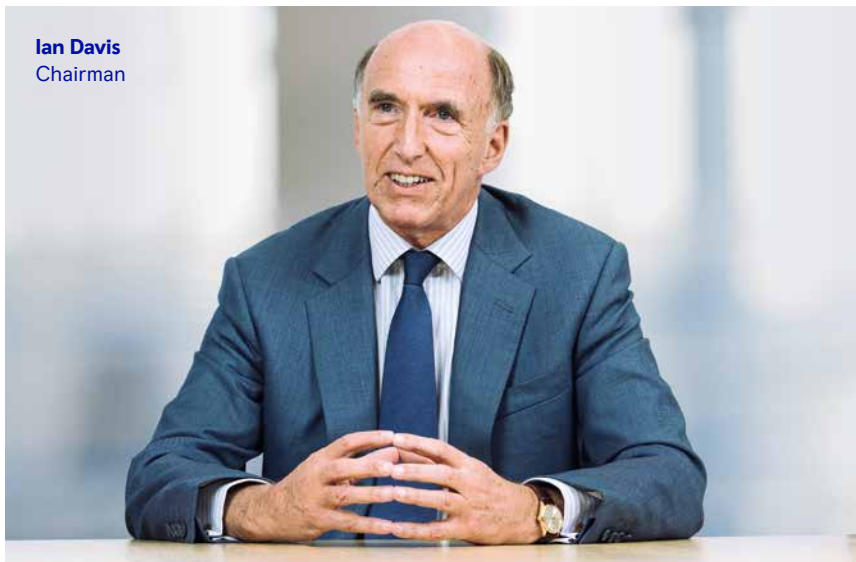


Chairman's Introduction to Directors' Report

Ian Davis
Chairman



Introduction

As I consider our approach to governance at Rolls-Royce, and reflect on the activities of the Board during 2017, I am pleased with the progress we are making. We have been undertaking some interesting and, at times, experimental initiatives designed to ensure the Board maintains an awareness and appreciation of the perspectives of our key stakeholder groups as we help to shape the Group's direction and strategy.


The Board and I were deeply saddened by the death of two colleagues in separate work-related incidents during the year. These tragic events reinforce the importance of health and safety across all that we do. We were also extremely sad to learn of the death of Dame Helen Alexander, a former Non-Executive Director of the Company and close colleague. Helen will be greatly missed by many, and she leaves behind a legacy and contribution to the advancement of corporate governance, notably in her work on the promotion of gender diversity.

In light of the operational challenges faced by the Civil Aerospace business, the Board remained regularly informed on the management of these issues including: conflicting demands on resource; the handling of impacted customers' interests; and the management of the resultant programme risks. As well as briefings from the Chief Executive, the Board also heard from the President – Civil Aerospace and members of his team throughout the year with updates on the latest developments.

Employee engagement

Employees and the Board were deeply disappointed by the business conduct that led to the announcement in January 2017 that the Group had entered into deferred prosecution agreements (DPAs) with the UK Serious Fraud Office and other authorities. We have continued to strengthen and embed ethics and compliance procedures across the Group. Our continuing ethics training and Code of Conduct clarify the responsibilities which apply to all Rolls-Royce employees. The Board remains committed to this programme as we believe that the right behaviours and culture will deliver enhanced long-term performance.

We encourage an honest, open and direct dialogue with our employees and their representatives. This led us to introduce two new initiatives to strengthen our employee engagement programme. The Meet the Board event in May was tremendously engaging and positively received. We also selected Irene Dorner as our Board employee champion. Irene has taken the lead in strengthening links between the Board and our employees, who are key stakeholders in the Group's future success. You can read more about these initiatives on page 73 and in Irene's introduction opposite.

 [For more information on employee engagement see People on page 46.](#)

Sustainability

Investment in our people and communities remains a key priority for the Board. During 2017, we maintained active graduate and apprenticeship development programmes and are proactively working to increase the number of women at all levels within Rolls-Royce. We are engaging with communities on an international basis through our research partnerships and STEM (science, technology, engineering and mathematics) programmes. As one of the world's leading industrial technology companies, we recognise we have an important role in addressing the risks and opportunities associated with climate change through our engineering expertise and operational strategy. See pages 44 and 45 for further information and pages 104 to 109 for the Safety & Ethics Committee Report.

Board apprentice programme

I am particularly proud that in 2017 we launched a new Board apprentice programme that provides coaching and board experience to a diverse group of emerging leaders selected from the Group's talent pool, each assigned to a Board or executive committee. This direct involvement in nurturing leadership talent is proving to be very rewarding for all participants, as well as serving to support diversity and our succession pipeline. See more on page 81.

Board developments

We welcomed two new Directors during 2017, as mentioned in the Nominations & Governance Committee Report on page 81. Beverly Goulet was appointed to the Board in July 2017 and joined the Nominations & Governance and Audit Committees. Beverly has 24 years' experience in the US airline industry and will enhance our customer perspective on the Board. To ensure strong executive leadership was in place at an important juncture for the Group as we refreshed our vision and strategy, Stephen Daintith joined the Board as Chief Financial Officer in April 2017 as previously announced.

In February 2018 it was announced that Nick Luff had been appointed to join the Board as a Non-Executive Director with effect from the conclusion of the AGM in May 2018, subject to shareholder approval.

During the year we renewed the terms of appointment for Ruth Cairnie, Lewis Booth and Sir Frank Chapman each for a further three-year term. In February 2018, we also agreed to extend Brad Singer's initial two-year appointment for a further three years. All Directors will stand for re-election at the AGM in May 2018. The Company and Brad Singer are party to a relationship agreement with ValueAct (a summary of which can be found at www.rolls-royce.com). The agreement will expire on 3 May 2018 but will be replaced with a new agreement covering treatment of confidential information and conflicts of interest only.

The Board has a diverse membership with varied and balanced experience and skills that are highly relevant to the Group's needs and challenges. We recognise that the Directors need to remain mindful of their duties to consider the interests of key stakeholders. We received training from the Company Secretary on our duties under the Companies Act 2006, of particular importance for those Board members who do not hold directorships at other UK companies, and a useful refresher for the other Directors. The Board also resolved in December to adopt our Board diversity policy which sets a target of a minimum of one third of women on the Board. See page 82 to read more.

More detail on the changes to the Board is set out in the Nominations & Governance Committee Report on page 81.

Stakeholder engagement

We set out to actively capture our stakeholders' views in a number of ways this year. As well as our employee engagement activities, we invited some of our Civil Aerospace customers to present to the Board and provide their views on what it is like to work with Rolls-Royce. The direct and open feedback was appreciated and helped our understanding of what is working well and which areas need more focus.

We benefit from having Brad Singer on the Board. He is able to provide an investor perspective drawing on his experience as chief operating officer of ValueAct, the Group's largest shareholder. To remain alert to the views of our wider shareholder base, in March 2017 we held the second of our governance events for fund managers and governance analysts. We also undertook an open and meaningful shareholder consultation exercise on our remuneration policy, approved with a majority of over 95% at the AGM in May 2017.

You can read about our stakeholder engagement activities on page 73.

Looking forward

The Board remains strongly committed to continuous improvement in governance. We actively reviewed and responded to the FRC's consultation to the UK Corporate Governance Code.

Areas we intend to focus on in 2018 include Brexit, health and safety, cyber security and sustainability. We will be monitoring developments in best practice and I look forward to continuing a progressive and innovative approach to governance in the year ahead.

Ian Davis
Chairman



IRENE DÖRNER, EMPLOYEE CHAMPION

Experiments are almost always by their very nature exciting and kicking off the employee champion activities has been no exception. I think it is important to get around the Group and see as many different cohorts of people in order to get a broad range of views. This presents challenges in itself and we have experimented with a variety of events, some more formal than others. I have attended dedicated sessions in theatre style, gatecrashed already existing

meetings and piggy-backed on other events. I hosted an online discussion with employees that was particularly rewarding because it allowed for a free flow of conversation across many sites on many subjects.

What has marked all of these events has been the openness of our people and their willingness to raise issues. Often there is simply a real curiosity to understand what the Board does, but equally we have had open discussions about: connecting the Rolls-Royce vision more closely to our employees; diversity and inclusion; working methods; career development; the effectiveness of the employee opinion survey; the role of employee representatives; transformation; and culture and communications.

I have been ably assisted by the formation of an employee stakeholder engagement group where we can discuss what we have learnt and plan our next moves.

I have reported back to the Board and continue to have open dialogues with various employees around Rolls-Royce

who have attended a session and have been motivated to take action on an issue which has particularly engaged them.

Future plans will include visiting our overseas sites. Recognising that the engagement in 2017 was primarily UK-focused, we will find ways to reach a wider audience and to bring their views in an organised manner to the Board and the heart of the organisation.

2017 was a foundational year on which we can build and learn how to do this better. I have no doubt that this initiative will evolve and offer opportunities for change for individuals and Rolls-Royce.

Irene Dörner
Non-Executive Director

Board of Directors



Ian Davis
Chairman of the Board and Chairman,
Nominations & Governance Committee

NG

Appointed to the Board in March 2013
and as Chairman in May 2013. Tenure: 5 years

Career, skills and experience

Ian was a partner at McKinsey for 31 years and served as chairman and worldwide managing director. He brings significant financial and strategic experience and has worked with and advised global organisations and companies, enabling him to draw on knowledge of diverse issues and outcomes to assist the Board.

Other principal roles

- BP p.l.c., senior independent director
- Johnson & Johnson Inc., director
- McKinsey & Company, senior partner emeritus



Warren East CBE
Chief Executive Officer

Appointed to the Board in January 2014
and as Chief Executive in July 2015. Tenure: 4 years

Career, skills and experience

Warren is an engineer and joined ARM Holdings plc in 1994 where he served as CEO from 2001 until 2013. He has a deep understanding of technology and has proven strategic and leadership skills in a global business. He is a fellow of the Institute of Engineering and Technology; the Royal Academy of Engineering; the Royal Society; and of the Royal Aeronautical Society. He was awarded a CBE in 2014 for services to the technology industry.

Other principal roles

- Dyson James Group Limited, director



Stephen Daintith
Chief Financial Officer

Appointed in April 2017. Tenure: less than 1 year

Career, skills and experience

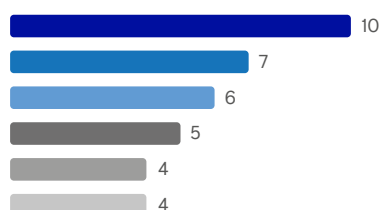
Stephen trained and qualified as a member of the ICAEW with PwC and has considerable financial expertise. His previous roles include CFO of Daily Mail and General Trust plc from January 2011 to April 2017. He worked in New York as the CFO and COO of Dow Jones and in London as the CFO of News International, both part of News Corporation. He also previously held several executive positions at British American Tobacco.

Other principal roles

- 3i Group plc, non-executive director

Note: Tenures are stated as at 6 March 2018.

Board skills and experience



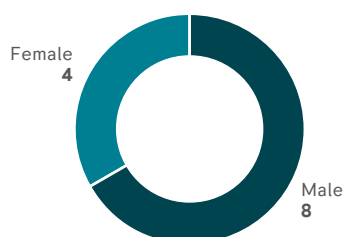
Number of Directors with:

- Chairman/CEO/CFO experience
- Related industry/operational
- Financial
- Engineering/technology
- Safety/regulatory/risk
- Remuneration/HR

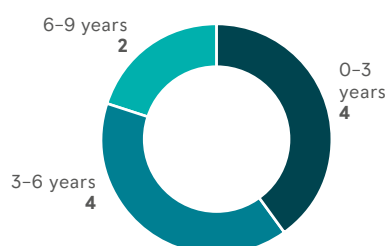
Key

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

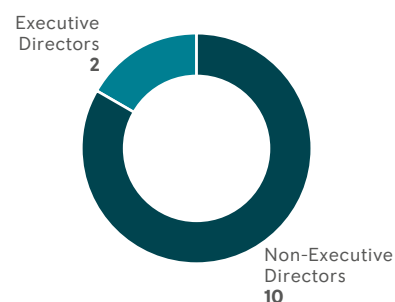
Board members by gender



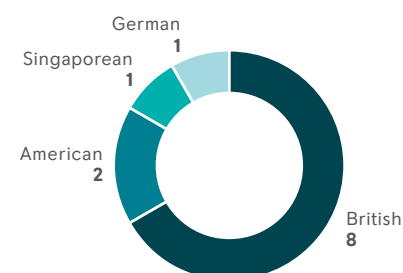
Non-Executive Directors' tenure



Balance of the Board



Board members by nationality *





Lewis Booth CBE
Independent Non-Executive Director
Chairman, Audit Committee

NG A R

Appointed in May 2011. Tenure: 6 years

Career, skills and experience

Lewis has considerable financial expertise and experience and brings an international perspective from his 42-year career in the motor industry. After gaining a bachelor of engineering degree with honours in mechanical engineering, Lewis began his career with British Leyland. He spent 34 years at Ford Motor Company including as executive vice president and CFO. He was awarded a CBE in 2012 for services to the UK automotive and manufacturing industries.

Other principal roles

- Mondelez International Inc., director
- Gentherm Inc., director



Ruth Cairnie
Independent Non-Executive Director
Chairman, Remuneration Committee

NG R ST

Appointed in September 2014. Tenure: 3 years

Career, skills and experience

A physicist by background, Ruth has strong strategic and commercial experience gained at Royal Dutch Shell Plc where she held a number of senior international roles, including executive vice president strategy and planning. Ruth has significant remuneration committee experience having chaired the remuneration committee at Keller Group plc from April 2012 to May 2017 and has been a member of the remuneration committee at Associated British Foods plc since 2014.

Other principal roles

- Associated British Foods plc, non-executive director
- ContourGlobal plc, non-executive director
- POWERful Women, industry chair



Sir Frank Chapman
Independent Non-Executive Director
Chairman, Safety & Ethics Committee

NG R SE

Appointed in November 2011. Tenure: 6 years

Career, skills and experience

Sir Frank has significant industrial and safety experience, having worked in the oil & gas industry for 38 years including appointments within Royal Dutch Shell plc and BP p.l.c. He has a life-long passion for engineering and innovation and a deep understanding of technology. He was chief executive of BG Group plc for 12 years and chairman of Golar LNG Ltd. Sir Frank is a fellow of the Royal Academy of Engineering, the Institute of Mechanical Engineers and the Energy Institute. He was knighted in 2011 for services to the oil & gas industry.

Other principal roles

- Myeloma UK, vice chairman



Irene Dörner
Independent Non-Executive Director

NG A SE

Appointed in July 2015. Tenure: 2 years

Career, skills and experience

Irene was CEO and president of HSBC, US until December 2014. Her background in risk management played a key role in strengthening the financial institution's risk processes and she brings this insight as part of her role on our Audit Committee. During a 30-year career at HSBC, she held a number of international roles including leading HSBC in Malaysia. Irene was a consultant at PwC, is an honorary fellow of St Anne's College, Oxford and a passionate advocate of diversity and inclusion.

Other principal roles

- AXA SA, director
- Control Risks Group Holdings Limited, chairman
- Virgin Money Holdings (UK) PLC, chair elect and non-executive director



Beverly Goulet
Independent Non-Executive Director

NG A

Appointed in July 2017. Tenure: less than 1 year

Career, skills and experience

Beverly, a US national, started her career as a securities and M&A lawyer and has spent a considerable amount of her career in the airline industry. From 1993 until June 2017, Beverly was a key member of the executive team of American Airlines where she served in a number of senior roles. Beverly brings valuable operational experience with significant knowledge of corporate finance and treasury matters.

Other principal roles

- Xenia Hotels & Resorts, director
- Dallas Women's Foundation, board member
- Rolls-Royce North America Holdings, Inc., board member



Lee Hsien Yang
Independent Non-Executive Director

NG A SE

Appointed in January 2014. Tenure: 4 years

Career, skills and experience

A Singaporean, Hsien Yang was formerly a member of our international advisory board and combines a strong background in engineering with extensive international business experience. He was chief executive of Singapore Telecommunications Limited for 12 years and served as chairman and non-executive director of Fraser and Neave Limited. He has significant industrial and financial skills.

Other principal roles

- Civil Aviation Authority of Singapore, chairman
- General Atlantic LLC and associated funds, special adviser
- The Islamic Bank of Asia Private Limited, chairman



Bradley Singer
Non-Independent Non-Executive Director

ST

Appointed in March 2016. Tenure: 2 years

Career, skills and experience

Bradley, a US national, has an outstanding record as a business leader. He brings experience of public companies during periods of change, growth and significant financial outperformance, particularly in the US. He has been senior executive vice president and CFO of Discovery Communications, Inc. and CFO and treasurer of American Tower Corp. Before these appointments, he worked as an investment banker at Goldman Sachs. He provides an investor perspective drawing on his experience as COO of ValueAct.

Other principal roles

- ValueAct Capital, partner and chief operating officer
- The Posse Foundation, director
- McIntire School Foundation, University of Virginia, trustee



Sir Kevin Smith CBE
Senior Independent Non-Executive Director
Chairman, Science & Technology Committee

NG R ST

Appointed in November 2015. Tenure: 2 years

Career, skills and experience

Sir Kevin has extensive industrial leadership experience and a deep knowledge of global engineering and manufacturing businesses, as well as the aerospace industry. He was CEO of GKN plc for nine years. Before joining GKN, he spent nearly 20 years with BAE Systems in a number of senior executive positions. He has an honorary fellowship doctorate from Cranfield University and is an honorary fellow of the University of Central Lancashire. He was awarded a CBE in 1997 and knighted in 2006 for services to industry.

Other principal roles

- Unitas Capital, senior adviser
- L.E.K. Consulting, European advisory board member
- University of Central Lancaster, industry steering group member



Jasmin Staiblin
Independent Non-Executive Director

NG ST

Appointed in May 2012. Tenure: 5 years

Career, skills and experience

A German national, Jasmin combines a strong background in advanced engineering and deep technology knowledge with extensive international business experience, having lived and worked in Switzerland, Sweden and Australia. She has been the CEO of Alpiq Holding AG since 2013. She held a number of senior positions in the ABB Group becoming CEO of ABB Switzerland from 2006 until 2012.

Other principal roles

- Alpiq Holding AG, chief executive officer
- Georg Fischer AG, board member



Pamela Coles
Company Secretary

Appointed in October 2014.

Career, skills and experience

Pamela is an expert in corporate governance and company law. She has been a fellow of ICSA: The Governance Institute, since 1997. She joined Rolls-Royce from Centrica plc, where she was head of secretariat. Pamela's previous roles also include group company secretary and a member of the executive committee at The Rank Group plc and company secretary and head of legal at RAC plc.

Other principal roles

- E-ACT, non-executive director

Board committee membership

	NG	A	R	SE	ST
Ian Davis	C				
Lewis Booth		C			
Ruth Cairnie			C		
Sir Frank Chapman				C	
Irene Dorner					
Beverly Goulet					
Lee Hsien Yang					
Bradley Singer					
Sir Kevin Smith					C
Jasmin Staiblin					

Key

- NG Nominations & Governance Committee
- A Audit Committee
- R Remuneration Committee
- SE Safety & Ethics Committee
- ST Science & Technology Committee
- C Denotes chairman of committee

Corporate Governance

The Board

The role of the Board

The Board is ultimately responsible to shareholders for the direction, management, performance and long-term success of the Company. It sets the Group's strategy and objectives and oversees and monitors internal controls, risk management, principal risks, governance and viability of the Company. In doing so, the Directors comply with their duties under section 172 Companies Act 2006.

The Board has established certain principal committees to assist it in fulfilling its oversight responsibilities, providing dedicated focus on particular areas, as set out below. Each committee chairman reports to the Board on the committee's activities after each committee meeting.

In addition to the Board's principal committees, it has established a sub-committee of Directors who each hold an appropriate level of UK national security clearance for the purpose of receiving and considering, on behalf of the Board, any UK classified information relating to the Group's programmes and activities. Beverly Goulet, a US national and independent Non-Executive Director, also sits on the board of Rolls-Royce North America Holdings, Inc. to create a link between the Board and the Group's North American governance structure.

