Additional financial information

Comparative figures have been restated to reflect the change in accounting policy for RRSAs and the amendments to IAS 19 – see note 1.

Underlying income statement

£ million	2013	Restated 2012	Change	
Revenue	**15,505**	12,209	3,296	27%
Civil aerospace	**6,655**	6,437	218	3%
Defence aerospace	**2,591**	2,417	174	7%
Marine	**2,527**	2,249	278	12%
Energy	**1,048**	962	86	9%
Power Systems	**2,831**	287	2,544	886%
Intra-segment	**(147)**	(143)	(4)	
Profit before financing and taxation	**1,831**	1,495	336	22%
Civil aerospace	**844**	743	101	14%
Defence aerospace	**438**	395	43	11%
Marine	**281**	294	(13)	-4%
Energy	**26**	19	7	37%
Power Systems	**294**	109	185	170%
Intra-segment	**2**	(11)	13	
Central costs	**(54)**	(54)	-	
Net financing	**(72)**	(61)	(11)	-18%
Profit before taxation	**1,759**	1,434	325	23%
Taxation	**(434)**	(317)	(117)	-37%
Profit for the year	**1,325**	1,117	208	19%
EPS	**65.59p**	59.59p	6.00p	10%
Payments to shareholders	**22.0p**	19.5p	2.5p	13%
Other items				
Gross R&D investment	**1,118**	919	199	22%
Net R&D charged to the income statement	**624**	531	93	18%

Underlying revenue increased £3.3 billion to £15.5 billion, of which £2.6 billion was due to the inclusion of Tognum from 1 January 2013. The remaining increase (six per cent) reflects a seven per cent growth in OE revenue and a four per cent increase in services revenue. Original equipment performance included growth of 21 per cent in Energy, 13 per cent in Defence aerospace and 12 per cent in Marine. Underlying services revenue continues to represent around half (47 per cent) of the Group's underlying revenue. In 2013, services revenue grew in all businesses, as the installed base of products continued to grow and the services network expanded.

Underlying profit before financing and taxation increased 22 per cent to £1.8 billion, including £190 million from the consolidation of Tognum from 1 January 2013. Excluding Tognum, the increase was due to a number of factors: increased revenue; continued strong margins in Defence aerospace and the restructured relationship with International Aero Engines AG.

Further discussion of trading is included in the business reviews on pages 6 to 10.

Underlying financing costs increased 18 per cent to £72 million, including £10 million from RRPS.

Underlying taxation was £434 million, an underlying tax rate of 24.7 per cent compared with 22.1 per cent in 2012.

Underlying EPS increased 10 per cent to 65.59 pence, lower than the increase in the underlying profit after tax due to the NCI share of Tognum.

Payments to shareholders: at the AGM on 1 May 2014, the directors will recommend an issue of 134 C Shares with a total nominal value of 13.4 pence for each ordinary share. Together with the interim issue on 2 January 2014 of 86 C Shares for each ordinary share with a total nominal value of 8.6 pence, this is

the equivalent of a total annual payment to ordinary shareholders of 22.0 pence for each ordinary share. Further details are on page 25.

Net underlying R&D charged to the income statement increased by 18 per cent to £624 million including £174 million from Tognum, reflecting a combination of increased spend of £33 million offset by higher net capitalisation of £61 million (due to the phasing of major new programmes, in particular the certification of the Trent XWB 84k), R&D tax credits of £28 million and net deferral of RRSA entry fees of £26 million. The Group continues to expect net R&D investment to remain within four to five per cent of Group underlying revenue.

Reported profit before tax has reduced from £2,766 million to £1,759 million. In addition to the changes in underlying profit before tax described above, reported profit before tax has been affected by the impact of mark-to-market of derivative contracts (£497 million reduction); (ii) the impact of consolidating Tognum (£322 million reduction, comprising the unrealised profit on reclassification to a subsidiary, the additional amortisation on recognised intangible assets and the revaluation of the put option on NCI); (iii) the net impact of disposals (£483 million reduction, disposal of RRTM in 2013 more than offset by the restructuring of IAE in 2012); and (iv) the cost of providing discretionary pension increases (£64 million). The reported tax charge is affected by the related tax impact of these items and the reduction of tax rates in the UK. This is set out in more detail in note 2 to the financial statements.

Balance sheet

£ million	**2013**	1 January 2013 including RRPS	Restated 31 December 2012
Intangible assets	**4,987**	4,866	2,901
Property, plant and equipment	**3,392**	3,109	2,564
Net post-retirement scheme deficits	**(793)**	(842)	(445)
Net working capital	**(970)**	(819)	(1,321)
Net funds	**1,939**	1,354	1,317
Provisions	**(733)**	(741)	(461)
Net financial assets and liabilities	**(1,587)**	(154)	(127)
Joint ventures and associates	**601**	523	1,800
Other net assets and liabilities	**(533)**	(515)	(232)
Net assets	**6,303**	6,781	5,996
Other items			
USD hedge book (US$ billion)	**$24.7**		$22.5
TotalCare assets	**1,901**		1,629
TotalCare liabilities	**(314)**		(317)
Net TotalCare Assets	**1,587**		1,312
Gross customer finance contingent liabilities[1]	**356**		569
Net customer finance contingent liabilities[2]	**59**		70

The balances recognised on 1 January 2013 as a result of the consolidation of Tognum are set out in note 11. The comments below relate to the changes after the consolidation of Tognum.

Intangible assets (note 7) represent long-term assets of the Group. These assets increased by £121 million with additional development, certification and software costs being largely offset by annual amortisation charges.

The carrying values of the intangible assets are assessed for impairment against the present value of forecast cash flows generated by the intangible asset. The principal risks remain: reductions in assumed market share; programme timings; increases in unit cost assumptions; and adverse movements in discount rates. There have been no significant impairments in 2013.

Property, plant and equipment increased by £283 million due to the ongoing development and refreshment of facilities and tooling as the Group prepares for increased production volumes.

Net post-retirement scheme deficits (note 9) reduced by £100 million as a result of adopting the amendments to IAS 19. During the year, the net deficit fell by £49 million, principally due to the movements in the assumptions used to value the underlying assets and liabilities in accordance with IAS 19. This reduction in the deficit was after agreeing to fund additional pension increases in the Rolls-Royce Pension Fund, where there is no indexation for pre-1997 service, at a cost of £64 million.

Overall funding across the schemes has improved in recent years as the Group has adopted a lower risk investment strategy that reduces volatility going forward and enables the funding position to remain stable: interest rate and inflation risks are largely hedged, and the exposure to equities is around 11 per cent of scheme assets.

The Group's funding of its defined benefit schemes is expected to increase modestly in 2014, largely as a result of funding the discretionary benefits.

Net funds increased by £0.6 billion to £1.9 billion due in part to the £250 million proceeds received on the sale of the Group's interest in the RTM322 engine. Average net funds were £350 million.

Investments in joint ventures and associates increased by 15 per cent, largely as a result of retained profits in existing joint ventures.

Provisions largely relate to warranties and guarantees provided to secure the sale of OE and services.

Net financial assets and liabilities relate to the fair value of foreign exchange, commodity and interest rate contracts, financial RRSAs and the put option on the NCI of Rolls-Royce Power Systems Holding GmbH, set out in detail in note 8. The change largely reflects the inclusion of the put option. There is also an impact of the change in the GBP/USD exchange rate on the valuation of foreign exchange contracts and the movement in put options on NCI of £259 million.

The USD hedge book increased ten per cent to US$24.7 billion. This represents around four years of net exposure and has an average book rate of £1 to US$1.59.

Net TotalCare assets relate to Long-Term Service Agreement (LTSA) contracts in the Civil Aerospace business, including the flagship services product TotalCare. These assets represent the timing difference between the recognition of income and costs in the income statement and cash receipts and payments.

Customer financing facilitates the sale of OE and services by providing financing support to certain customers. Where such support is provided by the Group, it is generally to customers of the civil aerospace business and takes the form of various types of credit and asset value guarantees. These exposures produce contingent liabilities that are outlined in note 10. The contingent liabilities represent the maximum aggregate discounted gross and net exposure in respect of delivered aircraft, regardless of the point in time at which such exposures may arise.

During 2013, the Group's gross exposure reduced by £213 million to £356 million, due largely to the expiry of guarantees. On a net basis, exposures reduced by £11 million.

Segmental reporting

During 2013, we have revised the internal structure of the business to focus on aerospace and marine and industrial markets and the internal reporting structure has been developed to reflect this.

Consequently, in accordance with IFRS 8 *Operating Segments*, from 1 January 2014, we will report the Group's segments as follows:

- Aerospace – comprising Civil aerospace and Defence aerospace; and
- Marine and Industrial Power Systems (MIPS) – comprising Marine, Power Systems, Nuclear and Energy.

The 2013 figures on the revised basis are included in note 12.

