INDEPENDENT AUDITORS' REPORT

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF ROLLS-ROYCE HOLDINGS PLC

Report on the audit of the financial statements

Opinion

In our opinion:

- Rolls-Royce Holdings plc's consolidated financial statements and company financial statements (the "financial statements") give a true and fair view of the state of the group's and of the company's affairs as at 31 December 2021 and of the group's profit and the group's cash flows for the year then ended;
- the consolidated financial statements have been properly prepared in accordance with UK-adopted international accounting standards;
- the company financial statements have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards, comprising FRS 101 "Reduced Disclosure Framework", and applicable law); and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006.

We have audited the financial statements, included within the Annual Report, which comprise: the consolidated and company balance sheets as at 31 December 2021; the consolidated income statement and consolidated statement of comprehensive income, the consolidated cash flow statement, and the consolidated and company statements of changes in equity for the year then ended; and the notes to the financial statements, which include a description of the significant accounting policies.

Our opinion is consistent with our reporting to the Audit Committee.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities under ISAs (UK) are further described in the Auditors' responsibilities for the audit of the financial statements section of our report. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independence

We remained independent of the group in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, which includes the FRC's Ethical Standard, as applicable to listed public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

During the period, we identified that we had been involved in the administrative preparation and filing of a subsidiary company's annual return under local company law, which is a prohibited service under paragraph 5.40 of the FRC's Ethical Standard. The service related to an immaterial subsidiary that did not form part of our evidence in respect of the group audit.

We confirm that based on our assessment of the breach, nature and scope of the service and the subsequent action taken, the provision of this service has not compromised our professional judgement or integrity and as such believe that an objective, reasonable and informed third party in possession of these facts would conclude that our integrity and objectivity has not been impaired and accordingly we remain independent for the purposes of the audit.

Other than the matter referred to above, to the best of our knowledge and belief, we declare that no non-audit services prohibited by the FRC's Ethical Standard were provided to the group or the company.

Other than those disclosed in note 7 to the consolidated financial statements, we have provided no non-audit services to the company or its controlled undertakings in the period under audit.

Our audit approach

Context

There is significant interest from stakeholders including members about how climate change will affect the group's businesses and its future financial performance. The Sustainability section of the Strategic Report describes the group's decarbonisation strategy and explains how climate change could have a significant impact on the group's businesses but also provides a number of significant opportunities. The group has publicly set out its 2030 net carbon zero from operations (excluding product testing and development) and net zero 2050 commitments and has a strategy aligned to meeting these albeit the pathway to the 2050 net zero target is not fully developed.

A number of financial risks could arise from both the physical and transitional risks due to climate change. Management, assisted by an independent expert, has evaluated these as disclosed in the Sustainability section of the Strategic Report. This, with further analysis has then informed the evaluation of financial risks that have been reflected by management in the preparation of the financial statements, or where appropriate allowed it to conclude there is no material impact. The future financial impacts are clearly uncertain given the timeframe involved and their dependency on how Governments, global markets, corporations and society respond to the issue of climate change. Accordingly, financial statements cannot capture all possible future outcomes as these are not yet known.

As part of our audit we understood the process management and its expert on climate change undertook to support the disclosures made within the Sustainability section of the Strategic Report (including the group's TCFD disclosures) and its assessment of the impact on the financial statements. Using our knowledge of the business and with assistance from our internal climate and valuation experts, we evaluated management's risk assessment, its estimates as described in note 1 of the consolidated financial statements and resulting disclosures where significant.

The key areas of the financial statements where management evaluated that climate change has a potential significant impact, taking into account the group's 2030 and 2050 commitments, are:

— Long term contract accounting in the UK Civil business (including contract loss provisions);

— The recoverability of deferred tax assets in the UK; and

— The recoverability of the carrying value of goodwill and certain intangible assets and the company's investments in subsidiary undertakings on the company balance sheet.

Where significant further details of how climate change has been considered in the above areas and our audit response is given in the key audit matters that follow. The impact of climate change in respect of the impairment assessments for goodwill and certain intangible assets did not give rise to an impairment or result in the assessment being sensitive to reasonably possible changes in key assumptions in those assessments including a sensitivity to reflect the impact of the group's 1.5ºC scenario aligned to the Paris Agreement that has been used in its TCFD disclosures. We also considered the impact of climate change in the Directors' assessments of going concern and viability and the associated disclosures in the going concern and viability statements within the Strategic Report.

Overview

Audit scope

— Following our assessment of the risks of material misstatement of the consolidated financial statements we subjected 37 individual components (including three joint ventures) to full scope audits for group purposes, which following an element of sub-consolidation, equates to 16 group reporting opinions. In addition, targeted specified procedures were performed for eight components.

— In addition, the group engagement team audited the company and other centralised functions including those covering the group treasury operations, corporate costs, corporate taxation, post-retirement benefits, and certain goodwill and intangible asset impairment assessments. The group engagement team performed audit procedures over the group consolidation and financial statements disclosures and performed group level analytical procedures over out of scope components.

— The components on which full scope audits, targeted specified procedures and centralised work was performed accounted for 93% of revenue from continuing and discontinued operations, 82% of loss before tax from continuing and discontinued operations and 89% of total assets.

— Central audit testing was performed where appropriate for reporting components in group audit scope who are supported by the group's Finance Service Centres (FSCs).

— As part of the group audit supervision process, the group engagement team performed 13 virtual file reviews, which included meetings on approach and conclusions with the component teams and review of their audit files and final deliverables. In person site visits to component teams in the UK and US and a virtual site visit to a component team in Germany were also performed.

Key audit matters

— Long-term contract accounting and associated provisions (group)

— Deferred tax asset recognition and recoverability (group)

— Translation of foreign-currency denominated transactions and balances (group)

— Presentation and accuracy of underlying results and disclosure of other one-off items (including exceptional items) (group)

— Determination of ITP Aero disposal group (group)

— Accounting treatment and related consolidation adjustments for Civil engine sales to related entities (group)

— Recoverability of the company's investment in subsidiary undertakings (company)

Materiality

- Overall group materiality: £80m (2020: £70m) based on approximately 0.6% of four year average underlying revenues from continuing and discontinued operations.
- Overall company materiality: £147m (2020: £147m) based on approximately 1.0% of total assets.
- Performance materiality: £60m (2020: £53m) (group) and £110m (2020: £110m) (company).

The scope of our audit

As part of designing our audit, we determined materiality and assessed the risks of material misstatement in the financial statements.

Key audit matters

Key audit matters are those matters that, in the auditors' professional judgement, were of most significance in the audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) identified by the auditors, including those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. These matters, and any comments we make on the results of our procedures thereon, were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

This is not a complete list of all risks identified by our audit.

Determination of the ITP Aero disposal group and the accounting treatment and related consolidation adjustments for Civil engine sales to related entities are new key audit matters this year. Recoverability of accounts receivable and contract assets, recoverability of intangible programme assets, ability of the group and company to continue as a going concern and impact of the COVID-19 pandemic, which were key audit matters last year, are no longer included because of developments in the industry and the outlook since 2020. The group recorded £481m of impairments to development expenditure in the year ended 31 December 2020 which included those programmes most sensitive to changes in forecasts. Following additional liquidity raised by the group in the year and the timing of the next debt maturity, we did not consider the ability of the company or group to continue as a going concern to be a key audit matter. Notwithstanding this, we audited management's assessment as detailed in the relevant section below. We have captured the impact of COVID-19, where applicable, separately in the individual key audit matters below. Otherwise, the key audit matters below are consistent with last year.

Key audit matter	How our audit addressed the key audit matter
Long-term contract accounting and associated provisions (group) *Audit Committee report and note 1 to the consolidated financial statements – Accounting policies – Revenue recognition* The Civil Aerospace and Defence businesses operate primarily with long-term customer contracts that span multiple periods. These long-term contracts require a number of assumptions to be made in order to determine the expected lifetime revenue and costs of the contract and the amounts of revenue and profit that are recognised in each reporting period. Small adjustments can have a significant impact on the results of an individual financial year. In addition, changes to the operating condition of engines such as changes in route structure can result in different performance assumptions and hence cost profiles which impact the expected profitability of a contract. For Defence, long term contracts tend to be for a fixed price or based on a cost plus or target cost reimbursement for qualifying costs and there are also some flying hours arrangements. For Civil Aerospace aftermarket contracts, cash is earned based on engine flying hours, which requires management to estimate future engine flying hours (EFH) and associated pricing in order to arrive at the total income expected over the life of a contract. There remains uncertainty over the speed and shape of recovery in EFH for large engines. The group expects international passenger traffic to reach 2019 levels in late 2024.	We focused our work on a number of contracts where we consider there to be the highest degree of management judgement or estimation and designed specific procedures over the long-term contract accounting targeted at the associated risks. We also sample tested the remaining population of contracts. This approach was applied in the Civil Aerospace and Defence businesses and was substantive in nature. The audit procedures performed included: — We attended meetings with Civil Aerospace and Defence engine programme and customer contract managers in order to understand the operational matters impacting the performance of specific contracts and any amendments to contractual arrangements required by changes to underlying expectations of performance; — We obtained and read the relevant sections of a sample of contracts to understand the key terms including performance obligations and pricing structures; — We assessed how management had forecast the speed and shape of the recovery of engine flying hours including by considering the downside scenarios modelled and comparing the assumptions to industry data; — We challenged management's judgments and associated risk adjustments relating to the risk of customer default and insolvency, the risk of airlines parking more mature aircraft as a result of COVID-19 and climate change concerns and the ability for contractual protection clauses to be enforced across the customer portfolio; — We re-performed the calculations used to determine the degree of completion for a sample of contracts and this was also used in assessing the magnitude of any catch-up adjustments;

