

ROLLS-ROYCE POWER ENGINEERING plc

ANNUAL REPORT

AND

FINANCIAL STATEMENTS 2001

COMPANY REGISTRATION NO: 1305027



ROLLS-ROYCE POWER ENGINEERING plc

DIRECTORS AND OFFICERS

| | |
|------------------|---|
| Directors | D R Bale J B Gaskell (resigned on 31 January 2002) J D Harvey P Heiden J Kempster (resigned on 31 December 2001) S Lanyado J Warren |
|------------------|---|

| | |
|------------------|----------|
| Secretary | J Warren |
|------------------|----------|

| | |
|--------------------------|---|
| Registered office | Moor Lane Derby DE24 8BJ Company registered in England, number 1305027 |
|--------------------------|---|

| | |
|-----------------|--|
| Auditors | KPMG Audit Plc 8 Salisbury Square London EC4Y 8BB |
|-----------------|--|

ROLLS-ROYCE POWER ENGINEERING plc

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REPORT OF THE DIRECTORS

The directors present their annual report and the audited financial statements for the year ended 31 December 2001.

PRINCIPAL ACTIVITIES

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

During the year ended December 31, 2001 the Company achieved a turnover of £651.1m (2000: £589.9m) and a loss on ordinary activities before taxation and after exceptional costs of £65.0m (2000: a loss of £162.2m).

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 (2000: Nil). No final ordinary dividend is recommended (2000: 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.

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

A particularly strong emphasis has been placed on effective employee communications and there are various forms of employee communication programmes across the Group, each adapted to the particular needs of individual businesses.

The Group consults with employees and their elected representatives on a wide range of topics relating to its overall business objectives. Management and employee representatives hold regular meetings at every location to discuss opportunities and issues of common interest.

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

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.

DIRECTORS

The directors of the Company who held office during 2001 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 2001, including immediate family, in the ordinary share capital of Rolls-Royce plc are as follows:

Rolls-Royce plc Ordinary 20p Shares

| | 1.1.01 (or date of appointment) | 31.12.01 |
|----------|---------------------------------|----------|
| D R Bale | 4,458 | 9,156* |
| | | |
| | | |
| | | |
| | | |
| | 4,458 | 9,156* |

Options over Rolls-Royce plc Ordinary Shares

| 1.1.01 (or date of appointment) | 31.12.01 | Exercise price (p) | Exercisable Dates |
|---------------------------------|----------|--------------------|-------------------|
| 44,500 | 44,500 | 176 | 2001-2005 |
| 1,380 | | 150 | 2001 |
| 15,444 | 15,444 | 194.25 | 2003-2010 |
| 11,584 | 11,584 | 194.25 | 2003-2010 |
| | 27,778 | 216 | 2004-2011 |
| | 879 | 108 | 2005 |
| 72,908 | 100,185 | | |

| | | |
|-------------|---|---------|
| J B Gaskell | | 66,653* |
| | | |
| | | |
| | - | 66,653* |

| | | | |
|---------|---------|-----|-----------|
| 153,375 | 153,375 | 163 | 2003-2010 |
| | 126,840 | 216 | 2004-2011 |
| | 507,358 | 216 | 2004-2011 |
| 153,375 | 787,573 | | |

| | 1.1.01(or date of appointment) | 31.12.01 | 1.1.01 (or date of appointment) | 31.12.01 | Exercise price (p) | Exercisable Dates |
|------------|--------------------------------|----------|---------------------------------|----------|--------------------|-------------------|
| J D Harvey | 28,285 | 16,292* | 20,000 | 20,000 | 176 | 2000-2005 |
| | | | 5,721 | 5,721 | 205 | 2003 |
| | | | 1,358 | 1,358 | 194 | 2003 |
| | | | 15,444 | 15,444 | 194.25 | 2003-2010 |
| | - | - | 33,977 | 33,977 | 194.25 | 2003-2010 |
| | | | | 48,149 | 216 | 2004-2011 |
| | | | | 1,407 | 108 | 2005 |
| | 28,285 | 16,292* | 76,500 | 126,056 | | |

