# Notes to the financial statements

For the year ended 31 December 2011

## 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 2011. 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 2010 reported as likely to impact the reporting of the Group's results, assets and liabilities in 2011.

The Group adopted all applicable amendments to standards with an effective date in 2011 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.

### 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 where actual spot rate may be used if it more accurately reflects the underlying substance of the transaction. Where practicable, transactions involving foreign currencies are protected by forward contracts. Assets and liabilities in foreign currencies are translated at the exchange rates ruling at the balance sheet date.

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 where the actual spot rate is used if 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.

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.

# Notes to the financial statements
Continued

## 1 Accounting policies and presentation (continued)

### 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 continuing subsidiaries.

Operating profit is profit before discontinued operations, taxation, finance costs and the share of post-tax profit 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:

- charges relating to the Group wide restructuring programme announced in 2008;
- the impact of the annual goodwill impairment review;
- asset impairment and restructuring charges which arise from events which 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 incurred on a business combination; and
- the 2010 UK Pension scheme curtailment.

The Group's post-tax share of joint venture profits is shown as a separate component of profit before tax. 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.

Net finance 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.

### 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. Revenue from royalties and the rendering of services 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.

## 1 Accounting policies and presentation (continued)

### Property, plant and equipment (continued)

*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 |

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 £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.

### Financial assets and liabilities

Financial liabilities are recorded in arrangements where payments, 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.

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***

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. 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 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 are subject to annual impairment reviews. Impairments are 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 relationships | 2-25 |
| Technology based assets | | 5-10 |

### 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.

## 1 Accounting policies and presentation (continued)

### 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 lent 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.

***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 impact of the adoption of IFRS 9 'Financial Instruments', IFRS 10 'Consolidated Financial Statements' including amendments to IAS 27, IFRS 11 'Joint Arrangements' including amendments to IAS 28 and IAS 19 'Employment Benefits' (revised) are being assessed. With regard to the specific change in IAS 19 relating to restriction on the expected rate of return on scheme assets to the interest rate on post-employment obligations, the impact on current year statutory profit would have been a reduction of £24 million.

All other revisions and amendments to standards and interpretations which have an implementation date in 2012 or 2013 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 24), post-employment obligations including the valuation of the Pension partnership plan asset (note 26), derivative and other financial instruments (notes 4c and 21), taxation (note 6) and impairment of non-current assets (note 12). The 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. Revenue from services, inter segment trading and royalties is not significant.

### (a) Sales

| | Automotive | | | | |
|---|---|---|---|---|---|
| | Driveline £m | Powder Metallurgy £m | Aerospace £m | Land Systems £m | Total £m |
| **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 |
| 2010 | | | | | |
| Subsidiaries | 2,180 | 759 | 1,451 | 664 | |
| Joint ventures | 253 | – | – | 35 | |
| | 2,433 | 759 | 1,451 | 699 | 5,342 |
| Other businesses | | | | | 87 |
| Management sales | | | | | 5,429 |
| Businesses sold and closed – Axles | | | | | 10 |
| Less: Joint venture sales | | | | | (355) |
| Income statement – sales | | | | | 5,084 |

## 2 Segmental analysis (continued)

### (b) Trading profit

| | 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 |
| 2010 | | | | | |
| Trading profit before depreciation, impairment and amortisation | 238 | 84 | 209 | 49 | |
| Depreciation and impairment of property, plant and equipment | (107) | (30) | (39) | (15) | |
| Amortisation of operating intangible assets | (3) | – | (6) | (1) | |
| Trading profit – subsidiaries | 128 | 54 | 164 | 33 | |
| Trading profit/(loss) – joint ventures | 41 | – | (2) | 4 | |
| | 169 | 54 | 162 | 37 | 422 |
| Other businesses | | | | | 3 |
| Corporate and unallocated costs | | | | | (14) |
| Management trading profit | | | | | 411 |
| Less: Joint venture trading profit | | | | | (44) |
| Income statement – trading profit | | | | | 367 |

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.

There is a net credit in Corporate of £2 million (2010: £8 million; Driveline £6 million and Corporate £2 million) within trading profit in respect of changes to retiree benefit arrangements.

**Gallatin temporary plant closure**

As a consequence of the Gallatin temporary plant closure, a Hoeganaes facility within Powder Metallurgy, following an incident on 27 May 2011, the Group has incurred a significant amount of incremental, one-off costs. The information presented in this note should be read in conjunction with page 32.

The Group income statement for the year ended 31 December 2011 includes a net pre-tax charge of £19 million in relation to the Gallatin temporary plant closure. The £19 million, which has been charged to trading profit, represents a gross cost of £34 million offset by recoveries from the Group's external insurer of £15 million. The £34 million covers the cost of responding to customer obligations, £20 million, including premium freight and powder supply charges, rectification and corrections to the plant configuration, £8 million, fixed employment costs that were unabsorbed in June and July as a result of no productive activity, £4 million, and professional fees and other costs amounting to £2 million.

The net £19 million charge attracts taxation relief of £4 million.

The impact on cash flows from operating activities was a net outflow of £19 million.

# Notes to the financial statements
Continued

## 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 |
| **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 | |
| 2010 | | | | | |
| Property, plant and equipment and operating intangible assets | 878 | 307 | 421 | 110 | 1,716 |
| Working capital | 72 | 89 | 67 | 58 | 286 |
| Net operating assets | 950 | 396 | 488 | 168 | |
| Goodwill and non-operating intangible assets | 81 | 29 | 296 | 54 | |
| Net investment | 1,031 | 425 | 784 | 222 | |

### (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 |
| **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 |
| 2010 | | | | | | | |
| Fixed asset additions and capitalised borrowing costs | | | | | | | |
| – property, plant and equipment | 88 | 26 | 60 | 8 | 1 | – | 183 |
| – intangible assets | 4 | – | 26 | 1 | – | – | 31 |
| Investments in Joint ventures | 107 | – | – | 12 | 24 | – | 143 |
| Other non-cash items – share-based payments | 1 | – | 1 | – | – | 1 | 3 |

## 2 Segmental analysis (continued)

### (e) Country analysis

| | United Kingdom £m | USA £m | Germany £m | Other countries £m | Total non-UK £m | Total £m |
|---|---|---|---|---|---|---|
| **2011** | | | | | | |
| Management sales by origin | **930** | **1,720** | **1,017** | **2,445** | **5,182** | **6,112** |
| Goodwill, other intangible assets, property, plant and equipment and investments in associate and joint ventures | **411** | **908** | **498** | **1,104** | **2,510** | **2,921** |
| 2010 | | | | | | |
| Management sales by origin | 819 | 1,571 | 858 | 2,181 | 4,610 | 5,429 |
| Goodwill, other intangible assets, property, plant and equipment and investments in joint ventures | 355 | 695 | 354 | 940 | 1,989 | 2,344 |

### (f) Other sales information

Subsidiary segmental sales gross of inter segment sales are; Driveline £2,491 million (2010: £2,234 million), Powder Metallurgy £851 million (2010: £765 million), Aerospace £1,481 million (2010: £1,451 million) and Land Systems £805 million (2010: £665 million). Inter segment transactions take place on an arms length basis using normal terms of business.

In 2011 and 2010, no customer accounted for 10% or more of subsidiary sales or management sales.

Management sales by product are: Driveline – CVJ systems 70% (2010: 77%), all-wheel drive systems 23% (2010: 18%), transaxle solutions 5% (2010: 5%) and other goods 2% (2010: nil). Powder Metallurgy – sintered components 83% (2010: 82%) and metal powders 17% (2010: 18%). Aerospace – aerostructures 64% (2010: 64%), engine components and sub-systems 28% (2010: 28%) and special products 8% (2010: 8%). Land Systems – power management devices 36% (2010: 27%), wheels and structures 37% (2010: 36%) and aftermarket 27% (2010: 37%).

During the year, Driveline's product groups were reassessed to better reflect the mix of business. Amounts shown above, together with 2010 comparatives reflect the current product groups.

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

| | 2011 £m | 2010 £m |
|---|---|---|
| Segmental analysis – property, plant and equipment and operating intangible assets | **1,916** | 1,716 |
| Segmental analysis – goodwill and non-operating intangible assets | **828** | 460 |
| Goodwill | **(534)** | (350) |
| Other businesses | **19** | 19 |
| Corporate assets | **7** | 6 |
| Balance sheet – property, plant and equipment and other intangible assets | **2,236** | 1,851 |

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

| | 2011 £m | 2010 £m |
|---|---|---|
| Segmental analysis – working capital | **306** | 286 |
| Other businesses | **11** | 6 |
| Corporate items | **(36)** | (47) |
| Accrued net financing costs | **(21)** | (19) |
| Restructuring provisions | **(10)** | (41) |
| Deferred and contingent consideration | **(29)** | (27) |
| Government refundable advances | **(42)** | (40) |
| Balance sheet – inventories, trade and other receivables, trade and other payables and provisions | **179** | 118 |

## 3 Adjusted performance measures

### (a) Reconciliation of reported and management performance measures

| | 2011 | | | | 2010 | | | |
|---|---|---|---|---|---|---|---|---|
| | 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 | 5,746 | 366 | – | 6,112 | 5,084 | 355 | (10) | 5,429 |
| *Trading profit* | 419 | 49 | – | 468 | 367 | 44 | – | 411 |
| *Restructuring and impairment charges* | – | – | – | – | (39) | – | 39 | – |
| *Change in value of derivative and other financial instruments* | (31) | – | 31 | – | 12 | – | (12) | – |
| *Amortisation of non-operating intangible assets arising on business combinations* | (22) | – | 22 | – | (19) | – | 19 | – |
| *UK Pension scheme curtailment* | – | – | – | – | 68 | – | (68) | – |
| *Gains and losses on changes in Group structure* | 8 | – | (8) | – | (4) | – | 4 | – |
| **Operating profit** | 374 | 49 | 45 | 468 | 385 | 44 | (18) | 411 |
| **Share of post-tax earnings of joint ventures** | 38 | (49) | 2 | (9) | 35 | (44) | 1 | (8) |
| Interest payable | (47) | – | – | (47) | (46) | – | – | (46) |
| Interest receivable | 5 | – | – | 5 | 6 | – | – | 6 |
| Other net financing charges | (19) | – | 19 | – | (35) | – | 35 | – |
| **Net financing costs** | (61) | – | 19 | (42) | (75) | – | 35 | (40) |
| **Profit before taxation** | 351 | – | 66 | 417 | 345 | – | 18 | 363 |
| **Taxation** | (45) | – | (15) | (60) | (20) | – | (17) | (37) |
| **Profit from continuing operations** | 306 | – | 51 | 357 | 325 | – | 1 | 326 |
| Profit attributable to non-controlling interests | (27) | – | 21 | (6) | (20) | – | 15 | (5) |
| Earnings | 279 | – | 72 | 351 | 305 | – | 16 | 321 |
| Earnings per share – p | 18.0 | – | 4.6 | 22.6 | 19.6 | – | 1.1 | 20.7 |

**Impact of Gallatin temporary plant closure**

Given the significance of the Gallatin incident and related net charge in 2011 (see note 2b), the table in 3b highlights the impact of the temporary plant closure on trading profit and margin.

