174**	855
(Loss)/profit on sale or termination of businesses	23	**(2)**	7
Profit before financing	2	**1,172**	862
Financing income	3	**2,276**	435
Financing costs	3	**(491)**	(3,186)
Net financing		**1,785**	(2,751)
Profit/(loss) before taxation		**2,957**	(1,889)
Taxation	4	**(740)**	547
Profit/(loss) for the year		**2,217**	(1,342)
Attributable to:			
Equity holders of the parent		**2,221**	(1,337)
Minority interests		**(4)**	(5)
Profit/(loss) for the year		**2,217**	(1,342)

* During the year, the Group has reviewed the allocation of costs. As a result, costs of £33m classified as cost of sales in 2008 have been reclassified as commercial and administrative costs.

Consolidated statement of comprehensive income

For the year ended December 31, 2009

	Notes	2009 £m	Restated* 2008 £m
Profit/(loss) for the year		**2,217**	(1,342)
Other comprehensive income			
Foreign exchange translation differences on foreign operations		**(158)**	603
Net actuarial (losses)/gains	17	**(1,148)**	944
Movement in unrecognised post-retirement surplus	17	**707**	(928)
Movement in post-retirement minimum funding liability	17	**40**	66
Transfers from transition hedging reserve		**(27)**	(80)
Net movements on cash flow hedging reserve in respect of joint ventures and associates	9	**22**	(41)
Movement in fair value of available for sale assets		**–**	(8)
Related tax movements	4	**141**	(4)
Total comprehensive income/(expense) for the year		**1,794**	(790)
Attributable to:			
Equity holders of the parent		**1,799**	(787)
Minority interests		**(5)**	(3)
Total comprehensive income/(expense) for the year		**1,794**	(790)

* 2008 figures have been restated to reflect the adoption of IFRIC 14 with effect from January 1, 2008 – see note 17.

Directors' report

Financial statements

Consolidated balance sheet

At December 31, 2009

	Notes	2009 £m	December 31, 2008 £m	Restated* January 1, 2008 £m
ASSETS				
Non-current assets				
Intangible assets	7	**2,472**	2,286	1,761
Property, plant and equipment	8	**2,009**	1,995	1,813
Investments – joint ventures and associates	9	**437**	345	284
Other investments	9	**58**	53	89
Other financial assets	15	**637**	366	343
Deferred tax assets	4	**360**	804	132
Post-retirement scheme surpluses	17	**75**	453	210
		6,048	6,302	4,632
Current assets				
Inventory	10	**2,432**	2,600	2,203
Trade and other receivables	11	**3,948**	3,929	2,585
Taxation recoverable		**12**	9	7
Other financial assets	15	**80**	24	171
Short-term investments		**2**	1	40
Cash and cash equivalents	12	**2,960**	2,469	1,896
Assets held for sale		**9**	12	7
		9,443	9,044	6,909
Total assets		**15,491**	15,346	11,541
LIABILITIES				
Current liabilities				
Borrowings	13	**(126)**	(23)	(34)
Other financial liabilities	15	**(168)**	(316)	(17)
Trade and other payables	14	**(5,628)**	(5,900)	(4,736)
Current tax liabilities		**(167)**	(184)	(188)
Provisions	16	**(210)**	(181)	(121)
		(6,299)	(6,604)	(5,096)
Non-current liabilities				
Borrowings	13	**(1,787)**	(1,325)	(1,030)
Other financial liabilities	15	**(868)**	(2,525)	(355)
Trade and other payables	14	**(1,145)**	(1,318)	(965)
Non-current tax liabilities		**–**	(1)	–
Deferred tax liabilities	4	**(366)**	(307)	(258)
Provisions	16	**(232)**	(188)	(180)
Post-retirement scheme deficits	17	**(930)**	(1,020)	(824)
		(5,328)	(6,684)	(3,612)
Total liabilities		**(11,627)**	(13,288)	(8,708)
Net assets		**3,864**	2,058	2,833
EQUITY				
Capital and reserves				
Called-up share capital	18	**326**	326	326
Share premium account		**631**	631	631
Hedging reserves		**(19)**	(22)	77
Translation reserve		**503**	660	59
Retained earnings		**2,423**	454	1,728
Equity attributable to equity holders of the parent		**3,864**	2,049	2,821
Minority interests		**–**	9	12
Total equity		**3,864**	2,058	2,833

* 2008 figures have been restated to reflect the adoption of IFRIC 14 with effect from January 1, 2008 (see note 17) and the adoption of Amendments to IAS 1 *Presentation of Financial Statements* relating to the classification of derivative financial instruments as current or non-current (see note 15).

The financial statements on pages 56 to 105 were approved by the Board on February 10, 2010 and signed on its behalf by:

Simon Robertson Chairman

Andrew Shilston Finance Director

Consolidated cash flow statement

For the year ended December 31, 2009

	Notes	2009 £m	2008 £m
Reconciliation of cash flows from operating activities			
Profit/(loss) before taxation		**2,957**	(1,889)
Share of profit of joint ventures and associates	9	**(93)**	(74)
Loss/(profit) on sale or termination of businesses	23	**2**	(7)
Profit on sale of property, plant and equipment		**(40)**	(11)
Net financing	3	**(1,785)**	2,751
Taxation paid		**(119)**	(117)
Amortisation of intangible assets	7	**121**	107
Depreciation and impairment of property, plant and equipment	8	**194**	208
Increase in provisions		**81**	39
Decrease/(increase) in inventories		**119**	(208)
Increase in trade and other receivables		**(85)**	(1,072)
(Decrease)/increase in trade and other payables		**(364)**	1,051
(Increase)/decrease in other financial assets and liabilities		**(303)**	144
Additional cash funding of post-retirement schemes		**(159)**	(117)
Share-based payments charge	19	**31**	40
Transfers of hedge reserves to income statement	15	**(27)**	(80)
Dividends received from joint ventures and associates	9	**77**	59
Net cash inflow from operating activities		**607**	824
Cash flows from investing activities			
Additions of unlisted investments		**(2)**	(1)
Disposals of unlisted investments		**–**	6
Additions of intangible assets		**(339)**	(389)
Disposals of intangible assets		**2**	–
Purchases of property, plant and equipment		**(258)**	(286)
Disposals of property, plant and equipment		**82**	68
Acquisitions of businesses	23	**(7)**	(47)
Disposals of businesses	23	**3**	6
Investments in joint ventures and associates		**(87)**	(32)
Disposals of joint ventures and associates		**–**	30
Additions to parent company shares		**–**	(41)
Net cash outflow from investing activities		**(606)**	(686)
Cash flows from financing activities			
Current borrowings – repayment of loans		**(10)**	(1)
Non-current borrowings – repayment of loans		**–**	(22)
– increase in loans		**693**	–
Capital element of finance lease payments		**(3)**	(4)
Net cash inflow/(outflow) from increase/(decrease) in borrowings		**680**	(27)
Interest received		**24**	52
Interest paid		**(66)**	(53)
Interest element of finance lease payments		**(1)**	(1)
(Increase)/decrease in government securities and corporate bonds		**(1)**	39
Net cash inflow from financing activities		**636**	10
Increase in cash and cash equivalents		**637**	148
Cash and cash equivalents at January 1		**2,460**	1,871
Foreign exchange		**(141)**	441
Cash and cash equivalents at December 31		**2,956**	2,460

Directors' report
Financial statements

Consolidated cash flow statement (continued)

For the year ended December 31, 2009

	2009 £m	2008 £m
Reconciliation of movements in cash and cash equivalents to movements in net funds		
Increase in cash and cash equivalents	637	148
Net cash (inflow)/outflow from (increase)/decrease in borrowings	(680)	27
Cash outflow/(inflow) from increase/(decrease) in government securities and corporate bonds	1	(39)
Change in net funds resulting from cash flows	(42)	136
Net funds (excluding cash and cash equivalents) of businesses acquired	–	(6)
Exchange adjustments	(141)	439
Fair value adjustments	110	(319)
Movement in net funds	(73)	250
Net funds at January 1 excluding the fair value of swaps	1,122	872
Net funds at December 31 excluding the fair value of swaps	1,049	1,122
Fair value of swaps hedging fixed rate borrowings	224	334
Net funds at December 31	1,273	1,456

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

	At January 1, 2009 £m	Funds flow £m	Exchange adjustments £m	Fair value adjustments £m	Reclassifi-cations £m	At December 31, 2009 £m
Cash at bank and in hand	938	358	(58)	–	–	1,238
Overdrafts	(9)	5	–	–	–	(4)
Short-term deposits	1,531	274	(83)	–	–	1,722
Cash and cash equivalents	2,460	637	(141)	–	–	2,956
Investments	1	1	–	–	–	2
Other current borrowings	(11)	10	–	–	(121)	(122)
Non-current borrowings	(1,324)	(693)	–	110	121	(1,786)
Finance leases	(4)	3	–	–	–	(1)
	1,122	(42)	(141)	110	–	1,049
Fair value of swaps hedging fixed rate borrowings	334			(110)		224
	1,456	(42)	(141)	–	–	1,273

Consolidated statement of changes in equity

For the year ended December 31, 2009

		Attributable to equity holders of the parent							
	Notes	Share capital £m	Share premium £m	Hedging reserves[1] £m	Translation reserves £m	Retained earnings £m	Total £m	Minority interests £m	Total equity £m
At January 1, 2008		326	631	77	59	2,081	3,174	12	3,186
Adoption of IFRIC 14 (note 17)		–	–	–	–	(353)	(353)	–	(353)
At January 1, 2008 restated		**326**	**631**	**77**	**59**	**1,728**	**2,821**	**12**	**2,833**
Loss for the year		–	–	–	–	(1,337)	(1,337)	(5)	(1,342)
Foreign exchange translation differences on foreign operations		–	–	–	601	–	601	2	603
Net actuarial gains		–	–	–	–	944	944	–	944
Movement in unrecognised post-retirement surplus		–	–	–	–	(928)	(928)	–	(928)
Movement in post-retirement minimum funding liability		–	–	–	–	66	66	–	66
Transfers from transition hedging reserve		–	–	(80)	–	–	(80)	–	(80)
Transfers to cash flow hedging reserve		–	–	(41)	–	–	(41)	–	(41)
Movement in fair value of available for sale assets		–	–	–	–	(8)	(8)	–	(8)
Related tax movements – deferred tax		–	–	22	–	(26)	(4)	–	(4)
Total comprehensive income for the year		**–**	**–**	**(99)**	**601**	**(1,289)**	**(787)**	**(3)**	**(790)**
Share-based payments adjustment[2]		–	–	–	–	26	26	–	26
Related tax movements – deferred tax	4	–	–	–	–	(11)	(11)	–	(11)
Other changes in equity in the year		**–**	**–**	**–**	**–**	**15**	**15**	**–**	**15**
At January 1, 2009		**326**	**631**	**(22)**	**660**	**454**	**2,049**	**9**	**2,058**
Profit for the year		–	–	–	–	2,221	2,221	(4)	2,217
Foreign exchange translation differences on foreign operations		–	–	–	(157)	–	(157)	(1)	(158)
Net actuarial losses		–	–	–	–	(1,148)	(1,148)	–	(1,148)
Movement in unrecognised post-retirement surplus		–	–	–	–	707	707	–	707
Movement in post-retirement minimum funding liability		–	–	–	–	40	40	–	40
Transfers from transition hedging reserve		–	–	(27)	–	–	(27)	–	(27)
Transfers to cash flow hedging reserve		–	–	22	–	–	22	–	22
Related tax movements – deferred tax		–	–	8	–	133	141	–	141
Total comprehensive income for the year		**–**	**–**	**3**	**(157)**	**1,953**	**1,799**	**(5)**	**1,794**
Share-based payments adjustment[2]		–	–	–	–	15	15	–	15
Transactions with minority interests		–	–	–	–	–	–	(4)	(4)
Related tax movements – deferred tax	4	–	–	–	–	1	1	–	1
Other changes in equity in the year		**–**	**–**	**–**	**–**	**16**	**16**	**(4)**	**12**
At December 31, 2009		**326**	**631**	**(19)**	**503**	**2,423**	**3,864**	**–**	**3,864**

[1] See accounting policies note 1 – hedge accounting. Hedging reserves include £nil (2008 £19m) in respect of the transition hedging reserve and £(19)m (2008 £(41)m) in respect of the cash flow hedging reserve.

[2] The share-based payment adjustment is the net of the credit to equity in respect of the share-based payment charge to the income statement and the actual cost to the Group.

Notes to the consolidated financial statements

1 Significant accounting policies

The Company

Rolls-Royce plc (the 'Company') is a company domiciled in the United Kingdom. The consolidated financial statements of the Company for the year ended December 31, 2009 comprise the Company and its subsidiaries (together referred to as the 'Group') and the Group's interest in jointly controlled and associated entities. The financial statements were authorised for issue by the directors on February 10, 2010.

Basis of preparation and statement of compliance

In accordance with European Union (EU) regulations, these financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB), as adopted for use in the EU effective at December 31, 2009 (Adopted IFRS). The Company has elected to prepare its parent company accounts under UK Generally Accepted Accounting Practices (GAAP).

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

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

The preparation of financial statements in conformity with Adopted IFRS requires the use of certain critical accounting estimates and judgements. The directors consider the potential key areas of judgements required to be made in applying the Group's accounting policies to be:

- A large proportion of the Group's activities relate to long-term aftermarket contracts. The determination of appropriate accounting policies for recognising revenue and costs in respect of these contracts requires judgement, in particular (i) whether an aftermarket contract is linked, for accounting purposes, to the related sale of original equipment and (ii) the appropriate measure of stage of completion of the contract.
- Where the Group participates in the financing of original equipment, judgement is required to determine whether revenue should be recognised or whether the transaction results in the consolidation of a special purpose financing entity.
- As set out in note 7, the Group has significant intangible assets. The decision as to when to commence capitalisation of development costs and whether sales of original equipment give rise to recognisable recoverable engine costs is a key judgement.
- As set out in note 21, the Group has contingent liabilities in respect of financing support provided to customers. Judgement is required to assess the likelihood of these crystallising, in order to assess whether a provision should be recognised.

Key sources of estimation uncertainty in applying the Group's accounting policies are described on page 66.

Basis of consolidation

The Group financial statements include the financial statements of the Company and all of its subsidiary undertakings made up to December 31, together with the Group's share of the results of joint ventures and associates up to December 31.

A subsidiary is an entity controlled by the Company. Control exists when the Company has the power, directly or indirectly, to govern the financial and operating policies of the entity so as to derive benefits from its activities.

A joint venture is an entity in which the Group holds a long-term interest and which is jointly controlled by the Group and one or more other venturers under a contractual arrangement. An associate is an entity, being neither a subsidiary nor a joint venture, in which the Group holds a long-term interest and where the Group has a significant influence. The results of joint ventures and associates are accounted for using the equity method of accounting.

Any subsidiary undertakings, joint ventures or associates sold or acquired during the year are included up to, or from, the dates of change of control.

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

1 Significant accounting policies (continued)

Significant accounting policies

Revenue recognition

Revenues comprise sales to outside customers after discounts, excluding value added tax.

Sales of products are recognised when the significant risks and rewards of ownership of the goods are transferred to the customer, the sales price agreed and the receipt of payment can be assured. On occasion, the Group may participate in the financing of engines in conjunction with airframe manufacturers, most commonly by the provision of guarantees as described in note 21. In such circumstances, the contingent obligations arising under these arrangements are taken into account in assessing whether significant risks and rewards of ownership have been transferred to the customer. Where it is judged that sufficient risks and rewards are not transferred, the transaction is treated as a leasing transaction, resulting in an operating lease between the Group and the customer. No deliveries of engines were treated as operating leases during 2009. Depending on the specific circumstances, where applicable, the financing arrangements may result in the consolidation of the entity established to facilitate the financing. Such special purpose entities will be consolidated as required by Adopted IFRS. No such entities were consolidated at December 31, 2009.

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

Linked sales of products and services are treated as a single contract where these components have been negotiated as a single commercial package and are so closely interrelated that they do not operate independently of each other and are considered to form a single project with an overall profit margin. Revenue is recognised on the same basis as for other sales of products and services as described above.

Provided that the outcome of construction contracts can be assessed with reasonable certainty, the revenues and costs on such contracts are recognised based on stage of completion and the overall contract profitability.

Full provision is made for any estimated losses to completion of contracts having regard to the overall substance of the arrangements.

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

Risk and revenue sharing partnerships (RRSPs)

From time to time, the Group enters into arrangements with partners who, in return for a share in future programme revenues or profits, make cash payments that are not refundable (except under certain remote circumstances). Cash sums received, which reimburse the Group for past expenditure, are credited to other operating income. The arrangements also require partners to undertake development work and/or supply components for use in the programme at their own expense. No accounting entries are recorded where partners undertake such development work or where programme components are supplied by partners because no obligation arises unless and until programme sales are made; instead, payments to partners for their share in the programme are charged to cost of sales as programme revenues arise.

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

Government investment

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

Government grants

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

Interest

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

1 Significant accounting policies (continued)

Taxation

The tax charge on the profit or loss for the year comprises current and deferred tax. Current tax is the expected tax payable for the year, using tax rates enacted or substantively enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

Deferred tax is provided using the balance sheet liability method, providing for temporary differences between the carrying amounts of the assets and liabilities for financial reporting purposes and the amounts used for taxation purposes.

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

Deferred tax is calculated using the enacted or substantively enacted rates that are expected to apply when the asset or liability is settled. Deferred tax is charged or credited in the income statement or other comprehensive income (OCI) as appropriate, except when it relates to items credited or charged directly to equity in which case the deferred tax is also dealt with in equity.

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

Foreign currency translation

Transactions in overseas currencies are translated into local currency at the exchange rates ruling on the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated into local currency at the rate ruling at the year-end. Exchange differences arising on foreign exchange transactions and the retranslation of assets and liabilities into sterling at the rate ruling at the year-end are taken into account in determining profit before taxation.

The trading results of overseas undertakings are translated at the average exchange rates for the year. The assets and liabilities of overseas undertakings, including goodwill and fair value adjustments arising on acquisition, are translated at the exchange rates ruling at the year end. Exchange adjustments arising from the retranslation of the opening net investments, and from the translation of the profits or losses at average rates, are taken to OCI.

Financial instruments

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

- Fixed deposits, principally comprising funds held with banks and other financial institutions, and trade receivables are classified as loans and receivables.
- Investments (other than fixed deposits and interests in joint ventures and associates) and short-term deposits (other than fixed deposits) are classified as available for sale.
- Borrowings, trade payables and financial RRSPs are classified as other liabilities.
- Derivatives, comprising foreign exchange contracts, interest rate swaps and commodity swaps, are classified as held for trading.

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

- Loans and receivables and other liabilities are held at amortised cost and not revalued (except for changes in exchange rates which are included in the income statement) unless they are included in a fair value hedge accounting relationship. Where such a relationship exists, the instruments are revalued in respect of the risk being hedged. If instruments held at amortised cost are hedged, generally by interest rate swaps, and the hedges are effective, the carrying values are adjusted for changes in fair value, which are included in the income statement.
- Available for sale assets are held at fair value. Changes in fair value arising from changes in exchange rates are included in the income statement. All other changes in fair value are recognised in OCI. On disposal, the accumulated changes in value recorded in OCI are included in the gain or loss recorded in the income statement.
- Held for trading instruments are held at fair value. Changes in fair value are included in the income statement unless the instrument is included in a cash flow hedge. If the instruments are included in a cash flow hedging relationship, which is effective, changes in value are recognised in OCI. When the hedged forecast transaction occurs, amounts previously recognised in OCI are recognised in the income statement.

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

1 Significant accounting policies (continued)

Hedge accounting

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

The Group does not apply hedge accounting in respect of commodity swaps held to manage the cash flow exposures of forecast transactions in those commodities.

The Group applies hedge accounting in respect of transactions entered into to manage the fair value and cash flow exposures of its borrowings. Forward foreign exchange contracts are held to manage the fair value exposures of borrowings denominated in foreign currencies and are designated as fair value hedges. Interest rate swaps are held to manage the interest rate exposures and are designated as fair value or cash flow hedges of fixed and floating rate borrowings respectively. In 2009 and 2008, cash flow hedging was undertaken only by joint ventures.

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

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

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

The portion of a gain or loss on an instrument used to hedge a net investment in a foreign operation that is determined to be an effective hedge is recognised in OCI. The ineffective portion is recognised immediately in the income statement.

Until December 31, 2004, and as allowed by IFRS 1 *First-time Adoption of International Financial Reporting Standards*, the Group applied hedge accounting for forecast foreign exchange transactions and commodity exposures in accordance with UK GAAP. On January 1, 2005, the fair values of derivatives used for hedging these exposures were included in the transition hedging reserve. This reserve is released to the income statement based on the designation of the hedges on January 1, 2005.

Purchased goodwill

Goodwill represents the excess of the fair value of the purchase consideration for shares in subsidiary undertakings, joint ventures and associates over the fair value to the Group of the net of the identifiable assets acquired and the liabilities assumed.

i) To December 31, 1997: Goodwill was written off to reserves in the year of acquisition.
ii) From January 1, 1998: Goodwill was recognised within intangible assets in the year in which it arose and amortised on a straight line basis over its useful economic life, up to a maximum of 20 years.
iii) From January 1, 2004, in accordance with IFRS 3 *Business Combinations*, goodwill is recognised as per (ii) above but is no longer amortised.

