

Arriva plc

Report on transition to International Financial Reporting Standards

Introduction and basis of preparation

This report provides an analysis of the key changes to Arriva plc consolidated reported results arising from the implementation of International Financial Reporting Standards ('IFRS'). IFRS in this document refers to standards that have been, or are expected to be, endorsed by the European Union and applicable for the year ending 31 December 2005. The Group's first full year results under IFRS will be for the year ending 31 December 2005, with comparative results for 2004 also restated to IFRS where applicable. The transition date for conversion to IFRS is therefore 1 January 2004.

IFRS, together with established practice for interpreting the standards, is still evolving and therefore the impact on the financial statements of implementing IFRS may be subject to change.

The interim statement to 30 June 2005, announced concurrently with this report on 8 September 2005, has been prepared in accordance with the accounting policies that the Group expects to apply in the 2005 year end financial statements. This report provides a narrative explanation and reconciliations between IFRS and previously reported financial information under UK GAAP as at 1 January 2004, 30 June 2004, and 31 December 2004.

Summary

The main impacts of IFRS on the Group's reported results are shown below:

- an increase in profit before tax for the year ended 31 December 2004 of £10.9 million, principally the result of acquired goodwill no longer being amortised,
- basic earnings per share for the same period increases from 36.2 pence to 42.6 pence, principally the result of not amortising goodwill. Earnings per share, excluding goodwill impairment, intangible asset amortisation and exceptional items, increases marginally from 44.9 pence to 45.1 pence,
- net assets at 1 January 2004 decreased by £107.8 million, mainly arising from:
 - recognition of obligations in respect of defined benefit pension schemes (decrease £174.8 million), and a related intangible asset (increase £12.0 million),
 - recognition of fair value of UK land and buildings as deemed cost (increase £24.6 million),
 - elimination from liabilities of 2003 final dividend (increase £26.1 million),
- net debt decreases by £7.9 million at 30 June 2004 and by £3.4 million at 31 December 2004 due to the proportional consolidation of joint venture cash.

Impact of key changes

Employee benefits: defined benefit pension schemes (IAS19)

The Group has previously accounted for pensions under UK GAAP using SSAP 24. In addition, the Group has previously made disclosures in its notes to the accounts required by the transitional rules of FRS17. The Group will not be adopting FRS17, and has moved directly from SSAP24 to IAS19 for the year ending 31 December 2005 and restated comparatives for 2004. The pension charge for the year ended 31 December 2004 was £0.1 million lower under IAS19 than SSAP24.

Group defined benefit schemes

IAS19 requires the recognition on the balance sheet of the assets and obligations of the Group's defined benefit schemes in accordance with its own requirements and the de-recognition of balances relating to SSAP24. This represents a significant change in balance sheet treatment and at 1 January 2004 results in a reduction in net assets of £162.8 million, net of deferred tax.

Subsequent to the initial recognition above, the pension deficit will be calculated at each year end. The profit and loss account will be charged with the estimated cost of providing current service benefits, together with a pension finance charge or credit representing the difference between the expected return on the schemes' assets and the interest charged on the schemes' liabilities. Both the service cost and pension finance charge/credit will be reported as part of operating costs. Movements in the pension deficit arising from actuarial gains and losses and changes to actuarial assumptions will be charged or credited in the Statement of Recognised Income and Expense in the period in which they arise.

These changes have been reflected in the results for the six months ended 30 June 2005 and comparative figures.

Railways Pension Scheme

Most employees in our UK Trains business are members of certain sections of the Railways Pension Scheme. The agreement under which the Group operates the Arriva Trains Wales franchise states that all pension obligations to the scheme will cease on expiry of the franchise, and therefore the obligations recognised on the balance sheet under IAS19 should only be those arising during the franchise term. The amended obligation will be made by way of a "franchise adjustment" to the pension obligation.

The Group's current franchise commenced operation in December 2003. At the time, the anticipated contribution levels and investment returns were sufficient to reduce the IAS19 pension deficit to £nil by the end of the franchise. Accordingly there is no franchise adjustment made on transition at 1 January 2004, and the full IAS19 liability of £12.0 million is reported in the balance sheet. Also on transition, an associated intangible asset has been recognised of the same amount. This is considered further under the heading "Intangible Assets" below.

