

Financial highlights

Revenue up 12.5% to £3,030.9m

Adjusted basic earnings per share up 6.9% to 30.9p

Dividend per share up 10.0% to 14.1p

UK Rail: excellent performance and award of two new franchises

North America: continued growth, now operating >21,000 school buses

UK Bus: strong revenue growth and increased passenger journeys

	2006	2005
Revenue (£m)	3,030.9	2,693.4
Adjusted operating profit ¹ (£m)	229.7	214.8
Operating profit (£m)	210.7	204.0
Adjusted profit before taxation ¹ (£m)	176.4	166.5
Profit before taxation (£m)	157.4	155.7
Adjusted basic EPS (pence)	30.9	28.9
Basic EPS (pence)	27.4	27.1
EBITDA ² (£m)	351.7	322.4
EBITDA: interest cover ³	6.6x	6.7x
Net debt at 31 March (£m)	(704.4)	(663.1)
Market capitalisation at 31 March (£m)	1,665	1,369

¹ Before intangible asset amortisation, bid costs and profit on disposal of fixed assets

² Adjusted operating profit as defined above plus depreciation

³ EBITDA divided by the net of finance costs and investment income

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Chairman's statement



This year is marked by the bombings in London in July. On behalf of the Board of FirstGroup plc and all of its employees I would like to express my condolences to the injured and to the bereaved. Although our operations were not directly affected, we are proud of the efforts our staff made to assist passengers in extremely challenging circumstances. I would like to take this opportunity to thank all of our staff involved for their courage and commitment during that very difficult time. The safety of our passengers and employees is our highest priority and we constantly strive to achieve the highest possible standards.

I am pleased to report another year of good progress across the Group. Revenue has increased to £3,030.9m (2005: £2,693.4m) and adjusted profit before tax (before intangible asset amortisation, bid costs and profit on disposal of fixed assets) increased to £176.4m (2005: £166.5m). Profit before tax increased to £157.4m (2005: £155.7m). This is a particularly strong performance given the additional cost increases faced by the Group during the year, specifically increases in fuel prices which impacted Group operating profit by £31m. Cash generation was again strong. EBITDA (adjusted operating profit* plus depreciation) increased to a record £351.7m (2005: £322.4m). Adjusted basic earnings per share has increased by 6.9% to 30.9p (2005: 28.9p) and basic earnings per share increased by 1.1% to 27.4p (2005: 27.1p). The Board has proposed a final dividend, subject to approval by shareholders, of 9.55p making a full year payment of 14.1p, an increase of 10%. The dividend is covered 2.4 times, before intangible asset

amortisation, bid costs and profit on disposal of fixed assets. It will be paid on 25 August 2006 to shareholders on the register on 21 July 2006. The dividend increase reflects the Board's confidence in the Group's strong cash generation and growth prospects. The Board is confident that this level of dividend growth is sustainable for the foreseeable future, at least until 2008.

This year saw the Group build on its successful rail portfolio with the award of two important rail franchises – Great Western and Thameslink/Great Northern (now renamed First Capital Connect). We were delighted to win both of these franchises as a result of substantial and comprehensive research and the expertise of our bidding team. We are now the UK's largest passenger rail operator, providing services from the north east of Scotland right down to the south west of England, and look forward to building on our record of success. We are shortlisted for the South Western franchise and look forward to submitting a robust and innovative bid.

Our North America division continues to perform well with high contract retention and new business won across all of our operations. These businesses have delivered consistent growth since we entered the North American market in 1999.

We believe that the bus is the natural solution to the increasing problem of congestion affecting our towns and cities. We continue to promote and develop a partnership approach to tackle the problem of traffic congestion. We have experienced encouraging growth in those areas where we are able to develop quality partnerships with Local Authorities to improve the services we

offer passengers through bus priority and other traffic management schemes.

During the year we further strengthened the Board with two new appointments. In July Professor David Begg joined the Board as a Non-Executive Director. David has vast experience and an impressive record in public transport and transport policy. Sid Barrie joined the Board as Commercial Director in August and his appointment further strengthens our commercial team. Both bring extensive experience to the Group.

I would like to take this opportunity to thank our staff for their continued hard work and commitment in delivering another year of strong growth. I would also like to welcome new employees including those at First Capital Connect and the enlarged First Great Western franchise and staff who have joined our businesses in the UK and US during the year.

We have a clear strategy to deliver value for shareholders by growing in our core businesses in the UK and North America and exploring opportunities to develop in new markets. We will continue to invest for growth in our businesses while remaining committed to increasing the dividend by 10% per annum and, where appropriate, share repurchases while maintaining our strong balance sheet.

A handwritten signature in black ink, which appears to read 'Martin Gilbert'.

Martin Gilbert
Chairman

*Operating profit referred to throughout this document refers to operating profit before intangible asset amortisation, bid costs and profit on disposal of fixed assets.



We are the UK's largest surface transport company, with revenue of over £3.0bn per annum and some 74,000 employees across the UK and North America.

Our vision is to **transform travel** by providing public transport services that are safe, reliable, high quality, personal and accessible.

We will build on our reputation for **innovation and investment** and continue to improve. By aiming for the top in everything we do we can deliver the highest levels of safety and service. In this report we demonstrate our commitment to delivering value for shareholders, customers, employees and the communities that we serve.

UK Rail

We are the UK's largest rail operator with four passenger rail franchises: First Great Western, First Capital Connect, First TransPennine Express and First ScotRail. We also operate Hull Trains, a non-franchised open access operator. We run nearly a quarter of the UK passenger rail network, with a balanced portfolio of intercity, commuter and regional rail operations, carrying over 250 million passengers a year. We also provide freight services through GB Railfreight and operate the Croydon Tramlink network which carries over 20 million passengers per annum. We have a strong track record of innovation and investment delivering improved services, such as new rolling stock and customer facilities across our rail operations.

North America

Headquartered in Cincinnati, Ohio, our three operations are spread across the US and Canada.

First Student

We are the second largest provider of student transportation in North America with a fleet of over 21,000 yellow school buses, carrying nearly 2 million students every day across the US and Canada.

First Transit

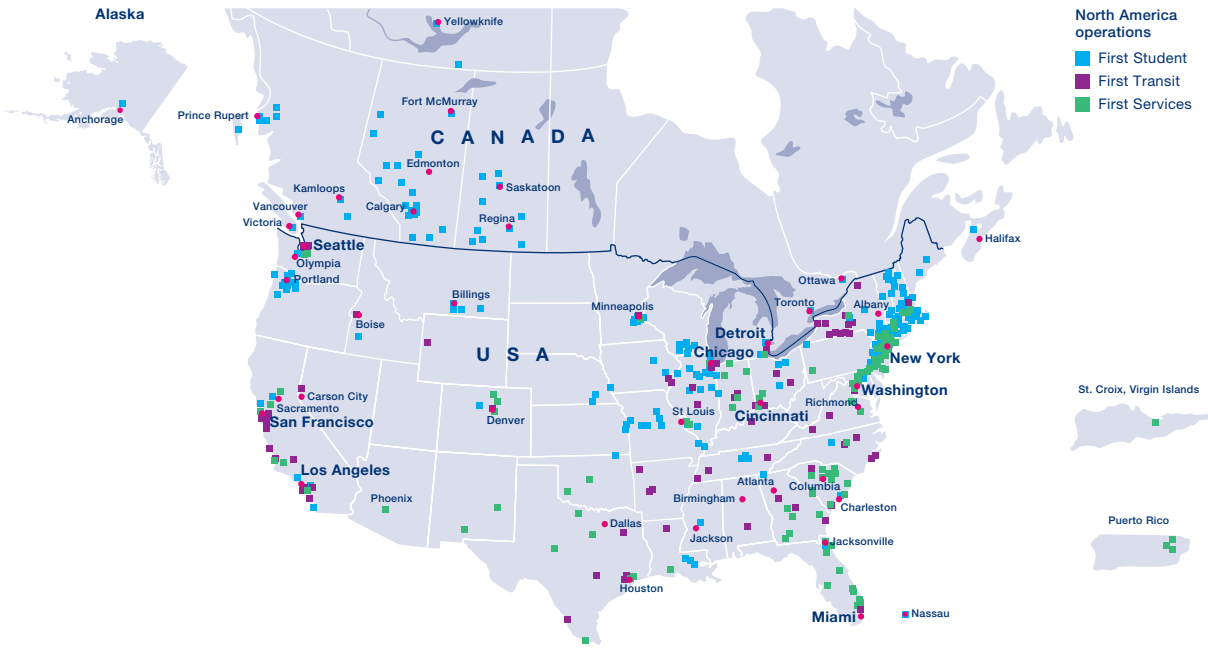
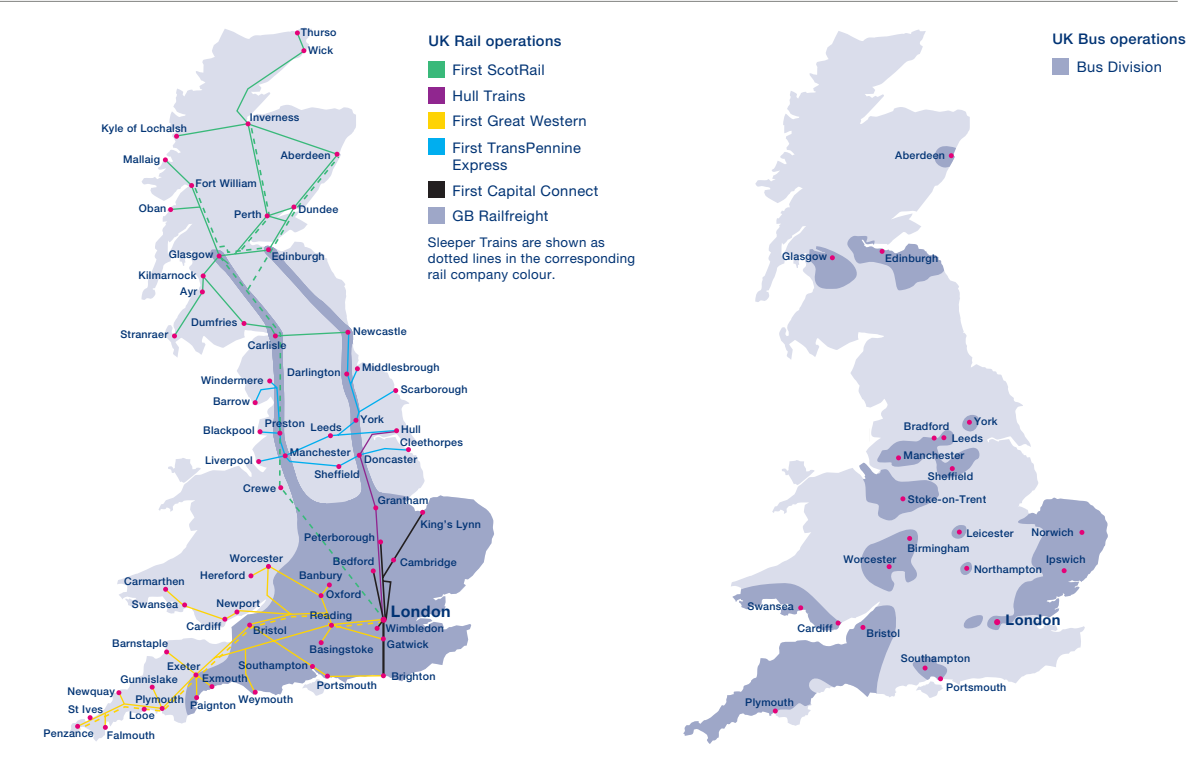
We are one of the largest private sector providers of transit management and contracting, managing public transport systems on behalf of transit authorities in cities such as Los Angeles, Houston and Denver. We are also one of the largest providers of airport shuttle bus services in the US, serving airports in cities such as Baltimore, Philadelphia and Miami. We also manage call centres, paratransit operations and other light transit activities.

First Services

Our Services division is the largest private sector provider of vehicle maintenance and support services in the US. We provide fleet maintenance for private and public sector customers such as the Federal Government, cities and fire and police departments. We also provide a range of services including vehicle maintenance, logistics support and facilities management to public and private sector clients including the US Navy and US Air Force.

UK Bus

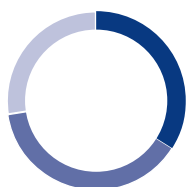
We are the UK's largest bus operator, running more than one in five of all local bus services. A fleet of some 9,000 buses carries 2.8 million passengers every day in over 40 major towns and cities. The majority of our operations are in urban areas where the bus is the most effective means of tackling traffic congestion. We continue to develop and promote effective partnerships and we are working with Local Authorities and other stakeholders to provide punctual and reliable services for passengers through Punctuality Improvement Partnerships, bus priority and other traffic management schemes.



Chief Executive's review



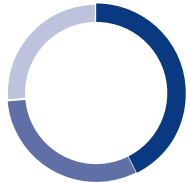
This year saw the Group build on its successful rail portfolio with the award of two new enlarged rail franchises, First Great Western and First Capital Connect. We were delighted to win both these **new franchises** as a result of extensive and comprehensive research and the expertise of our bidding team. Through these new franchises we have secured additional revenue of over £1.0 billion per annum for up to ten years.



Revenue

- UK Bus £1,031.2m
- UK Rail £1,164.9m
- North America £826.3m

Excluding other turnover £8.5m



Operating profit

- UK Bus £108.6m
- UK Rail £279.6m
- North America £67.1m

Excluding central items of £15.4m and financing element of leases £10.2m. Operating profit in UK Rail is stated after charging the finance costs of assets, which is implicit in the operating lease rentals, whereas UK and US Bus operating profits are stated before finance charges. Finance costs, as disclosed in note 9 to the accounts, were £61.8m and interest income as disclosed in note 8 to the accounts was £8.5m.

Overview Safety

The safety and security of our passengers and staff is at the forefront of everything we do and we actively endorse a culture of 'Safety First' throughout our business. We continually assess our working practices and procedures to ensure that we are doing everything we can to meet the highest possible standards of safety for our passengers and our staff. We have launched the 'Injury Prevention Programme' across the Group and established the 'First Safety Principles' to clearly set out the principles of safe working practices throughout the business. The simple message to all employees is 'if you cannot do it safely, don't do it'.

Results

I am pleased to report another successful year of growth in our businesses in the US and UK with record results. Group revenue increased by 12.5% to £3,030.9m (2005: £2,693.4m). Adjusted operating profit was £229.7m (2005: £214.8m). I am particularly pleased with this creditable performance given the strong headwinds we faced during the year, most notably the significant rise in fuel costs. Operating profit was impacted by £31m by additional fuel costs as a result of the rise in global oil prices. The Group generated record EBITDA (adjusted operating

profit plus depreciation) of £351.7m (2005: £322.4m) enabling us to continue to invest in the business as well as increasing the dividend by 10% and returning £23.0m to shareholders through further repurchase of equity during the year.

UK Rail

The UK Rail division operates passenger and freight services in the UK. Passenger rail franchises consist of First Great Western, First Capital Connect, First TransPennine Express and First ScotRail. We also operate Hull Trains, a non-franchised open access intercity passenger train operator, and we provide rail freight services through GB Railfreight. We are now the UK's largest rail operator carrying more than 250 million passengers per annum.

Results

I am very pleased with the excellent performance of our rail division during the year. Our current operations, excluding the new franchises which commenced operation after the year end, performed strongly delivering record revenue and profits.

250

million passengers per annum are carried across our rail operations making us the UK's largest rail operator. We provide services from the north east of Scotland down to the south west of England. We are the only operator to run every type of overground rail service in the UK, from high-speed intercity trains and overnight sleepers to local branch lines, regional and commuter services and open access, light rail and freight operations. We continue to build on our strong reputation of innovation, investment and customer service.



Revenue in the Group's rail division increased to £1,164.9m (2005: £1,059.7m) and operating profit increased by 23% to £79.6m (2005: £64.5m). The operating margin increased to 6.8% (2005: 6.1%). This is a particularly strong performance, given the effect of the July terrorist attacks on London which had an estimated adverse impact of £9.0m on our rail franchises during the first half of the year. We took a number of actions to encourage and promote rail travel and subsequently saw passenger journeys return to normal levels as public confidence recovered. These results demonstrate the strength of all our rail franchises which have continued to deliver strong passenger volume growth. We have now secured additional longer-term revenue for up to ten years across our UK rail portfolio with the award of two new enlarged rail franchises.

New franchises

We were delighted to be awarded both First Great Western and First Capital Connect franchises, worth over £1.0bn of revenue per annum. We commenced operation of both franchises on 1 April with a smooth handover reflecting the considerable effort made by the rail teams during the rigorous mobilisation process. Both of these franchises present a significant opportunity for the Group and

complement our existing rail portfolio. We are encouraged by the good start-up of both franchises and are experiencing strong revenue growth ahead of the projections made at the time of the bids. We are now the only operator to run every type of overground rail service in the UK, from high speed intercity trains and overnight sleepers to local branch lines, regional and commuter services and open access, light rail and freight operations. We will continue to build on our strong reputation of innovation, investment and customer service.

The Great Western franchise, which combines First Great Western, First Great Western Link and Wessex Trains, operates services across the South and West of England and South Wales. We have committed to a £200m investment programme, the vast majority of which will be spent in the first two years. This investment will deliver significant improvements across the franchise and customer benefits including improved capacity, safety and service. We are upgrading the train fleet to provide a step change in passenger comfort and facilities and to provide over 30% more seats during the morning and evening peak. We are also making a number of station improvements across the network including new ticket machines, improved facilities for customers,

new CCTV and help points and an additional 1,700 car parking spaces, representing an increase of 25% on the current mainline availability, and more cycle park facilities. In addition we will work together with Network Rail, the infrastructure provider, to tackle the deep-rooted performance issues on the Great Western network. We have just completed our most comprehensive and widespread consultation in advance of the introduction of the December 2006 timetable and have already responded to feedback received with the provision of service revisions, and where appropriate, additional services. We are delighted that Sir Chay Blyth has joined us to head the new Board of Directors at First Great Western. Sir Chay is a regular user of our services in the region and we look forward to drawing on his vision and inspiration as we continue to grow and develop this important franchise.

First Capital Connect operates across London and the South East. We have delivered a successful start-up of this new franchise and worked hard to ensure that customers saw improvements to the service right from the outset. We are investing £52m, the majority in the first three years of the franchise term, to improve the service offered to passengers. We will be introducing a number of improvements from cleaner,

51 new 100mph trains are being introduced across our First TransPennine Express network. The first train entered passenger service in March bringing a step change in quality for passengers. The new modern, high-performance intercity fleet has many new features such as air conditioning, improved seating, advanced passenger information systems, on-board CCTV security cameras and improved access for all.



smarter trains to enhanced station facilities including upgraded waiting areas and passenger information systems. Improvements to the timetable will substantially increase capacity at peak times, providing more seats for passengers in the morning and evening peak. Safety and security at our stations is key and we have already conducted a major review of all stations and as a result a number of significant enhancements will be introduced. We are recruiting additional frontline staff, investing in new CCTV equipment, help points and a new control centre to monitor security camera footage from a single central location. Revenue protection is one of our key priorities for this new franchise and we will be providing customers with improved ticketing facilities and will reduce revenue leakage through further ticket checks, additional revenue protection staff and the installation of automatic ticket gates at a number of key stations across the network. These initiatives aim to improve security, reduce ticketless travel and lessen vandalism.

Current operations

First ScotRail continues to deliver a strong performance, reflecting the dedication to providing service enhancements for passengers and ensuring the highest possible

standards of operation across the network. We have continued to focus on minimising delays caused by train performance failures and as a result have seen delays for which we are responsible fall by 26%. This excellent result far exceeds the franchise commitment of 2% reduction per annum. We are also pleased to see a marked improvement in the performance of the infrastructure. We are very pleased that reliability and punctuality is now more than 90%, the best performance in five years. Passenger volumes have increased by 11% since the start of the franchise in October 2004 and we were delighted to achieve the highest levels of customer satisfaction recorded for some time. Since we took over the franchise we have focused on improving customer service across all areas. We opened a new customer service centre in Fort William, creating 50 new jobs in rural Scotland, to provide general travel information, ticket sales, customer relations and assistance for disabled travellers. We also introduced an innovative free text alert service for passengers to provide advance warning if their train is expected to be delayed. We have improved training and development for employees and increased the number of frontline staff across the network. The personal safety of our passengers and staff is our main priority. As part of our commitment to safety more than 100 stations

across the First ScotRail network are being fitted with CCTV, help points and improved car park lighting. The winter timetable we launched in December provided improved commuter services into Glasgow and Inverness and enhancements to services in Aberdeenshire, the Highlands and Strathclyde.

First TransPennine Express continues to outperform with passenger volumes across the network increasing by 6.5% during the period, bringing the total passenger volume growth to 11% since the start of the franchise in February 2004. We continue to benefit from increased road congestion on the commuter corridor between Leeds and Manchester with an estimated 5 million journeys a year now made on this part of the rail network. Substantial volume growth of 30% has been achieved on services to and from Manchester Airport, we now carry 1.2 million passengers per annum on this key route. We were delighted to expand our First TransPennine network with the transfer of Manchester International Airport – Blackpool North services from Northern Rail with effect from June 2006. Passengers will benefit from the transfer of these services with the opportunity to travel on new rolling stock. This year a fleet of 51 new 100mph Siemens trains will be introduced on the network and the first of these new trains entered passenger service

GB Railfreight has built a reputation of a high level of service combined with a flexible business model. We were delighted to win a long-term contract to move **mail by rail**, carrying over 1 million letters per day between London and Scotland on behalf of Royal Mail. Our flexible and reliable business means we can tailor services to meet demand. At times of peak volumes, like Christmas, we provide more services to help move some of the 120 million pieces of mail to be delivered each day.

Nothing is more important to us than the **safety and security** of our passengers and staff. Across our rail operations we have introduced a range of safety and security enhancements such as CCTV, help points and improved lighting at car parks. We are pleased that our efforts have been recognised with further stations across our network achieving 'Secure Station' status during the year.



in March. Passengers in the region will benefit from the step change in quality and the many new features including air conditioning, improved seating, advanced passenger information systems, a first-class section, on-board CCTV security cameras and improved access for all. In May the Secretary of State for Transport, Douglas Alexander, opened a £28m train-care depot in Manchester to service the new trains. This state-of-the-art facility is designed to deliver optimum train performance and standards of cleanliness.

At First Great Western, growth has continued to be strong. Passenger income grew by 7.5% despite the impact of the London bombings in July. Passenger income growth has exceeded 8% over the last four years and this encouraging trend provides us with a strong platform for further growth in the new franchise. During the period we have worked hard with Network Rail and our industry partners through the Joint Performance Improvement Plan to prioritise and tackle the issues which impede performance. We have reduced the operator delays for which we are responsible by 30% in the last five years. As part of our commitment to integrated transport, and to ensure that public transport is even more convenient and better value, further PlusBus schemes were introduced during the year enabling passengers to switch

between different modes of transport using only one ticket. As a result we are encouraged that sales of PlusBus tickets have more than trebled during 2005. During the year we were pleased to receive Secure Station status for a number of stations including Slough, Newbury, Newton Abbott, Cholsey, Exeter St Davids, Plymouth, Totnes, Thatcham and Pangbourne bringing the total number of accredited stations in the region to 27.

At First Great Western Link, passenger income increased by 9% demonstrating the strong underlying performance of this railway despite the impact of the terrorist attacks in London last July. We invested in a refurbishment programme to improve the travel experience for passengers. A number of stations across the First Great Western Link network benefited from newly refurbished passenger facilities such as waiting rooms and booking halls and improved customer information boards. We also launched a package of security and safety improvements, in partnership with Transport for London, helping to make rail travel safer across the capital. The £400,000 investment programme delivered improvements including new CCTV, help points and new anti-vandal shelters at stations. In March we were pleased to achieve Secure Station status at Oxford

station following the accreditation of a number of our other First Great Western Link stations in the Thames Valley.

Hull Trains, our non-franchised, open access intercity train company operating between London Kings Cross and Hull, performed well during the year and delivered strong revenue and passenger growth. We now operate six weekday services and have recently introduced new 125mph trains on to the network. In response to demand we are currently expanding the First Class seating capacity offered on our services. We were delighted to win the 'Rolling Stock Excellence of the Year Award' and come runner up in the 'Rail Business of the Year' category at the recent Rail Business Awards. We also won the National Fleet Reliability Improvement Programme award for 'Reliability of Rolling Stock'.

GB Railfreight

GB Railfreight (GBRf), our freight company, had another successful year building on its reputation for a high level of service combined with a flexible business model. A number of new contracts were won during the year for clients including Royal Mail, Petrochem Carless, Knights Rail and Network Rail. In August GBRf will commence a significant ten-year contract with Metronet

In North America, as part of our strategy to expand in the fast growing 'light transit' market, we now operate **call centres** in eight cities across the US including New York, Chicago and Denver. The call centres, operated by First Transit, employ over 630 people who handle 5.5 million transport related calls and schedule some 7 million passenger journeys per annum.

In North America our **Services Division** provides a range of outsourced vehicle maintenance operations and support services in the private and public sectors. This fast growing business had another successful year increasing its dollar operating profit by nearly 40%. The services business we acquired last year is now successfully integrated and provides us entry into the large US Federal market.



to transport infrastructure materials as part of the programme to renew the London Underground network. In January we launched a new daily multi-modal service from the Port of Felixstowe to Exel at Doncaster, providing a 'turn up and go' service giving customers the flexibility to use it when they need to. A number of new rolling stock orders such as locomotives and wagons were placed to support the new contracts. The growth of GBRf and its successful tender for these contracts has taken thousands of heavy vehicles off already congested roads as it transports goods and equipment by rail. We are pleased with the development of GBRf and confident that there is scope to further expand our rail freight operations through this innovative and demand-responsive business.

Franchise bidding

We are delighted to be shortlisted for the South Western franchise. We have an excellent track record of innovation and investment and a highly experienced bidding team. We look forward to consulting widely and working with all of the stakeholders to develop exciting proposals for this franchise. We will be seeking to pre-qualify for the North London Lines concession which will be tendered by Transport for London later in the summer.

Outlook UK Rail

The strong performance of our rail operations reflects our expertise, innovation and the investment we have made in the businesses. We aim to deliver a high level of service and performance to our existing customers and attract new passengers on to the railways. This year has been particularly successful with the award of two major rail franchises to the Group and we look forward to building on that success in forthcoming franchise rounds. We remain confident about the Group's future opportunities in UK railways.

North America

In North America the Group is the second largest operator of student transportation with over 21,000 yellow school buses carrying nearly 2 million students every day across the US and Canada. We operate the largest transit contracting and management business in North America and we have a growing services division providing fleet maintenance and ancillary services to public and private sector clients.

Results

Our North American division has performed well during the year. Revenue from our three businesses increased to £826.3m or

\$1,476.0m (2005: £665.8m or \$1,230.2m), an increase in dollar terms of 20.0%. Operating profit was £67.1m or \$120.2m (2005: £62.4m or \$115.4m). Operating profit was impacted by \$10.0m as a result of increased fuel costs due to the rise in global oil prices and by \$8.4m as a result of increasing our insurance reserves. This was partially offset by the recovery of the 'lost' operational days from 2004/05 in First Student.

Since we acquired our North American business we have delivered consistent returns with EBITDA growth of approximately 13% per annum since 2000. The three businesses generate excellent returns with EBITDA of £122.0m or \$218.4m (2005: £109.3m or \$202.1m) and remain self-financing in terms of maintenance capital expenditure, organic growth through new contract wins and acquisitions. All investment for growth, whether it be contract bids or acquisitions, must meet the Group's rigorous internal rate of return targets.

First Student

This year we are pleased to have continued the growth of our yellow school bus business despite ongoing fuel cost pressures. Strong contract retention remains a feature of this business and we were pleased to retain over

21,000

yellow school buses are now operated by First Student making it the second largest operator of student transportation in North America. During the year we continued to expand and now carry nearly 2 million students every day across the USA and Canada. Our strategy is to win new business combined with organic growth of existing contracts and in-fill acquisitions at our target margins.



90% of our contracts that came up for renewal during the period. US Dollar revenue increased by 19.6% but operating profit was down by 3.2% as a result of higher fuel costs and the cost of increasing our insurance reserves. During the period we successfully integrated Cardinal, the business we acquired last year, and this continues to provide us with a good base for growth and synergies within our Canadian operations. We continued to grow our market share through a combination of new business wins, organic growth and acquisitions. In addition to the new business won in the first half of the year, we were pleased to win a new contract in Saskatchewan, Canada, and to make our first entry into Arizona. We will be seeking to expand our presence in this new market. In addition we were pleased to retain a number of important contracts including Washington and Massachusetts and we made four in-fill acquisitions in Wisconsin, New Jersey, Ohio and Vermont.

Looking ahead we had a successful bidding season and have renewed contracts and won new business on terms which better reflect the cost pressures we face. We are focused on delivering margin enhancement in the business and will continue to drive efficiencies where appropriate and re-profile contracts as they come up for re-tender. We

are confident that we will be able to continue to grow our yellow school bus business through our strategy to win new business combined with the organic growth of existing contracts and in-fill acquisitions at our target margins.

First Transit

US Dollar revenue increased by 13.5% and operating profit by 9.4%. We continue to focus on margin enhancement and during the period have implemented a programme of efficiencies which will also deliver further benefit in the new trading year. During the year we continued to grow with the commencement of new contracts including the provision of shuttle bus services at the University of Texas, additional transit management and contracting services in Washington D.C. and additional paratransit business in Philadelphia. We were pleased to retain a number of important contracts that came up for renewal including transit management and contracting business in Los Angeles and Denver. We continued to implement our strategy to increase our share of the 'light transit' market and we are now one of the largest operators of airport shuttle services in the US, providing bus services at a number of major airports. We recently won a contract to operate a further call centre in

Indianapolis bringing our call centre operations to a total of eight in cities such as New York, Portland, Chicago, Denver and Hartford.

We are confident that our Transit operation continues to provide opportunities for further growth in the fast growing areas of call centre management, paratransit, logistics consultancy and private shuttle buses. We will continue to develop our management expertise in these areas to exploit future opportunities to grow our presence in these markets.

