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COMPANIES HOUSE

Annual Report and Accounts 2016

serco

Serco is one of the world's leading international providers of services to governments. We operate in Asia Pacific, the Middle East, Europe, the UK and North America, and provide services in Defence, Health, Justice & Immigration, Transport and Citizen Services.

We employ 47,000 people, and our ambition is to be a trusted partner of governments, delivering superb public services that transform outcomes and make a positive difference for our fellow citizens. We will achieve this by being the best-managed business in our sector.

Strategic Report

Directors' Report

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Strategic Report

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Chairman's Statement

I am very pleased to see the substantial progress that was made in 2016. Having stabilised the business in the preceding period, we are now continuing with our plan to further improve how we operate and compete. Once the transformation stage is complete, we are confident that the business will start to make positive progress towards our long-term goals.

Serco is a remarkable company, supporting governments around the world in the delivery of essential public services. As your Chairman, I am proud of the work we do and of the achievements being made to implement the new strategy that was presented to shareholders in March 2015. Our five-year plan is on track and we are driving hard to achieve the ambition of being a superb provider of public services by being the best-managed business in the sector.

Delivering our strategic plan

Much has been achieved over the last three years in order to renew Serco: recruiting a new management team; carrying out the detailed Contract and Balance Sheet Review; developing the new strategy and its implementation plan; improving the morale of our people; delivering the corporate renewal programme; and strengthening the balance sheet. In 2016 we have now seen the necessary shift in focus to begin to build a successful future on these good foundations.

Over the course of the last 12 months we have therefore delivered essential elements of the 'Transform' stage of our turnaround, including: completing the rationalisation of our portfolio to achieve a strategic focus on public services in five sectors and four geographies; continued progress in reducing the burden of loss-making contracts; and rebuilding our business development capacity, which has supported an increase in our pipeline of larger new bid opportunities from £6.5bn at the end of 2015 to £8.4bn at the end of 2016. Furthermore, we are making progress on building differentiated capabilities and strengthening our sector propositions, which includes the successful development of our three Centres of Excellence covering Health, Transport and Justice & Immigration. These factors, together with clear progress on rebuilding customer confidence and trust in Serco, have contributed to a 40% increase in the value of order intake, signing contracts with a total value of £2.5bn during the year, or £3.2bn including our share of joint venture contracts.

You can read more about all of these points in Rupert Soames' Chief Executive's Review on pages 26 to 34.

Achieving our financial targets

Revenue from continuing and discontinued operations for 2016 was £3.0bn and Underlying Trading Profit was £82m, compared to our guidance at the start of the year of £2.8bn and approximately £50m respectively. The stronger performance reflected in part the benefit of foreign exchange movements over the course of the year, but to a larger degree reflected the resolution of a number of commercial matters and certain contracts running for longer. Whilst the benefits of these resolutions and contract timings are not expected to repeat in subsequent periods, they are the result of considerable hard work to achieve a favourable outcome in 2016. Elsewhere, it was the result of similar hard work to deliver cost savings slightly ahead of target and ensure our plans for operational improvements were all achieved during the year.

Operating profit before exceptional items was £98.5m. After exceptional items, net finance costs, tax and losses from discontinued operations, the loss for the year was £1.1m, compared to a loss of £153.1m for 2015.

Net Debt at year-end was £109m, also ahead of our guidance at the start of the year. This equates to EBITDA leverage of 0.7x, suitably below our medium-term target range of 1–2x and very comfortably below the 3.5x debt covenant requirement.

You can read more about the drivers of financial performance in Rupert's Chief Executive's Review, with further detail provided in the Divisional Reviews on pages 35 to 41 and the Finance Review on pages 42 to 63.

Strengthening our governance

On joining Serco in June 2015, I received a detailed briefing on the Corporate Renewal Programme and the independent oversight that was in place to ensure the programme was fully carried out. We have continued in 2016 to put in place additional actions to improve further the effectiveness of our governance, operational resilience and organisational change processes. Of particular note has been the introduction of the new Group Risk Committee which has overseen the strengthening of the Company's risk management processes, and in turn has enabled a focusing of the responsibilities of the Corporate Responsibility Committee which has replaced the Board Oversight Committee. Your Board has also been actively involved in evaluating individual bids containing a particular concentration of risks, as well as meeting regularly with management responsible for the delivery of the Company's key operations and for the development of new business.