| | | | | | | |
|------------|---|---|--------|--------|-----------|-----------|
| J Kempster | - | - | 4,254 | 4,254 | 194 | 2003 |
| | | | 21,687 | 21,687 | LTIP 2000 | |
| | | | 15,444 | 15,444 | 194.25 | 2003-2010 |
| | - | - | 57,658 | 57,658 | 194.25 | 2003-2010 |
| | - | - | 99,043 | 99,043 | | |

| | | | | | | |
|-----------|---|---------|---|---------|-----|-----------|
| S Lanyado | - | 37,213* | - | 13,888 | 216 | 2004-2011 |
| | | | - | 125,001 | 216 | 2004-2011 |
| | | | - | 555,556 | 216 | 2004-2011 |
| | | | - | 4,398 | 108 | 2005 |
| | - | 37,213* | - | 698,843 | | |

| | | | | | | |
|----------|---|---|--------|--------|--------|-----------|
| J Warren | - | - | 15,444 | 15,444 | 194.25 | 2003-2010 |
| | | | - | 19,098 | 216 | 2004-2011 |
| | | | 6,900 | - | 150 | 2001 |
| | | | 2,255 | 2,255 | 205 | 2003 |
| | | | - | 5,639 | 108 | 2007 |
| | - | - | 24,599 | 42,436 | | |

The share options for Mr J Kempster include awards made under a Long Term Incentive Plan, which is conditional upon performance criteria.

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

| | Annual Performance Related Award Scheme ¹ | | Profit Sharing Share Scheme ² | |
|-------------|--|------------|--|------------|
| | 1.1.2001 | 31.12.2001 | 1.1.2001 | 31.12.2001 |
| D R Bale | 2,808 | 5,045 | 900 | 1,981 |
| J B Gaskell | - | 3,192 | - | - |
| J D Harvey | 3,530 | 9,532 | 823 | 1,760 |
| J Kempster | 5,696 | 6,491 | 1218 | 2497 |
| S Lanyado | - | 4,141 | - | 572 |
| J Warren | 803 | 2,341 | - | - |

¹ Under the Annual Performance Related Award Scheme, shares vest after two years.

² Under the Profit Sharing Share Scheme, shares vest after three years.

Mr P Heiden is a member of the Rolls-Royce plc Board of Directors and his Director's interests and emoluments are disclosed in that Company's Annual Report and Financial Statements.

The market price of the ordinary shares of the Company's ultimate parent company, Rolls-Royce plc at December 31, 2001, was 166.5p and the range during 2001 was 121p to 250p.

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 2001 was £22.8m (2000: £24.0m).

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, 2001 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 for the re-appointment of KPMG Audit Plc as auditors of the Company is to be proposed at the forthcoming Annual General Meeting.

By order of the Board



J Warren
Secretary

11th July 2002.

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:

- Select suitable accounting policies and then apply them consistently;
- Make judgements and estimates that are reasonable and prudent;
- State whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements;
- 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 are also responsible 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.

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

We have audited the financial statements on pages 9 to 24.

RESPECTIVE RESPONSIBILITIES OF DIRECTORS AND AUDITORS

The directors are responsible for preparing the directors' 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 are properly prepared in accordance with the Companies Act. 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 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 affairs of the company as at 31 December 2001 and of the loss of the company 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

30th July, 2002

ROLLS-ROYCE POWER ENGINEERING PLC
Profit and Loss Account
For the year ended 31st December 2001

