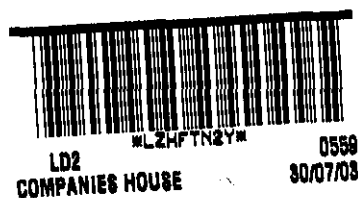


ROLLS-ROYCE POWER ENGINEERING plc

ANNUAL REPORT

AND

FINANCIAL STATEMENTS 2002



COMPANY REGISTRATION NO: 1305027

ROLLS-ROYCE POWER ENGINEERING plc

DIRECTORS AND OFFICERS

Directors	D R Bale		
	J Gaskell	resigned	31 January 2002
	J D Harvey		
	P Heiden	resigned	31 December 2002
	S Lanyado		
	R C Orgill	appointed	8 December 2002
	J Warren		

Secretary	J Warren
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Registered office	Moor Lane Derby DE24 8BJ Company registered in England, number 1305027
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Auditors	KPMG Audit Plc 8 Salisbury Square London EC4Y 8BB
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ROLLS-ROYCE POWER ENGINEERING plc

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ROLLS-ROYCE POWER ENGINEERING plc

REPORT OF THE DIRECTORS

The directors present their annual report and the audited financial statements for the year ended 31 December 2002.

PRINCIPAL ACTIVITIES

Rolls-Royce Power Engineering plc designs, manufactures, commissions and services a wide range of advanced engineered products for the defence, marine and energy markets, including the oil and gas industry and power generation.

RESULTS FOR THE YEAR

During the year ended December 31, 2002 the Company achieved a turnover of £642.2m (2001: £651.1m) and a loss on ordinary activities before taxation and after exceptional costs of £42.2m (2001: a loss of £65m).

The analysis of turnover and profits by business class and geographical area is given in Note 2 to the financial statements on page 15.

DIVIDEND

No interim dividend was paid (2001: Nil). No final ordinary dividend is recommended (2001: nil).

EMPLOYEES

The Company is part of the Rolls-Royce plc Group. The Group's employment policies and practices support its overall business objectives by motivating and developing employees to be responsive to the needs of the business and its customers. Policies continue to be reviewed and developed to support the changing needs of the business.

A strong emphasis is placed on effective employee communications and each business has its own programme of communication adapted to its particular needs.

The Group consults with employees and employee representatives on a wide range of topics relating to its overall business objectives. Regular meetings are held in each business to discuss opportunities and issues of common interest.

The Group operates an equal opportunities policy. The Group's policy is to provide, wherever possible, employment training and development opportunities for disabled people. It is also committed to supporting employees who become disabled and to helping disabled employees make the best possible use of their skills and potential.

Employees are able to participate in the Rolls-Royce Sharesave Scheme.

ROLLS-ROYCE POWER ENGINEERING plc

EDUCATION AND TRAINING

We continue to invest in our training and development programmes to ensure that our people attain the highest level of skills.

Employees are encouraged to take responsibility for their personal development and opportunities are available to extend their competency levels using a range of latest education and training techniques. The use of Appraisal Systems and Personal Development Planning continues to grow and opportunities for the Company to share best practice in these and other employee development and training activities is a high priority.

PENSION FUND

The Company maintains Pension Schemes for the majority of employees in the UK and overseas. The assets of the Schemes are kept independent of the Company's finances and are administered by Trustees. The most recent actuarial valuations indicated that the assets of the principal schemes were sufficient to meet the cost of benefits as and when they fall due.

HEALTH AND SAFETY POLICY

The Company confirms that it complies with the Health and Safety Policy and Procedures of its parent company, Rolls-Royce plc. These are described in the annual report of Rolls-Royce plc

DIRECTORS

The Directors of the Company who held office during 2002 are listed on page 1.

DIRECTORS' INTERESTS

None of directors, or their immediate family, had any beneficial interest in the shares of the Company during the year. The beneficial interests of directors holding office at 31 December 2002, including immediate family, in the ordinary share capital of Rolls-Royce plc are as follows:

Rolls-Royce plc Ordinary Shares

	1.1.02 ¹	31.12.02
D R Bale	9,156	12,654*
	9,156	12,654*

Options over Rolls-Royce plc Ordinary Shares

1.1.02 ¹	31.12.02	Exercise price (p)	Exercisable Dates
44,500	44,500	176	2001-2005
15,444	15,444	194.25	2003-2010
11,584	11,584	194.25	2003-2010
27,778	27,778	216	2004-2011
879	879	108	2005
-	69,149	188	2005-2012
100,185	169,334		

