Basis of preparation

As a UK listed company, Arriva plc is required to prepare its group accounts in accordance with EU endorsed International Financial Reporting Standards (IFRS), International Financial Reporting Interpretations Committee (IFRIC) interpretations and the Companies Act 1985 applicable to companies reporting under IFRS. These financial statements have been prepared in accordance with EU endorsed IFRS, IFRIC interpretations and the Companies Act 1985 applicable to companies reporting under IFRS for periods ending 31 December 2007.

The financial statements are prepared on the historical cost basis of accounting, other than for certain items of property, plant and equipment that have been stated at deemed cost under the transitional rules of IFRS, share-based payment charges and derivative financial instruments which are measured at fair value.

The principal accounting policies of the group are set out below:

Basis of consolidation

The consolidated financial statements incorporate the financial statements of Arriva plc and its subsidiaries made up to 31 December each year. Subsidiaries are entities over which the group has the power to govern the financial and operating policies, generally accompanying a shareholding of more than one half of the voting rights. Subsidiaries are fully consolidated from the date on which control is transferred to the group and de-consolidated from the date control ceases. The group's interests in jointly controlled entities are accounted for by proportional consolidation, combining its share of the joint ventures' profits, assets, liabilities and cash flows on a line-by-line basis with those of the group. Associates are those entities over which the group can exercise significant influence, but not control or joint control. Associates are accounted for using the equity method.

All business combinations are accounted for by applying the purchase method. On acquisition, the assets, liabilities and contingent liabilities are measured at their fair values at the date of acquisition. The excess of the cost of acquisition over the fair value of the group's share of net assets acquired is recorded as an intangible asset or goodwill. If the cost of acquisition is less than the fair value of the group's share of the net assets of the subsidiary acquired, the difference is recognised directly in the income statement.

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

Revenue recognition

Revenue represents the fair value of consideration received or receivable in respect of the provision of public transport services and related activities in the UK and mainland Europe. Generally, revenue is recognised by reference to the stage of completion method, principally with respect to the percentage of services rendered to fare-paying customers, or the percentage of services provided under contractual arrangements. For contractual arrangements where significant timing differences may arise between the timing of cash revenues and cash costs, revenue is recognised with respect to the proportion of the total costs incurred to date.

Revenue includes amounts attributed to UK train operating companies based principally on agreed models of route usage in respect of passenger receipts. In addition, franchise agreement receipts from the Welsh Assembly Government and the Department for Transport are treated as revenue.

Proceeds from the disposal of non-current assets are excluded from revenue.

Use of estimates and accounting assumptions

The preparation of financial statements requires management to make estimates and assumptions that affect the group's reported results. Although these estimates are based on management's best knowledge at the time, actual results could differ from those estimates. The key areas of judgment or estimation which could impact the results in the next financial year were they to change include the economic useful lives of property, plant and equipment (disclosed below), the use of actuarial assumptions for measurement of retirement benefit obligations (see note 21), the measurement of insurance provisions, and the use of forecasts in respect of the annual testing for impairment of goodwill.

Exceptional items

Exceptional items are those items which, because of their nature and materiality, merit separate presentation to allow a better understanding of the group's financial performance.

Segment reporting

The group's primary risks and rates of return are determined by both the business and geographical areas in which it operates. Disclosure of results by business segment is used as the basis for primary segment disclosures, in line with the group's internal management reporting structure.

Government grants

Government grants relating to capital expenditure are included as deferred income and are credited to the income statement over the expected useful economic life of the assets concerned. Revenue related grants are credited to the income statement when the related expenditure is expensed.

Foreign currency translation

The trading results of overseas subsidiary undertakings are translated into sterling using average rates of exchange. Foreign currency assets and liabilities are translated into sterling at the rates of exchange ruling at the balance sheet date.

Differences on exchange arising from the retranslation of the opening investment in subsidiary undertakings and the associated borrowings or hedging instruments, where hedge accounting is permitted, are taken to the Statement of Recognised Income and Expense. Cumulative currency gains and losses in reserves are recycled to the income statement on disposal of operations.

Property, plant and equipment

Land and buildings held for use in the delivery of passenger transport services and for administration purposes are stated in the balance sheet at cost or deemed cost.

Depreciation is calculated using the straight-line method to allocate the cost of each asset less its residual value over its estimated useful life as follows:

Buildings	50 years
Fixtures, fittings, plant and machinery	3 - 10 years
Motor vehicles - buses and coaches	up to 15 years
Rail rolling stock	up to 35 years

Major refurbishment work on rail rolling stock is capitalised and depreciated over the interval to the subsequent related major refurbishment. Interest costs incurred in financing the construction of certain assets are capitalised where they are considered significant in relation to the asset being constructed and the asset necessarily takes a substantial period of time to be prepared for its intended use. Rail rolling stock undergoing post construction acceptance testing is not depreciated until the commencement of full operational service.