## 3 Adjusted performance measures (continued)

### (b) Summary by segment

| | 2011 | | | 2010 | | |
|---|---|---|---|---|---|---|
| | Sales £m | Trading profit £m | Margin | Sales £m | Trading profit £m | Margin |
| Driveline | 2,678 | 191 | 7.1% | 2,433 | 169 | 6.9% |
| Powder Metallurgy | 845 | 72 | 8.5% | 759 | 54 | 7.1% |
| Aerospace | 1,481 | 166 | 11.2% | 1,451 | 162 | 11.2% |
| Land Systems | 847 | 68 | 8.0% | 699 | 37 | 5.3% |
| Other businesses (Cylinder Liners and Emitec) | 106 | 3 | | 87 | 3 | |
| Getrag (Driveline) | 117 | 4 | | – | – | |
| Stromag (Land Systems) | 38 | (1) | | – | – | |
| Corporate and unallocated costs | – | (16) | | – | (14) | |
| | 6,112 | 487 | 8.0% | 5,429 | 411 | 7.6% |
| Gallatin temporary plant closure | – | (19) | | | | |
| | 6,112 | 468 | 7.7% | | | |

## 4 Operating profit

The analysis of the components of operating profit is shown below:

### (a) Trading profit

| | 2011 £m | 2010 £m |
|---|---|---|
| Sales by subsidiaries | 5,746 | 5,084 |
| Less: Businesses sold and closed – (2010: Axles) | – | (10) |
| | 5,746 | 5,074 |
| **Operating costs** | | |
| Change in stocks of finished goods and work in progress | 32 | 31 |
| Raw materials and consumables | (2,636) | (2,157) |
| Staff costs (note 10) | (1,457) | (1,346) |
| Reorganisation costs (ii): | | |
| Redundancy and other employee related amounts | – | (4) |
| Impairment of plant and equipment | – | – |
| Depreciation of property, plant and equipment (iii) | (191) | (191) |
| Impairment of plant and equipment | (1) | (2) |
| Amortisation of intangible assets | (10) | (10) |
| Operating lease rentals payable: | | |
| Plant and equipment | (14) | (13) |
| Property | (29) | (32) |
| Impairment of trade receivables | (8) | (7) |
| Amortisation of government capital grants | 1 | 1 |
| Net exchange differences on foreign currency transactions | (1) | 2 |
| Acquisition related charges | (8) | – |
| Other costs | (1,005) | (979) |
| | (5,327) | (4,707) |
| **Trading profit** | 419 | 367 |

(i) EBITDA is subsidiary trading profit before depreciation, impairment and amortisation charges included in trading profit. EBITDA in 2011 was £621 million (2010: £570 million).

(ii) Reorganisation costs in 2010 reflect actions in the ordinary course of business to reduce costs, improve productivity and rationalise facilities in continuing operations.

(iii) Including depreciation charged on assets held under finance leases of less than £1 million (2010: £1 million).

(iv) Research and development expenditure in subsidiaries was £103 million (2010: £92 million).

## 4 Operating profit (continued)

### (a) Trading profit (continued)

(v) Auditors' remuneration

The analysis of auditors' remuneration is as follows:

| | 2011 £m | 2010 £m |
|---|---|---|
| Fees payable to PricewaterhouseCoopers LLP for the Company's annual financial statements | (0.3) | (0.6) |
| Fees payable to PricewaterhouseCoopers LLP and their associates for other services to the Group: | | |
| – Audit of the Company's subsidiaries pursuant to legislation | (3.4) | (3.1) |
| Total audit fees | (3.7) | (3.7) |
| – Other services pursuant to legislation | (0.1) | (0.1) |
| – Tax services | (0.7) | (0.6) |
| – Corporate finance transaction services | (0.2) | – |
| – Other services | (0.1) | (0.1) |
| Total non-audit fees | (1.1) | (0.8) |
| 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 | (4.8) | (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.

### (b) Restructuring and impairment charges in 2010

The prior year restructuring actions comprised facility and operation closures, permanent headcount reductions achieved through redundancy programmes and the structured use of short-time working arrangements, available through national or state legislation, by European, Japanese and North American subsidiaries. There have been no further restructuring charges during 2011.

In the comparative year to 31 December 2010 the Group incurred charges of £12 million for redundancy and post-employment costs, £2 million for short-term working costs, wholly wages and salaries and £25 million for other reorganisation costs. All of these costs were incurred in subsidiaries.

The segmental allocation of restructuring costs in the comparative year to 31 December 2010 was: Driveline £29 million, Powder Metallurgy £1 million, Aerospace £4 million and Land Systems £5 million.

Cash outflow in respect of previous restructuring plans was £31 million (2010: £55 million). Proceeds from sale of fixed assets, put out of use as part of previous restructuring programmes, of £2 million were recognised in the year (2010: £2 million).

### (c) Change in value of derivative and other financial instruments

| | 2011 £m | 2010 £m |
|---|---|---|
| Forward currency contracts (not hedge accounted) | (29) | (3) |
| Embedded derivatives | (3) | 3 |
| Commodity contracts (not hedge accounted) | (1) | – |
| | (33) | – |
| Net gains and losses on intra-group funding | | |
| Arising in year | 2 | 12 |
| Reclassified in year | – | – |
| | 2 | 12 |
| | (31) | 12 |

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 2011 and 2010 the Group used transactional hedge accounting in a limited number of instances.

## 4 Operating profit (continued)

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

| | 2011 £m | 2010 £m |
|---|---|---|
| Marketing related | – | – |
| Customer related | (17) | (16) |
| Technology based | (5) | (3) |
| | (22) | (19) |

### (e) Gains and losses on changes in Group structure

| | 2011 £m | 2010 £m |
|---|---|---|
| Profits and losses on sale or closure of businesses | | |
| Business sold – GKN Aerospace Engineering Services | 4 | – |
| Business sold and closed – (2010: Axles) | – | (5) |
| Profit on sale of joint venture | 4 | – |
| Investment write up on acquisition of GKN Aerospace Services Structures Corp. | – | 1 |
| | 8 | (4) |

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 includes £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 represents previous currency variations reclassified from other reserves.

On 1 September 2010 the Group concluded the sale of its European agricultural axles operations with other operations closed during the year. Sale proceeds were £5 million and a net loss of £5 million was realised representing trading losses of £2 million, tangible fixed asset impairment of £1 million, other asset write downs of £3 million and reclassified currency variations from other reserves of £1 million.

## 5 Net financing costs

| | 2011 £m | 2010 £m |
|---|---|---|
| **(a) Interest payable and fee expense** | | |
| Short term bank and other borrowings | (10) | (7) |
| Loans repayable within five years | (14) | (15) |
| Loans repayable after five years | (26) | (24) |
| Bond buy back premium | – | (1) |
| Government refundable advances | (2) | (2) |
| Borrowing costs capitalised | 6 | 4 |
| Finance leases | (1) | (1) |
| | (47) | (46) |
| Interest receivable | | |
| Short term investments, loans and deposits | 5 | 6 |
| Net interest payable and receivable | (42) | (40) |

The capitalisation rate on specific funding was 5.6% (2010: 5.6%) and on general borrowings was 6.1% (2010: 6.8%).

| | 2011 £m | 2010 £m |
|---|---|---|
| **(b) Other net financing charges** | | |
| Expected return on scheme assets | 153 | 145 |
| Interest on post-employment obligations | (170) | (176) |
| Post-employment finance charges | (17) | (31) |
| Unwind of discounts | (2) | (4) |
| | (19) | (35) |

# Notes to the financial statements
Continued

## 6 Taxation
### (a) Tax expense

| Analysis of charge in year | 2011 £m | 2010 £m |
|---|---|---|
| Current tax (charge)/credit | | |
| Current year charge | (82) | (65) |
| Utilisation of previously unrecognised tax losses and other assets | 10 | 20 |
| Net movement on provisions for uncertain tax positions | (22) | (27) |
| Adjustments in respect of prior years | 1 | (1) |
| | (93) | (73) |
| Deferred tax (charge)/credit | | |
| Origination and reversal of temporary differences | (26) | (23) |
| Tax on change in value of derivative financial instruments | 7 | (2) |
| Other changes in unrecognised deferred tax assets | 58 | 72 |
| Changes in tax rates | – | (2) |
| Adjustments in respect of prior years | 9 | 8 |
| | 48 | 53 |
| **Total tax charge for the year** | (45) | (20) |

**Analysed as:**

| Tax in respect of management profit | 2011 £m | 2010 £m |
|---|---|---|
| Current tax | (97) | (84) |
| Deferred tax | 37 | 47 |
| | (60) | (37) |
| Tax in respect of items excluded from management profit | | |
| Current tax credit | 4 | 11 |
| Deferred tax credit | 11 | 6 |
| | 15 | 17 |
| Total for tax charge for the year | (45) | (20) |

**Management tax rate**

The tax charge arising on management profits of subsidiaries of £377 million (2010: £327 million) was £60 million (2010: £37 million charge) giving an effective tax rate of 16% (2010: 11%). Details of the effective tax rate for the Group and the underlying events and transactions affecting this are given on page 33.

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 for future financial performance in particular legal entities or tax groups.