Key matters reserved to the Board

- ▶ The Group's long-term objectives, strategy and risk appetite
- ▶ The Group's organisation and capability
- ▶ Shareholder engagement and general meetings
- ▶ Overall corporate governance arrangements including Board and committee composition, committee terms of reference, Directors' independence and conflicts of interest
- ▶ Internal controls, governance and risk management frameworks
- ▶ Changes to the corporate or capital structure of the Company
- ▶ Annual report and accounts, and financial and regulatory announcements
- ▶ Significant changes in accounting policies or practices
- ▶ Annual budgets and financial expenditure and commitments above levels set by the Board
- ▶ Remuneration policy and remuneration of Directors and senior executives

The Board committees

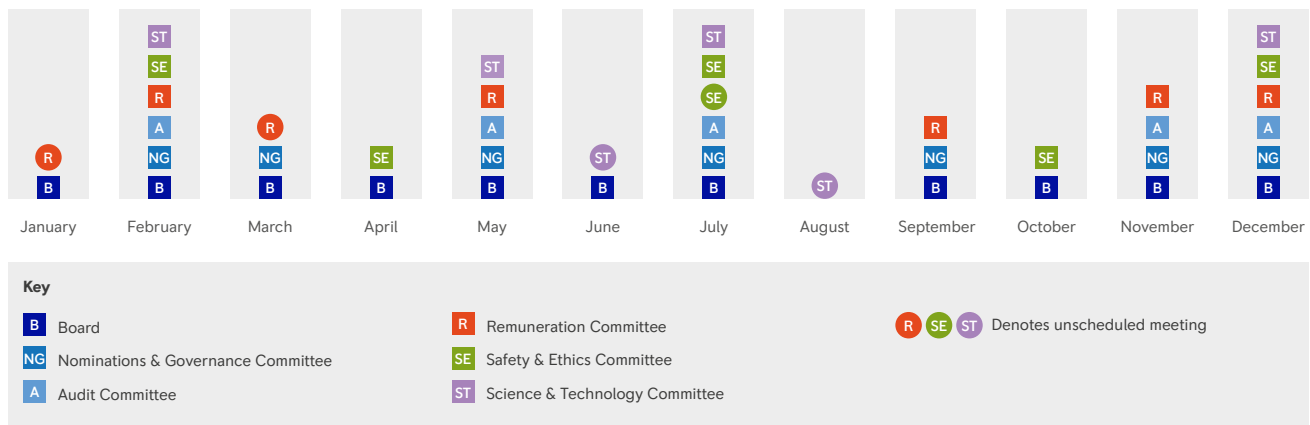
Nominations & Governance Committee	Audit Committee	Remuneration Committee	Safety & Ethics Committee	Science & Technology Committee
Board & committee composition	Financial reporting	Remuneration policy	Product safety	Technology strategy
Board nominations	Internal controls & risk management	Incentive design and setting of targets	HSE	Cross-sector technology
Succession planning	Internal audit	Executive remuneration review	Sustainability	Technology capabilities and skills
Corporate governance	External auditor		Ethics & compliance	Technology trends and risks
Oversight of principal risk – talent & capability	Oversight of principal risks – IT vulnerability, business continuity, market & financial shock		Oversight of principal risks – compliance, product safety	Oversight of principal risk – disruptive technologies & business models

Executive leadership team (ELT)

Matters that are not reserved to shareholders, the Board or one of the Board committees are the responsibility of the Chief Executive who has established and maintains a schedule of delegations of authority to members of the ELT and other management.

The ELT is an executive-level forum of the Group's most senior leaders, chaired by the Chief Executive. It comes together to communicate, review and agree on issues and actions of Group-wide significance. It helps to develop, implement and monitor strategic and operational plans, considers the continuing applicability, appropriateness and impact of risks, leads the Group's culture and aids the decision-making of the Chief Executive in managing the business in the performance of his duties. See rolls-royce.com for details of the ELT members.

Board and committee meetings held in 2017



Unscheduled meetings

The unscheduled meetings of the Remuneration Committee in January and March were to discuss 2017 bonus plan targets.

Two additional Science & Technology Committee calls were held, the first in June for the Committee to debrief on the site visits that took place in May, and the second in August to help shape the technology strategy presentation for the Board strategy meeting.

The unscheduled meeting of the Safety & Ethics Committee in July was to receive an update on the latest discussions and developments with certain regulators following the DPAs.

Non-attendance

Some Board members were unable to participate in certain Board and Committee meetings due to these being held on short notice or for medical reasons, as noted in the table below. If any Directors are unable to attend a meeting they communicate their opinions and comments on the matters to be considered via the Chairman of the Board or the relevant committee chairman.

Board and committee members and attendance at meetings in 2017

	Board (11 meetings)	Nominations & Governance (7 meetings)	Audit (5 meetings)	Remuneration (7 meetings)	Safety & Ethics (6 meetings)	Science & Technology (6 meetings)
Ian Davis	11/11	7/7				
Warren East	11/11					
Stephen Daintith (appointed 7 April 2017)	8/8					
Lewis Booth ¹	11/11	7/7	5/5	5/5		1/1
Ruth Cairnie	11/11	7/7		7/7		6/6
Sir Frank Chapman ²	10/11	6/7		6/7	5/6	
Irene Dorner	11/11	7/7	5/5		6/6	
Beverly Goulet (appointed 3 July 2017)	5/5	4/4	3/3			
Lee Hsien Yang ³	10/11	7/7	5/5		6/6	
Brad Singer	11/11					6/6
Sir Kevin Smith ⁴	10/11	6/7		6/7		6/6
Jasmin Staiblin ⁵	11/11	7/7				5/6

Former Directors

David Smith (stepped down on 24 February 2017)	2/2					
Colin Smith (stepped down on 4 May 2017)	5/5					
John McAdam (stepped down on 4 May 2017)	5/5	3/3		4/4	2/2	

¹ Lewis Booth was appointed to the Remuneration Committee and stepped down from the Science & Technology Committee in April 2017.

² Sir Frank Chapman was unable to attend the Safety & Ethics Committee in April due to unforeseen circumstances and the May meetings of the Board and committees due to medical reasons.

³ Lee Hsien Yang was unable to attend the June Board meeting due to unforeseen urgent personal matters.

⁴ Sir Kevin Smith was unable to attend the November meetings of the Board and committees due to medical reasons.

⁵ Jasmin Staiblin was unable to attend the unscheduled meeting of the Science & Technology Committee in August due to prior commitments and this being arranged on short notice.

Board's focus during the year

Area of focus	Matters considered	Outcome
Strategy and risk	Review and refresh the Group's vision and strategy	The Board approved the refreshed vision and strategy for the Group, rolled out internally and externally from early 2018. The Board held an all-day meeting with the ELT focused on the Group's overarching strategy, including discussions on all areas of the business and people capability. The Board provided reflections on the day at the subsequent Board meeting. Feedback and content of discussions were shared with the ELT and businesses.
	Review of principal risks, including 'deep dives' on: <ul style="list-style-type: none"> – political risk; – competitive position; and – major product programme delivery 	<p>The ongoing review of risks resulted in changes to principal risks in the year. The product failure risk was redefined as product safety. The description of the disruptive technologies and business models and business continuity principal risks were updated to reflect the TCFD recommendations (see page 60).</p> <p>The Board confirmed that the management of risks remained effective. Lord Powell, after obtaining input from other members of the international advisory board (IAB)¹, presented on political risk in March 2017, including: the implications of Brexit; potential military conflicts; and current geo-political factors for the Group. The Board considered the Group's competitive position as part of its strategy sessions in September, and separately reviewed the competitive positions of Power Systems and Marine. The Board reviewed the risks to delivery of Civil Aerospace widebody engine programmes periodically throughout the year with a detailed review of Trent 900 and Trent XWB business plan performance in December, leading into a detailed review of Trent 1000 business plan in 2018.</p>
	Ongoing cooperation with regulators following deferred prosecution agreements (DPAs)	The Board kept oversight of compliance with the DPAs. Lord Gold provided an update on his continuing areas of focus to the Board in March 2017.
Succession and leadership	Diversity and inclusion	<p>There is a continuing focus to increase diversity throughout the Group. The Board diversity policy was presented in November and approved in December 2017. The Board confirmed its support for the Group's updated diversity and inclusion policies and the introduction of Group targets to increase the percentage of roles held by women and other under-represented groups across the Group.</p> <p>During 2017, a number of significant projects were completed and key milestones reached. See page 47 for more details.</p>
	Effectiveness of the Board, Chairman and Chief Executive	<p>An external evaluation was undertaken and it concluded that the Board operated effectively in 2017.</p> <p>The Chairman and Chief Executive received constructive feedback on their respective performance.</p>
Financial performance	Review of financial KPIs	The Board obtained monthly financial performance reports and discussed the reports with the Chief Financial Officer at each Board meeting.
	Group tax policy review	The Board noted that new UK tax rules would require the Group to publish its tax strategy on the website during 2017. The Board approved and endorsed the approach.
	Aquisition of ITP Aero	Progress updates received. A sub-committee of the Board was set up to make decisions on the settlement of consideration for ITP Aero.
	New accounting standards (IFRS 15) reporting/impact	Updates provided throughout the year, giving the Board oversight on progress, introduction and the impact of IFRS 15.

¹ It was agreed in the year to disband the IAB but some former members, including Lord Powell, have been retained by the Company as advisers on geo-political issues.

Area of focus	Matters considered	Outcome
Operational performance/ challenges	Operational performance updates	Year-to-date status across key operational performance measures and key priorities presented throughout the year. The operational KPIs for each business were also discussed.
	Civil Aerospace programme challenges, including new product introduction	There were some operational challenges during the year as described in the Civil Aerospace review on pages 20 to 25. The Board remained regularly informed on the management of these issues, including steps to minimise customer disruption, and received briefings from the Chief Executive and President – Civil Aerospace on the latest developments and status of programmes.
	Safety incidents	The Board were briefed on the two employee fatalities during the year (more detail can be found on pages 46 and 107) and on plans to increase the focus on HSE across the Group.
Stakeholder engagement and governance	Investor engagement	Increased transparency in investor briefings. The governance event in March 2017 was successful with good engagement from fund managers and governance analysts.
	Stakeholder engagement	The Board received training from the Company Secretary on s.172 of the Companies Act 2006 which included a discussion around the Group's key stakeholders and a review of how the Board currently discharges this duty. The Board held the first successful Meet the Board event for employees in May 2017. Updates were given by Irene Dorner on her employee champion role and meetings/events she had attended.
	Government's green paper on corporate governance reform and FRC's proposed revisions to the UK Corporate Governance Code	The Board were kept up-to-date on the proposed changes to the governance landscape. An assessment of the Company's position and status against each recommendation was presented in November and the Company's response to the FRC on the proposed changes was outlined in February 2018.
	Matters reserved to the Board and delegated authorities	The Board confirmed these remained appropriate.
	UK Modern Slavery Act revisions	The anti-slavery and human trafficking statement was presented and approved by the Board early in 2017, and again in February 2018.
	UK gender pay gap reporting	Kept up-to-date on the Company's plan to report the required gender pay gap data for UK legal entities published on our website and on the UK Government website.

The Board's areas of focus in 2018 are expected to include:

- | | |
|--|--|
| ▶ The Group's vision, values and culture | ▶ Continuing to monitor compliance with the terms of the DPAs |
| ▶ Execution of strategic priorities | ▶ The implications of Brexit on the Group's activities |
| ▶ Overview of the restructuring of the businesses, support and management functions | ▶ Principal risk reviews |
| ▶ Strategic review of commercial marine operations | ▶ Cyber security updates |
| ▶ Monitoring management of Trent 1000 and Trent 900 in-service issues towards resolution | ▶ Stakeholder engagement programme |
| ▶ Civil Aerospace programme delivery ramp-up | ▶ Updates on the developments and changes to the corporate governance landscape and the UK Corporate Governance Code |
| ▶ Continued monitoring of financial and operational performance | ▶ Sustainability |
| ▶ Strong focus on safety and regular reviews of safety activities | |

Stakeholder engagement

Stakeholder engagement remains vital to building a sustainable business. This year, the Company took a significant step towards increasing stakeholder engagement with our two key employee engagement initiatives. The Board wanted to continue an honest and direct dialogue with our employees following the DPAs. The creation of the role of employee champion and our first Meet the Board event, detailed below, helped to strengthen the link between employees and the Board and ensure employee views can be taken into account as part of the Board's decision-making.

As part of training provided by the Company Secretary, the Board discussed the Company's key stakeholders, reviewed how we currently discharge the duty to promote the success of the Company and discussed what more could be done to help foster stakeholder relationships. The Board will continue to focus on stakeholder engagement more widely over the next year, with a focus on starting to build a comprehensive stakeholder engagement programme.

Employees

Employee champion

In early 2017, one of our Non-Executive Directors Irene Dorner became our first Board champion for employee engagement, our employee champion, taking the lead in looking at how the Company could strengthen the links between the Board and employees and bring those insights back to the boardroom.

In April 2017, she was introduced to all employees by a Group-wide communication and personally introduced at our Meet the Board event in May.

Irene has attended many events so far, including a European Works Council meeting in London, hosted a diversity and inclusion event in Bristol, met graduates and apprentices at Barnoldswick and Derby, and has participated in a live online interactive session with employees.

At the end of 2017, a communication video from Irene was made available to all employees updating them on her role and insights so far. We will continue communications in 2018 to ensure employees are aware of the activities Irene is taking part in.

As part of her role, Irene updated the Nominations & Governance Committee and the Board on her views and insights and she will continue to do so regularly. This was always an experimental year, however, the new initiative has proved to be of great interest to all involved and we intend to continue this interaction.

You can read more about Irene's view on her new role in her introduction on page 65.



MEET THE BOARD EVENT

In May 2017, following our AGM in Derby, we held our first Meet the Board event for employees. Our entire UK workforce, as well as visiting employees from overseas, were invited to apply for one of the 350 places available and participants were selected on a ballot. All Group employees were invited to submit questions in advance of the event. The meeting was recorded so it could be watched after the event had taken place by those employees unable to attend in person.

The meeting started with a welcome from the Chairman. Irene Dorner then spoke about her role as employee champion and Warren East provided a brief business update on 2016. The main focus of the meeting was a question and answer session. The quality of questions was excellent and generated a lively debate that covered a broad range of topics including diversity, behaviour, our strategy, future focus for the Group and each Board member's top priority. After the meeting, the Board joined attendees in the main reception area and this was another great opportunity for interaction.

The objective was for employees to gain a better understanding of the Board's role and to start a conversation that will lead to a stronger, more open and collaborative culture. The event was a huge success and based on some helpful feedback, we have already identified changes that will make future meetings even better.

One employee, interviewed immediately after the meeting said, "It was really helpful to have the apparent barriers broken down that can sometimes exist between the Board and the people that work in the organisation. I particularly enjoyed the openness, honesty and transparency".

In March 2018, we plan to hold a similar event in Friedrichshafen, Germany, and in May after the AGM in Derby, UK.

Shareholders

The Board continues to value the importance of building strong investor relations, delivered through an active shareholder communication programme. Since 2016, we have significantly enhanced disclosure and transparency through improved reporting, allied to proactive engagement and publications such as our periodic Investor Update newsletter. This was one of the Group's strategic priorities as set out on page 7.

In 2017, our engagement programme has focused on addressing key elements of the investment case, and identifying both risks and opportunities to the business. In particular, we have set out our focus on helping investors better understand the key drivers of cash across the businesses, together with the implementation of IFRS 15, which will see a material change in the way the business reports its financial results.

During the year, an extensive investor engagement programme has been undertaken involving formal events, site visits, smaller group and one-to-one investor meetings. Many of these provide the chance for institutional investors and equity analysts to meet senior executive management and ask more detailed questions that can improve individual knowledge or clarify areas of misunderstanding. We regularly monitor the Group's shareholder base and ensure management's time is allocated appropriately with regard to current and potential shareholder interests.

As well as attending numerous investor conferences and roadshows in the UK, Europe and the US, we were also active at trade-related events such as the Paris Airshow and the defence trade show DSEI, allowing investors to hear from key business managers. In total, over 400 one-to-one and group meetings took place in 2017, led by the Chief Executive, Chief Financial Officer, the director of investor relations or members of the investor relations team and supported by other management.

On governance-related matters there was a very significant consultation programme in advance of the remuneration policy vote at the AGM in May. In addition, another well-attended governance event was held in May, hosted by the Chairman. Fund managers and governance analysts heard from the Chief Executive on his strategic agenda and from the Board committee chairmen and had the opportunity to engage directly with them in small groups. The lead audit partner from KPMG also attended this event and answered questions. Topics covered at the event included board composition, skillset and 2017 priorities, financial reporting, IFRS 15 and risk management, and the context and design of the new remuneration policy. Materials from this event are available at www.rolls-royce.com.

The Chairman, Senior Independent Director and other members of the Board make themselves available to meet with institutional investors when requested. In 2018, the Chairman and Senior Independent Director have already attended governance meetings with some of our largest institutional shareholders in London and Edinburgh.

We also published quarterly Investor Update newsletters throughout the year, which include commentary on the investor relations calendar, key news flow and a Q&A section which addresses investor issues that have been raised in recent discussions. Feedback on this newsletter has been very positive.

Annual general meeting (AGM)

All holders of ordinary shares may attend the Company's AGM at which the Chairman and Chief Executive present a review of the key business developments during the year.

The AGM will be held on Thursday 3 May 2018 at Pride Park Stadium, Pride Park, Derby, DE24 8XL. The notice of meeting (notice) for the 2018 AGM will set out in full the resolutions for consideration by shareholders, together with explanatory notes and further information on the Directors standing for election and re-election. The Company intends to send the notice and any relevant papers to shareholders at least 20 working days before the meeting.

Notable events in 2017

CEO/CFO meetings	Investor conferences and other events	Investor Update newsletters	Total investor meetings
>150	18	4	>400

 More information on investor events, presentations, updates and the notice can be found at: www.rolls-royce.com

Board induction and development

The Chairman and Company Secretary arrange a comprehensive tailored induction programme for newly-appointed Non-Executive Directors, which includes dedicated time with Group executives and scheduled trips to business operations. The programme is tailored based on experience and background and the requirements of the role. All Directors visit the Group's main operating sites as part of their induction and are encouraged to make at least one visit to other sites each year throughout their tenure. In 2017, Board members visited locations including: Barnoldswick, Bristol and Derby, UK; Friedrichshafen, Germany; and Reston, US. We regard these site visits as an important part of continuing education as well as an essential part of the induction process. They help Directors understand the Group's activities through direct experience of seeing processes in operation and by having discussions with a range of employees.

Beverly Goulet was appointed to the Board in July 2017 and joined the Nominations & Governance and Audit Committees. Since her appointment she has undertaken a thorough induction and met with members of the ELT. She was also briefed by the Company Secretary on UK listed company requirements, the UK Corporate Governance Code and other key governance areas. Beverly has attended a number of site visits, including Bristol, UK and Reston, US.

It is important that the Directors continue to develop and refresh their understanding of the Group's activities. To facilitate this, the Board met local management and external stakeholders at its meetings in Derby and Bristol, UK and they are encouraged to visit the Group's facilities around the world.

It is also important that the Directors regularly refresh and update their skills and knowledge and receive relevant training when necessary. Members of the Board also attend relevant seminars, conferences and training events to keep up-to-date on developments in key areas.

Board induction programme for Beverly Goulet

Timing	People to meet	Key topics covered
Within first month	Chairman	Overview of the Board
	Chief Executive	Business model Current strategic priorities Opportunities/risks Current issues
	Chief Financial Officer	Finance, treasury and tax overviews Budget Accounting issues
	Company Secretary	UK Corporate Governance Code UK listed company requirements Directors' duties Board administration and meeting dates
Within first three months	ELT members	Overview of each business — Markets and competition — Operational and financial performance — KPIs — Current issues
Within first nine months	Committee chairmen	Overview of committees Plan of work for the year Current issues
	Senior management, including director of investor relations, director of internal audit and director of corporate affairs	Overview of specific business/functional areas
	Auditors	Audit report and findings Controls Accounting issues

Board effectiveness

Board evaluation

This year Independent Audit Limited (IAL) was invited back to undertake another externally-facilitated effectiveness review, following on from its yearly reviews since 2014. IAL has not provided any other services to the Company during the year. The evaluation was consciously 'light touch' compared to previous reviews and it was undertaken through a questionnaire-based survey. This was complemented by confidential one-to-one discussions between IAL and several members of the Board and management to help bring focus to the questions. The review covered four specific areas which had been identified as requiring further development during last year's review and the scope was agreed with the Company Secretary after consultation with the Chairman. The four specific areas of focus were: Board dynamics; focus; information; and culture.

A review of the effectiveness of Board committees was undertaken separately at the end of the year internally with the use of an effectiveness questionnaire. A thorough review of the committees will form part of next year's evaluation. To provide a renewed perspective, next year's evaluation will be undertaken by a new external provider and this will take place in the second half of 2018. Good progress had been made since the last effectiveness review and the Board feels that it is working more effectively. The Board discussed the findings of the report in December.

At a private meeting of the Non-Executive Directors, Sir Kevin Smith, Senior Independent Director, led a review of the Chairman's performance without the Chairman present.

Stages of the Board effectiveness process



The Nominations & Governance Committee also met without any management present to discuss the performance of the Chief Executive. The meetings concluded that both the Chairman and the Chief Executive continued to be effective and constructive feedback was shared with each of them.

Progress on four key areas

Areas of focus	IAL's findings in 2017	Focus for 2018
Board dynamics	The dynamics of the Board have improved, with good all-round commitment from Board members, a good mix of styles, a constructive approach and wide participation in meetings. Cross-membership and active collaboration has meant liaison across committees is working well.	Maintaining an open tone between the Non-Executive Directors and management to encourage constructive discussions on the challenges ahead. Responsibility: Chairman
Focus	Considerable progress has been made in setting a clear strategic direction and getting the right senior executives in place. The changes resulted in better discussions on the most relevant topics. There was a better balance of time during meetings, with more time spent on key discussion items.	Continue to oversee the execution of the Group's strategic priorities and how management are addressing the near-term operational challenges. Ensure agendas continue to allow enough time for the Board to focus on the most relevant topics and allow the appropriate amount of time for high-quality discussion. Responsibility: Chairman/Company Secretary
Information	There has been some progress in improving the information provided to the Board. However more work is needed to ensure papers focus on the relevant data and avoid excessive and unnecessary detail.	Improving information will continue to be a priority. In particular, management will focus on providing all the relevant information to allow informed debate without over-burdening the Board with excessive operational detail. Responsibility: Chief Executive/Chief Financial Officer/Company Secretary
Culture	The Board is confident with its approach to oversight of culture and takes a robust approach to assessing ethical standards: issues are well understood and are tracked.	The Board will remain focused on culture in 2018 and will be kept well-informed on progress with the latest restructuring plans, including monitoring of management's approach to embedding behaviours. Responsibility: Chairman/Chief Executive

Compliance with the UK Corporate Governance Code 2016 (the Code)

The Company is subject to the principles and provisions of the Code, a copy of which is available in full at www.frc.org.uk.

