DIRECTORS' REPORT

Compliance with the UK Corporate Governance Code 2016

The Company is subject to the principles and provisions of the UK Corporate Governance Code 2016 (the Code), a copy of which is available at www.frc.org.uk. For the year ended 31 December 2018, the Board considers that it has complied in full with the provisions of the Code. Further information on the application of the principles can be found in the Directors' Report on pages 57 to 105 and 200 to 203. With the publication in July 2018 of the revised UK Corporate Governance Code 2018 (the revised Code), the Board has reviewed its governance initiatives and programmes. Whilst reporting on the Company's compliance with the Code, we have also reported where possible in the spirit of the revised Code.

CHAIRMAN'S INTRODUCTION TO DIRECTORS' REPORT

IAN DAVIS
CHAIRMAN

Introduction

2018 has been an important year for the strengthening of corporate governance practices externally. This provided a backdrop for a review of our programmes and initiatives.

We saw the introduction of the FRC's revised Code in July. The Board welcomes the considered yet concise approach apparent in the revised Code that helps to clarify and guide in promoting a strong governance environment. From the good work that we have undertaken over recent years, we are pleased that we are well placed to meet the requirements of the revised Code.

I consider that we are a particularly active Board. We seek opportunities outside of the boardroom to find out about what is happening across the organisation and gain assurance that the Group is operating responsibly and effectively. For example, some Non-Executive Directors and I have attended executive-level committee meetings such as those of the environment & sustainability committee, the digital steering committee and the business audit committees. This enables us to gain deeper insights while visibly supporting management's goals in these areas.

This additional level of commitment by Board members has been of particular assistance to the Board during 2018 as much of our work has been centred on the themes of corporate culture and our engagement with stakeholders.

Corporate culture

We have continued to support the Executive Team with its ambitious restructuring programme. A key part of this depends on reinforcing the values, behaviours and mindset needed to position and drive the Group's strategy towards achieving its vision. The Board recognises that, to be successful in this, requires not just organisational restructuring but a cultural shift in inspiring our people to take accountability, be innovative and continuously seek out improved and more efficient ways of working.

This must, however, all be within the bounds of a defined framework that reflects our values and the type of group that Rolls-Royce wishes to be known and admired for. As well as other aspects, this of course includes a continuing strong focus on ethics and compliance, driving the highest standards of integrity, and in doing so meeting our obligations to regulators under our DPA. The Board has overseen and directly contributed to the work in this area during the year, which expands upon the Group's governance framework that we have previously endorsed.

In the summer, we reviewed and approved a refreshed version of our Code of Conduct and a simplified set of Group policies. These are aligned to our core values and are available at www.rolls-royce.com.

With the recognition that we need to continuously reinforce safety as a core value, we strongly supported the deployment of our Zero Harm Life-Saving Rules across the workforce earlier in the year. Occupational safety and wellbeing remain priorities for the Group and you can read more on this in the Safety & Ethics Committee Report on pages 96 to 101.

In September, we were briefed on the Group's new people framework, providing a structured approach to the development of our talented people and the nurturing of the skills and behaviours that will lead the Group to a successful and sustainable future.

We are taking a keen interest in how the diversity and inclusion (D&I) agenda is being progressed and promoted across the Group. I was personally delighted to be invited back to speak with the African and Caribbean professional network, one of a growing number of Rolls-Royce employee resource groups, having attended its inaugural conference in 2015.

For more information on D&I and employee engagement see Our People on pages 44 to 47.

Stakeholders

The revised Code has reinforced and expanded on the long-standing requirements of the UK Companies Act for directors to remain mindful of their duties to consider the interests of key stakeholders. At Rolls-Royce, we understand that who we are and how we behave matters not only to our people but to the many stakeholders who have an interest in our business.

In September, the Board undertook a thorough review of the Group's stakeholders and how we engage. This is set out in detail on pages 66 to 68.

Talent and succession

The Board was pleased with the increased focus by the Executive Team on leadership talent and the succession pipeline. Development plans are in place for those emerging leaders with potential to succeed current members of the Executive Team in due course. Following management restructuring activities, the Enterprise Leadership Group has also been refined and reset to a smaller, diverse core of key leaders who will take the business forward. There remains much to do in improving diversity amongst our leadership and management populations, a challenge which we are committed to support through monitoring of careful plans to attract and recruit, retain and develop our leaders of the future.

After the success of our inaugural Board apprentice programme launched in 2017, we incorporated the feedback received into a refined programme for 2018/19. This initiative provides coaching and board experience to a diverse group of emerging leaders selected from the Group's talent pool. Six individuals were selected for our second cohort. Under the sponsorship of two Board members and one Executive Team member for each apprentice, we were delighted to welcome them to their first meetings of the committees to which they have been assigned in November 2018. The programme will run for 18 months with a rotation to a different committee half way through the period. There are opportunities to participate in supplementary committees, masterclasses on board-relevant topics and other networking forums. As well as the experience gained by the apprentices, the Directors value the participation and perspectives brought by these individuals to our discussions.

Board developments

The Board has a diverse membership with varied and balanced experience and skills that are highly relevant to the Group's needs and challenges.

In February 2018, we agreed to extend Brad Singer's initial two-year appointment for a further three years. The Company and Brad are party to a relationship agreement with ValueAct. A new, simplified agreement was put in place in February (a summary of which can be found at www.rolls-royce.com).

At the AGM in May, shareholders confirmed the Board's recommendation to appoint Nick Luff as a Non-Executive Director with effect from the conclusion of the AGM. As chief financial officer at RELX plc, Nick brings listed company regulatory experience and technical financial and accounting skills. He also has extensive non-executive experience. These add real value to the work of the Board and the Audit Committee. Details of the selection and appointment process are in the Nominations & Governance Committee Report on page 73.

On the recommendation of the Nominations & Governance Committee, the Board agreed to extend Jasmin Staiblin's appointment for a third three-year term and Irene Dorner and Sir Kevin Smith's appointments for a second three-year term. Their biographies, including their Board skills and experience, can be found on pages 59 to 61.

All Directors will stand for re-election at the AGM in May 2019.

Looking forward

With the introduction of the revised Code, we have been able to reflect on our own governance framework and initiatives. Corporate culture, including anti-bullying and harrassment, safety and wellbeing, together with stakeholder engagement, will be areas of focus as we look forward to the year ahead.

Ian Davis
Chairman

STRATEGIC DECISIONS

In 2018, the Board made some important strategic decisions.

In January, the Board approved a strategic review of the Group's Commercial Marine business. After several options had been explored, we resolved later in the year to dispose of the business to KONGSBERG. In arriving at such a decision, we considered the interests of our key stakeholders, including our shareholders, customers, employees and the communities in which they work. We concluded that the Group was not in a position to make the investments required to enable the Commercial Marine business to reach its potential. However, we believed that under the right ownership the business could develop strongly over time for the benefit of its stakeholders. As a well-regarded marine industry company headquartered in Norway, KONGSBERG presented an attractive proposition as a trade buyer which was interested in working with the talented people in the business to drive it forward. When the deal concludes in 2019, the proceeds will serve to strengthen the Company's balance sheet as we look to both the challenges and the opportunities ahead.

Very similar considerations were applied by the Board when we resolved in March to dispose of our Power Systems fuel injection technologies business, L'Orange.

We concluded that the business was a better fit in the hands of Woodward Group as an appropriate owner but only after considering alternative options.

Stakeholder interests, including those of the employees of the business who would be able to continue to contribute to the business under its new ownership, were considered by the Board.

To ensure that the interests of customers were recognised, the Board acknowledged that L'Orange, which is based in Stuttgart, Germany, would remain an important partner and supplier to Rolls-Royce. Therefore, Power Systems entered into a long-term supply agreement with L'Orange for an initial term of 15 years.

The transaction completed in June 2018.

BOARD OF DIRECTORS

IAN DAVIS NG
Chairman of the Board
Chairman, Nominations & Governance Committee

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

Career Ian was a partner at McKinsey for 31 years and, during his time, served as chairman and worldwide managing director.

Board skills and experience Ian brings significant financial and strategic experience and has worked with and advised global organisations and companies. This enables 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., non-executive director
— McKinsey & Company, senior partner emeritus

WARREN EAST CBE
Chief Executive

Appointed to the Board in January 2014 and as Chief Executive in July 2015.

Career Warren is an engineer and joined ARM Holdings plc in 1994 where he was CEO from 2001 until 2013. He is a fellow of the Institute of Engineering and Technology; the Royal Academy of Engineering; the Royal Society; and the Royal Aeronautical Society. He was awarded a CBE in 2014 for services to the technology industry.

Board skills and experience Warren brings a deep understanding of technology and developing long-term partnerships. He also has proven strategic and leadership skills within a global business and a strong record of value creation.

Other principal roles
— Dyson James Group Limited, director

STEPHEN DAINTITH
Chief Financial Officer

Appointed in April 2017.

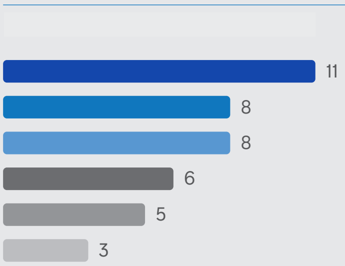
Career Stephen is a chartered accountant. His previous roles include CFO of Daily Mail and General Trust plc from January 2011 to April 2017. He was CFO and COO of Dow Jones in New York and CFO of News International in London, both part of News Corporation. Prior to this, he held executive positions at British American Tobacco plc.

Board skills and experience Stephen has a strong understanding of international business and an appreciation for looking beyond numbers to help improve performance. His change management experience allows him to make a significant contribution to the long-term growth of the business.

Other principal roles
— 3i Group plc, non-executive director

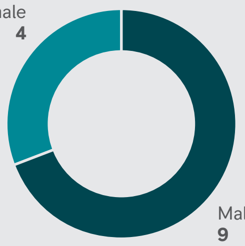
Composition of the Board

Board skills and experience

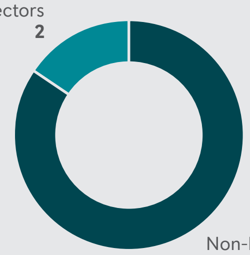


Number of Directors with:
- Chairman/CEO/CFO experience
- Related industry/operational
- Financial
- Engineering/technology
- Safety/regulatory/risk
- Remuneration/HR

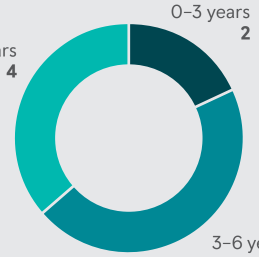
Board members by gender



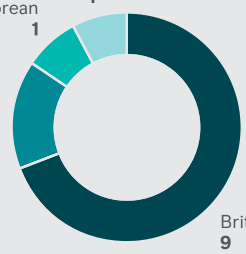
Balance of the Board



Non-Executive Directors' tenure



Board members by nationality *



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

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

LEWIS BOOTH CBE NG A R
Independent Non-Executive Director
Chairman, Audit Committee

Appointed in May 2011.

Career 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.

Board skills and experience Lewis has considerable financial expertise and experience, of great benefit to both the Board and in his role as Chairman of the Audit Committee. He brings a global perspective and is recognised as one of the strongest and most experienced international leaders in his sector.

Other principal roles
— Mondelez International Inc., director

RUTH CAIRNIE NG R ST
Independent Non-Executive Director
Chairman, Remuneration Committee

Appointed in September 2014.

Career A physicist by background, Ruth joined Royal Dutch Shell plc as a scientist. During her 37 years with the company, she held a number of senior positions, in the UK and internationally. From 2011 until her retirement in 2014, Ruth was executive vice president of strategy and planning for the global business.

Board skills and experience Ruth has strong strategic and commercial knowledge. Skilled in addressing technological and environmental challenges, she brings real value to the Science & Technology Committee. She also has significant experience as remuneration committee chair, both at Associated British Foods plc (ABF) and previously Keller Group plc.

Other principal roles
— ABF, non-executive director
— ContourGlobal plc, non-executive director
— POWERful Women, industry chair

SIR FRANK CHAPMAN NG SE ST
Independent Non-Executive Director
Chairman, Safety & Ethics Committee

Appointed in November 2011.

Career Sir Frank is a chartered engineer. With 40 years spent in the oil & gas sector, 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.

Board skills and experience Sir Frank has an outstanding record of business achievement, a life-long passion for engineering and innovation and a deep understanding of technology. His significant industrial and safety experience are invaluable to the Board and in particular in his role as chairman of the Safety & Ethics Committee.

Other principal roles
— Myeloma UK, vice chairman

IRENE DORNER NG A SE
Independent Non-Executive Director
Employee Champion

Appointed in July 2015.

Career Irene was CEO and president of HSBC, US until retiring in December 2014. During her 30-year career with HSBC, she held a number of international roles including CEO of HSBC in Malaysia. Irene is an honorary fellow of St Anne's College Oxford, she qualified as a barrister-at-law in London and until 2016, was a consultant at PwC.

Board skills and experience With a strong background in risk management, gained from the financial sector, Irene brings valuable insight as part of her role on our Audit Committee. As a passionate advocate of diversity and inclusion, she has embraced the role of Employee Champion and ensures the views of the workforce are properly reflected in the Board's discussions.

Other principal roles
— AXA SA, director
— Control Risks Group Holdings Limited, chairman

BEVERLY GOULET NG R A
Independent Non-Executive Director
Employee Champion, North America

Appointed in July 2017.

Career 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.

Board skills and experience Beverly brings valuable knowledge and operational experience gained from within the airline sector. Together with her expertise in finance, treasury, strategy, legal and governance matters, she actively takes part in the development and strengthening of our business.

Other principal roles
— Xenia Hotels, non-executive director
— Texas Women's Foundation, board member
— Rolls-Royce North America Holdings, Inc., board member

LEE HSIEN YANG NG A SE
Independent Non-Executive Director

Appointed in January 2014.

Career A Singaporean, Hsien Yang was chief executive of Singapore Telecommunications Limited for 12 years. He was a former member of the Rolls-Royce International Advisory Board, he served as chairman and non-executive director of Fraser and Neave Limited from 2007 to 2013 and Chairman of the Civil Aviation Authority of Singapore.

Board skills and experience Hsien Yang combines a strong background in engineering with extensive international business and management experience in a key market for the Company. His significant industrial and financial skills prove valuable in his committee memberships.

Other principal roles
— The Islamic Bank of Asia Private Limited, chairman

NICK LUFF NG SE A
Independent Non-Executive Director

Appointed in May 2018.

Career Nick is a chartered accountant. He is chief financial officer at RELX Group PLC, playing a key role in driving shareholder returns as the company transforms its business and simplifies its corporate structure. Nick was previously CFO of Centrica plc for 7 years and, prior to that, P&O Group. Nick has formerly been audit committee chairman and a non-executive director of both Lloyds Banking Group plc and QinetiQ Group plc.

Boards skills and experience Nick has broad financial skills and a track record of driving business performance. In addition, he has extensive non-executive experience. This exposure together with both financial and accounting expertise and a passion for engineering is invaluable to the Board.

Other principal roles
— RELX Group PLC, chief financial officer

BRADLEY SINGER ST
Non-Independent Non-Executive Director

Appointed in March 2016.

Career Brad, a US national, is a partner and COO of ValueAct Capital Management LP. 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.

Board skills and experience Brad has an outstanding record as a business leader, with experience of public companies during periods of change, growth and significant financial outperformance, particularly in the US. He provides an investor perspective drawing on his experience as COO of ValueAct.

Other principal roles
— ValueAct Capital, partner and COO
— The Posse Foundation, chairman
— McIntire School Foundation, University of Virginia, trustee

PAMELA COLES
Company Secretary
Chief Governance Officer

Appointed in October 2014.

Career Pamela is a fellow of the ICSA: The Governance Institute. 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.

Board skills and experience Pamela is an expert in corporate governance and company law. With a pragmatic approach to how the Governance Team supports the business, she has been instrumental in supporting the Chairman and the Non-Executive Directors to build strong relationships with the management team and has been able to offer advice and guidance on a wide range of topics.

Other principal roles
— E-ACT, non-executive director

SIR KEVIN SMITH CBE NG R ST
Senior Independent Director
Chairman, Science & Technology Committee

Appointed in November 2015.

Career Sir Kevin was CEO of GKN plc for nine years. Before 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.

Board skills and experience Sir Kevin has extensive industrial leadership experience and a deep knowledge of engineering and manufacturing businesses, as well as the aerospace industry. He makes a significant contribution to the growth and development of our key strategies, both as a member of the Board and as Chairman of the Science & Technology Committee.

Other principal roles
— Unitas Capital, senior adviser
— L.E.K. Consulting, European advisory board member

JASMIN STAIBLIN NG ST
Independent Non-Executive Director

Appointed in May 2012.

Career A German national, Jasmin was the CEO of Alpiq Holding AG from 2013 to 2018. Prior to this, she held a number of senior positions in the ABB Group working in Switzerland, Sweden and Australia, becoming CEO of ABB Switzerland from 2006 until 2012.

Board skills and experience Jasmin combines a strong background in advanced engineering and deep technology knowledge with extensive international business experience in the industrial sector. With a background dominated by science and technology, she makes a significant contribution both to the Board and as a member of the Science & Technology Committee.

Other principal roles
— Georg Fischer AG, non-executive director
— Seves, 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	■	■		■	
Nick Luff	■	■		■	
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 Chairman

Full Director's biographies can be found at: www.rolls-royce.com

CORPORATE GOVERNANCE

The Board

The role of the Board

The Board is ultimately responsible to shareholders for the direction, management, performance and long-term sustainable 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 of the 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

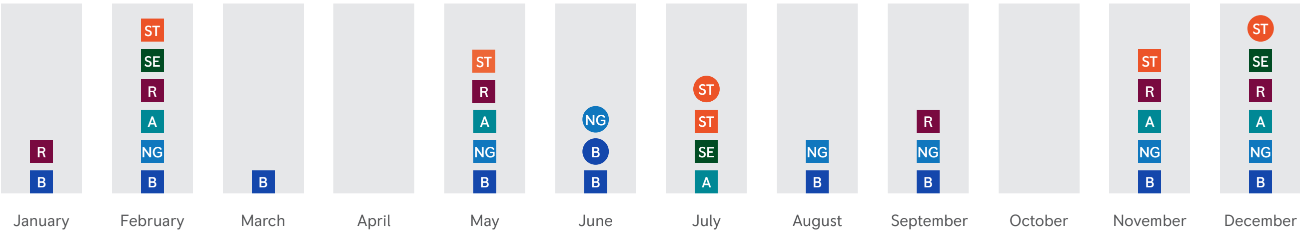
The Board committees

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 for Directors and senior management	Internal audit	Executive and senior management remuneration review	Sustainability	Technology capabilities and skills
Corporate governance	External audit	Workforce remuneration review and related policies	Ethics & compliance	Technology trends and risks
Oversight of principal risk – talent & capability	Oversight of principal risks – business continuity, market & financial shock, cyber threat		Oversight of principal risks – compliance, strategic transformation, safety	

Roles and responsibilities

The roles of the Chairman and Chief Executive are clearly defined and the Board supports the separation of the two roles. 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 and leads the Executive Team which comes together to communicate, review and agree on issues and actions of Group-wide significance. Non-Executive Directors support the Chairman and provide objective and constructive challenge to management. The Senior Independent Director (SID) provides a sounding board for the Chairman and serves as an intermediary for the Chief Executive, other Directors and shareholders when required. 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.

