GKN CONTINUING BUSINESSES

PRO FORMA PROFIT AND LOSS ACCOUNT

FOR THE YEAR ENDED 31 DECEMBER 2001

	Pro forma notes	Acquisitions in year £m	Other companies £m	Total 2001 £m	Total 2000 £m
Sales					
Subsidiaries		210	3,107	3,317	3,892
Share of joint ventures		–	963	963	180
Share of associates		–	57	57	62
		210	4,127	4,337	4,134
Operating profit					
Subsidiaries:					
Before exceptional items and goodwill amortisation		16	177	193	389
Goodwill amortisation		(1)	(37)	(38)	(28)
Exceptional items	1	–	(102)	(102)	(45)
Total subsidiaries		15	38	53	316
Share of joint ventures:					
Before goodwill amortisation		–	110	110	31
Goodwill amortisation		–	(5)	(5)	–
Total share of joint ventures		–	105	105	31
Share of associates		–	3	3	4
Total operating profit		15	146	161	351
Exceptional items					
Profits less losses on sale or closure of businesses:					
Subsidiaries	1	–	2	2	27
Share of associates	1	–	5	5	6
Profit before interest and taxation		15	153	168	384
Interest (payable)/receivable:					
Subsidiaries	2			(59)	(34)
Share of joint ventures and associates	2			(2)	(4)
Profit on ordinary activities before taxation				107	346
Taxation				(60)	(125)
Profit on ordinary activities after taxation				47	221
Minority interests – equity				(5)	(5)
Earnings of the year				42	216
Earnings per share – p	3			5.8	30.2
Diluted earnings per share – p	3			5.8	29.8
Results before goodwill amortisation and exceptional items					
Operating profit – £m				306	424
Profit before tax – £m				245	386
Earnings per share – p	3			24.7	39.1

GKN CONTINUING BUSINESSES

PRO FORMA STATEMENT OF NET ASSETS

AT 31 DECEMBER 2001

	2001 £m	2000 £m
Fixed assets		
Intangible assets – goodwill	**525**	535
Tangible assets	**1,399**	1,341
	1,924	1,876
Investments		
Joint ventures:		
Share of gross assets	**1,073**	304
Share of gross liabilities	**(861)**	(224)
	212	80
Associates	**9**	16
Other investments	**21**	32
	242	128
Total fixed assets	**2,166**	2,004
Current assets		
Stocks	**503**	595
Debtors	**546**	723
Cash at bank and in hand	**167**	143
	1,216	1,461
Creditors: amounts falling due within one year		
Short-term borrowings	**(295)**	(116)
Creditors	**(730)**	(1,067)
Taxation payable	**(190)**	(204)
Dividend payable	**(53)**	(93)
	(1,268)	(1,480)
Net current liabilities	**(52)**	(19)
Total assets less current liabilities	**2,114**	1,985
Creditors: amounts falling due beyond one year		
Term loans and obligations under finance leases	**(754)**	(623)
Provisions for liabilities and charges	**(302)**	(291)
Net assets	**1,058**	1,071

GKN CONTINUING BUSINESSES

PRO FORMA CASH INFLOW FROM OPERATING ACTIVITIES

FOR THE YEAR ENDED 31 DECEMBER 2001

	2001 £m	2000 £m
Operating profit from continuing operations	**53**	316
Depreciation and goodwill amortisation	**203**	185
Loss on sale of tangible fixed assets	**1**	–
Impairment of fixed assets	**19**	–
Decrease/(increase) in stocks	**44**	(58)
Decrease/(increase) in debtors	**71**	(58)
Increase/(decrease) in creditors	**3**	(16)
Increase/(decrease) in provisions	**9**	(1)
Increase/(decrease) in customer advances	**49**	(27)
Exceptional items	**–**	(6)
Net cash inflow from operating activities	**452**	335

PRO FORMA CASH FLOW STATEMENT

FOR THE YEAR ENDED 31 DECEMBER 2001

	2001 £m	2000 £m
Net cash inflow from operating activities (see above)	**452**	335
Dividends from joint ventures and associates	**49**	14
Returns on investments and servicing of finance		
Net interest paid	**(58)**	(29)
Dividends paid to minority interests	**(1)**	(3)
	(59)	(32)
Taxation	**(33)**	(58)
Capital expenditure and financial investment		
Purchase of tangible fixed assets	**(246)**	(246)
Other	**2**	1
	(244)	(245)
Acquisitions and disposals		
Purchase of subsidiaries and joint ventures	**(137)**	(223)
Sale of subsidiaries and joint ventures	**1**	114
	(136)	(109)
Cash inflow/(outflow) from continuing businesses	**29**	(95)

PRO FORMA MOVEMENT IN NET DEBT

FOR THE YEAR ENDED 31 DECEMBER 2001

	2001 £m	2000 £m
Cash inflow/(outflow) from continuing businesses (see above)	**29**	(95)
Dividends/redemption of 'B' Shares	**(148)**	(134)
Creation of AgustaWestland	**(144)**	–
Subsidiaries acquired and sold	**–**	(24)
Currency variations	**(6)**	(72)
Proceeds of share issues	**15**	12
New finance leases	**–**	(5)
Continuing businesses total outflow	**(254)**	(318)
Cash outflow from discontinued businesses	**(30)**	(2)
Net borrowings at beginning of period	**(601)**	(281)
Net borrowings at end of period	**(885)**	(601)

GKN CONTINUING BUSINESSES

PRO FORMA SEGMENTAL ANALYSIS

FOR THE YEAR ENDED 31 DECEMBER 2001

	Sales		Operating profit		Net operating assets	
	2001 £m	2000 £m	**2001 £m**	2000 £m	**2001 £m**	2000 £m
By business						
Automotive:						
Subsidiaries	**2,687**	2,530	**161**	281	**1,392**	1,447
Joint ventures	**157**	153	**26**	27	**91**	95
	2,844	2,683	**187**	308	**1,483**	1,542
Aerospace:						
Subsidiaries	**630**	1,362	**32**	108	**328**	148
Joint ventures	**806**	27	**84**	4	**106**	95
Associates	**57**	62	**3**	4	**4**	15
	1,493	1,451	**119**	116	**438**	258
	4,337	4,134	**306**	424	**1,921**	1,800
Goodwill amortisation	**–**	–	**(43)**	(28)	**–**	–
Exceptional items	**–**	–	**(102)**	(45)	**–**	–
Total	**4,337**	4,134	**161**	351	**1,921**	1,800
By region of origin						
Europe:						
Subsidiaries	**1,715**	2,570	**122**	274	**842**	794
Joint ventures	**851**	79	**93**	13	**127**	116
Associates	**57**	62	**3**	4	**4**	15
	2,623	2,711	**218**	291	**973**	925
Americas:						
Subsidiaries	**1,340**	1,131	**53**	106	**801**	724
Joint ventures	**68**	60	**11**	10	**42**	42
	1,408	1,191	**64**	116	**843**	766
Rest of the World:						
Subsidiaries	**262**	191	**18**	9	**77**	77
Joint ventures	**44**	41	**6**	8	**28**	32
	306	232	**24**	17	**105**	109
Total	**4,337**	4,134	**306**	424	**1,921**	1,800

Notes:

1 The analyses of operating profit by business and by region of origin include an allocation of costs incurred in the United Kingdom.

2 Intra-group sales between businesses and regions are not significant.

3 Operating profit of continuing businesses after charging goodwill amortisation and exceptional items is analysed by business as follows: Automotive £129 million (2000 – £287 million) and Aerospace £32 million (2000 – £64 million) and by region of origin as follows: Europe £125 million (2000 – £263 million), Americas £14 million (2000 – £72 million) and Rest of the World £22 million (2000 – £16 million).

4 Net operating assets are analysed as follows:

	2001 £m	2000 £m
Tangible fixed assets	**1,399**	1,341
Stocks	**503**	595
Debtors	**545**	721
Creditors – short-term	**(727)**	(1,062)
Net operating assets of joint ventures and associates	**201**	205
	1,921	1,800

GKN CONTINUING BUSINESSES

PRO FORMA FINANCIAL INFORMATION

Basis of preparation

The unaudited pro forma financial information for the continuing GKN Group which appears on pages 32 to 37 has been prepared as if the Industrial Services businesses had been demerged from the GKN Group on 1 January 2000 and excludes the costs of the transaction itself. It is based on the audited consolidated accounts of GKN for the years ended 31 December 2001 and 2000 from which the results of the Industrial Services businesses have been eliminated. The profit and loss account and net asset figures for the year to 31 December 2000 are those which appear in the Listing Particulars for 'New GKN plc' dated 22 June 2001.

Notes:

1 Exceptional items

	2001 £m	2000 £m
a) Operating exceptional items		
Asset impairments	**(70)**	(13)
Redundancy costs	**(23)**	(18)
Other	**(9)**	(14)
	(102)	(45)

Following the substantial downturn in civil aviation markets and uncertainties surrounding North American vehicle production levels which were apparent in the second half of the year, the Group took steps to reduce capacity in a number of aerospace and automotive plants. A reassessment was also made of the carrying value of certain aerospace investments. This resulted in a charge to operating profit in the year of £102 million and a cash outflow of £3 million with a further cash outflow of approximately £32 million anticipated in 2002.