Certification costs and participation fees

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

Research and development

In accordance with IAS 38 *Intangible Assets*, expenditure incurred on research and development, excluding known recoverable amounts on contracts, and contributions to shared engineering programmes, is distinguished as relating either to a research phase or to a development phase.

All research phase expenditure is charged to the income statement. For development expenditure, this is capitalised as an internally generated intangible asset only if it meets strict criteria, relating in particular to technical feasibility and generation of future economic benefits.

Expenditure that cannot be classified into these two categories is treated as being incurred in the research phase. The Group considers that, due to the complex nature of new equipment programmes, it is not possible to distinguish reliably between research and development activities until relatively late in the programme.

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

1 Significant accounting policies (continued)

Recoverable engine costs

On occasion, the Group may sell original equipment to customers at a price below its cost, on the basis that this deficit will be recovered from future aftermarket sales to the original customer. Where the Group has a contractual right to supply aftermarket parts to the customer and its intellectual rights, warranty arrangements and statutory airworthiness requirements provide reasonable control over this supply, these arrangements are considered to meet the definition of an intangible asset. Such intangible assets are recognised to the extent of the deficit and amortised on a straight-line basis over the expected period of utilisation by the original customer.

Software

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

Property, plant and equipment

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

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

i) Land and buildings, as advised by the Group's professional advisors:
   a) Freehold buildings – five to 45 years (average 23 years).
   b) Leasehold buildings – lower of advisor's estimates or period of lease.
   c) No depreciation is provided on freehold land.
ii) Plant and equipment – five to 25 years (average 14 years).
iii) Aircraft and engines – five to 20 years (average 16 years).

Leases

i) As lessee
   Assets financed by leasing agreements that give rights approximating to ownership (finance leases) are capitalised at their fair value and depreciation is provided on the basis of the Group depreciation policy. The capital elements of future obligations under finance leases are included as liabilities in the balance sheet and the current year's interest element, having been allocated to accounting periods to give a constant periodic rate of charge on the outstanding liability, is charged to the income statement. The annual payments under all other lease arrangements, known as operating leases, are charged to the income statement on a straight-line basis.
ii) As lessor
   Amounts receivable under finance leases are included within receivables and represent the total amount outstanding under the lease agreements, less unearned income. Finance lease income, having been allocated to accounting periods to give a constant periodic rate of return on the net investment, is included in revenue. Rentals receivable under operating leases are included in revenue on a straight-line basis.

Impairment of non-current assets

Impairment of non-current assets is considered in accordance with IAS 36 *Impairment of Assets*. Where the asset does not generate cash flows that are independent of other assets, impairment is considered for the cash-generating unit to which the asset belongs.

Goodwill and intangible assets not yet available for use are tested for impairment annually. Other non-current assets are assessed for any indications of impairment annually. If any indication of impairment is identified, an impairment test is performed to estimate the recoverable amount.

Recoverable amount is the higher of value in use or fair value less costs to sell if this is readily available. The value in use is the present value of future cash flows using a pre-tax discount rate that reflects the time value of money and the risk specific to the asset.

If the recoverable amount of an asset (or cash-generating unit) is estimated to be below the carrying value, the carrying value is reduced to the recoverable amount and the impairment loss recognised as an expense.

Inventory

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

1 Significant accounting policies (continued)

Cash and cash equivalents

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

Provisions

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

Post-retirement benefits

Pensions and similar benefits (principally healthcare) are accounted for under IAS 19 *Employee Benefits*. For defined benefit plans, obligations are measured at discounted present value whilst plan assets are recorded at fair value. The service and financing costs of such plans are recognised separately in the income statement; current service costs are spread systematically over the lives of employees and financing costs are recognised in the periods in which they arise. Actuarial gains and losses are recognised immediately in OCI.

Surpluses in schemes are recognised as assets only if they represent economic benefits available to the Group in the future. A liability is recognised to the extent that the minimum funding requirements in respect of past service will give rise to an unrecognisable surplus. Movements in unrecognised surpluses and minimum funding liabilities are recognised in OCI.

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

Share-based payments

The Group on behalf of its parent company, provides share-based payment arrangements to certain employees. These are principally equity-settled arrangements and are measured at fair value (excluding the effect of non-market based vesting conditions) at the date of grant. The fair value is expensed on a straight-line basis over the vesting period. The amount recognised as an expense is adjusted to reflect the actual number of shares or options that will vest, except where additional shares vest as a result of the TSR performance condition in the Performance Share Plan. The costs of these share-based payments are treated as a capital contribution from the parent company. Any payments made by the Group to its parent company in respect of these arrangements are treated as a return of this capital contribution.

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

The fair values of the share-based payment arrangements are measured as follows:

i) ShareSave plans – using the binomial pricing model;
ii) Performance Share Plan – using a pricing model adjusted to reflect non-entitlement to dividends (or equivalent) and the TSR market-based performance condition;
iii) Annual Performance Related Award plan deferred shares and free shares under the Share Incentive Plan – share price on the date of the award.

See note 19 for a further description of the share-based payment plans.

Contingent liabilities

In connection with the sale of its products, the Group will, on occasion, provide financing support for its customers. These arrangements fall into two categories; credit-based guarantees and asset value guarantees. In accordance with the requirements of IAS 39 *Financial Instruments: Recognition and Measurement* and IFRS 4 *Insurance Contracts*, credit-based guarantees are treated as insurance contracts. The Group considers asset value guarantees to be non-financial liabilities and accordingly these are also treated as insurance contracts. Provision is made as described above.

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

Key sources of estimation uncertainty

In applying the above accounting policies, management has made appropriate estimates in many areas, and the actual outcome may differ from those calculated. The key sources of estimation uncertainty at the balance sheet date, that have a significant risk of causing material adjustment to the carrying amounts of assets and liabilities within the next financial year are set out on page 103. The estimation of the relevant assets and liabilities involves the combination of a number of assumptions. Where appropriate and practicable, sensitivities are disclosed in the relevant notes.

1 Significant accounting policies (continued)

Current economic environment
The current economic environment could impact a number of estimates necessary to prepare the financial statements, in particular, the recoverable amount of assets and contingent liabilities. The Group has taken these factors into account in assessing the estimates set out below. These matters are discussed in more detail in the Finance Director's review.

Forecasts and discount rates
The carrying value of a number of items on the balance sheet are dependent on the estimates of future cash flows arising from the Group's operations:

- The assessment whether there are any indications of impairment of development, participation, certification and recoverable engine costs recognised as intangible assets are dependent on forecasts of cash flows generated by the relevant assets. (Carrying values at December 31, 2009 £1,290m; December 31, 2008 £1,072m.)
- The financial liabilities arising from financial risk and revenue sharing partnerships are valued at each reporting date using the amortised cost method. (Carrying values at December 31, 2009 £363m; December 31, 2008 £455m.) This involves calculating the present value of the forecast cash flows of the arrangement using the internal rate of return at the inception of the arrangement as the discount rate.
- The realisation of the deferred tax assets (carrying value at December 31, 2009 £360m; December 31, 2008 £804m restated) recognised is dependent on the generation of sufficient future taxable profits. The Group recognises deferred tax assets where it is more likely than not that the benefit will be realised.

Assessment of long-term contractual arrangements
The Group has long-term contracts that fall into different accounting periods. In assessing the allocation of revenues and costs to individual accounting periods, and the consequential assets and liabilities, the Group estimates the total revenues and costs forecast to arise in respect of the contract and the stage of completion based on an appropriate measure of performance as described under revenue recognition above.

Post-retirement benefits
The Group's defined benefit pension schemes and similar arrangements are assessed annually in accordance with IAS 19. The accounting valuation, which was based on assumptions determined with independent actuarial advice, resulted in a net deficit of £855m before deferred taxation being recognised on the balance sheet at December 31, 2009 (December 31, 2008 £567m restated). The size of the net deficit is sensitive to the market value of the assets held by the schemes and to actuarial assumptions, which include price inflation, pension and salary increases, the discount rate used in assessing actuarial liabilities, mortality and other demographic assumptions and the levels of contributions. Further details are included in note 17.

Provisions
As described in the accounting policy above, the Group measures provisions (carrying value at December 31, 2009 £442m; December 31, 2008 £369m) at the directors' best estimate of the expenditure required to settle the obligation at the balance sheet date. These estimates take account of information available and different possible outcomes.

Taxation
The tax payable on profits is determined based on tax laws and regulations that apply in each of the numerous jurisdictions in which the Group operates. Where the precise impact of these laws and regulations is unclear then reasonable estimates may be used to determine the tax charge included in the financial statements. If the tax eventually payable or reclaimable differs from the amounts originally estimated then the difference will be charged or credited in the financial statements for the year in which it is determined.

Revisions to Adopted IFRS in 2009
The following revisions have been adopted in the Group's financial statements in 2009:

- Amendments to IAS 1 *Presentation of Financial Statements* – these amendments revise requirements for the presentation of the financial statements and do not affect the Group's overall reported results.
- Improvements to IFRSs (2008) – the amendments to IAS 1 clarify the classification of derivative financial instruments as current or non-current. Previously the Group has classified all derivative financial instruments within the IAS 39 category 'held for trading' as current. As a result of these amendments, they have now been classified according to their maturity dates. The impact is shown in note 15.
- Amendments to IFRS 2 *Share-based Payments: Vesting Conditions and Cancellations* – these amendments concern certain aspects of the valuation of share-based payments and the impact of a cancellation by a grantee. These amendments have not had a significant impact on the charges recognised to date for share-based payments.
- Amendments to IFRS 7 *Financial Instruments: Disclosure* – these amendments require additional disclosure of the basis of fair value measurements and liquidity risks. Note 15 reflects these additional disclosure requirements.
- IFRS 8 *Operating Segments* – this standard amends the requirements for disclosure of segmental performance and does not have any effect on the Group's overall reported results. Note 2 reflects the new requirements.

1 Significant accounting policies (continued)

- Amendment to IAS 23 *Borrowing Costs* – the amendment generally eliminates the option to expense borrowing costs attributable to the acquisition, construction or production of a qualifying asset as incurred, and instead requires the capitalisation of eligible borrowing costs as part of the cost of the specific asset. There is no significant impact, as the Group generally funds qualifying assets from gross cash resources and consequently does not have significant eligible borrowing costs.
- IFRIC 12 *Service Concession Arrangements* – this interpretation is applicable to the Group's investments in the joint ventures operating the Future Strategic Tanker Aircraft contract with the UK Ministry of Defence. This contract commenced in 2008 and the adoption of IFRIC 12 does not have any material transitional impact.
- IFRIC 14 *IAS 19 The Limit of a Defined Benefit Asset, Minimum Funding Requirements and their Interaction* – this interpretation applies where regulatory funding requirements will result in an unrecognisable surplus arising in the future. It has been adopted with effect from January 1, 2008. The impact of the adoption of this interpretation is set out in note 17.

Revisions to IFRS not applicable in 2009

Standards and interpretations issued by the IASB are only applicable if endorsed by the EU. The following revisions to IFRS will be applicable in future periods, subject to endorsement where applicable:

- Revised IFRS 3 *Business Combinations* and amendments to IAS 27 *Consolidated and Separate Financial Statements* are applicable for 2010. These standards will affect the future accounting for acquisitions and transactions with non-controlling interests. There will be no retrospective impact.
- IFRIC 18 *Transfers of Assets from Customers* is applicable for 2010. This interpretation confirms the Group's existing policies for the recognition of assets received from customers and will not have a significant impact.
- Amendments to IFRS 2 *Group Cash-settled Share-based Payment Transactions* are applicable from 2010. If endorsed, these amendments will apply to the International ShareSave Scheme, but the impact is not anticipated to be significant.
- IFRS 9 *Financial Instruments* is applicable from 2013. If endorsed, this standard will simplify the classification of financial assets for measurement purposes, but is not anticipated to have a significant impact on the financial statements.

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

2 Segmental analysis

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

Civil aerospace – development, manufacture, marketing and sales of commercial aero engines and aftermarket services.
Defence aerospace – development, manufacture, marketing and sales of military aero engines and aftermarket services.
Marine – development, manufacture, marketing and sales of marine propulsion systems and aftermarket services.
Energy – development, manufacture, marketing and sales of power systems for the oil and gas industry and electrical power generation and aftermarket services.

Engineering and Technology, Operations and Services discussed in the business review, operate on a Group-wide basis across all the above segments.

The operating results are prepared on an underlying basis that excludes items considered to be non-underlying in nature. The principles adopted are:

Underlying revenues – Where revenues are denominated in a currency other than the functional currency of the Group undertaking, these exclude the release of the foreign exchange transition hedging reserve and reflect the achieved exchange rates arising on settled derivative contracts. There is no inter-segment trading and hence all revenues are from external customers.

Underlying profit before financing – Where transactions are denominated in a currency other than the functional currency of the Group undertaking, this excludes the release of the foreign exchange transition hedging reserve and reflects the transactions at the achieved exchange rates on settled derivative contracts.

2 Segmental analysis (continued)

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

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

This analysis also includes a reconciliation of the underlying results to those reported in the consolidated income statement. The analysis for 2008 has been restated on a consistent basis.

Year ended December 31, 2009	**Civil aerospace £m**	**Defence aerospace £m**	**Marine £m**	**Energy £m**	**Total reportable segments £m**
Underlying revenue from sale of original equipment	**1,855**	**964**	**1,804**	**558**	**5,181**
Underlying revenue from services	**2,626**	**1,046**	**785**	**470**	**4,927**
Total underlying revenue	**4,481**	**2,010**	**2,589**	**1,028**	**10,108**
Underlying operating profit excluding share of profit of joint ventures and associates	**409**	**247**	**263**	**23**	**942**
Share of profit of joint ventures and associates	**82**	**6**	**–**	**5**	**93**
Profit/(loss) on sale of businesses	**2**	**–**	**–**	**(4)**	**(2)**
Underlying profit before financing and taxation	**493**	**253**	**263**	**24**	**1,033**
Segment assets	**7,369**	**1,181**	**2,321**	**1,007**	**11,878**
Investments in joint ventures and associates	**271**	**62**	**77**	**27**	**437**
Segment liabilities	**(4,907)**	**(1,572)**	**(1,737)**	**(492)**	**(8,708)**
Net assets/(liabilities)	**2,733**	**(329)**	**661**	**542**	**3,607**
Investment in intangible assets, property, plant and equipment, joint ventures and associates	**522**	**56**	**122**	**20**	**720**
Depreciation and amortisation	**209**	**34**	**46**	**26**	**315**
Year ended December 31, 2008					
Underlying revenue from sale of original equipment	1,776	739	1,492	385	4,392
Underlying revenue from services	2,726	947	712	370	4,755
Total underlying revenue	4,502	1,686	2,204	755	9,147
Underlying operating profit excluding share of profit of joint ventures	503	215	185	(10)	893
Share of profit of joint ventures	55	8	(2)	9	70
Profit/(loss) on sale of businesses	8	–	–	(1)	7
Underlying profit/(loss) before financing and taxation	566	223	183	(2)	970
Segment assets	7,223	1,044	2,334	807	11,408
Investments in joint ventures	320	(7)	5	27	345
Segment liabilities	(7,297)	(1,265)	(1,886)	(457)	(10,905)
Net assets/(liabilities)	246	(228)	453	377	848
Investment in intangible assets, property, plant and equipment and joint ventures	520	84	68	35	707
Depreciation and amortisation	212	42	32	29	315

2 Segmental analysis (continued)

Reconciliation to reported results

Year ended December 31, 2009	Total reportable segments £m	Underlying central items £m	Total underlying £m	Underlying adjustments £m	Group £m
Revenue from sale of original equipment	5,181	–	5,181	128	5,309
Revenue from services	4,927	–	4,927	178	5,105
Total revenue	10,108	–	10,108	306	10,414
Operating profit excluding share of profit of joint ventures and associates	942	(50)[1]	892	189	1,081
Share of profit of joint ventures and associates	93	–	93	–	93
Loss on sale of businesses	(2)	–	(2)	–	(2)
Profit before financing and taxation	1,033	(50)	983	189	1,172
Net financing		(68)	(68)	1,853	1,785
Profit before taxation		(118)	915	2,042	2,957
Taxation		(187)	(187)	(553)	(740)
Profit/(loss) for the year		(305)	728	1,489	2,217
Year ended December 31, 2008					
Revenue from sale of original equipment	4,392	–	4,392	(15)	4,377
Revenue from services	4,755	–	4,755	(50)	4,705
Total revenue	9,147	–	9,147	(65)	9,082
Operating profit excluding share of profit of joint ventures	893	(51)[1]	842	(61)	781
Share of profit of joint ventures	70	–	70	4	74
Profit on sale of businesses	7	–	7	–	7
Profit before financing and taxation	970	(51)	919	(57)	862
Net financing		(36)	(36)	(2,715)	(2,751)
Profit/(loss) before taxation		(87)	883	(2,772)	(1,889)
Taxation		(217)	(217)	764	547
Profit/(loss) for the year		(304)	666	(2,008)	(1,342)

[1] Central corporate costs

Underlying adjustments

	2009				2008			
	Revenue £m	Profit before financing £m	Net financing £m	Taxation £m	Revenue £m	Profit before financing £m	Net financing £m	Taxation £m
Underlying performance	10,108	983	(68)	(187)	9,147	919	(36)	(217)
Release of transition hedging reserve	27	27	–	–	80	80	–	–
Recognise revenue at exchange rate on date of transaction	279	–	–	–	(145)	–	–	–
Realised losses/(gains) on settled derivative contracts[1]	–	274	60	–	–	(185)	(107)	–
Net unrealised fair value changes to derivative contracts[2]	–	14	1,835	–	–	4	(2,479)	–
Effect of currency on contract accounting	–	(126)	–	–	–	44	–	–
Revaluation of trading assets and liabilities	–	–	(17)	–	–	–	14	–
Financial RRSPs – foreign exchange differences and changes in forecast payments	–	–	72	–	–	–	(121)	–
Net post-retirement scheme financing	–	–	(97)	–	–	–	(22)	–
Related tax effect	–	–	–	(553)	–	–	–	764
Total underlying adjustments	306	189	1,853	(553)	(65)	(57)	(2,715)	764
Reported per consolidated income statement	10,414	1,172	1,785	(740)	9,082	862	(2,751)	547

[1] Realised (gains)/losses on settled derivative contracts included in profit before tax:
– includes £15m of realised losses (2008 £nil) deferred from prior years;
– excludes £6m of gains (2008 losses of £24m) realised in the year on derivative contracts settled in respect of trading cash flows that occurred after the year-end;
– excludes £14m of losses (2008 £nil) realised in respect of derivatives held in net investment hedges.

[2] The adjustment for unrealised fair value changes included in profit before financing includes the reversal of £5m of unrealised gains (2008 £4m) in respect of derivative contracts held by joint ventures and £9m (2008 £nil) of unrealised losses for which the related trading contracts have been cancelled and consequently the fair value loss has been recognised immediately in underlying profit.