## 6 Taxation (continued)

### (a) Tax expense (continued)

| Tax reconciliation | 2011 £m | 2011 % | 2010 £m | 2010 % |
|---|---|---|---|---|
| Profit before tax | 351 | | 345 | |
| Less share of post-tax earnings of joint ventures | (38) | | (35) | |
| Profit before tax excluding joint ventures | 313 | | 310 | |
| Tax charge calculated at 26.5% (2010: 28%) standard UK corporate tax rate | (83) | (26) | (87) | (28) |
| Differences between UK and overseas corporate tax rates | (16) | (5) | 8 | 3 |
| Non-deductible and non-taxable items | (2) | (1) | (11) | (4) |
| Utilisation of previously unrecognised tax losses and other assets | 10 | 3 | 20 | 7 |
| Other changes in unrecognised deferred tax assets | 58 | 19 | 72 | 23 |
| Changes in tax rates | – | – | (2) | (1) |
| Tax charge on ordinary activities | (33) | (10) | – | – |
| Net movement on provision for uncertain tax positions | (22) | (7) | (27) | (8) |
| Other adjustments in respect of prior years | 10 | 3 | 7 | 2 |
| Total tax charge for the year | (45) | (14) | (20) | (6) |

### (b) Tax included in comprehensive income

| | 2011 £m | 2010 £m |
|---|---|---|
| Deferred tax on post-employment obligations | 30 | 46 |
| Deferred tax on foreign currency gains and losses on intra-group funding | 1 | (3) |
| Current tax on post-employment obligations | 24 | 14 |
| Current tax on foreign currency gains and losses on intra-group funding | 1 | 1 |
| | 56 | 58 |

### (c) Current tax

| | 2011 £m | 2010 £m |
|---|---|---|
| Assets | 16 | 10 |
| Liabilities | (138) | (100) |
| | (122) | (90) |

### (d) Recognised deferred tax

| | 2011 £m | 2010 £m |
|---|---|---|
| Deferred tax assets | 224 | 171 |
| Deferred tax liabilities | (96) | (63) |
| | 128 | 108 |

There is a net £48 million deferred tax credit to the income statement in the year (2010: £53 million) and a further deferred tax credit of £31 million has been recorded directly in other comprehensive income (2010: £46 million). Primarily these credits relate to the recognition of previous unrecognised future tax deductions in the US, the UK and Japan, 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 | | Total |
|---|---|---|---|---|---|---|
| | Post-employment obligations £m | Tax losses £m | Other £m | Fixed assets £m | Other £m | £m |
| **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 |
| At 1 January 2010 | 74 | 45 | 46 | (145) | (6) | 14 |
| Other movements | 2 | – | – | (2) | – | – |
| Included in the income statement | (11) | 75 | 1 | (12) | – | 53 |
| Included in other comprehensive income | 46 | – | – | – | (3) | 43 |
| Businesses acquired | – | – | – | (3) | – | (3) |
| Currency variations | – | – | – | 1 | – | 1 |
| At 31 December 2010 | 111 | 120 | 47 | (161) | (9) | 108 |

Deferred tax assets totalling £41 million (2010: £39 million) have been recognised in territories where tax losses have been incurred in the year as future profitability is expected which will result in their realisation.

### (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.

| | 2011 | | | 2010 | | |
|---|---|---|---|---|---|---|
| | Tax value £m | Gross £m | Expiry period | Tax value £m | Gross £m | Expiry period |
| Tax losses – with expiry: national | 142 | 401 | 2012-2031 | 215 | 619 | 2011-2030 |
| Tax losses – with expiry: local | 20 | 487 | 2012-2031 | 41 | 480 | 2011-2030 |
| Tax losses – without expiry | 120 | 463 | | 109 | 399 | |
| Total tax losses | 282 | 1,351 | | 365 | 1,498 | |
| Post-employment obligations | 70 | 298 | | 66 | 245 | |
| Other temporary differences | 41 | 161 | | 38 | 136 | |
| Total other temporary differences | 111 | 459 | | 104 | 381 | |
| Unrecognised deferred tax assets | 393 | 1,810 | | 469 | 1,879 | |

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 £13 million (2010: £25 million) would be payable.

### (f) Changes in UK tax rate

A reduction in the mainstream rate of UK corporation tax to 26% took effect from April 2011 which gives rise to an effective UK tax rate of 26.5% for the year. Further reductions to 23% by 2014 are expected and at the balance sheet date a reduction to 25% had been substantively enacted, so UK deferred tax is measured at 25%. Further reductions will cause a corresponding reduction in the value of UK deferred tax assets but as substantial UK deferred tax assets are currently unrecognised, no material impact on the Group effective tax rate is expected.

### (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 Court of Appeal hearing regarding payments on account took place in November 2011 and the initial judgment is favourable toward GKN retaining existing payments on accounts received, although HMRC still has a right to appeal against this decision. The main case has been appealed to the UK Supreme Court and to the European Court of Justice (for further guidance on breach of community law). The Judgements for either Court are not expected until late Summer/early Autumn 2012. The continuing complexity of the case 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 Discontinued operations

There were no discontinued operations in 2011 or 2010.

## 8 Earnings per share

| | 2011 | | | 2010 | | |
|---|---|---|---|---|---|---|
| | Earnings £m | Weighted average number of shares million | Earnings per share pence | Earnings £m | Weighted average number of shares million | Earnings per share pence |
| Basic eps | 279 | 1,553.1 | 18.0 | 305 | 1,552.6 | 19.6 |
| Dilutive securities | – | 6.3 | (0.1) | – | 0.7 | – |
| **Diluted eps** | 279 | 1,559.4 | 17.9 | 305 | 1,553.3 | 19.6 |

Management basis earnings per share, 22.6p (2010: 20.7p) are presented in note 3 and use the weighted average number of shares consistent with basic earnings per share calculation.

## 9 Dividends

| | Paid or proposed in respect of | | Recognised | | |
|---|---|---|---|---|---|
| | 2011 pence | 2010 pence | 2012 £m | 2011 £m | 2010 £m |
| 2010 interim dividend paid | – | 1.5 | – | – | 23 |
| 2010 final dividend paid | – | 3.5 | – | 54 | – |
| 2011 interim dividend paid | 2.0 | – | – | 31 | – |
| 2011 final dividend proposed | 4.0 | – | 62 | – | – |
| | 6.0 | 5.0 | 62 | 85 | 23 |

The 2011 final year proposed dividend will be paid on 21 May 2012 to shareholders who are on the register of members at close of business on 27 April 2012.

## 10 Employees including Directors

| Employee benefit expense | 2011 £m | 2010 £m |
|---|---|---|
| Wages and salaries | (1,204) | (1,128) |
| Social security costs | (199) | (179) |
| Post-employment costs | (48) | (40) |
| Share-based payments | (6) | (3) |
| | (1,457) | (1,350) |

Short-time working expense of nil (2010: £2 million) included in restructuring charges comprises wages and salaries nil (2010: £2 million).

| Average monthly number of employees (including Executive Directors) | 2011 Number | 2010 Number |
|---|---|---|
| **By business** | | |
| Driveline | 16,197 | 15,472 |
| Powder Metallurgy | 6,162 | 5,738 |
| Aerospace | 8,632 | 8,609 |
| Land Systems | 4,848 | 4,294 |
| Other businesses | 896 | 716 |
| Businesses sold and closed – (2010: Axles) | – | 98 |
| Corporate | 190 | 169 |
| Total | 36,925 | 35,096 |

## 10 Employees including Directors (continued)

### Key management

The key management of the Group comprises GKN plc Board Directors and the members of the Group's Executive Committee during the year and their aggregate compensation is shown below. More detailed disclosure on Directors' remuneration is set out in the Directors' remuneration report on pages 56 to 68.

| Key management compensation | 2011 £m | 2010 £m |
|---|---|---|
| Salaries and short term employee benefits | 6.3 | 6.0 |
| Post-employment benefits | 0.7 | 0.8 |
| Share-based and medium term incentives and benefits | 4.2 | 3.2 |
| | 11.2 | 10.0 |

The amount outstanding at 31 December 2011 in respect of annual short term variable remuneration payable in cash was £1.9 million (2010: £1.8 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 33 of the business review. Management eps using the cash tax rate is 23.2p (2010: 20.4p). A total of £106,700 in dividends was received by key management in 2011 (2010: £27,100).

## 11 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. All options have been valued at the date of grant by an independent third party using a Monte Carlo model which uses the same principle as a binomial model.

Details of awards made in 2011 are set out below. Details of awards made since 7 November 2002 that impact the 2011 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 September 2004, April 2005, April 2006, August 2009, May 2010 and April 2011 under the 2004 scheme. In April 2007 awards were made to Directors under the 2004 scheme. Under both schemes options were granted with a fixed exercise price equal to the market price at 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 is 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. Inputs to the valuation model were: option price 110.08p to 380.3p, volatility 29% to 38%, expected dividend yield 3.3% to 6.2%, risk-free interest rate 2.80% to 5.40% and expected terms of 6.0 years to 6.7 years.

### (b) Long Term Incentive Plans (LTIP)

Awards were made to Directors and certain senior employees in March 2003 under the 2001 scheme and in September 2004, April 2006, April 2007, August 2009, August 2010 and April 2011 under the 2004 scheme. In April 2005 awards were made to Directors under the 2004 scheme. Under the 2001 scheme and under the 2004 scheme up to and including the April 2007 award, options were granted subject to TSR performance over a three year period compared with a comparator group. From the August 2009 award options were granted subject to eps performance over a three year period. There is no retest facility under either scheme. Inputs to the valuation model for awards made prior to 2009 were: option price nil, volatility 23% to 39%, expected dividend yield 3.3% to 6.2%, risk-free interest rate 4.05% to 5.40% and a term of 3 years to 4 years 9.5 months.

In respect of the 2009, 2010 and 2011 awards, the inputs to the valuation model were: option price nil, volatility nil, expected dividend yield 4.5%, and a term of 4 years. These awards were only made to main Board Directors.

### (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 deliverable dependent upon the extent to which profit growth targets are satisfied by the Group over a 3 year performance period. The PGIP is a cash-based incentive plan, however, for certain very senior employees the benefit is deliverable 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 interim 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 deliverable under the PGIP will be satisfied from GKN ordinary shares already in issue.

An award was made under the PGIP in April 2009; this award was a 2 year award that was entirely cash based and therefore not subject to the IFRS 2 requirements. The benefit under this scheme was delivered in 2011 based on the extent to which profit growth targets were satisfied by the Group over the 2 year performance period.

The expected volatility is based on historical volatility over a period commensurate with the term of the awards. The risk-free interest rate is the rate obtainable from government securities over the expected life of the equity incentive.

## 11 Share-based payments (continued)

### (d) Deferred Bonus Plan (DBP)

Awards were made to Directors and certain senior employees in April 2011. 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 any performance conditions and shares will be released after a two year vesting period.

Further details of the ESOS, LTIP, PGIP and DBP schemes are given in the Directors' remuneration report on pages 56 to 68.