Key audit matter	How our audit addressed the key audit matter
Long-term contract accounting and associated provisions (group) continued In addition, the profitability of aftermarket contracts typically assumes that there will be cost improvements over the lifetime (15–25 years) of the programmes. Significant judgement needs to be applied in determining time-on-wing, whether incremental costs should be treated as wastage or are part of the ongoing cost of servicing a contract, future exchange rates used to translate foreign currency income and costs and other operating parameters used to calculate the projected life cycle. These future costs are also risk adjusted to take into account forecasting accuracy which represents an additional judgement. At the development stage of a programme, agreements are entered into with certain Civil suppliers to share in the risk and rewards of the contracts (Risk and Revenue Sharing Partners – 'RRSP'). This can involve upfront participation fees from the RRSP that are amortised over the engine production phase. In addition, specified revenue and costs are recorded in the consolidated income statement net of the RRSP's share. The nature of the Civil Aerospace business gives rise to a number of contractual guarantees, warranties and potential claims, including the in-service issues of the Trent 1000 programme. The accounting for these can be complex and judgemental and may impact the consolidated income statement immediately or over the life of the contract. The valuation of provisions for the associated amounts may be judgemental and needs to be considered on a contract by contract basis. Management has engaged a third party expert to model the potential impact of climate change on its forecasts and has incorporated these estimates into the long-term contract models. This included an assessment of the impact on aviation demand, the potential impact of carbon prices on the group's direct emissions and those of its suppliers, and the potential impact of climate change on commodity prices in cost estimates. The impact of climate change on long-term contracts is highly uncertain and requires estimates on carbon prices, the cost and speed of decarbonisation, the ability of the group and its suppliers to pass on incremental costs.	— We compared the previously forecast results of a sample of contracts with the actual results to assess the performance of the contract and the historical accuracy of forecasting; — We verified a sample of costs incurred to third party documentation in order to test the assessment of the forecast costs to complete; — We assessed the assumptions relating to life cycle cost reductions to determine the likelihood of realisation and where relevant the speed at which they would be achieved, including the impact on the number of shop visits, validating these assumptions directly with the senior programme engineers; — We obtained support for the risk adjustments made in respect of future costs and challenged management's assumptions through assessment against historical performance, known technical issues and the stage of completion of the programme; — Where disruption has resulted in payments to customers we validated the settlement to contractual agreements, considered the terms of previous settlements, correspondence with customers, the forecast period of further aircraft being on the ground and the completeness of this liability; — We challenged the assessment of provisions for loss making or onerous contracts to determine the completeness of the unavoidable costs to fulfil the contractual obligations including an assessment of the discount rates used and how management has considered the potential impact of climate change; — We assessed the sensitivity of the Trent 1000 provision to reasonable changes in estimates, particularly in respect of the repair and overhaul facility capacity, technical cost creep on the known issues and cost outturns against previous provisions, in determining whether the provision was sufficient; — We read and understood the key terms of a sample of RRSP contracts to assess whether revenue and costs had been appropriately reflected, net of the share attributable to the RRSP in the consolidated income statement; — With assistance from our valuation experts, we considered the appropriateness of the key assumptions used by management's expert to model the impact of climate change, including the reasonableness of the carbon and commodity price forecasts. We validated management's assertions on the ability of suppliers and the group to pass on incremental costs by reviewing a sample of supplier and customer contracts for price change mechanisms. Where appropriate we performed independent sensitivity analysis to determine to what extent reasonably possible changes in these assumptions could result in material changes to the revenue recorded in the year and assessed the appropriateness of the associated disclosures; — We considered whether there were any indicators of management override of controls or bias in arriving at their reported position; and — We also assessed the adequacy of disclosures in note 1 of the key judgements and estimates involved in long-term contract accounting. Based on the work performed, we concur that management's estimates for long-term contract accounting and associated provisions and its disclosures of the key estimates and judgements involved are materially appropriate.

Key audit matter	How our audit addressed the key audit matter
Deferred tax asset recognition and recoverability (group) *Audit Committee report, note 1 to the consolidated financial statements – Accounting policies – Taxation and note 5 to the consolidated financial statements – Taxation* The recognition and recoverability of deferred tax assets in Rolls-Royce plc is a significant judgement. Rolls-Royce plc has recognised significant deferred tax assets on the basis of expected future levels of profitability. The magnitude of the assets recognised, which largely increased in the year as a result of the substantial enactment of the change in UK corporation tax rate from 19% to 25% from 1 April 2023, necessitates the need for a number of assumptions in assessing the future levels of profitability in the UK over an extended period. The additional UK loss recorded for 2021, along with the existence of tax losses brought forward and other deductible temporary differences in Rolls-Royce plc, combined with the impact of COVID-19 and climate change on future forecasts, presents a heightened risk that deferred tax assets previously recognised may not be recoverable. Since the recognised deferred tax asset is recoverable over a long period, management has reflected its assessment of the impact of climate change within the model forecasting probable taxable profits. This incorporates multiple assumptions including future carbon prices, commodity prices, the impact on aviation demand, the cost and speed of decarbonisation and the ability of suppliers and Rolls-Royce plc to pass on price changes. To assess the impact of inherent uncertainty it has performed sensitivities over key estimates.	We evaluated management's methodology for assessing the recognition and recoverability of deferred tax assets, including the ability to offset certain deferred tax liabilities and deferred tax assets. Where recognition is supported by the availability of sufficient probable taxable profits in future periods against which the asset can be utilised in future periods, our evaluation of these future profits considered both the business model and the applicable UK tax legislation. We tested the increase in the opening UK deferred tax asset balance as a result of the increase in the UK corporation tax rate. We assessed the future profit forecasts and the underpinning assumptions including management's risk weighting of profit forecasts in Rolls-Royce plc and tested the reasonableness of the assumptions and forecasts for periods beyond the normal five year forecasting horizon. Where applicable we assessed the consistency of the forecasts used to justify the recognition of deferred tax assets to those used elsewhere in the business, including for long-term contract accounting, impairment assessments, or for the Directors' viability and going concern statements. We also assessed the risk adjustments applied by management to these profit forecasts to future periods that are significantly further in time than the group's normal five year forecasting process and considered whether these appropriately reflect the estimation risk in the longer term forecasts. We challenged management to incorporate climate change as part of their probability weighted scenarios to forecast probable profit levels. As described in the long-term contract accounting and associated provisions key audit matter, this included deploying valuation experts to assess the reasonableness of carbon pricing and commodity assumptions, as well as the comparison of forecast aviation demand to third party sources. We considered the likelihood that the group and its suppliers would be able to pass on incremental climate related costs in the short, medium and longer term and verified that management's forecasts included the costs arising from the group's stated commitment to reach net zero for direct emissions by 2030. We requested that management perform additional sensitivity analysis to understand whether reasonably possible changes to these assumptions could lead to a material change in the recognised asset and where appropriate ensured that adequate disclosure was provided. We assessed the treatment of the losses that are realised or unrealised on the group's hedge book and whether they were treated appropriately and how they are recovered using the same profit forecasts. We also assessed the adequacy of disclosures over this area, particularly the impact of changes in key estimates of the asset recognised and this has been disclosed in notes 1 and 5. We did not identify any material uncorrected exceptions from our audit work.

Key audit matter	How our audit addressed the key audit matter
Translation of foreign-currency denominated transactions and balances (group) *Note 1 to the consolidated financial statements – Accounting policies – Foreign currency translation* Foreign exchange rate movements influence the reported consolidated income statement, the consolidated cash flow statement and the consolidated balance sheet. One of the group's primary accounting systems that is used by a number of its subsidiaries translates transactions and balances denominated in foreign currencies at a fixed budget rate for management information purposes. Foreign currency denominated transactions and balances are then re-translated to actual average and closing spot rates through manual adjustments. Due to the manual nature of the process and significance of the recurring adjustments needed there is a risk that transactions and balances denominated in foreign currencies are incorrectly translated in the consolidated financial statements.	In addition to our testing in other areas of the various financial statement line items, we performed the following specific audit procedures over this area: — Obtained an understanding of the process employed by management to correctly record the translation of foreign currency balances and transactions; — Tested on a sample basis the manual calculations of the adjustment needed to correctly record the translation of the foreign currency denominated transactions and balances; — Sampled balances and transactions requiring adjustment by source currency and tested to source data and assessed the completeness of these balances and transactions; — Created an independent expectation of the gain/loss on the translation of monetary assets and liabilities based on the movements in the group's key exchange rates and associated balances in the year; — Agreed the exchange rates used in management's translation adjustments to an independent source; and — For each adjustment sampled, assessed whether the foreign currency denominated balance or transaction was translated at the appropriate exchange rate depending on its nature. There were no material uncorrected exceptions from our audit work.
Presentation and accuracy of underlying results and disclosure of other one-off items (including exceptional items) (group) *Note 1 to the consolidated financial statements – Accounting policies – Presentation of underlying results, note 2 to the consolidated financial statements – Segmental analysis and note 28 to the consolidated financial statements – Derivation of summary of funds flow statement* In addition to the performance measures prescribed by International Financial Reporting Standards, the group also presents its results on an underlying basis, as the Directors believe this better reflects the performance of the group during the year. The group also presents a free cash flow metric which the Directors believe reflects the cash generated from underlying trading; this differs from the cash flows presented in the consolidated cash flow statement. The underlying results differ from the reported statutory results and are used extensively to explain performance to the shareholders. Alternative performance measures can provide investors with a better understanding of the group's performance if consistently calculated, properly used and presented. However, when improperly used and presented, these non-GAAP measures can mislead investors and may mask the real financial performance and position. There is judgement on whether items should be excluded from underlying profit or free cash flow.	We considered the judgements taken by management to determine what should be treated as a one-off or exceptional item and the translation of foreign currency amounts and obtained corroborative evidence for these. We also considered whether there were items that were recorded within underlying profit that are exceptional in nature and should be reported as an exceptional item. No such material items were identified. As part of this assessment we challenged management's rationale for the designation of certain items as exceptional or one-off and assessed such items against the group's accounting policy, considering the nature and value of those items. Within underlying results, foreign currency transactions are presented at rates achieved on derivative contracts hedging the net operating cash flows of the group and monetary assets and liabilities are retranslated at rates forecast to be achieved on derivative contracts when the associated cash flows occur. We agreed these forecast rates to the profile of the derivatives that are expected to mature in the future and tested their application to the relevant monetary assets and liabilities. We audited the reconciling items between the underlying profit before tax and free cash flow disclosed in note 28 including verifying that the items adjusted for are consistent with the prior period. We also considered whether free cash flow contains material one-off items which require further disclosure.

