

COMPANY NUMBER 01003142

ROLLS-ROYCE PLC
ANNUAL REPORT AND AUDITED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2023



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COMPANY INFORMATION

Registered office	Kings Place 90 York Way London N1 9FX
Independent Auditors	PricewaterhouseCoopers LLP Chartered Accountants and Statutory Auditors 1 Embankment Place London WC2N 6RH

STRATEGIC REPORT

The Directors present their Strategic Report on the Rolls-Royce plc Group (the Group), together with the audited Financial Statements for the year ended 31 December 2023. Rolls-Royce plc (the Company) is, indirectly, a wholly-owned subsidiary of Rolls-Royce Holdings plc (RRH).

Rolls-Royce plc is a public company limited by shares and incorporated under the Companies Act 2006. It holds the Group's listed debt facilities and is one of the main trading companies of the Group.

Group at a glance

UNDERLYING REVENUE^{1,2}	STATUTORY REVENUE¹	FREE CASH FLOW^{1,2}	STATUTORY CASH FLOWS FROM OPERATING ACTIVITIES³
£15,409m	£16,486m	£1,286m	£2,486m
2022: £12,691m	2022: £13,520m	2022: £504m	2022: £1,523m
UNDERLYING OPERATING PROFIT^{1,2}	STATUTORY OPERATING PROFIT¹	UNDERLYING OPERATING MARGIN	STATUTORY OPERATING MARGIN
£1,590m	£1,944m	10.3%	11.8%
2022: £652m	2022: £837m	2022: 5.1%	2022: 6.2%
UNDERLYING PROFIT BEFORE TAX^{1,2}	STATUTORY PROFIT/(LOSS) BEFORE TAX¹	NET DEBT	LIQUIDITY⁴
£1,262m	£2,427m	£(1,952)m	£7.2bn
2022: £206m	2022: £(1,502)m	2022: £(3,251)m	2022: £8.1bn
ORDER BACKLOG^{1,5}	GROSS R&D EXPENDITURE^{1,2,6}	COUNTRIES WITH ROLLS-ROYCE PRESENCE	EMPLOYEES (MONTHLY AVERAGE)
£68.5bn	£1.4bn	48	41,400
2022: £60.2bn	2022: £1.3bn	2022: 48	2022: 41,800

See note 2 on page 73 for a reconciliation between underlying and statutory results

1 2023 and 2022 figures represent the results of continuing operations

2 A reconciliation of alternative performance measures to their statutory equivalent is provided on pages 159 to 162

3 Statutory cash flows from operating activities has been represented as described on page 56

4 Liquidity is defined as cash and cash equivalents plus any undrawn facilities, as listed on page 36

5 See note 2 on page 72

6 See note 3 on page 75 for a reconciliation of gross R&D expenditure to total R&D expenditure

Group at a glance continued**OUR DIVISIONS IN 2023**

CIVIL AEROSPACE	DEFENCE	POWER SYSTEMS	NEW MARKETS
Civil Aerospace is a major manufacturer of aero engines for the large commercial aircraft, regional jets and business aviation markets. The business uses its engineering expertise, in-depth knowledge and capabilities to provide through-life service solutions for its customers.	Defence is a market leader in aero engines for military transport and patrol aircraft with strong positions in combat applications. It has significant scale in naval and designs, supplies and supports the nuclear propulsion plant for all of the UK Royal Navy's nuclear submarines.	Power Systems, with its product and solutions brand <i>mtu</i> , is a world leading provider of integrated solutions for onsite power and propulsion, developing sustainable solutions to meet the needs of its customers.	New Markets are early-stage businesses. They leverage our existing, in-depth engineering expertise and capabilities to develop sustainable products for new markets, focused on the transition to net zero.
UNDERLYING REVENUE	UNDERLYING REVENUE	UNDERLYING REVENUE*	R&D EXPENDITURE
Large Engines: 73% Business Aviation: 20% Regional: 3% V2500: 4%	Transport: 31% Combat 34% Submarines: 22% Naval: 8% Helicopters: 5%	Power Generation: 39% Governmental: 25% Marine: 12% Industrial: 24%	Rolls-Royce SMR: 46% Rolls-Royce Electrical: 54%
UNDERLYING REVENUE	UNDERLYING REVENUE	UNDERLYING REVENUE	UNDERLYING REVENUE
£7,348m 2022: £5,686m	£4,077m 2022: £3,660m	£3,968m 2022: £3,347m	£4m 2022: £3m
UNDERLYING OPERATING PROFIT	UNDERLYING OPERATING PROFIT	UNDERLYING OPERATING PROFIT	UNDERLYING OPERATING LOSS
£850m 2022: £143m	£562m 2022: £432m	£413m 2022: £281m	£(160)m 2022: £(132)m
UNDERLYING OPERATING MARGIN	UNDERLYING OPERATING MARGIN	UNDERLYING OPERATING MARGIN	UNDERLYING OPERATING MARGIN
11.6% 2022: 2.5%	13.8% 2022: 11.8%	10.4% 2022: 8.4%	n/a 2022: n/a

* In 2023, the naval business of Power Systems was moved from marine to governmental to better reflect the products and customer mix of this business

Chief Executive's review

Our transformation must be carried out at pace, with rigour and intensity. That is exactly what we have done in 2023 and the proof is in our performance. We now have a clear and granular strategy that will create a high-performing, competitive, resilient and growing Rolls-Royce with the strength to control and shape its own destiny.

Rolls-Royce is a great company, with a rich heritage and so much potential. This year, we have taken very significant steps towards realising that potential through our transformation programme. The pace at which we are delivering, achieved by managing the Group very differently, enabled us to raise our full-year financial guidance in July 2023 and our transformation has delivered a record performance. At our CMD in November 2023, we set out the scale of that potential over the mid-term. Our targets for the mid-term represent a step change in financial performance: quadrupling operating profit compared with 2022; operating margins representing an equal or better competitive performance benchmarked against our peers; sustainable cash flows delivering a more than 100% conversion of improved profits.

In addition to transforming our financial performance, we are also transforming our business. We are creating a simpler, more efficient, more effective and more capable organisation with the winning mindset and performance culture we need to succeed. Our strong progress in 2023 gives us good reason to be confident of achieving further growth in 2024 and unlocking our potential in the mid-term.

In last year's report, I set out my experience of partnering engineering expertise with a granular strategy, business acumen and intense performance management to create an organisation that thrives on strategic progress. This transformation has four key elements. The first is to put a mirror up to the organisation. This is not about giving an opinion, it is about presenting the data honestly about where the business is. During the latter half of 2022, we conducted extensive benchmarking of our Group performance and that of our businesses against our peers. That work showed there was significant scope for us to deliver materially higher profit, cash flows and returns in the mid-term, unlocking our potential and performing as well or better than our best competitors. The conversations this sparked within the organisation were incredibly energising because, at the same time, we presented a vision of what a winning Rolls-Royce will look like. This was evident when we conducted our main employee survey with record turnout and our highest ever engagement score.

The second principle is to set out a clear and granular strategy with well-defined strategic initiatives cascaded down through the organisation so that everyone knows their role in the transformation. This is what we set out at the CMD and I will go into further detail shortly.

Thirdly, the success of transformation relies on rigorous performance management driving year-on-year improvement. Our focus is on the strategic progress of Rolls-Royce. We are now creating the performance management framework which will ensure we manage closely against our goals. Performance management also means understanding the markets in which we operate and taking proactive action when the external environment changes. That requires robust management information provided in a timely manner in order to manage the future rather than merely reporting on the past.

Fourthly, transformation must be carried out through a systematic approach, with pace, rigour and intensity. Our performance in 2023 is not only about what we have done, but how we did it. Our people are energised and our strategy is being led by a strengthened Executive Team who are managing the business very differently within a new organisational structure that aligns with that strategy.

Record performance driven by every division

Our performance in 2023 was driven by the actions we took to improve efficiency, reduce costs and enhance our pricing position and commercial outcomes. This step-change has been achieved across all our divisions, despite a volatile environment with geopolitical uncertainty, supply chain challenges and inflationary pressures.

In Civil Aerospace (see page 21), we delivered improved operating profit and a four-fold margin increase despite engine flying hours only 88% of pre-pandemic levels. This was driven by increased aftermarket profit, in both large engines and business aviation, reflecting commercial optimisation and cost efficiencies, as well as volume growth. Defence (see page 23) delivered an improved operating margin of 13.8% (2022: 11.8%), which primarily reflected improved pricing and cost efficiencies. In Power Systems (see page 25), which reported an operating margin of 10.4% (2022: 8.4%), pricing and cost efficiency actions in the first half of the year resulted in a significantly improved operating profit and margin in the second half and in the full year.

As a result of our actions and our new ways of working, Group underlying operating profit rose by £0.9bn to £1.6bn supported by our transformation programme and strategic initiatives, with commercial optimisation and cost efficiency benefits across the Group. This means that we have already delivered more than half of the increase required to achieve the lower end of our mid-term target. Underlying operating margin more than doubled to 10.3%. Civil Aerospace, Defence and Power Systems all delivered materially higher margins compared to last year. This represents a huge step towards our mid-term target of 13-15% as we narrow the competitive gap. Free cash flow from continuing operations grew by approximately 150% to a best on record £1.3bn, principally due to higher operating profit. Civil Aerospace net long term service agreement (LTSA) creditor growth, net of risk and revenue sharing agreements (RRSAs), was £1.1bn (2022: £0.8bn). Continued LTSA balance growth reflects higher engine flying hours and the benefit of commercial optimisation, with LTSA invoiced flying hour receipts of £4.6bn (2022: £3.6bn). Our focus on working capital resulted in a release in the second half despite ongoing supply chain challenges. For the full year there was a net working capital outflow of £0.4bn (2022: £0.5bn). Inventory and debtor days both improved year-on-year, building further confidence in the actions we are taking to improve the quality of cash delivery.

During 2023, our teams continued to build momentum for the future with strong sales performance across all divisions. Civil Aerospace sealed fantastic customer wins, including orders with Air India, Turkish Airlines, Emirates, new customer EVA Air and, in early 2024, Delta Airlines. It was our best year for large aero-engine orders since 2007. This success is important in maintaining our momentum in the widebody market where our in-service fleet is growing faster than the market. While we currently power about a third of the widebody aircraft in service, in 2023 over half of new aircraft delivered were powered by Rolls-Royce engines, meaning we are growing share. The Defence team achieved generational wins, confirming the engine contract for the US Army's Future Long-Range Assault Aircraft (FLRAA) while our nuclear reactors are set to power submarines for the Royal Australian Navy under the trilateral AUKUS agreement. The multi-national next generation Global Combat Air Programme (GCAP) continued its positive momentum with the signing of the Convention of the Establishment of the GCAP programme by the Italian, Japanese and UK governments. Power Systems delivered an excellent sales performance with major wins from data centres and governmental customers, the latter including a deal to provide more than 50 Puma tank engines for the German Bundeswehr, ensuring that the pipeline for 2024 is largely full.

Chief Executive's review continued

This performance was achieved despite ongoing macro-economic and supply chain challenges, which we continued to mitigate. The macro-outlook remains uncertain and whilst we have advantaged businesses in attractive markets which provide a degree of resilience to the external environment, we have to remain very focused on increasing our resilience to external events, whether that be mitigating inflationary pressure and volatile commodity pricing through cost control measures, strengthening our balance sheet to insulate ourselves from sustained higher interest rates or robust supply chain management in an environment of enhanced geopolitical tensions globally.

Outcome of our strategic review: a granular strategy

Early in 2023, I set out our transformation programme including a rigorous and detailed strategic review across every division and sub-division in the Group. At our CMD, we set out the results of this extensive work and how we will unlock the potential of our business.

Our strategy will enable us to deliver on our proposition to our shareholders, which is to: build a high-performing, competitive and resilient business with profitable growth; grow sustainable free cash flow; and build a strong balance sheet and growing shareholder returns. This will transform Rolls-Royce into a more resilient and efficient business with higher quality of earnings and a focus on cash expansion and more sustainable cash flows. We will be a One Rolls-Royce team, with different ways of working and mindset, underpinned by a differentiated performance culture. This will be delivered through a new organisation that delivers efficiency, simplification and improved capabilities. Our strategic clarity ensures that the organisation will be focused, aligned and energised in the delivery of our strategy. Many of our leaders took part in the strategic review process. At the beginning of 2024, we started the process of cascading it to our people. Not only will everyone appreciate what the strategy means for them and the area of the business in which they work but also the role they play in delivering it. This is an alignment and engagement tool as well as serving as a performance management tool.

Portfolio choices and partnerships

In line with our strategy, we are making choices and executing on them. This allows us to allocate resources more effectively and drive profitable growth. We have segmented our portfolio into three categories: key investment areas for performance improvement and growth; areas where partnerships can create truly winning positions; and businesses and activities we will exit, though only at the right time and at the right price. Our strategic choices will drive value creation.

In Civil Aerospace, our focus will be on the widebody commercial airline market and business aviation, leveraging the value from our Trent and Pearl engine families and investing for the future with UltraFan. In Defence, we have opportunities to continue to improve pricing and performance with new programmes in transport, combat and submarines. We can also use our expertise in adjacent fields such as nuclear micro-reactors. In Power Systems, we will focus on governmental, marine and power generation end markets, where we see the strongest demand and an opportunity for better returns from our power-dense and reliable solutions.

In some cases we will grow in partnership to strengthen our market position. This can bring new skills, build capability and scale, as well as de-risk and reduce capital investment. In Civil Aerospace, we believe we are well positioned to re-enter the narrowbody market by choosing a partnership approach for the next programme. Our UltraFan technology is a vital step towards this. At the right time, with the right partner, we will decide the next steps. In Power Systems, our focused strategy on power generation will make this business more efficient and competitive and drive faster profitable growth. We are also considering potential partnerships to further grow our market position.

Battery storage systems are a logical complement to our stationary power generation business, as we have transferable capability. We are already developing a good position in Europe. A partnership with access to additional markets could strengthen our position. Finally, for small modular reactors (SMRs), a broad set of partners will strengthen our position to deliver the overall solution and reduce any future capital call.

In addition, we identified areas that are not strategic for Rolls-Royce. In total, we expect to generate between £1bn and £1.5bn from gross divestment proceeds, which would be in addition to our mid-term cash flow target.

OUR STRATEGIC FRAMEWORK

Portfolio choices and partnerships

The markets we have chosen to operate in, businesses we want to invest in and the partnerships that will help create truly winning positions.

Advantaged businesses and strategic initiatives

How we will create a competitive business, expand our earnings potential and sustainably improve our performance.

Efficiency and simplification

The importance of a company-wide focus to drive synergies that will enable us to be more competitive and simplify the way we operate.

Lower carbon and digitally enabled businesses

Our commitment to the energy transition and capturing the benefits of becoming digitally enabled

Chief Executive's review *continued*

Advantaged businesses and strategic initiatives

Our businesses are advantaged by enjoying strong positions in attractive markets. Across the areas in which we will focus, we have a series of strategic initiatives which underpin the profitable growth we see in the mid-term.

In Civil Aerospace, we have detailed plans to improve large engine margins by targeting both reduced costs and increased revenues. This cost and commercial discipline applies across original equipment (OE), aftermarket, spare engines and our time and materials activities. There are six levers we are pulling, three related to cost and three to revenues. We are extending time-on-wing with better product durability and greater use of digital tools; lowering shop visit costs with better working practices; and reducing product costs through better buying and engineering. On the revenue side, we intend to keep engines earning for longer with contract extensions and conversions, while implementing a new value-driven pricing strategy focused on creating win-win solutions with our customers and addressing onerous and low-margin contracts. Finally, we are driving rigour on contractual terms and conditions. In business aviation, we have established a great platform with our Pearl engines which positions us well to optimise commercial outcomes and grow margins.

Defence was already performing well but there is still an opportunity to improve through strong performance management, commercial optimisation initiatives and greater efficiency. Across transport, combat and submarines we are also seeing a benefit from volume and mix factors as we move from legacy programmes to new funded programmes. We have the same focus on commercial optimisation and value-pricing behaviours as we have across the Group and we are prioritising investment in areas that benefit from increased customer funding.

In Power Systems, our profit growth is being delivered through our power generation, governmental and marine end markets. In power generation, we are optimising our cost structure and focusing on key accounts to drive margin growth. We are also expanding our microgrid solutions and extending our services offering in battery energy storage systems, which is moving to a profitable business in the short term. In governmental, we are capturing near-term growth with scope expansion and investment. Lastly, in marine, we are developing alternative fuel solutions to strengthen our synthetic fuel-ready portfolio.

Efficiency and simplification

We are driving efficiency and simplification across the business. The Rolls-Royce Holdings plc group had a TCC/GM ratio of 0.80 times in 2022 and before that, 0.88 times in 2019. That is around two times higher than the best-in-class level for a business like ours. It is an important metric because it is a measure of the operating leverage of our business and, therefore, of our resilience. The Rolls-Royce Holdings plc group plan to approximately halve our total underlying cash costs as a proportion of underlying gross margin (TCC/GM) by the mid-term. Across the Group, we have efficiency initiatives underway that will deliver sustainable annualised savings of £400m to £500m, making us more competitively advantaged and fit for the future. This is supported by improved cost reporting capability and fundamentally shifting mindset on efficiencies, embedding them as a sustainable and strategic lever to underpin performance.

Lower carbon and digitally enabled businesses

Our strategic framework acknowledges the fundamental role of lower carbon solutions and digital technologies in the success of Rolls-Royce. We are committed to becoming a net zero company by 2050 and we support our customers to do the same. We are making good progress towards making our own operations net zero but there is a lot more to do to decarbonise the sectors in which we operate. Our technological expertise has a crucial role to play.

New lower carbon fuels will be central to achieving net zero in the medium term across many of our markets. In commercial aerospace, for instance, sustainable aviation fuel (SAF) is the answer for large aircraft. That is why we are very pleased to have successfully reached our target of testing all our in-service Trent and business jet engines with 100% SAF in 2023. We have also been working with our armed forces customers to achieve the same for the engines they use from our Defence division. We also believe the internal combustion engine can be made compatible with net zero, through the use of sustainable fuels. This is vital as many of our customers, such as data centre and governmental clients, will continue to use combustion engines well into the future. At the end of 2023, variants of all our major Power Systems engine platforms can run on sustainable fuels, such as hydrotreated vegetable oil. In marine, we are developing methanol-based solutions and for power generation we see hydrogen as a future solution. All these developments are based on existing engines. In some markets, such as yachts, hybrid solutions will be key and solutions are being developed. We are also prepared for the gradual transition to battery-based solutions, with the required capabilities and products in place.

We are also making increased use of new digital technologies across four areas: enhancing the customer experience; accelerating product design; improving manufacturing; and empowering our people. We are well known for our skill in collecting engine data in order to improve the performance of our engines while in service and, with digital twin capabilities, we can forecast the time an engine stays on wing. This is improving dispatch reliability and reducing disruption for customers.

Our future vision is raising the bar to 100% availability, where everything is planned and predictable, further improving the service we offer customers. Digital tools are also helping us design products more efficiently. Powerful virtual simulations and use of artificial intelligence (AI) can reduce the time it takes to develop and test a new engine.

In manufacturing, we are using digital tools, such as AI machine learning, to improve our inspection regimes. We also intend to make increasing use of AI to remove repetitive tasks, freeing our people to focus on high-value activity.

One Rolls-Royce focused on strategic delivery

The delivery of our ambitious strategy is through a new organisation structure. We now operate as One Rolls-Royce. This is a major shift away from the previous decentralised model and creates an aligned organisation benefiting from the ability to dynamically deploy resources to strategic priorities; common measures that enable us to assess our progress against our strategic priorities; improved performance through clear decisions and accountability; and finally, a simpler and more efficient operating model. This leaner and lower cost model reduces siloed working and eliminates the waste of duplicated tasks and capabilities in each division.

During 2023, we announced the new organisational design with a simplified leadership structure and plans to reduce the number of roles across the Group by 2,000 to 2,500 by the end of 2025. It simplifies our business, reducing layers and creating a clearer system of controls and alignment. It is not only about structural change, it is also about changing how we run our business. For instance, across Rolls-Royce we are taking a zero-based budgeting approach and have set a 10% to 15% reduction in targeted areas and we are controlling investment centrally to ensure we fund projects in line with strategy.

Chief Executive's review *continued*

We have brought together key areas crucial to our success, through a new engineering, technology and safety (ET&S) capability and an enterprise-wide procurement and supplier management organisation. ET&S is a significant change right at the heart of Rolls-Royce. Focused on programme delivery, ET&S will build and strengthen our competence and has responsibility for the delivery of some programmes, engineering standards, processes, methods and tools. This structure provides significant benefits to efficiency levels, capability and retention by ensuring we can move our engineering teams to the highest priority activities across all of our divisions, in-line with our strategy. By benefiting from the learning, tools, resources and capabilities that are common across projects we are better able to execute new product introduction. There are significant synergies across the Group that we will be able to exploit. For example, our GCAP project in Defence can benefit from the certification, design and system engineering that our business aviation team has built from the introduction of three new Pearl engines. Our SMR team can benefit from the manufacturing engineering capability that our Civil Aerospace business has built, while there are common engineering challenges in areas such as thermal management or controls that equally apply to Power Systems as to our Civil Aerospace and Defence divisions. This allows for better retention of talent in key skill areas, as work is balanced across all of the divisions, while also increasing capability by pulling best practice and experience from the whole Group.

Our Group-wide procurement and supplier management organisation, meanwhile, has a critical role to play in our success as we harness the scale of Rolls-Royce. It will support the consolidation of Group spend, leverage scale, develop consistent best-in-class standards and build people capability. We will leverage opportunities across the organisation to deliver approximately £1bn of gross third party cost savings in the mid-term.

Within this new One Rolls-Royce organisation, we have added new talent and strengthened our leadership, with almost half of the immediate direct reports to my leadership team either new to the role or in an expanded role. The Executive Team has also been strengthened, bringing new experience, capabilities and energy. During the year, Helen McCabe joined Rolls-Royce as Chief Financial Officer and Nicola Grady-Smith as Chief Transformation Officer. In 2022, Jörg Stratmann joined as President of Power Systems and I was closely involved in his appointment. During 2023, Rob Watson moved to President of Civil Aerospace, Adam Riddle became President of Defence and Chris Cholerton became Group President, with executive responsibility for the Group's nuclear operations, including Rolls-Royce Submarines and Rolls-Royce SMR. Simon Burr also took up the newly created post of Group Director of Engineering, Technology & Safety (ET&S) in 2023. Keeping our employees and customers safe is our number one priority. Nothing is more important than that. Always, every time. So, we have put product safety at the heart of this new organisation to strengthen our approach to technical safety and assurance. While Simon has leadership accountability for safety across the Group, every single person within Rolls-Royce has a responsibility to prioritise safety above all other considerations.

Looking forward

While we have a strong focus on delivering our short and mid-term targets, we are also investing heavily in product improvements, new product introductions and product cost improvement. All of these are long-term investments. This is in addition to the significant customer wins we have had that drive long-term growth. The result of this combination is a group being set up for enhanced financial performance. It means we are laying down foundations that will benefit us in the period long after our mid-term targets. For example, in Civil Aerospace, we are spending £1bn on time-on-wing improvements in a multi-year programme. This will double the time-on-wing of our Trent 1000 engine and, in non-benign environments, double the time-on-wing of the Trent XWB-97 as well as generating a 50% improvement in benign environments. We are investing in reducing shop visit costs, creating a more efficient and more resilient aftermarket operation; and in decreasing product costs so we can capture more of the value from the order book. Our win-win approach to contracting means we are better placed to be rewarded for our innovation, while our investment in new digital technologies will ensure a better experience for our customers, as well as make us more efficient. We are also expecting to invest further in UltraFan, having achieved the very important milestone of successful full power testing during 2023. UltraFan also provides us with opportunities to introduce technologies from the demonstrator into our existing fleet. Our Pearl and Trent engine families will benefit from these actions as they power the in-service fleet well into the 2040s.

In Power Systems, we see long-term potential for our competitive portfolio of products and are investing in making those products compatible with sustainable fuels and creating engines capable of using new fuels such as methanol. We are also developing the first new mtu engine for many years, an investment that will pay off beyond the mid-term. In Defence, our recent successes in securing a place on the US Air Force's B-52 and US Army's FLRAA will not start to deliver significantly until well after the mid-term. GCAP is expected to deliver a next generation combat aircraft in 2035, building on the progress we have already made with our Team Tempest partners in the UK. All these Defence programmes will result in engines and systems that will remain in service for 30 or 40 years after they are delivered. AUKUS, meanwhile, will see our submarines business delivering and servicing nuclear propulsion systems well into the second half of this century. Finally, of course, our SMR business has a compelling long-term growth story, with power stations expected to be in service for 60 years.

As a result, 2024 and even the mid-term targets are merely milestones. They are not the final destination. Rolls-Royce will continue to grow with enhanced margins and cash flow well into the long term as a result of our strategy and the choices we are making today.

Building a track record of delivery

This is a pivotal moment in the history of Rolls-Royce. We have set out a bold and achievable plan to create a high-performing, competitive, resilient and growing business. Our strategy is granular and owned throughout our business. The choices we have made in our strategic review are clear. Our mid-term targets are compelling. We are building a track record of delivery, while investing in the future. Our success will benefit not just our shareholders but all our stakeholders, including our customers as they meet the challenges and opportunities that define the future. We will also create more opportunities for our people, so everyone can be a part of an energising, rewarding and world-leading group. I would like to thank all of our people for their effort and hard work in 2023. Together, we are building One Rolls-Royce. A Group that can fully realise its potential, ensuring the excellence and innovation that has helped shape the modern world, endures long into the future.

Tufan Erginbilgic

Chief Executive

Strategy

In 2023, we developed a clear strategy to help Rolls-Royce perform to its full potential. We have already made good progress towards building a strong, competitive, resilient and growing business. This success is thanks to transformation and performance management. Rolls-Royce has been at the forefront of innovation for over a century. We set the standard for engineering excellence, providing mission-critical products and services to customers across the globe. We have built a world-class product portfolio and deep customer relationships. Our focus now is to translate our technical and market success into strong financial returns. We have the potential to achieve so much more. The progress made in 2023 gives us confidence in the delivery of our strategic plans. We are accelerating financial delivery and have set new, ambitious yet achievable mid-term targets.

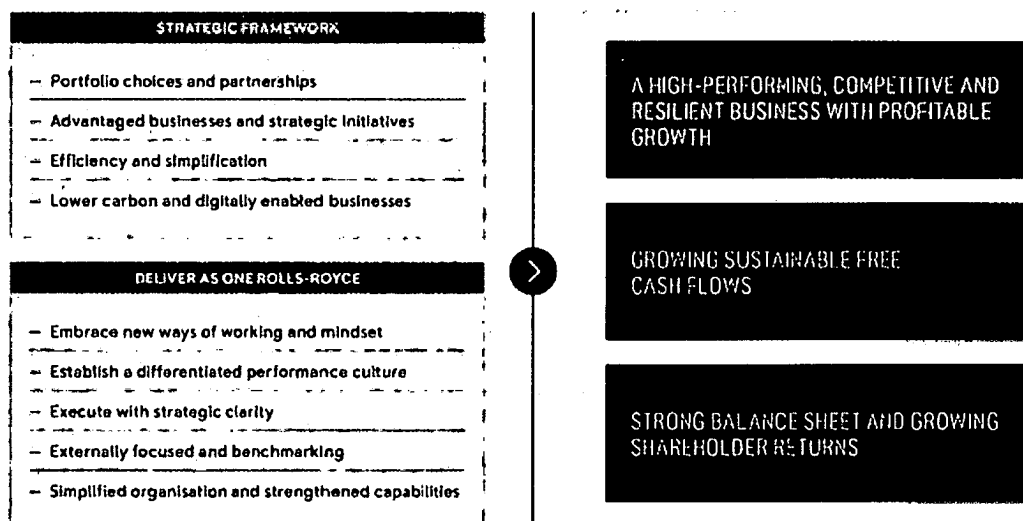
The Rolls-Royce proposition

1. Build a high-performing, competitive and resilient business with profitable growth.
2. Grow sustainable free cash flow.
3. Build a strong balance sheet and grow shareholder returns.

Delivering the proposition will make us a stronger partner to our customers as they face future challenges and opportunities. We will unlock our full potential by turning engineering excellence into strong financial performance.

To implement our strategy, we will be disciplined, agile and systematic. We will continue to have a tight focus on priorities, improve commercial discipline and seek efficiency in every step, whilst never compromising on integrity or safety. We will put the business on a stronger financial footing by delivering a sustainable reduction in working capital, higher operating margins and improved operational performance. Improving profitability will give us options to grow the business and enhance shareholder returns. This performance shift is also crucial to creating more opportunities for our people to be part of an energising, rewarding and world-leading team.

OUR TRANSFORMATION



DELIVERING SUSTAINABLE GROWTH THROUGH TRANSFORMATION

Our strategic framework to deliver the proposition

Portfolio Choices

We will make decisions on where to operate and where to invest based on clear criteria:

- Is the market attractive and growing?
- do we have a differentiated position?
- can we generate attractive returns?

We are making choices and executing on them. We are only investing where the market is attractive and growing, where we can build an advantaged position differentiated through strong customer relationships and competitive technology and where there are high barriers to entry. This allows us to allocate resources more effectively and drive profitable growth.

Strategy continued

We have segmented our portfolio into three categories:

- areas where we will invest to drive performance improvement and growth;
- areas where we can create truly winning positions through partnership; and
- business activities which we intend to exit.

Strategic Initiatives

We have launched a number of focused strategic initiatives to drive change across the Group, delivering improved value through top and bottom-line actions. These initiatives will enhance competitiveness, expand our earnings potential and sustainably improve our performance.

Efficiency and simplification

We have launched a Group-wide focus to drive synergies, make us more competitive and simplify the way we operate, enabling us to deliver our priorities as One Rolls-Royce. We are optimising our footprint and leveraging our scale to reduce third party costs; strengthening supply chain management to reduce inventory and working capital; and changing the way we work through a refreshed organisational design to reduce duplication and overheads, creating a more efficient organisation.

Commitment to the energy transition

We are committed to becoming a net zero company by 2050 and we are supporting our customers to do the same. We focus on areas where we have the greatest leverage, improving the efficiency of our products, enabling our customers to operate in the most efficient way and decarbonising our own operations and our supply chain.

Capturing the benefits of becoming digitally enabled

Digital technology will play an increasingly important role throughout our value chain. We already use data from products in service to create value for ourselves and for our customers. Future advances in digital, particularly AI, will further enhance operational performance and reduce costs across our industries and markets.

We focus on four areas: enhancing the customer experience; accelerating product design; improving manufacturing; and empowering our people.

CAPTURING PERFORMANCE IMPROVEMENT OPPORTUNITIES

Group mid-term targets

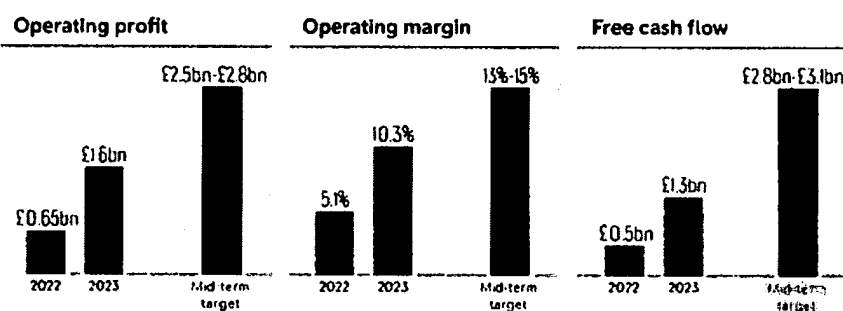
During our strategic review in 2023, we developed a new set of targets that represent a step change in ambition and performance. They are underpinned by our strategy and demonstrate we are creating a new company, taking Rolls-Royce significantly beyond any previous financial results.

We will build on our world-class engineering heritage to deliver a world-class investment proposition, significantly expanding our earnings and cash potential.

The high, but achievable, bar that we have set is reflective of our winning mindset:

- we will quadruple operating profit from the 2022 baseline to between £2.5bn-£2.8bn;
- we will expand operating margins to between 13% and 15% to be at least as competitive as our peers;
- we will grow sustainable cash flows to between £2.8bn and £3.1bn; and

We define the mid-term as a 2027 timeframe. Delivering these targets will mean we have created a financially and operationally resilient Group with an expanded earnings potential. They are milestones on our journey, not the destination, and we will continue to grow beyond them into the long term.



Strategy *continued***EXTERNAL ENVIRONMENT****Geopolitical tensions**

The ongoing Russia-Ukraine conflict and the more recent escalation of violence in the Middle East have destabilised international relations. Policy makers are strengthening their focus on national security in terms of defence, access to energy, critical commodities and key technologies, the latter through re-shoring critical industries and the use of sanctions and subsidies. These policies and actions are disrupting the competitive environment and, together with recent geopolitical risks to international trade, are contributing to price volatility and supply chain issues.

Rolls-Royce response

We see opportunity and risk from the changing security situation. On the opportunity side, we are extending production in our Power Systems division to meet a strong increase in demand from our governmental customers; this will drive longer-term benefits from higher sales of spares and services. We also see increased potential for Rolls-Royce SMR, as customers, particularly in Europe, seek to reduce their dependence on imported oil and gas and Russian nuclear technology. On the risk side, recognising the price and disruption risk in our supply chains, we are taking steps to build resilience, including dual sourcing where appropriate.

Economic slowdown

In 2023, we saw a further slowdown in global activity. The main reasons were the phasing out of post-pandemic effects and high interest rates designed to contain inflationary pressures. The slowdown is expected to continue through 2024 with advanced economies and China being most affected. The US economy, despite proving resilient in 2023, is expected to feel the effects of tighter financial conditions. Europe's growth remains contained by energy uncertainty and slowing external demand. China continues to struggle with its real estate crisis. Business demand is slowing in the manufacturing sector although supply chain problems are easing. A tight labour market may start to open but possibly not for specialised skills. Inflation is expected to normalise above central banks' target of 2% and so forecasters and financial market analysts do not expect interest rates to return to their previous low levels in the short term.

Rolls-Royce response

Across the Group, the diversity in our product portfolio helps to absorb short-term economic impacts and our high level of order backlog acts as a cushion for our business. On the demand side, we have advantaged businesses in markets that are set to grow ahead of GDP. For example, in the widebody market, mid-term growth is forecast to be in the region of 5% to 7% per annum driven by post pandemic recovery and new demand from a growing middle class in countries such as India and China. On the cost side, in addition to the existing inflation-linked pricing clauses in our Civil Aerospace division, we have taken measures to protect margins in our Power Systems division by reacting to price changes in energy, materials and wages. The steps we are taking to strengthen our financial performance will improve the Group's credit rating and contain the impact of high interest rates on our financing costs.

Supply chain uncertainties

As industries recovered from the pandemic, efforts to scale up production exposed underlying supply chain issues which had been exacerbated by cuts in capacity made during the crisis. Skills and experience had been lost and labour availability became a key growth constraint, significantly impacting lead times. With every industry increasing demand at the same time, even relative commodity materials such as steel became difficult and expensive to source. High interest rates also became a drag on recovery by constraining investment in production scale up. The situation is improving but shortages remain for some commodities, parts and components and we expect to experience challenges for at least another 18 to 24 months.

Rolls-Royce response

We are taking steps to improve supply chain efficiency and resilience. We are improving forecasting and planning and collaborating closely with suppliers to drive tighter management of lead times to ensure we have the inventory we need when we need it. Additional supply chain resilience benefits will come from our efforts to reduce cost and enhance commercial discipline. Operationally, we are simplifying product designs to improve sourcing options and we are improving manufacturing processes to reduce scrap and waste. Commercially, we are pushing for stronger contractual protection against inflationary impacts and supplier underperformance.

Long-term issues

Other significant long-term issues for our business include demographic trends, climate change and the intent to move towards a net zero economy. According to UN data, the expected growth in global population from eight to ten billion people by 2050 will be concentrated in urban areas, driving higher demand for energy and mobility solutions. The development in emerging economies of a stronger middle-class population, especially in India and China, will support growth in commercial aviation. Resource constraints are likely to increase geopolitical risk and Defence budgets will continue to rise in response. The global effort to decouple economic development from greenhouse gas emissions presents both a challenge and a generational business opportunity.

Rolls-Royce response

Thanks to our strong positions in Civil Aerospace and Power Systems we will benefit directly from the growing demand for global mobility. Our Defence division will grow within its core transport and combat segments and our unique capabilities will open other opportunities. Rolls-Royce SMR is seeking to enhance the economics of modular nuclear power generation to deliver a scalable, cost-effective source of low-carbon electricity, helping societies meet their development and sustainability goals. Across the Group we are working to ensure that all our products, in the air, at sea, and on land, can be used sustainably through ensuring compatibility with sustainable fuels and by developing technologies to enable the next generation of high efficiency solutions.

Business Model

OUR COMMON DRIVERS FOR SUCCESS

Advantaged businesses with strong positions in attractive and growing markets

OUR CORE DIVISIONS

CIVIL AEROSPACE

OUR ROLE IN SOCIETY

Link to risk

1 3 4 9 11

OUR BUSINESS MODEL DRIVERS

Link to risk

1 2 3 4 5 6
7 8 9 10 11

OUR UNIQUENESS

Link to risk

1 3 6 7 10 11

WHAT WE WILL ACHIEVE

A HIGH-PERFORMING, COMPETITIVE, RESILIENT AND GROWING BUSINESS

Link to risk

1 Safety 2 Compliance 3 Strategy 4 Execution 5 Business interruption 6 Climate change
7 Information & data 8 Market & financial shock 9 Political 10 Talent & capability 11 Technology

ONE ROLLS-ROYCE

Differentiated by deep customer relationships; market leading products and technology; engineering and commercial excellence



DEFENCE

Protect

We provide mission critical power and propulsion in the air, at sea and on land.
We enable operational independence and strategic and tactical advantage; helping nation states keep their citizens safe at home and protect their interests overseas.

YEARS OF PROVIDING GAS TURBINE POWER FOR DEFENCE CUSTOMERS

80

POWER SYSTEMS

Power

We provide answers to the challenges posed by the rapidly growing societal demands for energy and mobility.
We deliver high performance, dependable and sustainable power, enabling economic growth and development.

EXPECTED ANNUAL GROWTH RATE ACROSS OUR POWER GENERATION MARKETS

5%-7%

Customer-funded growth

We design, develop, manufacture and support high performance aero and naval gas turbines and nuclear power and propulsion systems.
We turn technology into differentiated products that provide customers with unique capabilities and stay in-service for decades.
We create broader economic value for the Group by balancing the volatility seen in commercial markets and by enabling synergies across technology, infrastructure, supply chain and product families.

DIFFERENT APPLICATIONS OF THE AE ENGINE FAMILY ACROSS DEFENCE AND CIVIL MARKETS

16

One core solution addressing multiple markets

We design, develop, manufacture and support high-performance reciprocating engines and broader system solutions for use at sea and on land.
We invent once and use many times, developing products and product families that can be used in different applications across multiple markets, delivering proven solutions for our customers and maximising the returns on investment to us.

NUMBER OF 54000 ENGINES SOLD ACROSS DIVERSE MARKETS

50k

Global access, local presence

We support over 180 armed forces in over 100 countries.
We provide whole engine design, development and manufacturing capability and operational independence in the US, UK and Germany and we work closely with partners in Japan, Italy, Spain, France and Australia.

HOME NATIONS WITH WHOLE ENGINE CAPABILITY

3

Structural advantage

We deliver unmatched power, reliability and efficiency in return for premium value.
We are recognised as the engine provider of choice where the mission matters: high integrity back-up power for critical infrastructure such as hospitals, airports and data centres; and high performance propulsion for yachts, military vehicles and naval vessels.

MARKET SHARE IN GOVERNMENTAL BUSINESS

>30%



DRIVEN BY COMMITTED EMPOWERED PEOPLE
OPERATING IN A PERFORMANCE CULTURE

WITH TRUST, INTEGRITY AND SAFETY
AS OUR CORE VALUES

Key Performance Indicators

Financial Performance Indicators ^{1,2}

Order Backlog (£bn)	HOW WE DEFINE IT	WHY IT IS IMPORTANT	LINK TO REMUNERATION
2019: 60.9 2020: 52.9 2021: 50.6 2022: 60.2 2023: 68.5	Total value of firm orders placed by customers for delivery of products and services where there is no right to cancel. This KPI is the same as the statutory measure for order backlog. See note 2 on page 72 for more information.	Order backlog provides visibility of future business activity.	Customer orders drive future revenue growth which, in turn, enables profit and cash flow growth. Profit and free cash flow performance are key financial metrics in the Incentive Plan.
Underlying Revenue (£m)			
2019: 15,450 2020: 11,430 2021: 10,947 2022: 12,691 2023: 15,409	Revenue generated from operations at the average exchange rate achieved on effective settled derivative contracts in the period that the cash flow occurs. See note 2 on page 69 for more information.	Underlying revenue provides a measure of business growth and activity.	Underlying revenue growth enables profit and cash flow growth, both of which are key financial metrics in the Incentive Plan.
Underlying operating profit/(loss) (£m)			
2019: 808 2020: (2,008) 2021: 414 2022: 652 2023: 1,590	Operating profit generated from operations at the average exchange rate achieved on effective settled derivative contracts in the period that the cash flow occurs. It excludes M&A, exceptional items and certain other items outside of normal operating activities. See note 2 on page 69 for more information.	Underlying operating profit indicates how the effect of growing revenue and control of our costs delivers value for our shareholders.	Profit is a key financial performance measure for our Incentive Plan.
Underlying operating margin (%)			
2019: 5.2 2020: (17.6) 2021: 3.8 2022: 5.1 2023: 10.3	Underlying operating profit (as defined above) as a percentage of underlying revenue (as defined above). It indicates how much profit the business makes for every one pound sterling of revenue generated.	Underlying operating margin indicates how effective the business is at converting revenue to profit. A higher margin is an indicator of increased value for our shareholders, as it demonstrates a higher conversion of revenue to profit.	Profit is a key financial performance measure for our Incentive Plan.
Free cash flow from continuing operations (£m)			
2019: 865 2020: (4,252) 2021: (1,484) 2022: 504 2023: 1,286	Free cash flow is cash flows from operating activities, adjusted to include capital expenditure and movements in investments, capital elements of lease payments, interest paid and to exclude amounts spent or received on business acquisitions or disposals, financial penalties paid and exceptional restructuring payments. Cash flow from operating activities is our statutory equivalent. See note 27 on page 112.	Free cash flow is a key metric used to measure the performance of our business and how effectively we are creating value for our shareholders. It enables the business to fund growth, reduce debt and make shareholder payments.	Free cash flow is a key financial metric in the Incentive Plan.

¹ The adoption of IFRS 16 Leases in 2019 had no material impact on our financial KPIs

² 2023, 2022 and 2021 figures represent the results of continuing operations. 2020 figures have been restated, where relevant, to show ITP Aero as a discontinued operation in line with 2021 reporting. 2019 figures have not been restated

A reconciliation from the alternative performance measure to its statutory equivalent can be found on pages 159 to 162.

Key Performance Indicators continued

Gross R&D expenditure ³ (£m) 2019 – 1,459 2020 – 1,225 2021 – 1,179 2022 – 1,287 2023 – 1,390	In-year gross cash expenditure on R&D excluding the impact of contributions and fees, amortisation and impairment of capitalised costs and amounts capitalised during the year.	This measure demonstrates the balance between long-term strategic investments and delivering short-term shareholder returns.	Disciplined control and allocation of R&D expenditure optimises in-year profit and cash flow performance without compromising long-term growth through innovation. There is a balance of long-term metrics which reward strong financial performance and also relative returns to our shareholders through total shareholder return (TSR) in the Incentive Plan.
Gross capital expenditure ⁴ (£m) 2019 – 747 2020 – 585 2021 – 304 2022 – 345 2023 – 429	In-year gross cash expenditure on capital excluding capital expenditure from discontinued operations.	This measure demonstrates the balance between long-term strategic investments and delivering short-term shareholder returns.	Disciplined control and allocation of capital expenditure optimises in-year profit and cash flow performance without compromising long-term capital requirements. There is a balance of long-term metrics which reward strong financial performance and also relative returns to our shareholders through total shareholder return (TSR) in the Incentive Plan.

³ This is a new KPI added in 2023 to provide information on gross R&D expenditure as this provides a more meaningful view of total R&D. The previous KPI presented was self-funded R&D as a proportion of underlying revenue

⁴ This is a new KPI added in 2023 to provide information on gross capital expenditure as this provides a more meaningful view of total capital expenditure. The previous KPI presented was capital expenditure as a proportion of underlying revenue

Key Performance Indicators continued**Non-financial Performance Indicators**

	HOW WE DEFINE IT	WHY IT IS IMPORTANT	LINK TO REMUNERATION
Safety index (%) 2021 – 74 2022 – 85 2023 – 94	In 2023, we changed our people metric to incorporate a 50% weighting to an internal safety index. The safety index is the leading measure of our safety culture, which was introduced across the Group in 2021. The index consists of a composite score of five leading indicators, with each indicator measuring a key element of our safety culture.	The measure is strongly aligned to our strategy of safety being the number one priority, with an emphasis on proactive measures.	This metric accounts for 5% of the Incentive Plan.
Employee engagement (scored 1 to 5) ⁵ 2019 – 3.53 2020 – 3.68 2021 – 3.73 2022 – 3.85 2023 – 3.99	Since 2019, we have been on a journey targeting upper quartile status versus Gallup's manufacturing organisations peer group. Responses to the engagement survey are scored on a scale of one to five. The employee engagement score averages the responses to all 12 questions in the survey. Our target for 2023 was to score a grand mean of 3.97.	Our people are crucial to delivering future business success. This is an objective way to assess how engaged our employees are with the business and its leaders.	Employee engagement performance against our target accounts for up to 5% of the Incentive Plan.
Sustainability The metrics for the Incentive Plan combine short-term measures which focus on in-year performance with longer-term strategic measures. The metric for sustainability is a longer-term measure with targets set at the start of 2021.	At the start of 2021, each division was set sustainability targets for the three-year performance period ended 31 December 2023.	We are committed to becoming a net zero company by 2050 and we support our customers to do the same. New fuels will be crucial to achieving net zero in the medium term across many of our markets.	This metric accounts for up to 5% of the Incentive Plan for 2023.

⁵ External assurance over the employee engagement score is provided by Bureau Veritas.

Financial review

We have ambitious, bold and achievable plans. We are driving sustainable and higher quality growth in earnings and cash flows. We have a clear capital framework and detailed plans to deliver our financial targets.

We have advantaged positions in attractive and growing end markets with world-leading capabilities and committed and motivated people. We have so much to be proud of and so much potential. I am delighted to be part of the Rolls-Royce team.

We are transforming Rolls-Royce into a high-performing, competitive, resilient and growing business. We have started on a journey that will take the Group to a place where we have the financial strength to invest in projects that will enable us to win, where we have strengthened our balance sheet to withstand external shocks and to enable us to reward our shareholders. We have made good progress in 2023 but there is still more work to do. The four key priorities which we will be focusing on.

1. Integrated performance management

Our strategic review highlighted the need for improved processes and a stronger culture of integrated performance management. We have already started to improve this and will strengthen it further. Strategic plans will be linked to annual budgets which in turn will be linked to in-year performance management. We will rigorously track performance and make interventions proactively. Targets will be underpinned and owned across the whole organisation.

2. Commercial and cost optimisation

We are developing sharper commercial acumen and a more cost-conscious culture across the organisation. This is underpinned by the philosophy that everyone must act like an owner, treating every pound spent as their own to deliver the most value for all our stakeholders. We are already transforming the way we work with new frameworks and higher quality training in place to build skills and capabilities.

3. Working capital optimisation

Working capital is a key focus as we look to strengthen our balance sheet. Our initiatives underpin a sustainable release of working capital benefit across the mid-term, which we define as a 2027 timeframe. The largest opportunity relates to inventory, where we are targeting a meaningful reduction in inventory days. Actions we will take include improving our demand planning and supply chain management. We also see an opportunity to improve receivables, with teams in place to drive down unbilled debt and review customer payment terms, as well as improving our payables performance. We have granular plans to underpin our targets. There are a number of working capital headwinds over the mid-term but the result of our actions offset these headwinds which result in a net working capital release.

4. Capital framework

Our capital framework is focused on three clear priorities.

- First, to obtain a strong balance sheet with an investment grade profile. A strong balance sheet will position us well to withstand volatility and external shocks and will allow us the financial flexibility for further investment for growth.
- Second, once the strength of our balance sheet is assured we are committed to reinstating and growing shareholder distributions.
- Third, a disciplined approach to investments. All investments must be aligned to the Group's strategy. Investments are prioritised on a Group-wide basis, focusing on those that drive the greatest shareholder value. We have strict financial and sustainability criteria and hurdle rates in place.

2023 financial performance

In 2023, we have made good progress against our strategic priorities and delivered a step change in financial performance which included some early benefits from our transformation efforts.

- **Driving growth in attractive markets:** Large engine flying hours (EFH) in Civil Aerospace recovered to 88% of 2019 levels, up from 65% in 2022. Large engine orders were the highest in more than 15 years, with major orders from Air India and Turkish Airlines. In Defence, the AUKUS submarine agreement was announced, which will be supported by the expansion of our submarines site in Raynesway, and work on our future programmes in the UK and US progressed well. In Power Systems, we are capturing strong demand for power generation solutions and services in the rapidly expanding data centre market.
- **Significantly improved profit and margins:** Underlying operating profit rose by £0.9bn to £1.6bn supported by our transformation programme and strategic initiatives, with commercial optimisation and cost efficiency benefits across the Group. Underlying operating margin more than doubled to 10.3%. Civil Aerospace, Defence and Power Systems all delivered materially higher margins compared to last year. The largest improvement was in Civil Aerospace, which delivered an operating margin of 11.6% compared to 2.5% in the previous year. This was driven by increased aftermarket profit, in both the large engines and business aviation segments, reflecting commercial optimisation and cost efficiencies, as well as volume growth. Defence delivered an improved operating margin of 13.8% (2022: 11.8%), which primarily reflected improved pricing and cost efficiencies. In Power Systems, which reported an operating margin of 10.4% (2022: 8.4%), pricing and cost efficiency actions in the first half of the year resulted in a significantly improved operating profit and margin in the second half and in the full year.
- **Record cash generation:** Free cash flow from continuing operations grew by approximately 150% to £1.3bn, principally due to higher operating profit. Civil net LTSA creditor growth net of risk and revenue sharing agreements (RRSAs) was £1.1bn (2022: £0.8bn). Continued LTSA balance growth reflects higher EFHs and the benefit of commercial optimisation, with LTSA invoiced flying hour receipts of £4.6bn (2022: £3.6bn). Our focus on working capital resulted in a release in the second half despite ongoing supply chain challenges. For the full year there was a net working capital outflow of £0.4bn (2022: £0.5bn). Inventory and debtor days both improved year on year building further confidence in the actions we are taking to improve the quality of cash delivery.
- **Building financial resilience:** Net debt improved to £2.0bn (2022: £3.3bn). We have £4.1bn of drawn debt, of which £0.5bn matures in 2024, £0.8bn in 2025 and £2.8bn in 2026-2028, and £1.7bn of lease liabilities. We have £3.7bn in cash and cash equivalents and £3.5bn undrawn facilities, totalling £7.2bn of liquidity, and expect to repay the 2024 and 2025 bonds from cash. We cancelled a £1.0bn undrawn UK Export Finance (UKEF) backed facility in the year, and a £1.0bn undrawn bank loan facility reflecting our higher cash balance and more resilient financial position.

2024 outlook

As we continue to deliver our strategy, we expect further improvements towards all our mid-term targets. This is despite the impact of continued supply chain challenges, which we expect to persist for 18 to 24 months, geopolitical uncertainty and inflationary pressures. Our forecast for 2024 underlying operating profit is £1.7bn-£2.0bn and free cash flow between £1.7bn-£1.9bn.

Mid-term outlook: growing profit and competitive margins

Our underlying operating profit and margins in 2023 represent a step change in financial performance, but there is still more to deliver. As detailed at our CMD, our key mid-term targets included operating profit of £2.5bn-£2.8bn with an operating margin between 13%-15%. This is a quadrupling of operating profit from the 2022 baseline, making margins equal to or better than our peers on a competitive basis. These targets are underpinned by the rigour of our extensive benchmarking, the findings of our strategic review and by our commercial optimisation, efficiency and simplification actions across the Group.

In Civil Aerospace, we expect the most material improvement in margins from 2.5% in 2022 to 15%-17% by the mid-term. We are driving higher widebody profit using the six levers of improvement: extending time-on-wing, lowering shop visit costs, reducing product costs, keeping engines earning for longer, implementing a new value-driven pricing strategy and driving rigour on contractual terms and conditions. We are also driving profitable improvement through our aftermarket business, time and material, OE and spare engines. In the business aviation market, we will increase profitability and market share due to the success of the Pearl engine family.

In Defence, we are targeting a 14%-16% operating margin by the mid-term. Our strategic focus is on growing our transport, combat and submarines activities. Operating profit growth and margin improvements will be driven by growth from volume and mix as we move from legacy programmes to new funded programmes and from prioritising investment as we focus our spend and benefit from an increase in customer funded programmes. Margins will also benefit from our efforts on commercial optimisation, including value-driven pricing, and from efficiency and simplification.

In Power Systems, where we are targeting a 12%-14% margin by the mid-term, profit growth will be delivered by strategic initiatives focused on power generation, governmental and marine end markets. In power generation, we are optimising our cost structure and focusing on key accounts to drive margin growth. We are also expanding our microgrid solutions and extending our service offering in battery energy storage systems which will become a profitable business in the short term. In governmental, we are capturing near-term growth with scope expansion and focused investment and in marine we are developing alternative fuel solutions to strengthen our synthetic-fuel-ready portfolio.

Mid-term outlook: sustainable and growing free cash flow

We expect mid-term free cash flow of £2.8bn-£3.1bn; an improvement of £2.3bn-£2.6bn compared to 2022. This free cash flow growth will primarily be driven by operating profit growth of between £1.8bn-£2.1bn as we ensure that all divisions are delivering to their full potential.

In addition to our expectation of higher operating profit, our mid-term free cash flow targets also reflect continued net growth in the Civil Aerospace long term service agreement (LTSA) balance of between £0.8bn-£1.2bn per annum. This is driven by: our young and growing widebody fleet, business aviation growth, benefits from currency as we consume our legacy hedges and the impact of strategic initiatives such as time-on-wing. Our cash flow target also reflects our more disciplined investment approach targeted at strategic growth and working capital improvements. As we pay down debt, our financing costs will reduce and the cash costs of closing out our over-hedged position, which has been a drag in recent years, will abate. Offsetting these cash flow benefits will be increased tax cash payments which will naturally increase as our profit grows.

Mid-term outlook: efficiency and simplification and total cash cost to gross margin ratio

Across all parts of the Group we are focused on efficiency and simplification. We are leveraging the power of One Rolls-Royce to simplify our organisation and drive efficiencies that will enable us to be more competitive and simplify the way we operate. We are right-sizing the organisation and ensuring it is structured to support strategy implementation, including plans to reduce 2,000 to 2,500 roles across the Group by the end of 2025. We expect severance costs to be between £200m-£250m, which will be taken as an exceptional charge. The reduction in roles will create an annualised sustainable benefit of around £200m once completed. This benefit is part of a collection of initiatives which, across the Group, will deliver a sustainable annualised saving of £400m-£500m. We plan to deliver around £1bn of gross third-party cost savings over the mid-term which will help offset the impact of inflationary and product cost increases. We are also more tightly aligning R&D spend to strategy. Finally, we have set a 10%-15% reduction in spend in targeted areas through zero-based budgeting.

Financial review continued**Statutory and underlying Group financial performance from continuing operations**

£ million	2023				2022	
	Statutory	Impact of hedge book ¹	Impact of acquisition accounting	Impact of other non-underlying items	Underlying	Underlying
Revenue	16,486	(1,077)	-	-	15,409	12,691
Gross profit	3,620	(461)	46	26	3,231	2,477
Operating profit	1,944	(475)	50	71	1,590	652
Gain arising on disposal of businesses	1	-	-	(1)	-	-
Profit before financing and taxation	1,945	(475)	50	70	1,590	652
Net financing income/(costs)	482	(915)	-	105	(328)	(446)
Profit before taxation	2,427	(1,390)	50	175	1,262	206
Taxation ²	(23)	285	(12)	(370)	(120)	(48)
Profit for the year from continuing operations	2,404	(1,105)	38	(195)	1,142	158

¹ Reflecting the impact of measuring revenue and costs at the average exchange rate during the year and the valuation of assets and liabilities using the year end exchange rate rather than the rate achieved on settled foreign exchange contracts in the year or the rate expected to be achieved by the use of the hedge book

² Taxation includes the recognition of a deferred tax asset on UK tax losses of £328m in other non-underlying items

Revenue: Underlying revenue of £15.4bn was up 21%, with double-digit growth in all three core divisions and particularly strong growth in Civil Aerospace. Statutory revenue of £16.5bn was 22% higher compared with 2022. The difference between statutory and underlying revenue is driven by statutory revenue being measured at average prevailing exchange rates (2023: GBP: USD 1.24; 2022: GBP: USD 1.24) and underlying revenue being measured at the hedge book achieved rate during the year (2023 GBP: USD 1.50; 2022: 1.50).

Operating profit: Underlying operating profit of £1,590m (10.3% margin) versus £652m (5.1% margin) in the prior year. This was due primarily to strong aftermarket growth in Civil Aerospace and commercial optimisation and cost efficiencies across the Group. The largest year on year improvement in margin was in Civil Aerospace, but Defence and Power Systems margins also rose materially. Statutory operating profit was £1,944m, higher than the £1,590m underlying operating profit largely due to the £475m negative impact from currency hedges in the underlying results. Net charges of £71m were excluded from the underlying results as these related to non-underlying items comprising net transformation and restructuring charges of £102m; partly offset by net impairment reversals of £8m, the write back of exceptional Trent 1000 programme charges of £21m; and a £2m pension past service credit.

Profit before taxation: Underlying profit before taxation of £1,262m included £(328)m net financing costs comprising £164m interest receivable, £(275)m interest payable and £(217)m of other financing charges and costs of undrawn facilities. Statutory profit before tax of £2,427m included £515m net fair value gains on derivative contracts, £(205)m net interest payable and net foreign exchange gains of £394m.

Taxation: Underlying tax charge of £(120)m (2022: £(48)m) reflects a tax charge on profits of £(198)m net of a tax credit arising on the recognition of a £78m deferred tax asset on previously unrecognised UK tax losses. The 2022 underlying tax charge relates to tax on overseas profits of £(175)m net of a tax credit on the increase in certain UK deferred tax assets of £127m. The statutory tax charge of £(23)m is lower than the underlying charge due to an additional £328m recognition of a deferred tax asset on UK tax losses. This is partially offset by a net tax charge of £(231)m on non-underlying items.

Free cash flow

£ million	2023					2022
	Cash flow	Impact of hedge book	Impact of acquisition accounting	Impact of other non-underlying items	Funds flow	Funds flow
Operating profit	1,944	(475)	50	71	1,590	652
Operating profit from discontinued operations	-	-	-	-	-	86
Depreciation, amortisation and impairment	1,019	-	(50)	9	978	953
Movement in provisions	(325)	48	-	21	(258)	(23)
Movement in Civil LTSA balance	1,708	(377)	-	-	1,331	792
Movement in prepayments to RRSAs for LTSA parts	(315)	63	-	-	(252)	(8)
Settlement of excess derivatives ¹	(389)	-	-	-	(389)	(326)
Interest received	159	-	-	-	159	36
Other operating cash flows ²	(62)	(8)	-	3	(67)	6
Operating cash flow before working capital and income tax	3,739	(751)	-	104	3,092	2,168
Working capital (excluding Civil LTSA balance and prepayment to RRSAs) ³	(236)	(123)	-	(37)	(396)	(526)
Cash flows on other financial assets and liabilities held for operating purposes	(845)	853	-	-	8	77
Income tax	(172)	-	-	-	(172)	(174)
Cash from operating activities	2,486	(21)	-	67	2,532	1,545
Capital element of lease payments	(291)	21	-	-	(270)	(198)
Capital expenditure	(699)	-	-	4	(695)	(504)
Investment	69	-	-	-	69	28
Interest paid	(333)	-	-	-	(333)	(352)
Other	54	-	-	(71)	(17)	(29)
Free cash flow	1,286	-	-	-	1,286	490
- of which is continuing operations	1,286	-	-	-	1,286	504

¹ The funds flow to 31 December 2022 has been represented to disclose cash flows on settlement of excess derivative contracts as cash flows from operating activities. As a result, operating cash flows before working capital and income tax during the year to 31 December 2022 have reduced by £(326)m to £2,168m. Cash flows on settlement of excess derivative contracts were previously shown after cash from operating activities in arriving at free cash flow. There is no impact to free cash flow.

² Other operating cash flows includes profit/(loss) on disposal, share of results and dividends received from joint ventures and associates, flows relating to our defined benefit post-retirement schemes, and share based payments.

³ Working capital includes inventory, trade and other receivables and payables, and contract assets and liabilities (excluding Civil LTSA balances and prepayment to RRSAs). Working capital was previously defined as inventory, trade and other receivables and payables, and contract assets and liabilities, excluding Civil LTSA.

Free cash flow in the year was £1.3bn, an improvement of £0.8bn compared with the prior year driven by:

Operating cash flow before working capital and income tax of £3.1bn, £0.9bn higher than the prior year. The improvement at the Group level was principally due to our actions on commercial optimisation and cost discipline. The movement in Civil LTSA balance was £1,331m (2022: £792m) driven by higher EFH receipts. RRSA prepayments were £252m (2022: £8m). The movement in provisions of £(258)m largely related to utilisation of the Trent 1000 provision, contract loss provisions and the settlement of a legal claim. The settlement of excess derivative contracts of £(389)m was in line with expectations, with a further cash outflow of £146m expected to be incurred in 2024, £148m in 2025 and £27m in 2026. Interest received was £159m, up from £36m in 2022 due to higher cash balances and higher interest rates in the year.

Working capital £(396)m, compared to £(524)m in the prior year. Inventory increased by £(0.2)bn in the year primarily driven by Civil Aerospace as a result of continued supply chain disruption. There was a net £(0.2)bn outflow from receivables, payables and contract liabilities reflecting the net of volume growth in receivables and an increase in advance payments from customers.

Income tax of £(172)m, net cash tax payments in 2023 were marginally lower than the prior year of £(174)m, mainly due to the receipt of refunds in respect of prior periods in the US and timing of payments in Germany.

The capital element of lease payments was £(270)m, £(72)m higher than the prior year as a result of timing of lease payments.

Capital expenditure of £(695)m, mainly £(429)m property, plant and equipment additions and £(284)m intangibles additions. The combined additions were higher than last year as a result of investment in site improvements across the Group.

Interest paid of £(333)m, including lease interest payments, has reduced by £19m as a result of the settlement of the UKEF £2bn loan facility in September 2022 slightly offset by higher interest on gross overdrafts.

Financial review continued**Balance Sheet**

£ million	2023	2022	Change
Intangible assets	4,009	4,098	(89)
Property, plant and equipment	3,728	3,936	(208)
Right of use assets	905	1,061	(156)
Joint ventures and associates	479	422	57
Civil LTSA ¹	(9,080)	(7,372)	(1,708)
RRSA prepayments for LTSA parts ¹	1,320	1,005	315
Working capital ¹	(1,049)	(1,682)	633
Provisions	(2,029)	(2,333)	304
Net debt ²	(1,952)	(3,251)	1,299
Net financial assets and liabilities ²	(2,037)	(3,625)	1,588
Net post-retirement scheme deficits	(253)	(420)	167
Taxation	2,605	2,468	137
Held for sale ³	54	-	54
Other net assets and liabilities	31	36	(5)
Net liabilities	(3,269)	(5,657)	2,388
Other items			
US\$ hedge book (US\$bn)	15	19	

¹ The total of these lines represents inventory, trade receivables and payables, contract assets and liabilities and other assets and liabilities in the statutory balance sheet

² Net debt includes £23m (2022: £86m) of the fair value of derivatives included in fair value hedges and the element of fair value relating to exchange differences on the underlying principal of derivatives in cash flow hedges

³ Held for sale assets relate to the sale of the off-highway engines business in the lower power range based in Power Systems

Key drivers of balance sheet movements were:

Civil LTSA: The £(1.7)bn movement in the net liability balance was mainly driven by an increase in invoiced LTSA receipts exceeding revenue recognised in the year, this is especially prevalent on new contracts where shop visits are not immediately scheduled.

RRSA prepayments for LTSA parts: The £0.3bn increase corresponds to the increase seen in the civil LTSA balance above. RRSA prepayments typically move in line with the civil LTSA as the RRSA prepayment represents amounts that we have paid to Risk and Revenue Share Partners for the parts that they will ultimately provide in support of our contracts.

Working capital: The £(1.0)bn net working capital position decreased by £0.6bn compared to the prior year. The movement comprised £0.1bn increase in inventory, mainly in Civil Aerospace due to supply chain disruption, £0.9bn increase in receivables due to higher trading volumes and prepayments from customers, £0.5bn reduction in payables due to changes in operational volumes and timing of supplier payments, partly offset by an increase in contract liabilities of £(0.9)bn driven by advanced payments received across the divisions.