For the year ended 31 December 2017, the Board considers that it has complied in full with the provisions of the Code. Below is a statement of compliance that explains how the Company has applied the principles and complied with the provisions in the Code.

A – LEADERSHIP

A1 The role of the Board

The Board is ultimately responsible for the management, direction and performance of the Company and its businesses. It sets the Group's strategy and objectives and oversees and monitors internal controls, risk management, principal risks, governance and viability of the Company.

The Board Governance document (available at www.rolls-royce.com) includes a clear schedule of matters reserved for the Board's approval, which is reviewed at least annually.

A2 Clear division of responsibilities

The roles of the Chairman and Chief Executive are clearly defined and the Board supports the separation of the two roles. The key responsibilities are clearly documented in our Board Governance document. The Chairman is responsible for the leadership and effectiveness of the Board. The Chief Executive is responsible for the running of the Company's business.

A3 Role of the Chairman

The Chairman ensures effective running of the Board and its committees in accordance with the highest standards of corporate governance. He sets the agenda for Board meetings making sure consideration is given to the main challenges and opportunities facing the Company and facilitates open and constructive dialogue during meetings.

A4 Role of the Non-Executive Directors

Non-Executive Directors are independent of management and bring a diverse set of skills and experience to meetings. The Non-Executive Directors support the Chairman and provide objective and constructive challenge to management. Their views are actively sought when developing proposals on strategy, including during discussions in meetings, in post-meeting conversations, or as part of the annual Board and ELT strategy day. All of the Board committees consist exclusively of Non-Executive Directors.

The Senior Independent Director provides a sounding board for the Chairman and serves as an intermediary for the Chief Executive, other Directors, and shareholders when required.

At the end of most scheduled Board meetings, the Chairman holds meetings with the Non-Executive Directors without the Executive Directors or management present.

B – EFFECTIVENESS

B1 The composition of the Board

The Board believes it operates effectively with the appropriate balance of independent Non-Executive and Executive Directors who have the right mix of skills, experience and knowledge of the Company. The Nominations & Governance Committee is responsible for regularly reviewing the composition of the Board.

Details of the Board, their biographies and committee membership are set out on pages 66 to 68.

The Board conducts a review of the independence of the Non-Executive Directors every year, based on the criteria in the Code and following consideration by the Nominations & Governance Committee as detailed on page 82. The review in November 2017 concluded that all the Non-Executive Directors, with the exception of Brad Singer, remained independent in character and judgement.

Brad Singer is a partner and the chief operating officer of ValueAct Capital, a major shareholder, and therefore was not considered independent under the provisions set out in the Code. A relationship agreement between the Company, ValueAct and Brad Singer, was in place throughout 2017 to manage any conflicts of interest that arise from his connection to ValueAct.

The Code does not consider the test of independence to be appropriate to the chairman of the company. However, Ian Davis did meet the Code's independence criteria upon his appointment as a Non-Executive Director in March 2013 and as Chairman in May 2013.

B2 Appointments to the Board

Appointments of new Directors are led by the Nominations & Governance Committee, which are recommended to the Board. Details of the appointment process, and changes made during the year, are set out in the Nominations & Governance Committee report on pages 79 to 82.

MWM Consulting provided external search consultancy services in relation to the appointments of Beverly Goulet and Nick Luff. They had no other connection to the Company during the year.

B3 Time commitment

Non-Executive Directors are advised of the time commitment expected from them on appointment. External appointments, which may affect existing time commitments for the Board's business, must be agreed with the Chairman. Full details of these are set out at www.rolls-royce.com.

B4 Induction, training and development

All new Directors receive a full induction programme when they are appointed to the Board, more details of which are on page 75. The Board received additional training throughout the year on key topics, as appropriate.

B5 Information and support

The Company Secretary makes sure that appropriate and timely information is provided to the Board and its committees and is responsible for advising and supporting the Chairman and Board on all governance matters. All Directors have access to the Company Secretary and may take independent professional advice at the Company's expense in conducting their duties.

B6 Evaluation

The Board evaluation for 2017 was externally facilitated and more details can be found on page 76. The Chairman also met each Director individually to discuss their contribution, performance over the year and any development needs. Following the meetings, the Chairman confirmed that each Director was committed to their role and they were effective.

At a private meeting of the Non-Executive Directors, Sir Kevin Smith, Senior Independent Director, led a review of the Chairman's performance without the Chairman present. The Nominations & Governance Committee also met without management present to discuss the performance of the Chief Executive. The meetings concluded that both the Chairman and the Chief Executive continued to be effective and constructive feedback was shared with them.

B7 Election/re-election

All Directors are subject to election or re-election at the AGM. Following recommendations from the Nominations & Governance Committee the Board considers that all Directors continue to be effective, committed to their roles and have sufficient time available to perform their duties. In accordance with the Code, Beverly Goulet and Nick Luff will seek election and all other Directors will seek re-election at the 2018 AGM.

C – ACCOUNTABILITY

C1 Financial and business reporting

The requirement for the Annual Report, taken as a whole, to be fair, balanced and understandable is taken into consideration in the drafting and reviewing process. See page 99 for the process to review the form and content. The Strategic Report, set out on pages 1 to 63, provides information about the Group's business model, performance, strategy and principal risks.

C2 Risk management and internal control

The Board has carried out a robust assessment of the principal risks facing the Company including those that would threaten its business model, future performance, solvency or liquidity. See pages 59 to 62 for more details on the Group's principal risks and a description of changes during the year.

In developing the internal governance framework (see page 82) the Group looked at how the risk management and internal control systems work together. You can read more about the risk management system on page 59 and details of the internal control system on page 101. The Board, with the advice of the Audit Committee, has reviewed the effectiveness of the risk management and internal control systems, including controls in relation to the financial reporting process, for the year under review and up to the date of this report. The Board confirms that the Group continues to be compliant with the Code, Financial Conduct Authority's Disclosure Guidance and Transparency Rules (DTR) in this regard.

The activities of the Audit Committee, which assists the Board with its responsibilities in relation to risk and assurance, are set out on pages 97 to 103.

C3 Audit Committee and auditors

The Audit Committee Report on pages 97 to 103 sets out details of how the Committee has discharged its duties and its areas of focus during the year.

In accordance with the Code and DTR 7.1 the Board is satisfied that Lewis Booth, Beverly Goulet and Irene Dorner, all members of the Audit Committee, have recent and relevant financial experience, and when considered as a whole, the Committee has competence relevant to the sector in which the Company operates to ensure the right balance of skills, experience, professional qualifications and knowledge.

D – REMUNERATION

D1 The level and components of remuneration

The Directors' remuneration report is set out on pages 83 to 96 which outlines the areas of focus during the year and a summary of the remuneration policy, as approved by shareholders at the 2017 AGM.

The Remuneration Committee sets levels of remuneration which are designed to promote the long-term success of the Group, aligning this with the Group's strategy and business objectives and ensuring it reflects our stakeholders' interests. It is responsible for recommending to the Board the remuneration policy for Executive Directors, other members of the ELT and for the Chairman, and for implementing the policy.

In November 2017 we decided to publish our data on gender pay earlier than required. More information is available on page 94 and at www.rolls-royce.com.

D2 Procedure

For more information on the work of the Remuneration Committee and Directors' remuneration see the report on pages 83 to 96.

Ruth Cairnie, the chairman of the Remuneration Committee, meets with institutional shareholders regularly, as appropriate.


E – RELATIONS WITH SHAREHOLDERS

E1 Dialogue with shareholders

The Board considers that effective channels of communication with the Company's institutional investors and individual shareholders are very important. You can read more about engagement with shareholders on page 74.

E2 Constructive use of General Meetings

The AGM provides a key opportunity for the Board to meet and communicate with shareholders. Shareholders can ask questions of the Board on matters put to the meeting, including the Annual Report and the running of the Company generally. Company representatives and the Company's Registrar are also available for any questions shareholders might have.

 [Terms of reference of the Board committees and shareholder information are available at www.rolls-royce.com](http://www.rolls-royce.com)

Nominations & Governance Committee Report

Ian Davis
Chairman of the
Nominations
& Governance
Committee



Key highlights

The appointment of Beverly Goulet as a Non-Executive Director was considered and recommended to the Board

Diversity and inclusion (including a new Board policy)

Talent, capability and succession

Monitoring of UK corporate governance proposals

Introduction

The Committee leads the process for nominations to the Board, making recommendations to the Board as appropriate. It gives full consideration to the composition of the Board and succession planning for Directors and senior executives. The Committee also keeps the Group's corporate governance arrangements under review and ensures they are consistent with best practice standards.

Operation of the Committee

The Committee consists wholly of independent Non-Executive Directors and the Chief Executive attends the meetings. Brad Singer, although not independent, attends meetings when it is considered appropriate. Our biographies are on pages 66 to 68. The Committee's responsibilities are outlined in its terms of reference, available at www.rolls-royce.com, which we review annually and refer to the Board for approval.

Committee members

Member	Attended	Eligible to attend
Ian Davis	7	7
Lewis Booth	7	7
Ruth Cairnie	7	7
Sir Frank Chapman	6	7
Irene Dorner	7	7
Beverly Goulet	4	4
Lee Hsien Yang	7	7
Sir Kevin Smith	6	7
Jasmin Staiblin	7	7

See page 70 for reasons of non-attendance.

Principal responsibilities

Board and committee composition

- Review the structure, size and composition of the Board and its committees regularly, to ensure that they remain appropriate, and to make any recommendations of any changes to the Board.
- Evaluate and consider any Director's conflicts of interest.

Board nominations

- Recommendation of new appointments to the Board.
- Oversee the induction plans, training and site visits for the Directors.

Succession planning

- Consider succession plans for Directors and senior executives.
- Diversity and inclusion reviews and implementation of policy.

Evaluation of Chairman, Chief Executive and Non-Executive Directors

- Conduct an annual evaluation of the Chairman.
- Conduct an annual evaluation of the Chief Executive.
- Review the independence of the Non-Executive Directors.

Corporate governance

- Review the Group's global governance framework.
- Keep up-to-date with the changing governance landscape and report on the Group's corporate governance practices to ensure they remain appropriate for a group the size and complexity of Rolls-Royce, taking account of best practice principles.

Principal risk – talent and capability

- Oversight of one of the Company's principal risks.

Areas of focus for 2018

- Diversity and inclusion
- Talent, capability and succession
- Employee engagement
- Culture and behaviour

Nominations & Governance Committee focus during 2017

Area of focus	Matters considered	Outcome
Board and committee composition	A review of the composition of the Board and committee membership	When reviewing Non-Executive Director appointments the Committee considers the current skills, experience and tenure of the Directors and assesses future needs against the longer-term strategy of the Group. The Committee recommended to the Board that Lewis Booth, chair of the Audit Committee, join the Remuneration Committee to strengthen the link between the Remuneration and Audit Committees.
Board nominations	Re-appointment of three Non-Executive Directors The appointment of Beverly Goulet as Non-Executive Director and oversight of Beverly's induction plan A review of site visits undertaken by Board members	The Committee satisfied itself that the Directors considered for re-appointment continued to be committed and effective. Members of the Committee were involved in the interview process for the new Non-Executive Director and the Committee recommended Beverly Goulet's appointment to the Board. You can read more about the appointment process on page 81.
Succession planning	Progress on succession planning Two updates on diversity and inclusion	There has been a continued focus on succession planning this year, with a number of changes to the ELT. The discussions focused on the executive pipeline. The Committee approved the Board diversity policy in December 2017. It was agreed to maintain focus on diversity and inclusion in 2018.
Evaluation of Chairman, Chief Executive and Non-Executive Directors	Annual review of the effectiveness of the Chairman and the Chief Executive, led by the Senior Independent Director and the Chairman respectively Annual review of whether the Non-Executive Directors remained independent, taking into account the independence criteria set out in the Code	The Chairman and Chief Executive continue to be effective. Feedback was shared directly with them. The review concluded that all Non-Executive Directors, with the exception of Brad Singer, remained independent.
Corporate governance	A review of our global governance framework Periodic governance updates from the Company Secretary	A refreshed governance framework was published internally in June 2017. The Committee has been kept informed about the changes to the governance landscape and the various proposals on UK corporate governance.
Oversight of principal risk – talent and capability	The principal risk is considered when discussing talent and capability	It was agreed that continuing focus was required, particularly on the high-potential and emerging talent pools. The Board apprentice programme was introduced as a pilot initiative.

Board and committee composition

The Committee regularly reviews the balance and composition of the Board, its committees and the executive team, as well as Non-Executive Director independence, skills and tenure. When reviewing the Non-Executive Directors appointments the Committee considers the current skills and experience of the Board and assesses future needs against longer-term succession planning in light of the Group's strategy.

The Committee also takes into account the need to make sure there is appropriate diversity on the Board. During the year, the Committee considered the external reviews on diversity, namely the Parker Review and the Hampton-Alexander Review, published in November 2016. Further details on our approach to diversity are

set out on pages 81 to 82. The Committee is satisfied with the current composition of the Board committees and believes that undue reliance is not placed on particular individuals. The Board committee membership is set out on page 68. This will be regularly reviewed and refreshed by the Board.

Board inductions, training and development

The Company Secretary is responsible for ensuring that new Directors have a thorough and appropriate induction. Each newly appointed Director has a structured induction programme and receives a comprehensive data pack providing detailed information on the Group. You can read more about inductions and continuing development on page 75.

Board nominations

In April 2017, Stephen Daintith was appointed to the Board as Chief Financial Officer. In July 2017, the Committee recommended to the Board the approval of Beverly Goulet as Non-Executive Director.

During the year, we considered and recommended to the Board the terms of appointment for Ruth Cairnie for a second three-year term and Lewis Booth and Sir Frank Chapman both for a third three-year term subject to annual shareholder re-election. For each re-appointment we consider the effectiveness and commitment of the Director and undertake a more thorough review of those Directors who are being re-appointed for their third three-year term. The Committee was satisfied with the Directors' continued commitment and effectiveness.

Beverly was identified as a candidate for the Board through our external search for a director with experience in the airline or aerospace sectors, with a particular focus on the US. Prior to her appointment, Beverly met with seven members of the Board and we collected references from chairmen of companies where she had previously worked. The Committee agreed that Beverly had strong functional expertise in finance, strategy and legal matters as well as a wealth of knowledge of the airline industry.

In February 2018, it was announced that Nick Luff, currently chief financial officer of RELX Group, would be appointed as Non-Executive Director with effect from close of the AGM in May 2018, subject to shareholder approval. Nick will join the Audit Committee and Nominations & Governance Committee. Nick was identified as a candidate that would bring significant expertise in finance and accounting to the Board. Prior to his appointment, Nick met with eight members of the Board including the Chairman, Chief Executive and Chief Financial Officer.

For Beverly's and Nick's appointments, the Committee appointed MWM Consulting. Prior to the new appointments, the Chairman agreed a Non-Executive Director profile and the Committee provided input into a shortlist of candidates for the roles. You can read their full biographies at www.rolls-royce.com.

Succession planning

The Committee is committed to regularly reviewing succession planning and it plays a vital role in promoting effective board succession, making sure that this is aligned to the Group's strategy. A principal risk to the business is the inability to attract, retain and incentivise talented individuals to deliver our strategy; the Committee is responsible for reviewing talent, capability and succession at the most senior levels of the business. There has been a continued focus on succession planning in the year and we have taken significant steps to strengthen our management and ELT.

In September, the Chief Executive and Group Human Resources Director led discussions on succession planning with the Board and the Committee. The review focused on the executive pipeline from which the future leaders of the Company were likely to emerge, both at ELT level and other key management areas. Strong successors have been identified for most ELT roles and future considerations have been taken into account in identifying successors both immediately below ELT level and those that would be ready to take up an ELT position in one or two moves. A diverse pipeline of 'ready later' emerging talent has been identified, and

a plan would be put in place to accelerate their path to succession where possible. It was also identified that there was a need for more rigour, challenge and calibration around talent and succession and we would review progress again in 2018.

As we reported last year, we recognise that succession planning includes nurturing our own talent pool and giving opportunities to those who are capable of growing into more senior roles. Throughout the year, Directors took opportunities to meet with senior management throughout the Company, including in Bristol where they met the Defence Aerospace leadership team and at the senior leadership conference where they met key managers. At the beginning of 2018, we were also pleased to announce the appointments of Chris Cholerton, former President – Defence Aerospace, as the new President – Civil Aerospace, and Tom Bell, a former employee, as the new President – Defence. These appointments come at a crucial time for our business as the Company seeks to make 2018 a breakthrough year.

Board apprentice programme

In 2017, we created a new Board apprentice programme. This is a nine-month programme that will provide leadership development experience to demonstrate our commitment to the participants' career progression and development as leaders in the organisation. The opportunity provides the participants with exposure to the Board and personal career development through observing and learning from boardroom experience.

The first high-potential candidates to participate in a trial of the programme brought diversity of thought, gender, nationality and ethnicity. The key elements of the programme include: early career conversations with the Group Human Resources Director or members of the senior leadership team; an orientation meeting providing an overview from Directors of what it means to be on a board; an opportunity to network with other candidates on the programme; attendance at Board/committee meetings; and networking with our ELT.

Diversity and inclusion

Diversity and inclusion continues to be an area of focus for the Committee. As mentioned on page 47, during 2017 we launched a new strategy with global targets to increase female participation at all levels of our organisation by 2020. The Committee was updated on progress against these and activities to drive diversity and inclusion across the Company including: establishing a Global Diversity and Inclusion Council; a number of senior female appointments; launching an online series of digital communications on diversity and inclusion focusing on key issues such as flexible working and mental health; launching the Board apprentice programme; and trialling female-only assessment centres for STEM roles.

Rolls-Royce is also a founding patron of the FTSE-100 Cross-Company Mentoring Programme which aims to widen the pool of eligible female board candidates. At the date of this report the percentage of women currently on our Board is 33% (2016: 23%). The Committee will instruct search consultants to identify, as a priority, female candidates who meet the skills and experience brief. As with all previous appointments, we will consider candidates from the widest possible pool and will only engage search firms that have signed up to the Voluntary Code of Conduct for Executive Search firms.

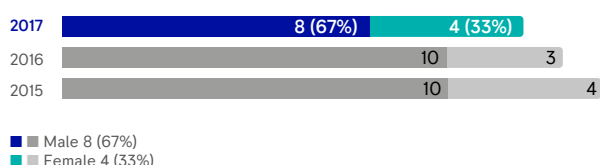
Board diversity policy

Objective	Progress
All Board appointments will be made in the context of the skills and experience that are needed for the Board to be effective.	The Committee regularly reviews the composition of the Board.
Maintain a balance so that, as a minimum, one third of the Directors are women.	The chart below highlights that the percentage of women on the Board is 33%, which is higher than last year.
Support and monitor Group activities to increase the percentage of senior management roles held by women and other under-represented groups.	The Committee focused on strengthening the pipeline of executive talent in the Company. Group activities include the external hiring of diverse senior managers and internal promotion activity and continued emphasis on diverse pipeline, graduate and apprentice recruitment. You can find out more on page 47.
Monitor, challenge and support internally set targets for diversity and inclusion at all levels across the organisation.	This is ongoing and will be kept under review. The charts on page 66 provide a clearer picture of our Board diversity and our diversity & inclusion targets are on page 47.

In the year, the Board approved the Board diversity policy which adopts a target that one third of Board members should be female. It is recognised that there will be periods of change on the Board and that this number may be smaller for periods of time while the Board is refreshed. It is our longer-term intention, however, to at least maintain this balance.

Our policy will continue to promote an inclusive and diverse culture and will reaffirm our aspiration to meet and exceed the recommended voluntary target of 33% of Board positions being held by women in 2020. The objectives in the policy remain relevant targets against which to measure our progress. We will continue to progress our Board diversity policy. During the year we are committed to set and publish a target for ELT and senior leadership gender balance. You can find the full policy at www.rolls-royce.com.

Board members by gender



Governance

We strive to take an innovative approach in all that we do and that includes our approach to governance. In 2017, we have carried out a number of initiatives such as our Meet the Board event, the Board apprentice programme and the appointment of Irene Dorner as our Non-Executive Director employee champion and we continue to look to be 'best in class' and to ensure our governance is appropriate for the Group and all our stakeholders.

The Group's governance framework continues to be effective. Following its launch in 2016, an updated version was issued in June 2017, containing a new section on strategy, planning and in-year appraisal. We continue to work on developing and maturing the framework, with the current focus on building on the considerable work done to date on our Group policies, to bring further improvements and ensure the Group policies are understood and embedded across the organisation. The outcome of this work will provide a condensed and more succinct set of Group policies.

