GKN HOLDINGS PLC
Registered Number: 66549

ANNUAL REPORT
31 DECEMBER 2012

Directors' Report

Directors: Mr N M Stein
Mrs J M Felton
Mr W C Seeger

1. The Directors present their report together with the audited consolidated financial statements of the Group and the Company for the year ended 31 December 2012.

2. **Statement of Directors' Responsibilities**

The Directors are responsible for preparing the annual report, the Directors' remuneration report and the Group and Company financial statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare Group and Company financial statements for each financial year. Under that law, the Directors are required to prepare the Group financial statements in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union (EU) and have elected to prepare the Company financial statements in accordance with applicable law and United Kingdom (UK) Accounting Standards (UK Generally Accepted Accounting Practice).

Under company law, the 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 the Company and of their profit or loss for that period. In preparing each of the Group and Company financial statements the Directors are required to:

- select appropriate accounting policies and apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- for the Group financial statements, state whether they have been prepared in accordance with IFRSs as adopted by the EU;
- for the Company financial statements, state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the Company financial statements; and
- prepare the financial statements on a going concern basis unless it is inappropriate to presume that the Group and the Company will continue in business.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Group's and the Company's transactions, 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 and as regards the Group financial statements, Article 4 of the IAS Regulation. They are also responsible for safeguarding the assets of the Company and the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Each of the Directors as at the date of this report, whose names are set out above, confirm that to the best of their knowledge:

- the Group financial statements, prepared in accordance with IFRSs as adopted by the EU, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Company and the undertakings included in the consolidation taken as a whole; and
- the Directors' report includes a fair review of the development and performance of the business and the position of the Company and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face.

The auditors' responsibilities in relation to the accounts are set out in their report on page 6.

3. Business Review

Principal Activities

The Company acts as a finance, investment and holding company. The Company is also a limited partner in GKN Investments LP. The Company has granted a licence to GKN Investments LP for the non-exclusive right to use and sub-licence the GKN trade marks.

The Company is also the company within the Group through which the Group's primary external borrowings are held.

The Company is a wholly owned subsidiary of GKN plc, the ultimate holding company of the GKN plc Group. Accordingly, both the GKN plc Group and the GKN Holdings plc Group are global engineering businesses serving mainly the automotive, industrial, land systems and aerospace markets.

Business Review

On 19 September 2012 the Company issued £450 million fixed rate notes paying 5.375% interest and maturing on 19 September 2022. On 1 October 2012 the Group's aerospace division acquired the aero engine components businesses from AB Volvo. Further details of the acquisition together with a review of the Group's businesses in 2012, including their position at the end of the year and likely future developments, are given in the 2012 annual report of GKN plc.

Financial Results

The consolidated income statement of the Group shows a profit for the year of £496 million (2011: £296 million). No interim dividend was paid during the year ended 31 December 2012 (2011: £nil) and the Directors have not proposed a final dividend (2011: nil).

Financial resources and going concern

At 31 December 2012, UK committed bank facilities were £917 million, £837 million of which were committed revolving credit facilities together with an £80 million eight-year amortising facility from the European Investment Bank (EIB). The next major maturities of the committed bank facilities are £592 million in 2016. At 31 December 2012, the £80 million facility from the EIB was fully drawn and drawings against the revolving credit facilities were £77 million, leaving undrawn, committed UK borrowing facilities totalling £760 million.

Capital market borrowings were £800 million at 31 December 2012 (31 December 2011: £526 million) and include existing unsecured £350 million 6.75% bonds maturing in October 2019 and new unsecured £450 million 5.375% bonds maturing in September 2022. The weighted average maturity profile of the Group's committed borrowing facilities was 6.1 years. At 31 December 2012, the Group had net borrowings of £871 million.

All of the Group's committed credit facilities have a financial covenant requiring EBITDA of subsidiaries to be at least 3.5 times net financing costs and net debt must be no greater than 3 times EBITDA of subsidiaries. The covenants are tested every six months using the previous 12 months' results. For the 12 months to 31 December 2012, EBITDA was 13 times greater than net interest, whilst net debt was 1.2 times EBITDA.

The Directors have taken into account both divisional and Group forecasts to assess the future funding requirements of the Group and compared them to the level of committed available borrowing facilities, described above. The Directors have concluded that the Group will have a sufficient level of headroom in the foreseeable future and that the likelihood of breaching covenants in this period is remote, such that it is appropriate for the financial statements to be prepared on a going concern basis.

Directors' Report (Continued)

3. Business Review (Continued)

Principal Risks and Uncertainties

The Company's risk management process includes an assessment of the likelihood and potential impact of a range of events to determine the overall risk level and to identify actions necessary to mitigate their impact. As a finance, investment and holding company within the GKN plc Group, aside from holding the Group's external borrowings, its dealings are almost exclusively with intra Group transactions. No significant risks and uncertainties have been identified other than those stated below. In addition, market and operational risk which could have a material impact on the future performance of the Company's subsidiaries and cause the financial results of those subsidiaries to differ materially from expected and historical performance are given in the annual report of GKN plc for 2012. Additional risks not currently known or which are regarded as immaterial could also affect future performance.

Pension deficit volatility

Pension deficit levels are affected by changes in asset values, discount rates, inflation and mortality assumptions. Accounting valuations of pension obligations can cause volatility in financial results. Additional Company pension contributions may have an impact on investment in businesses.

This risk is managed through the active management of pension scheme assets and a long-term view of liability assumptions including the level of benefits. Alternative funding and risk mitigation actions are implemented where appropriate.

Exchange rate volatility

Currency risks include: transactional (subsidiary sales or purchases in currencies other than their functional currency) and translational (exchange rate movements in investments in overseas operations). The Group's financial statements may fluctuate as a result of movements in exchange rates.

Exchange rate volatility is mitigated through natural hedging where possible, for example through local sourcing and the hedging of transaction exposures through forward foreign exchange contracts.

Complexity of global tax regimes

Given GKN's global footprint and against a background of complex tax laws on a global basis, it is possible that actual tax liabilities could differ from management judgements.

On-going monitoring of tax developments in major jurisdictions and a Group-wide tax compliance programme help mitigate this risk.

Financial risk management

The Company's activities form an integral part of the Group's strategy with regard to financial instruments. The Group's objectives, policies and strategies with regard to financial instruments are disclosed in the annual report of GKN plc for 2012.

3. **Business Review (Continued)**

Key Performance Indicators

Key performance indicators are measured either on a divisional or a GKN plc Group basis. The key performance indicators and the GKN Group's performance against them in 2012 are shown in the annual report of GKN plc for 2012. As a finance, investment and holding company dealing almost exclusively with intra Group transactions, the Directors believe that analysis using key performance indicators for the Company is not necessary or appropriate for an understanding of the development, performance or position of the business of the Company.

4. **Research and development**

Details of the Group's research and development are contained within the GKN plc 2012 annual report.

5. **Indemnities**

The Company has executed qualifying pension scheme indemnity provisions as defined by section 235 of the Companies Act 2006, for the benefit of the Directors and Officers of GKN Group Pension Trustee Limited and GKN Group Pension Trustee (No 2) Limited, the corporate trustees of the GKN Group Pension Scheme.

6. **Directors**

The current Directors of the Company are set out on the first page of this report. All Directors served throughout the year.

7. **Payments to suppliers**

It is Group policy to abide by the payment terms agreed with suppliers, provided that the supplier has performed its obligations under the contract. Given the nature and diversity of the Group's international purchasing arrangements and contracts, it is not Group policy to follow any specific code or standard in relation to payment practice. GKN Holdings plc, as a holding company, did not have any amounts owed to trade creditors at 31 December 2012.

8. **Employees**

Consultation with employees or their representatives has continued at all levels, with the aim of ensuring that their views are taken into account when decisions are made that are likely to affect their interests and that all employees are aware of the financial and economic performance of their business units and of the company as a whole. Communication with employees is promoted through a variety of means including in-house newsletters, briefing meetings and the GKN intranet which provides access to Group information, news, policies and procedures.

9. **Disabled Persons**

The Company's policy in relation to the employment of disabled persons is to give full consideration to job applications received from disabled persons. Candidates are selected and appointed on the basis of their ability to perform the duties of the job. Where appropriate, special training is given to facilitate engagement of the disabled and modifications to the job will be considered. Where an employee becomes disabled whilst employed by the Company, arrangements will be made wherever possible for re-training in order that a different job may be performed. Consideration for modifying jobs will be given.

10. **Donations**

Charitable donations made by GKN Group companies around the world totalled £616,400 in 2012. This included donations to UK registered charities of £58,600. In accordance with the GKN Group's policy, no political donations were made and no political expenditure was incurred during 2012.

The Group's US Aerospace business has a Political Action Committee (PAC) which is funded entirely by employees and their spouses. No funds are provided to the PAC by the GKN Group and any administrative services provided to the PAC by the US Aerospace business are fully charged to and paid for by the PAC, and the Company does not therefore consider these to be political donations. Employee contributions are entirely voluntary and no pressure is placed on employees to participate. Under US law, an employee-funded PAC must bear the name of the employing company.

11. **Corporate Governance**

The Company has chosen to take advantage of the exemptions available to it from sections 7.1 and 7.2 of the Disclosure and Transparency Rules (the "DTR") of the Financial Services Authority. The exemption from DTR 7.1 is available to the Company as it is a subsidiary undertaking of a parent undertaking which itself is subject to DTR 7.1. The exemption from DTR 7.2 is available to the Company as its shares are not traded on a regulated market.

12. **Auditors and Disclosure of Information to Auditors**

A resolution to reappoint PricewaterhouseCoopers LLP as auditors of the Company will be proposed at the 2013 annual general meeting. In the case of each of the persons who are Directors of the Company at the date when this report was approved:

- so far as each of the Directors is aware, there is no relevant audit information of which the Company's auditors are unaware; and
- each of the Directors has taken all the steps that he/she ought to have taken as a Director to make himself/herself aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

On behalf of the Board

K Watson
Secretary
26 April 2013

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF GKN HOLDINGS PLC

We have audited the Group financial statements of GKN Holdings plc for the year ended 31 December 2012 which comprise the Consolidated Income Statement, the Consolidated Statement of Comprehensive Income, the Consolidated Statement of Changes in Equity, the Consolidated Balance Sheet and the Consolidated Cash Flow Statement and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

Respective responsibilities of directors and auditors
As explained more fully in the Statement of Directors' Responsibilities set out on page 1, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.
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.

Scope of the audit of the financial statements
An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Group's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the Annual report and Financial Statements to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on financial statements
In our opinion the Group financial statements:

- give a true and fair view of the state of the Group's affairs as 31 December 2012 and of its profit loss and cash flows for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006 and Article 4 of the IAS Regulation.

Opinion on other matter prescribed by the Companies Act 2006
In our opinion the information given in the Directors' Report for the financial year for which the Group financial statements are prepared is consistent with the Group financial statements.

Matters on which we are required to report by exception
We have nothing to report in respect of the following:

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

- certain disclosures of Directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

Other matter
We have reported separately on the Parent Company financial statements of GKN Holdings plc for the year ended 31 December 2012.

Andrew Hammond (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Birmingham
30 April 2013

Notes:

(a) The maintenance and integrity of the GKN website is the responsibility of the Directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the website.

(b) Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Consolidated Income Statement

For the year ended 31 December 2012

	Notes	2012 £m	2011 £m
Sales	2	**6,510**	5,746
Trading profit		***508***	*419*
Change in value of derivative and other financial instruments		***126***	*(31)*
Amortisation of non-operating intangible assets arising on business combinations		***(37)***	*(22)*
Gains and losses on changes in Group structure		***5***	*8*
Reversal of inventory fair value adjustment arising on business combinations	13	***(37)***	-
Pension scheme curtailment	23	***63***	-
Operating profit	4	**628**	374
Share of post-tax earnings of joint ventures	11	**38**	38
Interest payable		**(60)**	(47)
Interest receivable		**8**	5
Other net financing charges		**(26)**	(19)
Net financing costs	5	**(78)**	(61)
Profit before taxation		**588**	351
Taxation	6	**(92)**	(55)
Profit after taxation for the year		**496**	296
Profit attributable to other non-controlling interests		**3**	6
Profit attributable to the Pension partnership		**20**	21
Profit attributable to non-controlling interests		**23**	27
Profit attributable to equity shareholders		**473**	269
		496	296

Consolidated Statement of Comprehensive Income

For the year ended 31 December 2012

	Notes	2012 £m	2011 £m
Profit after taxation for the year		**496**	296
Other comprehensive income			
Currency variations – subsidiaries			
Arising in year		**(134)**	(31)
Reclassified in year	4	**(4)**	(4)
Currency variations – joint ventures			
Arising in year	11	**(3)**	3
Reclassified in year	4	**-**	(2)
Derivative financial instruments – transactional hedging	18		
Arising in year		**13**	(1)
Reclassified in year		**(13)**	-
Actuarial gains and losses on post-employment obligations			
Subsidiaries	23	**(172)**	(277)
Joint ventures	11	**(2)**	-
Taxation	6	**108**	56
		(207)	(256)
Total comprehensive income for the year		**289**	40
Total comprehensive income for the year attributable to:			
Equity shareholders		**267**	13
Other non-controlling interests		**2**	6
Pension partnership		**20**	21
Non-controlling interests		**22**	27
		289	40

Consolidated Statement of Changes in Equity

For the year ended 31 December 2012

	Notes	Share capital £m	Share premium account £m	Retained earnings £m	Other reserves: Exchange reserve £m	Other reserves: Hedging reserve £m	Other reserves: Other reserves £m	Share-holders' equity £m	Non-controlling interests: Pension partner-ship £m	Non-controlling interests: Other £m	Total equity £m
At 1 January 2012		**362**	**301**	**2,730**	**356**	**(197)**	**(133)**	**3,419**	**344**	**28**	**3,791**
Profit for the year		**-**	**-**	**473**	**-**	**-**	**-**	**473**	**20**	**3**	**496**
Other comprehensive income/(expense)		**-**	**-**	**(73)**	**(133)**	**-**	**-**	**(206)**	**-**	**(1)**	**(207)**
Total comprehensive income/(expense)		**-**	**-**	**400**	**(133)**	**-**	**-**	**267**	**20**	**2**	**289**
Share-based payments	8	**-**	**-**	**6**	**-**	**-**	**-**	**6**	**-**	**-**	**6**
Distribution from Pension partnership to UK Pension scheme	23	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**(30)**	**-**	**(30)**
Purchase of shares in parent undertaking by Employee Share Ownership Trust		**-**	**-**	**(3)**	**-**	**-**	**-**	**(3)**	**-**	**-**	**(3)**
Dividends paid to non-controlling interests		**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**(2)**	**(2)**
Purchase of non-controlling interests		**-**	**-**	**(1)**	**-**	**-**	**-**	**(1)**	**-**	**(9)**	**(10)**
Transfers		**-**	**-**	**1**	**-**	**-**	**(1)**	**-**	**-**	**-**	**-**
At 31 December 2012		**362**	**301**	**3,133**	**223**	**(197)**	**(134)**	**3,688**	**334**	**19**	**4,041**
At 1 January 2011		362	301	2,683	388	(196)	(133)	3,405	346	28	3,779
Profit for the year		-	-	269	-	-	-	269	21	6	296
Other comprehensive income/(expense)		-	-	(223)	(32)	(1)	-	(256)	-	-	(256)
Total comprehensive income/(expense)		-	-	46	(32)	(1)	-	13	21	6	40
Share-based payments	8	-	-	6	-	-	-	6	-	-	6
Distribution from Pension partnership to UK Pension scheme	23	-	-	-	-	-	-	-	(23)	-	(23)
Purchase of shares in parent undertaking by Employee Share Ownership Plan Trust		-	-	(5)	-	-	-	(5)	-	-	(5)
Dividends paid to non-controlling interests		-	-	-	-	-	-	-	-	(6)	(6)
At 31 December 2011		362	301	2,730	356	(197)	(133)	3,419	344	28	3,791

Other reserves include accumulated reserves where distribution has been restricted due to legal or fiscal requirements and accumulated adjustments in respect of piecemeal acquisitions.

GKN HOLDINGS PLC

Registered Number: 66549

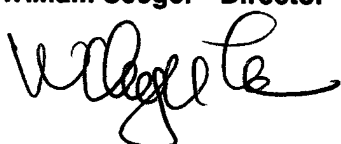
Consolidated Balance Sheet

At 31 December 2012

	Notes	2012 £m	2011 £m
Assets			
Non-current assets			
Goodwill	9	**551**	534
Other intangible assets	9	**989**	424
Property, plant and equipment	10	**1,964**	1,812
Investments in joint ventures	11	**153**	147
Other receivables and investments	12	**38**	37
Derivative financial instruments	18	**54**	21
Deferred tax assets	6	**302**	224
		4,051	3,199
Current assets			
Inventories	13	**885**	749
Trade and other receivables	14	**1,102**	962
Amounts receivable from parent undertaking		**2,122**	2,176
Current tax assets	6	**24**	16
Derivative financial instruments	18	**27**	5
Cash and cash equivalents	16	**181**	156
		4,341	4,064
Total assets		**8,392**	7,263
Liabilities			
Current liabilities			
Borrowings	16	**(115)**	(228)
Derivative financial instruments	18	**(11)**	(30)
Trade and other payables	15	**(1,392)**	(1,308)
Amounts payable to parent undertaking		**(8)**	(9)
Current tax liabilities	6	**(157)**	(138)
Provisions	19	**(47)**	(46)
		(1,730)	(1,759)
Non-current liabilities			
Borrowings	16	**(937)**	(466)
Derivative financial instruments	18	**(39)**	(72)
Deferred tax liabilities	6	**(204)**	(96)
Trade and other payables	15	**(328)**	(120)
Provisions	19	**(135)**	(91)
Post-employment obligations	23	**(978)**	(868)
		(2,621)	(1,713)
Total liabilities		**(4,351)**	(3,472)
Net assets		**4,041**	3,791
Shareholders' equity			
Share capital	20	**362**	362
Share premium account		**301**	301
Retained earnings		**3,133**	2,730
Other reserves		**(108)**	26
		3,688	3,419
Non-controlling interests		**353**	372
Total equity		**4,041**	3,791

The financial statements on pages 7 to 57 were approved by the Board of Directors and authorised for issue on 26 April 2013. They were signed on its behalf by:

William Seeger - Director



Consolidated Cash Flow Statement

For the year ended 31 December 2012

	Notes	2012 £m	2011 £m
Cash flows from operating activities			
Cash generated from operations	22	**592**	425
Interest received		**3**	5
Interest paid		**(62)**	(48)
Costs associated with refinancing		**(9)**	-
Tax paid		**(70)**	(48)
Dividends received from joint ventures	11	**41**	35
		495	369
Cash flows from investing activities			
Purchase of property, plant and equipment		**(278)**	(236)
Receipt of government capital grants		**7**	1
Purchase of intangible assets		**(63)**	(46)
Proceeds from sale and realisation of fixed assets		**6**	8
Payment of contingent consideration	4	**(2)**	-
Acquisition of subsidiaries (net of cash acquired)	21	**(446)**	(450)
Acquisition of other investments		**-**	(4)
Proceeds from sale of businesses (net of cash disposed)	4	**2**	5
Proceeds from sale of joint venture	4	**1**	8
Investments in joint ventures	11	**(5)**	(4)
		(778)	(718)
Cash flows from financing activities			
Distribution from Pension partnership to UK Pension scheme	23	**(30)**	(23)
Purchase of shares in parent undertaking		**(3)**	(5)
Purchase of non-controlling interests	22	**(10)**	-
Proceeds from borrowing facilities		**508**	115
Repayment of other borrowings		**(185)**	(10)
Finance lease payments		**(1)**	-
Amounts returned from deposit		**-**	4
Dividends paid to non-controlling interests		**(2)**	(6)
		277	75
Currency variations on cash and cash equivalents		**(15)**	(2)
Movement in cash and cash equivalents		**(21)**	(276)
Cash and cash equivalents at 1 January		**145**	421
Cash and cash equivalents at 31 December	22	**124**	145

Notes to the Consolidated Financial Statements

For the year ended 31 December 2012

1 Accounting policies and presentation

The Group's significant accounting policies are summarised below.