ROLLS-ROYCE POWER ENGINEERING plc

	1.1.02 ¹	31.12.02		1.1.02 ¹	31.12.02	Exercise price (p)	Exercisable Dates
J D Harvey	16,292	24,251*		20,000	20,000	176	2000-2005
				5,721	5,721	205	2003
				15,444	15,444	194.25	2003-2010
				33,977	33,977	194.25	2003-2010
	-	-		48,149	48,149	216	2004-2011
				1,407	1,407	108	2005
				-	58,511	188	2005-2012
	16,292	24,251*		124,698	183,209		
S Lanyado	37,213	75,474*		13,888	13,888	216	2004-2011
				125,001	125,001	216	2004-2011
				555,556	555,556	216	2004-2011
				4,398	4,398	108	2005
				-	255,319	188	2005-2012
	37,213	75,474*		698,843	954,162		
R Orgill	1,249	1,249*		-	-		
	1,249	1,249*		-	-		
J Warren	2,341	6,977*		15,444	15,444	194.25	2003-2010
				19,098	19,098	216	2004-2011
				2,255	2,255	205	2003
				5,639	5,639	108	2007
				-	23,936	188	2005-2012
				-	24,602	188	2005-2012
	2,341	6,977*		42,436	90,974		

*The above interests under ordinary shares include shares held in trust for the following directors:

	Annual Performance Related Award Scheme ²		Profit Sharing Share Scheme ³		SharePurchase Plan ⁴	
	1.1.2002 ¹	31.12.2002	1.1.2002 ¹	31.12.2002	1.1.2002 ¹	31.12.2002
D Bale	5,045	9,345	1,981	3,309	-	-
J D Harvey	9,532	15,024	1,760	1,760	-	192
S Lanyado	4,141	39,133	572	3,841	-	-
R C Orgill	-	-	1,249	1,249	-	-
J Warren	2,341	6,459	-	-	-	-

¹ Or date of appointment

² Under the Annual Performance Related Award Scheme, shares vest after two years.

³ Under the Profit Sharing Share Scheme, shares vest after three years.

⁴ Under the SharePurchase Plan, shares vest after five years.

The market price of the ordinary shares of the Company's ultimate parent company, Rolls-Royce plc at December 31, 2002, was 107p and the range during 2002 was 95.25p to 203.5p.

ROLLS-ROYCE POWER ENGINEERING plc

TANGIBLE FIXED ASSETS

Valuations of the Company's properties were obtained as at December 31, 1996, with the exception of properties in the process of being sold or those under consideration for disposal. Details are given in note 8 to the financial statements.

RESEARCH AND DEVELOPMENT

The Company and its subsidiary undertakings devote a substantial amount of time and effort to research and development activities and expenditure for 2002 was £16.2m (2001: £22.8m).

PAYMENT TO SUPPLIERS

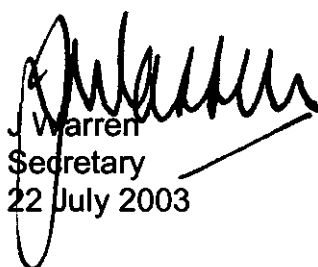
The Company does not follow any code or standard on payment practice. It seeks the best possible terms from suppliers and, when entering into binding purchasing contracts, gives consideration to quality, delivery price and the terms of payment. Suppliers are, in this way, made aware of these terms. The Company complies with these terms whenever it is satisfied that suppliers have provided the goods or services in accordance with the agreed terms and conditions. In the event of disputes, efforts are made to resolve them quickly.

The Company had the equivalent of 59 days purchases outstanding at December 31, 2002 based on the average daily amount invoiced by suppliers during the year.

AUDITORS

In accordance with Section 384 of the Companies Act 1985, a resolution to re-appoint KPMG Audit Plc as auditors of the Company will be proposed at the Annual General Meeting.

By order of the Board


J. Warren
Secretary
22 July 2003

ROLLS-ROYCE POWER ENGINEERING plc

DIRECTORS' RESPONSIBILITY FOR THE FINANCIAL STATEMENTS

Company law requires the directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the Company and of the profit or loss for that period. In preparing those financial statements, the directors are required to:

- (i) Select suitable accounting policies and then apply them consistently;
- (ii) Make judgements and estimates that are reasonable and prudent;
- (iii) State whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements;
- (iv) Prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Company and to enable them to ensure that the financial statements comply with the Companies Act 1985. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Company and to prevent and detect fraud and other irregularities.

ROLLS-ROYCE POWER ENGINEERING plc

Independent auditors' report to the members of Rolls-Royce Power Engineering plc

We have audited the financial statements on pages 9 to 28.

This report is made solely to the Company's members, as a body, in accordance with section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditors

The directors are responsible for preparing the annual report. As described on page 7, this includes responsibility for preparing the financial statements in accordance with applicable United Kingdom law and accounting standards. Our responsibilities, as independent auditors, are established in the United Kingdom by statute, the Auditing Practices Board and by our profession's ethical guidance.