| | | Continuing operations before exceptional items | Exception al items ¹ | Total 2001 £m | Restated 2000 £m |
|-------|--|--|------------------------------------|---------------------|------------------------|
| | | £m | £m | | |
| Notes | | | | | |
| 2 | Turnover | 651.1 | - | 651.1 | 589.9 |
| | Cost of sales | (573.1) | (39.3) | (612.4) | (676.5) |
| | Gross profit /(loss) | 78.0 | (39.3) | 38.7 | (86.6) |
| | Commercial, marketing and product support costs | (41.6) | - | (41.6) | (37.6) |
| | General & administrative costs | (17.1) | - | (17.1) | (4.5) |
| | Research & development (net) | (22.8) | - | (22.8) | (24.0) |
| | | (3.5) | (39.3) | (42.8) | (152.7) |
| 5 | Write-down of investments in subsidiaries | | (19.6) | (19.6) | |
| 5 | Provision against loan to subsidiary | - | (17.0) | (17.0) | - |
| 5 | Profit /(Loss) on sale of business | - | 2.8 | 2.8 | (16.9) |
| | Profit on sale of fixed assets | - | 9.0 | 9.0 | 1.3 |
| | Loss on ordinary activities | | | | |
| 2 | before interest | (3.5) | (64.1) | (67.6) | (168.3) |
| 4 | Net Interest and similar charges | 2.6 | - | 2.6 | 6.1 |
| | Loss on ordinary activities | | | | |
| 5 | before taxation | (0.9) | (64.1) | (65.0) | (162.2) |
| | Taxation credit/(charge) on ordinary activities | 2.5 | 13.4 | 15.9 | 48.7 |
| | Loss on ordinary activities | 1.6 | (50.7) | (49.1) | (113.5) |
| 17 | after taxation transferred to reserves | | | | |

¹ Exceptional item's are analysed in note 5.

Throughout these financial statements the 2000 comparatives have been restated to reflect FRS 19 "Deferred Tax" (see note 18).

ROLLS-ROYCE POWER ENGINEERING PLC

Balance sheet as at 31st December 2001

| Notes | 2001 £m | Restated 2000 £m |
|--|----------------|------------------------|
| Fixed assets | | |
| 7 Intangible assets | 19.6 | - |
| 8 Tangible assets | 44.0 | 43.4 |
| 9 Investments | 137.9 | 156.9 |
| At January 1, 2001 | <u>201.5</u> | <u>200.3</u> |
| Current assets | | |
| 10 Stocks and contract work in progress | 143.5 | 140.9 |
| 11 Debtors - amounts falling due within one year | 287.4 | 314.2 |
| 11 Debtors - amounts falling due after one year | 1,021.4 | 320.7 |
| 12 Short term deposits | 95.3 | 88.8 |
| Cash at bank and in hand | 14.9 | 3.7 |
| | <u>1,562.5</u> | <u>868.3</u> |
| 13 Creditors: Due within one year | <u>(753.3)</u> | <u>(283.9)</u> |
| Net current assets | 809.2 | 584.4 |
| Total assets less current liabilities | 1,010.7 | 784.7 |
| 14 Creditors: due after more than 1 year | (959.8) | (663.6) |
| 15 Provisions for liabilities and charges | <u>(148.9)</u> | <u>(170.0)</u> |
| Net liabilities | <u>(98.0)</u> | <u>(48.9)</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 | 7.0 |
| 17 Profit and loss account | (198.5) | (149.8) |
| Total shareholders' funds | <u>(98.0)</u> | <u>(48.9)</u> |

Approved by the Board of Directors on July 11th, 2002 and signed on its behalf by:



P Heiden
Finance Director

ROLLS-ROYCE POWER ENGINEERING PLC

STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES

For the year ended 31st December 2001

| | 2001 £m | Restated 2000 £m |
|---|---------------|------------------------|
| Profit attributable to the shareholders | (49.1) | (113.5) |
| Total recognised losses for the year | <u>(49.1)</u> | <u>(113.5)</u> |
| Prior year adjustment: | | |
| FRS 19 adjustment relating to deferred tax | (4.4) | |
| Total recognised losses recognised since last Annual Report | <u>(53.5)</u> | |

NOTE OF HISTORICAL COST PROFITS AND LOSSES

For the year ended 31st December 2001

| | 2001 £m | Restated 2000 £m |
|--|---------------|------------------------|
| Reported loss on ordinary activities before taxation | (65.0) | (162.2) |
| Realisation of revalued assets | 0.4 | (0.2) |
| Historical cost loss on ordinary activities before taxation | <u>(64.6)</u> | <u>(162.4)</u> |
| Historical cost loss for the year after taxation and dividends | <u>(48.7)</u> | <u>(113.7)</u> |