Key audit matter	How our audit addressed the key audit matter
Presentation and accuracy of underlying results and disclosure of other one-off items (including exceptional items) (group) continued A key adjustment between the statutory results and the underlying results relates to the foreign exchange rates used to translate foreign currency transactions and balances. The underlying results reflect the achieved rate on foreign currency derivative contracts settled in the period and retranslates assets and liabilities at the foreign currency rates at which they are expected to be realised or settled in the future. As the group can influence which derivative contracts are settled in each reporting period it has the ability to influence the achieved rate and hence the underlying results. This risk is more limited for free cash flow as there are a small number of items that are excluded from free cash flows. During the year, the group excluded a number of items from underlying profit before tax including £105m of credits from the net release of onerous contracts and Trent 1000 provisions and a net £45m of credits associated with lower restructuring costs.	We assessed the appropriateness and completeness of the disclosures of the impact of one-off or non-underlying items primarily in notes 1, 2, 4 and 28 to the consolidated financial statements and found them to be appropriate. This included assessing the explanations management provided on the reconciling items between underlying performance and statutory performance in note 2. We also assessed the appropriateness of excluding the results of ITP Aero from underlying profit, reflecting the internal reporting of the group and considered the associated disclosure explaining the change. Overall we found that the classification judgements made by management were in line with their policy for underlying results and exceptional items, had been consistently applied and there are no material uncorrected misstatements resulting from our testing.
Determination of ITP Aero disposal group (group) *Note 1 to the consolidated financial statements – Accounting policies – Discontinued operations and note 27 to the consolidated financial statements – Assets held for sale and discontinued operations* Following the group's announcement of the planned sale of ITP Aero, the business was classified as a discontinued operation held for sale. This resulted in the assets and liabilities being recognised as held for sale within the consolidated balance sheet and the results being presented within the loss from discontinued operations line on the consolidated income statement. There remains significant trading between ITP Aero and the rest of the group which is required to be eliminated when arriving at the group's results. Whether these adjustments should be classified within balances held for sale is judgemental and dependent on the structure of the business post disposal. Further, additional adjustments were required to be recorded in 2021 to reflect commercial restructuring between ITP Aero and the rest of the group prior to disposal.	We assessed the appropriateness of classifying ITP Aero as a discontinued operation held for sale based on the progress of the sale. This included validating management's judgement on the likelihood of the disposal through reviewing the sales agreement and understanding the status of the transaction, including the required regulatory approval. We have considered the restructuring made to contractual arrangements by the group prior to the sale of ITP Aero, including the transfer of businesses to the disposal group. We validated that these changes and the impact of intra-group trading had been appropriately eliminated in arriving at the consolidated results for the group. We also validated management's judgement that the impact of intra-group trading should be eliminated against the results of the discontinued operation, which most closely reflects the relationship the continuing group will have with ITP Aero following its sale. We assessed the adequacy of the disclosures in the notes to the consolidated financial statements explaining this change. We found them, along with the classifications, to be materially appropriate in the context of the consolidated financial statements when taken as a whole.

Key audit matter	How our audit addressed the key audit matter
Accounting treatment and related consolidation adjustments for Civil engine sales to related entities (group) *Audit Committee report and note 1 to the consolidated financial statements – Accounting policies – Revenue recognition* The group has historically made engine sales to related entities. In 2021, a new related entity was established, which will provide in some instances spare engine capacity to the group to support its installed fleet. A limited number of engine sales were made to this related entity in the year, which are expected to increase in the future. In order for revenue to be recognised on engine sales to related entities, these entities cannot be controlled by Rolls-Royce and control of the engines must have passed from the company and its subsidiaries to the related entity. There is significant judgement whether this is the case based on the terms of the sale, any ongoing arrangement and the structure of the entity. Accounting standards require the group's share of unrealised profit on sales to related entities to be eliminated and therefore the value of sales and the related unrealised profit need to be accurately reflected within the group's consolidation adjustments.	We considered management's assessment of whether the related entity was controlled by Rolls-Royce by reference to its articles of association, the indirect shareholding and the influence that Rolls-Royce has over the direction and strategy of the entity. We obtained and reviewed the engine sales contract and the capacity agreement setting out the ongoing arrangement between Rolls-Royce and the new related entity, as well as management's assessment of whether control of the engines and transfer of risks and reward of ownership, can be demonstrated. In assessing this, we considered: — The rights of the related entity to choose how engines are utilised and any commitments of the ongoing capacity agreement; — The commercial structure of the ongoing arrangement including commitments made and penalty arrangements; and — Whether Rolls-Royce remained exposed to risks associated with engine ownership following the sale including non-utilisation of engines, the risk to movements in the end of life engine value, the risk to damage or misuse to the engine and whether Rolls-Royce is committed to buy back the engines. We also considered whether there are any side agreements between Rolls-Royce and the related entity which may alter the main contract arrangements through our enquiries with management, review of meeting minutes and our audit procedures in other areas and did not identify any such arrangements. We verified that the group's share of unrealised profit from engine sales to related entities has been appropriately eliminated from the group's profit in the year. We reviewed the group's disclosure of the engine sales to related entities including the key judgement disclosed in note 1 and transactions with related parties disclosed in note 26 and found these to be appropriate. As a result of our work we did not identify any material exceptions from the treatment or disclosure of engine sales to related entities.
Recoverability of the company's investment in subsidiary undertakings (company) *Note 1 to the company financial statements - Accounting policies and note 2 to the company financial statements – Investments – Subsidiary Undertakings* Investments in subsidiaries of £14,716m (2020: £14,688m) are accounted for at cost less provision for impairment in the company balance sheet at 31 December 2021. Investments are tested for impairment if impairment indicators exist. If such indicators exist, the recoverable amounts of the investments in subsidiaries are estimated in order to determine the extent of the impairment loss, if any. Any such impairment loss is recognised in the income statement. A review for indicators of impairment was performed by management focusing on developments since the last quantitative impairment test performed in 2020. This included considering the latest available fore-casts, movements in the cost of capital and developments in the group in the year. Management also quantified the potential impact of climate change on the group's future cash flows including a consideration of the impact of the group's 1.5ºC scenario aligned to the Paris Agreement that has been used in its TCFD disclosures. Management's assessment identified no impairment triggers and that a further quantitative impairment test in 2021 was not required with the carrying value remaining fully recoverable.	We evaluated management's determination of whether any indicators of impairment existed. While the investment carrying value exceeded the market capitalisation of the group at 31 December 2021, the market capitalisation has increased in the year. We considered what would be a reasonable control premium that could be applied to the market capitalisation by reference of those achieved in past transactions of similar sized companies and the extent to which this bridges the gap between the market capitalisation and the carrying value. In addition, in auditing management's assessment, we: — Reconciled the group's latest cash flows to those audited as part of other key audit matters and compared them to those estimated in the 31 December 2020 impairment model; — Considered the developments in the group in the year including the establishment of Rolls-Royce Small Modular Reactors (SMR) business. We considered the value of this business implied by the minority investments committed in the year; and — Assessed the appropriateness of the group's cost of capital, which has decreased in the year, through deploying our valuation expert.

Key audit matter	How our audit addressed the key audit matter
Recoverability of the company's investment in subsidiary undertakings (company) continued	We validated the key assumptions included within management's assessment of the impact of climate change on the group's cash flows which was compared to the headroom determined in the 2020 impairment model. This included consideration of the costs of the group's 2030 commitment and with the assistance of our valuation experts assessing the reasonableness of management's assumptions on future carbon prices and changes in commodity prices. We performed sensitivities over other key assumptions and concluded that their potential impact on the headroom determined in the quantitative impairment test in 2020, would not have resulted in an impairment and therefore agree with management's conclusion that no impairment triggers exist. We reviewed the company's disclosure in note 1 to the company financial statements over the key judgement on whether an indicator of impairment was present at 31 December 2021 and found this to be appropriate. As a result of our work, we did not identify any material exceptions from management's judgement that no factors have occurred in 2021 which indicated that the headroom determined as part of the 2020 impairment test would have been significantly eroded to warrant a further impairment test at 31 December 2021.

How we tailored the audit scope

We tailored the scope of our audit to ensure that we performed enough work to be able to give an opinion on the financial statements as a whole, taking into account the structure of the group and the company, the accounting processes and controls, and the industry in which they operate.

Our scoping is based on the group's consolidation structure. We define a component as a single reporting unit which feeds into the group consolidation. Of the group's 433 reporting components, 37 individual components (including three joint ventures) were subject to full scope audits for group purposes, which following an element of consolidation, equates to 16 group reporting opinions. In addition, targeted specified procedures were performed for eight components.

The group operates Finance Service Centres (FSCs) to bulk process financial transactions in Derby (UK), Indianapolis (US) and Bengaluru (India). Based on our assessment it is not possible to fully test revenue and profit centrally as certain key processes, such as long-term contracting, remain within the business due to their nature and are not handled by the FSCs.

Our audit covered 93% of revenue from continuing and discontinued operations, 82% of loss before tax from continuing and discontinued operations and 89% of total assets. All entities that contribute in excess of 1% of the group's revenue were included in full scope.

Further specific audit procedures over central functions, the group consolidation and areas of significant judgement (including corporate costs, corporate taxation, certain goodwill and intangible asset impairment assessments, treasury and post-retirement benefits) were directly led by the group engagement team.