Basis of preparation

The consolidated financial statements (the “statements”) have been prepared in accordance with International Financial Reporting Standards (IFRS) as endorsed and adopted for use by the European Union. These statements have been prepared under the historical cost method except where other measurement bases are required to be applied under IFRS as set out below.

These statements have been prepared using all standards and interpretations required for financial periods beginning 1 January 2012. No standards or interpretations have been adopted before the required implementation date.

Standards, revisions and amendments to standards and interpretations

There were no changes in standards or interpretations outlined in the audited consolidated financial statements for the year ended 31 December 2011 reported as likely to have a material impact on the reporting of the Group's results, assets and liabilities in 2012.

The Group adopted all applicable amendments to standards with an effective date in 2012 with no material impact on its results, assets and liabilities.

Basis of consolidation

The statements incorporate the financial statements of the Company and its subsidiaries (together "the Group") and the Group's share of the results and equity of its joint ventures and associates.

Subsidiaries are entities over which, either directly or indirectly, the Company has control through the power to govern financial and operating policies so as to obtain benefit from their activities. This power is accompanied by a shareholding of more than 50% of the voting rights. The results of subsidiaries acquired or sold during the year are included in the Group's results from the date of acquisition or up to the date of disposal. All business combinations are accounted for by the purchase method. Assets, liabilities and contingent liabilities acquired in a business combination are measured at fair value.

Intra-group balances, transactions, income and expenses are eliminated.

Other non-controlling interests represent the portion of shareholders' earnings and equity attributable to third party shareholders.

Joint ventures

Joint ventures are entities in which the Group has a long term interest and exercises joint control with its partners over their financial and operating policies. In all cases voting rights are 50% or lower. Investments in joint ventures are accounted for by the equity method. The Group's share of equity includes goodwill arising on acquisition.

The Group’s share of profits and losses resulting from transactions between the Group and joint ventures are eliminated.

1 **Accounting policies and presentation (continued)**

Foreign currencies
Subsidiaries and joint ventures account in the currency of their primary economic environment of operation, determined having regard to the currency which mainly influences sales and input costs. Transactions are translated at exchange rates approximating to the rate ruling on the date of the transaction except in the case of material transactions when actual spot rate may be used where it more accurately reflects the underlying substance of the transaction. Where practicable, transactions involving foreign currencies are protected by forward contracts. Assets and liabilities denominated in foreign currencies are translated at the exchange rates ruling at the balance sheet date. Such transactional exchange differences are taken into account in determining profit before tax.

Material foreign currency movements arising on the translation of intra-group balances treated as part of the net investment in a subsidiary are recognised through equity. Movements on other intra-group balances are recognised through the income statement.

The Group's presentational currency is sterling. On consolidation, results and cash flows of foreign subsidiaries and joint ventures are translated to sterling at average exchange rates except in the case of material transactions when the actual spot rate is used where it more accurately reflects the underlying substance of the transaction. Assets and liabilities are translated at the exchange rates ruling at the balance sheet date. Such translational exchange differences are taken to equity.

Profits and losses on the realisation of currency net investments include the accumulated net exchange differences that have arisen on the retranslation of the currency net investments since 1 January 2004 up to the date of realisation.

Presentation of the income statement
IFRS is not fully prescriptive as to the format of the income statement. Line items and subtotals have been presented on the face of the income statement in addition to those required under IFRS.

Sales shown in the income statement are those of subsidiaries.

Operating profit is profit before discontinued operations, taxation, finance costs and the share of post-tax earnings of joint ventures accounted for using the equity method. In order to achieve consistency and comparability between reporting periods, operating profit is analysed to show separately the results of normal trading performance and individually significant charges and credits. Such items arise because of their size or nature and, comprise:

- the impact of the annual goodwill impairment review;
- asset impairment and restructuring charges which arise from events that are significant to any reportable segment;
- amortisation of the fair value of non-operating intangible assets arising on business combinations;
- changes in the fair value of derivative financial instruments and material currency translation movements arising on intra-group funding;
- profits or losses on businesses sold or closed which do not meet the definition of discontinued operations or which the Group views as capital rather than revenue in nature;
- profits or losses arising from business combinations including fair value adjustments to pre-combination shareholdings, changes in estimates of deferred and contingent consideration made after the provisional fair value period and material expenses and charges incurred on a business combination; and
- significant pension scheme curtailments.

The Group’s post-tax share of joint venture earnings is shown as a separate component of profit before tax. The Group’s share of material restructuring and impairment charges, amortisation of the fair value of non-operating intangible assets arising on business combinations and other net financing charges and their related taxation are separately identified, in the related note.

Net financing costs are analysed to show separately interest payable, interest receivable and other net financing charges. Other net financing charges include the net of interest payable on post-employment obligations and the expected return on pension scheme assets and unwind of discounts on fair value amounts established on business combinations.

1 **Accounting policies and presentation (continued)**

Revenue recognition

Sales

Revenue from the sale of goods is measured at the fair value of the consideration receivable which generally equates to the invoiced amount, excluding sales taxes and net of allowances for returns, early settlement discounts and rebates.

Invoices for goods are raised when the risks and rewards of ownership have passed which, dependent upon contractual terms, may be at the point of despatch, acceptance by the customer or, in Aerospace, certification by the customer. Sales of services under risk and revenue sharing partnerships are recognised by reference to the stage of completion based on services performed to date. The assessment of the stage of completion is dependent on the nature of the contract, but will generally be based on: costs incurred to the extent these relate to services performed up to the reporting date; achievement of contractual milestones where appropriate; or flying hours or equivalent for long-term aftermarket arrangements. Revenue from royalties is not significant.

Many businesses in Automotive and Land Systems recognise an element of revenue via a surcharge or similar raw material cost recovery mechanism. The surcharge invoiced or credited is generally based on prior period movement in raw material price indices applied to current period deliveries. Other cost recoveries are recorded according to the customer agreement. In those instances where recovery of such increases is guaranteed, irrespective of the level of future deliveries, revenue is recognised, or due allowance made, in the same period as the cost movement takes place.

Other income

Interest income is recognised using the effective interest rate method. Dividend income is not significant.

Sales and other income is recognised in the income statement when it can be reliably measured and its collectability is reasonably assured.

Property, plant and equipment

Property, plant and equipment is stated at cost less accumulated depreciation and impairment charges.

Cost

Cost comprises the purchase price plus costs directly incurred in bringing the asset into use and borrowings costs on qualifying assets. Where freehold and long leasehold properties were carried at valuation on 23 March 2000, these values have been retained as book values and therefore deemed cost at the date of the IFRS transition.

Where assets are in the course of construction at the balance sheet date they are classified as capital work in progress. Transfers are made to other asset categories when they are available for use.

Depreciation

Depreciation is not provided on freehold land or capital work in progress. In the case of all other categories of property, plant and equipment, depreciation is provided on a straight line basis over the course of the financial year from the date the asset is available for use.

Depreciation is applied to specific classes of asset so as to reduce them to their residual values over their estimated useful lives, which are reviewed annually.

The range of main rates of depreciation used are:

	Years
Freehold buildings	Up to 50
Steel powder production plant	18
General plant, machinery, fixtures and fittings	6 to 15
Computers	3 to 5
Commercial vehicles and cars	4 to 5

1 **Accounting policies and presentation (continued)**

Property, plant and equipment (continued)
Depreciation (continued)
Property, plant and equipment is reviewed at least annually for indications of impairment. Impairments are charged to the income statement. Similarly, where property, plant and equipment has been impaired and subsequent reviews demonstrate the recoverable value is in excess of the impaired value an impairment reversal is recorded. The amount of the reversal cannot exceed the theoretical net book amount at the date of the reversal had the item not been impaired. Impairment reversals are credited to the income statement against the same line item to which the impairment was previously charged.

Costs capitalised relating to leasehold properties are charged to the income statement in equal annual instalments over the period of the lease or 50 years, whichever is the shorter.

Leased assets
Operating lease rentals are charged to the income statement as incurred over the lease term. Finance leased assets are not significant.

Borrowing costs
Borrowing costs are capitalised as cost on qualifying tangible and intangible fixed asset expenditure. A qualifying asset is an asset or programme where the period of capitalisation is more than 12 months and the capital value is more than £25 million (2011: £10 million). For general borrowings the capitalisation rate is the weighted average of the borrowing costs outstanding during the year. For specific funding and borrowings the amount capitalised is the actual borrowing cost incurred less any investment income on the temporary investment of those borrowings. There has been no material impact on the current or prior period financial statements as a result of changing the qualifying asset threshold to £25 million.

Financial assets and liabilities
Financial liabilities are recorded in arrangements where payment, or similar transfers of financial resources, is unavoidable or guaranteed. In respect of the Group's Pension partnership arrangement payments are subject to discretion and can, if certain conditions are met, be avoided. In this instance, the arrangement is classified as a non-controlling interest.

Borrowings are measured initially at fair value which usually equates to proceeds received and includes transaction costs. Borrowings are subsequently measured at amortised cost.

Cash and cash equivalents comprise cash on hand and demand deposits, and overdrafts together with highly liquid investments of less than 90 days maturity. Other financial assets comprise investments with more than 90 days until maturity. Unless an enforceable right of set-off exists and there is an intention to net settle, the components of cash and cash equivalents are reflected on a gross basis in the balance sheet.

The carrying value of other financial assets and liabilities, including short term receivables and payables, are stated at amortised cost less any impairment provision unless the impact of the time value of money is considered to be material.

Derivative financial instruments
The Group does not trade in derivative financial instruments. Derivative financial instruments including forward foreign currency contracts are used by the Group to manage its exposure to risk associated with the variability in cash flows in relation to both recognised assets or liabilities or forecast transactions. All derivative financial instruments are measured at the balance sheet date at their fair value.

Where derivative financial instruments are not designated as or not determined to be effective hedges, any gain or loss on remeasurement is taken to the income statement. Where derivative financial instruments are designated as and are effective as cash flow hedges, any gain or loss on remeasurement is held in equity and recycled through the income statement when the designated item is transacted, unless related to the purchase of a business, when recycled against consideration.

Gains or losses on derivative financial instruments no longer designated as effective hedges are taken directly to the income statement.

Derivatives embedded in non-derivative host contracts are recognised at their fair value when the nature, characteristics and risks of the derivative are not closely related to the host contract. Gains and losses arising on the remeasurement of these embedded derivatives at each balance sheet date are taken to the income statement.

1 Accounting policies and presentation (continued)

Goodwill
Goodwill consists of the excess of the fair value of the consideration over the fair value of the identifiable intangible and tangible assets net of the fair value of the liabilities including contingencies of businesses acquired at the date of acquisition. Acquisition related expenses are charged to the income statement as incurred.

Goodwill in respect of business combinations of subsidiaries is recognised as an intangible asset. Goodwill arising on the acquisition of a joint venture is included in the carrying value of the investment.

Where negative goodwill arises, following reassessment of fair values, it is credited to the income statement in the year in which the acquisition is made.

Goodwill is not amortised but tested at least annually for impairment. Goodwill is carried at cost less any recognised impairment losses that arise from the annual assessment of its carrying value. To the extent that the carrying value exceeds the recoverable amount, determined as the higher of estimated discounted future net cash flows or recoverable amount on a fair value less cost to sell basis, goodwill is written down to the recoverable amount and an impairment charge is recognised in the income statement.

Other intangible assets
Other intangible assets are stated at cost less accumulated amortisation and impairment charges.

Computer software
Where computer software is not integral to an item of property, plant or equipment its costs are capitalised and categorised as intangible assets. Cost comprises the purchase price plus costs directly incurred in bringing the asset into use. Amortisation is provided on a straight line basis over its useful economic life which is in the range of 3-5 years.

Development costs and participation fees
Where development expenditure results in a new or substantially improved product or process and it is probable that this expenditure will be recovered it is capitalised. Cost comprises development expenditure and borrowing costs on qualifying assets or fair value on initial recognition when as a result of a business combination. In addition, payments made to engine manufacturers for participation fees relating to risk and revenue sharing partnerships, are carried forward in intangible assets to the extent that they can be recovered from future sales.

Amortisation is charged from the date the asset is available for use. In Aerospace, amortisation is charged over the asset's life up to a maximum of fifteen years for all programmes other than risk and revenue sharing partnerships where a maximum life of twenty five years is assumed, either on a straight line basis or, where sufficient contractual terms exist, a unit of production method is applied. In Automotive amortisation is charged on a straight line basis over the asset's life up to a maximum of seven years.

Capitalised development costs, including participation fees, are subject to annual impairment reviews with any resulting impairments charged to the income statement.

Research expenditure and development expenditure not qualifying for capitalisation is written off as incurred.

Assets acquired on business combinations – non-operating intangible assets
Non-operating intangible assets are intangible assets that are acquired as a result of a business combination, which arise from contractual or other legal rights and are not transferable or separable. On initial recognition they are measured at fair value. Amortisation is charged on a straight line basis to the income statement over their expected useful lives which are:

		Years
Marketing related assets	- brands and trademarks	20-50
	- agreements not to compete	Life of agreement
Customer related assets	- order backlog	Length of backlog
	- other customer contracts and relationships	2-25
Technology based assets		5-25

1 Accounting policies and presentation (continued)

Inventories

Inventories are valued at the lower of cost and estimated net realisable value with due allowance being made for obsolete or slow-moving items. Cost is determined on a first in, first out or weighted average cost basis. Cost includes raw materials, direct labour, other direct costs and the relevant proportion of works overheads assuming normal levels of activity. Net realisable value is the estimated selling price less estimated selling costs and costs to complete.

Taxation

Current tax and deferred tax are recognised in the income statement unless they relate to items recognised directly in other comprehensive income when the related tax is also recognised in other comprehensive income.

Full provision is made for deferred tax on all temporary differences resulting from the difference between the carrying value of an asset or liability in the consolidated financial statements and its tax base. The amount of deferred tax reflects the expected manner of realisation or settlement of the carrying amount of the assets and liabilities using tax rates enacted or substantively enacted at the balance sheet date.

Deferred tax assets are reviewed at each balance sheet date and are only recognised to the extent that it is probable that they will be recovered against future taxable profits.

Deferred tax is recognised on the unremitted profits of joint ventures. No deferred tax is recognised on the unremitted profits of overseas branches and subsidiaries except to the extent that it is probable that such earnings will be remitted to the parent in the foreseeable future.

Pensions and post-employment benefits

The Group's pension arrangements comprise various defined benefit and defined contribution schemes throughout the world. In the UK and in certain overseas companies pension arrangements are made through externally funded defined benefit schemes, the contributions to which are based on the advice of independent actuaries or in accordance with the rules of the schemes. In other overseas companies funds are retained within the business to provide for retirement obligations.

The Group also operates a number of defined contribution and defined benefit arrangements which provide certain employees with defined post-employment healthcare benefits.

The Group accounts for all post-employment defined benefit schemes through full recognition of the schemes' surpluses or deficits on the balance sheet at the end of each year. Actuarial gains and losses are included in other comprehensive income. Current and past service costs, curtailments and settlements are recognised within operating profit. Returns on scheme assets and interest on obligations are recognised in other net financing charges.

For defined contribution arrangements the cost charged to the income statement represents the Group's contributions to the relevant schemes in the year in which they fall due.

Government refundable advances

Government refundable advances are reported in Trade and other payables in the balance sheet. Refundable advances include amounts advanced by Government, accrued interest and directly attributable costs. Refundable advances are provided to the Group to part-finance expenditures on specific development programmes. The advances are provided on a risk sharing basis, i.e. repayment levels are determined subject to the success of the related programme. Interest is calculated using the effective interest rate method.

Share-based payments

Share options granted to employees and share-based arrangements put in place since 7 November 2002 are valued at the date of grant or award using an appropriate option pricing model and are charged to operating profit over the performance or vesting period of the scheme. The annual charge is modified to take account of shares forfeited by employees who leave during the performance or vesting period and, in the case of non-market related performance conditions, where it becomes unlikely the option will vest.

1 **Accounting policies and presentation (continued)**

Provisions
Provisions for onerous or loss making contracts, warranty exposures, environmental matters, restructuring, employee obligations and legal claims are recognised when: the group has a present legal or constructive obligation as a result of past events; it is probable that an outflow of resources will be required to settle the obligation; and the amount has been reliably estimated. Restructuring provisions comprise lease termination penalties and employee termination payments. Provisions are not recognised for future operating losses.

Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the obligation. Any increase in provisions due to discounting, only recorded where material, is recognised as interest expense.

Standards, revisions and amendments to standards and interpretations issued but not yet adopted

The Group does not intend to adopt any standard, revision or amendment before the required implementation date. The only material impact on the Group's assets, liabilities and results from a change in accounting policy in 2013 is expected to be from adoption of IAS 19, 'Employee benefits' (revised). The impact on the group will be as follows: a) to immediately recognise all past service credits; b) to replace interest cost on scheme liabilities and expected return on plan assets with a net interest amount that is calculated by applying the discount rate to the net defined benefit liability; and c) to split scheme administration costs previously reflected in "other net financing changes" between those relating to management of plan assets (to be presented within other comprehensive income) and other administration costs (to be presented in trading profit).

The expected impact; on net assets at 1 January 2012 is £8 million, on statutory profit before taxation for the year ended 31 December 2012 is £20 million and on management profit before taxation for the year ended 31 December 2012 is £4 million.

The impact of IFRS 9 'Financial Instruments', IFRS 10 'Consolidated Financial Statements' including amendment to IAS 27 and IFRS 11 'Joint Arrangements' including amendment to IAS 28 are being assessed with adoption expected after 1 January 2014.

All other revisions and amendments to standards and interpretations which have an implementation date in 2013 or 2014 are not expected to have a material impact on the Group's results, assets or liabilities.

Significant judgements, key assumptions and estimates
The Group's significant accounting policies are set out above. The preparation of financial statements, in conformity with IFRS, requires the use of estimates, subjective judgement and assumptions that may affect the amounts of assets and liabilities at the balance sheet date and reported profit and earnings for the year. The Directors base these estimates, judgements and assumptions on a combination of past experience, professional expert advice and other evidence that is relevant to the particular circumstance.

The accounting policies where the Directors consider the more complex estimates, judgements and assumptions have to be made are those in respect of acquired assets and liabilities - business combinations (note 21), post-employment obligations including the valuation of the Pension partnership plan asset (note 23), derivative and other financial instruments (notes 4b and 18), taxation (note 6) and impairment of non-current assets (note 9). Details of the principle estimates, judgements and assumptions made are set out in the related notes as identified.

2 Segmental analysis

The Group's reportable segments have been determined based on reports reviewed by the Executive Committee led by the Chief Executive. The operating activities of the Group are largely structured according to the markets served; automotive, aerospace and the land systems markets. Automotive is managed according to product groups; driveline and powder metallurgy. Reportable segments derive their sales from the manufacture of product and sale of service. Revenue from inter segment trading and royalties is not significant.