	2001 £m	2000 £m
b) Non-operating exceptional items – Profits less losses on sale or closure of businesses		
Subsidiaries:		
GKN Aerospace Services sale and closure of businesses	**9**	(17)
Goodwill previously written off to reserves	**(2)**	(8)
	7	(25)
GKN Automotive Driveline sale of businesses	**–**	62
Goodwill previously written off to reserves	**–**	(5)
	–	57
Other	**(5)**	(5)
Total subsidiaries	**2**	27
Share of associate:		
Alvis plc – sale of shares in Avimo Group Ltd	**5**	6

2 Interest

The interest charge for 2000 has been adjusted to reflect the terms of the Demerger including, inter alia, the transfer of other investments in the Industrial Services activities of £50 million as at 31 December 2000 and the associated loss of interest of £3 million.

GKN CONTINUING BUSINESSES

3 Earnings per share

Earnings per share for 2001 are based on earnings of the year of £42 million (2000 – £216 million) and calculated on the weighted average number of 720.1 million shares in issue and ranking for dividend (2000 – 715.4 million shares). Diluted earnings per share, which takes into account options over GKN plc shares, is calculated on the weighted average number of 727.6 million (2000 – 725.2 million) shares which comprises shares in both GKN plc (from 1 August 2001) and the former parent company (now GKN Holdings plc) (prior to 1 August 2001).

Earnings per share before goodwill amortisation and exceptional items, which the Directors consider gives a useful additional indication of underlying performance, is calculated on the earnings of the year adjusted as follows:

	Earnings		Earnings per share	
	2001 £m	2000 £m	**2001 p**	2000 p
Earnings of the year	**42**	216	**5.8**	30.2
Included in operating profit:				
Goodwill amortisation	**43**	28	**6.0**	3.9
Exceptional items	**102**	45	**14.2**	6.3
Non-operating exceptional items	**(7)**	(33)	**(1.0)**	(4.6)
Taxation attributable to exceptional items	**(2)**	24	**(0.3)**	3.3
Earnings before goodwill amortisation and exceptional items	**178**	280	**24.7**	39.1

CONSOLIDATED PROFIT AND LOSS ACCOUNT

FOR THE YEAR ENDED 31 DECEMBER 2001

	Notes	Continuing operations Acquisitions in year £m	Continuing operations Other companies £m	Industrial Services* £m	Total 2001 £m	Total 2000 £m
Sales						
Subsidiaries		210	3,107	115	3,432	4,124
Share of joint ventures		–	963	500	1,463	910
Share of associates		–	57	–	57	62
	2	210	4,127	615	4,952	5,096
Operating profit						
Subsidiaries:						
Before exceptional items and goodwill amortisation		16	177	10	203	421
Goodwill amortisation		(1)	(37)	(2)	(40)	(30)
Exceptional items	4	–	(102)	(4)	(106)	(45)
Total subsidiaries	3	15	38	4	57	346
Share of joint ventures:						
Before goodwill amortisation		–	110	70	180	168
Goodwill amortisation		–	(5)	(4)	(9)	(5)
Total share of joint ventures		–	105	66	171	163
Share of associates		–	3	–	3	4
Total operating profit		15	146	70	231	513
Exceptional items						
Profits less losses on sale or closure of businesses:						
Subsidiaries	4	–	2	(3)	(1)	27
Share of associates	4	–	5	–	5	6
Demerger costs	4	–	–	(20)	(20)	–
Profit before interest and taxation		15	153	47	215	546
Interest (payable)/receivable:						
Subsidiaries	5				(59)	(31)
Share of joint ventures and associates	5				(21)	(34)
Profit on ordinary activities before taxation					135	481
Taxation	6				(95)	(157)
Profit on ordinary activities after taxation					40	324
Minority interests – equity					(5)	(5)
Earnings of the year					35	319
Dividends	7				(108)	(143)
Transfer (from)/to reserves					(73)	176
Earnings per share – p	8				4.9	44.6
Diluted earnings per share – p	8				4.8	44.0
Results before goodwill amortisation and exceptional items						
Operating profit – £m					386	593
Profit before tax – £m					306	528
Earnings per share – p	8				31.1	54.5

*Industrial Services businesses are shown separately as they became discontinued on 7 August 2001.

CONSOLIDATED BALANCE SHEET
AT 31 DECEMBER 2001

	Notes	2001 £m	2000 £m
Fixed assets			
Intangible assets – goodwill	10	**525**	579
Tangible assets	11	**1,399**	1,391
		1,924	1,970
Investments:			
Joint ventures			
Share of gross assets		**1,073**	1,392
Share of gross liabilities		**(861)**	(1,053)
		212	339
Associates		**9**	16
Other investments		**21**	82
	12	**242**	437
Total fixed assets		**2,166**	2,407
Current assets			
Stocks	13	**503**	602
Debtors	14	**546**	755
Cash at bank and in hand	15	**167**	143
		1,216	1,500
Creditors: amounts falling due within one year			
Short-term borrowings	16	**(295)**	(116)
Creditors	17	**(730)**	(1,104)
Taxation payable	18	**(190)**	(204)
Dividend payable		**(53)**	(93)
		(1,268)	(1,517)
Net current liabilities		**(52)**	(17)
Total assets less current liabilities		**2,114**	2,390
Creditors: amounts falling due beyond one year			
Term loans and obligations under finance leases	19	**(754)**	(623)
Provisions for liabilities and charges	22	**(302)**	(291)
Net assets		**1,058**	1,476
Capital and reserves*			
Called up share capital	23/24	**364**	3,546
Share premium account	24	**3**	–
Revaluation reserve	24	**45**	48
Other reserves	24	**(84)**	(2,719)
Profit and loss account	24	**708**	582
Equity interest		**1,036**	1,457
Minority interest – equity		**22**	19
		1,058	1,476

*Consolidated capital and reserves at 31 December 2000 have been restated as explained in note 24.

The accounts were approved by the Board of Directors on 6 March 2002 and were signed by:

Sir David Lees, Marcus Beresford, Nigel Stein, Directors

STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES

FOR THE YEAR ENDED 31 DECEMBER 2001

	2001 £m	2000 £m
Earnings of the year		
Subsidiaries	**(70)**	218
Share of joint ventures	**99**	92
Share of associates	**6**	9
	35	319
Currency variations	**(21)**	3
Other reserve movements	**(3)**	(5)
Total recognised gains and losses of the year	**11**	317

Earnings of the year on an historical cost basis are not materially different from those reported above.

RECONCILIATION OF MOVEMENTS IN SHAREHOLDERS' EQUITY

FOR THE YEAR ENDED 31 DECEMBER 2001

	2001 £m	2000 £m
Total recognised gains and losses of the year	**11**	317
Dividends	**(108)**	(143)
Demerger of Industrial Services	**(451)**	–
Issue of Ordinary Shares net of costs	**15**	10
Redemption of 'B' Shares	**–**	(84)
Creation of AgustaWestland	**110**	–
Goodwill on businesses sold and closed	**2**	13
Total (decrease)/increase	**(421)**	113
Shareholders' equity at 1 January 2001	**1,457**	1,344
Shareholders' equity at 31 December 2001	**1,036**	1,457

MOVEMENT IN NET DEBT

FOR THE YEAR ENDED 31 DECEMBER 2001

	2001 £m	2000 £m
Increase/(decrease) in cash	**47**	(66)
Decrease in liquid resources and financing	**(196)**	(81)
Cash outflow before use of liquid resources and financing	**(149)**	(147)
Currency variations	**(6)**	(72)
Net proceeds of Ordinary Share issues	**15**	12
Redemption of 'B' Shares	**–**	(84)
New finance leases	**–**	(5)
Creation of AgustaWestland	**(144)**	–
Subsidiaries acquired and sold	**–**	(24)
Total decrease	**(284)**	(320)
Net borrowings at 1 January 2001	**(601)**	(281)
Net borrowings at 31 December 2001	**(885)**	(601)

CONSOLIDATED CASH FLOW STATEMENT
FOR THE YEAR ENDED 31 DECEMBER 2001

	Notes	2001 £m	2000 £m
Net cash inflow from operating activities	a	**439**	365
Dividends from joint ventures and associates		**75**	48
Returns on investments and servicing of finance			
Interest received		**16**	28
Interest paid		**(75)**	(57)
Dividends paid to minority interests		**(1)**	(3)
		(60)	(32)
Taxation			
United Kingdom		**15**	6
Overseas		**(51)**	(71)
		(36)	(65)
Capital expenditure and financial investment			
Purchase of tangible fixed assets		**(258)**	(261)
Sale of tangible fixed assets		**6**	8
Investment loans and additional capital contributions to joint ventures and associates		**(30)**	(45)
Other financial investments		**(1)**	(2)
		(283)	(300)
Acquisitions and disposals			
Purchase of subsidiaries	b	**(137)**	(214)
Purchase of joint ventures		**(9)**	(12)
Sale of subsidiaries	b	**10**	114
Sale of joint ventures		**–**	(1)
		(136)	(113)
Equity dividends paid		**(148)**	(50)
Cash outflow before use of liquid resources and financing		**(149)**	(147)
Management of liquid resources			
Increase in short-term loans and deposits		**(10)**	(13)
Decrease in short-term loans and deposits		**9**	7
	c	**(1)**	(6)
Financing			
Net proceeds from Ordinary Share issues		**15**	12
Redemption of 'B' Shares		**–**	(84)
Proceeds of other term borrowings		**728**	356
Repayment of other term borrowings		**(538)**	(188)
Finance leases		**(8)**	(9)
	c	**197**	87
Increase/(decrease) in cash	c	**47**	(66)