Board and committee meetings held in 2018



Key

B Board
NG Nominations & Governance Committee
A Audit Committee
R Remuneration Committee
SE Safety & Ethics Committee
ST Science & Technology Committee
NG B ST Denotes unscheduled meeting

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

Unscheduled meetings

The unscheduled meeting of the Board in June was to review the programme and content for the Capital Markets event. The unscheduled meeting of the Nominations & Governance Committee in June was to consider the re-appointment of Irene Dorner as a Non-Executive Director following the expiry of her first three-year term.

Two additional Science & Technology Committee calls were held. The first, in July, was for the Committee to be updated on progress with the technology efficiency and effectiveness review and the second in December was to follow up after a technical risk deep dive at the meeting held in November.

Non-attendance

Some Board members were unable to participate in certain Board and committee meetings due to the meeting being held to discuss the Director's reappointment, for medical reasons or due to critical business commitments, 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 scheduled meetings in 2018

	Board (9 meetings)	Nominations & Governance (6 meetings)	Audit (5 meetings)	Remuneration (6 meetings)	Safety & Ethics (3 meetings)	Science & Technology (4 meetings)
Ian Davis	9/9	6/6				
Warren East	9/9					
Stephen Daintith	9/9					
Lewis Booth	9/9	6/6	5/5	6/6		
Ruth Cairnie	9/9	6/6		6/6		4/4
Sir Frank Chapman	9/9	6/6		6/6	3/3	
Irene Dorner	9/9	6/6	5/5		3/3	
Beverly Goulet	9/9	6/6	5/5			
Lee Hsien Yang	9/9	6/6	5/5		3/3	
Nick Luff (appointed 3 May 2018)	5/5	4/4	3/3			
Brad Singer	9/9					4/4
Sir Kevin Smith[1]	8/9	5/6		6/6		4/4
Jasmin Staiblin[2]	9/9	4/6				4/4

[1] Sir Kevin Smith did not attend the August Board and Nominations & Governance Committee meetings due to medical reasons.
[2] Jasmin Staiblin did not attend the May meeting of the Nominations & Governance Committee as it was convened to discuss her re-appointment. She did not attend the December meeting of the same Committee due to critical business commitments.

Committee changes

From 1 January 2019, on the recommendation of the Nominations & Governance Committee, the Board approved the following changes to its committees: Sir Frank Chapman stepped down from the Remuneration Committee and joined the Science & Technology Committee; Beverly Goulet joined the Remuneration Committee; and Nick Luff joined the Safety & Ethics Committee.

Board's focus during the year

Area of focus	Matters considered	Outcome
Strategy and risk	Review the Group's strategy	The refreshed vision and strategy for the Group, approved by the Board in 2017, was rolled out internally and externally from early 2018. In September, the Board held a two-day meeting with the Executive Team focused on reviewing the progress with the execution of the Group's strategic plan and the longer-term context, including discussions on all areas of the business, people capability and the restructuring programme. The Board provided reflections on the day at the subsequent Board meeting. Feedback and content of discussions were shared with the Executive Team and businesses.
	Review of risk appetite and principal risks, including deep dives on: — political risk; — competitive position; and — major product programme delivery	The Board reviewed and approved the Group's risk appetite framework in February. Furthermore, the Board carried out a robust assessment of the principal risks facing the Company, set out on pages 51 to 54 and including those that would threaten its business model, future performance, solvency or liquidity. The Board received an update on the effectiveness of risk management from the Audit Committee in December. Lord Powell[1] supported a deep dive on political risk in March 2018, which included: the implications of Brexit; current geo-political factors; and the changing cyber security threats. The Board considered the Group's competitive position as part of its strategy sessions in September. The Board reviewed the risks associated with the delivery of Civil Aerospace programmes during the year and received regular updates from the President – Civil Aerospace, including the in-service issues with the Trent 1000 programme. The Board reviewed Power Systems in detail during its visit to Friedrichshafen, Germany in March and discussed the Defence business and strategy with the President – Defence in August.
	Disposal of the Commercial Marine business and Power Systems fuel injection technologies business, L'Orange	During the year, the Board approved the disposal of the Group's Commercial Marine business to KONGSBERG Gruppen ASA and the disposal of L'Orange to the Woodward Group. Progress updates were received by the Board. See page 58 for more details.
	Ongoing co-operation with regulators following deferred prosecution agreements (DPAs)	The Board kept oversight of compliance with the DPAs with regular updates provided by the Group's General Counsel.
Succession and leadership	Board appointments	During the course of the year, the Board welcomed Nick Luff as a Non-Executive Director. In addition, the Board approved the re-appointments of Brad Singer, Irene Dorner, Jasmin Staiblin and Sir Kevin Smith.
	Effectiveness of the Board, Chairman and Chief Executive	An external evaluation was undertaken and it concluded that the Board operated effectively in 2018. See page 70 for more details. The Chairman and Chief Executive received constructive feedback on their respective performance.
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. Two new KPIs were approved by the Board: cash flow per share and cash return on invested capital. See page 15 for more details.
	Introduction of new accounting standards (IFRS 9 and IFRS 15)	The financial reporting basis from the start of the year was in compliance with IFRS 9 and IFRS 15. In preparation for the changes, the Board had received updates regarding the introduction and impact of the new accounting standards during 2017.

[1] Lord Powell from the Council of Foreign Relations has been retained by the Company as an adviser 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	Operational challenges during the year are described in the Civil Aerospace review on pages 24 to 29. The Board remained regularly informed on the management of these issues, including steps to minimise customer disruption, and received regular briefings from the Chief Executive and President – Civil Aerospace.
	Safety incidents	The Board was briefed on the RIDDOR report that had resulted in the UK H&S Executive visiting the relevant site (more detail can be found on page 99). The safety walks quick guide was provided to the Directors for their future reference when visiting facilities.
Stakeholder engagement and governance	Investor engagement	Continued transparency in investor briefings. The Capital Markets event held in June was well received and introduced members of the Executive Team to our investors. In July, we published our first ESG newsletter which is available at www.rolls.royce.com.
	Employee engagement	The Board held two Meet the Board events for employees, in the UK and in Germany. Regular updates were given by Irene Dorner on her employee champion role and meetings/events she had attended. The Board considered a report on global employee relations. Irene Dorner also highlighted an emerging theme arising across her discussions with employees concerning bullying and harassment. This was considered by the Safety & Ethics Committee – see page 101 – and resulted in a global anti-bullying campaign which was launched at the end of the year and will continue into 2019.
	Other stakeholder engagement	The Board reviewed in detail its stakeholder groups and current engagement programmes. This is discussed in detail on pages 66 to 68.
	FRC's publication of the 2018 UK Corporate Governance Code (revised Code)	The Board was updated on the implications for Rolls-Royce of the changes following the publication of the revised Code.
	Matters reserved to the Board and delegated authorities	The Board carried out a full review of its matters reserved to ensure alignment with the revised Code and its delegated authorities.
	UK Modern Slavery Act	The anti-slavery and human trafficking statement was presented and approved by the Board in February 2018.

The Board's areas of focus in 2019 are expected to include:

- The Group's culture
- Execution of strategic priorities
- Overview of the restructuring of the businesses, support and management functions including management of associated risk
- Civil Aerospace operational delivery programme ramp-up
- Continued monitoring of financial and operational performance
- Continued strong focus on safety improvements
- Continuing to monitor compliance with the terms of the DPAs
- The implications of Brexit on the Group's activities
- Principal risk reviews
- Increased emphasis on sustainability
- Implementation of any required changes to the corporate governance framework introduced by the revised Code

Stakeholder engagement

At Rolls-Royce, we understand that who we are and how we behave matters not only to our people but to the many stakeholders who have an interest in our business. We believe that stakeholder engagement remains vital to building a sustainable business and we interact with many stakeholders at different levels of the organisation. Engagement is carried out by those most relevant to the stakeholder group or issue.

The table below identifies some of our stakeholders and how both the Company and the Board engages with them. More details can be found on www.rolls-royce.com. During the year, the Board has reviewed the different stakeholder groups and the current engagement programmes and identified further opportunities for strengthening both its relationships and understanding to facilitate the decisions and contributions made by the Board to the success of the business.

Customers	**Why they matter to us** Focusing on the needs of our customers is critical to the success of our business. We collaborate and innovate with our customers to improve product performance and value. **Type of engagement** - Contract negotiation, execution and management of ongoing relationships - Customer training - Satisfaction surveys and net promoter scores - Participation in industry forums and events - Partnerships with industry, STEM, graduate and apprentice activities **What matters to them** - Safety, quality and reliability - Value for money - Product performance and efficiency - Competitiveness - Our availability and responsiveness - Research and innovation - Sustainability performance - Relationship - Compliance **How the Board engages** The Board has kept very close to our businesses' customer engagement throughout the year, due to the highly regrettable and significant operational disruption caused to our affected airline customers as a result of the in-service issues with the Trent 1000. Civil Aerospace customers have been invited to present to the Board to share views on what it is like to work with us. Customer relationships across our businesses are discussed at most Board meetings as part of the Chief Executive's report. In addition, all business presidents regularly present to the Board and key customer relationships are part of the discussions. The Board's discussions benefit from Beverly Goulet's experience in the sector and she provides valuable insights into what matters to airline customers.
Investors	**Why they matter to us** Continued access to capital is vital to the long term performance of our business. We work to ensure that our investors and investment analysts have a strong understanding of our strategy, performance, ambition and culture. **Type of engagement** - Dedicated investor relations (IR) team - Annual report and accounts and Annual General Meeting - Corporate website, including dedicated investor section - Investor roadshows - Results presentations and post-results engagement with top shareholders - Stock Exchange announcements and press releases - Addressing regular analyst enquiries - Governance days for fund managers and governance analysts - IR briefing papers and governance newsletter - Capital Markets events - Investor consultations - Meetings with institutional shareholders on request to discuss governance approach and areas of interest **What matters to them** - Financial performance and economic impact - Governance and transparency - Sustainability performance - Confidence in Company's leadership - Stability and predictability with no surprises

Investors continued

How the Board engages

The Board receives a regular report from the director of investor relations on shareholder analyst feedback, especially post results. A Capital Markets event was held in June which proved to be a success and introduced two new members of the Executive Team to our key investors. In 2018, the Chief Executive and Chief Financial Officer met with investors in the UK and North America, following both the preliminary and interim results, and at various times throughout the year. The IR team is in constant dialogue with investors in the UK and North America. At our strategy day in September, we welcomed the external perspectives of bull and bear fund managers who presented their investment theses prior to taking questions from the Board. We have held 'governance days' in two of the last three years following the release of our Annual Report. These are led by the Chairman and attended by the Chief Executive and our committee chairs and seeks to provide a discussion forum for fund managers and governance analysts. With relative stability on governance topics in 2018, we published a well-received ESG newsletter instead to provide an update on our activities in these areas. The Chairman, Senior Independent Director and members of the Board make themselves available to meet with institutional investors when requested with the Chairman and SID meeting with the ESG representatives of some of our major shareholders in both London and Edinburgh in the first half of the year. The Company's AGM is held in different locations in order to reach a wider shareholder base. Of real benefit to the Board is the institutional investor perspective shared by Brad Singer as chief operating officer of ValueAct.

Employees

Why they matter to us

Employee engagement is critical to our success. We work to create a diverse and inclusive workplace where every employee can reach their full potential and be at their best. We engage with our people to ensure we are delivering to their expectations, supporting wellbeing and making the right business decisions. This ensures we can retain and develop the best talent.

Type of engagement

- Non-Executive Directors identified as Employee Champions
- Board apprentice programme
- Graduate and apprentice focused events
- Meet the Board events and 'town hall' briefings
- Informal leadership blogs, all employee webex programme and videos by Executive Team
- Employee relations and HSE dedicated teams
- Global HSE week, ongoing occupational safety and wellbeing programme
- Annual global employee opinion survey and individual performance reviews
- Employee volunteering
- Trade union representative participation

What matters to them

- Reputation
- Reward
- Employee development
- Employee engagement
- Talent pipeline and retention
- Career opportunities
- HSE performance
- Diversity and inclusion

How the Board engages

Irene Dorner has continued to meet with employee groups and has attended the employee stakeholder engagement meetings. She regularly provides feedback to the Board on employee topics of interest and/or concern, including our graduate and apprentice population. This direct link that Irene provides between the employees and the Directors is proving to be extremely valuable, particularly through this period of extensive change. The Board has recognised the success of Irene's role and has recently appointed Beverly Goulet as the Board's Employee Champion for our North American employees. Following on from the success of the first programme, the second Board apprentice programme for 2018/19 has been launched (see Nominations & Governance Committee Report on page 73). During the year, the Meet the Board events for employees were held in Friedrichshafen, Germany and Derby, UK. Both Directors and Executive Team members take every opportunity to meet with local employees and conduct town hall sessions when visiting different business locations. In 2018, in addition to the work of the employee champions, members of the Board met with employees during their visits to Indianapolis, US; Pune and Bangalore, India; and Singapore. The Board discussed employee relations in August and this will be reviewed by the Board as required but at least annually. Diversity statistics in respect of the graduate and apprentice programmes are reported to the Board periodically. Finally, when considering M&A activity, the Board always remains mindful of any impacts on employees (see strategic decisions on page 58).

Partners

Why they matter to us

Our external supply chain and our suppliers are vital to our performance. We engage with them to build trusting relationships from which we can mutually benefit and to ensure they are performing to our standards and conducting business to our expectations.

Type of engagement

- Global Supplier Code of Conduct and associated certification and risk monitoring processes
- Supplier conferences and forums, globally, regionally and by business
- Webex programme and global supplier portal
- Supplier working groups, information gathering, assessments and awards

What matters to them

- Winning more work
- Competitiveness
- Security of pipeline and programmes
- Maintaining strong relationships
- Building capability and expertise
- Responsible procurement, trust and ethics
- Operational improvement
- Technological advances, including digital solutions

How the Board engages

Suppliers' interests are considered as part of the Board's discussions on manufacturing strategy and when reviewing specific projects. Critical suppliers are, of course, considered as part of the assessment of the business continuity risks. However, with some 2,300 suppliers alone in the UK, the Board has agreed that this is a group they would like greater visibility of in 2019.

Communities

Why they matter to us

We are committed to building positive relationships with the communities in which we operate. We support communities and groups local and relevant to our operations, particularly educational outreach.

Type of engagement

- Dedicated community investment team
- Sponsorship and employee volunteering
- Employee volunteering on boards, committees and councils
- Engagement with local councils on community matters
- Corporate website

What matters to them

- Future talent pipeline
- Local operational impact
- Health, safety and environment performance

How the Board engages

Directors meet with relevant community groups on their site visits and will engage with certain community programmes should they be requested to do so. As Employee Champion, Irene Dorner takes opportunities to meet with relevant community groups as will Beverly Goulet in her new role as Employee Champion for North America.

Governing bodies and regulators

Why they matter to us

We engage with national governments, national/transnational agencies and key politicians and regulators to ensure that we can help shape policy, have licence to operate, attract funding, enable markets and ultimately win business. We work with governments globally where we have operations or future business opportunities.

Type of engagement

- Dedicated government relations team
- Rolls-Royce North America government security committee
- Group policy development on key issues aligned with government priorities
- Relationship management, both parliament and government, and responses to consultations
- Participation in industry bodies and government and industry working groups
- Conferences and speaking opportunities
- Dedicated export controls, compliance and tax teams to manage compliance to regulatory/legal requirements

What matters to them

- Trust and ethics
- Governance and transparency
- Industry support for policies
- Regulations, policies and standards
- Research and innovation
- Sustainability performance
- Regulatory compliance

How the Board engages

The Board receives frequent regulatory updates from the General Counsel. Briefings on how the business engages with airworthiness regulators are discussed at the Safety & Ethics Committee. In addition, regular updates are provided to both the Board and the Safety & Ethics Committee on engagement with the SFO, DoJ and other regulators in relation to ethics and compliance improvement programmes. Engagement with the tax authorities and related regulatory landscape is discussed at the Board and the Audit Committee. In addition, meetings with ministers and senior officials are held as relevant throughout the year, with the Chairman supporting the Chief Executive's engagement programme at various airshows. The Board's considerations are benefited by the previous experience of Lee Hsien Yang, having been Chairman of the Singapore CAA.

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 2018, Board members visited locations including: Oberursel and Friedrichshafen in Germany, Derby and Rotherham in the UK, Indianapolis and Reston in the US, Pune and Bangalore in India and Singapore. 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.

Nick Luff was appointed to the Board in May 2018 and at that time joined the Nominations & Governance and Audit Committees. Since his appointment he has undertaken a thorough induction and met with members of the Executive Team. He was also briefed by the Company Secretary on the Company's corporate governance arrangements. Nick has attended a number of site visits, including Derby in the UK, Indianapolis and Crosspointe in the US, and Singapore.

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 at its meetings in Derby, UK and Friedrichshafen, Germany.

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 Nick Luff

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

Board effectiveness

Board and committee review

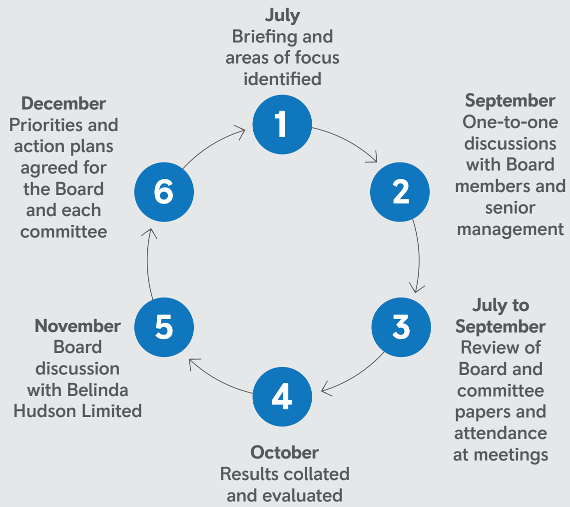
This year, having undertaken both benchmarking and tender exercises, Belinda Hudson Limited (BHL), experts in enhancing board effectiveness, was invited to undertake our externally-facilitated effectiveness review. BHL's appointment, in July, was based on cultural-fit, the research that BHL had undertaken which highlighted the areas that needed addressing, and commercial competitiveness. BHL has been appointed for a three-year term, with a slightly less in-depth review to be conducted in 2019.

A review of the effectiveness of the Board committees was undertaken at the same time as the Board. BHL has not provided any other service to the Company during the year.