At 31 December 2004, the full IAS19 liability is calculated as £13.1 million. The franchise adjustment, which represents the present value of the IAS19 liability at the end of the current franchise is £2.3 million, resulting in a reported pension obligation of £10.8 million.

UK properties revaluation (IFRS1)

The Group has elected to use the fair value of the UK land and buildings at 1 January 2004 as deemed cost. This has resulted in an increase in net assets at transition of £24.6 million, net of deferred tax, and an increase in depreciation for the year ended 31 December 2004 of £0.4 million.

No adjustment has been made to the carrying value of non-UK land and buildings.

Dividends proposed (IAS10)

IAS10 'Events after the Balance Sheet Date', does not permit the recognition of a liability for dividends until they have been approved. On this basis, dividends approved after the year end cannot be recognised as a liability in those year end accounts.

The final dividend declared for the year ended 31 December 2003 was approved in April 2004, and therefore requires reversing in the transitional balance sheet at 1 January 2004. Net assets are increased on transition by £26.1 million, and at 31 December 2004 by a further £1.4 million.

Business combinations (IFRS3)

On transition, the Group has taken the option under the transitional arrangements not to apply IFRS3 'Business Combinations' retrospectively to business combinations that occurred prior to the transition date. Accordingly, except for the adjustment required to negative goodwill noted below, the goodwill carried in the balance sheet under UK GAAP at 31 December 2003 has become the opening balance of goodwill under IFRS at 1 January 2004.

IFRS3 does not permit the annual amortisation of goodwill, but does require an annual impairment review of carrying values. Impairment reviews have been conducted on the carrying value of goodwill arising on business combinations at the transition date and 31 December 2004 with no impairments identified. Goodwill amortisation charged to the income statement in 2004 of £15.3 million is reversed under IFRS.

Negative goodwill arose on an acquisition prior to the transition date. The book value of the negative goodwill at 31 December 2003 was £3.9 million, and has been fully released in the transitional balance sheet at 1 January 2004.

Intangible assets (IFRS3, IAS38, IFRS1)

For business combinations made after the transition date, the Group has applied the criteria set out in IAS38 'Intangible Assets' in identifying and measuring the value of intangible assets. Customer contracts to provide bus and rail services have been identified on the 2004 acquisitions of SAF, PEG and Regentalbahn. The total value of intangible assets purchased on these business combinations was £34.8 million, and is being amortised over the lives of the contracts to which they relate, resulting in a charge in 2004 under IFRS of £1.8 million. To the extent of the identification of these intangible assets, goodwill previously disclosed on the acquisitions has been adjusted downwards accordingly. Deferred tax has been provided on the intangible assets arising from the

business combinations, resulting in additional goodwill reported of £12.8 million. This additional goodwill was reduced when the annual impairment test was applied to it, together with an associated release from the deferred tax provision, as the contracts unwound. In the year ended 31 December 2004 the impairment charged to the income statement was £0.6 million.

As noted earlier, the Group has recognised a pension deficit in respect of the Railways Pension Scheme of £12.0 million at 1 January 2004. A detailed consultation process has taken place with our peer group in the UK rail industry as to how to recognise such a deficit whilst also reflecting the position where there is no obligation to fund pensions beyond the expiry of the franchise. The outcome is the recognition of an intangible asset on transition of £12.0 million reflecting the right to operate the Arriva Trains Wales franchise. The Group has followed the initial recognition criteria of IAS38 which requires the retrospective assessment of the value of the intangible asset as at the date it was created. The intangible asset is being amortised over the life of the Arriva Trains franchise resulting in a charge of £0.8 million in the year ended 31 December 2004.

Share based payments (IFRS2)

IFRS2 'Share Based Payments', requires the Group to charge its income statement with the fair value of equity settled share based payments. In accordance with the transitional provisions, IFRS2 has been applied to all grants of equity instruments after 7 November 2002 that were unvested at 1 January 2005. The Group has used the Black Scholes model to measure the fair value of options granted. Profit before tax for the year ended 31 December 2004 is reduced by £0.2 million.

Joint ventures (IAS31)

Under IAS31 'Interests in Joint Ventures', proportional consolidation is the preferred basis for representing interests, with equity accounting permitted as an alternative.