(a) Sales

	Automotive				
	Driveline £m	Powder Metallurgy £m	Aerospace £m	Land Systems £m	Total £m
2012					
Subsidiaries	**2,945**	**874**	**1,584**	**889**	
Joint ventures	**291**	**-**	**-**	**44**	
	3,236	**874**	**1,584**	**933**	**6,627**
Acquisitions					
Subsidiaries	**-**	**-**	**191**	**-**	**191**
Other businesses					**86**
Management sales					**6,904**
Less: Joint venture sales					**(394)**
Income statement – sales					**6,510**
2011					
Subsidiaries	2,432	845	1,481	805	
Joint ventures	246	-	-	42	
	2,678	845	1,481	847	5,851
Acquisitions					
Subsidiaries	117	-	-	38	155
Other businesses					106
Management sales					6,112
Less: Joint venture sales					(366)
Income statement – sales					5,746

(b) Trading profit

	Automotive				
	Driveline £m	Powder Metallurgy £m	Aerospace £m	Land Systems £m	Total £m
2012					
Trading profit before depreciation, impairment and amortisation	**310**	**119**	**232**	**101**	
Depreciation and impairment of property, plant and equipment	**(124)**	**(32)**	**(41)**	**(17)**	
Amortisation of operating intangible assets	**(4)**	**-**	**(11)**	**(1)**	
Trading profit – subsidiaries	**182**	**87**	**180**	**83**	
Trading profit/(loss) – joint ventures	**53**	**-**	**(3)**	**5**	
	235	**87**	**177**	**88**	**587**
Acquisitions					
Trading profit – subsidiaries	**-**	**-**	**15**	**-**	**15**
Acquisition related charges	**-**	**-**	**(3)**	**-**	**(3)**
Restructuring charge	**-**	**-**	**(19)**	**-**	**(19)**
					(7)
Other businesses					**(4)**
Gallatin temporary plant closure					**2**
Corporate and unallocated costs					**(21)**
Management trading profit					**557**
Less: Joint venture trading profit					**(49)**
Income statement – trading profit					**508**

Acquisition related charges comprise; integration costs, £2 million and transaction professional fees, £6 million, offset by gains on commercial hedging contracts, £5 million.

2 Segmental analysis (continued)

(b) Trading profit (continued)

	Automotive				
	Driveline £m	**Powder Metallurgy £m**	**Aerospace £m**	**Land Systems £m**	**Total £m**
2011					
Trading profit before depreciation, impairment and amortisation	255	103	208	77	
Depreciation and impairment of property, plant and equipment	(107)	(31)	(34)	(13)	
Amortisation of operating intangible assets	(3)	-	(5)	(1)	
Trading profit – subsidiaries	145	72	169	63	
Trading profit/(loss) – joint ventures	46	-	(3)	5	
	191	72	166	68	497
Acquisitions					
Trading profit – subsidiaries	7	-	-	4	11
Acquisition related charges	(3)	-	-	(5)	(8)
					3
Other businesses					3
Gallatin temporary plant closure					(19)
Corporate and unallocated costs					(16)
Management trading profit					468
Less: Joint venture trading profit					(49)
Income statement – trading profit					419

No income statement items between trading profit and profit before tax are allocated to management trading profit, which is the Group's segmental measure of profit or loss.

During the year, GKN Driveline and GKN Land Systems exited their operations in Uruguay. Closure costs of £2 million are offset by previous currency variations of £2 million reclassified from other reserves.

The Group income statement for the year ended 31 December 2012 includes a net £2 million credit in relation to additional recoveries from the Group's insurer in respect of the temporary plant closure in Gallatin during 2011. The financial implication of this incident in 2011 was a net pre-tax charge of £19 million. The £19 million, which was charged to trading profit, represented a gross cost of £34 million offset by recoveries from the Group's external insurer of £15 million. The net £19 million charge attracted taxation relief of £4 million. The impact on cash flows in the year ended 31 December 2011 from operating activities was a net outflow of £19 million.

Corporate and unallocated costs include £2 million of transaction costs in 2012 related to the previously considered divestment of the Wheels business. In the comparative period, corporate and unallocated costs included a £2 million credit for a pension scheme curtailment.

2 **Segmental analysis (continued)**

(c) **Goodwill, fixed assets and working capital – subsidiaries only**

	Automotive				
	Driveline £m	Powder Metallurgy £m	Aerospace £m	Land Systems £m	Total £m
2012					
Property, plant and equipment and operating intangible assets	**950**	**319**	**941**	**137**	**2,347**
Working capital	**93**	**95**	**82**	**74**	**344**
Net operating assets	**1,043**	**414**	**1,023**	**211**	
Goodwill and non-operating intangible assets	**298**	**27**	**623**	**185**	
Net investment	**1,341**	**441**	**1,646**	**396**	
2011					
Property, plant and equipment and operating intangible assets	982	313	479	142	1,916
Working capital	77	100	56	73	306
Net operating assets	1,059	413	535	215	
Goodwill and non-operating intangible assets	321	29	282	196	
Net investment	1,380	442	817	411	

(d) **Fixed asset additions, investments in joint ventures and other non-cash items**

	Automotive						
	Driveline £m	Powder Metallurgy £m	Aerospace £m	Land Systems £m	Other Businesses £m	Corporate £m	Total £m
2012							
Fixed asset additions and capitalised borrowing costs							
- property, plant and equipment	**142**	**47**	**52**	**21**	**2**	**1**	**265**
- intangible assets	**9**	**4**	**53**	**1**	**-**	**-**	**67**
Investments in associate and Joint ventures	**125**	**-**	**-**	**10**	**22**	**-**	**157**
Other non-cash items – share-based payments	**2**	**1**	**1**	**-**	**-**	**2**	**6**
2011							
Fixed asset additions and capitalised borrowing costs							
- property, plant and equipment	136	44	58	18	1	-	257
- intangible assets	9	-	39	1	-	-	49
Investments in associate and Joint ventures	118	-	-	11	22	-	151
Other non-cash items – share-based payments	2	1	1	-	-	2	6

(e) **Country analysis**

	United Kingdom £m	USA £m	Germany £m	Other countries £m	Total non-UK £m	Total £m
2012						
Management sales by origin	**1,009**	**2,104**	**979**	**2,812**	**5,895**	**6,904**
Goodwill, other intangible assets, property, plant equipment and investments in associate and joint ventures	**443**	**932**	**484**	**1,802**	**3,218**	**3,661**
2011						
Management sales by origin	930	1,720	1,017	2,445	5,182	6,112
Goodwill, other intangible assets, property, plant equipment and investments in associate and joint ventures	411	908	498	1,104	2,510	2,921

2 Segmental analysis (continued)

(f) Other sales information

Subsidiary segmental sales gross of inter segment sales are; Driveline £2,999 million (2011: £2,491 million), Powder Metallurgy £875 million (2011: £851 million), Aerospace £1,775 million (2011: £1,481 million) and Land Systems £890 million (2011: £805 million). Inter segment transactions take place on an arms length basis using normal terms of business.

In 2012 and 2011, no customer accounted for 10% or more of subsidiary sales or management sales.

Management sales by product are: Driveline – CVJ systems 61% (2011: 70%), all-wheel drive systems 30% (2011: 23%), transaxle solutions 6% (2011: 5%) and other goods 3% (2011: 2%). Powder Metallurgy - sintered components 83% (2011: 83%) and metal powders 17% (2011: 17%). Aerospace - aerostructures 56% (2011: 64%), engine components and sub-systems 37% (2011: 28%) and special products 7% (2011: 8%). Land Systems – power management devices 41% (2011: 36%), wheels and structures 36% (2011: 37%) and aftermarket 23% (2011: 27%).

(g) Reconciliation of segmental property, plant and equipment and operating intangible fixed assets to the balance sheet

	2012 £m	2011 £m
Segmental analysis – property, plant and equipment and operating intangible assets	**2,347**	1,916
Segmental analysis – goodwill and non-operating intangible assets	**1,133**	828
Goodwill	**(551)**	(534)
Other businesses	**19**	19
Corporate assets	**5**	7
Balance sheet – property, plant and equipment and other intangible assets	**2,953**	2,236

(h) Reconciliation of segmental working capital to the balance sheet

	2012 £m	2011 £m
Segmental analysis – working capital	**344**	306
Other businesses	**10**	11
Corporate items	**(39)**	(36)
Accrued interest	**(17)**	(21)
Restructuring provisions	**(6)**	(10)
Deferred and contingent consideration	**(85)**	(29)
Government refundable advances	**(88)**	(42)
Balance sheet – inventories, trade and other receivables, trade and other payables and provisions	**119**	179

3 Adjusted performance measures

(a) Reconciliation of reported and management performance measures

	2012				2011			
	As reported £m	Joint ventures £m	Exceptional and non-trading items £m	Management basis £m	As reported £m	Joint ventures £m	Exceptional and non-trading items £m	Management basis £m
Sales	**6,510**	**394**	**-**	**6,904**	**5,746**	**366**	**-**	**6,112**
Trading profit	***508***	***49***	***-***	***557***	*419*	*49*	*-*	*468*
Change in value of derivative and other financial instruments	***126***	***-***	***(126)***	***-***	*(31)*	*-*	*31*	*-*
Amortisation of non-operating intangible assets arising on business combinations	***(37)***	***-***	***37***	***-***	*(22)*	*-*	*22*	*-*
Gains and losses on changes in Group structure	***5***	***-***	***(5)***	***-***	*8*	*-*	*(8)*	*-*
Reversal of inventory fair value adjustment arising on business combinations	***(37)***	***-***	***37***	***-***	*-*	*-*	*-*	*-*
Pension scheme curtailment	***63***	***-***	***(63)***	***-***	*-*	*-*	*-*	*-*
Operating profit	**628**	**49**	**(120)**	**557**	374	49	45	468
Share of post-tax earnings of joint ventures	**38**	**(49)**	**3**	**(8)**	38	(49)	2	(9)
Interest payable	**(60)**	**-**	**-**	**(60)**	(47)	-	-	(47)
Interest receivable	**8**	**-**	**-**	**8**	5	-	-	5
Other net financing charges	**(26)**	**-**	**26**	**-**	(19)	-	19	-
Net financing costs	**(78)**	**-**	**26**	**(52)**	(61)	-	19	(42)
Profit before taxation	**588**	**-**	**(91)**	**497**	351	-	66	417
Taxation	**(92)**	**-**	**11**	**(81)**	(55)	-	(15)	(70)
Profit after tax for the year	**496**	**-**	**(80)**	**416**	296	-	51	347
Profit attributable to non-controlling interests	**(23)**	**-**	**20**	**(3)**	(27)	-	21	(6)
Profit attributable to equity shareholders	**473**	**-**	**(60)**	**413**	269	-	72	341

Given the significance of the Gallatin incident and related net charge in 2011 (see note 2b), the table below highlights the impact of the temporary plant closure on management trading profit and margin.

(b) Summary of management performance measures by segment

	2012			2011		
	Sales £m	**Trading profit £m**	**Margin**	Sales £m	Trading profit £m	Margin
Driveline	**3,236**	**235**	**7.3%**	2,678	191	7.1%
Powder Metallurgy	**874**	**87**	**10.0%**	845	72	8.5%
Aerospace	**1,584**	**177**	**11.2%**	1,481	166	11.2%
Land Systems	**933**	**88**	**9.4%**	847	68	8.0%
Other businesses	**86**	**(4)**		106	3	
Engine Systems (Aerospace)	**191**	**(7)**		-	-	
Corporate and unallocated costs	**-**	**(21)**		-	(16)	
Prior year acquisitions	**-**	**-**		155	3	
	6,904	**555**	**8.0%**	6,112	487	8.0%
Gallatin temporary plant closure	**-**	**2**		-	(19)	
	6,904	**557**	**8.1%**	6,112	468	7.7%

4 **Operating profit**
The analysis of the additional components of operating profit is shown below:

(a) **Trading profit**

	2012 £m	2011 £m
Sales by subsidiaries	**6,510**	5,746
Operating costs		
Change in stocks of finished goods and work in progress	**(86)**	32
Raw materials and consumables	**(3,094)**	(2,636)
Staff costs (note 9)	**(1,603)**	(1,457)
Reorganisation costs (ii):		
Redundancy and other employee related amounts	**(6)**	-
Depreciation of property, plant and equipment (iii)	**(214)**	(191)
Impairment of property, plant and equipment	**(4)**	(1)
Amortisation of operating intangible assets	**(17)**	(10)
Operating lease rentals payable:		
Plant and equipment	**(15)**	(14)
Property	**(28)**	(29)
Impairment of trade receivables	**(3)**	(8)
Amortisation of government capital grants	**3**	1
Net exchange differences on foreign currency transactions	**-**	(1)
Acquisition related charges	**(3)**	(8)
Acquisition restructuring charges	**(19)**	-
Other costs	**(913)**	(1,005)
	(6,002)	(5,327)
Trading profit	**508**	419

(i) EBITDA is subsidiary trading profit before depreciation, impairment and amortisation charges included in trading profit. EBITDA in 2012 was £743 million (2011: £621 million).

(ii) Reorganisation costs in 2012 reflect actions in the ordinary course of business to reduce costs, improve productivity and rationalise facilities in continuing operations. This cost is included in trading profit.

(iii) Including depreciation charged on assets held under finance leases of less than £1 million (2011: less than £1 million).

(iv) Research and development expenditure in subsidiaries was £124 million (2011: £103 million).

(v) **Auditors' remuneration**
The analysis of auditors' remuneration is as follows:

	2012 £m	2011 £m
Fees payable to PricewaterhouseCoopers LLP for the audit of the parent company and consolidated annual financial statements	**-**	-
Fees payable to PricewaterhouseCoopers LLP and their associates for other services to the Group:		
- Audit of the Company's subsidiaries pursuant to legislation	**(4.3)**	(3.4)
Total audit fees	**(4.3)**	(3.4)
- Other services pursuant to legislation	**(0.1)**	(0.1)
- Tax advisory services	**(0.2)**	(0.2)
- Tax compliance services	**(0.6)**	(0.5)
- Corporate finance transaction services	**(0.7)**	(0.2)
- Other services	**-**	(0.1)
Total non-audit fees	**(1.6)**	(1.1)
Fees payable to PricewaterhouseCoopers LLP and their associates in respect of associated pension schemes:		
- Audit	**-**	-
- Other services	**-**	-
	-	-
Total fees payable to PricewaterhouseCoopers LLP and their associates	**(5.9)**	(4.5)

All fees payable to PricewaterhouseCoopers LLP, the Company's auditors, include amounts in respect of expenses. All fees payable to PricewaterhouseCoopers LLP have been charged to the income statement, with the exception of £0.1 million relating to the issuance of the new 2022 Bond (see note 16).

4 Operating profit (continued)

(b) Change in value of derivative and other financial instruments

	2012 £m	2011 £m
Forward currency contracts (not hedge accounted)	**117**	(29)
Embedded derivatives	**(1)**	(3)
Commodity contracts (not hedge accounted)	**1**	(1)
	117	(33)
Net gains and losses on intra-group funding		
Arising in year	**9**	2
Reclassified in year	**-**	-
	9	2
	126	(31)

IAS 39 requires derivative financial instruments to be valued at the balance sheet date and any difference between that value and the intrinsic value of the instrument to be reflected in the balance sheet as an asset or liability. Any subsequent change in value is reflected in the income statement unless hedge accounting is achieved. Such movements do not affect cash flow or the economic substance of the underlying transaction. In 2012 and 2011 the Group used transactional hedge accounting in a limited number of instances.

(c) Amortisation of non-operating intangible assets arising on business combinations

	2012 £m	2011 £m
Marketing related	**(1)**	-
Customer related	**(25)**	(17)
Technology based	**(11)**	(5)
	(37)	(22)

(d) Gains and losses on changes in Group structure

	2012 £m	2011 £m
Business sold	**1**	4
Profit on sale of joint venture	**-**	4
Gain on contingent consideration	**4**	-
	5	8

On 20 November 2012 the Group sold GKN Geplasmetal S.A. for cash consideration of £3 million. The profit on sale of £1 million comprises a £1 million loss on disposal of net assets and a £2 million gain on reclassification of previous currency variations from other reserves.

On 27 January 2012 the Group sold its 49% share in a joint venture company, GKN JTEKT (Thailand) Limited for cash consideration of £1 million, realising neither a profit nor a loss.

During the year, £2 million of contingent consideration relating to the purchase of Getrag Driveline Products in 2011 was paid in cash. The balance of the liability for contingent consideration recorded at 31 December 2011, £4 million, was released to the income statement outside trading profit.

On 31 March 2011 the Group sold its 49% share in a joint venture company, GKN JTEKT Limited, for cash consideration of £8 million. A profit on sale of £4 million was realised which included £2 million of previous currency variations reclassified from other reserves.

On 30 November 2011 the Group sold its Engineering Services division of GKN Aerospace for net cash consideration of £5 million. A profit on sale of £4 million was realised which represented previous currency variations reclassified from other reserves.

5 Net financing costs

	2012 £m	2011 £m
(a) Interest payable and fee expense		
Short term bank and other borrowings	**(10)**	(10)
Repayable within five years	**(15)**	(14)
Repayable after five years	**(34)**	(26)
Government refundable advances	**(5)**	(2)
Borrowing costs capitalised	**5**	6
Finance leases	**(1)**	(1)
	(60)	(47)
Interest receivable		
Short term investments, loans and deposits	**8**	5
Net interest payable and receivable	**(52)**	(42)

The capitalisation rate on specific funding was 7.5% (2011: 5.6%) and on general borrowings was 4.9% (2011: 6.1%).

	2012 £m	2011 £m
(b) Other net financing charges		
Expected return on post-employment scheme assets	**138**	153
Interest on post-employment obligations	**(158)**	(170)
Post-employment finance charges	**(20)**	(17)
Unwind of discounts	**(6)**	(2)
	(26)	(19)

6 Taxation

(a) Tax expense

Analysis of charge in year	2012 £m	2011 £m
Current tax (charge)/credit		
Current year charge	**(86)**	(92)
Utilisation of previously unrecognised tax losses and other assets	**8**	10
Net movement on provisions for uncertain tax positions	**(30)**	(22)
Adjustments in respect of prior years	**(4)**	1
	(112)	(103)
Deferred tax (charge)/credit		
Origination and reversal of temporary differences	**(81)**	(26)
Tax on change in value of derivative financial instruments	**(19)**	7
Other changes in unrecognised deferred tax assets	**136**	58
Adjustments in respect of prior years	**(16)**	9
	20	48
Total tax charge for the year	**(92)**	(55)

6 **Taxation (continued)**
(a) **Tax expense (continued)**

Significant judgements and estimates

The Group operates in many jurisdictions and is subject to tax audits which are often complex and can take several years to conclude. Therefore, the accrual for current tax includes provisions for uncertain tax positions which require estimates for each matter and the exercise of judgement in respect of the interpretation of tax laws and the likelihood of challenge to historic tax positions. Where appropriate, estimates of interest and penalties are included in these provisions. As amounts provided for in any year could differ from eventual tax liabilities, subsequent adjustments which have a material impact on the Group's tax rate and/or cash tax payments may arise. Tax payments comprise payments on account and payments on the final resolution of open items and, as a result, there can be substantial differences between the charge in the income statement and cash tax payments. With regard to deferred tax, judgement is required for the recognition of deferred tax assets, which is based on expectations of future financial performance in particular legal entities or tax groups.

	2012		2011	
Tax reconciliation	**£m**	**%**	£m	%
Profit before tax	**588**		351	
Less share of post-tax earnings of joint ventures	**(38)**		(38)	
Profit before tax excluding joint ventures	**550**		313	
Tax charge calculated at 24.5% (2011: 26.5%) standard UK corporate tax rate	**(135)**	**(24)**	(83)	(26)
Differences between UK and overseas corporate tax rates	**(37)**	**(7)**	(26)	(8)
Non-deductible and non-taxable items	**(4)**	**(1)**	(2)	(1)
Utilisation of previously unrecognised tax losses and other assets	**8**	**1**	10	3
Other changes in unrecognised deferred tax assets	**126**	**23**	58	19
Tax charge on ordinary activities	**(42)**	**(8)**	(43)	(13)
Net movement on provision for uncertain tax positions	**(30)**	**(5)**	(22)	(7)
Other adjustments in respect of prior years	**(20)**	**(4)**	10	3
Total tax charge for the year	**(92)**	**(17)**	(55)	(17)

(b) **Tax included in comprehensive income**

	2012	2011
	£m	£m
Deferred tax on post-employment obligations	**79**	30
Deferred tax on foreign currency gains and losses on intra-group funding	**1**	1
Current tax on post-employment obligations	**22**	24
Current tax on foreign currency gains and losses on intra-group funding	**6**	1
	108	56

(c) **Current tax**

	2012	2011
	£m	£m
Assets	**24**	16
Liabilities	**(157)**	(138)
	(133)	(122)

(d) **Recognised deferred tax**

	2012	2011
	£m	£m
Deferred tax assets	**302**	224
Deferred tax liabilities	**(204)**	(96)
	98	128

There is a net £20 million deferred tax credit to the income statement in the year (2011: £48 million) and a further deferred tax credit of £80 million has been recorded directly in other comprehensive income (2011: £31 million). These credits primarily relate to the recognition of previous unrecognised future tax deductions in the US and UK, based on management projections which indicate the future availability of taxable profits to absorb the deductions.