Condensed consolidated income statement

For the year ended 31 December 2013

	Notes	**2013 £m**	Restated* 2012 £m
Revenue	2	**15,513**	12,161
Cost of sales		**(12,197)**	(9,432)
Gross profit		**3,316**	2,729
Other operating income	3	**65**	–
Commercial and administrative costs		**(1,323)**	(993)
Research and development costs	3	**(683)**	(531)
Share of results of joint ventures and associates		**160**	173
Operating profit		**1,535**	1,378
Profit on reclassification of joint ventures to subsidiaries		**119**	–
Profit on disposal of businesses (2012 IAE restructuring £699m)	11	**216**	699
Profit before financing and taxation		**1,870**	2,077
Financing income	4	**327**	797
Financing costs	4	**(438)**	(108)
Net financing		**(111)**	689
Profit before taxation [1]		**1,759**	2,766
Taxation		**(380)**	(431)
Profit for the period		**1,379**	2,335
Attributable to:			
Ordinary shareholders		**1,367**	2,321
Non-controlling interests (NCI)		**12**	14
Profit for the period		**1,379**	2,335
Earnings per ordinary share attributable to shareholders	5		
Basic		**73.26p**	125.38p
Diluted		**72.44p**	123.73p
Underlying earnings per ordinary share are shown in note 5.			
Payments to ordinary shareholders in respect of the period	6		
Pence per share		**22.0p**	19.5p
Total		**414**	365
[1] Underlying profit before taxation	2	**1,759**	1,434

Condensed consolidated statement of comprehensive income

For the year ended 31 December 2013

	Notes	**2013 £m**	Restated* 2012 £m
Profit for the period		**1,379**	2,335
Other comprehensive income (OCI)			
Items that will not be reclassified to profit or loss			
Movements in post-retirement schemes	9	**48**	(305)
Share of OCI of joint ventures and associates		**–**	(46)
Related tax movements		**10**	105
		58	(246)
Items that may be reclassified to profit or loss			
Foreign exchange translation differences on foreign operations		**(64)**	(118)
Share of OCI of joint ventures and associates		**(6)**	(12)
Related tax movements		**1**	(1)
		(69)	(131)
Total comprehensive income for the period		**1,368**	1,958
Attributable to:			
Ordinary shareholders		**1,356**	1,945
Non-controlling interests		**12**	13
Total comprehensive income for the period		**1,368**	1,958

* Restated to reflect the amendments to IAS 19 *Employee Benefits* – see notes 1 and 9 and an amendment to the accounting policy for Risk and Revenue Sharing Arrangements – see note 1.

Condensed consolidated balance sheet

At 31 December 2013

	Notes	2013 £m	Restated* 31 December 2012 £m	Restated* 1 January 2012 £m
ASSETS				
Non-current assets				
Intangible assets	7	**4,987**	2,901	2,882
Property, plant and equipment		**3,392**	2,564	2,338
Investments – joint ventures and associates		**601**	1,800	1,680
Investments – other		**27**	6	10
Other financial assets	8	**674**	592	327
Deferred tax assets		**316**	342	387
Post-retirement scheme surpluses	9	**248**	348	520
		10,245	8,553	8,144
Current assets				
Inventories		**3,319**	2,726	2,561
Trade and other receivables		**5,092**	4,119	4,009
Taxation recoverable		**16**	33	20
Other financial assets	8	**74**	115	91
Short-term investments		**321**	11	11
Cash and cash equivalents		**3,990**	2,585	1,310
Assets held for sale		**6**	4	313
		12,818	9,593	8,315
Total assets		**23,063**	18,146	16,459
LIABILITIES				
Current liabilities				
Borrowings		**(207)**	(149)	(20)
Other financial liabilities	8	**(1,976)**	(312)	(111)
Trade and other payables		**(7,045)**	(6,401)	(6,263)
Tax liabilities		**(204)**	(126)	(138)
Provisions for liabilities and charges		**(348)**	(220)	(276)
Liabilities associated with assets held for sale		**–**	–	(135)
		(9,780)	(7,208)	(6,943)
Non-current liabilities				
Borrowings		**(2,164)**	(1,234)	(1,184)
Other financial liabilities	8	**(360)**	(418)	(919)
Trade and other payables		**(2,138)**	(1,672)	(1,533)
Tax liabilities		**(10)**	–	–
Deferred tax liabilities		**(882)**	(584)	(445)
Provisions for liabilities and charges		**(385)**	(241)	(226)
Post-retirement scheme deficits	9	**(1,041)**	(793)	(807)
		(6,980)	(4,942)	(5,114)
Total liabilities		**(16,760)**	(12,150)	(12,057)
Net assets		**6,303**	5,996	4,402
EQUITY				
Attributable to ordinary shareholders				
Called-up share capital		**376**	374	374
Share premium account		**80**	–	–
Capital redemption reserve		**163**	169	173
Cash flow hedging reserve		**(68)**	(63)	(52)
Other reserves		**250**	314	433
Retained earnings		**4,804**	5,185	3,473
		5,605	5,979	4,401
Non-controlling interests		**698**	17	1
Total equity		**6,303**	5,996	4,402

* Restated to reflect the amendments to IAS 19 *Employee Benefits* – see notes 1 and 9 and an amendment to the accounting policy for Risk and Revenue Sharing Arrangements – see note 1.

Condensed consolidated cash flow statement

For the year ended 31 December 2013

	Notes	2013 £m	Restated* 2012 £m
Reconciliation of cash flows from operating activities			
Operating profit		**1,535**	1,378
Loss/(profit) on disposal of property, plant and equipment		**7**	(9)
Share of results of joint ventures and associates		**(160)**	(173)
Dividends received from joint ventures and associates		**99**	129
Amortisation and impairment of intangible assets		**428**	231
Depreciation and impairment of property, plant and equipment		**372**	256
Impairment of investments		**–**	2
Decrease in provisions		**(17)**	(40)
Decrease/(increase) in inventories		**119**	(158)
Increase in trade and other receivables		**(533)**	(284)
Increase in trade and other payables		**376**	242
Cash flows on other financial assets and liabilities held for operating purposes		**9**	(29)
Net defined benefit post-retirement cost recognised in profit before financing	9	**279**	173
Cash funding of defined benefit post-retirement schemes	9	**(315)**	(299)
Share-based payments		**79**	55
Net cash inflow from operating activities before taxation		**2,278**	1,474
Taxation paid		**(238)**	(219)
Net cash inflow from operating activities		**2,040**	1,255
Cash flows from investing activities			
Additions of unlisted investments		**(1)**	–
Disposals of unlisted investments		**1**	4
Additions of intangible assets	7	**(503)**	(250)
Disposals of intangible assets		**–**	1
Purchases of property, plant and equipment		**(669)**	(435)
Government grants received		**21**	10
Disposals of property, plant and equipment		**7**	30
Acquisitions of businesses	11	**(37)**	(20)
Reclassification of joint ventures to subsidiaries		**245**	–
Acquisition of preference shares in subsidiary		**(34)**	–
Restructuring of International Aero Engines AG	11	**–**	942
Disposals of businesses	11	**273**	–
Investments in joint ventures and associates		**(43)**	(24)
Repayment of loan to Rolls-Royce Power Systems Holding GmbH		**–**	167
Transfer of subsidiary to associate		**–**	(1)
Net cash (outflow)/ inflow from investing activities		**(740)**	424
Cash flows from financing activities			
Repayment of loans		**(133)**	(99)
Proceeds from increase in loans	8	**1,013**	221
Net cash flow from increase in borrowings		**880**	122
Interest received		**15**	11
Interest paid		**(58)**	(52)
Increase in short-term investments		**(313)**	–
Issue of ordinary shares and cash received on share-based schemes vesting		**32**	–
Purchase of ordinary shares		**(3)**	(94)
Dividend to NCI		**(60)**	–
Redemption of C Shares		**(357)**	(318)
Net cash inflow/(outflow) from financing activities		**136**	(331)
Net increase in cash and cash equivalents		**1,436**	1,348
Cash and cash equivalents at 1 January		**2,585**	1,291
Exchange losses on cash and cash equivalents		**(34)**	(54)
Cash and cash equivalents at 31 December		**3,987**	2,585

* Restated to reflect the amendments to IAS 19 *Employee Benefits* – see notes 1 and 9 and an amendment to the accounting policy for Risk and Revenue Sharing Arrangements – see note 1.