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements have been properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the directors' report is not consistent with the financial statements, if the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and transactions with the Company is not disclosed.

Basis of audit opinion

We conducted our audit in accordance with Auditing Standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion

In our opinion the financial statements give a true and fair view of the state of the company's affairs as at December 31, 2002 and of its loss for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

KPMG Audit Plc

KPMG Audit Plc

Chartered Accountants

Registered Auditor

29 July 2003

**PROFIT AND LOSS ACCOUNT
FOR THE YEAR ENDED 31ST DECEMBER 2002**

		Continuing operations before exceptional items £m	Exceptional items ¹ £m	Total 2002 £m	2001 ¹ £m
Notes					
2	Turnover	642.2	-	642.2	651.1
	Cost of sales	<u>(602.9)</u>	<u>(7.1)</u>	<u>(610.0)</u>	<u>(612.4)</u>
	Gross profit/(loss)	39.3	(7.1)	32.2	38.7
Commercial, marketing and product support costs		(33.5)	-	(33.5)	(41.6)
General & administrative costs		(17.8)	-	(17.8)	(17.1)
Research & development (net)		<u>(16.2)</u>	<u>-</u>	<u>(16.2)</u>	<u>(22.8)</u>
		(28.2)	(7.1)	(35.3)	(42.8)
5	Write-down of investments in subsidiaries	-	-	-	(19.6)
5	Provision against loan to subsidiary	-	-	-	(17.0)
5	Provision against loan to Joint Venture	-	(1.0)	(1.0)	-
5	Profit/(Loss) on sale of business	-	(7.9)	(7.9)	2.8
	Profit on sale of fixed assets	<u>-</u>	<u>0.1</u>	<u>0.1</u>	<u>9.0</u>
2	Loss on ordinary activities before interest	(28.2)	(15.9)	(44.1)	(67.6)
4	Net interest and similar charges	<u>1.9</u>	<u>-</u>	<u>1.9</u>	<u>2.6</u>
5	Loss on ordinary activities before taxation	(26.3)	(15.9)	(42.2)	(65.0)
6	Taxation credit on ordinary activities	<u>6.6</u>	<u>4.2</u>	<u>10.8</u>	<u>15.9</u>
17	Loss on ordinary activities after taxation transferred to reserves	<u>(19.7)</u>	<u>(11.7)</u>	<u>(31.4)</u>	<u>(49.1)</u>

¹ Exceptional items are analysed in note 5. In 2001 exceptional items amounted to £64.1m

BALANCE SHEET
AS AT 31ST DECEMBER 2002

Notes	2002 £m	2001 £m
Fixed assets		
7 Intangible assets	36.7	19.6
8 Tangible assets	43.3	44.0
9 Investments	131.4	137.9
	<u>211.4</u>	<u>201.5</u>
Current assets		
10 Stocks and contract work in progress	185.2	143.5
11 Debtors – amounts falling due within one year	226.6	287.4
11 Debtors – amounts falling due after one year	125.4	1,021.4
12 Short term deposits	78.5	95.3
Cash at bank and in hand	6.5	14.9
	<u>622.2</u>	<u>1,562.5</u>
13 Creditors: Due within one year	<u>(343.2)</u>	<u>(753.3)</u>
Net current assets	<u>279.0</u>	<u>809.2</u>
Total assets less current liabilities	490.4	1,010.7
14 Creditors: due after more than 1 year	(484.9)	(959.8)
15 Provisions for liabilities and charges	(134.9)	(148.9)
Net liabilities	<u>(129.4)</u>	<u>(98.0)</u>
Capital and reserves		
16 Called up share capital	65.8	65.8
17 Share premium account	24.1	24.1
17 Capital redemption reserve	4.0	4.0
17 Revaluation reserve	6.6	6.6
17 Profit and loss account	(229.9)	(198.5)
Total shareholders' funds	<u>(129.4)</u>	<u>(98.0)</u>

Approved by the Board of Directors on 22 July 2003 and signed on its behalf by:

Director



STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES

For the year ended 31st December 2002

	2002 £m	2001 £m
Profit attributable to the shareholders	(31.4)	(49.1)
Total recognised losses for the year	<u>(31.4)</u>	<u>(49.1)</u>
Prior year adjustment:		
FRS 19 adjustment relating to deferred tax	-	(4.4)
Total recognised losses recognised since last Annual Report	<u>(31.4)</u>	<u>(53.5)</u>