RECONCILIATION OF MOVEMENTS IN SHAREHOLDERS' FUNDS

For the year ended 31st December 2001

| | 2001 £m | Restated 2000 £m |
|--------------------------------------|---------------|------------------------|
| At January 1 | (48.9) | 67.5 |
| Total recognised losses for the year | (49.1) | (113.5) |
| Prior year adjustment ¹ | - | (2.9) |
| At December 31 | <u>(98.0)</u> | <u>(48.9)</u> |

¹ Adjustment resulting from the adoption of FRS 19 "Deferred Tax" (see Accounting policies page 14).

ROLLS-ROYCE POWER ENGINEERING PLC

Notes to the accounts

1. Accounting Policies

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.

Turnover

Turnover consists of amounts invoiced to external customers, net of value added taxes, in respect of deliveries made, or work completed, during the year. In the case of long-term contracts, turnover is based on the sales value of work performed during the year by reference to the total sales value and stage of completion of these contracts.

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 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.

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 three to 25 years.

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 depreciation policy set out above. The capital elements of future obligations under finance leases are included as liabilities in the balance sheet and the current year's interest element 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.

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.

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.

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 share 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.

ROLLS-ROYCE POWER ENGINEERING PLC

Notes to the accounts continued

| | Turnover | | Loss before Interest | | Net Liabilities ¹ | |
|--|--------------|--------------|----------------------|----------------|------------------------------|----------------|
| | 2001 | 2000 | 2001 | 2000 | 2001 | 2000 |
| | £m | £m | £m | £m | £m | £m |
| 2 Analysis of turnover, loss and net assets | | | | | | |
| Analysis of business class | | | | | | |
| Power Engineering continuing operations | 644.9 | 554.4 | (46.5) | (152.8) | (189.2) | (138.0) |
| General Engineering | 6.2 | 35.5 | (21.1) | (15.5) | (12.6) | (3.4) |
| | <u>651.1</u> | <u>589.9</u> | <u>(67.6)</u> | <u>(168.3)</u> | <u>(201.8)</u> | <u>(141.4)</u> |

¹ Net liabilities exclude net cash of £103.8m (2000: £92.5m).

The above profit analysis is after charging exceptional items as follows:

| | | |
|---|---------------|----------------|
| Power Engineering continuing operations | (64.1) | (133.8) |
| General Engineering | - | (15.3) |
| | <u>(64.1)</u> | <u>(149.1)</u> |

Geographical analysis of turnover into specified markets

| | 2001 | 2000 |
|-----------------------|--------------|--------------|
| | £m | £m |
| United Kingdom | 446.0 | 434.4 |
| Africa | 19.0 | 5.4 |
| North America | 42.7 | 41.7 |
| Australia and Pacific | 23.8 | 23.6 |
| Middle East | 35.9 | 38.8 |
| Western Europe | 43.4 | 32.4 |
| Other | 40.3 | 13.6 |
| | <u>651.1</u> | <u>589.9</u> |