Provisions: The £0.3bn net reduction was primarily driven by the settlement of a legal claim, utilisation of the Trent 1000 provision, and a net £0.1bn reduction in contract loss provisions due to provision utilisation, renegotiations and extensions of some major contracts resulting in improved margins, partly offset by increased cost estimates from supply chain issues.

Net debt: Decreased from £(3.3)bn to £(2.0)bn driven by free cash inflow of £1.3bn. Our liquidity position is strong with £7.2bn of liquidity including cash and cash equivalents of £3.7bn and undrawn facilities of £3.5bn. Two undrawn facilities, totalling £2.0bn, were cancelled in 2023 reflecting our higher cash balance and more resilient financial position. Net debt included £(1.7)bn of lease liabilities (2022):£(1.8)bn).

Net financial assets and liabilities: A £ 1.6bn reduction in the net financial liabilities driven by contracts maturing in the year and a change in fair value of derivative contracts largely due to the impact of the movement in GBP:USD exchange rates.

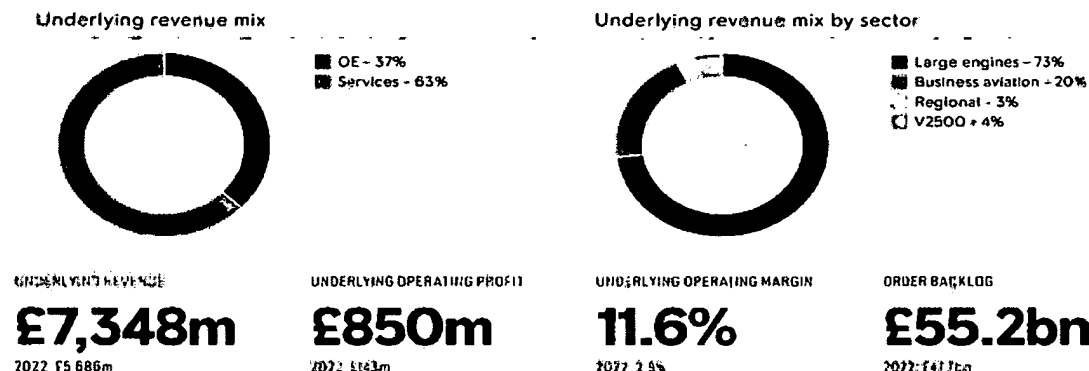
Taxation: The net tax asset has increased by £137m. This includes an overall increase in the deferred tax asset of £267m, due to increases in the deferred tax asset recognised on UK tax losses of £422m and other deferred tax assets of £101m, partly offset by a reduction of £256m on the deferred tax on foreign exchange derivative contracts. Other tax balance movements include increases in the deferred tax liability of £44m and net current tax liabilities of £86m.

Business review

OUR DIVISIONS

CIVIL AEROSPACE

Civil Aerospace is a major manufacturer of aero engines for the large commercial aircraft, regional jets and business aviation markets. The business uses its engineering expertise, in-depth knowledge and capabilities to provide through-life service solutions for its customers.



Market overview

Our Civil Aerospace division comprises four categories: large engines, business aviation, regional and V2500.

Our large installed product base of more than 4,860 engines powers 4 out of 5 of the new generation large aircraft. We have a 33% market share of the large engines in service globally and 41% of the engines on order. Large engine deliveries increased in 2023 to 262 (2022: 190) as we grow our market share.

We have a high-quality order book with 1,632 large engines (2022: 1,282). We have seen substantial new orders in 2023, including orders with Air India, Turkish Airlines, Emirates, EVA Air and in early 2024, Delta Airlines. 2023 was our best year for widebody engine orders since 2007. We are also seeing growth in the new Airbus A350 freighter market where there is clear demand for our products and services. During 2023, we took new orders of 678 large engines (2022: 150). Of the 262 large engine deliveries in 2023, 53 were spare engines (2022: 44). Spare engines are important to our customers as they support fleet health and aircraft availability.

In 2023, business aviation engine deliveries increased to 196 (2022: 165). There are currently over 6,500 in-service Rolls-Royce business aviation engines across our Tay, BR710 and AE 3007 platforms which provide power to a range of aircraft, including Gulfstream and Bombardier aircraft. There are over 1,200 BR725 and Pearl 15 engines in service which power the Gulfstream 650/G650ER and Bombardier 5500/6500. The Pearl 700, which is going through in-flight testing and already has a strong order book, will power the Gulfstream G700/ G800. The Pearl 10X, which is in development and has had a positive reaction from the market, will power the Dassault Falcon 10X. This will be the first time a Rolls-Royce engine powers a Dassault aircraft. Within the market, we have won the last three major campaigns, with the Pearl engine firmly established as the engine of choice.

The civil aerospace market further recovered from the effects of the pandemic in 2023. Large engine flying hours were 88% of 2019 levels (2022: 65%). The easing of global pandemic management measures, specifically in China, paired with fleet expansion are the main contributors to engine flying hour improvement. Industry forecasts predict a return to 2019 large engine flying levels in 2024 and we expect this to grow to 120%-130% by 2027. Business aviation engine flying hours continue to be above 2019 levels, as they were in 2022, having recovered more quickly from post-pandemic measures.

Total shop visits in 2023 were 1,227 (2022: 1,044) carried out to maintain and repair the engines in our fleet. Of these, 368 were large engine major shop visits (2022: 248). The increase was driven by higher utilisation levels and growth in the fleet.

Supply chain pressures remain a hurdle across the industry. We are proactively managing the risks, including consolidating spend with our high performing supplier group for cost, quality and reliability, improving our sourcing, renegotiating contracts and supporting our most important suppliers. We expect supply chain challenges to persist for the next 18 to 24 months. We are not experiencing any ongoing impact from the two supplier fires which we reported in our 2022 Annual Report.

Financial performance

Underlying revenue of £7.3bn increased 29% year on year, driven by higher shop visits and OE engine deliveries and commercial optimisation. Underlying OE revenues grew by 36% in the year to £2.7bn and services revenues grew by 25% to £4.6bn. LTSA revenue catch-ups were £(104)m (2022: £360m).

Business review *continued*

Underlying operating profit was £850m (11.6% margin) versus £143m in 2022 (2.5% margin). The year on year improvement was driven by higher large engine LTSA shop visit volumes and profitability, increased time and materials profits from life limited parts sales for large engines, and higher business aviation profits, again driven by aftermarket profit growth. In each case, our commercial optimisation actions helped drive margin improvements. This was complemented by cost efficiencies, with lower indirect costs net of inflation.

Financial overview

£ million	2023	Organic change	Fx	2022	Change	Organic change
Underlying revenue	7,348	1,645	17	5,686	1,662	29%
Underlying OE revenue	2,703	706	15	1,982	721	36%
Underlying services revenue	4,645	939	2	3,704	941	25%
Underlying gross profit	1,394	540	1	853	541	63%
Gross margin %	19.0%			15.0%	+4.0pt	+4.0pt
Commercial and administrative costs	(354)	18	(1)	(371)	17	(5)%
Research and development costs	(343)	112	(3)	(452)	109	(25)%
Joint ventures and associates	153	40	-	113	40	35%
Underlying operating profit	850	710	(3)	143	707	nm
Underlying operating margin %	11.6%			2.5%	+9.1pt	+9.1pt

	2023	2022	Change
Trading cash flow	626	226	400

Key operational metrics

	2023	2022	Change
Large engine deliveries	262	190	72
Business aviation engine deliveries	196	165	31
Total engine deliveries	458	355	103
Large engine LTSA flying hours (million)	13.5	10.0	3.5
Large engine LTSA major refurb	368	248	120
Large engine LTSA check & repair	471	455	16
Total large engine LTSA shop visits	839	703	136

1 Organic change is the measure of change at constant translational currency applying full year 2022 average rates to 2023. All underlying income statement commentary is provided on an organic basis unless otherwise stated.

Contract catch-ups were £(29)m (2022: £319m). The prior year benefitted from material positive contract catch-ups mostly associated with inflation assumption changes in 2022. Net onerous provisions/ releases were £(25)m (2022: £51m). We made good progress on onerous contracts in the year, releasing £385m of provisions taken in prior periods. However, this was more than offset by £410m new provisions taken in 2023 mostly related to industry wide supply chain constraints. Trading cash flow was £626m versus £226m in 2022. Improved cash flows were driven by higher operating profit, continued strong growth in the LTSA balance, partly offset by net working capital movements and increased investments in the year including improving time on wing for our Trent engines, investment in the Pearl business aviation engines and the UltraFan demonstrator engine test. LTSA invoiced flying hour receipts increased to £4.6bn (2022: £3.6bn).

Operational and strategic progress

As we outlined at our CMD, we are focused on the following six key levers to unlock value in the Civil Aerospace aftermarket business: extend time-on-wing; lower shop visit costs; reduce product costs; keep engines earning for longer; implement value-based pricing; and drive contractual rigour. We are making excellent progress against these initiatives. In addition, the same commercial and cost disciplines are being applied to other areas of our business too, where we are targeting profitable improvements in time and material, original equipment and spare engines.

We are improving engine performance whilst maintaining excellent safety and operational availability. For example, extending time-on-wing means our engines stay in service for longer periods between shop visits, reducing the lifetime maintenance cost. We aim to improve the average time-on-wing for modern Trent engines by at least 40% over the medium term. This means that relative to today's engine standard we will extend time to overhaul by almost two years. We are spending £1bn on time-on-wing improvements as part of a multi-year programme. This will double the time-on-wing of our Trent 1000 engine and in non-benign environments double the time-on-wing on the Trent XWB-97 as well as generating a 50% improvement in benign environments.

At the right time we believe we are well positioned to re-enter the narrowbody market by choosing a partnership approach for the next engine programme. Our UltraFan technology is a vital step towards this. The UltraFan demonstrator, our next generation of engine architecture and suite of technologies, achieved a significant milestone by running to maximum power in tests. These tests also showed the power gearbox handled accelerations and decelerations 20 times faster than we have previously achieved. We expect to continue to invest in the UltraFan following these significant milestones. UltraFan technologies can also be fitted to our existing Trent engines to increase time-on-wing, reduce cost and increase efficiency.

We remain focused on the transition to lower carbon and in reducing emissions in our markets. Our actions start with maximising the efficiency of our current fleet, as many of these engines will remain in service for decades to come. We have already demonstrated that all our production engines are 100% SAF compatible, and this year our Trent 1000 engines powered the world's first commercial transatlantic 100% SAF flight on a Virgin Atlantic Boeing 787 Dreamliner.

Outlook

Executing on our strategic initiatives, which include the six key levers previously mentioned, will mean that we are less exposed to fluctuations in engine flying hours. Industry forecasts do predict a continued recovery in international travel and in 2024 we expect large engine flying hours to be in the range of 100%-110% of 2019 levels. Business and regional markets are expected to continue to perform above 2019 levels with growth year-on-year.

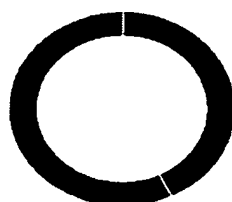
We expect operating profit to improve to 15%-17% in the mid-term as a result of the actions we are taking.

Business review continued

DEFENCE

Defence is a market leader in aero engines for military transport and patrol aircraft with strong positions in combat applications. It has significant scale in naval and designs, supplies and supports the nuclear propulsion plant for all of the UK Royal Navy's nuclear submarines.

Underlying revenue mix



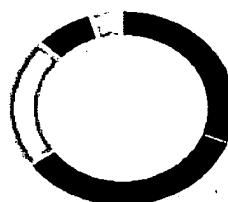
UNDERLYING REVENUE

£4,077m

2022: £3,660m

■ OE - 43%
■ Services - 57%

Underlying revenue mix by sector



■ Transport - 31%
■ Combat - 34%
■ Submarines - 22%
■ Naval - 8%
■ Helicopters - 5%

UNDERLYING OPERATING PROFIT

£562m

2022: £432m

UNDERLYING OPERATING MARGIN

13.8%

2022: 11.8%

ORDER BACKLOG

£9.2bn

2022: £8.5bn

Market overview

Our Defence business supports five distinct end markets: transport, where we are the market leader; combat, where we have full engine capability; submarines, where we have unique nuclear propulsion capability; naval, where our high power density engines bring real advantage; and helicopters, where we have accumulated huge experience in military and civil programmes. Our order book is strong at £9.2bn (2022: £8.5bn) and our order coverage is 90% (2022: 86%). We maintained our customer and shareholder commitments throughout the pandemic. Since then, the global security situation has led to governments increasing their commitment to defence. We continue to be selected as long-term partners in the development, manufacture and maintenance of defence power for critical military missions to deter threats, preserve life and maintain order. Rolls-Royce does not provide or manufacture weapons for our customers. We are a trusted and key supplier to many countries across the globe for the provision of defence power for the protection of society, preservation of peace and economic stability. We are chosen for our unrivalled engineering and technological capabilities as we push the boundaries of what is possible and provide our customers with cutting-edge solutions.

Recent substantial wins underpin our long-term growth as we have been chosen to participate on the FLRAA programme, B-52 re-engining, Tempest and the GCAP. In 2023, it was also announced that Rolls-Royce will provide reactors for Australia's nuclear-powered submarines under the AUKUS trilateral agreement. These contracts come along once in a generation and will provide substantial economic benefit.

The Defence market has demonstrated its resilience in recent years and our customers continue to invest in capability in our core markets. £45bn of new programmes will come online by 2050 within the transport and patrol market, creating a substantial opportunity for us, and we are very well positioned to capture a significant portion of these emerging opportunities. We continue to see strong momentum in this market demonstrated by the US Army selecting us for the FLRAA programme. Partnered with Bell and the US Army, we are excited to power FLRAA with our AE 1107F engine, providing a low risk, ready-now propulsion solution with best-in-class capabilities. The FLRAA platform will provide twice the range and speed for the US Army when compared with the existing Black Hawk helicopter capabilities.

Financial performance

Revenues increased by 12% in 2023 to £4.1bn, with year-on-year growth in all major end markets, notably double-digit revenue growth in combat and submarines. Combat growth was driven by the GCAP programme in the UK and the ramp-up of the F130 programme for the B-52 in the US. Total OE revenues grew by 8% in the year to £1.8bn and services revenues grew by 14% to £2.3bn.

Operating profit was £562m (13.8% margin) versus £432m (11.8% margin) in the prior year, reflecting commercial optimisation, cost efficiencies, and growth in submarines. A lower R&D charge reflected increased customer funding and our strategic focus on the most attractive future programmes.

Trading cash flow of £511m improved versus £426m last year, driven by higher underlying operating profit and our working capital initiatives which resulted in inventory reductions, and increased customer deposits.

Business review *continued*

Operational and strategic progress

One outcome of the Group strategic review in 2023 is to concentrate on areas where we leverage our differentiation. In Defence, we are focusing on growing sectors where we are strategically advantaged. These are combat, transport and submarines. There are opportunities to improve our position in the defence market through strong performance management, commercial optimisation and efficiency savings.

Financial overview

£ million	2023	Organic change ¹	FX	2022	Change	Organic change ¹
Underlying revenue	4,077	428	(11)	3,660	417	12%
Underlying OE revenue	1,766	136	(4)	1,634	132	8%
Underlying services revenue	2,311	292	(7)	2,026	285	14%
Underlying gross profit/(loss)	804	78	-	726	78	11%
Gross margin %	19.7%			19.8%	(0.1)pt	(0.1)pt
Commercial and administrative costs	(173)	2	(1)	(174)	1	(1)%
Research and development costs	(72)	49	1	(122)	50	(40)%
Joint ventures and associates	3	1	-	2	1	50%
Underlying operating profit	562	130	-	432	130	30%
Underlying operating margin %	13.8%			11.8%	+2.0pt	+1.9pt
	2023	2022	Change			
Trading cash flow	511	426	85			

¹ Organic change is the measure of change at constant translational currency applying full year 2022 average rates to 2023. All underlying Income statement commentary is provided on an organic basis unless otherwise stated

We have been designing and producing combat jet engines for 80 years and we currently support customers in 22 countries. In 2023, we produced 39 new engines, up from 20 to 30 per year in the 2018 to 2020 period. This increase was driven by the maturity of the F-35 programme which has moved to full-rate production. This drove an increased demand for our LiftSystem as well as increased demand for Typhoon and EJ200 in Germany, Spain and Qatar.

In 2021, we secured the contract to re-engine the B-52 for the US Air Force. With the ramp-up of B-52, we expect to increase production of our combat portfolio to 100 engines per year before the end of the decade and peak at over 130 engines per year by the early 2030s. In 2023, we completed the initial F130 engine testing for the B-52 aircraft. Continued testing at NASA Stennis Space Center in Mississippi accomplished our testing goals and allowed for the gathering of large amounts of data early in the programme. This will de-risk the integration of the F130 engine onto the B-52.

Rolls-Royce powered submarines have played a critical role in the UK's naval defence for over 60 years. This is a growing market with a recent increase in demand from the UK Ministry of Defence which includes providing all of the new reactor plants for the UK and Australia as part of the AUKUS trilateral agreement. This will ensure we are supporting naval propulsion with our nuclear expertise for another 60 years and beyond. To meet the enhanced demands from both the UK Royal Navy and AUKUS we are already on the journey to double the size of our site at Raynesway in the UK, developing cutting-edge manufacturing facilities and inspiring the nuclear experts of tomorrow to maintain our talent pool. AUKUS has given us enhanced surety of work that will take us well into the second half of this century.

At our CMD, we demonstrated how we are capturing performance improvement opportunities to grow our business. We outlined the key drivers for operating profit improvement as volume and mix, commercial optimisation, investment prioritisation and cost management.

Under volume and mix, the overall transport fleet is growing, generating higher flying hours and more shop visits. In combat, changes to the product mix yield higher profits due to the scale of newer programmes with similar themes in submarines which will see an increase in volume, funded development and infrastructure.

Under commercial optimisation, in the mid-term, all our major contracts will be renewed, providing us the opportunity to work with our customers to find win-win solutions that capture the fair value of our products and services.

Under investment priorities, the strategic review enabled us to take a more focused view on where and how to invest. We remain aligned with the Group investment priorities framework which will result in capital being allocated to the best projects. Our major customers strongly support our core differentiated strengths in transport, combat and submarines and, as a result, our customer-funded R&D is due to increase by 150% over the medium term.

Our financial results demonstrate that we are making progress on cost management as we embrace the Group-wide transformation activities and strive for a sustainably reduced cost base in the medium term and beyond.

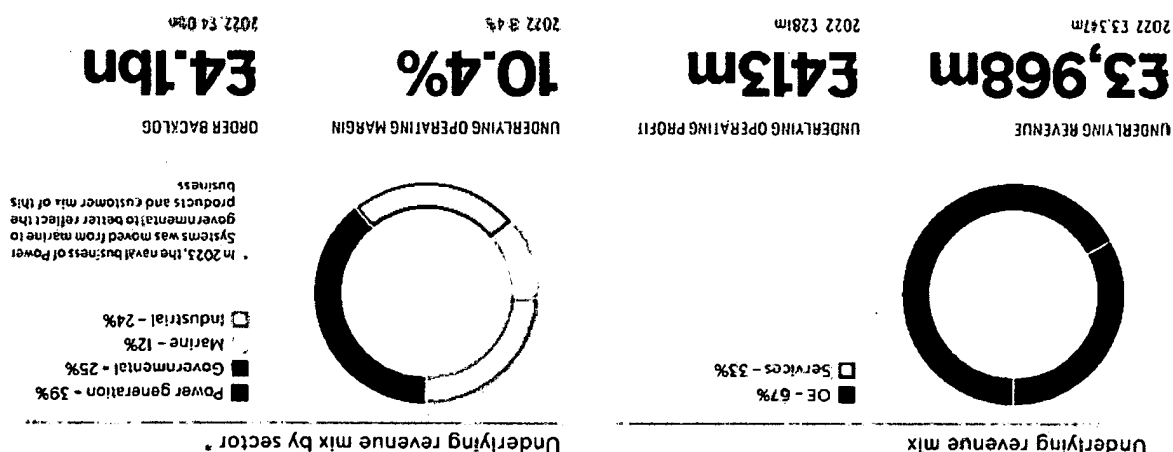
We are committed to becoming a net zero company by 2050 and we support our customers to do the same. The best solution for the defence markets which we operate in to decarbonise is via synthetic fuels, which can deliver a reduction in lifecycle carbon emissions compared to fossil fuels. Our micro-reactors can also play a big part in helping energy security and resilience as part of the energy transition.

Outlook

As we outlined at our CMD, we expect the defence market to grow. We expect our margins to improve to between 14%-16% in the mid-term, which we define as 2027, as long-term contracts underpin security for our Defence business for decades to come. Current geopolitical uncertainties do not immediately benefit our financial performance, however, they provide the backdrop which will support growth in defence budgets in the years to come.

POWER SYSTEMS

Power Systems, with its product and solutions brand *miu*, is a world-leading provider of integrated solutions for on-site power and propulsion, developing sustainable solutions to meet the needs of its customers.



Financial overview

£ million	2023	Organic change ¹	FX	2022	Change	Organic change ¹
Underlying revenue	3,968	539	82	3,347	621	16%
Underlying OE revenue	2,661	419	55	2,187	474	19%
Underlying services revenue	1,307	120	27	1,160	147	10%
Underlying gross profit	1,050	111	21	918	132	12%
Gross margin %	26.5%			27.4%	(0.9)pt	(0.9)pt
Commercial and administrative costs	(456)	(7)	(8)	(441)	(15)	2%
Research and development costs	(187)	21	(4)	(204)	17	(10)%
Joint ventures and associates	6	(2)	-	8	(2)	(25)%
Underlying operating profit	413	123	9	281	132	44%
Underlying operating margin %	10.4%			8.4%	+2.0pt	+2.0pt
	2023	2022	Change			
Trading cash flow	461	158	303			

¹ Organic change is the measure of change at constant translational currency applying full year 2022 average rates to 2023. All underlying income statement commentary is provided on an organic basis unless otherwise stated

Business review continued**Operational and strategic progress**

Based on the findings of our recent strategic review, which we presented at our CMD, we are confident that we will deliver strong profitable growth through focusing on the power generation, including battery energy storage systems, governmental and marine markets. In all these markets we are targeting to strengthen the highly attractive service business through additional offerings such as upgrade and retrofit kits or digital services. We are also developing the first new *mtu* Series 4000 engine for many years, an investment that will pay off beyond the mid-term. In addition, we will drive efficiency and simplification measures across the business, including streamlining our organisation and creating additional synergies across the Group.

In power generation, we are focusing on optimising our cost structure and further scaling the business. We are targeting a benefit from our strong position in mission-critical applications such as data centres and capturing significant growth as the market is growing rapidly, driven by global trends for data processing and AI. Battery energy storage systems (BESS) are a logical complement to our power generation business and expand our markets towards new applications such as utility-scale storage. Here we can leverage existing system capabilities and market access to create a profitable BESS business in the medium term.

In governmental, we have a leading position today and are well positioned to capture the strong market growth and even outgrow the market as our propulsion systems are well placed for the current investment cycle into military vehicles and naval vessels. Furthermore, we will drive additional growth by expanding our offering towards more integrated solutions such as ship automation products. Through disciplined investments in technologies, we are also strengthening our longer-term opportunities and underpinning our leading market position. In marine, we have a market leading position in the highly profitable yacht market and a strong position in commercial marine. Our target is to strengthen our leading position in yachts and further improve our position in commercial marine through various strategic measures. Part of this is our bridge-to-propeller strategy which creates profitable upsell potential and differentiation by providing our customers with fully integrated solutions from bridge automation to the propulsion system. Furthermore, we are securing our leading portfolio position by offering alternative-fuel ready engines to support our customers' transition towards sustainability.

As a result of our strategy to focus on power generation, governmental and marine end-markets and a detailed product portfolio analysis, we will be concentrating largely on higher-powered systems in the off-highway engines sector primarily from our in-house production. We have therefore decided to transfer our successful lower-power-range engines business, using Daimler technology and focused on the industrial construction and agriculture markets, to a partner. We have reached an agreement-in-principle with an industrial buyer to take over the lower-power-range engines business.

In all the above-mentioned markets, we have already made significant progress towards offering lower carbon solutions. However, the speed of transition and customer demand strongly varies between our market segments. Combustion engines will remain highly relevant for many years, increasingly powered by sustainable fuels. The use of sustainable diesel substitute hydrotreated vegetable oil (HVO) can reduce full lifecycle emissions by up to 90%. Nearly all our major engine platforms are already able to run on HVO and some of our customers are using this fuel to cut their emissions.

In marine, we are developing methanol-based solutions and for power generation we see hydrogen-based engines as a future solution. These developments are based on existing engines and given the progress already made we are well-positioned to deliver this transition. In addition, we are investing into electrification by offering hybrid solutions, for example, for the yacht or rail market and transitioning our power generation business gradually to complement battery-based solutions. By taking these steps we are participating in the energy transition and support our customers in various industries to achieve their growth and sustainability goals at the same time.

Outlook

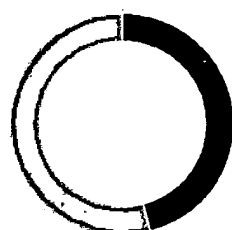
We have a resilient business model with strong market positions and opportunities in growing markets to unlock the full potential of our business. Based on a clear focus on profitable growth markets as well as efficiency and simplification measures, we target to achieve an operating margin of 12%-14% in the mid-term.

Business review continued

NEW MARKETS

New Markets are early-stage businesses. They leverage our existing, in-depth engineering expertise and capabilities to develop sustainable products for new markets, focused on the transition to net zero.

Value R&D spend £(137)m



■ Rolls-Royce SMR – 46%
□ Rolls-Royce Electrical – 54%

UNDERLYING REVENUE

£4m

2022: £3m

UNDERLYING OPERATING LOSS

£(160)m

2022: £(132)m

UNDERLYING OPERATING MARGIN

n/a

2022: n/a

Market overview

The market for small modular reactors (SMRs) is very attractive with real momentum behind the nuclear power ambitions in many countries, driven by energy security and decarbonisation targets. The role of SMRs is of particularly high interest and we see a large export opportunity in addition to the UK fleet potential.

We took the decision in 2023 to exit our Rolls-Royce Electrical business. We are looking at options to exit our advanced air mobility activities in the short term or reduce our position to a minority share with the intention to exit fully in the mid-term.

Financial performance

Planned cost increases in both Electrical and SMR to meet development milestones resulted in an increased operating loss of £(160)m a 20% increase from £(132)m in the prior year.

Trading cash flow was an outflow of £(63)m compared to £(57)m in the prior year, with SMR costs covered by third party funding. Rolls-Royce SMR is backed by world-class investors, including an international nuclear operator, and has received grants from the UK Government. Our current shareholding in the SMR business is more than 70% and in 2024 we will continue to explore partnerships that will strengthen our position to deliver the overall solution. Where agreements are reached, equity from these partnerships will likely be received in late 2024 or early 2025. Rolls-Royce has contributed approximately 10% of the total cash costs.

Financial overview

£m million	2023	Organic change ¹	FX	2022	Change	Organic change
Underlying revenue	4	1	-	3	1	33%
Underlying OE revenue	2	1	-	1	1	100%
Underlying services revenue	2	-	-	2	-	-
Underlying gross profit/(loss)	1	2	-	(1)	2	nm
Gross margin %	25.0%			(33.3)%	+58.3pt	+58.3pt
Commercial and administrative costs	(24)	(1)	-	(23)	(1)	4%
Research and development costs	(137)	(27)	(2)	(108)	(29)	25%
Joint ventures and associates	-	-	-	-	-	-
Underlying operating loss	(160)	(26)	(2)	(132)	(28)	20%

	2023	2022	Change
Trading cash flow	(63)	(57)	(6)

¹ Organic change is the measure of change at constant translation currency, applying full year 2022 average rates to 2023. All underlying income statement commentary is provided on an organic basis unless otherwise stated.

Business review *continued***Operational and strategic progress**

Rolls-Royce SMR is the UK's first domestic nuclear offering in more than 20 years. Our SMRs are designed to produce stable, affordable and emission-free electricity to power a million homes for at least 60 years.

The modular build approach is the fastest and cheapest way to get nuclear on-grid solutions to help meet global net zero ambitions. We are controlling the integrated design of the powerplant and enabling a very high level of modularisation. This moves work from onsite construction into a standardised, controlled, factory build with modules then assembled on site. This reduces cost, risk and time to construct and results in a highly competitive cost of electricity.

Rolls-Royce SMR has been successfully shortlisted in the first stage of the Great British nuclear SMR technology selection process, marking a significant step towards the first plants being built in the UK.

We welcome our shortlisting and are eager to build on this progress as we move quickly towards the next stage where we can work to agree a contract for fleet deployment. This should be as soon as possible, as the earlier this is achieved the more likely it is that our SMR fleet will be able to help the UK Government reach its ambition to deliver up to 24GW of nuclear power by 2050.

Rolls-Royce SMR is making very good progress through the generic design assessment (GDA) by the UK nuclear industry's independent regulators. We entered the UK regulatory process in April 2022 and continue to successfully move through the steps to secure design certification, putting us around two years ahead of rival technologies in Europe.

In Rolls-Royce Electrical we have made significant strides in developing electric and hybrid-electric power and propulsion technology. In 2023, we continued to further develop and test the products and power generation solutions we have been working on. Our electrical capabilities continued to provide electrical solutions to our core businesses and this includes leading on the EU-funded HE-ART programme that is focusing on demonstrating enabling technologies for regional aircraft hybridisation. Our engineers are also developing the embedded electrical technology for the global combat air programme.

Outlook

In Rolls-Royce SMR regulatory activities such as the GDA, factory development and siting plans will continue simultaneously as the work to secure firm domestic and export commitments continues. In addition to the UK, we are deeply engaged with governments, developers and potential industrial customers in the Czech Republic, Finland, Sweden, USA, Poland, the Netherlands and more. Selection processes in several countries are in progress.

We will need a broad set of partners to deliver our overall solution. Our partnership approach de-risks our profitable growth and reduces the future capital call on Rolls-Royce. It also brings additional expertise to help reduce delivery risk. Risk will also be mitigated by our commercial constructs, for example funding mechanisms such as the regulated asset base model in the UK. There is a credible path to be under contract for multiple units domestically and overseas by 2030, creating significant value.

In Rolls-Royce Electrical we will exit the advanced air mobility part of the business while retaining key electrical capabilities in the Group to support activities in Civil Aerospace, Defence and Power Systems.

Principal risks

The Rolls-Royce risk management and internal control system

Effective risk management helps Rolls-Royce to identify anything that could hinder or support the effective implementation of its strategy and business model. In order to achieve this, we have an established risk management and internal controls system, with the RRH Board overseeing its effectiveness. The RRH risk management and internal control systems are directly related to the Company, given it is a significant part of the RRH Group and the risks and internal controls of the Company are therefore subject to review as part of this process.

As well as including procedures to monitor the nature and extent of the principal risks the Group is willing to take in order to optimise its commercial opportunities and achieve its long-term strategic objectives, it also covers the monitoring of emerging risks.

At least once a year, the RRH Board, supported by the RRH Audit Committee, assesses how effectively we manage principal risks and, where we are not, reviews plans in place to address these. In 2023, there was an additional internal review on risk maturity which was incorporated into the effectiveness review.

For key principal risks, particularly compliance and safety, we have mandatory training and policies in place, linked to performance management and remuneration, which all our people are required to complete and comply with.

The RRH Audit Committee also reviews the Group's internal financial controls with financial reporting controls being subject to periodic review by the Group's internal controls team.

➤ Risk management

Risks facing the business are identified and assessed on a regular basis.

➤ Internal control

Internal controls are designed and deployed to mitigate these risks to an accepted level.

➤ Assurance

Assurance activities assess whether the controls are effective and risks are mitigated to an acceptable level in practice.

How Rolls-Royce manages risk

We use a framework which aligns with international standards for managing risk. This sets out requirements across the organisation for all categories of risk, including climate, finance, legal and operations, as well as providing guidance and tools. Everyone at Rolls-Royce has a role to play in identifying and managing risks, but the RRH Board (aided by its Committees) is ultimately accountable. An independent, central enterprise risk management team supports the divisions and functions in their effective management of risk.

Define - Risks are identified by individuals across all divisions and functions and at different layers of the organisation by considering what could stop us achieving our strategic, operational or compliance objectives or impact the sustainability of our business model (described on pages 31 and 35).

Quantify - Risk owners assess the likelihood of a risk materialising and the impact if it does, taking into account current mitigating control activities.

Control and assure - Risk owners consider the effectiveness of current mitigating control activities, supported by different assurance providers (detailed in the principal risk tables from pages 31 to 35).

Respond - Risk owners identify where additional activities may be needed to bring the risk within appetite. A judgement is made by assessing the Group's ability to reduce the impact of risks that do materialise and ensure the costs of operating particular controls are proportionate to the benefit provided.

Monitor, review and report - Risk owners report their assessment of the current risk status and action plans to divisions, functions and other review forums (including the Executive Team, RRH Board and RRH Board Committee meetings) as needed depending on the nature of the risk, for support, challenge and oversight.

Continuous improvement

We regularly benchmark the risk framework through active participation in industry groups and against best practice risk standards. Progress made in 2023 includes further embedding risk considerations in the investment committee decision-making process and five-year planning process.

We also made improvements to how we define, document and operate controls (e.g. for the safety and compliance principal risks). This is a key part of how we mitigate risk and keep within appetite, alongside assurance so we know the mitigation is effective. A risk and its mitigation is continually evaluated in response to external or internal factors changing the nature of the risk and how we manage it.

Emerging risks

In a fast-changing world, it is getting harder to predict the future in time to make decisions and act early enough to deal with unexpected, disruptive events. Rolls-Royce has processes in place to identify emerging risks, including:

- divisional risk identification;
- regulatory and compliance horizon scanning, including requirements relating to climate change;
- geopolitical horizon scanning and risk identification;
- new technologies horizon scanning;
- analysis of external emerging risk information; and
- strategic risk identification.

Principal risks continued

Outputs are assessed to identify any potential new impacts on Rolls-Royce. Where we do identify items, these are captured by either recording a new risk or amending an existing risk and managing this in accordance with the framework or added to an emerging risk watch list to monitor and/or investigate further. The RRH Board consider an annual summary of emerging risks and management's response. In 2023, we concluded that known significant risk trends are deteriorating simultaneously; in particular the effects of climate change, geopolitical conflict and tensions, the pace of technological advancements, and global economic constraints and their knock-on effect on society. This evolution has been reflected in the revised approach to principal risk interdependencies, shown in the diagram below.

We added two risks to the emerging risk watch list this year arising from external geopolitical tensions: the possibility of national power outages and an attack on physical infrastructure. Technology risk has also now been split out from the previously reported competitive environment risk, expanding it into a separate opportunity risk driver.

Principal risk interdependencies – pillars and drivers

	Principal risk pillars				
	Safety Product & people	Compliance With law & regulations	Strategy	Execution	Business Interruption
Principal risk drivers					
Climate change			x		x
Information & data	x	x	x		x
Market shock Financial shock			x	x x	x x
Political			x		x
Talent & capability			x	x	
Technology			x	x	

Changes to the principal risks profile in 2023

We continue to review our principal risks, their evolving nature and how well they are managed. In November 2023, the principal risk profile was refreshed to ensure it reflects where risks could impact the organisation in light of the strategic review. This resulted in a number of changes to our principal risks.

- Transformation has been replaced with a strategy risk, which incorporates the old transformation risk as well as elements of the previous competitive environment risk.
- Execution replaces elements of the previous competitive environment risk.
- Technology is now a separate principal risk, whereas previously it was captured under the competitive environment risk.
- Information & data risk includes the previous cyber risk but has been expanded to include physical as well as digital data.
- Business continuity risk is now called business interruption.

As part of this, we also looked at risk interdependencies, categorising principal risks as either a 'pillar' or a 'driver', with drivers being those risks that could cause one or more risk pillars to happen and/or make them worse if they do. The diagram above shows how the risks interconnect, with the crosses showing the interdependencies which will be a focus as part of our risk management and oversight in 2024.

Principal risks are owned by one or more members of the Executive Team and subject to a review at an Executive Team meeting at least once each year, before a review by the RRH Board or a RRH Board Committee.

Risks are managed against risk appetite (i.e. how much risk we are prepared to accept or be exposed to) as a mechanism for making decisions for how risks are managed and the actions needed to mitigate them.

Changes in overall risk levels

The overall risk profile has remained broadly stable. Where we have developed our strategy (as described on pages 8 to 10) and associated short to medium-term plans, the related risks have reduced accordingly. Successfully managing these risks will help us to achieve our goal of being a high-performing, competitive, resilient and growing business. The following tables detail the current principal risk pillars and drivers, together with how we manage them, how we assure them (in addition to internal audit), the oversight provided by the RRH Board and/or its Committees and how the risk levels have changed over the course of the year.

Principal risks continued**Principal Risks – Pillars**

Safety	
PRINCIPAL RISK DESCRIPTION	CONTROLS AND MITIGATING ACTIONS
Product: Failure to provide safe products People: Failure to create a place to work which minimises the risk of harm to our people, those who work with us, and the environment, would adversely affect our reputation and long-term sustainability	Product: - Our product safety management system includes controls designed to reduce - our safety risks as far as is reasonably practicable and to meet or exceed relevant - company, legal, regulatory and industry requirements - We verify and approve product design - We test adherence to quality standards during manufacturing - We validate conformance to specification for our own products and those of our - suppliers - We mandate safety awareness training - We use engine health monitoring to provide early warning of product issues - We take out relevant and appropriate insurance People: - Our HSE management system includes activities and controls designed to reduce - our safety risks as far as is reasonably practicable and to meet or exceed relevant - company, legal, regulatory and industry requirements - We reinforce our journey to zero harm - We use our crisis management framework

ASSURANCE ACTIVITIES AND PROVIDERS	OVERSIGHT FORUM(S)	BUSINESS MODEL
Product - Product safety assurance team - Product safety board - Technical product lifecycle audits People - Safety case interventions - HSE audit team	RRH Safety, Energy Transition & Tech Committee	- Our role in society - Our business model drivers - Our uniqueness
WHAT HAS CHANGED IN 2023?		
No overall change in risk status.		

Compliance		
PRINCIPAL RISK DESCRIPTION	CONTROLS AND MITIGATING ACTIONS	
Non-compliance by the Group with legislation or other regulatory requirements in the heavily regulated environment in which we operate (e.g. export controls; data privacy; use of controlled chemicals and substances; anti-bribery and corruption; human rights; and tax and customs legislation). This could affect our ability to conduct business in certain jurisdictions and would potentially expose us to: reputational damage; financial penalties; debarment from government contracts for a period of time; and suspension of export privileges (including export credit financing)	- We continuously develop and communicate a comprehensive suite of mandatory policies and processes and controls throughout the Group - We undertake third-party due diligence - We encourage, facilitate and investigate speak up cases - We investigate potential regulatory matters - Our financial control framework activities are designed to reduce financial reporting and fraud risks - We classify data to meet internal and external requirements and standards	
ASSURANCE ACTIVITIES AND PROVIDERS	OVERSIGHT FORUM(S)	BUSINESS MODEL
- Compliance teams - Financial controls team	- RRH Board - RRH Nominations, Culture & Governance Committee - RRH Audit Committee	Our business model drivers
WHAT HAS CHANGED IN 2023?		
No overall change in risk status.		

Principal risks continued

Strategy		
PRINCIPAL RISK DESCRIPTION		CONTROLS AND MITIGATING ACTIONS
Failure to develop an optimal strategy and continuously evolve it, investing in key areas for performance improvement and growth (taking into account risk reward), making difficult decisions for competitive advantage and the right portfolio and partnership choices, could result in us underperforming against our competitors and significantly reduce our ability to build a high-performing, competitive, resilient and growing company.		- We run a rigorous strategic review process - We benchmark our capabilities and performance against our competitors, the market and other external metrics - We align our R&D spend to our strategy, with a smaller, more focused portfolio - We make investment choices to improve the quality, delivery and durability of our existing products and services - We scan the horizon for competitive threats and opportunities, including patent searches - We invest in R&D opportunities to support the development of new products or services to protect and sustain our future market
ASSURANCE ACTIVITIES AND PROVIDERS	OVERSIGHT FORUM(S)	BUSINESS MODEL
- Group strategy team - Challenge from external advisers	- RRH Board	- Our business model drivers
WHAT HAS CHANGED IN 2023?		
This risk replaces transformation as well as part of the previous competitive environment risk and covers the development of the Group's strategy. It has reduced following completion of our strategic review which included a robust assessment of the competitive environment, agreement on priorities and changing how the organisation operates to enable execution.		

Execution		
PRINCIPAL RISK DESCRIPTION		CONTROLS AND MITIGATING ACTIONS
Failure to deliver as One Rolls-Royce on short to medium term financial plans, including efficient and effective delivery of quality products, services and programmes, or falling significantly short of customer expectations, would reduce our resilience and 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.		- We robustly performance manage our operational execution and monitor performance against plans - We keep control of costs with rigorous budgeting - We review product lifecycles - We protect our intellectual property (e.g. through patents) - We include inflation clauses in our contracts to manage cost increases - We work closely with our suppliers, driving tighter management of lead times
ASSURANCE ACTIVITIES AND PROVIDERS	OVERSIGHT FORUM(S)	BUSINESS MODEL
- Executive Team monitoring of execution	- RRH Board - Investment committee	- Our business model drivers
WHAT HAS CHANGED IN 2023?		
This risk replaces part of the previous competitive environment risks and covers delivery of strategic initiatives, including existing product delivery and improving performance, together with the associated financial plans. Although progress has been made (as we have articulated how we plan to monitor strategy execution from 2024 and introduced more robust monitoring of in-flight projects and programmes) we have held the risk level unchanged as we have yet to commence execution and monitoring. We are in the process of identifying and describing any new and changed risks arising from strategy development and execution, in addition to introducing new mitigations including zero-based budgeting.		

Principal risks continued

Business Interruption		
PRINCIPAL RISK DESCRIPTION		CONTROLS AND MITIGATING ACTIONS
A major disruption of our operations and ability to deliver our products, services and programmes could have an adverse impact on our people, internal facilities or external supply chain which could result in failure to meet agreed customer commitments and damage our prospects of winning future orders. Disruption could be caused by a range of events such as extreme weather or natural hazards (e.g. earthquakes or floods) which could increase in severity or frequency given the impact of climate change; political events; financial insolvency of a critical supplier; scarcity of materials; loss of data; fire; or infectious disease.		- We invest in capacity, equipment and facilities, dual sources of supply and in researching alternative materials - We provide supplier finance in partnership with banks to enable our suppliers to access funds at low interest rates - We hold buffer stock - We plan and practice IT disaster recovery, business continuity and crisis management exercises - We undertake supplier due diligence - We take out relevant and appropriate insurance
ASSURANCE ACTIVITIES AND PROVIDERS	OVERSIGHT FORUM(S)	BUSINESS MODEL
- Investment reviews - Supplier strategy and sourcing reviews - Group security and resilience team	- RRH Audit Committee	- Our business model drivers
WHAT HAS CHANGED IN 2023?		
This risk replaces business continuity and remains high due to the external threat landscape, such as geopolitical instability disrupting supply or demand.		

Principal Risks - Drivers

Climate Change		
PRINCIPAL RISK DESCRIPTION		CONTROLS AND MITIGATING ACTIONS
Failure to become a net zero company by 2050, leveraging technology to transition from carbon intensive products and services at pace could impact our ability to win future business; achieve operating results; attract and retain talent; secure access to funding; realise future growth opportunities; or force government intervention to limit emissions. In addition, physical risks from extreme weather events (and/or natural hazards) could potentially materialise, which may result in disruption.		- We invest in reducing carbon impact of existing products and zero carbon technologies to replace our existing products - Performance of climate scenario modelling and physical risk impact assessments - We balance our portfolio of products, customers and revenue streams to reduce our dependence on any one product, customer or carbon emitting fuel source - Communication of the actions we are taking to manage this risk, in order to demonstrate our alignment to societal expectations and global climate goals
ASSURANCE ACTIVITIES AND PROVIDERS	OVERSIGHT FORUM(S)	BUSINESS MODEL
- Strategy reviews - Technology reviews - Investment reviews - Group sustainability team - Climate steering committee	- RRH Board and its Committees - Executive Team and its committees	- Our business model drivers - Our role in society - Our uniqueness
WHAT HAS CHANGED IN 2023?		
This risk currently remains unchanged. Our intention is to complete a comprehensive review of our sustainability, energy transition and climate related strategy, including redefining group level targets in 2024.		

Information & data		
PRINCIPAL RISK DESCRIPTION		CONTROLS AND MITIGATING ACTIONS
Failure to protect the integrity and availability of data, both physical and digital, from attempts to cause us harm, such as through a cyber attack. Potential impacts include hindering data driven decision making, disrupting internal business operations and services for customers, or a data breach, all of which could damage our reputation, reduce resilience, and cause financial loss. Causes include ransomware threats, unauthorised access to property or systems for the extraction, corruption, destruction of data, or availability of access to critical data and intellectual property.		- We deploy web gateways, filtering, firewalls, intrusion, advanced persistent threat detectors and integrated reporting - We test software - Application of our crisis management framework to govern our response to potential cyber security incidents and significant IT disruption - We restrict access to our systems and locations
ASSURANCE ACTIVITIES AND PROVIDERS	OVERSIGHT FORUM(S)	BUSINESS MODEL
- Group cyber security team and security operations centre	- RRH Audit Committee	- Our business model drivers - Our uniqueness
WHAT HAS CHANGED IN 2023?		
This risk replaces the previous cyber threat risk and now includes physical data as well as digital. The risk remains high due to factors including the ongoing evolution of data security threats as well as increasing demands for additional data (e.g. to meet compliance requirements).		

Principal risks continued

Market & Financial Shock		
PRINCIPAL RISK DESCRIPTION		CONTROLS AND MITIGATING ACTIONS
The Group is exposed to market and financial risks, some of which are of a macro-economic nature (e.g. economic growth rates, foreign currency, oil price and interest rates) and some of which are more specific to us (e.g. reduction in air travel or defence spending, disruption to other customer operations, liquidity and credit risks). Significant extraneous market events could also materially damage our competitiveness and/or creditworthiness and our ability to access funding. This would affect operational results or the outcomes of financial transactions. Demand for our products and services could be adversely affected by factors such as current and predicted air traffic, fuel prices and age/replacement rates of customer fleets. A large proportion of our business is reliant on the civil aviation industry, which is cyclical in nature.		- We monitor trends, market demand and future market forecasts and make - Investment choices to maximise the related opportunities - We incorporate trends, demand and other dependencies in our financial forecasts - We balance our portfolio with the sale of OE and aftermarket services, providing - a broad product range and addressing diverse markets that have differing - business cycles - We execute our short, medium and long-term plans - Our financial control framework activities are designed to reduce financial - reporting risks - We analyse currency and credit exposures and include in-sourcing and - funding decisions - We develop, review and communicate treasury policies that are designed to hedge - residual risks using financial derivatives (covering foreign exchange, interest rates - and commodity price risk) - We raise finance through debt and equity programmes - We hedge with reference to volatility in external financial markets
ASSURANCE ACTIVITIES AND PROVIDERS	OVERSIGHT FORUM(S)	BUSINESS MODEL
- Five-year and strategic planning process - Strategy reviews - Technology reviews	- RRH Board - RRH Audit Committee	- Our business model drivers
WHAT HAS CHANGED IN 2023?		
Overall, this risk has remained the same. The external environment is increasingly uncertain, with ongoing inflation and high interest, the possibility of a recession in the short term across one or more countries and market volatility following elections (see political risk above). However, improvements made across the Group and strategic plans in place means that we are in a good position to manage this volatility.		

Political		
PRINCIPAL RISK DESCRIPTION		CONTROLS AND MITIGATING ACTIONS
Geopolitical factors leading to an unfavourable business climate and significant tensions between major trading parties or blocs could impact our strategy, execution, resilience, safety and compliance. Examples include changes in key political relationships explicit trade protectionism, differing tax or regulatory regimes, potential for conflict or broader political issues and heightened political tensions.		- We develop Group and country strategies and consider associated dependencies - We horizon scan for political implications and dependencies - We include diversification considerations in our investment and procurement choices
ASSURANCE ACTIVITIES AND PROVIDERS	OVERSIGHT FORUM(S)	BUSINESS MODEL
- Strategy reviews - Technology reviews - Supplier sourcing teams - Government relations teams	- RRH Board	- Our role in society - Our business model drivers
WHAT HAS CHANGED IN 2023?		
This risk has increased throughout the year, due to external factors including (but not limited to) the recent instability in the Middle East, plus upcoming elections that could increase geopolitical tensions, depending on the outcome.		

Principal risks continued

Talent & Capability		
PRINCIPAL RISK DESCRIPTION		CONTROLS AND MITIGATING ACTIONS
Failure to create a company where our people can build a successful career with better choices for development and personal growth will hinder our ability to identify, attract, retain and apply the critical capabilities and skills needed in appropriate numbers for the successful execution of our business strategy.		- We have implemented a new performance management framework to manage and reward our staff - We undertake succession planning and monitor the talent pipeline - We survey employee opinion - We develop, implement and review strategic resourcing plans - We are investing in our learning culture and people's development
ASSURANCE ACTIVITIES AND PROVIDERS	OVERSIGHT FORUM(S)	BUSINESS MODEL
- People leadership team	- RRH Nominations, Culture & Governance Committee	- Our business model drivers - Our uniqueness
WHAT HAS CHANGED IN 2023?		
This risk was high in 2022 due to the ongoing impacts of the pandemic and has remained high this year due to our current transformation programme. There have been some year-on-year improvements in agreed key measures and improvement plans in place for others. As part of our new strategy, we are investing in our learning and skills culture, challenging the way leaders lead whilst managing and rewarding performance and dealing with poor performance.		

Technology		
PRINCIPAL RISK DESCRIPTION		CONTROLS AND MITIGATING ACTIONS
Failure to become a digitally enabled business using tools including AI could hinder our ability to enhance the customer experience, drive the transition to lower carbon, accelerate product design, improve manufacturing and empower our people with new tools to improve productivity, as well as preventing us from creating new growth opportunities.		- Investment in R&D opportunities - We scan the horizon for emerging technology threats and opportunities
ASSURANCE ACTIVITIES AND PROVIDERS	OVERSIGHT FORUM(S)	BUSINESS MODEL
- Disruptive technology horizon scanning process - Strategy reviews - Investment reviews - Technology reviews	- RRH Safety, Energy Transition & Tech Committee	- Our role in society - Our business model drivers - Our uniqueness
WHAT HAS CHANGED IN 2023?		
Disruptive technology, as a threat (previously part of the competitive environment risk), was one of the primary considerations in setting strategy and is now a key element of the strategic initiatives. This has been reframed following both the strategy reviews and outputs of the horizon scanning exercise. We will continue to develop and evaluate this newly expanded risk.		

Going concern statement

Overview

The Directors have assessed the prospects of the Group, taking into account its current position, the Group's principal risks which are described on pages 29 to 35, and the Group's mid-term forecasts that considered a range of internal and external factors as part of the strategic review to support setting the Group's new mid-term targets which are set out on page 9.

The Strategic Report on pages 8 to 10 sets out the activities of the Group and the factors likely to impact its future development, performance and position. The Group's updated mid-term targets are set out on page 9.

The Financial Review on pages 16 to 20 sets out the financial position of the Group, its cash flows, liquidity position and the Group's capital framework. The notes to the accounts include the objectives, policies and procedures over financial risk management including financial instruments and hedging activities, exposure to credit risk, liquidity risk, interest rate risk and commodity price risk.

In adopting the going concern basis for preparing the consolidated and Company financial statements, the Directors have undertaken a review of the Group's cash flow forecasts and available liquidity, along with consideration of possible risks and uncertainties over an 18-month period from the date of this report to August 2025. The Directors have determined that an 18-month period is an appropriate timeframe over which to assess going concern as it considers the Group's short to medium-term cash flow forecasts and available liquidity.

Forecasts

Recognising the challenges of reliably estimating and forecasting the impact of external factors on the Group, the Directors have considered two forecasts in their assessment of going concern, along with a likelihood assessment of these forecasts. The base case forecast reflects the Directors' current expectations of future trading. A stressed downside forecast has also been modelled which envisages a 'stressed' or 'downside' situation that is considered severe but plausible. Both forecasts have been modelled over an 18-month period.

Industry forecasts predict a return to 2019 large engine flying levels in 2024, which is reflected in the Group's base case forecast. Macro-economic assumptions have been modelled using externally available data based on the most likely forecasts with general inflation at around 2%-3%, wage inflation at an average of 3%-5%, interest rates at around 3%-4% and GDP growth at around 2%-3%.

The stressed downside forecast assumes Civil Aerospace large engine flying hours remain at average fourth quarter 2023 levels throughout the 18-month period to August 2025, reflecting slower GDP growth in this forecast when compared with the base case. It also assumes a more pessimistic view of general inflation at around 1%-2% higher than the base case covering a broad range of costs including energy, commodities and jet fuel. Wage inflation in the stressed downside is 1%-5% higher than the base case and interest rates in the stressed downside are 1%-2% higher than the base case. These macro-economic pressures have been modelled across the whole going concern period. The stressed downside also considers lower demand as a result of slower market growth, and potential output risks associated with increasing volumes and possible ongoing supply chain challenges.

The future impact of climate change on the Group has been considered through climate scenarios. The climate scenarios modelled do not have a material impact on either the base case or stressed downside forecast over the 18-month period to August 2025.

Liquidity and borrowings

During 2023, the Group cancelled a £1bn undrawn UKEF-supported loan facility that was due to mature in March 2026 and a £1bn undrawn bank loan facility due to mature in January 2024. The £2.5bn undrawn revolving credit facility that was due to mature in April 2025 was refinanced in November 2023 with the new facility having a term of three years with the banks having the option to extend with two one-year extension options (3+1+1).

At 31 December 2023, the Group had liquidity of £7.2bn including cash and cash equivalents of £3.7bn and undrawn facilities of £3.5bn. The 18-month going concern period includes the maturity of a €550m bond repayable in May 2024 which we do not intend to refinance given the Group's cash and liquidity position, our assessment of the Group's cash flow forecasts and available liquidity over the 18-month period.

Based on borrowing facilities available at the date of this report the Group's committed borrowing facilities at 31 December 2023 and 31 August 2025 are set out below. None of the facilities are subject to any financial covenants or rating triggers which could accelerate repayment.

(£m)	31 December 2023	31 August 2025
Issued bond notes ¹	3,995	3,511
UKEF £1bn loan (undrawn) ²	1,000	1,000
Revolving credit facility (undrawn) ³	2,500	2,500
Total committed borrowing facilities	7,495	7,011

¹ The value of issued bond notes reflects the impact of derivatives on repayments of the principal amount of debt. The bonds mature by May 2028

² The £1bn UKEF sustainability-linked loan matures in September 2027 (currently undrawn)

³ The refinanced £2.5bn revolving credit facility matures in November 2028 (currently undrawn)

Taking into account the maturity of these borrowing facilities, the Group has committed facilities of at least £7bn available throughout the period to 31 August 2025. The next debt maturity is a \$1bn bond that is due to be repaid in October 2025, which is outside the 18-month going concern period.

Conclusion

After reviewing the current liquidity position and the cash flow forecasts modelled under both the base case and stressed downside, the directors consider that the Group has sufficient liquidity to continue in operational existence for a period of at least 18 months from the date of this report and are therefore satisfied that it is appropriate to adopt the going concern basis of accounting in preparing the consolidated and company financial statements.

Viability statement

The viability assessment considers liquidity over a longer period than the going concern assessment. The downside forecast uses the same assumptions as the going concern assessment for the first 18 months and in 2026 to 2028 assumes a slower recovery than assumed in the base case.

Consistent with previous years, the Directors have assessed viability over a five-year period which is in line with the Group's five-year planning process. The Directors continue to believe that this is the most appropriate time period to consider as, inevitably, the degree of certainty reduces over any longer period.

Severe but plausible scenarios have been modelled that estimate the potential impact of the Group's principal risks arising over the assessment period (descriptions of the principal risks and the controls in place to mitigate them can be found on pages 31 to 35). The risks chosen and scenarios used are as shown in the table below.

The cash flow impacts of these scenarios were overlaid on the five-year forecast to assess how the Group's liquidity would be affected. The scenarios assume an appropriate management response to the specific event which could be undertaken and also consider specific activities to improve liquidity such as raising additional funds, reducing expenditure and divesting parts of our business.

Reverse stress testing has also been performed to assess the severity of scenarios that would have to occur to exceed liquidity headroom. The assumptions used in these stress tests were not considered plausible, as shown in the table below.

On the basis described above, the Directors confirm that there is a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over the next five years.

In making this statement, the Directors have made the following key assumptions:

1. the Group continues to have access to its current undrawn facilities or the ability to obtain equivalent alternative sources of finance;
2. that implausible scenarios do not occur. Implausible scenarios include either multiple risks impacting at the same time or where management actions do not mitigate an individual risk to the degree assumed; and
3. that in the event of one or more risks occurring (which has a particularly severe effect on the Group) all potential actions (such as but not limited to restricting capital and other expenditure to only committed and essential levels, reducing or eliminating discretionary spend, reinstating pay deferrals, raising additional funds through debt or equity raises, executing disposals and undertaking further restructuring) would be taken on a timely basis.

This assessment is based on debt maturities over the assessment period as follows:

- a. €550m bond maturing in 2024
- b. \$1bn bond maturing in 2025
- c. £2.5bn revolving credit facility maturing in 2026 *
- d. €750m bond maturing in 2026
- e. £375m bond maturing in 2026
- f. £1bn UKEF loan maturing in 2027 *
- g. \$1bn bond maturing in 2027
- h. £545m bond maturing in 2027
- i. €550m bond maturing in 2028

* Currently undrawn facilities

The Group believes it has the early warning mechanisms to identify the need for such actions and, as demonstrated by our decisive actions over the course of the pandemic, has the ability to implement them on a timely basis if necessary.

PRINCIPAL RISK	SCENARIO ASSUMPTIONS AND IMPACTS
Safety (product)	Civil Aerospace product safety event resulting in aircraft being grounded, lower engine flying hour revenues, commercial penalties and additional costs (e.g. unplanned shop visits). The grounding time and number of shop visits required to exceed headroom are considered remote.
Compliance	A compliance breach resulting in fines (greater than those agreed as part of our DPAs) and loss of new business with governments and state owned companies. The probability of triggering the size of fine required to exceed headroom is considered remote.
Execution (previously competitive environment)	A programme issue on a major programme of the game (proportionate) scale as Trent 1000. The extent to which engine life would need to be impacted to breach headroom is considered remote.
Business interruption (previously business continuity)	The loss of a key element of our supply chain resulting in an inability to fulfil Civil Aerospace large engine orders for 12 months. Reverse stress testing would require the time over which orders could not be fulfilled to be extended beyond what is considered plausible.
Climate change	Transition risk from our 1.5c TCFD scenario where we receive lower revenues from existing Civil Aerospace and Power Systems products coupled with a business interruption at one of our facilities. The extent of time to over which orders cannot be fulfilled in order to breach headroom is considered not plausible.
Information & data (previously cyber)	A cyber-attack resulting in loss and corruption of data and resulting in business disruption, loss of EFHs, compliance concerns due to disclosure of data and potentially trigger debarment from government contracts. The time period over which EFHs would need to be affected to breach headroom is not considered plausible.
Market & financial shock	Civil Aerospace EFH remain flat at 2023 levels across the first 18 months, reduction in GDP impacts Defence and Power Systems fail to secure new business opportunities. The extent of additional EFH reductions necessary to breach headroom was considered not plausible, given this would require EFHs to drop to a quarter of the planned levels being significantly below the levels seen in the pandemic.
Political	Sanctions imposed between major trading blocs resulting in supply chain disruption and a loss of sales in impacted markets. Reverse stress testing showed that sanctions would need to persist over a period of time beyond what is considered plausible.

Section 172 and stakeholder engagement

Consistent communication with stakeholders is a priority for the Group leadership. The Directors maintain regular touchpoints with stakeholders to remain updated on their views and interests. The points identified through this engagement influence decision making and long-term strategy.

Examples of engagement with our key stakeholder groups

People

During 2023, the Group's Employee Champions, Bev Goulet and Wendy Mars, continued to represent the voice of our people in the RRH boardroom. The activities of the Employee Champions during 2023 and opportunities for further engagement in 2024 were discussed at the RRH Nominations, Culture & Governance Committee, which itself was changed from the Nominations & Governance Committee to provide a forum for the RRH Board's oversight of the Group's culture. The Employee Champions provide regular feedback on topics of interest and/or concern. This provides a valuable link between our people and the Directors. The Employee Champions continue to meet regularly with the employee stakeholder engagement committee, which provides support for their activities. In 2023, the Employee Champions had an engagement schedule of on-site and hybrid engagement activities which included virtual sessions with the global inclusion network chairs, inclusion champions and the people leadership team. Site visits included Bristol, UK and Washington, US.

Our Meet the Board event enabled around 60 colleagues to talk to the RRH Board in an informal setting. Questions this year related to the transformation programme, workplace inclusivity and the RRH Board's personal experiences. The refreshed flagship employee wellbeing initiative LiveWell was relaunched in 2023 to provide more tailored and extensive support to our people and to embed this within the culture of the Group. Our 2023 employee engagement survey had a record participation rate, identifying our strengths in progress and commitment to care and quality and our crowdsourcing activity invited employee views on our purpose and culture.

We believe that these methods of engagement with our people are effective in building and maintaining trust and communication whilst providing our people with a forum to influence change in relation to matters that affect them. Many of our people are also our shareholders and we encourage their participation in a variety of share plans.

During 2023, the RRH Remuneration Committee has discussed and supported the launch of a new global all-employee share plan, better aligned with the all-employee share plan strategy, focused on business performance and supporting the transformation programme.

Customers

The Directors recognise that the quality of the Group's customer relationships is based on mutual trust as well as our engineering expertise. We recognise that we must retain and strengthen our focus on the transition to a net zero carbon global economy by creating the sustainable power that our customers require. We continue to focus on helping our customers deliver their own sustainability agendas. During 2023, the Chief Executive and members of the Executive Team engaged with customers at the Paris and Dubai airshows and communicated our achievements regarding UltraFan and the compatibility of our products with 100% SAF. The Directors regularly receive operational updates, including customer metrics and feedback, across all the divisions. This greatly influences the Director's deliberations and its support for the Executive Team when considering our strategy. The RRH Chair and the Chief Executive continued to meet with key customers during 2023.

Suppliers and partners

The interests of both our suppliers and partners are regularly considered as part of discussions on manufacturing strategy and when reviewing specific projects. The Directors, and the Executive Team, work collaboratively with our suppliers and partners to continue to improve operational performance through various means. The Directors receive updates from the businesses on supplier performance and supply chain disruption. The Chief Executive engaged with leaders from across the industry, including attending an event with the Aerospace, Security and Defence Industries Association of Europe.

Communities

The Directors recognise the importance of our communities and understand that everything we do can have an impact on our local and global communities. The Group's charitable contributions and sponsorships committee continued to identify causes for donation and partnership. During 2023, this included emergency financial support in response to the earthquake in Turkey and funding the Unnati Scholarships which support 50 girls annually to pursue engineering degrees in India. The Group supports education and skills development through STEM outreach programmes. This included sponsorship of the UK's 2023 Big Bang Fair and projects with expert partners in South-East Asia, China, Germany, India and Japan. Additionally, the Group entered into the Defence Aviation Charter with the UK RAF and the Directors received updates on the Group's engagement during COP28 in the UAE.

Governing bodies and regulators

The Directors recognise the importance of governments and regulators as stakeholders. Not only are governments across the world customers but they also support the Group's investment in infrastructure and technology.

During 2023, the RRH Chair and the Chief Executive held meetings with ministers and senior officials on topics including the Atlantic Declaration, AUKUS and the SMR programme. Following the division of the BEIS Department, the Directors engaged with and briefed the new post-holders on the Group's strategy and performance. The Directors are updated on engagement with tax authorities and the related regulatory landscape. The General Counsel provides regular updates on compliance with regulation.

Investors

The investor relations team is the key interface with the investment community, providing frequent dialogue and feedback. The Chair of RRH and members of the RRH Board make themselves available to meet with institutional investors and seek to understand and prioritise the issues that matter most. In addition, the Directors and investor relations, interact regularly with investors, most notably after our financial results, capital markets events, site visits and at conferences.

In November 2023, the Group held its first CMD since the pandemic, at which the Chief Executive set out the progress of the transformation programme so far and shared with investors the results of the rigorous and detailed strategic review that had been carried out during 2023. The CMD was attended by more than 150 guests in person and broadcast live. The event included Executive Team presentations, investor Q&As and expo sessions highlighting the capabilities of the Group. Investor interest with the transformation programme has resulted in greater engagement with the Group during 2023.