I was delighted to welcome John Rishton as a Non-Executive Director in September 2016, with John taking over as Chair of the Audit Committee from Malcolm Wyman on 1 November 2016. John brings to Serco extensive executive and non-executive knowledge and experience, across a range of industries, and is already proving to be a valuable addition to the Board in areas that are key to strengthening Serco further. Having joined in 2013, Malcolm Wyman made a significant contribution to Serco during the prior period of stabilising the business, and more recently in 2016 during the process of appointing KPMG as the new External Auditor for the Group. Tamara Ingram also stepped down from the Board in July following her appointment as Chief Executive Officer of J.Walter Thompson Company LLC and her relocation to the US. I and the Board would like to express our appreciation for the contribution, time and energy Malcolm and Tamara spent supporting the strengthening of Serco.

You can read more about the background, structures and progress in our Corporate Governance Report on pages 74 to 125.

Shaping our future success

At the start of 2016 we refreshed Serco's Values. These are Trust, Care, Innovation and Pride, and sit at the very core of how the business operates. I and the rest of the Board have continued to benefit from seeing at first hand our contracts in operation, seeing Serco colleagues living our Values and demonstrating an absolute commitment to delivering excellent public services. We have also been able to see that the Values have been embedded successfully through our annual 'Viewpoint' employee engagement survey. I was particularly proud that, based on the responses of over 30,000 employees, Viewpoint has seen a further increase in the level of employee engagement, which is a key determinant of the future success of the business.

As we look ahead to 2017, it will be a further challenging year in terms of financial performance, and we have reiterated our guidance for revenue of approximately £3.1bn and Underlying Trading Profit of between £65m and £70m. Your Board is, however, absolutely focused on long-term, sustainable shareholder value creation, and doing so by protecting the best interests of shareholders alongside those of our employees, customers, and the societies and communities in which we work. Serco has a highly effective executive management team, a committed workforce that cares passionately about public service delivery, and a clear strategy to transform the business and position it for success in attractive markets. Once our transformation is completed over the course of the coming year, we expect to make good progress on restoring the growth, margins and returns of the business. I am confident that the collective actions being taken will ensure that Serco is fully restored as a superb provider of public services that everyone will be proud to be associated with.

I would like to thank all colleagues in the business for their efforts in achieving a successful 2016, and for their continued support in delivering the long-term turnaround of Serco.

Sir Roy Gardner
Chairman

Our Business

Serco has deep expertise: overlaid on our private sector techniques, drive and energy is a public service ethos that means that we can help deliver government services efficiently, but in a way that recognises the need for public accountability and trust.

What we do, and how we do it

Serco delivers services to governments and other institutions who serve the public or protect vital national interests. We focus on five sectors: Defence, Justice & Immigration, Transport, Health and Citizen Services, and deliver them in the UK, Europe, North America, Asia Pacific and the Middle East.

Since we were founded more than 50 years ago, we have delivered services through people, supported by effective processes, technology and skilled management. Our customers define what outcomes or services they need to deliver, and we develop new and more effective ways to deliver them. We deliver innovative solutions to some of the most complex challenges facing governments, bringing our experience, capability and scale to deliver the service standards, cost efficiencies and policy outcomes governments want. In this way we make a positive difference to the lives of millions of people around the world, and help keep nations safe.

Governments have two basic responsibilities: to develop policies, and to ensure that those policies are delivered. Some policies can be delivered simply by enacting legislation, relying on individuals and corporations to deliver the policy themselves by acting in accordance with the law, with the police and judiciary acting as enforcers of behaviour. An example of this would be a policy that required a speed limit of 20 mph near schools, which can be enforced by the police in the normal course of law enforcement. Other policies require substantial specialist workforces to be employed to deliver them.