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

ROLLS-ROYCE POWER ENGINEERING PLC

Notes to the accounts continued

| | 2001 Employees Number | 2000 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>3,929</u> | <u>4,636</u> |
| Actual number of persons employed at December 31 | <u>3,575</u> | <u>3,960</u> |
| The aggregate payroll costs of these persons were as follows: | | Restated |
| | 2001 £m | 2000 £m |
| Wages and salaries | 129.4 | 131.1 |
| Social security costs | 10.5 | 11.6 |
| Other pension credits (Note 19) | (5.6) | (6.0) |
| | <u>134.3</u> | <u>136.7</u> |
| 4 Net interest and similar charges | | Restated |
| | 2001 £m | 2000 £m |
| Interest payable on borrowings wholly repayable within five years | (0.4) | (0.3) |
| Other interest receivable | 1.4 | 0.2 |
| Interest receivable from parent company | 1.6 | 6.2 |
| | <u>2.6</u> | <u>6.1</u> |
| 5 Loss on ordinary Activities before Taxation | | Restated |
| | 2001 £m | 2000 £m |
| Loss on ordinary activities before taxation is arrived at after charging: | | |
| Exceptional items - industrial Trent provision | - | 120.0 |
| - Write-down of investments in subsidiaries | 19.6 | - |
| - Provision against loan to subsidiary company | 17.0 | - |
| - Ansty/Montreal restructuring | 39.3 | - |
| - (profit)/loss on disposal of businesses | (2.8) | 16.9 |
| - closure of diesel manufacturing site | - | 12.2 |
| Depreciation of owned tangible fixed assets | 6.0 | 5.3 |
| Hire of machinery and equipment (operating leases) | 1.1 | 0.5 |
| Hire of other assets (operating leases) | 0.5 | 0.4 |
| Auditors remuneration | 0.3 | 0.2 |
| Other consultancy fees paid | 0.5 | - |
| 6 Taxation on loss on ordinary activities | | Restated |
| | 2001 £m | 2000 £m |
| In respect of the year: | | |
| Group relief receivable at 30% (2000: 30%) on loss for the period | 15.2 | 51.6 |
| Adjustment in respect of previous period | 4.3 | 1.1 |
| Overseas tax | - | (0.5) |
| Total current tax | <u>19.5</u> | <u>52.2</u> |
| Deferred tax - origination and reversal of timing differences | (3.6) | (3.5) |
| Total tax credit | <u>15.9</u> | <u>48.7</u> |
| Reconciliation of tax charge | | |
| Loss on ordinary activities before tax | <u>65.0</u> | <u>162.2</u> |
| Nominal credit at UK Corporation tax rate of 30% (2000: 30%) | 19.5 | 48.7 |
| Expenses not deductible for tax purposes | (7.6) | (1.0) |
| Overseas tax for which no relief | - | (0.5) |
| Capital allowances for period in excess of depreciation | - | (0.3) |
| Other timing differences for period | 3.3 | 4.1 |
| Adjustments in respect of prior years | 4.3 | 1.2 |
| Total current tax | <u>19.5</u> | <u>52.2</u> |

ROLLS-ROYCE POWER ENGINEERING PLC
Notes to the accounts continued

7 Intangible fixed assets

| | Application Engineering ¹ £m |
|--|---|
| Cost | |
| At January 1, 2001 | - |
| Additions | <u>19.6</u> |
| At December 31, 2001 | <u>19.6</u> |
| Accumulated amortisation | |
| At December 31, 2001 | <u>-</u> |
| Net Book value at December 31, 2001 | <u>19.6</u> |
| Net Book Value at December 31, 2000 | <u>-</u> |

¹ See Accounting policies page 14.

8 Tangible fixed assets

Land and Buildings

| | Freehold £m | Short Leasehold £m | Plant and Machinery £m | Total £m |
|--|----------------|--------------------------|------------------------------|-------------|
| Cost or valuation | | | | |
| At January 1, 2001 | 16.6 | 1.1 | 68.9 | 86.6 |
| Additions | 0.2 | 0.5 | 11.1 | 11.8 |
| Other disposals | (3.9) | - | (8.3) | (12.2) |
| At December 31, 2001 | <u>12.9</u> | <u>1.6</u> | <u>71.7</u> | <u>86.2</u> |
| Depreciation | | | | |
| At January 1, 2001 | 2.8 | 0.1 | 40.3 | 43.2 |
| Charge for year | 0.3 | 0.1 | 5.6 | 6.0 |
| Other disposals | (1.1) | - | (5.9) | (7.0) |
| At December 31, 2001 | <u>2.0</u> | <u>0.2</u> | <u>40.0</u> | <u>42.2</u> |
| Net Book Value at December 31, 2001 | <u>10.9</u> | <u>1.4</u> | <u>31.7</u> | <u>44.0</u> |
| Net Book Value at December 31, 2000 | <u>13.8</u> | <u>1.0</u> | <u>28.6</u> | <u>43.4</u> |
| Anticipated useful lives | 5-45 years | period of leases | 3 - 25 years | |