In September, we established a new executive level group governance committee, chaired by the General Counsel. This new

committee will help to keep the governance framework and the development of the Group policies under review. It will oversee the effectiveness of the framework across the organisation and ensure that the Group's corporate governance and corporate compliance arrangements, practices and procedures (below Board level) are consistent with appropriate best practice principles and standards for a group of the size and complexity of Rolls-Royce.

The Nominations & Governance Committee is provided with regular updates on key developments to corporate governance. This year, the Committee has been kept informed about the changes to the governance landscape and the proposals from the government's green paper on UK corporate governance and the FRC's consultation on the UK Corporate Governance Code.

Conflicts of interest and independence

The Board continues to monitor and note potential conflicts of interest that each Director may have and recommends to the Board whether these should be authorised and whether any conditions should be attached to any authorisation. The Directors are regularly reminded of their continuing obligations in relation to conflicts, and are required annually to review and confirm their external interests, which helps to determine whether each of them continue to be considered independent.

Brad Singer, as a representative of a significant shareholder, is not considered to be independent. As noted on page 77, the conflict of interest was managed throughout the year by a relationship agreement between the Company, ValueAct and Brad Singer.

During the year, following an annual review, no additional conflicts of interest were identified which required approval by the Board. The Committee advised the Board that it considered that each of the remaining Non-Executive Directors continued to be independent.

Looking forward

I am pleased to report we have made good progress against our priorities for 2017 in relation to succession planning. However, we still have work to do in this area and in relation to diversity and inclusion.

During the course of 2018, the Committee will continue to keep under review any future UK corporate governance reforms as they are finalised and also review progress of our initiatives including the Board apprentice and employee engagement programmes.

Ian Davis
Chairman of the Nominations & Governance Committee

Remuneration Committee Report

Ruth Cairnie
Chairman of the
Remuneration
Committee



Key highlights

- Implementation of the new Directors' remuneration policy
- Strong bonus performance for 2017
- Stephen Daintith's appointment to the Board
- Employee engagement on executive remuneration

Introduction

I am pleased to present my second report as Chairman of the Remuneration Committee, outlining the areas of focus for the Committee during the year.

New remuneration policy

In 2017, we revised our remuneration policy to strengthen the connection to our strategy. The changes addressed the themes of transformation, competitiveness, alignment with shareholders and simplicity and included:

- simplifying the design of both short and long-term incentives;
- increasing the maximum level of long-term incentive plan (LTIP) award;
- reducing the vesting level for threshold performance in the LTIP and adding a two-year holding period.

In developing the new policy we engaged extensively with our major shareholders to understand their perspectives and address any concerns, and we secured strong support for the policy at the 2017 AGM (96%).

Based on the first year of implementation, the new policy is working well for us. The additional potential for performance-based awards has supported our talent agenda, enabling us to bring experience from other sectors into senior positions; an example is the appointment of Stephen Daintith as Chief Financial Officer. The structure of the performance-based incentives is much simpler and we have been able to communicate progress towards our targets more clearly to employees. The alignment of shareholder interests and our remuneration targets is evident: to pay out, our incentives require the continued ramp-up of new engine delivery, increase in flying hours, improvements in operational performance, strong cash management and a shift in our culture towards pace and simplicity. I am pleased that the clarity of our measures and strong link to strategy enables the Committee to have robust, data-driven debate about both targets and outcomes.

2017 outturns

The 2015 performance share plan (PSP) awards will not vest as the performance conditions were not met over the three-year performance period to 31 December 2017. This reflects the reset in performance expectations, notably EPS, during this performance period as the business entered a major period of transition. This is the third consecutive year that PSP has not vested, an outcome which aligns with our shareholders' experience over this period.

When setting targets for the 2017 annual bonus, the Committee took a diligent approach, recognising that many of the headwinds encountered in 2016 (for example the cash drain associated with delivery of increasing numbers of new engines) would continue to impact the businesses, but that substantial progress was needed on the path to a transformed business with stronger financial performance.

The reported financial performance in 2017 saw both underlying profit and free cash flow exceeding expectations. This resulted from the growth in our installed engines delivering significantly higher service revenue, a solid performance in Defence Aerospace and strong performance by Power Systems, together with the benefits of the transformation programme being felt. The higher profitability and better working capital management led to the growth in cash flow.

In determining the outcomes for bonus the Committee has rigorously examined the quality of both profit and cash flow outturns to ensure that awards reflect operational improvements and delivery of the transformation programme. Adjustments were made to remove the greater than budgeted benefit of the R&D capitalisation policy. After this adjustment both profit and cash outcomes remained above target levels.

For our non-financial incentive measures, our delivery metric was just above target level, with strong performances in some businesses offsetting challenges in Civil Aerospace. Employee engagement remained at the same level as in 2016 which limited the outturn of this metric to base level. The overall bonus outturn across both financial and non-financial metrics was 72% of maximum reflecting a strong performance in a year with many challenges.

The Committee also considered the bonus in the round, to decide whether this outperformance seemed appropriate, taking into account external factors, progress on the strategic journey and shareholder experience. Overall we felt that management had responded vigorously to the challenges posed by in-service issues as well as continued market challenges, for example in Marine, and had made good strategic progress. Taking everything into account we decided not to make any further adjustments.

I am also pleased that we are able to pay bonuses to employees throughout the organisation for a second consecutive year.

Board changes

Stephen Daintith joined the Board in April 2017. Awards that he would otherwise have forfeited from his previous employer were bought out, retaining performance conditions where relevant and matching or exceeding previous time horizons.

We also announced the departure of both Colin Smith and David Smith from the Board in 2017. In both cases outstanding PSP awards were pro-rated and will vest at the normal time against achievement of the relevant performance conditions. The 2015 PSP awards have lapsed as the targets were not met. Neither Colin nor David participated in any incentive plans in 2017. David Smith's contractual payments were mitigated due to his external appointment to QinetiQ.

2018 salary review and incentives

The Committee has reviewed the salary levels of the Executive Directors and has concluded that no increases will be made for 2018.

The only change we have made to the implementation of our policy is to increase the weighting of the cash metric in the annual bonus from 37.5% to 50%, reflecting that cash is the key performance metric across our business.

Gender pay

In line with the new UK regulations, we published our gender pay gap in November 2017. It showed a median pay gap of 8.1% (mean 8.3%) across all Rolls-Royce employees in the UK. While our UK gender pay gap is better than the UK national average, as with many engineering organisations we have a relatively low number of women in our business and they are not as well represented in higher level roles as men. We are working to improve the representation of diverse talent at all levels in the organisation with the adoption of the Board Diversity policy and with plans in place that are set out on pages 47, 81 and 82.

Engagement with employees

I am keen that the Committee keeps in touch with what our employees are thinking about executive remuneration. Combined with insights from shareholders, this helps ensure the Committee has a rounded view to inform the decisions that we make. At the end of 2017, I started to engage in employee focus groups to get feedback on this topic and I will continue to meet with employees in 2018. These meetings are closely aligned with the work of fellow director Irene Dorner in her role as employee champion.

In addition we have chosen to publish our CEO pay ratio versus UK employees in this year's report on page 93. We believe it is helpful to be as transparent as possible about executive pay.

Operation of the Committee

All members of the Committee are independent Non-Executive Directors. Lewis Booth joined the Committee in April 2017. Our biographies are on pages 67 and 68.

The Committee's responsibilities are outlined in its terms of reference which can be found at www.rolls-royce.com, and which we review annually and refer to the Board for approval.

In addition to its five scheduled meetings, the Committee held unscheduled meetings in January and March to discuss 2017 bonus plan targets.

Committee members

Member	Attended	Eligible to attend
Ruth Cairnie (chairman)	7	7
Lewis Booth	5	5
Sir Frank Chapman	6	7
Sir Kevin Smith	6	7

See page 70 for reasons of non-attendance.

Other attendees

In addition to the members of the Committee, the Chairman, Chief Executive, Chief Financial Officer and any of the Non-Executive Directors may attend one or more meetings at the Committee's invitation, although none was present during discussion of his or her own remuneration package. The Committee is supported by the Company Secretary, the Group HR Director and Global Performance, Reward & Pensions Director.

Advisers

During the year, the Committee had access to advice from Deloitte LLP's executive compensation advisory practice. Total fees for advice provided to the Committee during the year by Deloitte were £126,750 (2016: £159,175). Deloitte also advised the Company on tax, corporate compliance, employee global mobility, assurance, pensions and corporate finance and Deloitte MCS Limited provided consulting services. The Committee is exclusively responsible for reviewing, selecting and appointing its advisers.

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

Principal responsibilities

- Set and monitor the strategy and policy for the remuneration of Executive Directors, Chairman and members of the executive leadership team (ELT).
- Determine the design, conditions and coverage of annual incentives and LTIPs for senior executives and approve total and individual payments under the plans.
- Determine targets for any performance-related pay plans.
- Determine the issue and terms of all-employee share plans.
- Oversee any major changes in remuneration.

Areas of focus for 2018

The Committee is operating well with the members bringing a wealth of diverse experience. In 2018 in addition to our regular activities we will:

- Continue our focus on incentive measures and targets to ensure they remain aligned with strategy and performance
- Consider the forthcoming governance reforms and their impact on the Committee's remit and process
- Continue to develop our approach to engaging with employees
- With the HR function, consider how the wider reward strategy can play an even stronger role in supporting new behaviours and culture through the forthcoming business restructuring

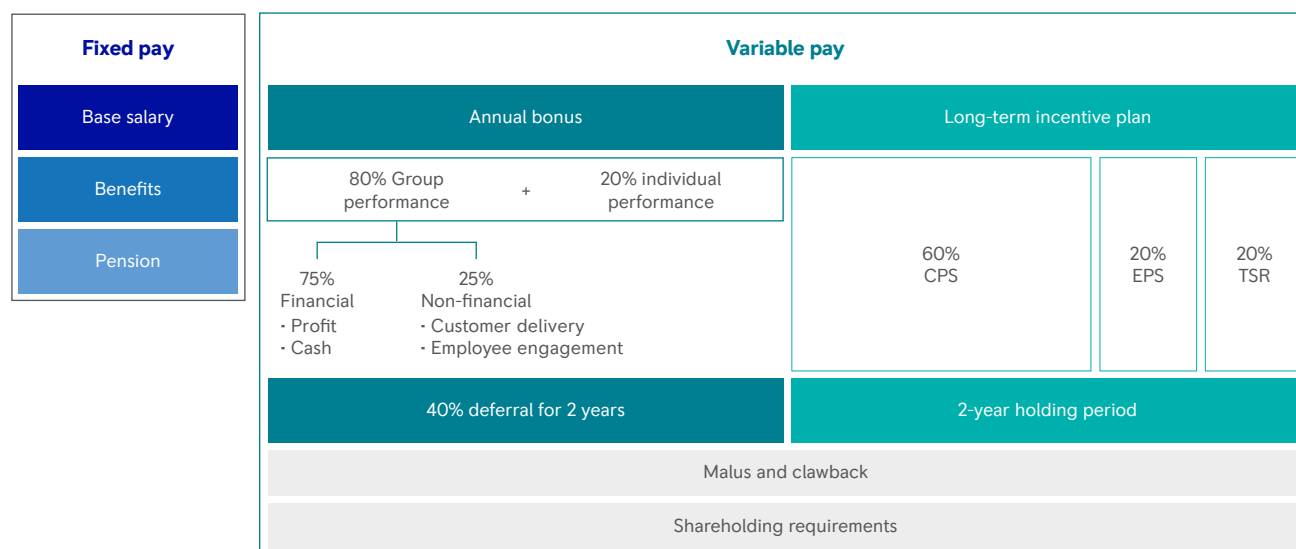
Ruth Cairnie

Chairman of the Remuneration Committee

Remuneration Committee focus during 2017

Area of focus	Matters considered	Outcome
Remuneration policy	Gain shareholder approval for a new policy to: <ul style="list-style-type: none"> – better align executive reward to the transformation agenda; – improve competitiveness of the total reward package to attract and retain talent; – align executive reward with the interests of shareholders; and – introduce simplified plans that can be cascaded down the organisation 	<p>The overall reward structure was reviewed with a continued focus on pay for performance. The designs of both annual bonus and LTIPs were simplified to additive models. Performance metrics focus on the measures that will drive the business strategy and align with shareholder interests.</p> <p>The maximum level of LTIP award was increased to 250% for the Chief Executive and 225% for other Executive Directors. At the same time the amount vesting at threshold was reduced from 30% to 20% and an additional two-year holding period was introduced. The new policy was approved by 96% of shareholders at the 2017 AGM.</p>
Base salaries	Review of base salaries in accordance with the remuneration policy and the broader employee context	Increase to Warren East's salary of 2% with effect from September 2017. There will be no increases for Warren East and Stephen Daintith for 2018.
Annual bonus	<p>2017 bonus – review of performance against the 2017 bonus targets</p> <p>2018 bonus – Review of measures and targets to ensure continued alignment to strategy</p>	<p>Warren East received a bonus of 122% of salary (68% of maximum). Stephen Daintith received a bonus of 83% of salary, equivalent to 113% of salary (75% of maximum) on a full-year basis. 40% of the awards were deferred into shares.</p> <p>The Committee agreed that for the 2018 bonus plan the same measures would apply as in 2017 but with more focus on free cash flow as the key performance metric. The weighting will be as follows:</p> <ul style="list-style-type: none"> – Profit – 25% – Cash – 50% – Customer delivery – 12.5% – Employee engagement – 12.5% <p>Awards will be based 80% on Group performance and 20% on individual performance. The maximum opportunities remain at 180% of salary for the Chief Executive and 150% for other Executive Directors.</p>
Long-term incentive plan	<p>2015 PSP – review of achievement of performance measures</p> <p>2018 LTIP – setting targets that ensure significant stretch</p>	<p>The 2015 awards will not vest due to performance conditions not being satisfied.</p> <p>For 2018 grants, targets will continue to be based on CPS (60%), EPS (20%) and TSR (20%). The EPS targets for threshold, on target and maximum vesting are now based on IFRS 15 accounting.</p> <p>The maximum opportunities remain at 250% for the Chief Executive and 225% for other Executive Directors.</p>
Executive Director changes	<p>Stephen Daintith joined the Board on 7 April 2017</p> <p>David Smith left Rolls-Royce on 28 February 2017</p> <p>Colin Smith left Rolls-Royce on 31 May 2017</p>	<p>Buy-out awards were made to Stephen Daintith to compensate him for awards he forfeited on joining Rolls-Royce.</p> <p>Payments were made to David Smith and Colin Smith in accordance with their contractual entitlements on leaving. The Committee mitigated the payments made to David Smith in relation to his appointment at QinetiQ.</p> <p>Neither David Smith or Colin Smith received a bonus for 2017. Existing long-term incentive awards will be pro-rated based on service and subject to achievement of plan performance conditions at the normal vesting dates.</p>

Summary of our remuneration policy



There are four key themes that underpin the policy:

Simplification

Stewardship

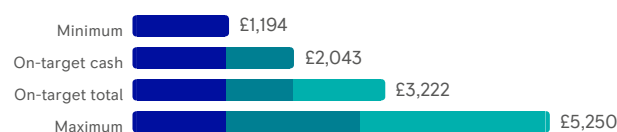
Talent

Supporting transformation

These themes continue to align to our organisational strategy and our reward programmes support them through a combination of salary, benefits, annual bonus and long-term incentives, underpinned by stretching performance measures and appropriate award levels. The full policy is in the 2016 Annual Report, available at www.rolls-royce.com.

Remuneration policy – worked examples for 2018

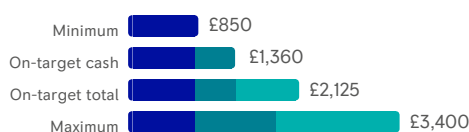
Chief Executive £000



■ Fixed remuneration (including salary, benefits and pension)
■ Annual bonus
■ Long-term incentive plan – this does not include share price growth

Minimum – fixed remuneration (salary, pension, benefits), no bonus award or LTIP vesting.
On-target cash – fixed remuneration, 50% of maximum bonus award, no LTIP vesting.
On-target total – fixed remuneration, 50% of maximum bonus award, 50% of LTIP vesting.
Maximum – fixed remuneration, 100% of maximum bonus award, 100% of LTIP vesting.

Chief Financial Officer £000



Shareholder voting

Results of resolutions 2 and 3 – proposed at the AGM on 4 May 2017

	For		Against		Withheld ¹
	Number of votes	%	Number of votes	%	Number of votes
Approval of the Directors' remuneration policy (resolution 2)	1,357,109,903	95.79	59,613,198	4.21	2,505,008
Approval of the Directors' remuneration report (resolution 3)	1,390,482,627	98.78	17,243,067	1.22	11,527,537

¹ Withheld votes are not counted towards the total percentage of votes cast.

Executive Directors' remuneration

The following pages 87 to 90 show how we have applied our remuneration policy during 2017 and disclose all elements of remuneration received by our Executive Directors. Details of remuneration received by our Non-Executive Directors during 2017 can be found on pages 95 and 96.

Executive Directors' single figure of remuneration (audited)

	Fixed pay						Variable pay				Other (f) £000		Total remuneration £000	
	Salary (a) £000		Benefits (b) £000		Pension (c) £000		Bonus (d) £000		Long-term incentives (e) £000					
	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016
Executive Directors														
Warren East	931	925	17	17	233	231	1,150	916	–	–	–	–	2,331	2,089
Stephen Daintith ¹	499	–	15	–	110	–	565	–	1,259	–	–	–	2,448	–
Former Executive Directors														
Colin Smith ²	229	550	63	156	73	176	–	413	–	–	418	–	783	1,295
David Smith ³	90	540	9	51	29	173	–	405	–	–	124	–	252	1,169
Total	1,749	2,015	104	224	445	580	1,715	1,734	1,259	–	542	–	5,814	4,553

¹ Stephen Daintith took up his role at Rolls-Royce on 7 April 2017. The LTIP awards which vested in 2017 represent part of his buy-out awards – see page 90.

² Colin Smith left Rolls-Royce on 31 May 2017. He received a payment totalling £469k in respect of the remainder of his contractual notice period of which £418k was paid in 2017.

³ David Smith left Rolls-Royce on 28 February 2017.

a) Salary

The Company provides competitive salaries suitable to attract and retain individuals of the right calibre to develop and execute the business strategy. The Committee reviewed Warren East and Stephen Daintith's salary in early 2018 and agreed there would be no increases for 2018.

Executive Director	Base salary as at 1 March 2018	Base salary as at 1 September 2017	Base salary as at 1 March 2016
Warren East	£943,500	£943,500	£925,000
Stephen Daintith (appointed 7 April 2017)	£680,000	£680,000	–

b) Executive Directors' benefits (audited)

Benefits are provided to ensure that remuneration packages remain sufficiently competitive to attract and retain individuals of the right calibre to develop and execute the business strategy and to enable them to devote themselves fully to their roles. The taxable value of all benefits paid to Executive Directors during 2017 is shown below.

	Car or car allowance inc. fuel allowance £000		Financial planning £000		Medical insurance £000		Travel and subsistence £000		Accommodation costs £000		Total £000	
	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016
Executive Directors												
Warren East	15	15	–	–	2	2	–	–	–	–	17	17
Stephen Daintith ¹	13	–	–	–	1	–	1	–	–	–	15	–
Former Executive Directors												
Colin Smith ²	13	30	5	6	–	2	3	7	42	111	63	156
David Smith ³	4	28	–	–	–	2	3	6	2	15	9	51
Total	45	73	5	6	3	6	7	13	44	126	104	224

¹ Stephen Daintith took up his role at Rolls-Royce on 7 April 2017.

² Colin Smith left Rolls-Royce on 31 May 2017.

³ David Smith left Rolls-Royce on 28 February 2017.

c) Pension entitlements (audited)

The Company provides competitive pension arrangements suitable to attract and retain individuals of the right calibre to develop and execute the business strategy. Executive Directors are offered membership of a defined contribution pension plan. A cash allowance may be payable in lieu of pension contributions, reduced to allow for additional National Insurance incurred. Warren East receives a cash allowance of 25% and Stephen Daintith receives a cash allowance of 22% of salary in lieu of pension accrual. The Group's UK pension schemes are funded, registered schemes and were approved under the regime applying until 6 April 2006. They include both defined contribution and defined benefit pension schemes and there is now only one defined benefit pension plan, the 'Rolls-Royce UK Pension Fund'. None of the current Directors is a member of this plan. Colin Smith, who left the Group on 31 May 2017, started to receive his pension on 1 December 2016.

d) Annual bonus outturn (audited)

The Company's annual bonus scheme is designed to incentivise the execution of the business strategy, delivery of financial targets and the achievement of personal objectives. Executive Directors receive any annual bonus awarded in March following the performance period. 60% of the bonus is paid in cash with the remaining 40% awarded in deferred shares. Deferred shares are held in trust for two years before being released, subject to the recipient still being employed by the Group and include the right to receive an amount equal in value to the C shares issued during the deferral period. The annual maximum for the Chief Executive is 180% of salary and 150% for the other Executive Director(s):

- 80% of the award is based on Group performance
- 20% of the award is based on individual performance

The Committee retains overriding discretion on the outturns of the annual bonus.

Malus and clawback provisions apply where there has been: a material misstatement of audited results; serious financial irregularity which invalidates the targets set; reputational damage; material failure of risk management; a serious breach of the Group's Global Code of Conduct; or individual gross misconduct. Clawback will apply from the date of deferral until three years after the release of shares.