NOTES ON THE CASH FLOW STATEMENT

FOR THE YEAR ENDED 31 DECEMBER 2001

	Continuing operations £m	Discontinued operations £m	Total 2001 £m	Total 2000 £m
a) Net cash inflow from operating activities				
Operating profit	**53**	**4**	**57**	346
Depreciation and goodwill amortisation	**203**	**6**	**209**	193
Loss/(profit) on sale of tangible fixed assets	**1**	**(1)**	**–**	(5)
Impairment of fixed assets	**19**	**4**	**23**	–
Decrease/(increase) in stocks	**44**	**(1)**	**43**	(59)
Decrease/(increase) in debtors	**71**	**4**	**75**	(55)
Increase/(decrease) in creditors	**3**	**(14)**	**(11)**	(25)
Increase/(decrease) in provisions	**9**	**(1)**	**8**	(1)
Increase/(decrease) in customer advances	**49**	**–**	**49**	(27)
Exceptional items (note 4)	**–**	**(14)**	**(14)**	(2)
Net cash inflow/(outflow) from operating activities (note i)	**452**	**(13)**	**439**	365

	Acquisitions		Sales	
	2001 £m	2000 £m	2001 £m	2000 £m
b) Purchase and sale of subsidiaries				
Fixed assets	**(66)**	(92)	**1**	34
Working capital and provisions	**(40)**	(9)	**3**	9
Taxation payable	**–**	6	**–**	(1)
Cash	**–**	1	**–**	3
Loans and finance leases	**3**	26	**(3)**	(2)
Minority interests	**–**	(13)	**–**	5
	(103)	(81)	**1**	48
Change from joint venture status	**–**	20	**–**	–
Surplus on sales	**–**	–	**7**	64
Goodwill	**(29)**	(160)	**2**	5
Total consideration	**(132)**	(221)	**10**	117
Deferred consideration	**(5)**	8	**–**	–
Consideration (paid)/received	**(137)**	(213)	**10**	117
Less: cash	**–**	(1)	**–**	(3)
Net cash (outflow)/inflow	**(137)**	(214)	**10**	114

	Net borrowings at end of year		Change in 2001		
	2001 £m	2000 £m	Cash £m	Liquid resources (note iii) £m	Financing £m
c) Analysis of movements in net debt					
Bank balances and cash (note ii)	**141**	117	**24**	**–**	**–**
Short-term loans and deposits	**26**	26	**–**	**–**	**–**
Bank overdrafts	**(21)**	(38)	**17**	**–**	**–**
Other short-term borrowings	**(274)**	(78)	**–**	**–**	**(196)**
Term loans	**(745)**	(610)	**–**	**–**	**(135)**
Finance leases:					
Due within one year	**(3)**	(5)	**–**	**–**	**2**
Due in more than one year	**(9)**	(13)	**–**	**–**	**4**
	(885)	(601)	**41**	**–**	**(325)**
Net proceeds of Ordinary Share issues			**–**	**–**	**(15)**
Creation of AgustaWestland			**–**	**–**	**144**
Currency variations			**6**	**1**	**(1)**
Net cash inflow/(outflow)			**47**	**1**	**(197)**

Notes:

i Included in cash inflow from operating activities is expenditure of £27 million (2000 – £12 million) in respect of operating exceptional items in 2000 and 2001.

ii Cash consists of cash in hand and bank balances and overdrafts repayable on demand as defined by FRS 1 (revised).

iii Liquid resources consist of short-term investments, loans and deposits excluding cash.

NOTES ON THE ACCOUNTS

1 Basis of consolidation

Accounting policies

These accounts are prepared under the historical cost convention, as modified by the revaluation of land and buildings, and comply with UK applicable accounting standards. New standards applied in the period were:

FRS 17 'Retirement Benefits' – The disclosures required by this standard are shown in note 26. As permitted by its transitional arrangements, figures arising under the standard have not been reflected in the financial statements.

FRS 18 'Accounting Policies' – The standard requires the Directors to adopt the most appropriate accounting policies for the purpose of giving a true and fair view of the Group's results. There have been no changes to the Group's accounting policies as a result of this requirement.

The Group's accounting policies are shown in the notes on pages 43 to 65.

Demerger of Industrial Services businesses

The restructuring of the Group following the demerger of the Industrial Services businesses (the 'Demerger'), to which reference is made in the Chairman's statement on page 6, the Financial Review on page 28 and the Directors' Report on page 69, has been accounted for using the principles of merger accounting under group reconstruction relief. The impact on shareholders' equity is detailed in note 24.

Composition of the Group accounts

The Group accounts consolidate the accounts for the year to 31 December 2001 of the Company and its subsidiaries.

Subsidiaries acquired and sold

The results of subsidiaries acquired or sold during the year, including the demerged businesses, are included in the consolidated profit and loss account from the date of acquisition or to the date of disposal. In the case of acquisitions during the year the acquisition method of accounting has been used.

Discontinued operations

Where material, profits or losses are analysed as discontinued operations where businesses are sold or closed by the date on which the accounts are approved. Where businesses are treated as sold or closed in the current year, the prior year's analyses are restated to reflect those businesses as discontinued.

Foreign currencies

The results and cash flows of overseas subsidiaries, joint ventures and associates are translated to sterling at average exchange rates. Where practicable, transactions involving foreign currencies are protected by forward contracts. Assets and liabilities in foreign currencies are translated at the appropriate forward contract rate or, if not covered, at the exchange rate ruling at the balance sheet date. Differences on revenue transactions are dealt with through the profit and loss account.

Where practicable, the Group's overseas equity investments are hedged by borrowings in the currencies in which those assets are denominated. Differences arising on translation of overseas net assets less exchange differences on borrowings which finance those net assets are dealt with through reserves.

The exchange rates used for the currencies most important to the Group's operations are:

	£1=euro	£1=US$
2001 average	**1.61**	**1.44**
2000 average	1.64	1.52
2001 year-end	**1.64**	**1.45**
2000 year-end	1.59	1.49

Derivatives and financial instruments

The Group's accounting policy for derivatives is to recognise in the profit and loss account gains and losses on hedges of revenues or operating payments only as they crystallise.

The Group uses forward foreign exchange contracts to manage its exposure to foreign exchange risks and hedge a proportion of its investment in overseas subsidiaries and investments denominated in foreign currencies, where such hedging can be carried out on an economically acceptable basis. Such financial instruments are treated as hedges against the underlying assets or liabilities, with

NOTES ON THE ACCOUNTS CONTINUED

1 Basis of consolidation continued

matching accounting treatments and cash flows. All gains or losses are taken to the statement of total recognised gains and losses until the instrument and the underlying hedged investment are sold, when the profit or loss arising is recognised in the profit and loss account. Interest differentials resulting from the use of financial instruments to hedge these exposures are dealt with in the profit and loss account.

Any instruments no longer designated as hedges are restated at market value and any gains or losses are taken directly to the profit and loss account.

The book values of short-term debtors and creditors are the same as their fair values and have been excluded from the financial instrument disclosures other than those on currency exposures.

Goodwill

Goodwill arising on consolidation consists of the excess of the purchase price over the fair value of the net assets of businesses acquired. Goodwill arising on acquisitions completed prior to 31 December 1997 has been eliminated against reserves. Goodwill arising on acquisitions after that date is capitalised as a fixed asset and amortised on a straight line basis over its estimated useful life up to a maximum of 20 years. Where an acquired business is sold and goodwill has been previously deducted from reserves, the goodwill is taken into account in calculating the profit or loss on sale.

2 Sales

Sales shown in the profit and loss account exclude value added taxes and, except in the case of long-term contracts in the AgustaWestland joint venture, represent the invoiced value of goods and services charged to external customers. On long-term contracts in AgustaWestland, sales are based on the estimated sales value of work done. The geographical markets supplied by subsidiaries, joint ventures and associates are as follows:

	Geographical markets supplied				
	United Kingdom £m	Continental Europe £m	Americas £m	Rest of the World £m	Total £m
Sales by subsidiaries					
By business:					
Automotive	272	1,098	1,009	308	2,687
Aerospace	102	143	380	5	630
Total continuing operations 2001	**374**	**1,241**	**1,389**	**313**	**3,317**
Discontinued operations – Industrial Services	–	–	100	15	115
Total 2001	**374**	**1,241**	**1,489**	**328**	**3,432**
By region of origin:					
United Kingdom	298	172	72	5	547
Continental Europe	42	1,050	28	48	1,168
Americas	34	19	1,282	5	1,340
Rest of the World	–	–	7	255	262
Total continuing operations 2001	**374**	**1,241**	**1,389**	**313**	**3,317**
Total continuing operations 2000	1,241	1,134	1,191	326	3,892
Discontinued operations – Industrial Services	–	–	206	26	232
Total 2000	1,241	1,134	1,397	352	4,124
Group share of sales by joint ventures and associates					
Continuing operations	503	293	137	87	1,020
Discontinued operations – Industrial Services	175	174	150	1	500
Total 2001	**678**	**467**	**287**	**88**	**1,520**
Continuing operations	54	73	64	51	242
Discontinued operations – Industrial Services	210	309	210	1	730
Total 2000	264	382	274	52	972

Analyses of sales, operating profit and net operating assets of subsidiaries, joint ventures and associates by business and by region of origin are shown on page 67.