	2013 £m	2012 £m
Reconciliation of movements in cash and cash equivalents to movements in net funds		
Net increase in cash and cash equivalents	**1,436**	1,348
Net cash flow from increase in borrowings	**(880)**	(122)
Net cash flow from increase in short-term investments	**313**	–
Change in net funds resulting from cash flows	**869**	1,226
Net funds (excluding cash and cash equivalents) of businesses acquired	**(204)**	(78)
Exchange losses on net funds	**(43)**	(54)
Fair value adjustments	**105**	2
Movement in net funds	**727**	1,096
Net funds at 1 January excluding the fair value of swaps	**1,213**	117
Net funds at period end excluding the fair value of swaps	**1,940**	1,213
Fair value of swaps hedging fixed rate borrowings	**(1)**	104
Net funds at 31 December	**1,939**	1,317

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

	At 1 January 2013 £m	Funds flow £m	Net funds of businesses acquired £m	Exchange differences £m	Fair value adjustments £m	Reclassi fications £m	At 31 December 2013 £m
Cash at bank and in hand	674	333		(25)	–	–	982
Money market funds	408	754		(5)	–	–	1,157
Short-term deposits	1,503	352		(4)	–	–	1,851
Overdrafts	–	(3)		–	–	–	(3)
Cash and cash equivalents	2,585	1,436	–	(34)	–	–	3,987
Short-term investments	11	313	–	(3)	–	–	321
Current borrowings	(149)	133	(4)	-	17	(201)	(204)
Non-current borrowings	(1,233)	(1,013)	(200)	(6)	88	201	(2,163)
Finance leases	(1)	-	-	-	-	–	(1)
Net funds excluding the fair value of swaps	1,213	869	(204)	(43)	105	–	1,940
Fair value of swaps hedging fixed rate borrowings	104				(105)		(1)
Net funds	1,317	869	(204)	(43)	–	–	1,939

Condensed consolidated statement of changes in equity

For the half-year ended 31 December 2013

	Attributable to ordinary shareholders								[1]
	Share capital	Share premium	Capital redemption reserve	Cash flow hedging reserve	Other reserves [1]	Retained earnings [2]	Total	Non-controlling interests	Total equity
	£m	£m	£m	£m	£m	£m	£m	£m	£m
At 1 January 2012, as previously reported	**374**	**-**	**173**	**(52)**	**433**	**3,590**	**4,518**	**1**	**4,519**
Effect of amendments to IAS 19 – see note 9	–	–	–	–	–	67	67	–	67
Effect of change in accounting policy for RRSAs – see note 1	–	–	–	–	–	(184)	(184)	–	(184)
At 1 January 2012, as restated	**374**	**-**	**173**	**(52)**	**433**	**3,473**	**4,401**	**1**	**4,402**
Total comprehensive income for the year	**-**	**-**	**-**	**(11)**	**(119)**	**2,075**	**1,945**	**13**	**1,958**
Issue of C Shares	–	–	(328)	–	–	4	(324)	–	(324)
Redemption of C Shares	–	–	324	–	–	(324)	–	–	-
Ordinary shares purchased	–	–	-	–	–	(94)	(94)	–	(94)
Share-based payments – direct to equity	–	–	-	–	–	47	47	–	47
Transactions with NCI [3]	–	–	-	–	–	116	116	48	164
Initial recognition of put option on NCI [5]	–	–	-	–	–	(121)	(121)	(45)	(166)
Related tax movements	–	–	-	–	–	9	9	–	9
Other changes in equity in the year	**–**	**–**	**(4)**	**–**	**–**	**(363)**	**(367)**	**3**	**(364)**
At 31 December 2012	**374**	**–**	**169**	**(63)**	**314**	**5,185**	**5,979**	**17**	**5,996**
Total comprehensive income for the year	**–**	**–**	**–**	**(5)**	**(64)**	**1,425**	**1,356**	**12**	**1,368**
Arising on issue of ordinary shares	2	80	-	-	-	(81)	1	-	1
Issue of C Shares	–	–	(366)	–	–	3	(363)	–	(363)
Redemption of C Shares	–	–	360	–	–	(360)	–	–	–
Ordinary shares purchased	–	–	–	–	–	(3)	(3)	-	(3)
Share-based payments – direct to equity	–	–	–	–	–	99	99	-	99
Reclassification of Rolls-Royce Power Systems AG [4]	–	–	–	–	–	–	–	669	669
Initial recognition of put option on NCI [5]	–	–	–	–	–	(1,477)	(1,477)	45	(1,432)
Transactions with NCI	–	–	–	–	–	–	–	(45)	(45)
Related tax movements	–	–	–	–	–	13	13	–	13
Other changes in equity in the year	**2**	**80**	**(6)**	**–**	**–**	**(1,806)**	**(1,730)**	**669**	**(1,061)**
At 31 December 2013	**376**	**80**	**163**	**(68)**	**250**	**4,804**	**5,605**	**698**	**6,303**

[1] Other reserves include a merger reserve of £3m and a translation reserve of £247m.

[2] At 31 December 2013, 11,960,535 ordinary shares with a net book value of £91m (2012 20,365,787, 2011 22,541,187 ordinary shares with net book values of £125m and £116m respectively) were held for the purpose of share-based payment plans and included in retained earnings. During the year, 16,603,840 ordinary shares with a net book value of £118m (2012 13,533,646 shares with a net book value of £85m) vested in share-based payment plans. During the year, the Company acquired 298,588 of its ordinary shares via reinvestment of dividends received on its own shares. In addition, the Company issued 7,900,000 new ordinary shares to the Group's share trust for its employees share-based payment plans with a net book value of £81m.

[3] On 2 January 2012, the Group contributed its interest in Bergen Engines AS to Rolls-Royce Power Systems Holding GmbH (RRPSH - previously Engine Holding GmbH), a company jointly held by Rolls-Royce and Daimler AG. Under the terms of agreement with Daimler, Rolls-Royce retained certain rights such that Bergen Engines continued to be classified as a subsidiary and consolidated.

[4] On 1 January 2013, the Group exercised rights in RRPSH that resulted in Rolls-Royce Power Systems AG (RRPS – formerly Tognum AG) being classified as a subsidiary and consolidated – see note 11.

[5] As part of the RRPSH shareholders' agreement, Daimler has the option to sell its shares in RRPSH to Rolls-Royce for a period of six years from 1 January 2013. The initial fair value of the exercise price of this option in respect of Bergen Engines AS (£166m) was recognised in 2012 and that amount in respect of Rolls-Royce Power Systems AG (£1,432m) has been recognised in 2013 has been charged to retained earnings. In addition, £45m of the initial recognition of the put option on NCI relating to Bergen Engine AS, recognised in 2012, has been reclassified from NCI to retained earnings. Subsequent movements in the value of this liability are included in the income statement, but excluded from the underlying results.

1 Basis of preparation and accounting policies

These financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) adopted for use in the EU (Adopted IFRS) in accordance with EU law (IAS Regulation EC 1606/2002).

The financial information set out above does not constitute the Company's statutory accounts for the years ended December 31, 2013 or 2012. Statutory accounts for 2012 have been delivered to the registrar of companies, and those for 2013 will be delivered in due course. The auditors have reported on those accounts; their reports were (i) unqualified, (ii) did not include references to any matters to which the auditors drew attention by way of emphasis without qualifying their reports and (iii) did not contain statements under section 498(2) or (3) of the Companies Act 2006.

Amendment to accounting policy for Risk and Revenue Sharing Arrangements

The Group has changed its accounting policy in respect of entry fees arising from Risk and Revenue Sharing Arrangements (RRSAs) following discussions with the Conduct Committee of the Financial Reporting Council (FRC).

RRSAs with key suppliers are a feature of our civil aerospace business. Under these arrangements the workshare partner shares in the risks and costs of developing an engine and, during the production phase, supplies components and receives a share of the programme revenues over the life of the engine programme. The share of development costs borne by the workshare partner and of the revenues it receives reflect the proportionate forecast cost of providing their parts compared to the overall forecast manufacturing cost of the engine.

The contribution to the development costs is achieved by the workshare partner performing its own development work, providing parts in the development phase and paying a non-refundable cash entry fee, such that both parties bear their proportionate share of the forecast nonrecurring development costs.

Historically, we recognised the entry fee as income when received, which we believed matched it to the recognition of non-recurring development costs incurred on behalf of the workshare partner. However, this did not take account of the fact that we capitalise some of our non-recurring development costs. Therefore, where we capitalise those costs, we will now defer the equivalent portion of the entry fee received and recognise it as the related costs are amortised in the production phase. As required by Adopted IFRS, we have made this change retrospectively; the impact of the change in policy in 2012 has been to increase profit before tax by £25 million and to reduce net assets at 31 December 2011 and 2012 by £184 million and £170 million respectively. Had the policy not been amended, profit before tax in 2013 would have been £39 million higher and at 31 December 2013 net assets £208 million higher.

Adopted IFRS does not explicitly deal with payments of this nature from suppliers and so, in developing an accounting treatment for entry fees that best reflects the commercial objectives of the contractual arrangement, we have analysed key features of RRSAs in the context of relevant accounting pronouncements and have had to weigh the importance of each feature in faithfully representing the overall commercial effect. Consequently this is a judgemental area. In summary, our view is that the development and production phases of the contract should be considered separately in accounting for the RRSA, which results in the entry fee being matched against the non-recurring development costs as described above.

The FRC Conduct Committee’s view is that the RRSA contract cannot be divided into separate development and production phases, as the fees and development components received by the Group during the development phase are exchanged for the obligation to pay the supplier a pre-determined share of any sales receipts during the production phase. On this basis the entry fees received would be deferred in their entirety and recognised over the period of production.