2 Segmental analysis (continued)

	2009 £m	December 31, 2008 £m	Restated* January 1, 2008 £m
Reportable segment assets	**11,878**	11,408	9,391
Investments in joint ventures and associates	**437**	345	284
Eliminations	**(457)**	(477)	(461)
Cash and cash equivalents and short-term investments	**2,962**	2,470	1,936
Fair value of swaps hedging fixed rate borrowings	**224**	334	42
Income tax assets	**372**	813	139
Post-retirement scheme surpluses	**75**	453	210
Total assets	**15,491**	15,346	11,541
Reportable segment liabilities	**(8,708)**	(10,905)	(6,808)
Eliminations	**457**	477	461
Borrowings	**(1,913)**	(1,348)	(1,064)
Fair value of swaps hedging fixed rate borrowings	**–**	–	(27)
Income tax liabilities	**(533)**	(492)	(446)
Post-retirement scheme deficits	**(930)**	(1,020)	(824)
Total liabilities	**(11,627)**	(13,288)	(8,708)
Net assets	**3,864**	2,058	2,833

* See note 17

Geographical segments

The Group's revenue by destination is shown below:

	2009 £m	2008 £m
United Kingdom	**1,458**	1,462
Rest of Europe	**2,273**	1,890
USA	**2,895**	2,214
Canada	**275**	299
Asia	**2,856**	2,439
Africa	**144**	143
Australasia	**230**	255
Other	**283**	380
	10,414	9,082

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

	2009 £m	2008 £m
United Kingdom	**2,764**	2,586
North America	**467**	463
Nordic countries	**824**	745
Germany	**574**	539
Other	**289**	293
	4,918	4,626

3 Net financing

	Note	2009 Per consolidated income statement £m	2009 *Underlying financing[1] £m*	2008 Per consolidated income statement £m	2008 *Underlying financing[1] £m*
Financing income					
Interest receivable		**21**	***21***	59	*59*
Fair value gains on foreign currency contracts[2]	15	**1,783**	–	–	–
Financial RRSPs – foreign exchange differences and changes in forecast payments	15	**72**	–	–	–
Fair value gains on commodity derivatives[2]	15	**52**	–	–	–
Expected return on post-retirement scheme assets	17	**305**	–	373	–
Fair value adjustments relating to parent company shares held under trust		–	–	3	*3*
Net foreign exchange gains		**43**	–	–	–
Other financing income		–	–	–	–
		2,276	***21***	435	*62*
Financing costs					
Interest payable		**(64)**	***(64)***	(69)	*(69)*
Fair value losses on foreign currency contracts[2]	15	–	–	(2,383)	–
Financial RRSPs – foreign exchange differences and changes in forecast payments	15	–	–	(121)	–
Financial charge relating to financial RRSPs	15	**(25)**	***(25)***	(26)	*(26)*
Fair value losses on commodity derivatives[2]	15	–	–	(96)	–
Interest on post-retirement scheme liabilities	17	**(402)**	–	(395)	–
Net foreign exchange losses		–	–	(91)	–
Other financing charges		–	–	(5)	*(3)*
		(491)	***(89)***	(3,186)	*(98)*
Net financing		**1,785**	***(68)***	(2,751)	*(36)*
Analysed as:					
Net interest payable		**(43)**	***(43)***	(10)	*(10)*
Net post-retirement scheme financing		**(97)**	–	(22)	–
Net other financing		**1,925**	***(25)***	(2,719)	*(26)*
Net financing		**1,785**	***(68)***	(2,751)	*(36)*
[1] See note 2					
[2] Net gain/(loss) on items held for trading		**1,835**	–	(2,479)	–

4 Taxation

	UK 2009 £m	UK 2008 £m	Overseas 2009 £m	Overseas 2008 £m	Total 2009 £m	Total 2008 £m
Current tax						
Current tax charge for the year	**26**	7	**129**	88	**155**	95
Less double tax relief	**(29)**	(7)	–	–	**(29)**	(7)
	(3)	–	**129**	88	**126**	88
Adjustments in respect of prior years	**(4)**	(9)	**(23)**	14	**(27)**	5
	(7)	(9)	**106**	102	**99**	93
Deferred tax						
Deferred tax charge/(credit) for the year	**628**	(574)	**21**	(50)	**649**	(624)
Adjustments in respect of prior years	**(12)**	2	**4**	(18)	**(8)**	(16)
	616	(572)	**25**	(68)	**641**	(640)
Recognised in the income statement	**609**	(581)	**131**	34	**740**	(547)

4 Taxation (continued)

Other tax (charges)/credits

	OCI		Equity	
		Restated*		
	2009 £m	2008 £m	**2009 £m**	2008 £m
Deferred tax				
net actuarial losses/(gains)	**342**	(267)	**–**	–
movement in unrecognised surplus on post-retirement schemes	**(198)**	260	**–**	–
movement in minimum funding liability	**(11)**	(19)	**–**	–
release of hedge reserve	**8**	22	**–**	–
share-based payment plans	**–**	–	**1**	(11)
Total in respect of the year	**141**	(4)	**1**	(11)

* See note 17

Tax reconciliation

	2009 £m	2008 £m
Profit/(loss) before taxation	**2,957**	(1,889)
Less share of profits of joint ventures and associates (note 9)	**(93)**	(74)
Profit/(loss) before taxation excluding joint ventures and associates	**2,864**	(1,963)
Nominal tax charge/(credit) at UK corporation tax rate 28.0% (2008 28.5%)	**802**	(559)
UK R&D credit	**(26)**	(25)
Rate differences	**7**	16
Other permanent differences	**5**	14
Benefit to deferred tax from previously unrecognised tax losses and temporary differences	**(21)**	(3)
Tax losses in year not recognised in deferred tax	**8**	21
Adjustments in respect of prior years	**(35)**	(11)
	740	(547)
Analysis of taxation charge:		
Underlying items (note 2)	**187**	217
Non-underlying items	**553**	(764)
	740	(547)

Deferred taxation assets and liabilities

	2009 £m	Restated* 2008 £m
At January 1	**497**	(126)
Amount (charged)/credited to income statement	**(641)**	640
Amount credited/(charged) to other comprehensive income	**141**	(4)
Amount credited/(charged) to equity	**1**	(11)
On acquisition of business	**–**	(5)
Exchange movements	**(4)**	3
At December 31	**(6)**	497

Analysed as:	**2009 £m**	December 31, 2008 £m	Restated* January 1, 2008 £m
Deferred tax assets	**360**	804	132
Deferred tax liabilities	**(366)**	(307)	(258)
	(6)	497	(126)

* See note 17

4 Taxation (continued)

The analysis of the deferred tax position is as follows:

	At January 1, 2009 £m	Recognised in income statement £m	Recognised in OCI £m	Recognised in equity £m	On acquisition £m	Exchange movements £m	At December 31, 2009 £m
Intangible assets	(200)	(53)	–	–	–	3	(250)
Property, plant and equipment	(146)	(17)	–	–	–	3	(160)
Other temporary differences	(31)	2	–	(2)	–	9	(22)
Amounts recoverable on contracts	(195)	(48)	–	–	–	–	(243)
Pensions and other post-retirement scheme benefits	168	(17)	133	–	–	(19)	265
Foreign exchange and commodity financial assets and liabilities	655	(609)	8	–	–	–	54
Losses	182	101	–	3	–	–	286
Advance corporation tax	64	–	–	–	–	–	64
	497	(641)	141	1	–	(4)	(6)

	At December 31, 2007 as previously reported £m	Adoption of IFRIC 14, recognised in OCI £m	At January 1, 2008 restated £m	Recognised in income statement £m	Recognised in OCI £m	Recognised in equity £m	On acquisition £m	Exchange movements £m	At December 31, 2008 restated £m
Intangible assets	(140)	–	(140)	(50)	–	–	(4)	(6)	(200)
Property, plant and equipment	(143)	–	(143)	3	–	–	–	(6)	(146)
Other temporary differences	62	–	62	(40)	–	(20)	–	(33)	(31)
Amounts recoverable on contracts	(145)	–	(145)	(50)	–	–	–	–	(195)
Pensions and other post-retirement scheme benefits	35	138	173	(26)	(26)	–	(1)	48	168
Foreign exchange and commodity financial assets and liabilities	(121)	–	(121)	754	22	–	–	–	655
Losses	124	–	124	49	–	9	–	–	182
Advance corporation tax	64	–	64	–	–	–	–	–	64
	(264)	138	(126)	640	(4)	(11)	(5)	3	497

	2009 £m	2008 £m
Advance corporation tax	118	118
Losses and other unrecognised deferred tax assets	59	67
Deferred tax not recognised on unused tax losses and other items on the basis that future economic benefit is uncertain	177	185

Unprovided temporary differences relating to investments in subsidiaries and joint ventures are now £nil (2008 £946m). This is as a result of a recent change in UK legislation, intended to exempt the great majority of overseas dividends from UK tax. The 2008 comparative reflected undistributed profits of the relevant entities which, if paid up by way of dividend, would have given rise to taxable income in the UK. No deferred tax was provided in respect of the resultant temporary differences because the timing of any reversals (by way of dividend flow) could be controlled and it was considered unlikely that dividends would be paid if they resulted in additional UK taxable income.

5 Employee information

	2009 Number	2008 Number
Average monthly number of Group employees during the year		
United Kingdom	**21,300**	22,500
Overseas	**17,200**	16,500
	38,500	39,000
Civil aerospace	**21,800**	22,700
Defence aerospace	**5,600**	5,700
Marine	**8,600**	8,100
Energy	**2,500**	2,500
	38,500	39,000

	£m	£m
Group employment costs[1]		
Wages and salaries	**1,725**	1,649
Social security costs	**194**	180
Share-based payments (note 19)	**31**	40
Pensions and other post-retirement scheme benefits (note 17)	**263**	218
	2,213	2,087

[1] Remuneration of key management personnel is shown in note 22.

6 Auditors' remuneration

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

	2009 £m	2008 £m
Fees payable to the Company's auditors for the audit of the Company's annual financial statements	**1.6**	1.6
Fees payable to the Company's auditors and its associates for the audit of the Company's subsidiaries pursuant to legislation	**2.5**	2.0
Total fees payable for audit services	**4.1**	3.6
Fees payable to the Company's auditors and its associates for other services:		
Other services pursuant to legislation	**0.3**	0.2
Other services relating to taxation	**0.4**	0.4
	4.8	4.2
Fees payable in respect of the Group's pension schemes:		
Audit	**0.2**	0.2
Other services relating to taxation	**0.1**	–

7 Intangible assets

	Goodwill £m	Certification costs and participation fees £m	Development expenditure £m	Recoverable engine costs £m	Software and other £m	Total £m
Cost:						
At January 1, 2008	801	504	514	366	109	2,294
Exchange adjustments	173	9	5	–	7	194
Additions	–	55	113	97	128	393
On acquisitions of businesses	41	–	–	–	11	52
On disposals of businesses	(2)	–	–	–	–	(2)
Disposals	–	–	–	–	(1)	(1)
At January 1, 2009	**1,013**	**568**	**632**	**463**	**254**	**2,930**
Exchange adjustments	(28)	(3)	(2)	–	(2)	(35)
Additions	–	66	121	123	32	342
On acquisitions of businesses	6	–	–	–	–	6
Disposals	–	–	–	–	(11)	(11)
At December 31, 2009	**991**	**631**	**751**	**586**	**273**	**3,232**
Accumulated amortisation and impairment:						
At January 1, 2008	–	150	150	204	29	533
Exchange adjustments	–	3	–	–	2	5
Provided during the year[1]	5	12	26	46	18	107
Disposals	–	–	–	–	(1)	(1)
At January 1, 2009	**5**	**165**	**176**	**250**	**48**	**644**
Exchange adjustments	–	(1)	–	–	(1)	(2)
Provided during the year[1]	2	13	29	46	31	121
Disposals	–	–	–	–	(3)	(3)
At December 31, 2009	**7**	**177**	**205**	**296**	**75**	**760**
Net book value at December 31, 2009	**984**	**454**	**546**	**290**	**198**	**2,472**
Net book value at December 31, 2008	1,008	403	456	213	206	2,286
Net book value at January 1, 2008	801	354	364	162	80	1,761

[1] Charged to cost of sales except development costs, which are charged to research and development costs

Goodwill

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

Cash-generating unit (CGU) or group of CGUs	Operating segment	2009 £m	2008 £m
Rolls-Royce Deutschland Ltd & Co KG	Civil aerospace	**244**	266
Commercial marine – arising from the acquisitions of Vinters plc and Scandinavian Electric Holdings AS	Marine	**645**	641
Other	Various	**95**	101
		984	1,008

7 Intangible assets (continued)

Goodwill (continued)

Goodwill has been tested for impairment during 2009 on the following basis:

- The carrying value of goodwill has been assessed by reference to values in use. These have been estimated using cash flows from the most recent forecasts prepared by management, which are consistent with past experience and external sources of information on market conditions. Given the long term and established nature of many of the Group's products (product lives are often measured in decades), these typically forecast the next ten years. Growth rates for the period not covered by the forecasts are based on a range of growth rates that reflect the products, industries and countries in which the relevant CGU or group of CGUs operate.
- The key assumptions on which the cash flow projections for the most recent forecast are based are discount rates, growth rates and the impact of foreign exchange rates on the relationship between selling prices and costs.
- The pre-tax cash flow projections have been discounted at 12.75 per cent (2008 12.75 per cent), based on the Group's weighted average cost of capital.

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

- Rolls-Royce Deutschland Ltd & Co KG – volume of engine deliveries, flying hours of installed fleet and cost escalation, these are based on current and known future programmes, estimates of customers' fleet requirements and long term economic forecasts. For the purposes of the impairment test only, cash flows beyond the ten-year forecasts are assumed to grow at 2.5 per cent (2008 2.5 per cent). The directors do not consider that any reasonably possible change in the key assumptions would cause the value in use of the goodwill to fall below its carrying value. For example, the overall level of business would need to reduce by more that 30 per cent to cause an impairment of this balance.
- Vinters plc – volume of equipment deliveries, capture of aftermarket and cost escalation, these are based on current and known future programmes, estimates of customers' fleet requirements and long term economic forecasts. For the purposes of the impairment test only, cash flows beyond the ten-year forecasts are assumed to grow at four per cent. The directors do not consider that any reasonably possible change in the key assumptions would cause the value in use of the goodwill to fall below its carrying value. For example, it would require a doubling of the discount rate to cause an impairment of this balance.

Other intangible assets

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

- The carrying values have been assessed by reference to value in use. These have been estimated using cash flows from the most recent forecasts prepared by management, which are consistent with past experience and external sources of information on market conditions over the lives of the respective programmes.
- The key assumptions underlying cash flow projections are assumed market share, programme timings, unit cost assumptions, discount rates, and foreign exchange rates.
- The pre-tax cash flow projections have been discounted at 11 per cent, based on the Group's weighted average cost of capital.
- No impairment is required on this basis. However, a combination of changes in assumptions and adverse movements in variables that are outside the Group's control (discount rate, exchange rate and airframe delays), could result in impairment in future years.

8 Property, plant and equipment

	Land and buildings £m	Plant and equipment £m	Aircraft and engines £m	In course of construction £m	Total £m
Cost:					
At January 1, 2008	699	2,110	174	176	3,159
Exchange adjustments	70	180	6	22	278
Additions	18	104	28	133	283
On acquisitions of businesses	18	–	–	–	18
On disposals of businesses	–	(13)	–	–	(13)
Reclassifications	17	69	–	(86)	–
Transferred to assets held for sale	(32)	(3)	–	–	(35)
Disposals/write-offs	(3)	(97)	(37)	–	(137)
At January 1, 2009	**787**	**2,350**	**171**	**245**	**3,553**
Exchange adjustments	(17)	(43)	(2)	(8)	(70)
Additions	22	94	20	155	291
Reclassifications	30	78	5	(113)	–
Transferred to assets held for sale	(12)	–	–	–	(12)
Disposals/write-offs	(4)	(92)	(31)	(3)	(130)
At December 31, 2009	**806**	**2,387**	**163**	**276**	**3,632**
Accumulated depreciation and impairment:					
At January 1, 2008	180	1,146	20	–	1,346
Exchange adjustments	18	106	3	–	127
Provided during the year[1]	44	155	9	–	208
On disposals of businesses	–	(11)	–	–	(11)
Transferred to assets held for sale	(22)	(3)	–	–	(25)
Disposals/write-offs	(2)	(85)	–	–	(87)
At January 1, 2009	**218**	**1,308**	**32**	**–**	**1,558**
Exchange adjustments	(2)	(25)	(1)	–	(28)
Provided during the year[1]	25	156	8	–	189
Impairment	4	1	–	–	5
Transferred to assets held for sale	(12)	–	–	–	(12)
Disposals/write-offs	(2)	(82)	(5)	–	(89)
At December 31, 2009	**231**	**1,358**	**34**	**–**	**1,623**
Net book value at December 31, 2009	**575**	**1,029**	**129**	**276**	**2,009**
Net book value at December 31, 2008	569	1,042	139	245	1,995
Net book value at January 1, 2008	519	964	154	176	1,813

[1] Depreciation provided during the year is charged to the income statement or included in the cost of inventory as appropriate.

8 Property, plant and equipment (continued)

Property, plant and equipment includes:

	2009 £m	2008 £m
Net book value of finance leased assets:		
Land and buildings	**9**	9
Plant and equipment	**6**	9
Aircraft and engines	**–**	–
Assets held for use in operating leases:		
Cost	**133**	141
Depreciation	**(31)**	(28)
Net book value	**102**	113
Non-depreciable land	**98**	113
Land and buildings at net book value comprise:		
Freehold	**559**	533
Long leasehold	**10**	12
Short leasehold	**6**	24
	575	569
Capital expenditure commitments – contracted but not provided for	**146**	122
Cost of fully depreciated assets	**473**	475

9 Investments

	Joint ventures				Associates[1]			Equity accounted	Other[2]
	Shares at cost £m	Share of post acquisition reserves £m	Loans £m	Total £m	Shares at cost £m	Share of post acquisition reserves £m	Total £m	Total £m	Unlisted £m
At January 1, 2008	124	146	14	284	–	–	–	284	57
Exchange adjustments	14	71	–	85	–	–	–	85	1
Additions	30	–	1	31	–	–	–	31	1
Taxation paid by the Group	–	3	–	3	–	–	–	3	–
Share of retained profit	(8)	25	(2)	15	–	–	–	15	–
Transferred to 'Assets held for sale'	–	(2)	–	(2)	–	–	–	(2)	–
Disposals	(13)	(9)	(8)	(30)	–	–	–	(30)	(6)
Transfer to cash flow hedging reserve[3]	–	(41)	–	(41)	–	–	–	(41)	–
At January 1, 2009	**147**	**193**	**5**	**345**	**–**	**–**	**–**	**345**	**53**
Exchange adjustments	(7)	(28)	–	(35)	4	–	4	(31)	–
Additions	15	–	1	16	71	–	71	87	2
Taxation paid by the Group	–	2	–	2	–	–	–	2	–
Impairment	(1)	–	–	(1)	–	–	–	(1)	(1)
Share of retained profit	–	18	–	18	–	(1)	(1)	17	–
Transfer to other investments	(5)	2	(1)	(4)	–	–	–	(4)	4
Disposals	(1)	1	–	–	–	–	–	–	–
Transfer from cash flow hedging reserve[3]	–	22	–	22	–	–	–	22	–
At December 31, 2009	**148**	**210**	**5**	**363**	**75**	**(1)**	**74**	**437**	**58**

[1] During the year, the Group acquired 33 per cent of ODIM ASA, listed on the Oslo Stock Exchange. The market value of the shares at December 31, 2009 was £50m. The value of the investment has been assessed on a value in use basis and is not considered to be impaired.
[2] These primarily comprise floating rate convertible loan stock.
[3] Certain of the Group's joint ventures hold interest rate and inflation swaps for which cash flow hedge accounting has been adopted.

9 Investments (continued)

Investments in joint ventures and associates are represented by:

	Joint ventures		Associates		Total	
	2009 £m	2008 £m	2009 £m	2008 £m	2009 £m	2008 £m
Share of aggregate assets:						
Non-current assets[4]	**1,143**	1,041	**69**	–	**1,212**	1,041
Current assets	**812**	940	**38**	–	**850**	940
Share of aggregate liabilities[5]:						
Current liabilities	**(709)**	(841)	**(20)**	–	**(729)**	(841)
Non-current liabilities	**(883)**	(795)	**(13)**	–	**(896)**	(795)
	363	345	**74**	–	**437**	345
[4] Non-current assets include goodwill of	**5**	10	**46**	–	**51**	10
[5] Liabilities include borrowings of	**(816)**	(655)	**(5)**	–	**(821)**	(655)
Share of income	**132**	104	**–**	–	**132**	104
Share of net financing	**(26)**	(16)	**(1)**	–	**(27)**	(16)
Share of taxation	**(12)**	(14)	**–**	–	**(12)**	(14)
Share of profit recognised in the income statement	**94**	74	**(1)**	–	**93**	74
Dividends received	**(77)**	(59)	**–**	–	**(77)**	(59)
Share of retained profit	**17**	15	**(1)**	–	**16**	15

The tax charge on joint venture profits represents an effective tax rate of 11 per cent (2008 16 per cent), a decrease of five per cent. This results from a change in profit mix between joint ventures taxed at different effective rates.

The principal joint ventures and associates are listed on pages 128 to 129.

10 Inventory

	2009 £m	2008 £m
Raw materials	**358**	328
Work in progress	**820**	1,008
Long-term contracts work in progress	**61**	34
Finished goods	**1,163**	1,192
Payments on account	**30**	38
	2,432	2,600
Inventories stated at net realisable value	**138**	144
Amount of inventory write-down	**83**	81
Reversal of inventory write-down	**5**	15

11 Trade and other receivables

	2009 £m	2008 £m
Trade receivables	**1,285**	1,421
Amounts recoverable on contracts[1]	**1,524**	1,448
Amounts owed by joint ventures and associates	**502**	451
Amounts owed by parent undertaking	**71**	–
Other receivables	**401**	404
Prepayments and accrued income	**165**	205
	3,948	3,929
Analysed as:		
Financial instruments (note 15):		
Trade receivables and similar items	**1,837**	1,939
Other non-derivative financial assets	**382**	369
Non-financial instruments	**1,729**	1,621
	3,948	3,929
Trade and other receivables expected to be recovered in more than one year:		
Trade receivables	**9**	24
Amounts recoverable on contracts	**1,178**	1,222
Amounts owed by joint ventures and associates	**14**	28
Amounts owed by parent undertaking	**–**	–
Other receivables	**35**	59
Prepayments and accrued income	**30**	38
	1,266	1,371

[1] The balance at December 31, 2009 includes a valuation allowance of £43m, being the directors' best estimate of the loss that will occur from the Group's contract with EPI Europrop International GmbH to participate in the development of the TP400 engine for the A400M military transport aircraft.