Goodwill

Goodwill represents the excess of the cost of an acquisition over the fair value of the group's share of the net identifiable assets, liabilities and contingent liabilities at the date of acquisition. Goodwill on acquisition of subsidiaries and joint ventures is disclosed separately in non-current assets. Goodwill on acquisition of associates is included in investments.

Goodwill is not amortised but is tested annually for impairment and carried at cost less accumulated impairment losses. Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold.

Goodwill previously eliminated against reserves has not been reinstated.

Intangible assets

Intangible assets are recognised when acquired as part of business combinations where customer related contractual cash flows exist, and their fair value can therefore be measured reliably. Intangible assets purchased separately are measured at cost. Intangible assets that have a finite life are amortised annually over their expected useful lives.

Impairment

At each balance sheet date the group reviews the carrying amount of its tangible and intangible assets to determine whether there are any indicators of impairment. If indicators of impairment exist then the recoverable amount of an asset or cash generating unit is estimated based on pre-tax discounted future cash flows.

Where individual assets do not generate cash flows independent from other assets, the group reviews the carrying value and recoverable amount of a cash generating unit. This is the smallest group of assets where independent cash flows are produced.

If the recoverable amount of an asset or cash generating unit is less than its carrying amount, the difference is recognised in the income statement as an impairment loss.

Inventories

Inventories are stated at the lower of cost and net realisable value after making allowances for slow moving or obsolete items.

Borrowings

Borrowings are recognised initially at fair value, net of transaction costs incurred. Borrowings are subsequently stated at amortised cost; any difference between the initial carrying value and the redemption value is recognised in the income statement over the period of the borrowings using the effective interest method.

Borrowings are classified as current liabilities unless the group has an unconditional right to defer settlement of the liability for at least twelve months after the balance sheet date.

Taxation

Current tax assets and liabilities are measured at the amount expected to be recovered from or paid to taxation authorities using the tax rates (and laws) that have been enacted or substantively enacted by the balance sheet date.

Deferred tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. However, deferred tax is not recognised if it arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss.

Deferred tax is determined using the tax rates (and laws) that have been enacted or substantively enacted by the balance sheet date and which are expected to apply when the related deferred tax asset is realised or the deferred tax liability is settled.

Deferred tax assets are recognised to the extent that it is probable that future taxable profits will be available against which the temporary differences can be utilised.

Deferred tax liabilities are recognised on taxable temporary differences associated with investments in subsidiaries and associates, except where the timing of the reversal of the temporary difference is controlled by the group and it is probable that the temporary difference will not reverse in the foreseeable future.

Pensions

The group operates both defined benefit and defined contribution retirement benefit schemes. The group also participates in a number of multi-employer retirement benefit schemes and a number of state-managed retirement benefit schemes.

The liability recognised in the balance sheet in respect of the group's defined benefit pension plans is the present value of the defined benefit obligation at the balance sheet date less the fair value of the plan assets, together with adjustments for unrecognised past service costs. The defined benefit obligation is calculated using the projected unit credit method. Formal actuarial valuations are carried out on a triennial basis, with updated calculations being prepared at each balance sheet date. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using interest rates of high-quality corporate bonds that are denominated in the currency in which the benefits will be paid, and that have terms to maturity approximating to the terms of the related pension liability.

The cost of providing future benefits (service cost) is charged to the income statement in net operating expenses. The return on scheme assets and interest obligation on scheme liabilities comprise a pension finance adjustment which is included in net operating expenses. Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are charged or credited to equity and shown in the Statement of Recognised Income and Expense in the period in which they arise.

Certain overseas defined benefit schemes, where the employer's underlying assets and liabilities are not separately identifiable within the scheme, are accounted for as defined contribution schemes under IAS19. Contributions to these schemes, and the group's defined contribution schemes, are charged to the income statement as they arise.

Share-based payments

The group issues equity settled share-based payments to certain employees, which are measured at fair value at the date of grant. The fair value is expensed on a straight-line basis over the vesting period, based on the group's estimate of shares that will eventually vest. The impact of revising original estimates, if any, is included in the income statement, with a corresponding adjustment to equity.

The proceeds received net of any directly attributable transaction costs are credited to share capital (nominal value) and share premium when the options are exercised.

Provisions

Provisions are recognised when the group has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation and the amount can be reliably estimated.