2017 annual bonus outturn

The Committee reviewed the 2017 outturn against the performance measures; 80% of annual bonus is based on Group performance and 20% is based on individual performance. The Group performance measures are shown below:

	Profit	Cash	Customer delivery	Employee engagement	Total
Weighting	37.5%	37.5%	12.5%	12.5%	100%
Base (25%)	£813m	(£207m)	80%	75	
Target (50%)	£953m	£93m	90%	77	
Maximum (100%)	£1,096m	£393m	100%	79	
2017 performance ¹	£1,062m	£255m	91%	75	
% of maximum	88%	77%	56%	25%	72%

¹ For the purposes of assessing performance the Committee adjusted the underlying profit and free cash flow to reflect unbudgeted foreign exchange movements and the greater than budgeted benefit from the R&D capitalisation policy.

Definitions used for performance measures:

Profit – underlying profit before tax that is reported by the Group for 2017, adjusted for unbudgeted acquisitions and disposals.

Cash – free cash flow which is cash flow before acquisitions and disposals, shareholder payments, foreign exchange and share buybacks.

Customer delivery – % on-time to purchase order, measured for new equipment, spare parts or equipment repair and overhaul.

Employee engagement – measured through our long-standing global employee opinion survey. 59% of our people participated in our survey in 2017 and our sustainable engagement score was 75.

Individual performance

Executive Directors have 20% of their bonus based on achievement of their personal objectives. Personal performance objectives are set at the beginning of the year and are aligned with the Group's internal strategic priorities.

For Executive Directors these have included:

- Sustain the transformation programme
- Build a strong and effective ELT
- Review the Group vision and strategy and portfolio
- Develop the medium term plan to achieve strategic goals and a focus on safety, cash and people
- Embed a simpler organisation with accountable, engaged and empowered people
- Improve management information systems to provide visibility on business economics and costs
- Develop clear plans and objectives on diversity

The Committee assesses performance against the objectives. The overall assessed percentage is based on the Committee's judgement and may include other factors and achievements in the year.

The following provides an overview of key achievements during the year for each Executive Director:

Warren East	Stephen Daintith
Delivered savings from the 2015 transformation programme at the top end of expectations	Delivered a step change in the performance of the finance function, strengthening leadership and transformation capability
Reshaped the ELT and improved its effectiveness	Significantly improved financial planning and analysis to provide better understanding of Group performance and its drivers
Delivered strong strategic progress including the successful launch of three new engines – Trent 1000 TEN, Trent 7000 and Trent XWB-97	Led medium term planning process across the Group to deliver a significant increase in free cash flow by 2020, increased focus on cost reduction and simplification of processes
Developed the new Group vision and strategy with enhanced focus on underlying technology for the future (electrical and digital). Re-organised the engineering & technology function to move more engineering closer to our customers	Successfully prepared for the introduction and implications of IFRS 15 both internally and externally
Undertook a strategic review of the Group resulting in the planned restructure into three operating businesses	Significantly improved market communications with greater clarity over key cash flow drivers

2017 annual bonus outturn (paid in March 2018)

	Group performance (% of salary)	Individual Performance (% of salary)	Total bonus (% of salary)	Total bonus (% of maximum)
Warren East	104%	18%	122%	68%
Stephen Daintith ¹	64%	19%	83%	55%

¹ The bonus received by Stephen Daintith was reduced pro-rata to reflect his joining date of 7 April 2017. The full year equivalent would have been 113% of salary and 75% of maximum.

e) Long-term incentives (audited)

Awards are made to Executive Directors under the LTIP to reward the execution and development of the business strategy over a multi-year period.

LTIP awards made in May 2017

The performance targets for awards made in May 2017 are shown below. Performance will be measured over three years to 31 December 2019.

	CPS (60%)	EPS (20%)	Relative TSR (20%)
Threshold (20% vesting)	60p	115p	Median
Mid (50% vesting)	80p	135p	Between median and upper quartile
Maximum (100% vesting)	110p	160p	Upper quartile

	Number of shares	% of salary	Face value of award £000	Performance period end date
Warren East	281,954	250	2,312	31 December 2020
Stephen Daintith	186,547	225	1,530	31 December 2020

PSP awards vesting in March 2018

The following sets out details in respect of the March 2015 PSP award (made under the 2014 remuneration policy) for which the final year of performance was the 2017 financial year. Subject to performance conditions, the vesting date of these awards is March 2018, three years after the awards were made.

	Targets for 2015-2017 period	Performance against targets
EPS growth (hurdle)	Awards will vest if EPS growth exceeds the OECD index of consumer prices. Awards will lapse if the hurdle is not met.	EPS growth of -39.4% over the three-year period underperformed the hurdle which was 4.1%.
Aggregate CPS	Aggregate CPS over three-year period of less than 60p – zero vesting. Aggregate CPS over three-year period of 100p – 100% vesting.	Aggregate CPS performance over three-year period of 26p.
Relative TSR	Relative TSR versus FTSE 100 constituents less than median – 1.0 x multiplier. Relative TSR versus FTSE 100 constituents equal to median – 1.25 x multiplier. Relative TSR versus FTSE 100 constituents equal to upper quartile – 1.5 x multiplier.	Relative TSR over the three-year period was below median.
Outturn	None of the 2015 awards will vest in March 2018.	

There are also outstanding awards, made under the Rolls-Royce Performance Share Plan (PSP), which were agreed prior to the approval of the LTIP at the AGM in 2017. These include awards made to Stephen Daintith to compensate for unvested incentives awarded to him at Daily Mail & General Trust plc (DMGT) which were forfeited as a result of him joining Rolls-Royce. The awards shown below are of equivalent value to the DMGT awards forfeited and reflect performance conditions and match or exceed the time horizons. Awards vesting in 2019 will be assessed against the 2016 PSP performance conditions.

PSP awards made to Stephen Daintith in May 2017

Number of shares	Face value of award £000	Vesting conditions	Vesting date	Outturn %
118,103	891	Determined by the extent to which DMGT awards vest	31 October 2017	100
14,792	112	Continued employment and good level of personal performance	31 December 2017	100
70,027	528	Determined by the Company's performance between 1 January 2016 and 31 December 2018	1 March 2019	
79,726	602	Determined by the Company's performance between 1 January 2016 and 31 December 2018	31 October 2019	

Malus and clawback provisions apply where there has been: a material misstatement of audited results; serious financial irregularity which invalidates the targets set; reputational damage; material failure of risk management; a serious breach of the Group's Global Code of Conduct; or individual gross misconduct. These provisions will apply from the date of the award until three years from the date of vesting.

All awards under the 2017 LTIP are subject to a further two-year holding period after the three-year performance period. The holding period will normally continue to apply post-employment.

f) Other (audited)**Payments for loss of office**

David Smith left the Group on 28 February 2017 and Colin Smith on 31 May 2017. Neither received a bonus award for 2017.

David Smith served six months of his 12 months' notice and received a payment in lieu of notice in relation to the remaining six months of his notice period, paid in monthly instalments. The Committee reduced these payments to account for his remuneration with QinetiQ resulting in total payments of £124k (which included unpaid holiday entitlement).

Colin Smith, having served four months of his 12 months' notice, received total payments of £469k in lieu of notice payable to him in eight instalments. Seven of these instalments, totalling £418k, were paid to him in 2017. The final instalment, which related to the last month of his notice period, was paid in January 2018. Outplacement support has also been provided.

Both will retain pro-rated PSP awards, granted prior to leaving, subject to the Company meeting the performance targets for those awards and subject to and in accordance with the rules of the plan. Shares will only be released on the normal vesting dates.

Payments to past directors

Colin Smith stepped down from the Board on 4 May 2017 and left the Group on 31 May 2017. A short-term agreement was put in place to represent the Company in an ambassadorial capacity for a maximum of 15 days to the end of 2017 and 35 days to the end of 2018. The 15 days that Colin carried out this role in 2017 will be paid in 2018.

Implementation of remuneration policy in 2018

Base salary	There will be no change to base salary for 2018; base salaries remain as: – Warren East – £943,500 – Stephen Daintith – £680,000																
Benefits	There will be no change to our approach to benefits in 2018, which includes car or car allowance, financial planning assistance, insurances and other benefits.																
Pensions	There will be no change to our approach to pensions in 2018. Pension arrangements will be: – Warren East: cash allowance of 25% of salary – Stephen Daintith: cash allowance of 22% of salary																
Annual bonus	For 2018, bonuses will continue to be awarded using a simple additive approach: – 80% of the award will be based on Group performance – 20% of the award will be based on individual performance For 2018, the Group measures will be unchanged, however there will be an increased weighting to free cash flow to emphasise this as the key performance metric for 2018: Profit (25%) – Free cash flow (50%) – Customer delivery (12.5%) – Employee engagement (12.5%) Maximum opportunities will remain unchanged: – Chief Executive – 180% of salary – Other Executive Directors – 150% of salary																
LTIP awards	For awards to be granted in 2018 performance measures will be weighted: – 60% on CPS – 20% on EPS – 20% on relative TSR (versus FTSE 100 and Global S&P Index, to recognise that Rolls-Royce is a global company). Performance will be measured over three years to 31 December 2020. Performance targets will be: <table><tr><th></th><th>CPS</th><th>EPS IFRS 15 basis ¹</th><th>Relative TSR</th></tr><tr><td>Threshold (20% vesting)</td><td>95p</td><td>73p</td><td>Median</td></tr><tr><td>Mid (50% vesting)</td><td>126p</td><td>86p</td><td>Between median and upper quartile</td></tr><tr><td>Maximum (100% vesting)</td><td>158p</td><td>103p</td><td>Upper quartile</td></tr></table> ¹ EPS is now based on IFRS 15 accounting which is a different basis from prior years' targets. Performance below threshold will result in that element lapsing in full. The above targets are not an indication of forecast numbers for the three-year period. Methodologies CPS – calculated as reported cash flow before the cost of business acquisitions or proceeds of disposals, foreign exchange translation effects, special payments into pension schemes and payments to shareholders, divided by the weighted average number of shares in issue. CPS is cumulative over a three-year period. The Committee will review CPS performance to ensure that it is a fair reflection of achievements over the period. EPS – calculated as cumulative absolute underlying EPS over the three-year performance period on an IFRS 15 basis. Relative TSR – measured 50% against the constituents of the FTSE 100 and 50% against the constituents of the S&P Global Industrials index. Award sizes for maximum performance – Chief Executive: 250% of salary – Other Executive Directors: 225% of salary Threshold vesting at 20% equates to 50% of salary for the Chief Executive and 45% of salary for other Executive Directors. LTIP awards will be subject to an additional shareholding period of two years following the three-year performance period.		CPS	EPS IFRS 15 basis ¹	Relative TSR	Threshold (20% vesting)	95p	73p	Median	Mid (50% vesting)	126p	86p	Between median and upper quartile	Maximum (100% vesting)	158p	103p	Upper quartile
	CPS	EPS IFRS 15 basis ¹	Relative TSR														
Threshold (20% vesting)	95p	73p	Median														
Mid (50% vesting)	126p	86p	Between median and upper quartile														
Maximum (100% vesting)	158p	103p	Upper quartile														

Other information

Executive Directors' share interests (audited)

The Directors and their connected persons hold the following interests in the ordinary shares of the Company:

	Ordinary shares	Conditional shares not subject to performance conditions (Deferred share bonus)	Conditional shares subject to performance conditions (PSP)	Conditional shares subject to performance conditions (LTIP)	Options over shares subject to savings contract (Sharesave)
	31 December 2017	6 March 2018	31 December 2017	31 December 2017	31 December 2017
Warren East	25,733	25,868	47,398	290,845	281,954
Stephen Daintith	70,433	70,433	–	149,753	186,547

Executive Directors' interests in vested and unvested shares – changes in 2017 (audited)

Warren East	31 December 2016	Granted during the year	Vested awards	Lapsed awards	31 December 2017	Market price at date of award (p)	Date of grant	Date of vesting	Market price at vesting (p)
PSP 2015	126,643	–	–	–	126,643	730.00	01/09/15	01/09/18	–
PSP 2016	164,202	–	–	–	164,202	676.00	01/03/16	01/03/19	–
Total	290,845	–	–	–	290,845	–	–	–	–
LTIP 2017 ¹	–	281,954	–	–	281,954	820.17	05/05/17	04/05/20	–
Deferred share bonus	–	47,398	–	–	47,398	772.83	01/03/17	01/03/19	–
Sharesave (options) ²	1,264	–	–	–	1,264	616.80	12/10/15	01/02/21	–

Stephen Daintith	31 December 2016	Granted during the year	Vested awards	Lapsed awards	31 December 2017	Market price at date of award (p)	Date of grant	Date of vesting	Market price at vesting (p)
PSP 2017 (buy-out award) ³	–	118,103	118,103	–	–	754.70	01/03/17	31/10/17	961.00
PSP 2017 (buy-out award) ³	–	14,792	14,792	–	–	754.70	01/03/17	31/12/17	840.80
PSP 2017 (buy-out award) ³	–	70,027	–	–	70,027	754.70	01/03/17	01/03/19	–
PSP 2017 (buy-out award) ³	–	79,726	–	–	79,726	754.70	01/03/17	31/10/19	–
Total	–	282,648	132,895	–	149,753	–	–	–	–
LTIP 2017 ¹	–	186,547	–	–	186,547	820.17	05/05/17	04/05/20	–
Sharesave (options) ²	–	925	–	–	925	758.40	13/10/17	01/02/21	–

¹ The LTIP grant price is the average of the closing mid-market price calculated over 2, 3 and 4 May 2017.

² For Sharesave, the price shown is the exercise price which was 85% of the market price at the date of the award.

³ The grant price for PSP awards made to Stephen Daintith was the average closing mid-market price calculated over one month, up to 22/09/16 (the date that his appointment to Rolls-Royce was announced). The exercise of the PSP award vesting on 31/12/17 took place on 02/01/18. More information on these awards is on page 90.

Shareholding requirement

Executive Directors are required to work towards holding beneficially-owned shares equivalent in value to a percentage of their salary by retaining at least one half of after-tax shares released from the PSP/LTIP until this requirement is met. For the Chief Executive this requirement is 250% of salary and for other Executive Directors this requirement is 200% of salary. The current shareholdings, as a percentage of the requirement, for Warren East and Stephen Daintith are 26% and 42% respectively.*

* The percentage of the requirement was calculated by reference to the May 2017 LTIP grant price and salary as at date of grant. Unvested PSP awards, LTIP awards and Sharesave options are not included in this calculation.

Former Executive Directors' share interests

At the time of leaving Rolls-Royce, former Executive Directors and their connected persons held the following interests in the ordinary shares of the Company:

Colin Smith – 224,370 ordinary shares (as at 31 May 2017)

David Smith – 42,367 ordinary shares (as at 28 February 2017)

Former Executive Directors' interests in vested and unvested shares – changes in 2017

Colin Smith	31 December 2016	Granted during the year	Vested awards	Lapsed awards	31 December 2017	Market price at date of award (p)	Date of grant	Date of vesting	Market price at vesting (p)
PSP 2014	53,336	–	–	(53,336)	0	984.33	07/05/14	03/03/17	–
PSP 2015 ¹	58,263	–	–	–	58,263	944.00	02/03/15	02/03/18	–
PSP 2016	81,361	–	–	–	81,361	676.00	01/03/16	01/03/19	–
Total	192,960	–	–	(53,336)	139,624	–	–	–	–
Sharesave (options) ²	758	–	–	758	–	616.80	12/10/15	–	–

David Smith	31 December 2016	Granted during the year	Vested awards	Lapsed awards	31 December 2017	Market price at date of award (p)	Date of grant	Date of vesting	Market price at vesting (p)
PSP 2014	18,287	–	–	(18,287)	0	984.33	03/03/14	03/03/17	–
PSP 2015 ¹	57,204	–	–	–	57,204	944.00	02/03/15	02/03/18	–
PSP 2016	79,882	–	–	–	79,882	676.00	01/03/16	01/03/19	–
Total	155,373	–	–	(18,287)	137,086	–	–	–	–
Sharesave (options) ²	758	–	–	758	–	616.80	12/10/15	–	–

¹ The 2015 PSP award lapsed on 2/3/2018.² For Sharesave, the price shown is the exercise price which was 85% of the market price at the date of the award.**Pay across the organisation**

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

- a comparison of the year-on-year percentage change in our Chief Executive's remuneration with the change in average remuneration across the UK;
- a year-on-year comparison of the total amount spent on employment costs across the Group and shareholder payments;
- a nine-year history of our Chief Executive's remuneration;
- our TSR performance over the same period; and
- an indication of the ratio between our Chief Executive's remuneration and the remuneration of employees.

Percentage change in Chief Executive remuneration

The following table compares the percentage change in the Chief Executive's salary, bonus and benefits (excluding LTIP) to the average percentage change in salary, bonus and benefits for all UK employees from 2016 to 2017.

Change in remuneration

	Salary	Benefits	Annual bonus
Chief Executive	2%	0%	25.6%
UK employees average ¹	2.3%	5%	2.1%

¹ UK employees were chosen as a comparator group in order to avoid the impact of exchange rate movements over the year. UK employees excluding apprentices, graduates and interns, make up 45% of the total employee population.

Chief Executive pay ratio

The Committee is mindful of the relationship between the remuneration of the Chief Executive and the wider employee population. All employees participate in a bonus plan. We also encourage all employees to join our Sharesave plan, launched every two years. For our recent launch around 50% of our employees globally joined the plan, sharing in 14 million shares/stock appreciation rights. Included below is the ratio of the remuneration of the Chief Executive to other UK employees in the Group during 2017. The ratio will be higher when Group performance triggers incentive pay-outs. The ratio could vary significantly depending on the extent that the Group's performance triggers the payment of short and long-term incentives.

CEO pay ratio (total remuneration)	CEO pay ratio (pay only)
41:1	21:1

Relative spend on pay

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

Payment to shareholders (£m) *

(Consolidated Cash Flow Statement)



* Value of C Shares issued during the year.

** Includes £306m costs of restructuring the UK defined benefit pension schemes.

Group employment costs (£m)

(Note 7 – Consolidated Financial Statements)



Chief Executive pay

Year	Chief Executive ¹	Single figure of total remuneration £000	Annual bonus as a % of maximum	LTIP as a % of maximum
2017	Warren East	2,331	68	–
2016	Warren East	2,089	55	–
2015	Warren East	543	0	–
2015	John Rishton	754	0	–
2014	John Rishton	2,596	0	45
2013	John Rishton ²	6,228	55	100
2012	John Rishton ²	4,577	85	–
2011	John Rishton	3,677	63	–
2011	Sir John Rose ³	3,832	–	75
2010	Sir John Rose	3,914	100	100

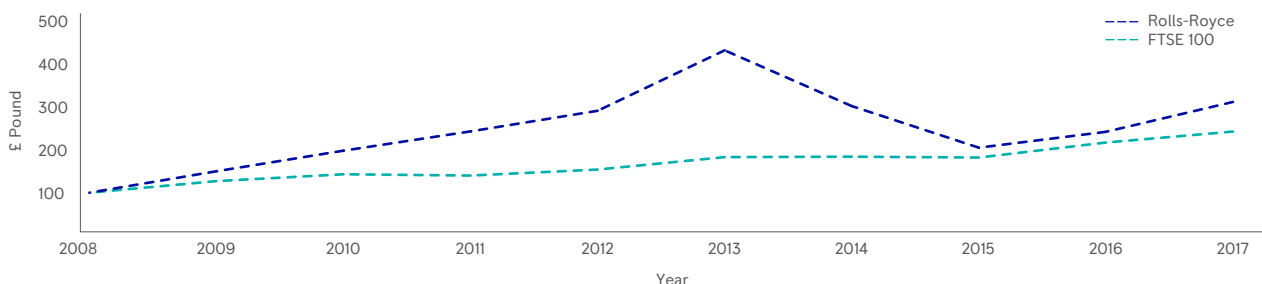
¹ On 31 March 2011, Sir John Rose retired and John Rishton was appointed. John Rishton retired on 2 July 2015 and Warren East was appointed as Chief Executive on 3 July 2015.

² John Rishton received a special grant of shares on joining the Company on 1 March 2011 to mirror the shares he forfeited on resigning from his previous employer. The share price had increased from 483.50p at the time this grant was made to 870p at the end of 2014. These are the main reasons why John Rishton's remuneration in 2012 and 2013 exceeded that of his predecessor.

³ The remuneration for Sir John Rose does not include any pension accrual or contribution as he received his pension from 1 February 2008.

TSR performance

The Company's TSR performance over the previous nine years compared to a broad equity market index is shown in the graph below. The FTSE 100 has been chosen as the comparator because it contains a broad range of other UK-listed companies. The graph shows the growth in value of a hypothetical £100 holding in the Company's ordinary shares over nine years, relative to the FTSE 100 index.



Gender pay reporting

The Company is committed to creating a diverse and inclusive place to work where our people can be themselves and be at their best. We published our gender pay gap in November 2017, which showed:



■ Median gender pay gap across all Rolls-Royce UK employees
■ Mean gender pay gap across all Rolls-Royce UK employees

Overall, women currently represent 15% of Rolls-Royce UK employees. Women are less well-represented than this figure in the higher pay quartiles due to proportionally more men being in senior level roles. Increasing the number of women in our business and moving towards a more balanced distribution of men and women across all levels is very important. We are making progress on this in many ways, such as increasing the proportion of women in our apprentice and graduate intakes. More details are available on page 47 and at www.rolls-royce.com.