One example would be a policy that asylum seekers should be housed in the community, rather than in detention, whilst their applications are processed: such a policy requires the government to employ – directly or indirectly – the people required to arrange housing and welfare services. Another example of a policy that requires a dedicated workforce to deliver it would be one that sought to help the long-term unemployed find jobs, which requires local offices and staff to support and encourage people through the job-finding process.

Public services require people

The delivery of many areas of government policy is labour intensive, and the number of people involved in the delivery of government services vastly outnumbers those involved in developing policy; in some countries, government is the largest employer. For example, according to the United States Bureau of Labor Statistics, nearly twice as many people (22 million) are employed by local, state and federal government as are in manufacturing (12 million).

Given that delivering public services is often labour intensive, this demands strong management of the processes to recruit, organise and oversee the hundreds or even thousands of people required to deliver a public service. Many public servants are talented managers, but all governments find it hard to attract and retain in the numbers required to deliver services in the face of private sector competition for these skills. Serco helps government by being a bridge between the drive, energy and innovation of the private sector, and the very specific requirements of public services.

Public services and delivery by the private sector

Governments have used private contractors to deliver public policy, often in very sensitive areas, for centuries. In medieval times, fighting wars and tax collection were often outsourced, in whole or part, to private enterprise. The transportation of prisoners from the UK to Australia, which started in 1788 and continued until 1868, was carried out entirely by private contractors. Today, in the UK, frontline medical services by the National Health Service are provided by some 280,000 general practitioners, the vast majority of whom are employed by private partnerships and companies. Some of the most sensitive and secret defence work, such as developing and supporting strategic nuclear weapons, is carried out by private companies.

Some services which governments need in order to deliver public policy are similar or identical to those required in the private sector, and suppliers can happily operate in both markets. Running payroll, providing telecoms networks and IT centres is not vastly different in the public and private sectors. But some government services – such as running prisons or providing air-traffic control – are unique to government and have no private sector equivalent. Many government services are bought only by government, and providing them is a specialist business, quite different from anything found in the private sector. However, many of them can be run efficiently on behalf of government by private companies using techniques, management, technology and processes developed in the private sector.

Unique demands of public service delivery

Providing government services to citizens, funded by taxpayers, is different, and in many ways more demanding, than providing services to the private sector or consumers. Politics, transparency and accountability to multiple stakeholders are seen only dimly in the private sector, but are writ large in the public sector, and need careful management. Serco has deep expertise in providing this bridge: overlaid on our private sector techniques, drive and energy is a public service ethos that means that we can help deliver government services efficiently, but in a way that recognises the need for public accountability and trust, and the fact that we are often looking after some of the most vulnerable and disadvantaged in society.

Serco's breadth and structure

As well as providing a bridge between the private and public sector, Serco also provides the international and inter-departmental sharing of ideas and best practice which governments often find hard to achieve. New approaches for running prisons and reducing youth re-offending in the UK come from Australia; hospitals we manage in the Middle East use processes developed in the UK; likewise our Defence business in the Middle East serves Australian armed forces. We transfer our insights, skills and processes from one sector or region to another, so we can anticipate and meet new challenges for customers. In our markets we are a rarity: a company that offers services covering front, middle, and back office requirements across multiple areas of government policy delivery, internationally.

We focus our activities in five areas of government service: Defence, Justice & Immigration, Transport, Health and Citizen Services. All these sectors are characterised by large and growing demand, and the requirement to employ significant numbers of people in service delivery.

We structure ourselves with four types of function: Divisions, Group, Centres of Excellence (CoEs) and Shared Services. All operational delivery is executed through five geographic Divisions: UK Central Government, UK & Europe Local & Regional Government, the Americas, Asia Pacific and the Middle East. Within their domains, Divisions are responsible for everything involved in winning and delivering contracts; 97% of our employees work in these Divisions. A lean Group function provides governance, strategy, asset allocation, policy-setting and oversight, as well as certain specialist consolidation and functional roles in Finance, Risk and HR. The Group also manages CoEs which provide focused expertise and support to the Divisions, and enable sharing of best practice and the development of common propositions in areas such as Transport, Justice & Immigration and Health. Shared Services provide common functional and processing support in areas such as IT, HR and finance to the Divisions.