NOTE OF HISTORICAL COST PROFITS AND LOSSES

For the year ended 31st December 2002

	2002 £m	2001 £m
Reported loss on ordinary activities before taxation	(42.2)	(65.0)
Realisation of revalued assets	-	0.4
Historical cost loss on ordinary activities before taxation	<u>(42.2)</u>	<u>(64.6)</u>
Historical cost loss for the year after taxation and dividends	<u>(31.4)</u>	<u>(48.7)</u>

RECONCILIATION OF MOVEMENTS IN SHAREHOLDERS' FUNDS

For the year ended 31st December 2002

	2002 £m	2001 £m
At January 1	(98.0)	(48.9)
Total recognised losses for the year	<u>(31.4)</u>	<u>(49.1)</u>
At December 31	<u>(129.4)</u>	<u>(98.0)</u>

1. ACCOUNTING POLICIES

a) Basis of accounting

The financial statements have been prepared in accordance with applicable accounting standards, on the historical basis of accounting, modified to include the revaluation of certain freehold and leasehold properties as disclosed in note 8 and have been prepared in accordance with applicable accounting standards. Adjustments have been made to comparative figures to put them on a consistent basis with the current year.

The Company is exempt by virtue of section 228 of the Companies Act 1985 from the requirement to prepare group financial statements. These financial statements present information about the Company as an individual undertaking and not about its group.

As permitted by FRS 1, no cash flow statement has been prepared, as a consolidated cash flow statement has been prepared by the ultimate parent Company.

Some small adjustments have been made to comparative figures to put them on a consistent basis with the current year.

b) Turnover

Turnover excluding value added tax and discounts, comprises sales to outside customers. Long-term contracts are included in turnover on the basis of the sales value of work performed during the year by reference to the total sales value and stage of completion of these contracts.

c) Stocks, contract provisions and long-term contracts

Stocks and work in progress are valued at the lower of cost and net realisable value. Full provision is made for any estimated losses to completion of contracts having regard to the overall substance of the arrangements including, if appropriate, related commitments and undertakings given by customers. Provided that the outcome of long-term contracts can be assessed with reasonable certainty, such contracts are valued at cost plus attributable cost plus attributable profit earned to date.

Progress payments received, when greater than recorded turnover, are deducted from the value of work in progress except to the extent payments on account exceed the value of work in progress on any contract where the excess is included in creditors. The amount by which recorded turnover of long term contracts is in excess of payments on account is classified as 'amounts recoverable on contracts' and is separately disclosed within debtors.

d) Depreciation

i) Land and buildings

Depreciation is provided on the original cost of purchases since 1996 and on the valuation of properties adopted at December 31, 1996 and is calculated on the straight line basis at rates sufficient to reduce them to their estimated residual value. Estimated lives, as advised by the Group's professional valuers, are:

- a) Freehold buildings – five to 45 years
- b) Leasehold land and buildings – lower of valuers' estimates or period of lease.

No depreciation is provided in respect of freehold land.

ii) Plant and equipment

Depreciation is provided on the original cost of plant and equipment and is calculated on a straight line basis at rates sufficient to reduce them to their estimated residual value. Estimated lives are in the range of five to 25 years.

e) Accounting for leases

Assets financed by leasing agreements which give rights approximating to ownership (finance leases) have been capitalised at amounts equal to the original cost of the assets to the lessors and depreciation provided on the basis of the Company's depreciation policy. The capital elements of future obligations under finance leases are included as liabilities in the balance sheet and the current year's interest element, having been allocated to accounting periods to give a constant periodic rate of charge on the outstanding balance, is charged to the profit and loss account. The annual payments under all other lease arrangements, known as operating leases, are charged to the profit and loss account on an accruals basis. Rental receivables as lessor under operating leases are included in turnover for the year on an accruals basis.

f) Foreign Currencies

Assets and liabilities denominated in foreign currencies are translated into sterling at the rate ruling at the year-end or, where applicable, at the estimated sterling equivalent, taking account of future foreign exchange and similar contracts. Exchange differences, including those arising from currency conversions in the usual course of trading, are taken into account in determining profit on ordinary activities before taxation.

g) Taxation

Provision for taxation is made at the current rate and for deferred taxation at the projected rate on all timing differences which have originated, but not reversed at the balance sheet date.

h) Research and development

The charge to the profit and loss account consists of research and development expenditure incurred in the year, excluding known recoverable costs on contracts, contributions to shared engineering programmes and application engineering. Application engineering expenditure, incurred in the adaptation of existing technology to new products, is capitalised and amortised over the program life, up to a maximum of ten years, where both the technical and commercial risks are considered to be sufficiently low.