Where work was performed by component auditors, we determined the level of involvement we needed to have in the audit work at those reporting units to be able to conclude whether sufficient appropriate audit evidence had been obtained as a basis for our opinion on the consolidated financial statements.

We issued formal written instructions to all component auditors setting out the audit work to be performed by each of them and maintained regular communication with the component auditors throughout the audit cycle. These interactions included attending certain component clearance meetings and holding regular conference calls, as well as reviewing and assessing any matters reported. The group engagement team also reviewed selected audit working papers for certain component teams to evaluate the sufficiency of audit evidence obtained and fully understand the matters arising from the component audits.

In addition, senior members of the group engagement team visited component teams in the UK, US and Germany. These visits were in-person for the UK and US and virtual in Germany due to COVID-19 pandemic related restrictions. They included meetings with the component auditor and attendance at component clearance meetings.

Materiality

The scope of our audit was influenced by our application of materiality. We set certain quantitative thresholds for materiality. These, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures on the individual financial statement line items and disclosures and in evaluating the effect of misstatements, both individually and in aggregate on the financial statements as a whole.

Based on our professional judgement, we determined materiality for the financial statements as a whole as follows:

	Financial statements – group	Financial statements – company
Overall materiality	£80m (2020: £70m).	£147m (2020: £147m).
How we determined it	Based on approximately 0.6% of four year average underlying revenues from continuing and discontinued operations	Based on approximately 1.0% of total assets
Rationale for benchmark applied	We have consistently used underlying revenue to determine materiality as opposed to a profit based benchmark. This is because there is considerable volatility in profit before tax as a result of revenue recognition under IFRS 15 and from the fair value movement in the group's derivatives. Underlying revenue continues to be a key performance metric for the group and is much less volatile than the profit metric. However, from 2020 COVID-19 introduced additional volatility that impacted benchmarks. To mitigate this we have used a four year average underlying revenue measure to calculate materiality. ITP Aero, which is classified as a discontinued operation, contributed a full year's results and remained part of the group at 31 December 2021. Therefore, in our view, it is appropriate to continue to take the results of this business into account when determining our materiality.	We determined our materiality based on total assets, which is more applicable than a performance-related measure as the company is an investment holding company for the group. The higher company materiality level was used for the purposes of testing balances not relevant to the group audit, such as investments in subsidiary undertakings and intercompany balances.

For each component in the scope of our group audit, we allocated a materiality that is less than our overall group materiality. The range of materiality allocated across components was between £5m and £74m. Certain components were audited to a local statutory audit materiality that was also less than our overall group materiality.

We use performance materiality to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds overall materiality. Specifically, we use performance materiality in determining the scope of our audit and the nature and extent of our testing of account balances, classes of transactions and disclosures, for example in determining sample sizes. Our performance materiality was 75% (2020: 75%) of overall materiality, amounting to £60m (2020: £53m) for the group financial statements and £110m (2020: £110m) for the company financial statements.

In determining the performance materiality, we considered a number of factors - the history of misstatements, risk assessment and aggregation risk and the effectiveness of controls - and concluded that an amount at the upper end of our normal range was appropriate.

We agreed with the Audit Committee that we would report to them misstatements identified during our audit above £3m (group audit) (2020: £3m) and £7m (company audit) (2020: £7m) as well as misstatements below those amounts that, in our view, warranted reporting for qualitative reasons.

Conclusions relating to going concern

Our evaluation of the directors' assessment of the group's and the company's ability to continue to adopt the going concern basis of accounting included:

- Testing the model used for management's going concern assessment which is primarily a liquidity assessment given there are no significant financial covenants in its committed debt facilities. Management's assessment covered the 18 months to August 2023. We focussed on this period and also considered the forecast liquidity in the subsequent four months to the end of 2023.
- Management's base case forecasts are based on its normal budget and forecasting process for each of its businesses for the next five years. We understood and assessed this process by business including the assumptions used for 2022 and 2023 and assessed whether there was adequate support for these assumptions. We also considered the reasonableness of the monthly phasing of cash flows. A similar assessment was performed of the downside cash flows, including understanding of the scenarios modelled by management, how they were quantified and the resultant monthly phasing of the downside cash flow forecasts.
- We read and understood the key terms of all committed debt facilities to understand any terms, covenants or undertakings that may impact the availability of the facility.

- Using our knowledge from the audit and assessment of previous forecasting accuracy we calculated our own sensitivities to apply to management's cash flow forecasts. We overlaid these on management's forecasts to arrive at our own view of management's downside forecasts. This included consideration of management's assessment of the impact of climate change and the likelihood of any downside risks crystallising in the period to August 2023.
- We assessed the adequacy of disclosures in the Going Concern statement and statements in note 1 of the consolidated and company financial statements and found these appropriately reflect the key areas of uncertainty identified.

Based on the work we have performed, we have not identified any material uncertainties relating to events or conditions that, individually or collectively, may cast significant doubt on the group's and the company's ability to continue as a going concern for a period of at least twelve months from when the financial statements are authorised for issue.

In auditing the financial statements, we have concluded that the directors' use of the going concern basis of accounting in the preparation of the financial statements is appropriate.

However, because not all future events or conditions can be predicted, this conclusion is not a guarantee as to the group's and the company's ability to continue as a going concern.

In relation to the directors' reporting on how they have applied the UK Corporate Governance Code, we have nothing material to add or draw attention to in relation to the directors' statement in the financial statements about whether the directors considered it appropriate to adopt the going concern basis of accounting.

Our responsibilities and the responsibilities of the directors with respect to going concern are described in the relevant sections of this report.

Reporting on other information

The other information comprises all of the information in the Annual Report other than the financial statements and our auditors' report thereon. The directors are responsible for the other information, which includes reporting based on the Task Force on Climate-related Financial Disclosures (TCFD) recommendations. Our opinion on the financial statements does not cover the other information and, accordingly, we do not express an audit opinion or, except to the extent otherwise explicitly stated in this report, any form of assurance thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If we identify an apparent material inconsistency or material misstatement, we are required to perform procedures to conclude whether there is a material misstatement of the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report based on these responsibilities.

With respect to the Strategic report and Directors' report, we also considered whether the disclosures required by the UK Companies Act 2006 have been included.

Based on our work undertaken in the course of the audit, the Companies Act 2006 requires us also to report certain opinions and matters as described below.

Strategic report and Directors' report

In our opinion, based on the work undertaken in the course of the audit, the information given in the Strategic report and Directors' report for the year ended 31 December 2021 is consistent with the financial statements and has been prepared in accordance with applicable legal requirements.

In light of the knowledge and understanding of the group and company and their environment obtained in the course of the audit, we did not identify any material misstatements in the Strategic report and Directors' report.

Directors' Remuneration

In our opinion, the part of the Remuneration Committee Report to be audited has been properly prepared in accordance with the Companies Act 2006.

Corporate governance statement

The Listing Rules require us to review the directors' statements in relation to going concern, longer-term viability and that part of the corporate governance statement relating to the company's compliance with the provisions of the UK Corporate Governance Code specified for our review. Our additional responsibilities with respect to the corporate governance statement as other information are described in the Reporting on other information section of this report.

Based on the work undertaken as part of our audit, we have concluded that each of the following elements of the corporate governance statement is materially consistent with the financial statements and our knowledge obtained during the audit, and we have nothing material to add or draw attention to in relation to:

— The directors' confirmation that they have carried out a robust assessment of the emerging and principal risks;

— The disclosures in the Annual Report that describe those principal risks, what procedures are in place to identify emerging risks and an explanation of how these are being managed or mitigated;

— The directors' statement in the financial statements about whether they considered it appropriate to adopt the going concern basis of accounting in preparing them, and their identification of any material uncertainties to the group's and company's ability to continue to do so over a period of at least twelve months from the date of approval of the financial statements;

— The directors' explanation as to their assessment of the group's and company's prospects, the period this assessment covers and why the period is appropriate; and

— The directors' statement as to whether they have a reasonable expectation that the company will be able to continue in operation and meet its liabilities as they fall due over the period of its assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.

Our review of the directors' statement regarding the longer-term viability of the group was substantially less in scope than an audit and only consisted of making inquiries and considering the directors' process supporting their statement; checking that the statement is in alignment with the relevant provisions of the UK Corporate Governance Code; and considering whether the statement is consistent with the financial statements and our knowledge and understanding of the group and company and their environment obtained in the course of the audit.

In addition, based on the work undertaken as part of our audit, we have concluded that each of the following elements of the corporate governance statement is materially consistent with the financial statements and our knowledge obtained during the audit:

— The directors' statement that they consider the Annual Report, taken as a whole, is fair, balanced and understandable, and provides the information necessary for the members to assess the group's and company's position, performance, business model and strategy;

— The section of the Annual Report that describes the review of effectiveness of risk management and internal control systems; and

— The section of the Annual Report describing the work of the Audit Committee.

We have nothing to report in respect of our responsibility to report when the directors' statement relating to the company's compliance with the Code does not properly disclose a departure from a relevant provision of the Code specified under the Listing Rules for review by the auditors.

Responsibilities for the financial statements and the audit

Responsibilities of the directors for the financial statements

As explained more fully in the Statement of Directors' responsibilities in respect of the Financial Statements, the directors are responsible for the preparation of the financial statements in accordance with the applicable framework and for being satisfied that they give a true and fair view. The directors are also responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the group's and the company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the group or the company or to cease operations, or have no realistic alternative but to do so.

Auditors' responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

Irregularities, including fraud, are instances of non-compliance with laws and regulations. We design procedures in line with our responsibilities, outlined above, to detect material misstatements in respect of irregularities, including fraud. The extent to which our procedures are capable of detecting irregularities, including fraud, is detailed below.