A reconciliation of option movements over the year to 31 December 2011 is shown below:

| | 2011 | | 2010 | |
|---|---|---|---|---|
| | Number 000s | Weighted average exercise price pence | Number 000s | Weighted average exercise price pence |
| Outstanding at 1 January | 20,617 | 121.58 | 17,096 | 121.32 |
| Granted | 1,637 | 199.66 | 5,446 | 134.70 |
| Forfeited | (868) | 132.93 | (1,289) | 178.28 |
| Exercised | (176) | 118.33 | (636) | 112.03 |
| Outstanding at 31 December | 21,210 | 127.17 | 20,617 | 121.58 |
| Exercisable at 31 December | 3,249 | 138.32 | 3,666 | 138.28 |

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

| | 2011 | | 2010 | |
|---|---|---|---|---|
| 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 | 18,680 | 7.00 | 19,613 | 7.95 |
| 195p-220p | 2,530 | 6.06 | 1,004 | 1.21 |

The weighted average share price during the year for options exercised over the year was 201.5p (2010: 146.60p). The total charge for the year relating to share-based payment plans was £6 million (2010: £3 million) all of which related to equity-settled share-based payment transactions. After deferred tax, the total charge was £6 million (2010: £3 million).

Liabilities in respect of share-based payments were not material at either 31 December 2011 or 31 December 2010. There were no vested rights to cash or other assets at either 31 December 2011 or 31 December 2010.

# Notes to the financial statements

Continued

## 12 Goodwill and other intangible assets

| Goodwill | 2011 £m | 2010 £m |
|---|---|---|
| **Cost** | | |
| At 1 January | 527 | 507 |
| Businesses acquired | 188 | 4 |
| Currency variations | – | 16 |
| **At 31 December** | 715 | 527 |
| **Accumulated impairment** | | |
| At 1 January | 177 | 169 |
| Currency variations | 4 | 8 |
| **At 31 December** | 181 | 177 |
| **Net book amount at 31 December** | 534 | 350 |

The carrying value of goodwill at 31 December comprised:

| Reportable segment | Business | Geographical location | 2011 £m | 2010 £m |
|---|---|---|---|---|
| Driveline | Driveline[(i)] | Americas | 126 | 58 |
| | Driveline[(i)] | Europe | 63 | 18 |
| Powder Metallurgy | Hoeganaes | North America | 22 | 22 |
| Aerospace | Aerostructures | North America | 33 | 32 |
| | Propulsion Systems | North America | 98 | 97 |
| | Propulsion Systems | North America | 38 | 38 |
| Land Systems | Power Management Devices[(ii)] | Europe | 70 | – |
| | Wheels and Structures | Italy | 20 | 20 |
| | | | 470 | 285 |
| Other businesses not individually significant to the carrying value of goodwill | | | 64 | 65 |
| | | | 534 | 350 |

(i) Includes goodwill arising on the acquisition of Getrag Driveline Products (see note 24).
(ii) Represents goodwill arising on the acquisition of Stromag (see note 24).

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 businesses 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.

The aggregation of assets for identifying CGUs has changed, in one case, during the year. In the prior year Driveline managed the Asia Pacific region separately from Japan and accordingly these areas were separate CGUs. During 2011 there has been a change in the structure of Driveline such that these two areas are now under common management. There has been no impact on reported results as a consequence of the change.

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 2011 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.

### Key assumptions

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.

## 12 Goodwill and other intangible assets (continued)

### Key assumptions (continued)

***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% (2010: 13%-24%), Europe 12%-14% (2010: 12%-13%) and Japan and Asia Pacific region countries 10%-17% (2010: 10%-17%).

Powder Metallurgy: Europe 12% (2010: 12%) and North America 13% (2010: 13%).

Aerospace: Europe 11% (2010: 11%) and North America 12% (2010: 12%).

Land Systems: Europe 12% (2010: 12%) and North America 13% (2010: 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% (2010: 3%-6%), Europe 3%-7% (2010: 3%-8%) and Japan and Asia Pacific region countries 2%-8% (2010: 1%-9%)

Powder Metallurgy: Europe 4% (2010: 3%) and North America 3% (2010: 3%)

Aerospace: Europe 3% (2010: 3%) and North America 3% (2010: 3%)

Land Systems: Europe 2%-3% (2010: 3%) and North America 3% (2010: 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 likely and potential changes in key assumptions has therefore been reviewed.

At 31 December 2011, the date of the Group's annual impairment test, the estimated recoverable amount of one individual CGU within the Group's Aerospace operations and one CGU within the Group's Driveline operations exceeded their carrying value by £60 million and £107 million respectively. The table below shows the discount rate, long term growth rate and forecast operating cash flow 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.

| Reportable segment | Driveline | Aerospace |
|---|---|---|
| Business | Americas | Propulsion Systems |
| Value in use excess over carrying value | £107m | £60m |
| Assumptions used in calculation of value in use | | |
| Pre-tax adjusted discount rate | 13% | 12% |
| Long term growth rate | 3% | 3% |
| Total pre-discounted forecast operating cash flow | £1,082m | £525m |
| Change required for the carrying value to exceed the recoverable amount | | |
| Pre-tax adjusted discount rate | 2.8%pts | 2.9%pts |
| Long term growth rate | 4.8%pts | 8.8%pts |
| Total pre-discounted forecast operating cash flow | 20% | 28% |

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.

# Notes to the financial statements
Continued

## 12 Goodwill and other intangible assets (continued)
### Other intangible assets

| Other Intangible Assets | 2011 Development costs £m | 2011 Computer software £m | 2011 Assets arising on business combinations £m | 2011 Total £m | 2010 Development costs £m | 2010 Computer software £m | 2010 Assets arising on business combinations £m | 2010 Total £m |
|---|---|---|---|---|---|---|---|---|
| **Cost** | | | | | | | | |
| At 1 January | 126 | 104 | 182 | 412 | 101 | 99 | 170 | 370 |
| Businesses acquired | – | – | 209 | 209 | – | – | 9 | 9 |
| Additions | 41 | 5 | – | 46 | 24 | 6 | – | 30 |
| Capitalised borrowing costs | 3 | – | – | 3 | 1 | – | – | 1 |
| Disposals | – | (9) | – | (9) | – | (3) | – | (3) |
| Businesses sold | – | (8) | – | (8) | – | – | – | – |
| Currency variations | – | (1) | (1) | (2) | – | 2 | 3 | 5 |
| **At 31 December** | 170 | 91 | 390 | 651 | 126 | 104 | 182 | 412 |
| **Accumulated amortisation** | | | | | | | | |
| At 1 January | 51 | 89 | 72 | 212 | 48 | 83 | 52 | 183 |
| Charge for the year | | | | | | | | |
| Charged to trading profit | 4 | 6 | – | 10 | 3 | 7 | – | 10 |
| Non-operating intangible assets | – | – | 22 | 22 | – | – | 19 | 19 |
| Restructuring and impairment | – | – | – | – | – | 1 | – | 1 |
| Disposals | – | (9) | – | (9) | – | (3) | – | (3) |
| Businesses sold | – | (8) | – | (8) | – | – | – | – |
| Currency variations | (1) | (1) | 2 | – | – | 1 | 1 | 2 |
| **At 31 December** | 54 | 77 | 96 | 227 | 51 | 89 | 72 | 212 |
| **Net book amount at 31 December** | 116 | 14 | 294 | 424 | 75 | 15 | 110 | 200 |

Other intangible assets include development costs of £54 million (2010: £28 million) which is in the course of development and £13 million (2010: £14 million) with a remaining amortisation period of up to 8 years (2010: 9 years) in respect of two aerospace programmes and £52 million (2010: £61 million) in respect of a customer relationship asset arising from one business combination with a remaining amortisation period of 6 years (2010: 7 years).

The net book amount of assets arising on business combinations includes marketing related assets of £10 million (2010: £4 million), customer related assets of £200 million (2010: £93 million) and technology based assets of £84 million (2010: £13 million).

## 13 Property, plant and equipment

| | 2011 | | | | 2010 | | | |
|---|---|---|---|---|---|---|---|---|
| | Land and buildings £m | Other tangible assets £m | Capital work in progress £m | Total £m | Land and buildings £m | Other tangible assets £m | Capital work in progress £m | Total £m |
| **Cost** | | | | | | | | |
| At 1 January | 693 | 3,678 | 91 | 4,462 | 660 | 3,564 | 82 | 4,306 |
| Businesses acquired | 43 | 74 | 8 | 125 | 1 | 1 | 1 | 3 |
| Additions | 17 | 159 | 78 | 254 | 20 | 97 | 63 | 180 |
| Capitalised borrowing costs | 1 | 2 | – | 3 | 1 | 2 | – | 3 |
| Disposals | (8) | (110) | – | (118) | (5) | (93) | – | (98) |
| Businesses sold | – | (9) | – | (9) | – | (8) | – | (8) |
| Transfers | – | 46 | (46) | – | – | 58 | (58) | – |
| Currency variations | (2) | (45) | (1) | (48) | 16 | 57 | 3 | 76 |
| **At 31 December** | 744 | 3,795 | 130 | 4,669 | 693 | 3,678 | 91 | 4,462 |
| **Accumulated depreciation and impairment** | | | | | | | | |
| At 1 January | 208 | 2,603 | – | 2,811 | 185 | 2,485 | – | 2,670 |
| Charge for the year | | | | | | | | |
| Charged to trading profit | | | | | | | | |
| Depreciation | 16 | 175 | – | 191 | 17 | 174 | – | 191 |
| Impairments | – | 1 | – | 1 | 1 | 1 | – | 2 |
| Restructuring and impairment | – | – | – | – | – | (1) | – | (1) |
| Businesses sold and closed | – | – | – | – | – | 1 | – | 1 |
| Disposals | (6) | (107) | – | (113) | (3) | (91) | – | (94) |
| Businesses sold | – | (9) | – | (9) | – | (4) | – | (4) |
| Currency variations | 3 | (27) | – | (24) | 8 | 38 | – | 46 |
| **At 31 December** | 221 | 2,636 | – | 2,857 | 208 | 2,603 | – | 2,811 |
| **Net book amount at 31 December** | 523 | 1,159 | 130 | 1,812 | 485 | 1,075 | 91 | 1,651 |

Included within other tangible assets at net book amount are general plant, machinery and steel powder production plant £1,137 million (2010: £1,056 million), fixtures, fittings and computers £20 million (2010: £17 million) and commercial vehicles and cars £2 million (2010: £2 million). The net book amount of assets under finance leases is land and buildings £2 million (2010: £2 million) and plant and equipment nil (2010: nil).