| Tangible fixed assets continued | 2001 | Restated |
|--|--------------|--------------|
| | £m | £m |
| Net book value of assets not being depreciated | <u>2.7</u> | <u>1.5</u> |
| Land and Buildings at cost or valuation comprise: | | |
| Cost | 7.9 | 7.6 |
| Valuation at December 31, 1996 | <u>6.6</u> | <u>10.1</u> |
| | <u>14.5</u> | <u>17.7</u> |
| On an historical basis the net book value of land and buildings would have been as | | |
| Cost | 10.1 | 13.6 |
| Depreciation | <u>(4.4)</u> | <u>(5.8)</u> |
| | <u>5.7</u> | <u>7.8</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.

ROLLS-ROYCE POWER ENGINEERING PLC
Notes to the accounts continued

9 Fixed Asset investments

| | Shares in Subsidiary Undertakings £m | Loans to Subsidiary Undertakings £m | Other Investments £m | Total £m |
|---|---|--|----------------------------|--------------|
| Cost less amounts written off at January 1, 2001 | 156.7 | - | 0.2 | 156.9 |
| Write-down in year | (19.6) | - | - | (19.6) |
| Disposals | 0.7 | - | (0.1) | 0.6 |
| Cost less amounts written off at December 31, 2001 | <u>137.8</u> | <u>-</u> | <u>0.1</u> | <u>137.9</u> |

10 Stocks and contract work in progress

| | 2001 £m | Restated 2000 £m |
|---|---------------|------------------------|
| Long term contract work in progress | 33.1 | 28.5 |
| Other work in progress | <u>53.5</u> | <u>57.4</u> |
| | 86.6 | 85.9 |
| Finished goods and goods for resale | 52.5 | 36.2 |
| Raw materials and consumables | 2.6 | 10.0 |
| Payments on account | <u>28.9</u> | <u>22.4</u> |
| | 170.6 | 154.5 |
| Progress payments received against: Long term contracts work in progress | <u>(27.1)</u> | <u>(13.6)</u> |
| | <u>143.5</u> | <u>140.9</u> |

11 Debtors

| | 2001 £m | Restated 2000 £m |
|--|----------------|------------------------|
| Amounts falling due within one year - | | |
| Trade debtors | 78.4 | 104.6 |
| Amounts recoverable on contracts | 59.1 | 66.2 |
| Amounts owed by parent company and fellow subsidiary undertakings | 46.8 | 63.6 |
| Group relief receivable | 17.5 | 51.6 |
| Other debtors | 73.3 | 16.8 |
| Prepayments and accrued income | <u>12.3</u> | <u>11.4</u> |
| | <u>287.4</u> | <u>314.2</u> |
| Amounts falling due after more than one year - | | |
| Trade debtors | 0.7 | 15.4 |
| Amounts recoverable on contracts | - | 0.1 |
| Amounts owed by parent company and fellow subsidiaries | 897.3 | 206.6 |
| Pension prepayment | 108.7 | 97.5 |
| Other debtors | <u>14.7</u> | <u>1.1</u> |
| | <u>1,021.4</u> | <u>320.7</u> |
| | <u>1,308.8</u> | <u>634.9</u> |

12 Short term deposits

The short term deposits are stated at cost and include call, short notice and term deposits with finance house and other negotiable instruments. Represents £95.3m due from parent company (2000 - £88.8m).