Turnover		Loss before Interest		Net Liabilities ¹	
2002	2001	2002	2001	2002	2001
£m	£m	£m	£m	£m	£m

2. Analysis of turnover, loss and net assets

Analysis of business class

Power Engineering continuing operations	639.4	644.9	(43.0)	(46.5)	(179.1)	(189.2)
General Engineering	2.8	6.2	(1.1)	(21.1)	(19.1)	(12.6)
	<u>642.2</u>	<u>651.1</u>	<u>(44.1)</u>	<u>(67.6)</u>	<u>(198.2)</u>	<u>(201.8)</u>

¹ Net liabilities exclude net cash of £68.8m (2001: £103.8m).

The above profit analysis is after charging exceptional items as follows

	2002	2001
	£m	£m
Power Engineering continuing operations	(15.9)	(64.1)
	<u>(15.9)</u>	<u>(64.1)</u>

Geographical analysis of turnover into specified markets

	2002	2001
	£m	£m
United Kingdom	384.7	446.0
Africa	33.2	19.0
North America	51.0	42.7
Australia and Pacific	1.0	23.8
Middle East	91.5	35.9
Western Europe	38.8	43.4
Other	42.0	40.3
	<u>642.2</u>	<u>651.1</u>

All turnover, loss before interest and net assets originate from the United Kingdom.

	2002 Employees Number	2001 Employees Number
3. Staff numbers and costs		
The average number of employees (including Directors) employed by the Company during the year was:		
United Kingdom	<u>3,474</u>	<u>3,929</u>
Actual number of persons employed at December 31	<u>3,403</u>	<u>3,575</u>
The aggregate payroll costs of these persons were as follows:		
	2002 £m	2001 £m
Wages and salaries	116.0	129.4
Social security costs	10.1	10.5
Other pension credits	(6.7)	(5.6)
	<u>119.4</u>	<u>134.3</u>
	2002 £m	2001 £m
4. Net interest and similar charges		
Interest payable on borrowings wholly repayable within five years	(1.5)	(0.4)
Other interest receivable	1.4	1.4
Interest receivable from parent company	2.0	1.6
	<u>1.9</u>	<u>2.6</u>
5. Loss on ordinary Activities before Taxation		
	2002 £m	2001 £m
Loss on ordinary activities before taxation is arrived at after charging:		
Exceptional items –		
- Write-down of investments in subsidiaries	-	19.6
- Provision against loan to subsidiary company	-	17.0
- Provision against loan to Joint Venture	1.0	-
- Restructuring	7.1	39.3
- Loss/(profit) on disposal of businesses	7.9	(2.8)
- Profit on sale of fixed assets	(0.1)	(9.0)
	<u>15.9</u>	<u>64.1</u>
Depreciation of owned tangible fixed assets	2.4	6.0
Hire of machinery and equipment (operating leases)	1.2	1.1
Hire of other assets (operating leases)	0.5	0.5
Auditors remuneration	0.4	0.3

ROLLS-ROYCE POWER ENGINEERING plc

Notes to the accounts continued

	2002 £m	2001 £m
6. Taxation on loss on ordinary activities		
In respect of the year:		
Group relief receivable at 30% (2001:30%) on loss for the period	17.1	15.2
Adjustment in respect of previous period	(2.4)	4.3
Overseas tax	(0.8)	-
Total current tax	13.9	19.5
Deferred tax – origination and reversal of timing differences	(3.1)	(3.6)
Total tax credit	10.8	15.9
Reconciliation of tax charge		
Loss on ordinary activities before tax	42.2	65.0
Nominal credit at UK Corporation tax rate of 30% (2001: 30%)	12.7	19.5
Expenses not deductible for tax purposes	(1.2)	(7.6)
Overseas tax for which no relief	(0.8)	-
Capital allowances for period in excess of depreciation	0.6	-
Other timing differences for period	5.0	3.3
Adjustments in respect of prior years	(2.4)	4.3
Total current tax	13.9	19.5
7. Intangible fixed assets	Application ¹ Engineering £m	
Cost		
At January 1, 2002	19.6	
Additions		
At December 31, 2002	17.1	
Accumulated amortisation		
At December 31, 2001 and 2002	-	
Net Book value at December 31, 2002	36.7	
Net Book value at December 31, 2001	19.6	

¹ See Accounting policy on Research and Development, page 14.