## 14 Investments in joint ventures

### Group share of results

| | 2011 £m | 2010 £m |
|---|---|---|
| Sales | 366 | 355 |
| Operating costs | (317) | (311) |
| Trading profit | 49 | 44 |
| Net financing costs | (1) | (1) |
| Profit before taxation | 48 | 43 |
| Taxation | (8) | (7) |
| Share of post-tax earnings – before exceptional and non-trading items | 40 | 36 |
| Amortisation of non-operating intangible assets arising on business combinations and other net financing charges, including tax of £1 million (2010: nil) | (2) | (1) |
| Share of post-tax earnings | 38 | 35 |

# Notes to the financial statements

Continued

## 14 Investments in joint ventures (continued)

### Group share of net book amount

| | 2011 | | | 2010 | | |
|---|---|---|---|---|---|---|
| | Group share of equity £m | Provisions for impairment £m | Net book amount £m | Group share of equity £m | Provisions for impairment £m | Net book amount £m |
| At 1 January | 143 | – | 143 | 113 | (1) | 112 |
| Share of post-tax earnings of joint ventures | 38 | – | 38 | 35 | – | 35 |
| Utilisation of provision | – | – | – | (1) | 1 | – |
| Actuarial gains on post-employment obligations, including deferred tax | – | – | – | – | – | – |
| Dividends paid | (35) | – | (35) | (23) | – | (23) |
| Additions | 4 | – | 4 | 10 | – | 10 |
| Disposals | (6) | – | (6) | – | – | – |
| Currency variations | 3 | – | 3 | 9 | – | 9 |
| **At 31 December** | 147 | – | 147 | 143 | – | 143 |

| | 2011 £m | 2010 £m |
|---|---|---|
| Non-current assets | 124 | 117 |
| Current assets | 127 | 139 |
| Current liabilities | (79) | (87) |
| Non-current liabilities | (25) | (26) |
| | 147 | 143 |

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 ventures are shown in note 29.

## 15 Other receivables and investments

| | 2011 £m | 2010 £m |
|---|---|---|
| Other investments | 4 | – |
| Indirect taxes and amounts recoverable under employee benefit plans | 23 | 20 |
| Other receivables | 10 | 3 |
| | 37 | 23 |

On 22 June 2011, the Group acquired a 31% shareholding (25% on a fully diluted basis) in Evo Electric Limited for cash consideration of £4 million. The investment has been designated as an associated undertaking.

Included in other receivables is a £9 million indemnity asset (see note 24).

## 16 Inventories

| | 2011 £m | 2010 £m |
|---|---|---|
| Raw materials | 355 | 305 |
| Work in progress | 242 | 208 |
| Finished goods | 152 | 124 |
| | 749 | 637 |

Inventories of £70 million (2010: £65 million) are carried at net realisable value. The amount of any write down of inventory recognised as an expense in the year was £1 million (2010: £4 million).

## 17 Trade and other receivables

| | 2011 £m | 2010 £m |
|---|---|---|
| Trade receivables | 840 | 664 |
| Amounts owed by joint ventures | 19 | 17 |
| Other receivables | 46 | 36 |
| Prepayments | 21 | 17 |
| Indirect taxes recoverable | 36 | 28 |
| | 962 | 762 |
| Provisions for doubtful debts against trade receivables | | |
| At 1 January | (10) | (8) |
| Charge for the year | | |
| Additions | (8) | (7) |
| Unused amounts reversed | 1 | 2 |
| Amounts used | 5 | 3 |
| Currency variations | – | – |
| **At 31 December** | (12) | (10) |
| Trade receivables subject to provisions for doubtful debts | 13 | 11 |
| Ageing analysis of trade receivables and amounts owed by joint ventures past due but not impaired | | |
| Up to 30 days overdue | 43 | 36 |
| 31 – 60 days overdue | 9 | 7 |
| 61 – 90 days overdue | 4 | 2 |
| More than 90 days overdue | 7 | 5 |

## 18 Trade and other payables

| | 2011 | | 2010 | |
|---|---|---|---|---|
| | Current £m | Non-current £m | Current £m | Non-current £m |
| Amounts owed to suppliers and customers | (975) | (9) | (766) | (4) |
| Amounts owed to joint ventures | (2) | – | – | – |
| Accrued interest | (21) | – | (19) | – |
| Government refundable advances | – | (42) | – | (40) |
| Deferred and contingent consideration | (12) | (17) | (5) | (22) |
| Payroll taxes, indirect taxes and audit fees | (73) | (1) | (46) | (1) |
| Amounts due to employees and employee benefit plans | (154) | (35) | (148) | (31) |
| Government grants | (2) | (6) | (4) | (4) |
| Customer advances and deferred income | (69) | (10) | (77) | (6) |
| | (1,308) | (120) | (1,065) | (108) |

Government refundable advances are forecast to fall due for repayment between 2014 and 2031. Non-current deferred and contingent consideration falls due as follows: one-two years £5 million (2010: £5 million) and two-five years £12 million (2010: £17 million). Non-current amounts owed to suppliers and customers fall due within two years.

# Notes to the financial statements
Continued

## 19 Net borrowings
### (a) Analysis of net borrowings

| | Notes | Current | Non-current | | | | Total |
|---|---|---|---|---|---|---|---|
| | | Within one year £m | One to two years £m | Two to five years £m | More than five years £m | Total £m | £m |
| **2011** | | | | | | | |
| Other borrowings | | | | | | | |
| £350 million 6¾% 2019 unsecured bond | i | – | – | – | (347) | (347) | (347) |
| £176 million 7% 2012 unsecured bond | i | (176) | – | – | – | – | (176) |
| Other secured US$ denominated loan | | (2) | (3) | (1) | – | (4) | (6) |
| Other long term borrowings | | – | – | (65) | (48) | (113) | (113) |
| Finance lease obligations | iv | (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** | v | 156 | – | – | – | – | 156 |
| **Other financial assets – bank deposits** | | – | – | – | – | – | – |
| **Net borrowings** | | (72) | (4) | (67) | (395) | (466) | (538) |
| 2010 | | | | | | | |
| Other borrowings | | | | | | | |
| £350 million 6¾% 2019 unsecured bond | i | – | – | – | (347) | (347) | (347) |
| £176 million 7% 2012 unsecured bond | i | – | (176) | – | – | (176) | (176) |
| Other secured US$ denominated loan | | (1) | (2) | (5) | – | (7) | (8) |
| Other long term borrowings | | (6) | – | – | – | – | (6) |
| Finance lease obligations | iv | (1) | (1) | (1) | – | (2) | (3) |
| Bank overdrafts | | (17) | – | – | – | – | (17) |
| Other short term bank borrowings | | (36) | – | – | – | – | (36) |
| Borrowings | | (61) | (179) | (6) | (347) | (532) | (593) |
| Bank balances and cash | | 158 | – | – | – | – | 158 |
| Short term bank deposits | ii | 280 | – | – | – | – | 280 |
| Cash and cash equivalents | v | 438 | – | – | – | – | 438 |
| Other financial assets – bank deposits | iii | 4 | – | – | – | – | 4 |
| Net borrowings | | 381 | (179) | (6) | (347) | (532) | (151) |

Other borrowings include: unsecured £350 million (2010: £350 million) 6¾% bond maturing in 2019 less unamortised issue costs of £3 million (2010: £3 million); unsecured £176 million (2010: £176 million) 7% bond maturing in 2012 less unamortised issue costs of nil (2010: nil); and a secured term loan of £6 million (2010: £8 million) secured by way of a fixed and floating charge on certain Aerospace fixed assets.

Other long term borrowings include £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 £33 million drawn from the Group's new 2016 Revolving Credit Facility of £445 million. The term of the facility is 5 years and attracts a variable interest rate.

**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 0.7% (2010: 0.5%). Deposits at both 31 December 2011 and 31 December 2010 had a maturity date of less than one month.
(iii) The interest rate on bank deposits in 2010 was 2% and they matured on 27 May 2011.
(iv) Finance lease obligations gross of finance charges fall due as follows: £1 million within one year (2010: £1 million), £3 million in one to five years (2010: £3 million) and nil in more than five years (2010: £1 million).
(v) £24 million (2010: £11 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.

## 19 Net borrowings (continued)

### (b) Fair values

| | 2011 | | 2010 | |
|---|---|---|---|---|
| | Book value £m | Fair value £m | Book value £m | Fair value £m |
| **Borrowings, other financial assets and cash and cash equivalents** | | | | |
| Other borrowings | (642) | (659) | (537) | (564) |
| Finance lease obligations | (3) | (3) | (3) | (3) |
| Bank overdrafts and other short term bank borrowings | (49) | (49) | (53) | (53) |
| Bank balances and cash | 150 | 150 | 158 | 158 |
| Short term bank deposits and other bank deposits | 6 | 6 | 284 | 284 |
| | (538) | (555) | (151) | (178) |
| **Trade and other payables** | | | | |
| Government refundable advances | (42) | (39) | (40) | (40) |
| Deferred and contingent consideration | (29) | (29) | (27) | (27) |
| | (71) | (68) | (67) | (67) |

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 2011. Bonds included within other borrowings have been valued using quoted closing market values.

## 20 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.

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.

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 | 0.4 | (1.5) | 0.7 |
| US dollar | (0.5) | 10.8 | 0.7 |

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. 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.

## 20 Financial risk management (continued)

### (a) Foreign currency risk (continued)

Analysis of net borrowings by currency:

| | 2011 | | | | 2010 | | | |
|---|---|---|---|---|---|---|---|---|
| | Borrowings £m | Cash and cash equivalents £m | Other financial assets £m | Total £m | Borrowings £m | Cash and cash equivalents £m | Other financial assets £m | Total £m |
| Sterling | (644) | 29 | – | (615) | (524) | 304 | 4 | (216) |
| US dollar | (12) | 16 | – | 4 | (30) | 18 | – | (12) |
| Euro | – | 34 | – | 34 | (1) | 19 | – | 18 |
| Others | (38) | 77 | – | 39 | (38) | 97 | – | 59 |
| | (694) | 156 | – | (538) | (593) | 438 | 4 | (151) |

### (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 30% to 70% of the level of underlying borrowings forecast to arise over a 12 month horizon. This policy remains suspended following a Board decision in December 2004. At 31 December 2011 87% (2010: 88%) of the Group's gross borrowings were subject to fixed interest rates.

As at 31 December 2011 £6 million (2010: £284 million) was in bank deposits, all of which was on deposit with banks on the Isle of Man (2010: £267 million in the UK).

### (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:

| | 2011 % | 2010 % |
|---|---|---|
| Driveline | 53 | 50 |
| Powder Metallurgy | 20 | 17 |
| Aerospace | 67 | 66 |
| Land Systems | 28 | 25 |

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 £940 million (2010: £761 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 AA- or equivalent, and assigning financial limits to individual counterparties.

The maximum exposure with a single bank for deposits is £6 million (2010: £56 million), whilst the maximum mark to market exposure for forward foreign currency contracts at 31 December 2011 to a single bank was £1 million (2010: £1 million).