ROLLS-ROYCE POWER ENGINEERING PLC
Notes to the accounts continued

13 Creditors: amounts falling due within one year

| | 2001 | Restated 2000 |
|--|--------------|------------------|
| | £m | £m |
| Bank loans and overdrafts | 6.4 | - |
| Payments on account in excess of work in progress | 76.3 | 70.0 |
| Trade creditors | 103.4 | 91.0 |
| Amounts owed to parent company and fellow subsidiaries | 493.3 | 70.7 |
| Corporate taxation | 0.5 | 0.7 |
| Other taxation and social security | 8.4 | 7.1 |
| Other creditors | 38.0 | 27.5 |
| Accruals and deferred income | 27.0 | 16.9 |
| | <u>746.9</u> | <u>283.9</u> |
| | <u>753.3</u> | <u>283.9</u> |

14 Creditors: amounts falling due after more than one year

| | | |
|---|--------------|--------------|
| Amounts owed to parent company and subsidiaries | 958.6 | 662.5 |
| Accruals and deferred income | 1.2 | 1.1 |
| | <u>959.8</u> | <u>663.6</u> |

15 Provisions for liabilities and charges

| | Restated Balance at 01.01.01 £m | Charged / (Released) to profit and loss account £m | Utilised £m | Balance at 31.12.01 £m |
|---|--|---|----------------|------------------------------|
| Pensions and post retirement benefits | 3.5 | - | - | 3.5 |
| Deferred taxation ¹ (Restated) | 13.8 | 3.6 | - | 17.4 |
| Discontinued operations | 1.5 | - | (0.6) | 0.9 |
| Warranty/Guarantees | 16.1 | 7.0 | (3.4) | 19.7 |
| Contract loss | 127.8 | 18.2 | (58.3) | 87.7 |
| Restructuring | 6.3 | 2.4 | (6.4) | 2.3 |
| Rationalisation | - | 15.5 | - | 15.5 |
| Other | 1.0 | 2.2 | (1.3) | 1.9 |
| | <u>170.0</u> | <u>48.9</u> | <u>(70.0)</u> | <u>148.9</u> |

¹ Adjustment resulting from the adoption of FRS 19 'Deferred Tax' (See Accounting policies page 14)

Post-employment, 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

| | 2001 | Restated 2000 |
|--|-------------|------------------|
| | £m | £m |
| Authorised - | | |
| Equity - | | |
| 332 million (2000: 332 million) ordinary shares of 25p per share | <u>83.0</u> | <u>83.0</u> |
| Allotted, issued and fully paid - | | |
| Equity - | | |
| 263,382,058 (2000: 263,382,058) ordinary shares of 25p per share | <u>65.8</u> | <u>65.8</u> |

ROLLS-ROYCE POWER ENGINEERING PLC

Notes to the accounts continued

17 Reserves

| | Equity Share Capital £m | Share Premium £m | Capital redemption reserve £m | Revaluation reserve £m | Profit and loss account £m | Total £m |
|---|----------------------------------|------------------------|--|------------------------------|-------------------------------------|---------------|
| Balance at January 1, 2001 | 65.8 | 24.1 | 4.0 | 7.0 | (149.8) | (48.9) |
| Loss retained for the financial year | - | - | - | - | (49.1) | (49.1) |
| | - | - | - | (0.4) | 0.4 | - |
| Disposals of revalued assets | | | | | | |
| Balance at December 31, 2001 | <u>65.8</u> | <u>24.1</u> | <u>4.0</u> | <u>6.6</u> | <u>(198.5)</u> | <u>(98.0)</u> |

18 Deferred taxation

| | 2001 | Restated 2000 |
|---|-------------|------------------|
| | £m | £m |
| At January 1 - Restated ¹ | 13.8 | 7.4 |
| Prior year adjustment | - | 2.9 |
| | 13.8 | 10.3 |
| Amount charged to Profit & Loss Account | 3.6 | 3.5 |
| At December 31 | <u>17.4</u> | <u>13.8</u> |

The analysis of the deferred tax provision is as follows:

| | | |
|--|-------------|-------------|
| Accelerated capital allowance | 5.3 | 5.0 |
| Other timing differences | 31.4 | 28.1 |
| Advance corporation tax | (19.3) | (19.3) |
| Full potential liability and provision | <u>17.4</u> | <u>13.8</u> |

At December 31, 2001 advance corporation tax of £19.3m (2000 - £19.3m) is available to carry forward against future corporation tax liabilities.