Leases

Leases of property, plant and equipment where the group has substantially all the risks and rewards of ownership are classified as finance leases. Finance leases are capitalised at the lease's inception at the lower of the fair value of the leased asset and the present value of the minimum lease payments. The corresponding rental obligations, net of finance charges, are included in other payables. Each lease payment is allocated between the liability and finance charges so as to achieve a constant rate of interest costs charged to the income statement on the outstanding balance. The property, plant and equipment acquired under finance leases are depreciated over the shorter of the asset's useful life and the lease term.

Leases where the lessor retains a significant portion of the risks and rewards of ownership are classified as operating leases. Payments made under operating leases (net of any incentives received from the lessor) are charged to the income statement on a straight-line basis over the period of the lease.

Cash and cash equivalents

Cash comprises cash in hand and demand deposits. Cash equivalents are short-term highly liquid investments with a maturity of less than 90 days that are readily convertible to known amounts of cash and subject to insignificant risk of changes in value.

Derivative financial instruments

The group uses derivative financial instruments to reduce exposures to foreign currency exchange risk, interest rate risk and changes in fuel prices to acceptable levels. All derivatives are initially recognised at fair value, and are subsequently remeasured to fair value at each reporting date.

Derivatives designated as hedging instruments are accounted for in line with the nature of the hedging arrangement. Derivatives are intended to be highly effective in mitigating the above risks, and hedge accounting is adopted where the required hedge documentation is in place and the relevant test criteria are met. Changes in the fair value of any derivative instruments that do not qualify for hedge accounting are recognised immediately in the income statement.

Foreign currency exchange risk

Derivatives are entered into in order to hedge exposure to foreign currency exchange risk. The group also uses foreign currency debt to hedge foreign currency exposures. Both the derivatives and debt are designated as hedges of net investments in overseas subsidiaries.

Interest rate and fuel price risk

Derivative instruments are used to manage the group's exposure to changes in cash flows arising from movements in interest rates and fuel prices. The derivatives are designated as cash flow hedges, and hedge accounting is used where it has been shown that the hedge relationship is highly effective.

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in equity at that time remains in equity and is recognised when the forecast transaction is ultimately recognised in the income statement. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in equity is immediately transferred to the income statement.

Dividend distribution

Dividend distributions to the company's shareholders are recognised in the group's financial statements in the period in which the dividends are paid.

New standards and interpretations

The following standards and interpretations have been issued by the International Accounting Standards Board (IASB) and IFRIC with an effective date that impacts on these financial statements.

International Accounting Standards and Interpretations		Effective date
IFRS7	Financial Instruments: Disclosures	1 January 2007
IAS1	Amendment - Presentation of financial statements	1 January 2007
IFRIC8	Scope of IFRS2	1 May 2006
IFRIC9	Reassessment of embedded derivatives	1 June 2006
IFRIC10	Interim financial reporting and impairment	1 November 2006

The adoption of IFRS7 has resulted in an increased level of disclosure relating to financial instruments, although there has been no effect on the reported income or net assets of the group. The adoption of the other above standards has not had a material impact on the group's financial statements.

The following standards and interpretations have been issued by the IASB and IFRIC with an effective date that does not impact on these financial statements.

International Accounting Standards and Interpretations		Effective date
IFRS2	Share-based Payments - Amendment relating to vesting conditions and cancellations	1 January 2009
IFRS3	Business Combinations - Comprehensive revision on applying the acquisition method	1 July 2009
IFRS8	Operating Segments	1 January 2009
IAS1	Presentation of Financial Statements - Comprehensive revision including requiring a statement of comprehensive income	1 January 2009
IAS1	Presentation of Financial Statements - Amendments relating to disclosure of puttable instruments and obligations arising on liquidation	1 January 2009
IAS23	Borrowing Costs - Comprehensive revision to prohibit immediate expensing	1 January 2009
IAS27	Consolidated and Separate Financial Statements - Consequential amendments arising from amendments to IFRS3	1 July 2009
IAS28	Investments in Associates - Consequential amendments arising from amendments to IFRS3	1 July 2009
IAS31	Interests in Joint Ventures - Consequential amendments arising from amendments to IFRS3	1 July 2009
IAS32	Financial Instruments: Presentation - Amendments relating to puttable instruments and obligations arising on liquidation	1 January 2009
IFRIC11	IFRS2: Group and Treasury Share Transactions	1 March 2007
IFRIC12	Service Concession Arrangements	1 January 2008
IFRIC13	Customer Loyalty Programmes	1 July 2008
IFRIC14	IAS19 - The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction	1 January 2008

The directors are currently reviewing the requirements of the above standards and interpretations to determine whether there will be a material impact on the group's financial statements.