## 20 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, issue new shares or sell assets to reduce borrowings.

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 2011 and 2010 were as follows:

| | 2011 £m | 2010 £m |
|---|---|---|
| Gross borrowings | 694 | 593 |
| EBITDA | 621 | 570 |
| **Gross borrowings to EBITDA ratio** | 1.1 times | 1.0 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 2011 and 2010 were as follows:

| | 2011 £m | 2010 £m |
|---|---|---|
| EBITDA | 621 | 570 |
| Net interest payable and receivable (excluding borrowing costs capitalised) | (48) | (44) |
| **EBITDA to net interest payable and receivable ratio** | 12.9 times | 13.0 times |

| | 2011 £m | 2010 £m |
|---|---|---|
| Net debt | 538 | 151 |
| EBITDA | 621 | 570 |
| **Net debt to EBITDA ratio** | 0.9 times | 0.3 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 £755 million of which nil expire in 2012. There were £113 million of drawings on these facilities at 31 December 2011. Committed facilities are provided through 15 banks.

***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 |
|---|---|---|---|---|---|
| 2011 | | | | | |
| Borrowings (note 19) | (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) |
| 2010 | | | | | |
| Borrowings (note 19) | (61) | (179) | (6) | (347) | (593) |
| Contractual interest payments and finance lease charges | (37) | (29) | (72) | (92) | (230) |
| Government refundable advances | – | – | (7) | (60) | (67) |
| Deferred and contingent consideration | (6) | (6) | (18) | – | (30) |
| Derivative financial instruments liabilities – receipts | 147 | 103 | 247 | 271 | 768 |
| Derivative financial instruments liabilities – payments | (160) | (114) | (271) | (285) | (830) |

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.

# Notes to the financial statements
Continued

## 20 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

| | Loans and receivables £m | Amortised cost £m | Held for trading: Financial assets £m | Held for trading: Financial liabilities £m | Derivatives used for hedging £m | Total £m |
|---|---|---|---|---|---|---|
| **2011** | | | | | | |
| Other receivables and investments | 10 | – | – | – | – | 10 |
| Trade and other receivables | 905 | – | – | – | – | 905 |
| Derivative financial instruments | – | – | 26 | (102) | – | (76) |
| Cash and cash equivalents | 156 | – | – | – | – | 156 |
| Borrowings | – | (694) | – | – | – | (694) |
| Trade and other payables | – | (1,078) | – | – | – | (1,078) |
| Provisions | – | (50) | – | – | – | (50) |
| | 1,071 | (1,822) | 26 | (102) | – | (827) |
| 2010 | | | | | | |
| Other receivables and investments | 3 | – | – | – | – | 3 |
| Trade and other receivables | 717 | – | – | – | – | 717 |
| Derivative financial instruments | – | – | 31 | (74) | 1 | (42) |
| Other financial assets | 4 | – | – | – | – | 4 |
| Cash and cash equivalents | 438 | – | – | – | – | 438 |
| Borrowings | – | (593) | – | – | – | (593) |
| Trade and other payables | – | (848) | – | – | – | (848) |
| Provisions | – | (31) | – | – | – | (31) |
| | 1,162 | (1,472) | 31 | (74) | 1 | (352) |

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 £14 million (2010: £8 million) is categorised as a Level 3 fair value measurement, see note 27.

## 21 Derivative financial instruments

| | 2011 | | | | | 2010 | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Assets | | Liabilities | | Total | Assets | | Liabilities | | Total |
| | Non-current £m | Current £m | Non-current £m | Current £m | £m | Non-current £m | Current £m | Non-current £m | Current £m | £m |
| Forward currency contracts | | | | | | | | | | |
| Not hedge accounted | 2 | 4 | (61) | (29) | (84) | 3 | 11 | (56) | (13) | (55) |
| Hedge accounted | – | – | – | – | – | – | 1 | – | – | 1 |
| Commodity contracts | | | | | | | | | | |
| Not hedge accounted | – | – | – | (1) | (1) | – | – | – | – | – |
| Embedded derivatives | 19 | 1 | (11) | – | 9 | 16 | 1 | (5) | – | 12 |
| | 21 | 5 | (72) | (30) | (76) | 19 | 13 | (61) | (13) | (42) |

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

## 21 Derivative financial instruments (continued)

### 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 has adopted transactional foreign currency hedge accounting for a limited number of contracts. The net value of forward foreign currency contracts subject to hedge accounting was less than £1 million (2010: £1 million). The cash flow and profit impact will occur in 2012 (2010: 2011 to 2012). A £1 million loss was recognised in equity during the year (2010: £1 million gain) in respect of contracts outstanding at 31 December 2011. No accumulated gain or loss was recycled through trading profit in the year (2010: nil). Cash flow hedging was 100% effective during 2011 and 2010.

## 22 Provisions

| | Restructuring £m | Warranty £m | Legal and environmental £m | Other £m | Total £m |
|---|---|---|---|---|---|
| At 1 January 2011 | (41) | (23) | (9) | (58) | (131) |
| Net charge for the year: | | | | | |
| Additions | – | (6) | (1) | (24) | (31) |
| Unused amounts reversed | – | 6 | 2 | 8 | 16 |
| Unwind of discounts | – | – | – | (1) | (1) |
| Businesses acquired | – | (19) | (3) | (29) | (51) |
| Amounts used | 31 | 7 | 1 | 21 | 60 |
| Currency variations | – | – | 1 | – | 1 |
| **At 31 December 2011** | (10) | (35) | (9) | (83) | (137) |
| Due within one year | (5) | (18) | (4) | (19) | (46) |
| Due in more than one year | (5) | (17) | (5) | (64) | (91) |
| | (10) | (35) | (9) | (83) | (137) |

### Restructuring

Restructuring provisions outstanding at 31 December 2011 relate primarily to the estimated future cash outflows in respect of reorganisation and onerous contracts (predominantly leases) arising from Group strategic restructuring programmes, details of the charges in respect of which are included in note 4b. Amounts are only set aside when irrevocable commitments exist at the balance sheet date and these invariably reflect actual or constructive contractual arrangements which indicate the amount and most likely timing of flows. Utilisation of the provision due in more than one year is expected as follows: £2 million in 2013 and £3 million from 2014.

### 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 £9 million in 2013 and £8 million from 2014.

### Legal and environmental

Legal provisions amounting to £4 million (2010: £5 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 used includes £1 million of environmental remediation expenditure.

Utilisation of the provision due in more than one year is estimated as £2 million in 2013 and £3 million from 2014.

### Other

Other provisions include claims provisions held within the Group's captive insurance company £14 million (2010: £13 million), provisions held in respect of onerous contracts and leases £22 million (2010: £2 million) and long service non-pension and other employee related obligations arising primarily in the Group's continental European subsidiaries £19 million (2010: £13 million). Claims provisions and charges are established in accordance with external insurance and actuarial advice. Non-beneficial lease provisions arising on prior year business combinations were £28 million (2010: £30 million). The movement on this provision included utilisation of £2 million and discount unwind of £1 million. Utilisation of other provisions due in more than one year is expected as follows: £8 million in 2013; £3 million in 2014; £7 million in 2015 and £46 million from 2016.

Vacant leasehold property provisions and non-beneficial contractual obligations included in Restructuring and Other provisions above amount to £50 million (2010: £31 million).

# Notes to the financial statements
Continued

## 23 Share capital

| | Issued and Fully Paid | |
|---|---|---|
| | 2011 £m | 2010 £m |
| Ordinary shares of 10p each | 159 | 159 |

| | 2011 Number 000s | 2010 Number 000s |
|---|---|---|
| Ordinary shares of 10p each | | |
| At 1 January | 1,590,530 | 1,590,528 |
| Shares issued under share option schemes | – | 2 |
| At 31 December | 1,590,530 | 1,590,530 |
| Deferred shares of 40p each | | |
| At 1 January | – | 743,904 |
| Cancellation[i] | – | (743,904) |
| At 31 December | – | – |
| At 31 December | 1,590,530 | 1,590,530 |

**Notes**

(i) A special resolution was passed at the 2010 Annual General Meeting to approve the purchase and subsequent cancellation of 705,519,691 deferred shares of 40p. The shares were purchased for an aggregate consideration of £0.01 and subsequently cancelled. The 38,384,253 deferred shares held in treasury were also cancelled. The deferred shares were not listed, had no voting or dividend rights, and only very limited rights on a return of capital.

At 31 December 2011, there were 37,388,984 ordinary shares of 10p each, with a total nominal value of £3.7 million, held as treasury shares (2010: 37,565,178 ordinary shares of 10p each with a total nominal value of £3.8 million). A total of 176,194 (2010: 634,401) shares were transferred out of treasury during 2011 to satisfy the exercise of options by participants under share option schemes. The remaining treasury shares, which represented 2.4% (2010: 2.4%) of the called up share capital at the end of the year, have not been cancelled but are held as treasury shares and represent a deduction from shareholders' equity.

At 31 December 2011, the GKN Employees' Share Ownership Plan Trust ("the Trust") held 2,219,116 ordinary shares (2010: 5,810). A total of 2,213,306 shares with a nominal value of £0.2 million were purchased by the Trust in the open market during 2011 (2010: nil) for cash consideration of £5 million (2010: nil). The shares held in the Trust will be used to satisfy the vesting and exercise of awards of ordinary shares made under the Group's share-based incentive arrangements. A dividend waiver operates in respect of shares held by the Trust.

During the year, shares issued under the share option schemes generated nil (2010: less than £1 million).

## 24 Business combinations

**Acquisition of Getrag Driveline Products**

GKN Driveline acquired the all-wheel-drive (AWD) components businesses from Getrag KG on 30 September 2011. The Group acquired 100% of the equity of:

1) Getrag Corporation, formerly a joint venture with Dana Corporation, based in the United States; and

2) Getrag All Wheel Drive AB, formerly a joint venture with Dana Holding Corporation and Volvo Car Corporation, based in Sweden.

The entities acquired are together referred to as "Getrag Driveline Products".

The core business of Getrag Driveline Products is the Tier 1 supply of geared driveline products, namely Power Transfer Units and Rear Drive Units for AWD vehicles, along with Final Drive Units for high performance rear wheel drive vehicles. It is an excellent fit with GKN's existing range of products and technology. The operations have a product, manufacturing and customer footprint which is complementary to GKN's own geared product business, which is predominantly based in Asia.

As part of the overall transaction, GKN is also acquiring an exclusive licence, principally for Europe and the Americas, to Getrag's electric drivetrain technology for use in electric and certain hybrid vehicles.