This review took the form of confidential one-to-one discussions between BHL and members of the Board and several senior management executives and BHL's attendance at Board and committee meetings as well as at the Board strategy day. The review covered specific areas identified as requiring further development during the previous year's review. The scope was agreed with the Company Secretary after consultation with the Chairman. The specific areas of focus were: Board composition and dynamics, the Board's role and the Board at work.

Good progress had been made since the last review and the Board feels that it is working more effectively. The Board discussed the findings of the report at its meeting in November, which BHL attended.

Stages of the Board and committees effectiveness review

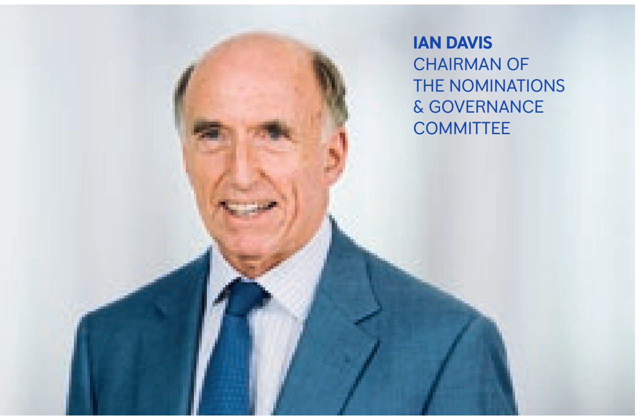


At a private meeting of the Non-Executive Directors, Sir Kevin Smith, SID, led a review of the Chairman's performance without the Chairman present. The Nominations & Governance Committee also met without any management present to discuss the performance of the Chief Executive. The meetings concluded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

Progress on key areas

Areas of focus	BHL's findings in 2018	Focus for 2019
Board composition and dynamics	The Board has a strong cadre of Non-Executive Directors and highly regarded executives who bring a good range of skills and a wealth of useful and relevant experience. Diversity is good in terms of nationality, gender, perspective and style. All Board members have shown strong commitment and resilience and collectively it is working effectively.	Continued focus on the Board succession programme and skills matrix together with a review of the composition of the Board's committees to maximise co-ordination across their respective duties and to prepare for future Board changes. **Responsibility: Chairman**
The Board's role	The Board is seen as a positive asset. Together with its committees, they are seen to add significant value. The Board's impact and how it has encouraged the executives to address specific matters was highlighted with those Non-Executive Directors with strong operational experience able to provide useful challenge, input and support during the restructuring and cultural change programme.	With engagement from different parts of the business, a restructuring update to be provided at each Board meeting with a watchful eye on the cultural impact as the change programme continues to be embedded across the Group. **Responsibility: Chairman/Company Secretary**
The Board at work	The combination of face-to-face meetings and telephone calls is working well, with the latter only being used for routine updates and not a forum for discussion of major proposals. There have been some positive and welcome developments in the quality of information provided to the Board which has increased the level of knowledge, understanding and confidence on the part of the Non-Executive Directors.	Emphasis on the co-ordination of agendas and papers between the Board and its committees and the Executive Team to strengthen further the linkage and feedback mechanisms. **Responsibility: Chief Executive/Chief Financial Officer/Company Secretary**

NOMINATIONS & GOVERNANCE COMMITTEE REPORT



IAN DAVIS
CHAIRMAN OF THE NOMINATIONS & GOVERNANCE COMMITTEE

"I was pleased that this year's evaluation concluded that the Committee was proactive in promoting good governance with an innovative approach."

Key highlights

- Appointment of Nick Luff as a Non-Executive Director
- Diversity and inclusion detailed update
- Talent and succession approach for Executive Team
- Implications of UK Corporate Governance Code 2018 (revised Code)

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 management and, in so doing, oversees the development of a diverse pipeline for succession. The Committee also keeps the Group's corporate governance arrangements under review and ensures they are consistent with best practice standards.

Membership and operation of the Committee

The Committee comprises wholly of independent Non-Executive Directors. Biographies are on pages 59 to 61 and meeting attendance is on page 63. Directors do not attend discussions relating to their re-appointment.

The Committee's responsibilities are outlined in its terms of reference which can be found at www.rolls-royce.com. We review these annually and refer them to the Board for approval. This year, we have made changes to our remit to ensure it aligns with the principles of the revised Code.

Other attendees

In addition to the members of the Committee, both the Chief Executive and Brad Singer, non-independent Non-Executive Director, attend when it is considered appropriate.

Committee evaluation review

This year, Belinda Hudson Limited (BHL) was appointed to undertake a review of the Committee. The effectiveness review process of the Board and its committees is discussed in greater detail on page 70. The Committee considered the review at its meeting in December and I was pleased that it concluded that the Committee is particularly strong and proactive in promoting good governance, with an innovative approach and a desire to ensure Rolls-Royce's governance is best in class, adds value and is appropriate for the Group and its stakeholders. Early in 2019, we reviewed the committees' composition to ensure skills and experience are best placed to support management in the delivery of the strategy. In addition, together with the Executive Directors, we will review the succession plan to identify the desired skills of future appointments and to continue the focus on the diversity and inclusion agenda.

Principal responsibilities

Board and committee composition

- Review the structure, size and composition of the Board and its committees regularly.
- Evaluate and consider the Directors' conflicts of interest.

Board nominations

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

Succession planning

- Consider succession plan for Directors and senior management.
- Oversee the development of a diverse pipeline for succession.
- Review implementation of diversity and inclusion policy.

Evaluation of Chairman, Chief Executive and Non-Executive Directors

- Evaluate annually the Chairman and 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.

Principal risk

- Talent and capability

Areas of focus for 2019

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

Nominations & Governance Committee focus during 2018

Area of focus	Matters considered	Outcome
Board and committee composition	A review of the composition of the Board and committee membership	In 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 reviewed the composition of the Board and its committees and recommended to the Board some changes to certain committees effective January 2019, as set out on page 63.
Board nominations	Re-appointment of four Non-Executive Directors The appointment of Nick Luff as Non-Executive Director and oversight of Nick's induction plan A review of site visits undertaken by Board members	Following individual reviews of each Director, 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 Nick Luff's appointment to the Board. You can read more about the appointment process on page 73.
Succession planning	Progress on succession planning Update on diversity and inclusion	The Committee focused primarily on the approach to Executive Team succession, following the introduction of a new talent review process. The Committee received a detailed update on the work to improve the diversity and inclusion agenda across the Group. You can read more about our diversity and inclusion programmes on pages 46 and 73.
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, in accordance with 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	Governance updates from the Company Secretary	The Committee has been kept informed about the changes to the governance landscape following the introduction of the revised Code and reviewed progress against its related initiatives.
Oversight of principal risk – talent and capability	The principal risk is considered when discussing talent and capability	A revised approach to talent review was considered in September and it was agreed that continuing focus was required, particularly on the high-potential and emerging talent pools in key geographies. Our second Board apprentice programme was launched in November 2018 (see page 73).

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 Hampton-Alexander Review, published in November 2018. Further details on our approach to diversity are set out on pages 73 and 74. 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 pages 61 and 63. 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 programme and receives a comprehensive data pack providing detailed information on the Group. You can read more about inductions and continuing development on page 69.

Board nominations

In February 2018, the Committee recommended to the Board the appointment of Nick Luff as Non-Executive Director.

During the year, we considered and recommended to the Board the terms of appointment for Brad Singer for a further three-year term, his initial appointment being for a two-year term. In addition, the Committee considered and recommended to the Board the re-appointment of Jasmin Staiblin for a third three-year term and Irene Dorner and Sir Kevin Smith both for second three-year terms subject to annual shareholder re-election. For each, 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.

As announced in February 2018, Nick Luff, chief financial officer of RELX Group, was appointed as a Non-Executive Director with effect from close of the AGM in May 2018, following shareholder approval. Nick is a member of the Audit Committee and Nominations & Governance Committee. You can read Nick's full biography at www.rolls-royce.com. Nick was identified as a candidate who 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 Nick's appointment, the Committee appointed MWM Consulting. MWM Consulting had no other connection to the Company during the year. In accordance with our Board diversity policy, we will only engage firms who have signed up to the Voluntary Code of Conduct for Executive Search firms. Prior to the new appointment, the Chairman agreed a Non-Executive Director profile and the Committee provided input into a shortlist of candidates for the role.

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 Group 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.

The Committee was pleased with the increased focus by the Executive Team on leadership talent and the succession pipeline. Development plans are in place for those emerging leaders with potential to succeed current members of the Executive Team in due course. Following management restructuring activities, the Enterprise Leadership Group below the Executive Team has also been refined and reset to a smaller, diverse core of key leaders who will take the business forward. There remains much to do in improving diversity amongst our leadership and management populations, a challenge which we are committed to addressing through monitoring of careful plans to attract and recruit, retain and develop our leaders of the future.

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 across the Group. At the beginning of 2018, we announced 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 came at a crucial time for our business as the Company set out to make 2018 a breakthrough year.

Board apprentice programme

In November 2018, we launched our second programme, the format of which incorporates the feedback from our pilot programme which ran in 2016/2017. Six individuals from different areas of the Group have been selected for the programme, via our talent succession process, which will run for 18 months. The purpose of the programme is to provide these individuals with leadership development experience and demonstrate our commitment to their career progression and development as leaders in the organisation.

Each apprentice will join two core Board committees, attending each one for a total of nine months. They have been aligned to one committee which is more synonymous with their current job role and one that provides them with more of a challenge. In addition to this, apprentices will be able to participate in supplementary committees to broaden their experience, attend masterclasses on a variety of board-relevant topics and take advantage of frequent networking opportunities. Throughout the programme, each apprentice will be mentored by two Board members and sponsored by the relevant Executive Team member as well as attending one-to-one sessions with the Chief People Officer. This framework intends to provide them with the right support and guidance for both them and the Board to get as much out of the programme as possible.

Diversity and inclusion

Diversity and inclusion continues to be an area of focus for the Committee. The Board has long understood the importance of diversity within our workforce and particularly the value of developing a diverse pipeline for succession to senior management. We continue to work to improve women's representation at Board level and in senior leadership positions, including as a supporter of The Mentoring Foundation, which owns and operates both the FTSE 100 cross-company mentoring executive programme and the next generation women leaders programme (the FTSE programmes). These programmes match high-potential female mentees with mentors who are chairs or senior leaders in other companies. In recent years, Ian Davis has acted as a mentor on the FTSE programmes to several senior women from other organisations and Rolls-Royce itself has placed eight mentees into the FTSE 100 cross-company mentoring programme. The Committee is pleased to be able to make this contribution and to offer our high-performing and aspirational women this opportunity to further their careers.

Furthermore, the Board is committed to supporting and monitoring Group activities to increase the percentage of senior management roles held by women and other under-represented groups across the organisation. In September, the Committee was updated on the Executive Team's diversity and inclusion strategy against the backdrop of the restructuring programme, see page 46. In December, the Board reviewed the Board diversity policy and approved certain amendments to ensure alignment with the revised Code and the recommendations of both the Hampton-Alexander Review regarding gender diversity and the Parker Review in respect of ethnic diversity. Our policy will continue to promote an inclusive and diverse culture and it reaffirms our aspiration to meet and exceed the recommended voluntary target of 33% of Board positions being held by women in 2020. 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. However, it is our longer-term intention to at least maintain this balance. You can find the full policy at www.rolls-royce.com.

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 on page 59 shows that the percentage of women on the Board is 30.8% This has reduced slightly since 2017 following the appointment of Nick Luff as a Non-Executive Director in May 2018.
Support and monitor Group activities to increase the percentage of senior management* roles held by women and other under-represented groups to 25% by 2020.	The Committee received an update on the diversity and inclusion strategy across the restructured business. This recognises the need to bring different people with different ways of thinking together to find simpler, more innovative, bolder ways of doing things to deliver better business outcomes.
Monitor, challenge and support internally set targets for diversity and inclusion at all levels across the organisation.	The charts on page 59 provide a clear picture of our Board diversity. Progress against our 2020 diversity targets across the Group are set out on page 46.

* Senior management defined as Executive Team and Enterprise Leadership Group which currently comprises 88 most senior roles.

Executive Team Diversity

The Executive Team currently comprises ten members, all of whom are male, following the departures of Mary Humiston and Marion Blakey during the year. The Committee has agreed a 2020 gender diversity target for the Executive Team of 23%. In September, the Committee considered the detailed succession plan for the Executive Team and noted that 36% of the candidates were female (2017: 21%). Currently 17% of the Enterprise Leadership Group are female as are half our Board apprentices.

Governance

We strive to take an innovative approach in all that we do and that includes our approach to governance. In 2018, we have carried out a number of initiatives including two Meet the Board events in the UK and Germany, the launch of our second Board apprentice programme and the appointment of Beverly Goulet as our Employee Champion for North America following the very successful employee engagement initiatives supported by Irene Dorner as our first Non-Executive Director Employee Champion. 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 has been reviewed in depth to ensure it is aligned with the objectives and ambitions of the restructured business. Having the framework in place enables the Executive Team to manage risk, drive critical business decisions and maintain consistent standards. It means the Group can act with pace and confidence in a way that meets the expectations of our stakeholders, including our customers, regulators, colleagues, partners and shareholders.

We also refreshed and simplified our Group policies. We now have a more succinct set of policies that communicate clear expectations of employees in a new, consistent format. The new Group policies were launched across the organisation in the autumn simultaneously with our code of conduct and are available to view in the sustainability section on www.rolls-royce.com.

The General Counsel and the Company Secretary will continue to help to keep the governance framework and the development of the Group policies under review. They 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 with the introduction of the revised 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 58, the conflict of interest was managed throughout the year by a relationship agreement between the Company, ValueAct and Brad Singer.

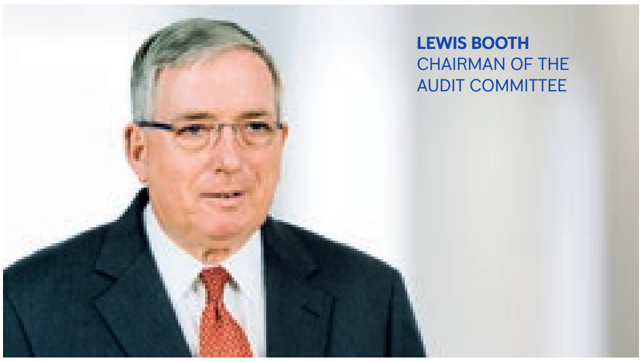
During the year, no additional conflicts of interest were identified which required approval by the Board. This was confirmed in an annual review by the Board. The Committee advised the Board that it considered that each of the remaining Non-Executive Directors continued to be independent.

Looking forward

In 2018, I believe the Committee has made strong progress in a number of key areas, particularly our detailed review of the Group's stakeholder engagement programme as well as gaining greater insight into the Group's culture as part of the restructuring programme. These areas of our remit have been emphasised in the revised Code and we will keep under review any enhancements to our work during 2019 to ensure our governance initiatives continue to aspire to be best in class and remain innovative, thoughtful and appropriate for the Group and all our stakeholders.

Ian Davis
Chairman of the Nominations & Governance Committee

AUDIT COMMITTEE REPORT



"The long business cycle coupled with complex contractual arrangements leads to the need for well considered judgements. In 2018, these have included embedding IFRS 15, accounting for the Trent 900 and Trent 1000 programmes and assessing the recognition of deferred tax assets."

Key highlights

- IFRS 15 embedded and IFRS 16 implementation on schedule
- Trent 900 and Trent 1000 exceptional items
- Focus on assessment of potential onerous contracts
- Transition to PwC as auditors
- Focus on risk management and internal control systems, including cyber security

Introduction

I am pleased to present the 2018 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 the external auditors for the open discussions that take place at our meetings and the importance they all attach to its work.

We have had a number of key issues to consider in 2018, most significantly:

- matters arising from embedding IFRS 15 *Revenue from Contracts with Customers* and the impact of IFRS 16 *Leases;*
- key judgements and estimates in accounting for the Trent 900 and Trent 1000 exceptional items;
- consideration of the recognition of UK deferred tax assets, particularly in light of the Group's negative balance sheet position;
- the impact of the restructuring programme announced in June 2018 on the people and processes on which the financial reporting and risk and control environment are based; and
- following the audit tender in 2016, PricewaterhouseCoopers LLP (PwC) appointment as the Company's new auditor.

Areas for focus in 2019

We will continue to pay particular attention to the maintenance of the control environment as the restructuring programme progresses, particularly within the finance transformation programme. We will continue to oversee the Group's management of its cyber threat principal risk. We will also focus on the smooth transition to IFRS 16 *Leases*.

Membership and operation of the Committee

In addition to myself, members of the Committee are Irene Dorner, Beverly Goulet, Nick Luff and Lee Hsien Yang. All members of the Committee are independent Non-Executive Directors. For the purposes of the Code and DTR 7.1, Irene Dorner, Beverly Goulet, Nick Luff and I have recent and relevant financial experience. The Board has confirmed that it believes the Committee as a whole has competence relevant to the Company's sector. Our biographies are on pages 60 and 61 and our meeting attendance is shown on page 63.

The Committee's responsibilities are outlined in its terms of reference which can be found at www.rolls-royce.com. We review these annually and refer them to the Board for approval. This year, we have made changes to our remit to ensure it aligns with the principles of the revised Code.

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. The Committee is supported by the General Counsel, the Company Secretary, the group controller, the head of group reporting, the group chief accountant, the director of internal audit, the head of enterprise risk management and the external auditors.

Committee evaluation review

This year, Belinda Hudson Limited (BHL) was appointed to undertake a review of the Committee. The effectiveness review process of the Board and its committees is discussed on page 70. I was pleased with the conclusion that the Committee had been strengthened and is becoming increasingly effective with the benefit of the support from the Chief Financial Officer and his team. To ensure we continuously improve, the review recommended that, in 2019, our focus will include: supporting the new director of internal audit; a review of the effectiveness of the internal audit function; and oversight of the non-financial aspects of the control environment.

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

- Monitoring the effectiveness of the risk management and internal control systems.
- Reviewing concerns of financial fraud.

2018 principal risks

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

Internal audit

- Scope, resources, results and effectiveness.

External audit

- Relationship with, and effectiveness of, the external auditor.
- Approving the external auditor's terms of engagement and fees.