6 **Taxation (continued)**
(d) **Recognised deferred tax (continued)**

The movements in deferred tax assets and liabilities (prior to the offsetting of balances within the same jurisdiction as permitted by IAS 12) during the year are shown below:

	Assets			Liabilities		
	Post-employment obligations £m	Tax losses £m	Other £m	Fixed assets £m	Other £m	Total £m
At 1 January 2012	**142**	**147**	**51**	**(206)**	**(6)**	**128**
Included in the income statement	**(14)**	**9**	**(6)**	**41**	**(10)**	**20**
Included in other comprehensive income	**79**	**-**	**-**	**-**	**1**	**80**
Businesses acquired	**21**	**-**	**14**	**(162)**	**-**	**(127)**
Currency variations	**(4)**	**(8)**	**(4)**	**14**	**(1)**	**(3)**
At 31 December 2012	**224**	**148**	**55**	**(313)**	**(16)**	**98**
At 1 January 2011	111	120	47	(161)	(9)	108
Included in the income statement	-	23	12	11	2	48
Included in other comprehensive income	30	-	-	-	1	31
Businesses acquired	-	-	(8)	(60)	-	(68)
Currency variations	1	4	-	4	-	9
At 31 December 2011	142	147	51	(206)	(6)	128

No deferred tax assets (2011: £41 million) have been recognised in territories where tax losses have been incurred in the year.

(e) **Unrecognised deferred tax assets**

Certain deferred tax assets have not been recognised on the basis that the Group's ability to utilise them is uncertain as shown below.

	2012			2011		
	Tax value £m	**Gross £m**	**Expiry period**	Tax value £m	Gross £m	Expiry period
Tax losses - with expiry: national	**115**	**329**	**2013-2031**	142	401	2012-2031
Tax losses - with expiry: local	**18**	**442**	**2013-2031**	20	487	2012-2031
Tax losses - without expiry	**60**	**244**		116	448	
Total tax losses	**193**	**1,015**		278	1,336	
Post-employment obligations	**1**	**4**		70	298	
Other temporary differences	**5**	**19**		41	161	
Total other temporary differences	**6**	**23**		111	459	
Unrecognised deferred tax assets	**199**	**1,038**		389	1,795	

No deferred tax is recognised on the unremitted earnings of overseas subsidiaries except where the distribution of such profits is planned. If these earnings were remitted in full, tax of £12 million (2011: £13 million) would be payable.

(f) **Changes in UK tax rate**
A reduction in the mainstream rate of UK corporation tax to 24% took effect from April 2012 which gives rise to an effective UK tax rate of 24.5% for the year. Further reductions to 20% by 2015 are expected and at the balance sheet date a reduction to 23% had been substantively enacted, so UK deferred tax is measured at 23%. Further reductions will cause a corresponding reduction in the value of UK deferred tax assets.

(g) **Franked investment income - litigation**
Since 2003, the Group has been involved in litigation with HMRC in respect of various advance corporate tax payments made and corporate tax paid on certain foreign dividends which, in its view, were levied by HMRC in breach of the Group's EU community law rights. A High Court judgment regarding payments on account was handed down in January 2013 confirming HMRC should repay payments on account to GKN. The European Court of Justice published its decision on 13 November 2012 and the case will return to the UK Courts.

The continuing complexity of the case and uncertainty over the issues raised means that it is not possible to predict the final outcome of the litigation with any reasonable degree of certainty and, as a result, no contingent asset has been recognised.

7 Employees including Directors

Employee benefit expense	2012 £m	2011 £m
Wages and salaries	**(1,309)**	(1,204)
Social security costs	**(225)**	(199)
Post-employment costs	**(63)**	(48)
Share-based payments	**(6)**	(6)
	(1,603)	(1,457)

Average monthly number of employees (including Executive Directors)	2012 Number	2011 Number
By business		
Driveline	**17,991**	16,197
Powder Metallurgy	**6,483**	6,162
Aerospace	**9,218**	8,632
Land Systems	**5,498**	4,848
Other businesses	**941**	896
Corporate	**204**	190
Total	**40,335**	36,925

Key management

The key management of the Group comprises GKN plc Board Directors and members of the Group's Executive Committee during the year and their aggregate compensation is shown below.

Key management compensation	2012 £m	2011 £m
Salaries and short term employee benefits	**4.3**	6.3
Post-employment benefits	**0.3**	0.7
Share-based and medium term incentives and benefits	**2.8**	4.2
	7.4	11.2

The amount outstanding at 31 December 2012 in respect of annual short term variable remuneration payable in cash was £1.2 million (2011: £1.9 million). Key management participate in certain incentive arrangements where the key performance metric is management earnings per share using the cash tax rate which is discussed on page 32 of the business review in the GKN plc group accounts. Management eps using the cash tax rate is 27.5p (2011: 23.2p). A total of £108,247 in dividends was received by key management in 2012 (2011: £106,700).

8 Share-based payments

The Group has granted options over shares to employees for a number of years under different schemes. Where grants were made after 7 November 2002 they have been accounted for as required by IFRS 2 "Share-based payment". Awards made before that date have not been so accounted.

Details of awards made in 2012 are set out below. Details of awards made since 7 November 2002 that impact the 2012 accounting charge are:

(a) Executive Share Option Schemes (ESOS)

Awards were made to Directors and certain senior employees in March 2003 under the 2001 scheme and in, August 2009, May 2010 and April 2011 under the 2004 scheme. Under both schemes options were granted with a fixed exercise price based on the average share price for the five dealing days immediately before the date of grant and subject to meeting performance conditions over a three year period. In the case of the 2001 scheme, the performance condition was based on earnings per share (eps) growth whilst under the 2004 scheme the condition was based on Total Shareholder Return (TSR) compared with that of comparator companies. Under the 2001 scheme only, where the performance condition is not satisfied in full after the first three years, retesting is carried out each year up to six years from the date of grant. Release is subject to the satisfaction of a personal shareholding requirement for Directors and certain very senior employees. No ESOS awards were granted during the period.

(b) Long Term Incentive Plans (LTIP)

Awards were made in August 2009, August 2010 and April 2011 to GKN plc Directors only subject to eps performance over a three year period. There is no retest facility under the scheme. Release is subject to Directors satisfying a personal shareholding requirement. No LTIP awards were granted during the period. On release, a cash amount will be paid equivalent to aggregate dividends per share paid in the period commencing 1 January in the performance period to the fourth anniversary of the date of grant.

(c) Profit Growth Incentive Plan (PGIP)

Awards were made in August 2010 and April 2011 under the PGIP to certain senior employees (excluding Directors). Any benefit under the PGIP will be delivered dependent upon the extent to which profit growth targets are satisfied by the Group over a three year performance period. The PGIP is a cash-based incentive plan, however, for certain very senior employees the benefit is delivered in shares; the number of shares will be released following the performance period if the minimum targeted profit growth is achieved. A maximum of twice the amount of shares will be released on achievement of the maximum profit growth target, with one and a half times the number being released for “medium” performance. No shares will be released and the awards will lapse if the minimum profit growth target is not achieved. Release is also conditional upon the satisfaction of a personal shareholding requirement for certain very senior employees. Any awards delivered under the PGIP will be satisfied from GKN ordinary shares held in the Employee Share Ownership Plan Trust. No PGIP awards were granted during the period.

8 Share-based payments (continued)

(d) Deferred Bonus Plan (DBP)

Awards were made to Directors and certain senior employees in April 2011 and August 2012. Awards are in respect of above target performance under the short term variable remuneration scheme which are compulsorily deferred into shares under the DBP. Awards are not subject to a further performance condition and shares will normally be released at the end of a two year deferral period. On release, a cash amount will be paid equivalent to aggregate dividends per share paid during the deferral period.

Details of awards granted during the year are set out below:

	Shares granted during period	Weighted average fair value at measurement date
2012 DBP awards	625,105	212.18p

The fair value of shares awarded under the DBP is calculated as the share price on the grant date.

(e) Sustainable Earnings Plan (SEP)

Awards comprising a Core Award and a Sustainability Award were made to Directors and certain senior employees in August 2012. A Core Award is subject to eps growth targets over an initial three year performance period and a Sustainability Award is subject to the highest level of eps achieved over the initial three year period being sustained for a further two year period. Sustained eps growth is measured independently in years four and five. 50% of the Core Award will be released at the end of the initial three year period; the balance of the Core Award together with the Sustainability Award will be released at the end of year five. There is no provision for retesting performance for either the Core Award or Sustainability Award. On release, dividends are treated as having accrued on the shares from the date of grant to the date of release with the value delivered in either shares or cash.

Details of SEP awards (both a Core Award and a Sustainability Award) granted during the year are set out below:

	Shares granted during period	Weighted average fair value at measurement date
2012 SEP awards	10,318,028	214.00p

The fair value of shares awarded under the SEP is calculated as the share price on the grant date.

Further details of the ESOS, LTIP, PGIP, DBP and SEP schemes are given in the Directors' remuneration report of GKN plc.

8 Share-based payments (continued)

A reconciliation of ESOS option movements over the year to 31 December 2012 is shown below:

	2012		2011	
	Number 000s	**Weighted average exercise price pence**	Number 000s	Weighted average exercise price pence
Outstanding at 1 January	21,210	127.17	20,617	121.58
Granted	-	-	1,637	199.66
Forfeited	(1,085)	175.41	(868)	132.93
Exercised	(8,746)	114.42	(176)	118.33
Outstanding at 31 December	11,379	132.37	21,210	127.17
Exercisable at 31 December	5,126	110.51	3,249	138.32

For options outstanding at 31 December the range of exercise prices and weighted average contractual life is shown in the following table:

	2012		2011	
Range of exercise price	**Number of shares 000s**	**Contractual weighted average remaining life years**	Number of shares 000s	Contractual weighted average remaining life years
110p-145p	**9,878**	**6.81**	18,680	7.00
195p-220p	**1,501**	**8.25**	2,530	6.06

The weighted average share price during the year for options exercised over the year was 208.9p (2011: 201.5p). The total charge for the year relating to share-based payment plans was £6 million (2011: £6 million) all of which related to equity-settled share-based payment transactions. After deferred tax, the total charge was £6 million (2011: £6 million).

Liabilities in respect of share-based payments were not material at either 31 December 2012 or 31 December 2011. There were no vested rights to cash or other assets at either 31 December 2012 or 31 December 2011.

9 Goodwill and other intangible assets

(a) Goodwill

	2012 £m	2011 £m
Cost		
At 1 January	**715**	527
Businesses acquired	**38**	188
Currency variations	**(34)**	-
At 31 December	**719**	715
Accumulated impairment		
At 1 January	**181**	177
Currency variations	**(13)**	4
At 31 December	**168**	181
Net book amount at 31 December	**551**	534

The carrying value of goodwill at 31 December comprised:

Reportable segment	Business	Geographical location	2012 £m	2011 £m
Driveline	Driveline	Americas	**118**	**126**
	Driveline	Europe	**63**	**63**
Powder Metallurgy	Hoeganaes	North America	**21**	**22**
Aerospace	Aerostructures	North America	**31**	**33**
	Engine Systems(i)	North America & Europe	**37**	**-**
	Engine Products	North America	**93**	**98**
	Special Products	North America	**36**	**38**
Land Systems	Power Management Devices	Europe	**71**	**70**
	Wheels and Structures	Italy	**19**	**20**
			489	**470**
Other businesses not individually significant to the carrying value of goodwill			**62**	**64**
			551	**534**

(i) Includes goodwill arising on the acquisition of Volvo Aerospace on 1 October 2012 (see note 21).

(b) Other intangible assets

	2012						
				Assets arising on business combinations			
	Development costs £m	Participation fees £m	Computer software £m	Marketing related £m	Customer related £m	Technology based £m	Total £m
Cost							
At 1 January 2012	**170**	**-**	**91**	**12**	**271**	**107**	**651**
Businesses acquired	**96**	**133**	**-**	**-**	**236**	**97**	**562**
Additions	**56**	**-**	**8**	**-**	**-**	**-**	**64**
Capitalised borrowing costs	**3**	**-**	**-**	**-**	**-**	**-**	**3**
Disposals	**-**	**-**	**(3)**	**-**	**-**	**-**	**(3)**
Businesses sold	**-**	**-**	**(2)**	**-**	**-**	**-**	**(2)**
Currency variations	**(1)**	**-**	**(3)**	**-**	**(8)**	**(4)**	**(16)**
At 31 December 2012	**324**	**133**	**91**	**12**	**499**	**200**	**1,259**
Accumulated amortisation							
At 1 January 2012	**54**	**-**	**77**	**2**	**71**	**23**	**227**
Charge for the year							
Charged to trading profit	**8**	**2**	**7**	**-**	**-**	**-**	**17**
Non-operating intangible assets	**-**	**-**	**-**	**1**	**25**	**11**	**37**
Disposals	**-**	**-**	**(3)**	**-**	**-**	**-**	**(3)**
Businesses sold	**-**	**-**	**(2)**	**-**	**-**	**-**	**(2)**
Currency variations	**2**	**-**	**(3)**	**-**	**(2)**	**(3)**	**(6)**
At 31 December 2012	**64**	**2**	**76**	**3**	**94**	**31**	**270**
Net book amount at 31 December 2012	**260**	**131**	**15**	**9**	**405**	**169**	**989**

9 **Goodwill and other intangible assets (continued)**

(b) **Other intangible assets (continued)**

	2011					
			Assets arising on business combinations			
	Development costs £m	Computer software £m	Marketing related £m	Customer related £m	Technology based £m	Total £m
Cost						
At 1 January 2011	126	104	6	145	31	412
Businesses acquired	-	-	7	126	76	209
Additions	41	5	-	-	-	46
Capitalised borrowing costs	3	-	-	-	-	3
Disposals	-	(9)	-	-	-	(9)
Businesses sold	-	(8)	-	-	-	(8)
Currency variations	-	(1)	(1)	-	-	(2)
At 31 December 2011	170	91	12	271	107	651
Accumulated amortisation						
At 1 January 2011	51	89	2	52	18	212
Charge for the year						
Charged to trading profit	4	6	-	-	-	10
Non-operating intangible assets	-	-	-	17	5	22
Disposals	-	(9)	-	-	-	(9)
Businesses sold	-	(8)	-	-	-	(8)
Currency variations	(1)	(1)	-	2	-	-
At 31 December 2011	54	77	2	71	23	227
Net book amount at 31 December 2011	116	14	10	200	84	424

Development costs of £78 million (2011: £54 million) and £11 million (2011: £13 million) in respect of two aerospace programmes are being amortised on a units of production basis. There is £44 million (2011: £52 million) in respect of a customer relationship asset arising from one previous business combination with a remaining amortisation period of 5 years (2011: 6 years). Following the acquisition of Volvo Aerospace in the year there are other intangible assets of £320 million in respect of four programmes with a remaining amortisation period of 25 years.

As a result of a further acquisition in the year (see note 21 for details) and the increased value of “assets arising on business combination”, further analysis has been provided for each sub-category. Comparative information has been enhanced for consistency. There has been no change to the total for “assets arising on business combinations” in the comparative period.

(c) **Impairment testing**

An impairment test is a comparison of the carrying value of the assets of a business or cash generating unit (CGU) to their recoverable amount. Where the recoverable amount is less than the carrying value, an impairment results. During the year, all goodwill (including amounts arising on the business acquired in the year) was tested for impairment with no impairment charges resulting.

For the purposes of carrying out impairment tests, the Group's total goodwill has been allocated to a number of CGUs and each of these CGUs has been separately assessed and tested. The size of a CGU varies but is never larger than a primary or secondary reportable segment. In some cases, a CGU is an individual subsidiary or operation.

All of the recoverable amounts were measured based on value in use. Detailed forecasts for the next five years have been used which are based on approved annual budgets and strategic projections representing the best estimate of future performance. In the case of an individual CGU within the Group’s Aerospace (Engine Products) business, value in use at 31 December 2012 was measured using operating cash flow projections covering the next ten years which incorporate the anticipated timing of volumes on current programmes. Management consider forecasting over this period to more appropriately reflect the length of business cycle of that CGU’s programmes, in particular the growth of certain military programmes.

9 **Goodwill and other intangible assets (continued)**
(c) **Impairment testing (continued)**

Significant judgements, assumptions and estimates
In determining the recoverable amount of all CGUs it is necessary to make a series of assumptions to estimate the present value of future cash flows. In each case, these key assumptions have been made by management reflecting past experience and are consistent with relevant external sources of information.

Operating cash flows
The main assumptions within forecast operating cash flow include the achievement of future sales prices and volumes (including reference to specific customer relationships, product lines and the use of industry relevant external forecasts of global vehicle production within Driveline businesses and consideration of specific volumes on certain US military and civil programmes within Aerospace), raw material input costs, the cost structure of each CGU and the ability to realise benefits from annual productivity improvements, the impact of foreign currency rates upon selling price and cost relationships and the levels of ongoing capital expenditure required to support forecast production.

Pre-tax risk adjusted discount rates
Pre-tax risk adjusted discount rates are derived from risk-free rates based upon long term government bonds in the territory, or territories, within which each CGU operates. A relative risk adjustment (or “beta”) has been applied to risk-free rates to reflect the risk inherent in each CGU relative to all other sectors on average, determined using an average of the betas of comparable listed companies.

The range of pre-tax risk adjusted discount rates set out below have been used for impairment testing. The range of rates reflects the mix of geographical territories within CGUs within the reportable segments.

Driveline: North and South America 13%-24% (2011: 13%-24%), Europe 12%-14% (2011: 12%-14%) and Japan and Asia Pacific region countries 10%-17% (2011: 10%-17%)
Powder Metallurgy: Europe 12% (2011: 12%) and North America 13% (2011: 13%)
Aerospace: Europe 11% (2011: 11%) and North America 12% (2011: 12%)
Land Systems: Europe 11%-14% (2011: 12%) and North America 13% (2011: 13%)

Long term growth rates
To forecast beyond the detailed cash flows into perpetuity, a long term average growth rate has been used. In each case, this is not greater than the published International Monetary Fund average growth rate in gross domestic product for the next five year period in the territory or territories where the CGU is primarily based. This results in a range of nominal growth rates:

Driveline: North and South America 3%-8% (2011: 3%-8%), Europe 2%-7% (2011: 3%-7%) and Japan and Asia Pacific region countries 2%-8% (2011: 2%-8%)
Powder Metallurgy: Europe 4% (2011: 4%) and North America 3% (2011: 3%)
Aerospace: Europe 3% (2011: 3%) and North America 3% (2011: 3%)
Land Systems: Europe 2%-4% (2011: 2%-3%) and North America 3% (2011: 3%)

Goodwill sensitivity analysis

The results of the Group’s impairment tests are dependent upon estimates and judgements made by management, particularly in relation to the key assumptions described above. Sensitivity analysis to potential changes in key assumptions has therefore been reviewed.

At 31 December 2012, the date of the Group's annual impairment test, the estimated recoverable amount of one individual CGU within the Group's Aerospace operations, one CGU within the Group’s Driveline operations and one CGU within the Group’s Land Systems operations exceeded their carrying value by £131 million, £480 million and £25 million respectively. The table below shows the discount rate, long term growth rate and forecast operating cashflow assumptions used in the calculation of value in use and the amount by which each assumption must change in isolation in order for the estimated recoverable amount to equal the carrying value.