The Group has used proportional consolidation to account for joint ventures. This has led to the restatement of 2004 comparatives for SAF and certain other smaller joint venture arrangements. Whilst there is no impact on net assets or profit before tax, the inclusion of balance sheet items on a line by line basis has reduced net debt by £3.4 million at 31 December 2004, principally representing the cash balances held in SAF.

Proceeds from the disposal of fixed assets (IAS16)

Under UK GAAP, the reported turnover for the Vehicle Rental and Bus and Coach distribution businesses included proceeds from the disposals of rental fleet held in fixed assets. IAS16 'Property, Plant and Equipment' does not permit the recognition of revenue on disposal of non current assets. Accordingly, reported revenue for the year ended 31 December 2004 is reduced by £52.0 million.

Financial instruments (IAS32, IAS39)

The Group uses various derivative financial instruments to hedge its exposures to foreign exchange translation risk, interest rate exposure and fuel prices.

The Group has opted to take advantage of the exemption in IFRS1 not to prepare comparative information under IAS32 and IAS39. The date of transition for IAS32 and IAS39 is therefore 1 January 2005, with net assets increasing by £3.7 million, net of deferred tax, reflecting the fair value of the derivatives at that date.

First time adoption (IFRS1)

In accordance with the requirements of IFRS 1 'First-time Adoption of International Financial Reporting Standards', the Group is subject to a number of voluntary and mandatory exemptions from full restatement to the requirements of IFRS, which have been applied as follows:

- IAS 32 'Financial Instruments: Disclosure and Presentation', and IAS 39 'Financial Instruments: Recognition and Measurement' will be adopted with effect from 1 January 2005,
- The Group has elected to use fair value as deemed cost for UK land and buildings at the date of transition,
- The Group has not applied IFRS 3 'Business Combinations' retrospectively to business combinations that occurred before the transition date,
- The Group has set cumulative translation differences to zero at the transition date for all subsidiaries. From the date of transition onwards foreign exchange differences on the retranslation of foreign subsidiaries are recognised in a separate reserve within equity, and,
- IFRS 2 'Share-based Payment' has been applied to all grants of equity instruments after 7 November 2002 that had not vested at 1 January 2005.

Arriva plc
Consolidated Balance Sheet
As at 1 January 2004 – Unaudited

	Previously Reported Under UK GAAP £'m	IAS 19 Employee benefits £'m	IFRS 1 UK properties revaluation £'m	IAS 10 Dividends proposed £'m	IFRS 3 Business combinations £'m	IFRS 2 Share based payments £'m	IAS 31 Joint ventures £'m	Total effect of transition to IFRS £'m	01/01/2004 Restated under IFRS £'m
Non-current assets									
Goodwill	226.2	-	-	-	3.9	-	-	3.9	230.1
Intangible assets	-	12.0	-	-	-	-	-	12.0	12.0
Property, plant and equipment	761.5	-	42.9	-	-	-	-	42.9	804.4
Investments	5.2	-	-	-	-	-	-	-	5.2
	992.9	12.0	42.9	-	3.9	-	-	58.8	1,051.7
Current assets									
Inventories	27.5	-	-	-	-	-	-	-	27.5
Trade and other receivables	251.9	(60.3)	-	-	-	-	-	(60.3)	191.6
Cash and cash equivalents	90.7	-	-	-	-	-	-	-	90.7
	370.1	(60.3)	-	-	-	-	-	(60.3)	309.8
Total assets	1,363.0	(48.3)	42.9	-	3.9	-	-	(1.5)	1,361.5
Current liabilities									
Trade and other payables	340.1	-	-	(26.1)	-	(0.4)	-	(26.5)	313.6
Tax liabilities	47.3	-	-	-	-	-	-	-	47.3
Bank overdrafts & loans	79.7	-	-	-	-	-	-	-	79.7
Obligations under finance lease	26.0	-	-	-	-	-	-	-	26.0
	493.1	-	-	(26.1)	-	(0.4)	-	(26.5)	466.6
Non-current liabilities									
Other loans	198.6	-	-	-	-	-	-	-	198.6
Obligations under finance lease	83.1	-	-	-	-	-	-	-	83.1
Retirement benefit obligations	-	212.4	-	-	-	-	-	212.4	212.4
Other non-current liabilities	47.3	(28.1)	-	-	-	-	-	(28.1)	19.2
Deferred tax liabilities	69.2	(69.8)	18.3	-	-	-	-	(51.5)	17.7
	398.2	114.5	18.3	-	-	-	-	132.8	531.0
Total liabilities	891.3	114.5	18.3	(26.1)	-	(0.4)	-	106.3	997.6
Net assets	471.7	(162.8)	24.6	26.1	3.9	0.4	-	(107.8)	363.9
Equity									
Share capital	9.8	-	-	-	-	-	-	-	9.8
Share premium account	9.5	-	-	-	-	-	-	-	9.5
Other reserves	60.8	-	-	-	-	-	-	-	60.8
Retained earnings	391.6	(162.8)	24.6	26.1	3.9	0.4	-	(107.8)	283.8
Total shareholders' equity	471.7	(162.8)	24.6	26.1	3.9	0.4	-	(107.8)	363.9
Minority interest in equity	-	-	-	-	-	-	-	-	-
Total equity	471.7	(162.8)	24.6	26.1	3.9	0.4	-	(107.8)	363.9