Our Business continued

Our Strategy

As managers, our job is to ensure Serco delivers value to the people and institutions who have an interest in our success: to our customers and service-users, by providing high-quality, resilient and innovative public services; to our shareholders, by providing sustainable and growing returns on capital; to our lenders, by providing them with a solid and secure credit; and to our colleagues, by enabling them to have interesting and rewarding careers.

We believe that good strategies are simply expressed. Our strategy is to be a superb provider of public services, by being the best-managed business in our sector. We are a B2G (Business to Government) business, specialising across five sectors: Defence, Justice & Immigration, Transport, Health and Citizen Services. We deliver these services in four regions: UK & Europe, North America, Asia Pacific and the Middle East.

The decision to focus on being a B2G business was taken in 2014, and was a change from the previous strategy which had been to serve both private and public sector customers. The strategy was changed as a result of the need to recapitalise the business following a troubled diversification into private sector outsourcing and the realisation that Serco had taken on a number of very heavily loss-making contracts. As a result of this the management team was changed in 2013 and 2014, and over £700m was raised by way of an equity Rights Issue in early 2015 and the disposal of non-core businesses later in that year.

Focusing the business on the public sector market was, in effect, going back to our roots. For some 20 years up until 2010, the company had delivered rapid growth and very significant value creation by being largely focused on the public sector. In recent years the public sector market has become more difficult as governments struggled with the effects of the financial crisis in 2008, slowdowns in military spending, and the election of governments committed to reducing public expenditure. Furthermore, governments have become much more skilled at contracting and focused on risk-transfer; as a consequence margins and risk-adjusted returns earned by many suppliers to government are much lower today than they were ten years ago.

However, despite what is now a more mature and difficult market than it was around the turn of the century, the business of providing services to government has attractions. We believe that the market is growing and will continue to do so because of two fundamental truths. First, that in many areas of public service provision, private companies, properly managed, can deliver services of higher quality and lower cost than governments can themselves. Second, that governments will continue to face huge pressure to deliver more and better public services, for less, and that this will lead them to focus relentlessly on value for money and the quality of service provision. This pressure comes from what we call 'the Four Forces' comprising:

- The relentless increase, at rates above GDP growth, of demand for public services across important areas of government. Examples are the pressures on health and social care driven by ageing populations, and growing prison populations.
- The need to reduce public debt and expenditure deficits.
- Rising expectations of service quality amongst public service users.
- The unwillingness of voters and corporate taxpayers to countenance tax increases.

The challenge facing governments worldwide can, like our strategy, be simply expressed: to deliver more, and better, for less.

In the face of this challenge, and having over recent years already plucked from the savings tree the low-hanging fruit, governments are having to find ever-more inventive and sophisticated ways of providing better public services at lower cost. For governments, as for companies in the private sector, when under pressure it is often best to focus intellectual and management energy on their core mission, and leave it to others to provide the development and operation of supporting activities. A modern army, air force or navy needs to concentrate its efforts on maintaining its fighting capability, not running the payroll, maintaining buildings or manoeuvring ships around in port with tugs. Likewise, hospitals need to concentrate their intellectual and management energy on delivering clinical services, not delivering meals to patients, cleaning the loos and maintaining the air-conditioning.

There are other factors that make the public sector marketplace attractive to us: whilst some niches may be disrupted by technology or other exogenous factors, we can be very confident that the world will still need prisons, will still need to manage immigration, and provide healthcare and transport, and that these services will be highly people-intensive for decades to come. The bank teller or shop assistant may be rightly fearful that technology will disintermediate their role, but a prison custody officer can sleep soundly in the knowledge that his or her skills will be required for years to come.