8. Tangible fixed assets

	<u>Land and Buildings</u>		Plant and Machinery	Total
	Freehold £m	Short Leasehold £m	£m	£m
Cost or valuation				
At January 1, 2002	12.9	1.6	71.7	86.2
Additions	-	-	4.6	4.6
On disposal of businesses	-	(0.2)	(1.1)	(1.3)
Other disposals	(0.1)	-	(5.6)	(5.7)
At December 31, 2002	<u>12.8</u>	<u>1.4</u>	<u>69.6</u>	<u>83.8</u>
Depreciation				
At January 1, 2002	2.0	0.2	40.0	42.2
Charge for year	0.2	0.1	2.1	2.4
On disposal of businesses	-	(0.1)	(0.9)	(1.0)
Other disposals	-	-	(3.1)	(3.1)
At December 31, 2002	<u>2.2</u>	<u>0.2</u>	<u>38.1</u>	<u>40.5</u>
Net Book Value at December 31, 2002	<u>10.6</u>	<u>1.2</u>	<u>31.5</u>	<u>43.3</u>
Net Book Value at December 31, 2001	<u>10.9</u>	<u>1.4</u>	<u>31.7</u>	<u>44.0</u>
Anticipated useful lives	5-45 years	period of leases	3-25 years	

	2002 £m	2001 £m
Net book value of assets not being depreciated	<u>3.0</u>	<u>2.7</u>

	2002		2001	
	Freehold £m	Short leasehold £m	Freehold £m	Short leasehold £m
Land and Buildings at cost or valuation comprise:				
Cost	6.2	1.4	6.5	1.4
Valuation at December 31, 1996	6.6	-	6.6	-
	<u>12.8</u>	<u>1.4</u>	<u>13.1</u>	<u>1.4</u>

Tangible fixed assets continued

On an historical basis the net book value of land and buildings would have been as follows:

	2002	2001
	£m	£m
Cost	7.6	10.1
Depreciation	(2.4)	(4.4)
	<u>5.2</u>	<u>5.7</u>

The Company has adopted FRS 15 'Tangible fixed assets' and has followed the transitional provisions to retain the book value of land and buildings, certain of which were revalued in 1996 (see below).

Properties were revalued as follows:

- i) Specialised properties, including certain of the Company's major manufacturing sites were revalued on a depreciated replacement cost basis;
- ii) Non-specialised properties were revalued by reference to their existing use value; and
- iii) Properties surplus to the Company's requirements were revalued on an open market basis.

The revaluation was carried out by Storey Sons & Parker, Chartered Surveyors, in accordance with the appraisal and valuation manual of the Royal Institution of Chartered Surveyors.

9. Fixed Asset Investments

	Shares in Subsidiary Under-taking £m	Other Investments £m	Total £m
Cost less amounts written off at January 1, 2002	137.8	0.1	137.9
Investment repaid	(6.5)	-	(6.5)
Cost less amounts written off at December 31, 2002	<u>131.3</u>	<u>0.1</u>	<u>131.4</u>

10. Stocks and contract work in progress

	2002 £m	2001 £m
Long term contract work in progress	40.5	33.1
Other work in progress	<u>59.3</u>	<u>53.5</u>
	99.8	86.6
Finished goods and goods for resale	68.7	52.5
Raw materials and consumables	1.9	2.6
Payments on account	<u>43.4</u>	<u>28.9</u>
	213.8	170.6
Progress payments received against: Long term contracts work in progress	<u>(28.6)</u>	<u>(27.1)</u>
	<u>185.2</u>	<u>143.5</u>

11. Debtors

	2002 £m	2001 £m
Amounts falling due within one year -		
Trade debtors	88.5	78.4
Amounts recoverable on contracts	50.2	59.1
Amounts owed by parent company and fellow subsidiary undertakings	49.4	46.8
Group relief receivable	15.0	17.5
Other debtors	19.8	73.3
Prepayments and accrued income	<u>3.7</u>	<u>12.3</u>
	226.6	287.4
Amounts falling due after more than one year -		
Trade debtors	0.2	0.7
Amounts owed by parent company and fellow subsidiaries	4.0	897.3
Pension prepayment	120.3	108.7
Other debtors	<u>0.9</u>	<u>14.7</u>
	125.4	1,021.4
	<u>352.0</u>	<u>1,308.8</u>

12. Short term deposits	2002	2001
	£m	£m
Amounts due from parent company and fellow subsidiaries	<u>78.5</u>	<u>95.3</u>

13. Creditors: amounts falling due within one year

	2002	2001
	£m	£m
Bank loans and overdrafts	<u>16.2</u>	<u>6.4</u>
Payments on account in excess of work in progress	64.2	76.3
Trade creditors	90.7	103.4
Amounts owed to parent company and fellow subsidiaries	111.1	493.3
Corporate taxation	0.5	0.5
Other taxation and social security	6.0	8.4
Other creditors	26.6	38.0
Accruals and deferred income	<u>27.9</u>	<u>27.0</u>
	<u>327.0</u>	<u>746.9</u>
	<u>343.2</u>	<u>753.3</u>

14. Creditors: amounts falling due after more than one year

	2002	2001
	£m	£m
Amounts owed to parent company and subsidiaries	484.1	958.6
Accruals and deferred income	0.2	1.2
Other creditors	<u>0.6</u>	<u>-</u>
	<u>484.9</u>	<u>959.8</u>