12 Cash and cash equivalents

	2009 £m	2008 £m
Cash at bank and in hand	**1,238**	938
Short-term deposits	**1,722**	1,531
	2,960	2,469
Overdrafts (note 13)	**(4)**	(9)
Cash and cash equivalents per cash flow statement (page 58)	**2,956**	2,460
Cash held as collateral against third party obligations	**77**	85

13 Borrowings

	Current		Non-current		Total	
	2009 £m	2008 £m	2009 £m	2008 £m	2009 £m	2008 £m
Unsecured						
Overdrafts	**4**	9	**–**	–	**4**	9
Bank loans	**2**	11	**204**	5	**206**	16
7 3/8% Notes 2016 £200m	**–**	–	**200**	200	**200**	200
5.84% Notes 2010 US$187m[1]	**120**	–	**–**	136	**120**	136
6.38% Notes 2013 US$230m[1]	**–**	–	**155**	178	**155**	178
6.55% Notes 2015 US$83m[1]	**–**	–	**57**	67	**57**	67
4 1/2% Notes 2011 €750m[2]	**–**	–	**677**	738	**677**	738
6.75% Notes 2019 £500m	**–**	–	**493**	–	**493**	–
Secured						
Obligations under finance leases[3] (note 20)	**–**	3	**1**	1	**1**	4
	126	23	**1,787**	1,325	**1,913**	1,348

[1] These notes are the subject of interest rate swap agreements under which the Group has undertaken to pay floating rates of interest, and currency swaps which form a fair value hedge.
[2] These notes are the subject of swap agreements under which counterparties have undertaken to pay amounts at fixed rates of interest and exchange in consideration for amounts payable at variable rates of interest and at fixed exchange rates.
[3] Obligations under finance leases are secured by related leased assets.

14 Trade and other payables

	Current		Non-current	
	2009 £m	2008 £m	2009 £m	2008 £m
Payments received on account[1]	**1,550**	1,635	**544**	549
Trade payables	**863**	1,042	**–**	–
Amounts owed to parent undertaking	**–**	165	**–**	–
Amounts owed to joint ventures and associates	**276**	372	**2**	9
Other taxation and social security	**71**	55	**–**	–
Other payables	**1,086**	1,170	**71**	206
Accruals and deferred income	**1,782**	1,461	**528**	554
	5,628	5,900	**1,145**	1,318
[1] Includes payments received from joint ventures	**200**	209	**259**	107

Analysed as:

	2009 £m	2008 £m
Financial instruments: (note 15)		
Trade payables and similar items	**2,142**	2,264
Other non-derivative financial liabilities	**381**	430
Non-financial instruments	**4,250**	4,524
	6,773	7,218

Included within trade and other payables are government grants of £31m (2008 £25m). During 2009, £2m of government grants were released to the income statement.

15 Financial instruments

This note should be read in conjunction with the Finance Director's review on pages 41 to 48.

Carrying values and fair values of financial instruments

	Notes	Valuation basis	Assets: Held for trading £m	Assets: Loans and receivables £m	Assets: Available for sale £m	Assets: Cash £m	Liabilities: Held for trading £m	Liabilities: Other £m	Total £m
At December 31, 2009									
Unlisted non-current asset investments	9	A	**–**	**58**	**–**	**–**	**–**	**–**	**58**
Trade receivables and similar items	11	B	**–**	**1,837**	**–**	**–**	**–**	**–**	**1,837**
Other non-derivative financial assets	11	B	**–**	**382**	**–**	**–**	**–**	**–**	**382**
Derivative financial assets		C	**717**	**–**	**–**	**–**	**–**	**–**	**717**
Short-term investments		B	**–**	**–**	**2**	**–**	**–**	**–**	**2**
Cash at bank and in hand	12	B	**–**	**–**	**–**	**1,238**	**–**	**–**	**1,238**
Short-term deposits	12	B	**–**	**1,722**	**–**	**–**	**–**	**–**	**1,722**
Borrowings	13	D	**–**	**–**	**–**	**–**	**–**	**(1,913)**	**(1,913)**
Derivative financial liabilities		C	**–**	**–**	**–**	**–**	**(673)**	**–**	**(673)**
Financial RRSPs		D	**–**	**–**	**–**	**–**	**–**	**(363)**	**(363)**
Trade payables and similar items	14	C	**–**	**–**	**–**	**–**	**–**	**(2,142)**	**(2,142)**
Other non-derivative financial liabilities	14	B	**–**	**–**	**–**	**–**	**–**	**(381)**	**(381)**
			717	**3,999**	**2**	**1,238**	**(673)**	**(4,799)**	**484**
At December 31, 2008									
Unlisted non-current asset investments	9	A	–	53	–	–	–	–	53
Trade receivables and similar items	11	B	–	1,939	–	–	–	–	1,939
Other non-derivative financial assets	11	B	–	369	–	–	–	–	369
Derivative financial assets		C	390	–	–	–	–	–	390
Short-term investments		B	–	–	1	–	–	–	1
Cash at bank and in hand	12	B	–	–	–	938	–	–	938
Short-term deposits	12	B	–	1,531	–	–	–	–	1,531
Borrowings	13	D	–	–	–	–	–	(1,348)	(1,348)
Derivative financial liabilities		C	–	–	–	–	(2,386)	–	(2,386)
Financial RRSPs		D	–	–	–	–	–	(455)	(455)
Trade payables and similar items	14	B	–	–	–	–	–	(2,264)	(2,264)
Other non-derivative financial liabilities	14	B	–	–	–	–	–	(430)	(430)
			390	3,892	1	938	(2,386)	(4,497)	(1,662)

Fair values equate to book values for both 2009 and 2008, with the following exceptions:

	2009 Book value £m	2009 Fair value £m	2008 Book value £m	2008 Fair value £m
Borrowings	**(1,913)**	**(2,012)**	(1,348)	(1,314)
Financial RRSPs	**(363)**	**(390)**	(455)	(487)

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

A These primarily comprise floating rate convertible loan stock. The conversion conditions are such that fair value approximates to the book value.
B Fair values are assumed to approximate to cost either due to the short-term maturity of the instruments or because the interest rate of the investments is reset after periods not exceeding six months.
C Fair values of derivative financial assets and liabilities are estimated by discounting expected future contractual cash flows using prevailing interest rate curves. Amounts denominated in foreign currencies are valued at the exchange rate prevailing at the balance sheet date. These financial instruments are included on the balance sheet at fair value, derived from observable market prices (Level 2 as defined by IFRS 7 *Financial Instruments: Disclosures*).
D Borrowing and financial RRSPs are carried at amortised cost. Fair values are estimated by discounting expected future contractual cash flows using prevailing interest rate curves. Amounts denominated in foreign currencies are valued at the exchange rate prevailing at the balance sheet date. For financial RRSPs, the contractual cash flows are based on future trading activity, which is estimated based on latest forecasts.

15 Financial instruments (continued)

Carrying values of other financial assets and liabilities

Further to the amendments to IAS 1 in the Improvements to IFRS (2008), derivative contracts are now classified as current or non-current based on their maturity dates. Previously all 'held for trading' items were deemed to be current. The effect is that: (i) financial assets comprising foreign exchange contracts (2008 £112m and 2007 £433m), commodity contracts (2007 £39m) and interest rate contracts (2008 £278m and 2007 £42m), previously reported as current assets; and (ii) financial liabilities comprising foreign exchange contracts (2008 £2,293m and 2007 £54m), commodity contracts (2008 £89m) and interest rate contracts (2008 £4m and 2007 £3m) previously reported as current liabilities, are presented as current or non-current as set out below.

	Foreign exchange contracts £m	Commodity contracts £m	Interest rate contracts £m	Total derivatives £m	Financial RRSPs £m	Total £m
At December 31, 2009						
Non-current assets	**429**	**11**	**197**	**637**	**–**	**637**
Current assets	**72**	**4**	**4**	**80**	**–**	**80**
Current liabilities	**(56)**	**(12)**	**–**	**(68)**	**(100)**	**(168)**
Non-current liabilities	**(589)**	**(14)**	**(2)**	**(605)**	**(263)**	**(868)**
	(144)	**(11)**	**199**	**44**	**(363)**	**(319)**
At December 31, 2008						
Non-current assets	88	–	278	366	–	366
Current assets	24	–	–	24	–	24
Current liabilities	(214)	(36)	(2)	(252)	(64)	(316)
Non-current liabilities	(2,079)	(53)	(2)	(2,134)	(391)	(2,525)
	(2,181)	(89)	274	(1,996)	(455)	(2,451)
At December 31, 2007						
Non-current assets	286	15	42	343	–	343
Current assets	147	24	–	171	–	171
Current liabilities	(4)	–	(1)	(5)	(12)	(17)
Non-current liabilities	(50)	–	(2)	(52)	(303)	(355)
	379	39	39	457	(315)	142

15 Financial instruments (continued)

Foreign exchange and commodity financial instruments

The Group uses various financial instruments to manage its exposure to movements in foreign exchange rates. The Group uses commodity swaps to manage its exposure to movements in the price of commodities (jet fuel and base metals). From January 1, 2005, the Group has not included foreign exchange or commodity financial instruments in any cash flow hedging relationships for accounting purposes. To hedge the currency risk associated with a borrowing denominated in US dollars, the Group has currency derivatives designated as part of fair value hedges.

Movements in the fair values of foreign exchange and commodity instruments were as follows:

	Foreign exchange instruments £m	Commodity instruments £m
At January 1, 2008	379	39
Fair value gains to fair value hedges[1,2]	83	–
Fair value losses to other derivative contracts[1]	(2,383)	(96)
Fair value of contracts settled	(236)	(32)
Fair value of derivative contracts assumed on formation of joint venture	(24)	–
At January 1, 2009	**(2,181)**	**(89)**
Fair value losses to fair value hedges[1,2]	**(33)**	**–**
Fair value losses to net investment hedges	**(14)**	**–**
Fair value gains to other derivative contracts[1]	**1,783**	**52**
Fair value of contracts settled	**301**	**26**
At December 31, 2009	**(144)**	**(11)**

1 Included in financing
2 Profit on related hedged items £33m (2008 £83m loss).

Interest rate financial instruments

The Group uses interest rate swaps, forward rate agreements and interest rate caps to manage its exposure to movements in interest rates. Where the effectiveness of the hedge relationship in a cash flow hedge is demonstrated, changes in the fair value that are deemed effective are included in the hedging reserve and released to match actual payments on the hedged item. During 2008 and 2009, the Group did not have any cash flow hedges, other than in joint ventures, which are not included in this analysis.

Movements in the fair values of interest rate financial instruments were as follows:

	Total £m	Included in fair value hedging relationships £m	Other interest rate financial instruments £m
At January 1, 2008	39	42	(3)
Fair value changes[1,2]	235	236	(1)
At January 1, 2009	**274**	**278**	**(4)**
Fair value changes[1,2]	**(75)**	**(77)**	**2**
At December 31, 2009	**199**	**201**	**(2)**

1 Included in financing
2 Profit on related hedged items £77m (2008 £236m loss).

Financial risk and revenue sharing partnerships (RRSPs)

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

15 Financial instruments (continued)

Movements in the amortised cost values of financial RRSPs were as follows:

	2009 £m	2008 £m
At January 1	**(455)**	(315)
Cash paid to partners	**55**	53
Additions	**(15)**	(40)
Exchange adjustments direct to reserves	**6**	(6)
Financing charge[1]	**(26)**	(26)
Excluded from underlying profit:		
Exchange adjustments[1]	**45**	(118)
Restructuring of financial RRSP agreements and changes in forecast payments[1]	**27**	(3)
At December 31	**(363)**	(455)

[1] Included in financing, excluding £1m of finance charge capitalised in intangible assets.

Risk management policies and hedging activities

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

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

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

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

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

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

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

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

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

15 Financial instruments (continued)

Derivative financial instruments

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

				Expected maturity			Fair value
	Nominal amount £m	Within one year £m	Between one and two years £m	Between two and five years £m	After five years £m	Assets £m	Liabilities £m
At December 31, 2009							
Foreign exchange contracts:							
Fair value hedges	**280**	**106**	**–**	**128**	**46**	**23**	**–**
Non-hedge accounted	**14,203**	**3,544**	**3,184**	**6,573**	**902**	**478**	**(645)**
Interest rate contracts:							
Fair value hedges	**809**	**116**	**500**	**142**	**51**	**201**	**–**
Non-hedge accounted	**35**	**20**	**–**	**–**	**15**	**–**	**(2)**
Commodity contracts:							
Non-hedge accounted	**169**	**62**	**59**	**48**	**–**	**15**	**(26)**
	15,496	**3,848**	**3,743**	**6,891**	**1,014**	**717**	**(673)**
At December 31, 2008							
Foreign exchange contracts:							
Fair value hedges	280	–	106	128	46	56	–
Non-hedge accounted	13,342	3,726	3,106	6,408	102	56	(2,293)
Interest rate contracts:							
Fair value hedges	848	–	130	660	58	278	–
Non-hedge accounted	65	25	22	–	18	–	(4)
Commodity contracts:							
Non-hedge accounted	271	106	73	92	–	–	(89)
	14,806	3,857	3,437	7,288	224	390	(2,386)

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

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

					Currencies purchased forward
	Sterling £m	US dollar £m	Euro £m	Other £m	Total £m
At December 31, 2009					
Currencies sold forward:					
Sterling	**–**	**280**	**–**	**77**	**357**
US dollar	**11,508**	**–**	**1,094**	**810**	**13,412**
Euro	**–**	**–**	**–**	**371**	**371**
Other	**54**	**116**	**129**	**44**	**343**
At December 31, 2008					
Currencies sold forward:					
Sterling	–	280	–	43	323
US dollar	10,096	–	1,189	1,097	12,382
Euro	–	–	–	614	614
Other	2	44	166	91	303

Other derivative financial instruments are denominated in the following currencies:

	2009 £m	2008 £m
Sterling	**15**	18
US dollar	**498**	666
Euro	**500**	500

15 Financial instruments (continued)

Non-derivative financial instruments

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

	Sterling £m	US dollar £m	Euro £m	Other £m	Total £m
At December 31, 2009					
Assets					
Unlisted non-current investments	**49**	**–**	**4**	**5**	**58**
Trade receivables and similar items	**242**	**1,175**	**225**	**195**	**1,837**
Other non-derivative financial assets	**130**	**54**	**40**	**158**	**382**
Short-term investments	**–**	**–**	**–**	**2**	**2**
Cash at bank and in hand	**488**	**366**	**129**	**255**	**1,238**
Short-term deposits	**1,517**	**1**	**192**	**12**	**1,722**
	2,426	**1,596**	**590**	**627**	**5,239**
Liabilities					
Borrowings	**(893)**	**(332)**	**(683)**	**(5)**	**(1,913)**
Financial RRSPs	**–**	**(303)**	**(60)**	**–**	**(363)**
Trade payables and similar items	**(886)**	**(811)**	**(221)**	**(224)**	**(2,142)**
Other non-derivative financial liabilities	**(187)**	**(86)**	**(23)**	**(85)**	**(381)**
	(1,966)	**(1,532)**	**(987)**	**(314)**	**(4,799)**
	460	**64**	**(397)**	**313**	**440**
At December 31, 2008					
Assets					
Unlisted non-current investments	46	1	4	2	53
Trade receivables and similar items	249	1,228	211	251	1,939
Other non-derivative financial assets	91	110	85	83	369
Short-term investments	–	–	–	1	1
Cash at bank and in hand	97	552	129	160	938
Short-term deposits	479	287	744	21	1,531
	962	2,178	1,173	518	4,831
Liabilities					
Borrowings	(203)	(385)	(746)	(14)	(1,348)
Financial RRSPs	–	(406)	(49)	–	(455)
Trade payables and similar items	(763)	(979)	(250)	(272)	(2,264)
Other non-derivative financial liabilities	(144)	(151)	(58)	(77)	(430)
	(1,110)	(1,921)	(1,103)	(363)	(4,497)
	(148)	257	70	155	334

Currency exposures

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

Functional currency of Group operation	Sterling £m	US dollar £m	Euro £m	Other £m	Total £m
At December 31, 2009					
Sterling	**–**	**2**	**–**	**(2)**	**–**
US dollar	**9**	**–**	**(6)**	**4**	**7**
Other	**–**	**4**	**(1)**	**4**	**7**
At December 31, 2008					
Sterling	–	11	(4)	1	8
US dollar	6	–	–	8	14
Other	–	–	(2)	5	3

15 Financial instruments (continued)

Ageing beyond contractual due date

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

	Within terms £m	Up to three months overdue £m	Between three months and one year overdue £m	More than one year overdue £m	Total £m
At December 31, 2009					
Unlisted non-current asset investments	**58**	**–**	**–**	**–**	**58**
Trade receivables and similar items	**1,509**	**237**	**67**	**24**	**1,837**
Other non-derivative financial assets	**363**	**14**	**3**	**2**	**382**
Derivative financial assets	**717**	**–**	**–**	**–**	**717**
Short-term investments	**2**	**–**	**–**	**–**	**2**
Cash at bank and in hand	**1,238**	**–**	**–**	**–**	**1,238**
Short-term deposits	**1,722**	**–**	**–**	**–**	**1,722**
	5,609	**251**	**70**	**26**	**5,956**
At December 31, 2008					
Unlisted non-current asset investments	53	–	–	–	53
Trade receivables and similar items	1,516	322	93	8	1,939
Other non-derivative financial assets	354	9	4	2	369
Derivative financial assets	390	–	–	–	390
Short-term investments	1	–	–	–	1
Cash at bank and in hand	938	–	–	–	938
Short-term deposits	1,531	–	–	–	1,531
	4,783	331	97	10	5,221

Contractual maturity analysis

	Gross values					
	Within one year £m	Between one and two years £m	Between two and five years £m	After five years £m	Discounting £m	Carrying value £m
At December 31, 2009						
Borrowings	**(112)**	**(903)**	**(366)**	**(1,183)**	**651**	**(1,913)**
Derivative financial liabilities	**(66)**	**(55)**	**(424)**	**(113)**	**(15)**	**(673)**
Financial RRSPs	**(118)**	**(45)**	**(109)**	**(179)**	**88**	**(363)**
Trade payables and similar items	**(2,139)**	**(2)**	**(1)**	**–**	**–**	**(2,142)**
Other non-derivative financial liabilities	**(377)**	**(2)**	**(1)**	**(1)**	**–**	**(381)**
	(2,812)	**(1,007)**	**(901)**	**(1,476)**	**724**	**(5,472)**
At December 31, 2008						
Borrowings	(92)	(202)	(1,005)	(313)	264	(1,348)
Derivative financial liabilities	(252)	(225)	(817)	(963)	(129)	(2,386)
Financial RRSPs	(56)	(177)	(127)	(198)	103	(455)
Trade payables and similar items	(2,255)	(5)	(4)	–	–	(2,264)
Other non-derivative financial liabilities	(408)	(21)	(1)	–	–	(430)
	(3,063)	(630)	(1,954)	(1,474)	238	(6,883)

15 Financial instruments (continued)

Interest rate risk

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

			2009				
			Period in which interest rate reprices				
	Effective interest rate %	Total £m	6 months or less £m	6-12 months £m	1-2 years £m	2-5 years £m	More than 5 years £m
Short-term investments[1]	8.6744%	**2**	2	–	–	–	–
Cash at bank and in hand[2]		**1,238**	1,238	–	–	–	–
Short-term deposits[3]		**1,722**	1,722	–	–	–	–
Unsecured bank loans							
€2.5m floating rate loan	EURIBOR + 1.2	**(1)**	(1)	–	–	–	–
€5m floating rate loan	EURIBOR + 0.5	**(4)**	(4)	–	–	–	–
Overdrafts[4]		**(4)**	(4)	–	–	–	–
75m Indian Rupee Fixed Rate Loan	9.8167%	**(1)**	(1)	–	–	–	–
Effect of interest rate swaps	6.1814%	**–**	15	–	–	–	(15)
£200m floating rate	GBP LIBOR + 0.267	**(200)**	(200)	–	–	–	–
Unsecured bond issues							
7 3/8% Notes 2016 £200m	7.3750%	**(200)**	–	–	–	–	(200)
5.84% Notes 2010 US$187m	5.8400%	**(120)**	–	(120)	–	–	–
Effect of interest rate swaps	USD LIBOR + 1.159	**–**	(120)	120	–	–	–
6.38% Notes 2013 US$230m	6.3800%	**(155)**	–	–	–	(155)	–
Effect of interest rate swaps	USD LIBOR + 1.26	**–**	(155)	–	–	155	–
6.55% Notes 2015 US$83m	6.5500%	**(57)**	–	–	–	–	(57)
Effect of interest rate swaps	USD LIBOR + 1.24	**–**	(57)	–	–	–	57
4 1/2% Notes 2011 €750m	4.5000%	**(677)**	–	–	(677)	–	–
Effect of interest rate swaps	GBP LIBOR + 0.911	**–**	(677)	–	677	–	–
6.75% Notes 2019 £500m	6.7500%	**(493)**	–	–	–	–	(493)
Other secured							
Obligations under finance leases	5.0000%	**(1)**	–	–	–	–	(1)
		1,049	**1,758**	**–**	**–**	**–**	**(709)**

[1] Interest on the short-term investments are at fixed rates.
[2] Cash at bank and in hand comprises bank balances and demand deposits and earns interest at rates based on daily bank deposit rates.
[3] Short-term deposits are deposits placed on money markets for periods up to three months and earn interest at the respective short-term deposit rates.
[4] Overdrafts bear interest at rates linked to applicable LIBOR rates that fluctuate in accordance with local practice.