Risk management is central to our thinking at both a strategic and an operational level. In terms of strategy, although being a focused and specialist B2G business, we think it beneficial, and a competitive advantage, to diversify our exposure to individual governments and sectors. Governments can be capricious; decision-making processes regularly come to a halt around elections; the attitude to using private companies can be volatile; political priorities can change in the blink of an eye, switching discretionary resources from defence to immigration to healthcare and back again. In this environment, being diversified both by sector and geography reduces risk and volatility. Most companies operating in our market are heavily focused in either a particular sector, or within a geography; in our market, Serco is a rare beast, operating amongst five sectors and four regions.

But management of risk is only one reason we favour a strategy of operating across a number of jurisdictions and sectors. Governments across the world face similar challenges, and we believe that we can gain competitive advantage and deliver value to customers by operating internationally. At a detailed operational level, providing cleaning and catering services in a hospital is very similar in Western Australia and in Abu Dhabi. In terms of capability, many of our contracts employ hundreds, and some, thousands, of people; so recruitment, training, staff rostering and time management are key capabilities applicable across all our sectors and geographies. The same is true of project and case management; we are also able to adopt consistent approaches to key operational tools such as Continuous Improvement.

An international footprint also helps us build customer interest and confidence. The fact that we are involved in running major urban rail infrastructure in the UK and Dubai helps us in rail bids in the United States; our proven track record in reducing recidivism amongst offenders in Australia is of interest to authorities in the UK. But, more broadly, when governments are considering awarding us an important project, the fact that other governments trust us to help them manage some of their most critical and secret areas of national security infrastructure is helpful in building confidence.

Market size

People ask: how large is the market for the private sector provision of public services? This is hard to determine with precision, as the boundaries of the market are fiendishly hard to define. Does the maintenance contract for a mainframe computer operated by the government fall within the definition of the market? How should we treat services provided by government-owned agencies operating on an arm's-length basis? Within Defence, do we count supply and support of, say, missile systems, or just the types of services we currently (as opposed to could) supply? And how do we disentangle the very different definitions of, and accounting for, expenditure used by the various governments with whom we deal?

In the last year we have done a lot of work to try and size the market in the sectors and geographies we currently operate in, which are clearly a subset of the global market. Our best guess is that the total annual value of government services in our target segments and geographies which could be provided by the private sector is around £300bn, of which around £100bn is delivered by private companies. Rather than concentrate on the absolute number, some key conclusions from our work are:

- the market for private sector delivery of government services is very large;
- the supply-side is fragmented; as a leading international supplier, our market share within our existing footprint, at around 3%, is small, although it is larger in some specific segments within certain sectors; and
- there is significant opportunity for growth, given that around two-thirds of the services that could be provided by the private sector are currently self-delivered by government.

Our Business continued

Our core sectors

Our business is focused on five sectors: Defence, Justice & Immigration, Transport, Health and Citizen Services. Our revenues, jurisdictions by region and key services in each of these sectors are shown below.

Revenue in 2016 (continuing operations, including share of joint ventures and associates) **£3,492m**

	Defence	Justice & Immigration	Transport	Health	Citizen Services
Revenue	£1,112m 32%	£569m 16%	£606m 17%	£355m 10%	£850m 25%
Regions	UK & Europe Americas Asia Pacific Middle East	Asia Pacific UK & Europe	UK & Europe Middle East Americas Asia Pacific	UK & Europe Asia Pacific Middle East	UK & Europe Americas Asia Pacific Middle East
Key Services	Base and operational support Engineering, management and information services Maritime services	Custodial services Immigration detention and services Detainee transport and monitoring	Rail and ferries Road traffic management Air traffic control	Non-clinical support services Patient administration and contact	Contact centres and case management Middle and back office services; IT services Employment and skills services

Implementing our strategy

We combine people, processes and technology to deliver superb services. Serco is not a process consultant or a technology business; we use process and technology as enabling tools, not as products to sell. Furthermore, since processes and technology depend entirely on people, it can be simply said that the success of our strategy will depend upon how well we manage, organise, motivate, develop and select people. So the answer to 'how?' is: 'by being the best-managed business in our sector'.

Having such an ambition may sound trite, but we believe that it is a worthy and value-creating aspiration, and one that we can use to inspire our management teams and customers. In any given circumstances, and whatever the slings and arrows of fortune, well-managed businesses do better than poorly-managed businesses, and the best-managed businesses do best of all.