The FRC Conduct Committee has confirmed that, in view of the change to the policy and the additional disclosure we have made, it does not intend to pursue its consideration of this accounting policy further. We will keep the size of the difference under review, and do not currently expect the difference between the two approaches to become material in the foreseeable future.

We consider that the policy we have adopted best reflects the commercial effect of the agreements and is accordance with Adopted IFRS. So far as we can tell it is also aligned with the approach taken by others in our industry under both IFRS and US accounting standards (which we believe does not conflict with IFRS in this regard).

The impact of the two different approaches on profit before tax and net assets is as follows:

	2013			2012		
	Reported profit before tax £m	**Underlying profit before tax £m**	**Net assets £m**	Reported profit before tax £m	Underlying profit before tax £m	Net assets £m
Previous policy	**1,798**	**1,798**	**6,511**	2,741	1,409	6,180
Difference	**(39)**	**(39)**	**(208)**	25	25	(184)
Adopted policy	**1,759**	**1,759**	**6,303**	2,766	1,434	5,996
Difference	**(37)**	**(37)**	**(365)**	(10)	(10)	(323)
Alternative policy[1]	**1,722**	**1,722**	**5,938**	2,756	1,424	5,673

[1] Consistent with FRC Conduct Committee’s view

As required by IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, this change has been made retrospectively; the impact of the change in policy in 2012 was been to increase profit before tax by £25 million and to reduce net assets at 31 December 2012 by £170 million. Had the policy not been amended, profit before tax in 2013 would have been £39 million higher and at 31 December 2013 net assets £208 million higher.

Amendments to IAS 19 *Employee Benefits*

With effect from 1 January 2013, the Group has adopted the amendments to IAS 19 *Employee Benefits* issued by the IASB in June 2011. A description of these amendments and their effect is set out in note 9. In summary, the amendments require:
- recognition of certain administrative costs as operating costs rather than being included in net financing;
- net financing to be calculated on the net asset or liability recognised on the balance sheet using a 'AA' corporate bond rate rather than using an expected rate of return for scheme assets;
- immediate recognition of previously unrecognised past-service credits.

The impact of adopting the amendments is:
- profit before financing £15 million higher (2012 £22 million higher);
- net post-retirement financing cost:£107 million higher (2012 £56 million higher); and
- net assets £73 million lower (2012 £100 million lower).

There were no other revisions to Adopted IFRS that became applicable in 2013 which had a significant impact on the Group's financial statements.

Where relevant, 2012 figures in the notes to the condensed consolidated financial statements have been restated to reflect the effect of both of the above. Restatement figures are marked “‡”.

2 Analysis by business segment

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

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

Engineering & Technology and Operations and Services operate on a Group-wide basis across all the above segments.

The operating results reviewed by the Board are prepared on an underlying basis, which the Board considers reflects better the economic substance of the Group's trading during the year. The principles adopted to determine the underlying results are:

Underlying revenues – Where revenues are denominated in a currency other than the functional currency of the Group undertaking, these reflect the achieved exchange rates arising on settled derivative contracts.

Underlying profit before financing – Where transactions are denominated in a currency other than the functional currency of the Group undertaking, this reflects the transactions at the achieved exchange rates on settled derivative contracts. In addition, adjustments have been made to exclude one-off charges on post-retirement schemes, the effects of acquisition accounting and profits arising on acquisitions and disposals.

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

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

This analysis also includes a reconciliation of the underlying results to those reported in the consolidated income statement.

	2013			2012		
	Original equipment £m	**Aftermarket £m**	**Total £m**	Original equipment £m	Aftermarket £m	Total £m
Underlying revenues						
Civil aerospace	**3,035**	**3,620**	**6,655**	2,934	3,503	6,437
Defence aerospace	**1,385**	**1,206**	**2,591**	1,231	1,186	2,417
Marine	**1,438**	**1,089**	**2,527**	1,288	961	2,249
Energy	**415**	**633**	**1,048**	344	618	962
Power Systems	**2,004**	**827**	**2,831**	118	169	287
Eliminate intra-segment revenue	**(72)**	**(75)**	**(147)**	(22)	(121)	(143)
	8,205	**7,300**	**15,505**	5,893	6,316	12,209

	2013 £m	2012‡ £m
Underlying profit before financing		
Civil aerospace	**844**	743
Defence aerospace	**438**	395
Marine	**281**	294
Energy	**26**	19
Power Systems	**294**	109
Eliminate intra-segment profit	**2**	(11)
Reportable segments	**1,885**	1,549
Underlying central items	**(54)**	(54)
Underlying profit before financing and taxation	**1,831**	1,495
Underlying net financing	**(72)**	(61)
Underlying profit before taxation	**1,759**	1,434
Underlying taxation	**(434)**	(317)
Underlying profit for the period	**1,325**	1,117
Attributable to: Ordinary shareholders	1,224	1,103
Non-controlling interests	101	14
	1,325	**1,117**

	Total assets		Total liabilities		Net assets/(liabilities)	
	2013	2012‡	**2013**	2012‡	**2013**	2012‡
	£m	£m	**£m**	£m	**£m**	£m
Civil aerospace	**10,082**	9,123	**(6,243)**	(5,819)	**3,839**	3,304
Defence aerospace	**1,454**	1,412	**(1,660)**	(1,797)	**(206)**	(385)
Marine	**1,916**	2,063	**(1,312)**	(1,467)	**604**	596
Energy	**1,461**	1,329	**(688)**	(570)	**773**	759
Power Systems	**3,956**	1,478	**(3,034)**	(282)	**922**	1,196
Eliminations	**(744)**	(682)	**733**	671	**(11)**	(11)
Reportable segments	**18,125**	14,723	**(12,204)**	(9,264)	**5,921**	5,459
Net funds	**4,358**	2,700	**(2,419)**	(1,383)	**1,939**	1,317
Tax assets/(liabilities)	**332**	375	**(1,096)**	(710)	**(764)**	(335)
Post-retirement scheme surpluses/(deficits)	**248**	348	**(1,041)**	(793)	**(793)**	(445)
	23,063	18,146	**(16,760)**	(12,150)	**6,303**	5,996

Group employees (average)

	2013	2012
Civil aerospace	**23,400**	21,500
Defence aerospace	**7,900**	7,800
Marine	**9,200**	8,800
Energy	**4,000**	3,700
Power Systems	**10,700**	1,000
	55,200	42,800

Reconciliation to reported results

Year ended 31 December 2013	**Total reportable segments £m**	**Underlying central items £m**	**Total underlying £m**	**Underlying adjustments £m**	**Group £m**
Revenue from sale of original equipment	**8,205**	–	**8,205**	**70**	**8,275**
Revenue from aftermarket services	**7,300**	–	**7,300**	**(62)**	**7,238**
Total revenue	**15,505**	–	**15,505**	**8**	**15,513**
Operating profit excluding share of results of joint ventures and associates	**1,726**	**(54)**	**1,672**	**(297)**	**1,375**
Share of results of joint ventures and associates	**159**	–	**159**	**1**	**160**
Profit on reclassification of joint ventures to subsidiaries	–	–	–	**119**	**119**
Profit on disposal of businesses	–	–	–	**216**	**216**
Profit before financing and taxation	**1,885**	**(54)**	**1,831**	**39**	**1,870**
Net financing		**(72)**	**(72)**	**(39)**	**(111)**
Profit before taxation		**(126)**	**1,759**	**-**	**1,759**
Taxation		**(434)**	**(434)**	**54**	**(380)**
Profit for the year		**(560)**	**1,325**	**54**	**1,379**
Attributable to: ordinary shareholders			**1,224**	**143**	**1,367**
NCI			**101**	**(89)**	**12**

Year ended 31 December 2012‡					
Revenue from sale of original equipment	5,893	–	5,893	41	5,934
Revenue from aftermarket services	6,316	–	6,316	(89)	6,227
Total revenue	12,209	–	12,209	(48)	12,161
Operating profit excluding share of results of joint ventures and associates	1,318	(54)	1,264	(59)	1,205
Share of results of joint ventures and associates	231	–	231	(58)	173
Profit on disposal of businesses	–	–	–	699	699
Profit before financing and taxation	1,549	(54)	1,495	582	2,077
Net financing		(61)	(61)	750	689
Profit before taxation		(115)	1,434	1,332	2,766
Taxation		(317)	(317)	(114)	(431)
Profit for the year		(432)	1,117	1,218	2,335
Attributable to: Ordinary shareholders			1,103	1,218	2,321
NCI			14	–	14