3 Operating profit

	2001 Continuing operations Acquisitions in year £m	2001 Continuing operations Other companies £m	2001 Discontinued operations £m	2001 Total £m	2000 Continuing operations £m	2000 Discontinued operations £m	2000 Total £m
Sales by subsidiaries	**210**	**3,107**	**115**	**3,432**	3,892	232	4,124
Change in stocks of finished goods and work in progress	**(9)**	**(45)**	**–**	**(54)**	31	–	31
Raw materials and consumables	**(22)**	**(988)**	**(46)**	**(1,056)**	(839)	(104)	(943)
Staff costs (note 9)	**(48)**	**(1,021)**	**(30)**	**(1,099)**	(1,115)	(50)	(1,165)
Redundancy and reorganisation costs:							
Exceptional (note 4)	**–**	**(32)**	**–**	**(32)**	(32)	–	(32)
Other	**–**	**(10)**	**–**	**(10)**	(8)	–	(8)
Depreciation written off tangible fixed assets (including £3 million in respect of assets under finance leases, 2000 – £4 million)	**(9)**	**(156)**	**(4)**	**(169)**	(157)	(6)	(163)
Amortisation of goodwill	**(1)**	**(37)**	**(2)**	**(40)**	(28)	(2)	(30)
Exceptional charge for asset impairments (note 4)	**–**	**(70)**	**(4)**	**(74)**	(13)	–	(13)
Other external charges	**(106)**	**(710)**	**(25)**	**(841)**	(1,415)	(40)	(1,455)
	(195)	**(3,069)**	**(111)**	**(3,375)**	(3,576)	(202)	(3,778)
Operating profit	**15**	**38**	**4**	**57**	316	30	346

Details of companies acquired and sold are given in the review of operations on pages 8 to 19 and note 25.

Other external charges include rental for hire of equipment £15 million (2000 – £16 million) and rental for leased property £17 million (2000 – £18 million). Auditors' remuneration was £2.6 million (2000 – £2.7 million). Non-audit fees payable to PricewaterhouseCoopers are subject to review by the Audit Committee and the policy for using auditors for non-audit work is set out in the Corporate Governance Report on page 74. The total payable in respect of such fees is analysed below:

	2001 £m	2000 £m
Fees in connection with the demerger of the Industrial Services businesses	**2.5**	0.6
Due diligence	**–**	0.2
Tax	**0.2**	0.2
Other	**0.4**	0.5
	3.1	1.5

Depreciation is not provided on freehold land or assets in the course of construction. In the case of buildings, computers and contract specific plant, depreciation is provided on valuation or original cost. For all other categories of asset, depreciation is provided on the written down value at the beginning of the financial year.

Depreciation is applied to specific classes of asset so as to reduce them to their residual values over their estimated useful lives. The range of main rates of depreciation used is:

	Straight line %	Reducing balance %
Freehold buildings	2	–
General plant, machinery, fixtures, fittings and equipment	10 to 20	10 to 35
Computers and major software	20 to 33⅓	–
Commercial vehicles and cars	–	40 to 45

Leasehold properties are amortised by equal annual instalments over the period of the lease or 50 years whichever is the shorter. Operating lease rentals are charged to the profit and loss account as incurred over the lease term.

NOTES ON THE ACCOUNTS CONTINUED

3 Operating profit continued

In accordance with the provisions of UITF 17 (revised 2000) no charge to profit has been made in respect of employee share options issued under Inland Revenue approved share save schemes.

Costs of reorganisation and redundancy which are not part of a fundamental restructuring are charged against operating profit in the period when the announcement is made.

Revenue expenditure on research and development and the cost of acquiring patents and know-how are written off as incurred. Research and development costs in continuing subsidiaries totalled £105 million (2000 – £77 million) after including £7 million of expenditure refunded by customers and other parties for development work carried out on their behalf and capital expenditure of £4 million.

In addition, GKN's share of research and development in AgustaWestland in the year totalled £115 million after including £103 million of expenditure refunded by customers and other parties for development work carried out on their behalf. In 2000, when still subsidiaries, the Westland companies' expenditure was £247 million of which £230 million was refunded.

4 Exceptional items

	2001 £m	2000 £m
a) Operating exceptional items		
Asset impairments	**(74)**	(13)
Redundancy costs	**(23)**	(18)
Other	**(9)**	(14)
	(106)	(45)

Operating exceptional items arose from:

i) the demerger of the Industrial Services businesses, which, together with the creation of the AgustaWestland joint venture at the beginning of the year, resulted in a number of investments not appropriate to the engineering activities of the Group being written off and a reduction in the level of central overheads; and

ii) the substantial downturn in civil aviation markets and uncertainties surrounding North American vehicle production levels which were apparent in the second half of the year, as a consequence of which the Group took steps to reduce capacity in a number of aerospace and automotive plants. A reassessment was also made of the carrying value of certain aerospace investments. These actions resulted in the above charge to operating profit of £106 million and a cash outflow in the year of £3 million with a further cash outflow of approximately £32 million anticipated in 2002.

	2001 £m	2000 £m
b) Non-operating exceptional items		
i) Profits less losses on sale or closure of businesses		
Subsidiaries:		
GKN Aerospace Services sale and closure of businesses	**9**	(17)
Goodwill previously written off to reserves	**(2)**	(8)
	7	(25)
GKN Automotive Driveline sale of businesses	**–**	62
Goodwill previously written off to reserves	**–**	(5)
	–	57
Other:		
Continuing operations	**(5)**	(5)
Discontinued operations	**(3)**	–
	(8)	(5)
Total subsidiaries	**(1)**	27
Share of associate:		
Alvis plc – sale of shares in Avimo Group Ltd	**5**	6
ii) Costs arising from the demerger of the Industrial Services businesses	**(20)**	–

Demerger costs

On 7 August 2001 the Group completed the demerger of its Industrial Services businesses to Brambles Industries plc and the merger of those businesses with Brambles Industries Limited of Australia. The direct costs of this transaction were £20 million, with cash of £14 million spent in 2001 and a further £6 million anticipated in 2002.

5 Interest (payable)/receivable

	2001 £m	2000 £m
Subsidiaries		
Loans to joint ventures and associates	**4**	7
Short-term investments, loans and deposits	**11**	19
	15	26
Loans from joint ventures	**(9)**	–
Short-term borrowings (including bank interest £33.5 million (2000 – £15.0 million))	**(38)**	(28)
Loans repayable within five years (including bank interest £0.9 million (2000 – £1.1 million))	**(1)**	(1)
Loans repayable after five years	**(24)**	(24)
Finance leases	**(2)**	(4)
	(59)	(31)
Share of joint ventures and associates		
Interest receivable	**11**	5
Interest payable	**(32)**	(39)
	(21)	(34)

NOTES ON THE ACCOUNTS CONTINUED

6 Taxation

	2001 £m	2000 £m
United Kingdom		
Corporation tax at 30%	**40**	65
Advance corporation tax	**–**	(10)
Adjustments in respect of prior years	**(15)**	(6)
	25	49
Double tax relief	**(46)**	(22)
	(21)	27
Overseas		
Continuing operations:		
Corporation taxes	**50**	86
Deferred tax	**1**	(5)
Adjustments in respect of prior years	**(8)**	8
	43	89
Discontinued operations	**21**	3
	64	92
Share of joint ventures and associates		
Continuing businesses	**38**	9
Discontinued businesses	**14**	29
	52	38
	95	157

Tax on exceptional items, included in the above, is: UK nil (2000 – £5 million), Overseas £17 million (2000 – £19 million), share of joint ventures and associates £1 million (2000 – nil). Of these balances, a £20 million charge arises in relation to the demerger of the Industrial Services businesses.

7 Dividends

	2001 £m	2000 £m
Equity dividends		
Interim (paid 28 September 2001) 7.6p per share (2000 – 6.9 p per share)	**55**	50
Final 7.3p per share (2000 – 12.9p per share)	**53**	93
	108	143

The 2000 dividend was paid by GKN Holdings plc (the former parent company of the Group) which, following the Demerger and capital restructuring, is now a 100% subsidiary of GKN plc, the new parent company of the continuing businesses. The final dividend per share is in respect of the continuing businesses; the 2000 dividends and 2001 interim dividend were in respect of the larger group, pre demerger of Industrial Services.