Segment	**Aerospace**	**Driveline**	**Land Systems**
Business	**Engine Products**	**Americas**	**Power Management Devices**
Value in use excess over carrying value	£131m	£480m	£25m
Assumptions used in calculation of value in use			
Pre-tax adjusted discount rate	12%	13%	12%
Long term growth rate	3%	3%	3%
Total pre-discounted forecast operating cashflow	£706m	£2,061m	£340m
Change required for the carrying value to exceed the recoverable amount			
Pre-tax adjusted discount rate	5.9%pts	8.0%pts	1.2%pts
Long term growth rate	29.4%pts	17.7%pts	1.8%pts
Total pre-discounted forecast operating cashflow	49%	45%	12%

Other than as disclosed above, it is not considered that a reasonably possible change in any of the key assumptions would generate a different impairment test outcome to the one included in this annual report.

10 **Property, plant and equipment**

	2012				
	Land and buildings £m	Plant and machinery £m	Other tangible assets £m	Capital work in progress £m	Total £m
Cost					
At 1 January 2012	**744**	**3,646**	**149**	**130**	**4,669**
Businesses acquired	**40**	**144**	**2**	**5**	**191**
Additions	**12**	**115**	**4**	**132**	**263**
Capitalised borrowing costs	**-**	**2**	**-**	**-**	**2**
Disposals	**(2)**	**(66)**	**(3)**	**-**	**(71)**
Businesses sold	**(1)**	**-**	**(1)**	**-**	**(2)**
Transfers	**8**	**101**	**2**	**(111)**	**-**
Currency variations	**(37)**	**(165)**	**(8)**	**(8)**	**(218)**
At 31 December 2012	**764**	**3,777**	**145**	**148**	**4,834**
Accumulated depreciation and impairment					
At 1 January 2012	**221**	**2,509**	**127**	**-**	**2,857**
Charge for the year					
Charged to trading profit					
Depreciation	**19**	**189**	**6**	**-**	**214**
Impairments	**1**	**3**	**-**	**-**	**4**
Disposals	**(1)**	**(64)**	**(3)**	**-**	**(68)**
Businesses sold	**(1)**	**-**	**(1)**	**-**	**(2)**
Currency variations	**(11)**	**(116)**	**(8)**	**-**	**(135)**
At 31 December 2012	**228**	**2,521**	**121**	**-**	**2,870**
Net book amount at 31 December 2012	**536**	**1,256**	**24**	**148**	**1,964**

	2011				
	Land and buildings £m	Plant and Machinery £m	Other tangible assets £m	Capital work in progress £m	Total £m
Cost					
At 1 January 2011	693	3,527	151	91	4,462
Businesses acquired	43	69	5	8	125
Additions	17	157	2	78	254
Capitalised borrowing costs	1	2	-	-	3
Disposals	(8)	(102)	(8)	-	(118)
Businesses sold	-	(8)	(1)	-	(9)
Transfers	-	45	1	(46)	-
Currency variations	(2)	(44)	(1)	(1)	(48)
At 31 December 2011	744	3,646	149	130	4,669
Accumulated depreciation and impairment					
At 1 January 2011	208	2,472	131	-	2,811
Charge for the year					
Charged to trading profit					
Depreciation	16	169	6	-	191
Impairments	-	1	-	-	1
Disposals	(6)	(99)	(8)	-	(113)
Businesses sold	-	(7)	(2)	-	(9)
Currency variations	3	(27)	-	-	(24)
At 31 December 2011	221	2,509	127	-	2,857
Net book amount at 31 December 2011	523	1,137	22	130	1,812

Included within other tangible assets at net book amount are fixtures, fittings and computers £23 million (2011: £20 million) and commercial vehicles and cars £1 million (2011: £2 million). The net book amount of assets under finance leases is land and buildings £2 million (2011: £2 million), plant and equipment £5 million (2011: nil) and other tangible assets nil (2011: nil).

As a result of a further acquisition in the year (see note 21 for details) and the increased value of “other tangible assets”, further analysis has been provided for each sub-category. Comparative information has been enhanced for consistency. There has been no change to the total of “plant and machinery” and “other tangible assets” in the comparative period.

11 **Investments in joint ventures**

Group share of results

	2012	2011
	£m	£m
Sales	**394**	366
Operating costs	**(345)**	(317)
Trading profit	**49**	49
Net financing costs	**(1)**	(1)
Profit before taxation	**48**	48
Taxation	**(7)**	(8)
Share of post-tax earnings - before exceptional and non-trading items	**41**	40
Exceptional and non-trading items	**(3)**	(2)
Share of post-tax earnings	**38**	38

Exceptional and non-trading items represent amortisation of non-operating intangible assets arising on business combinations and other net financing charges including tax nil (2011: £1 million).

Group share of net book amount

	2012			2011		
	Group share of equity	**Provisions for impairment**	**Net book amount**	Group share of equity	Provisions for impairment	Net book amount
	£m	**£m**	**£m**	£m	£m	£m
At 1 January	**147**	**-**	**147**	143	-	143
Share of post-tax earnings	**38**	**-**	**38**	38	-	38
Actuarial losses on post-employment obligations, including deferred tax	**(2)**	**-**	**(2)**	-	-	-
Dividends paid	**(41)**	**-**	**(41)**	(35)	-	(35)
Additions	**5**	**-**	**5**	4	-	4
Disposals	**(1)**	**-**	**(1)**	(6)	-	(6)
Currency variations	**(3)**	**-**	**(3)**	3	-	3
	143	**-**	**143**	147	-	147
Financial guarantee contract			**10**			-
At 31 December			**153**			147

	2012	2011
	£m	£m
Non-current assets	**129**	124
Current assets	**148**	127
Current liabilities	**(98)**	(79)
Non-current liabilities	**(36)**	(25)
	143	147
Financial guarantee contract	**10**	-
	153	147

The joint ventures have no significant contingent liabilities to which the Group is exposed and nor has the Group any significant contingent liabilities in relation to its interest in the joint ventures. The share of capital commitments of the joint venture is shown in note 26.

On 19 December 2012 the Group committed to provide £8 million of additional funding to Emitec, a 50% joint venture in equal proportion to the other 50% venturer. At the same time the Group signed a guarantee contract with Emitec's external bankers with regard to future debt repayment. The guarantee has been valued at £10 million based on future forecasts and an estimate of the probability of default if the guarantee were not in place.

The guarantee contract is included above with a corresponding liability (shown in note 18).

On 2 January 2013 the £8 million of funding was paid in cash.

12 Other receivables and investments

	2012 £m	2011 £m
Other investments	**4**	4
Indirect taxes and amounts recoverable under employee benefit plans	**21**	23
Other receivables	**13**	10
	38	37

Other investments represents the Group's 31% shareholding (25% on a fully diluted basis) in Evo Electric Limited which is designated as an associated undertaking. During the year further investment of £1 million has been offset by the Group's equity accounted share of results.

Included in other receivables is a £6 million (2011: £9 million) indemnity asset.

13 Inventories

	2012 £m	2011 £m
Raw materials	**399**	355
Work in progress	**307**	242
Finished goods	**179**	152
	885	749

Inventories of £68 million (2011: £70 million) are carried at net realisable value. The amount of any write down of inventory recognised as an expense in the year was £2 million (2011: £1 million). A fair value increase for inventory of £37 million relating to the acquisition of Volvo Aerospace (see note 21) has reversed during the period of ownership.

14 Trade and other receivables

	2012 £m	2011 £m
Trade receivables	**936**	840
Amounts owed by joint ventures	**13**	19
Other receivables	**56**	46
Prepayments	**54**	21
Indirect taxes recoverable	**43**	36
	1,102	962
Provisions for doubtful debts against trade receivables		
At 1 January	**(12)**	(10)
Charge for the year		
Additions	**(3)**	(8)
Unused amounts reversed	**2**	1
Amounts used	**5**	5
Currency variations	**-**	-
At 31 December	**(8)**	(12)
Trade receivables subject to provisions for doubtful debts	**8**	13
Ageing analysis of trade receivables and amounts owed by joint ventures past due but not impaired		
Up to 30 days overdue	**50**	**43**
31 – 60 days overdue	**11**	**9**
61 – 90 days overdue	**3**	**4**
More than 90 days overdue	**7**	**7**

There is no provision against other receivable categories.

15 Trade and other payables

	2012		2011	
	Current £m	**Non-current £m**	Current £m	Non-current £m
Amounts owed to suppliers and customers	**(955)**	**(77)**	(975)	(9)
Amounts owed to joint ventures	**(6)**	**-**	(2)	-
Accrued interest	**(17)**	**-**	(21)	-
Government refundable advances	**-**	**(88)**	-	(42)
Deferred and contingent consideration	**(73)**	**(12)**	(12)	(17)
Payroll taxes, indirect taxes and audit fees	**(77)**	**(1)**	(73)	(1)
Amounts due to employees and employee benefit plans	**(167)**	**(72)**	(154)	(35)
Government grants	**(3)**	**(8)**	(2)	(6)
Customer advances and deferred income	**(94)**	**(70)**	(69)	(10)
	(1,392)	**(328)**	(1,308)	(120)

Government refundable advances are forecast to fall due for repayment between 2014 and 2055. Non-current deferred and contingent consideration falls due as follows: one-two years £6 million (2011: £5 million) and two-five years £6 million (2011: £12 million). Non-current amounts owed to suppliers and customers fall due within two years.

Contingent consideration of £9 million (2011: £9 million) is included as payable based upon Filton achieving certain levels of sales in 2013, 2014 and 2015. The range of contingent consideration payable is nil to £9 million.

16 **Net borrowings**

(a) **Analysis of net borrowings**

	Notes	Current	Non-current				Total
		Within one year	One to two years	Two to five years	More than five years	Total	
		£m	£m	£m	£m	£m	£m
2012							
Unsecured capital market borrowings							
£450 million 5⅜ 2022 unsecured bond	i	-	-	-	(444)	(444)	(444)
£350 million 6¾% 2019 unsecured bond	i	-	-	-	(348)	(348)	(348)
Unsecured committed bank borrowings							
European Investment Bank	i	-	-	(48)	(32)	(80)	(80)
2013 Committed Revolving Credit Facility		(20)	-	-	-	-	(20)
2016 Committed Revolving Credit Facility		-	-	(51)	-	(51)	(51)
2017 Committed Revolving Credit Facility		-	-	-	-	-	-
Other		-	(5)	(8)	-	(13)	(13)
Other secured US$ denominated loan		(3)	-	-	-	-	(3)
Finance lease obligations	iii	(1)	-	(1)	-	(1)	(2)
Bank overdrafts		(57)	-	-	-	-	(57)
Other short term bank borrowings		(34)	-	-	-	-	(34)
Borrowings		(115)	(5)	(108)	(824)	(937)	(1,052)
Bank balances and cash		177	-	-	-	-	177
Short term bank deposits	ii	4	-	-	-	-	4
Cash and cash equivalents	iv	181	-	-	-	-	181
Net borrowings		66	(5)	(108)	(824)	(937)	(871)
2011							
Unsecured capital market borrowings							
£350 million 6¾% 2019 unsecured bond	i	-	-	-	(347)	(347)	(347)
£176 million 7% 2012 unsecured bond	i	(176)	-	-	-	-	(176)
Unsecured committed bank borrowings							
European Investment Bank	i	-	-	(32)	(48)	(80)	(80)
2016 Committed Revolving Credit Facility		-	-	(29)	-	(29)	(29)
Other		-	-	(4)	-	(4)	(4)
Other secured US$ denominated loan		(2)	(3)	(1)	-	(4)	(6)
Finance lease obligations	iii	(1)	(1)	(1)	-	(2)	(3)
Bank overdrafts		(11)	-	-	-	-	(11)
Other short term bank borrowings		(38)	-	-	-	-	(38)
Borrowings		(228)	(4)	(67)	(395)	(466)	(694)
Bank balances and cash		150	-	-	-	-	150
Short term bank deposits	ii	6	-	-	-	-	6
Cash and cash equivalents	iv	156	-	-	-	-	156
Net borrowings		(72)	(4)	(67)	(395)	(466)	(538)

Unsecured capital market borrowings include: unsecured £350 million (2011: £350 million) 6¾% bond maturing in 2019 less unamortised issue costs of £2 million (2011: £3 million) and a new unsecured £450 million 5⅜% bond maturing in 2022 less unamortised issue costs of £6 million.

During the year the Group repaid its £176 million 7% 2012 unsecured bond.

Unsecured committed bank borrowings include £80 million (2011: £80 million) drawn under the Group's European Investment Bank unsecured facility. The loan is due for repayment in five equal annual instalments of £16 million, commencing in June 2015 and attracts a fixed interest rate of 4.1% per annum payable annually in arrears. Also included is £71 million, net of £6 million unamortised issue costs (2011: £29 million net of £4 million unamortised issue costs) drawn from the Group's 2013 and 2016 Committed Revolving Credit Facilities of £612 million and no drawings from the Group's new 2017 Committed Revolving Credit Facilities of £225 million. The term of the new facility is 5 years and attracts a variable interest rate.

A secured term loan of £3 million (2011: £6 million) is secured by way of a fixed and floating charge on certain Aerospace fixed assets.

Notes

(i) Denotes borrowings at fixed rates of interest until maturity. All other borrowings and cash and cash equivalents are at variable interest rates unless otherwise stated.

(ii) The average interest rate on short term bank deposits was 0.5% (2011: 0.7%). Deposits at both 31 December 2012 and 31 December 2011 had a maturity date of less than one month.

(iii) Finance lease obligations gross of finance charges fall due as follows: £1 million within one year (2011: £1 million), £2 million in one to five years (2011: £3 million) and nil in more than five years (2011: nil).

(iv) £14 million (2011: £24 million) of the Group's cash and cash equivalents are held by the Group's captive insurance company to maintain solvency requirements and as collateral for Letters of Credit issued to the Group's principal external insurance providers. These funds cannot be circulated within the Group on demand.

16 **Net borrowings (continued)**
(b) **Fair values**

	2012		2011	
	Book value £m	**Fair value £m**	Book value £m	Fair value £m
Borrowings, other financial assets and cash and cash equivalents				
Other borrowings	**(959)**	**(1,021)**	(642)	(659)
Finance lease obligations	**(2)**	**(2)**	(3)	(3)
Bank overdrafts and other short term bank borrowings	**(91)**	**(91)**	(49)	(49)
Bank balances and cash	**177**	**177**	150	150
Short term bank deposits	**4**	**4**	6	6
	(871)	**(933)**	(538)	(555)
Trade and other payables				
Government refundable advances	**(88)**	**(99)**	(42)	(39)
Deferred and contingent consideration	**(85)**	**(85)**	(29)	(29)
	(173)	**(184)**	(71)	(68)

The following methods and assumptions were used in estimating fair values for financial instruments:

Unsecured bank overdrafts, other short term bank borrowings, bank balances and cash and short term bank deposits approximate to book value due to their short maturities. For other amounts, the repayments which the Group is committed to make have been discounted at the relevant interest rates applicable at 31 December 2012. Bonds included within other borrowings have been valued using quoted closing market values.

17 **Financial risk management**

The Group's activities give rise to a number of financial risks: market risk, credit risk and liquidity risk. Market risk includes foreign currency risk, cash flow and fair value interest rate risk and commodity price risk. The Group has in place risk management policies that seek to limit the effects of financial risk on financial performance. Derivative financial instruments, mainly forward foreign currency contracts, are used to hedge risk exposures that arise in the ordinary course of business. Further information is provided in the treasury management section of the business review.

Risk management policies have been set by the Board and are implemented by the central Treasury Department that receives regular reports from all the operating companies to enable prompt identification of financial risks so that appropriate actions may be taken. The Treasury Department has a policy and procedures manual that sets out specific guidelines to manage foreign currency risks, interest rate risk, financial credit risk and liquidity risk and the use of financial instruments to manage these.

(a) Foreign currency risk

The Group has transactional currency exposures arising from sales or purchases by operating subsidiaries in currencies other than the subsidiaries' functional currency. These exposures are forecast on a monthly basis by operating companies and are reported to the central Treasury Department. Under the Group's foreign currency policy, such exposures are hedged on a reducing percentage basis over a number of forecast time horizons using forward foreign currency contracts.

As a result of the Volvo Aerospace acquisition on 1 October 2012, specific transactional hedge arrangements have been taken out against future payroll costs to fix the USD functional currency amounts.

The Group's reporting currency for its consolidated financial statements is sterling. Changes in exchange rates will affect the translation of results and net assets of operations outside of the UK. The Group's largest exposures are the euro and the US dollar where a 1% movement in the average rate impacts trading profit of subsidiaries and joint ventures by £1 million and £2 million respectively.

Regarding financial instruments a 1% strengthening of sterling against the currency rates indicated below would have the following impact on operating profit:

	Trading profit: Payables and receivables £m	Derivative financial instruments £m	Intra-group funding £m
Euro	0.3	(2.7)	1.0
US dollar	(0.6)	18.2	0.2

The derivative sensitivity analysis has been prepared by reperforming the calculations used to determine the balance sheet values adjusted for the changes in the individual currency rates indicated with all other cross currency rates remaining constant. The sensitivity is a fair value change relating to derivatives for which the underlying transaction has not occurred at 31 December 2012. The Group intends to hold all such derivatives to maturity. The analysis of other items has been prepared based on an analysis of a currency balance sheet.

Analysis of net borrowings by currency:

	2012			2011		
	Borrowings £m	**Cash and cash equivalents £m**	**Total £m**	Borrowings £m	Cash and cash equivalents £m	Total £m
Sterling	**(972)**	**21**	**(951)**	(644)	29	(615)
US dollar	**(7)**	**25**	**18**	(12)	16	4
Euro	**(24)**	**29**	**5**	-	34	34
Others	**(49)**	**106**	**57**	(38)	77	39
	(1,052)	**181**	**(871)**	(694)	156	(538)

17 **Financial risk management (continued)**

(b) Interest rate risk

The Group is exposed to fair value interest rate risk on fixed rate borrowings and cash flow interest rate risk on variable rate net borrowings/funds. The Group's policy is to optimise interest cost in reported earnings and reduce volatility in the debt related element of the Group's cost of capital. This policy is achieved by maintaining a target range of fixed and floating rate debt for discrete annual periods, over a defined time horizon. The Group's normal policy is to require interest rates to be fixed for 50% to 80% of the level of underlying borrowings forecast to arise over a 12 month horizon. At 31 December 2012 82% (2011: 87%) of the Group's gross borrowings were subject to fixed interest rates.

As at 31 December 2012 £4 million (2011: £6 million) was in bank deposits, all of which was on deposit with banks on the Isle of Man (2011: £6 million).

(c) Credit risk

The Group is exposed to credit-related losses in the event of non-performance by counterparties to financial instruments. In terms of substance, and consistent with the related balance sheet presentation, the Group considers it has two types of credit risk; operational and financial. Operational credit risk relates to non-performance by customers in respect of trade receivables and by suppliers in respect of other receivables. Financial credit risk relates to non-performance by banks and similar institutions in respect of cash and deposits, facilities and financial contracts, including forward foreign currency contracts.

Operational

As tier-one suppliers to automotive, land systems and aerospace original equipment manufacturers the Group may have substantial amounts outstanding with a single customer at any one time. The credit profiles of such original equipment manufacturers are available from credit rating agencies. The failure of any such customer to honour its debts could materially impact the Group's results. However, there are many advantages in these relationships. In Land Systems there are a greater proportion of amounts receivable from small and medium sized customers.

Credit risk and customer relationships are managed at a number of levels within the Group. At a subsidiary level documented credit control reviews are required to be held at least every month. The scope of these reviews includes amounts overdue and credit limits. At a divisional level debtor ratios, overdue accounts and overall performance are reviewed regularly. Provisions for doubtful debts are determined at these levels based upon the customer's ability to pay and other factors in the Group's relationship with the customer.

At 31 December the largest 5 trade receivables as a proportion of total trade receivables analysed by major segment is as follows:

	2012	2011
	%	%
Driveline	**56**	53
Powder Metallurgy	**19**	20
Aerospace	**69**	67
Land Systems	**25**	28

The amount of trade receivables outstanding at the year end does not represent the maximum exposure to operational credit risk due to the normal patterns of supply and payment over the course of a year. Based on management information collected as at month ends the maximum level of trade receivables at any one point during the year was £1,055 million (2011: £940 million).