Section 172 and stakeholder engagement *continued*

Section 172 and our transformation programme

With the transformation programme guiding decision making in 2023, the sections below set out how the Directors have discharged their s172 duty alongside Group-wide reform. The transformation programme seeks to realign the Group's values and purpose to create long-term business success and the Directors recognise that effective engagement with our stakeholders is essential to create value for them. The Directors acknowledge their responsibility to all the Group's different but interrelated stakeholder groups and wider society and recognise their role in shaping and supporting our transformation programme for the long term.

All our Directors are briefed on their Companies Act 2006 duties during their induction. The Directors have ensured their duties under s172 noted below have been considered with regards to the transformation programme:

- a. the likely consequences of any decision in the long term;
- b. the interests of the Company's employees;
- c. the need to foster the Company's business relationships with suppliers, customers and others;
- d. the impact of the Company's operations on the community and the environment;
- e. the desirability of the Company maintaining a reputation for high standards of business conduct; and
- f. the need to act fairly between members of the Company.

The following examples should be read in conjunction with our stakeholder engagement section above.

STRATEGIC REVIEW

In considering the strategic review, the Directors prioritised the long-term interests of all stakeholders. The Group's revised investment priority is to focus on profitable opportunities in new technologies where the Group is differentiated, where the market size is sufficiently large and where there is a good fit and synergy with the Group's existing activities. The decisions made will create enduring value for all stakeholders. Nonetheless, our people's safety together with product and customer safety remains the Group's core priority.

Customers	Environment	Partners
The Group's customers are seeking a solution integrated into a larger system more than just a product. The Group's advantaged manufacturing expertise allows for the production of complex parts to exceptionally high specifications with high performance and reliability. The Group is refocusing its portfolio choices into growing markets where the Group has a differentiated position, strong customer recognition and excellent technology. This allows us to effectively leverage our expertise into next generation technologies, including UltraFan and nuclear micro-reactors.	The Group is committed to becoming a net zero company by 2050 through pursuing lower carbon opportunities. We support our customers to do the same. Within our Civil Aerospace and Defence divisions, integrating sustainable fuels can deliver 80% reduction in carbon emissions compared to fossil fuels. Powering Virgin Atlantic's commercial transatlantic 100% SAF flight is evidence of this ambition. Variants of our major Power Systems engine platforms can run on sustainable fuels such as HVO. We see hydrogen as a future solution for power generation. SMRs and micro-reactors will be needed to decarbonise the grid.	In certain cases, the Group will pursue growth through partnerships to strengthen existing market positions and enter new markets. The RRH Board evaluates opportunities which will allow for a mutual exchange of new skills and capability, as well as a reduction in capital investment. Such partnerships could assist with a re-entry into the narrowbody market or development of battery energy storage systems, where we have transferable capabilities. Regarding Rolls-Royce SMR, the Group values its existing partners and welcomes new ones to assist in delivering the overall solution.

Section 172 and stakeholder engagement continued

EFFICIENCY AND SIMPLIFICATION

A detailed review of the organisational design of the Group has identified synergies that can be harnessed from the One Rolls-Royce approach. The opportunity is being taken to right-size its cost base to deliver sustainable cost efficiencies across the whole Group. As part of this drive for simplification, the Group has brought its core technological expertise together with the introduction of the Group-wide ET&S business capability which will ensure alignment of standards and compliance.

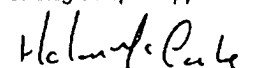
Employees	Suppliers
The Directors significantly increased Group-wide employee engagement during 2023. This included specific engagement following the decisions to reduce the number of roles across the Group by between 2,000 to 2,500 by the end of 2025 and an intention to exit Rolls-Royce Electrical. The Chief Executive held town halls throughout 2023. These were broadcast Groupwide and included live Q&A sessions allowing for direct conversations with the Directors and members of the Executive Team. More tailored sessions were held with individual members of the Executive Team, including inviting business groups across Germany to a One Rolls-Royce event in Berlin. The RRH Board has considered the interests of the Group's employees as part of the transformation programme. Pursuing One Rolls-Royce seeks to ensure a Group-wide winning culture which empowers our people. The revised organisational design will limit duplication of tasks and encourage employee upskilling.	The Group will significantly streamline how it works with suppliers. A Group-wide reorganisation of procurement processes and supplier management was initiated as part of the transformation programme. This seeks to consolidate Group spend, leverage scale and develop consistent best-in-class standards.

COMMERCIAL OPTIMISATION AND WORKING CAPITAL

The Group is bringing sharper commercial acumen and a more cost-conscious culture to everything it does. Working capital is also a key focus in order to strengthen our balance sheet and improve returns on invested capital. By conducting a deep-dive into the operational value chain and addressing working capital in its component parts, the Directors believe that there are sustainable improvements available. Building a profitable and sustainable business with a strong balance sheet will drive organisation-wide benefits, generate strong financial performance and create opportunities for all stakeholders.

Investors	Customers
Strengthening the balance sheet and achieving an investment grade credit profile through optimising working capital will deliver long-term benefits for our shareholders. Achieving this will enable the Group to better withstand volatility and external shocks and will provide greater financial flexibility in the future. Once the Group is confident this has been achieved, it is committed to reinstating and growing shareholder distributions. The transformation programme's focus on the most profitable growth activities will drive shareholder value.	Pursuing commercial optimisation means being rewarded by our customers for the value our products bring and the risks we take. Within Civil Aerospace, the Group is implementing a new value-driven pricing strategy and addressing onerous and low margin contracts. The Group is also driving rigour on contractual terms and conditions. In Defence, we have a focus on commercial optimisation and value pricing behaviours as we have in Civil Aerospace and we are prioritising investment in areas that benefit from increased customer funding.

Strategic Report approved by the Board on 20 March 2024 and signed on its behalf by:



Helen McCabe

Director

20 March 2024

DIRECTORS' REPORT

The Directors present their Directors' Report on the Rolls-Royce plc Group (the Group), together with the audited financial statements for the year ended 31 December 2023.

Directors

The Directors who held office during the year and up to the date of signing the Financial Statements were as follows:

Tufan Erginbilgic (appointed 1 January 2023)

Mark Gregory (appointed 1 March 2023)

Sarah Armstrong (appointed 1 March 2023)

Helen McCabe (appointed 4 August 2023)

Panos Kakoullis (resigned 4 August 2023)

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.

Dividends

The Directors do not recommend the payment of a dividend (2022: £nil).

Corporate governance

The Directors are responsible for the direction, management, performance and long-term sustainable success of the Company. The Board of RRH sets the Group's strategy and objectives and oversees and monitors internal controls, risk management, principal risks, governance and viability of the Group. It has established certain principal committees to assist in fulfilling its oversight responsibilities, providing dedicated focus on particular areas. RRH is subject to the principles and provisions of the UK Corporate Governance Code 2018 (the 'Code').

The Company operates in compliance with the Group's policies (including the diversity policy), procedures and governance framework. Details of RRH's compliance with the Code and the Group's policies, procedures and governance framework are set out in the RRH Annual Report 2023.

Risk management and internal control

The RRH Audit Committee oversees the Group's financial reporting, considering key accounting judgements and estimates; disclosures; compliance with regulations; and whether the Annual Report is fair, balanced and understandable. The RRH Audit Committee also monitors the effectiveness of the Group's risk management and internal control environment.

In addition, the RRH Audit Committee provides oversight in respect of the scope, resources, results, and effectiveness of internal audit. It is responsible for the relationship with, and the effectiveness of, the external auditors as well as approving their terms of engagement and fees.

Financial reporting

The Group has complex long-term contract accounting and every year the RRH Audit Committee spends much of its time reviewing the accounting policies and judgements implicit in the Group's financial results. In 2023, it considered the implications on our assumptions and key accounting judgements of the recovery in air travel globally, the improved financial performance of the Group and the Group-wide transformation programme, as well as changes in the global macro-economic and political environment.

The Directors have ensured that the disclosures in respect of all key areas of judgement are appropriate and balanced. They have continued to assess and consider the sensitivity of the estimates to changes in key assumptions which are summarised in note 1 of the Consolidated Financial Statements on page 53.

A summary of the principal matters considered by the RRH Audit Committee in respect of the 2023 Consolidated Financial Statements is set out below.

Area of focus	Considerations
Alternative Performance Measures (APMs)	As in previous years, the RRH Audit Committee reviewed the clarity of the definitions and the reconciliation of each APM to its statutory equivalent. The Committee concluded that there was no undue prominence of the APMs in the Annual Report. See page 160 for a reconciliation of APMs to their statutory equivalents. New KPIs were introduced during 2023, following the strategic review. The RRH Audit Committee challenged the calculation underpinning these KPIs to ensure the conclusions reached resulted in appropriate additional KPIs being disclosed.
Long-term contract accounting	The RRH Audit Committee considered the assessment of estimates of future revenue and costs on the Group's long-term contractual arrangements. This has continued to be a particular focus for the RRH Audit Committee due to the complex nature of long-term contract accounting, the recovery in air travel globally, the changing macro-economic conditions and the Group-wide transformation programme. As part of its considerations, it reviewed onerous contracts given their sensitivity to changes in revenue and cost assumptions. The RRH Audit Committee also reviewed catch-ups to understand the changes to revenue and cost assumptions driving them and looked at accounting for risk and revenue sharing arrangements. It reviewed the disclosures and concluded these, together with the assessments, were appropriate. See note 1 in the Consolidated Financial Statements.

Corporate Governance continued

Deferred tax assets	The RRH Audit Committee discussed the recoverability of deferred tax assets and the forecasts, assumptions and sensitivities applied in order to ascertain the recognition and recoverability of the deferred tax assets. It discussed the basis for the recognition of the UK deferred tax assets and considered the judgements and estimates necessary to assess the recoverability of the UK deferred tax assets. This was particularly important during 2023 due to the strategic review, the improved financial performance and the higher mid-term targets that have been communicated. The RRH Audit Committee considered this in light of the requirements set out in IAS 12 <i>Income Taxes</i> to assess probable profits when considering the recognition of the UK deferred tax assets. It confirmed the approach, which remained consistent with that taken in 2022, together with the disclosures set out in note 1 to the Consolidated Financial Statements.
Impact of climate change	The approach taken by management to assess the impact of climate change, the conclusions reached and the disclosures presented have been reviewed by the RRH Audit Committee, including considering the related TCFD recommendations. It received updates on the improving internal controls in relation to process and data and considered progress made with the Group's reporting. The RRH Audit Committee has ensured it understands and has continued to challenge the assumptions in the climate scenarios used by management to sensitise forecasts in respect of viability, long-term contract accounting, impairment assessments and deferred tax asset recognition. See note 1 in the Consolidated Financial Statements.
Accounting for complex treasury instruments	The RRH Audit Committee continued to consider numerous topics in relation to the Group's complex treasury instruments including the GBP:USD hedge book and associated hedge book rates and the long term planning rate used by management beyond the hedge book period. This included understanding and challenging management on the assumptions, the approach, the accounting and reporting.
Transformation programme: organisational design	The RRH Audit Committee considered the impact of the transformation programme, including the organisational design, on the assumptions and accounting judgements, and monitored whether the criteria required for a restructuring and transformation provision had been met.

Risk management and the internal control environment

Our risk management and internal control framework is described in the Principal Risks section on page 29. During the year, we focused on the effectiveness of risk controls and their assurance, ensuring actions to mitigate where needed and to manage risks in relation to our appetite for taking risk as described on page 30. We will continue to focus on embedding risk mitigation controls and risk appetite in 2024, embedding these more firmly as part of our routine processes and decision making, including in relation to strategic planning.

We also satisfied ourselves that the processes for identifying and managing risks are appropriate and that all principal risks and mitigating actions had been subject, during the year, to a detailed review by the Executive Team and the RRH Board or an appropriate RRH Board Committee. Based on this and on our other activities, including consideration of the work of internal and external audit and attendance at the RRH Board Committee meetings by divisional and functional risk owners, the RRH Board confirmed that a robust assessment of the principal risks and emerging risks facing the Group had been undertaken. Details of our principal risks are set out on pages 31 to 35. The RRH Board allocated certain principal risks to the RRH Audit Committee which considered these in detail throughout the year, as described below. From their discussions, they are satisfied that the principal risks that they oversee received appropriate management attention during 2023:

- Business continuity: the RRH Audit Committee received updates on the status of the continuity risk management of each business, including the risks to internal facilities and in the external supply chain, as well as an assessment of risk management effectiveness.
- Cyber: the RRH Audit Committee received updates on the status of cyber security risk, including lessons learnt from incidents and an assessment of risk management effectiveness. The cyber security strategy was kept under review during the year.
- Financial shock: the RRH Audit Committee has reviewed the Group's policies, procedures and controls for identifying, managing and mitigating financial shock. The Group is exposed to a number of financial risks, some of which are of a macro-economic nature (for example, foreign currency, oil price and interest rates) and some of which are more specific to the Group (for example, liquidity and credit risks).

Internal financial control

The RRH Audit Committee specifically reviews the Group's internal financial controls. During 2023, it reviewed the results of self-attestation and testing performed by the internal control and internal audit teams to confirm the effective operation of key financial controls across the Group. It monitored progress against the 2023 financial controls programme to strengthen the financial reporting and compliance controls. It confirmed completion of identified key activities. It also considered the external auditor's observations on the financial control environment.

Effectiveness of risk management and internal control systems

The RRH Audit Committee conducted a review of the effectiveness of the Group's risk management and internal control systems, including those relating to the financial reporting process. Where opportunities for improvement were identified, action plans have been put in place and progress is monitored by the RRH Audit Committee. In 2023, no significant weaknesses were identified.

Employment of disabled persons

We give full and fair consideration to all employment applications from people with disabilities. If an employee becomes disabled whilst working for us we take steps to support their continued working including, wherever possible, making adjustments to ways of working.

Employee engagement

Engagement is an outcome of our employee experience with a focus driven through our people leadership practices, purpose and performance culture. We believe that highly engaged colleagues fuel improved business outcomes. Engagement is one of our Group KPIs with continued links to leadership incentive plans (see page 15). Listening, understanding and acting on colleagues' questions and concerns is a critical aspect of our transformation journey. In 2023, our engagement grand mean was 3.99. We surpassed our Group target of 3.97, set in 2019 with our partner Gallup, and achieved a meaningful, consecutive increase of 0.14 since 2022 (0.47 since 2019). We also secured our highest participation rate of 80% with 32,544 colleagues completing the survey.

Employee engagement continued

We take a people first approach to listening, engagement and communication and believe our leaders play a vital role given the direct impact of their behaviour and actions on the people they lead. We provide data and insights to leaders through Gallup to enable them to work together with their teams on action plans and improvements. In 2023, we introduced new governance to monitor engagement across the Group. It enables better sharing of best practice where teams have made significant improvement as well as the ability to provide targeted learning to support the teams that need it most.

In addition to our survey, we provide a variety of channels for colleague engagement and listening, including interactive learning sessions, newsletters and team briefings as well as digital communication channels such as Viva Engage. Through our transformation programme we are introducing new ways to engage with colleagues and amplify employee voice. In 2023, we have held regular live town halls with Q&As hosted by our Chief Executive and Executive Team. Our global inclusion networks also play a key role in engagement and listening. Members of our networks have been invited to various leadership sessions this year and our Employee Champions have attended some of the network sessions to listen to what colleagues think about key topics.

In May 2023, the Group held another Meet the Board event continuing to foster engagement with Directors as well as encourage all colleagues to contribute and help co-create our transformation. Engaging colleagues to shape our future helps us to build a better and stronger business that everyone is proud of. We made CMD accessible for all colleagues to attend virtually and we held multiple local sessions to flow down key messages as well as creating new digital tools and resources to ensure that everyone had access to information on our new strategy and business plan.

Financial instruments and risk management

Details of financial instruments and risk management are set out in note 19 to the Consolidated Financial Statements.

Post balance sheet events

Details of important events affecting the Group which have occurred since the end of the financial year are set out in note 1 to the Consolidated Financial Statements.

Related party transactions

Details of related party transactions are set out in note 25 to the Consolidated Financial Statements.

Disclosures in the Strategic Report

The Directors have taken advantage of section 414C(11) of the Act to include disclosures in the Strategic Report including:

- the future development, performance and position of the Group;
- research and development activities; and
- engagement with suppliers, customers and others.

Disclosures in the Rolls-Royce Holdings plc Annual Report

The following disclosures are provided in the Company's ultimate parent entity annual report:

- greenhouse gas emissions (page 210 of RRH Annual Report 2023); and
- political donations (page 220 of RRH Annual Report 2023); and
- non-financial sustainability information statement (see page 32 of RRH Annual Report 2023).

Management report

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

Responsibility statements

Statement of Directors' responsibilities in respect of the Financial Statements

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

Company law requires the Directors to prepare financial statements for each financial year. Under that law, the Directors have prepared the Group Financial Statements in accordance with UK-adopted international accounting standards and the Company Financial Statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards, comprising FRS 101 Reduced Disclosure Framework and applicable law).

Under company law, Directors must not approve the Financial Statements unless they are satisfied that they give a true and fair view of the state of affairs of the Group and Company and of the profit or loss of the Group for that period. In preparing the financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- state whether applicable UK-adopted international accounting standards have been followed for the Group financial statements and United Kingdom Accounting Standards, comprising FRS 101 have been followed for the Company financial statements, subject to any material departures disclosed and explained in the financial statements;
- make judgements and accounting estimates that are reasonable and prudent; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Group and Company will continue in business.

The Directors are responsible for safeguarding the assets of the Group and the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities. The Directors are also responsible for keeping adequate accounting records that are sufficient to show and explain the Group's and the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Group and the Company and enable them to ensure that the financial statements and the Directors' Remuneration Report comply with the Companies Act 2006.

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

Directors' confirmations

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

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

- the Group financial statements, which have been prepared in accordance with UK-adopted international accounting standards, give a true and fair view of the assets, liabilities, financial position and profit of the Group;
- the Company financial statements, which have been prepared in accordance with United Kingdom Accounting Standards, comprising FRS 101, give a true and fair view of the assets, liabilities and financial position of the Company; and
- the Strategic Report includes a fair review of the development and performance of the business and the position of the Group and the Company, together with a description of the principal risks and uncertainties that it faces.

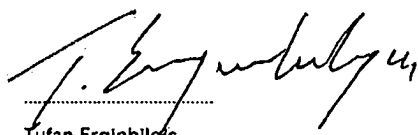
In the case of each Director in office at the date the Directors' Report is approved:

- so far as the Director is aware, there is no relevant audit information of which the Group's and Company's auditors are unaware; and
- they have taken all the steps that they ought to have taken as a Director in order to make themselves aware of any relevant audit information and to establish that the Group's and the Company's auditors are aware of that information.

Independent Auditors

The auditors, PriceWaterhouseCoopers LLP, have indicated their willingness to continue in office and a resolution for their re-appointment will be put to the 2024 annual general meeting.

Directors' Report approved by the Board on 20 March 2024 and signed on its behalf by:



Tufan Erginbilgic

Director

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CONSOLIDATED INCOME STATEMENT
For the year ended 31 December 2023

	Notes	2023 £m	2022 £m
Continuing operations			
Revenue	2	16,486	13,520
Cost of sales ¹		(12,866)	(10,763)
Gross profit	2	3,620	2,757
Commercial and administrative costs	2	(1,110)	(1,077)
Research and development costs	2, 3	(739)	(891)
Share of results of joint ventures and associates	11	173	48
Operating profit		1,944	837
Gain arising on disposal of businesses	26	119	81
Profit before financing and taxation		1,945	918
Financing income	4	1,183	355
Financing costs ²	4	(681)	(2,775)
Net financing income/(costs)		482	(2,420)
Profit/(loss) before taxation		2,427	(1,502)
Taxation	5	(23)	308
Profit/(loss) for the year from continuing operations		2,404	(1,194)
Discontinued operations			
Profit for the year from ordinary activities	26	—	68
Loss on disposal of discontinued operations	26	—	(148)
Loss for the year from discontinued operations		—	(80)
Profit/(loss) for the year		2,404	(1,274)
Attributable to:			
Ordinary shareholders		2,412	(1,269)
Non-controlling interests (NCI)		(8)	(5)
Profit/(loss) for the year		2,404	(1,274)
Other comprehensive (expense)/income		(171)	522
Total comprehensive income/(expense) for the year		2,233	(752)

1 Cost of sales includes a net release for expected credit losses (ECLs) of £48m (2022: charge of £73m). Further details can be found in note 13

2 Included within financing costs are fair value changes on derivative contracts. Further details can be found in notes 2, 4 and 19

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

For the year ended 31 December 2023

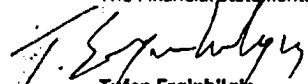
	Notes	2023 £m	2022 £m
Profit/(loss) for the year		2,404	(1,274)
Other comprehensive income/(expense) (OCI)			
Actuarial movements on post-retirement schemes	21	116	(156)
Revaluation to fair value of other investments	11	(4)	(4)
Share of OCI of joint ventures and associates	11	1	2
Related tax movements	5	(43)	89
Items that will not be reclassified to profit or loss		70	(69)
Foreign exchange translation differences on foreign operations		(228)	452
Foreign exchange translation differences reclassified to income statement on disposal of businesses	26	1	65
Hedging reserves reclassified to income statement on disposal of businesses		-	111
NCI disposed of on disposal of businesses		-	1
Movement on fair values charged to cash flow hedge reserve		(82)	(7)
Reclassified to income statement from cash flow hedge reserve		61	(55)
Costs of hedging		-	10
Share of OCI of joint ventures and associates	11	1	-
Related tax movements	5	4	14
Items that will be reclassified to profit or loss		(241)	591
Total other comprehensive (expense)/income		(171)	522
Total comprehensive income/(expense) for the year		2,233	(752)
Attributable to:			
Ordinary shareholders		2,241	(748)
NCI		(8)	(4)
Total comprehensive income/(expense) for the year		2,233	(752)
Total comprehensive income/(expense) for the year attributable to ordinary shareholders arises from:			
Continuing operations		2,241	(673)
Discontinued operations		-	(75)
Total comprehensive income/(expense) for the year attributable to ordinary shareholders		2,241	(748)

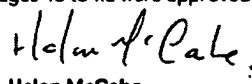
CONSOLIDATED BALANCE SHEET

As at 31 December 2023

	Notes	2023 £m	2022 £m
ASSETS			
Intangible assets	8	4,009	4,098
Property, plant and equipment	9	3,728	3,936
Right-of-use assets	10	905	1,061
Investments – joint ventures and associates	11	479	422
Investments – other	11	31	36
Other financial assets	19	360	542
Deferred tax assets	5	2,998	2,731
Post-retirement scheme surpluses	21	782	613
Non-current assets		13,292	13,439
Inventories	12	4,848	4,708
Trade receivables and other assets	13	8,460	7,271
Contract assets	14	1,242	1,481
Taxation recoverable		80	127
Other financial assets	19	34	141
Short-term investments	19		11
Cash and cash equivalents	15	3,784	2,607
Current assets		18,448	16,346
Assets held for sale	26	109	-
TOTAL ASSETS		31,849	29,785
LIABILITIES			
Borrowings and lease liabilities	16	(809)	(358)
Other financial liabilities	19	(425)	(992)
Trade payables and other liabilities	18	(6,896)	(6,983)
Contract liabilities	14	(6,098)	(4,825)
Current tax liabilities		(143)	(104)
Provisions for liabilities and charges	20	(532)	(632)
Current liabilities		(14,903)	(13,894)
Borrowings and lease liabilities	16	(4,950)	(5,597)
Other financial liabilities	19	(1,983)	(3,230)
Trade payables and other liabilities	18	(1,927)	(2,364)
Contract liabilities	14	(8,438)	(7,337)
Deferred tax liabilities	5	(330)	(286)
Provisions for liabilities and charges	20	(1,497)	(1,701)
Post-retirement scheme deficits	21	(1,035)	(1,033)
Non-current liabilities		(20,180)	(21,548)
Liabilities associated with assets held for sale	26	(55)	-
TOTAL LIABILITIES		(35,118)	(35,442)
NET LIABILITIES		(3,269)	(5,657)
EQUITY			
Called-up share capital	22	338	338
Share premium		631	631
Cash flow hedge reserve		12	26
Translation reserve		634	861
Accumulated losses		(4,936)	(7,547)
Equity attributable to ordinary shareholders		(3,321)	(5,691)
Non-controlling interest (NCI)		52	34
TOTAL EQUITY		(3,269)	(5,657)

The Financial Statements on pages 46 to 112 were approved by the Board on 20 March 2024 and signed on its behalf by:


Tufan Erginbilgic
 Chief Executive


Helen McCabe
 Chief Financial Officer

CONSOLIDATED CASH FLOW STATEMENT

For the year ended 31 December 2023

	Notes	2023 £m	Restated ¹ 2022 £m
Reconciliation of cash flows from operating activities			
Operating profit from continuing operations		1,944	837
Operating profit from discontinued operations	26	86	86
Operating profit		1,944	923
Loss on disposal of property, plant and equipment		18	18
Share of results of joint ventures and associates	11	(173)	(48)
Dividends received from joint ventures and associates	11	54	73
Amortisation and impairment of intangible assets	8	272	287
Depreciation and impairment of property, plant and equipment	9	423	430
Depreciation and impairment of right-of-use assets	10	334	287
Adjustment of amounts payable under residual value guarantees within lease liabilities	17	(10)	(3)
Impairment of and other movements on investments	11	75	75
Decrease in provisions		(325)	(197)
Increase in inventories		(200)	(887)
Movement in trade receivables/payables and other assets/liabilities		(1,348)	(58)
Movement in contract assets/liabilities		2,703	1,753
Cash flows on other financial assets and liabilities held for operating purposes ²		(845)	(660)
Cash flows on settlement of excess derivative contracts ^{1,3}		(389)	(326)
Interest received		159	36
Net defined benefit post-retirement cost recognised in profit before financing	21	41	27
Cash funding of defined benefit post-retirement schemes	21	(69)	(81)
Share-based payments	23	67	48
Net cash inflow from operating activities before taxation		2,658	1,697
Taxation paid		(172)	(174)
Net cash inflow from operating activities		2,486	1,523
Cash flows from investing activities			
Movement in other investments	11	1	(5)
Additions of intangible assets		(284)	(237)
Disposals of intangible assets	8	4	8
Purchases of property, plant and equipment		(429)	(359)
Disposals of property, plant and equipment		10	48
Acquisition of businesses		(14)	-
Disposal of businesses (including cash flows on disposals in prior periods)	26	(4)	1,398
Movement in investments in joint ventures and associates	11	(9)	(24)
Movement in short-term investments		11	(3)
Cash flows on other financial assets and liabilities held for non-operating purposes		(12)	-
Net cash (outflow)/inflow from investing activities		(726)	826
Cash flows from financing activities			
Repayment of loans		(1)	(2,024)
Proceeds from increase in loans		2	1
Capital element of lease payments		(291)	(218)
Net cash flow from decrease in borrowings and leases		(290)	(2,241)
Interest paid		(196)	(235)
Interest element of lease payments		(85)	(68)
Fees paid on undrawn facilities		(52)	(49)
Transactions with NCI ⁴		77	57
Dividends to NCI		(2)	(3)
Movement on balances with parent company		(2)	-
Net cash outflow from financing activities		(550)	(2,539)
Change in cash and cash equivalents		1,210	(190)
Cash and cash equivalents at 1 January		2,605	2,639
Exchange (losses)/gain on cash and cash equivalents		(84)	156
Cash and cash equivalents at 31 December ⁵		3,731	2,605

¹ The cash flow statement to 31 December 2022 has been represented as a result of a change in accounting policy to disclose cash flows on settlement of excess derivative contracts as cash flows from operating activities. As a result, there has been a decrease in cash flows from operating activities during the year to 31 December 2022 from £1,849m to £1,523m and a decrease in cash outflow from financing activities from £(2,865)m to £(2,539)m. There is no impact to the total change in cash and cash equivalents or to any alternative performance measures. See note 1 for further detail.

² Predominately relates to cash settled on derivative contracts held for operating purposes.

³ In 2020, the Group experienced a significant decline in its medium-term outlook and consequently a significant deterioration to its forecast net USD cash inflows. The Group took action to reduce the size of the USD hedge book by \$11.8bn across 2020-2026 to reflect the fact that at that time, future operating cash flows were no longer forecast to materialise. To achieve the necessary reduction in the hedge book, a separate and distinct set of foreign exchange derivative instruments were entered into to buy \$11.8bn. The associated cash outflow of these transactions is £1,674m and occurs over the period 2020-2026. This action had the impact of fixing the fair value of the over-hedged position and provided certainty over when the cash flows to settle the position would occur in future periods. During the year, the Group incurred a cash outflow of £389m (2022: £326m) and estimates that future cash outflows of £146m will be incurred in 2024 and £175m spread over 2025 and 2026.

⁴ Relates to NCI investment received in the year, in respect of Rolls-Royce SMR Limited.

⁵ The Group considers overdrafts (repayable on demand) and cash held for sale to be an integral part of its cash management activities and these are included in cash and cash equivalents for the purposes of the cash flow statement.

CONSOLIDATED CASH FLOW STATEMENT

For the year ended 31 December 2023

In deriving the consolidated cash flow statement, movement in balance sheet items have been adjusted for non-cash items. The cash flow in the year includes the sale of goods and services to joint ventures and associates – see note 25.

	2023 £m	2022 £m
Reconciliation of movements in cash and cash equivalents to movements in net debt		
Change in cash and cash equivalents	1,210	(190)
Cash flow from decrease in borrowings and leases	290	2,241
Cash flow from (decrease)/increase in short-term investments	(11)	3
Change in net debt resulting from cash flows	1,489	2,054
New leases and other non-cash adjustments on borrowings and lease liabilities	(191)	(170)
Exchange gains/(losses) on net debt	57	(150)
Fair value adjustments	7	70
Debt disposed of on disposal of businesses	-	53
Movement in net debt	1,362	1,857
Net debt at 1 January	(3,337)	(5,194)
Net debt at 31 December excluding the fair value of swaps	(1,975)	(3,337)
Fair value of swaps hedging fixed rate borrowings	23	86
Net debt at 31 December	(1,952)	(3,251)

CONSOLIDATED CASH FLOW STATEMENT CONTINUED

For the year ended 31 December 2023

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

	At 1 January £m	Funds flow £m	Net debt on disposal £m	Exchange differences £m	Fair value adjustments £m	Reclassifications £m	Other movements £m	At 31 December £m
2023								
Cash at bank and in hand	847	(79)	-	(29)	-	-	-	739
Money market funds	34	1,043	-	-	-	-	-	1,077
Short-term deposits	1,726	297	-	(55)	-	-	-	1,968
Cash and cash equivalents (per balance sheet)	2,607	1,261	-	(84)	-	-	-	3,784
Overdrafts	(2)	(51)	-	-	-	-	-	(53)
Cash and cash equivalents (per cash flow statement)	2,605	1,210	-	(84)	-	-	-	3,731
Short-term investments	11	(11)	-	-	-	-	-	-
Other current borrowings	(1)	(1)	-	-	(13)	(462)	(1)	(478)
Non-current borrowings	(4,105)	-	-	59	20	462	(4)	(3,568)
Lease liabilities	(1,847)	291	-	82	-	-	(186)	(1,660)
Financial liabilities	(5,953)	290	-	141	7	-	(191)	(5,706)
Net debt excluding the fair value of swaps	(3,337)	1,489	-	57	7	-	(191)	(1,975)
Fair value swaps hedging fixed rate borrowings ¹	86	-	-	(59)	(4)	-	-	23
Net debt	(3,251)	1,489	-	(2)	3	-	(191)	(1,952)
2022								
Cash at bank and in hand	795	17	-	35	-	-	-	847
Money market funds	49	(15)	-	-	-	-	-	34
Short-term deposits	1,777	(171)	-	120	-	-	-	1,726
Cash and cash equivalents (per balance sheet)	2,621	(169)	-	155	-	-	-	2,607
Cash and cash equivalents included within assets held for sale	25	(26)	-	1	-	-	-	-
Overdrafts	(7)	5	-	-	-	-	-	(2)
Cash and cash equivalents (per cash flow statement)	2,639	(190)	-	156	-	-	-	2,605
Short-term investments	8	3	-	-	-	-	-	11
Other current borrowings	(2)	2	-	(1)	-	-	-	(1)
Non-current borrowings	(6,023)	2,000	-	(125)	72	-	(29)	(4,105)
Borrowings included within liabilities held for sale	(59)	21	40	-	(2)	-	-	-
Lease liabilities	(1,744)	217	-	(179)	-	-	(141)	(1,847)
Lease liabilities included within liabilities held for sale	(13)	1	13	(1)	-	-	-	-
Financial liabilities	(7,841)	2,241	53	(306)	70	-	(170)	(5,953)
Net debt excluding fair value swaps	(5,194)	2,054	53	(150)	70	-	(170)	(3,337)
Fair value swaps hedging fixed rate borrowings ¹	37	-	-	125	(76)	-	-	86
Net debt	(5,157)	2,054	53	(25)	(6)	-	(170)	(3,251)

¹ Fair value of swaps hedging fixed rate borrowings reflects the impact of derivatives on repayments of the principal amount of debt. Net debt therefore includes the fair value of derivatives included in fair value hedges (2023: £34m, 2022: £38m) and the element of fair value relating to exchange differences on the underlying principal of derivatives in cash flow hedges (2023: £11m, 2022: £48m)

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December 2023

The following describes the nature and purpose of each reserve within equity:

Share capital – The nominal value of ordinary shares of 20p each in issue.**Share premium** – Proceeds received in excess of the nominal value of ordinary shares issued, less the costs of issue.**Hedging reserves** – Cumulative gains and losses on hedging instruments deemed effective in cash flow hedges and cost of hedging reserve.**Merger reserve** – The premium on issuing shares to acquire a business where merger relief in accordance with the Companies Act 2006 applies.**Translation reserve** – Gains and losses arising on retranslating the net assets of overseas operations into sterling.**Accumulated losses** – All other net gains and losses and transactions with owners not recognised elsewhere and ordinary shares held for the purpose of share-based payment plans.**Non-controlling interests** – The share of net assets or liabilities of subsidiaries held by third parties.

	Notes	Attributable to ordinary shareholders						Total	NCI	Total equity
		Share capital £m	Share premium £m	Cash flow hedging reserves ¹ £m	Merger reserve £m	Translation reserve £m	Accumulated losses £m			
At 1 January 2023		17,338	631	26	–	861	(7,547)	(5,691)	34	(5,657)
Profit/(loss) for the year		–	–	–	–	–	2,412	2,412	(8)	2,404
Foreign exchange translation differences on foreign operations		–	–	–	–	(226)	–	(226)	–	(226)
Foreign exchange translation differences reclassified to income statement on disposal of businesses	21	–	–	–	–	–	–	–	–	–
Actuarial movements on post-retirement schemes		–	–	–	–	–	116	116	–	116
Fair value movement on cash flow hedges		–	–	(82)	–	–	–	(82)	–	(82)
Reclassified to income statement from cash flow hedge reserve		–	–	61	–	–	–	61	–	61
Revaluation to fair value of other investments	11	–	–	–	–	–	(4)	(4)	–	(4)
OCI of joint ventures and associates	11	–	–	–	–	(1)	–	–	–	–
Related tax movements	5	–	–	–	–	(1)	(43)	(39)	–	(39)
Total comprehensive (expense)/income for the year		–	–	(14)	–	(227)	2,482	2,241	(8)	2,233
Share-based payments – direct to equity ²		–	–	–	–	–	50	50	–	50
Dividends to NCI		–	–	–	–	–	–	–	(2)	(2)
Transactions with NCI ³		–	–	–	–	–	57	57	28	85
Related tax movements	5	–	–	–	–	–	22	22	–	22
Other changes in equity in the year		–	–	–	–	–	129	129	26	155
At 31 December 2023		338	631	12	–	834	(4,938)	(3,321)	52	(3,269)
At 1 January 2022		338	631	(45)	650	342	(6,949)	(5,033)	26	(5,007)
Loss for the year		–	–	–	–	–	(1,269)	(1,269)	(5)	(1,274)
Foreign exchange translation differences on foreign operations		–	–	–	–	452	–	452	–	452
Hedging reserves reclassified to income statement on disposal of businesses		–	–	111	–	–	–	111	–	111
Foreign exchange translation differences reclassified to income statement on disposal of businesses		–	–	–	–	65	–	65	–	65
NCI disposed of on disposal of businesses		–	–	–	–	–	–	–	1	1
Actuarial movements on post-retirement schemes	21	–	–	–	–	–	(156)	(156)	–	(156)
Movement on fair value of cash flow hedges		–	–	(7)	–	–	–	(7)	–	(7)
Reclassified to income statement from cash flow hedge reserve		–	–	(55)	–	–	–	(55)	–	(55)
Cost of hedging		–	–	10	–	–	–	10	–	10
Revaluation to fair value of other investments	11	–	–	–	–	–	(4)	(4)	–	(4)
OCI of joint ventures and associates	11	–	–	–	–	–	2	2	–	2
Related tax movements	5	–	–	12	–	2	89	103	–	103
Total comprehensive income/(expense) for the year		–	–	71	–	519	(1,338)	(748)	(4)	(752)
Share-based payments – direct to equity ²		–	–	–	–	–	47	47	–	47
Dividends to NCI		–	–	–	–	–	–	–	(3)	(3)
Transactions with NCI ³		–	–	–	–	–	42	42	15	57
NCI on formation of subsidiary		–	–	–	–	–	–	–	–	–
Transfer to realised profit ⁴		–	–	–	(650)	–	650	–	–	–
Related tax movements	5	–	–	–	–	–	1	1	–	1
Other changes in equity in the year		–	–	–	(650)	–	740	90	12	102
At 31 December 2022		338	631	26	–	861	(7,547)	(5,691)	34	(5,657)

¹ Hedging reserves includes the cash flow hedge reserve of £12m and the cost of the hedging reserve of £nil (31 December 2022; £26m and £nil respectively)² Share-based payments – direct to equity is the share-based payment charge for the year less actual cost of vesting excluding those vesting from own shares and cash received on share-based schemes vesting³ Relates to NCI investment received in the year in respect of Rolls-Royce SMR Limited⁴ On disposal of ITP Aero on 15 September 2022, the premium recognised on issue of shares for the previous acquisition became realised on receipt of qualifying consideration. As such, the total merger reserve has been transferred to accumulated losses

1 Accounting policies

The Company and the Group

Rolls-Royce plc (the 'Company') is a public company limited by shares incorporated under the Companies Act 2006 and domiciled in England in the United Kingdom. The Consolidated Financial Statements of the Company for the year ended 31 December 2023 consist of the audited consolidation of the Financial Statements of the Company and its subsidiaries (together referred to as the Group) together with the Group's interest in jointly controlled and associated entities.

Basis of preparation and statement of compliance

The Company has elected to prepare its Individual Company Financial Statements under FRS 101 *Reduced Disclosure Framework*. They are set out on pages 113 to 141 with the associated accounting policies from page 115.

The Consolidated Financial Statements have been prepared in accordance with UK adopted International Accounting Standards (IAS) in conformity with the requirements of Companies Act 2006 and Interpretations issued by the IFRS Interpretations Committee (IFRS IC) applicable to companies reporting under UK adopted IFRS.

The Consolidated Financial Statements have been prepared on a going concern basis as described on page 36. The historical cost basis has been used except where IFRS require the revaluation of financial instruments to fair value and certain other assets and liabilities on an alternative basis, most significantly post-retirement scheme obligations are valued on the basis required by IAS 19 *Employee Benefits*.

The Consolidated Financial Statements are presented in sterling which is the Company's functional currency.

The preparation of the Consolidated Financial Statements requires management to make judgements and estimates that affect the statutory amounts of assets and liabilities at the date of the Consolidated Financial Statements and the statutory amounts of revenue and expenses during the reporting period. Actual future outcomes could differ from those estimates.

Going concern

The Directors have undertaken a comprehensive going concern review. In adopting the going concern basis for preparing the consolidated and Company Financial Statements, the Directors have undertaken a review of the Group's cash flow forecasts and available liquidity, along with consideration of the possible risks and uncertainties over an 18-month period from the date of this report to August 2025. The Directors have determined that an 18-month period is an appropriate timeframe over which to assess going concern as it considers the Group's short- to medium-term cash flow forecasts and available liquidity.

Recognising the challenges of reliably estimating and forecasting the impact of external factors on the Group, the Directors have considered two forecasts in the assessment of going concern, along with a likelihood assessment of these forecasts:

- the base case forecast, which reflects the Directors' current expectations of future trading; and
- a stressed downside forecast, which has also been modelled and envisages a 'stressed' or 'downside' situation that is considered severe but plausible.

Further details are given in the going concern review on page 36. After reviewing the current liquidity position and the cash flow forecasts modelled under both the base case and stressed downside, the Directors consider that the Group has sufficient liquidity to continue in operational existence for a period of at least 18 months from the date of this report and are therefore satisfied that it is appropriate to adopt the going concern basis of accounting in preparing the financial statements.

Climate change

In preparing the Consolidated Financial Statements the Directors have considered the potential impact of climate change, particularly in the context of the disclosures included in the Strategic Report within the 2023 Rolls-Royce Holdings plc Annual Report. The Group's climate strategy is to respond to the climate challenge by:

- decarbonising its operations, facilities and business activities. This will be met through continued investment in onsite renewable energy installations; the procurement of renewable energy; and continued investment in energy efficiency improvements to reduce the Group's overall energy demands and operating costs. An estimate of the investment required to meet these scope 1 and 2 emission improvements is included in the forecasts that support these Consolidated Financial Statements;
- enabling customers to operate their products in a way that is compatible with low or net zero carbon emissions. To accelerate this, the Group has demonstrated that all the commercial aero engines it produces, and the most popular reciprocating engines (that represent 80% of the Power Systems product portfolio) are compatible for use on sustainable fuels. The Group is also working with its armed forces customers to achieve the same for the engines they use from Defence;
- delivering new products and solutions that can accelerate the global energy transition, including investment in battery energy storage solutions in Power Systems, and in small modular reactors (SMRs). In the year, R&D costs of £137m (2022: £108m) within New Markets included investment to ready the SMR to progress through the Great British Nuclear SMR technology selection process and the second stage of the design assessment process. Future investment required to deliver these technologies is included in the forecasts that support the Consolidated Financial Statements; and by
- creating the necessary enabling environment, with public and policy support, to achieve our collective climate goals, through actively engaging with policy makers, regulators and others to advocate for the necessary policy and economic support we have identified.

1 Accounting policies *continued*

Climate change (continued)

The climate change scenarios previously prepared to assess the Group's strategic planning and its approach to managing climate related risk have continued to develop over the last year. The scenarios are used to assess how each of them impacts: the life of assets; future revenue projections; future profitability; and whether additional costs may occur. There remains inherent uncertainty around the quantification of the scenarios and how they will impact the Group. The Directors assess the assumptions on a regular basis to ensure that they are consistent with the risk management activities and the commitments made to investors and other stakeholders.

Based on the Taskforce for Climate-related Financial Disclosures (TCFD) recommendations set out in the Strategic Report within the 2023 Rolls-Royce Holdings plc Annual Report, the Group assesses the potential impact of climate-related transition and physical risks and opportunities. The Group has identified four key transition risks (relating to customer demand, cost due to carbon pricing, cost due to commodity pricing and changing investments needs) and three key physical risks (relating to facility disruption, supply chain disruption and impact on product performance) which may arise from the energy transition. The transition risks are the most likely to have an impact on the Consolidated Financial Statements, as exposure to physical risks will be greater in the longer-term.

The key sources of estimation uncertainty at the balance sheet date are set out on page 57 and the Directors have considered the impact of climate change on those estimates. The key assumptions used in this assessment are consistent with those used in the climate. A summary of the assessment is set out below.

Risk	How reflected in the Financial Statements	Impact on LTSA revenue recognition and provisions	Impact on impairment of non-financial assets	Impact on UK deferred tax asset utilisation
Changing customer demand	Overall forecast demand is expected to be robust in each scenario, although product mix may change with customer requirements.	Forecast EFH are based on customer and market data and therefore already include the latest expectation of the impact of climate change on demand. A sensitivity disclosing the impact of a 1% change in EFH forecasts over the remaining term of Civil LTSA contracts is disclosed on page 60.	Given the level of headroom in the programme intangible assets and Rolls-Royce Power Systems and Rolls-Royce Deutschland goodwill, the potential impact of a change in customer demand does not indicate any potential impact.	Forecast EFH are based on customer and market data and therefore include the latest expectation of the impact of climate change on demand. A sensitivity disclosing the impact of a 5% change in margin or shop visits is disclosed on page 61.
Changes in costs due to carbon pricing ¹ and commodity price changes ²	The potential impact of carbon pricing has been estimated by applying carbon prices to the forecast emissions generated by the Group and its supply chain. This impact, together with that from estimated commodity prices under each scenario, have been added/deducted to forecast costs in the base forecasts. The analysis reflects that: decarbonisation activities will occur in both the Group and its supply chain; and that some supplier contracts offer protection from cost increases in the short- to medium-term where pricing is fixed or subject to capped escalation clauses.	The increase in the cost base of the current Civil LTSA contracts due to carbon and commodity prices is estimated to be around 1% (2022: 1%) with the incremental cost included in the cost to complete estimates that drive revenue recognition. Changes in estimates have not had a significant impact on revenue catch-ups or contract loss provisions in the year (2022: not material). A sensitivity disclosing the impact of a 2% change in shop visit costs over the remaining term of Civil LTSA contracts is disclosed on page 60.	Given the level of headroom in the programme intangible assets and Rolls-Royce Power Systems and Rolls-Royce Deutschland goodwill, the potential impact of the cost increased in the scenarios does not indicate any potential impact. The assessment has considered each of the Group's <1.5oC, 1.7oC and 3.5oC scenarios.	The forecast of probable future taxable profits reflects the increase in the cost base that could arise from carbon and commodity prices consistent with the methodology applied for Civil Aerospace LTSA. Disclosed on page 61 is the impact of changing the proportion of cost increases that can be passed onto customers following the expiry of existing LTSAs.
1 Based on the IEA Net Zero by 2050 scenario (\$60 per tonne of carbon in 2023 to \$250 in 2050).				
2 Commodity prices from the Oxford Economics Global Climate Service and Databank				
Change in investment requirement	Changing investment requirements may arise due to the introduction /acceleration of new technologies. Research is expensed and development costs capitalised as incurred.	No impact to existing LTSAs.	Impairment tests are either performed on a value in use basis and the investment associated with new products is required to be excluded; or have sufficient headroom such that the estimated investment requirement is not significant.	Given the UK deferred tax asset recoverability is largely dependent on Civil and Defence aerospace markets, the increase in research and development expenditure required under this scenario does not have a material impact.

1 Accounting policies *continued*

Climate change (continued)

Items that may be impacted by climate-related risks, but which are not considered to be key areas of judgement or sources of estimation uncertainty in the current financial year are outlined below.

Useful lives of assets – The useful lives of property, plant and equipment and right-of-use assets could be reduced by climate-related matters, for example, as a result of physical risks, obsolescence or legal restrictions. The change in useful lives would have a direct impact on the amount of depreciation or amortisation recognised each year from the date of reassessment. The Directors' review of useful lives has taken into consideration the impacts of the Group's decarbonisation strategy (including the remaining useful life of assets that might be incompatible with the Group's commitment to decarbonise its facilities and considering the Group's physical risk assessment) and has not had a material impact on the results for the year. The Directors have also considered the remaining useful economic lives of material intangible assets, including the £1,920m and £238m capitalised development spend associated with the Trent and business aviation programmes disclosed in note 8. Given the measures the Group is taking, including demonstration that all the commercial aero-engines and 80% of the portfolio in Power Systems are compatible with SAF, the Directors judge that no adjustment is required to the useful economic lives.

Inventory valuation – Climate-related matters may affect the value of inventories as a result of a decline in selling prices or they could become obsolete due to a reduction in demand. After consideration of the typical stock-turns of the inventory in relation to the rate of change in the market the Directors consider that inventory is appropriately valued.

Recoverability of trade receivables and contract assets – The impact of climate-related matters could have an impact on the Group's customers in the future, especially those customers in the Civil Aerospace division. No material climate-related issues have arisen during the year that have impacted the assessment of the recoverability of receivables. The Group's expected credit loss (ECL) provision uses credit ratings which inherently will include the market's assessment of the climate change impact on credit risk of the counter parties. Given the maturity time of trade receivables and the majority of contract assets, climate change is unlikely to cause a material increase on counter party credit risk in that time.

Shore-based payment – A number of remuneration packages have included sustainability metrics. We are committed to reaching net zero carbon emissions by 2050, short-term targets were announced to help accelerate progress against this goal. These targets formed part of the Group's remuneration policy and at the end of 2023 these targets had been met, with the charge to the income statement reflecting this. A new Remuneration Policy is to be considered by shareholders at the AGM in May 2024.

Defined benefit pension plans – Climate-related risks could influence the performance of the invested assets and affect the financial position of defined benefit pension plans. As a result, this could have implications on the expected return on plan assets and measurement of defined benefit liabilities in future years. The Trustee of the Rolls-Royce UK Pension Fund (RRUKPF) meets the UK climate-related regulatory requirements. When making decisions about the plan, its analysis is carried out in a way consistent with TCFD. The Trustee has set a target for the plan asset portfolio to be net zero by 2050. Having assessed the risks and opportunities of climate change and considered the nature of the assets of the fund, climate change is unlikely to have a material impact on the position in the Consolidated Financial Statements.

Going concern – Given the short-term nature of the Group's going concern assessment, the impact of climate change does not have a significant impact. The Directors have considered the level of liquidity available, and the potential impact of the climate change risks, in making their assessment.

Presentation of underlying results

The Group measures financial performance on an underlying basis and discloses this information as an alternative performance measure (APM). This is consistent with the way that financial performance is measured by the Directors and reported to the Board in accordance with IFRS 8 *Operating Segments*. The Group believes this is the most appropriate basis to measure the in-year performance, as underlying results reflect the substance of trading activity, including the impact of the Group's foreign exchange forward contracts, which economically hedge net foreign currency cash flows at predetermined exchange rates. In addition, underlying results exclude the accounting impact of acquisition accounting and business disposals, impairment charges where the reasons are outside of normal operating activities, exceptional items, and certain other items which are market driven and outside of the control of management. Further details are given in note 2. A reconciliation of APMs to the statutory equivalent is provided on pages 160 to 164.

Revision to IFRS applicable in 2023

IFRS 17 Insurance Contracts

IFRS 17 issued in May 2018, establishes the principles for the recognition, measurement, presentation and disclosure of insurance contracts within the scope of the Standard. The Standard is effective for years beginning on or after 1 January 2023 with a requirement to restate comparatives.

The Group has reviewed whether its arrangements meet the accounting definition of an insurance contract. While some contracts, including Civil Aerospace LTSAs, may transfer an element of insurance risk, they relate to warranty and service type agreements that are issued in connection with the Group's sales of its goods or services and therefore will remain accounted for under the existing revenue and provisions standards. The Directors have judged that such arrangements entered into after the original equipment sale remain sufficiently related to the sale of the Group's goods and services to allow the contracts to continue to be measured under IFRS 15 *Revenue from Contracts with Customers* and IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

1 Accounting policies *continued*

Revision to IFRS applicable in 2023 (continued)

The Group has identified that the Standard will impact the results of its captive insurance company as it issues insurance contracts, however since the contracts insure other group companies, there is no impact on the Consolidated Financial Statements.

The Group has assessed that its parent company guarantee arrangements in the form of financial or performance guarantees, that meet the IFRS 17 definition of insurance contracts, have no impact on the Consolidated Financial Statements of the Group for the year to 31 December 2023, whilst there could be an impact on individual sets of financial statements of companies within the Group.

The Directors are not aware of any other contracts where IFRS 17 would have an impact on the Consolidated Financial Statements.

Other

IAS 12 *Income Taxes* has been amended to incorporate the following revisions for 'Deferred Tax related to Assets and Liabilities arising from a Single Transaction' and 'International Tax Reform: Pillar Two Model Rules'. There is no material impact on the Group as a result of the amendments relating to Deferred Tax related to Assets and Liabilities arising from a Single Transaction.

The Group is within the scope of the OECD Pillar Two (Global Minimum Tax) model rules. The legislation has been substantively enacted in some of the jurisdictions in which the Group operates including the UK and will be effective from 1 January 2024. Further information can be found in note 5.

There are no other new standards or interpretations issued by the IASB that had a significant impact on the Consolidated Financial Statements.

Change in accounting policy

At 31 December 2023, cash flows on settlement of excess derivatives have been reclassified from cash flows from financing activities to cash flows from operating activities in the cash flow statement as a result of a change in accounting policy. In line with the IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, a change in accounting policy can be made either where it is required by an IFRS or results in the financial statements providing reliable and more relevant information about the effects of transactions, other events or conditions on the entity's financial position, performance or cash flows.

The previous classification as cash flows from financing activities was based on the Directors' judgement of the economic nature of the activities as the cash flows relate to cash payments deferred in connection with the Group's action taken in 2020 to reduce the size of the USD hedge book by \$11.8bn across 2020 to 2026. The Directors have reassessed their judgement in line with IAS 7 *Statement of Cash Flows* and have concluded that it would be more appropriate to classify these cash flows as cash flows from operating activities.

As a result of the above, cash flows from operating activities during the year to 31 December 2022 has reduced by £(326)m to £1,523m with a corresponding decrease in cash flows from financing activities from £(2,865)m to £(2,539)m. There is no impact to the total change in cash and cash equivalents or to any alternative performance measures.

The above change resulted from a review which was prompted by an enquiry arising from a review of the Rolls-Royce Holdings plc 2022 Annual Report and Accounts by the Corporate Reporting Review team of the Financial Reporting Council (FRC). The FRC review was part of a regular review and assessment of the quality of corporate reporting in the UK undertaken by the FRC. Further information regarding the review of the Rolls-Royce Holdings plc 2022 Annual Report and Accounts is set out in the Audit Committee report on page 80 of Rolls-Royce Holdings plc 2023 Annual Report. The Group agreed to make the above change within its 2023 Annual Report and Accounts.

The FRC review was limited to the published 2022 Annual Report; it did not benefit from a detailed understanding of underlying transactions and provides no assurance that the 2022 Annual Report is correct in all material respects.

Key areas of judgement and sources of estimation uncertainty

The determination of the Group's accounting policies requires judgement. The subsequent application of these policies requires estimates, and the actual outcome may differ from that calculated. The key judgements and key sources of estimation uncertainty at the balance sheet date, that have a significant risk of causing material adjustment to the carrying amounts of assets and liabilities within the next financial year, are summarised below. Further details, together with sensitivities for key sources of estimation uncertainty where appropriate and practicable, are included within the significant accounting policies section of this note.

1 Accounting policies continued**Key areas of judgement and sources of estimation uncertainty (continued)**

Area	Key judgements	Key sources of estimation uncertainty	Page
Revenue recognition and contract assets and liabilities	– Whether Civil Aerospace OE and aftermarket contracts should be combined. – How performance on long-term aftermarket contracts should be measured. – Whether long-term aftermarket contracts contain a significant financing component. – Whether any costs should be treated as wastage. – Whether the Civil Aerospace LTSA contracts are warranty style contracts entered into in connection with OE sales and therefore can be accounted for under IFRS 15. – Whether sales of spare engines to joint ventures are at fair value. – When revenue should be recognised in relation to spare engine sales.	– Estimates of future revenue including customer pricing, and costs of long-term contractual arrangements, including the impact of climate change.	59
Risk and revenue sharing arrangements	– Determination of the nature of entry fees received.		60
Taxation		– Estimates necessary to assess whether it is probable that sufficient suitable taxable profits will arise in the UK to utilise the deferred tax assets recognised.	61
Research and development	– Determination of the point in time where costs incurred on an internal programme development meet the criteria for capitalisation. – Determination of the basis for amortising capitalised development costs.		63
Leases	– Determination of the lease term.		64
Impairment of non-current assets	– Determination of cash-generating units for assessing impairment of goodwill. – Whether there are indicators of potential reversal of previous impairments of programme-related intangible assets.		65
Provisions	– Whether any costs should be treated as wastage. – Whether the criteria to recognise transformation and restructuring provisions have been met.	– Estimates of the time to incorporate a modified and certified high-pressure turbine (HPT) blade into the fleet to resolve technical issues on the Trent 1000, and the implications of this on forecast future costs when assessing onerous contracts. – Estimates of the future revenues and costs to fulfil onerous contracts. – Assumptions implicit within the calculation of discount rates.	66
Post-retirement benefits		– Estimates of the assumptions for valuing the net defined benefit obligation.	67

Material accounting policies

The Group's significant accounting policies are set out on pages 58 to 67. These accounting policies have been applied consistently to all periods presented in these Consolidated Financial Statements.

1 Accounting policies *continued*

Basis of consolidation

The Consolidated Financial Statements include the Company Financial Statements and its subsidiary undertakings together with the Group's share of the results in joint arrangements and associates made up to 31 December.

A subsidiary is an entity controlled by the Company. Control exists when the Company has power over an entity, exposure to variable returns from its involvement with an entity and the ability to use its power over an entity so as to affect the Company's returns. Subsidiaries are consolidated in accordance with IFRS 10 *Consolidated Financial Statements*.

A joint arrangement is an entity in which the Group holds a long-term interest and which is jointly controlled by the Group and one or more other investors under a contractual arrangement. Joint arrangements may be either joint ventures or joint operations. Joint ventures are accounted for using the equity method of accounting and joint operations are accounted for using proportionate accounting.

An associate is an entity that is neither a subsidiary nor a joint arrangement, in which the Group holds a long-term interest and where the Group has a significant influence. The results of associates are accounted for using the equity method of accounting.

All intra-group transactions, balances, income and expenses are eliminated on consolidation. Adjustments are made to eliminate the profit or loss arising on transactions with joint arrangements and associates to the extent of the Group's interest in the entity. Transactions with non-controlling interests are recorded directly in equity.

Any subsidiary undertaking, joint arrangement or associate sold or acquired during the year are included up to, or from, the date of change of control. Details of transactions in the year are set out in note 25.

Revenue recognition and contract assets and liabilities

Revenue recognised comprises sales to the Group's customers after discounts and amounts payable to customers. Revenue excludes value added taxes. The transaction price of a contract is typically clearly stated within the contract, although the absolute amount may be dependent on escalation indices and long-term contracts that require the key estimates highlighted below to be made. Refund liabilities, where sales are made to customers with a right of return, are not typical in the Group's contracts. Where they do exist, and consideration has been received, a portion based on an assessment of the expected refund liability is recognised within other payables. The Group has elected to use the practical expedient not to adjust revenue for the effect of financing components where the expectation is that the period between the transfer of goods and services to customers and the receipt of payment is less than a year. Consideration is received in the form of deposits and payments for completion of milestones or performance obligations. LTSA cash receipts are typically received based on EFHs.

Sales of standard OE, spare parts and time and material (T&M) overhaul services are generally recognised on transfer of control to the customer. This is generally on delivery to the customer, unless the specific contractual terms indicate a different point. The Directors consider whether there is a need to constrain the amount of revenue to be recognised on delivery based on the contractual position and any relevant facts, however, this is not typically required.

Sales of OE and services that are specifically designed for the contract (most significantly in the Defence division) are recognised by reference to the progress towards completion of the performance obligation, using the cost method described in the key judgements, provided the outcome of contracts can be assessed with reasonable certainty.

The Group generates a significant portion of its revenue on aftermarket arrangements arising from the installed OE fleet. As a consequence, in particular in the Civil Aerospace large engine business, the Group will often agree contractual prices for OE deliveries that take into account the anticipated aftermarket arrangements. Sometimes this may result in losses being incurred on OE. As described in the key judgements, these contracts are not combined. The consideration in the OE contract is therefore allocated to OE performance obligations and the consideration in the aftermarket contract to aftermarket performance obligations.

Key areas of the accounting policy are:

- Future variable revenue from long-term contracts is constrained to take account of the risk of reduced utilisation e.g. EFHs, based on historical forecasting experience and the risk of aircraft being parked by the customer.
- A significant amount of revenue and cost related to long-term contract accounting is denominated in currencies other than that of the relevant Group undertaking, most significantly USD transactions in sterling and euro denominated undertakings. These are translated at estimated long-term exchange rates.
- The assessment of stage of completion is generally measured for each contract. However, in certain cases, such as for Corporate Care agreements, where there are many contracts covering aftermarket services each for a small number of engines, the Group accounts for a portfolio of contracts together, as the effect on the Consolidated Financial Statements would not differ materially from applying the standard to the individual contracts in the portfolio. When accounting for a portfolio of LTSAs, the Group uses estimates and assumptions that reflect the size and composition of the portfolio.
- A contract asset/liability is recognised where payment is received in arrears/advance of the revenue recognised in meeting performance obligations.
- Contract modifications of long-term service agreements can be accounted for as separate contracts, termination of the existing contract and the creation of a new contract, or as part of the existing contract. The treatment is dependent on whether the change in scope is because of the addition of promised goods or services that are distinct and whether the price increases by an amount that reflects their standalone selling prices.
- Where material, wastage costs (see key judgements on page 59) are recorded as an expense and excluded from the measure of progress of LTSA contracts.
- The Group recognises a liability for their obligation to repurchase parts it has sold to the maintenance, repair and overhaul bases who overhaul the Group's customers' engines.

If the expected costs to fulfil a contract exceed the expected revenue, a contract loss provision is recognised for the excess costs.

The Group pays participation fees to airframe manufacturers, its customers for OE, on certain programmes. Amounts paid are initially treated as contract assets and subsequently charged as a reduction to the OE revenue when the engines are transferred to the customer.

1 Accounting policies continued

Revenue recognition (continued)

The Group has elected to use the practical expedient to expense as incurred any incremental costs of obtaining or fulfilling a contract if the amortisation period of an asset created would have been one year or less. Where costs to obtain a contract are recognised in the balance sheet, they are amortised over the performance of the related contract (eight to 23 years).

Key judgement – Whether Civil Aerospace OE and aftermarket contracts should be combined

In the Civil Aerospace division, OE contracts for the sale of engines to be installed on new aircraft are with the airframers, while the contracts to provide spare engines and aftermarket goods and services are with the aircraft operators, although there may be interdependencies between them. IFRS 15 includes guidance on the combination of contracts, in particular that contracts with unrelated parties should not be combined. Notwithstanding the interdependencies, the Directors consider that the engine contract should be considered separately from the aftermarket contract. In making this judgement, they also took account of industry practice.

Key judgement – How performance on long-term aftermarket contracts should be measured

The Group generates a significant proportion of its revenue from aftermarket arrangements. These aftermarket contracts, such as Total Care and Corporate Care agreements in the Civil Aerospace division, cover a range of services and generally have contractual terms covering more than one year. Under these contracts, the Group's primary obligation is to maintain customers' engines in an operational condition. This is achieved by undertaking various activities, such as maintenance, repair and overhaul, and engine monitoring over the period of the contract. Revenue on these contracts is recognised over the period of the contract and the basis for measuring progress is a matter of judgement. The Directors consider that the stage of completion of the contract is best measured by using the actual costs incurred to date compared to the estimated costs to complete the performance obligations, as this reflects the extent of completion of the activities to be performed.

Key judgement – Whether long-term aftermarket contracts contain a significant financing component

Long-term aftermarket contracts typically cover a period of eight to 15 years. Their pricing is the subject of negotiation with individual customers under competitive circumstances. It is the Directors' judgement that the consideration received approximates to the cash selling price and any timing difference between consideration being received and the supply of goods and services is typical of the industry and arises for reasons other than to provide financing. The customers typically pay on an 'as used' basis (e.g. USD/EFH) which reflects the wear and tear of the engine as it flies and aligns to the customer's own revenue streams. An adjustment to the transaction price is therefore not required.

Key judgement – Whether any costs should be treated as wastage

In rare circumstances, the Group may incur costs of wasted material, labour or other resources to fulfil a contract where the level of cost was not reflected in the contract price. The identification of such costs is a matter of judgement and would only be expected to arise where there has been a series of abnormal events which give rise to a significant level of cost of a nature that the Group would not expect to incur and hence is not reflected in the contract price. Examples include technical issues that require resolution to meet regulatory requirements; have a wide-ranging impact across a product type; and cause significant operational disruption to customers. Similarly, in these rare circumstances, significant disruption costs to support customers resulting from the actual performance of a delivered good or service may be treated as a wastage cost. Provision is made for any costs identified as wastage when the obligation to incur them arises – see note 20.

Key judgement – Whether the Civil Aerospace LTSA contracts are warranty style contracts entered into in connection with OE sales and therefore can be accounted for under IFRS 15

The Group has considered whether these arrangements are insurance contracts as defined in IFRS 17. While they may transfer an element of insurance risk, they relate to warranty and service type agreements that are entered into in connection with the Group's sales of its goods or services and therefore continue to be accounted for under the existing revenue and provisions standards. The Directors have judged that such arrangements entered into after the original equipment sale remain sufficiently related to the sale of the Group's goods and services to allow the contracts to continue to be measured under IFRS 15 and IAS 37.

Key judgement – Whether sales of spare engines to joint ventures are at fair value

The Civil Aerospace division maintains a pool of spare engines to support its customers. Some of these engines are sold to, and held by, joint venture companies. The assessment of whether the sales price reflects fair value is a key judgement. The Group considers that based upon the terms and conditions of the sales, and by comparison to the sales price of spare engines to other third parties, the sales made to joint ventures reflect the fair value of the goods sold. See note 25 for the value of sales to joint ventures during the year.