First Services

Our Services division, which provides a range of outsourced vehicle maintenance, operations and support services in the private and public sectors, performed well during the year. US Dollar revenue increased by 35.3% and operating profit by 39.6%, reflecting a full year of strong trading performance from our services acquisition and also an improved operating margin.

Our fleet maintenance business continued to grow with new business to provide vehicle maintenance services to the State of Oklahoma and the Commonwealth of Pennsylvania and a number of private sector customers. We also won new contracts to

We believe the bus is the natural solution to the increasing problem of traffic congestion affecting our towns and cities. We continue to promote and develop **a partnership approach** to meet passengers' requirements for punctual and reliable services. We have seen good growth in the towns and cities where we are able to work with Local Authorities to deliver improved services and provide a successful, modern public transport system.



provide specialist mobile communications equipment for both Florida and Tennessee State Highway Patrol. Our Services business, which operates in the large federal market, continued to grow through new business and the securing of further contracted work from existing customers. In October, First Services successfully commenced operation of a substantial contract to provide land-based support services to the US Navy.

We are encouraged by the growth of our Services business and believe we are well placed to develop further opportunities in the growing US Federal market.

Outlook North America

Our North American division continues to deliver excellent returns for shareholders. We are confident that we can continue to grow and exploit opportunities in this large and fragmented market through our proven strategy of combining contract wins with well matched acquisitions at our target margins.

UK Bus

The Group is the largest bus operator in the UK with a fleet of some 9,000 buses, and a market share of approximately 23%. We carry over 2.8 million passengers every day.

Results

During the year on-bus revenue growth was strong, particularly in the second half of the year where it increased by 7.7% year on year in the last quarter. We have seen an encouraging trend of increased passenger journeys for the bus division overall. Total revenue increased to £1,031.2m (2005: £960.7m) as a result of revenue and passenger growth initiatives, improved tender results and pricing. Operating profit before lease financing costs was £108.6m (2005: £115.2m). Significant cost increases, in particular, fuel, continue to pressure margins in UK Bus. Our aim is to drive down unit costs through operational efficiencies and higher productivity. We are carrying out a detailed review of route profitability to ensure that we closely match service provision with demand and manage our resources as efficiently as possible. While margins in UK Bus remain under pressure, principally through increased fuel costs, our priority is to achieve sustainable growth in profits through high-quality customer service and increased patronage.

The new management team has been successful in driving a number of key initiatives through the business. 'Performance with Pride' has been a core objective within

our UK Bus division this year. We aim to meet customers' travel needs by providing a quality service that is sustainable, profitable and of which we are proud. Our continued focus on service quality together with actions taken by management have delivered improved vehicle reliability, increased mileage operated to its highest level in four years and eliminated driver shortages. We are making significant investment in our maintenance and engineering functions and have rolled out improved processes and best practice across the division through Standard Operating Procedures. I am pleased to report that we are beginning to see the benefit of this increased investment and expect this to continue.

London

In London our overall punctuality and reliability performance has improved over the year. We are committed to improving our service quality and investing in additional focused supervision of specific routes. We were delighted to be awarded the contract to operate one of the two Heritage Bus Routes on behalf of Transport for London. The routes commenced operation in November and we are proud to be entrusted with operating this high-profile contract.



In May 2006 we launched our first ftr scheme in York. ftr – our **premium urban travel concept** – introduces state of the art vehicles that look like trams but have the flexibility of a conventional bus and use normal roads. As part of the partnership, City of York Council is introducing improvements to bus stops, shelters and traffic lights that will enable ftr vehicles to move people around the city in comfort and without delay.

We are always looking for ways to improve our services and enable our buses to get through the traffic on time. We developed a **Punctuality Improvement Partnership (PIP)** with Greater Manchester Transport Authority to deliver improved bus services for passengers. Through the PIP process we have drawn up prioritised action plans to tackle key problem areas on the network. We've seen encouraging increases in customer satisfaction and are working with Local Authorities to introduce PIPs around the UK.



The Mayor of London has now approved plans to extend the Congestion Charging zone westward in 2007. We are well placed with depot location and additional capacity to provide further services should they be required in order to meet the needs of passengers.

As a major British company, we are delighted that London has been selected to host the 2012 Olympic Games. We have extensive experience of working with Local Authorities to deliver a successful public transport system for the Commonwealth Games in Manchester in 2002, and we look forward to working with the Olympic Transport Authority and others on the development of innovative and comprehensive plans to deliver a first class transport system for the Games.

Outside London

We continue to promote and develop a partnership approach to tackle the growing problem of traffic congestion affecting our towns and cities. We have seen good growth where we are able to work with Local Authorities to meet passengers' requirements for punctual and reliable services. Our bus operations in York continue to lead the industry's efforts to deliver improved services for passengers through effective partnerships with Local Authorities. In June 2005 our York

operation won 'Public Transport Operator of the Year' at the National Transport Awards. We are particularly proud that City of York Council nominated us for the award.

In May this year we launched ftr – our premium urban travel concept – in York. The ftr scheme introduces state-of-the-art articulated vehicles that look like trams but have the flexibility of a conventional bus and use normal roads. As part of the partnership, City of York Council is introducing a programme of improvements to traffic lights, bus stops and shelters that will enable the ftr vehicles to move people around the city in comfort and without delay. The second ftr service will begin in Leeds later this year and we are evaluating plans for further schemes in cities such as Sheffield, Swansea, Reading, Bath and Glasgow.

We are pleased to see continued passenger growth on the first 'Showcase route' launched in partnership with the City Council in Bristol. The second Showcase route, supported by South Gloucestershire Council, is due to be launched shortly. We are now working with the four Local Authorities in the area to deliver the Greater Bristol Bus Network, a comprehensive system to provide fast and reliable bus journey times along ten major corridors to compete effectively with the private car.

In Glasgow our partnership with the City Council, Strathclyde Passenger Transport and the Scottish Executive delivered the first Statutory Quality Partnership in the UK. The Statutory Quality Partnership, known as 'Streamline', will deliver improved bus information and signalling systems, together with traffic management measures on key corridors. Journey times on the first Streamline route have been reduced by almost 10%, and the system is enabling improvements in reliability. Early indications are that there is an encouraging increase in passenger volumes in the initial months of this partnership scheme.

We continue to develop Punctuality Improvement Partnerships (PIPs) with Local Authorities. Our first PIP, in partnership with Greater Manchester Passenger Transport Executive (GMPTE), continues to deliver improved bus services for passengers with further benefits to come. In the Greater Manchester area the PIP process has been used on a number of routes as part of a rolling programme to cover all services. The services have been intensively monitored and, working in partnership with GMPTE, we have drawn up prioritised action plans to tackle key issues. We have revised timetables and implemented other operational changes to address issues within our direct control.

new

bus investment continued during the year with over £95m invested in new low floor, easy access vehicles to deliver a high-quality, comfortable travelling experience for customers. Not only do they look good – these new buses also reduce the environmental impact of our operations, improve reliability and make bus travel attractive to more people.



We are encouraged that this has contributed to higher levels of customer satisfaction. On many issues, however, we require help from our partners, for example, to enable prioritised highway solutions to be pursued. We are working with Local Authorities to introduce PIPs around the country.

Aircoach, which operates express coaches between Dublin city centre and the airport and contracted services for airport car parks, performed well during the year. On-bus revenue growth was strong, particularly in Dublin where we have seen increased patronage on the airport route. A new yield management system for fares and a focus on sales and marketing helped to raise awareness and contributed to increased patronage numbers on our services from Dublin to Cork and Belfast. We were pleased to be awarded the contract to operate park and ride services at Belfast International Airport and continue to explore further opportunities in this marketplace.

We are delighted that Brent Humphries, one of our drivers at First Cymru, won the 'Bus Driver of the Year' award last year, coming first out of 120 entrants selected from the very best bus and coach drivers across the country. In addition, we are pleased that

three out of the top five runners up are drivers employed within our UK Bus division. Our Aberdeen team won the award for innovation at this year's UK Bus Awards for a project aimed at changing young people's attitudes towards bus travel helping to make it a safer and more pleasant experience for all passengers.

Investment

Our ongoing programme of investment and fleet renewal continued with capital expenditure of £95.4m in the period on new vehicles. In Glasgow we have made significant investment in new vehicles to support the UK's first Statutory Quality Partnership. In Manchester, during the period, we have invested in 158 new buses where we can maximise passenger growth. Further investment has been targeted in towns and cities with potential for passenger growth including Aberdeen, Bath, Bristol, Edinburgh and the Borders, Halifax, Huddersfield, Norwich and Stoke-on-Trent.

Concessionary fares

The Government's new concessionary fares schemes offering free travel on local bus services for people over 60 and disabled people in England was launched on 1 April 2006. Early indications show that

the schemes are working well and that concessionary fare passengers are making additional journeys. Our experience in Wales and Scotland indicates that free travel schemes offer substantial benefits to concessionary fare passengers. In some cases the schemes have helped to turn around a long-term decline in the number of bus passenger journeys, resulting in an extension to existing services and the introduction of new ones. We welcome the Government's announcement that free local bus travel will be extended to a nationwide scheme in 2008 which means those entitled will be able to use local bus services anywhere in England.

The new Scotland-wide free bus scheme for senior citizens and disabled people came into effect on 1 April 2006 and, we believe, this will benefit concessionaires. In March 2006 the Welsh Assembly Government launched a pilot for a half-fare bus travel scheme for 16 to 18 year olds in Bridgend, Wrexham, Denbighshire and Flintshire. As a major bus operator in Bridgend and across South Wales we are delighted to be participating in this innovative scheme and are working with the Welsh Assembly Government and other partners to ensure the success of the two-year pilot.

The recruitment and retention of high-quality staff is a key issue within our industry. We were the first in the industry to recruit drivers and engineers from Europe. In our UK Bus division we have recruited over 1,000 **European drivers** from Poland, the Czech Republic, Portugal, Malta and Slovakia. We are pleased with the success of this initiative which has eliminated our driver shortage.

We continue to work with the CarbonNeutral Company to raise awareness of climate change issues. During the year we worked with a number of schools to help students understand their 'carbon footprint' and develop ways to reduce it. We support **tree planting** initiatives in the UK and reforestation programmes in the cities where we operate in North America to help offset CO₂ emissions and protect, restore and enhance the natural capital of trees and forests.



Outlook UK Bus

Our UK Bus business continues to be a robust generator of cash, despite increased cost pressures. Revenue growth has been strong and we continue to demonstrate the effectiveness of partnerships with Local Authorities to deliver improved services and passenger growth. Our focus on reliability and punctuality and our investment in service quality has already delivered benefits and we expect this to continue. We are optimistic about the opportunities to continue to grow this business with the introduction of innovative new products, improved service quality and reliability while retaining a tight control on costs.

Corporate Social Responsibility

Corporate Social Responsibility is at the core of our business. It is reflected in our vision and values and our aim to transform the way people travel and how they feel about public transport. How we manage key issues such as safety, environment, our relationships with customers and our employees is key to achieving our vision.

As a public transport operator we recognise the vital role we play in supporting the needs of society to achieve more sustainable travel. The development of public transport is

essential if we are to reduce the growing negative social impacts associated with society's continuing reliance on the private car. We are working hard to reduce these impacts by providing the safest, most reliable service that we can to encourage more people to use public transport. We recognise the significant contribution we make to the communities we serve in providing important social and transport links. We also have an impact on the economy by providing an important and necessary public service, being a major employer both in the UK and North America and influencing the movement of people and goods through the services we provide. We believe that we have a responsibility to influence the views of policy makers by promoting partnerships, policies and initiatives that benefit public transport.

Full details of our activities and progress during the year can be found in our Corporate Social Responsibility Report which can be downloaded at www.firstgroup.com

Safety

Safety is our highest priority. We are continuously developing and improving our processes to ensure that a 'Safety First' culture is embedded throughout the Group. We strive to make our services as safe as possible for our passengers and our staff.

This year we have been working on a major safety initiative, the 'Injury Prevention Programme', that will drive a significant cultural change in safety across the Group. To support this initiative we have launched the First Safety Principles. These set out in clear, concise terms the principles of safe working practices and have been communicated and endorsed throughout the business.

The bombings in London on 7 July 2005 demonstrated that public transport remains a target for terrorist attack and reinforced the need for vigilance and awareness. Within our business we have, where appropriate, undertaken independent reviews by security experts to identify where we could implement further measures to improve overall security. We have enhanced our security function through the appointment of a Group Head of Security who will lead the development of our security strategy. In particular, we are looking at the use of new technology to provide greater security on vehicles and at sites. In our rail operations we are working to improve security for our passengers and staff.

Employees

Our staff are the public face of our business and ambassadors for the Group. I would like to thank all our employees for their continued

Our pioneering **Workplace Learning** initiative, in partnership with the Transport and General Workers Union, has been a great success. We now have 40 learning centres reaching around 60% of our UK bus employees with plans under way to further increase the coverage so that more of our employees have access to flexible, effective and valuable learning opportunities.



commitment to the Group. We aim to be the employer of choice in our industry and offer our staff opportunities to develop and grow to reach their full potential. We believe it is vital to engage with staff and promote an ongoing dialogue to better understand their views and concerns. We strive to continuously engage with our staff through a range of activities including informal meetings at depot level to a more formal staff satisfaction survey. We make significant investment in the training and development of our employees across the Group.

We have ongoing programmes for employees working towards recognised training in the form of vocational qualifications in the UK including our pioneering Workplace Learning initiative, in partnership with the Transport and General Workers Union. We now have 40 learning centres reaching around 60% of our UK Bus employees with plans to further increase the coverage so that more of our UK employees can gain access to flexible, effective and valuable learning opportunities. In North America employees can participate in the Automotive Service Excellence Programme designed to train and test technicians. First Student has continued to promote the 'Smith System of Defensive Driving'. This specialist training provides the

skills for school bus drivers to perform their duties safely in all traffic conditions.

The recruitment and retention of high-quality staff is a key issue within our industry. We continue to implement a range of initiatives within our businesses to address this important issue. We were the first in the industry to recruit drivers and engineers from Europe. We have recruited some 1,000 employees, mainly drivers and some engineers, from Poland, the Czech Republic, Portugal, Malta and Slovakia which eliminated our driver shortage. We were pleased that our initiative has been selected as an example of 'best practice' in demonstrating in practical terms how job mobility can support the broader aims of the European Employment Strategy.

Environment and community

We are pleased that our hard work has established an environmental management framework within the Group. This year we have achieved significant reductions in energy usage in the UK Rail division and in water usage in the UK Bus division. In North America we have made significant progress in developing our environmental reporting framework and this year are able to report on emissions and waste arising for the first time.

We participate in a number of trials to promote and develop the use of alternative fuels in public transport. In London we operate fuel cell buses as part of a European-wide trial and are pleased that the reliability of the technology has exceeded initial expectations. We also operate a number of gas buses and have been trialling hybrid vehicles. We will be working with BP, our fuel supplier, to introduce, where appropriate, biofuels to the business to further reduce carbon dioxide emissions.

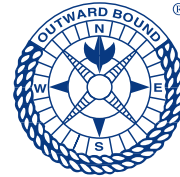
We continue to work with 'The CarbonNeutral Company' and this year we have been working with a number of schools to support them in understanding their carbon footprint and developing ways to reduce it. In North America we recently joined American Forest an organisation that works to protect, restore and enhance the natural capital of trees and forests.

We are proud to be supporters of the Outward Bound Trust, an educational charity that encourages young people to fulfil their potential through challenging outdoor experiences. Over the past ten years we have funded over 1,000 young people, between the ages of 11-18 years, to take part in an Outward Bound experience. As well as donations to support various

1,000

young people between the ages of 11-18 years have taken part in challenging outdoor experiences as a result of our continued support of Outward Bound. We are proud to have been associated with this educational charity for the past ten years and, through financial support and the provision of facilities, to have contributed to the development of thousands of young people in the UK.

The safety and security of our passengers and staff is our highest priority and we actively endorse a culture of 'Safety First' throughout our business. This year we launched the 'Injury Prevention Programme' that will drive a significant cultural change in safety across the Group. We also established the 'First Safety Principles' to clearly set out the principles of safe working practices. The simple message is 'if you cannot do it safely, don't do it'.



fundraiser events for the charity we have also provided workplace accommodation at our facility in Glasgow for the Outward Bound Metro team. The cost of equivalent facilities in the city would otherwise be prohibitive and this support has contributed to the development of over 2,000 young people, in 2004/05 alone.

During the year the Group and its staff in the UK and North America have continued to support a number of local and national charities and initiatives to benefit their communities. All of our operating companies support local events either through donations, sponsorship or use of resources and facilities made available to them by the Group.

Group outlook

We remain confident about our future prospects. Our UK Rail division continues to deliver strong passenger volume and income growth. Through the award of two new major franchises – First Great Western and First Capital Connect – we have secured additional revenue of over £1.0bn per annum for up to ten years. We look forward to building on our success in UK Railways and are delighted to be shortlisted for the South

Western franchise in this current round. In UK Bus we are encouraged by strong revenue growth and increased passenger journeys. We have seen the benefits of our increased focus on operational performance, service quality and driver recruitment. The first 'ftr' service was launched in York in May 2006 and we continue to promote and develop a partnership approach with Local Authorities who are committed to reducing traffic congestion to support successful, modern public transport systems to meet the needs of passengers. We continue to grow our North American Division and believe that the market continues to offer substantial opportunities for the Group. We are pleased to have delivered consistent returns for shareholders and more than doubled EBITDA since we made our first entry into the North American market in 1999. During the year we have continued to explore and develop opportunities in Europe. We have created a team to identify and bid for businesses, which represent the right opportunity for entry for us.

The Group is well placed for further growth. It has strong and predictable cash flows with some 50% of our revenues coming from contracted business in the UK and North America. The Board is committed to

increasing shareholder value by growing our core businesses, developing opportunities in new markets and dividend growth of 10% per annum for the foreseeable future, at least until 2008. This will be supported, where appropriate, by share repurchases while maintaining a strong balance sheet. Trading in the new financial year has started well and is in line with our expectations.

Moir Lockhead
Chief Executive



Divisional results	Year to 31 March 2006			Year to 31 March 2005		
	Revenue £m	Adjusted operating profit ¹ £m	Operating margin ¹ %	Revenue £m	Adjusted operating profit ¹ £m	Operating margin ¹ %
UK Bus	1,031.2	108.6	10.5	960.7	115.2	12.0
UK Rail	1,164.9	79.6	6.8	1,059.7	64.5	6.1
North America	826.3	67.1	8.1	665.8	62.4	9.4
Financing element of leases ²	–	(10.2)	–	–	(9.0)	–
Other ³	8.5	(15.4)	–	7.2	(18.3)	–
Total Group	3,030.9	229.7	7.6	2,693.4	214.8	8.0

¹ Before intangible asset amortisation, bid costs and profit on disposal of fixed assets

² Financing element of UK PCV operating lease costs

³ Tram operations, central management, Group information technology and other items

Throughout the Finance Director's review, operating profit, operating margin and EBITDA are defined as being before intangible asset amortisation, bid costs and profit on disposal of fixed assets

Overview

The Group has a portfolio of businesses in the United Kingdom and North America that generate strong and predictable profits and cash flows. Our aim is to increase shareholder value by investing these cash flows for growth, increasing dividends and repurchasing shares. Over the course of the year the market capitalisation of the Group has increased by 22% from £1.37 billion to £1.67 billion.

2005/06 was a landmark year with Group revenue exceeding £3 billion and adjusted operating profit exceeding £220 million for the first time. Our UK Rail and North American businesses have reported record earnings and EBITDA is the highest we have ever achieved, up 9.1% year on year to £351.7m.

This year also saw the Group established as the UK's largest passenger rail operator with the award of two important rail franchises, Great Western and Capital Connect which have combined revenues of over £1.0 billion per annum. We have now successfully commenced operation of both these franchises and these wins mean that UK Rail profits are secure over the medium term.

The pension deficit has decreased over the year by £89m to £132m partly due to further recovery of the stock market but also because of a major focus on reducing the cost of pension provision going forward and additional cash payments into the schemes during the year.

We have invested heavily in new buses during the year with a major fleet renewal in the UK which has lowered the average bus age by 0.4 years.

This is the first full year of reporting under International Financial Reporting Standards (IFRS) and a full reconciliation of the opening and closing 2005 balance sheets and the profit and loss for 2005 is set out in note 38.

Results

Revenue was £3,030.9m (2005: £2,693.4m), an increase of 12.5% and profit before taxation was £157.4m (2005: £155.7m). Adjusted operating profit was £229.7m (2005: £214.8m), an increase of 6.9%. Rail profits have increased considerably as a result of strong revenue growth. North American profits were up reflecting a high level of contract retention and new contract wins across all the businesses. There were lower profits in UK Bus because of higher fuel costs. For the Group as a whole, fuel costs were up £31m year on year.

UK Bus revenue was £1,031.2m (2005: £960.7m), an increase of 7.3%. Operating profit was £108.6m (2005: £115.2m), a reduction of 5.7%. These results reflect a creditable performance against a backdrop of cost increases in particular fuel. Fuel costs were £15.5m higher than last year reflecting the sharp increase in commodity prices. Other cost increases were offset by revenue growth and other actions to mitigate costs. On-bus revenue growth grew particularly

strongly in the second half with quarter 4 growth of 7.7% compared to 2004/05.

UK Rail revenue was £1,164.9m (2005: £1,059.7m), an increase of 9.9%. Operating profit was £79.6m (2005: £64.5m), an increase of 23.4%. 2005/06 saw a full year of the ScotRail franchise which commenced in October 2004 and there were strong performances by all existing Rail operations with the division delivering record turnover and profit despite the disruption following the terrorist attacks last summer. We estimate that the London bombings had a consequential adverse impact on operating profit of £9m. The two new rail franchises have begun well and with Great Western in particular continuing to enjoy strong demand.

North American revenue was £826.3m (2005: £665.8m). At constant exchange rates, this represents an increase of 20.0%. Operating profit was £67.1m (2005: £62.4m). In US Dollar terms this represents an increase of 4.2%. We have continued to grow our Yellow school bus operations and now operate in excess of 21,000 buses. First Student revenue increased by 19.6% in US Dollar terms, however profits were down by 3.2% because of higher fuel and insurance costs. First Transit US Dollar revenue and profits were up 13.5% and 9.4% respectively reflecting a number of important contract retentions and further expansion into the light transit market. First Services revenue increased by 35.3% in US Dollars and profits were 39.6% higher than 2005/06 with growth in both vehicle maintenance and services businesses. The services results were helped by a full year of SKE Support Services which was acquired in August 2004.

Central costs were lower than last year due to a number of non-recurring initiatives in 2004/05 including an upgrade of information technology systems, the International Financial Reporting Standards convergence project and development of new human resources policies and procedures.

Property

Property gains on disposal of £14.0m (2005: £3.3m) were realised during the year as part of the Group's ongoing programme of

disposing of older UK Bus depots. The more significant disposals included bus depots in Leicester and Motherwell.

Intangible asset amortisation

The intangible asset amortisation charge was £4.5m (2005: £2.2m) with the increase due to a full year charge for the ScotRail pension intangible and a higher charge for contract intangibles for acquisitions made either during the year or the preceding financial year.

Bid costs

Bid costs of £28.5m (2005: £11.9m) were incurred during the year and comprised principally rail refranchising costs for the Great Western, Capital Connect, Docklands Light Railway and Integrated Kent franchises. This expenditure represents the full costs of bidding and completing two major rail franchises that are expected to be highly profitable. We do not anticipate incurring these levels of expenditure in the foreseeable future.

Interest payable and similar charges

The net interest charge was £53.3m (2005: £48.3m) with the increase of £5.0m resulting from a higher average level of net debt and the higher interest costs on US Dollar denominated debt. The net interest charge is covered 6.6 times (2005: 6.7 times) by earnings before interest, taxation, depreciation and amortisation (EBITDA).

Taxation

The taxation charge on profit before intangible amortisation, bid costs and other exceptional items was £45.3m (2005: £44.6m) representing an effective rate of 26% (2005: 27%). Tax relief on US intangible amortisation, bid costs and other exceptional items, partly offset by deferred tax on property gains, reduced the tax charge to £40.0m (2005: £41.1m).

The actual cash effect of taxation to the Group was a credit of £3.3m (2005: a charge of £19.0m). The UK cash cost of taxation was reduced by increased pension payments and by favourable UK tax settlements achieved during the year. It is anticipated that

EBITDA by Division	Year to 31 March 2006			Year to 31 March 2005		
	Revenue £m	EBITDA £m	EBITDA %	Revenue £m	EBITDA £m	EBITDA %
UK Bus	1,031.2	167.5	16.2	960.7	168.6	17.5
UK Rail	1,164.9	84.9	7.3	1,059.7	69.4	6.5
North America	826.3	122.0	14.8	665.8	109.3	16.4
Financing elements of leases	–	(10.2)	–	–	(9.0)	–
Other	8.5	(12.5)	–	7.2	(15.9)	–
Total Group	3,030.9	351.7	11.6	2,693.4	322.4	12.0

the tax to be paid for 2006/07 will remain minimal. The Group pays a minimal amount of tax on its profits in the US due to tax losses carried forward and we believe that the level of the cash tax in the US will remain at a similar level for the medium term.

Dividends

The final dividend of 9.55 pence per ordinary share together with the interim dividend of 4.55 pence per ordinary share, gives a full year dividend of 14.1 pence, an increase of 10.0%. In accordance with IFRS the final dividend has not been provided for in the 2006 balance sheet. The final dividend will be paid on 25 August 2006 to shareholders on the register of members at the close of business on 21 July 2006.

EPS

Adjusted basic EPS, before intangible asset amortisation, bid costs and profit on disposal of fixed assets, was 30.9 pence (2005: 28.9 pence), an increase of 6.9%. Basic EPS was 27.4 pence (2005: 27.1 pence).

EBITDA

The Group's businesses continue to generate strong operating profits which are converted into cash. EBITDA for the year was £351.7m (2005: £322.4m) up 9.1%. EBITDA from North American operations was up 8.1% in US Dollar terms. EBITDA by division is set out above.

Cash flow

Cash generated by operations increased to £300.7m from £247.2m last year due to a lower working capital outflow and a higher depreciation charge compared to 2004/05. The working capital outflow of £27.1m (2005: outflow of £68.1m) was due to additional pension payments, over and above the profit

and loss charge, of £34m and growth in North America of £13m partly mitigated by the early receipt of cash from the First Capital Connect franchise of £21m.

Capital expenditure and acquisitions

Capital expenditure, as set out in note 15 to the consolidated financial statements was £209.1m (2005: £135.3m). Capital expenditure was predominantly in North American operations of £65.6m (2005: £36.5m), UK Bus operations of £102.4m (2005: £70.4m), UK Rail £16.9m (2005: £14.1m) and UK properties of £15.4m (2005: £11.7m).

The acquisitions made in 2005/06 were four bolt-on yellow school bus operations in North America and one small UK Bus operator. The total consideration for all acquisitions made during the year was £12.4m and provisional goodwill arising on all acquisitions amounted to £10.3m.

Funding and risk management

At the year end, total bank borrowing facilities amounted to £597m of which £527m is committed. Of these committed facilities, £316m were utilised at 31 March 2006 leaving committed headroom of £211m.

The maturity profile of committed banking facilities is regularly reviewed and well in advance of their expiry such facilities are extended or replaced.

At 31 March 2006 the Group's debt maturity was 7.8 years (2005: 9.0 years).

As the Group is a net borrower, it minimises cash and bank deposits, which arise principally in the Rail companies. The Group can only withdraw cash and bank deposits from the Rail companies on a permanent basis either up to the amount of retained

Finance Director's review continued

Analysis of net debt

	Fixed £m	Variable £m	Total £m
Cash	–	54.9	54.9
Rail ring-fenced cash and deposits	–	119.5	119.5
Sterling bond (2013 6.875%) ¹	(295.9)	–	(295.9)
Bond (2019 6.125%) ¹	(250.3)	–	(250.3)
Sterling bank loans and overdrafts	–	(246.2)	(246.2)
US Dollar bank and other loans and overdrafts	(0.5)	(4.5)	(5.0)
Canadian Dollar bank and other loans and overdrafts	(2.4)	(36.2)	(38.6)
Euro bank loans and overdrafts	–	(9.9)	(9.9)
HP and finance leases	(4.7)	(7.7)	(12.4)
Loan notes	(8.7)	(11.8)	(20.5)
Interest rate swaps, net	(57.0)	57.0	–
Total	(619.5)	(84.9)	(704.4)

¹Excludes accrued interest

profits or the amount determined by prescribed liquidity ratios. The Group limits deposits to short terms, and with any one bank to the maximum of £30m, depending upon the individual bank's credit rating, which must not be less than 'A' rated.

The Group does not enter into speculative financial transactions and uses financial instruments for certain risk management purposes only.

Interest rate risk

With regard to net interest rate risk, the Group reduces exposure by using a combination of fixed rate debt and interest rate derivatives to achieve an overall hedged position over the medium term of between 75% to 100%.

Commodity price risk

In the year, the UK was insulated from the rise in crude oil prices due to a fully hedged position. Looking ahead, we now have 38% coverage of our UK requirements for 2006/07 (total annual usage 2.6m barrels) at an average rate of \$59 per barrel (2005/06: average of \$38 per barrel). In North America (total annual usage 0.7m barrels) for 2006/07 we have 36% coverage on crude oil price risk at an average price of \$35 per barrel (2005/06: 64% hedged at \$27 per barrel).

Foreign currency risk

Group policies on currency risk affecting cash flow and profits are maintained to minimise

exposures to the Group by using a combination of hedge positions and derivative instruments where appropriate.

With regard to balance sheet translation risk, the Group hedges part of its exposure to the impact of exchange rate movements on translation of foreign currency net assets by holding currency swaps and net borrowings in foreign currencies. At 31 March 2006 foreign currency net assets were hedged 34% (2005: 35%).

Net debt

The Group's net debt at 31 March 2006 was £704.4m and was comprised as set out in the table above.

Balance sheet and net assets

Net assets increased by £107.4m over the year reflecting retained earnings (after the payment of £52.0m of dividends) for the year of £55.5m, actuarial gains on defined benefit pension arrangements (net of tax) of £25.7m and a net increase in the translation reserve of £41.9m. These positive movements were partly offset by a net increase in own shares held of £7.7m and a charge to reserves of £8.3m in respect of share options exercised during the year.