¹ Adjustment resulting from the adoption of FRS 19 'Deferred Tax' (See Accounting policies page 14)

ROLLS-ROYCE POWER ENGINEERING PLC

Notes to the accounts continued

19 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 schemes were as at March 31, 2000 (for the Rolls-Royce Pension Fund), and 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 £4,412m. The actuarial value of the assets of the principal schemes represented respectively 100.0% (for the Rolls-Royce Pension Fund), and 126.0% (for the Rolls-Royce Group Pension Scheme) 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 periods of between 12 and 13 years, being the average expected remaining service lives of the pensionable employees.

A provision of £3.5m (2000 - £3.5m) and a debtor of £108.7m (2000 - £97.5m) 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

FRS 17 'Retirement Benefits' will replace SSAP 24 'Accounting for Pension Costs' for periods ending on or after June 22, 2003. In the transaction period 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, 2001 taking account of the requirements of FRS 17.

The principal assumptions were as follows:

| | UK Schemes |
|---|------------|
| | % |
| Rate of increase in salaries | 4.00 |
| Rate of increase of pensions in payment and deferment | 2.25 |
| Discount rate | 6.00 |
| Inflation assumption | 2.50 |

The assets in the principal schemes and the expected rates of return at December 31, 2001 were as follows:

| | Expected long-term rate of return | Market value £m |
|-------------------------------------|--------------------------------------|--------------------|
| | % | |
| Equities | 8.5 | 528 |
| Sovereign debt | 5.0 | 197 |
| Corporate bonds | 6.0 | 110 |
| Other | 7.5 | 8 |
| Total market value of assets | | 843 |
| Present value of scheme liabilities | | (732) |
| Surplus in the scheme | | 111 |
| Related deferred tax liability | | (33) |
| Net pension asset | | 78 |

If the above amounts had been recognised in the financial statements, the net assets of the Company at December 31, 2001 would be increased by £5m, with a matching increase in the profit and loss reserve. These amounts have been calculated after taking account of pensions prepayments and provisions for pensions and other post-retirement benefits, net of related deferred taxation.

ROLLS-ROYCE POWER ENGINEERING PLC
Notes to the accounts continued

20 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.

21 Directors Emoluments

No remuneration has been received by the Directors in respect of their services to the company.

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

22 Commitments under operating leases

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

| | 2001 £m | 2000 £m |
|---|------------|------------|
| Land and buildings - leases expiring: | | |
| in two to five years | - | - |
| after five years | - | 0.1 |
| Other operating leases - leases expiring: | | |
| within one year | - | - |
| in two to five years | 0.8 | 1.1 |
| | <u>0.8</u> | <u>1.2</u> |

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

23 Capital commitments

| | 2001 £m | 2000 £m |
|---|------------|------------|
| Outstanding contracts for capital expenditure | <u>1.1</u> | <u>0.3</u> |

24 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

25 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, P O 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 AND JOINT VENTURES

The following were the principal subsidiary undertakings of Rolls-Royce Power Engineering plc during the year ended 31st December 2001. Effective group interest is 100% unless otherwise stated.

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

| | Incorporated in United Kingdom | Overseas* | Country of incorporation and/or operation |
|------------------------------------|---|---|--|
| Subsidiary Undertakings | Allen Power Engineering Limited Clayton Equipment Limited Derby Specialist Fabrications Limited Heaton Power Limited NEI Overseas Holdings Limited R-R Industrial Controls Limited Rolls-Royce Nuclear Engineering Services Limited Rolls-Royce Industrial Power (India) Ltd + Rolls-Royce Industrial Power (Overseas Projects) Limited Rolls-Royce Industrial Power Engineering(Overseas Projects) Ltd | Rolls-Royce Industrial Power (Malaysia) Ltd Rolls-Royce Industrial Power (Hong Kong) Ltd | Malaysia Hong Kong |
| Joint Ventures | | Northern Engineering Industries Africa Ltd* (24.4%) | South Africa |

* The shares in overseas subsidiary undertakings and joint ventures are held by subsidiary undertakings. The percentage of shares held refers to the ordinary share capital, none of which is held by the parent company.

+ Financial year ends 31st March