Financial

Credit risk is mitigated by the Group’s policy of only selecting counterparties with a strong investment graded long term credit rating, normally at least A- or equivalent, and assigning financial limits to individual counterparties.

The maximum exposure with a single bank for deposits is £4 million (2011: £6 million), whilst the maximum mark to market exposure for forward foreign currency contracts at 31 December 2012 to a single bank was £11 million (2011: £1 million).

17 **Financial risk management (continued)**

(d) Capital risk management

The Group defines capital as total equity. The Group's objectives when managing capital are to safeguard the ability to continue as a going concern in order to provide returns for shareholders and benefits for other stakeholders and to maintain a capital structure which optimises the cost of capital. In order to maintain or adjust the capital structure, the Group may adjust the amount of dividends paid to shareholders, return capital to shareholders or issue new shares.

The Group monitors borrowings on the basis of the ratio of gross borrowings to EBITDA. The Group seeks to operate at a gross debt to EBITDA of subsidiaries ratio of 3 times or less and the ratios at 31 December 2012 and 2011 were as follows:

	2012	2011
	£m	£m
Gross borrowings	**1,052**	694
EBITDA	**743**	621
Gross borrowings to EBITDA ratio	**1.4 times**	1.1 times

The Group's two external banking covenants require an EBITDA of subsidiaries to net interest payable and receivable ratio of 3.5 times or more and net debt to EBITDA of subsidiaries of 3 times or less measured at 30 June and 31 December. The ratios at 31 December 2012 and 2011 were as follows:

	2012	2011
	£m	£m
EBITDA	**743**	621
Net interest payable and receivable (excluding borrowing costs capitalised)	**(57)**	(48)
EBITDA to net interest payable and receivable ratio	**13.0 times**	12.9 times

	2012	2011
	£m	£m
Net debt	**871**	538
EBITDA	**743**	621
Net debt to EBITDA ratio	**1.2 times**	0.9 times

The Group monitors these ratios on a rolling basis and they are part of the budgeting and forecasting processes.

(e) Liquidity risk

The Group is exposed to liquidity risk as part of its normal financing and trading cycle at times when peak borrowings are required. Borrowings normally peak in May and September following dividend and bond coupon payments. The Group's policies are to ensure that sufficient liquidity is available to meet obligations when they fall due and to maintain sufficient flexibility in order to fund investment and acquisition objectives. Liquidity needs are assessed through short and long term forecasts. Committed bank facilities total £917 million of which £20 million expires in 2013, £592 million expires in 2016 and £225 million in 2017. In addition the Group’s European Investment Bank unsecured facility (£80 million) is repayable in five equal instalments of £16 million commencing in June 2015. There were £157 million of drawings on these facilities at 31 December 2012. Committed facilities are provided through 19 banks.

The Group also maintains £56 million of uncommitted facilities, provided by 3 banks. There were drawings of £53 million against these facilities at 31 December 2012.

Maturity analysis of borrowings, derivatives and other financial liabilities

	Within one year £m	One to two years £m	Two to five years £m	More than five years £m	Total £m
2012					
Borrowings (note 16)	**(115)**	**(5)**	**(108)**	**(824)**	**(1,052)**
Contractual interest payments and finance lease charges	**(57)**	**(57)**	**(154)**	**(166)**	**(434)**
Government refundable advances	**(2)**	**(8)**	**(30)**	**(137)**	**(177)**
Deferred and contingent consideration	**(74)**	**(6)**	**(6)**	**-**	**(86)**
Derivative financial instruments liabilities - receipts	**205**	**108**	**176**	**22**	**511**
Derivative financial instruments liabilities - payments	**(213)**	**(114)**	**(189)**	**(22)**	**(538)**
2011					
Borrowings (note 16)	(228)	(4)	(67)	(395)	(694)
Contractual interest payments and finance lease charges	(41)	(29)	(89)	(75)	(234)
Government refundable advances	-	-	(12)	(55)	(67)
Deferred and contingent consideration	(12)	(6)	(12)	-	(30)
Derivative financial instruments liabilities - receipts	333	223	314	262	1,132
Derivative financial instruments liabilities - payments	(360)	(237)	(341)	(273)	(1,211)

There is no significant difference in the contractual undiscounted value of other financial liabilities from the amounts stated in the balance sheet and balance sheet notes.

17 **Financial risk management (continued)**

(f) Commodity price risk

The Group is exposed to changes in commodity prices, particularly of metals, which has a significant impact on input costs and the overall financial results. The Group seeks to mitigate this exposure in a variety of ways including medium term price agreements, surcharges and advance purchasing. In rare circumstances and only in respect of certain specified risks the Group uses derivative commodity hedging instruments. The impact of such financial instruments in respect of the overall commodity price risk is not material.

(g) Categories of financial assets and financial liabilities

			Held for trading		
	Loans and receivables £m	Amortised cost £m	Financial assets £m	Financial liabilities £m	Total £m
2012					
Other receivables and investments	**13**	**-**	**-**	**-**	**13**
Trade and other receivables	**1,005**	**-**	**-**	**-**	**1,005**
Amounts receivable from parent undertaking	**2,122**	**-**	**-**	**-**	**2,122**
Derivative financial instruments	**-**	**-**	**81**	**(50)**	**31**
Cash and cash equivalents	**181**	**-**	**-**	**-**	**181**
Borrowings	**-**	**(1,052)**	**-**	**-**	**(1,052)**
Trade and other payables	**-**	**(1,228)**	**-**	**-**	**(1,228)**
Amounts payable to parent undertaking	**-**	**(8)**	**-**	**-**	**(8)**
Provisions	**-**	**(78)**	**-**	**-**	**(78)**
	3,321	**(2,366)**	**81**	**(50)**	**986**
2011					
Other receivables and investments	10	-	-	-	10
Trade and other receivables	905	-	-	-	905
Amounts receivable from parent undertaking	2,176	-	-	-	2,176
Derivative financial instruments	-	-	26	(102)	(76)
Cash and cash equivalents	156	-	-	-	156
Borrowings	-	(694)	-	-	(694)
Trade and other payables	-	(1,078)	-	-	(1,078)
Amounts payable to parent undertaking	-	(9)	-	-	(9)
Provisions	-	(50)	-	-	(50)
	3,247	(1,831)	26	(102)	1,340

For the purposes of IFRS7 derivative financial instruments are categorised as a Level 2 fair value measurement. The discounted contingent element of deferred and contingent consideration of £8 million (2011: £14 million) is categorised as a Level 3 fair value measurement, see note 15.

18 **Derivative financial instruments**

	2012					2011				
	Assets		**Liabilities**		**Total**	Assets		Liabilities		Total
	Non-current	**Current**	**Non-current**	**Current**		Non-current	Current	Non-current	Current	
	£m	**£m**	**£m**	**£m**	**£m**	£m	£m	£m	£m	£m
Forward currency contracts										
Not hedge accounted	**38**	**26**	**(21)**	**(10)**	**33**	2	4	(61)	(29)	(84)
Hedge accounted	**-**	**-**	**-**	**-**	**-**	-	-	-	-	-
Commodity contracts										
Not hedge accounted	**-**	**-**	**-**	**-**	**-**	-	-	-	(1)	(1)
Embedded derivatives	**16**	**1**	**(8)**	**(1)**	**8**	19	1	(11)	-	9
Financial guarantee contract	**-**	**-**	**(10)**	**-**	**(10)**	-	-	-	-	-
	54	**27**	**(39)**	**(11)**	**31**	21	5	(72)	(30)	(76)

Hedge accounting – cash flow hedges

The Group manages exposure to foreign currency fluctuations on forecast and outstanding purchase and sale transactions using forward foreign currency contracts. The Group adopted transactional foreign currency hedge accounting for a limited number of foreign currency contracts. The cash flows and related currency hedges to which hedge accounting applied all occurred before the end of 2012.

In order to mitigate exposure to foreign currency risk on the consideration payment for acquisition of Volvo Aerospace (see note 21), the Group entered into forward currency contracts to fix the Sterling value of the SEK denominated equity consideration. Hedge accounting was applied which resulted in the 'gain' of £13 million being taken to the Hedging Reserve. On settlement of consideration on 1 October 2012, the £13 million gain was recycled into the purchase price used for calculating goodwill.

Significant judgement and estimates

Forward foreign currency contracts, commodity contracts and embedded derivatives are marked to market using market observable rates and published prices together with forecast cash flow information where applicable. The amounts in respect of embedded derivatives represent commercial contracts denominated in US dollars between European Aerospace subsidiaries and customers outside the USA.

19 **Provisions**

	Contract provisions £m	Warranty £m	Claims and litigation £m	Employee obligations £m	Other £m	Total £m
At 1 January 2012	**(50)**	**(35)**	**(23)**	**(19)**	**(10)**	**(137)**
Net charge for the year:						
Additions	**-**	**(12)**	**(5)**	**(3)**	**(1)**	**(21)**
Unused amounts reversed	**3**	**2**	**-**	**1**	**-**	**6**
Unwind of discounts	**(5)**	**-**	**-**	**-**	**-**	**(5)**
Businesses acquired	**(31)**	**(14)**	**(6)**	**(6)**	**(7)**	**(64)**
Amounts used	**3**	**13**	**12**	**2**	**5**	**35**
Currency variations	**2**	**2**	**-**	**2**	**(2)**	**4**
At 31 December 2012	**(78)**	**(44)**	**(22)**	**(23)**	**(15)**	**(182)**
Due within one year	(4)	(26)	(7)	(4)	(6)	(47)
Due in more than one year	(74)	(18)	(15)	(19)	(9)	(135)
	(78)	**(44)**	**(22)**	**(23)**	**(15)**	**(182)**

As a result of a further acquisition in the year (see note 21 for details) and the increased value of “other provisions”, categories of provision have been reanalysed to provide a more relevant basis in the future.

Contract provisions
The Group has a small number of onerous contracts and a non-beneficial lease arrangement, primarily arising on business combinations. Onerous contracts relate to customer programmes where the unavoidable costs of delivering product are in excess of contracted sales prices.

Utilisation of the provision due in more than one year is estimated as £5 million in 2014 and £69 million from 2015.

Warranty
Provisions set aside for warranty exposures either relate to amounts provided systematically based on historical experience under contractual warranty obligations attaching to the supply of goods or specific provisions created in respect of individual customer issues undergoing commercial resolution and negotiation. In the event of a claim, settlement will be negotiated with the customer based on supply of replacement products and compensation for the customer's associated costs. Amounts set aside represent management's best estimate of the likely settlement and the timing of any resolution with the relevant customer.

Utilisation of the provision due in more than one year is estimated as £7 million in 2014 and £11 million from 2015.

Claims and litigation
Claims provisions are held in the Group’s captive insurance company and amount to £6 million (2011: £14 million). Claims provisions and charges are established in accordance with external insurance and actuarial advice.

Legal provisions amounting to £5 million (2011: £4 million) relate to management estimates of amounts required to settle or remove litigation actions that have arisen in the normal course of business. Further details are not provided to avoid the potential of seriously prejudicing the Group's stance in law. Amounts unused and reversed only arise when the matter is formally settled or when a material change in the litigation action occurs where legal advice confirms lower amounts need to be retained to cover the exposure.

As a consequence of primarily legacy activities a small number of sites in the Group are subject to environmental remediation actions, which in all cases are either agreed formally with relevant local and national authorities and agencies or represent management's view of the likely outcome having taken appropriate expert advice and following consultation with appropriate authorities and agencies. Amounts of £11 million (2011: £5 million) have been provided.

Utilisation of the provision due in more than one year is estimated as £4 million in 2014 and £11 million from 2015.

Employee obligations
Long service non-pension and other employee related obligations arising primarily in the Group's continental European subsidiaries amount to £23 million (2011: £19 million).

Utilisation of the provision due in more than one year is expected as follows: £4 million in 2014; £3 million in 2015, £2 million in 2016 and £10 million from 2017.

Other
Other provisions include £6 million in relation to previous reorganisation arising from the Group’s strategic restructuring programmes (2011: £10 million) and £7 million on acquisition of Volvo Aerospace relating to customer and supplier exposures. Utilisation of the provision due in more than one year is expected as follows: £2 million in 2014 and £7 million from 2015.

20 Share capital

	Authorised		Issued and Fully Paid	
	2012	2011	**2012**	2011
	£m	£m	**£m**	£m
Ordinary shares of 50p each	**450**	450	**362**	362

	Authorised		Issued	
	2012	2011	**2012**	2011
	Number	Number	**Number**	Number
	000s	000s	**000s**	000s
Ordinary shares of 50p each	**900,000**	900,000	**724,632**	724,632

21 Business combinations

Acquisition of Volvo Aerospace

GKN Aerospace acquired the aero engine components businesses from AB Volvo on 1 October 2012. The Group acquired 100% of the equity. The entities acquired are together referred to as "Volvo Aerospace" or "GKN Engine Systems".

Volvo Aerospace designs, engineers and manufactures components and sub-assemblies for aircraft engine turbines. Volvo Aerospace employs some 3,000 people based in Sweden, Norway and the US. The enlarged GKN Aerospace is a world leader in both aero structures and aero engine components. Within aero engines, the Group's composite leadership and now strong metallic technology provides a unique offering to customers who are focused on lightweight, high performance engine solutions.

The following amounts represent a provisional determination of the fair value of identifiable assets acquired and liabilities assumed. Final determination of the fair value of certain assets and liabilities will be completed within the one year measurement period as required by IFRS 3 "Business Combinations". The size and complexity of the Volvo Aerospace acquisition will necessitate the use of this measurement period to further analyse and assess a number of the factors used in establishing the asset and liability fair values as of the acquisition date including; significant contractual and operational factors underlying the customer related intangible assets, final negotiation of the purchase price, the assumptions underpinning certain provisions such as those for the loss making contracts and the related tax impacts of any changes made. Any potential adjustments could be material in relation to the preliminary values presented below:

	£m
Intangible assets arising on business combinations	
- customer related	236
- technology based	97
Operating intangible assets	
- development costs	96
- participation fees	133
Property, plant and equipment	191
Cash	30
Inventories	242
Trade and other receivables	115
Trade and other payables	(339)
Government refundable advances	(43)
Post-employment obligations	(67)
Provisions	(64)
Deferred tax	(127)
Provisional goodwill	38
	538
Satisfied by:	
Cash and cash equivalents	476
Deferred consideration	62
Fair value of consideration	538

From the date of acquisition to the balance sheet date, Volvo Aerospace contributed £191 million to sales and £15 million to trading profit excluding acquisition related charges of £3 million and restructuring costs of £19 million. If the acquisition had been completed on 1 January 2012 the Group's statutory sales and trading profit for the year ended 31 December 2012 are estimated at £6,996 million and £579 million respectively.

Acquisition related charges of £3 million and a restructuring charge of £22 million have been recorded in the income statement within trading profit (see note 2 for details).

Goodwill (which is not tax deductible) is attributable to the value of the assembled workforce and expected future sales synergies from combination with the Group's existing Aerospace business.

Prior year acquisitions

During the year the Group made a claim under an indemnity clause, relating to the purchase of Stromag Holding GmbH in 2011. The total claim of £4 million was in excess of the indemnity asset recorded £3 million so the residual £1 million has been recorded in the income statement within trading profit.

21 **Business combinations (continued)**
Significant judgements, assumptions and estimates in the acquisition accounting for Volvo Aerospace

Valuation of intangible assets —methodology

The fair value exercise was carried out in conjunction with third party experts and considered the existence of the intangible assets relevant and attributable to the business.

The intangible assets inherent in Volvo Aerospace's customer relationships/contracts were valued using an excess earnings method. This methodology places a value on the asset as a function of (a) management's estimate of the expected cash flows arising from the customer contracts; (b) discount rates reflective of the risks inherent in the cash flows; and (c) a contributory charge attributable to assets needed to generate the operating cash flows. An after tax discount rate of 10.0% to 11.0% was applied to the forecast cash flows.

The proprietary technology and know-how has been valued using a relief from royalty methodology. The cash flow forecasts supporting this valuation reflect the future sales to be generated in conjunction with the technology. The fair value attributed to proprietary technology represents the theoretical costs avoided by Volvo Aerospace from not having to pay a licence fee for the technology. The royalty rate used in the valuation was 3%, based on a review of licence agreements for comparable technologies in a similar segment. An after tax discount rate of 10.5% was applied to the forecast cash flows, a rate that reflects the inherent risk within cash flows and is comparable with the weighted average cost of capital for the acquisition.

The valuation of all intangible assets reflects the tax benefit of amortisation, which has meant a benefit assessed with reference to Sweden, Norway and the US tax laws. According to US tax law an intangible asset may be rateably amortised over 15 years regardless of its actual useful life, in Sweden the amortisation period is 5 years and in Norway the amortisation period is 25 years. As such, there is a tax benefit to an acquirer and hence values attributable to the intangible assets have been recognised. This value amounts to £124 million across all the intangibles recognised.

In order to attribute value to pre-existing development costs and participation fees an impairment exercise under IAS 36 was performed based on acquisition date information. The value recognised for "operating intangible assets" together with the value recognised for customer related "intangible assets arising on business combinations" is supported by underlying contract valuations prepared under IFRS 3.

Valuation of other assets and liabilities —methodology

Fair value adjustments on tangible fixed assets represent a net uplift on property, plant and equipment to fair values following external third party appraisal. The uplift primarily represents the restoration of asset values fully depreciated and the current market conditions.

Inventories acquired were assessed for scrap and obsolete items before being fair valued. Inventories acquired have been valued at current replacement cost for raw materials and selling price, adjusted for costs of completion and disposal and associated margin, for finished goods and work-in-progress. The fair value of the inventory uplift was £37 million.

Liabilities include an amount in respect of onerous contracts and government refundable advances.

At acquisition there were forecast unavoidable costs of meeting the obligations under long term agreements which exceed the contractual economic inflow they will generate. Accordingly an additional onerous contract liability of £29 million has been recognised using a risk adjusted pre-tax discount rate of 12%. Unavoidable costs include direct labour, material and specific engineering costs in addition to the net cost of purchasing fixed assets dedicated to the contract.

A liability of £43 million is included on the acquisition balance sheet for a contractual requirement to repay refundable advances provided by the Swedish Government under a risk sharing arrangement. The liability has been valued based on forecast cash flows and the effective interest rate methodology.

Volvo Aerospace has been determined to have a USD functional currency, which has been used in establishing the opening balance sheet and impacts post acquisition earnings.

22 Cash flow reconciliations

Cash generated from operations	2012 £m	2011 £m
Operating profit	**628**	374
Adjustments for:		
Depreciation, impairment and amortisation of fixed assets		
Charged to trading profit		
Depreciation	**214**	191
Impairment	**4**	1
Amortisation	**17**	10
Amortisation of non-operating intangible assets arising on business combinations	**37**	22
Change in value of derivative and other financial instruments	**(126)**	31
Amortisation of government capital grants	**(3)**	(1)
Net profits on sale and realisation of fixed assets	**(3)**	(3)
Gains and losses on changes in Group structure	**(5)**	(8)
Charge for share-based payments	**6**	6
Pension scheme curtailments and related cash	**(99)**	-
Movement in post-employment obligations	**(28)**	(34)
Change in amounts due from parent undertaking	**54**	(75)
Change in inventories	**73**	(60)
Change in receivables	**(70)**	(109)
Change in payables and provisions	**(107)**	80
	592	425

Movement in net debt	2012 £m	2011 £m
Movement in cash and cash equivalents	**(21)**	(276)
Net movement in other borrowings and deposits	**(323)**	(109)
Costs associated with refinancing	**9**	-
Finance leases	**(1)**	-
Currency variations	**3**	(2)
Movement in year	**(333)**	(387)
Net debt at beginning of year	**(538)**	(151)
Net debt at end of year	**(871)**	(538)

Reconciliation of cash and cash equivalents	2012 £m	2011 £m
Cash and cash equivalents per balance sheet	**181**	156
Bank overdrafts included within "current liabilities - borrowings"	**(57)**	(11)
Cash and cash equivalents per cashflow	**124**	145

On 27 January 2012 the Group purchased the non-controlling interest of 49% in GKN Driveline JTEKT Manufacturing Limited for total cash consideration of £10 million, £9 million of which was paid in the first half year. The Group now owns 100% of the equity share capital of this company.