Shares in issue

During the year 5.7m shares were repurchased for a total consideration of £23.0m and were initially held as treasury shares. In 2005/06 4.3m treasury shares

were used to satisfy the exercise of Save As You Earn (SAYE) options on the maturity of the 2002 SAYE scheme. As at 31 March 2006 there were 392.2m (2005: 393.6m) shares in issue, excluding 6.6m (2005: 5.2m) shares held in treasury. The weighted average number of shares in issue for the purpose of EPS calculations (excluding own shares held in trust for employees and treasury shares) was 392.6m (2005: 399.2m).

Foreign exchange

The results of the North American businesses have been translated at an average rate of £1:\$1.79 (2005: £1:\$1.85). The period end rate was £1:\$1.74 (2005: £1:\$1.87).

Pensions

The pensions deficit reduced over the course of the year by £89m to £132m. The main elements of this reduction being the additional cash contributions being paid into the UK Bus schemes, the continuing recovery of the stock market and UK Bus pay deals in many operating companies that cap pensionable pay going forward and therefore reduces the Group's exposure to volatility in pension costs.



Dean Finch
Finance Director

Board of Directors



1 Martin Gilbert LLD MA LLB CA

Chairman; Chairman of the Nomination Committee³

A Chartered Accountant, he is one of the founders and Chief Executive of Aberdeen Asset Management PLC. He was appointed to the Board of FirstGroup plc in 1995. He is Chairman of Chaucer Holdings PLC and a director of a number of investment trusts. He is a Non-Executive Director of Primary Health Properties PLC. Age 50.

2 Moir Lockhead OBE

Deputy Chairman and Chief Executive; Chairman of the Safety Committee^{3,4,5}

Chief Executive and Deputy Chairman since the Group's formation in 1995. Originally a mechanical engineer he joined Grampian Transport in 1985 as General Manager and went on to lead the successful employee buy-out of GRT Bus Group PLC. In 1996 he was awarded the OBE for services to the bus industry and he is a past President of the Confederation of Passenger Transport. Age 61.

3 Dean Finch BSc MBA ACA

Finance Director^{4,5}

Appointed to the Board as Commercial Director in February 2004 and subsequently appointed Finance Director later that year. He is also responsible for all of the Group's rail activities including franchising. He joined the Company in 1999 as Commercial Director of the Rail Division and was subsequently appointed Managing Director of the Rail Division in August 2001. He qualified as a Chartered Accountant with KPMG where he worked for 12 years specialising in Corporate Transaction Support Services including working for the Office of Passenger Rail Franchising on the privatisation of train operating companies. Age 39.

4 David Leeder BSc FILT

Director of International Development and Marketing^{4,5}

Appointed to the Board in May 2004. He joined the Group in 2001 as Managing Director UK Bus and assumed his present role as Director of International Development and Marketing in 2005. He has held various senior posts in the transport industry including Chief Executive of Travel West Midlands and subsequently Group Marketing Director of National Express Group plc. He is Vice Chair of the Commission for Integrated Transport. A Fellow of the Institute of Logistics and Transport, he is also a past President of the Confederation of Passenger Transport. Age 40.

5 Sidney Barrie LLB

Commercial Director; Company Secretary^{4,5}

Appointed to the Board in August 2005 as Commercial Director and subsequently Company Secretary. He joined the Group from Paull & Williamsons, solicitors in Aberdeen, where he was a senior partner and Head of Corporate acting for a number of listed and private companies. He had a long association with the Group in an advisory capacity going back to the original employee buy-out of GRT Bus Group PLC. In his current role he has responsibility for a range of commercial activities across the Group. Age 55.

6 David Dunn CA

Senior Independent Non-Executive Director; Chairman of the Audit Committee^{1,2,3}

Appointed to the Board as a Non-Executive Director in December 1999. He is a Chartered Accountant and is Non-Executive Chairman of Brammer plc. He is also a Non-Executive Director of Croda International plc and SMG plc. Age 61.

7 James Forbes CBE MSc BSc CEng MIEE

Non-Executive Director; Chairman of the Remuneration Committee^{1,2,3}

Appointed to the Board in April 2000, he is the former Chief Executive of Scottish and Southern Energy plc. His career began with the South of Scotland Electricity Board and he has since held various senior posts in the electricity industry. Age 59.

8 John Siewwright MA CA

Non-Executive Director^{1,2,3}

Appointed to the Board in May 2002, he is Managing Director and Chief Operating Officer of Global Markets and Investment Banking for Merrill Lynch & Co. A Chartered Accountant, he has held various senior management positions in banking in London, New York, Dublin and Japan. He is a member of the North American Board of the Michael Smurfit Business School, Dublin. Age 51.

9 Professor David Begg DSc BA

Non-Executive Director^{1,2,3}

Appointed to the Board as Non-Executive Director in August 2005. He is Chairman of Tube Lines Limited and Northern Way Transport Compact. He is also an adviser to Greater Manchester Passenger Transport Executive. He is a Director of the Centre for Transport Policy at The Robert Gordon University in Aberdeen and is publisher of Transport Times. Until last year he was Chairman of the Commission for Integrated Transport and a Non-Executive Director of the Strategic Rail Authority. Age 49.

10 Martyn Williams

Non-Executive Employee Director

Appointed to the Board as Employee Director in January 2003, he is currently serving a second term as Employee Director. He is employed as a customer services supervisor in Swansea and has worked for the Group for 28 years. Age 51.

¹ Member of the Audit Committee

² Member of the Remuneration Committee

³ Member of the Nomination Committee

⁴ Member of the Safety Committee

⁵ Member of the Executive Committee

Corporate governance

The Company applies all of the main and supporting principles of good governance set out in section 1 of the Combined Code on Corporate Governance published by the Financial Reporting Council in July 2003 (the 'Code'). The way in which it applies those principles is set out below. Except as described in paragraph 1.1 (b) below, the Company complies with all of the provisions of section 1 of the Code.

1 The Board and its principal committees

Details of the Board, its members and its principal committees are set out below.

1.1 The Board

(a) Board structure and responsibilities

The Board currently consists of the Chairman, four Executive Directors and five Non-Executive Directors. The Board meets at least eight times each year and is responsible for setting and reviewing the Company's strategy and objectives, reviewing the financial and operational performance of each of the Group's business units, agreeing and reviewing progress against the Group's annual budgets and setting and reviewing on a regular basis its longer-term business plans. It also has a schedule of matters specifically reserved to it including approval of the annual and interim financial statements, financing arrangements, material capital commitments, business acquisitions and disposals, relationships with regulatory authorities and operating and accounting policies.

During the year, the Board met eight times and all members of the Board attended all meetings held whilst they were Directors. The Board also held a number of separate strategy meetings.

(b) Board balance and independence

The independence of the Non-Executive Directors has been reviewed against the definition of independence in the Code. David Begg, David Dunn, Jim Forbes and John Sievwright are considered to be independent within this definition. As Martyn Williams is an employee of one of the Group's subsidiaries, he cannot be considered to be independent. However, the Board feels very strongly that it is extremely beneficial for its employees to be represented on the Board in this way so that important employee-related issues can be raised at the highest level and a two-way communication process between the management of the Company and its employees is maintained.

Therefore at present, the Company does not comply with the Code provision that at least one half of the Board, excluding the Chairman, is made up of Non-Executive Directors who are considered by the Board to be independent. The Board has engaged Spencer Stuart, executive search consultants, to assist in the search for a new independent Non-Executive Director. Discussions with a suitable candidate are at an advanced stage and it is anticipated that the Company will be in a position to make an announcement on the appointment of a new independent Non-Executive Director prior to the Annual General Meeting to be held on 13 July 2006. The appointment of a further independent Non-Executive Director will ensure

compliance by the Company with the Code. The Directors are confident that notwithstanding such non-compliance, and as reinforced by the performance evaluation referred to below, the Board and its Committees remain and will continue to be effective. The Directors are satisfied that the current Board possesses the breadth of business, financial and international experience necessary to manage effectively an organisation of the size and complexity of the Group.

(c) Roles of the Chairman and Chief Executive

The Chairman

The Chairman of the Board is Martin Gilbert. He has a written statement of responsibilities which has been approved by the Board:

The Chairman is responsible for:

- leadership of the Board, ensuring its effectiveness on all aspects of its role and setting its agenda, taking into account the issues relevant to the Group and the concerns of all Board members;
- ensuring, with the Chief Executive and Company Secretary, the provision of accurate, timely and clear information to the Board;
- ensuring effective communication with shareholders and that the Board develops an understanding of the views of major investors;
- managing the Board, ensuring that sufficient time is allowed for the discussion of complex or contentious issues;
- ensuring a regular evaluation of the performance of the Board as a whole, its Committees and individual Directors;
- taking the lead in identifying and meeting the development needs of individual Directors and the Board as a whole, with a view to enhancing the overall effectiveness of the team;
- facilitating the effective contribution of Non-Executive Directors and ensuring constructive relations between Executive and Non-Executive Directors;
- ensuring, with the Chief Executive and Company Secretary, that new Directors receive a comprehensive induction programme to ensure their early contribution to the Board;
- encouraging active engagement by all members of the Board.

The Board is of the opinion, reinforced by the performance evaluation review referred to below, that Martin Gilbert's significant and in-depth knowledge and experience of the Group's business, combined with his external business experience enables him to provide effective leadership of the Board and to continue to make a positive contribution to the Group's ongoing business.

The Chairman's other significant business commitments, which remain unchanged from last year, are described in his biography on page 19. The Board performance evaluation process confirmed that the other Board members are satisfied that Martin Gilbert has the necessary time available to devote to the proper performance of his duties as Chairman.

The Chief Executive

The Chief Executive is Moir Lockhead. The Chief Executive also has a written statement of responsibilities which has been approved by the Board:

The Chief Executive is responsible for:

- running the day-to-day business of the Group, within the authorities delegated to him by the Board;
- ensuring implementation across the Group of the policies and strategy set by the Board for the Group;
- day-to-day management of the executive and senior management team;
- leading the development of senior management within the Group with the aim of assisting the training and development of suitable individuals for future Director roles;
- ensuring that the Chairman is kept apprised in a timely manner of the issues facing the Group and of any important events and developments;
- leading the development of the Group's future strategy including identifying and assessing opportunities for the growth of its business and reviewing the performance of its existing businesses.

(d) Senior Non-Executive Director

David Dunn, who chairs the Audit Committee, is the Senior Independent Non-Executive Director. He is available to shareholders if they have concerns which contact through the normal channels of Chairman, Chief Executive or Finance Director has failed to resolve or for which such contact is inappropriate.

(e) Information and professional development of Board members

The Board receives detailed papers on the business to be conducted at each meeting well in advance and individual Board members have direct access to senior executives should they wish to receive additional information on any of the items for discussion. The head of each operating division attends Board meetings on a regular basis to ensure that the Board is properly informed about the performance of and current issues facing that division. Management give presentations on current issues facing the business. A number of Board meetings each year are held on site at operating locations in the UK and USA allowing the Directors to visit the Group's operations and to discuss key issues with local operational management and stakeholders.

All Directors have access to the advice and services of the Company Secretary and, if necessary, can seek independent professional advice at the Company's expense in the furtherance of their duties. The Company Secretary is responsible for advising the Board on corporate governance matters and for ensuring compliance with Board procedures.

Directors receive induction on appointment to the Board, which is tailored to their individual needs. This includes meetings with senior management and relevant external advisers. In addition, information is provided on their responsibilities and obligations under law, regulation and best practice guidelines. The induction process is supported during the year by the programme of business presentations and operational visits described above.

The Board also receives updates, as required, on changes to the law and the regulatory regimes affecting the Group.

(f) Performance evaluation

During the course of the year, the Board undertook an evaluation of its performance. The Chairman led the process, assisted by the Company Secretary. The objectives of this exercise were to ensure that the Board, its Committees and each individual Director continued to act effectively and to fulfil the duties and responsibilities expected of them, and also to identify any additional training requirements. A tailored questionnaire was developed, which each Director completed. The responses were analysed and discussed at a meeting of the Board. The Senior Independent Director led a process of evaluation of the performance of the Chairman. No significant issues were raised in the course of the evaluation process.

(g) Re-election of Directors

As required by the Company's Articles of Association, Directors offer themselves for re-election at least once every three years. Any Director appointed during the year is required to seek re-appointment by shareholders at the next Annual General Meeting. The biographical details of all the Directors, including those seeking re-election at the 2006 Annual General Meeting, are set out on page 19.

(h) Appointment of Non-Executive Directors

Non-Executive Directors are appointed by the Board for an initial term of three years, subject to re-appointment by shareholders. They have letters of appointment, which are available on request for inspection.

(i) Directors' and officers' liability insurance

The Company maintained Directors' and Officers' liability insurance cover throughout the year as permitted by section 310 of the Companies Act 1985. The cover was renewed on 1 April 2006.

2 Committees of the Board

In addition to the Audit, Remuneration and Nomination Committees, the terms of reference for which are published on the Company's website and details of which are set out below, the Board has also delegated certain matters to Committees. The principal such Committees are:

2.1 Executive Safety Committee ('ESC')

The ESC is chaired by the Chief Executive and meets on a monthly basis. It comprises the Executive Directors, other senior managers and safety officers. The ESC reviews the Group's safety performance and practices, develops safety policies and procedures and follows up on outstanding issues. During the year, a number of meetings were attended by independent safety experts and senior representatives of relevant industry bodies, including the Health & Safety Executive.

2.2 Executive Management Board ('EMB')

The EMB, which comprises the Executive Directors and certain senior business managers, is chaired by the Chief Executive. It acts as a general operating management committee and meets on a monthly basis to review outstanding issues and to consider the Group's operational and financial performance.

2.3 Executive Committee

The Executive Committee comprises the Executive Directors and meets on an ad hoc basis to consider matters which arise in the ordinary course of the Group's operations. It is chaired by the Chief Executive and has specific delegated powers within prescribed limits to deal with matters arising in the ordinary course which need to be considered before the next scheduled Board meeting.

2.4 Nomination Committee and appointments to the Board

The Nomination Committee is chaired by the Chairman and includes David Begg, David Dunn, Jim Forbes, John Siewwright and Moir Lockhead. Martyn Williams attends meetings of the Committee at the invitation of the Chairman of the Committee to represent the Group's employees. The Committee meets as required to discuss appointments to the Board of both Executive and Non-Executive Directors. Its recommendations are then put to the full Board for consideration. External search consultants are used to assist the process, where appropriate.

The Employee Director is elected by the Employee Directors' forum, which comprises the Employee Directors and representatives of each of the Company's UK subsidiaries, and serves a maximum of two three-year terms.

During the year, the Committee met twice. Items considered by the Committee include the potential appointments to the Board. In its deliberations, the Committee is required to have regard to the skills and experience needed for the future commercial and strategic development of the Group. All members of the Committee attended each meeting.

The Company's policy is to permit Executive Directors to accept a limited number of outside non-executive directorships, recognising that this is an effective way to broaden their knowledge and expertise. However, no such appointment can be taken up without prior Board approval. The Company's policy on fees relating to such outside directorships is set out on page 28 of the Directors' Remuneration Report.

2.5 Remuneration Committee

The Remuneration Committee, under the chairmanship of Jim Forbes, met four times during the year and all members of the Committee attended all of its meetings held whilst they were Directors. Details of the membership of the Remuneration Committee are set out in the Directors' Remuneration Report on pages 26 to 32, together with a statement of the Group's remuneration strategy and policy. Full details of Directors' remuneration appear on page 29.

2.6 Audit Committee

The Audit Committee is chaired by David Dunn and includes David Begg, Jim Forbes and John Siewwright. It met three times during the year and all members attended each of those meetings whilst they were Directors. The Group Director of Internal Audit attended each of those meetings and the Company's external auditors also attended two of those meetings. Executive Directors and other senior managers attended where requested and as appropriate.

The Board considers that each member of the Committee has sufficient and recent financial experience to enable the Committee to discharge its functions effectively.

Under its remit, the Committee keeps under review the effectiveness of the Company's financial reporting and internal control policies and procedures for the identification, assessment and reporting of risk. It also keeps under review the nature, scope and results of the audits conducted by the internal audit department and the external auditors, the consistency of accounting policies and reporting across the Group and it reviews the half-year and full-year financial statements before they are presented to the Board.

The Committee considers the Group's compliance with the Code and its related guidance and oversees the objectivity and effectiveness of internal audit. The work of the internal audit department is focused on areas of priority as identified by risk analysis and in accordance with an annual audit plan approved by the Committee and the Board. Reports are sent to senior executives of the Group and subsidiary units and there is a follow-up process to ensure that actions to resolve identified control weaknesses are implemented. The Group Director of Internal Audit has the right of direct access to the chairman of the Committee.

The Committee is responsible for making recommendations to the Board in respect of the appointment or re-appointment of the Group's external auditors and, subject to the approval of shareholders, recommends to the Board the audit fee to be paid to the external auditors. The Committee is also charged with monitoring the independence of the external auditors and the objectivity and

effectiveness of the external audit process. The objectivity and independence of the external auditors is considered on a regular basis, with particular regard to the level of non-audit fees. The majority of non-audit work is put out to tender, with the exception of due diligence work on acquisitions or potential acquisitions in both the UK and overseas, where the current auditors' knowledge of the Company's business processes and controls means that they are best placed to undertake this work cost-effectively on the Company's behalf. The majority of the non-audit work undertaken by the auditors during the year was associated with acquisition-related due diligence. Details of the audit and non-audit fees, including a breakdown of the non-audit fee, are set out in note 6 to the financial statements. The external auditors have direct access to the Committee to raise any matters that may concern them.

The Committee reviews with management a detailed analysis of the Group's financial information prior to completion and announcement of the half-year and full-year results and receives a report from the external auditors on the audit process. If necessary, the external auditors also meet separately with the Audit Committee and/or the Chairman, Chief Executive and Finance Director. The Annual Report and Financial Statements and interim results go through a detailed verification and due diligence process involving external advisers.

The Committee may request the Executive Directors and any other officers of the Group to attend its meetings but none has the right of attendance. Committee meetings may be requested by the external or internal auditors if they consider it necessary.

The business considered and discussed by the Committee during the year included the reports of the external auditors on the half-year and full-year results, the 2006/07 Group Internal Audit Plan and budget, papers concerning any regular and special audits and an executive summary of each internal audit report, risk analysis assessments and a review of the implications of changes in accounting standards and the application and implementation of International Financial Reporting Standards.

3 Financial reporting

The Directors have a commitment to best practice in the Group's external financial reporting in order to present a balanced and comprehensible assessment of the Group's financial position and prospects to its shareholders, employees, customers, suppliers and other third parties. This commitment encompasses all published information including but not limited to the year-end and interim financial statements, regulatory news announcements and other public information. A statement of the Directors' responsibility for preparing the financial statements may be found on page 35.

4 Internal controls

The Board has established procedures to meet the requirements of the Code and its related guidance on internal controls. These procedures, which are subject to regular review, provide an ongoing

process for identifying, evaluating and managing any significant risks faced by the Group.

4.1 Responsibility

The Board has overall responsibility for the system of internal control and assessing risk. The responsibility for establishing detailed control and risk management procedures within each subsidiary lies with the Executive Directors and subsidiary unit managing directors. A sound system of internal control is designed to manage rather than eliminate the risk of failure to achieve business objectives and can only provide reasonable and not absolute assurance against material misstatement or loss.

4.2 Control environment

The Board is committed to business integrity, high ethical and moral values and professionalism in all its activities, principles with which all managers and employees are required to comply. The Group has a Code of Ethics, which applies to all of its subsidiary undertakings, a copy of which is available on the Company's website.

The Group has a defined divisional organisational structure with lines of authority and delegated responsibility which allows the Board to plan, execute, control and monitor the business in a manner consistent with the Group's objectives. The day-to-day business management is delegated to the Executive Directors and subsidiary unit managing directors under the overall direction of the Chief Executive. As noted above, the Board reserves to itself a number of specific items, which ensures that it retains control over key business decisions and significant transactions in terms of size, type or risk. A number of the Group's key functions, including treasury, taxation, insurance, corporate finance, legal, corporate communications and procurement are dealt with centrally. Each of these functions is monitored by an Executive Director.

4.3 Monitoring

The Group adopts a financial reporting and information system which complies with generally accepted accounting practice. The Group Finance Manual, circulated by the Group Finance function to all subsidiaries, details the Group accounting policies and procedures with which subsidiaries must comply. These are also available on the Group's intranet. Budgets are prepared by subsidiary company management and are subject to review by both Group management and the Executive Directors. Monthly forecasts are completed during the year and compared against actions required. Each subsidiary unit prepares a monthly report of operating performance, with a commentary on variances against budget, forecasts and prior year. Similar reports are prepared at a Group level. Key performance indicators, both financial and operational, are monitored on a weekly basis. In addition, business units participate in strategic reviews which include consideration of long-term financial projections and the evaluation of business alternatives.

A process of annual self-assessment and hierarchical reporting provides for a documented and auditable trail of accountability from the subsidiary units to senior management to the Executive Directors. This process includes an internal control questionnaire and risk assessment and is signed off by the subsidiary unit directors. This process and the supporting documentation are reviewed by both the internal and external auditors. Detailed action plans are developed from these questionnaires to resolve any control weaknesses or significant risks identified.

4.4 Risks and Uncertainties

There are a number of potential risks and uncertainties that could have an impact on the Group's long-term performance.

Competitive pressures

Our businesses compete in the areas of pricing and service and face competition from a number of sources.

In UK Bus, our main competitor is the car as the cost of driving a car is generally perceived as less expensive than bus travel, especially if there is more than one person in the car. In order to make bus travel a viable alternative to the car we seek to work with local authorities to introduce bus priority measures and effect infrastructure changes that promote bus patronage.

The main competitor to our UK Rail businesses is again the car and to a lesser extent, long-distance coach operators and budget airlines. To mitigate the risk from these pressures, the Group works with local and national bodies to ensure that services are provided that meet or exceed the requirements of our stakeholders.

In North America our businesses cover a wide geographic spread competing with several large companies and a substantial number of smaller, locally owned or government owned operators. Our competitors in the yellow school bus business can also include school districts since most school districts operate their own yellow school buses. Similarly, while the majority of our Transit and Services business streams are operated by private entities, including several large companies, our Transit and Services businesses also compete with many municipalities. In North America our businesses compete on service, quality and price.

Legislation and regulation

Our businesses are subject to numerous laws regulating safety procedures, equipment specifications, employment requirements, environmental procedures, insurance coverage and other operating issues and considerations. These laws and regulations are constantly subject to change. The costs associated with complying with the adoption of new legislation, regulations or other laws could adversely impact the results of our operations.

To mitigate the risk of legislative or regulatory changes the Group regularly lobbies both governmental and transport bodies.

Labour costs

Labour costs represent the largest component of the Group's operating costs. Labour shortages, or low unemployment rates, could hinder the Group's ability to recruit and retain qualified employees leading to a higher than expected increase in the cost of recruitment, training and other staff costs.

To mitigate this risk, the Group seeks to structure our recruitment and retention strategies to attract and retain the right people.

Fuel costs

Fuel costs constitute a significant proportion of our cost base. Fuel prices and supplies are influenced significantly by international, political and economic circumstances as well as natural disasters. If a fuel supply shortage were to arise from a national strike or world supply difficulties, a disruption to oil imports or refining capacity due to a natural disaster or otherwise, higher fuel prices could impact on the Group's operating results.

To mitigate the risk of rising fuel costs the Group regularly enters into forward contracts to buy fuel at fixed prices. In addition the Group seeks to limit the impact of unexpected fuel price increases through efficiency and pricing measures.

Insurance costs

Insurance reserves are made for estimates of losses that we will ultimately incur on accidents or incidents that have been reported but not paid and accidents or incidents that have been incurred but not reported. These reserves are based on actuarial valuations that are regularly prepared by independent actuaries. The actuarial valuations consider a number of factors, including historical claim payment patterns and changes in case reserves, the assumed rate of increase in medical treatment costs and property damage repairs and ultimate compensation. Historical experience and recent trends are the most significant factors in the determination of these reserves. Given the magnitude of the claims involved and the length of time until the ultimate cost is known the use of any estimation technique is inherently uncertain.

The Group seeks to mitigate the risk of rising insurance costs by promoting a culture of safety in everything that we do, through the Executive Safety Committee that is headed up by the Chief Executive.

Terrorism

Terrorist acts and public concerns about potential attacks could adversely affect demand for our services. The Group has recently appointed a Head of Security who is responsible for improved security awareness, implementation of good practice and development of a passenger and employee security structure.

Economy

The level of economic activity effects the number of bus and train journeys taken by passengers in the United Kingdom. Any changes in

economic activity may impact on passenger numbers and hence our United Kingdom operations. The potential impact of this is reduced on certain rail franchises due to the existence of revenue share arrangements. In most UK Bus operating companies, the Group has the ability to modify services by giving 45 days' notice of such modifications.

Risk Assessment

The Board has established an ongoing process for identifying, evaluating and managing the significant risks faced by the Group. As an integral part of planning and review, management from each business area and major projects identify their risks, the probability of the risks occurring, the impact on the business should the risks occur and the actions taken to manage the risks. The risks are assessed on a regular basis and could be associated with a variety of internal and external sources including regulatory requirements, disruption to information systems, industrial relations issues, control breakdowns and social, ethical and environmental issues.

4.5 Whistleblowing

The Group has established procedures whereby employees of the Group may, in confidence, raise concerns relating to matters of potential fraud or other improprieties. These procedures also cover other issues affecting employees including health and safety issues. The confidential hotline, which covers all businesses across the Group and each country in which it operates, was re-launched during the year and the Committee is confident that these 'whistleblowing' arrangements are satisfactory and will enable the proportionate and independent investigation of such matters and appropriate follow-up action to be taken.

4.6 Review of effectiveness of financial controls

The Directors confirm that they have reviewed the effectiveness of the system of internal control for the year under review and to the date of approval of the Annual Report and Financial Statements through the monitoring process described above. In addition, the Directors confirm that they have conducted a specific annual review of the effectiveness of the Group's internal audit function.

4.7 Treasury Operations

The Board has set a policy for the management of those risks and this is set out in more detail in note 25 to the financial statements. A Group Treasury Policy has been formulated and adopted to ensure compliance with best practice and to control and monitor effectively the risks attendant upon treasury and banking operations.

4.8 Auditors

Deloitte & Touche LLP have expressed their willingness to continue in office as auditors and a resolution to reappoint them will be preposed at the forthcoming Annual General Meeting.

5 Relations with shareholders

The Group recognises the importance of regular communication with all of its shareholders. The full Annual Report and Financial Statements are made available to all shareholders and an Interim Report is published and sent to shareholders at the half-year. These reports are intended to provide shareholders and other interested parties with a clear and balanced understanding of the Group's operational performance, its financial results and prospects.

All investors are kept informed of key business activities, decisions, appointments etc. via regulatory news and press releases and the Group's website. There is also regular dialogue with institutional shareholders throughout the year and general presentations are made by the Chief Executive and Finance Director following the announcement of the full and half-year results. Other Directors, including Non-Executive Directors, attend meetings with major shareholders if requested.

Regular reports on investor relations activity and feedback from investors are submitted to the Board and senior management. The Non-Executive Directors have also had informal contact with major shareholders regarding the Group during the year and they expect that informal dialogue to continue.

6 Annual General Meeting

All shareholders have the opportunity to put questions to the Directors at the Company's Annual General Meeting, at which a report is made on the highlights of the key business developments during the year under review. The Chairmen of each of the Nomination, Remuneration and Audit Committees attend the Annual General Meeting to answer specific questions from shareholders. All Directors who then held office were present at the 2005 Annual General Meeting.

Notice of the Annual General Meeting is circulated to all shareholders at least 20 working days prior to the meeting. Separate resolutions are proposed at the Annual General Meeting on each substantially separate issue. Proxy votes are counted on all resolutions and, where votes are taken on a show of hands, the proxy results are subsequently announced to the meeting.

Directors' remuneration report

This report has been prepared in accordance with the Directors' Remuneration Report Regulations 2002 (the 'Regulations'). It also meets the requirements of the Listing Rules of the Financial Services Authority and describes how the Board has applied the main supporting principles of the Combined Code on Corporate Governance published by the Financial Reporting Council in July 2003 (the 'Code') relating to Directors' remuneration. The Company complies with all of the provisions of the Code. A resolution to approve this report will be proposed at the Company's Annual General Meeting to be held on 13 July 2006.

The Regulations require the Company's auditors to report to the Company's shareholders on the 'auditable' part of the Directors' remuneration report and to state whether in their opinion that part of the report has been properly prepared in accordance with the Companies Act 1985 (as amended by the Regulations). This report has therefore been divided into separate sections for audited and unaudited information.

Unaudited information Remuneration Committee

The Remuneration Committee (the 'Committee') is chaired by Jim Forbes. The other current members of the Committee are David Begg, David Dunn and John Sievwright. The Board considers each of the members of the Committee to be independent in accordance with the Code. None of the members of the Committee has any personal financial interest (other than as a shareholder) in the matters to be decided, conflict of interest arising from cross-directorships or any involvement in the day-to-day running of the business.

The remit of the Remuneration Committee was adopted in March 2004 in the light of the recent revisions to the Code and its terms of reference are available on request and are also published on the Company's website. These terms of reference will be kept under review to take into account any changes to the Code and corporate governance practice. The principal purpose of the Committee is to consider matters related to the remuneration of the Executive Directors and senior management below Board level.

The Committee met four times during the year and all members attended each meeting held whilst they were Directors.

In determining the Executive Directors' remuneration for the year, the Committee considered publicly available information, including the remuneration packages of those holding equivalent posts at the Company's peers within the transport industry and other companies of comparable market capitalisation. The Committee also consults with the Chief Executive although no Director participates in discussions concerning his own remuneration.

Remuneration policy

Aim

The aim of the Committee is to design remuneration packages for the Company's Executives which attract, retain and motivate the high-

calibre individuals necessary to maintain the Group's position as a leader in the public transportation industry. In implementing its policy, the Committee has given full consideration to the Principles of Good Governance of the Code with regard to Directors' remuneration.