Underlying adjustments	**2013**				2012‡			
	Revenue £m	**Profit before financing £m**	**Net financing £m**	**Taxation £m**	Revenue £m	Profit before financing £m	Net financing £m	Taxation £m
Underlying performance	**15,505**	**1,831**	**(72)**	**(434)**	12,209	1,495	(61)	(317)
Revenue recognised at exchange rate on date of transaction	**8**	**–**	**–**	**–**	(48)	–	–	–
Realised gains on settled derivative contracts [1]	**–**	**(10)**	**(5)**	**–**	–	(25)	–	–
Net unrealised fair value changes to derivative contracts [2]	**–**	**–**	**250**	**–**	–	–	747	–
Effect of currency on contract accounting	**–**	**(18)**	**–**	**–**	–	(23)	–	–
Put options on NCI and financial RRSPs - foreign exchange differences and other unrealised changes in value	**–**	**–**	**(251)**	**–**	–	–	11	–
Effect of acquisition accounting [3]	**–**	**(265)**	**–**	**–**	–	(69)	–	–
Profit on reclassification of joint ventures to subsidiaries	**–**	**119**	**–**	**–**	–			–
Post-retirement scheme past service costs	**–**	**(64)**	**–**	**–**	–	–	–	–
Net post-retirement scheme financing	**–**	**-**	**(26)**	**–**	–	–	(8)	–
Profit on disposal of businesses	**–**	**216**	**–**	**–**	–	–	–	–
Other [4]	**–**	**61**	**(7)**	**–**	–	–	–	–
Related tax effects	**–**	**–**	**–**	**54**	–	–	–	(151)
IAE restructuring	**–**	**–**	**–**	**–**	–	699	–	37
Total underlying adjustments	**8**	**39**	**(39)**	**54**	(48)	582	750	(114)
Reported per consolidated income statement	**15,513**	**1,870**	**(111)**	**(380)**	12,161	2,077	689	(431)

1 Realised gains on settled derivative contracts include adjustments to reflect the (gains)/losses in the same period as the related trading cash flows.
2 Unrealised fair value changes to derivative contracts: (i) include those included in equity accounted joint ventures; and (ii) exclude those for which the related trading contracts have been cancelled when the fair value changes are recognised immediately in underlying profit.
3 The adjustment eliminates charges recognised as a result of recognising assets in acquired businesses at fair value.
4 Other includes the exclusion of other operating income of £63m and the revaluation of preference shares in RRPS AG, which have now been acquired.

3 Other income and expenses

In October 2011, Rolls-Royce and United Technologies Corp. (UTC) announced their intention to form a new joint venture to develop an engine to power future mid-size aircraft (120-230 passenger aircraft). In September 2013, the parties agreed not to proceed with the partnership. Other operating income includes £63m from the settlement received by the Group as a result of this decision.

Research and development

	2013	2012
Expenditure in the year	**(750)**	(572)
Capitalised as intangible assets	**110**	38
Amortisation of capitalised costs	**(130)**	(55)
Net research and development cost	**(770)**	(589)
Entry fees received	**126**	33
Entry fees deferred in respect of charges in future years	**(50)**	(5)
Recognition of previously deferred entry fees	**11**	30
Net cost recognised in the income statement	**(683)**	(531)
Underlying adjustments relating to effects of acquisition accounting and foreign exchange	**59**	–
	(624)	(531)

4 Net financing

	2013 Per consolidated income statement £m	***Underlying financing £m***	2012 Per consolidated income statement £m	*Underlying financing £m*
Financing income				
Interest receivable	**15**	***15***	10	*10*
Fair value gains on foreign currency contracts	**287**	–	750	–
Put options on NCI and financial RRSAs – foreign exchange differences and changes in forecast payments	**8**	–	11	–
Financing on post-retirement scheme surpluses	**17**	–	26	–
	327	***15***	797	*10*
Financing costs				
Interest payable	**(58)**	***(58)***	(51)	*(51)*
Fair value losses on foreign currency contracts	**(3)**	–	–	–
Put options on NCI and financial RRSAs – foreign exchange differences and changes in forecast payments	**(259)**	–	–	–
Financial charge relating to financial RRSAs	**(9)**	***(9)***	(10)	*(10)*
Fair value losses on commodity derivatives	**(34)**	–	(3)	–
Financing on post-retirement scheme deficits	**(43)**	–	(34)	–
Net foreign exchange losses	**(5)**	–	–	–
Other financing charges	**(27)**	***(20)***	(10)	*(10)*
	(438)	***(87)***	(108)	*(71)*
Net financing	**(111)**	***(72)***	689	*(61)*
Analysed as:				
Net interest payable	**(43)**	***(43)***	(41)	*(41)*
Net post-retirement scheme financing	**(26)**	–	(8)	–
Net other financing	**(42)**	***(29)***	738	*(20)*
Net financing	**(111)**	***(72)***	689	*(61)*

5 Earnings per ordinary share (EPS)

Basic EPS are calculated by dividing the profit attributable to ordinary shareholders by the weighted average number of ordinary shares in issue during the period, excluding ordinary shares held under trust, which have been treated as if they had been cancelled. Diluted EPS are calculated by adjusting the weighted average number of ordinary shares in issue during the period for the bonus element of share options.

	2013			2012‡		
	Basic	**Potentially dilutive share options**	**Diluted**	Basic	Potentially dilutive share options	Diluted
Profit/(loss) (£m)	**1,367**	–	**1,367**	2,321	–	2,321
Weighted average shares (millions)	**1,866**	**21**	**1,887**	1,851	25	1,876
EPS (pence)	**73.26**	**(0.82)**	**72.44**	125.38[1]	(1.65)	123.73

The reconciliation between underlying EPS and basic EPS is as follows:

	2013		2012‡	
	Pence	**£m**	Pence	£m
Underlying EPS / Underlying profit attributable to ordinary shareholders	**65.59**	**1,224**	59.59[2]	1,103
Total underlying adjustments to profit before tax (note 2)	–	–	71.96	1,332
Related tax effects	**2.89**	**54**	(6.17)	(114)
Related NCI effects	**4.78**	**89**	–	–
EPS / Profit attributable to ordinary shareholders	**73.26**	**1,367**	125.38	2,321
Excluding IAE restructuring	**73.26**	**1,367**	**85.62**	**1,585**
IAE restructuring	–	–	**39.76**	**736**

[1] The impact of the restatement on the previously reported EPS of 123.23p was an increase of 1.40p relating to the IAS 19 amendments and an increase of 0.75p relating to the change in the accounting policy for RRSAs.

[2] The impact of the restatement on the previously reported underlying EPS of 59.27p was a decrease of 0.71p relating to the IAS 19 amendments and an increase of 1.03p relating to the change in the accounting policy for RRSAs.

6 Payments to shareholders in respect of the period

Payments to shareholders in respect of the period represent the value of C Shares to be issued in respect of the results for the period. Issues of C Shares were declared as follows:

	2013		2012	
	Pence per share	**£m**	Pence per share	£m
Interim (issued in January)	**8.6**	**162**	7.6	142
Final (issued in July)	**13.4**	**252**	11.9	223
	22.0	**414**	19.5	365

7 Intangible assets

	Goodwill £m	**Certification costs and participation fees £m**	**Development expenditure[1] £m**	**Recoverable engine costs £m**	**Customer relationships[1] £m**	**Software[1] £m**	**Other[1] £m**	**Total £m**
Cost:								
At 1 January 2013	**1,111**	**740**	**1,028**	**499**	**45**	**385**	**142**	**3,950**
Exchange differences	**(18)**	**3**	**5**	**–**	**(3)**	**(1)**	**17**	**3**
Additions	**–**	**185**	**110**	**52**	**–**	**69**	**87**	**503**
Acquisition of business	**773**	**–**	**508**	**–**	**433**	**–**	**286**	**2,000**
Disposal of business	**(5)**	**–**	**(5)**	**–**	**–**	**–**	**–**	**(10)**
At 31 December 2013	**1,861**	**928**	**1,646**	**551**	**475**	**453**	**532**	**6,446**
Accumulated amortisation:								
At 1 January 2013	**9**	**225**	**323**	**295**	**12**	**144**	**41**	**1,049**
Exchange differences	**(1)**	**–**	**(7)**	**–**	**(8)**	**–**	**5**	**(11)**
Charge for the period	**–**	**40**	**130**	**28**	**61**	**54**	**91**	**404**
Impairment	**17**	**–**	**3**	**–**	**4**	**–**	**–**	**24**
Disposal of business	**(2)**	**–**	**(5)**	**–**	**–**	**–**	**–**	**(7)**
At 31 December 2013	**23**	**265**	**444**	**323**	**69**	**198**	**137**	**1,459**
Net book value at:								
31 December 2013	**1,838**	**663**	**1,202**	**228**	**406**	**255**	**395**	**4,987**
31 December 2012	1,102	515	705	204	33	241	101	2,901

[1] Following the acquisition of RRPS on 1 January 2013, intangible assets relating to R&D, customer relationships and software have been reclassified from 'other' into their respective categories from 1 January 2012 onwards.

Goodwill has been tested for impairment during 2013 on the following basis:

- The carrying value of goodwill has been assessed by reference to value in use. These have been estimated using cash flows from the most recent forecasts prepared by management, which are consistent with past experience and external sources of information on market conditions. Given the long-term and established nature of many of the Group's products (product lives are often measured in decades), these forecast the next ten years. Growth rates for the period not covered by the forecasts are based on a range of growth rates (2.0 – 2.75 per cent) that reflect the products, industries and countries in which the relevant CGU or group of CGUs operate.
- The key assumptions for the impairment tests are the discount rate and, in the cash flow projections, the programme assumptions, the growth rates and the impact of foreign exchange rates on the relationship between selling prices and costs. Impairment tests are performed using prevailing exchange rates.
- The pre-tax cash flow projections have been discounted at 13 per cent (2012 13 per cent), based on the Group's weighted average cost of capital.