The identifiable assets acquired and liabilities assumed below are provisional as the review of certain liabilities and provisions is on-going.

| | £m |
|---|---|
| Intangible fixed assets | |
| – customer related | 75 |
| – technology based | 53 |
| – marketing related | 2 |
| Property, plant and equipment | 94 |
| Other non-current assets | 1 |
| Cash | 23 |
| Inventories | 36 |
| Trade and other receivables | 84 |
| Trade and other payables | (96) |
| Post-employment obligations | (1) |
| Provisions | (33) |
| Deferred tax | (38) |
| Provisional goodwill | 115 |
| | 315 |
| Satisfied by: | |
| Cash | 287 |
| Repayment of loan | 22 |
| Total cash and cash equivalents | 309 |
| Contingent consideration | 6 |
| Fair value of consideration | 315 |

The Group has agreed to pay the selling shareholders additional consideration of up to £6 million depending on Getrag Driveline Products' success in achieving future business awards in the post-acquisition period. The range of the total contingent consideration payment, based on individual contracts is nil to £8 million, however, there is a maximum cap of £6 million. The fair value of the contingent consideration at the acquisition date was £6 million, calculated using a discount rate equal to the incremental short term borrowing rate of 2%. There was no change in the contingent consideration balance at 31 December 2011.

From the date of acquisition to the balance sheet date, Getrag Driveline Products contributed £117 million to sales and £7 million to trading profit. If the acquisition had been completed on 1 January 2011 the Group's statutory sales and trading profit for the year ended 31 December 2011 are estimated at £6,082 million and £438 million respectively.

Acquisition related fees of £2 million incurred have all been charged to the income statement within trading profit.

Goodwill (which is not tax deductible) is attributable to the value of the assembled workforce, intangible assets that do not qualify for separate recognition and expected future synergies from combination with the Group's existing Driveline business.

## 24 Business combinations (continued)

### Acquisition of Stromag

GKN Land Systems acquired the entire share capital of Stromag Holding GmbH (Stromag) from former shareholders which included Equita GmbH & Co. Holding KGaA and a large number of other organisations and individuals, including management on 5 September 2011.

Stromag is a market leading engineer of industrial power management components with a strong technology base and focus on providing tailored solutions for its customers. Its core products include hydraulic clutches, electro-magnetic brakes and flexible couplings serving end-markets including agricultural equipment, construction and mining machinery, renewable energy and the metal processing industry with a recognised brand. The business is headquartered in Germany and has operations in Germany, France, USA, Brazil, India and China.

The identifiable assets acquired and liabilities assumed below are provisional as the review of certain liabilities and provisions remains on-going.

| | £m |
|---|---|
| Intangible fixed assets | |
| – customer related | 51 |
| – technology based | 23 |
| – marketing related | 5 |
| Property, plant and equipment | 31 |
| Indemnity asset | 12 |
| Cash | 12 |
| Inventories | 26 |
| Trade and other receivables | 20 |
| Trade and other payables | (24) |
| Provisions | (18) |
| Post-employment obligations | (11) |
| Deferred tax | (30) |
| Provisional goodwill | 73 |
| | 170 |
| Satisfied by: | |
| Cash | 143 |
| Repayment of loan | 27 |
| Fair value of total consideration, all cash and cash equivalents | 170 |

From the date of acquisition to the balance sheet date, Stromag contributed £38 million to sales and £4 million to trading profit. If the acquisition had been completed on 1 January 2011 the Group's statutory sales and trading profit for the year ended 31 December 2011 are estimated at £5,827 million and £428 million respectively.

Acquisition related fees of £2 million incurred have all been charged to the income statement within trading profit.

Goodwill (which is not tax deductible) is attributable to the value of the assembled workforce, intangible assets that do not qualify for separate recognition and expected future synergies from combination with the Group's existing Land Systems business.

The Group was indemnified for certain legal, environmental and warranty issues under the sale and purchase agreement. Provisions have been established under IAS 37 and a corresponding indemnity asset of £12 million was recorded. The indemnity asset is recorded in other receivables; non current £9 million, current £3 million. The range of outcomes for the indemnity receipt is nil to £12 million with payment based on contractual events.

## 24 Business combinations (continued)

### Judgements and estimates

***Valuation of non-operating intangibles – 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 businesses.

The intangible assets inherent in both Stromag and Getrag Driveline Products' 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 attrition rates on the expected cash flows arising from the contracts and forecast cash flows likely to accrue from the customer base; (b) expected cash flows arising from the asset; (c) discount rates reflective of the risks inherent in the cash flows; and (d) an asset charge attributable to operating assets needed to generate the cash flows. The cash flows attributable to customer relationships include an annual attrition rate of between 5% and 10% to reflect expected decay in future revenues. An after tax discount rate of 13.0% to 14.0% 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 both Stromag and Getrag Driveline Products from not having to pay a licence fee for the technology. The royalty rate used in the valuations was between 2.5% and 3%, based on a review of licence agreements for comparable technologies in similar industrial segments. An after tax discount rate of between 13% and 14.5% was applied to the forecast cash flows, a rate that reflects the higher inherent risk within cash flows compared to the weighted average cost of capital for the acquisitions.

As part of the Getrag Driveline Products transaction the vendor signed a non-compete agreement and in respect of relevant individuals was to keep confidential all information about technology, operations, or customers obtained of the business acquired for a period of five years. Although the vendor still operates in the automotive business it has retained no activities of a similar nature to those it disposed of. The costs of recreating the specific technology and processes it disposed of would be significant. A fair value of £2 million was identified for the covenant not to compete.

The tradename of Stromag was deemed to have measurable value as it is well recognised in its industry. It has been valued using a Relief from Royalty methodology based on projected cash flows attributable to the tradename and an assumed royalty rate (0.5%) that would be charged if the name were subject to licence within a comparable trade situation and an appropriate discount rate (15.5%) reflecting inherent risk in the project cash flows. A fair value of £5 million has been recognised.

The valuation of all intangible assets reflects the tax benefit of amortisation, which in the context of Getrag Driveline Products has meant a benefit assessed with reference to US and Swedish tax laws and in the context of Stromag has meant a benefit assessed with reference to German tax laws. According to US and German tax law an intangible asset may be rateably amortised over 15 years regardless of its actual useful life and in Sweden the amortisation period is 5 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 £12 million across all the intangibles recognised.

***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 disposal and a selling margin, for finished goods and work-in-progress. The value of the inventory uplift was £4 million with an adjustment for scrap and obsolete items of £1 million.

Liabilities include an amount in respect of an onerous contract and a refundable advance.

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 onerous contract liability of £20 million has been recognised using a risk adjusted discount rate of 12.5%. 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 £19 million is included on the acquisition balance sheet for a contractual requirement to repay refundable advances provided. The liability has been valued based on forecast cash flow, with the effect of discounting assessed as immaterial.

## 25 Cash flow reconciliations

| Cash generated from operations | 2011 £m | 2010 £m |
|---|---|---|
| Operating profit | 374 | 385 |
| Adjustments for: | | |
| Depreciation, impairment and amortisation of fixed assets | | |
| Charged to trading profit | | |
| Depreciation | 191 | 191 |
| Impairment | 1 | 2 |
| Amortisation | 10 | 10 |
| Amortisation of non-operating intangible assets arising on business combinations | 22 | 19 |
| Restructuring and impairment charges | – | – |
| Change in fair value of derivative and other financial instruments | 31 | (12) |
| Amortisation of government capital grants | (1) | (1) |
| Net profits on sale and realisation of fixed assets | (3) | (1) |
| Gains and losses on changes in Group structure | (8) | (1) |
| Charge for share-based payments | 6 | 3 |
| Movement in post-employment obligations | (34) | (116) |
| Change in inventories | (60) | (63) |
| Change in receivables | (109) | (117) |
| Change in payables and provisions | 80 | 121 |
| | 500 | 420 |

| Movement in net debt | 2011 £m | 2010 £m |
|---|---|---|
| Movement in cash and cash equivalents | (276) | 133 |
| Net movement in other borrowings and deposits | (109) | (6) |
| Bond buy back | – | 25 |
| Finance leases | – | 1 |
| Currency variations | (2) | (4) |
| Movement in year | (387) | 149 |
| Net debt at beginning of year | (151) | (300) |
| **Net debt at end of year** | (538) | (151) |

| Reconciliation of cash and cash equivalents | 2011 £m | 2010 £m |
|---|---|---|
| Cash and cash equivalents per balance sheet | 156 | 438 |
| Bank overdrafts included within “current liabilities – borrowings” | (11) | (17) |
| **Cash and cash equivalents per cash flow** | 145 | 421 |

## 26 Post-employment obligations

| Post-employment obligations as at the year end comprise: | | 2011 £m | 2010 £m |
|---|---|---|---|
| Pensions | – funded | (443) | (176) |
| | – unfunded | (355) | (363) |
| Medical | – funded | (22) | (17) |
| | – unfunded | (48) | (44) |
| | | (868) | (600) |

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. 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.

### (a) Defined benefit schemes – measurement and assumptions

Independent actuarial valuations of all major defined benefit scheme assets and liabilities were carried out at 31 December 2011. 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.

Key assumptions were:

| | UK % | Americas % | Europe % | ROW % |
|---|---|---|---|---|
| **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 |
| 2010 | | | | |
| Rate of increase in pensionable salaries | 4.35 | 3.50 | 2.50 | – |
| Rate of increase in payment and deferred pensions | 2.90 | 2.00 | 1.75 | n/a |
| Discount rate | 5.40 | 5.50 | 5.00 | 1.75 |
| Inflation assumption | 3.35 | 2.50 | 1.75 | 0.75 |
| Rate of increases in medical costs: | | | | |
| Initial/long term | 6.5/6.0 | 9.0/5.0 | n/a | n/a |

The discount rates in the table above for the UK and Europe were referenced against specific iBoxx indices, whilst the Citigroup liability index was the reference point for the USA discount rate. The reference for the UK discount rate was the yield as at 31 December on the iBoxx GBP Corporate rated AA bonds with a maturity of 15 years plus. The reference for the European discount rate was the yield as at 31 December on the iBoxx Euro Corporate rated AA bonds with a maturity of 10 years plus of 4.7%, adjusted to reflect the duration of liabilities. For the USA, the discount rate referenced both the Citigroup liability index and the Merrill Lynch US corporate AA 15+ years as at 31 December 2011 of 4.4 and 4.55, respectively.