Structure of remuneration packages

There are currently four main elements to the executive remuneration package:

- basic salary and benefits in kind;
- annual cash and deferred share bonus (both paid under the Executive Annual Bonus Plan);
- share options;
- pension provision.

The Committee considers the remuneration package as a whole, balancing each of the individual elements to ensure that overall, the remuneration received by each Executive Director is competitive but not excessive, contains an appropriate balance between fixed and variable (performance-related) remuneration and that each Executive Director has sufficient long-term incentive to ensure that his interests are aligned with those of shareholders. A high proportion of each Director's potential remuneration is performance-related.

The remuneration of the Executive Directors is made up of the following components:

Basic salary and benefits in kind

The basic salary and benefits in kind for each Executive Director are determined by the Committee for each financial year and when an individual changes position or responsibility. In determining appropriate levels, the Committee considers the Group as a whole and also the packages received by similar individuals at the Company's peers in the public transport sector and other companies of comparable market capitalisation. Details of the salaries and benefits in kind received by each of the Executive Directors in the year are shown on page 29.

Executive annual bonus plan

The Group operates a discretionary performance-related bonus plan for its senior management under which payment of bonuses is linked to achievement of budgeted annual Group operating profit targets and personal objectives (including safety targets). Where an Executive Director is also directly responsible for one or more operating division(s), payment of a proportion of the bonus is also linked to the profitability of those divisions. The Committee considers and agrees the Group and divisional objectives for all Executive Directors and the personal objectives for the Chief Executive. The Chief Executive, in consultation with the Committee, agrees the personal objectives for the other Executive Directors.

Each year, the Board sets challenging budget targets for the Group as a whole and for each business unit within the Group. The Committee's policy continues to be that bonuses will be payable for Group

performance against budget of between 90% and 110% although the level of bonus payable is heavily skewed towards performance in excess of 100% of budget. 70% of any bonus payable is dependent upon Group performance and the balance upon the achievement of safety objectives (up to 20%) and personal objectives (up to 10%).

Bonus payments comprise a mixture of cash and deferred share awards. Share awards for the year under review were deferred for five years and will lapse if the relevant individual leaves the Group during the deferral period for any reason other than redundancy, retirement or ill-health. The Committee considers it is appropriate for a proportion of the annual bonus to be taken in the form of deferred shares as this acts as a retention mechanism and also aligns that Executive's longer-term interests with those of the Company's shareholders.

As the award of any bonus is already dependent on the achievement of stringent targets, the Committee considers that it is not appropriate to attach further performance conditions on vesting of the deferred share element of any bonus other than that the relevant Executive remains employed by the Group and has not tendered his resignation at the end of the deferral period.

The level of bonus payable to Executive Directors in the year to 31 March 2006 was 110% of basic salary in the case of the Chief Executive and 100% of basic salary in the case of the other Executive Directors. Each of the Chief Executive and the other Executive Directors would receive half of their bonus in cash and the remaining half in the form of deferred shares.

For all Executive Directors, up to 50% of any bonus award will be payable in shares. The deferral period for these shares is five years in order to provide long-term lock-in and to further align the Directors' interests with those of shareholders. The same deferred period also applies to senior management within the Group. The bonus arrangements will be kept under review by the Committee for future years to ensure that they remain appropriate.

Share Option Schemes

Executive Share Option Scheme

The Company operates an Executive Share Option Scheme ('ESOS') for Executive Directors and other senior management.

The performance target applicable to awards under the scheme is that growth in the Company's annualised earnings per share ('EPS') over the three-year performance period must exceed the increase in the retail prices index ('RPI') over the same period by an average of at least 2% per annum.

Additionally, in respect of awards made in 2004, for the maximum award to vest, the Company's total shareholder return ('TSR') over the performance period must place the Company in the top 25% of companies in a group of the Company's listed transport peers. A proportion of the options between 0 and 100% (determined on a sliding scale) will vest if the Company's performance against that peer group is between the 25th and 50th percentile. No options will vest if

the Company's performance is below the 50th percentile. Unlike the awards made in previous years, the performance period may not be extended if the targets have not been met at the end of the three-year performance period.

The companies in the original TSR comparator group are Associated British Ports Holdings PLC, Arriva plc, BAA plc, The Go-Ahead Group plc, The Mersey Docks & Harbour Company, TBI plc, National Express Group plc, Exel plc, Tibbett & Britten (now part of Exel plc), Avis Europe plc, Stagecoach Group plc, British Airways plc, Peninsular & Oriental Steam Navigation Company and EasyJet plc.

If the performance targets are met, an option may be exercised without any further condition at any time during the rest of its ten-year life. If the holder leaves the Group before the end of the performance period by reason of ill-health, injury, disability, redundancy or retirement, an option may be exercised within 12 months if the performance target has been satisfied at the date of leaving. Early exercise of options may also be permitted within specific periods if there is a change of control of the Company as a result of a takeover, reconstruction, amalgamation or voluntary winding-up of the Company but only to the extent that the relevant performance targets have then been met on a pro rata basis.

Where the performance period includes the transition to the new International Accounting Standards, the definition of 'annualised EPS' is under review. The Committee, advised by the Audit Committee and the external auditors, will agree decisions regarding the management of the transition and will make any necessary adjustments to ensure that comparisons continue to be made on a fair, consistent and reasonable basis.

As a result of institutional shareholder feedback and general informed comment on the value of share option awards the Committee decided that, in view of the increased benefit implemented under the Executive annual bonus plan, as described above, it would not make any option awards during the year under review but would continue to review appropriate mechanisms to achieve longer-term incentives for Executive Directors.

Save As You Earn (SAYE) Scheme

The Company operated an SAYE Scheme for eligible employees during the year under review under which options may be granted on an annual basis at a discount of up to 20% of market value. The scheme expired during the year under review and a resolution is being proposed at the Annual General Meeting to be held on 13 July 2006 to approve a replacement scheme on materially the same terms. As with the previous scheme the Executive Directors will be eligible to participate in the new scheme.

Buy As You Earn (BAYE) Scheme

The Company operates a Share Incentive Plan under the title 'Buy As You Earn'. The scheme, which is open to all UK employees of the Group (including the Executive Directors), enables employees to

Directors' remuneration report

continued

purchase partnership shares from their gross income (before income tax and National Insurance deductions). The Company provides two matching shares for every three partnership shares, subject to a maximum Company contribution of shares to the value of £20 a month. The shares are held in trust for up to five years, in which case, no income tax or National Insurance will be payable. The matching shares will be forfeited if the corresponding partnership shares are removed from trust within three years from award.

Retirement benefits

Executive Directors are members of a number of defined benefit Group pension schemes. Their dependants are eligible for dependants' pensions and the payment of a lump sum in the event of death in service. Further details are set out on page 30.

Service contracts

It is the Company's policy to restrict notice periods for Executive Directors to a maximum of 12 months. In line with this policy, all of the Executive Directors have service contracts with an undefined term but which provide for a notice period of 12 months.

The contracts contain a provision, exercisable at the discretion of the Company, to pay an amount in lieu of notice on early termination of the contract. Such payments are limited to basic salary plus certain benefits but would not include entitlement to bonus or share options. There are no contractual provisions governing payment of compensation on early termination of the contracts. If it becomes necessary to consider early termination of a service contract, the Company will have regard to all the circumstances of the case, including mitigation, when determining any compensation to be paid. Details of the Executive Directors' contracts are set out below:

Date of service contract

Moir Lockhead	5 March 2001
Dean Finch	26 February 2004
David Leeder	3 September 2001
Sidney Barrie	31 August 2005

Where Board approval is given for an Executive Director to accept an outside non-executive directorship, unless the appointment is in connection with Group business, the individual Director is entitled to retain any fees received.

Non-Executive Directors

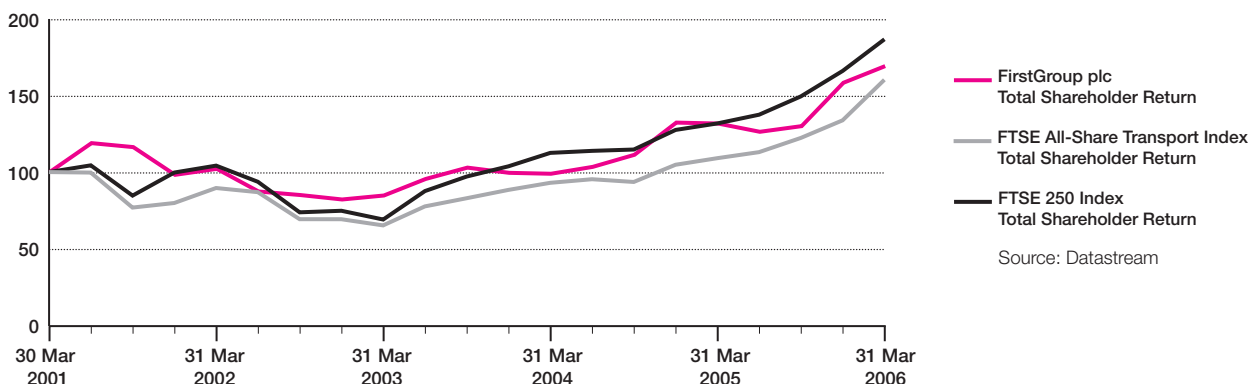
All Non-Executive Directors have a letter of appointment and their fees are determined by the Board based on surveys of fees paid to Non-Executive Directors of comparable companies. These letters of appointment are available for inspection at the Company's registered office during normal business hours and will be made available at the Annual General Meeting.

Non-Executive Directors cannot participate in any of the Company's share option schemes and, other than the Group Employee Director, are not eligible to join a Company pension scheme. Each of the Non-Executive Directors, other than David Dunn, who, with effect from January 2006 elected to receive all of his fees in cash and in the case of Martyn Williams with effect from January 2006, has elected to receive 40% of his fees in the form of shares in the Company in order to ensure that their interests are more closely aligned to those of the Company's shareholders. The shares are purchased on a monthly basis in the market. The appointment of each of the Non-Executive Directors is subject to early termination without compensation if he is not re-appointed at a meeting of shareholders where he is up for re-election.

Total shareholder return

The following graph shows, for the last five financial years of the Company, the total shareholder return on a holding of shares in the Company as against that of a hypothetical holding of shares made up of shares of the same kinds and number as those by reference to which the FTSE 250 Index and the FTSE All-Share Transport Index are calculated.

Total shareholder return index



This graph is included to meet the relevant legislative requirements and is not directly relevant to the performance criteria used for the Company's Executive Share Option Scheme. Nonetheless, the indices used were selected as the Company believes that they are the most appropriate and representative indices against which to measure the Company's performance for this purpose.

Audited information

Directors' remuneration

Details of the Directors' remuneration for the year ended 31 March 2006 are set out on the following pages.

Emoluments and compensation

The total salaries, fees and benefits paid to, or receivable by, each person who served as a Director of the Company at any time during the year for the period of such directorship are shown in the table below. These include any and all payments for services as a Director of the Company, its subsidiaries or otherwise in connection with the management of the Group.

	Salary 2006 £000	Cash bonus 2006 £000	Benefits in kind 2006 ¹ £000	Fees 2006 £000	Total 2006 £000	Total 2005 £000
Executive Directors						
Moir Lockhead	450	248	25	–	723	590
Dean Finch	300	150	18	–	468	330
David Leeder	264	128	19	–	411	303
Sidney Barrie ²	150	75	8	–	233	–
Non-Executive Directors						
Martin Gilbert	–	–	–	114	114	108
David Begg ²	–	–	–	25	25	–
David Dunn	–	–	–	39	39	35
Jim Forbes	–	–	–	39	39	35
John Sievwright	–	–	–	36	36	35
Martyn Williams	–	–	–	20	20	14
Total	1,164	601	70	273	2,108	1,450

¹The Directors received the following non-cash benefits in the year: Moir Lockhead: £19,000 company car, £5,000 private fuel and £1,000 medical insurance for himself and spouse; Dean Finch: £12,000 company car, £5,000 private fuel and £1,000 medical insurance for himself and family; David Leeder: £13,000 company car, £5,000 private fuel and £1,000 medical insurance for himself; Sidney Barrie: £7,000 car allowance, £1,000 medical insurance for himself and spouse.

²Appointed as a Director on 1 August 2005.

Directors' remuneration report

continued

Retirement benefits

Details of the retirement benefits for each of the Directors are set out in the table below:

	Moir Lockhead	Dean Finch	David Leeder	Sidney Barrie ¹
Scheme	2	3	3	3
Normal retirement age	65 ⁴	60	60	60
Directors' contributions during the year (£)	28,998	12,144	12,144	10,208
Increase in accrued pension during the year (net of inflation) (£ pa)	27,391	2,570	2,708	1,760
	(plus 82,174 cash)			
Increase in accrued pension during the year (£ pa)	32,415	2,905	2,928	1,760
	(plus 97,245 cash)			
Accrued pension as at 31 March 2006 (£ pa)	218,473	15,330	11,088	1,760
Transfer value of increase in accrued pension (net of inflation) during the year (£)	592,301	17,253	18,196	25,359
Transfer value of accrued pension at 31 March 2005 (£)	3,884,910	75,695	49,738	–
Transfer value of accrued pension at 31 March 2006 (£)	4,724,241	102,934	74,512	25,359
Increase in transfer value over the year, net of Director's contributions (£ pa)	810,333	15,095	12,630	15,151
Company contribution to FURBS during the year	–	–	11,531	–

¹Sidney Barrie joined the Board on 1 August 2005. The details shown in the table relate to the portion of the year during which he was a Director.

²Aberdeen City Council No.2 Pension Fund.

³FirstGroup Flexible Benefits Scheme.

⁴Normal retirement age under relevant scheme is 65 but benefits can be taken without reduction at 60 so transfer values for the purpose of this table have been calculated assuming immediate retirement.

Guaranteed Minimum Pensions have been ignored for the purpose of the transfer value calculations.

The Group does not have one pension scheme but instead operates a number of different schemes. All of the schemes in which the Executive Directors participate are defined benefit schemes and are not limited in membership to Executive Directors.

Directors' share options

The outstanding share options under the ESOS, deferred share bonus and SAYE Scheme granted to each of the serving Directors are set out in the table below. No price was paid for the award of any option. There have been no changes to the terms and conditions of any option awarded to Directors.

Directors	Scheme		At beginning of year or date of appointment (number of shares)	Granted during the year (number of shares)	Exercised during the year (number of shares)	Lapsed/ waived during the year (number of shares)	At end of year (number of shares)	Exercise price (pence)	Date from which exercisable	Expiry date
Moir Lockhead	ESOS:	2001	130,985	–	–	–	130,985	346.5	15.8.04	15.8.11
		2002	173,784	–	–	–	173,784	269	21.6.05	21.6.12
		2003	166,958	–	–	–	166,958	287	18.11.06	18.11.13
		2004	193,277	–	–	–	193,277	275.08	10.6.07	10.6.14
	Deferred share bonus ¹ :	2002 ²	25,080	–	25,080	–	–	nil	1.4.05	1.4.06
		2003	28,559	–	–	–	28,559	nil	1.4.06	1.4.07
		2004	34,062	–	–	–	34,062	nil	1.4.07	1.4.08
		2005	–	36,787	–	–	36,787	nil	1.4.08	1.4.09
Sidney Barrie	SAYE:	2005/06	–	678	–	–	678	325	1.5.09	31.10.09
Dean Finch	ESOS:	2001	18,470	–	–	–	18,470	346.5	15.8.04	15.8.11
		2002	24,535	–	–	–	24,535	269	21.6.05	21.6.12
		2003	58,930	–	–	–	58,930	287	18.11.06	18.11.13
		2004	90,883	–	–	–	90,883	275.08	10.6.07	10.6.14
	Deferred share bonus ¹ :	2002 ³	11,660	–	11,660	–	–	nil	1.4.05	1.4.06
		2003	13,720	–	–	–	13,720	nil	1.4.06	1.4.07
		2004	27,029	–	–	–	27,029	nil	1.4.07	1.4.08
		2005	–	38,344	–	–	38,344	nil	1.4.08	1.4.09
David Leeder	ESOS:	2002	26,914	–	–	–	26,914	269	21.6.05	21.6.12
		2003	64,643	–	–	–	64,643	287	18.11.06	18.11.13
		2004	90,883	–	–	–	90,883	275.08	10.6.07	10.6.14
	Deferred share bonus ¹ :	2002 ⁴	14,983	–	14,983	–	–	nil	1.4.05	1.4.06
		2003	7,163	–	–	–	7,163	nil	1.4.06	1.4.07
		2004	19,941	–	–	–	19,941	nil	1.4.07	1.4.08
		2005	–	29,311	–	–	29,311	nil	1.4.08	1.4.09
	SAYE 2002/03 ⁵	4,921	–	4,921	–	–	192	1.2.06	31.8.06	
	SAYE 2005/06	–	678	–	–	678	325	1.5.09	31.10.09	
Martyn Williams	SAYE:	2002/03 ⁶	787	–	787	–	–	192	1.2.06	31.8.06
		2003/04	636	–	–	–	636	232	1.2.07	31.8.07
		2004/05	567	–	–	–	567	267	1.2.08	31.8.08
		2005/06	–	345	–	–	345	325	1.5.09	31.10.09

¹The figures shown represent the number of nil-cost options which were granted under the deferred share element of the Executive Annual Bonus Plan in respect of the 2001/02, 2002/03, 2003/04 and 2004/05 financial years. The cash values of the 2005/06 award are Moir Lockhead: £248,000, Sidney Barrie: £75,000, Dean Finch: £150,000 and David Leeder: £128,000. These awards will take the form of nil cost options over shares which will, subject to satisfaction of the requirements of the plan, vest on 1 April 2011. The number of shares under option will depend on the market price of shares at the close of business on 17 May 2006.

²Exercised on 17 May 2005. The closing price on the date of exercise was 320.75p and the notional pre-tax gain on exercise was £80,444.10.

³Exercised on 16 May 2005. The closing price on the date of exercise was 321p and the notional pre-tax gain on exercise was £37,428.60.

⁴Exercised on 24 May 2005. The closing price on the date of exercise was 330.5p and the notional pre-tax gain on exercise was £49,518.82.

⁵Exercised on 1 February 2006.

⁶Exercised on 1 February 2006.

Directors' remuneration report continued

Market price of FirstGroup plc shares

The market price of FirstGroup plc shares at 31 March 2006 was 424.75p and the range during the year was 311.50p to 426.25p.

This report was approved by the Board of Directors, on the recommendation of the Remuneration Committee, on 10 May 2005 and signed on its behalf by



Sidney Barrie
Company Secretary
16 May 2006

Directors' report

The Directors have pleasure in submitting their Annual Report and Financial Statements for the year ended 31 March 2006.

Principal activities

The principal activity of the Group is the provision of passenger transport services.

Review of the business

Reviews of the business and principal events and likely future developments are given in the Chairman's statement, Chief Executive's review and in the Finance Director's review set out on pages 16 to 18. Our review of the principal risks and uncertainties of the business is set out on page 24.

Results and dividends

The results for the year are set out in the consolidated profit and loss account on page 36. The Directors recommend payment of a final dividend of £37.4m (9.55p per share), which, with the interim dividend of £17.9m (4.55p per share) paid on 8 February 2006, gives a total dividend of £55.3m (14.1p per share) for the year. The proposed final dividend, if approved, will be paid on 25 August 2006 to shareholders on the register at the close of business on 21 July 2006.

Share capital

Details of changes in share capital, including purchases by the Company of its own shares, are set out in note 28 to the consolidated financial statements. Authority for the Company to make market purchases of up to 57,500,000 of its own shares was renewed at the 2005 Annual General Meeting. This authority remains in place until the 2006 Annual General Meeting, when it is intended to seek a further renewal. Further to the authority given at the 2005 Annual General Meeting, the Company purchased 5,686,112 of its own shares, representing 1.43% of the Company's issued share capital, for a consideration of £22,982,884. The reason for the purchase was to reduce surplus cash balances and enhance earnings per share.

Directors

The Directors of the Company who served during the year were Martin Gilbert, Moir Lockhead, Sidney Barrie (appointed 1 August 2005), David Begg (appointed 1 August 2005), David Dunn, Dean Finch, Jim Forbes, David Leeder, John Sievwright and Martyn Williams. Biographical details of all the serving Directors are set out on page 19.

In accordance with the Company's Articles of Association, Jim Forbes and Martyn Williams will retire by rotation at the forthcoming Annual General Meeting and, being eligible, offer themselves for re-election. Sidney Barrie and David Begg, both of whom were appointed since the last Annual General Meeting will retire at the forthcoming Annual General Meeting and, being eligible, offer themselves for election. Details of the fees and remuneration of the Directors and their service contracts or terms of appointment are set out in the Directors' remuneration report on pages 26 to 32.

Directors' interests

The Directors who held office at the end of the year had the following interests in the ordinary shares of the Company:

	Ordinary 5p shares			
	At beginning of year or subsequent appointment		At end of year	
	Beneficial	Non-beneficial	Beneficial	Non-beneficial
Sidney Barrie	20,000	–	20,000	–
David Begg	–	–	2,645	–
David Dunn	21,817	–	24,837	–
Dean Finch	1,500	–	8,334	–
Jim Forbes	13,817	–	18,113	–
Martin Gilbert	62,219	–	74,959	–
David Leeder	1,364	–	10,636	–
Moir Lockhead	1,132,524	470,690	1,157,604	470,690
John Sievwright	21,317	–	25,332	–
Martyn Williams	965	–	2,138	–

Details of the Directors' share options are set out in the Directors' remuneration report on pages 26 to 32. Moir Lockhead also holds nominal non-beneficial interests in a number of the Company's subsidiary undertakings.

Between 1 April 2006 and 16 May 2006, the following changes occurred to Directors' interests:

On 25 April 2006, David Leeder acquired 34 shares pursuant to the Company's Buy As You Earn Scheme. On 25 April 2006, Martin Gilbert acquired 944 shares, Jim Forbes acquired 332 shares, each of David Begg and John Sievwright acquired 292 shares and Martyn Williams acquired 127 shares under the standing arrangements whereby they have elected to receive 40% of their monthly fees in the form of shares in the Company.

No Director is materially interested in any significant contract or agreement with the Group, other than their service contracts.

Significant interests

At 16 May 2006, the Company had been advised of the following holders of 3% or more of its issued share capital for the purpose of section 198 of the Companies Act 1985:

	Ordinary 5p shares	%
M&G Investment Management Ltd	25,727,967	6.45
Morley Fund Management Ltd	20,010,402	5.02
UBS Global Asset Management	15,566,913	3.90
Legal & General Investment Management Ltd	14,260,500	3.58

Employees

The Group is committed to employee involvement and uses a variety of methods to inform, consult and involve its employees in the

business. These include subsidiary company newsletters and circulars and also First Edition, a Group-wide newsletter, which is sent to all employees across the Group on a biannual basis. Senior managers within each division meet regularly to discuss current issues and employees are encouraged to discuss any issues with management at any time. Each Division also operates a confidential hotline which staff can use to report health and safety, employment-related and other issues concerning them.

The Group also has a regular dialogue with employees and representatives from Trades Unions. Each operating company has either an elected Company Council or, more typically, an Employee Director on its board. This principle extends to the plc Board where one of the Employee Directors is elected by his or her peers to represent employees across the Group.

Each Division has its own information and consultation arrangements and levels of employee involvement in the business differ. However, in the UK, the Group has worked with Trades Unions to set up a number of joint schemes, including workplace learning, credit unions, new national policies on assaults, drugs and alcohol, the restructuring of Group pension schemes and a joint committee to review staff uniform procedures.

The Group is committed to wide employee ownership. During the year, employees continued to have the opportunity to participate in the Group's Save As You Earn and Buy As You Earn schemes, details of which are set out in note 35 to the financial statements.

The Group is committed to equality of opportunity in all its employment practices, policies and procedures. To this end, within the framework of the law, we are committed wherever practicable to achieving and maintaining a workforce which broadly reflects the local catchment area within which we operate. We aim to ensure that no employee or potential employee will receive less favourable treatment due to their race, colour, nationality, ethnic origin, religion, sex, gender reassignment, sexual orientation, religion, marital status, trade union membership, age or disability.

Corporate Social Responsibility

The system of internal control described on pages 23 to 24 covers significant risks associated with social, environmental and health and safety issues. The Group publishes a separate Corporate Social Responsibility Report covering these matters, which will be available on our website at www.firstgroup.com.

Charitable and political contributions

The Group made various donations to UK charities totalling approximately £170,000 during the year (2005: £40,000) including donations to charities following the London bombings, the Pakistan earthquakes and Hurricane Katrina. No payments were made for political purposes.

Creditors

It is the Group's policy to abide by the payment terms agreed with suppliers wherever it is satisfied that the supplier has provided goods and services in accordance with agreed terms and conditions. A number of significant purchases including fuel, tyres and commitments under hire purchase contracts, finance leases and operating leases are paid by direct debit. At 31 March 2006, the Group had the equivalent of 28 days' (2005: 27 days') purchases outstanding, based on the ratio of Group trade creditors at the end of the year to the amounts invoiced during the year by trade creditors. The Company does not have any trade creditors in its balance sheet.

Audit information

In the case of each of the persons who are Directors of the Company at the date when this report was approved:

- so far as each of the Directors is aware, there is no relevant audit information (as defined in the Companies Act 1985) of which the Company's auditors are unaware; and
- each of the Directors has taken all the steps that he ought to have taken as a Director to make himself aware of any relevant audit information (as defined) and to establish that the Company's auditors are aware of that information.

Annual General Meeting

The Annual General Meeting will be held at the Aberdeen Exhibition and Conference Centre, Bridge of Don, Aberdeen, Scotland, AB23 8BL on Thursday 13 July 2006 at 11.00 am. The Notice of Meeting is contained in a separate letter from the Chairman accompanying this Annual Report.

Going concern

Whilst any consideration of future matters involves making a judgment, at a particular point in time, about future events which are inherently uncertain, after making inquiries, the Directors have formed the judgment, at the time of approving these financial statements, that there is a reasonable expectation that the Company and the Group have adequate resources to continue operating for the foreseeable future. For this reason, they continue to adopt the going concern basis in preparing these financial statements.

By order of the Board
Sidney Barrie
Company Secretary
16 May 2006

395 King Street
Aberdeen
AB24 5RP

Directors' responsibilities

The Directors are responsible for preparing the Annual Report and the accounts. The Directors are required to prepare accounts for the Group in accordance with International Financial Reporting Standards (IFRS) and have chosen to prepare Company financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (UK GAAP).

In the case of UK GAAP accounts, the Directors are required to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period. In preparing these financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

In the case of IFRS accounts, International Accounting Standard 1 requires that financial statements present fairly for each financial year the Company's financial position, financial performance and cash flows. This requires the faithful representation of the effects of transactions, other events and conditions in accordance with the

definitions and recognition criteria for assets, liabilities, income and expenses set out in the International Accounting Standards Board's 'Framework for the preparation and presentation of financial statements'. In virtually all circumstances, a fair presentation will be achieved by compliance with all applicable International Financial Reporting Standards. Directors are also required to:

- properly select and apply accounting policies;
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- provide additional disclosures when compliance with the specific requirements in International Financial Reporting Standards is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance; and
- prepare the accounts on a going concern basis unless, having assessed the ability of the Company to continue as a going concern, management either intends to liquidate the entity or to cease trading, or has no realistic alternative but to do so.

The Directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Company, for safeguarding the assets, for taking reasonable steps for the prevention and detection of fraud and other irregularities and for the preparation of a Directors' report and Directors' remuneration report which comply with the requirements of the Companies Act 1985.

Consolidated income statement

Year ended 31 March 2006

	Notes	Before amortisation, impairment charges and bid costs 2006 £m	Amortisation, impairment charges and bid costs 2006 £m	Total 2006 £m	Before amortisation, impairment charges and bid costs 2005 £m	Amortisation, impairment charges and bid costs 2005 £m	Total 2005 £m
Revenue							
Continuing operations	3	3,030.9	–	3,030.9	2,693.4	–	2,693.4
Operating costs before profit on disposal of fixed assets							
Continuing operations		(2,801.2)	(33.0)	(2,834.2)	(2,478.6)	(14.1)	(2,492.7)
Operating profit before profit on disposal of fixed assets							
Continuing operations		229.7	(33.0)	196.7	214.8	(14.1)	200.7
Operating profit before amortisation, impairment charges and bid costs							
		229.7	–	229.7	214.8	–	214.8
Amortisation and impairment charges	6	–	(4.5)	(4.5)	–	(2.2)	(2.2)
Bid costs	5	–	(28.5)	(28.5)	–	(11.9)	(11.9)
Operating profit		229.7	(33.0)	196.7	214.8	(14.1)	200.7
Profit on disposal of fixed assets		–	14.0	14.0	–	3.3	3.3
Operating profit	6	229.7	(19.0)	210.7	214.8	(10.8)	204.0
Investment income	3, 8	8.5	–	8.5	4.3	–	4.3
Finance costs	9	(61.8)	–	(61.8)	(52.6)	–	(52.6)
Profit before tax		176.4	(19.0)	157.4	166.5	(10.8)	155.7
Tax	10	(45.3)	5.3	(40.0)	(44.6)	3.5	(41.1)
Profit for the period from continuing operations		131.1	(13.7)	117.4	121.9	(7.3)	114.6
Attributable to:							
Equity holders of the parent		121.2	(13.7)	107.5	115.4	(7.3)	108.1
Minority interest		9.9	–	9.9	6.5	–	6.5
		131.1	(13.7)	117.4	121.9	(7.3)	114.6
Basic earnings per share	11			27.4p			27.1p
Diluted earnings per share	11			27.1p			26.9p

Dividends of £52.0m (2005: £48.0m) were paid during the year. Dividends of £37.4m (2005: £34.1m) were proposed for approval during the year.