Arriva plc
Consolidated Balance Sheet
As at 30 June 2004 – Unaudited

	Previously reported under UK GAAP £'m	IAS 19 Employee benefits £'m	IFRS 1 UK properties revaluation £'m	IAS 10 Dividends proposed £'m	IFRS 3 Business combinations £'m	IFRS 2 Share based payments £'m	IAS 31 Joint ventures £'m	Total effect of transition to IFRS £'m	30/06/2004 Restated under IFRS £'m
Non-current assets									
Goodwill	219.3	-	-	-	11.0	-	-	11.0	230.3
Intangible assets	-	11.6	-	-	12.7	-	-	24.3	24.3
Property, plant and equipment	807.7	-	42.3	-	-	-	14.4	56.7	864.4
Investments	25.4	-	-	-	(8.7)	-	(11.4)	(20.1)	5.3
	1,052.4	11.6	42.3	-	15.0	-	3.0	71.9	1,124.3
Current assets									
Inventories	22.7	-	-	-	-	-	0.2	0.2	22.9
Trade and other receivables	216.8	(63.6)	-	-	-	-	6.2	(57.4)	159.4
Cash and cash equivalents	170.7	-	-	-	-	-	10.8	10.8	181.5
	410.2	(63.6)	-	-	-	-	17.2	(46.4)	363.8
Total assets	1,462.6	(52.0)	42.3	-	15.0	-	20.2	25.5	1,488.1
Current liabilities									
Trade and other payables	355.1	-	-	(9.4)	-	(0.6)	17.3	7.3	362.4
Tax liabilities	45.3	-	-	-	-	-	-	-	45.3
Bank overdrafts & loans	102.8	-	-	-	-	-	2.9	2.9	105.7
Obligations under finance lease	26.8	-	-	-	-	-	-	-	26.8
	530.0	-	-	(9.4)	-	(0.6)	20.2	10.2	540.2
Non-current liabilities									
Other loans	208.2	-	-	-	-	-	-	-	208.2
Obligations under finance lease	104.9	-	-	-	-	-	-	-	104.9
Retirement benefit obligations	-	215.3	-	-	-	-	-	215.3	215.3
Other non-current liabilities	54.7	(34.7)	-	-	-	-	-	(34.7)	20.0
Deferred tax liabilities	71.7	(69.8)	17.8	-	4.4	-	-	(47.6)	24.1
	439.5	110.8	17.8	-	4.4	-	-	133.0	572.5
Total liabilities	969.5	110.8	17.8	(9.4)	4.4	(0.6)	20.2	143.2	1,112.7
Net assets	493.1	(162.8)	24.5	9.4	10.6	0.6	-	(117.7)	375.4
Equity									
Share capital	9.7	-	-	-	-	-	-	-	9.7
Share premium account	12.1	-	-	-	-	-	-	-	12.1
Other reserves	60.9	-	-	-	-	-	-	-	60.9
Retained earnings	410.4	(162.8)	24.5	9.4	10.6	0.6	-	(117.7)	292.7
Total shareholders' equity	493.1	(162.8)	24.5	9.4	10.6	0.6	-	(117.7)	375.4
Minority interest in equity	-	-	-	-	-	-	-	-	-
Total equity	493.1	(162.8)	24.5	9.4	10.6	0.6	-	(117.7)	375.4