Contractual arrangements

The Executive Directors have service agreements that set out the contract between each Executive Director and the Company.

Executive Directors' service contracts

	Date of contract	Notice period from Company	Notice period from individual
Warren East	21 April 2015	12 months	6 months
Stephen Daintith	21 September 2016	12 months	12 months

Payments received for serving on external boards

Executive Directors retain payments received from serving on the boards of external companies, the details of which are given below:

	Directorships held	Payments received and retained £000
Warren East	Dyson James Group Limited	80
Stephen Daintith	3i Group plc	75

Non-Executive Directors' remuneration

Single figure of remuneration (audited)

	Fees (£000)		Benefits (£000)		Total (£000)	
	2017	2016	2017	2016	2017	2016
Chairman and Non-Executive Directors						
Ian Davis	425	425	2	2	427	427
Lewis Booth ¹	95	100	69	14	164	114
Ruth Cairnie	90	83	4	2	94	85
Sir Frank Chapman	90	90	4	2	94	92
Irene Dorner	70	70	–	–	70	70
Beverly Goulet ²	35	–	11	–	46	–
Lee Hsien Yang	70	70	3	3	73	73
Brad Singer	70	58	20	–	90	58
Sir Kevin Smith	105	98	5	2	110	100
Jasmin Staiblin	70	70	7	4	77	74
Former Non-Executive Directors						
Dame Helen Alexander	–	31	–	–	–	31
Alan Davies	–	62	–	1	–	63
John McAdam ³	24	70	–	–	24	70
Total	1,144	1,227	125	30	1,269	1,257

¹ The tax treatment of travel expenses incurred by Lewis Booth, while travelling to and from the UK, changed in May 2016 (five years after his date of appointment and in accordance with HMRC rules). This change is reflected in the value of benefits reported.

² Beverly Goulet joined the Board on 3 July 2017.

³ John McAdam stepped down from the Board on 4 May 2017 after completing nine years.

Non-Executive Directors' fees

The Chairman's fee is reviewed by the Board as a whole on the recommendation of the Committee. The review of the other Non-Executive Directors' base fees is reserved to the Executive Directors, who consider recommendations from the Chairman. No individual may be involved in setting his or her own fee. The Chairman and the Non-Executive Directors are not eligible to participate in any of the Group's share schemes, incentive arrangements or pension schemes. A facility is in place which enables Non-Executive Directors (who reside in a permitted dealing territory) to use some or all of their fees, after the appropriate statutory deductions, to make market purchases of shares in the Company on a monthly basis. Ruth Cairnie, Sir Frank Chapman, Ian Davis, Lee Hsien Yang and Sir Kevin Smith use this facility.

Non-Executive Directors' fees

	2018 £000	2017 £000	2016 £000
Chairman	425	425	425
Other Non-Executive Directors base fee	70	70	70
Chairman of the Audit Committee	25	25	25
Chairman of the Remuneration Committee	20	20	20
Chairman of the Safety & Ethics Committee	20	20	20
Chairman of the Science & Technology Committee	20	20	20
Senior Independent Director	15	15	15

Non-Executive Directors' benefits (audited)

The benefits for Non-Executive Directors relate predominantly to travel, hotel and subsistence incurred in attending meetings. For Non-Executive Directors based outside the UK the Company may also pay towards tax advice and the cost of making tax filings.

Non-Executive Directors' share interests (audited)

The Non-Executive Directors and their connected persons hold the following interests in the ordinary shares of the Company:

Chairman and Non-Executive Directors	31 December 2017	6 March 2018
Ian Davis	57,436	58,141
Lewis Booth	60,000	60,000
Ruth Cairnie	14,097	14,626
Sir Frank Chapman	27,798	28,733
Irene Dorner	10,244	10,297
Beverly Goulet	4,250	4,272
Lee Hsien Yang	5,482	5,742
Brad Singer	–	–
Sir Kevin Smith	24,701	25,451
Jasmin Staiblin	–	–
Former Non-Executive Director	4 May 2017	
John McAdam (balance at date of stepping down from the Board)	3,362	n/a

Non-Executive Directors' letters of appointment

Our Non-Executive Directors serve a maximum of three, three-year terms (nine years in total).

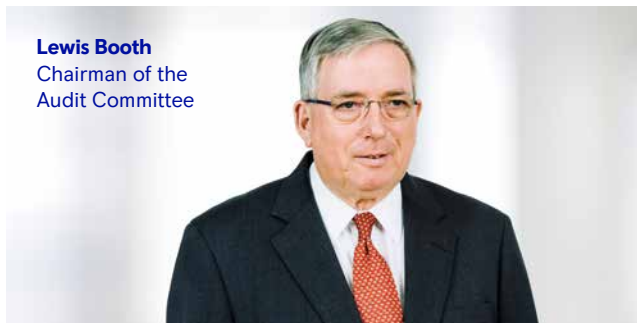
Chairman and Non-Executive Directors	Original appointment date	Current letter of appointment end date
Ian Davis	1 March 2013	28 February 2019
Lewis Booth	25 May 2011	24 May 2020
Ruth Cairnie	1 September 2014	31 August 2020
Sir Frank Chapman	10 November 2011	9 November 2020
Irene Dorner	27 July 2015	26 July 2018
Beverly Goulet	3 July 2017	2 July 2020
Lee Hsien Yang	1 January 2014	31 December 2019
Brad Singer	2 March 2016	3 May 2018
Sir Kevin Smith	1 November 2015	31 October 2018
Jasmin Staiblin	21 May 2012	20 May 2018

Statutory requirements

The Committee's composition, responsibilities and operation comply with the principles of good governance, as set out in the UK Corporate Governance Code with the Listing Rules (of the Financial Conduct Authority) and with the Companies Act 2006. The Directors' remuneration report has been prepared on the basis prescribed in the Large and Medium-sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013.

Audit Committee Report

Lewis Booth
Chairman of the
Audit Committee



Key highlights

Focus on business and functional risks

Preparations complete for the implementation of IFRS 15
Revenue from Contracts with Customers

Continued strengthening of the control environment

PwC confirmed its independence ahead of appointment in 2018 and transition progressing

Introduction

I am pleased to present the 2017 report of the Audit Committee which describes how the Committee has carried out its responsibilities during the year. I would like to thank the members of the Committee, the executive management team and KPMG for the open discussions that take place at our meetings and the importance they all attach to its work.

The Group has complex long-term accounting and every year we spend much of our time reviewing the accounting policies and accounting judgements implicit in our financial results. For 2017, this work has been compounded by preparing for the change in revenue recognition under IFRS 15, which has a major impact on the presentation of the accounts; management has been pro-active in analysing the effect of this new standard and providing input to the market on its impact, and we are satisfied that the interpretation, judgements, and estimates for IFRS 15 are appropriate. In addition, we reviewed the plans to implement IFRS 9 *Financial Instruments* from 2018.

As a result of the audit tender completed in 2016, we have been preparing for the appointment of PricewaterhouseCoopers LLP (PwC) as the Company's new auditor in 2018. This has required a significant effort to reassign work from PwC to ensure that they are independent, and I am delighted that they achieved this in October. The management team has introduced effective controls to ensure that PwC (and KPMG until the completion of their audit responsibilities) maintain their independence.

2017 has also seen the finance team strengthened at the senior level. Significant progress has been made in financial analysis and reporting and in the supporting management information systems. This has provided additional support for the Committee's work.

For 2018, work will continue to strengthen the control environment (including recommendations arising from the DPAs), review of all key accounting judgements, as well as reviewing the progress on IFRS 16 *Leases* which takes effect from 2019.

Operation of the Committee

All members of the Committee are independent Non-Executive Directors. Beverly Goulet joined the Committee on 3 July 2017. For the purposes of the Code and DTR 7.1, Beverly Goulet, Irene Dorner and I have recent and relevant financial experience. Our biographies are on page 67.

The Committee's responsibilities are outlined in its terms of reference, which can be found at www.rolls-royce.com, which we review annually and refer to the Board for approval. During 2017, we made an amendment to cover the revised Provision C.3.1 of the Code that requires the Committee, as a whole, to have competence relevant to the sector in which the Company operates, which the Nominations & Governance Committee confirmed is already the case.

Committee members

Member	Attended	Eligible to attend
Lewis Booth (chairman)	5	5
Irene Dorner	5	5
Beverly Goulet	3	3
Lee Hsien Yang	5	5

Principal responsibilities

Financial reporting

- Financial announcements, focusing on:
 - accounting policies, judgements and estimates;
 - inclusion of appropriate disclosures;
 - compliance with relevant regulations; and
 - whether the Annual Report is fair, balanced and understandable.

Risk and control environment

- Scope and effectiveness of the risk management system.
- Monitoring of financial fraud risks.
- Systems of internal control.

Principal risks

- Business continuity, market and financial shock, and IT vulnerability.

Internal audit

- Scope, resources, results and effectiveness.

External auditor

- Relationship with, and effectiveness of, the external auditor.
- Recommendations to the Board for the external auditor's appointment and fees.

Audit Committee focus during 2017

Area of focus	Matters considered	Outcome
Financial reporting	<p>The appropriateness and disclosure of accounting policies, key judgements and key estimates with a focus on:</p> <ul style="list-style-type: none"> – the methodology for capitalisation and amortisation of development costs; – carrying value of goodwill in Marine; – treatment, estimation and disclosure of costs in Civil Aerospace for the remediation of in-service issues on the Trent 1000 and Trent 900 programmes; – restructuring costs; and – acquisition of ITP Aero. <p>The implementation projects for IFRS 9, IFRS 15 and IFRS 16. In particular, the preparation of the restated information on an IFRS 15 basis which is included in notes 1 and 27 to the Consolidated Financial Statements.</p> <p>The form and content of the Annual Report.</p>	<p>The accounting policies, judgements and estimates are appropriate and balanced.</p> <p>Agreed the judgements and estimates to adopt IFRS 9.</p> <p>IFRS 15 interpretations, judgements and estimates made are appropriate.</p> <p>Agreed the approach being taken to implement IFRS 16 (see page 132).</p> <p>The Annual Report, taken as a whole, is fair, balanced and understandable.</p>
Risk and control environment	<p>Continued improvements to the enterprise risk management and internal controls systems, including a focus on core financial controls, and risks at remote locations.</p> <p>The processes for identifying and managing risks.</p> <p>The model for assessing the effectiveness of the Group's systems of internal control.</p> <p>The process and assumptions underlying the going concern and viability statements.</p>	<p>The internal control system meets the requirements of the Code. It will continue to be enhanced during 2018, including extending the documentation of internal controls to include compliance controls relating to the DPAs.</p> <p>Reported to the Board that an appropriate process is in place to make the viability statement.</p>
Principal risks	<p>Management's assessment of the risk of a business continuity event.</p> <p>The procedures for preventing, monitoring and combatting breaches of the security of the Group's IT systems.</p> <p>The Group's policies, procedures and controls for identifying, managing and mitigating a market shock.</p>	<p>Appropriate procedures are in place to identify and manage principal risks and all of these have been subject to a review by the Board or an appropriate Board committee.</p> <p>Appropriate procedures are in place to manage business continuity, cyber security and market shock risks.</p>
Internal audit	<p>The effectiveness of the internal audit function, its key findings and trends arising, and the resolution of these matters.</p>	<p>The scope and extent of internal audit are appropriate and the function remains effective.</p>
External audit	<p>The approach and scope of external audit and the effectiveness and independence of the external auditor.</p> <p>The extent of non-audit services provided by KPMG.</p> <p>The transition to PwC as auditor in 2018.</p>	<p>Assessed KPMG as effective and independent.</p> <p>No concerns over the nature and amount of the non-audit services provided by KPMG.</p> <p>Recommended that PwC be appointed as the Group's auditors at the 2018 AGM.</p> <p>Monitored the procedures to ensure that PwC became independent of the Group in October 2017 and approved enhanced policies to maintain this.</p>

Sector audit committees

To strengthen the ownership of accounting policies and controls, and to support our work, each of the Group's businesses and principal functions has its own sector audit committee. These committees are chaired by the director of internal audit, comprise business functional leaders and senior finance personnel and are attended by KPMG. They meet twice a year and:

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

The director of internal audit reported to this Committee on key matters arising and also provided updates on the work and effectiveness of the sector audit committees during the year.

In 2017, the sector audit committees continued to focus on the improvement projects for internal control and risk management process, in particular the embedding of these in our normal operational processes.

Members of the Committee attended at least one sector audit committee each, and we are satisfied that this process is now owned by the business and is helping to improve our risk management and the control environment.

Business and function presentations

In addition to a regular review of the sector audit committee process and any key issues identified, we have a regular schedule of presentations from each of the Group's businesses and its key functions. During 2017, we received presentations from the following:

- **Civil Aerospace** – key business risks (focusing on new programme introductions, ramp-up in production and in-service product issues); supply chain resilience; internal control environment (including financial analysis, the implementation of IFRS 15 in 2018 and planning and forecasting capability to reflect the business growth); and accounting policies, judgements and estimates.
- **Power Systems** – key accounting estimates (including warranty provisions and the impact of the transformation programme); key business risks (including regulatory compliance, competitive position, and transformation programmes); and the control environment.
- **Nuclear** – key accounting estimates (which principally relate to accounting for long-term contracts and are affected by the changing contractual arrangements with the UK MoD); key business risks (including government relations, programme delivery, IT security, and safety of nuclear facilities and products); future of civil nuclear markets; and the control environment.
- **Group tax director** – the main drivers of the Group's tax position and key tax risks and how they are managed (with specific consideration of tax disputes); key tax law developments and new requirements (in particular the new UK corporate offence of 'failure to prevent the facilitation of tax evasion'); key sources of estimation uncertainty (in particular the recognition of deferred tax assets); and key tax-related disclosures.

Financial reporting

During the year, we considered proposals for revisions to the methodologies applied to determine when development costs should be capitalised and how they should be amortised. These are described in more detail on pages 124 and 128. The Committee agreed that the experience on the significant number of new programmes in the Civil Aerospace business and changes in the way in which technical risk is being managed on these programmes indicated that the criteria for the capitalisation of development costs were generally met at an earlier stage than has previously been assessed, and that costs eligible for capitalisation continue to be incurred after the first engines have entered service. We were satisfied that appropriate governance procedures and controls are in place to manage this revised methodology. The impact of this change in 2017 is the capitalisation of an additional £83m of costs. We also agreed that an amortisation methodology that reflects the number of engines in service better reflects the pattern of consumption of the intangible asset.

A summary of the principal matters we considered in respect of the 2017 Consolidated Financial Statements is set out in the table on page 100. Where relevant (in particular, in regard to the carrying value of programme assets and estimates on long-term contractual arrangements) we took account of the potential impact of the in-service issues on the Civil Aerospace Trent 1000 and Trent 900 programmes. These are described on page 24.

We continued to monitor the implementation of new standards. Our conclusions on IFRS 15 are shown in the table on page 100. IFRS 9 is applicable from 2018. The impact on the Group is not significant and is described on page 130. IFRS 16 is applicable from 2019. In broad terms this requires a balance sheet liability to be reported for all leases. We considered progress of the project and analysis of the Group's lease portfolio.

Since the year end, we have reviewed the form and content of the Company's 2017 Annual Report, together with the processes used to prepare and verify it. We have reported to the Board that, taken as a whole, we consider the Annual Report to be fair, balanced and understandable. We further believe the Annual Report provides the necessary information for shareholders to adequately assess the Company's position and performance, business model and strategy.

In making this assessment, we considered:

- the process for preparing the Annual Report, including a steering committee, the core team, and instructions to contributors;
- written representations from management in respect of the business reviews, sustainability, principal risks and Financial Statements;
- the completion of a regulatory compliance checklist;
- all reviews performed (including the Board, the ELT and KPMG) and ensured that all feedback was appropriately reflected; and
- the presentation and discussion in the Strategic Report of: (i) the underlying as well as reported results; (ii) the in-service issues on the Trent 1000 and Trent 900 programmes; and (iii) trends, in particular, the impact of individually significant items.

Areas of focus for the 2017 Financial Statements

Key issue	Matters considered	Outcome
Accounting for development costs	Methodology for capitalisation and amortisation of development costs – see pages 124 and 128	We are satisfied that the revised methodology for capitalisation and amortisation of development costs appropriately reflects changes in the ways in which risk is managed in the programmes and the consumption of the programme asset.
Impairment of the carrying values of programme assets in Civil Aerospace	Assessments of the values of the principal programme assets, including key assumptions and estimates – see page 143	We are satisfied that no write-down of programme assets is required.
Determining the appropriateness of the judgements and estimates used in accounting for long-term contractual arrangements	Continuing appropriateness of the judgements We considered carefully the estimates used in the accounting regarding the cost of the in-service engine issues on the Trent 1000 and Trent 900 programmes and the resulting performance improvements	We are satisfied that the judgements continue to be appropriate and that the process produces balanced estimates, with appropriate consideration of the uncertainties. No significant changes to the basis of preparation were made in 2017.
Classification of restructuring costs	The criteria for excluding certain costs from the underlying results and whether the costs meet this criteria – see page 135	We are satisfied that the agreed criteria have been consistently applied.
The sale of engines to joint ventures	Basis for assessing the selling price – see page 166	We are satisfied that the price represents the fair value of the engines.
Indications of impairment of goodwill in Marine	The forecasts and the key assumptions on which they are based – see page 143	We are satisfied that no impairment is required but, as the headroom remains low, we will continue to monitor this. We were also satisfied that no adjustments were required in 2017 as result of the reorganisation of Marine announced in January 2018.
Deferred tax assets (DTAs) and advance corporation tax	Basis for recognition of DTAs arising from tax losses and advance corporation tax in the UK and non-recognition of DTAs in Norway	Based on the Group's forecasts and taking account of the current uncertainties in the oil & gas market, we are satisfied that the treatment is appropriate.
Acquisition of ITP Aero	The acquisition accounting focusing on the remeasurement of the existing joint venture investment and the allocation of the purchase price to the assets acquired, giving rise to the recognition of a gain – see page 167	We are satisfied that the provisional judgements and estimates made were appropriate and that, in accordance with IFRS 3 <i>Business Combinations</i> , these will be finalised in 2018.
Implementation of IFRS 9	The assessment of judgements and estimates necessary to implement IFRS 9 in 2018 – see page 130	We are satisfied that the judgements and estimates are appropriate.
Implementation of IFRS 15	The progress of the project to implement IFRS 15 in 2018 and the preparation of the disclosures of the impact of the change for 2017 (see pages 55 to 57, 131 to 132 and 170 to 171)	We are satisfied that the judgements and estimates made are appropriate and consistent with the new requirements; that the disclosures of the impact are appropriate; and that the Group has systems and processes in place to report on the new basis in 2018.

Risk and control environment

Assessment of principal risks

Risk management is a fundamental and integral part of how we work. All risks are managed through a risk management system (RMS – described on page 59) in accordance with policies and guidance approved by the Board.

Judgement is required in:

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

During 2017, on behalf of the Board, we monitored the RMS, including continued developments and improvements. These are described in more detail on page 59. We also specifically considered how risks at remote sites are identified and managed.

This process and the principal risks arising (see pages 59 to 62) then formed the basis for our assessment of the going concern and viability statements which are discussed on page 63. The processes are designed to identify and manage, rather than eliminate, the risk of failure to achieve our business objectives.

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

Internal control

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

The system comprises:

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

We routinely review controls over the Group's principal risks and the key risks and critical processes in each of the Group's businesses. Both the sector audit committees and this Committee also consider KPMG's observations on the Group's control environment.

During 2017, the Group completed the documentation of core financial controls in line with the plans established in 2015, and commenced a formal programme to continually assess and test the effective operation of those controls across the Group. In addition, it is extending the documentation of internal controls to include compliance controls relating to the DPAs. In 2017, the testing and assessment of core financial controls identified that further improvements are required to fully embed and mature these controls. Therefore new policies and formalised compensating internal controls specifically in respect of financial reporting were introduced.

We have conducted a review of the effectiveness of the Group's risk management and internal controls systems, including those relating to the financial reporting process, in accordance with the Code. These systems have been in place throughout 2017. We consider that they meet the requirements of the Code and the DTR.

Going concern and viability statements

We reviewed the processes and assumptions underlying the statements set out on page 63. In particular, we considered:

- the Group's forecast funding position over the next five years;
- an analysis of impacts of severe but plausible risk scenarios, ensuring that these were consistent with the risks reviewed by the Board as part of its strategy review;
- the impact of multiple risks occurring simultaneously;
- additional mitigating actions that the Group could take in extreme circumstances; and
- the current borrowing facilities in place and the availability of future facilities.

As a result, we were satisfied that the going concern and viability statements have been prepared on an appropriate basis.

Principal risks

We considered in detail the principal risks that have been allocated to us by the Board, see pages 61 and 62. From our discussions we are satisfied that all of the principal risks that we oversee have received significant management attention during the year. We reviewed:

Business continuity

In February, the director of civil aerospace operations updated us on how business continuity risks present in the external supply chain were being mitigated and governed.

In November, the Group's chief information officer updated us on the programme of work to identify and mitigate potential IT single points of failure.

In December, the director of civil aerospace operations presented information on supply chain resilience and potential single points of failure in our internal supply chain.