Consolidated statement of recognised income and expense

Year ended 31 March 2006

	2006 £m	2005 £m
Derivative hedging instrument movements	(35.1)	–
Exchange differences on translation of foreign operations	49.6	(14.2)
Actuarial gains on defined benefit pension schemes	36.7	20.8
Deferred tax on actuarial gains	(11.0)	(6.3)
Net income recognised directly in equity	40.2	0.3
Profit for the period	117.4	114.6
Total recognised income and expense for the period	157.6	114.9
Attributable to:		
Equity holders of the parent	147.7	108.4
Minority interests	9.9	6.5
	157.6	114.9
Increase in net assets on recognition of derivative financial instruments on adoption of IAS 39 at 1 April 2005	20.3	

Consolidated balance sheet

	Notes	2006 £m	2005 £m
Non-current assets			
Goodwill	13	503.1	465.8
Other intangible assets	14	30.0	29.4
Property, plant and equipment	15	926.5	835.0
Financial assets – derivative financial instruments	25	8.5	–
		1,468.1	1,330.2
Current assets			
Inventories	17	54.2	40.1
Trade and other receivables	18	373.1	368.7
Financial assets – cash and cash equivalents	21	174.4	154.1
– derivative financial instruments	25	14.1	–
		615.8	562.9
Non-current assets classified as held for sale	19	6.6	5.2
Total assets		2,090.5	1,898.3
Current liabilities			
Trade and other payables	20	545.1	507.3
Tax liabilities		47.8	52.8
Financial liabilities – obligations under finance leases	23	2.3	9.0
– bank overdrafts and loans	22	30.9	51.4
– loan notes	24	2.8	0.5
– derivative financial instruments	25	1.8	–
– current bond liability	22	23.1	–
		653.8	621.0
Net current liabilities		38.0	58.1
Non-current liabilities			
Financial liabilities – bonds	22	553.2	527.9
– bank loans	22	268.8	192.8
– obligations under finance leases	23	10.1	15.1
– loan notes	24	17.7	20.5
– derivative financial instruments	25	0.8	–
Retirement benefit obligation	36	132.0	221.1
Deferred tax liabilities	26	84.6	30.8
Long-term provisions	27	37.6	44.6
		1,104.8	1,052.8
Total liabilities		1,758.6	1,673.8
Net assets		331.9	224.5
Equity			
Share capital	28	19.9	19.9
Share premium account	29	238.8	238.8
Hedging reserves	29	1.9	–
Other reserves	29	4.6	4.6
Own shares	29	(26.6)	(18.9)
Translation reserves	30	27.7	(14.2)
Retained earnings	29	52.9	(16.3)
Equity attributable to equity holders of the parent		319.2	213.9
Minority interests		12.7	10.6
Total equity		331.9	224.5

Consolidated cash flow statement

Year ended 31 March 2006

	Note	2006 £m	2005 £m
Net cash from operating activities	32	235.0	193.7
Investing activities			
Interest received		5.9	6.8
Proceeds of disposal of property, plant and equipment		27.3	27.1
Purchases of property, plant and equipment		(196.2)	(124.3)
Acquisition of businesses		(12.4)	(14.9)
Acquisition of subsidiaries		–	(22.3)
Net cash used in investing activities		(175.4)	(127.6)
Financing activities			
Repurchase of ordinary share capital		(23.0)	(29.7)
Shares purchased by Employee Benefit Trust		(1.4)	(0.3)
Monies received on exercise of options		8.4	–
Dividends paid		(52.0)	(48.0)
Dividends paid to minority shareholders		(7.2)	(3.1)
Repayment of obligations under finance leases		(11.8)	(20.2)
Repayment of loan notes		(0.5)	(0.3)
Payment of new bank facility issue costs		(1.0)	–
New bank loans raised		55.7	90.4
Net cash from financing activities		(32.8)	(11.2)
Net increase in cash and cash equivalents		26.8	54.9
Cash and cash equivalents at beginning of year		145.9	92.2
Effect of foreign exchange rate changes		(2.8)	(1.2)
Cash and cash equivalents at end of year		169.9	145.9
		2006 £m	2005 £m
Cash and cash equivalents for cash flow statement purposes comprise:			
Cash and cash equivalents per balance sheet		174.4	154.1
Overdrafts		(4.5)	(8.2)
		169.9	145.9

Note to the consolidated cash flow statement – reconciliation of net cash flows to movement in net debt

Year ended 31 March 2006

	2006 £m	2005 £m
Increase in cash and cash equivalents in year	26.8	54.9
Increase in debt and finance lease financing	(43.4)	(70.0)
Debt acquired on acquisition of businesses	–	(20.6)
Lease and hire purchase contracts acquired with business/franchise	(0.7)	(2.2)
Fees on issue of new loan facility	1.0	–
Other non-cash movements in relation to financial instruments	(1.9)	(1.5)
Foreign exchange differences	(23.1)	7.0
Movement in net debt in year	(41.3)	(32.4)
Net debt at beginning of year	(663.1)	(630.7)
Net debt at end of year	(704.4)	(663.1)

Notes to the consolidated financial statements

1 General information

FirstGroup plc is a Company incorporated in the United Kingdom under the Companies Act 1985. The address of the registered office is 395 King Street, Aberdeen AB24 5RP. The nature of the Group's operations and its principal activities are set out in the Chief Executive's review on pages 4 to 15.

These financial statements are presented in pounds sterling because that is the currency of the primary economic environment in which the Group operates. Foreign operations are included in accordance with the accounting policies set out in note 2.

The parent Company financial statements and notes thereto are shown separately under UK GAAP on pages 76 to 83.

2 Significant accounting policies

New IFRS Accounting Standards

In August 2005 the IASB issued IFRS 7, *Financial instruments: disclosures*, which the Group will adopt in the financial year commencing 1 April 2007. The Group will have to disclose additional information about its financial instruments, their significance and the nature and extent of risks that they give rise to. More specifically the Group will need to disclose the fair value of its financial instruments and its risk exposure in greater detail. There will be no effect on the Group's results of operations or financial position.

In August 2005 the IASB issued an amendment to IAS 1, *Presentation of financial statements* which the Group will adopt in the financial year commencing 1 April 2006. The Group will disclose additional information about its objectives, policies and procedures for managing capital.

Basis of accounting

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRSs) for the first time. The disclosures required by IFRS 1 concerning the transition from UK GAAP to IFRSs are given in note 38. The financial statements have also been prepared in accordance with IFRSs adopted for use in the European Union and therefore comply with Article 4 of the EU IAS Regulation.

The financial statements have been prepared on the historical cost basis, except for the revaluation of certain financial instruments. The principal accounting policies adopted are set out below.

Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Company and entities controlled by the Company (its subsidiaries) made up to 31 March each year. Control is achieved where the Company has the power to govern the financial and operating policies of an investee entity so as to obtain benefits from its activities.

Minority interests in the net assets of the consolidated subsidiaries are identified separately from the Group's equity therein. Minority interests consist of those interests at the date of the original business combination and the minority's share of the changes in equity since the date of the combination. Losses applicable to the minority in excess of the minority's interest in the subsidiary's equity are allocated against the interests of the Group except to the extent that the minority has a binding obligation and is able to make an additional investment to cover the losses.

The results of subsidiaries acquired or disposed of during the year are included in the consolidated income statement from the effective date of acquisition or up to the effective date of disposal, as appropriate.

Where necessary, adjustments are made to the financial statements of subsidiaries to bring the accounting policies used into line with those used by the Group.

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

Business combinations

The acquisition of subsidiaries is accounted for using the purchase method. The cost of the acquisition is measured at the aggregate of the fair values, at the date of exchange, of assets given, liabilities incurred or assumed, and equity instruments issued by the Group in exchange for control of the acquiree, plus any costs directly attributable to the business combination. The acquiree's identifiable assets, liabilities and contingent liabilities that meet the conditions for recognition under IFRS 3 are recognised at their fair value at the acquisition date, except for non-current assets (or disposal groups) that are classified as held for sale in accordance with IFRS 5 *Non-Current Assets Held for Sale and Discontinued Operations*, which are recognised and measured at fair value less costs to sell.

Goodwill arising on acquisitions is recognised as an asset and initially measured at cost, being the excess of the cost of the business combination over the Group's interest in the fair value of the identifiable assets, liabilities and contingent liabilities recognised. If, after reassessment, the Group's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities exceeds the cost of the business combination, the excess is recognised immediately in the income statement.

The interest of minority shareholders in the acquiree is initially measured at the minority's proportion of the net fair value of the assets, liabilities and contingent liabilities recognised.

2 Significant accounting policies continued

Non-current assets held for sale

Non-current assets classified as held for sale are measured at the lower of carrying amount and fair value less costs to sell.

Non-current assets are classified as held for sale if their carrying amount will be recovered through a sale transaction rather than through continuing use. This condition is regarded as met only when the sale is highly probable and the asset is available for immediate sale in its present condition. Management must be committed to the sale which should be expected to qualify for recognition as a completed sale within one year from the date of classification.

Goodwill

Goodwill arising on consolidation represents the excess of the cost of acquisition over the Group's interest in the fair value of the identifiable assets and liabilities of a subsidiary, associate or jointly controlled entity at the date of acquisition.

Goodwill is initially recognised as an asset at cost and is subsequently measured at cost less any accumulated impairment losses. Goodwill which is recognised as an asset is reviewed for impairment at least annually. Any impairment is recognised immediately in profit or loss and is not subsequently reversed.

For the purpose of impairment testing, goodwill is allocated to each of the Group's cash-generating units. Cash-generating units to which goodwill has been allocated are tested for impairment annually, or more frequently where there is an indication that the unit may be impaired. If the recoverable amount of the cash-generating unit is less than the carrying amount of the unit, the impairment loss is allocated to the unit and then to the other assets of the unit pro-rata on the basis of the carrying amount of each asset in the unit. An impairment loss recognised for goodwill is not reversed in a subsequent period.

On disposal of a subsidiary, associate or jointly controlled entity, the attributable amount of goodwill is included in the determination of the profit or loss on disposal.

Goodwill arising on acquisitions before the date of transition to IFRSs has been retained at the previous UK GAAP amounts subject to being tested for impairment at that date. Goodwill written off to reserves under UK GAAP prior to 1998 has not been reinstated and is not included in determining any subsequent profit or loss on disposal.

Revenue recognition

Revenue principally comprises revenue from train passenger and freight services, road passenger transport, and certain management and maintenance services in the UK and North America. Where appropriate, amounts are shown net of rebates and sales taxes.

Revenue in UK Rail includes franchise agreement receipts from the Department for Transport (DfT) and Transport Scotland. Payments to the DfT for amounts due under the terms of a franchise are included in operating costs. Revenue also includes amounts attributable to the train operating companies ('TOCs'), predominantly based on models of route usage, by the Railway Settlement Plan in respect of passenger receipts. Where season tickets are issued in excess of one week's duration, the attributable share of income is deferred within creditors and is recognised in the Income Statement over the period covered by the season ticket.

UK Bus revenue principally comprises amounts receivable from ticket sales and concessionary fare schemes. Concessionary amounts are recognised in the period in which the service is provided based on a predetermined formula as agreed with the relevant local authority. Other Bus and services revenue from contracts with government bodies and similar organisations are recognised as the services are provided.

Interest income is recognised on an accruals basis.

Leasing

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases and the rental charges are charged against income on a straight-line basis over the life of the lease.

Assets held under hire purchase contracts and finance leases are recognised as assets of the Group at their fair value or, if lower, at the present value of the minimum lease payments, each determined at the inception of the lease. The corresponding liability is included in the balance sheet as a finance lease obligation. Lease payments are apportioned between finance charges and reduction of the lease obligation so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are charged directly against income, unless they are directly attributable to qualifying assets, in which case they are capitalised in accordance with the Group's general policy on borrowing costs (see below).

Benefits received and receivable as an incentive to enter into an operating lease are also spread on a straight-line basis over the lease term.

Notes to the consolidated financial statements

continued

2 Significant accounting policies continued

Foreign currencies

The individual financial statements of each Group company are presented in the currency of the primary economic environment in which it operates (its functional currency). For the purpose of the consolidated financial statements, the results and financial position of each Group company are expressed in pounds sterling, which is the functional currency of the Company, and the presentation currency for the consolidated financial statements.

In preparing the financial statements of the individual companies, transactions in currencies other than pounds sterling are recorded at the rates of exchange prevailing on the dates of the transactions. At each balance sheet date, monetary assets and liabilities that are denominated in foreign currencies are retranslated at the rates prevailing on the balance sheet date. Non-monetary assets and liabilities carried at fair value that are denominated in foreign currencies are translated at the rates prevailing at the date when the fair value was determined. Non-monetary items that are measured in terms of historical cost in a foreign currency are not retranslated.

Exchange differences arising on the settlement of monetary items, and on the retranslation of monetary items, are included in profit or loss for the period. Exchange differences arising on the retranslation of non-monetary items carried at fair value are included in profit or loss for the period except for differences arising on the retranslation of non-monetary items in respect of which gains and losses are recognised directly in equity. For such non-monetary items, any exchange component of that gain or loss is also recognised directly in equity.

In order to hedge its exposure to certain foreign exchange risks, the Group holds currency swaps and net foreign borrowings in foreign currencies (see below for details of the Group's policies in respect of derivative financial instruments and foreign exchange risks).

On consolidation, the assets and liabilities of the Group's overseas operations are translated at exchange rates prevailing on the balance sheet date. Income and expense items are translated at the average exchange rates for the period unless exchange rates fluctuate significantly during that period, in which case the exchange rates at the date of transactions are used. Exchange differences arising from the average or spot exchange rates used and the period end rate, if any, are classified as equity and transferred to the Group's translation reserve. Such translation differences are recognised as income or as expenses in the period in which the operation is disposed of.

Goodwill and fair value adjustments arising on the acquisition of a foreign entity are treated as assets and liabilities of the foreign entity and translated at the closing rate.

Borrowing costs

Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, which are assets that necessarily take a substantial period of time to get ready for their intended use or sale, are added to the cost of those assets, until such time as the assets are substantially ready for their intended use or sale.

All other borrowing costs are recognised in profit or loss in the period in which they are incurred.

Operating profit

Operating profit is stated after charging intangible asset amortisation and bid costs but before investment income and borrowing costs.

Retirement benefit costs

The Group operates or participates in a number of pension schemes, which include both defined benefit schemes and defined contribution schemes.

Payments to defined contribution retirement benefit schemes are charged as an expense as they fall due. There is no legal or constructive obligation to pay contributions into a defined contribution scheme if the fund has insufficient assets to pay all employees benefits relating to employee service in the current and prior periods.

For defined benefit schemes, the cost of providing benefits is determined using the Projected Unit Credit Method, with actuarial valuations being carried out at each balance sheet date. Actuarial gains and losses are recognised in full in the period in which they occur. They are recognised outside profit or loss and presented in the statement of recognised income and expense.

Past service cost is recognised immediately to the extent that the benefits are already vested, and otherwise is amortised on a straight-line basis over the average period until the benefits become vested.

The retirement benefit obligation recognised in the balance sheet represents the present value of the defined benefit obligation as adjusted for unrecognised past service cost, and as reduced by the fair value of scheme assets. Any asset resulting from this calculation is limited to past service cost, plus the present value of available refunds and reductions in future contributions to the scheme.

Various train operating companies in the UK Rail business participate in the Railways Pension Scheme, which is an industry-wide defined benefit scheme. The Group is obligated to fund the relevant section of the scheme over the period for which the franchise is held. The full liability is recognised on the balance sheet, which is then reduced by a franchise adjustment so that the net liability reflects the Group's obligations to fund the scheme over the franchise term.

2 Significant accounting policies continued

Taxation

The tax expense represents the sum of the tax currently payable and deferred tax.

The tax currently payable is based on taxable profit for the year. Taxable profit differs from net profit as reported in the income statement because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The Group's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the balance sheet date.

Deferred tax is the tax expected to be payable or recoverable on differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised. Such assets and liabilities are not recognised if the temporary difference arises from the initial recognition of goodwill, or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the tax profit nor the accounting profit.

Deferred tax liabilities are recognised for taxable temporary differences arising on investments in subsidiaries and associates, and interests in joint ventures, except where the Group is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realised. Deferred tax is charged or credited in the income statement, except when it relates to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities and when they relate to income taxes levied by the same taxation authority and the Group intends to settle its current tax assets and liabilities on a net basis.

Property, plant and equipment

Properties for provision of services or administrative purposes are carried at cost, less any recognised impairment loss. Cost includes professional fees and, for qualifying assets, borrowing costs capitalised in accordance with the Group's accounting policy. Depreciation of these assets, on the same basis as other property assets, commences when the assets are ready for their intended use.

Fixtures and equipment are stated at cost less accumulated depreciation and any recognised impairment loss.

Depreciation is charged so as to write off the cost of assets, other than freehold land, the land element of long leasehold properties or on assets in the course of construction, over their estimated useful lives, using the straight-line method, on the following bases:

Freehold buildings	50 years straight line
Long leasehold buildings	50 years straight line
Short leasehold properties	period of lease
Passenger carrying vehicles	7 to 15 years straight line
Other plant and equipment	3 to 25 years straight line

Assets held under finance leases are depreciated over their expected useful lives on the same basis as owned assets or, where shorter, over the term of the relevant lease.

The gain or loss arising on the disposal or retirement of an asset is determined as the difference between the sales proceeds and the carrying amount of the asset and is recognised in income.

Impairment of tangible and intangible assets excluding goodwill

At each balance sheet date, the Group reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Where the asset does not generate cash flows that are independent from other assets, the Group estimates the recoverable amount of the cash-generating unit to which the asset belongs. An intangible asset with an indefinite useful life is tested for impairment annually and whenever there is an indication that the asset may be impaired.

Recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have not been adjusted.

Notes to the consolidated financial statements

continued

2 Significant accounting policies continued

If the recoverable amount of an asset or cash-generating unit is estimated to be less than its carrying amount, the carrying amount of the asset (cash-generating unit) is reduced to its recoverable amount. An impairment loss is recognised as an expense immediately, unless the relevant asset is carried at a revalued amount, in which case the impairment loss is treated as a revaluation decrease.

Where an impairment loss subsequently reverses, the carrying amount of the asset (cash-generating unit) is increased to the revised estimate of its recoverable amount, but so that, the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset (cash-generating unit) in prior years. A reversal of an impairment loss is recognised as income immediately, unless the relevant asset is carried at a revalued amount, in which case the reversal of the impairment loss is treated as a revaluation increase.

Inventories

Inventories are stated at the lower of cost and net realisable value. Net realisable value represents the estimated selling price less all estimated costs of completion and costs to be incurred in marketing, selling and distribution.

Financial instruments

As permitted under IFRS 1, *First time adoption of International Financial Reporting Standards*, the Group has elected not to restate comparative financial information for the financial instruments standards IAS 32 and IAS 39. The effect of adoption of IAS 32 and IAS 39 on 1 April 2005 opening balance sheet is disclosed in note 29.

Financial assets and financial liabilities are recognised on the Group's balance sheet when the Group becomes a party to the contractual provisions of the instrument.

Basis of preparation of 2004/05 information

For the year ended 31 March 2005 financial information was prepared in accordance with UK GAAP. An extract from the UK GAAP accounting policy from the 2005 financial statements is set out below:

"Various derivative instruments are utilised by the Group principally to manage interest rate, fuel and foreign exchange risks. The Group does not enter into speculative derivative contracts. All such instruments are used for hedging purposes to alter the risk profile of an existing underlying exposure of the Group, in line with the Group's risk management policies. Amounts payable or receivable in respect of interest rate swaps and fuel derivatives are recognised as adjustments to interest expense and fuel costs respectively over the period of the contracts."

Financial Assets

The Group measures financial assets on initial recognition at fair value, and determines the classification of such assets at initial recognition and on any subsequent reclassification event.

Where there is no active market for a financial asset, fair value is determined using valuation techniques including recent commercial transactions and discounted cash flows. Otherwise financial assets are carried at amortised cost.

Financial assets are classified into one of four primary categories:

Fair value through profit and loss

This covers any financial asset designated on initial recognition to be measured at fair value with fair value changes to go through the profit and loss, and financial assets acquired principally for the purpose of trading in the short term.

Held to maturity investments

Non-derivative financial assets with fixed or determinable payments and fixed maturity are classified here when the Group has the intention and ability to hold to maturity. These financial assets are held at amortised cost using the effective interest method. Gains and losses are recognised in the income statement when the investments are derecognised or impaired as well as through amortisation.

Loans and receivables

Non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, do not qualify as trading assets and have not been designated as either fair value through profit or loss or Available For Sale. Such assets are carried at amortised cost. Gains and losses are recognised in the income statement when the loans and receivables are derecognised or impaired as well as through amortisation.

The most significant financial assets under this category are trade receivables and bank deposits.

Trade receivables are measured at fair value, i.e. original invoice amount, less an allowance for uncollectable amounts. Appropriate allowances for estimated irrecoverable amounts are recognised in profit or loss when there is objective evidence that the asset is impaired.

2 Significant accounting policies continued

Bank deposits are included within cash and cash equivalents. Cash and cash equivalents as defined for the cash flow statement comprise cash in hand, cash held at bank with immediate access, other short-term investments and bank deposits with maturities of three months or less from the date of inception and bank overdrafts. In the consolidated balance sheet cash includes cash and cash equivalents excluding bank overdrafts. Bank overdrafts that have no legal right of set-off against cash and cash equivalents are included within borrowings in current liabilities. All are carried on the balance sheet at cost. Cash and cash equivalents includes ring-fenced cash. Under the terms of the Rail franchise agreements, cash can only be distributed by the train operating companies either up to the amount of retained profits or the amount determined by prescribed liquidity ratios. The ring-fenced cash represents that which is not available for distribution or the amount required to satisfy the contractual liquidity ratio at the balance sheet date.

Available For Sale financial assets

Available For Sale financial assets are non-derivative financial assets that are designated as such, or that are not classified in any of the other categories. After initial recognition these assets are measured at fair value with gains or losses being recognised as a separate component of equity until the investment is derecognised or the investment is determined to be impaired, at which time the previously reported cumulative gain or loss is included in the income statement.

Financial liabilities and equity

Financial liabilities and equity instruments are classified according to the substance of the contractual arrangements entered into. An equity instrument is any contract that evidences a residual interest in the assets of the Group after deducting all of its liabilities. Equity instruments issued by the Company are recorded at the proceeds received net of direct issue costs.

Financial liabilities

Bank borrowings

Interest-bearing bank loans and overdrafts are recorded at the proceeds received, net of direct issue costs.

Sterling bonds and loan notes

These are measured either on an amortised cost basis or at fair value, if adopted.

Trade payables

Trade payables are initially measured at fair value, and are subsequently measured at amortised cost, using the effective interest rate method.

Derivative financial instruments and hedge accounting

The Group uses derivative financial instruments to hedge interest rate risks, foreign currency risks and fuel price risks. Use of such financial instruments is governed by policies and delegated authorities approved by the Board. The Group does not use derivative financial instruments for speculative purposes.

The main derivative financial instruments used by the Group are interest rate swaps and collars, fuel swaps and collars, and cross currency interest rate swaps. Such instruments are initially recognised at fair value and subsequently re-measured to fair value at the reported balance sheet date. The fair values are calculated by reference to market exchange rates, interest rates and fuel prices at the period end, and supported by counter-party confirmations.

Changes in the fair value of derivative financial instruments that do not qualify for hedge accounting as cash flow hedges or foreign currency hedges of a foreign net investment are recognised in the income statement as they arise.

Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated, or exercised, or no longer qualifies for hedge accounting. At that time, any cumulative gain or loss on the hedging instrument recognised in equity is retained in equity until the forecasted transaction occurs. If a hedged transaction is no longer expected to occur, the net cumulative gain or loss recognised in equity is transferred to the income statement for the period.

Derivatives embedded in other financial instruments or other host contracts are treated as separate derivatives when their risks and characteristics are not closely related to those of host contracts and the host contracts are not carried at fair value with unrealised gains or losses reported in the income statement.

Provisions

Provisions are recognised when the Group has a present obligation as a result of a past event and it is probable that the Group will be required to settle that obligation. Provisions are measured at the Directors' best estimate of the expenditure required to settle the obligation at the balance sheet date and are discounted to present value where the effect is material.

Notes to the consolidated financial statements

continued

2 Significant accounting policies continued

Insurance

The Group's policy is to self-insure high frequency, low value claims within the businesses. To provide protection above these types of losses, cover is obtained through third-party insurance policies. Provision is made under IAS 37 for the estimated cost of settling uninsured claims for incidents occurring prior to balance sheet date.

Share-based payments

The Group has applied the requirements of IFRS 2 *Share-based Payments*. In accordance with the transitional provisions, IFRS 2 has been applied to all grants of equity instruments after 7 November 2002 that were unvested as of 1 April 2005.

The Group issues equity-settled share-based payments to certain employees. Equity-settled share-based payments are measured at fair value at the date of grant. The fair value determined at the grant date of the equity-settled share-based payments is expensed on a straight-line basis over the vesting period, based on the Group's estimate of shares that will eventually vest and is adjusted for the effects of non-market-based vesting conditions.

Fair value is measured by use of a Black-Scholes model. The expected life used in the model has been adjusted, based on management's best estimate, for the effects of non-transferability, exercise restrictions, and behavioural considerations.

Dividend distribution

Dividend distribution to the Company's shareholders is recognised as a liability in the Group's financial statements in the period in which the dividends are approved by the Company's shareholders.

Critical accounting judgements and key sources of estimation uncertainty

In the process of applying the Group's accounting policies which are described above, management has made the following judgements that have the most significant effect on the amounts recognised in the financial statements.

Impairment of intangible assets (including goodwill)

Determining whether goodwill is impaired requires an estimation of the value in use of the cash-generating units to which the goodwill has been allocated. The value in use requires the entity to estimate the future cash flows expected to arise from the cash-generating unit and a suitable discount rate in order to calculate present value. The carrying amount of goodwill at the balance sheet date was £503.1m (2005: £465.8m) as set out in note 13 and the carrying amount of other intangible assets at balance sheet date was £30.0m (2005: £29.4m) as set out in note 14.

Defined benefit pension arrangements

Measurement of defined benefit pension obligations requires estimation of a suitable discount rate, the expected return on scheme assets, expected rate of future salary and pension increases along with assumptions about mortality rates. The most significant of these assumptions is the discount rate. A 0.1% movement in the discount rate applied would impact operating profit and the balance sheet deficit by approximately £1.0m and £30.0m respectively. The pension liability as at the balance sheet date was £132.0m (2005: £221.1m) as set out in note 36.

Self-insurance

Provision is made for all known incidents for which there is self-insurance using management's best estimate of the likely settlement of these incidents. The estimated settlement is reviewed on a regular basis with independent actuarial advice and the amount provided is adjusted as required. The Group's total insurance reserves as at the balance sheet date was £80.7m (2005: £74.3m) as set out in note 27.

3 Revenue

	2006 £m	2005 £m
Services rendered	3,030.9	2,693.4
Investment income (note 8)	8.5	4.3
Total revenue (as defined in IAS 18)	3,039.4	2,697.7

Revenue by business segment is set out in note 4 below.

4 Business and geographical segments

Business segments

For management purposes, the Group is currently organised into three operating divisions – UK Bus, UK Rail and North America. These divisions are the basis on which the Group reports its primary segment information. The principal activities of these divisions are set out in the Chief Executive's review.

Segment information about these businesses is set out below.

The segment results for the year to 31 March 2006 are as follows:

	UK Bus 2006 £m	UK Rail 2006 £m	North America 2006 £m	Group items 2006 £m	Total 2006 £m
Revenue	1,031.2	1,164.9	826.3	8.5	3,030.9
Segment results¹	108.6	79.6	67.1	(15.4)	239.9
Amortisation of intangible assets	–	(2.9)	(1.6)	–	(4.5)
Financing element of operating leases	(10.2)	–	–	–	(10.2)
Bid costs	–	(26.1)	–	(2.4)	(28.5)
Profit on disposal of fixed assets	14.0	–	–	–	14.0
Operating profit	112.4	50.6	65.5	(17.8)	210.7
Investment income					8.5
Finance costs					(61.8)
Profit before tax					157.4
Tax					(40.0)
Profit for the year					117.4

Other information	UK Bus 2006 £m	UK Rail 2006 £m	North America 2006 £m	Group items 2006 £m	Total 2006 £m
Capital additions	118.7	16.9	82.2	9.9	227.7
Depreciation and amortisation	58.9	8.2	56.5	2.9	126.5

Balance sheet	UK Bus 2006 £m	UK Rail 2006 £m	North America 2006 £m	Group items 2006 £m	Total 2006 £m
Total assets	740.1	332.8	946.6	71.0	2,090.5
Total liabilities	567.4	277.0	423.2	491.0	1,758.6

The segment results for the year to 31 March 2005 are as follows:

	UK Bus 2005 £m	UK Rail 2005 £m	North America 2005 £m	Group items 2005 £m	Total 2005 £m
Revenue	960.7	1,059.7	665.8	7.2	2,693.4
Segment results¹	115.2	64.5	62.4	(18.3)	223.8
Amortisation of intangible assets	–	(1.6)	(0.6)	–	(2.2)
Financing element of operating leases	(9.0)	–	–	–	(9.0)
Bid costs	–	(10.9)	–	(1.0)	(11.9)
Profit on disposal of fixed assets	3.3	–	–	–	3.3
Operating profit	109.5	52.0	61.8	(19.3)	204.0
Investment income					4.3
Finance costs					(52.6)
Profit before tax					155.7
Tax					(41.1)
Profit for the year					114.6

¹Before amortisation of intangible assets, financing element of UK Bus PCV operating leases, bid costs and profit on disposal of fixed assets.

Notes to the consolidated financial statements continued

4 Business and geographical segments continued

Other information	UK Bus 2005 £m	UK Rail 2005 £m	North America 2005 £m	Group items 2005 £m	Total 2005 £m
Capital additions	78.0	31.0	97.2	6.6	212.8
Depreciation and amortisation	53.4	6.5	47.4	2.5	109.8

Balance sheet	UK Bus 2005 £m	UK Rail 2005 £m	North America 2005 £m	Group items 2005 £m	Consolidated 2005 £m
Total assets	679.5	301.5	849.2	68.1	1,898.3
Total liabilities	642.6	288.3	390.1	352.8	1,673.8

Geographical segments

The Group's operations are located in the United Kingdom and North America. The following table provides an analysis of the Group's revenue by geographical market:

	2006 £m	2005 £m
United Kingdom	2,204.6	2,027.6
North America	826.3	665.8
	3,030.9	2,693.4

The following is an analysis of the carrying amount of segment assets, and additions to property, plant and equipment and intangible assets, analysed by the geographical area in which the assets are located:

	Carrying amount of segment assets		Additions to property, plant and equipment and intangible assets	
	2006 £m	2005 £m	2006 £m	2005 £m
United Kingdom	1,143.9	1,049.1	145.5	115.6
North America	946.6	849.2	82.2	97.2
	2,090.5	1,898.3	227.7	212.8

Other non-cash items, included within Group items, include the following charges:

	2006 £m	2005 £m
Share-based payments	3.2	2.9
Loss on disposal of plant and equipment	1.4	1.9
	4.6	4.8

5 Bid costs

Bid costs of £28.5m (2005: £11.9m) were incurred during the year and comprised principally rail refranchising costs for Greater Western, Capital Connect, Dockland Light Railway and Integrated Kent franchises. Costs of £2.4m (2005: £1.0m) were incurred on non-rail bids.