15 Financial instruments (continued)

	Effective interest rate %	Total £m	6 months or less £m	6-12 months £m	1-2 years £m	2-5 years £m	More than 5 years £m
			2008 Period in which interest rate reprices				
Short-term investments[1]	9.6769%	1	1	–	–	–	–
Cash at bank and in hand[2]		938	938	–	–	–	–
Short-term deposits[3]		1,531	1,531	–	–	–	–
Unsecured bank loans							
€2.5m floating rate loan	EURIBOR + 1.2	(2)	(2)	–	–	–	–
€5m floating rate loan	EURIBOR + 0.5	(5)	(5)	–	–	–	–
Overdrafts[4]		(9)	(9)	–	–	–	–
55m Indian Rupee Fixed Rate Loan	13.5455%	(1)	–	(1)	–	–	–
79.4m Norwegian Kroner Floating Rate Loan	NIBOR + 1.1	(8)	(8)	–	–	–	–
Effect of interest rate swaps	3.3521%	–	40	–	(22)	–	(18)
Unsecured bond issues							
7 3/8% Notes 2016 £200m	7.3750%	(200)	–	–	–	–	(200)
5.84% Notes 2010 US$187m	5.8400%	(136)	–	–	(136)	–	–
Effect of interest rate swaps	USD LIBOR + 1.159	–	(136)	–	136	–	–
6.38% Notes 2013 US$230m	6.3800%	(178)	–	–	–	(178)	–
Effect of interest rate swaps	USD LIBOR + 1.26	–	(178)	–	–	178	–
6.55% Notes 2015 US$83m	6.5500%	(67)	–	–	–	–	(67)
Effect of interest rate swaps	USD LIBOR + 1.24	–	(67)	–	–	–	67
4 1/2% Notes 2011 €750m	4.5000%	(738)	–	–	–	(738)	–
Effect of interest rate swaps	GBP LIBOR + 0.911	–	(738)	–	–	738	–
Other secured							
Obligations under finance leases	5.5226%	(4)	(3)	–	–	–	(1)
		1,122	1,364	(1)	(22)	–	(219)

1 Interest on the short-term investments are at fixed rates.
2 Cash at bank and in hand comprises bank balances and demand deposits and earns interest at rates based on daily bank deposit rates.
3 Short-term deposits are deposits placed on money markets for periods up to three months and earn interest at the respective short-term deposit rates.
4 Overdrafts bear interest at rates linked to applicable LIBOR rates that fluctuate in accordance with local practice.

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

In addition, the Group has undrawn committed borrowing facilities available as follows:

	2009 £m	2008 £m
Expiring after two years	**450**	650

15 Financial instruments (continued)

Sensitivity analysis

The Group is exposed to a number of foreign currencies. The most significant transactional currency exposures are US dollar with sterling and US dollar with euro.

At December 31, 2009 if sterling had weakened ten per cent against the US dollar with all other variables held constant, profit after tax for the year and equity would have been £864m lower (2008 £890m). If sterling had strengthened ten per cent against the US dollar with all other variables held constant, profit after tax for the year and equity would have been £707m higher (2008 £728m). There would have been no change to the underlying results that exclude unrealised gains and losses on foreign exchange derivatives.

At December 31, 2009 if the euro had weakened ten per cent against the US dollar with all other variables held constant, profit after tax and equity for the year would have been £88m lower (2008 £102m). If the euro had strengthened ten per cent against the US dollar with all other variables held constant, profit after tax for the year and equity would have been £72m higher (2008 £84m). There would have been no change to the underlying results that exclude unrealised gains and losses on foreign exchange derivatives.

At December 31, 2009 if the price of commodities had been ten per cent lower, with all other variables remaining constant, profit after tax for the year and equity would have been £11m lower (2008 £13m), arising mainly as the result of lower fair value gains on derivatives. If the price of commodities had been ten per cent higher, with all other variables remaining constant, profit after tax and equity would have been £11m higher (2008 £13m), arising mainly as the result of higher fair value gains on derivatives. There would have been no change to the underlying results that exclude unrealised gains and losses on commodity derivatives.

At December 31, 2009 the Group had no material sensitivity to changes in interest rates on that date. The main interest rate sensitivity for the Group arises as a result of the gross up of net cash and this is mitigated as described under the interest rate risk management policies on page 64.

16 Provisions

	At December 31, 2008 £m	**Exchange adjustments £m**	**Unused amounts reversed £m**	**Charged to income statement £m**	**Utilised £m**	**At December 31, 2009 £m**
Warranty and guarantees	182	**(4)**	**(8)**	**87**	**(33)**	**224**
Contract loss	38	**(1)**	**–**	**39**	**(18)**	**58**
Restructuring	16	**–**	**(6)**	**8**	**(10)**	**8**
Customer financing	73	**(2)**	**–**	**14**	**(14)**	**71**
Insurance	38	**–**	**–**	**7**	**–**	**45**
Other	22	**(1)**	**–**	**17**	**(2)**	**36**
	369	**(8)**	**(14)**	**172**	**(77)**	**442**

Analysed as:

	2009 £m	2008 £m
Current liabilities	**210**	181
Non-current liabilities	**232**	188
	442	369

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

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

Customer financing provisions cover guarantees provided for asset value and/or financing. These guarantees are considered to be insurance contracts in nature and provision is made in accordance with IFRS 4 *Insurance Contracts* and IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. These guarantees, the risks arising and the process used to assess the extent of the risk are described under the heading 'Sales financing' in the Finance Director's review on page 47. The related contingent liabilities arising from these guarantees and the sensitivity to movements in the value of the underlying security are discussed in note 21. It is estimated that the provision will be utilised as follows:

	2009 £m	2008 £m
Potential claims with specific claim dates:		
In one year or less	**3**	–
In more than one year but less than five years	**20**	6
In more than five years	**21**	27
Potential claims that may arise at any time up to the date of expiry of the guarantee:		
Up to one year	**19**	31
Up to five years	**4**	4
Thereafter	**4**	5
	71	73

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

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

17 Post-retirement benefits

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

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

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

The valuations of the defined benefit schemes are based on the most recent funding valuations, updated by the scheme actuaries to December 31, 2009. The most recent funding valuations of the main UK schemes were:

Scheme	Valuation date
Rolls-Royce Pension Fund (RRPF)	March 31, 2009
Rolls-Royce Group Pension Scheme	April 5, 2007
Vickers Group Pension Scheme	March 31, 2007

Restatement

IFRIC 14 *IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction* has been adopted in 2009. The interpretation requires that, where statutory funding requirements will result in an unrecognisable surplus arising in the future, a liability should be recognised. The rules of the RRPF are such that future contributions set out in the scheme's Recovery Plan will give rise to an unrecognisable surplus. In accordance with the transition rules of the interpretation, it has been applied from January 1, 2008, and the 2008 figures have been restated accordingly. The impact of adopting IFRIC 14 is as follows:

		Deferred tax (note 4)			
	Net post-retirement liability £m	Assets £m	Liabilities £m	Total £m	Retained earnings £m
At January 1, 2008, as previously reported	(123)	81	(345)	(264)	2,081
Adoption of IFRIC 14	(491)	51	87	138	(353)
At January 1, 2008, restated	(614)	132	(258)	(126)	1,728
At December 31, 2008, as previously reported	(142)	685	(307)	378	760
Adoption of IFRIC 14	(425)	119	–	119	(306)
At December 31, 2008, restated	(567)	804	(307)	497	454
Movements in 2008 recognised in other comprehensive income	66	68	(87)	(19)	

Amounts recognised in the income statement

	2009			2008		
	UK schemes £m	**Overseas schemes £m**	**Total £m**	UK schemes £m	Overseas schemes £m	Total £m
Defined benefit schemes:						
Current service cost	**94**	**29**	**123**	127	27	154
Past service cost	**2**	**4**	**6**	5	3	8
Ex-gratia payment paid directly by the Group	**–**	**–**	**–**	8	–	8
	96	**33**	**129**	140	30	170
Defined contribution schemes	**8**	**29**	**37**	6	20	26
Operating cost	**104**	**62**	**166**	146	50	196
Financing (income)/costs in respect of defined benefit schemes:						
Expected return on assets	**(285)**	**(20)**	**(305)**	(352)	(21)	(373)
Interest on liabilities	**355**	**47**	**402**	358	37	395
	70	**27**	**97**	6	16	22
Total income statement charge	**174**	**89**	**263**	152	66	218

17 Post-retirement benefits (continued)

The operating cost is charged as follows:

	Defined benefit		Defined contribution		Total	
	2009 £m	2008 £m	**2009 £m**	2008 £m	**2009 £m**	2008 £m
Cost of sales	**94**	124	**27**	19	**121**	143
Commercial and administrative costs	**26**	33	**7**	5	**33**	38
Research and development	**9**	13	**3**	2	**12**	15
	129	170	**37**	26	**166**	196

The Group operates a PaySave scheme in the UK. This is a salary sacrifice scheme under which employees elect to stop making employee contributions and the Group makes additional contributions in return for a reduction in gross contractual pay. As a result, there is a decrease in wages and salaries and a corresponding increase in pension costs of £36m (2008 £38m) in the year.

Amounts recognised in other comprehensive income

	2009 £m	2008 £m
Actuarial gain on scheme assets	**(270)**	178
Experience gains on scheme liabilities	**(878)**	766
Movement in unrecognised surplus	**707**	(928)
Movement in minimum funding liability	**40**	66
	(401)	82

Defined benefit schemes

Assumptions

The principal actuarial assumptions used at the balance sheet date were as follows:

	2009		2008	
	UK schemes %	**Overseas schemes %**	UK schemes %	Overseas schemes %
Rate of increase in salaries	**4.7**	**4.0**	4.5	3.9
Rate of increase of pensions in payment	**3.3**	**2.2**	2.9	0.5
Discount rate	**5.7**	**5.9**	6.4	6.1
Expected rate of return on scheme assets	**5.4**	**7.4**	4.1	6.9
Inflation assumption	**3.6**	**2.6**	3.0	2.6

[1] Benefits accruing after April 5, 2005 are assumed to increase in payment at a rate of 1.9 per cent.

The discount rates are determined by reference to the market yields on AA rated corporate bonds. For the main UK schemes, the rate is determined by using the profile of forecast benefit payments to derive a weighted average discount rate from the yield curve. For less significant UK schemes and overseas schemes, the rate is determined as the market yield at the average duration of the forecast benefit payments. The discount rates above are the weighted average of those for each scheme, based on the value of their respective liabilities.

The overall expected rate of return is calculated by weighting the individual returns expected from each asset class (page 97) in accordance with the actual asset balance in the schemes' investment portfolios.

The mortality assumptions adopted for the UK pension schemes are derived from the actuarial tables (PA92, other than RRPF which has adopted the SAPS tables in its 2009 valuation), with 80 per cent of long cohort, published by the Institute of Actuaries, projected forward and, where appropriate, adjusted to take account of the relevant scheme's actual experience. The resulting range of life expectancies in the principal UK schemes are as follows:

Life expectancy from age 65

Current pensioner	19.6 years to 23.5 years
Future pensioner	20.7 years to 24.2 years

17 Post-retirement benefits (continued)

The future costs of healthcare benefits are based on an assumed healthcare costs trend rate of eight per cent grading down to five per cent over six years.

Other demographic assumptions have been set on advice from the relevant actuary, having regard to the latest trends in scheme experience and other relevant data. The assumptions are reviewed and updated as necessary as part of the periodic actuarial valuation of the schemes.

Assumptions in respect of overseas schemes are also set in accordance with advice from local actuaries.

Amounts recognised in the balance sheet

			2009			December 31, 2008			January 1, 2008
	UK schemes £m	**Overseas schemes £m**	**Total £m**	UK schemes £m	Overseas schemes £m	Total £m	UK schemes £m	Overseas schemes £m	Total £m
Present value of funded obligations	**(6,714)**	**(406)**	**(7,120)**	(5,719)	(390)	(6,109)	(6,335)	(293)	(6,628)
Fair value of scheme assets	**7,048**	**354**	**7,402**	7,163	283	7,446	6,626	277	6,903
	334	**(52)**	**282**	1,444	(107)	1,337	291	(16)	275
Present value of unfunded obligations	**–**	**(417)**	**(417)**	–	(437)	(437)	–	(284)	(284)
Unrecognised surplus[1]	**(329)**	**(6)**	**(335)**	(1,036)	(6)	(1,042)	(110)	(4)	(114)
Minimum funding liability[2]	**(385)**	**–**	**(385)**	(425)	–	(425)	(491)	–	(491)
Net asset/(liability) recognised in the balance sheet	**(380)**	**(475)**	**(855)**	(17)	(550)	(567)	(310)	(304)	(614)
Analysed as:									
Post-retirement scheme surpluses	**75**	**–**	**75**	453	–	453	210	–	210
Post-retirement scheme deficits	**(455)**	**(475)**	**(930)**	(470)	(550)	(1,020)	(520)	(304)	(824)
	(380)	**(475)**	**(855)**	(17)	(550)	(567)	(310)	(304)	(614)

[1] Where a surplus has arisen on a scheme, in accordance with IAS 19 and IFRIC 14, the surplus is recognised as an asset only if it represents an unconditional economic benefit available to the Group in the future. Any surplus in excess of this benefit is not recognised in the balance sheet.
[2] A minimum funding liability arises where the statutory funding requirements are such that future contributions in respect of past service that will result in a future unrecognisable surplus.

Changes in present value of defined benefit obligations

			2009			2008
	UK schemes £m	**Overseas schemes £m**	**Total £m**	UK schemes £m	Overseas schemes £m	Total £m
At January 1	**(5,719)**	**(827)**	**(6,546)**	(6,335)	(577)	(6,912)
Exchange adjustments	**–**	**67**	**67**	–	(196)	(196)
Current service cost	**(94)**	**(29)**	**(123)**	(127)	(27)	(154)
Past service cost	**(2)**	**(4)**	**(6)**	(5)	(3)	(8)
Finance cost	**(355)**	**(47)**	**(402)**	(358)	(37)	(395)
Contributions by employees	**(3)**	**(3)**	**(6)**	(4)	(2)	(6)
Net benefits paid out	**324**	**33**	**357**	331	25	356
Actuarial (losses)/gains	**(865)**	**(13)**	**(878)**	776	(10)	766
Transfers	**–**	**–**	**–**	3	–	3
At December 31	**(6,714)**	**(823)**	**(7,537)**	(5,719)	(827)	(6,546)
Funded schemes	**(6,714)**	**(406)**	**(7,120)**	(5,719)	(390)	(6,109)
Unfunded schemes	**–**	**(417)**	**(417)**	–	(437)	(437)

17 Post-retirement benefits (continued)

Changes in fair value of scheme assets

	2009			2008		
	UK schemes £m	**Overseas schemes £m**	**Total £m**	UK schemes £m	Overseas schemes £m	Total £m
At January 1	**7,163**	**283**	**7,446**	6,626	277	6,903
Exchange adjustments	**–**	**(16)**	**(16)**	–	63	63
Expected return on assets	**285**	**20**	**305**	352	21	373
Contributions by employer	**232**	**56**	**288**	248	31	279
Contributions by employees	**3**	**3**	**6**	4	2	6
Benefits paid out	**(324)**	**(33)**	**(357)**	(331)	(25)	(356)
Actuarial (losses)/gains	**(311)**	**41**	**(270)**	264	(86)	178
At December 31	**7,048**	**354**	**7,402**	7,163	283	7,446
Actual return on scheme assets			**35**			551

The fair value of the scheme assets in the schemes and the expected rates of return at December 31, were as follows:

	2009		2008	
	Expected rate of return %	**Market value £m**	Expected rate of return %	Market value £m
UK schemes:				
LDI portfolios[1]	**5.0**	**5,736**	3.5	5,833
Equities	**7.8**	**1,107**	7.2	1,141
Sovereign debt	**4.5**	**18**	3.9	110
Corporate bonds	**5.5**	**8**	5.5	110
Other	**4.6**	**179**	1.9	(31)
	5.4	**7,048**	4.1	7,163
Overseas schemes:				
Equities	**9.3**	**194**	9.0	134
Corporate bonds	**4.7**	**136**	4.9	130
Other	**6.5**	**24**	5.9	19
	7.4	**354**	6.9	283

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

The scheme assets do not include any of the Group's own financial instruments, nor any property occupied by, or other assets used by, the Group.

The expected rate of return for LDI portfolios is determined by the implicit yield on the portfolio at the balance sheet date.
The expected rates of return on other individual categories of scheme assets are determined by reference to gilt yields. In the UK, equities and corporate bonds are assumed to generate returns that exceed the return from gilts by 3.25 per cent and 1.0 per cent per annum respectively.

The expected rates of return above are the weighted average of the rates for each scheme.

Future contributions

The Group expects to contribute approximately £270m to its defined benefit schemes in 2010.

17 Post-retirement benefits (continued)

Sensitivities

The revised investment strategies are designed to hedge the risks from interest rates and inflation on an economic basis. A reduction of 0.25 per cent in the discount rate would increase the obligations of the principal UK defined benefit schemes by approximately £243m. An equivalent movement in interest rates would increase the fair value of the assets by approximately £290m. The difference arises largely due to differences in the methods used to value the obligations for accounting and economic purposes. On an economic basis the correlation is in excess of 80 per cent. The principal remaining risks relate to the assumptions for mortality and increases in salaries. If the age ratings in respect of the principal UK defined benefit schemes were increased by one year, the scheme liabilities would increase by £137m. If the rate of increase in salaries were 0.5 per cent higher, scheme liabilities would increase by £117m.

The defined benefit obligation relating to post-retirement medical benefits would increase by £47m if the healthcare trend rate increases by one per cent, and reduce by £38m if it decreases by one per cent. The pension expense relating to post-retirement medical benefits, comprising service cost and interest cost, would increase by £5m if the healthcare trend increases by one per cent, and reduce by £4m if it decreases by one per cent.

History of defined benefit schemes

The history of the schemes for the current and prior years is as follows:

	2009 £m	2008 £m	2007 £m	2006 £m	2005 £m
Balance sheet					
Present value of defined benefit obligation	**(7,537)**	(6,546)	(6,912)	(6,899)	(7,220)
Fair value of scheme assets	**7,402**	7,446	6,903	5,906	5,563
Unrecognised surplus	**(335)**	(1,042)	(114)	(2)	(2)
Minimum funding liability	**(385)**	(425)	–	–	–
Deficit	**(855)**	(567)	(123)	(995)	(1,659)
Experience gains/losses					
Actuarial (losses)/gains on scheme assets	**(270)**	178	161	132	588
Experience (losses)/gains on scheme liabilities	**(878)**	766	350	470	(868)
Movement in unrecognised surplus	**707**	(928)	(112)	–	(2)
Recognition of minimum funding liability on January 1, 2008	**–**	(491)	–	–	–
Movement in minimum funding liability	**40**	66	–	–	–
Total amount recognised in OCI	**(401)**	(409)	399	602	(282)
Cumulative amounts recognised in OCI since January 1, 2004	**(98)**	303	712	313	(289)

18 Share capital

	Ordinary shares of 20p each Millions	**Nominal value £m**
Authorised		
At January 1, 2008 and December 31, 2009	**2,000**	**400**
Issued and fully paid		
At January 1, 2008 and December 31, 2009	**1,631**	**326**

Directors' report

Financial statements

19 Share-based payments

Share-based payment plans in operation during the year

The Group had the following share-based payment plans in respect of shares in its parent company, Rolls-Royce Group plc, in operation during the year:

Performance Share Plan (PSP)

This plan involves the award of shares to participants subject to performance conditions. Vesting of the performance shares is based on the achievement of both non-market based conditions (EPS and cash flow per share) and a market based performance condition (TSR).

ShareSave share option plan

Based on a three- or five-year monthly savings contract, eligible employees are granted share options with an exercise price of up to 20 per cent below the share price when the contract is entered into. Vesting of the options is not subject to the achievement of a performance target. In the UK, the plan is HM Revenue & Customs approved. Overseas, employees in 33 countries participate in ShareSave plans through arrangements which provide broadly comparable benefits to the UK plan. From 2007 onwards, the overseas schemes are cash-settled schemes.

Executive Share Option Plan (ESOP)

This plan involved the grant of market value share options to participants. It expired in 2009 and no further grants may be made. Remaining options under the plan are subject to a non-market based performance condition (growth in EPS) and have a maximum contractual life of ten years.

Annual Performance Related Award (APRA) plan deferred shares

Deferred shares are awarded as part of the APRA plan. One third of the value of any annual bonus is delivered in the form of a deferred share award. The release of deferred share awards is not dependent on the achievement of any further performance conditions other than that participants remain employed by the Group for two years from the date of the award in order to retain the full number of shares. During the two-year deferral period, participants are entitled to receive dividends, or equivalent, on the deferred shares. For deferred share awards made from 2010 onwards, 40 per cent of the value of any annual bonus will be delivered in the form of a deferred share award.

Share Incentive Plan (SIP)

This is the 'Free Share' element of the UK Share Incentive Plan. Eligible UK employees may receive shares as part of the Company component of any bonus paid. There are no conditions attached to the shares.

During the year the Group recognised a total expense of £31m (2008 £40m), of which £1.0m (2008 £0.4m) related to cash-settled arrangements. At December 31, 2009, the Group had a liability of £1.5m (2008 £0.6m) relating to cash-settled arrangements.

The movements in awards under the Group's various share plans are shown in the tables below.