Key judgement – When revenue should be recognised in relation to spare engine sales

Revenue is recognised at the point in time when a customer obtains control of a spare engine. The customer could be a related party, an external operator or a spare engine service provider. Depending on the contractual arrangements, judgement is required on when the Group relinquishes control of spare engines and, therefore, when the revenue is recognised. The point of control passing has been concluded to correspond to the point of legal sale, even for instances where the customer is contracted to provide some future spare engine capacity to the Group to support its installed engine base. In such cases, the customer has responsibility for generating revenue from the engines and exposure to periods of non-utilisation; exposure to risk of damage or loss, risk from residual value movements, and will determine if and when profits will be made from disposal. The spare engine capacity that will be made available to the Group in the future does not consist of identified assets and the provider retains a substantive right to substitute the asset through the Group's period of use. It is, therefore, appropriate to recognise revenue from the sale of the spare engines at the point that title transfers. During 2023, of the total 53 (2022: 44) large spare engine sales delivered, 27 (2022: 20) engines were sold to customers where contractual arrangement allows for some future spare engine capacity to be used by the Group. These sales contributed £578m (2022: £454m) to revenue for the year.

1 Accounting policies *continued*

Revenue recognition (continued)

Key estimate – Estimates of future revenue, including customer pricing, and costs of long-term contractual arrangements, including the impact of climate change

The Group has long-term contracts that fall into different accounting periods and which can extend over significant periods. The most significant of these are LTSA in the Civil Aerospace division, with contracts typically covering a period of eight to 15 years. The estimated revenue and costs are inherently imprecise and significant estimates are required to assess: EFHs, time-on-wing and other operating parameters; the pattern of future maintenance activity and the costs to be incurred; lifecycle cost improvements over the term of the contracts; and escalation of revenue and costs (that includes the impact of inflation). The impact of climate change on EFHs and costs is also considered when making these estimates. Industry and customer data on expected levels of utilisation is included in the forecasts used. Across the length of the current Civil Aerospace LTSA contracts, allowance has been made for around a 1% (2022: 1%) projected cost increase resulting from carbon pricing and commodity price changes.

The sensitivities below demonstrate how changes in assumptions (including as a result of climate change) could impact the level of revenue recognised were assumptions to change. The Directors believe that the estimates used to prepare the Consolidated Financial Statements take account of the inherent uncertainties, constraining the expected level of revenue as appropriate.

Estimates of future LTSA revenue within Civil Aerospace are based upon future EFH forecasts, influenced by assumptions over the recovery of the civil aviation industry. Finally, many of the revenues and costs are denominated in currencies other than that of the relevant group undertaking. These are translated at an estimated long-term exchange rate, based on historical trends and economic forecasts.

During the year, changes to the estimate in relation to the Civil Aerospace LTSA contracts resulted in adverse catch-up adjustments to revenue of £104m (2022: £360m).

Based upon the stage of completion of all LTSA contracts within Civil Aerospace as at 31 December 2023, the following reasonably possible changes in estimates would result in catch-up adjustments being recognised in the period in which the estimates change (at underlying rates):

- A change in forecast EFHs of 1% over the remaining term of the contracts would impact LTSA income and to a lesser extent costs, resulting in an in-year impact of around £20m. This would be expected to be seen as a catch-up change in revenue or, to the extent it impacts onerous contracts, within cost of sales.
- A 2% increase or decrease in our pricing to customers over the life of the contracts would lead to a revenue catch-up adjustment in the next 12 months of around £280m.
- A 2% increase or decrease in shop visit costs over the life of the contracts would lead to a revenue catch-up adjustment in the next 12 months of around £80m.

Risk and revenue sharing arrangements (RRSAs)

Cash entry fees received are initially deferred on the balance sheet as deferred receipts from RSA workshare partners within trade payables and other liabilities. The cash entry fee is a transaction with a supplier and is recognised as a reduction in cost of sales incurred. Individual programme amounts are allocated pro rata to the estimated number of units to be produced. Amortisation commences as each unit is delivered and then recognised on a 15-year straight-line basis.

The payments to suppliers of their shares of the programme cash flows for their production components are charged to cost of sales when OE sales are recognised or as LTSA costs are incurred. These prepayments are initially recognised within trade receivables and other assets.

The Group also has arrangements with third parties who invest in a programme and receive a return based on its performance, but do not undertake development work or supply parts. Such arrangements (financial RRSAs) are financial instruments as defined by IAS 32 *Financial Instruments: Presentation* and are accounted for using the amortised cost method.

Key judgement – Determination of the nature of entry fees received

RRSAs with key suppliers (workshare partners) are a feature of the civil aviation industry. Under these contractual arrangements, the key commercial objectives are that: (i) during the development phase the workshare partner shares in the risks of developing an engine by performing its own development work, providing development parts, and paying a non-refundable cash entry fee; and (ii) during the production phase the workshare partner supplies components in return for a share of the programme cash flows as a 'life of type' supplier (i.e. as long as the engine remains in service).

The non-refundable cash entry fee is considered to be one element of a long-term supply agreement. These receipts are deferred on the balance sheet and recognised against the cost of sales over the estimated number of units to be delivered on a similar basis to the amortisation of development costs.

Royalty payments

Royalty payments include payments to government bodies that have previously acquired an interest in a programme. These are recognised as a charge in cost of sales in line with sales made.

Government grants

Government grants received are varied in nature and are recognised in the income statement so as to match them with the related expenses that they are intended to compensate. Where grants are received in advance of the related expenses, they are initially recognised as liabilities within trade payables and other liabilities and released to match the related expenditure. Non-monetary grants are recognised at fair value.

1 Accounting policies continued

Interest

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

Taxation

The tax charge/credit on the profit or loss for the year comprises current and deferred tax:

- Current tax is the expected tax payable for the year, using tax rates enacted or substantively enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.
- Deferred tax is provided using the balance sheet liability method, providing for temporary differences between the carrying amounts of the assets and liabilities for financial reporting purposes and the amounts used for tax purposes and is calculated using the enacted or substantively enacted rates that are expected to apply when the asset or liability is settled. In the UK, the deferred tax liability on the pension scheme surplus is recognised consistently with the basis for recognising the surplus i.e. at the rate applicable to refunds from a trust.

Tax is charged or credited to the income statement or OCI as appropriate, except when it relates to items credited or charged directly to equity in which case the tax is also dealt with in equity.

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

Deferred tax assets are recognised only to the extent that it is probable that future taxable profits, which include the reversal of taxable temporary differences, will be available against which the assets can be utilised. Further details on the Group's tax position can be found on pages 76 to 79.

Key estimate – Estimates necessary to assess whether it is probable that sufficient suitable taxable profits will arise in the UK to utilise the deferred tax assets recognised

Deferred tax assets are only recognised to the extent it is probable that future taxable profits will be available, against which the deductible temporary difference can be utilised. On this basis, as at 31 December 2023, a deferred tax asset of £1,635m (2022: £2,040m) is not recognised in respect of UK tax losses. Further details are included in note 5.

In addition to taking into account a severe but plausible downside forecast (see below), the climate-related estimates and assumptions (set out on pages 53 to 55) have also been considered when assessing the recoverability of the deferred tax assets. Recognising the longer terms over which these assets will be recovered, the Group has considered the risk that regulatory changes could materially impact demand for our products and shifting investment focus towards more sustainable products and solutions. The climate scenarios prepared do not indicate a significant deterioration in demand or profitability for Civil Aerospace programmes given that all in production engines will be compatible with sustainable fuels.

While carbon and commodity pricing may put pressure on costs, decarbonisation and new supplier and customer contracts offer the opportunity to receive value for more efficient and sustainable products.

As explained in note 5, a 25% probability of there being a severe but plausible downside forecast in relation to the civil aviation industry has been taken into account in the assessment of the recovery of the UK deferred tax assets.

The estimates take account of the inherent uncertainties constraining the expected level of profit as appropriate. Changes in these estimates will affect future profits and, therefore, the recoverability of the deferred tax assets. The following sensitivities have been modelled to demonstrate the impact of changes in assumptions on the recoverability of deferred tax assets.

- A 5% change in margin in the main Civil Aerospace large engine programmes;
- A 5% change in the number of shop visits; and
- Assumed future cost increases from climate change expected to pass through to customers at 100% are restricted to 90% pass through.

All of these could be driven by a number of factors, including the impact of climate change as explained on pages 53 to 55 and macroeconomic factors.

A 5% change in margin or shop visits (which could be driven by fewer EFHs) would result in an increase/decrease in the deferred tax asset of around £90m.

If only 90% of assumed future cost increases from climate change are passed on to customers, this would result in a decrease in the deferred tax asset of around £10m, and if carbon prices were to double, this would be £50m.

Foreign currency translation

Transactions denominated in currencies other than the functional currency of the transacting group undertaking are translated into the functional currency at the average monthly exchange rate when the transaction occurs. Monetary assets and liabilities denominated in foreign currencies are translated into the relevant functional currency at the rate prevailing at the year end. Exchange differences arising on foreign exchange transactions and the retranslation of monetary assets and liabilities into functional currencies at the rate prevailing at the year end are included in profit/(loss) before taxation.

The trading results of Group undertakings are translated into sterling at the average exchange rates for the year. The assets and liabilities of overseas undertakings, including goodwill and fair value adjustments arising on acquisition, are translated at the exchange rates prevailing at the year end. Exchange adjustments arising from the retranslation of the opening net assets, and from the translation of the profits or losses at average rates, are recognised in OCI.

1 Accounting policies *continued*

Discontinued operations, held for sale and business disposals

A discontinued operation is defined in IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* as a component of an entity that has been disposed of or is classified as held for sale, represents a separate major line of business or geographical area of operations, is part of a single coordinated plan to dispose of such a line of business or is a subsidiary acquired exclusively with a view to resale. The results of discontinued operations are required to be presented separately in the income statement.

Assets and businesses are classified as held for sale when their carrying amounts will be recovered through sale rather than through continuing use.

Financial Instruments – Classification and measurement

Financial assets primarily include trade receivables, other non-derivative financial assets, cash and cash equivalents, short-term investments, derivatives (foreign exchange, commodity and interest rate contracts), and listed and unlisted investments.

- Trade receivables are classified either as held to collect and measured at amortised cost, or as held to collect and sell and measured at fair value, with movements in fair value recognised through other comprehensive income (FVOCI). The Group may sell trade receivables due from certain customers before the due date. Any trade receivables from such customers that are not sold at the reporting date are classified as 'held to collect and sell'.
- Cash and cash equivalents (consisting of balances with banks and other financial institutions, money-market funds, short-term deposits) and short-term investments are subject to low market risk. Cash balances, short-term deposits (with a maturity of primarily 3 months or less) and short-term investments are measured at amortised cost. Money market funds are measured at fair value, with movements in fair value recognised in the income statement as a profit or loss (FVPL).
- Derivatives and unlisted investments are measured at FVPL. The Company has elected to measure its listed investments at FVOCI.

Financial liabilities primarily consist of trade payables and other non-derivative financial liabilities, borrowings, derivatives and financial RSAs.

- Derivatives are classified and measured at FVPL.
- All other financial liabilities are classified and measured at amortised cost.

Financial Instruments – Impairment of financial assets and contract assets

IFRS 9 *Financial Instruments* sets out the basis for the accounting of ECLs on financial assets and contract assets resulting from transactions within the scope of IFRS 15. The Group has adopted the simplified approach to provide for ECLs, measuring the loss allowance at a probability weighted amount that considers reasonable and supportable information about past events, current conditions and forecasts of future economic conditions of customers. These are incorporated in the simplified model adopted by using credit ratings which are publicly available, or through internal risk assessments derived using the customer's latest available financial information. The ECLs are updated at each reporting date to reflect changes in credit risk since initial recognition. ECLs are calculated for all financial assets in scope, regardless of whether or not they are overdue.

Financial Instruments – Hedge accounting

Forward foreign exchange contracts and commodity swaps (derivative financial instruments) are held to manage the cash flow exposures of forecast transactions denominated in foreign currencies or in commodities respectively. Derivative financial instruments qualify for hedge accounting when: (i) there is a formal designation and documentation of the hedging relationship and the Group's risk management objective and strategy for undertaking the hedge at the inception of the hedge; and (ii) the hedge is expected to be effective.

In general, the Group has chosen to not apply hedge accounting in respect of these exposures.

The Group economically hedges the fair value and cash flow exposures of its borrowings. Cross-currency interest rate swaps are held to manage the fair value or cash flow exposures of borrowings denominated in foreign currencies and are designated as fair value hedges or cash flow hedges as appropriate. Interest rate swaps are held to manage the interest rate exposures of fixed and floating rate borrowings and may be designated as fair value hedges or cash flow hedges as appropriate. If the swaps are not designated as fair value or cash flow hedges, the economic effect is included in the underlying results – see note 2.

Changes in the fair values of derivatives that are designated as fair value hedges are recognised directly in the income statement. The fair value changes of effective cash flow hedge derivatives are recognised in OCI and subsequently recycled to the income statement in the same period or periods during which the hedged cash flows affect profit or loss. Any ineffectiveness in the hedging relationship is included in the income statement.

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

1 Accounting policies continued

Business combinations and goodwill

Goodwill recognised represents the excess of the fair value of the purchase consideration over the fair value to the Group of the net of the identifiable assets acquired and the liabilities assumed. On transition to IFRS on 1 January 2004, business combinations were not retrospectively adjusted to comply with UK-adopted International Accounting Standards and goodwill was recognised based on the carrying value under the previous accounting policies. Goodwill, in respect of the acquisition of a subsidiary, is recognised as an intangible asset. Goodwill arising on the acquisition of joint arrangements and associates is included in the carrying value of the investment.

Customer relationships

The fair value of customer relationships recognised as a result of a business combination relate to the acquired company's established relationships with its existing customers that result in repeat purchases and customer loyalty. Amortisation is charged on a straight-line basis over its useful economic life, up to a maximum of 15 years.

Certification costs

Costs incurred, in respect of meeting regulatory certification requirements for new Civil Aerospace aero-engine/aircraft combinations, including payments made to airframe manufacturers for this, are recognised as intangible assets to the extent that they can be recovered out of future sales. They are charged to the income statement over the programme life. Individual programme assets are allocated pro rata to the estimated number of units to be produced. Amortisation commences as each unit is delivered and then charged on a 15-year straight-line basis.

Research and development

Expenditure incurred on research and development is distinguished as relating either to a research phase or to a development phase. All research phase expenditure is charged to the income statement. Development expenditure is recognised as an internally generated intangible asset (programme asset) only if it meets strict criteria, relating in particular to technical feasibility and generation of future economic benefits. More specifically, development costs are capitalised from the point at which the following conditions have been met:

- the technical feasibility of completing the programme and the intention and ability (availability of technical, financial and other resources) to complete the programme asset and use or sell it;
- the probability that future economic benefits will flow from the programme asset; and
- the ability to measure reliably the expenditure attributable to the programme asset during its development.

Capitalisation continues until the point at which the programme asset meets its originally contracted technical specification (defined internally as the point at which the asset is capable of operating in the manner intended by the Directors).

Subsequent expenditure is capitalised where it enhances the functionality of the programme asset and demonstrably generates an enhanced economic benefit to the Group. All other subsequent expenditure on programme assets is expensed as incurred.

Individual programme assets are allocated pro rata to the estimated number of units to be produced. Amortisation commences as each unit is delivered and then charged on a straight-line basis over a maximum of 15-year. In accordance with IAS 38 *Intangible Assets*, the basis on which programme assets are amortised is assessed annually.

Key judgement – Determination of the point in time where costs incurred on an internal programme development meet the criteria for capitalisation

The Group incurs significant research and development expenditure in respect of various development programmes. Determining when capitalisation should commence and cease is a key judgement, as is the determination of when subsequent expenditure on the programme assets should be capitalised. During the year, £192m (2022: £131m) of development expenditure was capitalised.

Within the Group, there are established processes in place e.g. the Product Introduction and Lifecycle Management process (PILM). Within these processes, the technical feasibility, the commercial viability and financial assessment of the programme is assessed at certain milestones. When these are met, development expenditure is capitalised. Prior to this, expenditure is expensed as incurred.

The Group continues to invest in new technologies as a result of its decarbonisation commitments. As these are new technologies, there is a higher level of uncertainty over potential outcomes and, therefore, this could impact the level of expenditure that is capitalised or recognised in the income statement in future years. During 2023, no development costs incurred within New Markets were capitalised.

Subsequent expenditure after entry into service which enhances the performance of the engine and the economic benefits to the Group is capitalised. This expenditure is referred to as enhanced performance and is governed by the PILM process referred to above. All other development costs are expensed as incurred.

Key judgement – Determination of the basis for amortising capitalised development costs

The economic benefits of the development costs are primarily those cash inflows arising from LTSAs, which are expected to be relatively consistent for each engine within a programme. Amortisation of development costs is recognised on a straight-line basis over the estimated period of operation of the engine by its initial operator.

1 Accounting policies continued

Software

Software that is not specific to an item of property, plant and equipment is classified as an intangible asset, recognised at its acquisition cost and amortised on a straight-line basis over its useful economic life, up to a maximum of 10 years. The amortisation period of software assets is reviewed annually. The cost of internally developed software includes direct labour and an appropriate proportion of overheads.

Other intangible assets

These include intangible assets arising on acquisition of businesses, such as technology and which is amortised on a straight-line basis over a maximum of 15 years, and trademarks which are not amortised. They also include the costs incurred testing and analysing engines with the longest time in service (fleet leader engines) to gather technical knowledge on engine endurance, which are amortised on a straight-line basis over a maximum of 15 years.

Property, plant and equipment

Property, plant and equipment are stated at acquisition cost less accumulated depreciation and any provision for impairment in value. The cost of self-constructed assets includes the cost of materials, direct labour, an appropriate proportion of overheads and, where appropriate, interest.

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

- Land and buildings, as advised by the Group's professional advisers:
- Freehold buildings – three to 50 years (average 23 years); and
- No depreciation is provided on freehold land.
- Plant and equipment – two to 27 years (average 11 years).
- Aircraft and engines – five to 20 years (average 16 years).

Leases

Assets and liabilities arising from a lease are initially measured on a present value basis.

Lease liabilities include the net present value of the following lease payments:

- fixed payments less any lease incentive receivable;
- variable lease payments that are based on an index or a rate;
- amounts expected to be payable by the Group under residual value guarantees;
- the exercise price of a purchase option if the Group is reasonably certain to exercise that option; and
- payments of penalties for termination of the lease, if the lease term reflects the Group exercising that option.

Where leases commenced after the initial IFRS 16 Leases transition date, the lease payments are discounted using the interest rate implicit in the lease. If that rate cannot be determined, the Group's incremental borrowing rate is used, being the rate that the Group would have to pay to borrow the funds necessary to obtain an asset of similar value in a similar economic environment with similar terms and conditions. Where appropriate, lease liabilities are revalued at each reporting date using the spot exchange rate.

Right-of-use assets are measured at cost comprising the following:

- the amount of the initial measurement of lease liability or a revaluation of the liability;
- any lease payments made at or before the commencement date less any lease incentives received;
- any initial direct costs; and
- restoration costs.

Each right-of-use asset is depreciated over the shorter of its useful economic life and the lease term on a straight-line basis unless the lease is expected to transfer ownership of the underlying asset to the Group, in which case the asset is depreciated to the end of the useful life of the asset.

Short-term leases are leases with a lease term of 12 months or less. Payments associated with short-term leases and low-value leases are recognised on a straight-line basis as an expense in the income statement.

Key judgement – Determination of lease term
In determining the lease term, the Group considers all facts and circumstances that create an economic incentive to exercise an extension option, or not exercise a termination option. Extension options (or periods after termination) are only included in the lease term if the lease is reasonably certain to be extended (or not terminated). Certain land and building leases have renewal options with renewal dates for the most significant property leases in the next 12 months. Other renewals are evenly spread between 2025 to 2032 and then post 2038. The Group reviews its judgements on lease terms annually, including the operational significance of the site, especially where utilised for manufacturing activities.

1 Accounting policies *continued*

Impairment of non-current assets

Impairment of non-current assets is considered in accordance with IAS 36 *Impairment of Assets*. Where the asset does not generate cash flows that are independent of other assets, impairment is considered for the cash-generating unit (CGU) to which the asset belongs. Goodwill, indefinite life intangible assets and intangible assets not yet available for use are tested for impairment annually. Other intangible assets (including programme-related intangible assets), property, plant and equipment and investments are assessed for any indications of impairment annually. If any indication of impairment is identified, an impairment test is performed to estimate the recoverable amount.

If the recoverable amount of an asset (or CGU) is estimated to be below the carrying value, the carrying value is reduced to the recoverable amount and the impairment loss is recognised as an expense. The recoverable amount is the higher of value in use or fair value less costs of disposal. The value in use is the present value of future cash flows using a pre-tax discount rate that reflects the time value of money and the risk specific to the asset (or CGU). Fair value less costs of disposal (FVLCD) reflects market inputs or inputs based on market evidence if readily available. If these inputs are not readily available, the fair value is estimated by discounting future cash flows modified for market participants views. The relevant local statutory tax rates have been applied in calculating post-tax to pre-tax discount rates.

Key judgement – Determination of CGUs for assessing impairment of goodwill

The Group conducts impairment reviews at the CGU level. As permitted by IAS 36, impairment reviews for goodwill are performed at the groups of CGUs level, representing the lowest level at which the Group monitors goodwill for internal management purposes and no higher than the Group's operating segments. The main CGUs for which goodwill impairment reviews have been performed are Rolls-Royce Deutschland Ltd & Co KG and at an aggregated Rolls-Royce Power Systems AG level.

Key judgement – Whether there are indicators of potential reversal of previous impairments of programme-related intangible assets

Previously impaired intangible assets (including programme intangible assets but excluding goodwill) have been reviewed to ensure that no impairment reversal is required in accordance with IAS 36. In determining whether there was an indication that an impairment loss recognised in a prior period may no longer exist or may have decreased, the Directors considered whether the estimated service potential from the use of impaired assets had increased, other than by amounts generated through the passage of time (which would not represent an economic change in the value of the asset). An impairment of £573m was recorded in previous periods in relation to Business Aviation programme-related intangible assets. No indicator of reversal was present at 31 December 2023. Small changes to assumptions, including those related to discount rates which would be impacted by changes in market interest rates, could result in an increase in the asset's recoverable amount requiring a reversal in the future.

Inventories

Inventories are valued on a first-in, first-out basis, at the lower of cost and net realisable value. Cost comprises direct materials and, where applicable, direct labour costs and those direct and indirect overheads, including depreciation of property, plant and equipment, that have been incurred in bringing the inventories to their present location and condition. Net realisable value represents the estimated selling prices less all estimated costs of completion and costs to be incurred in marketing, selling and distribution. All inventories are classified as current as it is expected that they will be used in the Group's operating cycle, regardless of whether this is expected to be within 12 months of the balance sheet date.

Cash and cash equivalents

Cash and cash equivalents include cash at bank and in hand, investments in money-market funds and short-term deposits with a maturity of three months or less on inception. The Group considers overdrafts (repayable on demand) to be an integral part of its cash management activities and these are included in cash and cash equivalents for the purposes of the cash flow statement. Where the Group operates pooled banking arrangements across multiple accounts, these are presented on a net basis when it has both a legal right and intention to settle the balances on a net basis.

The Group's suppliers have access to a supply chain financing (SCF) programme through partnership with banks to enable smaller suppliers who are on standard 75 day or more payment terms and joint ventures (90-day standard payment terms) to receive their payment sooner. The election to utilise the programme is at the sole decision of the supplier. As the Group continues to have a contractual obligation to pay its suppliers under commercial terms which are unaffected by any utilisation of the programme, and it does not retain any ongoing involvement in the SCF, the related payables are retained on the Group's balance sheet and classified as trade payables. Further details are disclosed in note 18.

Provisions

Provisions are recognised when the Group has a present obligation as a result of a past event, and it is probable that the Group will be required to settle that obligation. Provisions are discounted to present value where the effect is material.

The principal provisions are recognised as follows:

- contract losses based on an assessment of whether the direct costs to fulfil a contract are greater than the expected revenue;
- warranties and guarantees based on an assessment of future claims with reference to past experience and recognised at the earlier of when the underlying products and services are sold and when the likelihood of a future cost is identified;
- Trent 1000 in-service issues when wastage costs are identified as described on page 59; and
- transformation and restructuring (included in other provisions) when the Group has approved a detailed and formal restructuring plan, and the restructuring has either commenced or has created a valid expectation to those affected.

1 Accounting policies continued

Provisions (continued)

Key judgement – Whether any costs should be treated as wastage

As described further on page 59, in rare circumstances, the Group may incur costs of wasted material, labour or other resources to fulfil a contract where the level of cost was not reflected in the contract price. The identification of such costs is a matter of judgement and would only be expected to arise where there has been a series of abnormal events which give rise to a significant level of cost of a nature that the Group would not expect to incur and hence is not reflected in the contract price. Provision is made for any costs identified as wastage when the obligation to incur them arises.

Specifically for the Trent 1000 wastage costs, provision has been made as the Group is an owner of an engine Type Certificate under which it has a present obligation to develop appropriate design changes to address certain engine conditions that have been noted in issued Airworthiness Directives. The Group is also required to ensure engine operators can continue to safely operate engines within the terms of their LTSAs, and this requires the engines to be compliant with the requirements of those issued Airworthiness Directives. These requirements cannot be met without the Group incurring significant costs in the form of replacement parts and customer claims. Given the significant activities of the Group in designing and overhauling aero engines it is very experienced in making the required estimates in relation to the number and timing of shop visits, parts costs, overhaul labour costs and customer claims.

Key judgement – Whether the criteria to recognise a restructuring provision have been met

On 17 October 2023 the Group announced plans for a simpler, more streamlined, organisation as part of its multi-year transformation. It is estimated that 2,000 to 2,500 roles will be removed globally.

IAS 19 requires that a liability and expense for termination benefits should be recognised at the earlier of (a) when an offer of those benefits can no longer be withdrawn; and (b) when the cost for a restructuring that is within the scope of IAS 37 that involves the payment of termination benefits is recognised.

The Directors have considered whether the Group's communications to employees during 2023 have led to an offer of benefits that could no longer be withdrawn. In a small number of situations this has been the case and a charge of £6m has been recognised in the year. For the significant majority of the 2,000 to 2,500 roles, the Directors do not consider that the plan of termination meets the requirement for a provision to be recognised on the basis that communications had not yet been in sufficient detail to identify the functions or locations of the roles, the expected completion date, or the type and amount of benefits that would be received should employees employment be terminated.

Key estimate – Estimates of the time to incorporate a modified and certified high-pressure turbine (HPT) blade into the fleet to resolve technical issues on the Trent 1000, and the implications of this on forecast future costs when assessing onerous contracts

The Group has provisions for Trent 1000 wastage costs at 31 December 2023 of £116m (2022: £179m). These represent the Directors' best estimate of the expenditure required to settle the obligations at the balance sheet date. These estimates take account of information available and different possible outcomes.

The Group considers that at 31 December 2023 the Trent 1000 contract loss provisions and the Trent 1000 wastage cost provision are most sensitive to changes in estimates. A 12-month delay in the availability of the modified HPT blade could lead to around a £30-£50m charge in relation to the Trent 1000 programme.

Key estimates – Estimates of the future revenues and costs to fulfil onerous contracts

The Group has provisions for onerous contracts at 31 December 2023 of £1,472m (2022: £1,592m).

An increase in Civil Aerospace large engine estimates of LTSA costs of 1% over the remaining term of the contracts could lead to around a £90-£120m increase in the provision for contract losses across all programmes.

Key estimates – Assumptions implicit in the calculation of discount rates

The contract loss provisions for onerous contracts are sensitive to changes in the discount rate used to value the provisions. The rate used for each contract is derived from bond yields (i.e. risk-free rates) with a similar duration and currency to the contract that they are applied to. The rate is adjusted to reflect the specific inflation characteristics of the contracts. The forecast rates are determined from third-party market analysis and average 4%. A 1% change in the discount rates used could lead to around a £70-£80m change in the provision.

Customer financing support

In connection with the sale of its products, the Group will, on occasion, provide financing support for its customers. Credit-based guarantees are disclosed as commitments or contingent liabilities dependent on whether aircraft have been delivered or not. As described on page 109, the Directors consider the likelihood of crystallisation in assessing whether provision is required for any liabilities.

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

1 Accounting policies continued

Post-retirement benefits

Pensions and similar benefits (principally healthcare) are accounted for under IAS 19.

For defined benefit plans, obligations are measured at discounted present value, using a discount rate derived from high-quality corporate bonds denominated in the currency of the plan, whilst plan assets are recorded at fair value. Surpluses in schemes are recognised as assets only if they represent economic benefits available to the Group in the future. Actuarial gains and losses are recognised immediately in OCI. The service and financing costs of such plans are recognised separately in the income statement:

- current service costs are spread systematically over the lives of employees;
- past-service costs and settlements are recognised immediately; and
- financing costs are recognised in the periods in which they arise.

UK pension obligations include the estimated impact of the obligation to equalise defined benefit pensions and transfer values for men and women.

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

Key estimate – Estimates of the assumptions for valuing the net defined benefit obligation

The Group's defined benefit pension schemes and similar arrangements are assessed annually in accordance with IAS 19. The valuations, which are based on assumptions determined with independent actuarial advice, resulted in a net deficit of £253m before deferred taxation being recognised on the balance sheet at 31 December 2023 (2022: deficit of £420m). The size of the net surplus/deficit is sensitive to the actuarial assumptions, which include the discount rate, price inflation, pension and salary increases, longevity and, in the UK, the number of plan members who take the option to transfer their pension to a lump sum on retirement or who choose to take the Bridging Pension Option. Following consultation, the UK scheme closed to future accrual on 31 December 2020.

A reduction in the discount rate of 0.25% from 4.50% could lead to an increase in the defined benefit obligations of the RR UK Pension Fund (RRUKPF) of approximately £185m. This would be expected to be broadly offset by changes in the value of scheme assets, as the scheme's investment policies are designed to mitigate this risk.

An increase in the assumed rate of inflation of 0.25% (RPI of 3.30% and CPI of 2.85%) could lead to an increase in the defined benefit obligations of the RRUKPF of approximately £75m.

A one-year increase in life expectancy from 20.8 years (male aged 65) and from 21.5 years (male aged 45) would increase the defined benefit obligations of the RRUKPF by approximately £155m.

Further details and sensitivities are included in note 21.

Share-based payments

The Group provides share-based payment arrangements to certain employees. These are principally equity-settled arrangements and are measured at fair value (excluding the effect of non-market based vesting conditions) at the date of grant. The fair value is expensed on a straight-line basis over the vesting period. The amount recognised as an expense is adjusted to reflect the actual number of shares or options that will vest, except where additional shares vest as a result market-based performance conditions where no adjustment is required as allowance for these performance conditions are included in the initial fair value.

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

The cost of shares of Rolls-Royce Holdings plc held by the Group for the purpose of fulfilling obligations in respect of employee share plans is deducted from equity in the consolidated balance sheet. See note 23 for a further description of the share-based payment plans.

Revisions to IFRS not applicable in 2023

Standards and interpretations issued by the IASB are only applicable if endorsed by the UK. 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.

IBOR reform transition

A number of the Group's lease liabilities have been based on a USD LIBOR index. The majority of contracts in which the Group is a lessee have been amended. These have been amended to Secured Overnight Financing Rate (USD Term SOFR) plus credit adjustment spread (CAS), and the impact to the Financial Statements is not material. There are a number of lease contracts which currently have fixed rentals which will move to floating rentals based on USD LIBOR after the end of the fixed rental period. These will be amended before the end of the fixed rental period to USD Term SOFR plus CAS. The Group has taken the practical expedient available to account for the lease modification required by the IBOR reform by applying IFRS 16 paragraph 42.

Post balance sheet events

The Group has taken the latest legal position in relation to any ongoing legal proceedings and reflected these in the 2023 results as appropriate.

2 Segmental analysis

The analysis by segment is presented in accordance with IFRS 8, on the basis of those segments whose operating results are regularly reviewed by the Board (who acts as the Chief Operating Decision Maker as defined by IFRS 8). The Group's four divisions are set out below.

Civil Aerospace	development, manufacture, marketing and sales of commercial aero engines and aftermarket services
Defence	development, manufacture, marketing and sales of military aero engines, naval engines, submarine nuclear power plants and aftermarket services
Power Systems	development, manufacture, marketing and sales of integrated solutions for onsite power and propulsion
New Markets	development, manufacture and sales of small modular reactor (SMR) and new electrical power solutions

Other businesses include the trading results of the UK Civil Nuclear business.

Underlying results

The Group presents the financial performance of the divisions in accordance with IFRS 8 and consistently with the basis on which performance is communicated to the Board each month.

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. The impact of the revaluation of monetary assets and liabilities (other than lease liabilities) using the exchange rate that is expected to be achieved by the use of the effective hedge book is recorded within underlying cost of sales. Underlying financing excludes the impact of revaluing monetary assets and liabilities to period end exchange rates. Lease liabilities are not revalued to reflect the expected exchange rates due to their multi-year remaining term, the Directors believe that doing so would not be the most appropriate basis to measure the in-year performance. Transactions between segments are presented on the same basis as underlying results and eliminated on consolidation. Unrealised fair value gains/(losses) on foreign exchange contracts, which are recognised as they arise in the statutory results, are excluded from underlying results. To the extent that the previously forecast transactions are no longer expected to occur, an appropriate portion of the unrealised fair value gain/(loss) on foreign exchange contracts is recorded immediately in the underlying results.

Amounts receivable/(payable) on interest rate swaps which are not designated as hedge relationships for accounting purposes are reclassified from fair value movement on a statutory basis to interest receivable/(payable) on an underlying basis, as if they were in an effective hedge relationship.

In the year to 31 December 2023, the Group was a net seller of USD at an achieved exchange rate GBP:USD of 1.50 (2022: 1.50) based on the USD hedge book.

In 2020, the Group experienced a significant decline in its medium-term outlook and consequently a significant deterioration to its forecast net USD cash inflows. The Group took action to reduce the size of the USD hedge book by \$11.8bn across 2020-2026 to reflect the fact that, at that time, future operating cash flows were no longer forecast to materialise. An underlying charge of £1.7bn was recognised within the underlying finance costs in 2020 and the associated cash settlement costs occur over the period 2020-2026. The derivatives relating to this underlying charge have been subsequently excluded from the hedge book, and therefore are also excluded from the calculation of the average exchange rate achieved in the current and future periods.

Underlying performance also excludes the following:

- the effect of acquisition accounting and business disposals;
- impairment of goodwill, other non-current and 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 the control of management.

Subsequent changes in items excluded from underlying performance in a prior period will also be excluded from underlying performance. All other changes will be recognised within underlying performance.

Acquisition accounting, business disposals and impairment

The Group excludes these from underlying results so that the current year and comparative results are directly comparable.

2 Segmental analysis continued

Exceptional Items

Items are classified as exceptional where the Directors believe that presentation of the results in this way is useful in providing an understanding of the Group's financial performance. Exceptional Items are identified by virtue of their size, nature or incidence.

In determining whether an event or transaction is exceptional, the Directors consider quantitative as well as qualitative factors such as the frequency or predictability of occurrence. Examples of exceptional items include one-time costs and charges in respect of aerospace programmes, costs of exceptional restructuring and transformation programmes and one-time past service charges and credits on post-retirement schemes.

Exceptional items are not allocated to segments and may not be comparable to similarly titled measures used by other companies.

Other Items

The financing component of the defined benefit pension scheme cost is determined by market conditions and has therefore been included as a reconciling difference between underlying and statutory performance.

The tax effects of adjustments above are excluded from the underlying tax charge. Changes in tax rates are excluded from the underlying tax charge. In addition, changes in the amount of recoverable deferred tax recognised are excluded from the underlying results to the extent that their recognition or derecognition was not originally recorded within the underlying results.

The following analysis sets out the results of the Group's divisions on the basis described above and also includes a reconciliation of the underlying results to those reported in the condensed consolidated income statement.

	Civil Aerospace £m	Defence £m	Power Systems £m	New Markets £m	Other businesses £m	Corporate and Inter- segment ¹ £m	Total Underlying £m
Year ended 31 December 2023							
Underlying revenue from sale of original equipment	2,703	1,766	2,661	2	12	–	7,144
Underlying revenue from aftermarket services	4,645	2,311	1,307	2	–	–	8,265
Total underlying revenue	7,348	4,077	3,968	4	12	–	15,409
Gross profit/(loss)	1,394	804	1,050	1	(15)	(3)	3,231
Commercial and administrative costs	(354)	(173)	(456)	(24)	–	(57)	(1,064)
Research and development costs	(343)	(72)	(187)	(137)	–	–	(739)
Share of results of joint ventures and associates	153	3	6	–	–	–	162
Underlying operating profit/(loss)	850	562	413	(160)	(15)	(60)	1,590
Year ended 31 December 2022							
Underlying revenue from sale of original equipment	1,982	1,634	2,187	1	–	(5)	5,799
Underlying revenue from aftermarket services	3,704	2,026	1,160	2	–	–	6,892
Total underlying revenue	5,686	3,660	3,347	3	–	(5)	12,691
Gross profit/(loss)	853	726	918	(1)	(29)	10	2,477
Commercial and administrative costs	(371)	(174)	(441)	(23)	(2)	(51)	(1,062)
Research and development costs	(452)	(122)	(204)	(108)	–	–	(886)
Share of results of joint ventures and associates	113	2	8	–	–	–	123
Underlying operating profit/(loss)	143	432	281	(132)	(31)	(41)	652

¹ Corporate and Inter-segment consists of costs that are not attributable to a specific segment and consolidation adjustments

2 Segmental analysis continued**Reconciliation to statutory results**

	Total underlying £m	Underlying adjustments and adjustments to foreign exchange £m	Group statutory results £m
Year ended 31 December 2023			
Continuing operations			
Revenue from sale of original equipment	7,144	491	7,635
Revenue from aftermarket services	8,265	588	8,851
Total revenue	15,409	1,077	16,486
Gross profit	3,231	389	3,620
Commercial and administrative costs	(1,084)	(48)	(1,110)
Research and development costs	(739)	–	(739)
Share of results of joint venture and associates	182	11	173
Operating profit	1,590	354	1,944
Gain arising on the acquisition and disposal of businesses	–	1	1
Profit before financing and taxation	1,590	355	1,945
Net financing	(328)	810	482
Profit before taxation	1,262	1,165	2,427
Taxation	(120)	97	(23)
Profit for the year	1,142	1,262	2,404
Attributable to:			
Ordinary shareholders	1,150	1,262	2,412
NCI	(8)	–	(8)
Year ended 31 December 2022			
Continuing operations			
Revenue from sale of original equipment	5,799	474	6,273
Revenue from aftermarket services	6,892	355	7,247
Total revenue	12,691	829	13,520
Gross profit	2,477	280	2,757
Commercial and administrative costs	(1,062)	(15)	(1,077)
Research and development costs	(886)	(5)	(891)
Share of results of joint venture and associates	123	(75)	48
Operating profit	652	185	837
Gain arising on disposal of businesses	–	81	81
Profit before financing and taxation	652	266	918
Net financing	(446)	(1,974)	(2,420)
Profit/(loss) before taxation	206	(1,708)	(1,502)
Taxation	(48)	356	308
Profit/(loss) for the year from continuing operations	158	(1,352)	(1,194)
Discontinued operations ¹	67	(147)	(80)
Profit/(loss) for the year	225	(1,499)	(1,274)
Attributable to:			
Ordinary shareholders	230	(1,499)	(1,269)
NCI	(5)	–	(5)

¹ Discontinued operations relate to the results of ITP Aero and are presented net of intercompany trading eliminations and related consolidation adjustments

2 Segmental analysis continued

Disaggregation of revenue from contracts with customers

Analysis by type and basis of recognition

	Civil Aerospace £m	Defence £m	Power Systems £m	New Markets £m	Other businesses £m	Corporate and Inter- segment £m	Total Underlying £m
Year ended 31 December 2023							
Original equipment recognised at a point in time	2,703	632	2,611	2	-	-	5,948
Original equipment recognised over time	-	1,134	50	-	12	-	1,196
Aftermarket services recognised at a point in time	1,227	854	1,206	2	-	-	3,289
Aftermarket services recognised over time	3,335	1,457	101	-	-	-	4,893
Total underlying customer contract revenue	7,265	4,077	3,968	4	12	-	15,326
Other underlying revenue ¹	83	-	-	-	-	-	83
Total underlying revenue²	7,348	4,077	3,968	4	12	-	15,409
Year ended 31 December 2022							
Original equipment recognised at a point in time	1,982	689	2,155	1	-	(5)	4,822
Original equipment recognised over time	-	945	32	-	-	-	977
Aftermarket services recognised at a point in time	865	769	1,076	2	-	-	2,712
Aftermarket services recognised over time	2,772	1,257	84	-	-	-	4,113
Total underlying customer contract revenue	5,619	3,660	3,347	3	-	(5)	12,624
Other underlying revenue ¹	67	-	-	-	-	-	67
Total underlying revenue²	5,686	3,660	3,347	3	-	(5)	12,691

¹ Includes leasing revenue

² Includes £(136)m, of which £(104)m relates to Civil LTSA contracts, (2022: £367m, of which £360m relates to Civil LTSA contracts) of revenue recognised in the year relating to performance obligations satisfied in previous years

	Total underlying £m	Underlying adjustments and adjustments to foreign exchange £m	Group statutory results ¹ £m
Year ended 31 December 2023			
Original equipment recognised at a point in time	5,948	491	6,439
Original equipment recognised over time	1,196	-	1,196
Aftermarket services recognised at a point in time	3,289	186	3,475
Aftermarket services recognised over time	4,893	382	5,275
Total customer contract revenue	15,326	1,059	16,385
Other revenue	83	18	101
Total revenue	15,409	1,077	16,486
Year ended 31 December 2022			
Original equipment recognised at a point in time	4,822	474	5,296
Original equipment recognised over time	977	-	977
Aftermarket services recognised at a point in time	2,712	164	2,876
Aftermarket services recognised over time	4,113	176	4,289
Total customer contract revenue	12,624	814	13,438
Other revenue	67	15	82
Total revenue	12,691	829	13,520

¹ During the year to 31 December 2023, revenue recognised within Civil Aerospace, Defence and Power Systems of £1,766m (2022: £1,788m) was received from a single customer

2 Segmental analysis *continued*

Analysis by geographical destination

The Group's revenue by destination of the ultimate operator is as follows:

	2023 £m	2022 £m
United Kingdom	2,230	1,669
Germany	1,035	855
Ireland	504	328
Turkey	399	220
Switzerland	379	334
France	351	255
Spain	290	188
Italy	282	238
Netherlands	149	95
Portugal	110	43
Norway	71	61
Rest of Europe	308	463
Europe	6,108	4,749
United States	4,668	4,334
Canada	430	267
North America	5,098	4,601
South America	230	168
Central America	106	91
Saudi Arabia	384	322
United Arab Emirates	148	180
Qatar	128	231
Rest of Middle East	200	164
Middle East	870	897
China	1,263	1,246
Japan	586	276
Singapore	437	317
South Korea	303	164
India	221	119
Thailand	132	-
Rest of Asia	529	381
Asia	3,471	2,503
Africa	313	282
Australasia	290	229
	16,486	13,520

Order backlog

Contracted consideration, translated at the estimated long-term exchange rates, that is expected to be recognised as revenue when performance obligations are satisfied in the future (referred to as order backlog) is as follows:

	2023			2022		
	Within five years £bn	After five years £bn	Total £bn	Within five years £bn	After five years £bn	Total £bn
Civil Aerospace	28.4	26.8	55.2	25.7	22.0	47.7
Defence	8.3	0.9	9.2	7.8	0.7	8.5
Power Systems	3.9	0.2	4.1	3.7	0.3	4.0
New Markets	-	-	-	-	-	-
Other businesses	-	-	-	-	-	-
	40.6	27.9	68.5	37.2	23.0	60.2

The parties to these contracts have approved the contract and customers do not have a unilateral enforceable right to terminate the contract without compensation. The Group excludes Civil Aerospace OE orders (for deliveries beyond the next seven-12 months) that customers have placed where they retain a right to cancel. The Group's expectation based on historical experience is that these orders will be fulfilled. Within the five years category, contracted revenue in Defence will largely be recognised in the next three years and Power Systems will be recognised over the next two years as it is a short cycle business.

2 Segmental analysis continued

		2023				2022			
		Revenue £m	Profit before financing £m	Net financing £m	Taxation £m	Revenue £m	Profit before financing £m	Net financing £m	Taxation £m
Underlying performance		15,409	1,590	(328)	(120)	12,691	652	(446)	(48)
Impact of foreign exchange differences as a result of hedging activities on trading transactions ¹	A	1,077	469	384	(210)	829	267	(358)	(81)
Unrealised fair value changes on derivative contracts held for trading ²	A	-	6	514	(130)	-	(3)	(1,768)	451
Unrealised fair value change to derivative contracts held for financing ³	A	-	-	7	(2)	-	-	191	(47)
Exceptional programme credits/(charges) ⁴	B	-	21	-	(5)	-	69	(3)	-
Exceptional transformation and restructuring (charges)/credits ⁵	B	-	(102)	-	25	-	(47)	-	4
Impairment reversals/(charges) ⁶	C	-	8	-	(2)	-	(65)	-	-
Effect of acquisition accounting ⁷	C	-	(50)	-	12	-	(58)	-	9
Other ⁸	D	-	2	(105)	24	-	22	(36)	(71)
Gains arising on disposals of businesses	C	-	1	-	-	-	81	-	(2)
Recognition of deferred tax assets ⁹	D	-	-	-	385	-	-	-	93
Total underlying adjustments		1,077	355	810	97	829	266	(1,974)	356
Statutory performance per consolidated income statement		16,486	1,945	482	(23)	13,520	918	(2,420)	308

A - FX, B - Exceptional, C - M&A and Impairment, D - Other

1 The impact of measuring revenues and costs at the average exchange rate during the year and the impact of valuation of assets and liabilities using the year end exchange rate rather than the achieved rate or the exchange rate that is expected to be achieved by the use of the hedge book increased statutory revenues by £1,077m (2022: £829m) and increased profit before financing and taxation by £469m (2022: £267m). Underlying financing excludes the impact of revaluing monetary assets and liabilities at the year end exchange rate

2 The underlying results exclude the fair value changes on derivative contracts held for trading. These fair value changes are subsequently recognised in the underlying results when the contracts are settled

3 Includes net fair value gains of £1m (2022: £190m) on any interest rate swaps not designated into hedging relationships for accounting purposes

4 During the year to 31 December 2023, £21m of Trent 1000 wastage costs provision previously recognised in respect of estimated costs to settle obligations have been reversed to reflect the current status of claims in respect of the Trent 1000 technical issues which were identified in 2019

5 During the year to 31 December 2023, the Group incurred total transformation and restructuring related charges of £102m (2022: £47m). In 2023, the Group announced a major multi-year transformation programme which consists of seven workstreams that were set out in the 2022 Annual Report. During the year, £88m was incurred in relation to this multi-year programme, comprising £45m for advisory fees and transformation office costs, £37m related to impairments and write-offs and £6m related to severance costs. In the year to 31 December 2023, a £14m (2022: £47m) charge related to initiatives to enable restructuring under a previous programme

6 The Group has assessed the carrying value of its assets. Further details are provided in notes 8, 9, 10 and 11

7 The effect of acquisition accounting includes the amortisation of intangible assets arising on previous acquisitions

8 Includes interest received of £83m (2022: interest received of £14m) on interest rate swaps which are not designated into hedge relationships for statutory purposes from interest payable on an underlying basis to fair value movement and £2m (2022: credit of £22m) of past-service credit on defined benefit schemes

9 Relates to the recognition of deferred tax assets on UK tax losses of £328m and foreign exchange derivatives of £57m. The £93m recognised in 2022 relates to foreign exchange derivatives

2 Segmental analysis *continued***Balance sheet analysis**

	Civil Aerospace £m	Defence £m	Power Systems £m	New Markets £m	Total reportable segments £m
Year ended 31 December 2023					
Segment assets	17,718	3,517	3,814	115	25,164
Interests in joint ventures and associates	444	7	28	-	479
Segment liabilities	(24,437)	(3,369)	(1,760)	(87)	(29,653)
Net (liabilities)/assets	(6,275)	155	2,082	28	(4,010)
Investment in intangible assets, property, plant and equipment, right-of-use assets and joint ventures and associates	562	176	160	17	915
Depreciation, amortisation and impairment	719	105	194	9	1,027
Year ended 31 December 2022					
Segment assets	17,537	3,430	4,084	135	25,186
Interests in joint ventures and associates	387	4	31	-	422
Segment liabilities	(25,346)	(3,140)	(1,796)	(97)	(30,379)
Net (liabilities)/assets	(7,422)	294	2,319	38	(4,771)
Investment in intangible assets, property, plant and equipment, right-of-use assets and joint ventures and associates	415	146	177	16	754
Depreciation, amortisation and impairment	755	128	193	6	1,082

Reconciliation to the balance sheet

	2023 £m	2022 £m
Total reportable segment assets excluding held for sale	25,164	25,186
Other businesses	8	19
Corporate and Inter-segment	(1,673)	(2,125)
Interests in joint ventures and associates	479	422
Assets held for sale	109	-
Cash and cash equivalents and short-term investments	3,784	2,618
Fair value of swaps hedging fixed rate borrowings	118	194
Deferred and income tax assets	3,078	2,858
Post-retirement scheme surpluses	782	613
Total assets	31,849	29,785
Total reportable segment liabilities excluding held for sale	(29,653)	(30,379)
Other businesses	(58)	(34)
Corporate and Inter-segment	2,010	2,457
Liabilities associated with assets held for sale	(55)	-
Borrowings and lease liabilities	(5,759)	(5,955)
Fair value of swaps hedging fixed rate borrowings	(95)	(108)
Deferred and income tax liabilities	(473)	(390)
Post-retirement scheme deficits	(1,035)	(1,033)
Total liabilities	(35,118)	(35,442)
Net liabilities	(3,269)	(5,657)

The carrying amounts of the Group's non-current assets including investments but excluding financial instruments, deferred tax assets and post-retirement scheme surpluses/(deficits), by the geographical area in which the assets are located, are as follows:

	2023 £m	2022 £m
United Kingdom	4,981	5,202
Germany	2,052	2,151
United States	1,414	1,465
Other	705	735
	8,152	9,553

3 Research and development

	2023 £m	2022 £m
Gross research and development costs	(1,390)	(1,287)
Contributions and fees ¹	548	359
Expenditure in the year	(842)	(928)
Capitalised as intangible assets	192	131
Amortisation and impairment of capitalised costs ²	(89)	(94)
Net cost recognised in the income statement	(739)	(891)
Underlying adjustments relating to effects of acquisition accounting and foreign exchange	-	5
Net underlying cost recognised in the income statement	(739)	(886)

¹ Includes £531m (2022: £350m) of government funding

² See note 8 for analysis of amortisation and impairment

4 Net financing

	2023		2022	
	Statutory £m	Underlying ¹ £m	Statutory £m	Underlying ¹ £m
Interest receivable and similar income ²	184	184	35	35
Net fair value gains on foreign currency contracts	574	-	-	-
Net fair value gains on non-hedge accounted interest rate swaps ³	1	-	190	-
Net fair value gains on commodity contracts	-	-	106	-
Financing on post-retirement scheme surpluses	30	-	24	-
Net foreign exchange gains	394	-	-	-
Financing income	1,183	184	355	35
Interest payable	(369)	(275)	(343)	(320)
Net fair value losses on foreign currency contracts	-	-	(1,875)	-
Foreign exchange differences and changes in forecast payments relating to financial RSSAs	(1)	-	(7)	-
Net fair value losses on commodity contracts	(60)	-	-	-
Financing on post-retirement scheme deficits	(42)	-	(26)	-
Net foreign exchange losses	-	-	(358)	-
Cost of undrawn facilities	(57)	(57)	(61)	(61)
Other financing charges	(152)	(160)	(105)	(100)
Financing costs	(681)	(492)	(2,775)	(481)
Net financing income/(costs)	482	(328)	(2,420)	(446)
Analysed as:				
Net interest payable	(205)	(111)	(308)	(285)
Net fair value gains/(losses) on derivative contracts	515	-	(1,579)	-
Net post-retirement scheme financing	(12)	-	(2)	-
Net foreign exchange gains/(losses)	394	-	(358)	-
Net other financing	(210)	(217)	(173)	(161)
Net financing income/(costs)	482	(328)	(2,420)	(446)

¹ See note 2 for definition of underlying results

² Includes interest income on cash balances and short-term deposits of £117m (2022: £28m) and similar income of £47m (2022: £7m) on money market funds

³ The condensed consolidated income statement shows the net fair value gain/(loss) on any interest rate swaps not designated into hedging relationships for accounting purposes. Underlying financing reclassifies the fair value movements on these interest rate swaps to net interest payable

5 Taxation

	UK		Overseas		Total	
	2023 £m	2022 £m	2023 £m	2022 £m	2023 £m	2022 £m
Current tax charge for the year	(19)	18	256	159	275	177
Adjustments in respect of prior years	(1)	(5)	2	(8)	2	(13)
Current tax	(19)	13	258	151	277	164
Deferred tax charge/(credit) for the year	224	(427)	(69)	(61)	155	(488)
Adjustments in respect of prior years	(5)	4	2	12	(3)	16
Recognition of deferred tax	(408)	-	-	-	(408)	-
Deferred tax	(187)	(423)	(67)	(49)	(254)	(472)
(Credited)/charged in the income statement	(188)	(410)	191	102	23	(308)

Other tax (charges)/credits

	OCI				Equity	
	Items that will not be reclassified		Items that will be reclassified			
	2023 £m	2022 £m	2023 £m	2022 £m	2023 £m	2022 £m
Deferred tax:						
Movement in post-retirement schemes	(43)	89	-	-	-	-
Cash flow hedge	-	-	5	12	-	-
Net investment hedge	-	-	(1)	2	-	-
Share-based payments - direct to equity	-	-	-	-	22	1
Other tax (charges)/credits	(43)	89	4	14	22	1

Tax reconciliation on continuing operations

	2023 £m	2022 £m
Profit/(loss) before taxation from continuing operations	2,427	(1,502)
Less: share of results of joint ventures and associates (note 11)	(139)	(9)
Profit/(loss) before taxation from continuing operations excluding joint ventures and associates	2,288	(1,511)
Nominal tax charge/(credit) at UK corporation tax rate 23.5% (2022: 19%)	538	(287)
UK tax rate differential ¹	16	(69)
Overseas rate differences ²	9	18
Exempt gain on disposal of businesses ³	-	(14)
R&D credits	(18)	(7)
Other permanent differences	18	23
Benefit to deferred tax from previously unrecognised tax losses and temporary differences ⁴	(57)	(134)
Tax losses and other temporary differences not recognised in deferred tax ⁵	9	159
Benefit arising from previously unrecognised tax losses ⁶	(85)	-
Recognition of deferred tax assets ⁷	(408)	-
Adjustments in respect of prior years	(1)	3
Underlying items (note 2)	23	(308)
Non-underlying items	(97)	(356)
	23	(308)

Tax on discontinued operations

	2023 £m	2022 £m
Tax charge on loss before taxation from discontinued operations	11	10
Tax credit on disposal of discontinued operations	-	(31)
	11	(21)

¹ The UK tax rate differential arises on the difference between the deferred tax rate and the UK statutory tax rate

² Overseas rate differences mainly relate to tax on profits or losses in countries such as the US and Germany

³ The exempt gain in 2022 relates to the disposal of Airtanker Holdings Ltd

⁴ Benefit to deferred tax from previously unrecognised tax losses and temporary differences mainly relates to foreign exchange derivatives

⁵ Movement on tax losses not recognised relate to foreign exchange derivatives

⁶ Relates to foreign exchange derivatives

⁷ The recognition of deferred tax relates to UK tax losses

5 Taxation continued**Deferred taxation assets and liabilities**

	2023 £m	2022 £m
At 1 January	2,445	1,792
Amount credited to income statement	254	495
Amount (charged)/credited to OCI	(44)	91
Amount credited to hedging reserves	5	12
Amount credited to equity	22	1
On acquisition/disposal of businesses ¹	(1)	28
Exchange differences	(13)	26
At 31 December	2,668	2,445
Deferred tax assets	2,998	2,731
Deferred tax liabilities	(330)	(286)
	2,668	2,445

¹ The 2023 deferred tax relates to the acquisition of Team Italia Marine S.R.L. The 2022 deferred tax relates to the disposal of ITP Aero

The analysis of the deferred tax position is as follows:

	At 1 January £m	Recognised in income statement £m	Recognised in OCI £m	Recognised in equity £m	Disposals related activity £m	Exchange differences £m	At 31 December £m
2023							
Intangible assets	(436)	6	-	-	(1)	-	(431)
Property, plant and equipment	230	(7)	-	-	-	6	229
Other temporary differences ¹	850	88	4	22	-	(12)	752
Net contract liabilities	64	(4)	-	-	-	-	60
Pensions and other post-retirement scheme benefits	(57)	(15)	(43)	-	-	(8)	(123)
Foreign exchange and commodity financial assets and liabilities	893	(243)	-	-	-	1	451
Losses	1,072	417	-	-	-	-	1,489
R&D credit	67	12	-	-	-	-	79
Advance corporation tax ²	162	-	-	-	-	-	162
	2,445	254	(39)	22	(1)	(13)	2,668
Recognised in:							
Continuing operations		254					
2022							
Intangible assets	(464)	29	-	-	-	(1)	(436)
Property, plant and equipment	193	33	-	-	6	(2)	230
Other temporary differences ¹	465	133	(1)	1	44	8	650
Net contract liabilities	73	(9)	-	-	-	-	64
Pensions and other post-retirement scheme benefits	(140)	(19)	89	-	-	13	(57)
Foreign exchange and commodity financial assets and liabilities	362	329	15	-	(22)	9	693
Losses	1,085	(12)	-	-	-	(1)	1,072
R&D credit	56	11	-	-	-	-	67
Advance corporation tax ²	162	-	-	-	-	-	162
	1,792	495	103	1	28	26	2,445
Recognised in:							
Continuing operations		472					
Discontinued operations		23					

¹ Other temporary differences mainly relate to the deferral of relief for interest expenses in the UK and revenue recognised earlier under local GAAP compared to IFRS in Germany

² Prior to 1999 advance corporation tax was paid to the UK Tax Authority when cash dividends were paid by the Group. This was a payment on account which was available to offset against UK corporation tax liabilities. Any unused balance remaining after 1999 can be carried forward indefinitely and utilised against future UK corporation tax liabilities

5 Taxation continued**Unrecognised deferred tax assets**

	2023 £m	2022 £m
Advance corporation tax	19	19
UK losses	1,635	2,040
Foreign exchange and commodity financial assets and liabilities	69	218
Losses and other unrecognised deferred tax assets	34	33
Deferred tax not recognised on unused tax losses and other items on the basis that future economic benefit is uncertain	1,757	2,310

Gross amount and expiry of losses and other deductible temporary differences for which no deferred tax asset has been recognised.

2023				
	Total gross losses and deductible temporary differences £m	UK losses £m	Foreign exchange and commodity financial assets and liabilities £m	Other deductible temporary differences £m
Expiry within five years	81	-	-	81
Expiry within six to 30 years	216	-	-	216
No expiry	6,891	6,537	275	79
	7,188	6,537	275	376

2022				
	Total gross losses and deductible temporary differences £m	UK losses £m	Foreign exchange and commodity financial assets and liabilities £m	Other deductible temporary differences £m
Expiry within five years	83	-	-	83
Expiry within six to 30 years	265	-	-	265
No expiry	9,057	8,157	871	27
	9,405	8,157	871	375

In addition to the gross balances shown above, advance corporation tax of £19m (2022: £19m) has not been recognised. Advance corporation tax has no expiry.

Of the total deferred tax asset of £2,998m, £2,399m (2022: £2,183m) relates to the UK and is made up as follows:

- £1,476m (2022: £1,054m) relating to tax losses;
- £412m (2022: £668m) arising on unrealised losses on derivative contracts;
- £162m (2022: £162m) of advance corporation tax; and
- £349m (2022: £299m) relating to other deductible temporary differences, in particular tax depreciation and relief for interest expenses.

The UK deferred tax assets primarily arise in Rolls-Royce plc and have been recognised based on the expectation that the business will generate taxable profits and tax liabilities in the future against which the losses and deductible temporary differences can be utilised.

Most of the UK tax losses relate to the Civil Aerospace large engine business which makes initial losses through the investment period of a programme and then makes a profit through its contracts for services. The programme lifecycles are typically in excess of 30 years.

Deferred tax assets are recognised only to the extent it is probable that future taxable profits will be available against which the assets can be utilised. A recoverability assessment has been undertaken, taking account of deferred tax liabilities against which the reversal can be offset and using latest UK forecasts, which are mainly driven by the Civil Aerospace large engine business, to assess the level of future taxable profits.

5 Taxation *continued*

The recoverability of deferred tax assets has been assessed on the following basis:

- using the most recent UK profit forecasts, covering the next five years which are consistent with external sources on market conditions;
- the long-term forecast profit profile of existing large engine programmes which are typically in excess of 30 years from initial investment to retirement of the fleet, including the aftermarket revenues earned from airline customers;
- the long-term forecast is adjusted to exclude engine programmes which are in the development stage with no confirmed orders;
- taking into account the risk that regulatory changes could materially impact demand for our products;
- consideration that although all Civil Aerospace large engines are now compatible with sustainable fuels, there is a risk that in the longer term demand will shift towards more sustainable products and solutions;
- the long-term forecast profit and cost profile of the other parts of the UK business;
- taking into consideration past performance and experience as well as a 25% probability of a severe but plausible downside forecast materialising in relation to the civil aviation industry; and
- consideration that, whilst profitable in 2023, the UK business has historically been loss making.

The assessment takes into account UK tax laws that, in broad terms, restrict the offset of carried forward tax losses to 50% of current year profits. In addition, the amounts and timing of future taxable profits incorporate:

- the impact of new contracts signed in 2023. These include the trilateral AUKUS agreement involving the UK Defence business;
- the outcomes of strategic initiatives including cost and commercial optimisation;
- the growth in Civil Aerospace engine flying hours; and
- management's assumptions on the impact of macroeconomic factors and climate change on the UK business.

The climate change scenarios previously prepared to assess the viability of our business strategy, decarbonisation plans and approach to managing climate-related risks have continued to develop over the last year. The scale up of sustainable aviation fuel is expected to play a crucial role in reaching net zero carbon emissions by 2050 and the Group has demonstrated that all Civil Aerospace production engines are compatible with sustainable aviation fuels. The impact that this could have on our costs and customer pricing is factored into the deferred tax assessment. However, benefits that may arise in the future from the development of breakthrough new technologies are not taken into account.

Based on the assessment, the Group has recognised a total UK deferred tax asset of £2,399m, which includes the re-recognition of a £57m deferred tax asset on unrealised losses on foreign exchange derivative contracts and recognition of a further £406m (of which £328m is non-underlying and £78m is underlying) deferred tax asset relating to UK tax losses. This reflects the conclusions that:

- Based on current financial results and an improved outlook it is probable that the UK business will generate taxable income and tax liabilities in the future against which these losses can be utilised.
- Using current forecasts and various scenarios these losses and other deductible temporary differences will be used in full within 30-40 years, which is within the expected programme lifecycles. An explanation of the potential impact of climate change on forecast profits and sensitivity analysis can be found in note 1.

Any future changes in tax law or the structure of the Group could have a significant effect on the use of losses and other deductible temporary differences, including the period over which they can be used. In view of this and the significant judgement involved the Board continuously reassesses this area.

The other significant deferred tax asset arises in Rolls-Royce Deutschland Ltd & Co KG, where the main activity is business aviation. The total net deferred tax asset is £328m (2022: £284m), which has been recognised in full. The deferred tax asset relates to revenue being recognised and taxed earlier under local tax rules resulting in a benefit when revenue is recognised in the accounts.

The deferred tax liability on the UK pension surplus has been calculated using the enacted tax rate of 35%. The Statutory Instrument reducing the tax rate on authorised surplus pension charges from 35% to 25% effective from 6 April 2024 has been enacted on 11 March 2024. Had the reduction in the tax rate to 25% been enacted at the Balance Sheet date it would have had the effect of reducing the deferred tax liability by £77m.

The Group is within the scope of the OECD Pillar Two (Global Minimum Tax) model rules. The legislation has been substantively enacted in some of the main jurisdictions in which the Group operates including the UK and Germany where the rules will be effective from 1 January 2024. Initial assessments indicate that Pillar Two income taxes will not be material to the Group and a majority of the jurisdictions in which the Group operates will meet one of the transitional safe harbours. For those jurisdictions which are material or where the statutory tax rate is close to 15%, the assessment is based on 2023 data. Elsewhere prior year data has been used.

For the year to 31 December 2023, the Group has applied the mandatory exception to recognising and disclosing information about deferred tax assets and liabilities related to Pillar Two income taxes.

The temporary differences associated with investments in subsidiaries, joint ventures and associates, for which a deferred tax liability has not been recognised, aggregate to £1,230m (2022: £1,062m). No deferred tax liability has been recognised on the potential withholding tax due on the remittance of undistributed profits as the Group is able to control the timing of such remittances and it is probable that consent will not be given in the foreseeable future.