8 Earnings per share

Earnings per share for 2001 are based on earnings of the year of £35 million (2000 – £319 million) and calculated on the weighted average number of 720.1 million shares in issue and ranking for dividend (2000 – 715.4 million shares). Diluted earnings per share, which takes into account options over GKN plc shares, is calculated on the weighted average number of 727.6 million (2000 – 725.2 million) shares which comprises shares in both GKN plc (from 1 August 2001) and the former parent company (now GKN Holdings plc) (prior to 1 August 2001).

Earnings per share before goodwill amortisation and exceptional items, which the Directors consider gives a useful additional indication of underlying performance, is calculated on the earnings of the year adjusted as follows:

	Earnings		Earnings per share	
	2001 £m	2000 £m	**2001 p**	2000 p
Earnings of the year	**35**	319	**4.9**	44.6
Included in operating profit:				
Goodwill amortisation	**49**	35	**6.8**	4.9
Exceptional items	**106**	45	**14.7**	6.3
Non-operating exceptional items	**16**	(33)	**2.2**	(4.6)
Taxation attributable to exceptional items	**18**	24	**2.5**	3.3
Earnings before goodwill amortisation and exceptional items	**224**	390	**31.1**	54.5

9 Staff costs and Directors' remuneration

	2001 £m	2000 £m
Wages and salaries	**925**	989
Social security costs	**128**	129
Other pension costs	**46**	47
	1,099	1,165

The average numbers employed by subsidiaries during the year were:

	2001	2000
United Kingdom	**8,111**	13,625
Continental Europe	**15,720**	14,490
Americas	**13,396**	12,032
Rest of the World	**2,787**	2,827
	40,014	42,974

Details of the Directors' remuneration, pension entitlement and share options are contained in the report on Directors' remuneration on pages 75 to 81.

NOTES ON THE ACCOUNTS CONTINUED

10 Goodwill

	Subsidiaries £m	Joint ventures £m	Total £m
Cost			
At 1 January 2001	627	108	735
Demerger of Industrial Services	(53)	(122)	(175)
Creation of AgustaWestland	–	110	110
Additions in year	29	22	51
Currency variations	5	(1)	4
At 31 December 2001	**608**	**117**	**725**
Accumulated amortisation			
At 1 January 2001	48	13	61
Demerger of Industrial Services	(6)	(17)	(23)
Charge for the year	40	9	49
Currency variations	1	–	1
At 31 December 2001	**83**	**5**	**88**
Net book value at 31 December 2001	**525**	**112**	**637**
Net book value at 31 December 2000	579	95	674

Joint venture goodwill in the above table is included in the Group's share of net assets of joint ventures shown in note 12.

11 Tangible assets

	Land and buildings £m	Other tangible fixed assets £m	Capital work in progress £m	Total £m
Cost or valuation				
At 1 January 2001	437	2,115	109	2,661
Demerger of Industrial Services	(15)	(81)	(10)	(106)
Creation of AgustaWestland	(3)	(166)	(2)	(171)
Subsidiaries acquired and sold	23	57	2	82
Capital expenditure	17	130	112	259
Disposals	(3)	(69)	–	(72)
Transfers	6	117	(123)	–
Currency variations	(2)	(16)	1	(17)
At 31 December 2001	**460**	**2,087**	**89**	**2,636**
Accumulated depreciation				
At 1 January 2001	45	1,225	–	1,270
Demerger of Industrial Services	(1)	(50)	–	(51)
Creation of AgustaWestland	–	(108)	–	(108)
Subsidiaries acquired and sold	–	16	–	16
Charge for the year	12	157	–	169
Disposals	(1)	(65)	–	(66)
Impairment (note 4)	–	22	–	22
Currency variations	–	(15)	–	(15)
At 31 December 2001	**55**	**1,182**	**–**	**1,237**
Net book value at 31 December 2001	**405**	**905**	**89**	**1,399**
Owned assets	393	889	89	1,371
Assets under finance leases	12	16	–	28
	405	**905**	**89**	**1,399**
Net book value at 31 December 2000	392	890	109	1,391

	Cost or valuation £m	Accumulated depreciation £m	Net book value 2001 £m	Net book value 2000 £m
Analysis of land and buildings:				
Freehold land	88	–	**88**	86
Freehold buildings	338	(43)	**295**	282
Long leases	1	(1)	**–**	2
Short leases (expiring on or before 31 December 2051)	33	(11)	**22**	22
	460	(55)	**405**	392

	£m
Cost or valuation of land and buildings at 31 December 2001 includes:	
1996 valuation	**185**
Earlier years' valuations	**13**
At cost or fair value on acquisition	**262**
	460

Major freehold and long leasehold properties in the UK, US, Germany and France were valued at 31 December 1996 by DTZ Debenham Thorpe and King Sturge & Co, chartered surveyors. Properties were valued, in accordance with the Appraisal and Valuation Manual of the Royal Institution of Chartered Surveyors, on the basis of open market value and existing use value except for specialised properties which were valued on a depreciated replacement cost basis.

In accordance with the transitional arrangements of FRS 15 these values have been retained as book values.

The original cost of land and buildings at 31 December 2001 was £435 million; the notional net book value on the original cost basis would have been £346 million.

Capital work in progress is expenditure on fixed assets in the course of construction. Transfers are made to other fixed asset categories when assets are available for use.

Where fixed assets are financed by leasing arrangements which give rights approximating to ownership, the assets are treated as if they had been purchased and the capital element of the leasing commitment is shown as obligations under finance leases. The rentals payable are apportioned between interest, which is charged to the profit and loss account, and capital, which reduces the outstanding obligation.

NOTES ON THE ACCOUNTS CONTINUED

12 Investments

	2001 £m	2000 £m
Joint ventures:		
Goodwill (note 10)	**112**	95
Other fixed assets	**159**	890
Current assets	**802**	407
Liabilities due within one year	**(689)**	(590)
Liabilities due beyond one year	**(172)**	(463)
Group's share of net assets	**212**	339
Associates	**9**	16
Loans to joint ventures and associates	**21**	73
Interest in own shares	**–**	5
Other investments	**–**	4
	242	437

The movement in book value of investments is as follows:

	2001 £m	2000 £m
At 1 January 2001	**437**	345
Demerger of Industrial Services	**(354)**	–
Creation of AgustaWestland	**101**	–
Profit retained by joint ventures and associates	**34**	53
Additions	**32**	59
Disposals	**–**	(27)
Other movements	**(7)**	(6)
Currency variations	**(1)**	13
At 31 December 2001	**242**	437

Joint ventures, although not subsidiaries, are those businesses in which the Group has a long-term interest and is able to share control with its partners under a contractual arrangement. Associates are those businesses in which the Group has a long-term interest and is able to exercise significant influence through its representation on the board of directors. Joint ventures and associates are stated at the Group's share of net assets.

AgustaWestland accounts for nearly all of the elements of the joint venture net assets shown in the table above. It also represents nearly all of the results of aerospace joint ventures shown in the segmental analysis on page 67 and the share of the continuing joint ventures and associates tax charge shown in note 6. Net interest payable was negligible.

The Group's share of net assets of joint ventures and associates includes debt without recourse to the Group of £58 million (2000 – £641 million).

Interest in own shares represents the cost, less amounts written off, of 1,219,238 50p Ordinary Shares acquired by the GKN Employee Benefit Trust and the GKN Overseas Employee Benefit Trust in the open market in connection with the GKN long-term incentive plan. At 31 December 2001 the shares, on which dividend rights have been waived, had a market value of £3.2 million.

Other investments include 686,694 shares of 5p each in Brambles Industries plc which were issued to the GKN Employee Benefit Trust and the GKN Qualifying Employee Share Ownership Trust (QUEST) as a consequence of the demerger of the Industrial Services businesses. At 31 December 2001 these shares had a market value of £2.3 million.

The Group's investment in shares of Alvis plc, shown as an associate, had a market value of £39.9 million at 31 December 2001 (2000 – £33.6 million).

13 Stocks

	2001 £m	2000 £m
Raw materials and consumables	**195**	169
Work in progress	**210**	246
Long-term work in progress	**–**	75
Finished goods and goods for resale	**98**	112
	503	602

Stocks are valued at the lower of cost and estimated net realisable value, due allowance being made for obsolete or slow-moving items. Cost includes the relevant proportion of works overheads assuming normal levels of activity.

On major aerospace programmes, that demonstrably have a life of more than ten years, net non-recurring initial costs (consisting of design, development and tooling) are amortised over a maximum period of ten years from the start of serial production. On other programmes design and development costs are written off as incurred and tooling over three years. Work in progress includes £41 million (2000 – £71 million) in respect of non-recurring costs.

Long-term work in progress in 2000 arose in GKN Westland operations and consisted of net costs, after deducting foreseeable losses of £631 million less payments on account of £556 million.

The replacement cost of stocks is not materially different from the historical cost value.