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

- The carrying values have been assessed by reference to value in use. These have been estimated using cash flows from the most recent forecasts prepared by management, which are consistent with past experience and external sources of information on market conditions over the lives of the respective programmes.
- The key assumptions underlying cash flow projections are assumed market share, programme timings, unit cost assumptions, discount rates, and foreign exchange rates.
- The pre-tax cash flow projections have been discounted at 11% (2012 11%), based on the Group's weighted average cost of capital.
- No impairment is required on this basis. However, a combination of changes in assumptions and adverse movements in variables that are outside the Company's control (discount rate, exchange rate and airframe delays), could result in impairment in future periods.

8 Financial assets and liabilities

Other financial assets and liabilities comprise:

	Derivatives							
	Foreign exchange contracts	Commodity contracts	Interest rate contracts	Total	Put options on NCI	Financial RRSAs	C Shares	Total
At 31 December 2013								
Non-current assets	**631**	**–**	**43**	**674**	**–**	**–**	**–**	**674**
Current assets	**72**	**2**	**–**	**74**	**–**	**–**	**–**	**74**
Current liabilities	**(63)**	**(16)**	**(1)**	**(80)**	**(1,858)**	**(22)**	**(16)**	**(1,976)**
Non-current liabilities	**(142)**	**(25)**	**(48)**	**(215)**	**–**	**(145)**	**–**	**(360)**
	498	**(39)**	**(6)**	**453**	**(1,858)**	**(167)**	**(16)**	**(1,588)**
At 31 December 2012								
Non-current assets	498	4	90	592	–	–	–	592
Current assets	104	6	5	115	–	–	–	115
Current liabilities	(97)	(8)	–	(105)	(167)	(30)	(10)	(312)
Non-current liabilities	(233)	(15)	(7)	(255)	–	(163)	–	(418)
	272	(13)	88	347	(167)	(193)	(10)	(23)

Derivative financial instruments	2013				2012
	Foreign exchange £m	Commodity £m	Interest rate £m	Total £m	Total £m
At January 1	272	(13)	88	**347**	(378)
Acquisition of businesses	4	(1)	–	**3**	–
Movements in fair value hedges	3	–	(91)	**(88)**	(2)
Movements in cash flow hedges	–	–	–	**-**	(4)
Movements in other derivative contracts	284	(34)	–	**250**	748
Contracts settled	(65)	9	(3)	**(59)**	(17)
At 31 December	**498**	**(39)**	**(6)**	**453**	347

Put options on NCI and financial risk and revenue sharing arrangements (RRSAs)	Put options on NCI		Financial RRSAs	
	2013 £m	2012 £m	2013 £m	2012 £m
At January 1	**(167)**	–	**(193)**	(230)
Cash paid to partners			33	35
On acquisition of business [1]	(2)	–		
Additions	(1,432)	(167)		–
Exchange adjustments included in OCI			(4)	1
Financing charge [2]			(9)	(10)
Excluded from underlying profit: [2]				
Exchange adjustments	(45)	5	4	9
Changes in estimated put options exercise prices	(212)	(5)		
Changes in forecast payments			2	2
At 31 December	**(1,858)**	(167)	**(167)**	(193)

[1] Arising on the reclassification of RRPS to a subsidiary – see note 11.
[2] Included in net financing.

9 Pensions and other post-retirement benefits

Movements in the net post-retirement position recognised in the balance sheet were as follows:

	UK schemes £m	Overseas schemes £m	Total £m
At 1 January 2013, restated – see below	**199**	**(644)**	**(445)**
Exchange adjustments	**–**	**(3)**	**(3)**
Current service cost	**(153)**	**(55)**	**(208)**
Past service cost	**(66)**	**(5)**	**(71)**
Net financing recognised in income statement	**12**	**(38)**	**(26)**
Contributions by employer	**249**	**66**	**315**
Acquisition of business	**–**	**(397)**	**(397)**
Recognised in OCI:			
Actuarial gains recognised in OCI	**(222)**	**135**	**(87)**
Returns on plan assets excluding financing	**(363)**	**(42)**	**(405)**
Movement in unrecognised surplus [1]	**407**	**–**	**407**
Movement on minimum funding liability [2]	**133**	**–**	**133**
Other	**–**	**(6)**	**(6)**
At 31 December 2013	**196**	**(989)**	**(793)**
Analysed as:			
Post-retirement scheme surpluses - included in non-current assets	**242**	**6**	**248**
Post-retirement scheme deficits - included in non-current liabilities	**(46)**	**(995)**	**(1,041)**
	196	**(989)**	**(793)**

[1] Where a surplus has arisen on a scheme, in accordance with IAS 19 and IFRIC 14, the surplus is recognised as an asset only if it represents an unconditional economic benefit available to the Group in the future. Any surplus in excess of this benefit is not recognised in the balance sheet.

[2] A minimum funding liability arises where the statutory funding requirements require future contributions in respect of past service that will result in a future unrecognisable surplus.

Amendments to IAS 19

Prior period figures have been restated to reflect the adoption of the amendments to IAS 19 *Employee Benefits*. Consequential tax effects have been reflected in deferred tax.

		As previously reported			Amendments			As restated		
	Note	UK	Overseas	Total	UK	Overseas	Total	UK	Overseas	Total
At 1 January 2012	A	**252**	**(649)**	**(397)**	**17**	**93**	**110**	**269**	**(556)**	**(287)**
Exchange adjustments		–	24	24	–	–	–	–	24	24
Current-service cost	B	(123)	(38)	(161)	(6)	(4)	(10)	(129)	(42)	(171)
Past-service cost	A	(2)	12	10	-	(12)	(12)	(2)	–	(2)
Net financing	C	(41)	(23)	(64)	58	(2)	56	17	(25)	(8)
Contributions by employer		250	47	297	2	–	2	252	47	299
Acquisition of business		5	–	5	–	–	–	5	–	5
Actuarial gains/(losses)	C	(659)	(118)	(777)	-	-	-	(659)	(118)	(777)
Return on plan assets excluding financing	C	(30)	20	(10)	(125)	6	(119)	(155)	26	(129)
Movement in unrecognised surplus	C	465	–	465	64	–	64	529	–	529
Movement in minimum funding liability	C	63	–	63	9	–	9	72	–	72
At 31 December 2012		**180**	**(725)**	**(545)**	**19**	**81**	**100**	**199**	**(644)**	**(445)**
Post-retirement scheme surpluses		317	12	329				336	12	348
Post-retirement scheme deficits		(137)	(737)	(874)				(137)	(656)	(793)
		180	**(725)**	**(545)**				**199**	**(644)**	**(445)**

[A] Previously, the Group had an unrecognised past-service credit related to the restructuring of certain overseas healthcare schemes in 2011. This has now been recognised in full at 1 January 2012. As a consequence, the amortisation of this past-service credit in 2012 is eliminated. In addition, an adjustment has been made in the calculation of the defined benefit obligation on one of the UK schemes to put it on a consistent basis with the other schemes.

[B] Previously, all administrative costs were offset against the expected return on scheme assets. The amendments only allow this in respect of the costs of managing scheme assets, other administrative expenses are now included in the current service cost.

[C] Previously, net financing comprised the expected return on scheme assets based on the actual assets held and a financing charge on scheme liabilities calculated using a 'AA' corporate bond rate. The amendments require net financing to be calculated on the net asset or liability recognised on the balance sheet using a 'AA' corporate bond rate. The net financing charge has reduced principally because the Group's UK scheme assets include significant liability driven investment portfolios. The expected return on these is largely driven by UK Government gilt rates and this was lower than the 'AA corporate bond rates required by the amendments. The amendments to financing have a consequential impact on amounts recognised in OCI: (i) the change in assumed return on scheme assets affects the related actuarial gains or losses; and (ii) the implicit financing on movements in the unrecognised surplus and the minimum funding liability is now included in OCI rather than the income statement.

10 Contingent liabilities and contingent assets

On 6 December 2012, the Company announced that it had passed information to the SFO relating to concerns in overseas markets. Since that date the Company has continued its investigations and is engaging with the SFO and other authorities in the UK, the USA and elsewhere. In December 2013, the Company announced that it had been informed by the SFO that it had commenced a formal investigation. The consequence of these disclosures will be decided by the regulatory authorities. It remains too early to predict the outcomes, but these could include the prosecution of individuals and of the Group. Accordingly, the potential for fines, penalties or other consequences (including debarment from government contracts, suspension of export privileges and reputational damage) cannot currently be assessed. As the investigation is ongoing, it is not yet possible to identify the timescale in which these issues might be resolved. In connection with the sale of its products the Group will, on some occasions, provide financing support for its customers. The Group's contingent liabilities related to financing arrangements are spread over many years and relate to a number of customers and a broad product portfolio.