Arriva plc
Consolidated Income Statement
Six months ended 30 June 2004 - Unaudited

	Previously reported under UK GAAP £'m	IAS 19 Employee benefits £'m	IFRS 1 UK properties revaluation £'m	IFRS 3 Business combinations £'m	IFRS 2 Share based payments £'m	IAS 31 Joint ventures £'m	IAS 16 Revenue £'m	Total effect of transition to IFRS £'m	30/06/2004 Restated under IFRS £'m
Revenue	880.7	-	-	-	-	2.7	(28.6)	(25.9)	854.8
Net operating expenses (before exceptional items, goodwill impairment and intangible asset amortisation)	(820.6)	0.5	(0.1)	-	(0.1)	(2.7)	28.6	26.2	(794.4)
Exceptional items	(0.3)	-	(0.4)	-	-	-	-	(0.4)	(0.7)
Goodwill impairment and intangible asset amortisation	(7.2)	(0.4)	-	6.7	-	-	-	6.3	(0.9)
Total net operating expenses	(828.1)	0.1	(0.5)	6.7	(0.1)	(2.7)	28.6	32.1	(796.0)
Group operating profit	52.6	0.1	(0.5)	6.7	(0.1)	-	-	6.2	58.8
Net finance costs	(7.4)	-	-	-	-	-	-	-	(7.4)
Profit on ordinary activities before taxation	45.2	0.1	(0.5)	6.7	(0.1)	-	-	6.2	51.4
Tax on profit on ordinary activities	(12.6)	(0.1)	0.4	0.1	-	-	-	0.4	(12.2)
Profit for the period	32.6	-	(0.1)	6.8	(0.1)	-	-	6.6	39.2
Attributable to:									
Equity holders of the parent	32.6	-	(0.1)	6.8	(0.1)	-	-	6.6	39.2
Equity minority interests	-	-	-	-	-	-	-	-	-
	32.6	-	(0.1)	6.8	(0.1)	-	-	6.6	39.2

Arriva plc
Consolidated Balance Sheet
As at 31 December 2004 and 1 January 2005 – Unaudited

	Previously reported under UK GAAP £'m	IAS 19 Employee benefits £'m	IFRS 1 UK properties revaluation £'m	IAS 10 Dividends proposed £'m	IFRS 3 Business combinations £'m	IFRS 2 Share based payments £'m	IAS 31 Joint ventures £'m	Total effect of transition to IFRS £'m	31/12/2004 Restated under IFRS £'m	IAS 32 / 39 Financial instruments £'m	01/01/2005 Restated under IFRS £'m
Non-current assets											
Goodwill	261.3	-	-	-	5.4	-	-	5.4	266.7	-	266.7
Intangible assets	-	11.2	-	-	34.4	-	-	45.6	45.6	-	45.6
Property, plant and equipment	906.7	-	41.8	-	-	-	14.1	55.9	962.6	-	962.6
Investments	29.0	-	-	-	(9.6)	-	(13.2)	(22.8)	6.2	-	6.2
	1,197.0	11.2	41.8	-	30.2	-	0.9	84.1	1,281.1	-	1,281.1
Current assets											
Inventories	26.0	-	-	-	-	-	0.2	0.2	26.2	-	26.2
Trade and other receivables	236.8	(74.7)	-	-	-	-	5.3	(69.4)	167.4	-	167.4
Financial assets - other	-	-	-	-	-	-	-	-	-	7.1	7.1
Cash and cash equivalents	75.8	-	-	-	-	-	5.9	5.9	81.7	-	81.7
	338.6	(74.7)	-	-	-	-	11.4	(63.3)	275.3	7.1	282.4
Total assets	1,535.6	(63.5)	41.8	-	30.2	-	12.3	20.8	1,556.4	7.1	1,563.5
Current liabilities											
Trade and other payables	349.8	-	-	(27.5)	-	(0.9)	9.8	(18.6)	331.2	-	331.2
Tax liabilities	59.4	-	-	-	-	-	-	-	59.4	-	59.4
Bank overdrafts & loans	128.8	-	-	-	-	-	2.5	2.5	131.3	(11.6)	119.7
Obligations under finance lease	15.2	-	-	-	-	-	-	-	15.2	-	15.2
Financial liabilities – other	-	-	-	-	-	-	-	-	-	13.4	13.4
	553.2	-	-	(27.5)	-	(0.9)	12.3	(16.1)	537.1	1.8	538.9
Non-current liabilities											
Syndicated loans	82.6	-	-	-	-	-	-	-	82.6	-	82.6
Other loans	155.7	-	-	-	-	-	-	-	155.7	-	155.7
Obligations under finance lease	46.9	-	-	-	-	-	-	-	46.9	-	46.9
Retirement benefit obligations	-	193.4	-	-	-	-	-	193.4	193.4	-	193.4
Other non-current liabilities	113.5	(40.5)	-	-	-	-	-	(40.5)	73.0	-	73.0
Deferred tax liabilities	73.1	(65.1)	17.5	-	12.5	(0.1)	-	(35.2)	37.9	1.6	39.5
	471.8	87.8	17.5	-	12.5	(0.1)	-	117.7	589.5	1.6	591.1
Total liabilities	1,025.0	87.8	17.5	(27.5)	12.5	(1.0)	12.3	101.6	1,126.6	3.4	1,130.0
Net assets	510.6	(151.3)	24.3	27.5	17.7	1.0	-	(80.8)	429.8	3.7	433.5
Equity											
Share capital	9.8	-	-	-	-	-	-	-	9.8	-	9.8
Share premium account	15.3	-	-	-	-	-	-	-	15.3	-	15.3
Other reserves	60.9	-	-	-	-	-	-	-	60.9	4.8	65.7
Retained earnings	422.4	(151.3)	24.3	27.5	17.7	1.0	-	(80.8)	341.6	(1.1)	340.5
Total shareholders' equity	508.4	(151.3)	24.3	27.5	17.7	1.0	-	(80.8)	427.6	3.7	431.3
Minority interest in equity	2.2	-	-	-	-	-	-	-	2.2	-	2.2
Total equity	510.6	(151.3)	24.3	27.5	17.7	1.0	-	(80.8)	429.8	3.7	433.5