The tax benefit as a result of this expenditure was a credit of £8.6m (2005: credit of £3.6m).

6 Operating profit

Operating profit has been arrived at after charging:

	2006 £m	2005 £m
Depreciation of property, plant and equipment (note 15)	122.0	107.6
Amortisation of intangible assets (note 14)	4.5	2.2
Cost of inventories recognised as an expense	358.2	278.5
Staff costs (note 7)	1,376.1	1,225.3
Auditors' remuneration for audit services (see below)	0.7	0.7

Amounts payable to Deloitte & Touche LLP and their associates by the Company and its UK subsidiary undertakings in respect of non-audit services were £0.2m (2005: £0.2m).

A more detailed analysis of auditors' remuneration is provided below:

	2006 £m	2005 £m
Audit services:		
Statutory audit	0.6	0.6
Audit-related regulatory reporting	0.1	0.1
	0.7	0.7
Other services:		
Due diligence	0.1	0.1
International Financial Reporting convergence assistance	0.1	0.1
	0.2	0.2
	0.9	0.9

A description of the work of the Audit Committee is set out in the corporate governance statement on page 22 and includes an explanation of how auditor objectivity and independence is safeguarded when non-audit services are provided by the auditors.

7 Staff costs

The average monthly number of employees (including Executive Directors) was:

	2006 No.	2005 No.
Operational	66,535	63,541
Administration	4,212	3,826
	70,747	67,367

Their aggregate remuneration (including Executive Directors) comprised:

	2006 £m	2005 £m
Wages and salaries	1,264.6	1,101.5
Social security costs	92.8	82.9
Other pension costs (note 36)	18.7	40.9
	1,376.1	1,225.3

Disclosures on Directors' remuneration, share options, long-term incentive schemes and pension entitlements required by the Companies Act 1985 and those specified for audit by the Financial Services Authority are contained in the tables/notes within the Directors' remuneration report on pages 26 to 32 and form part of these audited financial statements.

8 Investment income

	2006 £m	2005 £m
Interest income	8.5	4.3

Notes to the consolidated financial statements

continued

9 Finance costs

	2006 £m	2005 £m
Bond and bank borrowings	53.1	43.3
Loan notes	1.8	1.6
Finance charges payable in respect of hire purchase contracts and finance leases	0.8	2.2
Total borrowing costs	55.7	47.1
Notional interest on long-term provisions	6.1	5.5
	61.8	52.6

There was no interest capitalised into qualifying assets in either the year ended 31 March 2005 or 31 March 2006.

10 Tax on profit on ordinary activities

	2006 £m	2005 £m
Current tax	(3.3)	19.0
Deferred tax (note 26)	43.3	22.1
	40.0	41.1

Corporation tax is calculated at 30% (2005: 30%) of the estimated assessable profit for the year.

Taxation for other jurisdictions is calculated at the rates prevailing in the respective jurisdictions.

The charge for the year can be reconciled to the profit per the income statement as follows:

	2006 £m	2006 %	2005 £m	2005 %
Profit before tax	157.4	100.0	155.7	100.0
Tax at the UK corporation tax rate of 30%	47.2	30.0	46.7	30.0
Tax effect of expenses that are not deductible in determining taxable profit	0.9	0.6	–	–
Income not subject to tax	(0.5)	(0.3)	(1.6)	(1.0)
Effect of tax rates of subsidiaries operating in other jurisdictions	4.6	2.9	3.3	2.1
Adjustments to tax in respect of prior years	(12.2)	(7.8)	(7.3)	(4.7)
Tax expense and effective tax rate for the year	40.0	25.4	41.1	26.4

In addition to the amount charged to the income statement, tax relating to share-based payments, actuarial gains and cash flow and net investment hedges, amounting to £0.8m (2005: £5.4m) has been charged directly to equity.

11 Earnings per share (EPS)

Basic EPS is calculated by dividing the profit attributable to equity shareholders of £107.5m (2005: £108.1m) by the weighted average number of ordinary shares of 392.6m (2005: 399.2m).

Diluted EPS is calculated by dividing the profit attributable to equity shareholders of £107.5m (2005: £108.1m) by the weighted average number of ordinary shares of 396.5m (2005: 402.0m). The difference in the number of shares between the basic calculation and the diluted calculation represents the weighted average number of potentially dilutive ordinary shares. A reconciliation of the number of shares used in the basic and diluted measures is set out below:

	2006 No. m	2005 No. m
Weighted average number of shares used in basic calculation	392.6	399.2
SAYE share options	3.0	2.6
Executive share options	0.9	0.2
	396.5	402.0

11 Earnings per share (EPS) continued

The adjusted basic EPS and adjusted cash EPS are intended to demonstrate recurring elements of the results of the Group before amortisation of intangible assets, bid costs and profit on disposal of fixed assets. A reconciliation of the earnings used in the bases is set out below:

	2006		2005	
	£m	Earnings per share (p)	£m	Earnings per share (p)
Profit for basic EPS calculation	107.5	27.4	108.1	27.1
Amortisation of intangible assets ¹	4.3	1.1	2.2	0.5
Bid costs	28.5	7.2	11.9	3.0
Profit on disposal of fixed assets ²	(13.5)	(3.4)	(3.3)	(0.8)
Taxation effect of adjustments	(5.3)	(1.4)	(3.5)	(0.9)
Profit for adjusted basic EPS calculation	121.5	30.9	115.4	28.9
Depreciation ³	121.6	31.0	107.4	26.9
Profit for adjusted cash EPS calculation	243.1	61.9	222.8	55.8

¹Amortisation charge of £4.5m less £0.2m (2005: £2.2m less nil) attributable to equity minority interests.

²Profit on disposal of fixed assets of £14.0m less £0.5m (2005: £3.3m less nil) attributable to equity minority interests.

³Depreciation charge of £122.0m (2005: £107.6m) per note 15 less £0.4m (2005: £0.2m) of depreciation attributable to equity minority interests.

12 Dividends

	2006 £m	2005 £m
Amounts recognised as distributions to equity holders in the period:		
Final dividend for the year ended 31 March 2005 of 8.69p (2004: 7.9p) per share	34.1	31.8
Interim dividend for the year ended 31 March 2006 of 4.55p (2005: 4.125p) per share	17.9	16.4
	52.0	48.2
Proposed final dividend for the year ended 31 March 2006 of 9.55p (2005: 8.69p) per share	37.4	34.1

The proposed final dividend is subject to approval by shareholders at the Annual General Meeting and has not been included as a liability in these financial statements.

13 Goodwill

	2006 £m	2005 £m
Cost		
At 1 April	465.8	461.2
Additions	10.3	15.2
Exchange rate differences	27.0	(10.6)
At 31 March	503.1	465.8

Accumulated impairment losses

At 31 March	-	-
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Carrying amount

At 31 March	503.1	465.8
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Details of acquisitions in the year are shown in note 31. During the year, goodwill was reviewed for impairment in accordance with IAS 36. For the purposes of this impairment review goodwill has been valued on the basis of discounted future cash flows arising in each relevant cash-generating unit. The Group prepares cash flow forecasts derived from the most recent five year plan for the next four years and extrapolates cash flows for the following six years based on estimated growth rates of 2.5% for the United Kingdom and 3.0% for North America. A discount rate of 10.0% was used in arriving at the value in use for each of the cash-generating units. The calculation of value in use for each cash-generating unit is most sensitive to the principal assumptions of discount rate, growth rates and margins achievable. The Directors consider the assumptions to be reasonable based on historic performance of each cash-generating unit and are realistic in light of economic and industry forecasts.

Notes to the consolidated financial statements continued

13 Goodwill continued

The goodwill is split as follows:

	2006 £m	2005 £m
Carrying amount		
UK Bus	87.4	86.6
UK Rail	19.8	19.8
First Student	281.0	252.5
First Transit	57.3	53.3
First Services	57.6	53.6
	503.1	465.8

14 Other intangible assets

	Contracts acquired £m	Franchise agreements £m	Total £m
Cost			
At 1 April 2005	10.6	21.0	31.6
Additions	4.3	–	4.3
Exchange rate differences	0.8	–	0.8
At 31 March 2006	15.7	21.0	36.7
Amortisation			
At 1 April 2005	0.6	1.6	2.2
Charge for year	1.6	2.9	4.5
Exchange rate differences	–	–	–
At 31 March 2006	2.2	4.5	6.7
Carrying amount			
At 31 March 2006	13.5	16.5	30.0

	Contracts acquired £m	Franchise agreements £m	Total £m
Cost			
At 1 April 2004	–	4.1	4.1
Additions	10.6	16.9	27.5
Exchange rate differences	–	–	–
At 31 March 2005	10.6	21.0	31.6
Amortisation			
At 1 April 2004	–	–	–
Charge for year	0.6	1.6	2.2
Exchange rate differences	–	–	–
At 31 March 2005	0.6	1.6	2.2
Carrying amount			
At 31 March 2005	10.0	19.4	29.4

Contracts acquired through the purchases of businesses and subsidiary undertakings are amortised on a straight-line basis over their useful lives which is, on average, nine years.

The rail franchise agreement intangible asset represents the part of the economic benefit derived from the rail franchise agreement that is realised as a result of recognising our share of the rail pension deficit and is amortised on a straight-line basis over the term of the franchise. The largest element of the franchise intangible relates to the ScotRail franchise (carrying amount £13.4m (2005: £15.8m)) which is being amortised on a straight-line basis over seven years.

15 Property, plant and equipment

	Land and buildings £m	Passenger carrying vehicle fleet £m	Other plant and equipment £m	Total £m
Cost				
At 1 April 2005	149.1	1,228.7	161.4	1,539.2
Subsidiary undertakings and businesses acquired	–	4.0	–	4.0
Additions	16.2	155.5	37.4	209.1
Disposals	(5.1)	(64.2)	(2.9)	(72.2)
Reclassifications	(5.1)	–	5.1	–
Reclassified as held for sale	–	(27.3)	–	(27.3)
Exchange rate differences	1.9	35.2	2.7	39.8
At 31 March 2006	157.0	1,331.9	203.7	1,692.6
Accumulated depreciation and impairment				
At 1 April 2005	23.7	581.2	99.3	704.2
Subsidiary undertakings and businesses acquired	–	–	–	–
Charge for year	3.6	99.0	19.4	122.0
Disposals	(0.6)	(52.1)	(2.3)	(55.0)
Reclassifications	(5.1)	–	5.1	–
Reclassified as held for sale	–	(21.5)	–	(21.5)
Exchange rate differences	0.5	14.5	1.4	16.4
At 31 March 2006	22.1	621.1	122.9	766.1
Carrying amount				
At 31 March 2006	134.9	710.8	80.8	926.5

	Land and buildings £m	Passenger carrying vehicle fleet £m	Other plant and equipment £m	Total £m
Cost				
At 1 April 2004	141.5	1,156.3	154.6	1,452.4
Subsidiary undertakings and businesses acquired	2.9	29.5	2.4	34.8
Additions	12.2	96.5	26.6	135.3
Disposals	(6.9)	(25.6)	(21.1)	(53.6)
Reclassified as held for sale	–	(15.5)	–	(15.5)
Exchange rate differences	(0.6)	(12.5)	(1.1)	(14.2)
At 31 March 2005	149.1	1,228.7	161.4	1,539.2
Accumulated depreciation and impairment				
At 1 April 2004	21.5	536.8	102.5	660.8
Subsidiary undertakings and businesses acquired	–	–	–	–
Charge for year	3.0	88.0	16.6	107.6
Disposals	(0.7)	(23.4)	(19.2)	(43.3)
Reclassified as held for sale	–	(14.8)	–	(14.8)
Exchange rate differences	(0.1)	(5.4)	(0.6)	(6.1)
At 31 March 2005	23.7	581.2	99.3	704.2
Carrying amount				
At 31 March 2005	125.4	647.5	62.1	835.0

The carrying amount of the Group's passenger carrying vehicle fleet includes an amount of £44.4m (2005: £67.2m) in respect of assets held under finance leases.

At 31 March 2006 the Group had entered into contractual commitments amounting to £65.3m (2005: £97.8m), principally representing buses ordered in both the United Kingdom and North America.

Notes to the consolidated financial statements continued

16 Subsidiaries

A list of the significant investments in subsidiaries, including the name, country of incorporation, proportion of ownership interest is given in note 4 to the Company's separate financial statements on page 79.

	2006 £m	2005 £m
Spare parts and consumables	41.7	30.7
Property development work in progress	12.5	9.4
	54.2	40.1

There is no material difference between the balance sheet value of inventories and their replacement cost. There was no material write down of inventories during the current or prior year.

18 Trade and other receivables

	2006 £m	2005 £m
Amounts due within one year		
Trade debtors	279.3	258.2
Other debtors	38.8	61.1
Other prepayments and accrued income	55.0	49.4
	373.1	368.7

The Directors consider that the carrying amount of trade and other receivables approximates to their fair value.

Credit risk

The Group's principal financial assets are short-term bank balances and cash, derivative financial instruments and short-term trade and other receivables, which represent the Group's maximum exposure to credit risk in relation to financial assets.

The Group's credit risk is primarily attributable to its short-term trade receivables. The amounts presented in the balance sheet are net of allowances for doubtful receivables, estimated by the Group's management based on prior experience and their assessment of the current economic environment. The provision for doubtful receivables at the balance sheet date was £2.1m (2005: £2.7m).

The credit risk on short-term cash assets and derivative financial instruments is limited because the counterparties are banks with strong credit ratings assigned by international credit rating agencies.

The Group has no significant concentration of credit risk, with exposure spread over a large number of counterparties and customers.

19 Non-current assets classified as held for sale

Non-current assets held for sale comprise of North American yellow school buses which are surplus to requirement and are being actively marketed on the Internet. Gains or losses arising on the disposal of such assets are included in arriving at operating profit in the income statement. The Group expects to sell such yellow school buses within 12 months of them going onto the 'for sale' list.

20 Trade and other payables

	2006 £m	2005 £m
Amounts falling due within one year		
Trade creditors	129.7	122.4
Other creditors	106.5	47.0
Accruals and deferred income	294.9	324.6
Season ticket deferred income	14.0	13.3
	545.1	507.3

The Directors consider that the carrying amount of trade payables approximates to their fair value.

21 Cash and cash equivalents

	2006 £m	2005 £m
Cash and cash equivalents	174.4	154.1

The fair value of cash and cash equivalents matches the carrying value.

Cash and cash equivalents includes ring-fenced cash of £119.5m (2005: £70.3m). Under the terms of the Rail franchise agreements, cash can only be distributed by the train operating companies either up to the amount of retained profits or the amount determined by prescribed liquidity ratios. The ring-fenced cash represents that which is not available for distribution or the amount required to satisfy the liquidity ratio at the balance sheet date.

22 Financial liabilities – borrowings

	2006 £m	1 April 2005 £m	31 March 2005 £m
Current financial liabilities			
Short-term bank loans	26.4	43.2	43.2
Bank overdrafts	4.5	8.2	8.2
	30.9	51.4	51.4
Finance leases (note 23)	2.3	9.0	9.0
Loan notes (note 24)	2.8	0.5	0.5
Bond 6.875% (repayable 2013) – accrued interest	20.1	19.5	–
Bond 6.125% (repayable 2019) – accrued interest	3.0	3.0	–
	23.1	22.5	–
Total current financial liabilities	59.1	83.4	60.9
Non-current financial liabilities			
Syndicated unsecured bank loans	264.9	180.0	180.0
Other loans	3.9	12.8	12.8
	268.8	192.8	192.8
Finance leases (note 23)	10.1	15.1	15.1
Loan notes (note 24)	17.7	20.5	20.5
Bond 6.875% (repayable 2013)	295.9	296.1	296.0
Bond 6.125% (repayable 2019)	257.3	247.1	231.9
	553.2	543.2	527.9
Total non-current financial liabilities	849.8	771.6	756.3
Total financial liabilities	908.9	855.0	817.2
Gross borrowings repayment profile			
Within one year or on demand	59.1	83.4	
Between one and two years	21.1	25.6	
Between two and five years	271.7	193.1	
Over five years	557.0	552.9	
	908.9	855.0	

The non-current bond repayable in 2013 is measured on an amortised cost basis and had a par value of £300.0m. The non-current bond repayable in 2019 is measured on an amortised cost basis, adjusted for certain fair value movements on the bond that are fully and effectively hedged by swaps. The 2019 bond had a par value of £250.0m.

Effective interest rates

The effective interest rates at the balance sheet dates were as follows:

	2006 %	2005 %
Bank overdraft	LIBOR + 1%	LIBOR + 1%
Bank borrowings	LIBOR + 0.225% to 0.35%	LIBOR + 0.225% to 0.55%
Bond 2013	7.10%	7.10%
Bond 2019	6.18%	6.18%
Finance leases	LIBOR + 0.50% up to average fixed of 7.00%	LIBOR + 0.50% up to average fixed of 7.00%
Loan notes	LIBOR – 0.50% up to total fixed of 11.00%	LIBOR – 0.50% up to total fixed of 11.00%

Notes to the consolidated financial statements continued

22 Financial liabilities – borrowings continued

	2006 £m	1 April 2005 £m
Carrying value of gross borrowings by currency		
Sterling	853.5	832.3
Euros	9.9	–
US Dollar	5.0	2.2
Canadian Dollar	40.5	20.5
	908.9	855.0

Maturity of non-current financial liabilities

	31 March 2006					1 April 2005				
	Debt £m	Finance leases £m	Loan notes £m	Other £m	Total £m	Debt £m	Finance leases £m	Loan notes £m	Other £m	Total £m
Due in more than one year										
but not more than two years	1.2	2.2	17.7	–	21.1	2.5	2.6	20.5	–	25.6
Due in more than two years										
but not more than five years	267.1	4.6	–	–	271.7	185.7	7.4	–	–	193.1
Due in more than five years	0.5	3.3	–	553.2	557.0	4.6	5.1	–	543.2	552.9
Total	268.8	10.1	17.7	553.2	849.8	192.8	15.1	20.5	543.2	771.6

Borrowing facilities

The Group had £211.0m (2005: £313.0m) undrawn committed borrowing facilities as at 31 March 2006. Total bank borrowing facilities at 31 March 2006 stood at £597.0m (2005: £595.9m) of which £527.4m (2005: £526.6m) was committed and £69.6m (2005: £69.3m) was uncommitted.

23 Finance leases

The Group had the following obligations under finance leases as at the balance sheet dates:

	2006 £m	2005 £m
Due in less than one year	2.3	9.0
Due in more than one year but not more than two years	2.2	2.6
Due in more than two years but not more than five years	4.6	7.4
Due in more than five years	3.3	5.1
Total	12.4	24.1

The lease obligations are denominated in Sterling and Canadian Dollars. The Sterling leases have an average remaining life of seven years. The Canadian Dollar leases have an average remaining life of three years. The Group considers there to be no material difference between the fair value of the finance leases and the carrying amount in the balance sheet.

24 Loan notes

The Group had the following loan notes issued as at the balance sheet dates:

	2006 £m	2005 £m
Due in less than one year	2.8	0.5
Due in more than one year but not more than two years	17.7	20.5
Total	20.5	21.0

The loan notes have been classified by reference to the earliest date on which the loan note holder can request redemption. Loan notes of £19.7m (2005: £20.0m) are supported by unsecured bank guarantees.

25 Derivative financial instruments

	2006 £m	1 April 2005 £m
Non-current assets		
Cross currency swaps (net investment hedge)	–	16.7
Coupon swaps (fair value hedge)	8.1	–
Interest rate collars (cash flow hedge)	0.4	–
Fuel derivatives (cash flow hedge)	–	3.6
	8.5	20.3
Current assets		
Cross currency swaps (net investment hedge)	–	3.5
Coupon swaps (fair value hedge)	3.3	–
Fuel derivatives (cash flow hedge)	10.8	27.8
	14.1	31.3
Total assets	22.6	51.6
Current liabilities		
Interest rate swaps (cash flow hedge)	0.9	0.7
Cross currency swaps (net investment hedge)	0.9	–
Coupon swaps (fair value hedge)	–	4.5
	1.8	5.2
Non-current liabilities		
Interest rate swaps (cash flow hedge)	0.4	0.9
Cross currency swaps (net investment hedge)	0.4	–
Coupon swaps (fair value hedge)	–	1.5
	0.8	2.4
Total liabilities	2.6	7.6

During the year £2.0m was credited to the hedging reserve in respect of cash flow hedges. In addition £27.1m was recycled from the hedging reserve and credited to the income statement in respect of cash flow hedges.

Financial risks and management

The most material financial risks faced by the Group are the effects of changes in foreign exchange rates, interest rates and fuel prices. The Group manages these risks within the context of a set of formal treasury policies established by the Board. Certain risk management responsibilities are formally delegated by the Board, principally to a sub-committee of the Board and to the Group Finance Director.

Foreign currency

The Group's principal operations outside the UK are in the US and Canada, with the US being the most significant. The Group is exposed to foreign exchange risk in retranslating net assets and earnings in US Dollars and Canadian Dollars to Sterling for reporting purposes. The Group's objective is to hedge at a minimum of 30% for US Dollar net assets and 75% for other currencies. As at 31 March 2006 there was a net investment hedge of 34% of US net assets which were hedged with currency swaps and US Dollar debt. Retranslation risk on US Dollar earnings are substantially hedged through natural offset by US Dollar denominated costs, principally UK fuel costs and Dollar interest costs. With the exception of UK fuel, transactional currency exposures are minimal.

Interest rate risk

The Group has interest bearing cash and debt and therefore is exposed to the effects of changes to interest rates. The Group's policy objective is to maintain fixed interest rates at a minimum average of 75% of on-balance sheet net debt over the medium term, so that volatility is substantially reduced year on year. The main floating rate benchmarks are UK LIBOR and US Dollar LIBOR. The Group achieves the policy objective through fixed rate debt and cash flow hedge financial instruments, being interest rate swaps and collars. At 31 March 2006, 85% of net debt was fixed with an average duration of 4.1 years. It is Board policy to hedge 100% of interest rate risk in operating leases.

Commodity price risk – fuel prices

The Group purchases diesel fuel on a floating price basis in its UK Bus, UK Rail, US and Canadian bus operations and therefore is exposed to changes in diesel prices, of which the most significant element is crude oil price risk. The Group's policy objective is to maintain a significant degree of fixed price protection in the short term, so that the businesses have time to prepare and adjust for prices after the current hedge period expires. The Group uses a range of cash flow hedge financial instruments to achieve significant fixed price certainty, mainly swaps and collars. During the year to 31 March 2006, the Group hedged 100% of crude price risk in the UK and 64% of crude price risk in the US.

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continued

25 Derivative financial instruments continued

Credit risk

The maximum credit risk exposure of the Group is the gross carrying value of the financial assets as disclosed above, and trade receivables as disclosed in note 18. Most of trade receivables are with public or quasi-public bodies, principally the UK DfT, Network Rail, Transport for London, UK city councils; School Bus Boards and city councils in North America. The Group does not consider these counter parties to be a significant risk.

Financial instrument counter parties are subject to pre approval by the Board and it is Board policy to require institutions to have a credit rating of at least 'A' from an international rating agency.

Liquidity risk

The Group maintains committed bank facilities with core banks to provide prudent levels of borrowing headroom. At 31 March 2006, the total amount of committed facilities stood at £527m. It is Group policy to maintain a minimum of £100m of committed borrowing headroom, to support financial flexibility. At 31 March 2006, committed borrowing headroom stood at £211m under the Group's £520m syndicated bank facility. This bank facility expires in March 2010.

The Group has an average debt duration at 31 March 2006 of 7.8 years (2005: 9.0 years), principally provided by its two Sterling bonds, expiring in 2013 and 2019.

26 Deferred tax

The following are the major deferred tax liabilities and assets recognised by the Group and movements thereon during the current and prior reporting period.

	Accelerated tax depreciation £m	Other temporary differences £m	Tax losses £m	Total £m
At 1 April 2004	124.8	(77.6)	(41.1)	6.1
Charge/(credit) to income	11.5	11.5	(0.9)	22.1
Charge to equity	–	5.4	–	5.4
Acquisition of subsidiary	–	(2.2)	–	(2.2)
Exchange differences	(2.0)	(0.1)	1.5	(0.6)
At 31 March 2005	134.3	(63.0)	(40.5)	30.8
Financial Instrument recognition	–	9.9	–	9.9
At 1 April 2005 (as restated)	134.3	(53.1)	(40.5)	40.7
Charge/(credit) to income	32.9	32.0	(21.6)	43.3
Charge to equity	–	2.6	–	2.6
Acquisition of subsidiary	–	(3.6)	–	(3.6)
Exchange differences	4.9	(0.3)	(3.0)	1.6
At 31 March 2006	172.1	(22.4)	(65.1)	84.6

At the balance sheet date, the aggregate amount of temporary differences associated with undistributed earnings of subsidiaries for which deferred tax liabilities have not been recognised was £148m (2005: £104m). No liability has been recognised in respect of these differences because the Group is in a position to control the timing of the reversal of the temporary difference and it is probable that such differences will not reverse in the foreseeable future.

27 Provisions

	Insurance claims ¹ £m	Pensions £m	Total £m
At 1 April 2005	34.5	10.1	44.6
Provided in the year	25.4	0.2	25.6
Utilised in the year	(37.4)	(3.4)	(40.8)
Notional interest	6.1	–	6.1
Exchange rate differences	2.1	–	2.1
At 31 March 2006	30.7	6.9	37.6

¹Insurance claims accruals due within one year at 31 March 2006 amounted to £50.0m (2005: £39.8m) and are included in 'accruals and deferred income' within note 20. The amount included within provisions represents the estimate of amounts due after more than one year.

28 Called up share capital

	2006 £m	2005 £m
Authorised:		
600.0m ordinary shares of 5p each	30.0	30.0
Allotted, called up and fully paid		
398.8m ordinary shares of 5p each	19.9	19.9
	No. m	£m
At beginning and end of year	398.8	19.9

6,630,500 (2005: 5,200,000) shares were being held as treasury shares at 31 March 2006.

The Company has one class of ordinary shares which carry no right to fixed income.

29 Statement of changes in equity

	Hedging reserve £m	Share premium account £m	Own shares £m	Retained earnings £m
At 1 April 2004	–	238.8	(0.6)	(82.5)
Share repurchases	–	–	–	(12.0)
Retained profit for the financial year	–	–	–	108.1
Dividends paid	–	–	–	(48.2)
Movement in EBT, QUEST and treasury shares during the year	–	–	(18.3)	–
Actuarial gain on defined benefit pension schemes	–	–	–	20.8
Share-based payments provision	–	–	–	2.9
Deferred tax on actuarial gains	–	–	–	(6.3)
Deferred tax on share-based payments	–	–	–	0.9
At 31 March 2005	–	238.8	(18.9)	(16.3)
Financial instrument recognition ¹	37.0	–	–	(9.0)
At 1 April 2005 (as restated)	37.0	238.8	(18.9)	(25.3)
Retained profit for the financial year	–	–	–	107.5
Dividends paid	–	–	–	(52.0)
Movement in EBT, QUEST and treasury shares during the year	–	–	(7.7)	(8.3)
Current tax on share-based payments	–	–	–	1.8
Actuarial gain on defined benefit pension schemes	–	–	–	36.7
Deferred tax on actuarial gains	–	–	–	(11.0)
Derivative hedging instrument movements ¹	(35.1)	–	–	–
Share-based payments provision	–	–	–	3.2
Deferred tax on share-based payments	–	–	–	0.3
At 31 March 2006	1.9	238.8	(26.6)	52.9

¹Net of deferred tax.

- the hedging reserve records the movement on designated hedging items.
- the share premium account represents the premium on shares issued since 1999 and arose principally on the rights issue on the Ryder acquisition in 1999. The reserve is non-distributable.
- the own shares reserve represents the cost of shares in FirstGroup plc purchased in the market and either held as treasury shares or held in trust to satisfy the exercise of share options (see own shares below).

Own shares

The number of own shares held by the Group at the end of the year was 6,759,709 (2005: 5,487,369) FirstGroup plc ordinary shares of 5p each. Of these, 49,742 (2005: 22,906) were held by the FirstGroup plc Employee Benefit Trust, 79,467 (2005: 264,463) by the FirstGroup plc Qualifying Employee Share Ownership Trust and 6,630,500 (2005: 5,200,000) were held as treasury shares. Both trusts and treasury shares have waived the rights to dividend income from the FirstGroup plc shares. The market value of the shares at 31 March 2006 was £28.7m (2005: £18.9m).

Notes to the consolidated financial statements

continued

29 Statement of changes in equity continued

	Capital redemption reserve £m	Capital reserve £m	Total other reserves £m
At 31 March 2006 and 31 March 2005	1.9	2.7	4.6

There have been no movements on the capital redemption reserve or capital reserve during the year ended 31 March 2006.

- the capital redemption reserve represents the cumulative par value of all shares bought back and cancelled. The reserve is not distributable.
- the capital reserve arose on acquisitions in 2000. The reserve is not distributable.

30 Translation reserves

	£m
At 1 April 2004	–
Movement for the financial year	(14.2)
At 31 March 2005	(14.2)
Reclassify to hedging reserve on financial instrument recognition	(7.7)
Movement for the financial year	49.6
At 31 March 2006	27.7

- the translation reserve records exchange differences arising from the translation of the accounts of foreign currency denominated subsidiaries offset by movements on loans used to hedge the net investment in foreign subsidiaries.