6 Auditors' remuneration

	2023 £m	2022 £m
Fees payable to the Company's auditors and its associates for the audit of the Parent company and consolidated financial statements	6.6	6.4
Fees payable to the Company's auditor and its associates for the audit of the Company's subsidiaries pursuant to legislation	5.5	5.5
Total fees payable for audit services	12.1	11.9
Fees payable to the Company's auditor and its associates for other services:		
Audit related assurance services ¹	0.7	1.3
Other assurance services ²	0.2	0.2
Total fees payable to the Company's auditor and its associates ³	13.0	13.4
Fees payable in respect of the Group's pension schemes:		
Audit	0.1	0.1

¹ This includes £0.7m (2022: £0.7m) for the review of the half-year report and £nil (2022: £0.6m) in respect of assurance procedures over certain grant claims

² This includes £0.1m (2022: £0.1m) in respect of agreed upon procedures in respect of levies payable and £0.1m for sustainability assurance work (2022: £0.1m)

³ Audit fees for overseas entities are reported at the average exchange rate for the year

7 Employee information

	2023 Number	2022 Number
United Kingdom	20,900	19,900
Germany	10,000	9,700
United States	5,300	5,000
Italy	900	900
Singapore	700	700
Canada	700	700
India	600	500
Spain	100	1,800
Rest of world	2,200	2,600
Monthly average number of employees	41,400	41,800
Civil Aerospace	18,300	17,700
Defence	12,000	11,000
Power Systems	9,800	9,400
New Markets	1,200	800
Corporate ¹	100	100
Monthly average number of employees excluding discontinued operations	41,400	39,000
ITP Aero (classified as discontinued operation)	-	2,800
Monthly average number of employees	41,400	41,800

	2023		2022	
	Total	Continuing operations	Discontinued operations	Total
	£m	£m	£m	£m
Wages, salaries and benefits	2,940	2,629	117	2,746
Social security costs	416	378	27	405
Share-based payments (note 23)	67	48	-	48
Pensions and other post-retirement scheme benefits (note 21)	346	268	2	270
Group employment costs ²	3,769	3,323	146	3,469

¹ Corporate consists of employees who do not provide a shared service to the segments. Where corporate functions provide such a service, employees have been allocated to the segments on an appropriate basis

² Remuneration of key management personnel is shown in note 25

8 Intangible assets

	Goodwill £m	Certification costs £m	Development expenditure £m	Customer relationships £m	Software ¹ £m	Other ² £m	Total £m
Cost:							
At 1 January 2022	1,060	933	3,393	475	978	833	7,672
Additions	-	-	131	-	78	21	230
Disposals	-	-	-	-	(90)	(1)	(91)
Exchange differences	75	2	80	37	12	33	239
At 31 December 2022	1,135	935	3,604	512	978	886	8,050
Additions	-	-	192	-	79	13	284
Acquisition of businesses (see note 26)	8	-	-	2	-	-	10
Transferred to held for sale ³	(10)	-	-	-	-	(185)	(195)
Transferred to current assets ⁴	-	-	-	-	(23)	-	(23)
Disposals	-	(4)	-	-	(27)	(2)	(33)
Reclassifications ⁵	-	-	(1)	-	3	(1)	1
Exchange differences	(32)	(1)	(32)	(16)	(6)	(12)	(99)
At 31 December 2023	1,101	930	3,783	498	1,004	699	7,995
Accumulated amortisation and impairment:							
At 1 January 2022	34	425	1,760	342	650	420	3,631
Charge for the year ⁶	-	21	77	35	86	33	252
Impairment	-	-	17	-	13	5	35
Disposals	-	-	-	-	(82)	(1)	(83)
Exchange differences	2	1	58	29	8	19	117
At 31 December 2022	36	447	1,912	406	675	476	3,952
Charge for the year ⁶	-	24	89	41	84	41	279
Impairment	-	-	-	-	-	(7)	(7)
Transferred to held for sale ³	-	-	-	-	-	(144)	(144)
Transferred to current assets ⁴	-	-	-	-	(14)	-	(14)
Disposals	-	(4)	-	-	(23)	(2)	(29)
Reclassifications ⁵	-	-	-	-	1	(1)	-
Exchange differences	(1)	-	(25)	(14)	(5)	(6)	(51)
At 31 December 2023	35	467	1,976	433	718	357	3,986
Net book value at:							
At 31 December 2023	1,066	463	1,787	65	286	342	4,009
At 31 December 2022	1,099	488	1,692	106	303	410	4,098

¹ Includes £97m (2022: £93m) of software under course of construction which is not amortised

² Other intangibles includes trademarks, brands and the costs incurred testing and analysing engines with the longest time in service (fleet leader engines) to gather technical knowledge on engine endurance which will improve reliability and enable the Group to reduce the costs of meeting LTSA obligations

³ At 31 December 2023, the Group held for sale the assets and liabilities of the off-highway engines business in the lower power range based in Power Systems. See note 26 for further detail

⁴ During the year, the Group signed a service concession arrangement with a customer effective from 1 January 2024. Accordingly, assets that will be derecognised have been transferred to trade receivables and other assets to reflect the nature of these assets as current assets

⁵ Includes reclassifications within intangible assets or from property, plant and equipment when available for use

⁶ Charged to cost of sales and commercial and administrative costs except development costs, which are charged to research and development costs

At 31 December 2023, the Group had expenditure commitments for software of £30m (2022: £37m).

The carrying amount of goodwill or intangible assets allocated across multiple CGUs is not significant in comparison with the Group's total carrying amount of goodwill or intangible assets with indefinite useful lives.

8 Intangible assets *continued*

Goodwill

In accordance with the requirements of IAS 36, goodwill is allocated to the Group's CGUs, or groups of CGUs, that are expected to benefit from the synergies of the business combination that gave rise to the goodwill as follows:

Cash-generating unit (CGU) or group of CGUs

	Primary operating segment	2023 £m	2022 £m
Rolls-Royce Power Systems AG	Power Systems	788	818
Rolls-Royce Deutschland Ltd & Co KG	Civil Aerospace	237	241
Other	Various	31	40
		1,056	1,099

Goodwill has been tested for impairment during 2023 on the following basis:

- The carrying values of goodwill have been assessed by reference to the recoverable amount, being the higher of value in use or fair value less costs of disposal (FVLCOB).
- The recoverable amount has been estimated using cash flows from the most recent forecasts prepared by the Directors, which are consistent with past experience and external sources of information on market conditions. These forecasts generally cover the next five years. Growth rates for the period not covered by the forecasts are based on growth rates of 2% which reflects the products, industries and countries in which the relevant CGU or group of CGUs operate. Inflation has been included based on contractual commitments where relevant. Where general inflation assumptions have been required, these have been estimated based on externally sourced data. General inflation assumptions of 2% to 4% have been included in the forecasts, depending on the nature and geography of the flows.
- The key forecast assumptions for the impairment tests are the discount rate and the cash flow projections, in particular the programme assumptions (such as sales volumes and product costs), the impact of foreign exchange rates on the relationship between selling prices and costs, and growth rates. Impairment tests are performed using prevailing exchange rates.
- The Group believes there are significant business growth opportunities to come from Rolls-Royce playing a leading role in the transition to net zero, whilst at the same time climate change poses potentially significant risks. The assumptions used by the Directors are based on past experience and external sources of information. Based on the climate scenarios prepared, the forecasts do not assume a significant deterioration of demand for Civil Aerospace (including Rolls-Royce Deutschland) programmes given that all commercial aero-engines were compatible with sustainable fuels by the end of 2023. Similarly, 80% of the engines in Power Systems are compatible with sustainable fuels. The investment required to ensure our new products will be compatible with net zero operation, and to achieve net zero scope 1 + 2 GHG emissions is reflected in the forecasts used.

A 1.5°C scenario has been prepared using key data points from external sources, including Oxford Economics, Global Climate Service and Databank and the International Energy Agency. This scenario has been used as the basis of a sensitivity. It is assumed that governments adopt stricter product and behavioural standards and measures that result in higher carbon pricing. Under these conditions, it is assumed that markets are willing to pay for low carbon solutions and that there is an economic return from strategic investments in low carbon alternatives. The sensitivity has considered the likelihood of demand changes for our products based on their relative fuel efficiency in the marketplace and the probability of alternatives being introduced earlier than currently expected. The sensitivity also reflects the impact of a broad range of potential costs imposed by policy or regulatory interventions (through carbon pricing). This sensitivity does not indicate the need for an impairment charge.

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

Rolls-Royce Power Systems AG

- Recoverable amount represents FVLCOB to reflect the future strategy of the business. The Directors consider that disclosing information prepared on a FVLCOB basis here is a more useful representation of the recoverable amount when considering the future strategy of the business, including the impact of climate-related risks and opportunities. Due to the unavailability of observable market inputs or inputs based on market evidence, the fair value is estimated by discounting future cash flows (Level 3 as defined by IFRS 13 *Fair Value Measurement*) modified for market participants' views;
- Trading assumptions (e.g. volume of equipment deliveries, pricing achieved and cost escalation) that are based on current and known future programmes, estimates of market share and long-term economic forecasts;
- Plausible downside scenario in relation to macro-economic factors included with a 25% weighting;
- Cash flows beyond the five-year forecasts are assumed to grow at 2.0% (2022: 1.0%); and
- Nominal post-tax discount rate 9.2% (2022: 10.0%).

The Directors do not consider that any reasonably possible changes in the key assumptions (including taking consideration of the climate-related risks above) would cause the FVLCOB of the business to fall below its carrying value of goodwill.

8 Intangible assets continued

Rolls-Royce Deutschland Ltd & Co KG

- Recoverable amount represents the value in use of the assets in their current condition;
- Trading assumptions (e.g. volume of engine deliveries, flying hours of installed fleet, including assumptions on the recovery of the aerospace industry, and cost escalation) that are based on current and known future programmes, estimates of market share and long-term economic forecasts; Plausible downside scenario in relation to macro-economic factors included with a 25% weighting;
- Cash flows beyond the five-year forecasts are assumed to grow at 2.0% (2022: 2.0%); and
- Nominal post-tax discount rate of 14.4% (2022: 13.2%).

The Directors do not consider that any reasonably possible changes in the key assumptions (including taking consideration of the climate-related risks above) would cause the value in use of the goodwill to fall below its carrying value.

Other CGUs

Goodwill balances across the Group that are not considered to be individually significant were also tested for impairment, resulting in no impairment charge (2022: £nil) being recognised at 31 December 2023.

Material intangible assets (excluding goodwill)

The carrying amounts and the residual life of the material intangible assets (excluding goodwill) for the Group are as follows:

	Residual life ¹	Net book value	
		2023 £m	2022 £m
Trent programme intangible assets ²	2-15 years	1,920	1,826
Business aviation programme intangible assets ³	11-15 years	238	250
Intangible assets related to Power Systems ⁴		370	466
		2,528	2,542

¹ Residual life reflects the remaining amortisation period of those assets where amortisation has commenced. As per page 64, the amortisation period of 15 years will commence on those assets which are not being amortised as the units are delivered

² Included within the Trent programmes are the Trent 1000, Trent 7000 and Trent XWB

³ Included within business aviation are the Pearl 700 and Pearl 15

⁴ Includes £112m (2022: £114m) in respect of a brand intangible asset which is not amortised. Remaining assets are amortised over a range of three to 15 years

Intangible assets (including programme intangible assets) have been reviewed for impairment in accordance with IAS 36. Assessments have considered potential triggers of impairment such as external factors including climate change, significant changes with an adverse effect on a programme and by analysing latest management forecasts against those prepared in 2022 to identify any deterioration in performance. Where a trigger event has been identified, an impairment test has been carried out. Where an impairment was required, the test was 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 the Directors, which are consistent with past experience and external sources of information on market conditions over the lives of the respective programmes; and
- The key assumptions underpinning cash flow projections are based on estimates of product performance related estimates, future market share and pricing and cost for uncontracted business. Climate-related risks are considered when making these estimates consistent with the assumptions above.

There have been no (2022: none) individually material impairment charges or reversals recognised during the year.

9 Property, plant and equipment

	Land and buildings £m	Plant and equipment £m	Aircraft and engines £m	In course of construction £m	Total £m
Cost:					
At 1 January 2022	1,865	4,986	1,046	300	8,197
Additions	34	127	26	162	349
Disposals/write-offs	(38)	(142)	(81)	(1)	(262)
Reclassifications ¹	3	82	(3)	(82)	-
Exchange differences	72	172	11	21	276
At 31 December 2022	1,936	5,225	999	400	8,560
Additions	19	147	34	223	423
Transferred to current assets ²	(90)	(93)	-	(43)	(226)
Disposals/write-offs	(19)	(309)	(33)	(9)	(370)
Reclassifications ¹	69	78	13	(146)	14
Exchange differences	(32)	(86)	(7)	(13)	(138)
At 31 December 2023	1,883	4,962	1,006	412	8,263
Accumulated depreciation and impairment:					
At 1 January 2022	614	3,244	414	8	4,280
Charge for the year ³	79	296	55	-	430
Impairment	5	(5)	-	-	-
Disposals/write-offs	(24)	(142)	(57)	-	(223)
Reclassifications ¹	(2)	5	(3)	-	-
Exchange differences	23	109	4	1	137
At 31 December 2022	695	3,507	413	9	4,624
Charge for the year ³	70	296	40	-	406
Impairment ⁴	4	6	1	6	17
Transferred to current assets ²	(48)	(61)	-	-	(109)
Disposals/write-offs	(18)	(299)	(25)	-	(342)
Reclassifications ¹	17	(9)	8	(7)	9
Exchange differences	(11)	(56)	(3)	-	(70)
At 31 December 2023	709	3,384	434	8	4,535
Net book value at:					
At 31 December 2023	1,174	1,578	572	404	3,728
At 31 December 2022	1,241	1,718	586	391	3,936

¹ Includes reclassifications between categories of property, plant and equipment and of assets under construction to the relevant classification in property, plant and equipment right-of-use assets or intangible assets when available for use

² During the year, the Group signed a service concession arrangement with a customer effective from 1 January 2024. Accordingly, assets that will be derecognised have been transferred to trade receivables and other assets to reflect the nature of these assets as current assets

³ Depreciation is charged to cost of sales and commercial and administrative costs or included in the cost of inventory as appropriate

⁴ The carrying values of property, plant and equipment have been assessed during the year in line with IAS 36. Material items of plant and equipment and aircraft and engines are assessed for impairment together with other assets used in individual programmes – see potential triggers considered in note 8. Land and buildings are generally used across multiple programmes and are considered based on future expectations of the use of the site, which includes any implications from climate-related risks. As a result of this assessment, there are no (2022: none) individually material impairment charges or reversals in the year

Property, plant and equipment includes:

	2023			2022		
	Land and buildings £m	Plant and equipment £m	Aircraft and engines £m	Land and buildings £m	Plant and equipment £m	Aircraft and engines £m
Assets held for use in leases where the Group is the lessor:						
Cost	6	38	760	6	41	732
Depreciation	(4)	(21)	(348)	(4)	(22)	(317)
Net book value	2	17	412	2	19	415
				2023 £m	2022 £m	
Capital expenditure commitments				222	221	
Cost of fully depreciated assets				2,084	2,184	

The Group's share of equity accounted entities' capital commitments is £16m (2022: £34m).

10 Right-of-use assets

	Land and buildings £m	Plant and equipment £m	Aircraft and engines £m	Total £m
Cost:				
At 1 January 2022	456	143	1,785	2,384
Additions/modifications of leases	52	34	59	145
Disposals	(30)	(19)	(22)	(71)
Exchange differences	28	4	5	37
At 31 December 2022	506	162	1,827	2,495
Additions/modifications of leases	38	56	104	198
Acquisition of businesses (see note 26)	2	-	-	2
Disposals	(8)	(22)	(54)	(82)
Transferred to current assets ¹	(4)	-	-	(4)
Reclassifications to PPE	(5)	-	(10)	(15)
Exchange differences	(18)	(2)	(3)	(23)
At 31 December 2023	513	194	1,864	2,571
Accumulated depreciation and impairment:				
At 1 January 2022	186	66	929	1,181
Charge for the year ²	43	37	190	270
Impairment ³	(2)	(1)	20	17
Disposals	(13)	(19)	(22)	(54)
Exchange differences	16	1	3	20
At 31 December 2022	230	84	1,120	1,434
Charge for the year ²	42	42	179	263
Impairment ³	3	6	62	71
Disposals	(6)	(22)	(54)	(82)
Transferred to current assets ¹	-	-	-	-
Reclassifications from PPE	(1)	-	(8)	(9)
Exchange differences	(9)	(1)	(1)	(11)
At 31 December 2023	259	109	1,298	1,666
Net book value at:				
At 31 December 2023	254	85	566	905
At 31 December 2022	276	78	707	1,061
Right-of-use assets held for use in operating leases where the Group is the lessor:				
Cost	6	-	1,864	1,870
Depreciation	(3)	-	(1,298)	(1,301)
Net book value at 31 December 2023	3	-	566	569
Cost	6	-	1,827	1,833
Depreciation	(3)	-	(1,120)	(1,123)
Net book value at 31 December 2022	3	-	707	710

¹ During the year, the Group signed a service concession arrangement with a customer effective from 1 January 2024. Accordingly, assets that will be derecognised have been transferred to trade receivables and other assets to reflect the nature of these assets as current assets

² Depreciation is charged to cost of sales and commercial and administrative costs as appropriate

³ The carrying values of right-of-use assets have been assessed during the year in line with IAS 36. Material items of plant and equipment and aircraft and engines are assessed for impairment together with other assets used in individual programmes – see potential triggers considered in note 8. Land and buildings are generally used across multiple programmes and are considered based on future expectations of the use of the site (which includes any implications from climate-related risks). As a result of this assessment, the carrying values of assets, where a trigger was identified, have been assessed by reference to value in use considering assumptions such as estimated future cash flows, product performance related estimates and climate-related risks. An impairment charge of £71m has been recognised, which includes £27m in relation to lease engines that have been returned following the termination of the lease by the lessee. In addition, during the year, a number of existing leases were extended as a result of renegotiations. An assessment was performed in reference to value in use to support the increase in asset value over the extended lease term, and as a result, an impairment of £26m has been recognised in Civil Aerospace (2022: no individually material impairment charges or reversals)

11 Investments

Composition of the Group

The entities contributing to the Group's financial results are listed on pages 142 to 147.

Where the Group does not own 100% of the shares of a group undertaking, there are a number of arrangements with the other shareholder(s) that give the Group the option or potential obligation to acquire the third parties' shares. These arrangements have been assessed and are not considered to have a significant value, individually or in aggregate.

The Group does not have any non-wholly owned subsidiaries that have a material non-controlling interest.

Equity accounted and other investments

	Equity accounted			Other ¹
	Joint ventures £m	Associates £m	Total £m	£m
At 1 January 2022	403	1	404	36
Additions	29	-	29	7
Disposals	-	(1)	(1)	(2)
Impairment	(74)	-	(74)	(1)
Share of retained loss ²	(25)	-	(25)	-
Reclassification of deferred profit to deferred income ³	(4)	-	(4)	-
Repayment of loans	(5)	-	(5)	-
Revaluation of other investments accounted for at FVOCI	-	-	-	(4)
Exchange differences	96	-	96	-
Share of OCI	2	-	2	-
At 1 January 2023	422	-	422	36
Additions ⁴	9	-	9	-
Disposals	(5)	-	(5)	(1)
Share of retained profit ²	119	-	119	-
Reclassification of deferred profit to deferred income ³	(18)	-	(18)	-
Revaluation of other investments accounted for at FVOCI	-	-	-	(4)
Exchange differences	(50)	-	(50)	-
Share of OCI	2	-	2	-
At 31 December 2023	479	-	479	31

¹ Other investments includes unlisted investments of £24m (2022: £26m) and listed investments of £7m (2022: £10m)

² See table below

³ The Group's share of unrealised profit on sales to joint ventures is eliminated against the carrying value of the investment in the entity. Any excess amount, once the carrying value is reduced to nil, is recorded as deferred income

⁴ During the year, additions to investments of £9m includes the second instalment of investment related to the joint venture, Beijing Aero Engine Services Company Limited of £6m

Reconciliation of share of retained profit/(loss) to the income statement and cash flow statement:

	2023 £m	2022 £m
Share of results of joint ventures and associates	139	9
Adjustments for intercompany trading ¹	34	39
Share of results of joint ventures and associates to the Group	173	48
Dividends paid by joint ventures and associates to the Group (cash flow statement)	(54)	(73)
Share of retained profit/(loss) (above)	119	(25)

¹ During the year, the Group sold spare engines to Rolls-Royce & Partners Finance, a joint venture and subsidiary of Alpha Partners Leasing Limited. The Group's share of the profit on these sales is deferred and released to match the depreciation of the engines in the joint venture's financial statements. In 2023 and 2022, profit deferred on the sale of engines was lower than the release of that deferred in prior years

11 Investments continued

The following joint ventures are considered to be individually material to the Group:

	Principal location	Activity	Ownership interest
Alpha Partners Leasing Limited (APL)	UK	Aero-engine leasing	50.0%
Hong Kong Aero Engine Services Limited (HAESL)	Hong Kong	Aero-engine repair and overhaul	50.0%
Singapore Aero Engine Services Pte Limited (SAESL)	Singapore	Aero-engine repair and overhaul	50.0%

Summarised financial information of the Group's individually material joint ventures is as follows:

	APL		HAESL		SAESL	
	2023	2022	2023	2022	2023	2022
	£m	£m	£m	£m	£m	£m
Revenue	371	310	3,214	2,388	2,224	2,012
Profit and total comprehensive income for the year	106	55	73	72	29	31
Dividends paid during the year	(5)	(22)	(67)	(66)	-	-
Profit for the year included the following:						
Depreciation and amortisation	(166)	(190)	(11)	(13)	(20)	(21)
Interest income	15	-	-	-	7	1
Interest expense	(122)	(89)	(4)	(2)	(2)	(3)
Income tax expense	(37)	(13)	(14)	(14)	(2)	(2)
Current assets	336	375	1,103	886	954	865
Non-current assets	3,048	3,199	93	98	130	154
Current liabilities	(261)	(480)	(886)	(716)	(790)	(687)
Non-current liabilities	(2,358)	(2,389)	(73)	(26)	(8)	(60)
Net assets	765	705	237	242	286	272
Included in the above:						
Cash and cash equivalents	223	239	12	6	99	61
Current financial liabilities ¹	(165)	(411)	-	(135)	-	-
Non-current financial liabilities ¹	(1,914)	(2,003)	(66)	(17)	(8)	(60)

Reconciliation to the carrying amount recognised in the Consolidated Financial Statements

	50.0%	50.0%	50.0%	50.0%	50.0%	50.0%
Ownership interest	50.0%	50.0%	50.0%	50.0%	50.0%	50.0%
Group share of net assets above	383	353	119	121	143	136
Goodwill	-	-	36	38	11	11
Adjustments for intercompany trading	(383)	(353)	-	(2)	(4)	-
Included in the balance sheet	-	-	155	157	150	147

¹ Excluding trade payables and other liabilities

The summarised aggregated results of the Group's share of equity accounted investments is as follows:

	Individually material joint ventures (above)		Other joint ventures		Associates		Total	
	2023	2022	2023	2022	2023	2022	2023	2022
	£m	£m	£m	£m	£m	£m	£m	£m
Profit/(loss) and total comprehensive income for the year	104	79	37	(68)	-	-	141	11
Assets:								
Non-current assets	1,637	1,726	159	199	-	-	1,796	1,925
Current assets	1,197	1,063	359	327	-	-	1,556	1,390
Liabilities: ¹								
Current liabilities	(969)	(942)	(264)	(245)	-	-	(1,233)	(1,187)
Non-current liabilities	(1,220)	(1,237)	(43)	(58)	-	-	(1,263)	(1,295)
Group adjustment for goodwill	47	49	-	-	-	-	47	49
Adjustment for intercompany trading	(387)	(355)	(37)	(105)	-	-	(424)	(460)
Included in the balance sheet	305	304	174	118	-	-	479	422
¹ Liabilities include borrowings of:	(1,076)	(1,313)	(60)	(84)	-	-	(1,136)	(1,397)

12 Inventories

	2023 £m	2022 £m
Raw materials	516	479
Work in progress	1,679	1,633
Finished goods	2,853	2,593
Payments on account	-	3
	4,848	4,708
Inventories stated at net realisable value	187	209
Amount of inventory write-down	79	85
Reversal of inventory write-down	21	27

13 Trade receivables and other assets

	Current		Non-current ¹		Total	
	2023 £m	2022 £m	2023 £m	2022 £m	2023 £m	2022 £m
Trade receivables	2,724	2,376	40	43	2,764	2,419
Prepayments ²	1,032	737	102	37	1,134	774
RRSA prepayment for LTSA parts ²	236	149	1,084	856	1,320	1,005
Receivables due on RRSAs	1,159	928	193	255	1,352	1,183
Amounts owed by joint ventures and associates	731	632	10	16	741	648
Amounts due from parent undertakings ³	-	335	337	-	337	335
Other taxation and social security receivable	160	147	13	9	173	156
Costs to obtain contracts with customers ⁴	7	12	109	67	116	79
Other receivables and similar assets ⁴	478	617	45	55	523	672
	6,527	5,933	1,933	1,338	8,460	7,271

Trade receivables and other assets are analysed as follows:

Financial Instruments (note 19):		
Trade receivable and similar items	5,194	4,482
Other non-derivative financial assets	332	775
Non-financial instruments	2,934	2,014
	8,460	7,271

1 Trade receivables and other assets have been presented on the face of the balance sheet in line with the operating cycle of the business. Further disclosure is included in the table above and relate to amounts not expected to be received in the next 12 months in line with specific customer payment arrangements, including customers on payment plans

2 At 31 December 2023, prepayments to RRSA partners for LTSA parts have been shown separately to provide additional detail for the reader. These amounts reflect the contractual share of EFH flows from customers paid to RRSA partners in return for the supply of parts in future periods under long-term supply contracts. In the prior year, these amounts were included within prepayments. There is no change to the total amount of trade receivables and other assets

3 Amounts due from parent undertakings are interest free and repayable on demand. Whilst the Company could demand repayment, the Directors consider that the intention would be to not call upon this balance for repayment in the next 12 months, but is expected to be settled within the normal operating cycle

4 These are amortised over the term of the related contract in line with engine deliveries, resulting in amortisation of £9m (2022: £11m) in the year. There were no impairment losses

5 Other receivables includes unbilled recoveries relating to completed overhaul activity where the right to consideration is unconditional

The Group has adopted the simplified approach to provide for ECLs, measuring the loss allowance at a probability weighted amount incorporated by using credit ratings which are publicly available, or through internal risk assessments derived using the customer's latest available financial information.

The ECLs for trade receivables and other financial assets has decreased by £(104)m to £242m (2022: increased by £87m to £346m). This movement is mainly driven by the Civil Aerospace business of £(100)m, of which £(82)m relates to specific customers and £(18)m relates to updates to the recoverability of other receivables.

The assumptions and inputs used for the estimation of the ECLs are shown in the table below:

	2023			2022		
	Trade receivables and other financial assets £m	Loss allowance £m	Average ECL rate %	Trade receivables and other financial assets £m	Loss allowance £m	Average ECL rate %
Credit rating C and above	2,081	(102)	5%	1,972	(177)	9%
Credit rating below C	80	(6)	8%	124	(16)	13%
Without credit rating	3,807	(134)	4%	3,507	(153)	4%
	5,768	(242)	4%	5,603	(346)	6%

13 Trade receivables and other assets continued

The movements of the Group's ECLs provision are as follows:

	2023 £m	2022 £m
At 1 January	(348)	(259)
Increases in loss allowance recognised in the income statement during the year	(80)	(118)
Loss allowance utilised	34	22
Releases of loss allowance previously provided	128	45
Exchange differences	22	(36)
At 31 December	(242)	(346)

14 Contract assets and liabilities

	Current		Non-current ¹		Total ²	
	2023 £m	2022 £m	2023 £m	2022 £m	2023 £m	2022 £m
Contract assets						
Contract assets with customers	534	621	481	617	1,015	1,238
Participation fee contract assets	26	28	201	215	227	243
	560	649	682	832	1,242	1,481

¹ Contract assets and contract liabilities have been presented on the face of the balance sheet in line with the operating cycle of the business. Contract liabilities are further split according to when the related performance obligation is expected to be satisfied and therefore when revenue is estimated to be recognised in the income statement. Further disclosure of contract assets is provided in the table above, which shows within current the element of consideration that will become unconditional in the next year.

² Contract assets are classified as non-financial instruments.

The balance includes £494m (2022: £885m) of Civil Aerospace LTSA assets and £410m (2022: £263m) Defence LTSA assets.

The decrease in the Civil Aerospace balance is due to higher invoicing than revenue recognised in relation to the completion of performance obligations on those contracts with a contract asset balance. Revenue recognised relating to performance obligations satisfied in previous years was £64m (2022: £26m) in Civil Aerospace.

The increase in the Defence balance is due to revenue recognition in relation to performance obligations completed being higher than the payments received from the customer.

No impairment losses in relation to these contract assets (2022: none) have arisen during the year.

Participation fee contract assets have reduced by £16m (2022: £3m) due to amortisation of £15m and foreign exchange on consolidation of £1m.

The absolute value of ECLs for contract assets has decreased by £15m to £6m (2022: £21m).

	Current		Non-current		Total	
	2023 £m	2022 £m	2023 £m	2022 £m	2023 £m	2022 £m
Contract liabilities	6,098	4,825	8,438	7,337	14,536	12,162

Contract liabilities are analysed as follows¹:

Financial Instruments (note 19)	1,358	420
Non-financial instruments	13,178	11,742
	14,536	12,162

¹ Amounts within contract liabilities as at 31 December 2022 have been represented to better reflect the nature of the balance between financial and non-financial instruments. This resulted in an increase in financial instruments of £586m and a corresponding decrease in non-financial instruments. There is no impact to total contract liabilities.

During the year £3,813m (2022: £3,321m) of the opening contract liability was recognised as revenue.

Contract liabilities have increased by £2,374m. The movement in the Group balance is largely as a result of increases in Civil Aerospace of £1,865m and Defence of £381m. The Civil Aerospace increase is primarily a result of growth in LTSA liabilities of £1,317m to £9,574m (2022: £8,257m) driven by price escalation, the continued rise in EFHs and the associated customer receipts, as well as commercial discipline driving more timely invoicing and recovery of contractual fees. In 2023 contract liabilities increased by £168m as a result of revenue recognised in relation to performance obligations satisfied in previous years (2022: £334m decrease). The increase in Defence is from the receipt of deposits in advance of performance obligations being completed.

15 Cash and cash equivalents

	2023 £m	2022 £m
Cash at bank and in hand	739	847
Money-market funds	1,077	34
Short-term deposits	1,988	1,726
Cash and cash equivalents per the balance sheet	3,784	2,607
Overdrafts (note 16)	(53)	(2)
Cash and cash equivalents per cash flow statement (page 49)	3,731	2,605

Cash and cash equivalents at 31 December 2023 includes £279m (2022: £235m) that is not available for general use by the Group. This balance includes £40m (2022: £40m) which is held in an account that is exclusively for the general use of Rolls-Royce Submarines Limited and £195m (2022: £138m) which is held exclusively for the use of Rolls-Royce Saudi Arabia Limited. This cash is not available for use by other entities within the Group. The remaining balance relates to cash held in non-wholly owned subsidiaries and joint arrangements.

Balances are presented on a net basis, when the Group has both a legal right of offset and the intention to either settle on a net basis or realise the asset and settle the liability simultaneously.

16 Borrowings and lease liabilities

	Current		Non-current		Total	
	2023 £m	2022 £m	2023 £m	2022 £m	2023 £m	2022 £m
Unsecured						
Overdrafts	53	2	-	-	53	2
Bank loans	3	1	-	-	3	1
0.875% Notes 2024 €550m ¹	475	-	472	-	475	472
3.625% Notes 2025 \$1,000m ¹	-	-	770	801	770	801
3.375% Notes 2026 £375m ²	-	-	361	351	361	351
4.625% Notes 2026 €750m ³	-	-	649	661	649	661
5.75% Notes 2027 \$1,000m ³	-	-	782	825	782	825
5.75% Notes 2027 £545m	-	-	542	541	542	541
1.625% Notes 2028 €550m ¹	-	-	455	444	455	444
Other loans	-	-	9	10	9	10
Total unsecured	531	3	3,568	4,105	4,099	4,108
Lease liability – Land and buildings	42	46	382	400	424	446
Lease liability – Aircraft and engines	203	278	949	1,047	1,152	1,325
Lease liability – Plant and equipment	33	31	151	45	84	76
Total lease liabilities	278	355	1,382	1,492	1,660	1,847
Total borrowings and lease liabilities	809	358	4,950	5,597	5,759	5,955

All outstanding items described as notes above are listed on the London Stock Exchange

- These notes are the subject of cross-currency interest rate swap agreements under which the Group has undertaken to pay floating rates of GBP interest, which form a fair value hedge. They are also subject to interest rate swap agreements under which the Group has undertaken to pay fixed rates of interest, which are classified as fair value through profit and loss
- These notes are the subject of interest rate swap agreements under which the Group has undertaken to pay floating rates of interest, which form a fair value hedge. They are also subject to interest rate swap agreements under which the Group has undertaken to pay fixed rates of interest, which are classified as fair value through profit and loss
- These notes are the subject of cross-currency interest rate swap agreements under which the Group has undertaken to pay fixed rates of GBP interest, which form a cash flow hedge

The Group has access to the following undrawn committed borrowing facilities at the end of the year:

	2023 £m	2022 £m
Expiring within one year	751	-
Expiring after one year	3,500	5,500
Total undrawn facilities	3,500	5,500

Further details can be found in the going concern and liquidity statements on page 36.

During the year to 31 December 2023, the Group cancelled its undrawn £1bn bank loan facility which was due to mature in January 2024 and its undrawn UKEF £1bn facility which was due to mature in March 2026. These facilities had remained undrawn during the year. In addition, the Group replaced the £2,500m committed bank borrowing facility with a new £2,500m facility with a maturity date of November 2026 with the banks having the option to extend with two one-year extension options (3+1+1).

17 Leases**Leases as lessee**

The net book value of lease right-of-use assets at 31 December 2023 was £905m (2022: £1,016m), with a lease liability of £1,660m (2022: £1,947m), per notes 10 and 16, respectively. Leases that have not yet commenced to which the Group is committed have a future liability of £5m and consist of mainly plant and equipment and properties. The consolidated income statement shows the following amounts relating to leases:

	2023	2022
	£m	£m
Land and buildings depreciation and impairment ¹	(49)	(41)
Plant and equipment depreciation and impairment ²	(48)	(56)
Aircraft and engines depreciation and impairment ³	(241)	(210)
Total depreciation and impairment charge for right-of-use assets	(338)	(287)
Adjustment of amounts payable under residual value guarantees within lease liabilities ^{3,4}	10	3
Expense relating to short-term leases of 12 months or less recognised as an expense on a straight-line basis²	(49)	(28)
Expense relating to variable lease payments not included in lease liabilities^{3,5}	(5)	(2)
Total operating costs	(378)	(314)
Interest expense ⁶	(85)	(68)
Total lease expense	(463)	(382)
Income from sub-letting right-of-use assets	31	32
Total amount recognised in income statement	(432)	(350)

¹ Included in cost of sales and commercial and administration costs depending on the nature and use of the right-of-use asset

² Included in cost of sales, commercial and administration costs, or research and development depending on the nature and use of the right-of-use asset

³ Included in cost of sales

⁴ Where the cost of meeting residual value guarantees is less than that previously estimated, as could have been mitigated or liabilities waived by the lessor, the lease liability has been remeasured. Where the value of this remeasurement exceeds the value of the right-of-use asset, the reduction in the lease liability is credited to cost of sales

⁵ Variable lease payments primarily arise on a small number of contracts where engine lease payments are dependent upon utilisation rather than a periodic charge

⁶ Included in financing costs

The total cash outflow for leases in 2023 was £429m (2022: £316m). Of this, £375m related to leases reflected in the lease liability, £49m to short-term leases where lease payments are expensed on a straight-line basis and £5m for variable lease payments where obligations are only due when the assets are used. The timing difference between income statement charge and cash flow relates to costs incurred at the end of leases for residual value guarantees and restoration costs that are recognised within depreciation over the term of the lease, the most significant amounts relate to engine leases.

Engine leases in the Civil Aerospace business often include clauses that require the engines to be returned to the lessor with specific levels of usable life remaining or cash payments to the lessor. The costs of meeting these requirements are included in the lease payments. The amounts payable are calculated based upon an estimate of the utilisation of the engines over the lease term, whether the engine is restored to the required condition by performing an overhaul at our own cost or through the payments of amounts specified in the contract and any new contractual arrangements arising when the current lease contracts end. Amounts due can vary depending on the level of utilisation of the engines, overhaul activity prior to the end of the contract, and decisions taken on whether ongoing access to the assets is required at the end of the lease term. During the year, adjustments to return conditions at the end of leases resulted in a credit of £10m to the income statement. The lease liability at 31 December 2023 included £354m relating to the cost of meeting these residual value guarantees in the Civil Aerospace business. Up to £76m is payable in the next 12 months, £185m is due over the following four years and the remaining balance after five years.

Leases as lessor

The Group acts as lessor for engines to Civil Aerospace customers when they require engines to support their fleets. Lease agreements with the lessors provide protection over the assets. Usage in excess of specified limits and damage to the engine while on lease are covered by variable lease payment structures. Lessee bankruptcy risk is managed through the Cape Town Convention on International Interests in Mobile Equipment (including a specific protocol relating to aircraft equipment), an international treaty that creates common standards for the registration of lease contracts and establishes various legal remedies for default in financing agreements, including repossession and the effect of particular states' bankruptcy laws. Engines are only leased once the Group confirm that appropriate insurance documentation is established that covers the engine assets to pre-agreed amounts. All such contracts are operating leases. The Group also leases out a small number of properties, or parts of properties, where there is excess capacity under operating leases.

	2023	2022
Operating lease income^{1,2}	£m	£m
	104	84

¹ Includes variable lease payments received of £87m (2022: £72m) that do not depend on an index or a rate

² Items of property, plant and equipment subject to an operating lease are disclosed in note 9

Total non-cancellable future operating lease rentals (undiscounted) of £91m (2022: £95m) are receivable over the next 12 years, £12m (2022: £12m) is due within one year, £43m (2022: £45m) between one to five years and £36m (2022: £38m) after five years.

In a limited number of circumstances, the Group sublets properties that are treated as a finance lease when the arrangement transfers substantially all the risks and rewards of ownership of the asset. At 31 December 2023, the total undiscounted lease payments receivable is £35m (2022: £39m) on annual lease income of £4m (2022: £4m). The discounted finance lease receivable at 31 December 2023 is £28m (2022: £32m). There was no (2022: Enl) finance income recognised during the year.

18 Trade payables and other liabilities

	Current		Non-current		Total	
	2023	2022	2023	2022	2023	2022
	£m	£m	£m	£m	£m	£m
Trade payables	1,608	1,735	-	-	1,608	1,735
Accruals	1,134	1,477	96	199	1,230	1,676
Customer discounts ¹	1,018	828	773	1,016	1,791	1,844
Payables due on RRSAs	1,713	1,392	-	-	1,713	1,392
Deferred receipts from RRSA workshare partners	56	32	774	829	830	861
Amounts owed to joint ventures and associates	542	567	-	-	542	567
Government grants ²	130	21	54	41	84	62
Other taxation and social security	92	88	-	-	92	88
Other payables ³	703	843	230	279	933	1,122
	6,896	6,983	1,927	2,364	8,823	9,347

Trade payables and other liabilities are analysed as follows:

Financial Instruments (note 19): ⁴

Trade payables and similar items	5,091	5,376
Other non-derivative financial liabilities	2,521	2,748
Non-financial instruments	1,211	1,223
	8,823	9,347

¹ Customer discounts include customer concession credits. Revenue recognised comprises sales to the Group's customers after such items. Customer concession credits are discounts given to a customer upon the sale of goods or services. A liability is recognised to correspond with the recognition of revenue when the performance obligation is met as set out on page 58. The largest element of the balance, approximately £1.2bn arises when the Civil business delivers its engines to an airframer. A concession is often payable to the end customer (e.g. an airline) on delivery of the aircraft from the airframer. The concession amounts are known and the payment date is reasonably certain, hence there is no significant judgement or uncertainty associated with the timing of these amounts. Warranty credits of £364m and customer concessions of £1,480m have been represented at 31 December 2023 to be included within customer discounts to better reflect the nature of these balances

² During the year, £74m (2022: £20m) of government grants were released to the Income statement

³ Other payables includes payroll liabilities and HM Government UK levies

⁴ Amounts within financial instruments classified as trade payables and similar items and other non-derivative financial liabilities as at 31 December 2022 have been represented to better reflect the nature of the balance. This resulted in a decrease in trade payables and similar items of £363m and a corresponding increase in other non-derivative financial instruments. There is no impact to total trade payables and other liabilities

The Group's payment terms with suppliers vary on the products and services being sourced, the competitive global markets the Group operates in and other commercial aspects of suppliers' relationships. Industry average payment terms vary between 90 to 120 days. The Group offers reduced payment terms for smaller suppliers, who are typically on 75-day payment terms, so that they are paid in 30 days. In line with civil aviation industry practice, the Group offers a supply chain financing (SCF) programme in partnership with banks to enable suppliers, including joint ventures who are on 90-day standard payment terms, to receive their payments sooner. The SCF programme is available to suppliers at their discretion and does not change rights and obligations with suppliers nor the timing of payment of suppliers. At 31 December 2023, suppliers had drawn £418m under the SCF scheme (2022: £422m) of which £154m (2022: £180m) is drawn by joint ventures. The Group, in some cases, settles the costs incurred by joint venture as a result of them utilising either the Group offered SCF arrangement, or an alternative SCF arrangement. During the year to 31 December 2023, the Group incurred costs of £28m (2022: £12m) to settle the costs incurred by joint ventures as a result of them utilising the Group offered SCF arrangement. These costs are included within other financing charges

19 Financial Instruments

Carrying values and fair values of financial instruments

	Notes	Basis for determining fair value	Assets			Liabilities		Total
			FVPL £m	FVOCI £m	Amortised cost £m	FVPL £m	Other £m	£m
2023								
Other non-current asset investments	11	A	24	7	-	-	-	31
Trade receivables and similar items	13	B/C	-	9	5,185	-	-	5,194
Other non-derivative financial assets	13	B	-	-	332	-	-	332
Other assets		D/F	32	-	12	-	-	44
Derivative financial assets ¹		C	350	-	-	-	-	350
Cash and cash equivalents	15	B	1,077	-	2,707	-	-	3,784
Borrowings	16	E/F	-	-	-	-	(4,099)	(4,099)
Lease liabilities	16	G	-	-	-	-	(1,660)	(1,660)
Derivative financial liabilities ¹		C	-	-	-	(2,228)	-	(2,228)
Financial RRSAs		H	-	-	-	-	(17)	(17)
Other liabilities		H	-	-	-	-	(163)	(163)
Trade payables and similar items	18	B	-	-	-	-	(5,091)	(5,091)
Other non-derivative financial liabilities	18	B	-	-	-	-	(2,521)	(2,521)
Contract liabilities	14	B	-	-	-	-	(1,358)	(1,358)
			1,483	16	8,236	(2,228)	(14,909)	(7,402)
2022								
Other non-current asset investments	11	A	26	10	-	-	-	36
Trade receivables and similar items	13	B/C	-	10	4,472	-	-	4,482
Other non-derivative financial assets	13	B	-	-	775	-	-	775
Other assets		D	35	-	-	-	-	35
Derivative financial assets ¹		C	648	-	-	-	-	648
Short-term investments		B	-	-	11	-	-	11
Cash and cash equivalents	15	B	34	-	2,573	-	-	2,607
Borrowings	16	E/F	-	-	-	-	(4,108)	(4,108)
Lease liabilities	16	G	-	-	-	-	(1,847)	(1,847)
Derivative financial liabilities ¹		C	-	-	-	(4,099)	-	(4,099)
Financial RRSAs		H	-	-	-	-	(22)	(22)
Other liabilities		H	-	-	-	-	(101)	(101)
Trade payables and similar items ²	18	B	-	-	-	-	(5,376)	(5,376)
Other non-derivative financial liabilities ²	18	B	-	-	-	-	(2,748)	(2,748)
Contract liabilities ³	14	B	-	-	-	-	(1,006)	(1,006)
			743	20	7,831	(4,099)	(15,208)	(10,713)

¹ In the event of counterparty default relating to derivative financial assets and derivative financial liabilities offsetting would apply and financial assets and liabilities held with the same counterparty would net off. If this occurred with every counterparty, total financial assets would be £3m (2022: £8m) and liabilities £1,881m (2022: £3,459m)

² As described in note 18, trade payables and similar items at 31 December 2022 has decreased by £363m with a respective increase in other non-derivative financial liabilities

³ As described in note 14, contract liabilities at 31 December 2022 has increased by £586m

19 Financial Instruments continued

Fair values equate to book values for both 2023 and 2022, with the following exceptions:

	Basis for determining fair value	2023		2022	
		Book value £m	Fair value £m	Book value £m	Fair value £m
Other assets	F	12	12	-	-
Borrowings	E	(4,034)	(3,877)	(4,095)	(3,812)
Borrowings	F	(65)	(67)	(13)	(15)
Financial RRSAs	H	(17)	(16)	(22)	(22)

The fair value of a financial instrument is the price at which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arms-length transaction. There have been no transfers during the year from or to Level 3 valuation. Fair values have been determined with reference to available market information at the balance sheet date, using the methodologies described below.

- A These primarily comprise unconsolidated companies where fair value approximates to the book value. Listed investments are valued using Level 1 methodology
- B Fair values are assumed to approximate to cost either due to the short-term maturity of the instruments or because the interest rate of the investments is reset after periods not exceeding six months. Money market funds are valued using Level 1 methodology
- C Fair values of derivative financial assets and liabilities and trade receivables held to collect or sell are estimated by discounting expected future contractual cash flows using prevailing interest rate curves. For commodity derivatives forward commodity prices are used to determine expected future cash flows. Amounts denominated in foreign currencies are valued at the exchange rate prevailing at the balance sheet date. These financial instruments are included on the balance sheet at fair value, derived from observable market prices (Level 2)
- D Other assets are included on the balance sheet at fair value, derived from observable market prices or latest forecast (Level 2/Level 3). At 31 December 2023, Level 3 assets totalled £25m (2022: £25m)
- E Borrowings are carried at amortised cost. Amounts denominated in foreign currencies are valued at the exchange rate prevailing at the balance sheet date. The fair value of borrowings is estimated using quoted prices (Level 1)
- F Borrowings are carried at amortised cost. Amounts denominated in foreign currencies are valued at the exchange rate prevailing at the balance sheet date. The fair value of borrowings is estimated by discounting contractual future cash flows (Level 2)
- G The fair value of lease liabilities are estimated by discounting future contractual cash flows using either the interest rate implicit in the lease or the Group's incremental cost of borrowing (Level 2)
- H The fair value of RRSAs and other liabilities are estimated by discounting expected future cash flows. The contractual cash flows are based on future trading activity, which is estimated based on latest forecasts (Level 3)

IFRS 13 Fair Value Measurement defines a three level valuation hierarchy:

Level 1 – quoted prices for similar instruments;

Level 2 – directly observable market inputs other than Level 1 inputs; and

Level 3 – inputs not based on observable market data

Carrying value of other financial assets and liabilities

	Foreign exchange contracts £m	Commodity contracts £m	Interest rate contracts ¹ £m	Total derivatives £m	Financial RRSAs £m	Other £m	Total £m
2023							
Non-current assets	72	-	254	326	-	34	360
Current assets	10	6	8	24	-	10	34
Assets	82	6	262	350	-	44	394
Current liabilities	(351)	(10)	(13)	(374)	(10)	(41)	(425)
Non-current liabilities	(1,766)	(15)	(73)	(1,854)	(7)	(122)	(1,983)
Liabilities	(2,117)	(25)	(86)	(2,228)	(17)	(163)	(2,408)
	(2,035)	(19)	176	(1,878)	(17)	(119)	(2,014)
2022							
Non-current assets	58	25	436	519	-	23	542
Current assets	87	40	2	129	-	12	141
Assets	145	65	438	648	-	35	683
Current liabilities	(966)	(1)	(2)	(969)	(8)	(15)	(992)
Non-current liabilities	(3,030)	(2)	(98)	(3,130)	(14)	(86)	(3,230)
Liabilities	(3,996)	(3)	(100)	(4,099)	(22)	(101)	(4,222)
	(3,851)	62	338	(3,451)	(22)	(66)	(3,539)

¹ Includes the foreign exchange impact of cross-currency interest rate swaps

19 Financial Instruments continued

Derivative financial instruments

The Group uses various financial instruments to manage its exposure to movements in foreign exchange rates. The Group uses commodity swaps to manage its exposure to movements in the price of commodities (jet fuel and base metals). To hedge the currency risk associated with a borrowing denominated in a foreign currency, the Group has currency derivatives designated as part of fair value or cash flow hedges. The Group uses interest rate swaps and forward rate agreements to manage its exposure to movements in interest rates.

Movements in the fair values of derivative financial assets and liabilities were as follows:

	Foreign exchange instruments		Commodity instruments		Interest rate instruments – hedge accounted ¹		Interest rate instruments – non-hedge accounted		Total	
	2023 £m	2022 £m	2023 £m	2022 £m	2023 £m	2022 £m	2023 £m	2022 £m	2023 £m	2022 £m
At 1 January	(3,851)	(3,039)	62	32	125	57	213	37	(3,451)	(2,913)
Movements in fair value										
hedges	-	-	-	-	(71)	(74)	-	-	(71)	(74)
Movements in cash flow										
hedges	-	(56)	-	-	(78)	142	-	-	(78)	86
Movements in other derivative contracts ²										
Contracts settled	574	(1,875)	(60)	106	-	-	1	190	515	(1,579)
At 31 December	(2,035)	(3,851)	(19)	62	45	125	131	213	(1,878)	(3,451)

¹ Includes the foreign exchange impact of cross-currency interest rate swaps

² Included in net financing

Financial risk and RRSA's and other financial assets and liabilities

The Group has financial liabilities arising from financial RRSA's that are valued at each reporting date using the amortised cost method. This involves calculating the present value of the forecast cash flows of the arrangements using the internal rate of return at the inception of the arrangements as an appropriate discount rate. Other liabilities includes royalties payable to airframers where the present value of the liability is calculated using the Group's average borrowing rate as that reflects the nature of the balance in line with the effective interest method. In each case below the fair value of the assets and liabilities reflect a level 3 valuation.

Movements in the carrying values were as follows:

	Financial RRSA's		Other – assets		Other – liabilities	
	2023 £m	2022 £m	2023 £m	2022 £m	2023 £m	2022 £m
At 1 January	(22)	(12)	25	15	(101)	(75)
Exchange adjustments included in OCI	1	(2)	-	2	2	(4)
Additions	-	(6)	-	11	(80)	(35)
Financing charge ¹	-	-	-	-	(8)	(4)
Excluded from underlying profit/(loss):						
Changes in forecast payments ¹	(1)	(7)	-	-	-	-
Cash paid	5	5	-	(3)	11	8
Other	-	-	-	-	13	9
At 31 December	(17)	(22)	25	25	(163)	(101)

¹ Included in financing

19 Financial Instruments continued**Effect of hedging instruments on the financial position and performance**

To manage the risk of changes in the fair values of fixed rate borrowings (the hedged items), the Group has entered into fixed-to-floating interest rate swaps (the hedging instruments), which, for accounting purposes, are designated as fair value hedges. The impact of fair value hedges on the financial position and performance of the Group is as follows:

	Hedged item ¹				Hedging instrument ²							Weighted average interest rate
	Nominal £m	FV adjustment in the period £m	FV adjustment since inception £m	Carrying amount £m	Nominal £m	Carrying amount asset £m	Carrying amount liability £m	FV movement in the period £m	Hedge ineffective- ness in the period ³ £m	Weighted average FX rate		
At 31 December 2023												
Sterling	(375)	(10)	14	(361)	375	-	(14)	10	-	1.00	SONIA + 0.89	
USD	(658)	31	(112)	(770)	658	104	-	(30)	1	1.52	SONIA + 1.47	
Euro	(968)	(14)	37	(931)	968	-	(56)	16	2	1.14	SONIA + 0.92	
At 31 December 2022												
Sterling	(375)	43	24	(351)	375	-	(24)	(43)	-	1.00	SONIA +0.89	
USD	(658)	(20)	(143)	(801)	658	134	-	18	(2)	1.52	SONIA +1.47	
Euro	(968)	49	52	(916)	968	-	(72)	(51)	(2)	1.14	SONIA +0.92	

¹ Hedged items are included in borrowings in the balance sheet

² Hedging instruments are included in other financial assets or liabilities in the balance sheet

³ Hedge ineffectiveness is included in net financing in the income statement

To manage the foreign exchange rate risk in cash flows on fixed rate non-GBP borrowings (the hedged items) the Group has entered into fixed-to-fixed cross-currency interest rate swaps (the hedging instruments) to hedge the cashflows into GBP, which for accounting purposes are designated as cash flow hedges.

The impact of cash flow hedges on the financial position and performance of the Group is as follows:

	Hedged item		Hedging instrument ¹						Hedging reserves		
	Nominal £m	FV movement in the period £m	Nominal £m	Carrying amount asset/ (liability) £m	FV movement in the period £m	Hedge ineffectiveness in the period £m	Weighted average FX rate	Weighted average interest rate	Amount recognised in OCI £m	Recycled to net financing £m	Closing cash flow hedge reserve £m
At 31 December 2023											
USD	(772)	65	772	28	(62)	3	1.29	5.33	61	(41)	(5)
Euro	(677)	14	677	(17)	(14)	-	1.11	5.45	21	(20)	(8)
At 31 December 2022											
USD	(772)	(104)	772	89	109	5	1.29	5.33	(111)	96	(25)
Euro	(677)	(35)	677	(2)	35	-	1.11	5.45	(27)	28	(9)

¹ Hedging instruments are included in other financial assets or liabilities in the balance sheet

² Hedge ineffectiveness is included in net financing in the income statement

19 Financial Instruments *continued*

Risk management policies and hedging activities

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

Foreign currency exchange rate risk – The Group has significant cash flows (most significantly USD, followed by the euro) denominated in currencies other than the functional currency of the relevant trading entity. To manage its exposures to changes in values of future foreign currency cash flows, so as to maintain relatively stable long-term foreign exchange rates on settled transactions, the Group enters into derivative forward foreign currency transactions. In addition, the Group enters in to fixed-to-floating cross-currency interest rate swaps to manage its exposure to changes in fair value as a result of foreign exchange risk. See below.

The Group economically hedges its GBP/USD exposure by forecasting highly probable net USD receipts up to five years forward. Hedges are taken out within prescribed maximum and minimum hedge positions set out in the Group FX policy. The maximum and minimum policy bands decline gradually over the five-year horizon and are calculated as a percentage of forecast net income. A similar policy is operated for the Group's EUR/USD exposure. For accounting purposes, these derivative contracts are not designated in hedging relationships.

The Group also has exposures to cash flows on EUR and USD denominated fixed rate borrowings. To manage its exposures to changes in values of future foreign currency cash flows, the Group has entered into fixed-to-fixed cross-currency interest rate swaps, which, for accounting purposes, are designated as cash flow hedges. The swaps have similar critical terms to the hedged items, such as the initial exchange amounts, payment dates and maturities. Therefore, there is an economic relationship and the hedge ratio is established as 1:1. Possible sources of ineffectiveness in the cash flow hedge relationship are changes in the credit risk of either party to the interest rate swap. Another possible source of ineffectiveness would be if the notional of the borrowings is less than the notional of the derivative, for example, in the event of a partial repayment of hedged debt prior to its maturity.

The Group regards its interests in overseas subsidiary companies as long-term investments. The Group aims to match its translational exposures by matching the currencies of assets and liabilities.

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

Credit risk – The Group is exposed to credit risk to the extent of non-payment by either its customers or the counterparties of its financial instruments. The effective monitoring and controlling of credit risk is a key component of the Group's risk management activities. The Group has credit policies covering both trading and financial exposures. Credit risks arising from treasury activities are managed by a central treasury function in accordance with the Group credit policy. The objective of the policy is to diversify and minimise the Group's exposure to credit risk from its treasury activities by ensuring the Group transacts strictly with 'BBB' or higher rated financial institutions based on pre-established limits per financial institution. At the balance sheet date, there were no significant concentrations of credit risk to individual customers or counterparties. The Group's revenue is generated from customers located across multiple geographical locations (see note 2). These customers are typically: airframers and airline operators relating to Civil Aerospace; government defence departments for the UK and US; and multiple smaller entities for Power Systems. Whilst there are a limited number of customers related to Civil Aerospace and Defence, they are spread across various geographical locations. The maximum exposure to credit risk at the balance sheet date is represented by the carrying value of each financial asset, including derivative financial instruments.

Interest rate risk – The Group's interest rate risk is primarily in relation to its fixed rate borrowings (fair value risk), floating rate borrowings and cash and cash equivalents (cash flow risk). Interest rate derivatives are used to manage the overall interest rate profile of the Group. The fixed or floating rate interest rate decision on long-term borrowings is determined for each new agreement at the point it is entered into. The aggregate interest rate position of the Group is reviewed regularly and can be revised at any time in order to react to changes in market conditions or circumstances.

The Group also has exposures to the fair values of non-derivative financial instruments such as EUR, GBP and USD fixed rate borrowings. To manage the risk of changes in these fair values, the Group has entered into fixed-to-floating interest rate swaps and cross-currency interest rate swaps which, for accounting purposes are designated as fair value hedges. The swaps have similar critical terms to the hedged items, such as the reference rate, reset dates, notional amounts, payment dates and maturities. Therefore, there is an economic relationship and the hedge ratio is established as 1:1. Possible sources of ineffectiveness in the fair value hedge relationship are changes in the credit risk of either party to the interest rate swap and, for cross-currency interest rate swaps, the cross-currency basis risk as this risk is present in the hedging instrument only. Another possible source of ineffectiveness would be if the notional of the borrowings is less than the notional of the derivative, for example in the event of a partial repayment of hedged debt prior to its maturity.

The Group has exposure to changes in cash flows due to changes in interest rates. To manage this risk the Group has entered into floating-to-fixed interest rate swaps to hedge a proportion of its floating rate exposure to fixed rates. The swaps have similar critical terms to the floating leg of swaps that form part of the fair value hedges, such as the reference rate, reset dates, notional amounts, payment dates and maturities. For accounting purposes, these derivative contracts are generally not designated as hedging instruments.

Commodity price risk – The Group has exposures to the price of jet fuel, base metals and energy arising from business operations. To minimise its cash flow exposures to changes in commodity prices, the Group enters into derivative commodity transactions. The commodity hedging policy is similar to the Group FX policy, in that the Group forecasts highly probable exposures to commodities, and takes out hedges within prescribed maximum and minimum levels as set out in the policy. The maximum and minimum policy bands decline gradually over time. For accounting purposes, these derivative contracts are generally not designated in hedging relationships.

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

19 Financial Instruments *continued***Derivative financial instruments**

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

	Expected maturity					Fair value	
	Nominal amount £m	Within one year £m	Between one and two years £m	Between two and five years £m	After five years £m	Assets £m	Liabilities £m
At 31 December 2023							
Foreign exchange contracts:							
Non-hedge accounted	15,972	6,965	4,341	4,666	-	82	(2,117)
Interest rate contracts:							
Fair value hedges	2,001	484	658	859	-	103	(69)
Cash flow hedges	1,449	-	-	1,449	-	28	(17)
Non-hedge accounted	2,001	484	658	859	-	131	-
Commodity contracts:							
Non-hedge accounted	257	102	73	82	-	6	(25)
	21,680	8,036	5,730	7,915	-	350	(2,228)
At 31 December 2022							
Foreign exchange contracts:							
Non-hedge accounted	22,844	9,539	4,180	8,898	227	145	(3,996)
Interest rate contracts:							
Fair value hedges	2,001	-	484	1,033	484	135	(97)
Cash flow hedges	1,449	-	-	1,449	-	89	(2)
Non-hedge accounted	2,001	-	484	1,033	484	214	(1)
Commodity contracts:							
Non-hedge accounted	219	97	79	43	-	65	(3)
	28,514	9,636	5,227	12,456	1,195	648	(4,099)

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

Currency analysis

Foreign exchange contracts are denominated in the following currencies:

	Nominal amount of currencies purchased forward				
	Sterling £m	USD £m	Euro £m	Other £m	Total £m
At 31 December 2023					
Currencies sold forward:					
Sterling	-	1,573	-	115	1,688
USD	11,389	-	2,316	303	14,008
Euro	53	171	-	21	245
Other	6	3	22	-	31
At 31 December 2022					
Currencies sold forward:					
Sterling	-	4,321	45	146	4,512
USD	16,246	-	1,578	253	18,077
Euro	30	160	-	40	230
Other	-	8	17	-	25

The nominal value of interest rate and commodity contracts are denominated in the following currencies:

	2023 £m	2022 £m
Sterling	2,376	2,376
USD	1,671	1,629
Euro	1,681	1,665

19 Financial Instruments continued

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

	Sterling £m	USD £m	Euro £m	Other £m	Total £m
At 31 December 2023					
Other non-current investments	10	21	-	-	31
Trade receivables and similar items	556	4,039	513	86	5,194
Other non-derivative financial assets	94	163	58	17	332
Other assets	-	22	22	-	44
Short-term investments	-	-	-	-	-
Cash and cash equivalents	1,242	869	1,463	210	3,784
Assets	1,902	5,114	2,056	313	9,385
Borrowings	(904)	(1,605)	(1,590)	-	(4,099)
Lease liabilities	(195)	(1,222)	(45)	(198)	(1,660)
Financial RSAs	-	(7)	(10)	-	(17)
Other liabilities	(32)	(131)	-	-	(163)
Trade payables and similar items	(976)	(3,561)	(493)	(61)	(5,091)
Other non-derivative financial liabilities	(334)	(2,008)	(134)	(45)	(2,521)
Contract liabilities	-	(1,358)	-	-	(1,358)
Liabilities	(2,441)	(9,892)	(2,272)	(304)	(14,909)
	(539)	(4,778)	(216)	9	(5,524)
At 31 December 2022					
Other non-current investments	10	16	10	-	36
Trade receivables and similar items	566	3,270	565	81	4,482
Other non-derivative financial assets	61	666	33	15	775
Other assets	-	24	11	-	35
Short-term investments	-	-	11	-	11
Cash and cash equivalents	398	897	1,155	157	2,607
Assets	1,035	4,873	1,785	253	7,946
Borrowings	(893)	(1,627)	(1,587)	(1)	(4,108)
Lease liabilities	(181)	(1,401)	(49)	(216)	(1,847)
Financial RSAs	-	(7)	(15)	-	(22)
Other liabilities	(11)	(90)	-	-	(101)
Trade payables and similar items ¹	(690)	(3,952)	(675)	(59)	(5,376)
Other non-derivative financial liabilities ¹	(271)	(2,304)	(129)	(44)	(2,748)
Contract liabilities ²	-	(1,006)	-	-	(1,006)
Liabilities	(2,046)	(10,387)	(2,455)	(320)	(15,208)
	(1,011)	(5,514)	(670)	(67)	(7,262)

¹ As described in note 18, trade payables and similar items at 31 December 2022 has decreased by £363m with a respective increase in other non-derivative financial liabilities² As described in note 14, contract liabilities at 31 December 2022 has increased by £586m**Currency exposures**

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

Functional currency of Group operations	Sterling £m	USD £m	Euro £m	Other £m	Total £m
At 31 December 2023					
Sterling	-	-	-	5	5
USD	(6)	-	1	-	(5)
Euro	1	4	-	(2)	3
Other	109	38	40	-	187
At 31 December 2022					
Sterling	-	-	1	4	5
USD	(7)	-	(2)	7	(2)
Euro	(1)	-	-	-	(1)
Other	108	26	86	-	220

19 Financial Instruments continued**Ageing beyond contractual due date of financial assets**

	Within terms £m	Up to three months overdue £m	Between three months and one year overdue £m	More than one year overdue £m	Total £m
At 31 December 2023					
Other non-current asset investments	31	-	-	-	31
Trade receivables and similar items	4,381	650	87	66	5,184
Other non-derivative financial assets	328	-	4	-	332
Other assets	44	-	-	-	44
Derivative financial assets	350	-	-	-	350
Cash and cash equivalents	3,784	-	-	-	3,784
	8,928	650	91	66	9,735
At 31 December 2022					
Other non-current asset investments	36	-	-	-	36
Trade receivables and similar items	3,981	219	169	113	4,482
Other non-derivative financial assets	755	9	10	1	775
Other assets	35	-	-	-	35
Derivative financial assets	648	-	-	-	648
Short-term investments	11	-	-	-	11
Cash and cash equivalents	2,607	-	-	-	2,607
	8,073	228	179	114	8,594

Contractual maturity analysis of non-derivative financial liabilities

	Gross values				Carrying value £m
	Within one year £m	Between one and two years £m	Between two and five years £m	After five years £m	
At 31 December 2023					
Borrowings	(694)	(943)	(3,042)	(14)	(4,099)
Lease liabilities	(358)	(368)	(687)	(735)	(1,860)
Financial RRSAs	(10)	-	(1)	(4)	(17)
Other liabilities	(42)	(6)	(25)	(90)	(163)
Trade payables and similar items	(4,952)	(15)	(47)	(77)	(5,091)
Other non-derivative financial liabilities	(1,648)	(235)	(267)	(573)	(2,521)
Contract liabilities	(1,358)	-	-	-	(1,358)
	(9,060)	(1,565)	(4,079)	(1,293)	(14,899)
At 31 December 2022					
Borrowings	(168)	(653)	(3,612)	(510)	(4,108)
Lease liabilities	(435)	(311)	(886)	(734)	(1,847)
Financial RRSAs	(10)	(7)	(1)	(5)	(22)
Other liabilities	(15)	(10)	(30)	(46)	(101)
Trade payables and similar items ¹	(5,128)	(131)	(65)	(52)	(5,376)
Other non-derivative financial liabilities ¹	(1,591)	(443)	(267)	(438)	(2,748)
Contract liabilities ²	(1,006)	-	-	-	(1,006)
	(8,353)	(1,555)	(4,870)	(1,785)	(15,208)

¹ As described in note 18, trade payables and similar items at 31 December 2022 has decreased by £363m with a respective increase in other non-derivative financial liabilities

² As described in note 14, contract liabilities at 31 December 2022 has increased by £586m

19 Financial Instruments continued**Expected maturity analysis of derivative financial instruments**

	Gross values				Carrying value £m
	Within one year £m	Between one and two years £m	Between two and five years £m	After five years £m	
At 31 December 2023					
Derivative financial assets:					
Cash inflows	2,024	1,943	2,333	-	
Cash outflows	(2,021)	(1,805)	(2,311)	-	
Other net cash flows ¹	88	43	33	-	
	91	181	55	-	350
Derivative financial liabilities:					
Cash inflows	5,535	3,296	4,377	-	
Cash outflows	(6,418)	(4,027)	(5,189)	-	
Other net cash flows ¹	(21)	(13)	(3)	-	
	(904)	(744)	(815)	-	(2,228)
At 31 December 2022					
Derivative financial assets:					
Cash inflows	3,002	551	3,179	-	
Cash outflows	(2,907)	(540)	(2,886)	-	
Other net cash flows ¹	131	90	98	7	
	226	101	391	7	648
Derivative financial liabilities:					
Cash inflows	6,658	4,238	8,290	722	
Cash outflows	(8,019)	(5,162)	(10,604)	(745)	
Other net cash flows ¹	(10)	(10)	(4)	-	
	(1,371)	(934)	(2,318)	(23)	(4,099)

¹ Derivative financial assets and liabilities that are settled on a net cash basis

Interest rate risk

In respect of income-earning financial assets and interest-bearing financial liabilities, the following table indicates their effective interest rates. The value shown is the carrying amount before taking account of swaps.