Arriva plc
Consolidated Income Statement
Year ended 31 December 2004 - Unaudited

	Previously reported under UK GAAP £'m	IAS 19 Employee benefits £'m	IFRS 1 UK properties revaluation £'m	IFRS 3 Business combinations £'m	IFRS 2 Share based payments £'m	IAS 31 Joint ventures £'m	IAS 16 Revenue £'m	Total effect of transition to IFRS £'m	31/12/2004 Restated under IFRS £'m
Revenue	1,800.2	-	-	-	-	10.8	(52.0)	(41.2)	1,759.0
Net operating expenses (before exceptional items, goodwill impairment and intangible asset amortisation)	(1,683.6)	0.1	(0.4)	15.3	(0.2)	(9.4)	52.0	57.4	(1,626.2)
Exceptional items	(2.6)	-	(0.7)	-	-	-	-	(0.7)	(3.3)
Goodwill impairment and intangible asset amortisation	-	(0.8)	-	(2.4)	-	-	-	(3.2)	(3.2)
Total net operating expenses	(1,686.2)	(0.7)	(1.1)	12.9	(0.2)	(9.4)	52.0	53.5	(1,632.7)
Group operating profit before joint venture	114.0	(0.7)	(1.1)	12.9	(0.2)	1.4	-	12.3	126.3
Share of operating profit in joint venture	1.4	-	-	-	-	(1.4)	-	(1.4)	-
Group operating profit	115.4	(0.7)	(1.1)	12.9	(0.2)	-	-	10.9	126.3
Net finance costs	(17.0)	-	-	-	-	-	-	-	(17.0)
Profit on ordinary activities before taxation	98.4	(0.7)	(1.1)	12.9	(0.2)	-	-	10.9	109.3
Tax on profit on ordinary activities	(27.6)	0.1	0.8	0.6	0.1	-	-	1.6	(26.0)
Profit for the period	70.8	(0.6)	(0.3)	13.5	(0.1)	-	-	12.5	83.3
Attributable to:									
Equity holders of the parent	70.7	(0.6)	(0.3)	13.5	(0.1)	-	-	12.5	83.2
Equity minority interests	0.1	-	-	-	-	-	-	-	0.1
	70.8	(0.6)	(0.3)	13.5	(0.1)	-	-	12.5	83.3