Cash outflow in respect of previous restructuring plans was £4 million (2011: £31 million). Proceeds from sale of fixed assets, put out of use as part of previous restructuring programmes, of nil were recognised in the year (2011: £2 million).

23 Post-employment obligations

Post-employment obligations as at the year end comprise:		2012 £m	2011 £m
Pensions	- funded	**(422)**	(443)
	- unfunded	**(481)**	(355)
Medical	- funded	**(24)**	(22)
	- unfunded	**(51)**	(48)
		(978)	(868)

The Group's pension arrangements comprise various defined benefit and defined contribution schemes throughout the world. The main externally funded defined benefit pension schemes operate in the UK, US and Japan. During the year, the UK defined benefit pension scheme was split into two separate schemes (referred to as GKN1 and GKN2 below), each with different characteristics. In Europe, funds are retained within certain businesses to provide defined benefit pension benefits. In addition, in the US and UK a number of retirement plans are operated which provide certain employees with post-employment medical benefits. As part of the Volvo Aerospace acquisition (see note 21 and note (d) below) certain pension assets and liabilities were acquired by the Group.

Independent actuarial valuations of all major defined benefit scheme assets and liabilities were carried out at 31 December 2012. The present value of the defined benefit obligation, the related current service cost and the past service cost were measured using the projected unit credit method.

(a) Defined benefit schemes – significant judgements, assumptions and estimates

Key assumptions:

	UK		Americas	Europe	ROW
	GKN1 %	GKN2 %	%	%	%
2012					
Rate of increase in pensionable salaries	**n/a**	**3.90**	**3.50**	**2.50**	**-**
Rate of increase in payment and deferred pensions	**3.00**	**3.00**	**2.00**	**1.75**	**n/a**
Discount rate	**3.80**	**4.30**	**4.10**	**3.20**	**1.45**
Inflation assumption	**2.80**	**2.90**	**2.50**	**1.75**	**n/a**
Rate of increases in medical costs:					
Initial/long term	**6.1/6.1**		**8.0/5.0**	**n/a**	**n/a**
2011					
Rate of increase in pensionable salaries	4.00		3.50	2.50	-
Rate of increase in payment and deferred pensions	3.10		2.00	1.75	n/a
Discount rate	4.70		4.50	4.90	1.65
Inflation assumption	3.00		2.50	1.75	n/a
Rate of increases in medical costs:					
Initial/long term	6.0/5.4		8.5/5.0	n/a	n/a

Historically the discount rate for the UK was referenced against the yield on the iBoxx index for GBP Corporate rated AA bonds with a maturity of 15 years plus and, as at 31 December 2012, this was 4.07%. However, following the separation of the UK pension scheme and for further consistency between the term of the bond yields used to determine the discount rate and the estimated term of the pension obligations (around 12 years for GKN1 and around 17 years for GKN2) a term specific discount rate has been adopted for each UK scheme in 2012. This has been derived from the Mercer pension discount yield curve, which is based on corporate bonds with two or more AA-ratings. The European discount rate of 2.7% was calculated with reference to the yield as at 31 December 2012 on the index of iBoxx Euro Corporate rated AA bonds with a maturity of 10 years plus, adjusted to reflect the duration of liabilities. For the USA, the discount rate referenced the Citigroup pension liability index, the Merrill Lynch US corporate AA 15+ years index and the Towers Watson rate:LINK benchmark as at 31 December 2012 (4.05, 4.04 and 4.07 respectively). There was no change in approach to European and US discount rate calculations.

The underlying mortality assumptions for the major schemes, consistent with the prior year, are as follows:

United Kingdom
Data on the UK schemes' mortality experience is collected and reviewed annually. The key current year mortality assumptions for both GKN1 and GKN2 use S1NA (year of birth) mortality tables allowing for medium cohort projections with a minimum improvement of 1% and adjustments of +0.7 and +1.3 years for male/female members of GKN1 and +0.1 and +0.4 years for male/female members of GKN2. These assumptions give the following expectations for each scheme: for GKN1 a male aged 65 lives for a further 21.3 years and a female aged 65 lives for a further 24.0 years whilst a male aged 45 is expected to live a further 23.2 years from age 65 and a female aged 45 is expected to live a further 25.9 years from age 65. For GKN2 a male aged 65 lives for a further 21.8 years and a female aged 65 lives for a further 24.8 years whilst a male aged 45 is expected to live a further 23.7 years from age 65 and a female aged 45 is expected to live a further 26.7 years from age 65.

Overseas
In the USA, PPA2012 tables have been used whilst in Germany the RT2005-G tables have again been used. In the USA the longevity assumption for a male aged 65 is that he lives a further 19.2 years (female 21.0 years) whilst in Germany a male aged 65 lives for a further 18.6 years (female 22.7 years). The longevity assumption for a USA male currently aged 45 is that he also lives for a further 19.2 years once attaining 65 years (female 21.0 years), with the German equivalent assumption for a male being 21.3 years (female 25.2 years). These assumptions are based solely on the prescribed tables not on actual GKN experience.

23 **Post-employment obligations (continued)**
(a) **Defined benefit schemes – significant judgements, assumptions and estimates (continued)**

Assumption sensitivity analysis
The impact of a one percentage point movement in the primary assumptions on the defined benefit net obligations as at 31 December 2012 is set out below:

	UK		Americas		Europe		ROW	
	Liabilities £m	Income statement £m	Liabilities £m	Income statement £m	Liabilities £m	Income statement £m	Liabilities £m	Income statement £m
Discount rate +1%	365	24.1	40	(0.8)	68	(0.2)	4	(0.2)
Discount rate -1%	(457)	(22.8)	(50)	1.2	(88)	0.5	(4)	0.2
Rate of inflation +1%	(391)	(23.8)	-	-	(55)	(2.8)	-	-
Rate of inflation -1%	295	21.3	-	-	46	2.3	-	-
Rate of increase in medical costs +1%	(2)	(0.1)	(2)	(0.2)	-	-	-	-
Rate of increase in medical costs -1%	2	0.1	2	0.2	-	-	-	-

Judgements and estimates

Pension partnership interest
On 31 March 2010 the Group agreed an asset-backed cash payment arrangement with the Trustee of the UK Pension scheme to help address the UK pension funding deficit. In connection with the arrangement certain UK freehold properties and a non-exclusive licence over the GKN trade marks, together with associated rental and royalty rights, were transferred to a limited partnership established by the Group. The partnership is controlled by and its results are consolidated by the Group. The fair value of the assets transferred was £535 million. On 31 March 2010, the Group made a special contribution to the UK Pension scheme of £331 million and on the same date the UK Pension scheme used this contribution to acquire a nominal limited interest in the partnership for its fair value of £331 million. The UK Pension scheme's nominal partnership interest entitles it to a distribution from the income of the partnership of £30 million per annum for 20 years subject to a discretion exercisable by the Group in certain circumstances. At inception the discounted value of the cash distributions was assessed at £331 million which was recognised as a pension plan asset and as a non-controlling interest in equity. In accordance with IAS 19 a plan asset has been recognised given that the UK pension schemes have unfettered rights to freely transfer or sell their interests in the arrangement to a third party. Other factors relevant to recognition as a plan asset include the ability of third parties to value the asset, the income interest inherent in the arrangement is held by a legally separate entity, the asset is held solely to fund employee benefits, there are restrictions on its availability to the Group's creditors in a bankruptcy and restrictions exist on the assets' return to the Group. In accordance with IAS 32 the non-controlling interest in equity arises as there is an unconditional right to avoid making cash payments due to discretion provisions which form part of the agreement. A distribution of £30 million for the year to 31 December 2011 was made in the second quarter of 2012 (2011: £23 million).

The Pension partnership interest has been valued on a discounted cash flow basis. The valuation is carried out on an arm's length basis from a market participant's perspective. This considers factors relevant to the risk assessments that are specific to the arrangement structure and would reasonably be considered by a market participant should they have the opportunity to participate in the arrangement. The valuation considered separately the profiles of the originating royalty and rental income streams using the Group's current budget and forecast data with other factors considered being related expenses including taxation, timing of the distributions, exchange rates, bond yields and the Group's weighted average cost of capital. Monte Carlo simulation techniques are used to assess the valuation impact of various scenarios attributable to potential value and risk assessments that a reasonable market participant could consider.

(b) **Defined benefit schemes - reporting**
The amounts included in operating profit are:

	Employee benefit expense £m	Pension scheme settlement/ curtailments £m	Total £m
2012			
Current service cost	(44)	-	(44)
Past service	1	-	1
Settlement/curtailments	1	53	54
	(42)	53	11
2011			
Current service cost	(38)	-	(38)
Past service	1	-	1
Settlement/curtailments	4	-	4
	(33)	-	(33)

The amounts recognised in the balance sheet are:

	2012					
	UK £m	**Americas £m**	**Europe £m**	**ROW £m**	**Total £m**	2011 £m
Present value of unfunded obligations	**(17)**	**(62)**	**(451)**	**(2)**	**(532)**	(403)
Present value of funded obligations	**(2,846)**	**(282)**	**(39)**	**(38)**	**(3,205)**	(3,158)
Fair value of plan assets	**2,522**	**181**	**36**	**20**	**2,759**	2,693
Net obligations recognised in the balance sheet	**(341)**	**(163)**	**(454)**	**(20)**	**(978)**	(868)

The contribution expected to be paid by the Group during 2013 to the UK scheme is £33 million and to overseas schemes £32 million. Additionally, section (a) of this note, above, describes the Pension partnership interest created on 31 March 2010 under which a distribution of £30 million is expected to be made in the first half of 2013.

23 **Post-employment obligations (continued)**
(b) **Defined benefit schemes – reporting (continued)**

Cumulative actuarial gains and losses recognised in equity are as follows:

	2012 £m	2011 £m
At 1 January	**(635)**	(358)
Net actuarial losses in year	**(172)**	(277)
At 31 December	**(807)**	(635)

Movement in schemes' obligations (funded and unfunded) during the year

	UK £m	**Americas £m**	**Europe £m**	**ROW £m**	**Total £m**
At 1 January 2012	**(2,663)**	**(469)**	**(383)**	**(46)**	**(3,561)**
Businesses acquired	**-**	**-**	**(158)**	**-**	**(158)**
Current service cost	**(33)**	**(2)**	**(6)**	**(3)**	**(44)**
Interest	**(123)**	**(17)**	**(18)**	**-**	**(158)**
Contributions by participants	**(4)**	**-**	**-**	**-**	**(4)**
Actuarial gains and losses	**(170)**	**(16)**	**(106)**	**(1)**	**(293)**
Benefits paid	**130**	**15**	**17**	**4**	**166**
Past service cost	**-**	**1**	**-**	**-**	**1**
Settlements/curtailments	**-**	**123**	**152**	**-**	**275**
Currency variations	**-**	**21**	**12**	**6**	**39**
At 31 December 2012	**(2,863)**	**(344)**	**(490)**	**(40)**	**(3,737)**
At 1 January 2011	(2,448)	(399)	(369)	(44)	(3,260)
Businesses acquired	-	(1)	(13)	-	(14)
Current service cost	(24)	(4)	(6)	(4)	(38)
Interest	(129)	(21)	(19)	(1)	(170)
Contributions by participants	(4)	-	-	-	(4)
Actuarial gains and losses	(201)	(55)	(2)	2	(256)
Benefits paid	127	17	16	3	163
Past service cost	-	1	-	-	1
Settlements/curtailments	16	-	-	1	17
Currency variations	-	(7)	10	(3)	-
At 31 December 2011	(2,663)	(469)	(383)	(46)	(3,561)

Movement in schemes' assets during the year

	UK £m	**Americas £m**	**Europe £m**	**ROW £m**	**Total £m**
At 1 January 2012	**2,391**	**248**	**31**	**23**	**2,693**
Businesses acquired	**-**	**-**	**91**	**-**	**91**
Expected return on assets	**123**	**13**	**1**	**1**	**138**
Actuarial gains and losses	**102**	**13**	**4**	**2**	**121**
Contributions by Group	**30**	**21**	**44**	**2**	**97**
Contributions by participants	**4**	**-**	**-**	**-**	**4**
Settlements/curtailments	**-**	**(88)**	**(133)**	**-**	**(221)**
Benefits paid	**(128)**	**(15)**	**(1)**	**(5)**	**(149)**
Currency variations	**-**	**(11)**	**(1)**	**(3)**	**(15)**
At 31 December 2012	**2,522**	**181**	**36**	**20**	**2,759**
At 1 January 2011	2,364	245	28	23	2,660
Businesses acquired	-	-	2	-	2
Expected return on assets	134	17	1	1	153
Actuarial gains and losses	-	(19)	-	(2)	(21)
Contributions by Group	23	19	-	3	45
Contributions by participants	4	-	-	-	4
Settlements/curtailments	(13)	-	-	-	(13)
Benefits paid	(121)	(17)	-	(3)	(141)
Currency variations	-	3	-	1	4
At 31 December 2011	2,391	248	31	23	2,693

The defined benefit obligation is analysed between funded and unfunded schemes as follows:

	2012					
	UK £m	**Americas £m**	**Europe £m**	**ROW £m**	**Total £m**	2011 £m
Funded	**(2,846)**	**(282)**	**(39)**	**(38)**	**(3,205)**	(3,158)
Unfunded	**(17)**	**(62)**	**(451)**	**(2)**	**(532)**	(403)
	(2,863)	**(344)**	**(490)**	**(40)**	**(3,737)**	(3,561)

23 **Post-employment obligations (continued)**

(b) **Defined benefit schemes – reporting (continued)**

The fair value of the assets in the schemes and the expected rates of return were:

	UK		Americas		Europe		ROW	
	Long term rate of return expected %	Value £m	Long term rate of return expected %	Value £m	Long term rate of return expected %	Value £m	Long term rate of return expected %	Value £m
At 31 December 2012								
Equities (inc. Hedge Funds)	**8.0**	**775**	**8.7**	**121**	**-**	**-**	**5.1**	**8**
Bonds	**3.8**	**1,210**	**2.1**	**56**	**-**	**-**	**0.6**	**7**
Property	**6.6**	**97**	**-**	**-**	**-**	**-**	**-**	**-**
Cash and net current assets	**0.5**	**63**	**2.3**	**4**	**-**	**-**	**-**	**-**
Partnership plan asset (GKN1/ GKN2)	**4.4/6.0**	**342**	**-**	**-**	**-**	**-**	**-**	**-**
Other assets	**4.3**	**35**	**-**	**-**	**5.5**	**36**	**1.3**	**5**
		2,522		**181**		**36**		**20**
At 31 December 2011								
Equities (inc. Hedge Funds)	7.8	696	8.9	166	-	-	5.8	8
Bonds	3.9	1,182	3.0	75	-	-	0.9	9
Property	6.6	97	-	-	-	-	-	-
Cash and net current assets	0.5	39	2.3	7	-	-	-	-
Partnership plan asset	6.1	344	-	-	-	-	-	-
Other assets	4.7	33	-	-	4.8	31	0.9	6
		2,391		248		31		23

The expected return on plan assets is a blended average of projected long term returns for the various asset classes. Equity returns are developed based on the selection of the equity risk premium above the risk-free rate which is measured in accordance with the yield on government bonds. Bond returns are selected by reference to the yields on government and corporate debt, as appropriate to the plan's holdings of these instruments. All other asset classes returns are determined by reference to current experience. As part of the split of the UK pension scheme, the UK scheme assets were divided between GKN1 and GKN2, including the income interest in the Pension Partnership arrangement.

The actual return on plan assets was £259 million (2011: £132 million).

23 **Post-employment obligations (continued)**

History of experience gains and losses

	UK	Americas	Europe	ROW
2012				
Experience adjustments arising on scheme assets:				
Amount - £m	**102**	**13**	**4**	**2**
Percentage of scheme assets	**4.0%**	**7.2%**	**11.1%**	**10.0%**
Experience gains/(losses) on scheme liabilities:				
Amount - £m	**(3)**	**-**	**(2)**	**-**
Percentage of the present value of scheme liabilities	**(0.1%)**	**-**	**(0.4%)**	**-**
Present value of scheme liabilities - £m	**(2,863)**	**(344)**	**(490)**	**(40)**
Fair value of scheme assets - £m	**2,522**	**181**	**36**	**20**
Deficit - £m	**(341)**	**(163)**	**(454)**	**(20)**
2011				
Experience adjustments arising on scheme assets:				
Amount - £m	-	(19)	-	(2)
Percentage of scheme assets	-	(7.7%)	-	(8.7%)
Experience gains/(losses) on scheme liabilities:				
Amount - £m	(34)	1	4	1
Percentage of the present value of scheme liabilities	(1.3%)	0.2%	1.0%	2.2%
Present value of scheme liabilities - £m	(2,663)	(469)	(383)	(46)
Fair value of scheme assets - £m	2,391	248	31	23
Deficit - £m	(272)	(221)	(352)	(23)
2010				
Experience adjustments arising on scheme assets:				
Amount - £m	77	10	-	(1)
Percentage of scheme assets	3.3%	4.1%	-	(4.3%)
Experience gains/(losses) on scheme liabilities:				
Amount - £m	71	(5)	(1)	-
Percentage of the present value of scheme liabilities	2.9%	(1.3%)	(0.3%)	-
Present value of scheme liabilities - £m	(2,448)	(398)	(369)	(45)
Fair value of scheme assets - £m	2,364	245	28	23
Deficit - £m	(84)	(153)	(341)	(22)
2009				
Experience adjustments arising on scheme assets:				
Amount - £m	152	21	(1)	-
Percentage of scheme assets	7.9%	9.8%	(3.7%)	-
Experience gains/(losses) on scheme liabilities:				
Amount - £m	-	1	6	-
Percentage of the present value of scheme liabilities	-	0.3%	1.7%	-
Present value of scheme liabilities - £m	(2,440)	(355)	(352)	(39)
Fair value of scheme assets - £m	1,930	215	27	18
Deficit - £m	(510)	(140)	(325)	(21)
2008				
Experience adjustments arising on scheme assets:				
Amount - £m	(539)	(86)	-	(4)
Percentage of scheme assets	(30.6%)	(43.1%)	-	(21.0%)
Experience gains/(losses) on scheme liabilities:				
Amount - £m	7	2	(5)	-
Percentage of the present value of scheme liabilities	0.3%	0.5%	(1.4%)	-
Present value of scheme liabilities - £m	(2,043)	(401)	(353)	(46)
Fair value of scheme assets - £m	1,759	202	29	19
Deficit - £m	(284)	(199)	(324)	(27)

(c) **Defined contribution schemes**

The Group operates a number of defined contribution schemes outside the United Kingdom. The charge to the income statement in the year was £21 million (2011: £15 million).

23 **Post-employment obligations (continued)**

(d) **Changes to Group post-employment obligations arrangements**

St Louis

On 1 April 2012 the Group transferred the assets and liabilities of its defined benefit pension scheme of the hourly paid workers at GKN Aerospace's St. Louis facility to the International Association of Mechanists and Aerospace Workers ('IAM') National Pension Fund. At this date the IAM National Pension Fund had over 1,750 participating employers with over £5 billion of investment assets under management, and as at 31 December 2011 it was in a net surplus position. From 1 April 2012 the members associated with this pension scheme are part of a multi-employer pension arrangement and as the total assets are not capable of separate determination the Group will account for its future obligations as if it were part of a defined contribution scheme.

The post-employment obligation was actuarially assessed at 31 March 2012 and the current service cost, other pension financing charge, actuarial gains and losses and contributions were recorded to this date consistent with other defined benefit pension schemes in the Group. At 31 March 2012, the scheme had an IAS 19 deficit of £55 million (31 December 2011: £68 million), which has subsequently been de-recognised from the balance sheet.