14 Debtors

	2001 £m	2000 £m
Due within one year:		
Trade debtors	**388**	500
Amounts recoverable on contracts	**–**	37
Amounts owed by joint ventures and associates	**18**	38
Advance corporation tax recoverable	**1**	2
Other debtors	**37**	67
Prepayments and accrued income	**28**	39
	472	683
Due in more than one year:		
Other debtors	**74**	72
	546	755

15 Cash at bank and in hand

	2001 £m	2000 £m
Bank balances and cash	**141**	117
Short-term loans and deposits	**26**	26
	167	143

NOTES ON THE ACCOUNTS CONTINUED

16 Short-term borrowings

	2001 £m	2000 £m
Bank overdrafts (note 20)	**21**	38
Short-term loans (note 20):		
AgustaWestland	**72**	–
Other	**202**	78
	295	116

17 Creditors

	2001 £m	2000 £m
Trade creditors	**295**	429
Bills payable	**10**	10
Customer advances	**50**	315
Amounts owed to joint ventures and associates	**4**	15
Indirect and payroll taxes	**31**	37
Obligations under finance leases (note 20)	**3**	5
Other creditors	**121**	83
Accruals and deferred income	**216**	210
	730	1,104

18 Taxation payable

	2001 £m	2000 £m
United Kingdom taxation	**56**	85
Overseas taxation	**134**	119
	190	204

19 Creditors: amounts falling due beyond one year

	2001 £m	2000 £m
Term loans (note 20)	**745**	610
Obligations under finance leases (note 20)	**9**	13
	754	623

Term loans include:

› Bank borrowings.

› Unsecured £300 million (2000 – £300 million) 6.75% bonds maturing in 2019 less issue costs of £4 million.

› Secured term loans of £33 million (2000 – £33 million), including £30 million debenture stocks of Westland Group plc which are secured by a floating charge on the undertaking and assets of that company and certain of its subsidiaries and guaranteed by GKN Holdings plc.

20 Analysis of financial liabilities

The disclosures made in notes 20 and 21 should be read in conjunction with the discussion of the Group's objectives, policies and strategies with regard to financial instruments in the financial review on pages 28 to 31. Short-term debtors and creditors arising directly from the Group's operations are excluded from the following disclosures other than those on currency exposures.

After taking into account the various interest rate and forward foreign exchange contracts entered into by the Group, the effective currency and interest rate exposure of the Group's borrowings were as follows:

				Fixed rate borrowings	
	Floating rate borrowings £m	Fixed rate borrowings £m	Total borrowings £m	Weighted average interest rate %	Weighted average time for which rate is fixed Years
At 31 December 2001					
Sterling	644	330	974	7.1	16.7
US dollar	11	1	12	5.2	10.3
Euro zone currencies	21	1	22	0.2	6.3
Other	43	1	44	1.3	4.2
	719	**333**	**1,052**	**7.1**	**16.6**
At 31 December 2000					
Sterling	320	330	650	7.2	17.7
US dollar	11	1	12	2.8	13.3
Euro zone currencies	28	1	29	2.1	3.9
Other	52	1	53	–	5.0
	411	333	744	7.2	17.6

The interest rates on floating rate borrowings are determined by reference to applicable LIBORs.

The maturity of the Group's borrowings at 31 December 2001 was as follows:

	2001 £m	2000 £m
Bank loans, overdrafts and other borrowings repayable as follows:		
Within one year	**295**	116
One to two years	**329**	17
Two to five years	**86**	263
After five years	**330**	330
	1,040	726
Finance leases repayable as follows:		
Within one year	**3**	5
One to two years	**3**	4
Two to five years	**3**	6
After five years	**3**	3
	12	18
Total borrowings	**1,052**	744

At 31 December 2001 the Group had the following undrawn committed borrowing facilities:

	2001 £m	2000 £m
Expiring within one year	**137**	86
Expiring in more than one year but not more than two years	**137**	120
Expiring in more than two years	**215**	412
	489	618

NOTES ON THE ACCOUNTS CONTINUED

21 Financial instruments

a) Financial assets

	Bank and cash balances		Short-term loans and deposits	
	2001 £m	2000 £m	**2001 £m**	2000 £m
Sterling	**17**	20	**19**	18
US dollar	**62**	36	**–**	–
Euro zone currencies	**38**	45	**–**	–
Other	**24**	16	**7**	8
	141	117	**26**	26

The bank and cash balances comprise £67 million (2000 – £54 million) in respect of short-term balances earning interest and £74 million (2000 – £63 million) in respect of balances which are non-interest earning. The weighted average interest rate at year-end on the interest earning cash balances, which was all floating and set by reference to relevant LIBORs, was 2.2% (2000 – 5.3%). Surplus cash is deposited for short-term periods typically with a maturity of less than three months. The weighted average interest rate on the deposit account balances is 3.1% (2000 – 4.3%).

b) Currency exposures

As explained in the financial review on page 30, the Group's objective in managing the translational currency exposures arising from its overseas investments is to ensure that changes in the sterling equivalent of assets and liabilities caused by currency movements do not have a material impact on the sterling value of shareholders' equity. At 31 December 2001, there were £924 million of synthetic borrowings created through the use of forward foreign exchange contracts to hedge such exposures denominated in euro (38%), US dollars (57%) and yen (5%) mirrored by synthetically created sterling deposits. Net gains and losses arising from these translational currency exposures are recognised in the statement of total recognised gains and losses. Interest differentials resulting from the use of financial instruments to hedge those exposures are dealt with through the profit and loss account.

After taking into account the effects of forward foreign exchange contracts, at 31 December 2001 there were no material currency exposures giving rise to gains or losses recognised in the profit and loss account.

c) Fair values of financial assets and liabilities

The comparison of fair and book values of all the Group's financial assets and liabilities is set out below:

	2001		2000	
	Book value £m	**Fair value £m**	Book value £m	Fair value £m
Financial instruments held or issued to finance the Group's operations				
Bank and cash balances	**141**	**141**	117	117
Short-term loans and deposits	**26**	**26**	26	26
Short-term borrowings and current portion of long-term borrowings	**(295)**	**(295)**	(116)	(116)
Long-term borrowings	**(745)**	**(741)**	(610)	(637)
Finance leases	**(12)**	**(12)**	(18)	(18)
Financial instruments held to manage interest rate and currency exposures				
Interest rate swaps and similar instruments	**(4)**	**(1)**	(5)	(4)
Forward foreign exchange contracts	**–**	**5**	–	(8)
Financial instruments held to hedge currency exposures on expected future trading transactions				
Forward foreign exchange contracts	**–**	**(17)**	–	(14)
At 31 December	**(889)**	**(894)**	(606)	(654)

In addition to the above, the Group has loans to joint ventures and associates, shown within investments, with a book and fair value of £21 million.

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

› Short-term borrowings, cash and deposits approximate to book value due to their short maturities.

› Long-term borrowings: Bank and other loans carrying fixed rates of interest – the repayments which the Group is committed to make have been discounted at the relevant interest rates applicable at 31 December 2001. Bonds – quoted closing market value.

› Interest rate instruments – discounted cash flow analysis based on interest rates derived from market yield curves.

› Forward exchange contracts and currency swaps – marked-to-market.

d) Hedges

As explained in the financial review on page 30, the Group's policy is to hedge the exposures summarised below. Translational currency exposures are hedged where the costs and results of such hedging are economically acceptable.

› Interest rate risk – using interest rate swaps, swaptions and forward rate agreements.

› Transactional and translational currency exposures – using forward foreign exchange contracts and currency swaps.

Gains or losses on instruments used for hedging are not recognised until the exposure that is being hedged is itself recognised. Unrecognised gains or losses on instruments used for hedging both transactional and translational currency exposures and the movements therein are as follows:

	Gains £m	Losses £m	Total net gains/(losses) £m
Unrecognised gains and losses on hedges at 31 December 2000	33	(54)	(21)
Gains and losses from previous years recognised in 2001	(3)	2	(1)
Gains and losses arising before 1 January 2001 that were not recognised in 2001	30	(52)	(22)
Gains and losses arising in 2001 that were not recognised in that year	10	3	13
Unrecognised gains and losses on hedges at 31 December 2001	**40**	**(49)**	**(9)**
Expected to be recognised in 2002	24	(22)	2
Expected to be recognised after 2002	16	(27)	(11)
	40	**(49)**	**(9)**

Of the net unrecognised gains and losses on hedges shown at 31 December 2001, a profit of £5 million will be dealt with through reserves and matched with offsetting movements on translational foreign exchange variances. The balance will be accounted for in the profit and loss account together with the profits arising on the ultimate realisation of the underlying hedged transactions.

NOTES ON THE ACCOUNTS CONTINUED

22 Provisions for liabilities and charges

	Deferred taxation £m	Post-retirement £m	Other £m	Total £m
At 1 January 2001	1	195	95	291
Demerger of Industrial Services	1	–	(1)	–
Creation of AgustaWestland	(1)	–	(2)	(3)
Charge for the year	1	28	1	30
Subsidiaries acquired and sold	1	14	–	15
Paid or accrued during the year	–	(20)	(7)	(27)
Currency variations	(1)	(4)	1	(4)
At 31 December 2001	**2**	**213**	**87**	**302**

Deferred taxation

Provision is made for deferred taxation to the extent there is a reasonable probability that such tax will become payable in the foreseeable future. For United Kingdom subsidiaries the provision is calculated at 30% less losses available for set-off against future profits.

The potential full deferred taxation liability arising on fixed asset and other timing differences was £51 million (2000 – £159 million). No provision is made for any additional taxation which might arise on remittance of retained profits of overseas subsidiaries, joint ventures and associates except where distribution of such profits is planned. The 2001 charge to profits for deferred taxation on a full liability basis under SSAP15 would have been £4 million (2000 – £37 million).