Audit Committee focus during 2018

Area of focus	Matters considered	Outcome
Financial reporting	The appropriateness and disclosure of accounting policies, key judgements and key estimates with a focus on: — the adoption of IFRS 15 — the methodology for the identification of abnormal costs on the Trent 1000 programme — judgements and estimates on the Trent 900 programme following the decision to shorten the Airbus A380 programme — recognition and disclosure of restructuring costs — judgements and estimates necessary to assess the recognition of the UK deferred tax assets — finalisation of the acquisition of ITP Aero The implementation project for IFRS 16. In particular, the preparation of the restated information on an IFRS 16 basis which is included in note 1 to the Consolidated Financial Statements The form and content of the Annual Report	The accounting policies, judgements and estimates are appropriate and balanced. Agreed the judgements and estimates to adopt IFRS 16 and the assessment of the impact included on page 123. The Annual Report, taken as a whole, is fair, balanced and understandable.
Risk and control environment	The continuing development of the enterprise risk management and internal controls systems The processes for identifying and managing risks The effectiveness of the Group's systems of internal control The progress against the commitments under the DPAs as they relate to financial reporting The process and assumptions underlying the going concern and viability statements	The internal control system has been enhanced to include compliance controls required for the DPAs. Agreed the importance of ensuring that emerging risks were considered and the need to maintain focus on further embedding risk management during the restructuring activities. Reported to the Board that an appropriate process is in place to make the going concern and viability statements, particular attention was given to the going concern status of the Group's material subsidiaries.
2018 Principal risks	Management's assessment of the risk of, and procedures to manage, a business continuity event The procedures for preventing, detecting and recovering from any breaches of the Group's IT systems security The Group's policies, procedures and controls for identifying, managing and mitigating a market or financial shock	Appropriate procedures are in place to identify and manage principal risks and all of these have been subject to a review by the Board or an appropriate Board committee. Appropriate resources are being focused on managing the business continuity, IT vulnerability and market and financial shock principal risks, in line with the Group's agreed risk appetite.
Internal audit	The effectiveness of the internal audit function, its key findings and trends arising, and the resolution of these matters	While the scope and extent of internal audit are appropriate and the function remains effective, we noted the importance of maintaining this through the restructuring programme and the opportunity to further enhance its robustness.
External audit	The transition to PwC as auditor in 2018 The approach, scope and risk assessments of external audit and the effectiveness and independence of the external auditor The extent of non-audit services provided by the external auditors	Monitored PwC's transition work plan and activities. No concerns over the nature and amount of the non-audit services provided by PwC. Recommended that PwC be re-appointed as the Group's auditor at the 2019 AGM.

Business audit committees

Each of the Group's businesses has its own audit committee. These committees are now chaired by the respective business president, and comprise business functional leaders, internal audit and senior finance personnel and are also attended by PwC. 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.

We receive reports on key matters arising and updates on the work and effectiveness of the business audit committees during the year.

During 2018, the business audit committees focused on the continuous improvement of our internal control and risk management processes, in particular the embedding of these in our normal operational processes.

Members of the Committee were invited to the business audit committee meetings during 2018 and do periodically attend meetings during the year. We believe that this provides a key level of support to the reviews we undertake in our meetings.

Business and function presentations

In addition to a regular review of the business 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 2018, we received presentations from the following:

- **Civil Aerospace** – issues arising from the embedding of IFRS 15, the financial implications of the Trent 1000 in-service issues and the shortening of the Trent 900 programme, including the key estimates underlying these, and the impact on existing contracts, in particular whether they are onerous.
- **Defence** – the business environment and in particular pressure on UK and US defence budgets; business risk process, monitoring and planned enhancements; key accounting judgements and estimates for long-term contracts; and the status of the Defence internal control framework.
- **Power Systems** – key accounting estimates (including warranty and compliance provisions); the introduction of an enhanced 'Controls Framework for Finance and Controlling' with a specific focus on fraud prevention; and the risk management process (including risk culture and risk management tools).
- **Group Tax** – the main drivers of the Group's tax position and key tax risks and how they are managed (with specific consideration of tax audits and disputes); key tax law developments and new requirements (in particular developments in the taxation of the digital economy); and key sources of estimation uncertainty (in particular the recognition of deferred tax assets).

Financial reporting

As I have previously noted, 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 2018, the Trent 900 and Trent 1000 exceptional items have again highlighted these complexities and the need for well-considered judgements on the appropriate accounting for the costs of meeting our obligations under our long-term agreements.

The Group has an established process for preparing the Consolidated Financial Statements, including:

- maintenance of internal financial controls – see page 79;
- monitoring of developments in financial reporting;
- review of financial statements by local management prior to submission to group finance for further review and explanations;
- certification by management of each business unit;
- preparation and review of consolidation adjustments;
- review of the draft Consolidated Financial Statements prior to submission to the Committee and the Board; and
- review of the Consolidated Financial Statements by the Committee and the Board together with reports from management and the auditors on significant judgements, estimates, changes in accounting policies and any other relevant matters.

The scope of the external audit is set out in PwC's report on page 187.

A summary of the principal matters we considered in respect of the 2018 Consolidated Financial Statements is set out in the table on page 78.

Fair, balanced and understandable

Since the year end, we have reviewed the form and content of the Company's 2018 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 Executive Team and PwC) 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 programme; and (iii) trends, in particular, the impact of individually significant items.

Areas of focus for the 2018 Financial Statements

Key issue	**Matters considered**	**Outcome**
Adoption of IFRS 15 *Revenue from Contracts with Customers*	The embedding of the significant changes, most significantly in Civil Aerospace, and the resolution of additional matters arising, in particular, how changes in estimates on long-term aftermarket contracts impact in the reported results The appropriateness of the long-term planning rate that is used to translate transactions in long-term contracts The appropriateness of the disclosures in the financial statements – see pages 113 to 116	We were satisfied that: — while additional matters arose on transferring the new IFRS 15 processes to a live environment, these have been resolved satisfactorily; — the long-term planning rate remains appropriate; and — the required disclosures are included in the Financial Statements.
Adoption of IFRS 9 *Financial Instruments*	The appropriateness of the disclosures in the financial statements – see page 113	We were satisfied that the required disclosures are included in the Financial Statements.
Accounting for Trent 1000 in-service issues	Development of a methodology for identifying abnormal costs of wasted material, labour and other resources and the application of this to the Trent 1000 – see page 115	We were satisfied that the methodology adopted appropriately reflects the nature of the costs and that these abnormal costs should be excluded from the performance.
Accounting for the impact of the decision to shorten the Airbus A380 programme on the Trent 900 programme	The consequences on existing contractual arrangements with both customers and suppliers The potential impairment of programme assets	We were satisfied, that, while at this early stage estimates were necessary, the impacts have been appropriately reflected in the results and that these should be excluded from the underlying performance.
Consideration of onerous contracts	Review of procedures to assess whether contracts are onerous, including the consequential impact of the Trent 1000 and Trent 900 issues above	We were satisfied that an appropriate assessment had been made and that appropriate provision had been made for contracts identified as onerous.
Classification of restructuring costs	The criteria for excluding certain costs from the underlying results and whether the costs meet this criteria – see page 124	We reviewed the criteria in the context of the ongoing restructuring programme and were satisfied that they are appropriate and have been consistently applied.
Finalisation of accounting of the acquisition of ITP Aero	The update of the fair value of the assets and liabilities acquired, which were provisional in the 2017 Consolidated Financial Statements	We were satisfied that the updated values have been prepared appropriately, including third-party valuations where necessary.
Accounting for business disposals	Treatment of contingent consideration on the disposal of L'Orange – see page 165	We reviewed the assessment of the potential contingent consideration and were satisfied that there are currently no indications that it will be significant.
	Classification of the Commercial Marine business as a disposal group held for sale to be completed in 2019 – see page 166	We reviewed the anticipated disposal in the context of the definitions within IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* and were satisfied that it is appropriately classified.
Classification of joint arrangements	A review of the classification of joint arrangements in accordance with IFRS 10 *Consolidated Financial Statements* and IFRS 11 *Joint Arrangements*	The review resulted in the reclassification of a number of joint arrangements. However, we were satisfied that these were not significant individually or in aggregate.
The sale of engines to joint ventures	Basis for assessing the selling price – see page 163	We were satisfied that the price represents the fair value of the engines.
Deferred tax assets (DTAs)	Basis for recognition of DTAs arising from tax losses and advance corporation tax in the UK	Based on the forecasts of the relevant Group entities, we were satisfied that the treatment is appropriate.
Implementation of IFRS 16 *Leases*	The progress to implement IFRS 16 in 2019 and the preparation of the disclosures of the impact of the change for 2018 – see page 123	We were satisfied that the judgements and estimates made are appropriate and consistent with the new requirements; that the disclosures of the impact in the Financial Statements are appropriate; and that the Group has systems and processes in place to report on the new basis in 2019.

Risk and control environment

Assessment of principal risks

All risks are managed through a risk management system (RMS described on page 50) in accordance with policies and guidance approved by the Board. On behalf of the Board, the Committee monitors the RMS, including continued developments and improvements. We continue to pay particular attention to the assessment and management of risks at remote sites. The processes are designed to identify and manage, rather than eliminate, the risk of failure to achieve our business objectives.

In managing the identified risks, judgement is necessary to:

— evaluate the risks facing the Group in achieving its objectives;
— determine the risks that are considered acceptable;
— determine the likelihood of those risks materialising;
— assess the Group's ability to reduce the impact of risks that do materialise; and
— ensure the costs of operating particular controls are proportionate to the benefit provided.

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 Group had been undertaken.

The principal risks arising are described on pages 51 to 54. These formed a key element of our assessment of the going concern and viability statements, described further below.

Internal control

The Board has overall responsibility to 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 is based on business best practice and 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 have reviewed controls over the Group's principal risks and the key risks and critical processes in each of the Group's businesses. In addition, both the business audit committees and this Committee consider the auditor's observations on the control environment.

During 2018, we reviewed the results of attestation and testing performed by the internal control and internal audit teams to confirm the effective operation of key financial controls across the Group, with an improving trend in the results compared to previous years. We also reviewed the progress of the programme to strengthen financial reporting and compliance controls to meet our DPA commitments, including the work to document and assess the process risks and design of controls in our key finance processes. We have made progress in embedding a financial controls awareness and culture with additional training and guidance provided to our finance teams. Opportunities to further strengthen and automate the financial controls have been identified and will be addressed in the 2019 work plan. These focus on strengthening the supervisory review and oversight controls that provide assurance over the detailed key financial controls, and enhancing and embedding standardised IT controls to operate consistently over all of our key financial systems. We will pay particular attention to ensuring that the control environment is maintained during the restructuring activities.

We have conducted a review of the effectiveness of the Group's risk management and internal control systems, including those relating to the financial reporting process, in accordance with the Code. Where opportunities for improvement were identified, action plans have been put in place and progress is monitored by the Committee. We consider that our review of the risk management and internal control systems, in place throughout 2018, meet the requirements of the Code and the DTR.

Going concern and viability statements

Having regard to the net liabilities of £1,052m on the Group's 2018 balance sheet, we paid particular attention to these assessments. We reviewed the processes and assumptions underlying the statements set out on page 55, considering in particular:

— the Group's forecast funding position over the next five years;
— the forecasts for material subsidiaries making up this position;
— 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 could be taken 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.

2018 Principal risks

As set out on page 50, the Board allocated certain principal risks to the Committee and we considered these in detail through the year. 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 November, the chief information officer updated the Committee on business continuity risks related to the Group's key IT systems. In December, we reviewed plans to mitigate business continuity risks related to the Group's supply chain and received an update on the business continuity exercises that the Civil Aerospace business had undertaken. We also received updates on investment plans to help to reduce these risks.

IT vulnerability

In May and November, the chief information officer and the cyber security director updated the Committee on IT vulnerability risks, including the increasingly hostile landscape that the Group is experiencing.

We also reviewed the cyber security strategy, the resources and investments required to maintain resilience and the potential risks that need to be managed during the restructuring activities.

Market and financial shock

In July, we reviewed potential key risks, focusing particularly on liquidity and credit rating risks and how they are managed by the financial risk committee.

We satisfied ourselves that any market or financial shock that could result from Brexit has been included in the scenario analysis on which the viability statement is based.

Our risk management system

We satisfied ourselves that appropriate progress had been made during the year to strengthen the RMS, as described on page 50. We also identified opportunities to further improve the RMS, for example the requirement of the revised Code to consider emerging risks and how the Group's horizon scanning activities can be applied further.

Internal audit

The director of internal audit regularly reports to the Committee:

- **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.
- **Annually** – compliance with expenses policies for the directors and the Executive Team; and an internal audit work plan for the following year.
- **As required** – the results of audits on advisor processes (including payments) and offset and monitoring, as part of the Group's response to the DPAs.

At least once a year, the Committee meets the director of internal audit privately to discuss: the activities, findings and resolution of control weaknesses; progress against the agreed plan; and the resourcing of the department. Specific topics discussed in 2018 included: process and control design; compliance to process; data security and integrity; project management; and accountability. I also meet the director of internal audit before each meeting and on an ad-hoc basis throughout the year, as do other members of the Committee.

We continue to focus on the nature and number of issues raised by internal audit and the time to complete the related actions. While we are pleased to observe a continued reduction in the time to complete actions, we noted that the underlying root causes remain largely unchanged. These areas will be a focus for the improved systems and processes being designed to achieve the restructuring plans. The future work 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. There has been increased turnover in resource in the second half of 2018 and we discussed plans to maintain sufficient resource.

Based on the reports and discussion, we are satisfied that the scope, extent and effectiveness of internal audit work are appropriate for the Group and that there is an appropriate plan for ensuring that this continues to be the case, particularly through the restructuring activities.

External audit

Audit transition and the 2018 audit

Following the audit tender process in 2016, PwC was formally appointed as the Company's auditor at the 2018 AGM. We assessed PwC's qualifications, expertise and resources, independence and the effectiveness of the external audit process.

The Committee reviewed the quality of the external audit throughout the year and considered the performance of PwC, taking into account the Committee's own assessment and feedback, the results of a survey of senior finance personnel across the Group focusing on a range of factors we considered relevant to audit quality, feedback from the auditors on their performance against their own performance objectives and the firm-wide audit quality inspection report issued by the FRC in June 2018.

Based on these reviews, the Committee concluded that there had been appropriate focus and challenge by PwC on the primary areas of the audit and that they had applied robust challenge and scepticism throughout the audit. Consequently, as noted above, the Committee has recommended to the Board that they be reappointed at the AGM in May 2019.

During the year significant time has been spent on transition activities, including:

- shadowing KPMG through the 2017 year-end process;
- planning workshops held with Group and business teams;
- review of KPMG's working papers; and
- detailed walkthrough tests of key processes and controls.

In May 2018, PwC presented its audit plan, which identified its assessment of the key audit risks and the proposed scope of audit work. We agreed the approach and scope to be undertaken. Subsequently, an updated plan was agreed in November 2018, building on the work undertaken at the half-year and other transition activities.

Key risks and the audit approach to these risks are discussed in the Independent Auditor's Report (pages 186 to 196), which also highlights the other significant risks that PwC drew to our attention.

As part of the reporting of the half-year and full-year results, in July 2018 and February 2019, PwC 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. Where effective to do so, PwC also reported on its assessment of the Group's controls.

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

During 2018, the Audit Quality Review team (AQRT) of the FRC conducted a review of KPMG's audit of the Group's Financial Statements for the year ended 31 December 2017. In January 2019, the AQRT provided its final report to me. The report highlighted two areas of estimation risk which we discussed initially with PwC in January 2019 and again in February 2019 as part of the final audit discussions.

Non-audit services

In order to safeguard the auditor's independence and objectivity, and in accordance with the FRC's Ethical Standard, we do not engage PwC 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 PwC are set out in note 7 to the Consolidated Financial Statements. All proposed services must be pre-approved in accordance with the policy which is reviewed and approved annually. Above defined levels, my approval is also required before PwC is engaged. Quarterly, we also review the non-audit fees charged by PwC. In addition, in 2018, we continued to review fees charged by KPMG until they had completed the 2017 audits of all significant subsidiary companies.

Non-audit related fees paid to the auditor during the year were £0.9m (including £0.5m relating to the review of the half-year results) representing 10% (2017 (KPMG): 24%) of the audit fee. Our annual review of the external auditor takes into account the nature and level of all services provided.

Based on our review of the services provided by PwC 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 PwC.

Compliance

During 2018, 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 monitoring:

— the finance transformation programme (see page 17);
— the impact of the restructuring activities on the risk and internal control environment;
— the continued improvements to the internal control systems, with particular focus on the supervisory review and oversight controls; and
— in light of the current environment, a continuing focus on the Group's response to cyber security risks.

In addition to the continuing oversight by the Safety & Ethics Committee of the ethics and compliance programme (see page 101), we will continue to monitor actions relating to risk management, internal controls and other matters relevant to the Committee that arise out of Lord Gold's recommendations and the DPAs.

Lewis Booth
Chairman of the Audit Committee

REMUNERATION COMMITTEE REPORT

RUTH CAIRNIE
CHAIRMAN OF THE REMUNERATION COMMITTEE

"Our policy is designed to support the strategic focus of the Company as it undergoes its transformation. We remain satisfied that the policy works well."

Key highlights

- First LTIP payout for four years
- Business performance drives bonus above target
- Consideration of revised Code

Introduction

I am pleased to present my report as Chair of the Remuneration Committee, outlining what we have achieved in the year.

Our remuneration policy

Our policy is designed to support the strategic focus of the Company as it undergoes its industrial transformation to new engine models and greatly increased volumes. This is reflected in the key policy themes of transformation, competitiveness, alignment with shareholders and simplicity, with a strong emphasis on ramp-up in cash flow generation as the most important financial metric. We remain satisfied that the policy works well.

2018 outturns

In terms of customer delivery, 2018 was a challenging year especially in dealing with the issues on the Trent 1000 engines. In addition, our delivery of widebody engines fell short of the significant ramp-up we had targeted, in part due to industry-wide supply chain constraints. We also had delivery issues in the Defence and Power Systems businesses. As a result, our customer delivery metric in the annual bonus did not hit the base level and no bonus element was earned, reflecting that the experience of some of our customers was disappointing in 2018.

Our other non-financial metric in our bonus plan is employee engagement, where in 2018 we maintained the same level as in 2017. As a result, the bonus outcome was at the base level; year-on-year improvement would have been required for on-target performance, which was known to be a challenging target given the significant restructuring activity in 2018 and the impact this has had across the organisation.

On our key financial bonus metrics, both profit and cash finished ahead of target. Our operational cash flow increased significantly in 2018 and has positioned us well to achieve at least £1bn of free cash flow by 2020. Similarly underlying profit increased, with strong performances from all businesses despite the challenges arising from Trent 1000 in-service issues.

Underlying profit does not include the accounting impacts of non-operational factors. In particular it excludes our US dollar hedge book valuation adjustment, which is a non-cash consequence of managing our foreign exchange risk. This year, there were also several exceptional charges not included in underlying profit, as detailed on page 124. After due consideration, the Committee concluded that underlying profit remained the appropriate basis for our bonus calculation, in line with the normal definitions we use.

In determining the outcomes for bonus purposes, the Committee continues rigorously to examine the quality of both profit and cash, ensuring that executives are being rewarded for genuine operational improvements. The Committee also reviewed the resulting outturn in the round, to assess whether it was a fair reflection of performance over the year, taking into account a number of factors. While the underlying profit measure excludes the exceptional Trent 1000 charge, the free cash flow measure, which this year had a higher weighting of 50%, includes the unplanned costs incurred in the year. The Trent 1000 issues also contributed to the zero outturn for the customer delivery metric, as described above. The in-service issues therefore had a significant impact on the bonus outturn, and the Committee did not consider it appropriate to make any further adjustment. The Committee also recognised the way in which the organisation responded to the challenge, both in terms of mitigating actions and progress on long-term solutions.