	2023			2022		
	Fixed rate £m	Floating rate £m	Total £m	Fixed rate £m	Floating rate £m	Total £m
Short-term investments	-	-	-	-	11	11
Cash and cash equivalents ¹	-	3,784	3,784	-	2,607	2,607
Borrowings	(4,036)	(63)	(4,099)	(4,096)	(12)	(4,108)
Lease liabilities	(1,269)	(391)	(1,660)	(1,235)	(612)	(1,847)
	(5,305)	3,330	(1,975)	(5,331)	1,994	(3,337)
Weighted average interest rates						
Borrowings	3.7%	5.9%		3.7%	4.7%	
Lease liabilities ²	4.6%	6.8%		3.9%	6.3%	

¹ Cash and cash equivalents comprises bank balances and term deposits and earn interest based on short-term floating market interest rates

² Interest rates for lease liabilities are considered to be the discount rates at the balance sheet date

None (2022: none) of the Group's borrowings are subject to financial covenants and there are no rating triggers on any of the Group's facilities that could require the Group to accelerate or repay any facility for a given movement in the Group's credit rating.

£105m (2022: £111m) of the Group's lease liabilities include a customary loan-to-value covenant. The Group has several contractual cures available in the event the stipulated loan-to-value ratio is exceeded. Failure by the Group to satisfy its contractual obligations under the covenant gives rights to the lessor to terminate its lease and claim termination amounts for the outstanding lease balance. At 31 December 2023, none (2022: none) of these were in breach.

19 Financial Instruments continued**Sensitivity Analysis**

	2023	2022
	£m	£m
Sensitivities at 31 December (all other variables held constant) – Impact on profit after tax and equity		
Sterling 10% weaker against the USD	(1,207)	(1,600)
Sterling 10% stronger against the USD	988	1,309
Euro 10% weaker against the USD	(176)	(46)
Euro 10% stronger against the USD	144	38
Sterling 10% weaker against the Euro	(17)	(17)
Sterling 10% stronger against the Euro	14	14
Commodity prices 10% lower	(17)	(21)
Commodity prices 10% higher	17	21
Interest rates 50 basis points lower	(43)	(65)
Interest rates 50 basis points higher	42	64

20 Provisions for liabilities and charges

	At 1 January 2023	Charged to income statement ¹	Reversed	Utilised	Transfer for held for sale	Exchange differences	At 31 December 2023
	£m	£m	£m	£m	£m	£m	£m
Contract losses	1,592	500	(433)	(185)	(8)	(2)	1,472
Warranty and guarantees	317	112	(14)	(91)	(8)	(10)	308
Trent 1000 wastage costs	179	45	(29)	(79)			116
Employer liability claims	33	1	(7)	(3)			24
Tax related interest and penalties	16	19		(2)		(1)	22
Claims and litigation	122	71	(39)	(111)			43
Other	74	26	(18)	(35)		(1)	46
	2,333	764	(540)	(506)	(8)	(14)	2,029
Current liabilities	632						532
Non-current liabilities	1,701						1,497

¹ The charge to the income statement within net financing includes £59m (2022: £33m) within net financing as a result of the unwinding of the discounting of provisions previously recognised

Contract losses

Provisions for contract losses are recorded when the direct costs to fulfil a contract are assessed as being greater than the expected recoverable amount. Provisions for contract losses are measured on a fully costed basis and during the year, £185m of the provision has been utilised. Additional contract losses for the Group of £500m have been recognised as a result of increases in the estimates of future LTSA costs, due to inflationary increases and costs associated with supply chain challenges. Contract losses of £433m previously recognised have been reversed following the renegotiation of some major contracts resulting in contract extensions and improved margins. The Group continues to monitor the contract loss provision for changes in the market and revises the provision as required. The value of the remaining contract loss provisions reflect, in each case, the single most likely outcome. The provisions are expected to be utilised over the term of the customer contracts, typically within eight to 16 years.

IAS 37 requires a company to recognise any impairment loss that has occurred on assets used in fulfilling the contract before recognising a separate provision for an onerous contract. No impairments were required for any of the assets used solely for the fulfilment of onerous contracts. No impairments were required for any of the assets solely used in the fulfilment of onerous contracts. However, as per note 10, a number of aero engine lease right-of-use assets were impaired during the year and these will be used on a range of contracts some of which are onerous.

The Trent 1000 Intangible assets (certification costs and development costs) and Trent 1000 spare engines (right of use and owned) are tested for impairment as part of the Trent 1000 Cash generating unit (CGU) and no impairment was required.

Warranty and guarantees

Provisions for warranty and guarantees relate to products sold and are calculated based on an assessment of the remediation costs related to future claims based on past experience. During the year, £112m of additional provision has been recognised representing the single best estimate of warranty and guarantee costs to be incurred on relevant sales and £91m of previously recognised costs have been utilised. The provision generally covers a period of up to three years.

Trent 1000 wastage costs

In November 2019, the Group announced the outcome of testing and a thorough technical and financial review of the Trent 1000 TEN programme, following technical issues which were identified in 2019, resulting in a revised timeline and a more conservative estimate of durability for the Improved HP turbine blade for the TEN variant. During the year, the Group has utilised £79m of the Trent 1000 wastage costs provision. This represents customer disruption costs and remediation shop visit costs attributable to the wastage costs provision. During the year, a net charge to the provision of £16m has been recognised reflecting the discount unwind and updates to forecasted costs based on the latest available information. The value of the remaining provision reflects the single most likely outcome and is expected to be utilised in 2024.

20 Provisions for liabilities and charges *continued*

Employer liability claims

The provision relating to employer healthcare liability claims is as a result of a historical insolvency of the previous provider and is expected to be utilised over the next 30 years.

Tax related interest and penalties

Provisions for tax related interest and penalties relate to uncertain tax positions in some of the jurisdictions in which the Group operates. Utilisation of the provisions will depend on the timing of resolution of the issues with the relevant tax authorities.

Claims and litigation

Provisions for claims and litigation represent ongoing matters where the outcome for the Group may be unfavourable. During the year, judgment in respect of a legal claim was rendered by the High Court on 3 July 2023 resulting in a charge to the income statement of £34m. The judgment was satisfied in August 2023 resulting in a £92m utilisation. The value of any remaining provisions reflects the single most likely outcome in each case.

The balance also includes the best estimate of any retained exposure by the Group's captive insurance company for any claims that have been incurred but not yet reported to the Group as that entity retains a portion of the exposures it insures on behalf of the remainder of the Group. Such exposures include policies for aviation claims, employer liabilities and healthcare claims. Significant delays can occur in the notification and settlement of claims and judgement is involved in assessing outstanding liabilities, the ultimate cost and timing of which cannot be known with certainty at the balance sheet date. The insurance provisions are based on information currently available, however it is inherent in the nature of the business that ultimate liabilities may vary if the frequency or severity of claims differs from estimated.

Other

Other items are individually immaterial. The value of any remaining provisions reflects the single most likely outcome in each case.

21 Post-retirement benefits

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

- The UK defined benefit scheme is funded, with the assets held in a separate UK trust. The scheme closed to future accrual on 31 December 2020 for all active members and there are no new defined benefit accruals in the UK scheme. As at 31 December 2023 the scheme was estimated to be funded at 113% on the Technical Provisions basis.
- The Group also operates a large trust-based defined contribution scheme for current employees in the UK (RRRST). Pension contributions are generally paid as a salary sacrifice under which employees agree to a reduction in gross contractual pay in return for the Group making additional pension contributions on their behalf. As a result, there is a decrease in wages and salaries and a corresponding increase in pension costs of £72m (2022: £46m) in the year.
- Overseas defined benefit schemes are a mixture of funded and unfunded plans and provide benefits in line with local practice. Additionally, in the US, and to a lesser extent in some other countries, the Group's employment practices include the provision of healthcare and life insurance benefits for retired employees. These healthcare schemes are unfunded.

The valuations of the defined benefit schemes are based on the results of the most recent funding valuation from 31 March 2023, where relevant, updated by the scheme actuaries to 31 December 2023.

Changes to the UK defined benefit scheme

During the year, Power Systems continued to replace a number of their existing defined benefit schemes with a new company pension scheme to offer payment options at time of retirement for other employee populations not included in 2022. The new system, which is similar in structure to a defined contribution scheme with a guarantee from the Company in accordance with German legislation, significantly reduces interest risks and longevity risks for the employer for future commitments. A past service cost of £3m has been recognised within non-underlying operating profit in relation to this new scheme. In addition, Rolls-Royce Power Systems concluded a works agreement resulting in a change to jubilee benefits offered to employees based in Friedrichshafen. A past service credit of £5m has been recognised within non-underlying operating profit.

Other

The Group is aware of a UK High Court legal ruling in June 2023 between Virgin Media Limited and NTL Pension Trustees II Limited, which decided that certain historic rule amendments were invalid if they were not accompanied by the actuarial certifications. The ruling is subject to appeal and the Group is monitoring developments. Whilst this ruling was in respect of another scheme, any final judgment would need to be reviewed for its relevance to the RRUKPF scheme. As yet the RRUKPF pension advisers have not completed any analysis and, as the outcome of the appeal is still unknown, no adjustments have been made to the Consolidated Financial Statements at 31 December 2023.

21 Post-retirement benefits continued**Amounts recognised in the income statement**

	2023			2022		
	UK schemes £m	Overseas schemes £m	Total £m	UK schemes £m	Overseas schemes £m	Total £m
Defined benefit schemes:						
Current service cost and administrative expenses	8	35	43	8	44	52
Past-service credit and settlement loss	(2)	(2)	(2)	(6)	(19)	(25)
Defined contribution schemes	195	98	293	154	87	241
Operating cost	203	131	334	156	112	268
Net financing (credit)/charge in respect of defined benefit schemes	(29)	41	12	(21)	23	2
Total income statement charge	174	172	346	135	135	270

The operating cost is charged as follows:

	Defined benefit		Defined contribution		Total	
	2023 £m	2022 £m	2023 £m	2022 £m	2023 £m	2022 £m
Cost of sales	33	37	211	168	244	205
Commercial and administrative costs	2	(17)	41	38	43	21
Research and development costs	6	7	41	33	47	40
Discontinued operations	41	27	293	239	334	266
	41	27	293	241	334	268

Net financing comprises:

	2023			2022		
	UK schemes £m	Overseas schemes £m	Total £m	UK schemes £m	Overseas schemes £m	Total £m
Financing on scheme obligations	218	66	284	149	46	195
Financing on scheme assets	(247)	(25)	(272)	(170)	(23)	(193)
Net financing (income)/charge in respect of defined benefit schemes	(29)	41	12	(21)	23	2
Financing income on scheme surpluses	(29)	(1)	(30)	(21)	(3)	(24)
Financing cost on scheme deficits	(29)	42	13	(21)	26	5

Amounts recognised in OCI in respect of defined benefit schemes

	2023			2022		
	UK schemes £m	Overseas schemes £m	Total £m	UK schemes £m	Overseas schemes £m	Total £m
Actuarial gains and losses arising from:						
Demographic assumptions ¹	180	-	180	19	-	19
Financial assumptions ²	(132)	(63)	(195)	3,423	602	4,025
Experience adjustments ³	116	1	117	(235)	(7)	(242)
Return on scheme assets excluding financing income ²	(12)	26	14	(3,751)	(207)	(3,958)
	152	(36)	116	(544)	388	(156)

¹ For the UK Scheme, this reflects the latest available CMI mortality projections and an update of the post-retirement mortality assumptions based on an analysis prepared for the 31 March 2023 funding valuation

² Actuarial gains and losses arising from financial assumptions arise primarily due to changes in discount rate and inflation

³ This reflects an experience gain as a result of allowance for updated membership data following the valuation during the year offset by realised inflation being higher than expected in the year

21 Post-retirement benefits continued

Amounts recognised in the balance sheet in respect of defined benefit schemes

	2023			2022		
	UK schemes £m	Overseas schemes £m	Total £m	UK schemes £m	Overseas schemes £m	Total £m
Present value of funded obligations	(4,537)	(993)	(5,530)	(4,621)	(944)	(5,565)
Fair value of scheme assets	5,304	520	5,824	5,215	493	5,708
Net asset/(liability) on funded schemes	787	(473)	294	594	(451)	143
Present value of unfunded obligations	-	(547)	(547)	-	(563)	(563)
Net asset/(liability) recognised in the balance sheet	787	(1,020)	(253)	594	(1,014)	(420)
Post-retirement scheme surpluses ¹	787	15	782	594	19	613
Post-retirement scheme deficits	-	(1,035)	(1,035)	-	(1,033)	(1,033)

¹ The surplus in the UK scheme is recognised as, on an ultimate wind-up when there are no longer any remaining members, any surplus would be returned to the Group, which has the power to prevent the surplus being used for other purposes in advance of this event

Overseas schemes are located in the following countries:

	2023			2022		
	Assets £m	Obligations £m	Net £m	Assets £m	Obligations £m	Net £m
Canada	199	(239)	(40)	187	(226)	(39)
Germany	31	(679)	(648)	10	(638)	(628)
US pensions schemes	290	(301)	(11)	296	(308)	(12)
US healthcare schemes	-	(318)	(318)	-	(333)	(333)
Other	-	(3)	(3)	-	(2)	(2)
Net asset/(liability) recognised in the balance sheet	520	(1,540)	(1,020)	493	(1,507)	(1,014)

Defined benefit schemes

Assumptions

Significant actuarial assumptions for UK schemes at the balance sheet date were as follows:

	2023	2022
Discount rate	4.50%	4.80%
Inflation assumption (RPI)	3.30%	3.50%
Inflation assumption (CPI)	2.85%	2.95%
Transfer take-up assumption (employed deferred/deferred)	35%/25%	50%/40%
Bridging Pension Option (BPO) assumption	30%	30%
Life expectancy from age 65: current male pensioner	20.8 years	21.9 years
future male pensioner currently aged 45	21.5 years	23.2 years
current female pensioner	22.8 years	23.7 years
future female pensioner currently aged 45	24.1 years	25.5 years

Discount rates are determined by reference to the market yields on AA rated corporate bonds. The rate is determined by using the profile of forecast benefit payments to derive a weighted average discount rate from the yield curve.

The inflation assumption is determined by the market-implied assumption based on the yields on long-term index-linked government securities.

The mortality assumptions adopted for the UK pension schemes are derived from the SAPS S3 'All' actuarial tables, with future improvements in line with the CMI 2022 core projections updated to reflect use of an 'A' parameter of 0.25% for future improvements and long-term improvements of 1.25%. Where appropriate, these are adjusted to take account of the scheme's actual experience.

The assumption for transfers and the BPO is based on actual experience and actuarial advice.

Other assumptions have been set on advice from the actuary, having regard to the latest trends in scheme experience and the assumptions used in the most recent funding valuation. The rate of increase of pensions in payment is based on the rules of the scheme, combined with the inflation assumption where the increase is capped.

Assumptions for overseas schemes are less significant and are based on advice from local actuaries. The principal assumptions are:

	2023	2022
Discount rate	4.20%	4.70%
Inflation assumption	1.80%	2.30%
Long-term healthcare cost trend rate	4.75%	4.75%
Male life expectancy from age 65: current pensioner	20.5 years	20.5 years
future pensioner currently aged 45	22.4 years	22.4 years

21 Post-retirement benefits continued**Changes in present value of defined benefit obligations**

	2023			2022		
	UK schemes £m	Overseas schemes £m	Total £m	UK schemes £m	Overseas schemes £m	Total £m
At 1 January	(4,621)	(1,507)	(6,128)	(8,010)	(2,204)	(10,214)
Exchange differences	-	54	54	-	(165)	(165)
Current service cost	(4)	(33)	(37)	(4)	(43)	(47)
Past-service cost	-	2	2	6	24	30
Finance cost	(218)	(66)	(284)	(149)	(49)	(198)
Contributions by employees	-	(9)	(9)	-	(4)	(4)
Benefits paid out	142	80	222	329	102	431
Actuarial gains	164	(61)	103	3,207	599	3,806
Transfers	-	(2)	(2)	-	(2)	(2)
Transfer to held for sale	-	2	2	-	-	-
Settlement	-	-	-	-	235	235
At 31 December	(4,537)	(1,540)	(6,077)	(4,621)	(1,507)	(6,128)
Funded schemes	(4,537)	(993)	(5,530)	(4,621)	(944)	(5,565)
Unfunded schemes	-	(547)	(547)	-	(563)	(563)

The defined benefit obligations are in respect of:

Active plan participants ¹	(1,584)	(731)	(2,315)	(1,681)	(693)	(2,374)
Deferred plan participants	(1,287)	(100)	(1,387)	(1,172)	(93)	(1,265)
Pensioners	(1,666)	(709)	(2,375)	(1,768)	(721)	(2,489)
Weighted average duration of obligations (years)	16	12	15	17	13	16

¹ Although the UK scheme closed to future accrual on 31 December 2020, members who became deferred as a result of the closure and remain employed by the Group retain some additional benefits compared to other deferred members. The obligations for these members are shown as active plan participants

Changes in fair value of scheme assets

	2023			2022		
	UK schemes £m	Overseas schemes £m	Total £m	UK schemes £m	Overseas schemes £m	Total £m
At 1 January	5,215	493	5,708	9,128	861	9,989
Exchange differences	-	(21)	(21)	-	77	77
Administrative expenses	(4)	(1)	(5)	(4)	(1)	(5)
Financing	247	25	272	170	23	193
Return on plan assets excluding financing	(12)	26	14	(3,751)	(207)	(3,958)
Contributions by employer	-	69	69	1	80	81
Contributions by employees	-	9	9	-	4	4
Benefits paid out	(142)	(80)	(222)	(329)	(102)	(431)
Settlement	-	-	-	-	(242)	(242)
At 31 December	5,304	520	5,824	5,215	493	5,708
Total return on scheme assets	235	51	286	(3,581)	(184)	(3,765)

21 Post-retirement benefits continued

Fair value of scheme assets at 31 December

	2023		2022	
	UK schemes	Overseas schemes	UK schemes	Overseas schemes
£m	£m	£m	£m	£m
Sovereign debt	3,259	118	3,377	3,574
Corporate debt instruments	1,998	270	2,266	1,492
Interest rate swaps	170	-	170	196
Inflation swaps	86	-	86	212
Cash and similar instruments ¹	(892)	-	(892)	(1,066)
Liability driven investment (LDI) portfolios ²	4,619	388	5,007	4,408
Listed equities	-	69	69	78
Unlisted equities	32	-	32	40
Synthetic equities ³	20	-	20	(8)
Corporate debt instruments	630	-	630	-
Cash	-	10	10	5
Other	3	53	56	33
At 31 December	5,304	520	5,824	5,215
1 UK cash and similar instruments include repurchase agreements on UK Government bonds amounting to €(993)m (2022: €(1,221)m). The latest maturity date for these short-term borrowings is September 2024				
2 A portfolio of gilt and swap contracts, backed by investment-grade credit instruments and diversified Equity funds, that is designed to hedge the majority of the interest rate and inflation risks associated with the schemes' obligations				
3 Portfolios of swap contracts designed to provide investment returns in line with global equity markets. The maximum exposure (notional value and accrued returns) on the portfolios was £379m (2022: £344m)				

The investment strategy for the UK scheme is controlled by the Trustee in consultation with the Group. The scheme assets do not directly include any of the Group's own financial instruments, nor any property occupied by, or other assets used by, the Group. At 31 December 2023, there was no indirect holding of the Group's financial instruments (2022: none).

Future contributions

The Group expects to contribute approximately £73m to its overseas defined benefit schemes in 2024 (2022: £70m).

In the UK, any cash funding of RRUKPF is based on a statutory triennial funding valuation process. The Group and the Trustee negotiate and agree the actuarial assumptions used to value the liabilities (Technical Provisions); assumptions which may differ from those used for accounting set out on page 105. The assumptions used to value Technical Provisions must be prudent rather than a best estimate of the liability. Most notably, the Technical Provisions discount rate is currently based upon UK Government bond yields plus a margin (0.5% at the 31 March 2023 valuation) rather than being based on yields of AA corporate bonds. Once each valuation is signed, a Schedule of Contributions (SoC) must be agreed which sets out the cash contributions to be paid. The most recent valuation, as at 31 March 2023, agreed by the Trustee in October 2023, showed that the RRUKPF was estimated to be 115% funded on the Technical Provisions basis (estimated to be 113% at 31 December 2023). All cash due has been paid in full and the current SoC does not currently require any cash contributions to be made by the Group.

Sensitivities

The calculations of the defined benefit obligations are sensitive to the assumptions set out above. The following table summarises how the estimated impact of a change in a significant assumption would affect the UK defined benefit obligation at 31 December 2023, while holding all other assumptions constant. This sensitivity analysis may not be representative of the actual change in the defined benefit obligation as it is unlikely that the change in assumptions would occur in isolation of one another as some of the assumptions may be correlated.

For the most significant funded schemes, the investment strategies hedge the risks from interest rates and inflation measured on a proxy solvency basis.

For the UK scheme, the interest rate and inflation hedging is currently based on UK Government bond yields without any adjustment for any credit spread. The sensitivity analysis set out below have been determined based on a method that estimates the impact on the defined benefit obligation as a result of reasonable changes in key assumptions occurring at the end of the reporting period.

	2023	2022
£m	£m	£m
Reduction in the discount rate of 0.25% ¹	Obligation	Obligation
	Plan assets (LDI portfolio)	Plan assets (LDI portfolio)
Increase in inflation of 0.25% ¹	Obligation	Obligation
	Plan assets (LDI portfolio)	Plan assets (LDI portfolio)
Increase of 1% in transfer value assumption	Obligations	Obligations
One year increase in life expectancy	Obligations	Obligations
The differences between the sensitivities on obligations and plan assets arise largely due to differences in the methods used to value the obligations for accounting purposes and the adopted proxy solvency basis		

22 Share capital

	Equity	
	Ordinary shares of 20p each Millions	Nominal value £m
At 1 January and 31 December 2022	1,691	338
At 31 December 2023	1,691	338

23 Share-based payments

Effect of share-based payment transactions on the Group's results and financial position

	2023 £m	2022 £m
Total expense recognised for equity-settled share-based payment transactions	50	47
Total cost recognised for cash-settled share-based payment transactions	17	1
Share-based payments recognised in the consolidated income statement	67	48
Liability for cash-settled share-based payment transactions	18	1

A description of the share-based payment plans is included in the Directors' Remuneration Report on pages 84 to 110 of Rolls-Royce Holdings plc 2023 Annual Report. The equity-settled share based payment plans are operated by Rolls-Royce Holdings plc.

Movements in the Group's share-based payment plans during the year

	ShareSave		LTIP	DSBP
	Number Millions	Weighted average exercise price Pence	Number Millions	Number Millions
Outstanding at 1 January 2022	75.1	132	77.0	0.8
Granted	0.1	104	47.2	12.3
Forfeited	(9.6)	161	(13.4)	(0.2)
Exercised	-	-	(17.8)	(0.7)
Outstanding at 31 December 2022	65.6	127	93.0	12.2
Granted	0.1	115	44.7	7.0
Forfeited	(12.3)	203	(29.1)	(1.9)
Exercised	-	-	(7.6)	(0.1)
Outstanding at 31 December 2023	53.4	107	101.0	17.2
Exercisable at 31 December 2023	-	-	-	-
Exercisable at 31 December 2022	-	-	-	-

The weighted average share price at the date share options were exercised was 159p (2022: 95p). The closing price at 31 December 2023 was 300p (2022: 93p).

The weighted average remaining contractual life for the share options as at 31 December 2023 was one year (2022: two years) and the range of exercise prices for the share options as at 31 December 2023 was 97p to 261p.

Fair values of share-based payment plans

The weighted average fair value per share of equity-settled share-based payment plans granted during the year, estimated at the date of grant, are as follows:

	2023	2022
LTIP	216p	90p
DSBP	157p	91p

Long-term Incentive plans (LTIP)

The fair value of shares awarded are calculated using a pricing model that takes account of the non-entitlement to dividends (or equivalent) during the vesting period and the market-based performance condition based on expectations about volatility and the correlation of share price returns in the group of FTSE 100 companies and which incorporates into the valuation the interdependency between share price performance and total shareholder return (TSR) vesting. This adjustment decreases the fair value of the award relative to the share price at the date of grant.

ShareSave

The fair value of the options granted is calculated using a pricing model that assumes that participants will exercise their options at the beginning of the six-month window if the share price is greater than the exercise price. Otherwise, it assumes that options are held until the expiration of their contractual term. This results in an expected life that falls somewhere between the start and end of the exercise window.

Deferred Share Bonus Plan (DSBP)

The fair value of shares awarded under DSBP is calculated as the share price on the date of the award, excluding expected dividends (or equivalent).

24 Contingent liabilities

In January 2017, after full cooperation, the Company concluded deferred prosecution agreements (DPA) with the SFO and the US Department of Justice (DoJ) and a leniency agreement with the MPF, the Brazilian federal prosecutors. The terms of both DPAs have now expired. The Company has submitted a final report to the Controller General, Brazil (CGU) under the terms of a two-year leniency agreement signed in October 2021 relating to the same historical matters. Certain authorities are investigating members of the Group for matters relating to misconduct in relation to historical matters. The Group is responding appropriately. Action may be taken by further authorities against the Group or individuals. In addition, the Group could still be affected by actions from other parties, including customers, customers' financiers and the Company's current and former investors, including certain potential claims in respect of the Group's historical ethics and compliance disclosures which have been notified to the Group. The Directors are not currently aware of any matters that are likely to lead to a material financial loss over and above the penalties imposed to date, but cannot anticipate all the possible actions that may be taken or their potential consequences.

The Group has, in the normal course of business, entered into arrangements in respect of export finance, performance bonds, grant funding, countertrade obligations and minor miscellaneous items, which could result in potential outflows if the requirements related to those arrangements are not met. Various Group undertakings are party to legal actions and claims (including with tax authorities) which arise in the ordinary course of business, some of which are for substantial amounts.

In connection with the sale of its products, the Group will, on some occasions, provide financing support for its customers, generally in respect of civil aircraft. The Group's commitments relating to these financing arrangements are spread over many years, relate to a number of customers and a broad product portfolio and are generally secured on the asset subject to the financing. These include commitments of \$0.9bn (2022: \$1.2bn) (on a discounted basis) to provide facilities to enable customers to purchase aircraft (of which approximately \$0.7bn could be called during 2024). These facilities may only be used if the customer is unable to obtain financing elsewhere and are priced at a premium to the market rate. Significant events impacting the international aircraft financing market, the failure by customers to meet their obligations under such financing agreements, or inadequate provisions for customer financing liabilities may adversely affect the Group's financial position.

Customer financing provisions are made to cover guarantees provided for asset value and/or financing where it is probable that a payment will be made. These are reported on a discounted basis at the Group's borrowing rate to better reflect the time span over which these exposures could arise. The values of aircraft providing security are based on advice from a specialist aircraft appraiser. There were no provisions for customer financing provisions at 31 December 2023 or 31 December 2022.

The Group has responded appropriately to the Russia-Ukraine conflict to comply with international sanctions and export control regime, and to continue to implement the business decision to exit from Russia. The Group could be subject to action by impacted customers, suppliers and other contract parties.

While the outcome of the above 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.

25 Related party transactions

	2023 £m	2022 £m
Sale of goods and services ¹	6,700	5,074
Purchases of goods and services ¹	(7,471)	(5,577)
Lease payments to joint ventures and associates	(244)	(163)
Guarantees of joint arrangements' and associates' borrowings	2	3
Guarantees of non-wholly owned subsidiaries' borrowings	3	3
Dividends received from joint ventures and associates	54	73
Other income received from joint ventures and associates	6	2

¹ The Group has both sales and purchasing arrangements with its maintenance, repair and overhaul joint ventures. As part of this arrangement, the Group issues and receives credit notes usable against amounts receivable and payable to these related parties. Purchases of goods and services from related parties are presented to be shown gross of these concessions. This is consistent with the presentation of sales to related parties. Purchases from related parties incurred during the year to 31 December 2022 have been represented on this basis resulting in an increase to this balance of £662m.

During the year, the Company settled £2m of C-shares redeemed in the year that had been issued by its ultimate parent. This resulted in an increase of amounts owed by parent undertakings to £337m (2022: £335m). The expected credit loss provision recognised on this balance is nil (2022: nil).

Included in sales of goods and services to related parties are sales of spare engines amounting to £48m (2022: £19m). Profit recognised in the year on such sales amounted to £88m (2022: £50m), including profit on current year sales and recognition of profit deferred on similar sales in previous years. Cash receipts relating to the sale of spare engines amounted to £73m (2022: £40m).

Included in other financing charges in the income statement are interest costs of £34m (2022: £17m) incurred during the year which have been settled by the Group on behalf of joint ventures, including the £28m of costs incurred for using the Group offered SCF arrangement set out in note 18.

The aggregated balances with joint ventures and parent undertaking are shown in notes 13 and 18. Transactions with Group pension schemes are shown in note 21.

25 Related party transactions continued

Key management personnel are deemed to be the Directors and the members of the Executive Team. Remuneration for key management personnel is shown below:

	2023 £m	2022 £m
Salaries and short-term benefits	25	17
Post-retirement schemes	-	-
Share-based payments	15	10
	40	27

More detailed information regarding the Directors' remuneration, shareholdings, pension entitlements, share options and other long-term incentive plans is shown in the Directors' Remuneration Report on pages 84 to 110 of Rolls-Royce Holdings plc 2023 Annual Report. The charge for share-based payments above is based on when the award is charged to the income statement in accordance with IFRS 2 *Share-Based Payments*, rather than when the shares vest, which is the basis used in the Directors' Remuneration Report.

26 Acquisitions, disposals, held for sale and discontinued operations

Acquisitions

On 30 June 2023, the Group completed its acquisition of Team Italia/Onyx Marine SRL for a cash consideration of £14m. Team Italia specialises in yacht bridges and marine navigation and automation systems. The acquisition will provide key technology for marine automation systems and will strengthen Power Systems' position as a yacht market leader. The acquisition price of £14m has been allocated to £8m of goodwill, £2m of customer relationships, £2m to right-of-use assets and £2m to other current assets and liabilities.

Disposals

During the year, the Group divested their 49% shareholding in joint venture, Shanxi North MTU Diesel Co. Limited to the current JV partner for proceeds of £5m. The carrying value of the Group's investment that was derecognised was £5m resulting in nil profit on disposal.

Reconciliation of profit on disposal of businesses in continuing operations to the income statement:

	Total £m
Profit/(loss) before taxation on disposal	1
Cumulative currency translation gain/(loss) on liquidation of joint venture	(1)
Adjustment to consideration on disposals completed in prior periods	2
Profit on disposal of businesses per income statement	2

Reconciliation of cash flow on acquisition and disposal of businesses to the cash flow statement:

	Total £m
Proceeds on disposal (see above)	5
Cash outflow on acquisitions	(14)
Cash outflow on disposals completed in prior periods	(9)
Cash flow on acquisition and disposal of businesses per cash flow statement	(18)

26 Acquisitions, disposals, held for sale and discontinued operations continued

Held for sale

At 31 December 2023, the Group was in positive discussions with Deutz AG for the sale of the off-highway engines business in the lower power range based in Power Systems. The business is available for sale in its current condition and the sale is considered highly probable based on the agreement-in-principle reached as at 31 December 2023. In line with IFRS 5, the assets and liabilities related to the business have been classified as held for sale and measured at the lower of their carrying value or fair value less costs to sell, resulting in a £7m impairment reversal.

The table below summarises the categories of assets and liabilities classified as held for sale at 31 December 2023. There were no assets or liabilities held for sale at 31 December 2022.

	2023
	£m
Intangible assets	51
Inventory	11
Trade receivables and other assets	47
Assets held for sale	109
Trade payables and other liabilities	(41)
Contract liabilities	(4)
Provisions for liabilities and charges	(8)
Post-retirement scheme deficits	(2)
Liabilities associated with assets held for sale	(55)
Net assets held for sale	54

Discontinued operations

ITP Aero represented a separate major line of business and was classified as a disposal group held for sale up to the date of disposal. Therefore, the results up to 15 September 2022, in line with IFRS 5, were classified as discontinued operations.

The financial performance and cash flow information presented reflects the operations for the year that have been classified as discontinued operations.

	2023	2022
	£m	£m
Revenue	-	275
Operating profit ¹	-	86
Profit before taxation ¹	-	78
Income tax charge ¹	-	(10)
Profit for the year from discontinued operations on ordinary activities	-	68
Costs of disposal of discontinued operations ²	-	-
Loss on disposal of discontinued operations (see above)	-	(148)
Loss for the year from discontinued operations	-	(80)
Net cash inflow from operating activities ²	-	85
Net cash outflow from investing activities ²	-	(67)
Net cash outflow from financing activities	-	(25)
Exchange gain/(losses)	-	-
Net change in cash and cash equivalents	-	(7)

¹ Profit from discontinued operations on ordinary activities is presented net of intercompany trading eliminations and related consolidation adjustments

² Cash flows from investing activities include £nil (2022: £42m) costs of disposal paid during the year that are not a movement in the cash balance of the disposal group as they were borne centrally

27 Derivation of summary funds flow statement

	2023				2022
	Cash flow	Impact of hedge book	Impact of acquisition accounting	Impact of other non-underlying items	Funds flow
	£m	£m	£m	£m	£m
Operating profit/(loss)	1,944	(475)	50	71	1,590
Operating profit from discontinued operations	-	-	-	-	86
Depreciation, amortisation and impairment	1019	-	(50)	9	978
Movement in provisions	(325)	48	-	21	(258)
Movement in Civil LTSA balance	1,708	(377)	-	-	1,331
Movement in prepayments to RRSAs for LTSA parts	(315)	63	-	-	(252)
Settlement of excess derivatives	(389)	-	-	-	(389)
Loss on disposal of property, plant and equipment ¹	18	-	-	-	18
Joint venture trading ¹	(119)	-	-	-	(119)
Interest received ¹	159	-	-	-	159
Contributions to defined benefit schemes in excess of underlying operating profit charge ¹	(28)	-	-	2	(26)
Share-based payments ¹	67	-	-	-	67
Other ¹	-	(8)	-	1	(7)
Operating cash flow before working capital and taxation²	3,739	(751)	-	104	3,092
Increase in inventories ³	(200)	-	-	-	(200)
Movement in trade receivables/payables and other assets/liabilities (excluding prepayments to RRSAs for LTSA parts) ³	(2,090)	(184)	-	(57)	(2,291)
Movement in contract assets/liabilities (excluding Civil LTSA) ³	995	51	-	-	1,046
Revaluation of trading assets (excluding exceptional items) ³	208	(10)	-	-	198
Realised derivatives in financing ³	853	-	-	-	853
Cash flows on other financial assets and liabilities held for operating purposes	(845)	853	-	-	18
Income tax	(172)	-	-	-	(172)
Cash from operating activities²	2,486	(21)	-	67	2,532
Capital element of lease payments	(291)	21	-	-	(270)
Capital expenditure	(699)	-	-	4	(695)
Investment	69	-	-	-	69
Interest paid	(333)	-	-	-	(333)
Other (M&A, restructuring and financial penalties paid)	(154)	-	-	(71)	(225)
Free cash flow	1,288	-	-	-	490
- of which is continuing operations	1,288	-	-	-	504

¹ Included in other operating cash flows in the summarised free cash flow on page 19

² The funds flow to 31 December 2022 has been represented to disclose cash flows on settlement of excess derivative contracts as cash flows from operating activities. As a result, operating cash flows before working capital and income tax during the year to 31 December 2022 have reduced by £(326)m to £2,168m. Cash flows on settlement of excess derivative contracts were previously shown after cash from operating activities in arriving at free cash flow. There is no impact to free cash flow

³ Included in working capital (excluding Civil LTSA balance) in the summarised free cash flow on page 19

The comparative information to 31 December 2023 has been presented in a different format to align to the current year presentation. In some instances, the groupings of items may have changed.

Free cash flow is a measure of the financial performance of the businesses' cash flows which is consistent with the way in which performance is communicated to the Board. Free cash flow is defined as cash flows from operating activities including capital expenditure and movements in investments, capital elements of lease payments, interest paid, amounts paid relating to the settlement of excess derivatives and excluding amounts spent or received on activity related to business acquisitions or disposals and other material exceptional or one-off cash flows. The Board considers that free cash flow reflects cash generated from the Group's underlying trading.

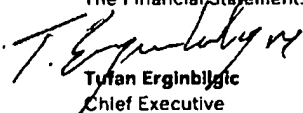
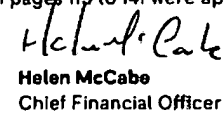
Cash flow from operating activities is determined to be the nearest statutory measure to free cash flow. The reconciliation between free cash flow and cash flow from operating activities can be found on page 162.

COMPANY BALANCE SHEET
 At 31 December 2023

	Notes	2023 £m	2022 £m
ASSETS			
Intangible assets	3	2,233	2,154
Property, plant and equipment	4	1,591	1,673
Right-of-use assets	5	146	138
Investments - subsidiary undertakings	6	1,473	1,453
Investments - joint ventures and associates	6	38	26
Investments - other	6	31	35
Loan receivable from subsidiary undertaking	6	1,699	1,774
Other financial assets	14	330	522
Deferred tax assets	16	2,198	1,990
Post-retirement schemes surpluses	17	767	594
Non-current assets		10,504	10,359
Inventories	7	2,326	2,086
Trade receivables and other assets	8	7,931	7,969
Contract assets	9	749	1,057
Taxation recoverable		2	2
Other financial assets	14	84	261
Cash and cash equivalents	10	3,085	1,917
Current assets		14,177	13,292
TOTAL ASSETS		24,681	23,651
LIABILITIES			
Borrowings and lease liabilities	11	(520)	(39)
Other financial liabilities	14	(426)	(997)
Trade payables and other liabilities	13	(9,908)	(10,456)
Contract liabilities	9	(4,227)	(3,388)
Current tax liabilities		(2)	(2)
Provisions for liabilities and charges	15	(320)	(352)
Current liabilities		(15,403)	(15,234)
Borrowings and lease liabilities	11	(3,715)	(4,249)
Other financial liabilities	14	(1,839)	(3,232)
Trade payables and other liabilities	13	(1,770)	(2,205)
Contract liabilities	9	(6,084)	(5,153)
Deferred tax liabilities	16	(269)	(208)
Provisions for liabilities and charges	15	(1,273)	(1,466)
Non-current liabilities		(15,050)	(16,513)
TOTAL LIABILITIES		(30,453)	(31,747)
NET LIABILITIES		(5,772)	(8,096)
EQUITY			
Called-up share capital	18	338	338
Share premium		631	631
Merger reserve		-	-
Other reserves		183	199
Accumulated losses		(6,924)	(9,264)
TOTAL EQUITY		(5,772)	(8,096)
Profit/(loss) for the year		2,185	(633)

The Company has elected to take the exemption under section 408 of the Companies Act 2006 from presenting the parent company income statement.

The Financial Statements on pages 113 to 141 were approved by the Board on 20 March 2024 and signed on its behalf by:



Tufan Erginbilig **Helen McCabe**
 Chief Executive Chief Financial Officer

Company's registered number: 01003142

COMPANY STATEMENT OF COMPREHENSIVE INCOME

For the year ended 31 December 2023

	Notes	2023 £m	2022 £m
Profit/(loss) for the year		2,185	(633)
Other comprehensive income/(expense) (OCI)			
Actuarial movement in post-retirement schemes	17	152	(544)
Revaluation to fair value of other investments	6	(4)	(4)
Related tax movements		(54)	190
Items that will not be reclassified to profit or loss		94	(358)
Movement on fair values (debited)/credited to hedging reserves		(82)	76
Reclassified to income statement from cash flow hedge reserve		61	(72)
Costs of hedging		10	10
Foreign exchange translation differences on foreign operations		3	3
Related tax movements		(5)	(4)
Items that will be reclassified to profit or loss		(16)	13
Total other comprehensive income/(expense)		78	(345)
Total comprehensive income/(expense) for the year		2,263	(978)

COMPANY STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December 2023

	Note	Share capital £m	Share premium £m	Merger reserves £m	Other reserves ¹ £m	Accumulated losses £m	Total equity £m
At 1 January 2022		338	631	650	186	(8,963)	(7,158)
Loss for the year		-	-	-	-	(633)	(633)
Actuarial movement in post-retirement schemes	17	-	-	-	-	(544)	(544)
Reclassified to income statement from cash flow hedge reserve		-	-	-	(72)	-	(72)
Fair value on movement on cash flow hedges		-	-	-	76	-	76
Revaluation to fair value of other investments	6	-	-	-	-	(4)	(4)
Costs of hedging		-	-	-	10	-	10
Foreign exchange translation differences on foreign operations		-	-	-	3	-	3
Related tax movements		-	-	-	(4)	190	186
Total comprehensive income/(expense) for the year		-	-	-	13	(991)	(978)
Share-based payments – direct to equity ²	19	-	-	-	-	39	39
Transfer to realised profit ³		-	-	(650)	-	650	-
Related tax movements		-	-	-	-	1	1
Other changes in equity in the year		-	-	(650)	-	690	40
At 1 January 2023		338	631	-	199	(9,264)	(8,096)
Profit for the year		-	-	-	-	2,185	2,185
Actuarial movement in post-retirement schemes	17	-	-	-	-	152	152
Reclassified to income statement from cash flow hedge reserve		-	-	-	61	-	61
Fair value on movement on cash flow hedges		-	-	-	(82)	-	(82)
Revaluation to fair value of other investments	6	-	-	-	-	(4)	(4)
Related tax movements		-	-	-	5	(54)	(49)
Total comprehensive income/(expense) for the year		-	-	-	(16)	2,279	2,263
Share-based payments – direct to equity ²	19	-	-	-	-	39	39
Related tax movements		-	-	-	-	22	22
Other changes in equity in the year		-	-	-	-	61	61
At 31 December 2023		338	631	-	183	(6,924)	(5,772)

¹ Other reserves includes a translational reserve of £4m (2022: £7m) and £159m (2022: £159m) relating to the premium which arose on shares issued on a 1989 acquisition. This also includes the cash flow hedge reserve of £14m (2022: £30m). During the year, costs of hedging of £nil (2022: £10m) were recognised and reclassified to the income statement

² Share-based payments – direct to equity is the share-based payment charge for the year less the actual cost of vesting excluding those vesting own shares and cash received on share-based schemes vesting

³ On disposal of ITP Aero on 15 September 2022, consideration of £1,335m was received resulting in a profit on disposal of £673m. The premium recognised on issue of shares for the previous acquisition became realised on receipt of qualifying consideration. As such, the total merger reserve has been transferred to accumulated losses

1 Accounting policies

The Company

Rolls-Royce plc (the 'Company') is a public company limited by shares incorporated under the Companies Act 2006 and domiciled in England in the United Kingdom. The Company's registered number is 01003142 and its registered address is at Kings Place, 90 York Way, London, N1 9FX, United Kingdom.

Basis of preparation

In preparing these financial statements, the Company applies the recognition, measurement and disclosure requirements of International Financial Reporting Standards as adopted by the UK (UK-adopted International accounting standards), but makes amendments where necessary in order to comply with the Companies Act 2006 and to take advantage of the following FRS 101 disclosure exemptions:

- a cash flow statement and related notes
- IFRS 2 *Share Based Payment* in respect of group settled share-based payments;
- in respect of transactions with wholly owned subsidiaries;
- IFRS 7 *Financial Instruments: Disclosures*;
- the requirements of paragraphs 30 and 31 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*;
- comparative period reconciliations for share capital, investments, property, plant and equipment, intangible assets and additional comparative information as required by IAS 1; and
- in respect of the compensation of key management personnel.

The accounting policies set out below have, unless otherwise stated, been applied consistently to all periods presented in these Financial Statements.

The Financial Statements are presented in sterling, which is the Company's functional currency.

As permitted by Section 408 of the Companies Act 2006, a separate income statement for the Company has not been included in these Financial Statements. As permitted by the audit fee disclosure regulations, the disclosure of non-audit fees information is not included in respect of the Company.

These Financial Statements have been prepared on a going concern basis. Further details are given in the Going Concern Statement on page 36. After due consideration, the Directors consider that the Company has sufficient liquidity to continue in operational existence for a period of at least 18 months from the date of this report and are therefore satisfied that it is appropriate to adopt the going concern basis of accounting in preparing the Financial Statements.

In preparing the Company Financial Statements, the Directors have considered the potential impact of climate change, please see pages 53 to 55 for further details.

Revision to IFRS applicable in 2023

IFRS 17 Insurance Contracts

IFRS 17, issued in May 2018, establishes the principles for the recognition, measurement, presentation and disclosure of insurance contracts within the scope of the Standard. The Standard is effective for years beginning on or after 1 January 2023 with a requirement to restate comparatives.

The Company has reviewed whether its arrangements meet the accounting definition of an insurance contract. While some contracts, including Civil Aerospace LTSAs, may transfer an element of insurance risk, they relate to warranty and service type agreements that are issued in connection with the Company's sales of its goods or services and therefore will remain accounted for under the existing revenue and provisions standards. The Directors have judged that such arrangements entered into after the original equipment sale remain sufficiently related to the sale of the Company's goods and services to allow the contracts to continue to be measured under IFRS 15 *Revenue from Contracts with Customers* and IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

The Company enters into financial guarantees where the Company guarantees payment in case of its subsidiary defaulting on a debt; and performance guarantees where the Company guarantees certain subsidiaries or its joint ventures performance to a customer. The Company has reviewed and concluded that its arrangements meet the accounting definition of an insurance contract under IFRS 17. The Company has assessed the probability of losses on its financial and performance guarantees and has determined that the probability is remote after consideration of both historical and forward-looking triggers and as such the estimated liability is immaterial. As a result, no transition accounting entries were required as at 1 January 2023 and, as the estimated liability is immaterial at 31 December 2023, no liability has been recognised in the Company Financial Statements.

At 31 December 2023, financial guarantees amounted to £1,336m (2022: £1,337m) and performance guarantees amounted to £1,722m (2022: £1,659m). Prior to adoption of IFRS 17 these potential exposures were considered to be contingent liabilities until such time that it became probable that the Company would be required to make a payment under the guarantee. Under IFRS 17 the Company must recognise any obligation at the inception of the contract for the expected fulfilment cash flows under the contract on a best estimate basis (liability for remaining coverage).

There are no other new standards or interpretations issued by the IASB that had a material impact for the year ended 31 December 2023.

1 Accounting policies *continued*

Material accounting policies

The Company's material accounting policies are set out below. These accounting policies have been applied consistently to all periods presented in these Financial Statements.

Key areas of judgement and sources of estimation uncertainty are disclosed on page 57 and further details, together with sensitivities, are included within the significant accounting policies section where applicable.

Revenue recognition and contract assets and liabilities

Revenue recognised comprises sales to the Company's customers after discounts and amounts payable to customers. Revenue excludes value added taxes. The transaction price of a contract is typically clearly stated within the contract, although the absolute amount may be dependent on escalation indices and long-term contracts rely on the key estimates highlighted below. Refund liabilities where sales are made to customers with a right of return are not typical in the Company's contracts. Where they do exist, and consideration has been received, a portion, based on an assessment of the expected refund liability is recognised within other payables. The Company has elected to use the practical expedient not to adjust revenue for the effect of financing components, where the expectation is that the period between the transfer of goods and services to customers and the receipt of payment is less than a year. Consideration is received in the form of deposits and payments for completion of milestones or performance obligations. LTSA cash receipts are typically received based on EFHs.

Sales of standard OE, spare parts and time and material (T&M) overhaul services are generally recognised on transfer of control to the customer. This is generally on delivery to the customer unless the specific contractual terms indicate a different point. The Directors consider whether there is a need to constrain the amount of revenue to be recognised on delivery based on the contractual position and any relevant facts, however, this is not typically required.

Sales of OE and services that are specifically designed for the contract (most significantly in the Defence division) are recognised by reference to the progress towards completion of the performance obligation, using the cost method described in the key judgements, provided the outcome of contracts can be assessed with reasonable certainty.

The Company generates a significant portion of its revenue and profit on aftermarket arrangements arising from the installed OE fleet. As a consequence, in particular in the Civil Aerospace large engine business, the Company will often agree contractual prices for OE deliveries that take into account the anticipated aftermarket arrangements. Sometimes this may result in losses being incurred on OE. As described in the key judgements, these contracts are not combined. The consideration in the OE contract is therefore allocated to OE performance obligations and the consideration in the aftermarket contract to aftermarket performance obligations.

Key areas of accounting policy are:

- Future variable revenue from long-term contracts is constrained to take account of the risk of reduced utilisation e.g. EFHs, based on historical forecasting experience and the risk of aircraft being parked by the customer.
- A significant amount of revenue and cost related to long-term contract accounting is denominated in currencies other than that of the Company, most significantly USD transactions in sterling. These are translated at estimated long-term exchange rates.
- A contract asset/liability is recognised where payment is received in arrears/advance of the costs incurred to meet performance obligations.
- Contract modifications of LTSAs can be accounted for as separate contracts, termination of the existing contract and the creation of a new contract, or as part of the existing contract. The treatment is dependent on whether the change in scope is because of the addition of promised goods or services that are distinct and whether the price increases by an amount that reflects their standalone selling prices.
- Where material, wastage costs (see key judgements on page 117) are recorded as an expense and excluded from the measure of progress of LTSA contracts.
- The Company recognises a liability for their obligation to repurchase parts it has sold to the maintenance, repair and overhaul bases who overhaul the Company's customers' engines.

If the expected costs to fulfil a contract exceed the expected revenue, a contract loss provision is recognised for the excess costs.

The Company pays participation fees to airframe manufacturers, its customers for OE, on certain programmes. Amounts paid are initially treated as contract assets and subsequently charged as a reduction to the OE revenue when the engines are transferred to the customer.

The Company has elected to use the practical expedient to expense as incurred any incremental costs of obtaining or fulfilling a contract if the amortisation period of an asset created would have been one year or less. Where costs to obtain a contract are recognised in the balance sheet, they are amortised over the performance of the related contract (one to eight years).

1 Accounting policies continued

Revenue recognition (continued)

Key judgement – Whether Civil Aerospace OE and aftermarket contracts should be combined

In the Civil Aerospace division, OE contracts for the sale of engines to be installed on new aircraft are with the airframers, while the contracts to provide spare engines and aftermarket goods and services are with the aircraft operators, although there may be interdependencies between them. IFRS 15 includes guidance on the combination of contracts, in particular that contracts with unrelated parties should not be combined. Notwithstanding the interdependencies, the Directors consider that the engine contract should be considered separately from the aftermarket contract. In making this judgement, they also took account of industry practice.

Key judgement – How performance on long-term aftermarket contracts should be measured

The Company generates a significant proportion of its revenue from aftermarket arrangements. These aftermarket contracts, such as TotalCare agreements in the Civil Aerospace division, cover a range of services and generally have contractual terms covering more than one year. Under these contracts, the Company's primary obligation is to maintain customers' engines in an operational condition. This is achieved by undertaking various activities, such as maintenance, repair and overhaul, and engine monitoring over the period of the contract. Revenue on these contracts is recognised over the period of the contract and the basis for measuring progress is a matter of judgement. The Directors consider that the stage of completion of the contract is best measured by using the actual costs incurred to date compared to the estimated costs to complete the performance obligations, as this reflects the extent of completion of the activities to be performed.

Key judgement – Whether long-term aftermarket contracts contain a significant financing component

Long-term aftermarket contracts typically cover a period of eight to 15 years. Their pricing is the subject of negotiation with individual customers under competitive circumstances. It is the Directors' judgement that the consideration received approximates to the cash selling price and any timing difference between consideration being received and the supply of goods and services is typical of the industry and arises for reasons other than to provide financing. The customers typically pay on an "as used" basis (e.g. USD/EFH) which reflects the wear and tear of the engine as it flies and aligns to the customer's own revenue streams. An adjustment to the transaction price is therefore not required.

Key judgement – Whether any costs should be treated as wastage

In rare circumstances, the Company may incur costs of wasted material, labour or other resources to fulfil a contract where the level of cost was not reflected in the contract price. The identification of such costs is a matter of judgement and would only be expected to arise where there has been a series of abnormal events which give rise to a significant level of cost of a nature that the Company would not expect to incur and hence is not reflected in the contract price. Examples include technical issues that: require resolution to meet regulatory requirements; have a wide-ranging impact across a product type; and cause significant operational disruption to customers. Similarly, in these rare circumstances, significant disruption costs to support customers resulting from the actual performance of a delivered good or service may be treated as a wastage cost. Provision is made for any costs identified as wastage when the obligation to incur them arises – see note 15.

Key judgement – When revenue should be recognised in relation to spare engine sales

Revenue is recognised at the point in time when a customer obtains control of a spare engine. The customer could be a related party, an external operator or a spare engine service provider. Depending on the contractual arrangements, judgement is required on when the Company relinquishes control of spare engines and, therefore, when the revenue is recognised. The point of control passing has been concluded to correspond to the point of legal sale, even for instances where the customer is contracted to provide some future spare engine capacity to the Company to support its installed engine base. In such cases, the customer has responsibility for generating revenue from the engines and exposure to periods of non-utilisation; exposure to risk of damage or loss, risk from residual value movements, and will determine if and when profits will be made from disposal. The spare engine capacity that will be made available to the Company in the future does not consist of identified assets and the provider retains a substantive right to substitute the asset through the Company's period of use. It is, therefore, appropriate to recognise revenue from the sale of the spare engines at the point that title transfers. During 2023, of the total 53 (2022: 44) large spare engine sales delivered, 27 (2022: 20) engines were sold to customers where contractual arrangement allows for some future spare engine capacity to be used by the Company. These sales contributed £578m (2022: £454m) to revenue for the year.

Key judgement – Whether the Civil Aerospace LTSA contracts are warranty style contracts entered into in connection with OE sales and therefore can be accounted for under IFRS 15

The Company has considered whether these arrangements are insurance contracts as defined in IFRS 17. While they may transfer an element of insurance risk, they relate to warranty and service type agreements that are entered into in connection with the Company's sales of its goods or services and therefore continue to be accounted for under the existing revenue and provisions standards. The Directors have judged that such arrangements entered into after the original equipment sale remain sufficiently related to the sale of the Company's goods and services to allow the contracts to continue to be measured under IFRS 15 and IAS 37.

Key estimate – Estimates of future revenues, including customer pricing, and costs of long-term contractual arrangements including the impact of climate change

The Company has long-term contracts that fall into different accounting periods and which can extend over significant periods (generally up to 25 years). The most significant of these are LTSAs in the Civil Aerospace division, with contracts typically covering a period of eight to 15 years. The estimated revenue and costs are inherently imprecise and significant estimates are required to assess: EFHs, time-on-wing and other operating parameters; the pattern of future maintenance activity and the costs to be incurred; lifecycle cost improvements over the term of the contracts; and escalation of revenue and costs (that includes the impact of inflation). The impact of climate change on EFHs and costs is also considered when making these estimates. Industry and customer data on expected levels of utilisation is included in the forecasts used. Across the length of the current Civil Aerospace LTSA contracts, allowance has been made for around a 1% (2022: 1%) projected cost increase resulting from carbon pricing and commodity price changes.

1 Accounting policies continued

Revenue recognition (continued)

The sensitivities below demonstrate how changes in assumptions (including as a result of climate change) could impact the level of revenue recognised were assumptions to change. The Directors believe that the estimates used to prepare the Company Financial Statements take account of the inherent uncertainties, constraining the expected level of revenue as appropriate.

Estimates of future LTSA revenue within Civil Aerospace are based upon future EFH forecasts, influenced by assumptions over the recovery of the civil aviation industry. Finally, many of the revenues and costs are denominated in currencies other than that of the Company. These are translated at an estimated long-term exchange rate, based on historical trends and economic forecasts.

During the year, changes to the estimate in relation to the Civil Aerospace LTSA contracts resulted in adverse catch-up adjustments to revenue of £188m (2022: favourable catch-up adjustment of £170m).

Based upon the stage of completion of all LTSA contracts within Civil Aerospace as at 31 December 2023, the following reasonably possible changes in estimates would result in catch-up adjustments being recognised in the period in which the estimates change (at underlying rates):

- A change in forecast EFHs of 1% over the remaining term of the contracts would impact LTSA income and to a lesser extent costs, resulting in an in-year impact of around £10m. This would be expected to be seen as a catch-up change in revenue or, to the extent it impacts onerous contracts, within cost of sales.
- A 2% increase or decrease in our pricing to customers over the life of the contracts would lead to a revenue catch-up adjustment in the next 12 months of around £250m.
- A 2% increase or decrease in shop visit costs over the life of the contracts would lead to a revenue catch-up adjustment in the next 12 months of around £55m.

Risk and revenue sharing arrangements (RRSAs)

Cash entry fees received are initially deferred on the balance sheet as deferred receipts from RSA workshare partners within trade payables and other liabilities. The cash entry fee is a transaction with a supplier and is recognised as a reduction in cost of sales incurred. Individual programme amounts are allocated pro rata to the estimated number of units to be produced. Amortisation commences as each unit is delivered and then recognised on a 15-year straight-line basis.

The payments to suppliers for their shares of the programme cash flows for their production components are charged to cost of sales when OE sales are recognised or as LTSA costs are incurred. These prepayments are initially recognised within trade receivables and other assets.

The Company also has arrangements with third parties who invest in a programme and receive a return based on its performance, but do not undertake development work or supply parts. Such arrangements (financial RRSAs) are financial instruments as defined by IAS 32 *Financial Instruments: Presentation* and are accounted for using the amortised cost method.

Key judgement – Determination of the nature of entry fees received

RRSAs with key suppliers (workshare partners) are a feature of the civil aviation industry business. Under these contractual arrangements, the key commercial objectives are that: (i) during the development phase the workshare partner shares in the risks of developing an engine by performing its own development work, providing development parts and paying a non-refundable cash entry fee; and (ii) during the production phase it supplies components in return for a share of the programme cash flows as a 'life of type' supplier (i.e. as long as the engine remains in service).

The non-refundable cash entry fee is judged by the Company to be a contribution towards the development expenditure incurred. These receipts are deferred on the balance sheet and recognised against the cost of sales over the estimated number of units to be delivered on a similar basis to the amortisation of development costs – see page 121.

Royalty payments

Royalty payments include payments to government bodies that have previously acquired an interest in a programme. These are recognised as a charge in cost of sales in line with sales made.

Government grants

Government grants received are varied in nature and are recognised in the income statement so as to match them with the related expenses that they are intended to compensate. Where grants are received in advance of the related expenses, they are initially recognised as liabilities within trade payables and other liabilities and released to match the related expenditure. Non-monetary grants are recognised at fair value.

Interest

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

Taxation

The tax charge/credit on the profit or loss for the year comprises current and deferred tax:

- Current tax is the expected tax payable for the year, using tax rates enacted or substantively enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.
- Deferred tax is provided using the balance sheet liability method, providing for temporary differences between the carrying amounts of the assets and liabilities for financial reporting purposes and the amounts used for tax purposes and is calculated using the enacted or substantively enacted rates that are expected to apply when the asset or liability is settled. The deferred tax liability on the pension scheme surplus is recognised consistently with the basis for recognising the rate applicable to refunds from a trust.

Tax is charged or credited in the income statement or OCI as appropriate, except when it relates to items credited or charged directly to equity in which case the tax is also dealt with in equity.

1 Accounting policies continued

Taxation recognition (continued)

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

Deferred tax assets are recognised only to the extent that it is probable that future taxable profits, which include the reversal of taxable temporary differences, will be available against which the assets can be utilised. Further details on the Company's tax position can be found on pages 135 to 136.

Key estimate – Estimates necessary to assess whether it is probable that sufficient suitable taxable profits will arise in the UK to utilise the deferred tax assets recognised

Deferred tax assets are only recognised to the extent it is probable that future taxable profits will be available, against which the deductible temporary difference can be utilised. On this basis a deferred tax asset of £1,627m is not recognised in respect of UK tax losses. Further details are included in note 16.

In addition to taking into account a severe but plausible downside forecast (see below), the climate-related estimates and assumptions (set out on pages 53 to 55) have also been considered when assessing the recoverability of the deferred tax assets. Recognising the longer terms over which these assets will be recovered, the Company has considered the risk that regulatory changes could materially impact demand for our products and shifting investment focus towards more sustainable products and solutions. The climate scenarios prepared do not indicate a significant deterioration in demand or profitability for Civil Aerospace programmes given that all in production engines are now compatible with sustainable fuels.

While carbon and commodity pricing may put pressure on costs, decarbonisation and new supplier and customer contracts offer the opportunity to receive value for more efficient and sustainable products.

As explained in note 16, a 25% probability of there being a severe but plausible downside forecast in relation to the civil aviation industry has been taken into account in the assessment of the recovery of the UK deferred tax assets.

The estimates take account of the inherent uncertainties constraining the expected level of profit as appropriate. Changes in these estimates will affect future profits and therefore the recoverability of deferred tax assets. The following sensitivities have been modelled to demonstrate the impact of changes in assumptions on the recoverability of deferred tax assets.

A 5% change in margin in the main Civil Aerospace large engine programmes.

A 5% change in the number of shop visits driven by EFHs.

Assumed future cost increases from climate change expected to pass through to customers at 100%, are restricted to 90% pass through.

All of these could be driven by a number of factors, including the impact of climate change as explained on pages 53 to 55 and changes in foreign exchange rates.

A 5% change in margin or shop visits (which could be driven by fewer EFHs as a result of climate change) would result in an increase/decrease in the deferred tax asset of around £90m.

If only 90% of assumed future cost increases from climate changes are passed on to customers, this would result in a decrease in the deferred tax asset of around £10m, and if carbon prices were to double, this would be £50m.

Foreign currency translation

Transactions denominated in currencies other than the functional currency of the Company are translated into the functional currency at the average monthly exchange rate when the transaction occurs. Monetary assets and liabilities denominated in foreign currencies are translated into sterling at the rate prevailing at the year end. Exchange differences arising on foreign exchange transactions and the retranslation of assets and liabilities into sterling at the rate prevailing at the year-end are included in profit/(loss) before taxation.

The trading results of the Company are translated into sterling at the average exchange rates for the year. The assets and liabilities of foreign operations are translated at the exchange rates prevailing at the year end. Exchange adjustments arising from the retranslation of the opening net assets, and from the translation of the profits or losses at average rates, are recognised in OCI.