31 Acquisition of businesses and subsidiary undertakings

	2006 £m	2005 £m
Provisional fair values of net assets acquired:		
Tangible assets	4.0	34.8
Intangible assets	4.3	10.6
Other current assets	–	17.1
Cash at bank and in hand	–	3.5
Loans and finance leases	–	(20.6)
Minority shareholders' interests	–	(4.2)
Other creditors	(6.2)	(19.2)
	2.1	22.0
Goodwill (note 13)	10.3	15.2
	12.4	37.2
Satisfied by cash paid and payable	12.4	37.2

There was no material difference between the book value and the provisional fair values of the net assets acquired and there were no adjustments required in respect of accounting policy alignments. The intangible assets calculation is provisional and will be finalised during 2006/07.

The businesses and subsidiary undertakings acquired during the year contributed £0.7m (2005: £8.1m) to the Group's net operating cash flows. There were no other cash flow movements from the businesses acquired during the year or the previous year.

If the acquisition of the businesses and undertakings acquired during the year had been completed on the first day of the financial year, Group revenues from these acquisitions for the period would have been £10.1m (2005: £87.8m) and the Group operating profit from these acquisitions attributable to equity holders of the parent would have been £1.6m (2005: £9.0m).

The goodwill represents the management relationships acquired and the reputation of the existing business.

The businesses and subsidiary undertakings acquired during the year and dates of acquisition were:

Business acquired	Date acquired	% Voting equity instruments acquired
Thunderbird Transit, Inc	20 June 2005	100%
Black Prince Limited	30 July 2005	100%
SBS Transit, Inc	14 September 2005	100%
Mathieu Enterprises, Inc	20 January 2006	100%
C&R Bus Co	1 February 2006	100%

32 Notes to the consolidated cash flow statement

	2006 £m	2005 £m
Operating profit	196.7	200.7
Adjustments for:		
Depreciation charges	122.0	107.6
Amortisation of intangible assets	4.5	2.2
Share based payments	3.2	2.9
Loss on disposal of plant and equipment	1.4	1.9
Operating cash flows before working capital	327.8	315.3
Increase in inventories	(9.6)	(2.6)
Decrease/(increase) in receivables	3.9	(41.0)
Decrease in payables	(21.4)	(24.5)
Cash generated by operations	300.7	247.2
Corporation tax paid	(3.5)	(16.1)
Interest paid	(61.3)	(35.1)
Interest element of hire purchase contracts and finance lease payments	(0.9)	(2.3)
Net cash from operating activities	235.0	193.7

33 Contingent liabilities

To support subsidiary undertakings in their normal course of business, the Company and certain subsidiaries have indemnified certain banks and insurance companies who have issued performance bonds for £225.9m (2005: £225.1m) and letters of credit for £138.6m (2005: £149.2m). The performance bonds relate to the North American businesses of £135.7m (2005: £123.9m) and the UK Rail franchise operations of £90.2m (2005: £101.2m). Performance bonds for UK Rail franchise operations increased by £43.7m on 1 April 2006 following the award of two new rail franchises which commenced operation on this date. The letters of credit relate substantially to insurance arrangements in the UK and North America.

The Company has provided unsecured loan facilities of £103m to First Greater Western Trains Limited, the wholly owned subsidiary that commenced the Greater Western franchise on 1 April 2006, a £46m unsecured loan facility to First Capital Connect Limited, the wholly owned subsidiary that commenced its franchise on 1 April 2006, a £3.2m (2005: £3.2m) unsecured loan facility to First/Keolis TransPennine Limited, and a £13.6m (2005: £13.6m) unsecured loan facility to First ScotRail Limited. None of these loan facilities were drawn at 31 March 2006. These facilities represent contingent liabilities of the Company in relation to these subsidiaries, but they do not represent contingent liabilities of the Group.

The Company is party to certain unsecured guarantees granted to banks for overdraft and cash management facilities provided to itself and subsidiary undertakings. The Company has given certain unsecured guarantees for the liabilities of its subsidiary undertakings arising under certain loan notes, hire purchase contracts, finance leases, operating leases, supply contracts and certain pension scheme arrangements. It also provides unsecured cross guarantees to certain subsidiary undertakings as required by VAT legislation. UK Bus subsidiaries have provided unsecured guarantees on a joint and several basis to the Trustees of the UK Bus Occupational Pension Scheme.

Certain of the Company's subsidiaries have issued unsecured guarantees to the Company's Sterling bondholders. These unsecured guarantees rank pari passu with unsecured guarantees provided by those subsidiaries to lenders participating in the Group's £520m (2005: £520m) syndicated unsecured bank facility.

Notes to the consolidated financial statements continued

34 Operating lease arrangements

	2006 £m	2005 £m
Minimum lease payments made under operating leases recognised in income statement for the year	430.5	399.2

At the balance sheet dates, the Group had outstanding commitments for future minimum lease payments under non-cancellable operating leases, which fall due as follows:

	2006 £m	2005 £m
Within one year	349.1	425.4
In the second to fifth years inclusive	1,307.6	1,307.8
After five years	252.8	562.1
	1,909.5	2,295.3

The rail businesses have contracts with Network Rail for access to the railway infrastructure (track, stations and depots). They also have contracts under which they lease rolling stock.

Subsequent to 31 March 2006 the Group commenced the Greater Western and Capital Connect franchises assuming operating lease commitments for future minimum lease payments under non-cancellable operating leases of £1,011.0m.

35 Share based payments

Equity-settled share option plans

(a) Save as you earn (SAYE)

The Group operates an Inland Revenue approved savings related share option scheme. Grants were made in December 2002, December 2003 and December 2004. The scheme is based on eligible employees being granted options and their agreement to opening a sharesave account with a nominated savings carrier and to save weekly or monthly over a specified period. Sharesave accounts are held with Lloyds TSB. The right to exercise the option is at the employee's discretion at the end of the period previously chosen for a period of six months.

	SAYE 2002 Options No.	SAYE 2003 Options No.	SAYE 2004 Options No.
Outstanding at the beginning of the year	4,995,147	1,407,555	2,698,997
Exercised during the year	(4,407,808)	(29,379)	(3,834)
Lapsed during the year	(243,527)	(184,398)	(225,985)
Outstanding at the end of the year	343,812	1,193,778	2,469,178
Exercisable at the end of the year	343,812	-	-
Weighted average exercise price (pence)	192.0	232.0	267.0
Weighted average share price at date of exercise (pence)	408.0	334.1	368.9

(b) Executive share option scheme (ESOS)

The executive share option scheme (ESOS), together with the deferred share element of the Executive Bonus Scheme replaced the Long-term incentive plan (LTIP). Options are exercisable between three and ten years of the date of grant provided that the pre-determined performance criteria are met.

	ESOS 2001 Options No.	ESOS 2002 Options No.	ESOS 2003 Options No.	ESOS 2004 Options No.
Outstanding at the beginning of the year	732,326	1,097,584	1,206,346	1,381,893
Forfeited during the year	(8,008)	(18,124)	(10,472)	(41,102)
Exercised during the year	(325,985)	-	-	-
Outstanding at the end of the year	398,333	1,079,460	1,195,874	1,340,791
Exercisable at the end of the year	398,333	-	-	-
Weighted average exercise price (pence)	346.5	269.0	287.0	275.1
Weighted average share price at date of exercise (pence)	413.7	N/A	N/A	N/A

35 Share based payments continued

	DBS 2002 Options No.	DBS 2003 Options No.	DBS 2004 Options No.	DBS 2005 Options No.
(c) Deferred bonus shares (DBS)				
Outstanding at the beginning of year	204,466	271,326	304,268	–
Granted during the year	–	–	–	347,657
Forfeited during the year	(28,432)	(25,698)	(36,385)	(1,120)
Exercised during the year	(176,034)	–	–	–
Outstanding at the end of the year	–	245,628	267,883	346,537
Exercisable at the end of the year	–	–	–	–
Weighted average exercise price (pence)	Nil	Nil	Nil	Nil
Weighted average share price at date of exercise (pence)	341.7	N/A	N/A	N/A

The fair values of the options granted during 2005/06 and 2004/05 were measured using a Black-Scholes model. The inputs into the Black-Scholes model were as follows:

	2006	2005
Weighted average share price (pence):		
DBS	326.0	272.5
SAYE 2004	–	333.75
ESOS 2004	–	275.1
Weighted average exercise price (pence):		
DBS	–	–
SAYE 2004	–	267.0
ESOS 2004	–	275.1
Expected volatility	35%	35%
Expected life		
– Executive plans	–	10 years
– SAYE schemes	–	3 years
– Deferred share bonus plans	3 years	3 years
Risk-free rate of interest		
– DBS	4.99%	4.99%
– ESOS 2004	–	5.09%
– SAYE 2004	–	4.99%
Expected dividend yield	4.5%	4.5%

Expected volatility was determined by calculating the historical volatility of the Group's share price over the previous five years. The expected life used in the model has been adjusted based on management's best estimate, for the effects of non-transferability, exercise restrictions, and behavioural considerations.

Allowances have been made for the SAYE schemes for the fact that, amongst a group of recipients some are expected to leave before an entitlement vests. The accounting charge is then adjusted over the vesting period to take account of actual forfeitures, so although the total charge is unaffected by the pre-vesting forfeiture assumption, the timing of the recognition of the expense will be sensitive to it. Fair values for the SAYE include a 10% p.a. pre-vesting leaver assumption whereas the Executive and deferred share plans exclude any allowance for pre-vesting forfeitures.

The Group used the inputs noted above to measure the fair value of the new share options.

(d) Buy As You Earn (BAYE) scheme

BAYE enables eligible employees to purchase shares from their gross income. The Company provides two matching shares for every three shares bought by employees, subject to a maximum Company contribution of shares to the value of £20 per employee per month. If the shares are held in trust for five years or more, no income tax and national insurance will be payable. The matching shares will be forfeited if the corresponding partnership shares are removed from trust within three years of award.

At 31 March 2006 there were 4,576 (2005: 4,313) participants in the BAYE scheme who have cumulatively purchased 1,781,489 (2005: 1,361,344) shares with the Company contributing 553,009 (2005: 438,584) matching shares on a cumulative basis.

The Group recognised total expenses of £3.2m (2005: £2.9m) related to equity-settled share-based payment transactions.

Notes to the consolidated financial statements continued

35 Share based payments continued

(e) LTIP

Options still unexercised under the LTIP are as follows:

	2006 No.	2005 No.	Award price (p)
Date of award			
3 July 2000	145,452	151,298	236.0

36 Retirement benefit schemes

Defined contribution schemes

The Group operates defined contribution retirement benefit schemes for all qualifying employees. The assets of the schemes are held separately from those of the Group in funds under the control of trustees. Where there are employees who leave the schemes prior to vesting fully in the contributions, the contributions payable by the Group are reduced by the amount of forfeited contributions.

The total cost charged to income of £2.8m (2005: £4.2m) represents contributions payable to these schemes by the Group at rates specified in the rules of the plans.

Defined benefit schemes

The Group operates or participates in a number of pension schemes which cover the majority of UK employees and certain North American employees. These are principally defined benefit schemes under which benefits provided are based on employees' number of years of service and either career average or final salary. The scope of benefits varies between schemes. The assets of the schemes are held in separately administered trusts which are managed independently of the Group's finances by investment managers appointed by the schemes' trustees.

The various defined benefit schemes include five UK Bus Division schemes where the subsidiary undertaking is a participating employer in a scheme operated by a local authority. These schemes are subject to relevant local government regulations. Great Western Trains Company Limited, First ScotRail Limited, First Great Western Link Limited, GB Rail and TransPennine Express have sections in the Railways Pension Scheme (RPS), which is an industry-wide arrangement. Under the terms of the RPS, any fund deficit or surplus is shared by the employer (60%) and the employees (40%).

At their last triennial valuations, the defined benefit schemes had funding levels between 69.0% and 99.6% (2005: 68.0% and 121.0%). The market value of the assets at 31 March 2006 for all defined benefit schemes totalled £1,993m (2005: £1,578m).

Contributions are paid to all defined benefit schemes in accordance with rates recommended by the schemes' actuaries. The valuations are made using the Projected Unit Credit Method.

The valuation assumptions used for accounting purposes have been made uniform to Group standards, as appropriate, when each scheme is actuarially valued.

	2006 %	2005 %
Key assumptions used:		
Discount rate	5.0	5.5
Expected return on scheme assets	7.3	7.6
Expected rate of salary increases	4.1	4.1
Future pension increases	2.6	2.6

Amounts recognised in income in respect of these defined benefit schemes are as follows:

	2006 £m	2005 £m
Current service cost	53.4	46.1
Interest cost	89.0	80.0
Expected return on scheme assets	(107.6)	(87.9)
Interest on franchise adjustment	(2.3)	(1.5)
Past service cost	(16.6)	–
	15.9	36.7

Actuarial gains and losses have been reported in the statement of recognised income and expense.

The actual return on scheme assets was £348.0m (2005: £150.7m).

36 Retirement benefit schemes continued

The amount included in the balance sheet arising from the Group's obligations in respect of its defined benefit pension schemes is as follows:

	2006 £m	2005 £m
Fair value of schemes' assets	1,992.6	1,578.4
Present value of defined benefit obligations	(2,193.8)	(1,881.8)
Rail franchise adjustment (60%)	38.3	41.7
Adjustment for employee share of RPS deficits (40%)	30.9	40.6
Deficits in schemes	(132.0)	(221.1)
Liability recognised in the balance sheet	(132.0)	(221.1)
This amount is presented in the balance sheet as follows:		
Current liabilities	-	-
Non-current liabilities	(132.0)	(221.1)
	(132.0)	(221.1)

Movements in the present value of defined benefit obligations (DBO) were as follows:

	2006 £m	2005 £m
At 1 April	1,881.8	1,415.8
New Rail franchises	-	294.2
Group service cost	53.4	46.1
Group past service cost	(16.6)	-
Group interest cost	89.0	80.0
Employee share of change in DBO (not attributable to franchise adjustment)	73.6	45.0
Actuarial loss	145.8	38.4
Benefit payments	(35.0)	(36.9)
Currency loss/(gain)	1.8	(0.8)
At 31 March	2,193.8	1,881.8

Movements in the fair value of scheme assets were as follows:

	2006 £m	2005 £m
At 1 April	1,578.4	1,137.0
New Rail franchises	-	246.6
Expected return on assets	107.6	87.9
Company contributions	68.3	54.8
Employee contributions	32.9	26.2
Employee share of return on assets	50.5	15.6
Gain on assets	188.7	47.6
Benefits paid from schemes	(35.0)	(36.9)
Currency gain/(loss)	1.2	(0.4)
At 31 March	1,992.6	1,578.4

Movements in the franchise adjustment were as follows:

	2006 £m	2005 £m
At 1 April	69.2	31.9
New Rail franchises	-	16.3
Interest on franchise adjustment	2.3	1.5
Employee share of change in DBO (attributable to franchise adjustment)	(2.0)	8.3
Actuarial (loss)/gain on franchise adjustment	(5.6)	11.2
At 31 March	63.9	69.2

Notes to the consolidated financial statements continued

36 Retirement benefit schemes continued

The analysis of the scheme assets and the expected rate of return at the balance sheet dates were as follows:

	Expected return 2006 %	Fair value of assets 2006 £m	Expected return 2005 %	Fair value of assets 2005 £m
Equity instruments	8.35	1,444.8	8.8	1,094.4
Debt instruments	4.3	317.6	4.7	282.4
Property	6.3	135.9	6.8	121.8
Other assets	3.6	94.3	3.6	79.8
		1,992.6		1,578.4

The expected rates of return on assets at 31 March 2006 and 31 March 2005 were determined by looking at the individual asset classes and applying a model developed by Watson Wyatt, an independent firm of Actuaries.

The history of experience adjustments is as follows:

	2006 £m	2005 £m
Fair value of schemes' assets	1,992.6	1,578.4
Present value of defined benefit obligations	(2,193.8)	(1,881.8)
Rail franchise adjustment (60%)	38.3	41.7
Adjustment for employee share of RPS deficits (40%)	30.9	40.6
Deficits in the schemes	(132.0)	(221.1)
Experience gain on scheme assets		
Amount (£m)	188.7	47.6
Percentage of scheme assets (%)	10.8	3.4
Experience gain on scheme liabilities		
Amount (£m)	13.6	15.5
Percentage of scheme liabilities (%)	0.7	0.8
Experience gain on scheme liabilities after franchise adjustment		
Amount (£m)	8.0	26.7
Percentage of scheme liabilities (%)	0.4	1.4

The estimated amounts of contributions expected to be paid to the schemes during the financial year to 31 March 2007 is £78.1m (year to 31 March 2006: £72.4m).

Accounting for UK Rail pension arrangements

The Group recognises its share of Train Operating Companies' deficits that the Group expects to fund over the term of the respective franchises. This is accounted for by way of a franchise adjustment.

36 Retirement benefit schemes continued

Had the Group accounted for UK Rail pensions as if the respective franchises had an indefinite duration, the impact on the financial statements would have been as follows:

	2006 £m	2005 £m
Balance sheet		
Pension deficit	(38.3)	(41.7)
Intangible assets	(16.5)	(19.4)
Deferred taxation	16.4	18.3
Impact on net assets	(38.4)	(42.8)
Income statement		
Unwinding of discount on franchise adjustment	(2.3)	(1.5)
Intangible asset amortisation	2.9	1.6
Deferred taxation	(0.2)	–
Impact on profit for the period from continuing operations	0.4	0.1
Statement of recognised income and expense		
Actuarial losses/(gains) on franchise adjustment	5.6	(11.2)

37 Related party transactions

Transactions between the Company and its subsidiaries, which are related parties, have been eliminated on consolidation and are not disclosed in this note.

Remuneration of key management personnel

The remuneration of the Directors, who are the key management personnel of the Group, is set out below in aggregate for each of the categories specified in IAS 24 *Related Party Disclosures*. Further information about the remuneration of individual directors is provided in the Directors' Remuneration Report on pages 26 to 32.

	Year to 31 March 2006 £m	Year to 31 March 2005 £m
Basic salaries	1.2	1.0
Performance related bonuses	0.6	0.3
Benefits in kind	0.1	0.1
Fees	0.3	0.2
Pension contributions	0.2	0.2
Share-based payment	0.4	0.3
	2.8	2.1

38 Explanation of transition to IFRSs

The Group's transition date to IFRS is 1 April 2004, the beginning of the earliest period for which it presents IFRSs in its first financial statements, and as such an opening IFRS balance sheet has been prepared at that date. Consequently, 2004/05 comparative information has been restated under IFRS.

Changes to IFRS restatement previously published

Our preliminary interpretation of IAS 12 in our IFRS transition document published on the Group's website on 28 September 2005, identified a GAAP difference relating to the recognition of deferred tax and the application of rollover relief. Current accounting practice does not recognise this GAAP difference. Accordingly our deferred tax liability at 1 April 2004 is £7.9m lower than previously stated and the deferred tax liability at 31 March 2005 is £8.2m lower than previously published.

In order to make the transition to IFRS easier, IFRS 1 allows some exemptions from full retrospective application of certain standards. In preparing these financial statements in accordance with IFRS 1, the Group has applied the mandatory exemptions and certain of the optional exemptions from full retrospective application of IFRS.

Business combinations exemption

The Group has applied the business combinations exemption in IFRS 1. It has not restated business combinations that took place prior to the 1 April 2004 transition date.

Notes to the consolidated financial statements

continued

38 Explanation of transition to IFRSs continued

Cumulative translation differences exemption

The Group has elected to set the previously accumulated, cumulative translation differences to zero at 1 April 2004. This exemption has been applied to all subsidiaries in accordance with IFRS 1.

Financial instruments IAS 32 and IAS 39 exemption

The Group has elected not to apply the requirements of IAS 32 and IAS 39 in relation to financial instruments until 1 April 2005.

Employee benefits

The Group has elected in accordance with IAS 19, *Employee benefits*, to recognise all actuarial gains and losses to be charged or credited to the statement of recognised income and expense in the period in which they arise.

Share-based payments

The Group has applied IFRS 2, *Share-based payments*, to equity-settled awards not vested at 1 April 2005 and granted on or after 7 November 2002.

Estimates exemption

Estimates under IFRS at 1 April 2004 are consistent with estimates at the same date under UK GAAP.

The following reconciliations provide a quantification of the effect of the transition to IFRS and details of the impact of the transition on:

- equity at 1 April 2004 and 31 March 2005;
- profit for the year to 31 March 2005.

38 Explanation of transition to IFRSs continued

Reconciliation of equity at 1 April 2004 (date of transition to IFRSs)

	Notes	UK GAAP £m	Effect of transition to IFRSs £m	IFRSs £m
Property, plant and equipment	1	797.6	(6.0)	791.6
Goodwill		461.2	–	461.2
Intangible assets	2	–	4.1	4.1
Total non-current assets		1,258.8	(1.9)	1,256.9
Trade and other receivables	2	394.7	(59.1)	335.6
Inventories		35.1	–	35.1
Short-term bank deposits		30.3	–	30.3
Cash and cash equivalents		94.9	–	94.9
Total current assets		555.0	(59.1)	495.9
Non-current assets classified as held for sale	1	–	6.0	6.0
Total assets		1,813.8	(55.0)	1,758.8
Bonds		535.1	–	535.1
Bank loans, overdrafts, finance leases and loan notes		220.8	–	220.8
Trade and other payables	3	522.1	(31.8)	490.3
Employee benefits	2	6.4	234.9	241.3
Provisions	2	31.7	4.9	36.6
Current tax liabilities		46.3	–	46.3
Deferred tax liability	4	96.4	(90.3)	6.1
Total liabilities		1,458.8	117.7	1,576.5
Total assets less total liabilities		355.0	(172.7)	182.3
Issued capital		20.1	–	20.1
Revaluation reserve	5	3.4	(3.4)	–
Share premium account		238.8	–	238.8
Other reserves		4.4	–	4.4
Own shares		(0.6)	–	(0.6)
Hedging and translation reserves		–	–	–
Retained earnings	6	86.8	(169.3)	(82.5)
Minority interest		2.1	–	2.1
Total equity		355.0	(172.7)	182.3

Notes to the reconciliation of equity at 1 April 2004

1 IFRS 2 establishes a separate classification of non-current assets held for sale. The Group have reclassified £6.0m of buses held for sale and presented them separately on the face of the balance sheet.

2 The Group has adopted IAS 19, *Employee benefits*, in respect of all its defined benefit pension schemes. The balance sheet impact of the implementation of the Standard is to recognise a pension liability of £241.3m in the Group's IFRS balance sheet as at 1 April 2004 in place of the £59.1m SSAP 24 prepayment and a £6.4m creditor previously held under UK GAAP. In addition there is a reclassification of £4.9m to long-term provisions. An intangible asset of £4.1m has also been recognised representing the economic benefit derived from the franchise that is attributable to our share of certain rail pension scheme deficits. The Group has also recognised £89.6m of a deferred tax asset on the pension liability.

3 As required by IAS 10, *Events after the balance sheet date*, no provision is made within the accounts for the final proposed dividend because at the balance sheet date it was still subject to approval. The result is a £31.8m increase in reported net assets.

4 In addition to the deferred tax asset on pension adjustments explained in note 2 above, the Group has also recognised a deferred tax asset of £0.7m with respect to an opening reserves adjustment of £2.4m under IFRS 2, *Share-based payments*.

5 Under IFRS 1 the Group has taken the option to measure individual items of land and buildings, previously revalued, at cost. This has resulted in a £3.4m reclassification from the revaluation reserve to retained earnings.

6 Retained earnings impact of all IFRS adjustments, principally the IAS 19 adjustments less the deferred tax asset recognised on these adjustments.

Notes to the consolidated financial statements continued

38 Explanation of transition to IFRSs continued

Reconciliation of equity at 31 March 2005 (date of last UK GAAP financial statements)

	Notes	UK GAAP £m	Effect of transition to IFRSs £m	IFRSs £m
Property, plant and equipment	1	840.2	(5.2)	835.0
Goodwill	2	450.6	15.2	465.8
Other intangible assets	2	–	29.4	29.4
Total non-current assets		1,290.8	39.4	1,330.2
Trade and other receivables	3	437.8	(69.1)	368.7
Inventories		40.1	–	40.1
Short-term bank deposits		7.5	–	7.5
Cash and cash equivalents		146.6	–	146.6
Total current assets		632.0	(69.1)	562.9
Non-current assets classified as held for sale	1	–	5.2	5.2
Total assets		1,922.8	(24.5)	1,898.3
Bonds		527.9	–	527.9
Bank loans, overdrafts, finance leases and loan notes		289.3	–	289.3
Trade and other payables	4	541.4	(34.1)	507.3
Employee benefits	3	5.7	215.4	221.1
Provisions		40.2	4.4	44.6
Current tax liabilities		52.8	–	52.8
Deferred tax liability	5	107.3	(76.5)	30.8
Total liabilities		1,564.6	109.2	1,673.8
Total assets less total liabilities		358.2	(133.7)	224.5
Issued capital		19.9	–	19.9
Revaluation reserve	6	1.8	(1.8)	–
Share premium account		238.8	–	238.8
Other reserves		4.6	–	4.6
Own shares		(18.9)	–	(18.9)
Hedging and translation reserves	7	–	(14.2)	(14.2)
Retained earnings	8	101.4	(117.7)	(16.3)
Minority interest		10.6	–	10.6
Total equity		358.2	(133.7)	224.5

Notes to the reconciliation of equity at 31 March 2005

1 As explained in note 1 to the reconciliation of equity at 1 April 2004, the Group has reclassified certain buses as non-current assets held for sale. The net realisable value of buses held for sale at 31 March 2005 was £5.2m.

2 IAS 36, *Impairment of assets*, no longer permits the amortisation of goodwill. Instead goodwill is carried at cost and is subject to regular impairment reviews.

The Group has chosen under the transitional arrangements of IFRS 1, to apply IFRS 3 prospectively from the transition date. Accordingly all prior business combination accounting is frozen at the transition date and the value of goodwill is frozen at 1 April 2004 and goodwill amortisation previously reported under UK GAAP for 2004/05 is reversed for the Group's IFRS statements.

The impact of IAS 36 has been that the goodwill amortisation charge of £25.8m has been reversed. Under IFRS 3, the goodwill additions of £25.8m have been split between other contract intangibles of £10.6m and £15.2m of goodwill. There is an amortisation charge of £0.6m on the contracts intangible.

A deferred tax liability of £7.9m has been recognised due to the reversal of goodwill amortisation and the subsequent amortisation charge on contract intangibles.

38 Explanation of transition to IFRSs continued

3 The Group has adopted IAS 19, *Employee Benefits*, in respect of its defined benefit pension schemes. The Balance Sheet impact of the implementation of this Standard is to recognise a pension liability of £221.1m in the Group's IFRS balance sheet at 31 March 2005 in place of a £69.1m SSAP prepayment and £5.7m creditor previously held under UK GAAP. In addition there is a reclassification of £4.4m to long-term provisions. An intangible asset of £19.4m has also been recognised representing the economic benefit derived from the franchise agreements that is attributable to our share of certain rail pension deficits. The Group has also recognised a deferred tax asset of £81.9m on these pension adjustments.

4 As required by IAS 10, *Events after the Balance Sheet Date*, no provision is made within the accounts for the final proposed dividend because at the balance sheet date it was still subject to approval. The result is a £34.1m increase in reported net assets.

5 In addition to the deferred tax liability on goodwill explained in note 2 above and the deferred tax asset on pension adjustments explained in note 3 above, the Group has also recognised a deferred tax asset of £2.5m under IFRS 2, *Share-based payments*.

6 Under IFRS 1 the Group has taken the option to measure individual items of land and buildings, previously revalued, at cost. At 31 March 2005 this resulted in a £1.8m reclassification from the revaluation reserve to retained earnings.

7 As at 31 March 2005 £14.2m has been reclassified to hedging and translation reserves from retained earnings.

8 Retained earnings impact of all IFRS adjustments, principally the IAS 19 pension adjustments less the deferred tax asset recognised on these adjustments.

Reconciliation of profit for the year to 31 March 2005

	Notes	UK GAAP £m	Effect of transition to IFRSs £m	IFRSs £m
Revenue		2,693.4	–	2,693.4
Operating expenses	1	(2,481.8)	3.2	(2,478.6)
Operating profit		211.6	3.2	214.8
Amortisation charges	2	(25.8)	23.6	(2.2)
Bid costs		(11.9)	–	(11.9)
Profit on disposal of fixed assets		3.3	–	3.3
Finance income		4.3	–	4.3
Finance costs		(52.6)	–	(52.6)
Profit before tax		128.9	26.8	155.7
Tax expense	3	(32.7)	(8.4)	(41.1)
Net profit		96.2	18.4	114.6

Notes to the reconciliation of the income statement for 2005

1 The Group has adopted IAS 19, *Employee Benefits*, in respect of all defined benefit pension schemes. This has resulted in a £6.1m credit to the income statement as the pension charge under IAS 19 is lower than that previously charged under SSAP 24.

As required by IFRS 2, *Share-based Payments*, an income statement charge of £2.9m has been made based on the fair value of the outstanding share options granted since 7 November 2002.

2 IAS 36 no longer permits the amortisation of goodwill and therefore £25.8m of a goodwill amortisation charge under UK GAAP has been reversed.

Intangible asset amortisation charges of £1.6m and £0.6m have been provided on the rail franchise intangible and contract intangibles respectively.

Notes to the consolidated financial statements continued

38 Explanation of transition to IFRSs continued

3 Deferred tax effect of adjustments on transition to IFRS:

	£m
Deferred tax charge on reversal of goodwill amortisation	8.1
Deferred tax charge on IAS 19 pension charge reduction	1.4
Deferred tax credit on IFRS 2 share-based payment charge	(0.9)
Deferred tax credit on intangible asset amortisation	(0.2)
Increase in deferred tax charge	8.4

Reconciliation of cash flows for the year to 31 March 2005

The transition from UK GAAP to IFRS does not change any of the cash flows of the Group. The cash flow statement under IFRS is similar to the format under UK GAAP but presents certain cash flows in different categories and in a different order than under UK GAAP. All of the IFRS transitional adjustments net out within net cash from operating activities.