The discounted values of contingent liabilities relating to delivered aircraft and other arrangements where financing is in place, less insurance and indemnity arrangements and relevant provisions were:

	2013		2012	
	£m	***$m***	£m	*$m*
Gross contingent liabilities	**356**	***589***	569	*925*
Value of security	**(217)**	***(360)***	(381)	*(620)*
Indemnities	**(80)**	***(132)***	(118)	*(191)*
Net commitments	**59**	***97***	70	*114*
Net commitments with relevant security reduced by 20% [1]	**78**	***129***	133	*216*
Security includes unrestricted cash collateral of:	**50**	***83***	64	*104*

[1] Although sensitivity calculations are complex, the reduction of the relevant security by 20% illustrates the sensitivity of the contingent liability to changes in this assumption.

There are also net contingent liabilities in respect of undelivered aircraft, but it is not considered practicable to estimate these as deliveries can be many years in the future, and the relevant financing will only be put in place at the appropriate time.

Contingent liabilities exist in respect of guarantees provided by the Group in the ordinary course of business for product delivery, performance and reliability. The Group has, in the normal course of business, entered into arrangements in respect of export finance, performance bonds, countertrade obligations and minor miscellaneous items. Various Group undertakings are parties to legal actions and claims which arise in the ordinary course of business, some of which are for substantial amounts. While the outcome of some of these matters cannot precisely be foreseen, the directors do not expect any of these arrangements, legal actions or claims, after allowing for provisions already made, to result in significant loss to the Group.

11 Acquisitions and disposals

Acquisitions

Rolls-Royce Power Systems AG (RRPS - previously Tognum AG)

From 25 August 2011 to 31 December 2012 the Group's interest in RRPS was classified as a joint venture and equity accounted. On 1 January 2013, conditions were fulfilled which gave the Group certain rights that resulted in RRPS being classified as a subsidiary and consolidated. Accordingly, Rolls-Royce's joint venture interest in Rolls-Royce Power Systems Holding GmbH (RRPSH) has been reclassified as a subsidiary. The fair values of the identifiable assets and liabilities assumed are £1,339 million, giving rise to goodwill of £773 million, as set out in the table below. Rolls-Royce and Daimler AG (Daimler) each hold 50 per cent of the shares of RRPSH, which itself held over 99 per cent of the shares of RRPS. During 2013, RRPSH acquired the remaining 1 per cent of shares of RRPS. RRPS is a premium supplier of engines, propulsion systems and components for marine, energy, defence, and other industrial applications (often described as 'off-highway' applications).

Other

On 30 April 2013, the Group acquired 100% of the issued share capital of HyperTherm High-Temperature Composites, Inc., a producer of state-of-the-art composite materials, including ceramic matrix composites, engineered coatings and thermal-structural components.

On 15 August 2013, the Group acquired 100% of SmartMotor AS, a leading specialist in the development of permanent magnet technology.

On 24 December 2013, the Group acquired the remaining 49% of shares not held in Composite Technology and Applications Limited, a business engaged in the development of composite fan blades and containment cases for the next generation of advanced turbofan engines.

For each of the other acquisitions noted, the acquisition cost (net of cash and borrowings acquired) has been allocated to identifiable assets and liabilities – principally technology, patents and licences, customer relationships, trademark, order backlog and other intangible assets.

Identifiable assets acquired and liabilities assumed

	RRPS £m	Other £m	Total £m
Intangible assets	1,192	35	**1,227**
Property, plant and equipment	545	1	**546**
Investments in joint ventures, associates and other unlisted investments	50	–	**50**
Inventory	737	–	**737**
Trade and other receivables	487	2	**489**
Taxation recoverable	48	–	**48**
Cash and cash equivalents	240	5	**245**
Trade and other payables	(693)	(3)	**(696)**
Current tax liabilities	(77)	–	**(77)**
Borrowings	(203)	(1)	**(204)**
Other financial assets and liabilities	(27)	–	**(27)**
Deferred tax	(283)	1	**(282)**
Provisions	(280)	–	**(280)**
Post-retirement schemes	(397)	–	**(397)**
Total identifiable assets and liabilities	1,339	40	**1,379**
Goodwill arising	773	–	**773**
Total consideration	2,112	40	**2,152**
Exercise price of put option on NCI	(1,432)	–	**(1,432)**
	680	40	**720**
Consideration satisfied by:			
Cash consideration	–	37	**37**
Existing shareholding	1,443	3	**1,446**
NCI	669	–	**669**
	2,112	40	**2,152**
Net cash flow arising on acquisition:			
Cash consideration	–	37	**37**
Less: cash and cash equivalents acquired	(240)	(5)	**(245)**
Cash flow per cash flow statement	(240)	32	**(208)**

In accordance with the provisions of IFRS 3 *Business Combinations*, the Group has opted not to recognise goodwill in respect of the non-controlling interest. The existing joint venture investment holding in RRPSH has been revalued, giving rise to a gain of £115 million.

As part of the RRPSH shareholders' agreement, Daimler has the option to sell its shares in RRPSH to Rolls-Royce for a period of six years from 1 January 2013. The initial fair value of the exercise price of this option in respect of RRPS has been recognised as a liability (£1,432 million), which has been charged to retained earnings. Subsequent movements in the value of this liability will be included in the income statement, but excluded from the underlying results.

Disposals

On 29 January 2013, Alstom acquired the Group's wholly owned subsidiary Tidal Generation Limited.

On 2 September 2013, Turbomeca (a Safran company) acquired the Group's 50 per cent shareholding and interest in the RTM322 helicopter engine programme for which it has received a cash consideration of €293 million. Rolls-Royce will progressively transfer its operational responsibilities in the engine programme to Turbomeca over a multi-year period.

	RTM322 £m	Tidal Generation £m	Total £m
Intangible assets – goodwill	–	3	**3**
Investments in joint venture	2	–	**2**
Cash and cash equivalents	–	2	**2**
Trade and other payables	–	(2)	**(2)**
Provisions for liabilities and charges	(2)	–	**(2)**
Net assets	–	3	**3**
Profit on disposal of business	194	22	**216**
Disposal costs	3	–	**3**
Proceeds deferred in respect of transitional services and retain obligations	53	–	**53**
Disposal proceeds	250	25	**275**
Cash and cash equivalents disposed	–	(2)	**(2)**
Cash inflow per cash flow statement	250	23	**273**

12 Segmental analysis from 1 January 2014

During 2013, the management structure of the business has been revised and the internal reporting structure has been developed to reflect this. These changes will be reflected in the segmental analysis with effect from 1 January 2014. Had they been in place during 2013, the segmental analysis shown in note 2 would be as follows:

	Aerospace			Marine & Industrial Power Systems						
Year ended 31 December 2013	Civil £m	Defence £m	**Total £m**	Marine £m	Power Systems £m	Nuclear & Energy £m	Intra-segment £m	**Total £m**	Inter-segment £m	**Total reportable segments £m**
Underlying revenue from sale of:										
Original equipment	3,035	1,385	**4,420**	1,236	2,004	617	(72)	**3,785**	–	**8,205**
Aftermarket services	3,620	1,206	**4,826**	801	827	921	(75)	**2,474**	–	**7,300**
Underlying revenue	**6,655**	**2,591**	**9,246**	**2,037**	**2,831**	**1,538**	**(147)**	**6,259**	–	**15,505**
Underlying operating profit excluding share of results of joint ventures and associates	708	424	**1,132**	233	296	63	2	**594**	–	**1,726**
Share of results of joint ventures and associates	136	14	**150**	–	(2)	11	–	**9**	–	**159**
Underlying profit before financing and taxation	**844**	**438**	**1,282**	**233**	**294**	**74**	**2**	**603**	–	**1,885**
Segment assets	9,587	1,437	**11,024**	1,701	3,927	1,616	(10)	**7,234**	(734)	**17,524**
Investments in joint ventures and associates	495	17	**512**	5	29	55	–	**89**	–	**601**
Segment liabilities	(6,243)	(1,660)	**(7,903)**	(985)	(3,034)	(1,015)	–	**(5,034)**	733	**(12,204)**
Net assets	**3,839**	**(206)**	**3,633**	**721**	**922**	**656**	**(10)**	**2,289**	(1)	**5,921**
Investment in intangible assets, property plant and equipment and joint ventures and associates	891	103	**994**	23	142	80	–	**245**	–	**1,239**
Depreciation, amortisation and impairment	349	53	**402**	63	272	63	–	**398**	–	**800**

Principal risks and uncertainties

The following table describes the risks that the risk committee, with endorsement from the Board, consider to have the most material potential impact on the Group. They are specific to the nature of our business notwithstanding that there are other risks that may occur and may impact the achievement of the Group's objectives.

The risk committee discussions have been focused on these risks and the actions being taken to manage them.