The Group had a remaining obligation of £20 million at 31 March 2012 being the principal amount payable to the IAM National Pension Fund over 4 years. An obligation of £21 million at 31 December 2012 is included in the Group's net post-employment obligation of £978 million.

The net pension scheme curtailment of £35 million has been recognised in the income statement, including related professional fees.

Volvo Aerospace

In connection with the acquisition in the year of Volvo Aerospace, the Group took control of defined benefit pension arrangements, including assets of £91 million, defined benefit liabilities of £158 million, giving a net deficit of £67 million (see note 21). The majority of this deficit (£64 million) related to the Swedish ITP2 scheme, and subsequent to the acquisition the Group entered into a fully insured buy-out arrangement with a third party insurer, Alecta, in relation to past service liabilities in the ITP2 scheme. Under the terms of this arrangement, the Group made an incremental cash payment of £46 million, resulting in a net curtailment credit of £18 million recognised in the income statement.

Arrangements have been made for future service in relation to benefits accruing under the ITP2 scheme also to be fully insured as they arise, via monthly payments to the relevant third party insurer, such that the Group will account for its future obligations under this scheme as if it were part of a defined contribution scheme, for as long as the insurance based arrangement subsists.

In addition to the net curtailment gain a further credit of £10 million was realised on the settlement of associated payroll taxes.

This took the total pension scheme curtailment credit for the ITP2 arrangement to £28 million.

The aggregate of the IAM net pension scheme curtailment and that for the Swedish ITP2 scheme was £63 million (2011: nil).

24 Contingent assets and liabilities

Aside from the unrecognised contingent asset referred to in note 6 in respect of Franked Investment Income, there were no other material contingent assets at 31 December 2011 or 31 December 2012.

In the case of certain businesses performance bonds and customer finance obligations have been entered into in the normal course of business.

25 Operating lease commitments - minimum lease payments

The minimum lease payments which the Group is committed to make at 31 December are:

	2012		2011	
	Property £m	**Vehicles, plant and equipment £m**	Property £m	Vehicles, plant and equipment £m
Payments under non-cancellable operating leases:				
Within one year	**25**	**12**	25	12
Later than one year and less than five years	**78**	**22**	78	20
After five years	**110**	**3**	118	2
	213	**37**	221	34

26 Capital expenditure

Contracts placed against capital expenditure sanctioned at 31 December 2012 so far as not provided by subsidiaries amounted to £96 million property, plant and equipment, £18 million intangible assets (2011: £118 million property, plant and equipment, £6 million intangible assets) and the Group's share not provided by joint ventures amounted to £20 million property, plant and equipment, nil intangible assets (2011: £1 million property, plant and equipment, nil intangible assets).

27 Related party transactions

In the ordinary course of business, sales and purchases of goods take place between subsidiaries and joint venture companies priced on an ‘arm’s length’ basis. Sales by subsidiaries to joint ventures in 2012 totalled £65 million (2011: £88 million). The amount due at the year end in respect of such sales was £13 million (2011: £19 million). Purchases by subsidiaries from joint ventures in 2012 totalled £36 million (2011: £1 million). The amount due at the year end in respect of such purchases was nil (2011: nil).

At 31 December 2012 a Group subsidiary had £6 million payable to a joint venture company in respect of an unsecured financing facility bearing interest at 1 month LIBOR plus $^1/_8$% (2011: £2 million).

28 Principal Subsidiaries

The following represent the principal subsidiary undertakings of the GKN Group at 31 December 2012. These subsidiaries were included in the consolidation and are held indirectly by the Company through intermediate holding companies. The undertakings located overseas operate principally in the country of incorporation. The equity share capital of these undertakings is wholly owned by the GKN Group.

A full list of subsidiaries and joint ventures will be attached to the next annual return of the Company.

Subsidiary	Country of incorporation	Interest
GKN Aerospace Chem-tronics Inc	USA	Common stock
GKN Aerospace North America, Inc	USA	Common stock
GKN Aerospace Services Ltd	England	Ordinary shares
GKN Aerospace Sweden AB	Sweden	Ordinary shares
GKN do Brasil Ltda	Brazil	Quota capital
GKN Driveline Celaya SA de CV	Mexico	Ordinary shares
GKN Driveline Deutschland GmbH	Germany	Ordinary shares
GKN Driveline Japan Ltd	Japan	Ordinary shares
GKN Driveline Köping AB	Sweden	Ordinary shares
GKN Driveline Newton LLC*	USA	Membership interest (no share capital)
GKN Driveline North America Inc	USA	Common stock
GKN Driveline Polska Sp. Zo.o	Poland	Ordinary shares
GKN Sinter Metals, LLC**	USA	Membership interest (no share capital)
GKN Sinter Metals SpA	Italy	Ordinary shares
GKN Westland Aerospace, Inc	USA	Common stock
Hoeganaes Corporation	USA	Common stock

* The principal place of business of GKN Driveline Newton LLC is 1848 Getrag Parkway, Newton North Carolina, USA.

** The principal place of business of GKN Sinter Metals LLC is 3300 University Drive, Auburn Hills, Michigan, USA.

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF GKN HOLDINGS PLC

We have audited the Parent Company financial statements of GKN Holdings plc for the year ended 31 December 2012 which comprise the Balance Sheet and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

Respective responsibilities of directors and auditors
As explained more fully in the Statement of Directors' Responsibilities set out on page 1, the Directors are responsible for the preparation of the Parent Company financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the Parent Company financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

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.

Scope of the audit of the financial statements
An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Parent Company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the Annual report and financial statements to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on financial statements
In our opinion the Parent Company financial statements:

- give a true and fair view of the state of the Company's affairs as at 31 December 2012;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matter prescribed by the Companies Act 2006
In our opinion the information given in the Directors' Report for the financial year for which the Parent Company financial statements are prepared is consistent with the Parent Company financial statements.

Matters on which we are required to report by exception
We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept by the Parent Company, or returns adequate for our audit have not been received from branches not visited by us; or
- the Parent Company financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of Directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

Other matter
We have reported separately on the Group financial statements of GKN Holdings plc for the year ended 31 December 2012.

Andrew Hammond (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Birmingham
30 April 2013

Notes:

(a) The maintenance and integrity of the GKN website is the responsibility of the Directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the website.

(b) Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Balance Sheet of GKN Holdings plc
at 31 December 2012

	Notes	2012 £m	2011 £m
Fixed assets			
Investment in subsidiaries	4	**1,099**	1,249
Current assets			
Amounts due from Group undertakings		**1,522**	952
Deferred tax assets		**73**	22
Corporation tax assets		**9**	4
		1,604	978
Current liabilities			
Creditors: amounts falling due in less than one year	5	**(12)**	(15)
Borrowings	6	**(20)**	(176)
		(32)	(191)
Net current assets		**1,572**	787
Total assets less current liabilities		**2,671**	2,036
Non-current liabilities			
Borrowings	6	**(923)**	(456)
Post-employment obligations	7	**(71)**	-
Net assets		**1,677**	1,580
Capital and reserves			
Share capital	8	**362**	362
Share premium account	8	**301**	301
Other non-distributable reserves	8	**288**	288
Profit and loss account	8	**726**	629
	9	**1,677**	1,580

The financial statements on pages 59 to 65 were approved by the Board of Directors and authorised for issue on 26 April 2013. They were signed on its behalf by:

William Seeger - Director

Notes to the Financial Statements of GKN Holdings plc
For the year ended 31 December 2012

1 Significant accounting policies and basis of preparation

The separate financial statements of the Company are presented as required by the Companies Act 2006. They have been prepared under the historical cost convention except where other measurement bases are required to be applied and in accordance with applicable United Kingdom Accounting Standards and law. In accordance with FRS 1 (revised 1996) and FRS 8 the Company has taken advantage of the exemptions not to prepare a cash flow statement and not to disclose transactions with wholly owned subsidiary undertakings. As the consolidated financial statements have been prepared in accordance with IFRS 7, the Company is exempt from the disclosure requirements of FRS 29. Other new accounting standards issued by the Accounting Standards Board and effective from 1 January 2012 have had no impact on the financial statements of the Company.

The principal accounting policies are summarised below. They have been applied consistently in both years presented.

Investments
Fixed asset investments in subsidiaries are shown at cost less provision for impairment. Fixed asset investments are reviewed at least annually for indications of impairment with any resulting impairment charges taken to the profit and loss account. When events or circumstances arise that indicate that previously charged impairments may have reversed; recoverable amounts are reassessed and any impairment reversal is taken to the profit and loss account.

Profit and loss account
Turnover represents revenue receivable in respect of trademark fees charged to GKN Group companies for using the GKN trademark and logo and is measured at the fair value of the consideration receivable which equates to the invoiced amount excluding sales taxes. Interest income is recognised using the effective interest method. Dividend and other investment income is recognised when the right to receive payment is established. Current tax is recognised in the profit and loss account unless items relate to equity.

Foreign currencies
Where practicable, transactions involving foreign currencies are protected by forward contracts. Assets and liabilities in foreign currencies are translated at the appropriate forward contract rate or, if not covered, at the exchange rate ruling at the balance sheet date. Differences on revenue transactions are dealt with through the profit and loss account.

Taxation
Provision is made for deferred tax in so far as a liability or asset arises as a result of transactions that have occurred by the balance sheet date and give rise to an obligation to pay more tax in the future, or a right to pay less tax in the future. A deferred tax asset is only recognised to the extent that it may be considered recoverable. Deferred tax assets and liabilities are not discounted.

Dividends
The annual final dividend is not provided for until approved at the annual general meeting whilst interim dividends are charged in the period they are paid.

2 Profit and loss account

As permitted by section 408 of the Companies Act 2006 the Company has elected not to present its own profit and loss account for the year. The profit for the year ended 31 December 2012 was £119 million (2011: £1 million loss).

Auditors' remuneration for audit services to the Company was less than £0.1 million (2011: less than £0.1 million).

The directors received no remuneration for their services to the Company (2011: nil).

Three directors exercised share options over GKN plc shares during the year (2011: nil).

3 Taxation

At 31 December 2012 a deferred tax asset of £nil (2011: £41 million) in respect of tax losses has not been recognised on the basis that the future recovery of the asset is uncertain.

Changes in UK tax rate
A reduction in the mainstream rate of UK corporation tax to 24% took effect from April 2012 which gives rise to an effective UK tax rate of 24.5% for the year. The main rate of tax was reduced by 1% to 23% from 1 April 2013 and further reductions are proposed to reduce the main rate by 2% to 21% on 1 April 2014 and a further 1% to 20% on 1 April 2015. The further reductions will cause a corresponding reduction in the value of deferred tax assets as rates become substantively enacted.

Notes to the Financial Statements of GKN Holdings plc (continued)
For the year ended 31 December 2012

4 Fixed asset investments

Investments in subsidiary undertakings	Cost £m	Accumulated impairment £m	Carrying value £m
At 1 January 2012	1,249	-	1,249
Return of capital	(150)	-	(150)
At 31 December 2012	**1,099**	**-**	**1,099**

During the year GKN Euro Investments Limited made a distribution of £150 million, representing a return of issued share capital.

Principle subsidiary companies, the investments in which are held through intermediate holding companies are shown in note 28 of the consolidated financial statements.

5 Creditors

	2012 £m	2011 £m
Other creditors	**-**	(1)
Accruals	**(12)**	(14)
	(12)	(15)

6 Borrowings

	Notes	Current: Within one year £m	Non-Current: One to two years £m	Non-Current: Two to five years £m	Non-Current: More than five years £m	Non-Current: Total £m	**Total £m**
2012							
£450 million 5⅜% 2022 unsecured bond	(i)	-	-	-	(444)	(444)	**(444)**
£350 million 6¾% 2019 unsecured bond	(i)	-	-	-	(348)	(348)	**(348)**
£80 million 4.1% unsecured amortising loan	(i)	-	-	(48)	(32)	(80)	**(80)**
Committed Revolving Credit Facilities		(20)	-	(51)	-	(51)	**(71)**
		(20)	-	(99)	(824)	(923)	**(943)**
2011							
£350 million 6¾% 2019 unsecured bond	(i)	-	-	-	(347)	(347)	**(347)**
£176 million 7% 2012 unsecured bond	(i)	(176)	-	-	-	-	**(176)**
£80 million 4.1% unsecured amortising loan	(i)	-	-	(32)	(48)	(80)	**(80)**
Committed Revolving Credit Facilities		-	-	(29)	-	(29)	**(29)**
		(176)	-	(61)	(395)	(456)	**(632)**

Notes:
(i) Denotes borrowings at fixed rates of interest until maturity. All other borrowings are at variable interest rates unless otherwise stated.

Unsecured capital market borrowings include: unsecured £350 million (2011: £350 million) 6¾% bond maturing in 2019 less unamortised issue costs of £2 million (2011: £3 million) and a new unsecured £450 million 5⅜% bond maturing in 2022 less unamortised issue costs of £6 million.

During the year the Group repaid its £176 million 7% 2012 unsecured bond.

Unsecured committed bank borrowings include £80 million (2011: £80 million) drawn under the Group's European Investment Bank unsecured facility. The loan is due for repayment in five equal annual instalments of £16 million, commencing in June 2015 and attracts a fixed interest rate of 4.1% per annum payable annually in arrears. Also included is £71 million, net of £6 million unamortised issue costs (2011: £29 million net of £4 million unamortised issue costs) drawn from the Group's 2013 and 2016 Committed Revolving Credit Facilities of £612 million and nil drawings from the Group's new 2017 Committed Revolving Credit Facilities of £225 million. The term of the new facility is 5 years and attracts a variable interest rate.

The Company's activities from an integral part of the GKN plc Group's strategy with regard to financial instruments. The GKN plc Group's objectives, policies and strategies with regard to financial instruments are disclosed in full in the accounts of GKN plc.

Notes to the Financial Statements of GKN Holdings plc (continued)
For the year ended 31 December 2012

7 Post-employment obligations

The company's post-employment obligation of £71 million as at the year end comprises one funded defined benefit pension scheme in the UK.

During the year, a UK defined benefit pension scheme was split into two separate schemes (referred to as GKN1 and GKN2), each with different characteristics. The GKN1 scheme no longer qualifies as a multi-employer arrangement as on 30 September 2012 the Company assumed all obligations. Consequently the defined benefit obligation was recognised on the company balance sheet with subsequent defined benefit pension scheme accounting required.

An independent actuarial valuation of the defined benefit scheme assets and liabilities was carried out at 30 September 2012 and 31 December 2012. The present value of the defined benefit obligation, the related current service cost and the past service cost were measured using the projected unit credit method.

(a) Defined benefit schemes – significant judgements, assumptions and estimates

Key assumptions:

	GKN1 %
2012	
Rate of increase in pensionable salaries	**n/a**
Rate of increase in payment and deferred pensions	**3.00**
Discount rate	**3.80**
Inflation assumption	**2.80**

For consistency between the term of the bond yields used to determine the discount rate and the estimated term of the pension obligations around 12 years for GKN1 a term specific discount rate has been adopted. This has been derived from the Mercer pension discount yield curve, which is based on corporate bonds with two or more AA- ratings.

The underlying mortality assumptions for the scheme is as follows:

Data on the UK schemes' mortality experience is collected and reviewed annually. The key current year mortality assumptions for the scheme uses S1NA (year of birth) mortality tables allowing for medium cohort projections with a minimum improvement of 1% and adjustments of +0.7 and +1.3 years for male/female members. These assumptions give the following expectations for the scheme a male aged 65 lives for a further 21.3 years and a female aged 65 lives for a further 24.0 years whilst a male aged 45 is expected to live a further 23.2 years from age 65 and a female aged 45 is expected to live a further 25.9 years from age 65.

Notes to the Financial Statements of GKN Holdings plc (continued)
For the year ended 31 December 2012

7 **Post-employment obligations (continued)**

(a) **Defined benefit schemes – significant judgements, assumptions and estimates (continued)**

Assumption sensitivity analysis

The impact of a one percentage point movement in the primary assumptions on the defined benefit net obligations as at 31 December 2012 is set out below:

	Liabilities £m	Income statement £m
Discount rate +1%	82	3
Discount rate -1%	(97)	(2)
Rate of inflation +1%	(82)	(3)
Rate of inflation -1%	61	2

Pension partnership interest

On 31 March 2010 the Group agreed an asset-backed cash payment arrangement with the Trustee of the UK Pension scheme to help address the UK pension funding deficit. Details of the GKN Holdings plc Group impact is disclosed in note 23 of the consolidated accounts.

(b) **Defined benefit schemes - reporting**

There was no current service cost in the period from 1 October 2012 to 31 December 2012.

The amounts recognised in the balance sheet at 31 December 2012 were:

	£m
Present value of funded obligations	**(881)**
Fair value of plan assets	**810**
Net obligations recognised in the balance sheet	**(71)**

The contribution expected to be paid by the company during 2013 to the scheme is £3 million.

Notes to the Financial Statements of GKN Holdings plc (continued)
For the year ended 31 December 2012

7 **Post-employment obligations (continued)**
(b) **Defined benefit schemes – reporting (continued)**

Cumulative actuarial gains and losses recognised in equity are £22 million.

Movement in schemes' obligations from 1 October 2012 to 31 December 2012:

	£m
At 1 October 2012	**(840)**
Current service cost	**-**
Interest	**(9)**
Contributions by participants	**-**
Actuarial gains and losses	**(51)**
Benefits paid	**19**
At 31 December 2012	**(881)**

Movement in schemes' assets from 1 October 2012 to 31 December 2012:

	£m
At 1 October 2012	**790**
Expected return on assets	**9**
Actuarial gains and losses	**29**
Contributions by Group	**2**
Contributions by participants	**-**
Benefits paid	**(20)**
At 31 December 2012	**810**

The fair value of the assets in the schemes and the expected rates of return were:

	Long term rate of return expected %	Value £m
At 31 December 2012		
Equities (inc. Hedge Funds)	**3.8**	**183**
Bonds	**3.8**	**463**
Property	**3.8**	**23**
Cash and net current assets	**3.8**	**22**
Partnership plan asset	**3.8**	**119**
Other assets	**3.8**	**-**
		810

The expected return on plan assets is a blended average of projected long term returns for the various asset classes. Equity returns are developed based on the selection of the equity risk premium above the risk-free rate which is measured in accordance with the yield on government bonds. Bond returns are selected by reference to the yields on government and corporate debt, as appropriate to the plan's holdings of these instruments. All other asset classes returns are determined by reference to current experience.

The actual return on plan assets was £38 million.

Notes to the Financial Statements of GKN Holdings plc (continued)
For the year ended 31 December 2012

8 Reserves

	Share premium account £m	Other non-distributable reserves £m	Profit and loss account £m
At 1 January 2012	301	288	629
Profit for the year	-	-	119
Actuarial gains and losses on post-employment obligations	-	-	(22)
At 31 December 2012	**301**	**288**	**726**

Dividends paid to parent undertaking in the year are nil (2011: nil).

Details of the share capital of GKN Holdings plc are contained within note 20 to the consolidated financial statements.

9 Reconciliation of movements in shareholders' funds

	2012 £m	2011 £m
At 1 January	**1,580**	1,581
Profit/(loss) for the year	**119**	(1)
Actuarial gains and losses on post-employment obligations	**(22)**	-
At 31 December	**1,677**	1,580

10 Contingent liabilities

At 31 December 2012 the Company had no contingent liabilities in respect of bank and other guarantees (2011: nil). In the case of certain businesses, performance bonds and customer finance obligations have been entered into in the normal course of business.

11 Related party transactions

In accordance with FRS 8 the Company has taken advantage of the exemption not to disclose the transactions with wholly owned subsidiary undertakings. There were no other related party transactions during the year.

12 Ultimate and immediate parent company

GKN plc is the ultimate and immediate parent company. Copies of its accounts may be obtained from PO Box 55, Ipsley House, Ipsley Church Lane, Redditch, Worcestershire, B98 0TL.