Overall it was felt than an outcome of 56% of maximum was reflective of the Group's progress and performance during the year.

The targets for the 2016 long term incentive plan (LTIP) have been met and as a result awards will vest. This is the first time in four years that LTIP awards have vested, and it reflects the actions taken by Warren and his team to improve business performance, particularly a significant growth in cash generation. As our LTIP extends to wider management, I am pleased that the significant efforts of this group will be recognised. In line with the agreement with shareholders in 2016 to modify the EPS hurdle measure, Warren's award is capped at 150% of salary.

2019 salary review and incentives

The Committee has reviewed the salary levels of the Executive Directors and concluded that no increases will be made for 2019.

For the bonus for 2019 the same financial and non-financial metrics will be retained; however, we will change how we measure the non-financial elements. In relation to customers, we want to recognise that there are a number of different ways that our customers experience our performance, so we have developed a balanced scorecard of metrics for each business, that better reflects the broader aspects of performance in addition to on-time delivery, which has been our only measure to date. For example, in Civil Aerospace we will include a measure of aircraft on ground (AOG) as this is clearly a critical driver of customer satisfaction.

On employee engagement we are moving to a simpler employee survey tool in 2019, the Gallup Q12 survey. This survey aligns better to the key levers that will drive cultural change. We are not making any changes to the design of the LTIP for 2019 as we believe that the current design and measures continue to align with our strategic priorities.

The revised Code

During 2018, the Committee has considered the revised corporate governance requirements relevant to remuneration. We will use the review of our remuneration policy in 2019, for approval at the 2020 AGM, as our main opportunity to assess how we will take the revised Code into account.

In 2019, the Committee will place an increased focus on the linkage between our culture and reward, to ensure that incentives drive behaviours consistent with that culture. Part of the personal element of our bonus plan is already dependent on demonstration of the Company behaviours and values. This has been a strong focus for the Executive Team in 2018 and will continue to be a focus across the organisation in 2019. We have chosen to publish our CEO pay ratio versus UK employees for a second year, in advance of it becoming a mandatory requirement, as we recognise the importance of being open and transparent about executive pay.

As we review our policy during 2019, we will be giving further consideration to our post-employment shareholding policy and pensions, mindful of shareholders' views in these areas.

The revised Code emphasises judgement and discretion. As I have outlined in my report in previous years, the Committee rigorously reviews incentive outturns to ensure that they reflect business performance. We have a history of applying discretion to adjust awards to ensure outcomes reflect the broader context, including shareholder experience. The Committee also reviews the underlying performance of the business on potential outcomes of incentives on a regular basis to ensure that, before and during the life of awards, an ongoing level of scrutiny of performance and reward is maintained.

UK gender pay

We are now in the second year of publishing our gender pay gap and our results this year reflect a similar position to the previous year. As with many engineering organisations, we need to increase the number of women at all levels in the Group. We have global targets to improve the representation of women and have increased the number of women in our succession and talent pipelines. We continue to focus on encouraging young women to see STEM as a future career, but we recognise that there is more to do.

Ruth Cairnie
Chairman of the Remuneration Committee

Membership and operation of the Committee

In 2018, members of the Committee were Ruth Cairnie, Lewis Booth, Sir Frank Chapman and Sir Kevin Smith. Following a review of the Board committees' composition, Sir Frank Chapman stepped down from the Committee at the end of the year and Beverly Goulet joined the Committee from 1 January 2019. All members of the Committee are independent Non-Executive Directors. Our biographies are on pages 60 and 61 and our meeting attendance is shown on page 63.

The Committee's responsibilities are outlined in its terms of reference which can be found at www.rolls-royce.com. We review these annually and refer them to the Board for approval. This year, we have made changes to our remit to ensure it aligns with the principles of the revised Code.

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 were present during discussion of his or her own remuneration package. The Committee is supported by the Company Secretary, Harry Holt – Chief People Officer and Natasha Rice – People Director, Performance and Reward.

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 £73,415 (2017: £126,750). Fees are based on a time and materials basis. 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.

Committee evaluation review

This year, Belinda Hudson Limited (BHL) was appointed to undertake a review of the Board and its Committees; the review is discussed in greater detail on page 70. The Committee was pleased that the review concluded that it is operating effectively with the members providing strong views and robust challenge to support management in this area. It was particularly encouraging that BHL recognised the Committee for adopting current best practice in all respects and being an early adopter of developing best practice. The Committee discussed the review in December and agreed to continue the approach of open dialogue and innovative thinking into our review of the remuneration policy and our response to the revised Code in 2019.

Principal responsibilities

- Determine the remuneration policy for the Executive Directors and set the remuneration for the Chairman, the Executive Directors and Senior Management.
- Review workforce remuneration and related policies and the alignment of incentives and rewards with our culture.
- 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 2019

In 2019, in addition to our regular activities we will:

- Review the remuneration policy to ensure that it continues to support the business strategy and is aligned to the broader executive remuneration landscape, including the revised Code.
- Continue to focus on incentive measures and targets to ensure they remain aligned with performance and strategy.
- Develop our approach to understanding remuneration across the wider workforce and how this should be taken into account by the Committee in setting executive remuneration.

Remuneration Committee focus during 2018

Area of focus	Matters considered	Outcome
Base salaries	Review of base salaries in accordance with the remuneration policy and the broader employee context	The Committee reviewed the salary levels of the Executive Directors and concluded that no increases would be made in 2018.
Annual bonus	2018 bonus – review of performance against the 2018 bonus targets	Warren East and Stephen Daintith received a bonus of 60% of maximum. 40% of the awards were deferred into shares.
	2019 bonus – review of measures and targets to ensure continued alignment to strategy	The Committee agreed that for the 2019 bonus plan the same measures would apply as in 2018: — Profit – 25% — Cash – 50% — Customer satisfaction – 12.5% — Employee engagement – 12.5% 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.
Long-term incentive plan	2016 PSP – review of achievement of performance measures	The 2016 awards will vest in March 2019 capped at 150% of salary for the Chief Executive and 130% of salary for other Executive Directors, prior to the impact of share price growth and dividends.
	2019 LTIP – setting targets that ensure significant stretch	For 2019 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. The maximum opportunities remain at 250% for the Chief Executive and 225% for other Executive Directors.
Revised Code requirements	Review of the revised Code and impacts for the Committee	The Committee undertook a detailed review of the revised Code and approved appropriate changes to its terms of reference at its meeting in December. As part of this review, the Committee's remit has been revised to ensure the remuneration and policies applying to the wider workforce are taken into account by the Committee in setting executive remuneration. The Committee is already periodically briefed by the Chief People Officer and the People Director, Performance & Reward on topics relating to workforce practices, such as gender pay, employee engagement and wider employee pay and conditions. However it was determined that during 2019 this would be supplemented by an additional meeting to provide the Committee with a more in-depth briefing on overall workforce pay and practices. During the year, the revised Code provisions relating to executive remuneration were considered. A number of the new provisions such as holding periods and the use of judgement and discretion already form part of the remuneration policy and the Committee's approach. We will present a new policy for approval at the 2020 AGM, and during 2019 will consult with shareholders on any proposed changes, including areas such as post-employment shareholding requirements and executive pensions.

Summary of our remuneration policy

Fixed pay

- Base salary
- Benefits
- Pension

Variable pay

Annual bonus

80% Group performance + 20% individual performance

75% Financial
- Profit
- Cash

25% Non-financial
- Customer delivery
- Employee engagement

40% deferral for 2 years

Long-term incentive plan

60% CPS | 20% EPS | 20% TSR

3-year performance period plus 2-year holding period

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 Our Code; or individual gross misconduct. Clawback will apply until three years after the release of shares.

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.

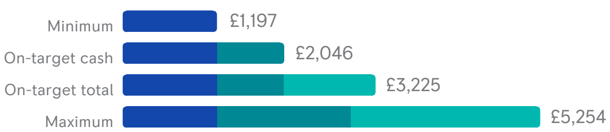
There are four key themes that underpin the policy:

Simplification | Stewardship | Talent | Supporting transformation

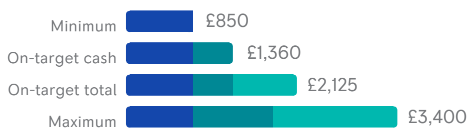
These themes continue to align to our organisational strategy and our reward programmes support them through a combination of salary, benefits, annual bonus and long-term incentives, underpinned by stretching performance measures and appropriate award levels. The full policy can be found in the 2016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

Remuneration policy – worked examples for 2019

Chief Executive £000



Chief Financial Officer £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.

Shareholder voting

The remuneration policy was last approved by shareholders at our AGM on 4 May 2017. The remuneration report was last approved by shareholders at our AGM on 3 May 2018. Details of voting are shown below.

	For		Against		Withheld [1]
	Number of votes	%	Number of votes	%	Number of votes
Approval of the Directors' remuneration policy (4 May 2017)	1,357,109,903	95.79	59,613,198	4.21	2,505,008
Approval of the Directors' remuneration report (3 May 2018)	1,390,091,256	98.87	15,919,095	1.13	3,639,984

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

Executive Directors' remuneration

The following pages 86 to 94 show how we have applied our remuneration policy during 2018 and disclose all elements of remuneration received by our Executive Directors. Details of remuneration received by our Non-Executive Directors during 2018 can be found on pages 94 and 95.

Executive Directors' single figure of remuneration (audited)

	Salary (a) [1] £000		Benefits (b) £000		Bonus (c) £000		Long-term incentives (d) [2] £000		Pension (e) £000		Total remuneration £000	
	2018	2017	**2018**	2017	**2018**	2017	**2018**	2017	**2018**	2017	**2018**	2017
Executive Directors												
Warren East	**944**	931	**17**	17	**1,012**	1,150	**1,734**	–	**236**	233	**3,943**	2,331
Stephen Daintith [3]	**680**	499	**19**	15	**608**	565	**1,644**	1,259	**150**	110	**3,101**	2,448

1 Neither Warren East nor Stephen Daintith received a salary increase in 2018. The last increase made to Warren East was in September 2017.
2 The average share price for the three months to 31 December 2018 has been used to calculate the LTIP value (as the actual value is not known at the date of signing this report).
3 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 91. The remaining buy-out awards will vest in 2019 and have been included in the table above as they are both based on performance up to 31 December 2018.

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 the salaries of Warren East and Stephen Daintith in early 2019 and agreed there would be no increases for 2019.

Executive Director	Base salary as at 1 March 2019	Base salary as at 1 March 2018
Warren East	**£943,500**	£943,500
Stephen Daintith	**£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 2018 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	
Executive Directors	**2018**	2017	**2018**	2017	**2018**	2017	**2018**	2017	**2018**	2017	**2018**	2017
Warren East	**15**	15	**–**	–	**2**	2	**–**	–	**–**	–	**17**	17
Stephen Daintith	**17**	13	**–**	–	**2**	1	**–**	1	**–**	–	**19**	15

c) 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

2018 annual bonus outturn

The Committee reviewed the 2018 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	25%	50%	12.5%	12.5%	100%
Base (25%)	£256m	£426m	85%	75	
Target (50%)	£356m	£576m	92%	76	
Maximum (100%)	£556m	£876m	100%	80	
2018 performance [1]	£400m	£727m	83%	75	
% of maximum	61%	75%	0%	25%	56%
Adjusted % of maximum [2]					**56%**

[1] Adjusted to exclude ITP Aero, non-core businesses, FX, exceptional items and the impact of accounting effects.
[2] The Committee reviewed the Group and business unit outturns in the round, based on assessment of overall underlying performance during the year and the experience of shareholders. Factors taken into account include the quality of financial performance and the manner in which the Trent 1000 issues have been managed.

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

Definitions used for performance measures:

Profit – underlying profit before tax that is reported by the Group for 2018, 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 engagement survey. 57% of our people participated in our survey in 2018 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:

— deliver Group revenue, profit and cash for 2018 and key operational and entry into service targets, ensuring a clear path to £1bn free cash flow by 2020 and beyond;

— address in-service quality problems to rebuild customer confidence and trust;

— deliver the next phase of restructuring, including headcount, a simpler structure and simplification of portfolio;

— deliver culture change through changing behaviours, new leadership model;

— drive M&A disposals to deliver targeted disposal proceeds in 2018;

— deliver a new finance operating model; and

— accelerate progress on diversity and HSE.

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
Profit and cash exceeded budget expectation despite challenges.	Core free cashflow delivered ahead of budget, business positioned well to achieve £1bn by 2020.
Operational disruption of Trent 1000 has been managed and a permanent solution identified.	Clear goals established on cashflow per share and cash returns on invested capital, linked to key business drivers; compelling Group commitments for the mid-term established and communicated.
New, simpler organisation structure launched with three empowered businesses, leaner head office and Group Business Services established.	Led the restructuring programme; good progress delivered and real momentum for change.
One third of total headcount reduction target delivered in 2018.	A new driver-based budgeting process launched as a key foundation for the new finance model.
Implemented a simpler management grading structure and new behaviour framework.	Strengthened the finance function with focus on talent and improving capability.
D&I targets and plans progressed across the Group; Group governance strengthened; increased focus on HSE performance across the organisation with progress made but more to do.	Balance sheet strengthened with improved trading and disposal of L'Orange and divestment of Commercial Marine nearing completion.

2018 annual bonus outturn (paid in March 2019)

	Group performance (% of maximum)	Individual performance (% of maximum)	Total bonus (% of maximum)	Total bonus (% of salary)
Warren East	56%	75%	60%	107%
Stephen Daintith	56%	75%	60%	89%

d) Long-term incentives (audited)

Conditional share awards are made to Executive Directors under the LTIP to reward the execution and development of the business strategy over a multi-year period. The conditional shares are then subject to a further two-year holding period.

LTIP awards made in March 2018

The performance targets for awards made in March 2018 are shown below. Performance will be measured over three years to 31 December 2020.

	CPS (60%)	EPS (20%)	Relative TSR (20%)
Threshold (20% vesting)	95p	73p	Median
Mid (50% vesting)	126p	86p	Between median and upper quartile
Maximum (100% vesting)	158p	103p	Upper quartile

	Number of shares	% of salary	Face value of award £000	Performance period end date
Warren East	275,083	250	2,359	31 December 2020
Stephen Daintith	178,432	225	1,530	31 December 2020

PSP awards vesting in March 2019

The following sets out details in respect of the March 2016 PSP award (made under the 2014 remuneration policy) for which the final year of performance was the 2018 financial year. Subject to performance conditions, the vesting date of these awards is March 2019, three years after the awards were made.

	Targets for 2017-2018 period	Performance against targets
EPS growth (hurdle) [1]	Awards will vest if EPS growth exceeds the OECD index of consumer prices. Awards will lapse if the hurdle is not met.	Hurdle achieved [2]
Aggregate CPS	Aggregate CPS over three-year period of less than 10p – zero vesting. Aggregate CPS over three-year period of 50p – 100% vesting.	Aggregate CPS performance over three-year period of 51p.
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 between median and upper quartile, generating a 1.4 multiplier.
Outturn		The 2016 awards will vest in March 2019 capped at 150% of salary for the CEO and 130% of salary for other Executive Directors

[1] As disclosed in the 2015 Annual Report, the EPS hurdle was measured over the period 2017 and 2018. In recognition of this change, the maximum vesting level was reduced from 180% of salary to a cap of 150% for the Chief Executive and from 150% to 130% of salary for other Executive Directors, prior to the impact of share price growth and dividends.

[2] Over the performance period of the PSP award, the Company was required to change from accounting under IAS 18 to IFRS 15. As extensively disclosed, this had a significant effect on reported profit and EPS. Audited results are available under IAS 18 for 2016 and 2017, and under IFRS 15 for 2017 and 2018. We have therefore tested for achievement of the hurdle for each performance year separately. Between 2016 and 2017, under IAS 18, EPS grew by 22.6% (from 30.1p to 36.8p). Compared to OECD consumer price inflation of 2.3%. Between 2017 and 2018, under IFRS 15, EPS grew 242% from (1.4p) to 3p compared to OECD consumer price inflation of 2.4%. The hurdle was therefore considered to be met.

Outstanding PSP awards made to Stephen Daintith in May 2017

The remaining buy-out awards made to Stephen Daintith will vest in March and October 2019. As previously disclosed, they were based on the 2016 PSP and, as shown above, the performance conditions have been met and the awards will vest at 130% of grant value.

e) 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. The cash allowance is generally calculated as equivalent to the cost of the pension contributions after allowing for National Insurance costs. However, some historic levels of cash allowance will continue to be honoured. 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 are members of this plan. The Committee will consider the requirements of the revised Code, to align pension contributions for newly-hired Executive Directors to the wider workforce as part of its policy review in 2019.

Other (audited)

PSP awards vesting in March 2019

Colin Smith stepped down from the Board on 4 May 2017 and left the Group on 31 May 2017. He retained pro-rated PSP awards. In accordance with the rules of the Performance Share Plan, 48% of the 2016 PSP award will vest on 1 March 2019 and Colin will receive 38,415 shares worth around £422,000 (based on the average share price for the three months to 31 December 2018). Colin has no further outstanding awards.

David Smith left the Group on 28 February 2017 and retained pro-rated PSP awards. In accordance with the rules of the Performance Share Plan, 39% of the 2016 PSP award will vest on 1 March 2019 and David will receive 31,005 shares worth around £340,000 (based on the average share price for the three months to 31 December 2018). David has no further outstanding awards.

Payments to past directors

A short-term agreement was put in place between the Company and Colin Smith, for Colin to represent the Company in an ambassadorial capacity for a maximum of 15 days to the end of 2017 (which was extended to 21.5 days) and 35 days to the end of 2018. Total payments of £114,000 have been made under this agreement. This arrangement has been extended into 2019 up to a maximum of 35 days.

Payments for loss of office

As set out in last year's report, Colin Smith, having served four months of his 12 month's notice, was entitled to receive payments of £469,000 in lieu of notice payable to him in eight instalments. Seven of these instalments were paid to Colin in 2017 and the final instalment of £49,000 was paid to him in January 2018.

Implementation of remuneration policy in 2019

Base salary	There will be no change to base salary for 2019; base salaries remain as: — Warren East – £943,500 — Stephen Daintith – £680,000
Benefits	There will be no change to our approach to benefits in 2019, 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 2019. Pension arrangements will be: — Warren East: cash allowance of 25% of salary — Stephen Daintith: cash allowance of 22% of salary In the event of any new appointment, the Committee will be mindful of shareholder views and relativity to the wider workforce.
Annual bonus	For 2019, 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 2019, the Group measures and weightings will be unchanged. Profit (25%) – Free cash flow (50%) – Customer satisfaction (12.5%) – Employee engagement (12.5%) Targets are commercially sensitive and will be disclosed following assessment of performance. Maximum opportunities will remain unchanged: — Chief Executive – 180% of salary — Other Executive Directors – 150% of salary
LTIP awards	For awards to be granted in 2019 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 2021. Performance targets will be:

	CPS	EPS IFRS 15 basis	Relative TSR
Threshold (20% vesting)	112p	81p	Median
Mid (50% vesting)	150p	95p	Between median and upper quartile
Maximum (100% vesting)	187p	109p	Upper quartile

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.