Based on our understanding of the group and industry, we identified that the principal risks of non-compliance with laws and regulations related to the UK Corporate Governance Code, the Listing Rules of the UK Financial Conduct Authority, tax compliance legislation, the regulations of country aviation authorities such as the Civil Aviation Authority, import and export restrictions (including International Traffic in Arms Regulations), and the UK Bribery Act, and we considered the extent to which non-compliance might have a material effect on the financial statements. We also considered those laws and regulations that have a direct impact on the financial statements such as the Companies Act 2006 and tax legislation. We evaluated management's incentives and opportunities for fraudulent manipulation of the financial statements (including the risk of override of controls), and determined that the principal risks were related to : (1) posting inappropriate journal entries to manipulate financial results; (2) management bias in accounting estimates such as long-term contract accounting and associated provisions and deferred tax asset recognition; (3) the sale of Civil engines to related entities for no clear commercial purpose or above market prices; and (4) inappropriately including or excluding transactions from the group's underlying or free cash flow alternative performance metrics. The group engagement team shared this risk assessment with the component auditors so that they could include appropriate audit procedures in response to such risks in their work. Audit procedures performed by the group engagement team and/or component auditors included:

— Discussions throughout the year with management, internal audit, the group's internal and external legal counsel, and the head of ethics and compliance, including consideration of known or suspected instances of non-compliance with laws and regulation and fraud;

— Reading the minutes of the group's Safety, Ethics & Sustainability committee and assessment of 'speak-up' matters reported through the group's Ethics Line and the results of management's investigation of such matters;

— Reading the minutes of Board meetings to identify any inconsistencies with other information provided by management;

— Reviewing legal expense accounts to identify significant legal spend that may be indicative of non-compliance with laws and regulations;

— Challenging assumptions and judgements made by management in determining significant accounting estimates (because of the risk of management bias), in particular in relation to long-term contract accounting and associated provisions and the recoverability of deferred tax assets (see related key audit matters above);

— Testing the purpose and the pricing of sales of spare engines to related entities;

— Understanding and evaluating changes in processes and controls as a result of the COVID-19 pandemic;

— Identifying and testing unusual journal entries, in particular journal entries posted with unusual account combinations, and testing all material consolidation journals; and

— Challenging why certain items are excluded or included from underlying profit or free cash flow.

There are inherent limitations in the audit procedures described above. We are less likely to become aware of instances of non-compliance with laws and regulations that are not closely related to events and transactions reflected in the financial statements. Also, the risk of not detecting a material misstatement due to fraud is higher than the risk of not detecting one resulting from error, as fraud may involve deliberate concealment by, for example, forgery or intentional misrepresentations, or through collusion.

Our audit testing might include testing complete populations of certain transactions and balances, possibly using data auditing techniques. However, it typically involves selecting a limited number of items for testing, rather than testing complete populations. We will often seek to target particular items for testing based on their size or risk characteristics. In other cases, we will use audit sampling to enable us to draw a conclusion about the population from which the sample is selected.

A further description of our responsibilities for the audit of the financial statements is located on the FRC's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditors' report.

Use of this report

This report, including the opinions, has been prepared for and only for the company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Other required reporting

Companies Act 2006 exception reporting

Under the Companies Act 2006 we are required to report to you if, in our opinion:

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

We have no exceptions to report arising from this responsibility.

Appointment

Following the recommendation of the Audit Committee, we were appointed by the members on 3 May 2018 to audit the financial statements for the year ended 31 December 2018 and subsequent financial periods. The period of total uninterrupted engagement is four years, covering the years ended 31 December 2018 to 31 December 2021.

Other matter

As required by the Financial Conduct Authority Disclosure Guidance and Transparency Rule 4.1.14R, these financial statements form part of the ESEF-prepared annual financial report filed on the National Storage Mechanism of the Financial Conduct Authority in accordance with the ESEF Regulatory Technical Standard ('ESEF RTS'). This auditors' report provides no assurance over whether the annual financial report has been prepared using the single electronic format specified in the ESEF RTS.

Ian Chambers (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London
24 February 2022

SUSTAINABILITY ASSURANCE STATEMENT

Independent Limited Assurance Statement

To the stakeholders of Rolls-Royce Holdings plc

Introduction and objectives of work

Bureau Veritas UK Limited (Bureau Veritas) has been engaged by Rolls-Royce Holdings plc (Rolls-Royce) to provide limited assurance over selected sustainability performance indicators for inclusion in its 2021 Annual Report and website. This Assurance Statement applies to the related information included within the scope of work described below.

Scope of work

The scope of our work was limited to assurance over the following information included within Rolls-Royce's 2021 Annual Report ('the Report') for the period 1st of January to the 31st of December 2021 (the 'Selected Information'):

- Total Energy consumption;
- Total Scope 1 & 2 greenhouse gases (GHG) emissions (location based);
- Total waste;
- Total Reportable Injuries;
- Number of people reached through the Science, Technology, Engineering and Mathematics (STEM) education outreach programmes; and
- Employee engagement score - 'grand mean' and increase compared to 2020.

Reporting criteria

The Selected Information are reported according to the Rolls-Royce "Basis of Reporting", a copy of which is available from http://rolls-royce.com/sustainability.

Limitations and exclusions

Excluded from the scope of our work is verification of any information relating to:

- Activities outside the defined verification period;
- Financial data taken from the Report which are audited by an external financial auditor;
- The appropriateness of the reporting criteria; and
- Other information included in Rolls-Royce's Report;

This limited assurance engagement relies on a risk based selected sample of sustainability data and the associated limitations that this entails. The scope of a limited assurance engagement is substantially less than for reasonable assurance both in terms of the risk assessment procedures and in performing the procedures to address the identified risks. This independent statement should not be relied upon to detect all errors, omissions or misstatements that may exist.

Responsibilities

This preparation and presentation of the Selected Information in the Report are the sole responsibility of the management of Rolls-Royce.

Bureau Veritas was not involved in the drafting of the Report or of the Reporting Criteria. Our responsibilities were to:

- obtain limited assurance about whether the Selected Information has been prepared in accordance with the Reporting Criteria;
- form an independent conclusion based on the assurance procedures performed and evidence obtained; and
- report our conclusions to the management of Rolls-Royce.

Assessment Standard

We performed our work to a limited level of assurance in accordance with the International Standard on Assurance Engagements (ISAE) 3000 Revised, Assurance Engagements Other than Audits or Reviews of Historical Financial Information (effective for assurance reports dated on or after December 15, 2015), and in accordance with International Standard on Assurance Engagements 3410 – 'Assurance Engagements on Greenhouse Gas Statements' ('ISAE 3410'), issued by the International Auditing and Assurance Standards Board.

Summary of work performed

As part of its independent verification, Bureau Veritas undertook the following activities remotely:

1. Conducted interviews with relevant personnel of Rolls-Royce;
2. Carried out nine virtual site audits, selected employing a risk-based approach, in the United Kingdom, Germany, Italy, the Netherlands, Singapore, Brazil and Indonesia;
3. Reviewed the data collection and consolidation processes used to compile the Selected Information, including assessing assumptions made, the data scope and reporting boundaries;
4. Reviewed documentary evidence produced by Rolls-Royce;
5. Agreed a sample of the Selected Information to the corresponding source documentation;
6. Re-performed aggregation calculations of the Selected Information; and
7. Report our conclusions and recommendation in a formal Management Report to Rolls-Royce.

Conclusion

On the basis of our methodology and the activities described above, nothing has come to our attention to indicate that the Selected Information has not been properly prepared, in all material respects, in accordance with the Reporting Criteria.

It should be noted that there were data gaps with regards to: energy facility data for Civil Nuclear Grenoble; natural gas data from MTU Friedrichshafen. The gaps were not considered material (with respect to the Basis of Reporting) to the whole and that the data will be restated in 2022 accordingly.

Statement of Independence, Integrity and Competence

Bureau Veritas is an independent professional services company that specialises in quality, environmental, health, safety and social accountability with over 185 years history. Its assurance team has extensive experience in conducting verification over environmental, social, ethical and health and safety information, systems and processes.

Bureau Veritas operates a certified Quality Management System which complies with the requirements of ISO 9001:2015, and accordingly maintains a comprehensive system of quality control including documented policies and procedures regarding compliance with ethical requirements, professional standards and applicable legal and regulatory requirements.

Bureau Veritas has implemented and applies a Code of Ethics, which meets the requirements of the International Federation of Inspections Agencies (IFIA) across the business to ensure that its employees maintain integrity, objectivity, professional competence and due care, confidentiality, professional behaviour and high ethical standards in their day-to-day business activities.

The assurance team for this work does not have any involvement in any other Bureau Veritas projects with Rolls-Royce.

Bureau Veritas UK Limited
London
23 February 2022

Certificate of Registration can be provided on request
International Federation of Inspection Agencies – Compliance Code – Third Edition

GREENHOUSE GAS EMISSIONS

In 2021, our total gross greenhouse gas (GHG) emissions were 393,000 tonnes of carbon dioxide equivalent (tCO_2e). This represents a decrease of 8% compared with 426,000 tCO_2e in 2020.