15. Provisions for liabilities and charges

	Balance at January 1, 2002 £m	Charged / (Released) to profit and loss account £m	Utilised £m	Balance at December 31, 2002 £m
Deferred taxation	17.4	3.1	-	20.5
Pensions and post retirement benefits	3.5	0.2	-	3.7
Discontinued operations	0.9	3.0	-	3.9
Warranty Guarantees	19.7	2.4	(3.6)	18.5
Contract loss	87.7	31.6	(50.2)	69.1
Restructuring	2.3	(0.8)	(1.3)	0.2
Rationalisation	15.5	7.1	(10.5)	12.1
Other	1.9	5.4	(0.4)	6.9
	<u>148.9</u>	<u>52.0</u>	<u>(66.0)</u>	<u>134.9</u>

The analysis of the deferred tax provision is as follows:

	2002 £m	2001 £m
Accelerated capital allowances	5.7	5.3
Other timing differences	34.1	31.4
Advance Corporation tax	<u>(19.3)</u>	<u>(19.3)</u>
	<u>20.5</u>	<u>17.4</u>

Pensions and other post-retirement provisions are long term in nature and the timing of their utilisation is uncertain. Provisions for discontinued operations, contract loss, restructuring and rationalisation are generally expected to be utilised within one year. Warranty provisions relate to products sold and generally cover a period of up to three years. Other provisions comprise numerous liabilities with varying expected utilisation rates.

16. Share capital

2002
£m

2001
£m

Authorised -

Equity -

332 million (2001: 332 million) ordinary shares
of 25p per share

83.0

83.0

Allotted, issued and fully paid -

Equity -

263,382,058 (2001: 263,382,058) ordinary
shares of 25p per share

65.8

65.8

17. Reserves

	Equity Share Capital £m	Share Premium £m	Capital redemption reserve £m	Revaluation reserve £m	Profit and loss account £m	Total £m
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Balance at January 1, 2002	65.8	24.1	4.0	6.6	(198.5)	(98.0)
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Loss retained for the financial year	-	-	-	-	(31.4)	(31.4)
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Balance at December 31, 2002	65.8	24.1	4.0	6.6	(229.9)	(129.4)
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18. Pensions

The Company's pension schemes are mainly of the defined benefit type and the assets of the schemes are held in separate trustee administered funds.

The pension cost relating to the UK schemes is assessed in accordance with the advice of independent qualified actuaries using the projected unit method. The latest actuarial valuations of the principal scheme was as at April 5, 2001 for the Rolls-Royce Group Pension Scheme. The principal assumptions used were that in the long term the average return on investments would be between 2.0% and 2.25% per annum higher than the average increase in pay and between 3.5% and 4.0% per annum higher than the average increase in pensions.

Assets were valued on a market related basis.

The aggregate of the market values of the UK schemes at the dates of the latest actuarial valuations was £967.7m. The actuarial value of the assets of the principal scheme represented 126% of the value of the projected accrued liabilities.

The difference between the value of the assets and the value of the projected accrued liabilities (after allowing for expected future increases in earnings and discretionary pension increases) is being amortised over 12 years, being the average expected remaining service lives of the pensionable employees.

A provision of £3.7m (2001 - £3.5m) and a debtor of £120.3m (2001 - £108.7m) are included in the balance sheet, being the difference between the accumulated amounts paid into the pension funds and the accumulated pension costs.

FRS 17 disclosures

The full implementation of FRS 17 'Retirement Benefits' has been deferred, however certain disclosures are required which are included below.

The valuations with respect to UK schemes have been based on the most recent actuarial valuations (as noted above) and updated by the scheme actuary to December 31, 2002 taking account of the requirements of FRS 17.

The principal assumptions were as follows:

	UK Schemes
	%
Rate of increase in salaries	3.8
Rate of increase of pensions in payment and deferment	2.0
Discount rate	5.5
Inflation assumption	2.3

The assets in the schemes and the expected rate of return at December 31, 2002 were as follows:

	Expected long-term Rate of return %	Market Value £m
Equities	8.0	399
Sovereign debt	4.4	192
Corporate bonds	5.0	99
Other	4.3	9
Total market value of assets		699
Present value of scheme liabilities		(768)
Deficit in the scheme		(69)
Related deferred tax asset		21
Net pension liability		(48)

Amounts charged to profit and loss account

	£m
Operating profit	
Current service charge	6.6
Finance income	
Expected return on pension scheme assets	(60.0)
Interest on pension scheme liabilities	42.9
	(17.1)
Total (credit)	(10.5)

Movement in scheme deficits during the year

	£m
At January 1, 2002	110.8
Current service cost	(6.6)
Contributions	-
Finance income	17.1
Actuarial loss	(189.8)
At December 31, 2002	(68.5)