We are great believers in succinctness and simplicity. Accordingly, we have managed to fit our strategy and performance framework – of what is a very complex and diverse business – into a single graphic that we use throughout the business:

Our performance framework

Our values

Trust | Care | Innovation | Pride

Our purpose – what we want to be

A trusted partner of governments, delivering superb public services that transform outcomes and make a positive difference for our fellow citizens

Our organising principles

Flair, agility, innovation Empowerment Decentralisation of execution	Loose – Tight management Disciplined entrepreneurialism	Rigour, discipline Common processes Centralised intent

Our method

Winning good business Executing brilliantly	Being the best-managed company in the sector	A place people are proud to work Profitable and sustainable

Our deliverables

Engagement >60% and increasing	Revenue growth of ~5–7%	Trading margin ~5–6%

Our Business continued

Our performance framework continued

The purpose of the performance framework is to provide a structure which will deliver value to our customers, shareholders, and to the people who work in the business. We start with our Values.

Our values

Whilst we use technology and processes, the core of our business is using people – many thousands of them – to deliver public services. It is of central importance to our success that our colleagues – many of whom are former public servants – and our customers believe that we have values appropriate to a company delivering services funded by taxpayers to often vulnerable and disadvantaged citizens. "Working at the leading edge of technology" may be inspiring to people working for IT businesses, but they are not reasons why a prison officer makes a cup of tea for a suicidal prisoner at two o'clock in the morning; why a housing officer leaves the comfort of an office to walk a nervous asylum seeker's child to school on their first day; why an engineer crawls into that impossibly small space in the foetid bowels of an aircraft-carrier to make sure the cable-ties are secured just right so they will stay in place for the next 20 years. It is because they care about their work and take pride in it. Before our customers will give us sensitive work, they have to trust us. And to win business we have to come up with innovative solutions which will enable governments to deliver more, and better, for less. This is why our Values of Trust, Care, Innovation and Pride are important.

Our organising principles

Our organising principles have to reflect the fact that many of the things our customers want are mutually exclusive: they want excellent and resilient services, delivered by highly motivated staff, but they want them to be low cost; they want local accountability and flexibility, but they also want strong governance and risk management. As a management team, we believe in the principle of subsidiarity: that decisions should be taken by managers who are as close to the customer as possible. But we are also conscious of the fact that many of our contracts carry with them risks that need careful management and supervision. So we describe our organising principles with two concepts: 'loose-tight', and 'disciplined entrepreneurialism'. Neither of these is our own invention; they are based on the work of, respectively, Tom Peters and Jim Collins. They describe in subtly different ways an approach to management which recognises the need for both local management autonomy and strong governance. Two quotations from their works give a taste of the type of organisation we are trying to achieve:

"Loose-Tight...is the co-existence of firm central direction and maximum individual autonomy. ... Organisations that live by the loose-tight principle, are on the one hand rigidly controlled, yet at the same time allow (indeed insist on), autonomy, entrepreneurship, and innovation from their people." Tom Peters: In Search of Excellence

"Avoid bureaucracy and hierarchy and instead create a culture of discipline. When you put two complementary forces together – a culture of discipline with an ethic of entrepreneurship – you get a magical alchemy of superior performance and sustained results."
Jim Collins: Good to Great

Our method

The method we use to deliver our aspiration to be the best-managed business in our sector and to deliver our strategy is to concentrate on doing four things really well. These are the things we want Serco to be famous for:

- **Winning good business**
- **Executing brilliantly**
- **Being a place people are proud to work**
- **Being profitable and sustainable**

We try to make sure that everything we do improves our performance against one or more of these objectives, and start from a position where we know we can do much better. We can improve the way we bid and manage contracts; develop innovative propositions; measure performance; reduce the cost and improve the quality of our administrative systems and processes. None of these comes easily or quickly, and we need to steer a tricky course between the urgent need to reduce our costs in line with reduced revenues in the short-term and investing in systems and processes that will produce sustainable benefits in the long-term.