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 2018	27 February 2019	31 December 2018	31 December 2018	31 December 2018	31 December 2018
Warren East	35,540	35,680	101,039	164,202	557,037	1,264
Stephen Daintith	70,937	71,320	26,374	149,753	364,979	925

Executive Directors' interests in vested and unvested shares – changes in 2018 (audited)

Warren East	31 December 2017	Granted during the year	Vested awards	Lapsed awards	31 December 2018	Market price at date of award (p)	Date of grant	Vesting Date/ Lapse Date	Market price at vesting (p)
PSP 2015	126,643	–	–	126,643	–	730.00	01/09/15	01/09/18	n/a
PSP 2016	164,202	–	–	–	164,202	676.00	01/03/16	01/03/19	–
Total	**290,845**	**–**	**–**	**126,643**	**164,202**				
LTIP 2017	281,954	–	–	–	281,954	820.17	05/05/17	05/05/20	–
LTIP 2018	–	275,083	–	–	275,083	857.47	08/03/18	08/03/21	–
Total	**281,594**	**275,083**	**–**	**–**	**557,037**				
Deferred share bonus (2016)	47,398	–	–	–	47,398	772.83	01/03/17	01/03/19	–
Deferred share bonus (2017)	–	53,641	–	–	53,641	857.47	08/03/18	01/03/20	–
Total	**47,398**	**53,641**	**–**	**–**	**101,039**				
Sharesave (options) [1]	1,264	–	–	–	**1,264**	616.80	12/10/15	01/02/21	–

Stephen Daintith	31 December 2017	Granted during the year	Vested awards	Lapsed awards	31 December 2018	Market price at date of award (p)	Date of grant	Date of vesting	Market price at vesting (p)
PSP 2017 (buy-out award) [2]	70,027	–	–	–	70,027	754.70	05/05/17	01/03/19	–
PSP 2017 (buy-out award) [2]	79,726	–	–	–	79,726	754.70	05/05/17	31/10/19	–
Total	**149,753**	**–**	**–**	**–**	**149,753**				
LTIP 2017	186,547	–	–	–	186,547	820.17	05/05/17	05/05/20	–
LTIP 2018	–	178,342	–	–	178,432	857.47	08/03/18	08/03/21	–
Total	**186,547**	**178,342**	**–**	**–**	**364,979**				
Deferred share bonus (2017)	–	26,374	–	–	**26,374**	857.47	08/03/18	01/03/20	–
Sharesave (options) [1]	925	–	–	–	**925**	758.40	13/10/17	01/02/21	–

1 For Sharesave, the price shown is the exercise price which was 85% of the market price at the date of the award.
2 The grant price for PSP awards made to Stephen Daintith was the average closing mid-market price calculated over one month, up to 22 September 2016 (the date that his appointment to Rolls-Royce was announced).

Shareholding requirement (audited)

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 61% and 68% respectively *. As part of our 2019 policy review we will be developing post-employment shareholding requirements in line with the revised Code requirement.

* The percentage of the requirement was calculated by reference to the average share price, over the three months to 31 December 2018, and salary as at the date of the last grant on 8 March 2018. Unvested PSP awards, LTIP awards and Sharesave options are not included in this calculation.

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 ten-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 2017 to 2018.

Change in remuneration

	Salary	Benefits	Annual bonus
Chief Executive	0%	0%	-12%
UK employees average [1]	-2.06%	-9.86%	-12%

[1] UK employees were chosen as a comparator group in order to avoid the impact of exchange rate movements over the year. UK employees including apprentices, graduates and interns, make up 43% of the total employee population. The decline in the year reflects the significant reduction in senior manager headcount.

Chief Executive pay ratio

The Committee is mindful of the relationship between the remuneration of the Chief Executive and the wider employee population. This is the second year that we have voluntarily published our CEO pay ratio and we have taken into account the new regulations in how this has been approached.

We have used Method A in determining the ratio, using the full-time equivalent total remuneration of all UK employees. This has led to us including additional groups of employees in the calculation this year, including graduates, apprentices and interns.

The ratio has increased significantly in 2018 due to the vesting of long term incentives (compared to no vesting in 2017) and a small impact of including additional employees as noted above.

	CEO pay ratio (total remuneration)	CEO pay ratio (salary only)
2018	**72:1**	**21.1**
2017	41:1	21.1

The ratios shown above reflect average remuneration for the Chief Executive and UK employees.

CEO pay ratio quartiles (total remuneration)

25th	**Median**	**75th**
92:1	77:1	72:1

In terms of the wider workforce:

- all employees participate in a bonus plan; and
- we encourage all employees to join our Sharesave plan, launched every two years. For our most recent launch in 2017, around 50% of our employees joined the plan, sharing in 14 million shares/stock appreciation rights.

Relative importance of 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)

Group employment costs (£m)

(Note 8 – Employee Information)

* Value of C Shares redeemed during the year

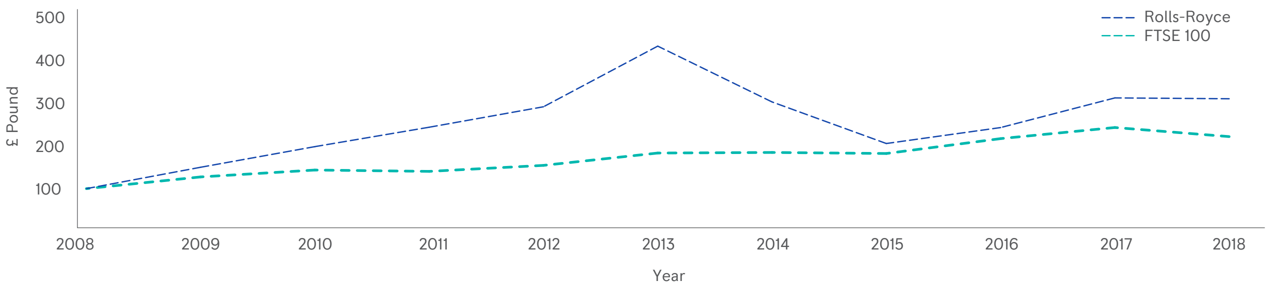
Chief Executive pay

Year	Chief Executive [1]	Single figure of total remuneration £000	Annual bonus as a % of maximum	LTIP as a % of maximum
2018	Warren East	3,943	60	100
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]	3,914	100	100
2009	Sir John Rose	2,409	29	93

[1] On 31 March 2011, Sir John Rose retired and John Rishton was appointed. John Rishton retired on 2 July 2015 and Warren East was appointed 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 ten 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 ten 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 UK gender pay gap in December 2018, which showed:

Median gender pay gap across all Rolls-Royce employees in the UK

Mean gender pay gap across all Rolls-Royce employees in the UK

Overall, women currently represent 15.5% of our total workforce, however we have increased the percentage of women in the top pay quartile this year. Diversity remains a challenge for our business and the engineering sector as a whole, but we are committed to improving both these issues. In 2017 we launched a diversity and inclusion strategy with targets to increase female participation at all levels in our organisation. More details of the initiatives we are undertaking to support this can be found on page 46.

Contractual arrangements

Each Executive Director has a service agreement that sets out the contract between that 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	65

Non-Executive Directors' remuneration

Single figure of remuneration (audited)

	Fees (£000)		Benefits (£000)		Total (£000)	
Chairman and Non-Executive Directors	**2018**	2017	**2018**	2017	**2018**	2017
Ian Davis	**425**	425	**2**	2	**427**	427
Lewis Booth [1]	**95**	95	**29**	69	**124**	164
Ruth Cairnie	**90**	90	**3**	4	**93**	94
Sir Frank Chapman	**90**	90	**5**	4	**95**	94
Irene Dorner [2]	**76**	70	**1**	–	**77**	70
Beverly Goulet	**70**	35	**7**	11	**77**	46
Lee Hsien Yang	**70**	70	**4**	3	**74**	73
Nick Luff [3]	**46**	–	**–**	–	**46**	–
Brad Singer	**70**	70	**6**	20	**76**	90
Sir Kevin Smith	**105**	105	**2**	5	**107**	110
Jasmin Staiblin	**70**	70	**10**	7	**80**	77
Former Non-Executive Directors						
John McAdam	**–**	24	**–**	–	**–**	24
Total	**1,207**	1,144	**69**	125	**1,276**	1,269

1 The tax treatment of travel expenses incurred by Lewis Booth, for travel to and from the UK, changed in May 2016 (five years from his date of appointment and in accordance with HMRC rules). This change is reflected in the value of benefits reported.
2 Irene Dorner received an increase of £15,000 per annum in July 2018 to reflect the additional time commitment as a result of taking on the role of Employee Champion.
3 Nick Luff joined the Board on 3 May 2018.

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, Ian Davis and Lee Hsien Yang use this facility.

Non-Executive Directors' fees

	2018 £000	2017 £000
Chairman	425	425
Other Non-Executive Directors base fee	70	70
Chairman of the Audit Committee	25	25
Chairman of the Remuneration Committee	20	20
Chairman of the Safety & Ethics Committee	20	20
Chairman of the Science & Technology Committee	20	20
Senior Independent Director	15	15
Employee Champion	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 2018	27 February 2019
Ian Davis	60,747	61,534
Lewis Booth	60,000	60,000
Ruth Cairnie	16,876	17,415
Sir Frank Chapman	33,203	33,226
Irene Dorner	10,370	10,425
Beverly Goulet	4,302	4,325
Lee Hsien Yang	6,871	7,135
Nick Luff	10,000	10,000
Brad Singer	–	–
Sir Kevin Smith	26,536	26,679
Jasmin Staiblin	–	–

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 2021
Beverly Goulet	3 July 2017	2 July 2020
Lee Hsien Yang	1 January 2014	31 December 2019
Nick Luff	3 May 2018	2 May 2021
Brad Singer	2 March 2016	2 May 2021
Sir Kevin Smith	1 November 2015	31 October 2021
Jasmin Staiblin	21 May 2012	20 May 2021

* On 26 February 2019, the Board unanimously approved a further three-year extension to the appointment term of Ian Davis. A revised letter of appointment will be issued on 1 March 2019.

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 2016, 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.

SAFETY & ETHICS COMMITTEE REPORT

"Matters of product safety, the safety and wellbeing of our people, the integrity of our assets and infrastructure, and ensuring ethical, respectful and compliant behaviours are critical to the Group's sustainability"

Key highlights

- Supporting executive leadership with embedding its value of 'operate safely' and promoting safety culture as a 'state of being'
- Review of product safety management in Civil Aerospace, with a particular focus on the Trent 1000 in-service issues
- Maintaining product safety, occupational safety and asset integrity focus during organisational change
- Monitoring of compliance with obligations under the DPAs
- Maintaining oversight of the implementation of Lord Gold's recommendations on ethics and compliance
- Overseeing deployment of the enhanced code of conduct (Our Code)

Introduction

The Committee played an important role during 2018, supporting management in promoting a sharp focus on our core values. This is particularly important with the significant organisational changes that the Group is working through and the operational and financial challenges presented by the in-service issues with the Trent 1000.

Matters of product safety, the safety and wellbeing of our people, the integrity of our assets and infrastructure, and ensuring ethical, respectful and compliant behaviours are critical to the Group's sustainability and must be preserved when other high priority challenges present themselves.

The Committee has therefore continued to encourage and support the Group's progress in seeking to embed a culture where these values remain front of mind.

Membership and operation of the Committee

In addition to myself, members of the Committee during 2018 were Irene Dorner and Lee Hsien Yang. Nick Luff joined the Committee with effect from 1 January 2019. All members of the Committee are independent Non-Executive Directors. Our biographies are on pages 60 and 61 and our meeting attendance is on page 63.

The Committee's responsibilities are outlined in its terms of reference which can be found at www.rolls-royce.com. We review these annually and refer them to the Board for approval. This year, we have made changes to our remit to ensure it aligns with the principles of the revised Code.

Committee evaluation review

This year, Belinda Hudson Limited (BHL) was appointed to undertake a review of the Committee. The effectiveness review process of the Board and its committees is discussed in greater detail on page 70.

I was pleased that the review concluded that the Committee is strong and diligent, in particular in overseeing product safety, occupational safety, ethics and compliance. The Committee discussed the review at its meeting in December and considered the areas for ongoing development that had been highlighted. With the desire to improve continuously, we agreed that in 2019 our work would continue to support the executives with efforts to improve safety culture across the organisation, as well as conducting a review of the Committee's role in overseeing sustainability issues.

Principal responsibilities

Product safety

- Maintain an understanding of and keep under review the Group's framework for effective governance of product safety.
- 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 Our Code and anti-bribery and corruption policies under review.
- Support the Board with their review of issues raised through the Ethics Line and other channels including reviewing the results of any investigations into ethical or compliance breaches or allegations of misconduct.

2018 principal risks

- Compliance and product safety.

Areas of focus for 2019

- Oversight of activities to meet continuing obligations under the DPAs and to implement Lord Gold's recommendations, including review of Lord Gold's final report due during the year
- Supporting leadership's performance improvement on HSE

Safety & Ethics Committee focus during 2018

Area of focus	Matters considered	Outcome
Product safety	Maintaining safety during organisational change Product safety policy and processes, training, safety assurance framework and competence in manufacturing Product safety performance and in-service issues Product safety management systems Product safety in Civil Aerospace Product safety in digital products and in technology development	The Committee was satisfied that product safety governance remained robust following organisational restructuring. The safety assurance framework is a sound incremental development. Safety performance remained at expected levels, with safety aspects of in-service issues handled competently and appropriately. The product safety management system in Civil Aerospace is effective and well-operated. Digital products are deemed to be emerging, and less mature, and therefore require particular focus to ensure high standards are observed.
HSE	Detailed reviews of serious injury, high potential incidents and interventions by regulators Events, key findings, shared learning and actions HSE ambition, strategy and plans for continuous improvement HSE performance including incidents, injuries, waste, energy use and GHG emissions metrics HSE programmes – LiveWell, asset care, waste action	Overall, despite some year-on-year HSE improvements, the 2018 TRI performance was disappointing and missed key targets. Investigations from some serious incidents are being rigorously pursued, and lessons learned implemented. Rolls-Royce recognises that HSE is a top leadership priority and on-going efforts focus on reaching the Company's Zero Harm campaign objectives. Strengthening of HSE leadership, strategies, plans and communications as part of a structured approach to achieve continuous improvement. HSE programmes are at varying maturity levels but there are signs of progress.
Sustainability	Review of sustainability strategy and governance in-year and planned activity	Planning for an additional 2019 focus on environmental performance, combining both current operational metrics and longer-term strategic product development investments, to provide a complete picture of the environmental trajectory of the Group.
Ethics & compliance	Compliance with continuing obligations under the DPAs and implementation of Lord Gold's recommendations Deployment of Our Code and Group policies Resourcing of ethics and compliance team and effectiveness of compliance officers Embedding of ethics and compliance culture and behaviours. Review of number and nature of concerns raised through the Ethics Line Management of intermediaries including screening, appointments, payments, termination and settlements	Reviewed detailed plans for, and progress on, compliance. Reviewed the second annual report to DoJ. The enhanced code of conduct and simplified suite of Group policies were issued in 2018. The ethics and compliance team is effective. Bullying and harassment were prevalent themes and we will be monitoring the effectiveness of management's campaigns to address this. The intermediary processes are effective to manage the risks.
Oversight of 2018 principal risks	Principal risks of compliance and product safety reviewed	These principal risks are reviewed and discussed at every meeting of the Committee and both continue to be managed effectively.

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 keep pace with the science and technological innovation that enables product designs to evolve and extend operational boundaries.

In 2018, 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.

As in 2017, we maintained a focus throughout the year on how safety risk was being managed through the period of major organisational restructuring for the Group. We oversaw changes made to the product safety governance and risk management model. The principles behind the way accountability is assigned and product safety is governed remain. However, some adjustments to the structure of the business-level product safety review boards were required to align to the new organisational structure.

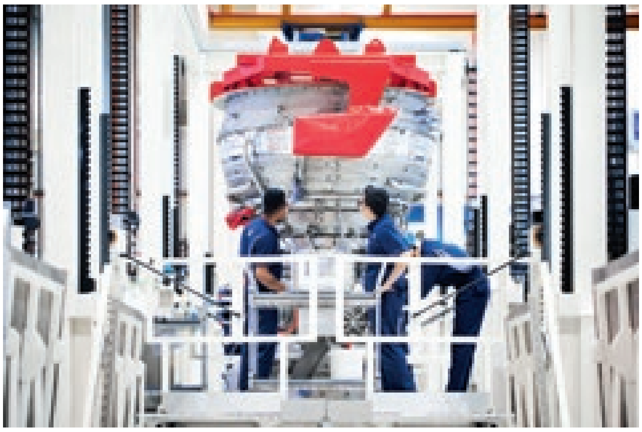
The Committee was assured that appropriate checks and balances were being used. Phased efficiencies were being introduced that preserved and improved product safety governance while achieving headcount reductions in the wider restructured Group.

Each year the Committee reviews particular aspects of the Group's product safety management system (PSMS) to ensure we maintain a good working knowledge of it and can oversee how it is being continuously improved. At our meeting in February 2018, we discussed a report on product safety assurance, covering the work undertaken to monitor effectiveness and improvements that are proposed to the PSMS and the processes within it. We reviewed delivery against 2017 plans, noting some excellent progress, and discussed the product safety assurance team's workplan for the remainder of 2018.

A key component of the 2018 workplan was the phased deployment of a new product safety assurance framework. This encourages a more consistent, structured and pro-active approach across the enterprise to assess what could go wrong, which complements the existing product safety processes. We discussed this in February and reviewed it in more detail in July. The framework will enable a more comprehensive means of managing our product safety principal risk in each of the businesses and provide clear lines of sight to key controls. This more forward-looking approach is particularly important in the current operating environment of organisational and technological change.

We also reviewed how product safety is managed through in-service product life. This covered three aspects: the identification during design of the limitations on operation and necessary maintenance; the processes used to identify and manage in-service safety concerns; and the performance of pro-active periodic safety reviews of products in service, where operational knowledge is used to identify opportunities to improve the safety or safety assurance of products.

We were briefed in February 2018 on enhancements to the programme of product safety training. A new course for senior managers had been added and the Board undertook an abridged version of this in May 2018. This interactive course was based on real case studies from outside Rolls-Royce. My colleagues and I found it



CIVIL AEROSPACE PRODUCT SAFETY – TRENT 1000 WORKSHOP

The Committee received briefings at each of its meetings during the year on specific issues that had arisen with products in service. This centred around the in-service issues with the Trent 1000 and included updates on investigations of root cause, assessment of implications, and oversight of the Group's response including redesign of certain components.