Financial Instruments – Classification and measurement

Financial assets primarily include trade receivables, cash and cash equivalents, short-term investments, derivatives (foreign exchange, commodity and interest rate contracts), and listed and unlisted investments.

- Trade receivables and amounts due from subsidiary and parent undertakings are classified either as held to collect and measured at amortised cost or as held to collect and sell and measured at fair value, with movements in fair value recognised through other comprehensive income (FVOCI).
- Cash and cash equivalents (consisting of balances with banks and other financial institutions, money-market funds and short-term deposits) and short-term investments are subject to low market risk. Cash balances, short-term deposits (with a maturity of primarily three months or less) and short-term investments are measured at amortised cost. Money market funds are measured at fair value, with movements in fair value recognised in the income statement as a profit or loss (FVPL).
- Derivatives and other investments are measured at FVPL. The Company elected to measure its listed investment at FVOCI.

Financial liabilities primarily consist of trade payables, amounts due from group undertakings, borrowings, derivatives, and financial RSAs.

- Derivatives are classified and measured at FVPL.
- All other financial liabilities are classified and measured at amortised cost.

1 Accounting policies *continued*

Financial Instruments – Impairment of financial assets and contract assets

IFRS 9 *Financial Instruments* sets out the basis for the accounting of ECLs on financial assets and contract assets resulting from transactions within the scope of IFRS 15 *Revenue from Contracts with Customers*. The Company has adopted the simplified approach to provide for ECLs, measuring the loss allowance at a probability weighted amount that considers reasonable and supportable information about past events, current conditions and forecasts of future economic conditions of customers. These are incorporated in the simplified model adopted by using credit ratings which are publicly available or through internal risk assessments derived using customer's latest available financial information. The ECLs are updated at each reporting date to reflect changes in credit risk since initial recognition. ECLs are calculated for all financial assets in scope, regardless of whether or not they are overdue.

Financial Instruments – Hedge accounting

Forward foreign exchange contracts and commodity swaps (derivative financial instruments) are held to manage the cash flow exposures of forecast transactions denominated in foreign currencies or in commodities respectively. Derivative financial instruments qualify for hedge accounting when: (i) there is a formal designation and documentation of the hedging relationship and the Company's risk management objective and strategy for undertaking the hedge at the inception of the hedge; and (ii) the hedge is expected to be effective. In general, the Company has chosen to not apply hedge accounting in respect of these exposures.

The Company economically hedges the fair value and cash flow exposures of its borrowings. Cross-currency interest rate swaps are held to manage the fair value or cash flow exposures of borrowings denominated in foreign currencies and are designated as fair value hedges or cash flow hedges as appropriate. Interest rate swaps are held to manage the interest rate exposures of fixed and floating rate borrowings and may be designated as fair value hedges or cash flow hedges as appropriate. If the swaps are not designated as fair value or cash flow hedges, the economic effect is included in the underlying results – see note 2.

Changes in the fair values of derivatives that are designated as fair value hedges are recognised directly in the income statement. The fair value changes of effective cash flow hedge derivatives are recognised in OCI and subsequently recycled in the income statement in the same period or periods during which the hedged cash flows affect profit or loss. Any ineffectiveness in the hedging relationships is included in the income statement.

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

Certification costs

Costs incurred, in respect of meeting regulatory certification requirements for new Civil Aerospace aero-engine/aircraft combinations, including payments made to airframe manufacturers for this, are recognised as intangible assets to the extent that they can be recovered out of future sales. They are charged to the income statement over the programme life. Individual programme assets are allocated pro-rata to the estimated number of units to be produced. Amortisation commences as each unit is delivered and then charged on a 15-year straight-line basis.

Research and development

Expenditure incurred on research and development is distinguished as relating either to a research phase or to a development phase. All research phase expenditure is charged to the income statement. Development expenditure is recognised as an internally generated intangible asset (programme asset) only if it meets strict criteria, relating in particular to technical feasibility and generation of future economic benefits. More specifically, development costs are capitalised from the point at which the following conditions have been met:

- the technical feasibility of completing the programme and the intention and ability (availability of technical, financial and other resources) to complete the programme asset and use or sell it;
- the probability that future economic benefits will flow from the programme asset; and
- the ability to measure reliably the expenditure attributable to the programme asset during its development.

Capitalisation continues until the point at which the programme asset meets its originally contracted technical specification (defined internally as the point at which the asset is capable of operating in the manner intended by the Directors).

Subsequent expenditure is capitalised where it enhances the functionality of the programme asset and demonstrably generates an enhanced economic benefit to the Company. All other subsequent expenditure on programme assets is expensed as incurred.

Individual programme assets are allocated pro-rata to the estimated number of units to be produced. Amortisation commences as each unit is delivered and then charged over a maximum of 15-years. In accordance with IAS 38 *Intangible Assets*, the basis on which programme assets are amortised is assessed annually.

1 Accounting policies continued

Research and development (continued)

Key judgement – Determination of the point in time where costs incurred on an internal programme development meet the criteria for capitalisation

The Company incurs significant research and development expenditure in respect of various development programmes. Determining when capitalisation should commence and cease is a critical judgement, as is the determination of when subsequent expenditure on the programme assets should be capitalised. During the year, £186m (2022: £120m) of development expenditure was capitalised.

Within the Company, there are established processes in place e.g. the Product Introduction and Lifecycle Management process (PILM). Within these processes, the technical feasibility, the commercial viability and financial assessment of the programme is assessed at certain milestones. When these are met, development expenditure is capitalised. Prior to this, expenditure is expensed as incurred.

The Company continues to invest in new technologies as a result of its decarbonisation commitments. As these are new technologies, there is a higher level of uncertainty over potential outcomes and, therefore, this could impact the level of expenditure that is capitalised or recognised in the income statement in future years.

Subsequent expenditure after entry into service, which enhances the performance of the engine and the economic benefits to the Company is capitalised. This expenditure is referred to as enhanced performance and is governed by the PILM process referred to above. All other development costs are expensed as incurred.

Key judgement – Determination of the basis for amortising capitalised development costs

The economic benefits of the development costs are primarily those cash inflows arising from LTSAs, which are expected to be relatively consistent for each engine within a programme. Amortisation of development costs is recognised on a straight-line basis over the period of operation of the engine by its initial operator.

Software

Software that is not specific to an item of property, plant and equipment is classified as an intangible asset, recognised at its acquisition cost and amortised on a straight-line basis over its useful economic life up to a maximum of 10 years to reflect the expected useful lives of the assets. The amortisation period of software assets is reviewed annually. The cost of internally developed software includes direct labour and an appropriate proportion of overheads.

Other intangible assets

These include the costs incurred testing and analysing engines with the longest time in service (fleet leader engines) to gather technical knowledge on engine endurance, which are amortised on a straight-line basis over a maximum of 15 years.

Investment in subsidiaries, joint ventures and associates

Investments in subsidiaries, joint ventures and associates are held at cost less accumulated depreciation.

Joint arrangements

The Company accounts for joint operations by consolidating their results on a proportional basis, rather than holding them at their investment value.

Property, plant and equipment

Property, plant and equipment are stated at acquisition cost less accumulated depreciation and any provision for impairment in value. The cost of self-constructed assets includes the cost of materials, direct labour and an appropriate proportion of overheads and, where appropriate, interest.

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

- Land and buildings, as advised by the Company's professional advisors:
- freehold buildings – five to 40 years (average 26 years);
- no depreciation is provided on freehold land.
- Plant and equipment – five to 20 years (average 12 years).
- Aircraft and engines – five to 20 years (average 13 years).

Leases

Assets and liabilities arising from a lease are initially measured on a present value basis.

Lease liabilities include the net present value of the following lease payments:

- fixed payments less any lease incentive receivable;
- variable lease payments that are based on an index or a rate;
- amounts expected to be payable by the Company under residual value guarantees;
- the exercise price of a purchase option if the Company is reasonably certain to exercise that option; and
- payments of penalties for termination of the lease, if the lease term reflects the Company exercising that option.

1 Accounting policies continued

Leases (continued)

Where leases commence after the initial IFRS 16 Leases transition date, the lease payments are discounted using the interest rate implicit in the lease. If that rate cannot be determined, the Company's incremental borrowing rate is used, being the rate that the Company would have to pay to borrow the funds necessary to obtain an asset of similar value in a similar economic environment with similar terms and conditions. Where appropriate, lease liabilities are revalued at each reporting date using the spot exchange rate.

Right-of-use assets are measured at cost comprising the following:

- the amount of the initial measurement of lease liability or a revaluation of the liability;
- any lease payments made at or before the commencement date less any lease incentives received;
- any initial direct costs; and
- restoration costs.

Each right-of-use asset is depreciated over the shorter of its useful economic life and the lease term on a straight-line basis unless the lease is expected to transfer ownership of the underlying asset to the Company, in which case the asset is depreciated to the end of the useful life of the asset.

Short-term leases are leases with a lease term of 12 months or less. Payments associated with short-term leases and low value leases are recognised on a straight-line basis as an expense in the income statement.

Key judgement – Determining the lease term

In determining the lease term, the Company considers all facts and circumstances that create an economic incentive to exercise an extension option, or not exercise a termination option. Extension options (or periods after termination) are only included in the lease term if the lease is reasonably certain to be extended (or not terminated). Certain land and building leases have renewal options although there are no renewal dates for any of the most significant property leases in the next 12 months. The most significant renewal is in 2038. The Company reviews its judgements on lease terms annually, including the operational significance of the site, especially where utilised for manufacturing activities.

Impairment of non-current assets

Impairment of non-current assets is considered in accordance with IAS 36 *Impairment of Assets*. Where the asset does not generate cash flows that are independent of other assets, impairment is considered for the cash-generating unit (CGU) to which the asset belongs. Intangible assets not yet available for use are tested for impairment annually. Other intangible assets (including programme-related intangible assets), property, plant and equipment and investments are assessed for any indications of impairment annually. If any indication of impairment is identified, an impairment test is performed to estimate the recoverable amount.

If the recoverable amount of an asset (or CGU) is estimated to be below the carrying value, the carrying value is reduced to the recoverable amount and the impairment loss recognised as an expense. The recoverable amount is the higher of value in use or fair value less costs of disposal, if this is readily available. The value in use is the present value of future cash flows using a pre-tax discount rate that reflects the time value of money and the risk specific to the asset (or CGU). The relevant local statutory tax rates have been applied in calculating post-tax to pre-tax discount rates.

Inventories

Inventories are valued on a first-in, first-out basis, at the lower of cost and net realisable value. Cost comprises direct materials and, where applicable, direct labour costs and those overheads, including depreciation of property, plant and equipment, that have been incurred in bringing the inventories to their present location and condition. Net realisable value represents the estimated selling prices less all estimated costs of completion and costs to be incurred in marketing, selling and distribution. All inventories are classified as current as it is expected that they will be used in the Company's operating cycle, regardless of whether this is expected to be within 12 months of the balance sheet date.

Cash and cash equivalents

Cash and cash equivalents include cash at bank and in hand, investments in money-market funds and short-term deposits with a maturity of three months or less on inception. Where the Company operates pooled banking arrangements across multiple accounts, these are presented on a net basis when it has both a legal right and intention to settle the balances on a net basis.

The Company's suppliers have access to a supply chain financing (SCF) programme through partnership with banks. This enables smaller suppliers who are on our standard 75 day or more payment terms, and joint ventures (90-day standard payment terms) to receive their payment sooner. The election to utilise the programme is the sole decision of the supplier. As the Company continues to have a contractual obligation to pay its suppliers and it does not retain any ongoing involvement in the SCF, the related payables are retained on the Company's balance sheet and classified as trade payables. Further details are disclosed in note 10.

Provisions

Provisions are recognised when the Company has a present obligation as a result of a past event, and it is probable that the Company will be required to settle that obligation and are discounted to present value where the effect is material.

The principal provisions are recognised as follows:

- contract losses based on an assessment of whether the direct costs to fulfil a contract are greater than the expected revenue;
- warranty and guarantees based on an assessment of future claims with reference to past experience and recognised at the earlier of when the underlying products and services are sold and when the likelihood of a future cost is identified;
- Trent 1000 in-service issues when wastage costs are identified as described on page 117; and
- transformation and restructuring (included in other provisions) when the Company has approved a detailed and formal restructuring plan, and the restructuring has either commenced or has created a valid expectation to those affected.

1 Accounting policies continued

Provision (continued)

Key judgement – Whether any costs should be treated as wastage

As described further on page 117, in rare circumstances, the Company may incur costs of wasted material, labour or other resources to fulfil a contract where the level of cost was not reflected in the contract price. The identification of such costs is a matter of judgement and would only be expected to arise where there has been a series of abnormal events which give rise to a significant level of cost of a nature that the Company would not expect to incur and hence is not reflected in the contract price. Provision is made for any costs identified as wastage when the obligation to incur them arises.

Specifically for the Trent 1000 wastage costs, a provision has been made as the Company is an owner of an engine Type Certificate under which it has a present obligation to develop appropriate design changes to address certain engine conditions that have been noted in Issued Airworthiness Directives. The Company is also required to ensure engine operators can continue to safely operate engines within the terms of their LTSAs, and this requires the engines to be compliant with the requirements of those Issued Airworthiness Directives. These requirements cannot be met without the Company incurring significant costs in the form of replacement parts and customer claims. Given the significant activities of the Company in designing and overhauling aero engines it is very experienced in making the required estimates in relation to the number and timing of shop visits, parts costs, overhaul labour costs and customer claims.

Key judgement – Whether the criteria to recognise a transformation and restructuring provision have been met

On 17 October 2023, the Company announced plans for a simpler, more streamlined, organisation as part of its multi-year transformation. It is estimated that 2,000 to 2,500 roles will be removed across the Rolls-Royce Holdings Plc Group. As at 31 December 2023, there was no communicated allocation of this between Group entities.

IAS 19 requires that a liability and expense for termination benefits should be recognised at the earlier of: (a) when an offer of those benefits can no longer be withdrawn; and (b) when the cost for a restructuring that is within the scope of IAS 37 that involves the payment of termination benefits is recognised.

The Directors have considered whether the Company's communications to employees during 2023 have led to an offer of benefits that could no longer be withdrawn. In a small number of situations this has been the case and a charge of £4m has been recognised in the year. For the significant majority of the 2,000 to 2,500 roles, the Directors do not consider that the plan of termination met the requirement for a provision to be recognised on the basis that communications as at 31 December 2023 had not been in sufficient detail to identify the functions or locations of the roles, the expected completion date, or the type and amount of benefits that would be received should employees employment be terminated.

Key estimates – Estimates of the time to incorporate a modified and certified high-pressure turbine (HPT) blade into the fleet to resolve technical issues on the Trent 1000, and the implications of this on forecast future costs when assessing onerous contracts

The Company has provisions for Trent 1000 wastage costs at 31 December 2023 of £116m (2022: £179m). These represent the Directors' best estimate of the expenditure required to settle the obligations at the balance sheet date. These estimates take account of information available and different possible outcomes.

The Company considers that at 31 December 2023 the Trent 1000 contract loss provisions and the Trent 1000 wastage cost provision are most sensitive to changes in estimates. A 12-month delay in the availability of the modified HPT blade could lead to around a £30-50m charge in relation to the Trent 1000 programme.

Key estimates – Estimates of the future revenues and costs to fulfil onerous contracts

The Company has provisions for onerous contracts at 31 December 2023 of £1,441m (2022: £1,544m).

An increase in Civil Aerospace large engine estimates of LTSA costs of 1% over the remaining term of the contracts could lead to around a £90-£120m increase in the provision for contract losses across all programmes.

Key estimates – Assumptions implicit in the calculation of discount rates

The contract loss provisions for onerous contracts are sensitive to changes in the discount rate used to value the provision. The rate used for each contract is derived from bond yields (i.e. risk-free rates) with a similar duration and currency to the contract that they are applied to. The rate is adjusted to reflect the specific inflation characteristics of the contract. The forecast rates are determined from third-party market analysis and average 4%. A 1% change in the discount rate used could lead to around a £70-£80m change in the provision.

Customer financing support

In connection with the sale of its products, the Company will, on occasion, provide financing support for its customers. Credit-based guarantees are disclosed as commitments or contingent liabilities dependent on whether aircraft have been delivered or not. As described on page 141, the Directors consider the likelihood of crystallisation in assessing whether provision is required for any liabilities.

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

1 Accounting policies continued

Post-retirement benefits

Pensions and similar benefits are accounted for under IAS 19 *Employee Benefits*.

For defined benefit plans, obligations are measured at discounted present value whilst plan assets are recorded at fair value. Surpluses in schemes are recognised as assets only if they represent economic benefits available to the Company in the future. Surpluses in schemes are recognised as assets only if they represent economic benefits available to the Company in the future. Actuarial gains and losses are recognised immediately in OCI. The service and financing costs of such plans are recognised separately in the Income statement

- current service costs are spread systematically over the lives of employees;
- past-service costs and settlements are recognised immediately; and
- financing costs are recognised in the periods in which they arise.

UK pension obligations include the estimated impact of the obligation to equalise defined benefit pensions and transfer values respectively for men and women.

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

Key estimate – Estimates of the assumptions for valuing the defined benefit obligation
The Company's defined benefit pension schemes and similar arrangements are assessed annually in accordance with IAS 19 *Employee Benefits*. The valuations, which are based on assumptions determined with independent actuarial advice, resulted in a net surplus of £767m before deferred taxation being recognised on the balance sheet at 31 December 2023 (2022: £594m). The size of the net surplus/deficit is sensitive to the actuarial assumptions, which include the discount rate, price inflation, pension and salary increases, longevity and, in the UK, the number of plan members who take the option to transfer their pension to a lump sum on retirement or who choose to take the Bridging Pension Option. Following consultation, the UK scheme closed to future accrual on 31 December 2020.
A reduction in the discount rate of 0.25% from 4.50% could lead to an increase in the defined benefit obligations of the RR UK Pension Fund (RRUKPF) of approximately £185m. This would be expected to be broadly offset by changes in the value of scheme assets, as the scheme's investment policies are designed to mitigate this risk.
An increase in the assumed rate of inflation of 0.25% (RPI of 3.30% and CPI of 2.85%) could lead to an increase in the defined benefit obligations of the RRUKPF of approximately £75m.
A one-year increase in life expectancy from 20.8 years (male aged 65) and from 21.5 years (male aged 45) would increase the defined benefit obligations of the RRUKPF by approximately £155m.
Further details and sensitivities are included in note 17.

Share-based payments

The Company provides share-based payment arrangements to certain employees, which are settled in Rolls-Royce Holdings plc shares. These are principally equity-settled arrangements and are measured at fair value (excluding the effect of non-market based vesting conditions) at the date of grant. The fair value is expensed on a straight-line basis over the vesting period. The amount recognised as an expense is adjusted to reflect the actual number of shares or options that will vest, except where additional shares vest as a result of market-based conditions, where no adjustment is required as allowance for this is included in the initial fair value.

Post balance sheet events

The Company has taken the latest legal position in relation to any ongoing legal proceedings and reflected these in the 2023 results as appropriate.

2 Employee information and emoluments of directors

The total amount of remuneration paid to Directors for the year ended 31 December 2023 was £11,891,000 (2022: £6,142,000). £5,960,000 of this was attributed to the highest paid Director (2022: £3,718,000). A cash allowance in lieu of company contributions to a pension scheme was also paid to five Directors (2022: two), which totalled £330,000 (2022: £199,000). No Directors exercised share options during the year (2022: none) nor received vested shares under the Long-Term Incentive Plan (2022: none). One director received payments for loss of office which totalled £483,000 (2022: £nil).

No Director accrued any retirement benefits in the year (2022: none).

The aggregate employment costs were as follows:

	2023	2022
	£m	£m
Wages, salaries and benefits	947	856
Social security costs	117	102
Share-based payments (note 19)	39	39
Pensions and other post-retirement scheme benefits (note 17)	144	111
Employment costs	1,247	1,108

The monthly average number of persons employed by the Company during the year was 15,600 (2022: 14,800).

3 Intangible assets

	Development costs £m	Certification costs £m	Software and other ¹ £m	Total £m
Cost				
At 1 January 2023	2,063	903	1,084	4,050
Additions	186	–	61	247
Disposals	–	(4)	(22)	(26)
Reclassifications	(2)	–	2	–
At 31 December 2023	2,247	899	1,125	4,271
Accumulated amortisation and impairment				
At 1 January 2023	757	433	708	1,898
Charge for the year ²	63	23	80	166
Disposals	–	(4)	(20)	(24)
At 31 December 2023	820	452	768	2,038
Net book value				
At 31 December 2023	1,427	447	359	2,233
At 31 December 2022	1,306	470	378	2,154

¹ Includes £88m (2022: £88m) of software under course of construction which is not amortised

² Charged to cost of sales and commercial and administrative costs except development costs, which are charged to research and development

At 31 December, the Company had expenditure commitments for software of £25m (2022: £31m).

The carrying amount and the residual life of the material intangible assets for the Company are as follows:

	Residual life ¹	Net book value	
		2023	2022
		£m	£m
Trent programme intangible assets ²	Two to 15 years	1,920	1,826

¹ Residual life reflects the remaining amortisation period of those assets where amortisation has commenced. As per page 121, the amortisation period of 15 years will commence on those assets which are not being amortised as the units are delivered

² Included within the Trent programmes are the Trent 1000, Trent 7000 and Trent XWB

Intangible assets (including programme intangible assets) have been reviewed for impairment in accordance with IAS 36. Assessments have considered potential triggers of impairment such as external factors including climate change, significant changes with an adverse effect on a programme and by analysing latest management forecasts against those prepared in 2022 to identify any deterioration in performance.

The Company believe there are significant business growth opportunities to come from Rolls-Royce playing a leading role in the transition to net zero, whilst at the same time climate change poses potentially significant risks. The assumptions used by the Directors are based on past experience and external sources of information. The main climate-related areas that have been considered are the risk that regulatory changes could materially impact demand for its products (and hence the utilisation of the products whilst in service and their useful lives) and shifting investment focus towards more sustainable products and solutions. Based on the climate scenarios prepared, the forecasts do not assume a significant deterioration of demand for Civil Aerospace programmes given that all commercial aero-engines are compatible with sustainable fuels by the end of 2023. The investment required to ensure our new products will be compatible with net zero operation, and to achieve net zero scope 1 + 2 GHG emissions is reflected in the forecasts used.

A 1.5°C scenario has been prepared using key data points from external sources including Oxford Economics, Global Climate Service and Databank and the International Energy Agency. This scenario has been used as the basis of a sensitivity. It is assumed that governments adopt stricter product and behavioural standards and measures that result in higher carbon pricing. Under these conditions it is assumed that markets are willing to pay for low carbon solutions and that there is an economic return from strategic investments in low carbon alternatives

Where a trigger event has been identified, an impairment test has been carried out. Where an impairment test was required this was performed on the following basis:

- The carrying values of assets in their current condition have been assessed by reference to value in use. These have been estimated using cash flows from the most recent forecasts prepared by the Directors, which are consistent with past experience and external sources of information on market conditions over the lives of the respective programmes; and
- The key assumptions underlying cash flow projections are based on estimates of product performance related estimates, future market share and pricing and cost for uncontracted business. Climate-related risks are considered when making these estimates consistent with the assumptions above.

There have been no (2022: none) individually material impairment charges or reversals recognised during the year.

4 Property, plant and equipment

	Land and buildings £m	Plant and equipment £m	Aircraft and engines £m	In course of construction £m	Total £m
Cost or valuation					
At 1 January 2023	672	2,639	241	97	3,649
Additions	8	44	8	67	128
Reclassifications ¹	36	31	1	(68)	-
Reclassifications from right-of-use assets	5	-	-	-	5
Disposals/write-offs	(15)	(230)	(32)	(8)	(285)
Exchange differences	-	(2)	-	-	(2)
At 31 December 2023	907	2,482	218	90	3,697
Accumulated depreciation					
At 1 January 2023	300	1,783	86	7	2,176
Charge for the year ²	34	141	13	-	188
Impairment ³	4	(2)	-	-	2
Reclassifications ¹	18	(10)	1	(7)	-
Reclassifications to right-of-use assets	1	-	-	-	1
Disposals/write-offs	(14)	(223)	(24)	-	(261)
At 31 December 2023	341	1,689	76	-	2,106
Net book value					
At 31 December 2023	566	793	142	90	1,591
At 31 January 2023	572	856	155	90	1,673

¹ Includes reclassifications between the categories of property, plant and equipment and reclassifications of assets under construction to the relevant classification in property, plant and equipment, right-of-use assets or intangible assets when available for use

² Depreciation is charged to cost of sales or commercial and administrative costs or included in the cost of inventory as appropriate

³ The carrying values of property, plant and equipment have been assessed during the period in line with IAS 36. Material items of plant and equipment and aircraft and engines are assessed for impairment together with other assets used in individual programmes – see assumptions in note 3. Land and buildings are generally used across multiple programmes and are considered based on future expectations of the use of the site, which includes any implications from climate-related risks as explained in note 3. As a result of this assessment, there are no individually material impairment charges or reversals in the year

Property, plant and equipment includes:

	2023	2022				
	Land and buildings £m	Plant and equipment £m	Aircraft and engines £m	Land and buildings £m	Plant and equipment £m	Aircraft and engines £m
Assets held for use in leases where the Company is the lessor:						
Cost	-	-	-	-	3	-
Depreciation	-	-	-	-	(3)	-
Net book value	-	-	-	-	-	-
	2023			2022		
	£m			£m		
Capital expenditure commitments	54			61		
Cost of fully depreciated assets	1,056			1,088		

5 Right-of-use assets

	Land and buildings	Plant and equipment	Aircraft and engines	Total
	£m	£m	£m	£m
Cost				
At 1 January 2023	131	99	14	244
Additions/modifications of leases	17	28	7	52
Disposals	-	(11)	-	(11)
Reclassifications to PPE	(65)	-	-	(65)
At 31 December 2023	143	116	21	280
Accumulated depreciation and impairment				
At 1 January 2023	53	48	5	106
Charge for the year	11	24	5	40
Disposals	(1)	(11)	-	(11)
Reclassifications to PPE	(1)	-	-	(1)
At 31 December 2023	63	61	10	134
Net book value				
At 31 December 2023	80	55	11	146
At 31 December 2022	78	51	9	138
Right-of-use assets held for use in operating leases				
Cost	1	-	21	22
Depreciation	-	-	(10)	(10)
Net book value at 31 December 2023	1	-	11	12

6 Investments

	Subsidiary undertakings ¹				Joint ventures and associates ²		Other investments ³	
	Shares at cost	Loans ⁴	at cost	Loans ⁴	Total	Total	Total	Total
	£m	£m	£m	£m	£m	£m	£m	£m
At 1 January 2023	1,453	1,774	28	-	28	28	35	35
Additions ⁵	20	-	9	-	9	-	-	-
Disposals	-	-	-	-	-	-	-	-
Repayment of loan and interest ⁴	-	(75)	-	-	-	-	-	-
Revaluation of investments accounted for at FVOCI ⁵	-	-	-	-	-	-	(4)	(4)
Exchange differences	-	-	1	-	1	-	-	-
At 31 December 2023	1,473	1,699	36	-	36	36	31	31

¹ Subsidiary and joint venture undertakings and associates are listed on pages 142 to 143. The Company has unlisted share capital in Nightingale Insurance Limited, one of its subsidiaries at 31 December 2023 of £30m (2022: £30m).

² Other investments includes unlisted investments of £24m (2022: £23m) and listed investments of £1m (2022: £0m).

³ During the year to 31 December 2023, the Company invested an additional £20m in Rolls-Royce SMRI Limited (2022: £10m). Additions to investments in joint ventures and associates of £6m includes the second instalment of investment related to the joint venture, Belling Aero Engine Services Company Limited of £6m.

⁴ The Company has an interest-bearing outstanding loan to Viarex International Limited, one of its subsidiaries. The loan is classified as a loan receivable from subsidiary undertakings within non-current assets as the loan is considered to be recoverable in full. During the year to 31 December 2023, the Company received £10m (2022: £20m) and accrued interest of £5m (2022: £28m). No interest securing during the year (2022: £6m) has been capitalised and is shown within repayment of loan and interest for the year.

⁵ The Company has elected to value the listed investments at fair value through other comprehensive income.

7 Inventories

	2023	2022
	£m	£m
Raw materials	33	17
Work in progress	728	696
Finished goods	1,565	1,369
Payments on account	-	4
	2,326	2,086
Inventories stated at net realisable value	124	139
Amount of inventory write-down	9	10
Reversal of inventory write-down	14	12

Inventories are stated after provisions for impairment of £216m (2022: £226m).

8 Trade receivables and other assets

	Current		Non-current ¹		Total	
	2023 £m	2022 £m	2023 £m	2022 £m	2023 £m	2022 £m
Trade receivables	1,358	1,161	40	43	1,398	1,204
Prepayments	624	514	25	35	649	549
RRSA prepayment for LTSA parts ²	235	149	1,085	856	1,320	1,005
Receivables due on RRSAs	1,159	928	193	255	1,352	1,183
Amounts owed by:						
Subsidiary undertakings	1,178	1,915	475	544	1,651	2,459
Joint ventures	667	598	18	5	675	603
Parent undertaking ³	—	335	337	—	337	335
Other taxation and social security receivable	99	105	25	—	124	105
Costs to obtain contracts with customers ⁴	—	2	1	2	1	4
Other receivables ⁵	388	493	36	29	424	522
	5,706	6,200	2,225	1,769	7,931	7,969

¹ Trade receivables and other assets have been presented on the face of the balance sheet in line with the operating cycle of the business. Further disclosure is included in the table above and relate to amounts not expected to be received in the next 12 months in line with specific customer payment arrangements, including customers on payment plans, or formal payment terms on balances with related undertakings

² At 31 December 2023, prepayments to RRSA partners for LTSA parts have been shown separately to provide additional detail for the user of the accounts of the balances included. In the prior year, these amounts were included within prepayments. There is no change to the total amount of trade receivables and other assets. These amounts reflect the contractual share of EFH flows from customers paid to RRSA partners in return for the supply of parts in future periods under long-term supply contracts

³ Amounts due from parent undertakings are interest free and repayable on demand. Whilst the Company could demand repayment, the Directors consider that the intention would be to not call upon this balance for repayment in the next 12 months, but is expected to be settled within the normal operating cycle

⁴ These are amortised over the term of the related contract in line with engine deliveries, resulting in amortisation of £2m (2022: £1m) in the year. There were no impairment losses (2022: none)

⁵ Other receivables include unbilled recoveries relating to completed overhaul activity where the right to consideration is unconditional

All amounts owed by subsidiary undertakings (except those listed below) are unsecured, interest free, have no fixed date of repayment and are repayable on demand.

- US\$578m (£455m) balance receivable from Rolls-Royce Overseas Investments Limited (2022: US\$644m (£535m)). This incurs interest at US Federal Reserve rate + 3.18% and has a repayment date of 31 December 2026.
- €11m (£10m) receivable from Aerospace Transmission Technologies GmbH (2022: €11m (£10m)) This incurs interest at EURIBOR + 2% and has a repayment date of 31 December 2037.
- €11m (£10m) receivable from Europea Microfusioni Aerospaziali Spa (2022: €7m (£6m)). This incurs interest at 8.0% and has a repayment date of June 2026.

The ECLs on amounts due to group undertakings reduced to £5m (2022: £16m). The assumptions and inputs used for the estimation of the allowance takes into account their market credit ratings.

The ECLs for trade receivables and other financial assets have decreased by £47m to £163m (2022: Increased by £68m to £210m). This movement is mainly driven by the Civil Aerospace business of £(43)m, of which £(25)m relates to specific customers and £(18)m relates to updates to the recoverability of other receivables.

8 Trade receivables and other assets continued

The Company has adopted the simplified approach to provide for ECLs, measuring the loss allowance at a probability weighted amount incorporated by using credit ratings which are publicly available, or through internal risk assessments derived using the customer's latest available financial information. The assumptions and inputs used for the estimation of the ECLs are shown in the table below:

	2023			2022		
	Trade receivables and other financial assets	Loss allowance	Average ECL rate	Trade receivables and other financial assets	Loss allowance	Average ECL rate
	£m	£m		£m	£m	
Credit rating C and above	1,089	(68)	6%	1,016	(92)	9%
Credit rating below C	3	-	0%	51	(4)	8%
Without credit rating	2,731	(95)	3%	2,655	(114)	4%
	3,823	(163)	4%	3,722	(210)	6%

The movements of the Company's ECLs provision are as follows:

	2023	2022
	£m	£m
At 1 January	(210)	(142)
Increases in loss allowance recognised in the Income statement during the year	(56)	(82)
Loss allowance utilised	19	19
Releases of loss allowance previously provided	68	21
Exchange differences	16	(26)
At 31 December	(163)	(210)

9 Contract assets and liabilities

	Current		Non-current ¹		Total ²	
	2023	2022	2023	2022	2023	2022
	£m	£m	£m	£m	£m	£m
Contract assets						
Contract assets with customers	243	408	349	484	592	892
Participation fee contract assets	13	16	144	149	157	165
	256	424	493	633	749	1,057

¹ Contract assets and contract liabilities have been presented on the face of the balance sheet in line with the operating cycle of the business. Contract liabilities is further split according to when the related performance obligation is expected to be satisfied and therefore when revenue is estimated to be recognised in the income statement. Further disclosure of contract assets is provided in the table above, which shows within current the element of consideration that will become unconditional in the next year.

² Contract assets are classified as non-financial instruments.

The balance includes £441m (2022: £818m) of Civil Aerospace LTSA assets and £87m (2022: £29m) of Defence LTSA assets. The decrease in the Civil Aerospace balance is due to higher invoicing than revenue recognised in relation to completion of performance obligations on those contracts with a contract asset balance. Revenue recognised relating to performance obligations satisfied in previous year was £55m (2022: £26m) in Civil Aerospace.

The increase in the Defence balance is due to revenue recognition in relation to performance obligations completed being higher than the payments received from the customer.

Participation fee contract assets have reduced due to amortisation. No impairment losses (2022: none) of contract assets have arisen during the year.

The absolute value of expected credit losses for contract assets has decreased by £16m to £5m (31 December 2022: £21m).

	Current		Non-current		Total	
	2023	2022	2023	2022	2023	2022
	£m	£m	£m	£m	£m	£m
Contract liabilities	4,227	3,388	6,084	5,153	10,311	8,541

During the year £2,511m (2022: £2,039m) of the opening contract liability was recognised as revenue.

Contract liabilities have increased by £1,770m. The movement in the balance is largely as a result of increases in Civil Aerospace of £1,583m and Defence of £189m.

The Civil Aerospace increase is primarily a result of growth in LTSA liabilities of £1,024m to £7,365m (2022: £6,341m) driven by price escalation, the continued rise in EFH's and the associated customer receipts, as well as commercial discipline driving more timely invoicing and recovery of contractual fees. In 2023, contract liabilities increased by £(243)m as a result of revenue recognised in relation to performance obligations satisfied in previous years (2022: £120m decrease). The increase in Defence is due to the receipt of deposits in advance of performance obligations being completed.

10 Cash and cash equivalents

	2023 £m	2022 £m
Cash at bank and in hand	128	199
Money-market funds	1,000	4
Short-term deposits	1,957	1,714
Cash and cash equivalents	3,085	1,917
Overdrafts (note 11)	-	-

Balances are presented on a net basis when the Company has both a legal right of offset and the intention to either settle on a net basis or realise the asset and settle the liability simultaneously.

11 Borrowings and lease liabilities

	Current		Non-current		Total	
	2023 £m	2022 £m	2023 £m	2022 £m	2023 £m	2022 £m
Unsecured						
0.875% Notes 2024 €550m ¹	475	-	472	-	475	472
3.625% Notes 2025 \$1,000m ¹	-	-	770	801	770	801
3.375% Notes 2026 £375m ¹	-	-	361	351	361	351
4.625% Notes 2026 €750m ³	-	-	649	661	649	661
5.75% Notes 2027 \$1,000m ³	-	-	782	825	782	825
5.75% Notes 2027 £545m	-	-	542	541	542	541
1.625% Notes 2028 €550m ¹	-	-	455	444	455	444
Total unsecured	475	-	3,559	4,095	4,034	4,095
Lease liabilities						
Lease liability - Land and buildings	14	15	111	109	125	124
Lease liability - Aircraft and engines	8	4	11	12	19	16
Lease liability - Plant and equipment	23	20	34	33	57	53
Total lease liabilities	45	39	156	154	201	193
Total borrowings and lease liabilities	520	39	3,715	4,249	4,235	4,288

	Less than one year £m	Between one and five years £m	After five years £m	Total £m
At 31 December 2023				
Borrowings	475	3,559	-	4,034
Lease liabilities	45	102	54	201
	520	3,661	54	4,235
At 31 December 2022				
Borrowings	-	3,651	444	4,095
Lease liabilities	39	118	36	193
	39	3,769	480	4,288

All outstanding items described as notes above are listed on the London Stock Exchange.

- These notes are the subject of cross-currency interest rate swap agreements under which the Company has undertaken to pay floating rates of GBP interest, which form a fair value hedge. They are also subject to interest rate swap agreements under which the Company has undertaken to pay fixed rates of interest, which are classified as fair value through profit and loss.
- These notes are the subject of interest rate swap agreements under which the Company has undertaken to pay floating rates of interest, which form a fair value hedge. They are also subject to interest rate swap agreements under which the Company has undertaken to pay fixed rates of interest, which are classified as fair value through profit and loss.
- These notes are the subject of cross-currency interest rate swap agreements under which the Company has undertaken to pay fixed rates of GBP interest, which form a cash flow hedge.

The Company has access to the following undrawn committed borrowing facilities at the end of the year:

	2023 £m	2022 £m
Expiring within one year	-	-
Expiring after one year	3,500	5,500
Total undrawn facilities	3,500	5,500

At 31 December 2023, the Company had total undrawn facilities of £3,500m (2022: £5,500m).

During the year to 31 December 2023, the Group cancelled its undrawn £1bn bank loan facility which was due to mature in January 2024 and its undrawn UKEF £1bn facility which was due to mature in March 2026. These facilities had remained undrawn during the year. In addition, the Group replaced the £2,500m committed bank borrowing facility with a new £2,500m facility with a maturity date of November 2026 with the banks having the option to extend with two one-year extension options (3+1+1).

12 Leases

Leases as lessee

The net book value of lease right-of-use assets at 31 December 2023 was £146m (2022: £138m), with a lease liability of £201m (2022: £193m) (per notes 5 and 11 respectively). Leases that have not yet commenced to which the Company is committed have a future liability of £nil. The financial statements include the following amounts relating to leases:

	2023 £m	2022 £m
Land and buildings depreciation and impairment	(11)	(9)
Aircraft and engines depreciation and impairment	(24)	(19)
Plant and equipment depreciation and impairment	(5)	(4)
Total depreciation and impairment for right-of-use assets	(40)	(32)

The total cash outflow for leases in 2023 was £57m (2022: £51m). Of this £47m related to leases reflected in the lease liability, £10m to short-term leases where lease payments are expensed on a straight-line basis and nil for variable lease payments where obligations are only due when the assets are used. The timing difference between income statement charge and cash flow relates to costs incurred at the end of leases for residual value guarantees and restoration costs that are recognised within depreciation over the term of the lease, the most significant amounts relate to engine leases.

Leases as lessor

The Company acts as lessor for engines to Civil Aerospace customers when they require engines to support their fleets. Lease agreements with the lessee provide protection over the Company's assets. Usage in excess of specified limits and damage to the engine while on lease are covered by variable lease payment structures. Lessee bankruptcy risk is managed through the Cape Town Convention on International Interests in Mobile Equipment (including a specific protocol relating to aircraft equipment), an international treaty that creates common standards for the registration of lease contracts and establishes various legal remedies for default in financing agreements, including repossession and the effect of particular states' bankruptcy laws. Engines are only leased once the Company can confirm that appropriate insurance documentation is established that covers the engine assets to pre-agreed amounts. All such contracts are operating leases. The Company also leases out a small number of properties, or parts of properties, where there is excess capacity under operating leases.

Total non-cancellable future operating lease rentals receivables (undiscounted) of £4m (2022: £1m), are predominantly due after five years.

In a limited number of circumstances, the Company sublets properties that are treated as a finance lease when the arrangement transfers substantially all the risks and rewards of ownership of the asset. At 31 December 2023, the total undiscounted lease payments receivable is £35m (2022: £39m) on annual lease income of £4m (2022: £4m). The discounted finance lease receivable at 31 December 2023 is £28m (2022: £32m). There was £nil (2022: £nil) finance income recognised during the year.

13 Trade payables and other liabilities

	Current		Non-current		Total	
	2023 £m	2022 £m	2023 £m	2022 £m	2023 £m	2022 £m
Trade payables	803	845	-	-	803	845
Payables due on RRSAs	1,713	1,392	-	-	1,713	1,392
Amounts owed to:						
Subsidiary undertakings	4,598	5,301	-	-	4,598	5,301
Joint ventures and associates	530	557	-	-	530	557
Customer discounts ¹	974	773	730	969	1,704	1,742
Accruals	929	1,291	81	182	1,010	1,473
Deferred receipts from RRSA workshare partners	56	32	774	829	830	861
Government grants ²	23	18	11	13	34	31
Other taxation and social security	27	26	-	-	27	26
Other payables ³	255	221	174	212	429	433
	9,908	10,456	1,770	2,205	11,678	12,661

¹ Customer discounts include customer concession credits. Revenue recognised comprises sales to the Company's customers after such items. Customer concession credits are discounts given to a customer upon the sale of goods or services. A liability is recognised to correspond with the recognition of revenue when the performance obligation is met as set out on page 118. The largest element of the balance, approximately £1.2bn arises when the Civil business delivers its engines to an airframer. A concession is often payable to the end customer (e.g. an airline) on delivery of the aircraft from the airframer. The concession amounts are known and the payment date is reasonably certain, hence there is no significant judgement or uncertainty associated with the timing of these amounts. Warranty credits of £564m and customer concessions of £1,378m have been represented at 31 December 2023 to be included within customer discounts to better reflect the nature of these balances

² During the year £6m (2022: £3m) of government grants were recognised in the income statement

³ Other payables includes payroll liabilities and HM Government levies

All amounts due to subsidiary undertakings (except those outlined below) are unsecured, interest free and are repayable on demand.

The Company is part of the Rolls-Royce group banking arrangements and the Company's main bank accounts are subject to offset and pooling arrangements with cash balances acquired from other group entities. As a result of these arrangements the balances are presented as intercompany payables as funds are pooled by the Company on the last working day of the month with funds returned the next day. The amounts owed by the Company of £999m as at 31 December 2023 (2022: £1,213m) are interest bearing and repayable on demand.

13 Trade payables and other liabilities *continued*

As a result of the IBOR reform, a number of intercompany balances that previously accrued interest based on a LIBOR Index, have been amended during the year.

Other intercompany balances outstanding at 31 December 2023 were as follows:

- US\$15m (£12m) balance payable to Rolls-Royce Canada Limited (2022: US\$15m (£12m)). This incurs interest at 0.06% less than the FED rate mid-point (2022: 3 months USD LIBOR rate +0.1%) and is repayable on demand.
- CAD 180m (£107m) balance payable to Rolls-Royce Canada Limited (2022: CAD 237m (£146m)). This incurs interest at 0.06% less than the CORRA (2022: 3-month CAD LIBOR rate +0.1%) and is repayable on demand.
- US\$310m (£244m) balance payable to Rolls-Royce North America (USA) Holdings Co (2022: US\$300m (£249m)). This incurs interest at 0.06% less than the FED rate mid-point (2022: 1 month USD LIBOR rate +0.1%) and is repayable on demand.
- US\$345m (£271m) balance payable to Rolls-Royce Power Systems AG (2022: US\$171m (£142m)). This incurs interest at 0.06% less than the FED rate mid-point (2022: USD LIBOR rate +0.1%) and is repayable on demand.
- £81m balance payable to Nightingale Insurance Limited (2022: £81m). This incurs interest at Bank of England base interest rate -0.06% and is repayable on demand.
- €420m (£365m) balance payable to Rolls-Royce Power Systems AG (2022: €335m (£297m)). This incurs interest at EURIBOR +0.1% and is repayable on demand.
- €600m (£521m) balance payable to RR Deutschland Ltd & Co KG (2022: €200m (£177m)). This incurs interest at the 3-month EURIBOR rate +0.1% and is repayable on demand.
- £103m balance payable to RR SMR Limited (2022: £50m). This incurs interest at the Bank of England base interest rate -0.06% and is repayable on demand.
- NOK31m (£2m) balance payable to RR Electrical Norway (2022: Enil). This incurs interest at the policy rate published by Norges bank -0.06% and is repayable 15 March 2024.

All payables' balances are repayable on demand as either no formal loan agreement in place or no final due date set – therefore all remain in the current classification.

The carrying amounts of trade and other payables are considered to be the same as their fair values, due to their short-term nature.

The Company's payment terms with suppliers vary on the products and services being sourced, the competitive global markets the Company operates in and other commercial aspects of suppliers' relationships. Industry average payment terms vary between 90 to 120 days. The Company offers reduced payment terms for smaller suppliers, who are typically on 75-day payment terms, so that they are paid in 30 days. In line with civil aviation industry practice, the Company offers a supply chain financing (SCF) programme in partnership with banks to enable suppliers, including joint ventures, who are on standard 90-day payment terms to receive their payments sooner. The SCF programme is available to suppliers at their discretion and does not change rights and obligations with suppliers nor the timing of payment to suppliers. At 31 December 2023, suppliers had drawn £418m under the SCF scheme (2022: £422m) of which £154m (2022: £180m) is drawn by joint ventures. The Company, in some cases, settles the costs due from the joint venture as a result of them utilising either the Company offered SCF arrangement, or an alternative SCF arrangement. During the year to 31 December 2023, the Company incurred costs of £28m (2022: £12m) to settle the costs incurred by joint ventures as a result of them utilising the Company offered SCF arrangement; these costs are included within other financing charges.

14 Other financial assets and liabilities

Details of the Company's policies on the use of financial instruments are given in the accounting policies on pages 119 to 120.

The fair values of other financial instruments held by the Company are as follows:

	Foreign exchange contracts £m	Commodity contracts £m	Interest rate contracts £m ¹	Total derivatives £m	Financial RRSAs £m	Other £m	Total £m
At December 2023							
Current assets	70	6	8	84	-	-	84
Non-current assets	78	-	254	330	-	-	330
Assets	148	6	262	414	-	-	414
Current liabilities	(357)	(10)	(13)	(380)	(18)	(28)	(426)
Non-current liabilities	(1,769)	(15)	(73)	(1,857)	(81)	(1)	(1,939)
Liabilities	(2,126)	(25)	(86)	(2,237)	(99)	(29)	(2,365)
	(1,980)	(19)	176	(1,823)	(99)	(29)	(1,951)
At 31 December 2022							
Current assets	219	40	2	261	-	-	261
Non-current assets	61	25	436	522	-	-	522
Assets	280	65	438	783	-	-	783
Current liabilities	(973)	(2)	(2)	(977)	(9)	(11)	(997)
Non-current liabilities	(3,031)	(2)	(98)	(3,131)	(101)	-	(3,232)
Liabilities	(4,004)	(4)	(100)	(4,108)	(110)	(11)	(4,229)
	(3,724)	61	338	(3,325)	(110)	(11)	(3,446)

¹ Includes the foreign exchange impact of cross-currency interest rate swaps

Where applicable, market values have been used to determine fair values. Where market values are not available, fair values have been calculated by discounting expected future cash flows at prevailing interest rates and translating at prevailing exchange rates.

Derivative financial instruments

The Company uses various financial instruments to manage its exposure to movements in foreign exchange rates. The Company uses commodity swaps to manage its exposure to movements in the price of commodities (jet fuel and base metals). To hedge the currency risk associated with a borrowing denominated in a foreign currency, the Company has currency derivatives designated as part of a fair value or cash flow hedge. The Company uses interest rate swaps and forward rate agreements to manage its exposure to movements in interest rates.

Movements in the fair values of derivative financial assets and liabilities were as follows:

	Foreign exchange Instruments 2023 £m	Commodity Instruments 2023 £m	Interest rate Instruments - hedge accounted ¹ 2023 £m	Interest rate Instruments - non-hedge accounted 2023 £m	Total 2023 £m
At 1 January	(3,724)	61	125	213	(3,325)
Movements in fair value hedges	-	-	(71)	-	(71)
Movements in cash flow hedges	-	-	(78)	-	(78)
Movements in other derivative contracts	626	(80)	-	1	547
Contracts settled	1,118	(20)	69	(83)	1,084
At 31 December	(1,980)	(19)	45	131	(1,823)

¹ Includes the foreign exchange impact of cross-currency interest rate swaps

14 Other financial assets and liabilities continued**Financial risk and RRSAs and other financial liabilities**

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

Movements in carrying values were as follows:

	Financial RRSAs	Other - liabilities
	2023	2023
	£m	£m
At 1 January	(110)	(11)
Cash paid	13	-
Additions	-	(18)
Changes in forecast payments	12	-
Financing charge	(8)	-
Exchange adjustments	(6)	-
At 31 December	(99)	(29)

15 Provisions for liabilities and charges

	At 1 January 2023	Charged to income statement ¹	Reversed	Utilised	At 31 December 2023
	£m	£m	£m	£m	£m
Contract losses	1,544	745	(398)	(164)	1,441
Trent 1000 wastage costs	179	45	(29)	(79)	116
Warranty and guarantees	19	2	(8)	(1)	12
Employer liability claims	4	1	(1)	(1)	3
Other	72	152	(23)	(80)	211
	1,818	945	(459)	(325)	1,599
Current liabilities	352	-	-	-	320
Non-current liabilities	1,466	-	-	-	1,279

¹ The charge to the income statement within net financing includes £59m (2022: £33m) within net financing as a result of the unwinding of the discounting of provisions previously recognised

Contract losses

Provisions for contract losses are recorded when the direct costs to fulfil a contract are assessed as being greater than the expected revenue. During the year, additional contract losses for the Company of £459m have been recognised as a result of changes in future cost estimates, primarily in relation to LTSA shop visits. Contract losses of £164m have been utilised and £398m previously recognised have been reversed following improvements to cost estimates and time on wing across various large engine programmes as a result of operational improvements and contractual extensions. The Company continues to monitor the contract loss provision for changes in the market and revises the provision as required. The value of the remaining contract loss provisions reflect, in each case, the single most likely outcome. The provisions are expected to be utilised over the term of the customer contracts, typically within eight to 16 years.

IAS 37 requires a company to recognise any impairment loss that has occurred on assets used in fulfilling the contract before recognising a separate provision for an onerous contract. No impairments were required for any of the assets solely used in the fulfilment of onerous contracts.

15 Provisions for liabilities and charges continued

Warranty and guarantees

Provisions for warranty and guarantees primarily relate to products sold and are calculated based on an assessment of the remediation costs related to future claims based on past experiences. The provision generally covers a period of up to three years.

Trent 1000 wastage costs

In November 2019, the Group announced the outcome of testing and a thorough technical and financial review of the Trent 1000 TEN programme, following technical issues which were identified in 2019, resulting in a revised timeline and a more conservative estimate of durability for the improved HP turbine blade for the TEN variant. During the year, the Group has utilised £79m of the Trent 1000 wastage costs provision. This represents customer disruption costs and remediation shop visit costs attributable to the wastage costs provision. During the year, a net charge to the provision of £16m has been recognised reflecting the discount unwind and updates to forecasted costs based on the latest available information. The value of the remaining provision reflects the single most likely outcome and is expected to be utilised in 2024.

Employer liability claims

The provision relating to employer healthcare liability claims is as a result of a historical insolvency of the previous provider and is expected to be utilised over the next 30 years.

Other

Other provisions includes provisions for claims and litigation and represent ongoing matters where the outcome for the Group may be unfavourable. During the year, judgment in respect of a legal claim was rendered by the High Court on 3 July 2023 resulting in a charge to the income statement of £34m. The judgment was satisfied in August 2023 resulting in a £92m utilisation. The value of any remaining provisions reflects the single most likely outcome in each case. Other items are individually immaterial.

16 Deferred taxation

	2023 £m	2022 £m
At 1 January	1,782	1,171
Amount credited to income statement	174	424
Amount (charged)/credited to statement of OCI	(49)	186
Amount credited to equity	22	1
At 31 December	1,929	1,782
Deferred tax assets	2,198	1,990
Deferred tax liabilities	(269)	(208)
Deferred tax	1,929	1,782

The analysis of the deferred tax position is as follows:

	2023 £m	2022 £m
Property, plant and equipment	198	159
Intangible assets	(382)	(357)
Other temporary differences ¹	294	244
Pensions and other post-retirement scheme benefits	(269)	(208)
Foreign exchange and commodity financial assets and liabilities	412	668
Losses	1,443	1,054
Advance corporation tax ²	162	162
R&D credit	71	60
	1,929	1,782

Unprovided deferred tax	2023 £m	2022 £m
Other temporary differences	–	–
Foreign exchange and commodity financial assets and liabilities	69	218
Losses	1,827	2,023
	1,896	2,241

Gross amount of losses and other deductible temporary differences for which no deferred tax has been recognised on which there is no expiry	2023 £m	2022 £m
Other temporary differences	–	–
Foreign exchange and commodity financial assets and liabilities	275	871
Losses	6,508	8,092
	6,783	8,963

¹ Other temporary differences mainly relate to the deferral of relief for interest expenses under the corporate interest restriction rules

² Prior to 1999 advance corporation tax was paid to the UK Tax Authority when cash dividends were paid by the Group. This was a payment on account which was available to offset against UK corporation tax liabilities. Any unused balance remaining after 1999 can be carried forward indefinitely and utilised against future UK corporation tax liabilities

16 Deferred taxation *continued*

The total deferred tax asset of £2,198m (2022: £1,990m) is made up as follows:

- £1,443m (2022: £1,054m) relating to tax losses;
- £412m (2022: £668m) arising on unrealised losses on derivative contracts;
- £162m (2022: £162m) of advance corporation tax; and
- £181m (2022: £106m) relating to other deductible temporary differences, in particular tax depreciation and relief for interest expenses.

The deferred tax assets have been recognised based on the expectation that the business will generate taxable profits and tax liabilities in the future against which the losses and deductible temporary differences can be utilised.

Most of the tax losses relate to the Civil Aerospace large engine business which makes initial losses through the investment period of a programme and then makes a profit through its contracts for services. The programme lifecycles are typically in excess of 30 years.

Deferred tax assets are recognised only to the extent that it is probable that future taxable profits will be available against which the assets can be utilised. A recoverability assessment has been undertaken, taking account of deferred tax liabilities against which the reversal can be offset and using latest UK forecasts, which are mainly driven by the Civil Aerospace large engine business, to assess the level of future taxable profits.

The recoverability of deferred tax assets has been assessed on the following basis:

- Using the most recent UK profit forecasts which are consistent with past experience and external sources on market conditions;
- The long-term forecast profit profile of certain major large engine programmes which is typically in excess of 30 years from initial investment to retirement of the fleet, including the aftermarket revenues earned from airline customers;
- the long-term forecast is adjusted to exclude engine programmes which are in the development stage with no confirmed orders;
- Taking into account the risk that regulatory changes could materially impact demand for our products;
- Consideration that all Civil Aerospace large engines are now compatible with sustainable fuels, there is a risk that in the longer term demand will shift towards more sustainable products and solutions;
- taking into consideration past performance and experience as well as a 25% probability of a severe but plausible downside forecast materialising in relation to the civil aviation industry; and
- The long-term forecast profit and cost profile of the other parts of the business.

The assessment takes into account UK tax laws that, in broad terms, restrict the offset of the carried forward tax losses to 50% of current year profits. In addition, the amounts and timing of future taxable profits incorporate:

- the impact of new contracts signed in 2023. These include the trilateral AUKUS agreement involving the UK Defence business;
- the outcomes of strategic initiatives including cost and commercial optimisation;
- the growth in Civil Aerospace engine flying hours; and
- management's assumptions on the impact of macroeconomic factors and climate change on the business.

The climate change scenarios previously prepared to assess the viability of the business strategy, decarbonisation plans and approach to managing climate-related risks have continued to develop over the last year.

The scale up of sustainable aviation fuel is expected to play a crucial role in reaching net zero carbon emissions by 2050 and the Company has demonstrated that all Civil Aerospace production engines are compatible with sustainable aviation fuels. The impact that this could have on our costs and customer pricing is factored into the deferred tax assessment. However, benefits that may arise in the future from the development of breakthrough new technologies are not taken into account.

Based on the assessment, a deferred tax asset of £2,198m has been recognised, which includes the re-recognition of a £57m deferred tax asset on unrealised losses on foreign exchange derivative contracts and a £389m deferred tax asset relating to UK tax losses. This reflects the conclusions that:

- Based on current financial results and an improved outlook it is probable that the UK group will generate taxable income and tax liabilities in the future against which these losses can be utilised.
- Using current forecasts and various scenarios these losses and other deductible temporary differences will be used in full within 30-40 years which is within the expected large engine programme lifecycles. An explanation of the potential impact of climate change on forecast profits and sensitivity analysis can be found in note 1.

Any future changes in tax law or the structure of the Company could have a significant effect on the use of losses and other deductible temporary differences, including the period over which they can be used. In view of this and the significant judgement involved the Board continuously reassesses this area.

The deferred tax liability on the UK pension surplus has been calculated using the enacted tax rate of 35%. The Statutory Instrument reducing the tax rate on authorised surplus pension charges from 35% to 25% effective from 6 April 2024 has been enacted on 11 March 2024. Had the reduction in the tax rate to 25% been enacted at the Balance Sheet date it would have had the effect of reducing the deferred tax liability by £77m.

The temporary differences associated with investments in subsidiaries, joint ventures and associates, for which a deferred tax liability has not been recognised, aggregate to £1,230m (2022: £1,062m). No deferred tax liability has been recognised on the potential withholding tax due on the remittance of undistributed profits as the Company is able to control the timing of such remittances and it is probable that consent will not be given in the foreseeable future.

17 Post-retirement benefits

The Company operates a funded UK defined benefit scheme, with the assets held in a separate trustee administered fund. Employees are entitled to retirement benefits based on either their final or career average salaries and length of service.

The UK defined benefit scheme is funded, with the assets held in a separate UK trust. The scheme closed to future accrual on 31 December 2020 for all active members and there are no new defined benefit accruals in the UK scheme. As at 31 December 2023 the scheme was estimated to be funded at 113% on the Technical Provisions basis.

The valuation of the defined benefit scheme is based on the most recent funding valuation from 31 March 2023, where relevant, updated by the scheme actuaries to 31 December 2023.

The Group is aware of a UK High Court legal ruling in June 2023 between Virgin Media Limited and NTL Pension Trustees II Limited, which decided that certain historic rule amendments were invalid if they were not accompanied by the actuarial certifications. The ruling is subject to appeal and the Group is monitoring developments. Whilst this ruling was in respect of another scheme, any final judgment would need to be reviewed for its relevance to the RRUKPF scheme. As yet the RRUKPF pension advisers have not completed any analysis and, as the outcome of the appeal is still unknown, no adjustments have been made to the Financial Statement at 31 December 2023.

	2023 £m	2022 £m
Amounts recognised in OCI in respect of defined benefit schemes		
Actuarial gains and losses arising from:		
Demographic assumptions ¹	180	19
Financial assumptions ²	(132)	3,423
Experience adjustments ³	116	(235)
Return on scheme assets excluding financing income ²	(12)	(3,751)
	152	(544)

¹ This reflects latest available CMI mortality projections and an update of the post-retirement mortality assumptions based on an analysis prepared for the 31 March 2023 funding valuation

² Actuarial gains and losses arising from financial assumptions arise primarily due to changes in interest rates and inflation

³ This reflects an experience gain as a result of allowance for updated membership data following the valuation during the year offset by realised inflation being higher than expected in the year

	2023 £m	2022 £m
Amounts recognised in the balance sheet in respect of defined benefit schemes		
Present value of funded obligations	(4,537)	(4,621)
Fair value of scheme assets	5,304	5,215
Net asset recognised in the balance sheet – Post retirement surplus ¹	767	594

¹ The surplus is recognised as on an ultimate wind-up when there are no longer any remaining members, any surplus would be returned to the Company, which has the power to prevent the surplus being used for other purposes in advance of this event

Assumptions

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

	2023 £m	2022 £m
Discount rate	4.50%	4.80%
Inflation assumption (RPI)	3.30%	3.50%
Inflation assumption (CPI)	2.85%	2.95%
Transfer assumption (employed deferred/deferred)	35%/25%	50%/40%
Bridging Pension Option (BPO) assumption	30%	30%
Life expectancy from age 65: current male pensioner	20.8 years	21.9 years
future male pensioner currently aged 45	21.5 years	23.2 years
current female pensioner	22.8 years	23.7 years
future female pensioner currently aged 45	24.1 years	25.5 years

Discount rates are determined by reference to the market yields on AA rated corporate bonds. The rate is determined by using the profile of forecast benefit payments to derive a weighted average discount rate from the yield curve.

The inflation assumption is determined by the market-implied assumption based on the yields on long-term index-linked government securities.

The mortality assumptions adopted for the UK pension schemes are derived from the SAPS S3 'All' actuarial tables, with future improvements in line with the CMI 2022 core projections updated to reflect use of an 'A' parameter of 0.25% for future improvements and long-term improvements of 1.25%. Where appropriate, these are adjusted to take account of the scheme's actual experience.

The assumption for transfers and the BPO has been updated based on actual experience and actuarial advice.

Other assumptions have been set on advice from the actuary, having regard to the latest trends in scheme experience and the assumptions used in the most recent funding valuation. The rate of increase of pensions in payment is based on the rules of the scheme, combined with the inflation assumption where the increase is capped.

17 Post-retirement benefits continued

	2023 £m	2022 £m
Changes in present value of defined benefit obligations		
At 1 January	(4,621)	(8,010)
Current service cost	(4)	(4)
Past-service credit	-	6
Finance cost	(218)	(149)
Benefits paid out	142	329
Actuarial gains	184	3,207
At 31 December	(4,537)	(4,621)
Funded schemes	(4,537)	(4,621)

	2023 £m	2022 £m
The defined benefit obligations are in respect of:		
Active plan participants ¹	(1,584)	(1,681)
Deferred plan participants	(1,287)	(1,172)
Pensioners	(1,666)	(1,768)
Weighted average duration of obligations (years)	16	17

¹ Although the UK scheme closed to future accrual on 31 December 2020, members who became deferred as a result of the closure and remain employed by the Company retain some additional benefits compared with other deferred members. The obligations for these members are shown as active plan participants

	2023 £m	2022 £m
Changes in fair value of scheme assets		
At 1 January	15,215	9,128
Administrative expenses	(4)	(4)
Financing	247	170
Return on plan assets excluding financing	(12)	(3,751)
Contributions by employer	-	1
Benefits paid out	(142)	(329)
At 31 December	5,304	5,215
Total return on plan assets	235	(3,581)

	2023 £m	2022 £m
Fair value of scheme assets		
Sovereign debt	3,259	3,574
Corporate debt instruments	1,996	1,492
Interest rate swaps	170	196
Inflation swaps	86	212
Cash and similar instruments ¹	(892)	(1,066)
Liability driven investment (LDI) portfolios ²	4,619	4,408
Unlisted equities	32	40
Synthetic equities ³	20	(8)
Corporate debt instruments	630	772
Other	35	3
At 31 December	5,304	5,215

¹ Cash and similar instruments include repurchase agreements on UK Government bonds amounting to £(993)m (2022: £(1,221)m). The latest maturity date for these short-term borrowings is September 2024

² A portfolio of gilt and swap contracts, backed by investment grade credit instruments and diversified liquidity funds assets, that is designed to hedge the majority of the interest rate and inflation risks associated with the schemes' obligations

³ Portfolios of swap contracts designed to provide investment returns in line with global equity markets. The maximum exposure (notional value and accrued returns) on the portfolios was £379m (2022: £329m)

The investment strategy is controlled by the Trustee in consultation with the Company. The scheme assets do not directly include any of the Company's own financial instruments, nor any property occupied by, or other assets used by, the Company. At 31 December 2023, there was no indirect holding of the Company's financial instruments (2022: none).

17 Post-retirement benefits continued

Future contributions

The Company does not expect to contribute to its defined benefit scheme in respect of 2024 (2023: £nil).

The cash funding of RRUKPF is based on a statutory triennial funding valuation process. The Company and the Trustee negotiate and agree the actuarial assumptions used to value the liabilities (Technical Provisions); assumptions which may differ from those used for accounting set out above. The assumptions used to value Technical Provisions must be prudent rather than a best estimate of the liability. Most notably, the Technical Provisions discount rate is currently based upon UK Government bond yields plus a margin (0.5% at the 31 March 2023 valuation) rather than being based on yields of AA corporate bonds. Once each valuation is signed, a Schedule of Contributions (SoC) must be agreed which sets out the cash contributions to be paid. The most recent valuation, as at 31 March 2023, agreed by the Trustee in October 2023, showed that the RRUKPF was estimated to be 115% funded on the Technical Provisions basis (estimated to be 113% at 31 December 2023). All cash due has been paid in full and the current SoC does not currently require any cash contributions to be made by the Company.