Aspect	tCO_2e	2017	2018	2019	2020	2021
Emissions from activities for which the company own or control including the combustion of fuel and operation of facilities. [Direct GHG Emissions (Scope 1)]	Global (excluding UK)	158,442	160,179	164,507	157,215	**150,988**
	UK	99,454	84,868	92,355	86,116	**65,800**
Emissions from the purchase of electricity, heat, steam and cooling purchased for our own use. [Indirect GHG Emissions (Scope 2) location-based]	Global (excluding UK)	154,846	152,797	141,335	116,900	**121,222**
	UK	122,635	100,808	86,803	65,909	**55,320**
Total gross GHG emissions	Global (excluding UK)	313,288	312,976	305,842	274,115	**272,210**
	UK	222,089	185,676	179,158	152,025	**121,120**
Energy consumption used to calculate above emissions- kWh	Global (excluding UK)	1,160,297,295	1,184,321,753	1,180,296,329	1,063,819,977	**1,011,759,540**
	UK	810,019,730	761,816,226	775,039,189	685,752,411	**566,815,284**
Intensity Ratio (total GHG emissions per £m revenue)	Total	38.6	34.2	30.3	37.1	**34.9**
Emissions from the purchase of electricity, heat, steam and cooling purchased for our own use. [Indirect GHG Emissions (Scope 2) market-based]	Global (excluding UK)	0	0	303	2,023	**191**
	UK	0	4	1,833	2,043	**1,878**
Outside of Scopes	Global (excluding UK)	0	0	0	0	**0**
	UK	0	0	20,743	45,213	**22,841**
Additional Supporting Information						
Electricity purchased from renewable sources – kWh	Global (including UK)	0	0	245,314,593	304,067,206	**283,164,576**
Energy generated on-site from renewable sources kWh	Global (including UK)	3,201,945	5,076,053	7,517,844	7,401,115	**2,424,931**

The above figures include 283,164,576 kWh of renewable energy purchases either backed by the Renewable Energy Guarantees of Origin (REGO) scheme in the UK or the Guarantees of Origin (GoO) from a relevant EU Member State. This energy is used by the majority of our facilities in the UK and Germany. The source in the UK includes a proportion of electricity that was generated by the combustion of biofuel. The associated emissions are included above under the location-based Scope 2 emissions (using grid average emission factors). They are also reported separately as market-based Scope 2 emissions (covering the emissions of nitrous oxide and methane) and Outside of Scopes (covering the emissions of carbon dioxide). This has resulted in a net reduction of 65,000 tonnes from our total GHG emissions. In addition, the above figures include 2,424,931 kWh of electricity and heat generated on-site from renewable energy sources, including solar panels and ground source heat pumps.

We include the reporting of fugitive emissions of hydrofluorocarbons (HFCs), associated with air conditioning equipment, into our GHG emissions figures. These include emissions from our facilities in the US and Canada only. We do not anticipate that emissions from other facilities will have a significant impact on the above figures.

With the exceptions noted above, we have reported on the underlying energy use and emission sources required under the Companies (Directors' Report) and Limited Liability Partnerships (Energy and Carbon Report) Regulations 2018. In accordance with these regulations, the above statement includes emissions associated with the ITP Aero business which was classified as a discontinued business on 30 June 2021, since Rolls-Royce remained responsible for its activities in 2021. All these sources fall within the scope of our Consolidated Financial Statements.

We have used the GHG Protocol Corporate Accounting and Reporting Standard (revised edition) as of 31 December 2014 utilising the operational control approach, supplemented by the GHG Reporting Guidance for the Aerospace Industry (version 3) and emission factors from the UK Government's GHG Conversion Factors for Company Reporting 2021. We report our emissions of: carbon dioxide; methane; nitrous oxide; hydrofluorocarbons and perfluorocarbons on a carbon dioxide equivalent basis. We had no emissions of sulphur hexafluoride or nitrogen trioxide.

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

OTHER FINANCIAL INFORMATION

Foreign exchange

Foreign exchange rate movements influence the reported income statement, the cash flow and closing net funds balance. The average and spot rates for the principal trading currencies of the Group are shown in the table below:

		2021	2020	Change
USD per GBP	Year-end spot rate	**1.35**	1.36	-1%
	Average spot rate	**1.38**	1.28	+8%
EUR per GBP	Year-end spot rate	**1.19**	1.11	+7%
	Average spot rate	**1.16**	1.13	+3%

The Group's global corporate income tax contribution

The Group's total corporation tax payments in 2021 were £185m. Around 90% of this was paid in the US, Germany, UK, Singapore and Canada which reflects the fact that the majority of the Group's business is undertaken, and employees are based, in these countries. The balance was paid in around 40 other countries.

In common with most multinational groups, the total of all profits and losses for corporate income tax purposes is not the same as the consolidated loss before tax reported on page 109. The main reasons for this are:

(i) the consolidated income statement is prepared under IFRS, whereas the corporate income tax profits and losses for each company are determined by local accounting rules;

(ii) accounting rules require certain income and costs relating to our commercial activities to be eliminated from, or added to, the aggregate of all the profits of the Group companies when preparing the consolidated income statement (consolidation adjustments); and

(iii) specific tax rules including exemptions or incentives as determined by the tax laws in each country.

In most cases, (i) and (ii) are only a matter of timing and therefore tax will be paid in an earlier or later year. The impact of (iii) will often be permanent depending on the relevant tax law. Further information on the tax position of the Group can be found as follows:

— Audit Committee Report (page 84) – updates were given to the Audit Committee during the year which covered key sources of estimation uncertainty, in particular the recognition of deferred tax assets;

— note 1 to the Consolidated Financial Statements (page 124) – Details of key areas of uncertainty and accounting policies for tax; and

— note 5 to the Consolidated Financial Statements (page 144 and 145) Details of the tax balances in the Consolidated Financial Statements together with a tax reconciliation. This explains the main drivers of the tax rate and the impact of our assessment on the recovery of UK deferred tax assets.

Information on the Group's approach to managing its tax affairs can be found at rolls-royce.com.

Investments and capital expenditure

The Group subjects all major investments and capital expenditure to a rigorous examination of risks and future cash flows to ensure that they create shareholder value. All major investments, including the launch of major programmes, require Board approval.

The Group has a portfolio of projects at different stages of their lifecycles. All of our major investments and projects are assessed using a range of financial metrics, including discounted cash flow and return on investment.

Financial risk management

The Board has established a structured approach to financial risk management. The Financial risk committee (Frc) is accountable for managing, reporting and mitigating the Group's financial risks and exposures. These risks include the Group's principal counterparty, currency, interest rate, commodity price, liquidity and credit rating risks outlined in more depth in note 20. The Frc is chaired by the Chief Financial Officer or group controller. The Group has a comprehensive financial risk policy that advocates the use of financial instruments to manage and hedge business operations risks that arise from movements in financial, commodities, credit or money markets. The Group's policy is not to engage in speculative financial transactions. The Frc sits quarterly to review and assess the key risks and agree any mitigating actions required.

Capital structure

£m	2021	2020
Total equity	**(4,636)**	(4,875)
Cash flow hedges	**45**	94
Group capital	**(4,591)**	(4,781)
Net debt	**(5,157)**	(3,576)

Operations are funded through various shareholders' funds, bank borrowings, bonds and notes. The capital structure of the Group reflects the judgement of the Board as to the appropriate balance of funding required. Funding is secured by the Group's continued access to the global debt markets. Borrowings are funded in various currencies using derivatives where appropriate to achieve a required currency and interest rate profile. The Board's objective is to retain sufficient financial investments and undrawn facilities to ensure that the Group can both meet its medium-term operational commitments and cope with unforeseen obligations and opportunities.

The Group holds cash and short-term investments which, together with the undrawn committed facilities, enable it to manage its liquidity risk.

During the year, the Group repaid £300m of commercial paper drawn under the Covid Commercial Finance Facility and a €750m bond at its maturity in June 2021. The Group also drew the £2,000m loan maturing 2025.

During 2021 the Group entered into a new £1,000m loan maturing 2026 (supported by an 80% guarantee from UK Export Finance).

The £2,500m revolving credit facility, the £1,000m UKEF-supported loan and £1,000m bank loan were undrawn at the period end.

At the year end, the Group retained aggregate liquidity of £7.1bn, including cash and cash equivalents of £2.6bn and undrawn borrowing facilities of £4.5bn.

The Group has no material debt maturities until 2024. The maturity profile of the borrowing facilities is regularly reviewed to ensure that refinancing levels are manageable in the context of the business and market conditions. There are no rating triggers in any borrowing facility that would require the facility to be accelerated or repaid due to an adverse movement in the Group's credit rating. The Group conducts some of its business through a number of joint ventures. A major proportion of the debt of these joint ventures is secured on the assets of the respective companies and is non-recourse to the Group. This debt is further outlined in note 12.

Credit rating

£m	Rating	Outlook
Moody's Investors Service	Ba3-	Negative
Standard & Poor's	BB-	Stable
Fitch	BB-	Stable

The Group subscribes to Moody's, Standard & Poor's and Fitch for independent long-term credit ratings with the ratings in the table above being applicable at the date of this report.

Accounting

The Consolidated Financial Statements have been prepared in accordance with International Financial Reporting Standards (IFRS), as adopted by the UK.

No new accounting standards had a material impact in 2021. Other than Amendments to IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* – Onerous Contracts described on page 131, the Group does not consider that any standards, amendments or interpretations issued by the IASB, but not yet applicable will have a significant impact on the Consolidated Financial Statements in 2022.

RECONCILIATION OF ALTERNATIVE PERFORMANCE MEASURES (APMS) TO THEIR STATUTORY EQUIVALENT

Alternative performance measures (APMs)

Business performance is reviewed and managed on an underlying basis. These alternative performance measures reflect the economic substance of trading in the year, including the impact of the Group's foreign exchange activities. In addition, a number of other APMs are utilised to measure and monitor the Group's performance.

Definitions and reconciliations to the relevant statutory measure are included below.

Underlying results from continuing operations

Underlying results include underlying revenue, underlying operating profit and underlying EPS. Underlying results are presented by recording all relevant revenue and cost of sales transactions at the average exchange rate achieved on effective settled derivative contracts in the period that the cash flow occurs. Underlying results also exclude: the effect of acquisition accounting and business disposals, impairment of goodwill and other non-current assets where the reasons for the impairment are outside of normal operating activities, exceptional items and certain other items which are market driven and outside of managements control. Statutory results have been adjusted for discontinued operations and underlying results from continuing operations have been presented on the same basis. Further detail can be found in note 2 and note 27.