Independent auditors' report to the members of FirstGroup plc

We have audited the Group financial statements of FirstGroup plc for the year ended 31 March 2006 which comprise the Consolidated income statement, Consolidated statement of total recognised income and expense, Consolidated balance sheet, Consolidated cash flow statement and the related notes 1 to 38. These Group financial statements have been prepared under the accounting policies set out therein. We have also audited the information in the Directors' remuneration report that is described as having been audited.

We have reported separately on the individual Company financial statements of FirstGroup plc for the year ended 31 March 2006.

This report is made solely to the Company's members, as a body, in accordance with section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of Directors and auditors

The Directors' responsibilities for preparing the annual report, the Directors' remuneration report and the Group financial statements in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted for use in the European Union are set out in the statement of Directors' responsibilities.

Our responsibility is to audit the Group financial statements and the part of the Directors' remuneration report described as having been audited in accordance with relevant United Kingdom legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the Group financial statements give a true and fair view, in accordance with the relevant financial reporting framework, and whether the Group financial statements and the part of the Directors' remuneration report described as having been audited have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation. We report to you whether in our opinion the information given in the Directors' report is consistent with the Group financial statements. We also report to you if we have not received all the information and explanations we require for our audit, or if information specified by law regarding Directors' transactions with the Company and other members of the Group is not disclosed.

We also report to you if, in our opinion, the Company has not complied with any of the four Directors' remuneration disclosure requirements specified for our review by the Listing Rules of the Financial Services Authority. These comprise the amount of each element in the remuneration package and information on share options, details of long-term incentive schemes, and money purchase and defined benefit schemes. We give a statement, to the extent possible, of details of any non-compliance.

We review whether the corporate governance statement reflects the Company's compliance with the nine provisions of the 2003 FRC Combined Code specified for our review by the Listing Rules of the Financial Services Authority, and we report if it does not. We are not required to consider whether the Board's statement on internal control covers all risks and controls, or form an opinion on the effectiveness of the Group's corporate governance procedures or its risk and control procedures.

We read the Directors' report and the other information contained in the annual report for the above year as described in the contents section including the unaudited part of the Directors' remuneration report and we consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the Group financial statements.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the Group financial statements and the part of the Directors' remuneration report described as having been audited. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the Group financial statements, and of whether the accounting policies are appropriate to the Group's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the Group financial statements and the part of the Directors' remuneration report described as having been audited are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the Group financial statements and the part of the Directors' remuneration report described as having been audited.

Opinion

In our opinion:

- the Group financial statements give a true and fair view, in accordance with IFRSs as adopted for use in the European Union, of the state of the Group's affairs as at 31 March 2006 and of its profit for the year then ended; and
- the Group financial statements and the part of the Directors' remuneration report described as having been audited have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation; and
- the information given in the Directors' report is consistent with the Group financial statements.

Independent auditors' report to the members of FirstGroup plc continued

Separate opinion in relation to IFRS

As explained in note 2 of the Group financial statements, the Group, in addition to complying with its legal obligation to comply with IFRSs as adopted for use in the European Union, has also complied with the IFRSs as issued by the International Accounting Standards Board. Accordingly, in our opinion the financial statements give a true and fair view, in accordance with IFRSs, of the state of the Group's affairs as at 31 March 2006 and of its profit for the year then ended.

Deloitte & Touche LLP
Chartered Accountants and Registered Auditors
London
United Kingdom
16 May 2006

Group financial summary

	IFRS		UK GAAP		
	2006 £m	2005 £m	2004 £m	2003 £m	2002 £m
Consolidated income statement					
Group turnover	3,030.9	2,693.4	2,479.0	2,291.0	2,164.1
Operating profit before amortisation, bid costs and other exceptional items	229.7	214.8	204.1	216.1	215.0
Amortisation	(4.5)	(2.2)	(25.9)	(25.8)	(27.3)
Bid costs	(28.5)	(11.9)	(6.7)	(3.4)	(3.6)
Other exceptional items, net	-	-	(6.8)	(7.2)	(16.9)
Operating profit before profit on disposal of fixed assets	196.7	200.7	164.7	179.7	167.2
Operating profit	210.7	204.0	184.3	189.7	164.2
Net interest payable	(53.3)	(48.3)	(42.8)	(56.3)	(56.3)
Exceptional interest charge	-	-	(18.7)	-	-
Profit before taxation	157.4	155.7	122.8	133.4	107.9
Taxation	(40.0)	(41.1)	(30.6)	(35.8)	(33.9)
Profit after taxation	117.4	114.6	92.2	97.6	74.0
EBITDA	351.7	322.4	307.1	315.3	310.1
Earnings per share					
	pence	pence	pence	pence	pence
Adjusted basic	30.9	28.9	27.3	26.8	25.8
Basic	27.4	27.1	22.3	23.4	17.6
Adjusted cash	61.9	55.8	52.4	50.6	48.5
Consolidated balance sheets					
	£m	£m	£m	£m	£m
Fixed assets	1,474.7	1,335.4	1,258.8	1,272.5	1,344.5
Net current liabilities	(38.0)	(58.1)	(92.9)	(115.5)	(127.4)
Creditors: amounts due after more than one year	(982.6)	(977.4)	(682.8)	(630.9)	(687.9)
Provision for liabilities and charges	(122.2)	(75.4)	(128.1)	(124.0)	(110.7)
Equity minority interests	(12.7)	(10.6)	(2.1)	(1.1)	(1.0)
Equity shareholders' funds	319.2	213.9	352.9	401.0	417.5
Share data					
Number of shares in issue (excluding treasury shares and shares in trusts)	million	million	million	million	million
At year end	392.0	393.6	403.0	413.4	419.8
Average	392.6	399.2	410.0	416.7	419.8
Share price					
	pence	pence	pence	pence	pence
At year end	425	343	268	240	302
High	426	379	306	339	365
Low	311	256	219	200	243
Market capitalisation					
	£m	£m	£m	£m	£m
At year end	1,665	1,369	1,078	992	1,268

The amounts disclosed for 2004 and earlier periods are stated on the basis of UK GAAP because it is not practicable to restate amounts for periods prior to the date of transition to IFRSs. The principal differences between UK GAAP and IFRSs are explained in note 38 to the accounts which provides an explanation of the transition to IFRSs.

Company balance sheet

At 31 March 2006

	Notes	2006 £m	2005 (restated*) £m
Fixed assets			
Investments	4	1,684.0	1,684.0
Current assets			
Financial assets – derivative financial instruments	5	16.5	–
Debtors	6	895.6	844.1
		912.1	844.1
Creditors: amounts falling due within one year			
Financial liabilities – derivative financial instruments	5	(1.8)	–
– current bond liability		(23.1)	–
		(666.5)	(710.3)
		(691.4)	(710.3)
Net current assets			
		220.7	133.8
Total assets less current liabilities			
		1,904.7	1,817.8
Creditors: amounts falling due after more than one year			
Financial liabilities – derivative financial instruments	5	(0.8)	–
Provisions for liabilities and charges		(0.1)	–
		1,080.4	1,103.3
Financed by:			
Capital and reserves			
Called up share capital	8	19.9	19.9
Share premium account	9	238.8	238.8
Other reserves	9	261.5	262.1
Own shares	9	(26.6)	(18.4)
Profit and loss account	9	586.8	600.9
Equity shareholders' funds		1,080.4	1,103.3

*See note 1.

Notes to the Company financial statements

1 Significant accounting policies

Basis of accounting

The following accounting policies have been used consistently throughout the year and the preceding year with the exception of the adoption of FRS 25 and FRS 26.

Under the first time adoption of UK Financial Reporting Standards, the Company has elected not to restate comparative financial information for the financial instrument standards, FRS 25 and FRS 26. The effect of the adoption of FRS 25 and FRS 26 on the 1 April 2005 opening balance sheet equity is described in note 7 Reserves. The relevant accounting policy is explained under 'Financial Instruments' below. In addition, FRS 21, *Events after the balance sheet date*, was applied as described below.

Post-balance sheet events

In accordance with FRS 21, *Events after the balance sheet date*, the Company now recognises dividends in the accounting period in which they are approved. Comparative figures as at 31 March 2005 have been restated to reflect this change in accounting policy and net assets have decreased by £55.6m. Amounts due from subsidiary undertakings is £89.7m lower than previously stated, dividends payable is £34.1m lower than previously stated and retained profit and loss account is £55.6m lower at 31 March 2005 than previously stated.

Cash flow statement

The Company has taken the advantage of the exemption under FRS 1 (revised) not to disclose a cash flow statement.

Investments

Fixed asset investments in subsidiaries and associates are shown at cost less provision for impairment.

For investments in subsidiaries acquired for consideration, including the issue of shares qualifying for merger relief, cost is measured by reference to the nominal value only of the shares issued. Any premium is ignored.

Foreign currencies

Transactions in currencies other than Sterling are recorded at the rate of exchange on the date of the transaction. At each balance sheet date, monetary assets and liabilities that are denominated in foreign currencies are retranslated at the rates prevailing at the relevant balance sheet date. Exchange differences arising on the settlement of monetary items, and on the retranslation of non-monetary items at each balance sheet date are included in the profit or loss for the accounting period.

Taxation

The charge for taxation is based on the profit or loss for the year and takes into account taxation deferred because of timing differences between the treatment of certain items for taxation and accounting purposes. Provision is made for deferred tax on all timing differences except those arising from the revaluation of fixed assets for which there is no binding agreement to sell on property gains if it is anticipated that rollover relief will be available and on the undistributed profits of overseas subsidiaries, associates and joint ventures. Deferred tax is calculated at the rates at which it is estimated the tax will arise. Deferred tax assets are recognised to the extent that it is regarded as more likely than not that they will be recovered. The deferred tax provision is not discounted to net present value.

Financial Instruments

From 1 April 2005 derivative financial instruments are initially recorded at fair value and then for reporting purposes are remeasured to fair value at each subsequent balance sheet date.

Derivative financial instruments and hedge accounting

The Company uses derivative financial instruments to hedge interest rate risks, foreign currency risks and fuel price risks. Use of such financial instruments is governed by policies and delegated authorities approved by the Board. The Company does not use derivative financial instruments for speculative purposes.

The main derivative financial instruments used by the Company are interest rate swaps and collars, fuel swaps and collars, and cross currency interest rate swaps. Such instruments are initially recognised at fair value and subsequently remeasured to fair value at the reported balance sheet date. The fair values are calculated by reference to market exchange rates, interest rates and fuel prices at the period end, and supported by counter-party confirmations.

Changes in the fair value of derivative financial instruments that do not qualify for hedge accounting as cash flow hedges or foreign currency hedges of a foreign net investment are recognised in the income statement as they arise.

Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated, or exercised, or no longer qualifies for hedge accounting. At that time, any cumulative gain or loss on the hedging instrument recognised in equity is retained in equity until the forecasted transaction occurs. If a hedged transaction is no longer expected to occur, the net cumulative gain or loss recognised in equity is transferred to the income statement for the period.

Notes to the Company financial statements continued

1 Significant accounting policies continued

Derivatives embedded in other financial instruments or other host contracts are treated as separate derivatives when their risks and characteristics are not closely related to those of host contracts and the host contracts are not carried at fair value with unrealised gains or losses reported in the income statement.

Note 9 sets out the restatement as at 1 April 2005.

Related party transactions

As permitted under FRS 8, *Related party transactions*, the Company has taken advantage of the exemption not to disclose transactions between Group companies.

Debt

Debt is initially stated at the amount of the net proceeds after the deduction of issue costs. The carrying amount is increased by the amortisation of debt issuance fees in respect of the accounting period and reduced by repayments made in the period.

Dividend distribution

Dividend distribution to the Company's shareholders is recognised as a liability in the Company's financial statements in the period in which the dividends are approved by the Company's shareholders.

2 Profit for the year

As permitted by section 230 of the Companies Act 1985 the Company has elected not to present its own profit and loss account for the year. FirstGroup plc reported a profit for the financial year ended 31 March 2006 of £15.5m (2005: profit of £120.1m).

The auditors' remuneration for audit services to the Company was £0.1m (2005: £0.1m).

The Company had no employees in the current or preceding financial year.

3 Dividends

Amounts recognised as distributions to equity holders in the period:

	2006 £m	2005 £m
Final dividend for the year ended 31 March 2005 of 8.69p (2004: 7.9p) per share	34.1	31.8
Interim dividend for the year ended 31 March 2006 of 4.55p (2005: 4.125p) per share	17.9	16.4
	52.0	48.2
Proposed final dividend for the year ended 31 March 2006 of 9.55p (2005: 8.69p) per share	37.4	34.1

The proposed final dividend is subject to approval by shareholders at the Annual General Meeting and has not been included as a liability in these financial statements.

4 Fixed asset investments

	Unlisted subsidiary undertakings £m	Other investments £m	Total £m
Cost			
At 1 April 2005 and 31 March 2006	1,689.4	8.1	1,697.5
Provisions			
At 1 April 2005 and 31 March 2006	(5.4)	(8.1)	(13.5)
Net book value			
At 31 March 2006 and 31 March 2005	1,684.0	–	1,684.0

4 Fixed asset investments continued

Subsidiary undertakings

The principal subsidiary undertakings of FirstGroup plc at the end of the year were:

UK local bus and coach operators

CentreWest London Buses Limited
First Aberdeen Limited+
First Beeline Buses Limited
First Bristol Limited
First Capital East Limited
First Capital North Limited
First Somerset & Avon Limited
First Cymru Buses Limited
First Eastern Counties Buses Limited
First Edinburgh Limited+
First Essex Buses Limited
First Glasgow (No. 1) Limited+
First Glasgow (No. 2) Limited+
First Hampshire and Dorset Limited
First Manchester Limited

First Midland Red Buses Limited
First PMT Limited
First South Yorkshire Limited
First Wessex Limited
First West Yorkshire Limited
First Devon & Cornwall Limited
First York Limited
Leicester CityBus Limited (94%)
Northampton Transport Limited

North America school bus operators

First Student, Inc†
FirstBus Canada Limited‡
FirstGroup America, Inc†
FirstGroup USA, Inc†
Cardinal Transportation Group, Inc†
Cardinal Coach Lines Limited‡ (60%)

Transit contracting and fleet maintenance

First Transit, Inc†
SKE Support Services, Inc†

Rail companies

Great Western Trains Company Limited
FirstInfo Limited
First/Keolis TransPennine Limited (55%)
Hull Trains Company Limited (80%)
GB Railfreight Limited
First Great Western Link Limited
First ScotRail Limited

All subsidiary undertakings are wholly owned at the end of the year except where percentage of ownership is shown above. All these companies above are incorporated in Great Britain and registered in England and Wales except those marked + which are registered in Scotland, those marked † which are incorporated in the United States of America and those marked ‡ which are registered in Canada.

All shares held in subsidiary undertakings are ordinary shares, with the exception of Leicester CityBus Limited where the Group owns 100% of its redeemable cumulative preference shares, as well as 94% of its ordinary shares.

All of these subsidiary undertakings are owned via intermediate holding companies.

Advantage has been taken of section 231(5) of the Companies Act 1985 to list only those undertakings as are required to be mentioned in that provision, as an exhaustive list would involve a statement of excessive length.

Other investments

The interest in other investments at the end of the year is a 6% interest in the ordinary share capital of Prepayment Cards Limited, which is incorporated in Great Britain and registered in England and Wales.

Notes to the Company financial statements continued

	2006 £m	1 April 2005 £m
5 Derivative financial instruments		
Non-current assets		
Cross currency swaps (net investment hedge)	–	16.7
Coupon swaps (fair value hedge)	8.1	–
Interest rate collars (cash flow hedge)	0.4	–
	8.5	16.7
Current assets		
Cross currency swaps (net investment hedge)	–	3.5
Coupon swaps (fair value hedge)	3.3	–
Fuel derivatives (cash flow hedge)	4.7	21.2
	8.0	24.7
Total assets	16.5	41.4
Current liabilities		
Interest rate swaps (cash flow hedge)	0.9	0.7
Cross currency swaps (net investment hedge)	0.9	–
Coupon swaps (fair value hedge)	–	4.5
	1.8	5.2
Non-current liabilities		
Interest rate swaps (cash flow hedge)	0.4	0.9
Cross currency swaps (net investment hedge)	0.4	–
Coupon swaps (fair value hedge)	–	1.5
	0.8	2.4
Total liabilities	2.6	7.6

For 2006, the Company has taken advantage of the exemption under FRS 25 for parent company accounts. For 2005 comparatives, the Company has taken advantage of the exemption under FRS 13, *Derivatives and other financial instruments: disclosure*, for parent company accounts.

The disclosures are included within the Group accounts.

	2006 £m	2005 £m
6 Debtors		
Amounts due within one year		
Amounts due from subsidiary undertakings	895.6	827.9
Corporation tax recoverable	–	15.3
Deferred taxation	–	0.9
	895.6	844.1

	2006 £m	2005 £m
7 Creditors		
Amounts due within one year		
Bank loans and overdrafts	175.7	179.6
Loan notes	1.3	0.3
Corporation tax	3.5	–
Other creditors	0.3	–
Amounts due to subsidiary undertakings	478.5	498.0
Accruals and deferred income	7.2	32.4
	666.5	710.3

7 Creditors continued

	2006 £m	2005 £m
Amounts falling due after more than one year		
Bank loans		
– Due in more than two years but not more than five years	264.9	180.0
Loan notes		
– Due in more than one year but not more than two years	5.3	6.6
£300.0m Sterling bond – 6.875% 2013	295.9	296.0
£250.0m bond – 6.125% 2019	257.3	231.9
	823.4	714.5

Borrowing facilities

The maturity profile of the Company's undrawn committed borrowing facilities is as follows:

	2006 £m	2005 £m
Facilities maturing:		
More than two years	202.6	306.4

8 Called up share capital

	2006 £m	2005 £m
Authorised		
600.0m ordinary shares of 5p each	30.0	30.0
Allotted, called up and fully paid		
Ordinary shares of 5p each	19.9	19.9

The Company had 398.8m (2005: 398.8m) shares in issue at 31 March 2006 including 6,630,500 (2005: 5,200,000) shares held as treasury shares at this date.

9 Reserves

	Share premium account £m	Own shares £m	Profit and loss account £m
At 31 March 2005 (as previously stated)	238.8	(18.4)	656.5
Prior year adjustment:			
Restatement for FRS 21	–	–	(55.6)
At 31 March 2005 (as restated)	238.8	(18.4)	600.9
Financial instrument recognition	–	–	31.5
At 1 April 2005 (as restated)	238.8	(18.4)	632.4
Retained loss for the year	–	–	(36.5)
Movement in EBT, QUEST and Treasury shares during the year	–	(8.2)	(7.9)
Foreign exchange differences	–	–	(1.2)
At 31 March 2006	238.8	(26.6)	586.8

Own shares

The number of own shares held by the Group at the end of the year was 6,759,709 (2005: 5,487,369) FirstGroup plc ordinary shares of 5p each. Of these, 49,742 (2005: 22,906) were held by the FirstGroup plc Employee Benefit Trust, 79,467 (2005: 264,463) by the FirstGroup plc Qualifying Employee Share Ownership Trust and 6,630,500 (2005: 5,200,000) were held as treasury shares. Both trusts and treasury shares have waived the rights to dividend income from the FirstGroup plc shares. The market value of the shares at 31 March 2006 was £28.7m (2005: £18.9m).

Notes to the Company financial statements

continued

9 Reserves continued

	Hedging reserve £m	Capital redemption reserve £m	Capital reserve £m	Merger reserve £m	Total other reserves £m
At 31 March 2005	–	1.9	93.8	166.4	262.1
Financial instrument recognition	(0.8)	–	–	–	(0.8)
At 1 April 2005 (as restated)	(0.8)	1.9	93.8	166.4	261.3
Derivative hedging instrument movement	0.2	–	–	–	0.2
At 31 March 2006	(0.6)	1.9	93.8	166.4	261.5

10 Reconciliation of movement in equity shareholders' funds

	2006 £m	2005 (restated) £m
Profit for the financial year	15.5	120.1
Dividends	(52.0)	(48.2)
	(36.5)	71.9
Own shares purchased and cancelled	–	(11.9)
Movement in EBT, QUEST and treasury shares during the year	(16.1)	(17.8)
Derivative hedging instrument movement	30.9	–
Foreign exchange differences	(1.2)	(0.5)
Net (reduction in)/addition to equity shareholders' funds	(22.9)	41.7
Equity shareholders' funds at beginning of year (as previously reported)	1,103.3	1,061.6
Equity shareholders' funds at end of year	1,080.4	1,103.3

11 Contingent liabilities

To support subsidiary undertakings in their normal course of business, the Company and certain subsidiaries have indemnified certain banks and insurance companies who have issued performance bonds for £225.9m (2005: £225.1m) and letters of credit for £138.6m (2005: £149.2m). The performance bonds relate to the North American businesses of £135.7m (2005: £123.9m) and the UK Rail franchise operations of £90.2m (2005: £101.2m). Performance bonds for UK Rail franchise operations increased by £33.5m on 1 April 2006 following the award of two new rail franchises which commenced operation on this date. The letters of credit relate substantially to insurance arrangements in the UK and North America.

The Company has provided unsecured loan facilities of £103.0m to Great Western Trains Limited, the wholly owned subsidiary that commenced the Greater Western franchise on 1 April 2006, a £46.0m unsecured loan facility to First Capital Connect Limited, the wholly owned subsidiary that commenced its franchise on 1 April 2006, a £3.2m (2005: £3.2m) unsecured loan facility to First/Keolis TransPennine Limited, and a £13.6m (2005: £13.6m) unsecured loan facility to First ScotRail Limited. None of these loan facilities were drawn at 31 March 2006 or at 31 March 2005.

The Company is party to certain unsecured guarantees granted to banks for overdraft and cash management facilities provided to itself and subsidiary undertakings. The Company has given certain unsecured guarantees for the liabilities of its subsidiary undertakings arising under certain loan notes, hire purchase contracts, finance leases, operating leases, supply contracts and certain pension scheme arrangements. It also provides unsecured cross guarantees to certain subsidiary undertakings as required by VAT legislation. UK Bus subsidiaries have provided unsecured guarantees on a joint and several basis to the Trustees of the UK Bus Occupational Pension Scheme.

Certain of the Company's subsidiaries have issued unsecured guarantees to the Company's Sterling bondholders. These unsecured guarantees rank pari passu with unsecured guarantees provided by those subsidiaries to lenders participating in the Group's £520.0m (2005: £520.0m) syndicated unsecured bank facility.

Independent auditors' report to the members of FirstGroup plc

We have audited the individual Company financial statements of FirstGroup plc for the year ended 31 March 2006 which comprise balance sheet and the related notes 1 to 11. These individual Company financial statements have been prepared under the accounting policies set out therein.

The corporate governance statement and the Directors' remuneration report are included in the Group annual report of FirstGroup plc for the year ended 31 March 2006. We have reported separately on the Group financial statements of FirstGroup plc for the year ended 31 March 2006 and on the information in the Directors' remuneration report that is described as having been audited.

This report is made solely to the Company's members, as a body, in accordance with section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of Directors and auditors

The Directors' responsibilities for preparing the annual report and the individual Company financial statements in accordance with applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice) are set out in the statement of Directors' responsibilities.

Our responsibility is to audit the individual Company financial statements in accordance with relevant United Kingdom legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the individual Company financial statements give a true and fair view, in accordance with the relevant financial reporting framework, and whether the individual Company financial statements have been properly prepared in accordance with the Companies Act 1985. We report to you whether in our opinion the information given in the Directors' report is consistent with the individual Company financial statements. We also report to you if the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding Directors' remuneration and other transactions is not disclosed.

We read the other information contained in the annual report for the above year as described in the contents section and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the individual Company financial statements.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the individual Company financial statements. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the individual Company financial statements, and of whether the accounting policies are appropriate to the Company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the individual Company financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the individual Company financial statements.

Opinion

In our opinion:

- the individual Company financial statements give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the Company's affairs as at 31 March 2006;
- the individual Company financial statements have been properly prepared in accordance with the Companies Act 1985;
- the information given in the Directors' report is consistent with the Company financial statements.

Deloitte & Touche LLP
Chartered Accountants and Registered Auditors
London
United Kingdom
16 May 2006

Shareholder information

Shareholder enquiries

The Company's share register is maintained on our behalf by Lloyds TSB Registrars, who are responsible for making dividend payments and updating the register, including details of changes to shareholders' addresses and purchases and sales of the Company's shares. If you have any questions about your shareholding in the Company or need to notify any changes to your personal details you should contact: Lloyds TSB Registrars, The Causeway, Worthing, West Sussex BN99 6DA. Telephone: 0870 600 3973.

Employees with queries about shares held in the Company's employee share schemes should contact Lloyds TSB Registrars at the same address or by telephoning 0870 241 3938.

Duplicate shareholder accounts

If you receive more than one copy of Company mailings this may indicate that more than one account is held in your name on the Register. This happens when the registration details of separate transactions differ slightly. If you believe more than one account exists in your name you may contact the Registrars to request that the accounts are combined. There is no charge for this service.

Direct dividend payments

If you would like your dividend to be paid directly into your bank or building society account, you should contact the Registrars or complete the dividend mandate attached to your dividend cheque. Mandating your dividends has a number of advantages. Firstly, the dividend will go into your account on the payment date – there is no chance of it being delayed in the post and you do not have to wait for a cheque to clear. Secondly, the payment method is more secure than receiving a cheque through the post. Thirdly, you still receive tax information about the dividend, which is sent direct to you at your registered address.

Online information

The Registrars also provide an online service enabling you to access details of your shareholding. To view your details and a range of general information about holding shares, visit www.shareview.co.uk.

FirstGroup policy on discounts for shareholders

Shareholders are reminded that it is not Group policy to offer travel or other discounts to shareholders, as they may be used only by a small number of individuals. The Group would rather maximise dividends, which are of benefit to all shareholders.

Unsolicited mail

As the Company's share register is, by law, open to public inspection, shareholders may receive unsolicited mail from organisations that use it as a mailing list. To limit the amount of unsolicited mail you receive, write to the Mailing Preference Society, FREEPOST 22, London W1E 7EZ or register online at www.mpsonline.org.uk.

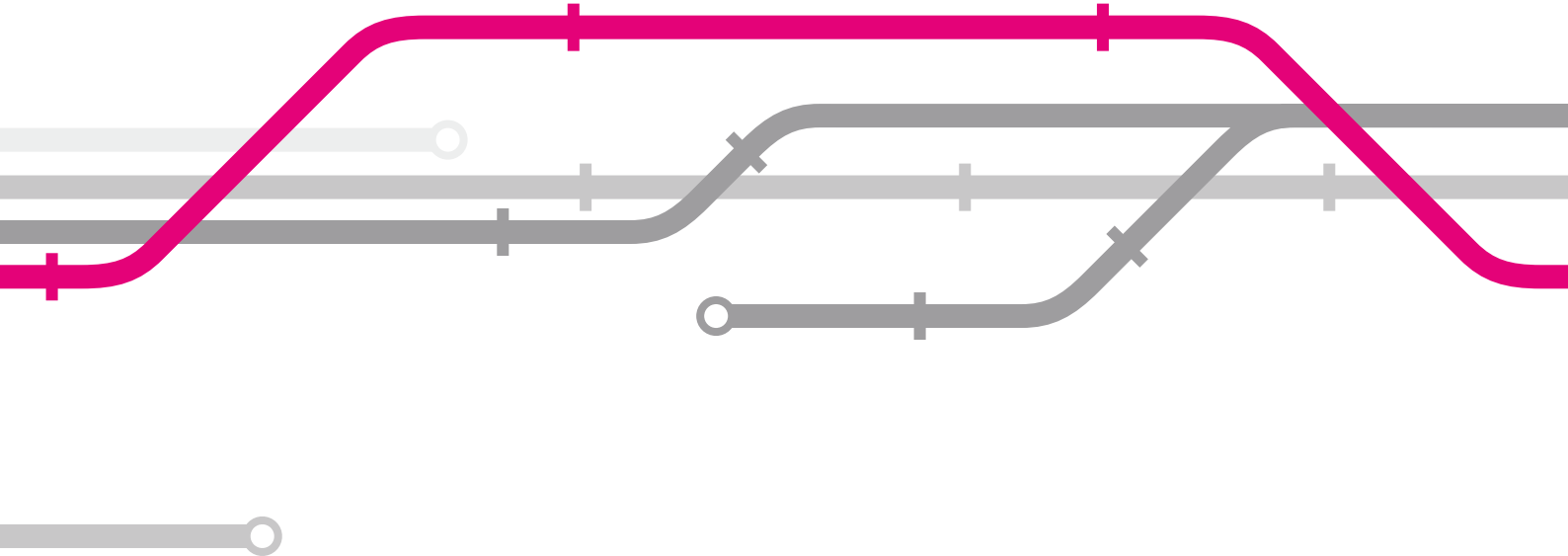
Shareholder profile

At 28 April 2006	Number of holders	%	Shares held	%
By category				
Individuals	45,334	95.1	55,469,701	13.9
Banks and nominees	2,134	4.5	330,990,955	83.0
Insurance and assurance	1	–	300	–
Other companies	207	0.4	12,289,744	3.1
Other institutions	2	–	621	–
	47,678	100.0	398,751,321	100.0
By size of holding				
1-1,000	36,783	77.1	9,285,744	2.3
1,001-5,000	8,418	17.7	18,659,485	4.7
5,001-10,000	1,325	2.8	9,257,118	2.3
10,001-100,000	832	1.7	22,237,967	5.6
Over 100,000	320	0.7	339,311,007	85.1
	47,678	100.0	398,751,321	100.0

Financial calendar

Annual General Meeting	13 July 2006
Shares trade ex dividend	19 July 2006
Record date for final dividend*	21 July 2006
Final dividend payment	25 August 2006
Interim results announced	November 2006
Interim dividend paid	February 2007
Preliminary announcement of full year results	May 2007

*Shareholders recorded on the register at this date will receive the final dividend.



Principal and Registered Office
FirstGroup plc
395 King Street
Aberdeen AB24 5RP
Telephone: 01224 650100
Facsimile: 01224 650140

Registered in Scotland
number SC157176

London Office
FirstGroup plc
Third Floor
E Block
Macmillan House
Paddington Station
London W2 1FG
Telephone: 020 7291 0505
Facsimile: 020 7636 1338

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