The underlying mortality assumptions for the major schemes are as follows:

#### United Kingdom

Such is the size and profile of the UK scheme that data on the scheme's mortality experience is collected and reviewed annually. The key current year mortality assumptions for the scheme use S1NA (year of birth) mortality tables allowing for medium cohort projections with a minimum improvement of 1% and a +0.5 age rating for male members and a +0.7 age rating for female members consistent with the prior year. Using these assumptions, a male aged 65 lives for a further 20.7 years and a female aged 65 lives for a further 23.3 years. A male aged 45 is expected to live a further 22.4 years from age 65 and a female aged 45 is expected to live a further 25.1 years from age 65.

#### Overseas

In the USA, PPA2011 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 19.1 years (female 21.0 years) whilst, in Germany, a male aged 65 lives for a further 18.4 years (female 22.5 years). The longevity assumption for a USA male currently aged 45 is that he also lives for a further 19.1 years once attaining 65 years (female 21.0 years), with the German equivalent assumption for a male being 21.1 years (female 25.1 years). These assumptions are based solely on the prescribed tables not on actual GKN experience.

# Notes to the financial statements
Continued

## 26 Post-employment obligations (continued)

### (a) Defined benefit schemes – measurement and assumptions (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 2011 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% | 366 | 1.8 | 56 | (0.5) | 44 | – | 5 | (0.2) |
| Discount rate -1% | (433) | 0.8 | (70) | 0.5 | (54) | (0.1) | (5) | 0.2 |
| Rate of inflation +1% | (342) | (22.1) | – | – | (37) | (2.3) | – | – |
| Rate of inflation -1% | 291 | 20.3 | – | – | 31 | 2.0 | – | – |
| Rate of increase in medical costs +1% | (1) | (0.1) | (2) | (0.2) | – | – | – | – |
| Rate of increase in medical costs -1% | 1 | 0.1 | 1 | 0.2 | – | – | – | – |

### (b) Defined benefit schemes – reporting

**The amounts included in operating profit are:**

| | Trading Profit | | | |
|---|---|---|---|---|
| | Employee benefit expense £m | Redundancy and other employment amounts £m | UK Pension scheme curtailment £m | Total £m |
| **2011** | | | | |
| Current service cost | (38) | – | – | (38) |
| Past service | 1 | – | – | 1 |
| Settlement/curtailments | 4 | – | – | 4 |
| | (33) | – | – | (33) |
| 2010 | | | | |
| Current service cost | (35) | – | – | (35) |
| Past service | 1 | (1) | – | – |
| Settlement/curtailments | 9 | – | 68 | 77 |
| | (25) | (1) | 68 | 42 |

**The amounts recognised in the balance sheet are:**

| | 2011 | | | | | |
|---|---|---|---|---|---|---|
| | UK £m | Americas £m | Europe £m | ROW £m | Total £m | 2010 £m |
| Present value of unfunded obligations | (13) | (39) | (351) | – | (403) | (407) |
| Present value of funded obligations | (2,650) | (430) | (32) | (46) | (3,158) | (2,853) |
| Fair value of plan assets | 2,391 | 248 | 31 | 23 | 2,693 | 2,660 |
| Net obligations recognised in the balance sheet | (272) | (221) | (352) | (23) | (868) | (600) |

The contribution expected to be paid by the Group during 2012 to the UK scheme is £29 million and to overseas schemes £45 million. Section (d) of this note describes the Pension partnership interest created on 31 March 2010 under which the second distribution of £30 million is expected to be made in the first half of 2012.

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

| | 2011 £m | 2010 £m |
|---|---|---|
| At 1 January | (358) | (334) |
| Net actuarial losses in year | (277) | (24) |
| At 31 December | (635) | (358) |

## 26 Post-employment obligations (continued)

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

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

| | UK £m | Americas £m | Europe £m | ROW £m | Total £m |
|---|---|---|---|---|---|
| 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 | – | 1 | – | – | 1 |
| Settlements/curtailments | 16 | – | – | 1 | 17 |
| Currency variations | – | (7) | 10 | (3) | – |
| **At 31 December 2011** | (2,663) | (469) | (383) | (46) | (3,561) |
| At 1 January 2010 | (2,440) | (355) | (352) | (39) | (3,186) |
| Businesses acquired | – | – | – | – | – |
| Current service cost | (22) | (4) | (6) | (3) | (35) |
| Interest | (135) | (22) | (18) | (1) | (176) |
| Contributions by participants | (4) | – | (1) | – | (5) |
| Actuarial gains and losses | (61) | (26) | (20) | (2) | (109) |
| Benefits paid | 129 | 17 | 17 | 3 | 166 |
| Past service | (1) | 1 | – | – | – |
| Settlements/curtailments | 86 | – | – | 6 | 92 |
| Currency variations | – | (10) | 11 | (8) | (7) |
| At 31 December 2010 | (2,448) | (399) | (369) | (44) | (3,260) |

**Movement in schemes' assets during the year:**

| | UK £m | Americas £m | Europe £m | ROW £m | Total £m |
|---|---|---|---|---|---|
| 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 |
| At 1 January 2010 | 1,930 | 215 | 27 | 18 | 2,190 |
| Businesses acquired | – | – | – | – | – |
| Expected return on assets | 128 | 16 | 1 | – | 145 |
| Actuarial gains and losses | 76 | 10 | – | (1) | 85 |
| Contributions by Group | 39 | 16 | – | 2 | 57 |
| Special contribution | 331 | – | – | – | 331 |
| Contributions by participants | 4 | – | 1 | – | 5 |
| Settlements/curtailments | (15) | – | – | – | (15) |
| Benefits paid | (129) | (18) | (1) | (1) | (149) |
| Currency variations | – | 6 | – | 5 | 11 |
| At 31 December 2010 | 2,364 | 245 | 28 | 23 | 2,660 |

## 26 Post-employment obligations (continued)

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

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

| | 2011 | | | | | 2010 |
|---|---|---|---|---|---|---|
| | UK £m | Americas £m | Europe £m | ROW £m | Total £m | £m |
| Funded | (2,650) | (430) | (32) | (46) | (3,158) | (2,853) |
| Unfunded | (13) | (39) | (351) | – | (403) | (407) |
| | (2,663) | (469) | (383) | (46) | (3,561) | (3,260) |

**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 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 |
| At 31 December 2010 | | | | | | | | |
| Equities (inc. Hedge Funds) | 7.8 | 741 | 8.5 | 171 | – | – | 5.5 | 11 |
| Bonds | 5.0 | 1,115 | 3.6 | 69 | – | – | 1.0 | 8 |
| Property | 6.6 | 90 | – | – | – | – | – | – |
| Cash and net current assets | 0.5 | 39 | 2.8 | 5 | – | – | – | – |
| Partnership plan asset | 6.1 | 346 | – | – | – | – | – | – |
| Other assets | 5.5 | 33 | – | – | 4.8 | 28 | 1.3 | 4 |
| | | 2,364 | | 245 | | 28 | | 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.

The Pension partnership interest has been valued on a discounted cash flow basis. 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.

The actual return on plan assets was £132 million (2010: £230 million).

## 26 Post-employment obligations (continued)

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

**History of experience gains and losses:**

| 2011 | UK | Americas | Europe | ROW |
|---|---|---|---|---|
| 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 | UK | Americas | Europe | ROW |
|---|---|---|---|---|
| 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 | UK | Americas | Europe | ROW |
|---|---|---|---|---|
| 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 | UK | Americas | Europe | ROW |
|---|---|---|---|---|
| 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) |

| 2007 | UK | Americas | Europe | ROW |
|---|---|---|---|---|
| Experience adjustments arising on scheme assets: | | | | |
| Amount – £m | 21 | – | (1) | (1) |
| Percentage of scheme assets | 0.9% | – | (4.8%) | (7.1%) |
| Experience gains/(losses) on scheme liabilities: | | | | |
| Amount – £m | (7) | 4 | (3) | – |
| Percentage of the present value of scheme liabilities | (0.3%) | 1.6% | (1.4%) | – |
| Present value of scheme liabilities – £m | (2,264) | (270) | (268) | (24) |
| Fair value of scheme assets – £m | 2,248 | 212 | 21 | 14 |
| Deficit – £m | (16) | (58) | (247) | (10) |

# Notes to the financial statements
Continued

## 26 Post-employment obligations (continued)

### (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 £15 million (2010: £15 million).

### (d) 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. The first distribution of £23 million for the period from 31 March to 31 December 2010 was made in the second quarter of 2011.

## 27 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.

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

Contingent consideration of £9 million (2010: £9 million) is payable and provided upon Filton achieving certain levels of sales in 2013, 2014 and 2015. The range of contingent consideration payable is nil to £9 million. Note 24 contains details of contingent consideration relating to the current year acquisition of Getrag Driveline Products.

## 28 Operating lease commitments – minimum lease payments
The minimum lease payments which the Group is committed to make at 31 December are:

| | 2011 | | 2010 | |
|---|---|---|---|---|
| | 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 | 26 | 10 |
| Later than one year and less than five years | 78 | 20 | 75 | 17 |
| After five years | 118 | 2 | 105 | 2 |
| | 221 | 34 | 206 | 29 |

## 29 Capital expenditure
Contracts placed against capital expenditure sanctioned at 31 December 2011 so far as not provided by subsidiaries amounted to £118 million property, plant and equipment, £6 million intangible assets (2010: £89 million property, plant and equipment, £7 million intangible assets) and the Group's share not provided by joint ventures amounted to £1 million property, plant and equipment, nil intangible assets (2010: less than £1 million property, plant and equipment, nil intangible assets).

## 30 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 2011 totalled £88 million (2010: £89 million). The amount due at the year end in respect of such sales was £19 million (2010: £17 million). Purchases by subsidiaries from joint ventures in 2011 totalled £1 million (2010: £2 million). The amount due at the year end in respect of such purchases was nil (2010: nil).

At 31 December 2011 a Group subsidiary had £2 million payable to a joint venture company in respect of an unsecured financing facility bearing interest at 1 month LIBOR plus 1/8% (2010: nil).

GKN invested £1 million in GKN EVO eDrive Systems Limited, a joint venture company between GKN plc and EVO Electric Limited. The joint venture company was established in June 2011.

## 31 Post balance sheet events
On 27 January 2012 the Group announced the dissolution of its Driveline joint arrangements with JTEKT Corporation ('JTEKT') in Rayong, Thailand. On the same date the Group acquired the remaining shares in a non-controlling interest, GKN Driveline JTEKT Manufacturing Limited. Following the dissolution, GKN now owns 100% of GKN Driveline JTEKT Manufacturing Limited. The Group paid JTEKT net consideration of approximately £8 million, with further deferred consideration of £1 million contingent upon certain specified future business awards.