History of experience gains and losses and amount recognised in statement of total recognised gains and losses

	£m
Difference between the expected and actual return on scheme assets	
Amount	(163.3)
Percentage of scheme costs	(23%)
Experience gains and losses on scheme liabilities	
Amount	6.0
Percentage of the present value of scheme liabilities	1%
Effect of changes in assumptions underlying the present value of scheme liabilities	
Amount	(32.5)
Percentage of the present value of scheme liabilities	(4%)
Total amount recognised in the statement of total recognised gains and losses	
Amount	(189.8)
Percentage of the present value of scheme liabilities	(25%)

Net assets

If the above net pensions liabilities had been recognised in the financial statements, the net assets and profit and loss reserve would be as follows:

	2002 £m	2001 £m
Net liabilities per balance sheet	(129.4)	(98.0)
Net pension (liability)	(48.0)	(77.5)
Pension prepayment ¹	(84.2)	(76.1)
Provisions for pensions and other post retirement benefits ²	2.6	-
Total FRS 17 pension adjustment	(129.6)	(153.6)
Net liabilities under FRS 17	(259.0)	(251.6)

¹Pension prepayment currently recorded: £120.3m (2001 £108.7m) less related deferred tax liability of £36.1m (2001 £32.6m)

²Provisions currently recorded £3.7m (2001 £nil) less related deferred tax asset of £1.1m (2001 £nil)

Profit and loss reserve

	2002 £m	2001 £m
Profit and loss reserve	(229.9)	(198.5)
Total FRS 17 pension adjustment	(129.6)	(154.8)
Profit and loss reserve under FRS 17	(359.5)	(353.3)

19. Contingent liabilities

The Company has in the normal course of business, entered into guarantees in respect of export finance, bills discounted, performance bonds etc.

There are claims outstanding, which arise under contracts carried out by the Company. It is not possible to predict with certainty the results of these claims but the Directors believe, in the light of advice received and taking into account counter claims, claims against third parties and provisions in the accounts, that the outcome will not have a material affect on the Company's financial position.

20. Directors Emoluments

The Directors in respect of their services to the Company have received no remuneration.

Details of Directors' share interests are disclosed in the Directors' Report.

21. Commitments under operating leases

At 31st December, future annual commitments under non-cancellable operating leases were as follows:

	2002 £m	2001 £m
Land and buildings – leases expiring:		
Within one year	0.2	-
In two to five years	0.7	-
Other operating leases – leases expiring:		
within one year	0.3	-
in two to five years	0.4	0.8
	<u>1.6</u>	<u>0.8</u>

The majority of leases of land and buildings are subject to rent reviews

22. Capital commitments

	2002 £m	2001 £m
Outstanding contracts for capital expenditure	0.2	1.1

23. Related Party Transactions

The Company has taken advantage of the exemption in FRS 8 not to disclose related party transactions with its parent company Rolls-Royce plc and other group companies

24. Ultimate Holding Company

The Company's ultimate holding company and controlling party as defined by FRS 8 is Rolls-Royce plc, a company which is registered in England and Wales.

Copies of Rolls-Royce plc's Directors' Report and Financial Statements can be obtained from Rolls-Royce plc, PO Box 31 Moor Lane, Derby, DE24 8BJ.

Under Financial Report Standard 8 the Company is exempt from the requirement to disclose related party transactions with the Rolls-Royce Group and its associates on the grounds that it is a wholly owned subsidiary undertaking of Rolls-Royce plc.

PRINCIPAL SUBSIDIARY UNDERTAKINGS

The following were the principal subsidiary undertakings of Rolls-Royce Power Engineering plc during the year ended 31st December 2002. Effective group interest is 100% unless otherwise stated.

The principal wholly owned UK subsidiary undertakings trade as agents of the Company.

		Country of Incorporation And / or Operation (if not UK)
UK	Allen Gears Limited Allen Power Engineering Limited Clayton Equipment Limited Derby Specialist Fabrications Limited Heaton Power Limited NEI Overseas Holdings Limited Precision Machined Products Limited R-R Industrial Controls Limited Rolls-Royce Nuclear Engineering Services Limited Rolls-Royce Industrial Power (India) Limited + Rolls-Royce Industrial Power (Overseas Projects) Limited Rolls-Royce Industrial Power Engineering (Overseas Projects) Limited Variable Message Signs Limited	
Overseas*	Rolls-Royce Industrial Power (Malaysia) Ltd Rolls-Royce Industrial Power (Hong Kong) Ltd	Malaysia Hong Kong

* The shares in overseas subsidiary undertakings and joint ventures are held by subsidiary undertakings.

+ Financial year ends 31st March