	Number of shares	
PSP	**2009 Millions**	2008 Millions
Outstanding at January 1	**13.2**	14.0
Awarded during the year	**10.1**	5.1
Forfeited during the year	**(0.7)**	(0.7)
Additional entitlements arising from TSR performance	**–**	1.3
Vested during the year	**(4.2)**	(6.5)
Outstanding at December 31	**18.4**	13.2

	2009		2008	
ShareSave	**Number of share options Millions**	**Weighted average exercise price Pence**	Number of share options Millions	Weighted average exercise price Pence
Outstanding at January 1	**29.7**	**303p**	43.3	260p
Granted during the year	**11.9**	**387p**	–	–
Forfeited during the year	**(2.3)**	**352p**	(1.7)	333p
Exercised during the year	**(11.9)**	**192p**	(11.9)	144p
Outstanding at December 31	**27.4**	**384p**	29.7	303p
Exercisable at December 31	**–**	**–**	1.6	141p

19 Share-based payments (continued)

ESOP	2009 Number of share options Millions	2009 Weighted average exercise price Pence	2008 Number of share options Millions	2008 Weighted average exercise price Pence
Outstanding at January 1	**2.1**	**177p**	2.3	175p
Forfeited during the year	**(0.2)**	**209p**	–	–
Exercised during the year	**(0.7)**	**213p**	(0.2)	156p
Outstanding at December 31	**1.2**	**154p**	2.1	177p
Exercisable at December 31	**1.2**	**154p**	2.1	177p

Deferred shares under APRA	Number of shares 2009 Millions	Number of shares 2008 Millions
Outstanding at January 1	**2.8**	3.4
Awarded during the year	**2.3**	1.5
Forfeited during the year	**(0.1)**	(0.1)
Additional shares accrued from conversion/reinvestment of B/C Shares	**0.1**	0.1
Vested during the year	**(1.7)**	(2.1)
Outstanding at December 31	**3.4**	2.8

Free Shares under SIP	Number of shares 2009 Millions	Number of shares 2008 Millions
Awarded during the year	**1.2**	1.2

Options were exercised on a regular basis during the year. The average share price during the year was 386p (2008 382p).

Fair values

The weighted average fair values per share for PSP awards, ShareSave grants, APRA deferred share awards, and SIP Free Share awards included in the expense for the year were as follows:

	2009	2008	2007	2006	2005
PSP awards – 25% TSR uplift	**253p**	458p	557p	494p	282p
PSP awards – 50% TSR uplift	**282p**	n/a	n/a	n/a	n/a
ShareSave – 3 year grants	**144p**	–	230p	–	131p
ShareSave – 5 year grants	**167p**	–	264p	–	154p
APRA deferred share awards	**290p**	440p	502p	448p	260p
SIP Free Share awards	**330p**	439p	499p	462p	257p

Details of the assumptions used in the calculation of these fair values are set out below. Expected volatility is based on the historical volatility of Rolls-Royce Group plc's share price over the seven years prior to the grant or award date. Until 2007, expected dividends were based on Rolls-Royce Group plc's payments to shareholders over the five years prior to the grant or award date. From 2008, expected dividends are based on the payments to shareholders in respect of the previous year.

PSP awards

The fair value of shares awarded under the PSP are calculated using the market value of shares at the time of the award adjusted to take into account non-entitlement to dividends (or equivalent) during the vesting period and the TSR performance condition. The PSP fair values were calculated using the following assumptions:

	2009	2008	2007	2006	2005
Weighted average share price	**260p**	430p	501p	444p	262p
Expected dividends	**14.70p**	13.00p	8.30p	7.92p	7.81p
Volatility	**32%**	29%	29%	32%	34%
Correlation	**35%**	29%	26%	19%	19%
Expected life	**3 years**	3 years	3 years	3 years	3 years
Risk free interest rate	**1.9%**	4.1%	5.2%	4.3%	4.9%

19 Share-based payments (continued)

The PSP has a TSR market-based performance condition, such that Rolls-Royce Group plc's TSR over the performance period will be compared with the TSR of the companies constituting the FTSE 100 index on the date of grant. If Rolls-Royce Group plc's TSR exceeds the median TSR of the FTSE 100, the number of shares that vest will be increased by 25 per cent. For conditional awards made from 2009 onwards, a further stretch was incorporated for certain senior executives, such that if TSR performance exceeds the upper quartile of the FTSE 100 index, awards are increased by 50 per cent, with straight-line vesting between median and upper quartile performance. The fair values of the awards of shares under the PSP have been adjusted to take into account this market-based performance condition using a pricing model based on expectations about volatility and the correlation of share price returns in the group of FTSE 100 companies and which incorporates into the valuation the interdependency between share-price performance and TSR vesting. This adjustment increases the fair value of the award relative to the share-price at the date of grant.

ShareSave awards

The fair value of options granted under the ShareSave plan are calculated using a binomial pricing model with the following assumptions:

	2009	2007	2005	2003
Weighted average share price	**462p**	553p	351p	173p
Exercise price	**387p**	416p	298p	142p
Volatility	**36%**	37%	40%	43%
Expected dividends	**14.30p**	8.80p	7.86p	7.61p
Expected life[1] – 3 year ShareSave	**3.3-3.8 years**	3.3-3.8 years	3.3-3.8 years	3.2-3.7 years
– 5 year ShareSave	**5.3-5.8 years**	5.3-5.8 years	5.3-5.8 years	5.2-5.7 years
Risk free interest rate	**2.4%**	5.0%	4.4%	4.6%

[1] The binomial pricing model assumes that participants will exercise their options at the beginning of the six month window if the share price is greater than the exercise price. Otherwise it assumes that options are held until the expiration of their contractual term. This results in an expected life that falls somewhere between the start and end of the exercise window.

Deferred shares under APRA and Free Shares under SIP

The fair value of shares awarded under these plans is calculated as the share price on the date of the award.

20 Operating and finance leases

Operating leases

Leases as lessee

		2009 £m	2008 £m
Rentals paid	– hire of plant and machinery	**68**	64
	– hire of other assets	**24**	25
Non-cancellable operating lease rentals are payable as follows:			
Within one year		**82**	104
Between one and five years		**182**	163
After five years		**123**	205
		387	472

Leases as lessor

	2009 £m	2008 £m
Rentals received – credited within revenue from aftermarket services	**22**	26
Non-cancellable operating lease rentals are receivable as follows:		
Within one year	**5**	6
Between one and five years	**11**	13
After five years	**5**	3
	21	22

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

- Sublease payments of £18m (2008 £15m) and sublease receipts of £11m (2008 £11m) were recognised in the income statement in the year.
- Purchase options exist on aero engines, land and buildings and plant and equipment with the period to the purchase option date varying between one to five years.
- Renewal options exist on aero engines, land and buildings and plant and equipment with the period to the renewal option varying between one to 21 years at terms to be negotiated upon renewal.
- Escalation clauses exist on some leases and are linked to LIBOR.
- The total future minimum sublease payments expected to be made is £14m (2008 £88m) and sublease receipts expected to be received is £4m (2008 £6m).

Finance leases

Finance lease liabilities are payable as follows:

	2009 Payments £m	2009 Interest £m	2009 Principal £m	2008 Payments £m	2008 Interest £m	2008 Principal £m
Within one year	**–**	**–**	**–**	4	1	3
Between one and five years	**1**	**–**	**1**	–	–	–
After five years	**–**	**–**	**–**	1	–	1
	1	**–**	**1**	5	1	4

There were no contingent rents recognised as an expense in the year (2008 £nil). The future minimum sublease receipts expected under non-cancellable subleases is £4m (2008 £6m).

21 Contingent liabilities

In connection with the sale of its products the Group will, on some occasions, provide financing support for its customers. The Group's contingent liabilities relating to financing arrangements are spread over many years and relate to a number of customers and a broad product portfolio.

Contingent liabilities are disclosed on a discounted basis. As the directors consider the likelihood of these contingent liabilities crystallising to be remote, this amount does not represent a value that is expected to crystallise. However, the amounts are discounted at the Group's borrowing rate to reflect better the time span over which these exposures could arise. The contingent liabilities are denominated in US dollars. As the Group does not adopt cash flow hedge accounting for forecast foreign exchange transactions, this amount is reported, together with the sterling equivalent at the reporting date spot rate.

The discounted values of contingent liabilities relating to delivered aircraft and other arrangements where financing is in place, less insurance arrangements and relevant provisions, were:

	2009		2008	
	£m	$m	£m	$m
Gross contingent liabilities	704	1,137	775	1,086
Contingent liabilities net of relevant security[1]	134	217	155	222
Contingent liabilities net of relevant security reduced by 20 per cent[2]	233	376	246	354
[1] Security includes unrestricted cash collateral	77	124	85	123

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

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

Contingent liabilities exist in respect of guarantees provided by the Group in the ordinary course of business for product delivery, performance and reliability. The Group has, in the normal course of business, entered into arrangements in respect of export finance, performance bonds, countertrade obligations and minor miscellaneous items. Various Group undertakings are parties to legal actions and claims which arise in the ordinary course of business, some of which are for substantial amounts. These include claims, which are yet to be substantiated, received by EPI Europrop International GmbH (EPI) in which the Group is a partner, which is developing the TP400 engine for the Airbus A400M aircraft. As a consequence of the insolvency of an insurer as previously reported, the Group is no longer fully insured against known and potential claims from employees who worked for certain of the Group's UK-based businesses for a period prior to the acquisition of those businesses by the Group. While the outcome of some of these matters cannot precisely be foreseen, the directors do not expect any of these arrangements, legal actions or claims, after allowing for provisions already made, to result in significant loss to the Group.

There is continuing uncertainty about the A400M programme. Airbus is currently in negotiation with its customers to determine the future of the programme. The timing and outcome of these negotiations, and their possible impact on EPI and the Group, is uncertain. In the event that the programme were cancelled, at December 31, 2009, the Group's balance sheet included net assets of £17m in relation to the programme, which would require impairment.

22 Related party transactions

	2009 £m	2008 £m
Sales of goods and services to joint ventures and associates	**2,136**	1,555
Purchases of goods and services from joint ventures and associates	**(1,900)**	(1,482)
Operating lease payments to joint ventures and associates	**(45)**	(36)
Guarantees of joint ventures' and associates' borrowings	**15**	13
Dividends received from joint ventures and associates	**77**	59
RRSP receipts from joint ventures and associates	**7**	19
Interest received from joint ventures and associates	**–**	2
Other income received from joint ventures and associates	**52**	102

The aggregated balances with Rolls-Royce Group plc and joint ventures are shown in notes 11 and 14. Transactions with Group pension schemes are shown in note 17.

In the course of normal operations, related party transactions entered into by the Group have been contracted on an arms-length basis. Rolls-Royce Group plc is a non-trading holding company for Rolls-Royce plc.

Key management personnel are deemed to be the directors and the members of the Group Executive as set out in the Annual report of Rolls-Royce Group plc. Remuneration for key management personnel is shown below:

	2009 £m	2008 £m
Salaries and short-term benefits	**11**	9
Post-retirement schemes	**2**	2
Share-based payments	**4**	6
	17	17

23 Acquisitions and disposals

During the year, the Group acquired 58 per cent of the shares of Tidal Generation Limited (previously a joint venture with a Group interest of 42 per cent) and 49 per cent of shares in Europea Microfusioni Aerospaziali S.p.A. (previously a subsidiary with a Group interest of 51 per cent) as summarised below:

	Total £m
Trade and other receivables	2
Cash at bank and in hand	3
Trade and other payables	(1)
Net assets acquired	4
Goodwill arising	6
Acquisition cost	10
Less cash in acquired businesses	(3)
Cash outflow per cash flow statement	7

There were no significant fair value adjustments in respect of the net assets acquired.

During the year, the Group disposed of its interests in a number of small businesses, as summarised below:

	Total £m
Trade and other receivables	2
Assets held for resale	2
Net assets	4
Profit on sale or termination of businesses	(2)
Disposal proceeds	2
Receipt of proceeds deferred at December 31, 2008	1
Cash inflow per cash flow statement	3

Company financial statements

December 31, 2009

Company balance sheet

At December 31, 2009

	Notes	2009 £m	* Restated 2008 £m
Fixed assets			
Intangible assets	3	**569**	546
Tangible assets	4	**1,041**	1,029
Investments – subsidiary undertakings	5	**1,750**	1,647
Investments – joint ventures	5	**51**	71
Investments – other	5	**49**	46
		3,460	3,339
Current assets			
Stocks	6	**1,240**	1,328
Debtors – amounts falling due within one year	7	**2,183**	2,476
Debtors – amounts falling due after one year	7	**932**	1,433
Other financial assets – amounts falling due within one year	10	**114**	217
Other financial assets – amounts falling due after one year	10	**646**	476
Short-term deposits		**1,644**	1,456
Cash at bank and in hand		**663**	554
Assets held for resale		**9**	9
		7,431	7,949
Creditors – amounts falling due within one year			
Borrowings	8	**(511)**	(637)
Other financial liabilities	10	**(158)**	(384)
Other creditors	9	**(5,093)**	(5,896)
		(5,762)	(6,917)
Net current assets		**1,669**	1,032
Total assets less current liabilities		**5,129**	4,371
Creditors – amounts falling due after one year			
Borrowings	8	**(1,782)**	(1,319)
Other financial liabilities	10	**(896)**	(2,461)
Other creditors	9	**(773)**	(792)
		(3,451)	(4,572)
Provisions for liabilities and charges	11	**(99)**	(100)
Net assets/(liabilities) excluding post-retirement schemes		**1,579**	(301)
Post-retirement scheme surpluses		**237**	664
Post-retirement scheme deficits		**(50)**	(32)
Net assets		**1,766**	331
Capital and reserves			
Called-up share capital	14	**326**	326
Share premium account	15	**631**	631
Revaluation reserve	15	**47**	51
Transition hedging reserve	15	**–**	20
Other reserves	15	**167**	167
Profit and loss account	15	**595**	(864)
Total shareholders' funds		**1,766**	331

* The Company has reclassified derivative financial instruments into those falling due with and after one year – see note 10.

The financial statements on pages 107 to 126 were approved by the Board on February 10, 2010 and signed on its behalf by:

Simon Robertson Chairman

Andrew Shilston Finance Director

Statement of total recognised gains and losses

For the year ended December 31, 2009

	2009 £m	2008 £m
Profit/(loss) attributable to the shareholders of Rolls-Royce plc	**1,937**	(1,656)
Net actuarial (losses)/gains	**(1,176)**	1,040
Movement in unrecognised post-retirement surplus	**491**	(453)
Movement in fair value of available for sale assets	**–**	(8)
Related tax movements	**192**	(163)
Total recognised gains/(losses) relating to the year	**1,444**	(1,240)

Reconciliation of movements in shareholders' funds

For the year ended December 31, 2009

	2009 £m	2008 £m
At January 1	**331**	1,612
Total recognised gains/(losses) for the year	**1,444**	(1,240)
Transfer from transition hedging reserve	**(27)**	(78)
Share-based payments adjustment	**11**	15
Related tax movements	**7**	22
At December 31	**1,766**	331

Notes to the Company financial statements

1 Significant accounting policies

Basis of accounting
The financial statements have been prepared in accordance with applicable accounting standards on the historical cost basis, modified to include the revaluation of land and buildings.

As permitted by the Companies Act 2006, a separate profit and loss account for the Company has not been included in these financial statements.

As permitted by FRS 1 *Cash flow statements*, no cash flow statement has been prepared, as a consolidated cash flow statement has been prepared by the ultimate parent company.

Some small adjustments have been made to comparative figures to put them on a consistent basis with the current year.

Revenue recognition
Revenues comprise sales to external customers after discounts, and excluding value added tax.

Sales of products are recognised when the significant risks and rewards of ownership of the goods are transferred to the customer, the sales price agreed and the receipt of payment can be assured.

Sales of services and long-term contracts are recognised when the outcome of the transaction can be reliably estimated. Revenue is recognised by reference to the stage of completion based on services performed to date as a percentage of the total contractual obligation. The assessment of the stage of completion is dependent on the nature of the contract, but will generally be based on: costs incurred to the extent these relate to services performed up to the reporting date; achievement of contractual milestones where appropriate; or flying hours or equivalent for long-term aftermarket arrangements.

Linked sales of product and services are treated as a single long-term contract where these components have been negotiated as a single commercial package and are so closely interrelated that they do not operate independently of each other and are considered to form a single project with an overall profit margin. Revenue is recognised on the same basis as for other sales of products and services as described above.

Full provision is made for any estimated losses to completion of contracts having regard to the overall substance of the arrangements.

Progress payments received on long-term contracts, when greater than recorded turnover, are deducted from the value of work in progress except to the extent that payments on account exceed the value of work in progress on any contract where the excess is included in creditors. The amount by which recorded turnover of long-term contracts is in excess of payments on account is classified as 'amounts recoverable on contracts' and is separately disclosed within debtors.

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

Risk and revenue sharing partnerships (RRSPs)
From time-to-time, the Company enters into arrangements with partners who, in return for a share in future programme revenues or profits, make cash payments that are not refundable (except under certain remote circumstances). Cash sums received, which reimburse the Company for past expenditure, are credited to other operating income. The arrangements also require partners to undertake development work and/or supply components for use in the programme at their own expense. No accounting entries are recorded where partners undertake such development work or where programme components are supplied by partners because no obligation arises unless and until programme sales are made; instead, payments to partners for their share in the programme are charged to cost of sales as programme revenues arise.

The Company has arrangements with partners who do not undertake development work or supply parts. Such arrangements are considered to be financial instruments as defined by FRS 25 *Financial instruments*: *Presentation* and are accounted for using the amortised cost method.

Research and development
The charge to the profit and loss account consists of research and development expenditure incurred in the year, excluding known recoverable costs on contracts, contributions to shared engineering programmes and application engineering. Application engineering expenditure, incurred in the adaptation of existing technology to new products, is capitalised and amortised over the programme life, up to a maximum of 15 years, where both the technical and commercial risks are considered to be sufficiently low.

Interest
Interest receivable/payable is credited/charged to the profit and loss account using the effective interest method.

1 Significant accounting policies (continued)

Taxation

Provision for taxation is made at the current rate and for deferred taxation at the projected rate on all timing differences that have originated, but not reversed at the balance sheet date.

Deferred tax is calculated using the enacted or substantively enacted rates that are expected to apply when the asset or liability is settled.

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

Foreign currency translation

Transactions in overseas currencies are translated into local currency at the exchange rate ruling on the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated into sterling at the rate ruling at the year-end. Exchange differences arising on foreign exchange transactions and the retranslation of assets and liabilities into sterling at the rate ruling at the year-end are taken into account in determining profit on ordinary activities before taxation.

Financial instruments

FRS 26 *Financial instruments: recognition and measurement* requires the classification of financial instruments into separate categories for which the accounting requirement is different. Rolls-Royce has classified its financial instruments as follows:

- Fixed deposits, principally comprising funds held with banks and other financial institutions, are classified as loans and receivables.
- Investments (other than interests in joint ventures and fixed deposits) and short-term deposits (other than fixed deposits) are classified as available for sale.
- Borrowings, trade creditors and financial RRSPs are classified as other liabilities.
- Derivatives, comprising foreign exchange contracts, interest rate swaps and commodity swaps are classified as held for trading.

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

- Loans and receivables and other liabilities are held at amortised cost and not revalued (except for changes in exchange rates, which are included in the profit and loss account) unless they are included in a fair value hedge accounting relationship. Where such a relationship exists, the instruments are revalued in respect of the risk being hedged. If instruments held at amortised cost are hedged, generally by interest rate swaps, and the hedges are effective, the carrying values are adjusted for changes in fair value, which are included in the profit and loss account.
- Available for sale assets are held at fair value. Changes in fair value arising from changes in exchange rates are included in the profit and loss account. All other changes in fair value are taken to reserves. On disposal, the accumulated changes in value recorded in reserves are included in the gain or loss recorded in the profit and loss account.
- Held for trading instruments are held at fair value. Changes in fair value are included in the profit and loss account unless the instrument is included in a cash flow hedge. If the instruments are included in a cash flow hedging relationship, which is effective, changes in value are taken to reserves. When the hedged forecast transaction occurs, amounts previously recorded in reserves are recognised in the profit and loss account.

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

Hedge accounting

The Company does not apply hedge accounting in respect of forward foreign exchange contracts held to manage the cash flow exposures of forecast future transactions denominated in foreign currencies.

The Company does not apply hedge accounting in respect of commodity swaps held to manage the cash flow exposures of forecast future transactions in those commodities.

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

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

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

1 Significant accounting policies (continued)

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

The portion of a gain or loss on an instrument used to hedge a net investment in a foreign operation that is determined to be an effective hedge is recognised directly in reserves. The ineffective portion is recognised immediately in the profit and loss account.

Until December 31, 2004 the Company applied hedge accounting for forecast foreign exchange transactions and commodity exposures in accordance with UK Accounting Standards. On January 1, 2005, the fair values of derivatives used for hedging these exposures were included in the transition hedging reserve. This reserve is released to the profit and loss account based on the designation of the hedges on January 1, 2005.

Certification costs and participation fees

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

Software

The cost of acquiring software that is not specific to an item of tangible fixed assets is classified as an intangible asset.

Tangible fixed assets and depreciation

Tangible fixed assets are stated at cost or valuation less accumulated depreciation and any provision for impairments in value.

Depreciation is provided on a straight-line basis to write-off the cost or valuation, less the estimated residual value, over the estimated useful life. Estimated useful lives are as follows:

i) Land and buildings, as advised by the Group's professional valuers:
   a) Freehold buildings – five to 45 years (average 24 years).
   b) Leasehold land and buildings – lower of valuers' estimates or period of lease.
   c) No depreciation is provided in respect of freehold land.
ii) Plant and equipment – five to 25 years (average 14 years).
iii) Aircraft and engines – five to 20 years (average 16 year).
iv) No depreciation is provided on assets in the course of construction.