Post-retirement

Post-retirement includes provisions relating to pension benefits of £159 million (2000 – £161 million) and provisions for other post-retirement benefits of £54 million (2000 – £34 million).

Other

Other provisions comprise mainly legal and other claims, environmental and warranty provisions, the timing of which is inherently uncertain. They are established based on historical information or professional assessment.

23 Share capital

	Authorised		Allotted, called up and fully paid	
	2001 £m	2000 £m	**2001 £m**	2000 £m
Ordinary Shares of 50p each	**450**	–	**364**	–

	Number ('000)	Number ('000)	**Number ('000)**	Number ('000)
Ordinary Shares of 50p each	**900,000**	–	**727,052**	–

The options held by Group employees over GKN plc shares were as follows:

	SAYE scheme Number ('000)	UK and overseas executive schemes Number ('000)
At 1 January 2001 (a)	13,234	1,484
From 1 January to 31 July 2001:		
Granted	–	–
Exercised	(1,732)	(588)
Lapsed	(1,533)	–
At 31 July 2001 (b)	9,969	896
At 1 August 2001 (c)	23,925	2,150
From 1 August to 31 December 2001 (d):		
Granted	12,718	4,152
Exercised	(3,347)	(388)
Lapsed	(4,205)	(3)
At 31 December 2001	**29,091**	**5,911**
Option price per share	92.91p–330.83p	70.83p–301.67p
Exercisable at dates extending to	2009	2011

Notes:

(a) Options over GKN Holdings plc (formerly GKN plc) Ordinary Shares.

(b) Participants holding options over GKN Holdings plc Ordinary Shares granted under the SAYE or executive share option schemes prior to the Demerger could elect, by 29 January 2002, to exchange these options for options over GKN plc Ordinary Shares in the ratio of 2.4 GKN plc shares for every GKN Holdings plc share under option (with a corresponding adjustment to the option price). Participants not electing to exchange their options had to exercise them by 29 January 2002 or they would lapse. Any GKN Holdings plc shares issued as a result of such exercises were automatically exchanged for GKN plc shares in the above ratio.

(c) For the purpose of this Note, all outstanding options over GKN Holdings plc Ordinary Shares held at 31 July 2001 (being the last day of trading in such shares before the imposition of New GKN plc (subsequently renamed GKN plc) as the parent company of the GKN Group in connection with the Demerger) have been converted into options over GKN plc Ordinary Shares in the ratio stated in (b) above.

(d) For the purpose of this Note, options over GKN Holdings plc Ordinary Shares exercised or lapsed during the period 1 August to 31 December 2001 are treated as options over GKN plc Ordinary Shares in the ratio stated in (b) above. All options granted in 2001 were over GKN plc Ordinary Shares (under the GKN SAYE Share Option Scheme 2001 at 217p per share exercisable between 2005 and 2009, and under the GKN Executive Share Option Scheme 2001 at 242.75p-301.67p per share exercisable between 2004 and 2011).

The consideration received by the GKN Group in 2001 in connection with the exercise of options was £14.9 million. Employees paid £12.7 million to the Group for the issue of these shares and the balance of £2.2 million comprised contributions to the QUEST from subsidiaries.

NOTES ON THE ACCOUNTS CONTINUED

24 Capital and reserves

	Notes	Share capital £m	Share premium account £m	Revaluation reserve £m	Other reserves £m	Profit and loss account £m	Total £m
Group							
At 1 January 2001		361	290	48	176	582	1,457
Restatement on a pro forma basis		3,185	(290)	–	(2,895)	–	–
At 1 January 2001 restated	a	3,546	–	48	(2,719)	582	1,457
Demerger of Industrial Services	b	(3,185)	(9)	–	2,634	109	(451)
Arising from Ordinary Share issues	c	3	12	–	–	–	15
Transfer to profit and loss account		–	–	–	–	(73)	(73)
Realisation of revaluation reserve		–	–	–	–	–	–
Currency variations:							
Overseas net assets		–	–	(1)	(4)	(15)	(20)
Foreign currency borrowings		–	–	–	–	(1)	(1)
Creation of AgustaWestland		–	–	–	–	110	110
Subsidiaries, joint ventures and associates acquired and sold		–	–	–	–	2	2
Transfers between reserves		–	–	(2)	5	(3)	–
Other movements		–	–	–	–	(3)	(3)
At 31 December 2001		**364**	**3**	**45**	**(84)**	**708**	**1,036**
Parent company and subsidiaries		364	3	45	(110)	666	968
Joint ventures and associates		–	–	–	26	42	68
		364	**3**	**45**	**(84)**	**708**	**1,036**
Company							
Arising from share issues		3,549	3	–	–	–	3,552
Reduction in capital		(3,185)	–	–	–	261	(2,924)
Profit and loss account		–	–	–	–	579	579
At 31 December 2001		**364**	**3**	**–**	**–**	**840**	**1,207**

Notes:

a) Capital and reserves have been restated on a pro forma basis to reflect GKN plc's share structure as though it had been in existence at 1 January 2001.

b) Represents the reduction in capital and demerger of the Industrial Services businesses.

c) Represents the issue of 1.7 million shares in GKN Holdings plc (formerly GKN plc) prior to the Group's reconstruction and Demerger and 3.3 million shares in GKN plc following the Demerger.

d) Cumulative goodwill eliminated directly against reserves amounts to £691 million (2000 – £785 million).

Demerger of the Industrial Services businesses

The demerger of the Industrial Services businesses was effected in part by means of a reduction in capital of the Company under Section 135 of the Companies Act 1985 (the 'Reduction'). The Reduction followed the implementation of a Scheme of Arrangement under Section 425 of the Companies Act 1985 (the 'Scheme'). This principally involved the insertion of a new holding company above GKN Holdings plc (then GKN plc) and the exchange of shares in GKN Holdings plc for shares in the new holding company.

Changes in authorised, allotted and issued Ordinary Share capital

GKN plc was incorporated on 30 March 2001 as Mistycove plc. On 18 May 2001, its name was changed to New GKN plc and on 1 August 2001 its name was changed to GKN plc.

GKN plc was incorporated with an authorised share capital of £50,000 divided into 50,000 Ordinary Shares of £1 each, two of which were issued. On 13 June 2001, the Company increased its authorised share capital from £50,000 to £99,998 by the creation of 49,998 Redeemable Preference Shares of £1 each. These shares were allotted and issued to UBS AG, acting through its business group UBS Warburg, at par for cash.

The Redeemable Preference Shares carried a fixed non-cumulative preferential dividend at a rate of 6% per annum, such dividend to be paid on 31 January in each year. The Redeemable Preference Shares ranked for dividends in preference to the Ordinary Shares of the Company and carried no voting rights.

On 14 June 2001, the Company exercised its right to redeem the Redeemable Preference Shares at par. An amount equivalent to the par value of the Redeemable Preference Shares was credited to a capital redemption reserve from the profit and loss account reserve. These shares were redesignated as unissued Ordinary Shares of £1 upon redemption.

On 19 June 2001, the entire issued share capital of the Company was subdivided into 20 Ordinary Shares of 10p each. The entire authorised but unissued share capital of the Company was also subdivided into 999,960 Ordinary Shares of 10p each. The Company then increased its authorised share capital by the creation of 12 Ordinary Shares of 10p each. The Company then effected a bonus issue of an additional 39 Ordinary Shares of 10p each to each of the shareholders in the Company on the register of members at 5.00pm on 18 June 2001, such shares being paid up in full at par out of the amount standing to the credit of the Company's capital redemption reserve. Every 49 existing Ordinary Shares of 10p each in the issued and authorised but unissued share capital of the Company were then consolidated into one Ordinary Share of 490p each.

On 19 June 2001, the Company further increased its authorised share capital by the creation of 899,979,591 Ordinary Shares of 490p each and one Special Share of 490p. The Special Share carries a fixed dividend of 2p payable on 31 January in each year and carries no voting rights. On 1 August 2001, the Company issued 723,742,349 Ordinary Shares of 490p and 1 Special Share of 490p as part of the Scheme in order to insert the Company as a new holding company above GKN Holdings plc (formerly GKN plc). The Company has not recognised any share premium on this transaction, applying the provisions of the Companies Act 1985 (Part V, Section 131) which allows relief from the creation of a share premium account.

On 6 August 2001, the Company carried out a reconstruction of its business by way of a court approved reduction of capital, resulting in the cancellation of paid up capital to the extent of 440p on each issued Ordinary Share of 490p and to the extent of 440p on the issued Special Share of 490p.

This reduction of capital was effected through the transfer of the GKN Industrial Services businesses to Brambles Industries plc in consideration of the allotment and issue to the holders of the Company's Ordinary Shares of Brambles Industries plc Ordinary Shares, on the basis of one Brambles Industries plc Ordinary Share in respect of each of the Company's Ordinary Shares held, and the allotment and issue of one Special Voting Share in the capital of Brambles Industries plc to the holder of the Company's Special Share.