We also spent time reviewing progress made with improvements agreed last year to mitigate specific business continuity risks and to address internal audit recommendations.

IT vulnerability

In May, the director, security, risk & compliance updated the Committee on the potential key risks related to cyber security, how the threat landscape is changing and how lessons are being learnt. We also reviewed the cyber security strategy, designed to improve the visibility of threats, enforcement of cyber security policies and learning from intelligence gained about the main cyber risk actors as well as our 'defence in depth' approach.

In November, we received an update from the Group's chief information officer on the progress that was being made to mitigate the cyber security threats that we discussed in May.

We also received ad hoc updates during cyber attacks such as WannaCry.

Market and financial shock

In July, we reviewed potential key risks, including liquidity and credit rating risks and how they are managed by the Group's financial risk committee.

We also considered the impact of other risks, notably changing accounting standards and Brexit.

Our risk management system

In February, we reviewed the programme to enhance the risk management system and in July and December reviewed progress that had been made. In December, we also received an update from the head of enterprise risk management on the development of the risk appetite framework to use risk metrics to inform decision making. The framework includes upper and lower limits and triggers to provide early warning if the limit of the Group's capacity to withstand principal risks was being approached.

Internal audit

The director of internal audit provides the Committee with:

- quarterly: a dashboard identifying the key trends and findings from internal audit reports, and the resolution of actions agreed;
- biannually: a detailed update of significant findings and his perspectives on the internal control environment, management responses to underlying root causes and systemic issues;
- the results of audits on advisor processes (including payments) and conflicts of interest, as part of the Group's response to the DPAs;
- an annual report on compliance with expenses policies for the directors and ELT members; and
- a work plan for the following year.

I meet the director of internal audit privately before each meeting and on an ad-hoc basis throughout the year, as do other members of the Committee. As a whole, we have a private meeting with him at least once a year. These discussions cover the activities, findings, resolution of control weaknesses, progress against the agreed plan and the resourcing of the department. Specific topics discussed in 2017 included: process and control design; compliance to process; data security and integrity; project management; and accountability.

The nature and number of issues raised by internal audit and the time to complete the related actions remains a key focus. We pay particular attention to the small number of overdue actions and were pleased to observe a continued reduction in the time to complete actions.

The plan is developed to focus on the key risks facing the business. We monitor changes during the course of the year.

We considered and reviewed the effectiveness of the Group's internal audit function, including resources, plans and performance as well as the function's interaction with management. The outcome of the 2017 review was positive and identified opportunities for continued improvement which are being implemented.

We are satisfied that the scope, extent and effectiveness of internal audit work are appropriate for the Group and that there is a sound plan for ensuring that this continues to be the case as our business progresses and risks change. I was pleased to see that the continued improvement in the function was recognised by the Institute of Internal Audit when awarding it the Private Sector Outstanding Team of the Year.

External audit

2017 audit

During the year, KPMG presented the audit strategy, which identified their assessment of the key audit risks and the proposed scope of audit work. We agreed the approach and scope of audit work to be undertaken and we also assessed KPMG's qualifications, expertise and resources, independence and the effectiveness of the external audit process.

Key risks and the audit approach to these risks are discussed in the Independent Auditor's Report (pages 183 to 194), which also highlights the other significant risks that KPMG drew to our attention. We continue to support the extended auditor's report and KPMG's approach which goes beyond the minimum requirements, providing additional clarity on the key judgements and estimates.

As part of the reporting of the half-year and full-year results, in July 2017 and February 2018, KPMG reported to the Committee on its assessment of the Group's judgements and estimates in respect of these risks and the adequacy of the reporting. KPMG also reported on its assessment of the Group's control environment.

It is important that for areas of judgement that are finely balanced, KPMG provide additional insight to assist in making the most appropriate judgement. In our meetings and discussions with KPMG and management, it is clear that this role is being performed well.

I meet with the lead partner prior to each meeting and the whole Committee has a private meeting with KPMG at least once a year.

Non-audit services provided by KPMG

In order to safeguard the auditor's independence and objectivity, and in accordance with the FRC's Ethical Standard, we do not engage KPMG for any non-audit services except where it is work that they must, or are clearly best-suited to, perform. Accordingly, our policies for the engagement of the auditor to undertake non-audit services broadly limit these to audit-related services such as reporting to lenders and grant providers.

Fees paid to KPMG are set out on page 141 and summarised on page 103. All proposed services must be pre-approved in accordance with the policy which is reviewed and approved annually. Above defined levels, my pre-approval is required. During 2017, we have further strengthened the process and controls in this area. We also review quarterly the non-audit fees charged by KPMG.

Non-audit related fees paid to KPMG during the year were 24% (2016: 17%) of the audit fee. Our annual review of the external auditor takes into account the nature and level of all services provided.

	2017		2016	
	£m	% of audit fee	£m	% of audit fee
Audit	7.6		6.8	
Non-audit				
Audit-related ¹	0.7	10	0.6	9
Tax compliance	0.1	1	0.5	7
Other	1.0	13	0.1	1
	1.8	24	1.2	17

¹ Includes £0.3m for the review of the half-year report.

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

Auditor transition and appointment of PwC

The Committee reviews and makes recommendations to the Board with regard to the appointment of the external auditor.

Following the audit tender process in 2016, we recommended to the Board that PwC be appointed as auditor for the financial year commencing 1 January 2018. No contractual obligations restricted our choice of external auditor.

During 2017, we have monitored the activities of the audit transition team, which was established to ensure that the transition is as seamless as possible. A key part of the activities was to ensure that, on appointment, PwC meets the independence requirements and that we have procedures to ensure that this is maintained (and that of KPMG until the completion of their audit responsibilities). This involved moving existing PwC engagements, most significantly global tax compliance, to alternative providers. PwC became independent in October 2017. As well as this, during 2017, PwC has attended the Committee meetings and sector audit committee meetings, made familiarisation visits to our major sites and held a global planning workshop. Following the confirmation of independence, PwC has reviewed KPMG's audit files for 2016 and our key accounting policies and judgements, including those relating to IFRS 15. We are also working on a detailed plan for each of the subsidiary companies around the world.

KPMG has been the Company's auditor since 1990. On behalf of the Company, I express my thanks to them for their contribution over this period.

Ian Chambers, as the PwC lead audit partner, will be required to rotate after five years and other key audit partners will be required to rotate every seven years. We will monitor compliance with these requirements. The Committee and the Board will recommend PwC's appointment at the 2018 AGM.

Compliance

During 2017, the Company complied with The Statutory Audit Services for Large Companies Market Investigation (Mandatory Use of Competitive Tender Processes and Audit Committee Responsibilities) Order 2014.

Looking forward

As well as our regular review of accounting policies, our focus will include:

- the audit transition activities;
- the implementation of IFRS 16, including the supporting processes and controls;
- embedding and maturing the finance processes and core financial controls with continued training and education;
- completion of the documentation of compliance controls relating to the DPAs;
- strengthening the information technology controls over key finance systems; and
- the continuing development of the management information systems and improvements to the underlying systems and tools.

In addition to the continuing oversight by the Safety & Ethics Committee of the ethics and compliance programme (see page 109), we will continue to monitor the Group's actions relating to risk management, internal controls and other matters relevant to the Committee that arise out of Lord Gold's recommendations, and from the agreements with prosecuting authorities.

Lewis Booth

Chairman of the Audit Committee

Safety & Ethics Committee Report



Key highlights

Supporting executive leadership with renewed focus on HSE

Review of product safety in Defence Aerospace

Maintaining product safety, occupational safety and asset integrity focus during organisational change

Monitoring of compliance with obligations under the deferred prosecution agreements (DPAs)

Maintaining oversight of the implementation of Lord Gold's recommendations on ethics and compliance

Further embedding compliance culture in the businesses

Review of the Group's refreshed approach to sustainability

Introduction

This year the importance of the Committee's role in assisting the Board, and guiding and overseeing management, has been evident. As part of organisational transformation, there has been significant executive leadership emphasis on driving greater ambition in all aspects of safety and ethics. Employee, customer and public expectations in these areas continue to increase. I and the other Committee members welcome the opportunity to support the leadership as it strives for continuous performance improvement.

The Committee has carefully monitored compliance with the DPAs. We have reviewed the handling of product in-service issues, the investigations and conclusions from occupational health and safety and asset integrity incidents, and have acted as a sounding board for plans to improve the Group's vigour and approach to sustainability.

Operation of the Committee

All members of the Committee are independent Non-Executive Directors. Our biographies are on page 67. The Committee's responsibilities are outlined in its terms of reference, available at www.rolls-royce.com, which we review annually and refer to the Board for approval.

In addition to the usual scheduled meetings during the year, the Committee added extra calls in April and October so that we could maintain more regular oversight over the Group's compliance with its obligations under the DPAs, the implementation of Lord Gold's recommendations on ethics and compliance, and the embedding of compliance culture within the businesses. We held an unscheduled meeting to receive an update on the latest discussions with regulators following the DPAs. The Committee also conducted an on-site product safety review of Defence Aerospace operations.

Committee members

Member	Attended	Eligible to attend
Sir Frank Chapman (chairman)	5	6
Irene Dorner	6	6
Lee Hsien Yang	6	6

See page 70 for reasons of non-attendance.

Principal responsibilities

Product safety

- Maintain an understanding of, and keep under review, the Group's framework for the effective governance of product safety, including risk management, policies, training, capability and elements of the product safety management system.
- Monitor product safety performance, the response to product in-service issues and lessons learned.

HSE

- Oversee HSE governance, review performance, incidents and monitor improvement projects.
- Guide and support management in the promotion of a culture of leadership in HSE.

Sustainability

- Oversee the Group's approach to sustainability, including how environmental/climate impacts from its operations are managed, and monitor performance towards sustainability targets.

Ethics & compliance

- Review the Group's compliance with relevant legislation.
- Keep the Global Code of Conduct (Global Code) and anti-bribery and corruption policies under review.
- Review reports on issues raised through the Ethics Line and other channels and review the results of any investigations into ethical or compliance breaches or allegations of misconduct.

Principal risks: compliance and product safety

- Maintain oversight of these principal risks. The product failure principal risk was redefined as product safety during the year (see page 59).

Areas of focus for 2018

- Oversight of the Group's activities to meet its continuing obligations under the DPAs and to implement Lord Gold's recommendations
- Oversight of the deployment of the revised Global Code of Conduct
- Supporting leadership with the development of structured improvement plans to support the Group's increasing safety ambition

Safety & Ethics Committee focus during 2017

Area of focus	Matters considered	Outcome
Product Safety	<p>Maintaining safety during organisational change</p> <p>Product safety policy and processes, training, safety assurance case and competence in manufacturing</p> <p>Product safety performance and issues in service</p> <p>Product safety management systems</p> <p>Product safety in Defence Aerospace</p>	<p>The Committee was satisfied that product safety governance remained robust following changes to organisational accountability.</p> <p>Safety performance remained at expected acceptable levels, with safety aspects of in-service issues handled competently and appropriately.</p> <p>The product safety management system in Defence Aerospace is effective and well-operated.</p>
HSE	<p>Monitoring investigations into two employee fatalities and the Company's response</p> <p>Detailed reviews of serious injury and high potential incidents including asset integrity matters</p> <p>Events, key findings, shared learning and actions</p> <p>HSE ambition, strategy and plans for continuous HSE improvement</p> <p>HSE performance including incidents, injuries, waste, energy use and GHG emissions metrics</p> <p>HSE programmes – LiveWell, asset care, waste action</p>	<p>Support to the employees' families and colleagues has been made available. Several investigations are being undertaken but are not yet concluded.</p> <p>Strengthening of HSE leadership, strategies, plans and communications as part of a structured approach to achieve continuous improvement.</p> <p>Programmes are at varying maturity levels but there are signs of progress. Energy consumption target has been met three years early. Waste reduction target time horizons have been restated to realistic levels following review.</p>
Sustainability	<p>Review of sustainability strategy, governance, in-year and planned activity</p> <p>Publication of annual anti-slavery and human trafficking statement under UK Modern Slavery Act 2015 amendments</p> <p>Review of plans to meet external sustainability reporting requirements in light of increased regulations and stakeholder expectations</p>	<p>A revised approach aligned to the Group's new vision was agreed. A new ELT-level committee has been formed to oversee environment and sustainability matters, including policy, approach and key performance indicators.</p> <p>The Group's anti-slavery and human trafficking statement was reviewed and approved.</p> <p>Reviewed the transparency and credibility of existing external reporting and agreed an approach to participation in key sustainability assessments.</p>
Ethics & compliance	<p>Updates on dialogue with regulators and agencies and impact on customers and partners post-DPAs</p> <p>Compliance with continuing obligations under the DPAs and implementation of Lord Gold's recommendations</p> <p>Plans to refresh Global Code of Conduct and policies</p> <p>Resourcing of ethics and compliance team, and effectiveness of compliance officers</p> <p>Embedding of ethics and compliance culture and behaviours. Review of number and nature of Ethics Line contacts</p> <p>Management of intermediaries including termination, settlements, screening, appointments and payments</p> <p>Progress with Data Privacy Binding Corporate Rules application</p>	<p>The Committee was kept apprised of continuing cooperation. Customers and partners were appropriately engaged.</p> <p>Reviewed detailed plans for, and progress on, compliance. Reviewed the first annual report to US Department of Justice.</p> <p>A new Global Code is to be issued in 2018.</p> <p>The ethics and compliance team is effective and has been strengthened in some areas.</p> <p>There is anecdotal evidence from business leaders that cultural change is being embedded in the businesses. Continued oversight is required.</p> <p>The intermediary processes are effective to manage the risks.</p> <p>The Committee supported the approach on data privacy. The decision of the Information Commissioner on Binding Corporate Rules is awaited.</p>
Oversight of principal risks	<p>Principal risks of compliance and product safety reviewed</p>	<p>These principal risks are reviewed and discussed at every meeting of the Committee, and both are being managed effectively.</p>

Product safety

Rolls-Royce aims to go beyond compliance with regulatory product safety standards, setting a goal of continuous product safety improvement, in common with other industry participants. This is regarded as fundamental to the Group's licence to operate and to the sustainability of our business. Product safety encompasses the design, manufacture, assembly, installation, in-service operation, maintenance and repair of products, across all of our businesses, and regions where we operate. It is critical that product safety processes develop continuously to underpin the science and technological innovation that enables product designs to evolve and extend operational boundaries.

In 2017, we continued with our rolling review programme of key product safety topics across the Rolls-Royce businesses, as well as considering special topics and in-service issues as they arose.

Throughout the year, we retained a focus on how safety risk was being managed through the period of transformation for the Group. This included overseeing changes to the product safety governance model and policy to reflect new organisational accountabilities aligned to changes in senior operations and engineering roles. We also emphasised the importance of ensuring safety processes continued on a positive trajectory against a backdrop of organisational change and pursuit of operational and cost efficiencies. Emphasis continued on the evolution of our product safety competence across the workforce, with new employees being appropriately trained on processes from the outset.

We monitor improvements that are proposed to the Group's product safety management system (SMS). We reviewed the work of the product safety process council, part of the role of which is to ensure that the product safety processes are clearly understood and effective. The council gathers information from a broad range of sources including KPIs, audits, user surveys and feedback, and safety governance forums. Together these ensure that there is regular, diverse activity to monitor the state of our safety processes. These indicators showed the product safety processes to be effective, efficient and fit-for-purpose, and also continued to highlight opportunities for improvement in some areas. This led to work in 2017 on: continued communication to increase awareness;

further safety case guidance and user support; document simplification and updates; development of a product safety assurance case; reporting tool simplifications; corporate audit of targeted safety processes; and updates to the senior managers' product safety awareness training.

We reviewed progress on the use of a safety case to articulate why a product is acceptably safe to operate, supported by evidence (see example safety case below). The preparation of a product safety case was introduced to the Group's processes based on best practice from the Rolls-Royce Nuclear business. We saw how the introduction of a safety case served to increase further the focus on safety in a structured and consistent manner across the businesses. We also noted the lessons being learned and captured for future projects on how to structure safety cases.

The Committee received briefings at each of its meetings during the year on issues that had arisen with products in service. These included updates on investigations of root cause, assessment of implications, and oversight of the Group's response. The Committee was satisfied that processes and plans were appropriate and effective in identifying, managing and retiring safety risk. We were kept updated on the programme to address the issues previously identified on the Trent 1000 fleet and were satisfied with the approach taken from a safety perspective.

In February, we reviewed the overall metrics for product safety in 2016. We noted that neither the number nor rate of safety events for 2016 indicated any significant concern with either the safety performance of the Group's products or with performance in managing safety issues.

In December, we reviewed the processes for ensuring competence in manufacturing, as an element of the SMS.

We were briefed on the activity during the year to refresh the product safety training for employees, which we noted would be more targeted to particular roles.

We also reviewed the product safety principal risk and supported the proposal to the Board to redefine this as product safety (you can read more about this on page 59).

Example safety case



* ALARP: as low as reasonably practicable.



DEFENCE AEROSPACE PRODUCT SAFETY WORKSHOP

In order to provide effective oversight of product safety risk, the Committee remains conversant with product safety processes and the Group's SMS. In September 2017, we focused our attention on product safety in Defence Aerospace with a visit to the Group's facilities in Bristol, UK.

We were briefed by the product safety leadership team on Defence Aerospace markets, products and operating environments. We learned about the governance of product safety through a robust product safety review board structure. We also discussed the product safety processes within Defence Aerospace joint ventures and how these interact with the Group's own processes under a defined management plan.

We examined specific cases, how these were being handled, findings, corrective measures taken and the relationship management maintained with third parties involved. We were given a detailed briefing on the 'red top' and safety alert report processes, and reviewed current metrics.

We also gained an understanding of the military certification regulatory regimes and how these differ from the equivalent civil aerospace processes. This covered how engine documentation on legacy platforms is registered to maintain product knowledge and enable continuing support under the business' historic engines policy.

We visited the Defence Aerospace operations centre and saw how incidents in service are handled. We then moved on to air safety investigations with a visit to the investigations workshops. We observed how the forensic teams work as leaders in this field using advanced equipment and techniques such as electron beam microscopy and 3D scanning.

We visited the maintenance, repair and overhaul facility, where we were able to gauge a strong and supportive product safety culture on the shop floor. We also viewed the new test bed for the TP400 engine that will allow for significantly enhanced test capability. The day finished with further discussions over dinner with key members of the Defence Aerospace team.

Overall, the workshop provided a good level of confidence to the Committee that the SMS, as operated in Defence Aerospace, was effective, robust and competently operated.

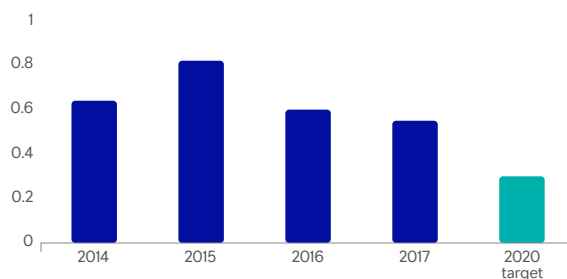
HSE

The Committee maintained focus on HSE developments during a particularly challenging year in this area.

We regret to report that there were two employee fatalities in October. The first was the death of an electrical engineer employed in the civil nuclear business, while working at a customer site in central France. The matter remains under investigation. The second was an employee of Power Systems who died from injuries sustained in a road traffic accident while on the way to a customer's site in Germany. No other vehicles were involved. These two tragic incidents have remained under the Committee's review and are a stark reminder of the critical importance of managing HSE effectively across all activities. The leadership's heightened HSE performance ambition aims to eliminate all recordable incidents.

We were given detailed briefings on HSE matters throughout the year. In July and December, we reviewed the Group's HSE key activities, performance metrics, insights and learning, noting that the total reportable injury (TRI) rate was behind the year-on-year target trajectory. Again, this added stimulus to the leadership's determination to achieve higher HSE performance levels. Asset integrity, infrastructure maintenance and control of contractors were common factors across a number of these incidents and will be targeted for improvement as part of the structured HSE improvement plans.