Following the briefings we had received in 2017 and in February 2018, and given the significance of the issues, the Committee felt it important to gain a deeper insight into how the product safety aspects were being assessed and managed in practice in line with the PSMS. We therefore arranged for members of the Committee to meet with Civil Aerospace engineering leaders and members of the product safety assurance team during two workshops held in May 2018 at the Group's facilities in Derby, UK.

In the first of the workshops, we received updates on product safety for the Trent 1000 from the chief engineer of this programme. We then undertook a tour of the large engine test bed in Derby, before a discussion on the regulatory framework and requirements in Civil Aerospace.

The second session was a more detailed technical review, where we examined the Trent 1000 intermediate pressure compressor (IPC) rotor blade issue, and received an explanation and demonstration of how numerical risk assessments are performed using data to predict the rate of events. We undertook a detailed comparison of the original risk assessment with the then current risk assessment, noting the significant degree of learning that the ongoing assessments were generating to enable the modelling system to be improved. Finally, we spent some time reviewing the management of other Trent 1000 issues that had been experienced in service.

Overall, the workshop provided a good level of confidence to the Committee. It allowed us to endorse to the Board in July the conclusion that the PSMS was being robustly applied to the Trent 1000 in-service issues and that it was effective in managing the product safety risk to be as low as reasonably practicable. The Committee will continue to oversee the resolution of the issues from a product safety perspective in 2019.

thought provoking and powerful in reinforcing the role that we, the Company's employees and our partners, must play in driving a culture where safety is an uncompromised priority and concerns are openly raised and addressed. In addition to the senior managers course, the more technical classroom-based product safety training for engineers was also refreshed later in the year. Feedback received on the new courses has been very positive and the Committee welcomed this as a key step in reinforcing product safety awareness.

In February 2018, we reviewed the overall metrics for product safety in the previous year. The metrics indicated that the safety performance of our mature and maturing products was stable or improving and that the businesses were managing safety issues effectively. The data did show an increase in Trent engine 'potential hazard red tops'. These are issues which have been identified and have the potential to result in an accident or incident but had not done so. This increase was principally driven by the rate of introduction of new engine types in the fleet and the associated early-life safety learning. We were assured that the Civil Aerospace business was addressing these issues during the year.

In late 2017, the Company acquired full ownership of ITP Aero, and as a consequence now has inherent accountability for the product safety risk arising from its activities. We therefore discussed a review of how it managed product safety. ITP Aero was already a long-standing supplier and a risk and revenue sharing partner of the Group on key components for a number of programmes, including Trent XWB. The Group therefore already had a good level of understanding of ITP Aero's approach to product safety. The Group now has oversight of the product safety processes and the product safety assurance team reported to us that they were comfortable with how these were being applied to its products. It was noted that the Company was not permitted to obtain detailed visibility over ITP Aero's supplies to the Company's competitors but we took comfort that its other OEM customers would have oversight as part of their programmes.

During the year, we reviewed and endorsed some relatively minor changes to the Group's product safety policy, that now incorporates some statements of expectations taken from the PSMS.

In December, we reviewed safety in digital products and safety in technology development. It was recognised that, as these were both emerging areas of high activity and innovation in the Company, a particular degree of focus on product safety was warranted to ensure consistency with the high standards observed in more mature areas of the business. This will be maintained in 2019.

We also reviewed the product safety principal risk and were satisfied this was being managed effectively and within the boundaries of the agreed risk appetite. At each of our meetings we received updates on incidents in service and, as part of these reviews, discussed any emerging product safety risks and how these were being identified and managed as part of the PSMS. We were particularly pleased to see examples of lessons learned from working on issues in older fleets being applied to the Group's newer products.

HSE

The Committee and management objective remains to drive continuous improvement in HSE performance. We discussed HSE matters at each of our meetings during the year and the different levels of maturity in HSE leadership across the business of the Group.

In February, we were updated on the conclusion of the investigations into the fatalities of the two employees in separate incidents in 2017, as reported in the previous annual report. The Company has extracted learning from these incidents and implemented improvements. These include: assessing lock-out mechanisms for electrical cabinet doors on the Group's estate, requiring second-level approval to open them; more use of CCTV for lone workers; work on ergonomics and state of mind commissioned with Grenoble University; improvements to the driving for work standard and global travel policy; a road safety awareness campaign in Power Systems; specialist securing of loads in vehicles; the specification of minimum car safety requirements; and the promotion of defensive driver training for high mileage drivers.

Safety culture was the prevalent theme of our meetings in the year and in February we reviewed the planned Zero Harm activity to improve this. This included: reinforcing HSE across the Group's leadership by using it as a theme at the senior leadership conference in March; holding HSE engagement sessions with the business and function leadership teams; refreshing the approach to HSE training for managers; improving HSE inductions across the Group's estate; reporting HSE leading indicators to the Executive Team; and initiating a dedicated electrical safety programme. There were also two additional new measures introduced to increase awareness of HSE.

The first was the introduction across the Group of Zero Harm Life-Saving Rules, a set of ten simple safety messages chosen with reference to particular areas of safety concern within the Group based on previous incidents. Their introduction and reinforcement campaigns are a very welcome step forward to support the embedding of our safety culture.

The second was the promotion of HSE safety walks, supported by a pocket-sized guide containing suggested questions to ask related to HSE. The Committee continues to encourage observation and intervention as one of the most effective methods of incident prevention and so we were very supportive of the new guide and the promotion of safety walks. The Committee itself conducted safety walks at the Power Systems plant in Friedrichshafen, Germany in March and at the large engine assembly and test facility in Derby, UK in May, making an intervention to improve working practices regarding the use of temporary platforms.

At each of our meetings, we review the Group's HSE key activities, performance metrics, insights and learning, including the total reportable injury (TRI) rate. This is discussed in more detail on page 47. The Group failed to meet its target TRI rate for 2018, primarily due to the rates at Power Systems and ITP Aero remaining significantly higher than for the rest of the Group. However, both of these businesses have made significant improvements against their 2017 TRI performance through concerted focus and this will continue into 2019 and beyond.

The Committee however remains concerned that the number of major and high potential incidents in 2018, while fewer than in 2017, is still unacceptably high. The most serious injury in the year was a fall from height in which an employee in Derby suffered a fracture of both wrists. The UK Health and Safety Executive conducted an investigation across our Derby and Hucknall sites, also engaging with me directly. Corrective actions were required, which the Committee is overseeing to ensure full implementation.

We were briefed on steps taken to help manage HSE risks that may arise from the organisational change. There were 11 sites in total occupied by civil nuclear, submarines or naval marine operations that were being integrated into the Power Systems or Defence businesses as part of the reorganisation. HSE packs for each site were developed and handover meetings arranged to ensure the receiving business understood the operational activities, infrastructure and related site risks.

We were updated on the Zero Harm safety case programme, with sites having been assessed against numbers of high consequence hazards, business activity complexity and incident history. This had resulted in 53 out of 195 sites being assessed as requiring a safety case, and the development of these being prioritised over an 18-month programme plan, accelerated from three years. The programme is generating momentum in HSE reporting and improvement activity and we will keep progress under review.

Good progress was noted with the LiveWell programme, including the Group's approach to workplace wellbeing. This is recognised as leading practice by the Royal Society of Public Health. The Group introduced its global tobacco-free campus policy from 1 January 2019 following preparatory work through the year, including support to smokers. Local legislative requirements have, however, prevented the policy from being implemented in Germany, France and Italy. LiveWell accreditation was achieved by 68% of the Group's sites by the end of 2018.

The Group's mental health strategy and approach was also revised during the year. We discussed this very important topic at our meeting in December and will keep this under review. In 2018, a trained mental health champions network and community of practice was established, after a pilot in the UK. The Chief Executive has signed the 'time to change' pledge committing the Group to combat stigma attached to mental health issues in the workplace.

We discussed management's proposed move to a regional HSE model, designed to reinforce line accountability for HSE, enable more agile support and provide improved assurance to business leaders. To support this, the Committee was well-positioned to draw on lessons from the ethics and compliance improvement programme. We discussed with the HSE team that business line management accountability needed to be underpinned and resourced with central professional support during a transition period until this reached an appropriate level of embedded maturity in the businesses with appropriate policies, processes and controls in place. The Committee was also able to provide anecdotes from the oil & gas majors, where gaining appropriate levels of experience and competence in safety was a pre-requisite to career advancement in operations and general management roles. We noted that, organisationally, the HSE function had been moved from the operations function to report to the Chief People Officer, as a means of driving centrally a cultural change in behaviours.

The Committee conducted an annual review of the HSE Group policy, which was subject to some minor changes to align with the Group's new vision and values launched early in 2018.

Sustainability

We were briefed in July about the work across the Group on sustainability topics, focused through the executive-level environment & sustainability committee (E&SC).

At the Safety & Ethics Committee in December 2017 (as reported in the previous Annual Report), we agreed that the pre-existing sustainability strategy would be reconsidered. This has enabled the Group to concentrate on developing position statements on material issues. This includes developing a single environmental position statement that crystallises operational and longer-term strategic commitments. It also sets out the Company's commitment through investment to the decarbonisation of its product portfolio and supporting the global transition to a low carbon economy. Through reports from the E&SC and the Science & Technology Committee, this Committee will oversee how this position statement is applied across the Group and summarise in future annual reports sustainability progress across all activities in the Group.

We were briefed on: the Company's approach to the management of the risk of 'conflict minerals' being potentially used in our supply chain; the review of a sustainable alternative fuels strategy; and a review of the approach to investor engagement in sustainability topics. This resulted in the development of the Group's first environmental, social and governance (ESG) newsletter, which was sent to investors and other external stakeholders in July this year. The newsletter highlighted progress made against the commitments set out in our previous annual report and demonstrates commitment to increasing our external engagement on these important topics.

The Company has maintained its listing in the Dow Jones Sustainability Index (DJSI), one of only five aerospace and defence companies to achieve this. Overall, our score improved slightly from 2017 and we achieved industry leading scores for the social dimension of the assessment, including top scores for the environmental reporting and corporate citizenship and philanthropy question sets.

MEMBER OF
Dow Jones
Sustainability Indices
In Collaboration with RobecoSAM

SAM | Sustainability Award
Silver Class 2019

You can read more about the Group's sustainability activities on pages 41 to 49.

Ethics and compliance

Following the DPAs, much of the Committee's focus in the year has been on overseeing the Group's ethics and compliance work plans – see Ethics and Compliance report on page 48. This included obligations to the regulators and monitoring progress in implementing the recommendations put forward by Lord Gold in his reports. Lord Gold attended all 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: continuing his engagement with employee focus groups to understand how the ethics and compliance programme is working in practice; monitoring the continuing work to embed the right behaviours and attitudes across the organisation; and assessing the resource needed to drive the programme, both centrally and within the businesses.

The Group's ethics and compliance workplans were reported to the Committee throughout the year, including monitoring resourcing of the teams across the organisation. We noted the reports of a good level of engagement by ITP Aero as it sought to align to the requirements of the Group's programme, having joined the Group at the end of 2017.

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

We continued to keep the level and nature of adviser engagements under review following a significant reduction in 2017 and were notified of any claims received during the year from any advisers who had been terminated in the past.

The Committee reviews statistics and details of Ethics Line reports at our meetings and in 2018 we observed that bullying and harassment were prevalent themes. This had also been picked up as a theme by Irene Dorner in her role as Employee Champion and brought to the Board's attention. This warranted a focused response and in December we received a briefing from the Chief People Officer and members of his team, with input from the head of ethics and compliance, on the planned campaign activity to seek to drive out such behaviours. We will review the impact of this activity during 2019.

In autumn 2018, we oversaw the roll-out of our enhanced code of conduct and a suite of refreshed and simplified Group policies combined into one simple manual for employees. The Group's enhanced code of conduct was developed in digital format including a mobile-enabled app, allowing employees to access it wherever they are, which is of particular benefit to shop floor workers or those in remote locations. The launch of Our Code was supported by new training modules that were subject to mandatory completion during the year, with managers who failed to do so being subject to capped performance reviews. Of the population of several thousand managers required to complete the training, only one failed to do so by the due date without having acceptable grounds for mitigation; a remarkable improvement on previous completion rates for core training modules.

We also monitored the Company's ongoing compliance with the General Data Privacy Regulations and progress with the Company's application for Data Privacy Binding Corporate Rules.

Looking forward

In the year ahead, we will be carefully reviewing the content of Lord Gold's final report to be issued later this year and progress with all previous, and any final, recommendations made. We will continue to oversee the Company's compliance with the DPAs and its annual reporting to the DoJ.

We will monitor developments with the Civil Aerospace large engine in-service issues towards full mitigation of product safety risk to expected levels.

We will continue to monitor and support progress and performance on the Zero Harm and LiveWell programmes to mitigate HSE risks, with a particular interest in seeing injury rates and high potential incidents reduce. A careful eye will be kept on leading indicator trends as a pre-cursor to future underlying outturn performance. We will also keep the environmental performance of our operations, and other sustainability measures, under review.

In 2019, we look forward to seeing tangible progress from the continuing efforts by management to drive the desired behaviours and mindset, reinforcing an ethical and safety-focused culture across the organisation.

Sir Frank Chapman
Chairman of the Safety & Ethics Committee

SCIENCE & TECHNOLOGY COMMITTEE REPORT

SIR KEVIN SMITH
CHAIRMAN OF THE SCIENCE & TECHNOLOGY COMMITTEE

"The Committee feels privileged and excited to participate in the technology journey with the many extremely talented people who will deliver the future for Rolls-Royce and its shareholders."

Key highlights

- Technology strategy, investment and programmes review
- Electrical systems strategy
- Review of UltraFan, Advance3 and power gearbox programmes
- Services strategy
- Micro-grids strategy
- Workshop on new product offerings
- Visit to the IT innovation hub and manufacturing facilities

Introduction

The Group invests more than £1bn 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 on the research and technology part of this, providing directional input and oversight of the Group's scientific and technological strategy, processes and related investments.

Membership and operation of the Committee

Members of the Committee during 2018, all Non-Executive Directors, were myself, Ruth Cairnie, Brad Singer and Jasmin Staiblin. Sir Frank Chapman joined the Committee from 1 January 2019. Our biographies are on pages 60 and 61 and meeting attendance is on page 63.

The Committee's responsibilities are outlined in its terms of reference, available at www.rolls-royce.com. We review these annually and refer them to the Board for approval.

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. The Committee is supported by the Company Secretary and the Chief Technology Officer (CTO).

Committee evaluation review

This year, Belinda Hudson Limited (BHL) was appointed to undertake a review of the Committee. The effectiveness review process of the Board and its committees is discussed in greater detail on page 70. The Committee considered the review in December and I was pleased that it concluded that the Committee is playing a key role in helping the CTO and his team with their approach to technology. In 2019, our focus will include the continued reinforcement of the alignment between technology and competitiveness and the need for efficient execution of our technology plans. We will also keep under review the composition of the Committee and future technology knowledge, and encourage the improvement in the Committee's meeting materials.

Principal responsibilities

Technology strategy

- Review the strategic direction of the Group's research, technology and development activities and 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.

2018 principal risk

- Disruptive technologies and business model.

Areas of focus for 2019

- Oversight of the Group's technology programme
- Update on key programmes including SMRs and UltraFan
- Review of Group activities in digital and electrical technologies
- Review of technology across the Defence business
- Follow-up on services and the technology efficiency and effectiveness reviews
- Assessment of skills and capability development and alignment with the technology strategy

Science & Technology Committee focus during 2018

Area of focus	Matters considered	Outcome
Technology strategy	The Group's technology strategy Investment allocation Review of key technology programmes Efficiency and effectiveness review	The strategic objectives and associated investment funding allocations were confirmed to be appropriate. The review of key technology programmes helped shape the agenda and discussions at the Board strategy meeting. The Committee made a number of recommendations to management to improve the efficiency and effectiveness of the Group's future research and technology programme.
Cross-sector technology	UltraFan demonstrator The Group's electrical systems strategy Micro-grids	UltraFan demonstrator review confirmed that progress was satisfactory and advised the Board on approval of the next phase of programme funding. Direction of the Group electrical strategy supported and the excellent progress to date acknowledged. Potential for micro-grid synergies across the Group recognised.
Technology capabilities and skills	Engineering capabilities of the future Visits to large engine assembly, test bed and IT innovation hub	Plan endorsed to shift to electrical system skills from mechanical capability. Visits were insightful, provided physical evidence of progress on key technology programmes and gave an invaluable opportunity to meet the teams.
Technology trends and risks	Internet of Things Ceramic matrix composites (CMCs)	Endorsement of the Internet of Things programme. Support for future programme recognising the strategic importance of CMCs for the Group.
Oversight of principal risk	Disruptive technologies and business model	The principal risk review confirmed that the identification of disruptive technology threats and ongoing mitigation activities supported the direction for future key activities.

2018 overview

In 2018, the Committee continued with its work from the previous year in overseeing technology strategy, the prioritisation of resources towards technology development and acquisition and assessing competitiveness in key technology and product areas. In doing this, we place importance on ensuring an active dialogue with engineering and technology leaders and experts, inviting relevant employees to Committee meetings, meeting with employees during site visits and developing future leaders through the Board apprentice programme.

At the first meeting of the year in February 2018, we reviewed the 2018 technology programme and the investment funding allocation, and received an update on the progress made on technology plans for each business. As reported last year, significant investment is directed towards aerospace technology demonstrators to validate new architectures and gas turbine technologies vital to supporting future competitiveness. We dedicated one meeting to conducting a detailed review of the UltraFan demonstrator programme, noting its scalable architecture design and its differentiating technologies which would enable a step change in efficiency. We discussed the phased investments proposed to deliver the programme and the approach to managing risks and programme dependencies. During the year, we received regular updates on the progress of the programme and the Committee visited the dedicated team area in Derby and met with key staff. We also viewed the Advance3 test vehicle which forms the core of the UltraFan demonstrator and undertook a tour of the Civil Aerospace large engine assembly and test facility in Derby, UK. The Committee advised the Board on progress and funding continuation of the programme.

The Committee also reviewed key enabling technologies for gas turbines including the Group's strategy and competitive position on silicon carbide CMCs and progress on development and maturing of the technology.

The Group's new vision and strategy recognises the need to grow capability in electrical technologies and we received an update on the Group's electrical strategy and exciting plans in this increasingly important area of focus. We were encouraged by the progress made on a number of demonstrator programmes and electrical component technologies. The potential for deployment of electrical and hybrid technologies in civil aviation, marine, defence and rail for propulsion and power generation applications was clear and we support the direction of the technology roadmap. This included the E-Fan X programme launched with Airbus and Siemens in 2017 that is working towards a flight demonstration of a complete hybrid regional aircraft-sized propulsion system in 2020.