Risk or uncertainty and potential impact	How we manage it
Product failure Product not meeting safety expectations, or causing significant impact to customers or the environment through failure in quality control.	• Operating a safety first culture • Our engineering design and validation process is applied from initial design, through production and into service • The safety committee reviews the scope and effectiveness of the Group's product safety policies to ensure that they operate to the highest industry standards • A safety management system (SMS) has been established by a dedicated team. This is governed by the Product Safety Review Board and is subject to continual improvement based on experience and industry best practice. Product safety training is an integral part of our SMS • Crisis management team led by the Director – Engineering and Technology or General Counsel as appropriate
Business continuity Breakdown of external supply chain or internal facilities that could be caused by destruction of key facilities, natural disaster, regional conflict, financial insolvency of a critical supplier or scarcity of materials which would reduce the ability to meet customer commitments, win future business or achieve operational results.	• Continued investment in adequate capacity and modern equipment and facilities • Identifying and assessing points of weakness in our internal and external supply chain, our IT systems and our people skills • Selection and development of stronger suppliers • Developing dual sources or dual capability • Developing and testing site-level incident management and business recovery plans • Crisis management team led by the Director – Engineering and Technology or General Counsel as appropriate • Customer excellence centres provide improved response to supply chain disruption
Competitor action The presence of large, financially strong competitors in the majority of our markets means that the Group is susceptible to significant price pressure for original equipment or services even where our markets are mature or the competitors are few. Our main competitors have access to significant government funding programmes as well as the ability to invest heavily in technology and industrial capability.	• Accessing and developing key technologies and service offerings which differentiate us competitively • Focusing on being responsive to our customers and improving the quality, delivery and reliability of our products and services • Partnering with others effectively • Driving down cost and improving margins • Protecting credit lines • Investing in innovation, manufacturing and production • Understanding our competitors
International trade friction Geopolitical factors that lead to significant tensions between major trading parties or blocs which could impact the Group's operations. For example: explicit trade protectionism; differing tax or regulatory regimes; potential for conflict; or broader political issues.	• Where possible, locating our domestic facilities in politically stable countries and/or ensuring that we maintain dual capability • Diversifying global operations to avoid excessive concentration of risks in particular areas • Network of regional directors proactively monitors local situations • Maintaining a balanced business portfolio in markets with high technological barriers to entry and a diverse customer base • Understanding our supply chain risks • Proactively influencing regulation where it affects us

Risk or uncertainty and potential impact	How we manage it
Major product programme delivery Failure to deliver a major product programme on time, to specification or technical performance falling significantly short of customer expectations would have potentially significant adverse financial and reputational consequences, including the risk of impairment of the carrying value of the Group's intangible assets and the impact of potential litigation.	• Major programmes are subject to Board approval • Major programmes are reviewed at levels and frequencies appropriate to their performance against key financial and non-financial deliverables and potential risks throughout a programme's life cycle • Technical audits are conducted at pre-defined points performed by a team that is independent from the programme • Programmes are required to address the actions arising from reviews and audits and progress is monitored and controlled through to closure • Knowledge management principles are applied to provide benefit to current and future programmes
Compliance Non-compliance by the Group with legislation or other regulatory requirements in the regulated environment in which it operates (for example: export controls; offset; use of controlled chemicals and substances; and anti-bribery and corruption legislation) compromising our ability to conduct business in certain jurisdictions and exposing the Group to potential: reputational damage; financial penalties; debarment from government contracts for a period of time; and/or suspension of export privileges or export credit financing), any of which could have a material adverse effect.	• An uncompromising approach to compliance is now, and should always be, the only way to do business • The Group has an extensive compliance programme. This programme and the Global Code of Conduct are promulgated throughout the Group and are updated and reinforced from time to time, to ensure their continued relevance, and to ensure that they are complied with both in spirit and to the letter. The Global Code of Conduct and the Company's compliance programme are supported by appropriate training • A legal and compliance team has been put in place to manage the current specific issue through to a conclusion and beyond • Lord Gold has reviewed the Group's current compliance procedures and an improvement plan is being implemented
Market shock The Group is exposed to a number of market risks, some of which are of a macro-economic nature, for example, foreign currency exchange rates, and some which are more specific to the Group, for example liquidity and credit risks, reduction in air travel or disruption to other customer operations. Significant extraneous market events could also materially damage the Group's competitiveness and/or credit worthiness. This would affect operational results or the outcomes of financial transactions.	• Maintaining a strong balance sheet, through healthy cash balances and a continuing low level of debt • Providing financial flexibility by maintaining high levels of liquidity and an investment grade 'A' credit rating • The portfolio effect from our business interests, both in terms of original equipment to aftermarket split and our different segments provide a natural shock absorber since the portfolios are not correlated • Deciding where and what currencies to source in, where and how much credit risk is extended or taken and hedging residual risk through the financial derivatives markets (foreign exchange, interest rates and commodity price risk)
IT vulnerability Breach of IT security causing controlled data to be lost, made inaccessible, corrupted or accessed by unauthorised users.	• Establishing 'defence in depth' through deployment of multiple layers of software and processes including web gateways, filtering, firewalls, intrusion, advanced persistent threat detectors and integrated reporting • Security and network operations centres have been established • Active sharing of information through industry, government and security forums

Annual General Meeting (AGM) and directorate change

This year's AGM will be held at 11.00am on Thursday, 1 May 2014 at the QEII Conference Centre, Broad Sanctuary, Westminster, London SW1P 3EE. The AGM notice and the annual report will be available to view on the Group's website.

In accordance with the UK Corporate Governance Code and the Company's Articles of Association, all directors are required to retire at each AGM. All of the current directors intend to put themselves forward for election or re-election at the AGM on 1 May 2014 with the exception of Iain Conn who is not seeking re-election and will retire from the Board at the conclusion of the meeting. Mr Conn has served as a non-executive director since 2005 and as the Senior Independent Director since 2007. Lewis Booth, subject to his re-election at the AGM, will succeed Iain Conn as the Senior Independent Director with effect from the conclusion of the AGM. Mr Booth has been a non-executive director since 2011.

Payments to shareholders

Payments to shareholders: at the AGM on 1 May 2014, the directors will recommend an issue of 134 C Shares with a total nominal value of 13.4 pence for each ordinary share. The final issue of C shares will be made on 1 July 2014 to shareholders on the register on 25 April 2014 and the final day of trading with entitlement to C Shares is 22 April 2014. Together with the interim issue on 2 January 2014 of 86 C Shares for each ordinary share with a total nominal value of 8.6 pence, this is the equivalent of a total annual payment to ordinary shareholders of 22.0 pence for each ordinary share.

The payment to shareholders will, as before, be made in the form of redeemable C Shares which shareholders may either choose to retain or redeem for a cash equivalent. The Registrar, on behalf of the Company, operates a C Share Reinvestment Plan (CRIP) and can, on behalf of shareholders, purchase ordinary shares from the market rather than delivering a cash payment. Shareholders wishing to redeem their C Shares or else redeem and participate in the CRIP must ensure that their instructions are lodged with the Registrar, Computershare Investor Services Plc, no later than 5.00pm on 2 June 2014. Redemption will take place on 3 July 2014.

The statements below have been prepared in connection with the Company's full Annual report for the year ended 31 December 2013. Certain parts thereof are not included in this announcement.

Going concern

The Group's business activities, together with the factors likely to affect its future development, performance and position and a summary of the principal risks affecting the business are set out in the strategic report. The financial position of the Group, its cash flows, liquidity position, borrowing facilities and financial risks are also described in the strategic report and the directors' report. In addition, the consolidated financial statements include the Group's objectives, policies and processes for financial risk management, details of its cash and cash equivalents, indebtedness and borrowing facilities and its financial instruments, hedging activities and its exposure to counterparty credit risk, liquidity risk, currency risk, interest rate risk and commodity pricing risk.

The Group meets its funding requirements through a mixture of shareholders' funds, bank borrowings, bonds, notes and finance leases. The Group has facilities of £3.6 billion of which £2.4 billion was drawn at the year end. £200 million of these facilities mature in 2014.

The Group's forecasts and projections, taking into account reasonably possible changes in trading performance, show that the Group has sufficient financial resources. If the put option on Rolls-Royce Power Systems Holding GmbH (formerly named Engine Holding GmbH) is exercised by Daimler AG, (estimated cost £1.9 billion), the directors consider that the Group would be able to raise additional resources in the necessary timeframe to meet this commitment. As a consequence, the directors have a reasonable expectation that the Company and the Group are well placed to manage their business risks and to continue in operational existence for the foreseeable future, despite the current uncertain global economic outlook.

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

Responsibility statements

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

i) each of the Group and parent company financial statements, prepared in accordance with IFRS and UK Accounting Standards respectively, gives a true and fair view of the assets, liabilities, financial position and profit or loss of the issuer and the undertakings included in the consolidation taken as a whole;
ii) the strategic report and the directors report includes a fair review of the development and performance of the business and the position of the Company and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face; and
iii) the annual report, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the Company's performance, business model and strategy.

By order of the Board

John Rishton
Chief Executive
12 February 2014

Mark Morris
Chief Financial Officer
12 February 2014