TRI rate (per 100 employees) *

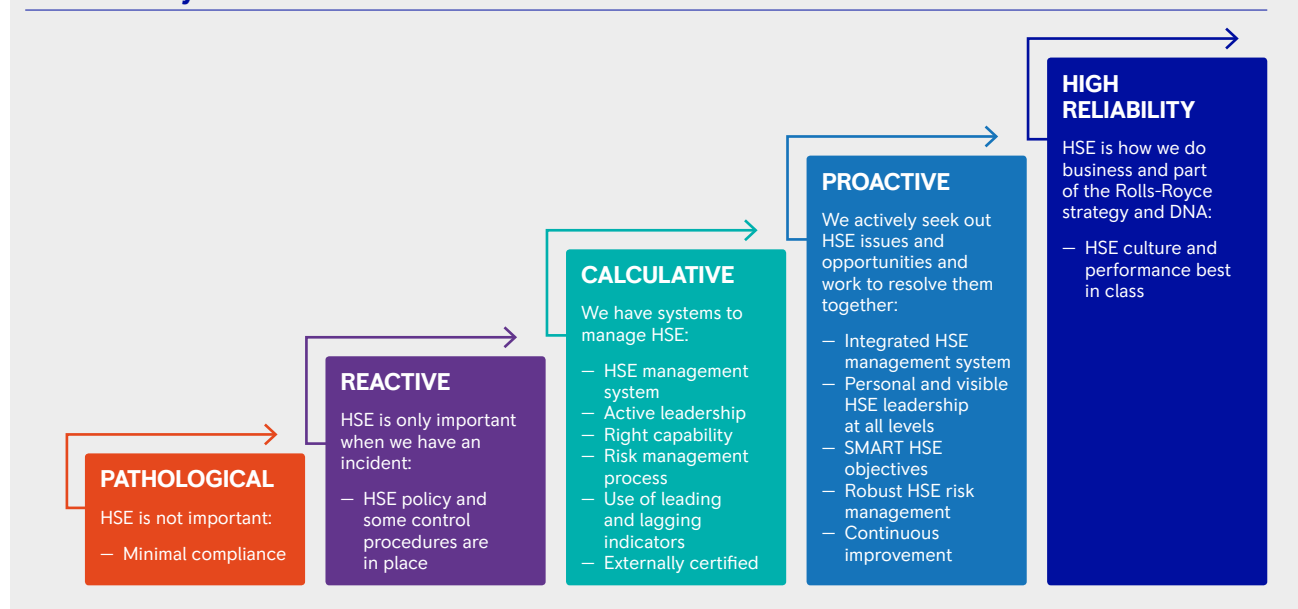


* External assurance over STEM, energy, GHG and TRI rate data provided by Bureau Veritas. See page 195 for the sustainability assurance statement.

We were briefed on the Group's asset care strategy for Group property assets and manufacturing assets, noting that the property maintenance capital programme had been revised and re-prioritised based on asset criticality, condition, reliability data and lifecycle cost. We were encouraged that quarterly asset reports for certain sites outside the Americas had been introduced to provide an overview to local stakeholders of maintenance provided, costs, safety critical maintenance requirements, equipment reliability analysis, training needs and improvements delivered. We also welcomed the introduction of a new leading indicator to track planned maintenance schedule adherence for high-consequence safety critical equipment.

Slips, trips and falls remained the highest single cause of reportable injury and we reviewed the range of activities undertaken to mitigate this risk, including housekeeping, toolkits to help leaders engage and reinforce safety awareness, and a dynamic risk assessment application for use by employees working at customer locations to assess the safety risk level of their work environment.

HSE maturity model



We reviewed a proposal to revise the Group's target, set at the end of 2014, to reduce the amount of waste produced from the Group's operations by 25% by 2020, normalised on turnover. Due to historical data discrepancies and inaccuracies we agreed a proposal in June 2017 to retain the 25% reduction target but to extend the time period to achieve this from 2020 to 2025.

In July, we received a briefing on the Group's aspiration to achieve significantly higher levels of HSE performance and move Rolls-Royce to a leading position in HSE across all businesses. We noted the benchmarking that had been undertaken with a number of large companies and supported the Group's adoption of the HSE maturity model shown above, and the refocused strategy of themes and enablers to achieve high reliability.

The ELT members conducted a focused session in November on safety culture, challenging themselves on what more could be done to promote vigilance and awareness to keep employees safe. We were briefed on this in December and were encouraged to see commitment to demonstrating strong and sustained safety leadership. Work continues on developing structured improvement plans and defining common leadership themes and communications plans. The Committee will be keeping the Group's progress on this under close review during 2018 and beyond.

Sustainability

Some organisational changes in the first half of the year provided an opportunity for a fresh look at the Group's approach to sustainability.

We were briefed in July on some changes to the HSE and sustainability team structure to enable more strategic and aligned thinking across broader sustainability themes. In December, the team returned to present an update on a refreshed sustainability strategy. We discussed and endorsed a move away from having a separate, standalone, sustainability strategy with its own vision and principles, in favour of building on the strong alignment to the Group's refreshed vision, its strategic focus areas and business

model. This approach allows the sustainability team to support the businesses and functions in embedding consideration of sustainability issues into core business strategies, policies, risk assessments, decision-making tools and programmes, and in doing so to identify and exploit opportunities.

The Committee has previously cautioned against the introduction of too many new safety and ethics initiatives, with attendant risks of confusion and dilution of key messages. A fresh look has been taken across these initiatives and many have been rationalised as part of a simpler approach.

We were briefed during the year on the Group's response to the new EU Non-Financial Reporting Regulations, UK gender pay gap reporting, and consideration of the recommendations of the FSB Taskforce on Climate-related Financial Disclosures (TCFD), as well as the publication in early 2018 of the Group's annual update on progress against the UK Modern Slavery Act revisions.

Our overall score in the annual Dow Jones Sustainability Index (DJSI) declined slightly in 2017 versus 2016. Analysis showed this was largely as a result of the introduction of new question sets, significant changes to other sections, and receiving a lower score in the codes of conduct and export control sections as a result of the regulatory investigations leading to the DPAs in January. We were pleased to remain within the top 10% overall and to remain listed in both the DJSI World index (as one of only four aerospace and defence companies out of 36 invited to participate) and DJSI Europe index. Particularly encouraging was that we achieved the maximum possible score for environmental reporting and the industry-leading scores for human rights and stakeholder engagement. This contributed to the Company qualifying for inclusion in RobecoSAM's 2018 Sustainability Yearbook and receiving a Bronze Class distinction for excellent sustainability performance.



A new executive-level environment and sustainability committee, co-chaired by the Chief Operating Officer and Chief Technology Officer, was formed during the year to provide executive level oversight of the Group's response to sustainability issues including policy, approach and related KPIs.

Overall, the Committee is supportive of the increased focus and governance on sustainability topics and with the continued strengthening of the Group's reporting. This includes the Group's updated website at www.rolls-royce.com/sustainability, which has its contents structured around the core topic areas of environment, people, ethics, customers and suppliers, and performance.

You can read more about the Group's sustainability activities on pages 44 to 49.

Ethics and compliance

Following the DPAs, much of the Committee's focus in the year has been on overseeing the Group's work plans to meet its continuing obligations to the regulators, and monitoring progress in implementing the recommendations put forward by Lord Gold in his reports. Lord Gold himself attended most Committee meetings during the year and updated the Committee on how he has been overseeing and supporting this work, as well as reporting on his particular areas of focus and activities. This included a review of processes for the granting of commercial concessions to customers, and attending employee focus groups and other internal events to understand views from the workforce on 'speaking up' and on the Group's culture in the area of ethics and compliance.

The Committee has also taken a keen interest in hearing from the leaders of some of the businesses as to how ethics and compliance are being embedded into the Group's culture in practice. We scheduled two additional Committee meetings, which took place in April and October, to provide more time for status updates and discussion of these topics.

We discussed the need for the business leadership to continue to drive the right behaviours, as well as having the right processes, so that individuals are accountable for their own actions and feel able to speak up. To help us understand how this was progressing, we received separate updates from the president and the chief compliance officer of the Civil Aerospace business, and from the chief financial officer and general counsel & head of integrity at Power Systems. It was noted that the businesses operated globally across territories that had different levels of maturity and sophistication regarding ethics and compliance, and this could present challenging situations for employees such as field service engineers who work in remote locations. A programme of compliance verification visits to selected sites had been introduced to check the effectiveness of training and levels of awareness, so that any gaps could be promptly addressed. We heard about specific examples of areas for improvement being identified and addressed either through additional training or improved communications, processes or controls. Overall we were assured that the leadership teams, supported by the central ethics and compliance function, were setting the 'tone from the top', by expressing clearly and regularly the high standards expected and encouraging employees to speak up.

At each of our meetings during the year, we received an update from the General Counsel on the Group's continuing dialogue and cooperation with regulators and government agencies. We also received reports and briefings from the chief compliance counsel on ethics and compliance matters generally.

In the 2016 Annual Report, we reported on the significant reduction in the number of advisers used by the Group over recent years, and the stringent vetting process for any new engagements. We kept the level and nature of adviser engagements under review in 2017, and were notified of any claims received during the year from any advisers who had been terminated in the past. We noted the careful approach taken with regard to termination of certain Power Systems' advisers to ensure that customers were not exposed to gaps in capability for safety-critical work.

We kept the resourcing and capabilities of the compliance team under review, both centrally and within the businesses. We were satisfied that the responsibilities of the director of risk, who left the business during the year, had been assumed either by the general counsel or the chief compliance counsel through an orderly transition process. We recognised the need for the compliance team to remain appropriately balanced between roles in the central team and within the businesses. We were therefore supportive of the recruitment of the new director of ethics and compliance at Power Systems, and the proposed addition of a number of new roles. We also recommended that likely resourcing requirements for the compliance function in the longer term be considered.

Another area of interest for the Committee, and for Lord Gold, during the year was the coordination of training, disciplinary processes and the employee communications strategy to help drive the desired culture. We received briefings from the Group HR Director and members of her team, with input from the chief compliance counsel, on activity in this area. The Committee recognised the need to balance the drive to embed accountability for behaviour with considerations of employees' legal rights to privacy, but encouraged the team to explore ways to show the workforce real examples of consequences for breach of the Global Code or group policies, or for failure to complete mandatory training.

We examined proposals to refresh the Global Code in 2018. The current Global Code was first introduced in 2013 and we agreed that a comprehensive review was therefore timely. The new Global Code will also be supported by new training modules designed to bring it to life in a simple, understandable and relevant way, focusing on behaviours. We look forward to seeing progress on this in 2018. We were also pleased to see this approach to providing a simplified and more concise document being applied in the consolidation of several group policies into one simple manual for employees.

Looking forward

Overall, this has been a year of challenge in all of the areas overseen by the Committee, that has required us to be constructively critical and supportive of management's ambitions and plans.

In 2018, we will continue our focus on ensuring the Group progresses its ambitions for an improved HSE performance, continues to evolve product safety processes and meets its regulatory obligations under the DPAs. More generally, we will continue to provide support to management on the embedding of a productive culture encompassing all aspects of safety and ethics.

Sir Frank Chapman

Chairman of the Safety & Ethics Committee

Science & Technology Committee Report



Sir Kevin Smith
Chairman of the
Science & Technology
Committee

Key highlights

Technology strategy, investment and programmes review

Electrical systems strategy

Additive layer manufacturing (ALM) strategy

Competitiveness of civil aero engines and reciprocating engines

Emerging and disruptive technologies

Virtual tour of Advance3 build shop and UltraFan power gearbox test facility

Visits to Trent XWB final assembly, a large engine test bed and the National Composites Centre

Introduction

The Group invests more than £1 billion each year in R&D to conceive, design and deliver world-class technology that meets our customers' current and future needs. In a fast-changing world, the Committee provides dedicated focus, directional input and oversight of the Group's scientific and technological strategy, processes and related investments.

Operation of the Committee

All members of the Committee are Non-Executive Directors. Lewis Booth stepped down from the Committee in April 2017 when he joined the Remuneration Committee. Our biographies are on pages 67 to 68. The Committee's responsibilities are outlined in its terms of reference, available at www.rolls-royce.com, which we review annually and refer to the Board for approval.

The Committee held four meetings face to face and two via teleconference during the year.

Committee members

Member	Attended	Eligible to attend
Sir Kevin Smith (chairman)	6	6
Lewis Booth	1	1
Ruth Cairnie	6	6
Brad Singer	6	6
Jasmin Staiblin	5	6

See page 70 for reasons of non-attendance.

Principal responsibilities

Technology strategy

- Review the strategic direction of the Group's research, technology and development activities.
- Ensure investment is allocated appropriately.
- Keep under review the key technology programmes.
- Assist the Board in its oversight of major R&D investment and provide assurance on its competitiveness and the adequacy of R&D investment.

Cross-sector technology

- Oversee the effectiveness of key engineering and technology processes and operations, including delivery of major product development and technology programmes.

Technology capabilities and skills

- Oversee processes for ensuring effective resourcing and development of required technological capability and skills.
- Conduct visits to R&D facilities.

Technology trends and risks

- Provide assurance on the identification and management of key technological risks.
- Review and consider any other topics or risks appropriate to the overall remit of the Committee as delegated by the Board.

Principal risk – disruptive technologies and business models

- Oversee one of the Group's principal risks. This risk was added in 2016 to reflect the increasing importance of transformative technologies and new ways of doing business.

Areas of focus for 2018

- Oversight of the Group's technology programme
- A review of technology partnering strategy
- Update on key programmes including Advance3, UltraFan and small modular reactors
- Technology for services
- Advanced manufacturing technology and industry digitisation
- A review of electrical and digital skills and capability development

Science & Technology Committee focus during 2017

Area of focus	Matters considered	Outcome
Technology strategy	<p>The Group's technology strategy</p> <p>Investment allocation</p> <p>Review of key technology programmes</p> <p>Review of competitiveness of civil aero engines</p> <p>Review of competitiveness of reciprocating engines</p>	<p>Confirmed that the strategic objectives and associated investment funding allocations were appropriate.</p> <p>Supported the strengthening of the approach to electrical systems.</p> <p>Endorsed the creation of the Chief Technology Officer's organisation.</p> <p>The reviews of competitiveness shaped inputs and recommendations for the Board strategy discussions in September and helped confirm the appropriateness of our technology plans.</p>
Cross-sector technology	<p>The Group's electrical systems strategy and advanced manufacturing strategy</p>	<p>Endorsed the initial programme of electrical systems technology demonstrators and the creation of a dedicated management structure at Group level.</p> <p>Had early sight of the Group's updated advanced manufacturing strategy, provided comments and identified areas of follow-up.</p>
Technology capabilities and skills	<p>A new focus on electrical systems requires additional resources, new capabilities and skills and a different way of thinking</p> <p>Visits to Trent XWB final assembly/test bed and the National Composites Centre</p> <p>Live virtual tours of Advance3 and UltraFan power gearbox rig</p>	<p>Requested a more detailed electrical system skills and capability development plan which would be reviewed in 2018.</p> <p>Visits were insightful, provided physical evidence of progress on key technology programmes and provided an invaluable opportunity to meet the teams.</p>
Technology trends and risks	<p>Disruptive potential from various sources including digital technologies, novel materials and manufacturing</p> <p>Opportunities and threats in electrical systems</p>	<p>We are satisfied that the Group has robust processes in place to identify disruptive threats and opportunities and develop appropriate actions.</p>
Oversight of principal risk	<p>The principal risk of disruptive technologies and business models was reviewed twice during the year</p>	<p>We are confident that we are receiving enough detail around this principal risk and on the ways the risk is being kept under review by the Group.</p>

2017 overview

The Committee's main focus for 2017 was on our technology strategy and on aligning this to the Group's strategic reviews, the allocation of technology funding and our competitiveness in key technology and product areas. At the beginning of the year, we reviewed the programme of work to deliver in 2017 and the investment funding allocation and received an update on the progress made on technology plans for each business.

Of note was a significant increase in spend in our aerospace businesses as activity on our technology demonstrator programmes ramps up. Although there were resource constraints, the overall programme was considered reasonable.

We gave our support to management in seeking to take a new approach to strategic planning for technology. In the past, investment has been allocated principally by matching resource bids from the businesses to our product strategies. At the beginning of the year, it had been decided by management that a stronger Group-driven approach should be developed to allocate investment across different types of technology programmes which provided synergy and opportunity across the Group. This will achieve a better balance of product-specific technologies with broader sector opportunity. Each Committee member gave time to management individually and provided input to help shape the approach and align it to the Group's strategy.

We received a briefing on the Group's activities in additive layer manufacturing (ALM), its development, supply chain and reasons for its importance.

We noted that the use of ALM globally has been rising at a 35% compound annual growth rate. The Group is exploring a number of partnership and supply chain strategies to accelerate its development. The Group's technology focus in ALM is on specialised materials, such as high temperature alloys and parts with high value and high manufacturing complexity. The Committee benefited significantly from a visit to the ALM research facility in 2016 and will keep the delivery of the Group's strategy for ALM under review.

Throughout the year, the Committee discussed technology competitiveness and carried out a specific review on the Civil Aerospace business and the market for large engines. We looked at: the business' product and technology strategies and product evolution path; the relative position on key technologies versus competitors; the fundamental capability drivers and enabling technologies; and an analysis of our R&D/R&T spend compared to competitors. A similar session was held with the Power Systems team to discuss competitiveness of our reciprocating engine technology.

We also reviewed the Group's emerging electrical systems strategy. There is a growing demand for electrical capability across all our platforms hence this is an important area of focus to ensure the Group positions itself competitively for the future. We heard about potential future applications of hybrid electrical configurations for aircraft in the aerospace businesses and how electrical systems technology was rapidly increasing in the markets addressed by our Marine and Power Systems businesses.



ADVANCE3

In May, we viewed a live virtual tour of the Advance3 where we were shown some of the expert work on how the demonstrator engine was being assembled and the high degree of instrumentation required in preparation for the initial engine test.

The Advance3 reflects a new engine core architecture (the high pressure system and the intermediate pressure system differ from the Trent engine family) and includes new technology such as a radically revised fuel system.

The Committee was updated on each of the businesses' electrical systems demonstrator programmes which vary significantly in complexity and pace. This highlighted implications in terms of skills, the requirement for a resourcing strategy, as well as a shift in thinking for senior leadership.

Rolls-Royce has a solid platform of electrical activities on which to build, covering rail (hybrid trains), power generation (including micro-grids), marine (hybrid and full electric ships) and applications in aerospace. We also noted the strong opportunity for cross-company synergies in electrical systems.

In May, as part of the review of competitiveness of civil aero engines, we visited our site in Derby, UK, where we received a tour of the Trent XWB final assembly and test facility, the large aero engine development test facility and test preparation area.

We also received a virtual tour of the UltraFan power gearbox rig via videolink from Dahlewitz, Germany. This facility is the largest of its kind in the world and is critical to supporting changes to engine architecture and component technologies to form the core of the next generation of more efficient Rolls-Royce aero engines. The rig simulates real in-service pitch and roll conditions by tilting the gearbox to place it under different torque and load, which enables analysis of oil flows for heat management. The rig is now fully functional and provides the Group with a very powerful capability for the future.

In September, the Board visited our site in Bristol, UK and also had the opportunity to visit the National Composites Centre (NCC). The NCC was established by the University of Bristol, in collaboration with sponsors including Rolls-Royce, and its key objective is to enable UK design and manufacturing enterprises to deliver winning solutions in the application of composites. The visit provided valuable background to our understanding of the technology development route for the UltraFan composite fan system.

In December 2016, the Committee was allocated responsibility for overseeing management of the Group's new principal risk of disruptive technologies and business models. This was brought to the Committee twice for discussion in 2017. We were updated on the key processes the Company has developed to keep the risk under review, including five advisory boards with external subject matter experts that report to and support the ELT.

Looking forward

In my view, the Science & Technology Committee is the most exciting and uplifting of the Board committees and I feel privileged to chair it. Our subject matter is the life blood of the Group vested in some extremely talented people. I am grateful to all of them for the support they have given during the year.

I have been pleased with our progress this year as the Group has carried out a detailed review of its technology strategy.

In 2018, we will continue to focus on supporting management and the Board in further deploying this strategy with a particular focus on technology skills and capability development and building partnerships to accelerate progress.

Sir Kevin Smith

Chairman of the Science & Technology Committee



Deborah Harris, STEM Ambassador and Rolls-Royce engineering graduate, hosted the 2017 Science Prize award event at the London Science Museum

ROLLS-ROYCE SCIENCE PRIZE

The science prize initiative was launched in 2004 as part of the Group's continuing commitment to science education. It is designed to foster, recognise and reward outstanding work in science and maths teaching. It promotes innovative and sustainable strategies for teaching and contributes to continuous professional development by providing science and maths teachers with the support they need to implement big ideas. Since the launch of the programme, over 20,000 applications have been received and £1.5 million has been given out in prize money to over 600 schools across the UK.

Responsibility Statements

Statement of Directors' responsibilities in respect of the Annual Report and the Financial Statements

The Directors, as detailed on pages 66 to 68, 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, including FRS 101 *Reduced Disclosure Framework*, and applicable law.

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

In preparing each of the Group and parent company Financial Statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable, relevant, reliable and prudent;
- for the Group Financial Statements, state whether they have been prepared in accordance with IFRS as adopted by the EU;
- for the parent company Financial Statements, state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the parent company Financial Statements;
- assess the Group and parent Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and
- use the going concern basis of accounting unless they either intend to liquidate the Group or the parent Company or to cease operations, or have no realistic alternative but to do so.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the parent and Group's transactions and disclose with reasonable accuracy at any time the financial position of the parent company and enable them to ensure that its Financial Statements comply with the Companies Act 2006. They are responsible for such internal control as they determine is necessary to enable the preparation of Financial Statements that are free from material misstatement, whether due to fraud or error and have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

Under applicable law and regulations, the Directors are also responsible for preparing a Strategic Report, Directors' Report, Directors' remuneration report and corporate governance statement that complies with that law and those regulations.

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

Responsibility Statements under the Disclosure Guidance and Transparency Rules

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

- each of the Group and parent company Financial Statements, prepared in accordance with IFRS as adopted by the EU and UK Accounting Standards respectively, gives a true and fair view of the assets, liabilities, financial position and profit or loss of the Company and the undertakings included in the consolidation taken as a whole;
- the Strategic Report on pages 1 to 63 and Directors' Report on pages 64 to 114 and pages 198 to 201 include a fair review of the development and performance of the business and the position of the Company and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face; and
- the Annual Report, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group's position and performance, business model and strategy.

By order of the Board

Pamela Coles
Company Secretary
6 March 2018