The difference of £261,466,349 between the amount of paid up capital cancelled and the carrying value of the GKN Industrial Services businesses has been credited to the profit and loss account reserve.

NOTES ON THE ACCOUNTS CONTINUED

25 Acquisitions

	Date	Additional direct shareholding %	Group shareholding at 31 December 2001 %
Subsidiaries			
Boeing's St. Louis aerospace structures operation (USA)	January 2001	100	100
Premco Machine Limited (Canada)	January 2001	100	100
The PresMet Corporation (USA)	January 2001	100	100

The book and fair value of net assets acquired and total consideration payable for subsidiary acquisitions are analysed below:

	Book value prior to acquisition £m	Revaluations £m	Accounting policy alignment £m	Fair value to the Group £m
Tangible fixed assets	60	6	–	66
Stocks	54	(5)	(3)	46
Debtors	14	–	–	14
Creditors	(5)	–	–	(5)
Provisions	(17)	2	–	(15)
Loans and finance leases	(3)	–	–	(3)
Net assets acquired	103	3	(3)	103
Goodwill				29
Consideration including costs				132

The post-acquisition contribution of subsidiary acquisitions to Group cash flow was a net cash inflow of £32 million from operating activities, payments of £1 million in respect of interest, payments of £nil in respect of taxation and payments of £20 million in respect of capital expenditure and financial investment.

26 Post-retirement benefits

The Group's pension arrangements comprise various defined benefit and defined contribution schemes throughout the world.

In the UK, pension arrangements are made through externally funded defined benefit schemes. Independent actuarial valuations of the three main schemes have been carried out as at April 2000 using the projected unit method. The market value related basis assumes a yield pre-retirement of 6.5% per annum, which exceeds the annual rate of increases in pensionable salaries by 2.5% (GKN Group Pension Scheme and the Westland Staff Pension Scheme) and 2% (Executive and Senior Staff Pension Scheme) with a yield post-retirement of 5.0% per annum, which exceeds pension increases by 2.5%.

The aggregate market value of the assets at the valuation date was £2,046 million and the aggregate funding level on an on-going basis was 101%. Company contributions in the year totalled £24 million (2000 – £34 million) compared with the regular cost in accordance with the application of SSAP 24 of £15 million (2000 – £29 million). The total charge to operating profit was £14 million (2000 – £25 million). A cumulative advance payment of £59 million is included in other long-term debtors (2000 – £66 million).

In certain overseas companies funds are retained within the business to provide for retirement obligations. The annual charge to provide for these obligations, which is determined in accordance with actuarial advice or local statutory requirements, amounted to £27 million (2000 – £18 million).

The Group operates a number of retirement plans which provide certain employees with post-retirement healthcare benefits. The liability for providing these benefits is recognised on an actuarial basis and included in post-retirement and other provisions disclosed in note 22. The principal actuarial assumptions for the main UK plan as at December 2000, the date of the last review, were that the discount rate would be 7% per annum and that medical costs would initially increase by 8% per annum for three years falling to 4.5% over the next five years.

The following information is provided in accordance with the requirements of FRS 17.

Actuarial assessments of all the principal defined benefit post-retirement plans were carried out as at 31 December 2001.

The major assumptions used were:

	UK %	USA %	Germany %
Rate of increase in salaries	4.0	3.5	3.0
Rate of increase in pensions in payment	2.5	na	2.0
Discount rate	6.0	7.25	6.0
Inflation assumption	2.5	2.5	2.0
Rate of increase in medical costs: initial/long-term	8.0/4.5	9.0/5.0	na

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

	UK		USA		Germany	
	Long-term rate of return expected at 31 December 2001 %	Value at 31 December 2001 £m	Long-term rate of return expected at 31 December 2001 %	Value at 31 December 2001 £m	Long-term rate of return expected at 31 December 2001 %	Value at 31 December 2001 £m
Equities	7.5	951	8.5	92	–	–
Bonds	5.2	390	6.4	31	–	–
Property	7.0	54	–	–	–	–
Cash	4.0	27	4.2	4	–	–
Other assets	5.9	40	5.9	3	7	4
		1,462		130		4

The overall position in respect of funded defined benefit pension schemes, unfunded pension obligations and other post-retirement provisions disclosed in note 22 is:

	At 31 December 2001 £m
Total market value of assets	1,596
Present value of post-retirement liabilities	(1,996)
Deficit	(400)
Related deferred tax credit	87
Net post-retirement liability	(313)
Post-retirement liability already included in balance sheet	144
Additional liability	(169)

If the additional post-retirement liability of £169 million set out above were to be recognised in the financial statements, net assets and profit and loss reserve at 31 December 2001 would be as follows:

	£m
Net assets per balance sheet	1,058
Post-retirement liability already included in balance sheet	144
Net assets excluding post-retirement liability	1,202
Net post-retirement liability under FRS 17	(313)
Net assets including post-retirement liability	889
Profit and loss reserve	708
Additional post-retirement liability	(169)
Profit and loss reserve including post-retirement liability	539

In addition to the above, the Group's share of unrecognised post-retirement liabilities in joint ventures totalled £18 million.

NOTES ON THE ACCOUNTS CONTINUED

27 Commitments and contingent liabilities

Contingent liabilities

At 31 December 2001 the Group had contingent liabilities in respect of bank and other guarantees amounting to nil (2000 – nil). In the case of certain joint venture companies engaged in long-term contracts, performance bonds and customer finance obligations have also been entered into in the normal course of business.

Capital expenditure

Contracts placed against capital expenditure sanctioned at 31 December 2001 so far as not provided for by subsidiaries amounted to £52 million (2000 – £69 million) and the Group's share not provided for by joint ventures and associates amounted to £2 million (2000 – £31 million).

Operating leases

The minimum payments which the Group is committed to make in 2002 under operating leases are as follows:

	2001		2000	
	Land and buildings £m	Equipment £m	Land and buildings £m	Equipment £m
Leases which expire				
Within one year	**2**	**3**	1	3
Two to five years	**5**	**10**	4	10
After five years	**5**	**–**	10	–
	12	**13**	15	13

28 Related party transactions

In the ordinary course of business sales and purchases of goods and services take place between subsidiaries, joint ventures and associates priced on an 'arms-length' basis. These transactions are not significant except for amounts charged to the AgustaWestland group of companies totalling £13 million in respect of management fees and commissions, £5 million in respect of property rentals and £57 million for production materials supplied.

In addition, interest of £9 million, charged at a daily rate of Base Rate less 0.5 percentage points, was paid by the GKN Group in respect of a current account between the two groups.

In the prior year, before the creation of AgustaWestland (see note 29), there were charges from GKN Westland Helicopters Ltd to EH Industries Ltd (which at the time was owned jointly by GKN and Finmeccanica SpA) of £258 million and, conversely, charges made by EH Industries Ltd to GKN Westland Helicopters Ltd of £60 million under the terms of contracts in connection with the manufacture and sale of EH 101 helicopters.

There are no other related party transactions requiring disclosure under FRS 8 'Related Party Disclosures'.

29 Creation of AgustaWestland

At the beginning of 2001 the Group and Finmeccanica SpA each contributed the assets of their helicopter businesses, 'Westland' and 'Agusta' respectively, to a new joint venture company AgustaWestland NV, the shares in which are held equally by the two parties.

The transaction has been accounted for so as to reflect its substance, whereby the Group has exchanged 50% of its interest in the net liabilities of Westland for a 50% interest in the fair value of the tangible net assets of Agusta. These fair values remain provisional pending finalisation of certain outstanding issues.

The impact on the pro forma statement of net assets of the continuing businesses at 31 December 2000 on page 33 is shown in the table below:

	Pro forma net assets at 31 December 2000 £m	Adjustments £m	Revised £m
Fixed assets:			
Investments	128	101	229
Other	1,876	(64)	1,812
	2,004	37	2,041
Current assets	1,461	(409)	1,052
Current liabilities	(1,480)	479	(1,001)
Long-term liabilities and provisions	(914)	3	(911)
Net assets	1,071	110	1,181

The adjustments column reflects the removal from the consolidated balance sheet of the net liabilities of Westland and the introduction as an investment of 50% of the net assets of AgustaWestland.

BALANCE SHEET OF GKN PLC

AT 31 DECEMBER 2001

	Notes	2001 £m
Fixed assets		
Investments in subsidiaries at cost		**3,548**
Current assets		
Cash at bank and in hand		**3**
Creditors: amounts falling due within one year		
Amounts owed to subsidiaries		**(2,291)**
Dividend payable		**(53)**
		(2,344)
Net current liabilities		**(2,341)**
Total assets less current liabilities		**1,207**
Net assets		**1,207**
Capital and reserves		
Called up share capital	23/24	**364**
Share premium account	24	**3**
Profit and loss account	24	**840**
Equity interest		**1,207**

There are no comparative figures since the Company was incorporated in March 2001 (see note 24).

The accounts were approved by the Board of Directors on 6 March 2002 and were signed by:

Sir David Lees, Marcus Beresford, Nigel Stein, Directors

As permitted by the Companies Act 1985 a separate profit and loss account for the parent company has not been presented.

Information on the principal divisions, subsidiaries, joint ventures and associates is shown on pages 82 and 83.