Revenue from continuing operations	Notes	2021 £m	2020 £m
Statutory revenue		11,218	11,491
Derivative & FX adjustments	2	(271)	(61)
Underlying revenue		10,947	11,430

Operating profit/(loss) from continuing operations	Notes	2021 £m	2020 £m
Statutory operating profit/(loss)		513	(1,972)
Derivative & FX adjustments	2	40	(1,003)
Programme exceptional charges	2	(105)	(620)
Restructuring exceptional charges	2	(45)	470
Acquisition accounting & M&A	2	50	85
Impairments & asset write-offs	2	(9)	1,336
Pension past service credit	2	(47)	(308)
Other underlying adjustments	2	17	4
Underlying operating profit/(loss)		414	(2,008)

Basic EPS from continuing operations	Notes	2021 pence	2020 pence
Statutory basic EPS		1.48	(51.81)
Effect of underlying adjustments to profit/(loss) before tax	6	3.96	(19.94)
Related tax effects		(5.33)	4.27
Basic underlying EPS		0.11	(67.48)

Underlying results from discontinued operations

Results from discontinued operations	Notes	2021 £m	2020 £m
Profit/(loss) for the year from discontinued operations on ordinary activities	27	36	(68)
Costs of disposal on discontinued operations	27	(39)	–
Statutory loss from discontinued operations		(3)	(68)
Acquisition accounting & M&A		64	48
Derivative & FX adjustments		5	(3)
Impairments & asset write-offs		–	82
Restructuring exceptional charges		(1)	19
Related tax effects		(14)	(36)
Underlying profit from discontinued operations		51	42

Trading cash flow

Trading cash flow is defined as free cash flow (as defined on page 216) before the deduction of recurring tax and post-employment benefit expenses. Trading cash flow per segment is used as a measure of business performance for the relevant segments. For a reconciliation of group trading cash flow to free cash flow and reported cash flow, see note 28.

	Notes	2021 £m	2020 £m
Civil Aerospace		(1,670)	(4,510)
Defence		377	298
Power Systems		219	162
New Markets		(56)	(55)
Total reportable segments trading cash flow		(1,130)	(4,105)
Other businesses		(43)	(30)
Central and Inter-segment		(38)	(63)
Trading cash flow from continuing operations		(1,211)	(4,198)
Discontinued business		46	84
Trading cash flow		(1,165)	(4,114)
Underlying operating profit charge (exceeded by)/in excess of contributions to defined benefit schemes		(92)	160
Tax [1]		(185)	(231)
Free cash flow		(1,442)	(4,185)

[1] See page 112 for tax paid on statutory cash flow.

Free cash flow

Free cash flow is a measure of financial performance of the business' cash flow to see what is available for distribution among those stakeholders funding the business (including debt holders and shareholders). Free cash flow is the change in cash and cash equivalents excluding: transactions with ordinary shareholders; amounts spent or received on activity related to business acquisitions or disposals; financial penalties paid; exceptional restructuring payments; proceeds from increase in loans; and repayment of loans. Free cash flow from continuing operations has been presented to remove free cash flow from discontinued operations as defined in note 27. For further detail, see note 28.

	2021 £m	2020 £m
Statutory change in cash and cash equivalents	(775)	(995)
Net cash flow from changes in short-term investments, borrowings and lease liabilities	(658)	(1,636)
Movement in net debt from cash flows	(1,433)	(2,631)
Exclude: capital element of lease payments	(374)	(284)
Rights issue	–	(1,972)
Payments to shareholders	4	92
Business acquisitions & disposals	(49)	119
Penalties paid on agreements with investigating bodies	156	135
Restructuring exceptional cash flow	231	323
Other underlying adjustments	23	33
Free cash flow	(1,442)	(4,185)
Less: discontinued operations free cash flow [1]	(43)	(70)
Free cash flow from continuing operations	(1,485)	(4,255)

[1] Discontinued operations free cash excludes: transactions with parent company of £(15)m (2020: £103m), movements in borrowings of £22m (2020: £7m), exceptional restructuring costs of £8m (2020: £2m), M&A costs of £44m (2020: nil) and other of £29m (2020: £(21)m).

Free cash flow from cash flows from operating activities

In addition to the above, a reconciliation of free cash flow to the statutory cash flow from operating activities has been provided below:

	2021 £m	2020 £m
Statutory cash flows from operating activities	(259)	(3,009)
Capital expenditure (including investment from NCI and movement in joint ventures, associates and other investments)	(489)	(933)
Capital element of lease payments	(374)	(284)
Interest paid	(331)	(259)
Settlement of excess derivatives	(452)	(202)
Exceptional restructuring costs	231	323
M&A costs	50	12
Financial penalties paid	156	135
Other	26	32
Free cash flow	(1,442)	(4,185)
Discontinued operations free cash flow	(43)	(70)
Free cash flow from continuing operations	(1,485)	(4,255)

Gross R&D expenditure

R&D expenditure during the year excluding the impact of contributions and fees, including government funding, amortisation and impairment of capitalised costs and amounts capitalised during the year.

Gross R&D expenditure from continuing operations	Notes	2021 £m	2020 £m
Statutory research and development cost		(778)	(1,204)
Amortisation and impairment of capitalised cost	3	70	560
Capitalised as intangible assets		(105)	(228)
Contributions and fees		(366)	(353)
Gross R&D Expenditure		(1,179)	(1,225)

Key performance indicators

The following measures are key performance indicators and are calculated using alternative performance measures or statutory results. See below for calculation of these amounts.

Order backlog

Order backlog, also known as unrecognised revenue, is the amount of revenue on current contracts that is expected to be recognised in future periods. Civil Aerospace OE orders where the customer has retained the right to cancel (for deliveries in the next 7–12 months) are excluded. Further details are included in note 2 on page 136.

Self funded R&D as a proportion of underlying revenue

Self-funded cash expenditure on R&D before any capitalisation or amortisation relative to underlying revenue. Self-funded R&D and underlying revenue are presented for continuing operations in line with presentation in the statutory income statement. We expect to spend approximately 5% of underlying revenue on R&D although this proportion will fluctuate depending on the stage of development of current programmes. We expect this proportion will reduce modestly over the medium term.

	Notes	2021 £m	2020 £m
Gross R&D expenditure	3	(1,179)	(1,225)
Contributions and fees	3	366	353
Self funded R&D	3	(813)	(872)
Underlying revenue		10,947	11,430
		%	%
Self funded R&D as a % of underlying revenue		7.4	7.6

Capital expenditure as a proportion of underlying revenue

Cash purchases of PPE in the year relative to underlying revenue presented for continuing operations. All proposed investments are subject to rigorous review to ensure that they are consistent with forecast activity and will provide value for money. We measure annual capital expenditure as the cash purchases of property, plant and equipment acquired during the period; over the medium-term we expect a proportion of around 3-4%.

	2021 £m	2020 £m
Purchases of PPE (cash flow statement)	328	585
Less: capital expenditure from discontinued operations	(24)	(33)
Net capital expenditure	304	552
Underlying revenue	10,947	11,430
	%	%
Capital expenditure as a proportion of underlying revenue	2.8	4.8

DIRECTORS' REPORT

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Board of Directors

The Directors of the Company who were in office during the year and up to the date of signing the financial statements were Anita Frew, Warren East, Panos Kakoullis, Paul Adams, George Culmer, Irene Dorner, Beverly Goulet, Lee Hsien Yang, Nick Luff, Mike Manley, Wendy Mars, Sir Kevin Smith, and Dame Angela Strank. In addition, Lewis Booth, Sir Frank Chapman, Stephen Daintith, Sir Ian Davis and Jasmin Staiblin served as Directors during the year before stepping down from the Board. Their respective resignation dates can be found on page 76.

Directors' indemnities

The Directors have the benefit of an indemnity provision contained in the Articles. 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 the Company and its subsidiaries and for their directors and officers.

Share price

During the year, the share price increased by 10% from 112p to 123p, compared to a 14% increase in the FTSE aerospace and defence sector and a 13% increase in the FTSE 100. The Company's share price ranged from 87p in both January and July 2021 to 150p in November 2021.

Share capital

On 31 December 2021, the Company's issued share capital comprised:

8,367,596,989	Ordinary shares	20p each
24,928,266,686	C Shares	0.1p each
1	Special Share	£1

The ordinary shares are listed on the London Stock Exchange.

The Company issues non-cumulative redeemable preference shares (C Shares) as an alternative to paying a cash dividend. Further information on payments to shareholders is on page 220.

Share class rights

The full share class rights are set out in the Company's Articles, which are available at 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, paid on a twice-yearly basis. 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 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.

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.

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 provisions of the 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 their successor or nominee.

Shareholder agreements and consent requirements
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 2021 AGM, an ordinary resolution was passed authorising the Directors to allot new ordinary shares up to a nominal value of £557,839,799 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 sooner of the 2022 AGM or 30 June 2022, and the Directors propose to renew each of them at the 2022 AGM to be held on 12 May 2022. The Board believes that these authorities will allow the Company to retain flexibility to respond to circumstances and opportunities as they arise.

Authority to purchase own shares
At the 2021 AGM, the Company was authorised by shareholders to purchase up to 836,759,698 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 sooner of the conclusion of the 2022 AGM or 30 June 2022. A resolution to renew the authority will be proposed at the 2022 meeting.

The Company did not purchase any of its own ordinary shares under this authority during 2021.

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.

Major shareholdings
At 31 December 2021, the following shareholders had notified an interest in the issued ordinary share capital of the Company in accordance with section 5.1.2 of the Disclosure and Transparency Rules:

Shareholder	Date of change in interest	% of issued ordinary share capital
Blackrock, Inc.	24 December 2021	5.03
Causeway Capital Management LLC	28 September 2021	6.95
Harris Associates L.P.	16 November 2020	4.99
The Capital Group Companies, Inc.	10 November 2020	8.69

As at 24 February 2022, the following changes had been notified:

- Causeway Capital Management LLC notified the Company that on 19 January 2022 their holding had increased to 7.05% of issued ordinary share capital.
- The Capital Group Companies, Inc. notified the Company that on 3 February 2022 their holding had decreased to 4.98% of issued ordinary share capital.