We received a detailed presentation on opportunities in micro-grids from the Power Systems business unit's strategy and systems design representatives. The micro-grid market is attractive with high growth potential, including export markets. As well as helping decarbonise electricity production, micro-grids can provide the required operational flexibility to optimise costs, emissions and the availability of the integrated system. We were briefed on the principal components that comprise a micro-grid and their respective characteristics and on the system controls architecture. We examined the rationale for the Company to enter this market, the strength of its offering and achievements to date, as well as areas planned for future development. We discussed the possible business models to address this market and the business case associated with each, noting Power Systems' existing and developing capabilities and the opportunities available to fill capability gaps. Finally, we reviewed the planned investment roadmap that will enable the business to continue to pursue developing micro-grid markets.

We had a briefing on the future market for transport for long-range supersonic business jets and commercial aircraft. This covered the design challenges and different propulsion system concepts that apply to supersonic flight, how the Group's technology was positioned with regard to powering a new generation of supersonic aircraft, and the associated research and technology budget requirements. We also considered the concept of hypersonic passenger transport, discussing the vehicle requirements, propulsion system concepts and feasibility challenges.

Further, the Committee reviewed the Group's services strategy and associated technology development plans. We encouraged management to be bolder in pursuing new technology and ways of working, noting that services would in future contribute significantly more than half of the Group's revenue.

We also reviewed manufacturing technologies to improve productivity. During the course of the year, we benefited from various visits to UK facilities in Derby, Sheffield, Rotherham, Barnoldswick and Washington to see the application of advanced technologies and to meet Company experts. We encouraged management to fully embed across the Group the many good improvement initiatives as a prerequisite of the advanced manufacturing programme.

Together with our other Board colleagues, we visited the IT innovation hub, an area dedicated to facilitate the generation and testing of innovative ideas to further the Company's ambitions through creative thinking and best use of digital technology. We received a briefing on the work of the hub by the R^2 Data Labs team and learned about some recent projects and ideas that were showcased. We were also briefed on plans to transform engineering and how this will drive major changes in our skills mix in the coming years. This is driven by the introduction of new technology and the associated automation of many transactional engineering tasks. It is also impacted by the expectation that certain skill sets will grow significantly as electrical systems and digital capability become more prevalent in our product portfolio over the coming years. We reviewed the work that is being done to support these changes.

The Committee added an additional meeting by teleconference to undertake a detailed review of the efficiency and effectiveness of technology programmes and their delivery. We received information on the effectiveness of historical investments in technology to understand what proportion of the investment has carried through to the final product. The Committee supports the changes the Company is introducing to improve the impact of technology programmes in the context of managing technology acquisition as a portfolio. We recommended broad leadership engagement and governance around setting investment priorities and the delivery of technology programmes.

We also gave our support to further development of the approach to strategic management of technology acquisition and reviewed the Company's approach to technology partnering as a means of obtaining access to co-investment, skilled resources and accelerating technology development. We discussed in general terms the various models and opportunities that could be used to achieve this. We discussed the risks and opportunities arising from each, notably in respect of the protection/exploitation of intellectual property and considered specific examples of previous partnering arrangements the Company had put in place. We then went on to consider a number of specific opportunities and their potential value.

We further reviewed the Company's risk appetite with regard to the Group's 2018 principal risk of disruptive technologies and business models. We considered assessments on a range of potentially disruptive technologies and the Group's activities in each area. This will remain a live process to ensure awareness of potential shifts. We received a progress report on the Group's work on the Internet of Things and tagging and tracking technology for use on our assets and those of our customers, with activities covering the full lifecycle of our products including design, manufacture, operations and services.

ULTRAFAN

In May, we visited the test beds to see the Advance3 engine between test runs and were briefed on initial performance results of test data compared to pre-test predictions. The Advance3 reflects a new engine core architecture which, together with a power gearbox, will form the new UltraFan demonstrator.

Our Committee dedicated a workshop to assess the Group's technology position with regard to supporting new product offerings and managing risk and new ways of working to reduce development timescales. While it is not possible to completely de-couple the strategic, financial and operational aspects of a proposed new programme from technological aspects, the focus of the Committee's review was on the latter so that we could report our conclusions to the Board to assist its broader decision-making. The review was attended by representatives from the Civil Aerospace technology project team, the technical assurance team, and a team of former senior engineers of the Company, as quasi-independent participants. We held a follow-on meeting by teleconference in early December before reporting back to the Board with our conclusions and recommendations.

Looking forward

The Company sits at a pivotal point in its development. 2018 started with the launch of a new vision grounded in innovation. This prioritised the development of new capabilities in electrical and digital technologies along with those critical to the future competitiveness of our existing products such as Ultrafan, Advance3 and micro-grids. This technology will build the future Rolls-Royce with exciting new products and services delivering value in existing and new markets, with current and new customers.

The Committee feels privileged and excited to participate in this journey with the many extremely talented people who will deliver that future for Rolls-Royce and its shareholders. The Committee will continue to focus on the alignment of our research and technology strategy with the future needs of the business, the efficient execution of our research and technology programmes and the assessment of skills and capabilities to support them.

In conclusion, I would like to pay tribute to the support Rolls-Royce receives from governments both in the UK and our key international locations. Their foresight and recognition of the future economic value of technology and its contribution to national industrial competitiveness is a credit to them and their support is both necessary and welcome.

Sir Kevin Smith
Chairman of the Science & Technology Committee

RESPONSIBILITY STATEMENTS

Statement of Directors' responsibilities in respect of the Financial Statements

The Directors are responsible for preparing the Annual Report and the Financial Statements in accordance with applicable law and regulation.

Company law requires the Directors to prepare financial statements for each financial year. Under that law the Directors have prepared the Group Financial Statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union and the parent company Financial Statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards, comprising 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 the profit or loss of the Group and parent company for that period.

In preparing the Financial Statements, the Directors are required to:

— select suitable accounting policies and then apply them consistently;

— state whether applicable IFRSs, as adopted by the European Union, have been followed for the Group Financial Statements and United Kingdom Accounting Standards comprising FRS 101, have been followed for the Company Financial Statements, subject to any material departures disclosed and explained in the Financial Statements;

— make judgements and accounting estimates that are reasonable and prudent; and

— prepare the Financial Statements on the going concern basis unless it is inappropriate to presume that the Group and parent company will continue in business.

The Directors are also responsible for safeguarding the assets of the Group and parent company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Group and parent company's transactions and disclose with reasonable accuracy at any time the financial position of the Group and parent company. This enables them to ensure that the Financial Statements and the Directors' Remuneration Report comply with the Companies Act 2006 and, as regards the Group's Consolidated Financial Statements, Article 4 of the IAS Regulation.

The Directors are responsible for the maintenance and integrity of the parent company's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Directors' confirmations

The Directors consider that the Annual Report, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group and parent company's position and performance, business model and strategy.

Each of the Directors, whose names and functions are listed in the Directors' Report, confirm that to the best of his or her knowledge:

— the Group Financial Statements, which have been prepared in accordance with IFRSs as adopted by the European Union, give a true and fair view of the assets, liabilities, financial position and loss of the Group;

— the parent company Financial Statements, which have been prepared in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards, comprising FRS 101 *Reduced Disclosure Framework*, and applicable law), give a true and fair view of the assets, liabilities, financial position and result of the Company; and

— the Strategic Report includes a fair review of the development and performance of the business and the position of the Group and parent company, together with a description of the principal risks and uncertainties that it faces.

By order of the Board

Pamela Coles
Company Secretary
28 February 2019

OTHER STATUTORY INFORMATION

Share capital

On 31 December 2018, the Company's issued share capital comprised of:

1,895,710,451	Ordinary shares	20p each
29,071,130,784	C Shares	0.1p each
1	Special Share	£1

The ordinary shares are listed on the London Stock Exchange.

Payment to shareholders

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

Shareholders can choose to:

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

The CRIP is operated by Computershare Investor Services PLC (the Registrar). The Registrar will purchase ordinary shares in the market for shareholders electing to reinvest their C Share proceeds. Shareholders wishing to participate in the CRIP or redeem their C Shares in July 2019 must ensure that their instructions are lodged with the Registrar no later than 5.00pm (BST) on 3 June 2019 (CREST holders must submit their election in CREST before 3.00pm (BST) on 3 June 2019). Redemption will take place on 4 July 2019.

At the 2019 AGM, the Directors will recommend an issue of 71 C Shares with a total nominal value of 7.1p for each ordinary share. The C Shares will be issued on 1 July 2019 to shareholders on the register on 26 April 2019 and the final day of trading with entitlement to C Shares is 25 April 2019. Together with the interim issue on 3 January 2019 of 46 C Shares for each ordinary share with a total nominal value of 4.6p, this is the equivalent of a total annual payment to ordinary shareholders of 11.7p for each ordinary share.

Further information for shareholders is on pages 204 and 205.

Share class rights

The full share class rights are set out in the Company's Articles of Association (Articles), which are available at www.rolls-royce.com. The rights are summarised below.

Ordinary shares

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

C Shares

C Shares have limited voting rights and attract a preferential dividend of 75% of LIBOR on the 0.1p nominal value of each share, paid on a twice-yearly basis. The Company has the option to redeem the C Shares compulsorily, at any time if: the aggregate number of C Shares in issue is less than 10% of the aggregate number of all C Shares issued on or prior to that time or the event of a capital restructuring of the Company; the introduction of a new holding company; the acquisition of the Company by another company; or a demerger from the Group.

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

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

Special Share

Certain rights attach to the special rights non-voting share (Special Share) issued to the UK Secretary of State for Business, Energy & Industrial Strategy (Special Shareholder). These rights are set out in the Articles. Subject to the provisions of the Companies Act 2006 (the Act), the Treasury Solicitor may redeem the Special Share at par value at any time. The Special Share confers no rights to dividends but in the event of a winding-up it shall be repaid at its nominal value in priority to any other shares.

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

Restrictions on transfer of shares and limitations on holdings

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

Shareholder agreements and consent requirements

The Company and Bradley Singer are party to a relationship agreement with ValueAct (a summary of which can be found at www.rolls-royce.com).

No disposal may be made to a non-Group member which, alone or when aggregated with the same or a connected transaction, constitutes a disposal of the whole or a material part of either the nuclear propulsion business or the assets of the Group as a whole, without the consent of the Special Shareholder.

Authority to issue shares

At the AGM in 2018, authority was given to the Directors to allot new C Shares up to a nominal value of £500m as an alternative to a cash dividend.

In addition, an ordinary resolution was passed authorising the Directors to allot new ordinary shares up to a nominal value of £123,347,889 equivalent to one-third of the issued share capital of the Company. This resolution also authorised the Directors to allot up to two thirds of the total issued share capital of the Company, but only in the case of a rights issue.

A further special resolution was passed to effect a disapplication of pre-emption rights for a maximum of 5% of the issued share capital of the Company.

These authorities are valid until the AGM in 2019 or 2 August 2019, whichever is earlier, and the Directors propose to renew each of them at the 2019 AGM. The Board believes that these authorities will allow the Company to retain flexibility to respond to circumstances and opportunities as they arise.

ITP Aero

Following approval from the relevant authorities in Spain, on 19 December 2017 the Group acquired a 53.1% shareholding in ITP Aero from SENER resulting in ITP Aero becoming a wholly-owned subsidiary of the Company. The consideration of €718m will be settled over a two-year payment period, payable in eight equal instalments, and the agreement with SENER allows the Company flexibility to settle up to 100% of the consideration in the form of ordinary shares. Five payments were settled in 2018, all in the form of ordinary shares, as follows:

Instalment	No. of ordinary shares	Date
1st	9,612,581	15 January 2018
2nd	9,624,396	19 March 2018
3rd	9,719,544	19 June 2018
4th	8,398,166	19 September 2018
5th	10,202,227	19 December 2018

Final consideration as to whether the remaining three instalments will be settled in the form of cash or ordinary shares will be determined by the Company during the remaining payment period.

Authority to purchase own shares

At the AGM in 2018, the Company was authorised by shareholders to purchase up to 185,021,833 of its own ordinary shares representing 10% of its issued ordinary share capital.

The authority for the Company to purchase its own shares expires at the conclusion of the AGM in 2019 or 2 August 2019, whichever is the earlier. A resolution to renew the authority will be proposed at the 2019 meeting.

Deadlines for exercising voting rights

Electronic and paper proxy appointments, and voting instructions, must be received by the Registrar not less than 48 hours before a general meeting.

Voting rights for employee share plan shares

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

Change of control

Contracts and joint venture agreements

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

Borrowings and other financial instruments

The Group has a number of borrowing facilities provided by various banks. These facilities generally include provisions which may require any outstanding borrowings to be repaid or the alteration or termination of the facility upon the occurrence of a change of control of the Company. At 31 December 2018, these facilities were less than 19% drawn (2017: 22%).

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

Employee share plans

In the event of a change of control of the Company, the effect on the employee share plans would be as follows:

- PSP – awards would vest pro rata to service in the performance period, subject to Remuneration Committee judgement of Group performance.
- APRA deferred shares – the shares would be released from trust immediately.
- Sharesave – options would become exercisable immediately. The new controlling company might offer an equivalent option in exchange for cancellation of the existing option.
- Share Incentive Plan (SIP) – consideration received as shares would be held within the SIP, if possible, otherwise the consideration would be treated as a disposal from the SIP.
- LTIP – awards would vest on the change of control, subject to the Remuneration Committee's judgement of performance and may be reduced pro rata to service in the vesting period. Any applicable holding period will cease in the event of a change in control.

Accounting policies, financial instruments and risk

Details of the Group's accounting policies, together with details of financial instruments and risk, are provided in notes 1 and 17 to the Consolidated Financial Statements on pages 117 and 144.

Employment of disabled people

Rolls-Royce is an inclusive employer committed to building a diverse workforce. We give full and fair consideration to all applications for employment by disabled persons together with the continued employment of any employee who suffers disability whilst employed by the Group. All employees are able to take advantage of our training programmes in developing their careers and promotion opportunities are open to employees regardless of disability. For more information please see page 44.

Major shareholdings

At 31 December 2018, the following shareholders had notified an interest in the issued ordinary share capital of the Company in accordance with the DTR:

Shareholder	Date notified	% of issued ordinary share capital *
ValueAct Capital Master Fund, L.P.	1 February 2018	10.94
The Capital Group Companies, Inc	13 October 2017	5.07
Credit Suisse Group AG	3 May 2017	3.91

* Percentages are shown as a percentage of the Company's issued share capital when the Company was notified of the change in holding.

On 4 January 2019, in accordance with the DTR, BlackRock, Inc. disclosed an increase in their shareholding to 5.01% *. As at 28 February 2019, no further changes had been notified.

Directors

The names of the Directors who held office during the year are set out on page 63.

Directors' Indemnities

The Directors have the benefit of an indemnity provision contained in the Company's Articles of Association. In addition, the Directors have been granted a qualifying third party indemnity provision which was in force throughout the financial year and remains in force. Also, throughout the year, the Company purchased and maintained Directors' and Officers' liability insurance in respect of itself and for its Directors and Officers.

Disclosures in the Strategic Report

The Board has taken advantage of Section 414C(11) of the Act to include disclosures in the Strategic Report including:

- employee involvement;
- the future development, performance and position of the Group;
- the financial position of the Group;
- R&D activities;
- the principal risks and uncertainties; and
- particulars of important events affecting the Company since the financial year end.

Political donations

The Company's policy is that it does not, directly or through any subsidiary, make what are commonly regarded as donations to any political party. However, the Act defines political donations very broadly and so it is possible that normal business activities, such as sponsorship, subscriptions, payment of expenses, paid leave for employees fulfilling certain public duties and support for bodies representing the business community in policy review or reform, which might not be thought of as political expenditure in the usual sense, could be captured. Activities of this nature would not be thought of as political donations in the ordinary sense of those words. The resolution to be proposed at the AGM, authorising political donations and expenditure, is to ensure that the Group does not commit any technical breach of the Act.

During the year, expenses incurred by Rolls-Royce North America, Inc. in providing administrative support for the Rolls-Royce North America political action committee (PAC) was US$111,961 (2017: US$118,104). PACs are a common feature of the US political system and are governed by the Federal Election Campaign Act.

The PAC is independent of the Group and independent of any political party. The PAC funds are contributed voluntarily by employees and the Group cannot affect how they are applied, although under US law, the business expenses are paid by the employee's company. Such contributions do not count towards the limits for political donations and expenditure for which shareholder approval will be sought at this year's AGM to renew the authority given at the 2018 AGM.

Greenhouse gas emissions

In 2018, our total greenhouse gas (GHG) emissions were 596 kilotonnes carbon dioxide equivalent (ktCO_2e). This represents a decrease of 5% compared with 627 ktCO_2e in 2017.

We have revised our total GHG emissions for 2017 to reflect the actual figures for the full year, rather than estimated figures prepared in line with our basis of reporting. This has had a material impact on previously reported figures. The figures for 2016, 2017 and 2018 include emissions associated with ITP Aero. Emissions associated with L'Orange have been removed from these figures but do not have a material impact.

We have included the reporting of fugitive emissions of hydrofluorocarbons (HFCs), associated with air conditioning equipment, into our GHG emissions figures from 2016. Figures from 2014 and 2015 exclude emissions from these sources. These include emissions from our facilities in the UK, US, Canada and France only. We do not anticipate that emissions from other facilities will have a material impact.

Total GHG emissions (ktCO_2e)	2014	2015☑	2016☑	2017☑	2018☑
Direct emissions (Scope 1)	456	374	368	331	**305**
Indirect emissions (Scope 2)	396	375	336	296	**291**
Total emissions (Scope 1 + Scope 2)	852	749	704	627	**596**
Intensity ratio (total emissions normalised by revenue) (ktCO_2e/£m)	0.062	0.055	0.047	0.043	**0.038**

☑ We engaged Bureau Veritas to undertake a limited assurance engagement, reporting to Rolls-Royce Holdings plc, using the assurance standards ISAE 3000 and ISAE 3410 over the energy, GHG, TRI rate and STEM data that has been highlighted with ☑ and as set out on pages 43 to 47 and in the table above. The sustainability assurance statement is included on page 197.

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

We have used the GHG Protocol Corporate Accounting and Reporting Standard (revised edition) as of 31 December 2014, data gathered to fulfil our requirements under the Carbon Reduction Commitment (CRC) Energy Efficiency scheme and emission factors from the UK Government's GHG Conversion Factors for Company Reporting 2018.

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

Branches

Rolls-Royce is a global company and our activities and interests are operated through subsidiaries, branches of subsidiaries, joint ventures and associates which are subject to the laws and regulations of many different jurisdictions. Our subsidiaries, joint ventures and associates are listed on pages 178 to 185.

Financial instruments

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

Related party transactions

Related party transactions are set out in note 24 to the Consolidated Financial Statements.

Information required by UK Listing Rule (LR) 9.8.4

There are no disclosures to be made under LR 9.8.4.

Management report

The Strategic Report and the Directors' Report together are the management report for the purposes of Rule 4.1.8R of the DTR.

Disclosure of information to auditors

Each of the persons who is a Director at the date of approval of this report confirms that so far as the Director is aware, there is no relevant audit information of which the Company's auditor is unaware. The Director has taken all steps that he or she ought to have taken as a director in order to make himself or herself aware of any relevant audit information and to establish that the Company's auditor is aware of that information.

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