Impairment of fixed assets

Impairment of fixed assets is considered in accordance with FRS 11 *Impairment of fixed assets and goodwill*. Where the asset does not generate cash flows that are independent of other assets, impairment is considered for the income-generating unit to which the asset belongs.

Intangible assets not yet available for use are tested for impairment annually. Other fixed assets are assessed for any indications of impairment annually. If any indication of impairment is identified, an impairment test is performed to estimate the recoverable amount.

Recoverable amount is the higher of value in use or fair value less costs to sell – if this is readily available. The value in use is the present value of future cash flows using a pre-tax discount rate that reflects the time value of money and the risk specific to the asset.

If the recoverable amount of an asset (or income-generating unit) is estimated to be below the carrying value, the carrying value is reduced to the recoverable amount and the impairment loss recognised as an expense.

1 Significant accounting policies (continued)

Accounting for leases

i) As Lessee

Assets financed by leasing agreements that give rights approximating to ownership (finance leases) have been capitalised at amounts equal to the original cost of the assets to the lessors and depreciation provided on the basis of the Company depreciation policy. The capital elements of future obligations under finance leases are included as liabilities in the balance sheet and the current year's interest element, having been allocated to accounting periods to give a constant periodic rate of charge on the outstanding balance, is charged to the profit and loss account.

The annual payments under all other lease arrangements, known as operating leases, are charged to the profit and loss account on a straight-line basis.

ii) As Lessor

Amounts receivable under finance leases are included under debtors and represent the total amount outstanding under lease agreements less unearned income. Finance lease income, having been allocated to accounting periods to give a constant periodic rate of return on the net cash investment, is included in turnover.

Rentals receivable under operating leases are included in turnover on a straight-line basis.

Stock

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

Provisions

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

Post-retirement benefits

Pensions and similar benefits are accounted for under FRS 17 *Post-retirement benefits*. For defined benefit plans, obligations are measured at discounted present value whilst plan assets are recorded at fair value. The service and financing costs of such plans are recognised separately in the profit and loss account; service costs are spread systematically over the lives of employees and financing costs are recognised in the periods in which they arise. Actuarial gains and losses are recognised immediately in the statement of total recognised gains and losses.

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

Share-based payments

The Company participates in Rolls-Royce Group plc employee share-based payment arrangements. These are equity-settled arrangements and are measured at fair value (excluding the effect of non-market based vesting conditions) at the date of grant. The fair value is expensed on a straight-line basis over the vesting period, based on the Company's estimate of shares or options that will eventually vest. The costs of these share-based payments are treated as a capital contribution from the parent company. Any payments made by the Company to its parent company, in respect of these arrangements, are treated as a return of this capital contribution.

The fair values of the share-based payment arrangements are measured as follows:

i) ShareSave – using the binomial pricing method;
ii) Performance Share Plan – using a pricing model adjusted to reflect non-entitlement to dividends (or equivalent) and the TSR market-based condition;
iii) Annual performance Related Award plan and free shares under the Share Incentive plan – share price on the date of the award.

See note 17 for further description of the share-based payment plans.

2 Emoluments of directors

	2009 Highest paid director £000	2009 Other directors £000	2008 Highest paid director £000	2008 Other directors £000
Aggregate emoluments excluding deferred share plans	**1,110**	**3,638**	1,125	3,526
Aggregate amounts relating to deferred share plans	**837**	**1,361**	1,492	1,841
Aggregate value of Company contributions to Company defined contribution pensions schemes	**–**	**524**	–	558
Accrued pension of highest paid director	**450**	**–**	449	–
Gains realised on exercise of share options	**–**	**51**	–	9

	2009 Number	2008 Number
Number of directors with accruing retirement benefits:		
Defined contribution schemes	**2**	2
Defined benefit schemes	**2**	2
Number of directors with enhanced protection rights within defined benefit schemes	**2**	2
Number of directors exercising share options	**2**	1
Number of directors receiving shares as part of long-term incentives schemes	**5**	5

[1] Member of defined benefit scheme, started to receive pension on February 1, 2008.
[2] Includes gains under the ShareSave plan.
[3] Two directors were contributing members of both defined contribution and defined benefit schemes (2008 two directors)

3 Intangible assets

	Certification costs and participation fees £m	Software and other £m	Total £m
Cost:			
At January 1, 2009	**526**	**211**	**737**
Additions	38	22	60
At December 31, 2009	**564**	**233**	**797**
Accumulated amortisation:			
At January 1, 2009	**152**	**39**	**191**
Provided during the year	13	24	37
At December 31, 2009	**165**	**63**	**228**
Net book value at December 31, 2009	**399**	**170**	**569**
Net book value at January 1, 2009	374	172	546

4 Tangible assets

	Land and buildings £m	Plant and equipment £m	Aircraft and engines £m	In course of construction £m	Total £m
Cost or valuation:					
At January 1, 2009	**407**	**1,282**	**41**	**127**	**1,857**
Additions	3	51	18	71	143
Reclassifications	6	51	4	(61)	-
Transferred to 'Assets held for sale'	(12)	–	–	–	(12)
Disposals/write-offs	(2)	(62)	(28)	–	(92)
At December 31, 2009	**402**	**1,322**	**35**	**137**	**1,896**
Accumulated depreciation:					
At January 1, 2009	**116**	**708**	**4**	**–**	**828**
Provided during the year	14	84	4	–	102
Transferred to 'Assets held for sale'	(12)	–	–	–	(12)
Disposals/write-offs	(1)	(59)	(3)	–	(63)
At December 31, 2009	**117**	**733**	**5**	**–**	**855**
Net book value at December 31, 2009	**285**	**589**	**30**	**137**	**1,041**
Net book value at January 1, 2009	291	574	37	127	1,029

Tangible fixed assets include:	2009 £m	2008 £m
Net book value of finance leased assets	**13**	17
Non-depreciable land	**47**	57
Land and buildings at cost or valuation comprise:		
Cost	**250**	248
Valuation at December 31, 1996	**152**	159
	402	407
Land and buildings at net book value comprise:		
Freehold	**279**	284
Long leasehold	**4**	5
Short leasehold	**2**	2
	285	291
On an historical cost basis the net book value of land and buildings would have been as follows:		
Cost	**386**	390
Depreciation	**(148)**	(139)
	238	251
Capital expenditure commitments – contracted but not provided for	**82**	86

5 Investments

	Subsidiary undertakings[1]			Joint ventures[2]	Other
	Shares at cost[3] £m	Shares at cost £m	Loans £m	Total £m	Unlisted investments at cost £m
At January 1, 2009	**1,647**	**66**	**5**	**71**	**46**
Additions	87	1	1	2	–
Transfer to 'other investments'[4]	–	(5)	(1)	(6)	4
Transfer to 'subsidiary undertakings'	16	(16)	–	(16)	–
Impairment	–	–	–	–	(1)
At December 31, 2009	**1,750**	**46**	**5**	**51**	**49**

1 The principal subsidiary undertakings are listed on page 127.
2 The principal joint ventures are listed on pages 128 and 129.
3 The Company has guaranteed the uncalled share capital of Nightingale Insurance Limited, one of its subsidiaries. At December 31, 2009, this guarantee was £25m (2008 £25m).
4 During the year, the Company reduced its ownership interest in a joint venture to that of an investment. The difference between values attributable to this investment is due to the companies share of post acquisition reserves, which form part of the cost of investment when recorded within Other investments.

6 Stocks

	2009 £m	2008 £m
Raw materials	**106**	44
Work in progress	**303**	368
Long-term contracts work in progress	**15**	22
Finished goods	**800**	881
Payments on account	**16**	13
	1,240	1,328

7 Debtors

	Falling due within one year		Falling due after one year	
	2009 £m	2008 £m	2009 £m	2008 £m
Trade debtors	**315**	408	**1**	3
Amounts recoverable on contracts	**78**	–	**609**	578
Amounts owed by parent undertaking	**72**	–	**–**	–
Amounts owed by subsidiary undertakings	**1,040**	1,392	**–**	–
Amounts owed by joint ventures and associates	**455**	394	**5**	5
Deferred tax assets (note 12)	**–**	–	**292**	794
Other debtors	**146**	202	**–**	15
Prepayments and accrued income	**77**	80	**25**	38
	2,183	2,476	**932**	1,433

8 Borrowings

	Falling due within one year		Falling due after one year	
	2009 £m	2008 £m	**2009 £m**	2008 £m
Unsecured				
Overdrafts	**391**	634	**–**	–
Bank loans	**–**	–	**200**	–
7 3/8% Notes 2016 £200m	**–**	–	**200**	200
5.84% Notes 2010 US$187m[1]	**120**	–	**–**	136
6.38% Notes 2013 US$230m[1]	**–**	–	**155**	178
6.55% Notes 2015 US$83m[1]	**–**	–	**57**	67
4 1/2% Notes 2011 €750m[2]	**–**	–	**677**	738
6.75% Notes 2019 £500m	**–**	–	**493**	–
Secured				
Obligations under finance leases[3]:				
Less than one year	**–**	3	**–**	–
	511	637	**1,782**	1,319
Repayable				
Between one and two years – otherwise			**677**	136
Between two and five years – otherwise			**355**	916
After five years – otherwise			**750**	267
			1,782	1,319

[1] These notes are subject to interest rate swap agreements under which the Company has undertaken to pay floating rates of interest, and currency swaps which form a fair value hedge.
[2] These notes are the subject of swap agreements under which counterparties have undertaken to pay amounts at fixed rates of interest and exchange in consideration for amounts payable at variable rates of interest and at fixed exchange rates.
[3] Obligations under finance leases are secured by related leased assets.

9 Other creditors

	Falling due within one year		Falling due after one year	
	2009 £m	2008 £m	**2009 £m**	2008 £m
Payments received on account[1]	**387**	383	**525**	547
Trade creditors	**426**	431	**–**	–
Amounts owed to parent undertaking	**–**	168	**–**	–
Amounts owed to subsidiary undertakings	**2,211**	2,995	**–**	–
Amounts owed to joint ventures	**258**	321	**2**	4
Corporate taxation	**95**	101	**–**	–
Other taxation and social security	**38**	18	**–**	–
Other creditors	**832**	905	**69**	190
Accruals and deferred income	**846**	574	**177**	51
	5,093	5,896	**773**	792
[1] Includes payments received from joint ventures	**161**	209	**259**	107

10 Other financial assets and liabilities

Details of the Company's policies on the use of financial instruments are given in the accounting policies on page 110.

The Company adopted FRS 25 and FRS 26 *Financial instruments* prospectively from January 1, 2005. Consistent with the presentation of such amounts in the consolidated financial statements, in the current period the Company has reconsidered the classification of its derivative financial instruments in the balance sheet between amounts due within one year and after one year. Those derivatives with settlement dates greater than 12 months from the balance sheet date are now classified as due greater than one year. Previously all derivative instruments were classified as current. Comparatives have been represented consistently. The effect is that financial assets comprising foreign exchange contracts (£415m) and interest rate contracts (£278m) were previously reported as assets falling due within one year, and financial liabilities comprising foreign exchange contracts (£2,367m), commodity contracts (£89m) and interest rate contracts (£4m) were previously reported as liabilities falling due within one year.

The fair values of derivative financial instruments held by the Company are as follows:

	Foreign exchange contracts £m	Commodity contracts £m	Interest rate contracts £m	Financial RRSPs £m	Total £m
At December 31, 2009					
Assets – amounts falling due within one year	**106**	**4**	**4**	**–**	**114**
Assets – amounts falling due after one year	**438**	**11**	**197**	**–**	**646**
Liabilities – amounts falling due within one year	**(97)**	**(11)**	**–**	**(50)**	**(158)**
Liabilities – amounts falling due after one year	**(617)**	**(15)**	**(2)**	**(262)**	**(896)**
	(170)	**(11)**	**199**	**(312)**	**(294)**
At December 31, 2008					
Assets – amounts falling due within one year	217	–	–	–	217
Assets – amounts falling due after one year	198	–	278	–	476
Liabilities – amounts falling due within one year	(271)	(36)	(2)	(75)	(384)
Liabilities – amounts falling due after one year	(2,096)	(53)	(2)	(310)	(2,461)
	(1,952)	(89)	274	(385)	(2,152)

Foreign exchange and commodity financial instruments

The Company uses various financial instruments to manage its exposure to movements in foreign exchange rates. The Company uses commodity swaps to manage its exposure to movements in the price of commodities (jet fuel and base metals). From January 1, 2005, the Company has not included foreign exchange or commodity financial instruments in any cash flow hedging relationships for accounting purposes. To hedge the currency risk associated with a borrowing denominated in US dollars, the Company has currency derivatives designated as part of a fair value hedge.

Movements in the fair values of foreign exchange and commodity financial instruments were as follows:

	Foreign exchange instruments £m	Commodity instruments £m
At January 1, 2008	297	39
Fair value changes to derivative contracts not in accounting hedging relationships	(2,044)	(96)
Fair value changes to fair value hedges[1]	83	–
Fair value of derivative contracts assumed on formation of joint venture	(24)	–
Fair value of contracts settled	(264)	(32)
At January 1, 2009	**(1,952)**	**(89)**
Fair value changes to derivative contracts not in accounting hedging relationships	1,562	52
Fair value changes to fair value hedges[1]	(33)	–
Fair value of contracts settled	253	26
At December 31, 2009	**(170)**	**(11)**

[1] Profit on related hedged items £33m (2008 £(83)m loss)

10 Other financial assets and liabilities (continued)

Interest rate financial instruments

The Company uses interest rate swaps, forward rate agreements and interest rate caps to manage its exposure to movements in interest rates. Where the effectiveness of the hedge relationship in a cash flow hedge is demonstrated, changes in the fair value that are deemed effective are included in the hedging reserve and released to match actual payments on the hedged item.

Movements in the fair values of interest rate financial instruments were as follows:

	Total £m	Included in fair value hedging relationships £m	Other interest rate financial instruments £m
At January 1, 2008	39	42	(3)
Changes during the year	235	236	(1)
At January 1, 2009	**274**	**278**	**(4)**
Changes during the year	**(75)**	**(77)**	**2**
At December 31, 2009	**199**	**201**	**(2)**

Where applicable, market values have been used to determine fair values. Where market values are not available, fair values have been calculated by discounting expected future cash flows at prevailing interest rates and translating at prevailing exchange rates.

Financial risk and revenue sharing partnerships (RRSPs)

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

Movements in the amortised cost values of financial RRSPs are as follows:

	2009 £m	2008 £m
At January 1	**(385)**	(317)
Cash paid to partners	**57**	74
Financing charge	**(22)**	(26)
Exchange adjustments	**44**	(116)
Changes in forecast payments	**(6)**	–
At December 31	**(312)**	(385)

11 Provisions for liabilities and charges

	At December 31, 2008 £m	Unused amounts reversed £m	Charged to profit and loss account £m	Utilised £m	At December 31, 2009 £m
Warranties and guarantees	27	**–**	**7**	**(5)**	**29**
Contract loss	–	**–**	**5**	**–**	**5**
Customer financing	58	**–**	**14**	**(15)**	**57**
Restructuring	15	**(6)**	**8**	**(9)**	**8**
	100	**(6)**	**34**	**(29)**	**99**

Provisions for warranties and guarantees primarily relate to products sold and generally cover a period of up to three years.
Provisions for contract loss and restructuring are generally expected to be utilised within two years.
Customer financing provisions cover guarantees provided for asset values and/or financing as described in note 18. Timing of utilisation is uncertain.

12 Deferred taxation

	£m
At January 1, 2009	**548**
Amount credited to profit and loss account	**(520)**
Amount credited to statement of total recognised gains and losses	**192**
At December 31, 2009	**220**

There are other deferred tax assets totalling £102m (2008 £102m) that have not been recognised on the basis that their future economic benefit is uncertain.

The undistributed profits of overseas subsidiary undertakings and joint ventures may be liable to overseas taxes and/or United Kingdom tax (after allowing for double tax relief) if remitted as dividends to the UK. No deferred tax has been provided as there are currently no commitments to pay such dividends.

The analysis of the deferred tax position is as follows:

	2009 £m	2008 £m
Fixed asset timing differences	**(117)**	(119)
Other timing differences	**45**	17
Pensions and other post-retirement scheme benefits	**(72)**	(246)
Foreign exchange and commodity financial assets and liabilities	**54**	655
Losses	**249**	180
Advance corporation tax	**61**	61
	220	548
Included within:		
Debtors – amounts falling due after one year	**292**	794
Provisions	**–**	–
Post-retirement scheme surpluses	**(92)**	(259)
Post-retirement scheme deficits	**20**	13
	220	548

The above figures exclude taxation payable on capital gains which might arise from the sale of fixed assets at the values at which they are stated in the Company's balance sheet.

13 Post-retirement benefits

Defined benefit schemes

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

The valuations of the defined benefit schemes are based on the most recent funding valuations, updated by the scheme actuaries to December 31, 2009. The most recent funding valuations of the main schemes were:

Scheme	Valuation date
Rolls-Royce Pension Fund (RRPF)	March 31, 2009
Rolls-Royce Group Pension Scheme	April 5, 2007
Vickers Group Pension Scheme	March 31, 2007

The principal actuarial assumptions used at the balance sheet date were as follows:

	2009 %	2008 %
Rate of increase in salaries	**4.7**	4.5
Rate of increase of pensions in payment	**3.3**	2.9
Discount rate	**5.7**	6.4
Expected rate of return on scheme assets	**5.4**	4.1
Inflation assumption	**3.6**	3.0

[1] Benefits accruing after April 5, 2005 are assumed to increase at a rate of 1.9 per cent.

The discount rates are determined by reference to the market yields on AA rated corporate bonds. For the main schemes, the rate is determined by using the profile of forecast benefit payments to derive a weighted average discount rate from the yield curve. For less significant schemes the rate is determined as the market yield at the average duration of the forecast benefit payments. The discount rates above are the weighted average of those for each scheme, based on the value of their respective liabilities.

The overall expected rate of return is calculated by weighting the individual returns expected from each asset class (see below) in accordance with the actual asset balance in the schemes' investment portfolios.

The mortality assumptions adopted for the pension schemes are derived from the actuarial tables (PA92, other than RRPF which has adopted the SAPS tables in its 2009 valuation), with 80 per cent of long cohort, published by the Institute of Actuaries, projected forward and, where appropriate, adjusted to take account of the relevant scheme's actual experience. The resulting range of life expectancies in the principal schemes are as follows:

Life expectancy from age 65	
Current pensioner	19.6 years to 23.5 years
Future pensioner	20.7 years to 24.2 years

Other demographic assumptions have been set on advice from the relevant actuary, having regard to the latest trends in scheme experience and other relevant data. The assumptions are reviewed and updated as necessary as part of the periodic actuarial valuation of the schemes.

13 Post-retirement benefits (continued)

Amounts recognised in the balance sheet

	2009 £m	2008 £m
Present value of funded obligations	(6,714)	(5,719)
Fair value of scheme assets	7,048	7,163
Unrecognised surplus[1]	(75)	(566)
Surplus/(deficit)	259	878
Related deferred tax (liability)/asset	(72)	(246)
Net asset/(liability) recognised in the balance sheet	187	632
Analysed as:		
Post-retirement scheme surpluses	237	664
Post-retirement scheme deficits	(50)	(32)
	187	632

[1] Where a surplus has arisen on a scheme, in accordance with FRS 17 *Retirement benefits*, the surplus is recognised as an asset only if it represents a future economic benefit available to the Company. Any surplus in excess of this benefit is not recognised in the balance sheet. Surpluses have arisen largely as a result of differences between the actuarial and FRS 17 valuation assumptions.

Changes in present value of defined benefit obligations

	2009 £m	2008 £m
At January 1	(5,719)	(6,335)
Current service cost [1]	(94)	(127)
Past service cost	(2)	(5)
Finance cost	(355)	(358)
Contributions by employees	(3)	(4)
Net benefits paid out	324	331
Actuarial gains	(865)	776
Transfers	–	3
At December 31	(6,714)	(5,719)

[1] The Company made no ex-gratia payments directly to scheme members (2008 £8m)

Changes in fair value of scheme assets

	2009 £m	2008 £m
At January 1	7,163	6,626
Expected return on assets	285	352
Contributions by employer	232	248
Contributions by employees	3	4
Benefits paid out	(324)	(331)
Actuarial gains	(311)	264
At December 31	7,048	7,163
Actual return on plan assets	(26)	616

The fair value of the scheme assets and the expected rates of return at December 31, were as follows:

		2009		2008
	Expected rate of return %	Market value £m	Expected rate of return %	Market value £m
LDI portfolio[1]	5.0	5,736	3.5	5,833
Equities	7.8	1,107	7.2	1,141
Sovereign debt	4.5	18	3.9	110
Corporate bonds	5.5	8	5.5	110
Other	4.6	179	1.9	(31)
	5.4	7,048	4.1	7,163

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

13 Post-retirement benefits (continued)

The scheme assets do not include any financial instruments of the Rolls-Royce Group plc group, nor any property occupied by, or other assets used by, the group.

The expected rate of return for LDI portfolios is determined by the implicit yield on the portfolio at the balance sheet date.

The expected rates of return on other individual categories of scheme assets are determined by reference to gilt yields. Equities and corporate bonds are assumed to generate returns that exceed the return from gilts by 3.25 per cent and 1.00 per cent per annum respectively.