Changes to the Articles of Association

The Articles may be amended or new articles may be adopted by a special resolution of the shareholders of the Company, subject to the provisions of the Act.

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 2021, these facilities were 47% drawn (2020: 26%).

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:

— Incentive Plan – deferred share awards will normally vest immediately, and may be time pro-rated. The new controlling company might offer an award in exchange instead (normally on substantially equivalent terms to the existing award).

— ShareSave – options would become exercisable immediately. The new controlling company might offer an equivalent option in exchange for cancellation of the existing option.

— Share Purchase Plan (SPP) – consideration received as shares would be held within the SPP, if possible, otherwise the consideration would be treated as a disposal from the SPP.

— 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.

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 2022 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$41,852 (2020: US$68,100). 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 2021 AGM.

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 employment of disabled people;

— the future development, performance and position of the Group; and

— research and development activities.

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.

By order of the Board
Pamela Coles
Chief Governance Officer
24 February 2022

SHAREHOLDER INFORMATION

Managing your shareholding

Your shareholding is managed by Computershare Investor Services plc (the Registrar). When making contact with the Registrar please quote your Shareholder Reference Number (SRN). This is a 10-digit number prefixed with the letter 'C' that can be found on the right-hand side of your share certificate or in any other shareholder correspondence.

You can manage your shareholding at investorcentre.co.uk, speak to the Registrar on +44 (0)370 703 0162 (8.30am to 5.30pm Monday to Friday) or you can write to the Registrar at Computershare Investor Services plc, The Pavilions, Bridgwater Road, Bristol, BS13 8AE.

If you hold your shares in a share dealing account (sometimes referred to as a nominee account) then you must contact your account provider with any questions about your shareholding.

Payments to shareholders

The Company makes payments to shareholders by issuing redeemable C Shares of 0.1p each. You can redeem C Shares for cash and either take the cash or reinvest the proceeds in the C Share Reinvestment Plan (CRIP) to purchase additional ordinary shares providing you complete a payment instruction form, which is available from the Registrar. Once you have submitted your payment instruction form, you will receive cash or additional ordinary shares each time the Company issues C Shares. If you choose to receive cash, we strongly recommend that you include your bank details on the payment instruction form and have payments credited directly to your bank account. This removes the risk of a cheque going astray and means that cleared payments will be credited to your bank account on the payment date.

Under the terms of certain of its recent loan facilities, the Company is restricted from declaring, making or paying distributions to shareholders on or prior to 31 December 2022 and then on from 1 January 2023 unless certain conditions are satisfied. The restrictions on distributions do not prevent shareholders from redeeming C Shares issued in January 2020 or prior to that.

Shareholders wishing to redeem their existing C Shares, or participate in the CRIP must lodge instructions with the Registrar to arrive no later than 5.00pm on 1 June 2022 (CREST holders must submit their election in CREST by 2.55pm). The payment of C Share redemption monies will be made on 5 July 2022 and the CRIP purchase will begin as soon as practicable after 5 July 2022.

Share dealing

The Registrar offers shareholders an internet dealing service at investorcentre.co.uk and a postal dealing service. Real-time dealing is available during market hours, 8.00am to 4.30pm, Monday to Friday excluding bank holidays. Orders can still be placed outside of market hours. The fee for internet and postal dealing is 1.4% of the transaction value subject to a minimum fee of £40. The fee for telephone dealing is 1% of the transaction value plus £50. Stamp duty of 0.5% is payable on all purchases. This service is only available to shareholders resident in certain jurisdictions. Before you can trade you must register to use the service. Other share dealing facilities are available but you should always use a firm regulated by the FCA (see fca.org.uk/register).

Your share certificate

Your share certificate is an important document. If you sell or transfer your shares you must make sure that you have a valid share certificate in the name of Rolls-Royce Holdings plc. If you place an instruction to sell your shares and cannot provide a valid share certificate, the transaction cannot be completed and you may be liable for any costs incurred by the broker. If you are unable to find your share certificate, please inform the Registrar immediately.

American Depositary Receipts (ADR)

ADR holders should contact the depositary, JP Morgan, by calling +1(800) 990 1135 (toll free within the US) or +1(651) 453 2128 (outside the US) or via adr.com/contact/jpmorgan.

Warning to shareholders – investment scams

We are aware that some of our shareholders have received unsolicited telephone calls or correspondence, offering to buy or sell their shares at very favourable terms. The callers can be very persuasive and extremely persistent and often have professional websites and telephone numbers to support their activities.

These callers will sometimes imply a connection to Rolls-Royce and provide incorrect or misleading information. This type of call should be treated as an investment scam - the safest thing to do is hang up.

You should always check that any firm contacting you about potential investment opportunities is properly authorised by the FCA. If you deal with an unauthorised firm you will not be eligible for compensation under the Financial Services Compensation Scheme. You can find out more about protecting yourself from investment scams by visiting the FCA's website at fca.org.uk/consumers, or by calling the FCA's consumer helpline on 0800 111 6768 (overseas callers dial +44 20 70661000). If you have already paid money to share fraudsters contact Action Fraud immediately on 0300 123 2040, whose website is actionfraud.police.uk.

Remember: if it sounds too good to be true it probably is.

Visit Rolls-Royce online

Visit rolls-royce.com to find out more about the latest financial results, the share price, payments to shareholders, the financial calendar and shareholder services.

Communication preferences

You can sign up to receive the latest news updates to your phone or email by visiting rolls-royce.com and registering for our alert service. If you do not wish to receive a hard copy Annual Report in future, please email webqueries@computershare.co.uk.

Analysis of ordinary shareholders at 31 December 2021

Type of holder	Number of shareholders	% of total shareholders	Number of shares	% of total shares
Individuals	165,527	98.04	208,277,962	2.49
Institutional and other investors	3,315	1.96	8,159,319,027	97.51
Total	168,842	100.00	8,367,596,989	100.00
Size of holding (number of ordinary shares)				
1 – 150	49,888	29.55	4,365,281	0.05
151 – 500	59,513	35.25	15,958,468	0.19
501 – 10,000	54,905	32.52	105,711,262	1.26
10,001 – 100,000	3,721	2.20	90,981,893	1.09
100,001 – 1,000,000	485	0.29	168,017,648	2.01
1,000,001 and over	330	0.20	7,982,562,437	95.40
Total	168,842	100.00	8,367,596,989	100.00

GLOSSARY

ABC	anti-bribery and corruption
ACARE	Advisory Council for Aviation Research and Innovation in Europe
AGM	annual general meeting
ALPS	Advanced Low Pressure System
AMRCs	Advanced Manufacturing Research Centres
AOG	aircraft on ground
APM	alternative performance measure
Articles	Articles of Association of Rolls-Royce Holdings plc
bps	basis points
Brexit	UK exit from the European Union
C Shares	non-cumulative redeemable preference shares
C&A	commercial and administrative
CEO	chief executive officer
CFO	chief financial officer
Our Code	Global Code of Conduct
the Code	UK Corporate Governance Code 2018
Company	Rolls-Royce Holdings plc
CPS	cash flow per share
CRIP	C Share reinvestment plan
D&I	diversity & inclusion
DJSI	Dow Jones Sustainability Index
DoJ	US Department of Justice
DPAs	deferred prosecution agreements
DTR	the FCA's Disclosure Guidance and Transparency Rules
EASA	European Aviation Safety Agency
EFH	engine flying hours
EIS	entry into service
ELG	Enterprise Leadership Group
EPS	earnings per share
ERG	employee resource group
ESG	environment, social and governance
EU	European Union
EUR	euro
EVTOL	electric vertical take-off and landing
FCA	Financial Conduct Authority
FCF	free cash flow
FRC	Financial Reporting Council
FTE	full time equivalent
FX	foreign exchange
GBP	Great British pound or pound sterling
GHG	greenhouse gas
Group	Rolls-Royce Holdings plc and its subsidiaries
HPT	high pressure turbine
HSE	health, safety and environment
IASB	International Accounting Standards Board
IFRS	International financial reporting standards
KPIs	key performance indicators
ktCO_2e	kilotonnes carbon dioxide equivalent
kW	kilowatts
LGBTQ+	lesbian, gay, bisexual, transgender and queer/questioning
LIBOR	London inter-bank offered rate
LRIP	low rate initial production
LTIP	long-term incentive plan
LTPR	long-term planning exchange rate
LTSA	long-term service agreement
M&A	mergers & acquisitions
MoU	memorandum of understanding
MRO	maintenance repair and overhaul
MW	megawatts
NCI	non-controlling interest
NED	Non-Executive Director
OCI	other comprehensive income
OE	original equipment
OECD	Organisation for Economic Co-operation and Development
OEM	original equipment manufacturer
P&L	profit and loss
PBT	profit before tax
PPE	property, plant and equipment
PSMS	product safety management system
PSP	performance share plan
R&D	research and development
R&T	research and technology
REACH	registration, evaluation, authorisation and restriction of chemicals
Registrar	Computershare Investor Services PLC
RMS	risk management system
RRMS	Rolls-Royce management system
RRSAs	risk and revenue sharing arrangements
SAF	sustainable aviation fuel
SID	Senior Independent Director
SFO	UK Serious Fraud Office
SMR	small modular reactors
STEM	science, technology, engineering and mathematics
TCFD	Taskforce on Climate-related Financial Disclosures
TRI	total reportable injuries
TSR	total shareholder return
USAF	United States Air Force
USD/US$	United States dollar
UTCs	University Technology Centres

Trade marks

The following trade marks which appear throughout this Annual Report are trade marks registered and owned by companies within the Rolls-Royce Group:

CorporateCare®
mtu®
Pascal®
Pearl®
Pioneering the power that matters™
Pioneers of Power®
RB211®
The Alethia Framework™
TotalCare®
Trent®
TwinAlytics®
UltraFan®