Sensitivities

The calculations of the defined benefit obligations are sensitive to the assumptions set out on page 137. The following table summarises how the estimated impact of a change in a significant assumption would affect the UK defined benefit obligation at 31 December 2023, while holding all other assumptions constant. This sensitivity analysis may not be representative of the actual change in the defined benefit obligation as it is unlikely that the change in assumptions would occur in isolation of one another as some of the assumptions may be correlated.

For the most significant funded schemes, the investment strategies are designed to hedge the risks from interest rates and inflation on a proxy solvency basis.

The interest rate and inflation hedging is currently based on UK Government bond yields without any adjustment for any credit spread. The sensitivity analysis set out below has been determined based on a method that estimates the impact on the defined benefit obligation as a result of reasonable changes in key assumptions occurring at the end of the reporting period.

		2023 £m	2022 £m
Reduction in discount rate of 0.25% ¹	Obligation	(185)	(205)
	Plan assets (LDI portfolio)	(204)	235
Increase in inflation rate of 0.25% ¹	Obligation	(75)	(70)
	Plan assets (LDI portfolio)	(77)	91
Increase of 1% in transfer value assumption	Obligations	(30)	(30)
One year increase in life expectancy	Obligations	(155)	(215)

¹ The differences between the sensitivities on obligations and plan assets arise largely due to differences in the methods used to value the obligations for accounting purposes and the adopted proxy solvency basis

Defined contribution schemes

The Company operates a number of defined contribution schemes. The total expense recognised in the income statement was £165m (2022: £130m).

18 Share capital

	Equity ordinary shares of 20p each (millions)	Nominal value £m
Authorised		
At 1 January and 31 December 2023	2,000	400
Issued and fully paid		
At 1 January and 31 December 2023	1,691	338

Rights, preferences and restrictions

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; to appoint one or more proxies or, if they are corporations, corporate representatives; and to exercise voting rights. The ordinary shares are not listed.

19 Share-based payments**Effect of share-based payment transactions on the Company's results and financial position**

	2023 £m	2022 £m
Total expense recognised for equity-settled share-based payment transactions	39	39

Share-based payment plans in operation during the year

During the year, the Company participated in the following share-based payment plans operated by Rolls-Royce Holdings plc:

Long-Term Incentive Plan (LTIP)

The fair value of shares awarded is calculated using a pricing model that takes account of the non-entitlement to dividends (or equivalent) during the vesting period and the market-based performance condition based on expectations about volatility and the correlation of share price returns in the group of FTSE 100 companies and which incorporates into the valuation the interdependency between share price performance and TSR vesting. This adjustment decreases the fair value of the award relative to the share price at the date of grant.

ShareSave

The fair value of the options granted is calculated using a pricing model that assumes that participants will exercise their options at the beginning of the six-month window if the share price is greater than the exercise price. Otherwise it assumes that options are held until the expiration of their contractual term. This results in an expected life that falls somewhere between the start and end of the exercise window.

Deferred Share Bonus Plan (DSBP)

The fair value of shares awarded under DSBP is calculated as the share price on the date of the award, excluding expected dividends (or equivalent).

The weighted average share price at the date share options were exercised was 159p (2022: 95p) per share. The closing price at 31 December 2023 was 300p (2022: 93p).

The range of exercise prices for the share options as at 31 December 2023 was 97p to 261p.

Grant - vest	Expiry date (31 January)	Exercise price in pence per share option	ShareSave (millions)	
			2023	2022
2017 - 2023	2023	261	-	1.2
2019 - 2023	2023	232	-	1.8
2019 - 2025	2025	232	1.7	1.8
2021 - 2025	2025	97	30.7	33.4
			32.4	38.2

The weighted average remaining contractual life for the cash settled options as at 31 December 2023 was one year (2022: two years).

20 Contingent liabilities

Certain authorities are investigating members of the Group, of which the Company operates, for matters relating to misconduct in relation to historical matters. The Group is responding appropriately. Action may be taken by further authorities against the Group or individuals. In addition, the Group could still be affected by actions from other parties, including customers, customers' financiers and current and former investors, including certain potential claims in respect of the Group's historical ethics and compliance disclosures which have been notified to the Group. The Directors are not currently aware of any matters that are likely to lead to a material financial loss over and above the penalties imposed to date, to the Group or to the Company, but cannot anticipate all the possible actions that may be taken or their potential consequences.

The Company has, in the normal course of business, entered into arrangements in respect of export finance, performance bonds, grant funding, countertrade obligations and minor miscellaneous items. Various Company undertakings are party to legal actions and claims (including with tax authorities) which arise in the ordinary course of business, some of which are for substantial amounts. As a consequence of the insolvency of an insurer as previously reported, the Company is no longer fully insured against known and potential claims from employees who worked for certain of the Company's UK based businesses for a period prior to the acquisition of those businesses by the Company.

In connection with the sale of its products, the Company will, on some occasions, provide financing support for its customers, generally in respect of civil aircraft. The Company's commitments relating to these financing arrangements are spread over many years, relate to a number of customers and a broad product portfolio and are generally secured on the asset subject to the financing. These include commitments of \$0.9bn (2022: \$1.2bn) (on a discounted basis) to provide facilities to enable customers to purchase aircraft (of which approximately \$0.7bn could be called during 2023). These facilities may only be used if the customer is unable to obtain financing elsewhere and are priced at a premium to the market rate. Significant events impacting the international aircraft financing market, the failure by customers to meet their obligations under such financing agreements, or inadequate provisions for customer financing liabilities may adversely affect the Company's financial position.

Customer financing provisions are made to cover guarantees provided for asset value and/or financing where it is probable that a payment will be made. These are reported on a discounted basis at the Company's borrowing rate to better reflect the time span over which these exposures could arise. The values of aircraft providing security are based on advice from a specialist aircraft appraiser. There were no provisions for customer financing provisions at 31 December 2023 or 31 December 2022.

The Company has responded appropriately to the Russia-Ukraine conflict to comply with international sanctions and export control regime, and to continue to implement the business decision to exit from Russia. The Company could be subject to action by impacted customers, suppliers and other contract parties.

While the outcome of the above matters cannot precisely be foreseen, the Directors do not expect any of these arrangements, legal actions or claims, after allowing for provisions already made, to result in significant loss to the Company.

21 Related party transactions

	2023 £m	2022 £m
Sale of goods and services	6,528	4,961
Purchases of goods and services ¹	(7,108)	(5,317)
Guarantees of joint arrangements' and associates' borrowings	2	3
Guarantees of non-wholly owned subsidiaries' borrowings	3	3

¹ The Company has both sales and purchasing arrangements with its maintenance, repair and overhaul joint ventures. As part of this arrangement, the Company issues and receives credit notes usable against amounts receivable and payable to these related parties. Purchases of goods and services from related parties are presented to be shown gross of these concessions. This is consistent with the presentation of sales to related parties. Purchases from related parties incurred during the year to 31 December 2022 have been represented on this basis resulting in an increase to this balance of £662m.

The Company is a wholly owned subsidiary of its ultimate parent Rolls-Royce Holdings plc and is included within the consolidated results of Rolls-Royce Holdings plc and therefore has taken advantage of the exemption in FRS 101 not to disclose related party transactions with its parent company and other wholly owned group companies. The aggregated balances with joint ventures and parent undertakings are shown in notes 8 and 13.

During the year, the Company transacted with its non-wholly owned subsidiary, Rolls-Royce SMR Limited:

	2023 £m	2022 £m
Sales to Rolls-Royce SMR Limited	7	3
Purchases from Rolls-Royce SMR Limited	-	-
Receivables with Rolls-Royce SMR Limited	2	1
Payables to Rolls-Royce SMR Limited	(103)	(50)

22 Parent and ultimate parent company

The Company's direct parent is Rolls-Royce Group Limited.

The ultimate parent undertaking and the smallest and largest group to consolidate these financial statements is Rolls-Royce Holdings plc. Copies of the Rolls-Royce Holdings plc consolidated financial statements can be obtained from the Company Secretary at Kings Place, 90 York Way, London, N1 9FX, United Kingdom.

Subsidiaries

As at 31 December 2023, the companies listed below and on the following pages are indirectly held by Rolls-Royce plc, except those indicated as being held directly by Rolls-Royce plc. The financial year end of each company is 31 December unless otherwise indicated.

Company name	Address	Class of shares	% of class held
Aerospace Transmission Technologies GmbH * ¹	Adelheldstrasse 40, D-88046, Friedrichshafen, Germany	Capital Stock	50
Amalgamated Power Engineering Limited ²	London ³	Deferred Ordinary	100
Bristol Siddeley Engines Limited * ²	London ³	Ordinary	100
Brown Brothers & Company, Limited ⁴	Taxiway, Hillend Industrial Estate, Dalgety Bay, Dunfermline, Fife, KY11 9JT, Scotland	Ordinary	100
C.A. Parsons & Company Limited ⁴	London ³	Ordinary	100
Derby Specialist Fabrications Limited ²	London ³	Ordinary	100
Europea Microfusloni Aerospaziali S.p.A*	Zona Industriale ASI, 83040 Morra de Sanctis, Avellino, Italy	Ordinary	100
Heaton Power Limited ²	London ³	Ordinary	100
John Thompson Cochran Limited ²	Taxiway, Hillend Industrial Estate, Dalgety Bay, Dunfermline, Fife, KY11 9JT, Scotland	6% Cumulative Preference Ordinary	100
Karl Maybach-Hilfe GmbH	Maybachplatz 1, 88045, Friedrichshafen, Germany	Capital Stock	100
Kinolt Immo SA	Rue de l'Avenir 61, 4460, Grace-Hollogne, Belgium	Ordinary	100
Kinolt Immobilien SA	Rue de l'Avenir 61, 4460, Grace-Hollogne, Belgium	Ordinary	100
Kinolt Trading and Contracting LLC ⁵	REGUS Service Office, Office No. 1034, Shoumoukh Tower, 10th Floor, Tower B, C-Ring Road, Al Sadd, PO Box 207207, Doha, Qatar	Ordinary	49
Kinolt Sistemas de UPS SpA	Bucarest No 17 Oficina, No 33, Previdencia, Santiago, Chile	Ordinary	100
Kinolt UK Limited ²	London ³	Ordinary	100
LLC Rolls-Royce Solutions Rus	Shabolovka Street 2, 119049, Moscow, Russian Federation	Ordinary	100
MTU Cooltech Power Systems Co., Limited ¹	Building No 2, No 1633 Tianchen Road, Quingpu District, Shanghai, China	Equity	50
MTU India Private Limited ⁶	6th Floor, RMZ Galleria, S/Y No. 144 Bengaluru, Bangalore, Kamataka 560,064, India	Ordinary	100
MTU Polska Sp. z o.o.	Ul. Lekka 3., Lokal U4. Raum, PLZ: 01-910, Ort: Warszawa, Poland	Ordinary	100
NEI International Combustion Limited ²	London ³	Ordinary	100
NEI Mining Equipment Limited ²	London ³	Ordinary	100
NEI Nuclear Systems Limited ²	London ³	Ordinary	100
NEI Parsons Limited ²	London ³	Ordinary	100
NEI Peebles Limited ²	London ³	Ordinary	100
NEI Power Projects Limited ²	London ³	Ordinary	100
Nightingale Insurance Limited	PO Box 33, Dorey Court, Admiral Park, St Peter Port GY1 4AT, Guernsey	Ordinary	100
No-Break Power Limited ²	London ³	Ordinary	100
Powerfield Limited ²	Derby ⁷	Ordinary	100
PT Rolls-Royce	Secure Building Blok B, Jl. Raya Protokol Halim, Perdanakusuma, Jakarta, 13610, Indonesia	Ordinary	100
PT Rolls Royce Solutions Indonesia	Secure Building Blok B, Jl. Raya Protokol Halim, Perdanakusuma, Jakarta, 13610, Indonesia	Ordinary	100
Rolls-Royce (Ireland) Unlimited Company ²	Ulster International Finance, 1st Floor IFSC House, IFSC, Dublin 1, Ireland	Ordinary	100
Rolls-Royce (Thailand) Limited	989 Floor 12A, Unit B1, B2, Siam Piwat Tower, Rama 1, Pathumwan, Bangkok, 10330, Thailand	Ordinary	100
Rolls-Royce Aero Engine Services Limited * ²	London ³	Ordinary	100
Rolls-Royce Australia Pty Limited	Level 1, 60 Martin Place, Sydney NSW 2000, Australia	Ordinary	100
Rolls-Royce Australia Services Pty Limited	Level 1, 60 Martin Place, Sydney NSW 2000, Australia	Ordinary	100
Rolls-Royce Brasil Limitada*	Rua Jose Versolato, No. 111, Torre B, Sala 2502, Centro, São Bernardo do Campo, São Paulo, CEP 09750-730, Brazil	Quotas	100
Rolls-Royce Canada Limited	9500 Côte de Liesse, Lachine, Québec H8T 1A2, Canada	Common Stock	100
Rolls-Royce Chile SpA	Alcantra 200 office 601, Piso 6, C.O. 7550159 Las Condes, Santiago, Chile	Ordinary	100
Rolls-Royce China Holding Limited*	305 Indigo Building 1, 20 Jiuxianqiao Road, Beijing, 100016, China	Registered Capital	100
Rolls-Royce Commercial Aero Engines Limited * ²	London ³	Ordinary	100

Subsidiaries continued

Company name	Address	Class of shares	% of class held
Rolls-Royce Controls and Data Services Limited * 2	London 3	Ordinary	100
Rolls-Royce Controls and Data Services (NZ) Limited	c/o Deloitte, 80 Queen Street, Auckland Central, Auckland 1010, New Zealand	Ordinary	100
Rolls-Royce Controls and Data Services (UK) Limited * 4	Derby 7	Ordinary	100
Rolls-Royce Corporation	Wilmington 8	Common Stock	100
Rolls-Royce Crosspointe LLC	Wilmington 8	Partnership (no equity)	100
Rolls-Royce Defense Products and Solutions, Inc.	Wilmington 8	Common Stock	100
Rolls-Royce Defense Services, Inc.	Wilmington 8	Common Stock	100
Rolls-Royce Deutschland Ltd & Co KG	Amtsgericht Potsdam, Blankenfelde-Mahlow,	Ordinary	100
Rolls-Royce Electrical Norway AS*	Jarleveien 8A, 7041, Trondheim 500, Norway	Ordinary	100
Rolls-Royce Energy Angola, Limitada 2	Rua Rei Katyavala, Edifício Rei Katyavala, Entrada B, Piso 8, Luanda, Angola	Quota	100
Rolls-Royce Energy Systems Inc. 2	Wilmington 8	Common Stock	100
Rolls-Royce Engine Services Holdings Co.	Wilmington 8	Common Stock	100
Rolls-Royce Engine Services Limitada Inc. 9	Bldg. 06 Berthaphil Compound, Jose Abad Santos Avenue, Clark Special Economic Zone, Clark,	Capital Stock	100
Rolls-Royce Erste Beteiligungs GmbH*	Eschenweg 11, 15827 Blankenfelde-Mahlow,	Capital Stock	100
Rolls-Royce Finance Company Limited 2	London 3	Deferred Ordinary	100 100
Rolls-Royce Finance Holdings Co.	Wilmington 8	Common Stock	100
Rolls-Royce Fuel Cell Systems Limited * 4	Derby 7	Ordinary	100
Rolls-Royce General Partner (Ireland) Limited *	29 Earlishot Terrace, Dublin 2, Ireland	Ordinary	100
Rolls-Royce General Partner Limited * 2	London 3	Ordinary	100
Rolls-Royce High Temperature Composites, Inc.	Corporation Service Company, 2710 Gateway Oaks Drive, Suite 150N, Sacramento, California 95833,	Ordinary	100
Rolls-Royce Holdings Canada Inc.*	9500 Côte de Liesse, Lachine, Québec H8T 1A2,	Common C	100
Rolls-Royce Hungary Kft	Gizella U. 51-57, 1143 Budapest, Hungary	Cash shares	100
Rolls-Royce India Limited 2, 8, 10	Derby 7	Ordinary	100
Rolls-Royce India Private Limited 8	Birla Tower West, 2nd Floor 25, Barakhamba Road, New Delhi, 110001, India	Equity	100
Rolls-Royce Industrial & Marine Power Limited 4	London 3	Ordinary	100
Rolls-Royce Industrial Power (India) Limited 2, 8, 10	Derby 7	Ordinary	100
Rolls-Royce Industrial Power Engineering (Overseas Projects) Limited 4	Derby 7	Ordinary	100
Rolls-Royce Industries Limited * 4	Derby 7	Ordinary	100
Rolls-Royce International Limited *	Derby 7	Ordinary	100
Rolls-Royce Japan Co., Limited	31st Floor, Kasumigaseki Building, 3-2-5 Kasumigaseki, Chiyoda-Ku, Tokyo, 100-6031, Japan	Ordinary	100
Rolls-Royce Leasing Limited *	Derby 7	Ordinary	100
Rolls-Royce Malaysia Sdn. Bhd.	Unit A-3-6 TTDI Plaza, Jalan Wan Kadir 3, Taman Tun Dr Ismail, 6000 Kuala Lumpur, Malaysia	Ordinary	100
Rolls-Royce Marine North America, Inc.	Wilmington 8	Common Stock	100
Rolls-Royce Military Aero Engines Limited * 2, 8, 10	London 3	Ordinary	100
Rolls-Royce New Zealand Limited	c/o Deloitte, 80 Queen Street, Auckland Central, Auckland 1010, New Zealand	Ordinary	100
Rolls-Royce North America (USA) Holdings Co.	Wilmington 8	Common Stock	100
Rolls-Royce North America Holdings, Inc.	Wilmington 8	Common Stock	100
Rolls-Royce North America Ventures, Inc.	Wilmington 8	Common Stock	100
Rolls-Royce North America, Inc.	Wilmington 8	Common Stock	100

Subsidiaries continued

Company name	Address	Class of shares	% of class held
Rolls-Royce North American Technologies, Inc.	Wilmington ⁸	Common Stock	100
Rolls-Royce Oman LLC	Bait Al Reem, Business Office #131, Building No 81, Way No 3409, Block No 234, Al Thaqafa Street, Al Khuwair, PO Box 20, Postal Code 103, Oman	Ordinary	100
Rolls-Royce Operations (India) Private Limited ^{2, 6}	Biria Tower West, 2nd Floor, 25 Barakhamba Road, New Delhi, 110001, India	Ordinary	100
Rolls-Royce Overseas Holdings Limited ^{2, 4}	Derby ⁷	Ordinary Ordinary A	100 100
Rolls-Royce Overseas Investments Limited ⁴	Derby ⁷	Ordinary	100
Rolls-Royce Placements Limited	London ³	Ordinary	100
Rolls-Royce Power Engineering Limited	Derby ⁷	Ordinary	100
Rolls-Royce Power Systems AG	Maybachplatz 1, 88045, Friedrichshafen, Germany	Ordinary	100
Rolls-Royce Retirement Savings Trust Limited ^{2, 6}	Derby ⁷	Ordinary	100
Rolls-Royce Saudi Arabia Limited	3010 – Al Arid, Unit No 1, Riyadh 13332 – 7663, Saudi	Cash shares	100
Rolls-Royce Singapore Pte. Ltd.	6 Shenton Way, #33-00 OUE, Downtown Singapore 068809, Singapore	Ordinary	100
Rolls-Royce SMR Limited ²	Derby ⁷	Ordinary	75.7
Rolls-Royce Solutions (Suzhou) Co. Ltd	9 Long Yun Road, Suzhou Industrial Park, Suzhou 215024, Jiang Su, China	Ordinary	100
Rolls-Royce Solutions Africa (Pty) Limited	36 Marconi Street, Montague Gardens, Cape Town, 7441, South Africa	Capital Stock	100
Rolls-Royce Solutions America Inc.	Wilmington ⁸	Ordinary	100
Rolls-Royce Solutions Asia Pte. Limited	10 Tukang Innovation Drive, Singapore 618302	Ordinary	100
Rolls-Royce Solutions Augsburg GmbH	Dasinger Strasse 11, 86165, Augsburg, Germany	Capital Stock	100
Rolls-Royce Solutions Benelux B.V.	Merwedestraat 86, 3313 CS, Dordrecht, Netherlands	Ordinary	100
Rolls-Royce Solutions Berlin GmbH	Villa Rathenau, Wilhelminenhofstrasse 75, 12459 Berlin, Germany	Common Seed Preferred Series A Preferred	100 100 100
Rolls-Royce Solutions Brasil Limitada	Via Anhanguera, KM 29203, 05276-000 Sao Paulo –	Ordinary	100
Rolls-Royce Solutions Enerji Deniz Ve Savunma Anonim Şirketi	Hatıra Sokak, No. 5, Ömerli Mahellesi, 34555 Arnavutköy, Istanbul, Turkey	Ordinary	100
Rolls-Royce Solutions France S.A.S.	Immeuble Colorado, 8/10 rue de Rosa Luxembourg-Parc des Bellevues 95610, Erangy-sur-Oise, France	Ordinary	100
Rolls-Royce Solutions GmbH	Maybachplatz 1, 88045, Friedrichshafen, Germany	Capital Stock	100
Rolls-Royce Solutions Hong Kong Limited	No.8 Hart Avenue, Unit D, 8th Floor, Tsim Sha Tsui, Kowloon, Hong Kong	Ordinary	100
Rolls-Royce Solutions Ibérica s.l.u.	Calle Copérnico 26-28, 28823 Coslada, Madrid, Spain	Ordinary	100
Rolls-Royce Solutions Israel Limited	4 Ha'Alon Street, South Building, Third Floor, 4059300 Kfar Neter, Israel	Ordinary	100
Rolls-Royce Solutions Italia S.r.l.	Via Aurelia Nord, 328, 19021 Arcola (SP), Italy	Capital Stock	100
Rolls-Royce Solutions Japan Co. Limited	Resorttrust Building 4-14-3, Nishitenma Kita-ku, Osaka 530-0047, Japan	Ordinary	100
Rolls-Royce Solutions Korea Limited	22nd Floor, Olive Tower, 41 Sejongdaero 9 gil, Junggu, 100-737 Seoul, Republic of Korea	Ordinary	100
Rolls-Royce Solutions Liège Holding S.A.	Rue de l'Avenir 61, 4460, Grace-Hollogne, Belgium	Ordinary	100
Rolls-Royce Solutions Liège S.A.	Rue de l'Avenir 61, 4460, Grace-Hollogne, Belgium	Ordinary	100
Rolls-Royce Solutions Magdeburg GmbH	Friedrich-List-Strasse 8, 39122 Magdeburg, Germany	Capital Stock	100
Rolls-Royce Solutions Mexico City S.A. de C.V.	Xochicalco 620, Colonia Letran Valle, Delegacion Benito Juarez, Mexico City 03650, Mexico	Common Shares	100
Rolls-Royce Solutions Middle East FZE	53B5SR06, Jebel Ali Free Zone, South P.O. Box 61141, Dubai, United Arab Emirates	Ordinary	100
Rolls-Royce Solutions Ruhstorf GmbH	Rothofer Strasse 8, 94099 Ruhstorf a.d. Rott, Germany	Capital Stock	100
Rolls-Royce Solutions South Africa (Pty) Limited	36 Marconi Street, Montague Gardens, Cape Town, 7441, South Africa	Ordinary	100

Subsidiaries continued

Company name	Address	Class of shares	% of class held
Rolls-Royce Solutions UK Limited	Derby ⁷	Ordinary	100
Rolls-Royce Solutions Willich GmbH	Konrad-Zuse-Str. 3, 47877, Willich, Germany	Ordinary	100
Rolls-Royce Sp z.o.o.*	Opolska 100 31-323, Krakow, Poland	Ordinary	100
Rolls-Royce Submarines Limited *	Atlantic House, Raynesway, Derby, Derbyshire DE21 7BE, United Kingdom	Ordinary	100
Rolls-Royce Technical Support Sarl	Centreda I, Avenue Didier Daurat, 31700 Blagnac, Toulouse, France	Ordinary	100
Rolls-Royce Total Care Services Limited * ⁴	Derby ⁷	Ordinary	100
Rolls Royce Turkey Güç Çözümleri San. ve Tic.Ltd.Şti.	Acibadem Mah. Çeçen Sk. Akasya A Kule Kent Etabı Blok No: 25, İç Kapı No:13, Üsküdar, İstanbul, Turkey	Cash shares	100
Rolls-Royce UK Pension Fund Trustees Limited	Derby ⁷	Ordinary	100
Rolls-Royce Zweite Beteteiligungs GmbH	Eschenweg 11, 15827 Blankenfelde-Mahlow,	Capital Stock	100
Ross Ceramics Limited	Derby ⁷	Ordinary	100
Servowatch Systems Limited	Endeavour House, Benbridge Industrial Estate, Holloway Road, Heybridge, Maldon, Essex CM9	Ordinary	100
Sharing in Growth UK Limited ¹¹	Derby ⁷	Limited by guarantee	100
Spare IPG 20 Limited ⁴	London ³	Ordinary	100
Spare IPG 21 Limited ²	London ³	Ordinary	100
Spare IPG 24 Limited ⁴	London ³	Ordinary	100
Spare IPG 32 Limited ⁴	London ³	Ordinary	100
Spare IPG 4 Limited ²	London ³	Ordinary	100
Team Italia Marine S.R.L.	Kampanien, Via Luigi Einaudi 114/B, 61032 Fano, Pesaro and Urbino, Italy	Ordinary	100
The Bushing Company Limited ⁴	London ³	Ordinary	100
Timec 1487 Limited ²	London ³	Ordinary	100
Turbine Surface Technologies Limited ¹	Unit 13a, Little Oak Drive, Sherwood Park, Annesley, Nottinghamshire NG15 0DR, United Kingdom	Ordinary A Ordinary B	Nil 100
Vessel Lifter, Inc. ²	Corporation Service Company, 1201 Hays Street, Tallahassee, Florida 32301, United States	Common Stock	100
Vinters Defence Systems Limited ²	London ³	Ordinary	100
Vinters Engineering Limited	Derby ⁷	Ordinary	100
Vinters International Limited ⁴	Derby ⁷	Ordinary	100
Vinters Limited * ⁴	Derby ⁷	Ordinary	100
Vinters-Armstrongs (Engineers) Limited ²	London ³	Ordinary	100
Vinters-Armstrongs Limited ²	London ³	Ordinary B	100
Yocova Private Ltd * ²	London ³	Ordinary	100
Yocova PTE. Ltd.*	6 Shenton Way, #33-00 OUE, Downtown Singapore 068809, Singapore	Ordinary	100

* Owned directly by Rolls-Royce plc

¹ Although the interest held is 50%, the Company controls the entity (see note 1 to the Consolidated Financial Statements) and, as a result, consolidates the entity and records a non-controlling interest

² Dormant entity

³ Kings Place, 90 York Way, London N1 9FX, United Kingdom

⁴ Entity to take advantage of s479A Companies Act 2006 (s479A) audit exemption for the year ended 31 December 2023. Rolls-Royce plc will issue a guarantee pursuant to s479A in relation to the liabilities of the entity

⁵ Although the interest held is 49%, the Company controls the entity (see note 1 to the Consolidated Financial Statements) and, as a result, consolidates the entity and records a non-controlling interest

⁶ Reporting year end is 31 March 2024

⁷ Moor Lane, Derby, Derbyshire DE24 8BJ, United Kingdom

⁸ Corporation Service Company, 251 Little Falls Drive, Wilmington, Delaware 19809, United States

⁹ Entity in liquidation

¹⁰ Entity to take advantage of s479A Companies Act 2006 (s479A) audit exemption for the year ending 31 March 2024. Rolls-Royce plc will issue a guarantee pursuant to s479A in relation to the liabilities of the entity

¹¹ The entity is not included in the consolidation, as Rolls-Royce plc does not have a beneficial interest in the net assets of the entity

¹² The entity is accounted for as a joint operation (see note 1 to the Consolidated Financial Statements)

¹³ Entity is accounted for as a joint venture as approval is required from the other shareholder for operationally running the affairs of the entity

Joint Ventures and Associates

Company name	Address	Class of shares	% of class held	Group interest held %
Aero Gearbox International SAS * ¹²	18 Boulevard Louis Sequin, 92700 Colombes, France	Ordinary	50	50
Airtanker Services Limited *	Airtanker Hub, RAF Brize Norton, Carterton, Oxfordshire OX18 3LX, United Kingdom	Ordinary	23.5	23.5
Alpha Leasing (US) (No.2) LLC	Wilmington ⁸	Partnership (no equity held)	-	50
Alpha Leasing (US) (No.4) LLC	Wilmington ⁸	Partnership (no equity held)	-	50
Alpha Leasing (US) (No.5) LLC	Wilmington ⁸	Partnership (no equity held)	-	50
Alpha Leasing (US) (No.6) LLC	Wilmington ⁸	Partnership (no equity held)	-	50
Alpha Leasing (US) (No.7) LLC	Wilmington ⁸	Partnership (no equity held)	-	50
Alpha Leasing (US) (No.8) LLC	Wilmington ⁸	Partnership (no equity held)	-	50
Alpha Leasing (US) LLC	Wilmington ⁸	Partnership (no equity held)	-	50
Alpha Partners Leasing Limited	1 Brewer's Green, London SW1H 0RH, United Kingdom	Ordinary A	100	50
Beijing Aero Engine Services Company Limited *	Room 711, Building 2, No.1 Jinhang Middle Road, Shunyi District, Beijing, China	Capital	50	50
CFMS Limited	43 Queen Square, Bristol BS1 4QP, United Kingdom	Limited by guarantee	-	50
Clarke Chapman Portia Port Services Limited	Maritime Centre, Port of Liverpool, Liverpool L21 1LA, United Kingdom	Ordinary A	100	50
Egypt Aero Management Services ⁹	EgyptAir Engine Workshop, Cairo International Airport, Cairo, Egypt	Ordinary	50	50
EPI Europrop International GmbH	Pelkovenstr. 147, 80992 München, Germany	Capital Stock	28	28
Eurojet Turbo GmbH *	Lillenthalstrasse 2b, 85399 Halbergmoos, Germany	Ordinary	33	33
Force MTU Power Systems Private Limited	Mumbai Pune Road, Akurdi, Pune, Maharashtra 411035, India	Capital Stock	49	49
Genlistics Holdings Limited *	Derby ⁷	Ordinary A	100	50
Global Aerospace Centre for Icing and Environmental Research Inc. ¹²	1000 Marie-Victorin Boulevard, Longueuil Québec J4G 1A1, Canada	Ordinary	50	50
Hoeller Electrolyzer GmbH ¹³	Alter Holzhafen, 23966 Wismar, Germany	Ordinary	54.2	54.2
Hong Kong Aero Engine Services Limited	33rd Floor, One Pacific Place, 88 Queensway, Hong Kong	Ordinary	50	50
International Aerospace Manufacturing Private Limited ^{6, 12}	Survey No. 3 Kempapura Village, Varthur Hobli, Bangalore, KA 560037, India	Ordinary	50	50
ITP Next Generation Turbines SLU *	Parque Tecnológico Edificio 300, 48170, Zamudio, Vizcaya, Spain	Ordinary-B	25	25
Light Helicopter Turbine Engine Company (unincorporated partnership)	Suite 119, 9238 Madison Boulevard, Madison, Alabama 35758, United States	Partnership (no equity held)	-	50
Manse Opus Management Company Limited ⁹	Third Floor Queensberry House, 3 Old Burlington Street, London W1S 3AE, United Kingdom	Limited by guarantee	33	33
MEST Co., Limited	97 Bukjeonggongdan 2-gil, Yangsan-si, Gyeongsangnam-do, 50571, Republic of Korea	Normal	46.8	46.8

Joint Ventures and Associates continued

Company name	Address	Class of shares	% of class held	Group interest held %
MTU Power Systems Sdn. Bhd.	Level 10 Menara LGB, 1 Jalan Wan Kadir Taman Tun Dr Ismail 6000 Kuala Lumpur, Malaysia	Ordinary A	100	49
MTU Turbomeca Rolls-Royce ITP GmbH *	Am Söldnermoos 17, 85399 Hallbergmoos, Germany	Capital Stock	25	25
MTU Turbomeca Rolls-Royce GmbH *	Am Söldnermoos 17, 85399 Hallbergmoos, Germany	Capital Stock	33.3	33.3
MTU Yuchai Power Company Limited	No 7 Danan Road, Yuzhou, Yulin, Guangxi, China, 537005, China	Capital Stock	50	50
N3 Engine Overhaul Services GmbH & Co KG	Gerhard-Höltje-Strasse 1, D-99310, Arnstadt, Germany	Capital Stock	50	50
N3 Engine Overhaul Services Verwaltungsgesellschaft MbH	Gerhard-Höltje-Strasse 1, D-99310, Arnstadt, Germany	Capital Stock	50	50
Rolls Laval Heat Exchangers Limited * 2	Derby 7	Ordinary	50	50
Rolls-Royce & Partners Finance (US) (No 2) LLC	Wilmington 8	Partnership (no equity held)	-	50
Rolls-Royce & Partners Finance (US) LLC	Wilmington 8	Partnership (no equity held)	-	50
SAFYRR Propulsion Limited * 2	Derby 7	B Shares	100	50
Singapore Aero Engine Services Private Limited	11 Calshot Road, 509932, Singapore	Ordinary	50	50
Taec Ucak Motor Sanayi AS	Levent Mahallesi Prof. Ahmet Kemal Aru Sk. No: 4/1, Beşiktaş, Turkey	Cash Shares	49	49
Techjet Aerofoils Limited 12	Tefen Industrial Zone, PO Box 16, 24959, Israel	Ordinary A Ordinary B	50 50	50
TRT Limited *	Derby 7	Ordinary B	100	50
Turbo-Union GmbH *	Lilienthalstrasse 2b, 85399 Halbergmoos, Germany	Capital Stock	40.0	40.0
United Battery Management GmbH 9	Wilhelmshofstr. 76/77, 12459, Berlin,	Ordinary	30	30
Xian XR Aero Components Co., Limited 12	Xujilawan, Beijiao, Po Box 13, Xian 710021, Shaanxi, China	Ordinary	49	49

* Directly held by the Company

1 Although the interest held is 50%, the Company controls the entity (see note 1 to the Consolidated Financial Statements) and, as a result, consolidates the entity and records a non-controlling interest

2 Dormant entity

3 Kings Place, 90 York Way, London N1 9FX, United Kingdom

4 Entity to take advantage of s479A Companies Act 2006 (s479A) audit exemption for the year ended 31 December 2023. Rolls-Royce plc will issue a guarantee pursuant to s479A in relation to the liabilities of the entity

5 Although the interest held is 49%, the Company controls the entity (see note 1 to the Consolidated Financial Statements) and, as a result, consolidates the entity and records a non-controlling interest

6 Reporting year end is 31 March 2024

7 Moor Lane, Derby, Derbyshire DE24 8BJ, United Kingdom

8 Corporation Service Company, 251 Little Falls Drive, Wilmington, Delaware 19809, United States

9 Entity in liquidation

10 Entity to take advantage of s479A Companies Act 2006 (s479A) audit exemption for the year ending 31 March 2024. Rolls-Royce plc will issue a guarantee pursuant to s479A in relation to the liabilities of the entity

11 The entity is not included in the consolidation, as Rolls-Royce plc does not have a beneficial interest in the net assets of the entity

12 The entity is accounted for as a joint operation (see note 1 to the Consolidated Financial Statements)

13 Entity is accounted for as a joint venture as approval is required from the other shareholder for operationally running the affairs of the entity

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF ROLLS-ROYCE PLC**Report on the audit of the financial statements**

Opinion

In our opinion:

- Rolls-Royce 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 2023 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 as applied in accordance with the provisions of the Companies Act 2006;
- the company financial statements have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards, including 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 and audited financial statements, (the "Annual Report"), which comprise: the consolidated and company balance sheets as at 31 December 2023; the consolidated income statement, the consolidated and company statements of comprehensive income, the consolidated cash flow statement, the consolidated and company statements of changes in equity for the year then ended; and the notes to the financial statements, comprising material accounting policy information and other explanatory information.

Our opinion is consistent with our reporting to the Audit Committee of Rolls-Royce Holdings plc (the company's ultimate parent company).

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.

To the best of our knowledge and belief, we declare that non-audit services prohibited by the FRC's Ethical Standard were not provided.

Other than those disclosed in note 6, we have provided no non-audit services to the company or its controlled undertakings in the period under audit.

Our audit approach**Overview****Audit scope**

- Following our assessment of the risks of material misstatement of the financial statements, including the impact of climate change, we subjected 35 individual components (including three joint ventures) to full scope audits for group reporting purposes, which with an element of sub-consolidation, equates to 16 group reporting opinions. In addition, nine components performed targeted specified procedures.
- Leveraging some of the component audit work and the group team's audit of centralised functions including those covering the group treasury operations, corporate taxation, post-retirement benefits and certain goodwill and intangible asset impairment assessments, the group team audited the company. 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 audit procedures were performed accounted for 96% of revenue, 76% of profit before taxation and 90% of total assets.
- Some centralised 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 met with and discussed the approach and results of audit procedures with component teams and reviewed their audit files and final deliverables. In person site visits to components in the UK, Germany and US were also performed.
- The company comprises a number of the UK components that were in scope for the group audit. We leveraged that work for the purposes of the company audit and performed additional testing on how the company related components were combined, with appropriate eliminations made, to form the company financial statements. Our work accounted for 76% of the total assets of the company.

Key audit matters

- Long-term contract accounting and associated provisions (group and company)
- Deferred tax asset recognition and recoverability (group and company)
- Translation of foreign-currency denominated transactions and balances (group and company)
- Presentation and accuracy of underlying results and disclosure of other one-off items (including exceptional items) (group)

Materiality

- Overall group materiality: £93m (2022: £80m) based on approximately 0.6% of underlying revenue (2022: approximately 0.6% of five year average underlying revenues from continuing operations).
- Overall company materiality: £80m (2022: £70m) based on approximately 1.0% of revenue (2022: Based on approximately 1.0% of five year average revenues).
- Performance materiality: £80m (2022: £70m) (group) and £60m (2022: £53m) (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.

The key audit matters below are consistent with last year.

Key audit matter	How our audit addressed the key audit matter
<i>Long-term contract accounting and associated provisions (group and company)</i> <i>Directors' Report and note 1 to the consolidated and company financial statements – Accounting policies – Revenue recognition and contract assets and liabilities</i> 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/loss that are recognised in each reporting period. Small adjustments in assumptions can have a significant impact on the results of an individual financial year. Changes to the profile of shop visits or operating conditions of engines can result in different performance assumptions and hence cost profiles. Some contracts include inflation linked price escalations which require judgement to determine the extent to which future price increases are highly probable not to reverse and therefore can be recognised. These changes to forecasts can result in revisions to the revenue previously recognised. 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, income is earned based on engine flying hours (EFH). Management is required to estimate this to determine the total income expected over the life of a contract. The group expects large engine EFH to recover to pre-pandemic levels during 2024. In addition, the profitability of Civil Aerospace aftermarket contracts typically assumes that there will be significant cost improvements over the lifetime (eight to 15 years) of the contracts. Significant assumptions need to be made 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 Aerospace 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	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. 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 that could have an impact on 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; • 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; • 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 assess the validity 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; • We recalculated the price escalation included within the contracts; • We challenged the assessment of provisions for onerous contracts to determine the completeness of the unavoidable costs to fulfil the contractual obligations. We also validated the rates used to discount the future cash flows; • 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

Key audit matter	How our audit addressed the key audit matter
phase. In addition, certain 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 are judgemental and need to be considered on a contract by contract basis. Management has modelled the potential impact of climate change on its forecasts and has incorporated these estimates into the long-term contracts for Civil Aerospace, which is the business with the highest expected exposure to the impact of climate change. This included incorporating the potential impact of carbon prices on the group's direct emissions including engine testing 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 and assessing the associated impact on aviation demand.	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 to model the impact of climate change, including deploying valuation experts to benchmark the carbon and commodity price forecasts utilised. We validated management's assertions on the ability of suppliers and the group to pass on incremental costs by reviewing 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 read and challenged management's accounting papers that were prepared to explain the positions taken in respect of their key contract judgements; • 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 is materially appropriate, in the context of the financial statements taken as a whole.
<i>Deferred tax asset recognition and recoverability (group and company)</i> <i>Directors' Report, note 1 to the consolidated and company financial statements – Accounting policies – Taxation, note 5 to the consolidated financial statements and note 16 to the company financial statements – Deferred taxation</i> The recognition and recoverability of deferred tax assets in Rolls-Royce plc, where there have been significant taxable losses in the past, is based on a number of significant assumptions. Deferred tax assets can be recognised in relation to these losses to the extent it is probable that there will be sufficient future taxable profits to utilise them. Rolls-Royce plc has recognised significant deferred tax assets on the basis of expected future levels of profitability. The magnitude of the assets recognised necessitates the need for a number of assumptions in assessing the future levels of profitability in the UK over an extended period. This requires assumptions on future profits from the group's aftermarket and original equipment sales including EFH, associated costs and the future exchange rates used to translate foreign currency denominated amounts. At 31 December 2023, the group recognised £2,399m (2022: £2,183m) of deferred tax assets in the UK of which £1,476m (2022: £1,054m) relate to tax losses. The company recognised £2,198m (2022: £1,990m) of deferred tax assets of which £1,443m (2022: £1,054m) relate to tax losses. £406m of additional deferred tax assets have been recognised in the year as a result of the latest assessment, including from the impact of new contracts (including the trilateral AUKUS agreement) signed in the year, the growth in Civil EFH, the expected outcome of the group's strategic initiatives and other macroeconomic factors. £1,635m of potential deferred tax assets in relation to UK losses remain unrecognised in the group financial statements on the basis that management has judged there are not yet sufficient probable future taxable profits for them to be utilised against. £1,627m of these unrecognised deferred tax assets relate to the company.	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 brought forward tax losses can be utilised, our evaluation of these future profits considered both the business model and the applicable UK tax legislation. We assessed the future profit forecasts of the UK tax group and the underpinning assumptions including management's risk weighting of particular profit streams in Rolls-Royce plc and tested that the assumptions, including the forecasts for periods beyond the normal five year forecasting horizon, were reasonable. In doing this, we verified that the forecasts did not include taxable profit growth that could not be demonstrated as probable. 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, for the going concern assessment and longer term viability statement. 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 considered the appropriateness of the climate change assumptions modelled as part of their probability weighted scenarios to forecast probable profit levels and performed consistent procedures to those set-out in the long-term contract accounting and associated provisions key audit matter. We also performed 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

Key audit matter	How our audit addressed the key audit matter
The existence of tax losses brought forward from prior periods and other deductible temporary differences in Rolls-Royce plc, combined with the impact of 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 their 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 of government action 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 management has performed sensitivities over key estimates.	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 of the consolidated financial statements; and notes 1 and 16 of the company financial statements. We did not identify any material uncorrected exceptions from our audit work.
<i>Translation of foreign-currency denominated transactions and balances (group and company)</i> <i>Note 1 to the consolidated and company financial statements – Accounting policies – Foreign currency translation</i> Foreign exchange rate movements influence the reported consolidated income statement, the consolidated cash flow statement and consolidated and company balance sheets. 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 and company financial statements.	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 system reports identifying transactions and balances in source currency by agreeing these to general ledger balances; • 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 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 and compared this to the gain recorded in the year; and • Agreed the exchange rates used in management's translation adjustments to an independent source. There were no material uncorrected exceptions from our audit work.
<i>Presentation and accuracy of underlying results and disclosure of other one-off items (including exceptional items) (group)</i> <i>Note 1 to the consolidated financial statements – Accounting policies – Presentation of underlying results, note 2 to the consolidated financial statements – Segmental analysis and note 27 to the consolidated financial statements – Derivation of summary funds flow statement.</i> 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 significantly from the reported statutory results and are used extensively to explain performance to shareholders. Alternative performance measures can provide investors with additional 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 in determining whether items should be excluded from underlying profit or free cash flow. 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	We have considered the judgements taken by management to determine what should be treated as an 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 have 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 tested the reconciling items between the underlying operating profit and free cash flow disclosed in note 27 including verifying that the items adjusted for are consistent with the prior period. This included validating a sample of restructuring costs and verifying that the costs were sufficiently related to the announced transformation programme. 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
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. One of the items excluded from underlying profit is exceptional restructuring costs associated with the new transformation programme. Judgement is required to determine what costs are related to this programme to warrant exclusion from underlying profit.	We assessed the appropriateness and completeness of disclosures of the impact of one-off or non-underlying items primarily in notes 1, 2 and 27 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. 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.

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 324 reporting components, 35 individual components (including three joint ventures) were subject to full scope audits for group purposes, which following an element of sub-consolidation, equates to 16 group reporting opinions; and nine components performed targeted specified audit procedures.

In order to achieve audit coverage over the financial statements, under our audit methodology, we test both the design and operation of relevant business process controls and perform substantive testing over each financial statement line item.

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 group audit covered 96% of revenue, 76% of profit before tax and 90% of total assets. All entities that contribute in excess of 1% of the group's revenue were included in scope.

Further specific audit procedures over central functions, the group consolidation and areas of significant judgement (including corporate taxation, certain goodwill balances and intangible assets, treasury and post-retirement benefits) were performed by the group audit 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 have visited component teams across all group's major segments in the UK, US and Germany. These visits were in-person for these locations. They included meetings with the component auditor and with local management.

The company comprises a number of businesses and we leveraged the testing performed over the largest of these that was obtained for the group audit. In addition, we centrally tested certain items such as derivatives as part of our treasury operations, defined benefit obligations, as well as corporate taxation. We audited company level adjustments including intercompany balances and the recoverability of investments in subsidiaries.

The impact of climate risk on our audit

As part of our audit we made enquiries of management to understand the process they adopted to assess the extent of the potential impact of climate risk on the group's and company's financial statements. In addition to enquiries with management, we understood the governance process in place to assess climate risk, reviewed the group's assessment of climate related risk including both physical and transition risks and read additional reporting made on climate related matters, including its CDP public submission and the ultimate parent company's disclosures in line with the Task Force on Climate-related Financial disclosure (TCFD) framework.

We held meetings with management including the group's sustainability team to consider the completeness of management's climate risk assessment and its consistency with internal climate plans and board minutes, including whether the time horizons management have used take account of all relevant aspects of climate change such as transition risks. We also considered the consistency with the group's communications on climate related impacts. The group's short and medium term targets are currently under review, although it remains committed to emission reductions. The group has also set out net zero 2050 commitments, albeit the pathway to this is not fully developed.

We considered the following areas which depend on medium to long-term profit or cash flow forecasts to potentially be materially impacted by climate risk and consequently we focused our audit work in these areas: 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. Our findings were reported to and discussed with the Audit Committee of Rolls-Royce Holdings plc (the ultimate parent company) and management. Where significant, further details of how climate change has been considered in these areas and our audit response is given in the key audit matters above.

To respond to the audit risks identified in these areas we tailored our audit approach to address these, in particular, we:

- Deployed our valuation experts to benchmark carbon pricing and key commodity price forecasts against forecasts of future prices and found them to be materially reasonable. These have been incorporated by management in their forecasts of the group's future cost base for long-term contract accounting and associated provisions as well as scenarios utilised in assessing the recoverability of deferred tax assets, goodwill and other assets;
- Considered the reasonableness of management's assertion that climate change is unlikely to have a material impact on aviation demand by comparing management's EFH forecasts against other industry benchmarks and considering the sensitivity of EFH to different GDP growth rates expected under differing climate scenarios;
- Verifying that estimates of capital and cash costs from reductions to the group's scope 1 and scope 2 emissions have been incorporated in the group's forecasts including those used for going concern and the disclosures around the viability of the group that are included in the Strategic Report;
- Considered whether management had adequately reflected the risk of regulatory changes or demand changes to the extent known in the useful economic lives and recoverable value of other intangible assets including those related to diesel engines produced by Power Systems;
- Validated management's judgement that climate change is unlikely to have a material impact on other estimates at 31 December 2023 including the recoverability of inventory or the expected credit loss provision associated with trade receivables and contract assets by considering the short timeframe these assets are expected to be utilised compared to the period over which transition and physical risks are expected to arise; and
- Where appropriate, performed independent sensitivity analysis to determine to what extent reasonably possible changes in the climate related assumptions in the group's forecasts could result in material changes to the impacted balances and assessed the appropriateness of the associated disclosures.

We also considered the consistency of the disclosures in relation to climate change (including the disclosures in the Sustainability section of the Strategic Report) within the Rolls-Royce Holdings plc Annual Report and our knowledge obtained from our audit. This included considering the models management used in the TCFD scenario analysis and if the assumptions in those models are consistent with the assumptions used elsewhere in the financial statements.

As disclosed within the Sustainability section of the Rolls-Royce Holdings plc Annual Report the achievement of net zero by 2050 will require significant change across the aviation sector in particular, including widespread adoption of Sustainable Aviation Fuels or other alternative fuel sources. Management has not included the incremental cost of this in its longer term forecasts, based on the assumptions that such costs can be passed onto customers and will occur after the average life of the current existing contracts.

Our procedures did not identify any material impact in the context of our audit of the financial statements as a whole for the year ended 31 December 2023. The future estimated financial impacts of climate risk are clearly uncertain given the medium to long-term timeframes involved and their dependency on how governments, global markets, corporations and society respond to the issue of climate change and the speed of technological advancements that may be necessary. Accordingly, financial statements cannot capture all possible future outcomes as these are not yet known.

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	£93m (2022: £80m).	£80m (2022: £70m).
How we determined it	Based on approximately 0.6% of underlying revenue (2022: Based on approximately 0.6% of five-year average underlying revenues from continuing operations).	Based on approximately 1.0% of revenue (2022: Based on approximately 1.0% of five year average revenues).
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 more stable than the profit metric. Reflecting the reduced impact that the COVID-19 pandemic has had on the group's revenue in the year, we have reverted back to basing our materiality on in-year underlying revenue only.	Consistent with the group financial statements, we have used revenue to determine materiality as opposed to a profit based benchmark. We have used statutory revenue rather than underlying revenue because underlying revenue is not disclosed for the company. Reflecting the reduced impact that the COVID-19 pandemic has had on the company's revenue in the year, we have reverted back to basing our materiality on in-year revenue only.

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 £4m and £70m. 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% (2022: 75%) of overall materiality, amounting to £80m (2022: £70m) for the group financial statements and £60m (2022: £53m) 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 of Rolls-Royce Holdings plc (the company's ultimate parent company) that we would report to them misstatements identified during our audit above £3m (group audit) (2022: £3m) and £3m (company audit) (2022: £3m) 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 2025. We focused on this period and also considered the subsequent four months to the end of 2025;
- 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 2024 and 2025 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 on the stressed downside cash flows, including understanding of the scenarios modelled by management, how they were quantified and the resultant monthly phasing of the stressed downside cash flow forecast;
- We have 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 2025;
- We considered the potential mitigating actions that management may have available to it to reduce costs, manage cash flows or raise additional financing and assessed whether these were within the control of management and possible in the period of the assessment; and
- 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.

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. 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 2023 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.

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 regulations of country aviation authorities such as the Civil Aviation Authority, import and export restrictions including sanctions, 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 Listing Rules of the UK Financial Conduct Authority, 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; (3) the sale of Civil engines to joint ventures 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 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;
- Assessment of 'speak-up' matters reported through the group's Ethics Line and the results of management's investigation of such matters;
- Verifying sales of spare engines to joint ventures are in line with the approved timetable and are at a price supported by external valuation;
- 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;
- 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 and review of disclosures included in the Annual Report explaining and reconciling alternative performance measures to statutory metrics.

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 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 of Rolls-Royce Holdings plc (the company's ultimate parent company), 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 six years, covering the years ended 31 December 2018 to 31 December 2023.

Other matter

In due course, as required by the Financial Conduct Authority Disclosure Guidance and Transparency Rule 4.1.14R, these financial statements will 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 will be prepared using the single electronic format specified in the ESEF RTS.



Ian Morrison (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London
20 March 2024

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:

£m		2023	2022	Change
USD per GBP	Year-end spot rate	1.27	1.20	+6%
	Average spot rate	1.24	1.24	0%
EUR per GBP	Year-end spot rate	1.15	1.13	+2%
	Average spot rate	1.15	1.17	-2%

The Group's global corporate income tax contribution

The Group's total corporation tax payments in 2023 were £172m. Around 90% of this is paid in the US, Germany, Singapore and Canada. Together with the UK, where tax losses are currently generated (see note 5), the operations in these countries are where the majority of the Group's business is undertaken, and employees are based. The balance of tax payments are made 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 profit before taxation reported on page 46.

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

- Rolls-Royce Holdings plc Audit Committee Report (page 80 of the Rolls-Royce Holdings plc Financial Statements) – updates were given to the Audit Committee during the year;
- note 1 to the Consolidated Financial Statements (page 53) – details of key areas of uncertainty and accounting policies for tax; and
- note 5 to the Consolidated Financial Statements (pages 76 to 79) – 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 www.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 19. The Frc is chaired by the Chief Financial Officer. 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	2023	2022
Total equity	(3,269)	(5,657)
Cash flow hedges	(12)	(26)
Group capital	(3,281)	(6,042)
Net debt	(1,952)	(3,251)

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 to 31 December 2023, the Group cancelled its undrawn £1bn bank loan facility, which was due to mature in January 2024 and its undrawn UKEF £1bn facility, which was due to mature in March 2026. These facilities had remained undrawn during the year. In addition, the Group replaced the £2,500m committed bank borrowing facility with a new £2,500m facility with a maturity date of November 2026 with the banks having the option to extend with two one-year extension options (3+1+1).

At the year end, the Group retained aggregate liquidity of £7.2bn, including cash and cash equivalents of £3.7bn and undrawn borrowing facilities of £3.5bn.

The Group has one material debt maturity in 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 16.

Credit rating

£m	Rating	Outlook
Moody's Investors Service	Ba2	Positive
Standard & Poor's	BB+	Positive
Fitch	BB+	Positive

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 IFRS, as adopted by the UK.

During the year, the Group adopted IFRS 17 described on page 55. The Group identified that the Standard will impact the results of its captive insurance company as it issues insurance contracts, however, since the contracts insure other group companies, there is no material impact on the Consolidated Financial Statements. The Group also concluded that its parent company guarantee arrangements in the form of financial or performance guarantees, that meet the IFRS 17 definition of insurance contracts, have no impact on the Consolidated Financial Statements of the Group for the year to 31 December 2023.

There are no other new standards or interpretations issued by the IASB that had a significant impact on the Consolidated Financial Statements.

Following a review which was prompted by an enquiry arising from a review of the Group's 2022 Annual Report and Accounts by the Corporate Reporting Review team of the Financial Reporting Council (FRC), cash flows on settlement of excess derivatives have been reclassified from cash flows from financing activities to cash flows from operating activities in the cash flow statement as a result of a change in accounting policy as at 31 December 2023.

The previous classification as cash flows from financing activities was based on the Directors judgement of the economic nature of the activities as the cash flows relate to cash payments deferred in connection with the Group's action to reduce the size of the USD hedge book by \$11.8bn across 2020 to 2026. The Directors have reassessed their judgement in line with IAS 7 *Statement of Cash Flows* and have concluded that it would be more appropriate to classify these cash flows as cash flows from operating activities.

As a result of the above, cash flows from operating activities during the year to 31 December 2022 have reduced by £(326)m to £1,523m with a corresponding decrease in cash outflows from financing activities from £(2,865)m to £(2,538)m. There is no impact to the total change in cash and cash equivalents or to any alternative performance measures.

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 2024.

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. All comparative periods relate to 31 December 2022.

Underlying results from continuing operations

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 notes 2 and 26.

	2023 £m	2022 £m
Revenue from continuing operations		
Statutory revenue	16,486	13,520
Derivative and FX adjustments	(1,077)	(829)
Underlying revenue	15,409	12,691

	2023 £m	2022 £m
Gross profit from continuing operations		
Statutory gross profit	3,620	2,757
Derivative and FX adjustments	(461)	(262)
Programme exceptional credits	(21)	(69)
Exceptional transformation and restructuring charges	55	8
Acquisition accounting and M&A	46	53
Impairments	(8)	(10)
Other underlying adjustments	-	-
Underlying gross profit	3,231	2,477

	2023 £m	2022 £m
Commercial and administrative costs from continuing operations		
Statutory commercial and administrative (C&A) costs	(1,110)	(1,077)
Derivative and FX adjustments	1	(2)
Exceptional transformation and restructuring charges	47	39
Other underlying adjustments	(2)	(22)
Underlying C&A Costs	(1,064)	(1,062)

	2023 £m	2022 £m
Research and development costs from continuing operations		
Statutory research and development (R&D) costs	(739)	(891)
Derivative and FX adjustments	(4)	-
Acquisition accounting	4	5
Underlying R&D costs	(739)	(886)

	2023 £m	2022 £m
Operating profit from continuing operations		
Statutory operating profit	1,944	837
Derivative and FX adjustments	(475)	(264)
Programme exceptional credits	(21)	(69)
Restructuring exceptional charges	102	47
Acquisition accounting and M&A	50	58
Impairments	(8)	65
Other underlying adjustments	(2)	(22)
Underlying operating profit	1,590	652
Underlying operating margin	10.3%	5.1%

Underlying results from discontinued operations

	2023 £m	2022 £m
Results from discontinued operations		
Profit for the year from discontinued operations on ordinary activities	-	68
Costs of disposal on discontinued operations prior to disposal	-	-
Loss on disposal of discontinued operations	-	(148)
Statutory operating loss	-	(80)
Derivative and FX adjustments	-	(1)
Restructuring exceptional charges	-	-
Acquisition accounting and M&A	-	179
Related tax effects	-	(31)
Underlying operating profit	-	67

Organic change

Organic change is the measure of change at constant translational currency applying full year 2022 average rates to 2023. The movement in underlying change to organic change is reconciled below.

All amounts below are shown on an underlying basis and reconciled to the nearest statutory measure above.

Total group income statement

	2023 £m	2022 £m	Change £m	FX £m	Organic change £m	Organic change %
Underlying revenue	15,409	12,691	2,718	88	2,630	21%
Underlying gross profit	3,231	2,477	754	22	732	30%
Underlying operating profit	1,590	652	938	5	933	143%
Net financing costs	(328)	(446)	118	-	118	(26)%
Underlying profit before taxation	1,262	206	1,056	5	1,051	-
Taxation	(120)	(48)	(72)	(1)	(71)	-
Underlying profit for the year from continuing operations	1,142	158	984	4	980	-

Civil Aerospace

	2023 £m	2022 £m	Change £m	FX £m	Organic change £m	Organic change %
Underlying revenue	7,348	5,686	1,662	17	1,645	29%
Underlying OE revenue	2,703	1,982	721	15	706	36%
Underlying services revenue	4,645	3,704	941	2	939	25%
Underlying gross profit	1,394	853	541	1	540	63%
Commercial and administrative costs	(354)	(371)	17	(1)	18	(5)%
Research and development costs	(343)	(452)	109	(3)	112	(25)%
Joint ventures and associates	153	113	40	-	40	35%
Underlying operating profit	850	143	707	(3)	710	-

Defence

	2023 £m	2022 £m	Change £m	FX £m	Organic change £m	Organic change %
Underlying revenue	4,077	3,660	417	(11)	428	12%
Underlying OE revenue	1,766	1,634	132	(4)	136	8%
Underlying services revenue	2,311	2,026	285	(7)	292	14%
Underlying gross profit	804	726	78	-	78	11%
Commercial and administrative costs	(173)	(174)	1	(1)	2	(1)%
Research and development costs	(72)	(122)	50	1	49	(40)%
Joint ventures and associates	3	2	1	-	1	50%
Underlying operating profit	562	432	130	-	130	30%

Power Systems

	2023 £m	2022 £m	Change £m	FX £m	Organic change £m	Organic change %
Underlying revenue	3,968	3,347	621	82	539	16%
Underlying OE revenue	2,661	2,187	474	55	419	19%
Underlying services revenue	1,307	1,160	147	27	120	10%
Underlying gross profit	1,050	918	132	21	111	12%
Commercial and administrative costs	(456)	(441)	(15)	(8)	(7)	2%
Research and development costs	(187)	(204)	17	(4)	21	(10)%
Joint ventures and associates	6	8	(2)	–	(2)	(25)%
Underlying operating profit	413	281	132	9	123	44%

New Markets

	2023 £m	2022 £m	Change £m	FX £m	Organic change £m	Organic change %
Underlying revenue	4	3	1	–	1	33%
Underlying OE revenue	2	1	1	–	1	100%
Underlying services revenue	2	2	–	–	–	–
Underlying gross profit/(loss)	1	(1)	2	–	2	–
Commercial and administrative costs	(24)	(23)	(1)	–	(1)	4%
Research and development costs	(137)	(108)	(29)	(2)	(27)	25%
Joint ventures and associates	–	–	–	–	–	–
Underlying operating loss	(160)	(132)	(28)	(2)	(26)	20%

Trading cash flow

Trading cash flow is defined as free cash flow (as defined below) 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 27.

	2023 £m	2022 £m
Civil Aerospace	626	226
Defence	511	426
Power Systems	461	158
New Markets	(63)	(57)
Total reportable segments trading cash flow	1,535	753
Other businesses	5	5
Central and Inter-segment	(56)	(50)
Trading cash flow from continuing operations	1,484	708
Discontinued operations	–	(12)
Trading cash flow	1,484	696
Underlying operating profit charge exceeded by contributions to defined benefit schemes	(26)	(32)
Tax ¹	(172)	(174)
Free cash flow	1,286	490

¹ See page 49 for tax paid on statutory cash flow

Free cash flow

Free cash flow is a measure of financial performance of the businesses' cash flow to see what is available for distribution among those stakeholders funding the business (including debt holders and shareholders). Free cash flow represents cash flows from operating activities, including capital expenditure and movements in investments, capital elements of lease payments, interest paid and excluding amounts spent or received on activity related to business acquisitions or disposals, financial penalties paid and exceptional restructuring payments. Free cash flow from continuing operations has been presented to remove free cash flow from discontinued operations as defined in note 26. For further detail, see note 27.

Free cash flow from cash flows from operating activities

	2023 £m	2022 £m
Statutory cash flows from operating activities ¹	2,486	1,523
Capital expenditure	(699)	(512)
Investment (including investment from NCI and movement in joint ventures, associates and other investments)	69	(218)
Capital element of lease payments	(291)	(352)
Interest paid	(333)	(326)
Exceptional transformation and restructuring costs	69	76
M&A costs	2	2
Other	(17)	(29)
Free cash flow	1,286	490
Discontinued operations free cash flow ²	-	14
Free cash flow from continuing operations	1,286	504

¹ Statutory cash flows from operating activities at 31 December 2022 has been represented. See note 1

² Discontinued operations free cash excludes: transactions with parent company of £nil (2022: £(65)m), movements in borrowings of £nil (2022: £22m), exceptional restructuring costs of £nil (2022: £nil), M&A costs of £nil (2022: £44m) and other of £nil (2022: £(6)m)

Group 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. For further detail, see note 3.

Gross Capital expenditure

Gross capital expenditure during the year excluding capital expenditure from discontinued operations. All proposed investments are subject to rigorous review to ensure that they are consistent with forecast activity and provide value for money. The Group measures annual capital expenditure as the cash purchases of PPE acquired during the year.

	2023 £m	2022 £m
Purchases of PPE (cash flow statement)	429	359
Less: capital expenditure from discontinued operations	-	(14)
Net capital expenditure	429	345

Key performance indicators

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

All comparative periods relate to 31 December 2022, unless otherwise stated.

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 seven to 12 months) are excluded. Further details are included in note 2 of the Consolidated Financial Statements.

GLOSSARY

AAM	advanced air mobility	IASB	International Accounting Standards Board
APM	alternative performance measure	IFRS	International financial reporting standards
Articles	Articles of Association of Rolls-Royce plc	KPIs	key performance indicators
C&A	commercial and administrative	LIBOR	London Inter-bank offered rate
CEO	chief executive officer	LTIP	long-term incentive plan
Our Code	Global Code of Conduct	LTSA	long-term service agreement
the Code	UK Corporate Governance Code 2018	M&A	mergers & acquisitions
Company	Rolls-Royce plc	MRO	maintenance, repair and overhaul
D&I	diversity & inclusion	MW	megawatts
DoJ	US Department of Justice	OE	original equipment
DPAs	deferred prosecution agreements	PBT	profit before tax
DTR	the FCA's Disclosure Guidance and Transparency Rules	PPE	property, plant and equipment
EFH	engine flying hours	PSP	performance share plan
ERG	employee resource group	R&D	research and development
ESG	environment, social and governance	R&T	research and technology
EU	European Union	REACH	registration, evaluation, authorisation and restriction of chemicals
EUR	euro	RMS	risk management system
EVTOL	electric vertical take-off and landing	RRH	Rolls-Royce Holdings plc
FCA	Financial Conduct Authority	RRMS	Rolls-Royce management system
FX	foreign exchange	RRSAs	risk and revenue sharing arrangements
GBP	Great British pound or pound sterling	SAF	sustainable aviation fuel
GHG	greenhouse gas	SFO	UK Serious Fraud Office
Group	Rolls-Royce plc and its subsidiaries	SMR	small modular reactors
HPT	high pressure turbine	TCFD	Taskforce on Climate-related Financial Disclosures
HSE	health, safety and environment	TSR	total shareholder return
		USD/US\$	United States dollar