The expected rates of return above are the weighted average of the rates for each scheme.

Future contributions

The Company expects to contribute approximately £220m to its defined benefit schemes in 2010.

Sensitivities

The investment strategies are designed to hedge the risks from interest rates and inflation on an economic basis. A reduction of 0.25 per cent in the discount rate would increase the obligations of the principal UK defined benefit schemes by approximately £243m. An equivalent movement in interest rates would increase the fair value of the assets by approximately £290m. The difference arises largely due to differences in the methods used to value the obligations for accounting and economic purposes. On an economic basis the correlation is in excess of 80 per cent. The principle remaining risks relate to the assumptions for mortality and increases in salaries. If the age ratings in respect of the principal UK defined benefit schemes were increased by one year, the scheme liabilities would increase by £137m. If the rate of increase in salaries were 0.5 per cent higher, scheme liabilities would increase by £117m.

History of defined benefit schemes

The history of the schemes for the current and prior years is as follows:

	2009 £m	2008 £m	2007 £m	2006 £m	2005 £m
Balance sheet					
Present value of defined benefit obligations	**(6,714)**	(5,719)	(6,335)	(5,785)	(6,102)
Fair value of scheme assets	**7,048**	7,163	6,626	5,101	4,809
Unrecognised surplus	**(75)**	(566)	(113)	–	–
Asset/(deficit)	**259**	878	178	(684)	(1,293)
Experience gains/(losses)					
Actuarial (losses)/gains on scheme assets	**(311)**	264	157	114	503
Experience (losses)/gains on scheme liabilities	**(865)**	776	309	477	(745)
Movement in unrecognised surplus	**491**	(453)	(113)	–	–
Total amount recognised in the statement of total recognised gains and losses	**(685)**	587	353	591	(242)
Cumulative amount recognised in the statement of total recognised gains and losses[1]	**(493)**	192	(395)	(748)	(1,339)

[1] Since January 1, 2002

Defined contribution schemes

The Company operates a number of defined contribution schemes. The total expense recognised in the profit and loss account was £7m (2008 £6m).

14 Share capital

	Equity ordinary shares of 20p each Millions	**Nominal value £m**
Authorised		
At January 1, and December 31, 2009	**2,000**	**400**
Issued and fully paid		
At January 1, and December 31, 2009	**1,631**	**326**

15 Movements in capital and reserves

	Share capital £m	Share premium £m	Revaluation reserve £m	Non-distributable reserves: Transition hedging reserve[1] £m	Non-distributable reserves: Other reserves £m	Profit and loss account £m	Total equity £m
At January 1, 2009	**326**	**631**	**51**	**20**	**167**	**(864)**	**331**
Total recognised gains relating to the year	–	–	–	–	–	1,444	1,444
Transfers between reserves	–	–	(4)	–	–	4	–
Transfer from transition hedging reserve	–	–	–	(27)	–	–	(27)
Share-based payments adjustment	–	–	–	–	–	11	11
Related tax movements	–	–	–	7	–	–	7
At December 31, 2009	**326**	**631**	**47**	**0**	**167**	**595**	**1,766**

[1] See accounting policies note 1 – hedge accounting

16 Operating lease annual commitments

	2009 £m	2008 £m
Leases of land and buildings which expire:		
Between one and five years	**3**	3
After five years	**1**	4
Other leases which expire:		
Within one year	**1**	–
Between one and five years	**4**	3

17 Share-based payments

Share-based payment plans in operation during the year

The Company participated in the following share-based payment plans of Rolls-Royce Group plc in operation during the year:

Performance Share Plan (PSP)

This plan involves the award of shares to participants subject to performance conditions. Vesting of the performance shares is based on the achievement of both non-market based conditions (EPS and cash flow per share) and a market based performance condition (TSR).

ShareSave share option plan

Based on a three- or five-year monthly savings contract, eligible employees are granted share options with an exercise price of up to 20 per cent below the share price when the contract is entered into. Vesting of the options is not subject to the achievement of a performance target. In the UK, the plan is HM Revenue & Customs approved. Overseas, employees in 33 countries participate in ShareSave plans through arrangements which provide broadly comparable benefits to the UK plan. From 2007 onwards, the overseas schemes are cash-settled schemes.

Executive Share Option Plan (ESOP)

This plan involved the grant of market value share options to participants. It expired in 2009 and no further grants may be made. Remaining options under the plan are subject to a non-market based performance condition (growth in EPS) and have a maximum contractual life of ten years.

Annual Performance Related Award (APRA) plan deferred shares

Deferred shares are awarded as part of the APRA plan. One third of the value of any annual bonus is delivered in the form of a deferred share award. The release of deferred share awards is not dependent on the achievement of any further performance conditions other than that participants remain employed by the Group for two years from the date of the award in order to retain the full number of shares. During the two-year deferral period, participants are entitled to receive dividends, or equivalent, on the deferred shares. For deferred share awards made from 2010 onwards, 40 per cent of the value of any annual bonus will be delivered in the form of a deferred share award.

17 Share-based payments (continued)

Share Incentive Plan (SIP)

This is the 'Free Share' element of the UK Share Incentive Plan. Eligible UK employees may receive shares as part of the Company component of any bonus paid. There are no conditions attached to the shares.

The Company recognised a total expense of £19m (2008 £24m).

The movements in awards under the various share plans are shown in the tables below:

PSP	Number of shares 2009 Millions	Number of shares 2008 Millions
Outstanding at January 1	**7.8**	8.7
Awarded during the year	**6.0**	2.8
Forfeited during the year	**(0.5)**	(0.5)
Additional entitlements arising from TSR performance	**–**	0.9
Vested during the year	**(2.6)**	(4.1)
Outstanding at December 31	**10.7**	7.8

	2009		2008	
ShareSave	Number of share options Millions	Weighted average exercise price Pence	Number of share options Millions	Weighted average exercise price Pence
Outstanding at January 1	**18.9**	**288p**	29.5	241p
Granted during the year	**7.5**	**387p**	–	–
Forfeited during the year	**(1.3)**	**353p**	(0.8)	334p
Exercised during the year	**(7.6)**	**171p**	(9.8)	143p
Outstanding at December 31	**17.5**	**381p**	18.9	288p
Exercisable at December 31	**–**	**–**	1.1	141p

	2009		2008	
ESOP	Number of share options Millions	Weighted average exercise price Pence	Number of share options Millions	Weighted average exercise price Pence
Outstanding at January 1	**0.9**	**176p**	1.0	177p
Forfeited during the year	**–**	**–**	–	–
Exercised during the year	**(0.3)**	**205p**	(0.1)	194p
Outstanding at December 31	**0.6**	**165p**	0.9	176p
Exercisable at December 31	**0.6**	**165p**	0.9	176p

Deferred shares under APRA	Number of shares 2009 Millions	Number of shares 2008 Millions
Outstanding at January 1	**1.4**	1.8
Awarded during the year	**1.2**	0.8
Forfeited during the year	**–**	–
Additional shares accrued from conversion of B Shares	**0.1**	–
Vested during the year	**(1.0)**	(1.2)
Outstanding at December 31	**1.7**	1.4

Free shares under SIP	Number of shares 2009 Millions	Number of shares 2008 Millions
Awarded during the year	**1.0**	1.0

Options were exercised on a regular basis during the year. The average share price during the year was 386p (2008 382p).

17 Share-based payments (continued)

Fair values

The weighted average fair values per share for PSP awards, ShareSave grants, APRA deferred share awards, and SIP Free Share awards included in the expense for the year were as follows:

	2009	2008	2007	2006	2005
PSP awards – 25% TSR uplift	**253p**	458p	557p	494p	282p
PSP awards – 50% TSR uplift	**282p**	n/a	n/a	n/a	n/a
ShareSave – 3 year grants	**144p**	–	230p	–	131p
ShareSave – 5 year grants	**167p**	–	264p	–	154p
APRA deferred share awards	**290p**	440p	502p	448p	260p
SIP Free Share awards	**330p**	439p	499p	462p	257p

Details of the assumptions used in the calculation of these fair values are set out below. Expected volatility is based on the historical volatility of the Rolls-Royce Group plc share price over the seven years prior to the grant or award date. Until 2007, expected dividends were based on payments to shareholders over the five years prior to the grant or award date. From 2008, expected dividends were based on payments to shareholders in respect of the previous year.

PSP awards

The fair value of shares awarded under the PSP are calculated using the market value of shares at the time of the award, adjusted to take into account non-entitlement to dividends (or equivalent) during the vesting period and the TSR performance condition. The PSP fair values were calculated using the following assumptions:

	2009	2008	2007	2006	2005
Weighted average share price	**260p**	430p	501p	444p	262p
Expected dividends	**14.70p**	13.00p	8.30p	7.92p	7.81p
Volatility	**32%**	29%	29%	32%	34%
Correlation	**35%**	29%	26%	19%	19%
Expected life	**3 years**	3 years	3 years	3 years	3 years
Risk free interest rate	**1.9%**	4.1%	5.2%	4.3%	4.9%

The PSP has a TSR market-based performance condition, such that the Rolls-Royce Group plc TSR over the performance period will be compared with the TSR of the companies constituting the FTSE 100 index on the date of grant. If the Rolls-Royce Group plc TSR exceeds the median TSR of the FTSE 100, the number of shares that vest will be increased by 25 per cent. The fair value of an award of shares under the PSP has been adjusted to take into account this market-based performance condition using a pricing model based on expectations about volatility and the correlation of share price returns in the group of FTSE 100 companies and which incorporates into the valuation the interdependency between share price performance and TSR vesting. This adjustment increases the fair value relative to the share price at the date of grant.

ShareSave awards

The fair value of options granted under the ShareSave plan are calculated using a binomial pricing model with the following assumptions:

	2009	2007	2005	2003
Weighted average share price	**462p**	553p	351p	173p
Exercise price	**387p**	416p	298p	142p
Volatility	**36%**	37%	40%	43%
Expected dividends	**14.30p**	8.80p	7.86p	7.61p
Expected life[1] – 3 year ShareSave	**3.3-3.8 years**	3.3-3.8 years	3.3-3.8 years	3.2-3.7 years
– 5 year ShareSave	**5.3-5.8 years**	5.3-5.8 years	5.3-5.8 years	5.2-5.7 years
Risk free interest rate	**2.4%**	5.0%	4.4%	4.6%

[1] The binomial pricing model assumes that participants will exercise options at the beginning of the six month window if the share price is greater than the exercise price. Otherwise it assumes that options are held until the expiration of their contractual term. This results in an expected life that falls somewhere between the start and end of the exercise window.

Deferred shares under APRA and Free Shares under SIP

The fair value of shares awarded under these plans is calculated as the share price on the date of award.

18 Contingent liabilities

In connection with the sale of its products the Company will, on some occasions, provide financing support for its customers. The Company's contingent liabilities relating to financing arrangements are spread over many years and relate to a number of customers and a broad product portfolio.

Contingent liabilities are disclosed on a discounted basis. As the directors consider the likelihood of these contingent liabilities crystallising to be remote, this amount does not represent a value that is expected to crystallise. However, the amounts are discounted at the Company's borrowing rate to reflect better the time span over which these exposures could arise. The contingent liabilities are denominated in US dollars. As the Company does not adopt cash flow hedge accounting for forecast foreign exchange transactions, this amount is reported together with the sterling equivalent at the reporting date spot rate.

The discounted value of the total gross contingent liabilities relating to financing arrangements on all delivered aircraft less insurance arrangements and relevant provisions were:

	2009		2008	
	£m	***$m***	£m	*$m*
Gross contingent liabilities	**704**	***1,137***	775	*1,086*
Contingent liabilities net of relevant security [1]	**134**	***217***	155	*222*
Contingent liabilities net of relevant security reduced by 50% [2]	**233**	***376***	246	*354*
[1] Unrestricted cash collateral held as security	**77**	***124***	85	*123*

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

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

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

Where the Company enters into financial guarantee contracts to guarantee the indebtedness of other companies within its group, the Company considers these to be insurance arrangements, and accounts for them as such. In this respect, the Company treats the guarantee contract as a contingent liability until such time as it becomes probable that the Company will be required to make a payment under the guarantee. At December 31, 2009, there were Company guarantees in respect of joint ventures amounting to £15m (2008 £13m).

The Company participates in a Cash Pooling Arrangement. Under the Pooling Arrangement the Company benefits from more favourable interest rates than would be available outside of the Pooling Arrangement as well as more streamlined treasury functions. As part of the Pooling Arrangement, the Company cross-guarantees the borrowings of other pooling participants. At December 31, 2009 these guarantees amounted to £35m (2008 £24m)

19 Related party transactions

The Company is a wholly owned subsidiary of Rolls-Royce Group plc and therefore has taken advantage of the exemption in FRS 8 *Related party disclosures* not to disclose related party transactions with its parent company and other group companies.

There are no significant related party transactions with non wholly owned group companies.

The aggregated balances with joint ventures are shown in notes 7 and 9.

20 Ultimate holding company

The ultimate holding company is Rolls-Royce Group plc, incorporated in Great Britain. The financial statements for Rolls-Royce Group plc may be obtained from the Company Secretary, Rolls-Royce Group plc, 65 Buckingham Gate, London SW1E 6AT.

Principal subsidiary undertakings
At December 31, 2009

Incorporated within the UK – directly held unless marked*

Company	Activity
Optimized Systems and Solutions Limited	Equipment health management and advanced data management services
Rolls-Royce Fuel Cell Systems Limited	Development of fuel cell systems
Rolls-Royce International Limited	International support and commercial information services
Rolls-Royce Leasing Limited	Engine leasing
Rolls-Royce Marine Electrical Systems Limited*	Marine electrical systems
Rolls-Royce Marine Power Operations Limited	Nuclear submarine propulsion systems
Rolls-Royce Power Development Limited	Generation of electricity from independent power projects
Rolls-Royce Power Engineering plc	Energy and marine systems
Rolls-Royce Total Care Services Limited	Aero engine aftermarket support services
Tidal Generation Limited	Development of tidal generation systems

The above companies operate principally in the UK and the effective Group interest is 100 per cent, other than Rolls-Royce Fuel Cell Systems Limited in which it is 80 per cent.

Incorporated overseas – directly held unless marked*

Country	Company	Activity
Brazil	Rolls-Royce Brasil Limitada	Aero engine repair and overhaul
Canada	Rolls-Royce Canada Limited*	Industrial gas turbines and aero engine sales, service and overhaul
China	Rolls-Royce Marine (Shanghai) Limited*	Manufacture and supply of marine equipment
Finland	Rolls-Royce OY AB*	Manufacture of marine winches and propeller systems
France	Rolls-Royce Civil Nuclear SAS*	Instrumentation and control systems and one lifecycle management for nuclear power plants
France	Rolls-Royce Technical Support SARL*	Aero engine project support
Germany	Rolls-Royce Deutschland Ltd & Co KG*	Aero engine design, development and manufacture
Guernsey	Nightingale Insurance Limited*	Insurance services
India	Rolls-Royce India Private Limited*	Diesel engine project management and customer support
India	Rolls-Royce Operations (India) Private Limited*	Engineering support services
Italy	Europea Microfusioni Aerospaziali S.p.A.	Manufacture of gas turbine engine castings
Norway	Rolls-Royce Marine AS*	Design and manufacture of ship equipment
Norway	Scandinavian Electric Holding AS*	Marine electrical systems
Singapore	Rolls-Royce Singapore Pte Limited*	Energy and marine aftermarket support services
Sweden	Rolls-Royce AB*	Manufacture of marine propeller systems
US	Data Systems & Solutions LLC*	Instrumentation and control systems and one lifecycle management for nuclear power plants
US	Optimized Systems and Solutions Inc.*	Equipment health management and advanced data management services
US	Rolls-Royce Commercial Marine Inc.*	Marine aftermarket support services
US	Rolls-Royce Corporation*	Design, development and manufacture of gas turbine engines
US	Rolls-Royce Crosspointe LLC*	Manufacturing facility for aero engine parts
US	Rolls-Royce Energy Systems Inc.*	Energy turbine generator packages
US	Rolls-Royce Engine Services – Oakland Inc.*	Aero engine repair and overhaul
US	Rolls-Royce Defense Services Inc.*	Aero engine repair and overhaul
US	Rolls-Royce Naval Marine Inc.*	Design and manufacture of marine equipment
US	Seaworthy Systems Inc.*	Marine support services

The above companies operate principally in the country of their incorporation.
The effective Group interest is 100 per cent.

A list of all subsidiary undertakings will be included in the Company's annual return to Companies House.

Principal joint ventures and associates

At December 31, 2009

Joint ventures

Incorporated within the UK – directly held unless marked*

	Class	% of class held	% of total equity held
Airtanker Holdings Limited Strategic tanker aircraft PFI project	Ordinary	20	20
Airtanker Services Limited Provision of aftermarket services for strategic tanker aircraft	Ordinary	22	22
Alpha Partners Leasing Limited Aero engine leasing	A Ordinary B Ordinary	100 –	50
Composite Technology & Applications Limited Development of aero engine fan blades	A Ordinary B Ordinary	100 –	51
Genistics Holdings Limited Trailer-mounted field mobile generator sets	A Ordinary B Ordinary	100 –	50
Rolls-Royce Goodrich Engine Control Systems Limited* Development and manufacture of aero engine controls	Ordinary	50	50
Rolls-Royce Snecma Limited (UK & France) Aero engine collaboration	A Shares B Shares	– 100	50
Rolls-Royce Turbomeca Limited (UK & France) Aero engine collaboration	A Shares B Shares	– 100	50
Rolls Wood Group (Repair and Overhauls) Limited Industrial gas turbine repair and overhaul	A Ordinary B Ordinary	100 –	50
TRT Limited Aero engine turbine blade repair services	A Ordinary B Ordinary	– 100	49.5
Turbine Surface Technologies Limited Aero engine turbine surface coatings	A Ordinary B Ordinary	– 100	50
Turbo-Union Limited (UK, Germany & Italy) RB199 engine collaboration	Ordinary A Shares	40 37.5	40

Directors' report

Financial statements

Principal joint ventures and associates (continued)

At December 31, 2009

Joint ventures

Incorporated overseas – directly held unless marked*

		Class	% of class held	% of total equity held
China	Xian XR Aero Components Co Limited Manufacturing facility for aero engine parts	Ordinary	49	49
Germany	EPI Europrop International GmbH (effective interest 35.5%) A400M engine collaboration	Ordinary	28	28
Germany	EUROJET Turbo GmbH (UK, Germany, Italy & Spain) (effective interest 39%) EJ200 engine collaboration	Ordinary	33	33
Germany	MTU, Turbomeca, Rolls-Royce GmbH (UK, France & Germany) MTR390 engine collaboration	Ordinary	33.3	33.3
Germany	N3 Engine Overhaul Services Verwaltungsgesellschaft mbh* Aero engine repair and overhaul	Ordinary	50	50
Hong Kong	Hong Kong Aero Engine Services Limited* Aero engine repair and overhaul	Ordinary	45	45
Israel	Techjet Aerofoils Limited* Manufacture of compressor aerofoils for gas turbines	A Ordinary B Ordinary	50 50	50
Malaysia	Advanced Gas Turbine Solutions Sdn Bhd* Industrial gas turbine aftermarket services	Ordinary	49	49
Singapore	International Engine Component Overhaul Pte Limited* Aero engine repair and overhaul	Ordinary	50	50
Singapore	Singapore Aero Engine Services Private Limited (effective interest 39%)* Aero engine repair and overhaul	Ordinary	30	30
Spain	Industria de Turbo Propulsores SA Aero engine component manufacture and maintenance	Ordinary	46.9	46.9
Switzerland	IAE International Aero Engines AG (UK, Germany, Japan & US) V2500 engine collaboration	A Shares B Shares C Shares D Shares	100 – – –	32.5
US	Alpha Leasing (US) LLC, Alpha Leasing (US) (No.2) LLC, Alpha Leasing (US) (No.4) LLC, Alpha Leasing (US) (No.5) LLC, Rolls-Royce & Partners Finance (US) LLC, Rolls-Royce & Partners Finance (US) (No.2) LLC* Aero engine leasing	Partnerships	50	–
US	Exostar LLC* Business to business internet exchange	Partnership	17.6	–
US	GE Rolls-Royce Fighter Engine Team LLC* F136 development engine for the Joint Strike Fighter (JSF) Programme	Partnership	40	–
US	Texas Aero Engine Services, LLC* Aero engine repair and overhaul	Partnership	50	–
US	Williams-Rolls Inc. (UK & US)* Small aero engine collaboration	Common	15	15

Unincorporated overseas – held by subsidiary undertaking

US	Light Helicopter Turbine Engine Company (LHTEC) Rolls-Royce Corporation has a 50 per cent interest in this unincorporated partnership which was formed to develop and market jointly the T800 engine

Associate

Incorporated overseas – held by subsidiary undertaking

		Class	% of class held	% of total equity held
Norway	ODIM ASA Provider of specialist marine handling systems	Ordinary	33	33

The countries of principal operations are stated in brackets after the name of the company, if not the country of incorporation.

© Rolls-Royce plc 2010

Rolls-Royce plc
Registered office:
65 Buckingham Gate
London
SW1E 6AT

T +44 (0)20 7222 9020
www.rolls-royce.com

Registered in England and Wales No 1003142