Our deliverables

The tangible evidence of our success or otherwise will be a return to industry rates of growth and margins. In recent years our revenues have been shrinking and our underlying trading margins are far too low at around 2–3%. Our challenge, and our opportunity, is to get back to long-term industry rates of Revenue growth, which we believe are around 5–7%, and Trading Profit margins across Serco's mix of business in the range of 5–6%. If this turns out to be correct, and markets turn out as expected, we believe that after a period of restructuring and transformation, it will be possible to increase growth rates and margins towards the average of our peers.

Progress to date

In terms of progress towards our goals, in 2014 we identified three distinct phases in the implementation of our strategy. The first phase – Stabilisation – recognised the urgent need to recapitalise the business and restore customer and employee confidence following the very significant write-downs following the realisation that Serco had a number of very heavily loss-making contracts. This phase was completed in 2014, and we are now mid-way through the Transformation phase. This will be followed from 2018 by the Growth phase as we seek to reap the rewards of Transformation and start our journey back towards industry-average growth rates and margins.

Our Ambition

To be a superb provider of public services by being the best-managed business in our sector

2014 **Stabilise**	2015–2017 **Transform**	2018–2020 **Grow**	**Planned Outcome**
• Hire new management • Identify issues • Develop strategy and implementation plan • Undertake Contract and Balance Sheet Review • Stabilise morale • Roll out corporate renewal	• Strengthen balance sheet • Rebuild confidence and trust • Improve risk management • Rationalise portfolio • Mitigate loss-making contracts • Strengthen sector propositions • Re-build business development and pipeline • Build differentiated capability • Improve execution and cost efficiency	• Harvest benefits of transformation • Leverage scale and capability • Build out geographical footprint • Move into new sub-segments • Continuously review portfolio	Chosen sectors will grow at ~5–7% Industry margins in our sectors ~5–6% **We believe our performance can match this**

In terms of progress in the Transformation phase:

- We have successfully strengthened our balance sheet, following the Rights Issue completed in April 2015 and the disposal of our private sector BPO business; together these raised over £700m, and our Net Debt: EBITDA now stands at 0.7x, with period-end net debt reduced from £745m at the end of 2013 to £109m at the end of 2016.
- We have made excellent progress rebuilding confidence and trust with our major customers, in large part due to greatly improved operational performance.
- Portfolio rationalisation has been completed, concluding with the disposal of the majority of our private sector BPO business at the end of 2015.
- We continue to mitigate the impact of loss-making contracts; we have always regarded our Onerous Contract Provisions as a portfolio, knowing that the actual out-turn on individual contracts would almost certainly be different from the original estimates made at the end of 2014. To the end of 2016, actual expenditure against the £447m of Onerous Contract Provisions has been very close to the original estimate, with £209m spent to date against the original plan of approximately £220m.
- We continue to strengthen our sector propositions, most particularly through the work carried out by our new CoEs covering Health, Justice & Immigration, and Transport. These CoEs have been heavily involved in developing propositions to support major bids such as Barts Health NHS Trust (won in 2016), Doha and Riyadh metros, and Grafton prison in Australia.
- Our pipeline of bidding opportunities has grown very substantially – from £5bn at the end of 2014 to £8.4bn at the end of 2016. This reflects a greatly improved business development capability.
- We have succeeded in reducing the businesses' operating costs; in 2016 they were £1.1bn lower than in 2013. The majority of this reduction relates to costs removed from contracts which have ended and businesses disposed of, but it is certainly an achievement to have reduced costs broadly in line with revenues. Improving our cost efficiency is a major focus for us in 2017.

Summary

We believe we have the right strategy for our business, and to date we have held to our original implementation plan. So far, so good, but the real test of the strategy will be our ability to start growing revenues and improving margins in the Growth phase of our plan.

Key Performance Indicators

We use Key Performance Indicators (KPIs) to monitor our performance, ensuring we have a balance and an appropriate emphasis to both financial and non-financial aspects. Alongside this, in 2016 we have continued to further improve our Management Information, including the contract performance monitoring process which tracks KPIs specific to each customer operation, our monthly management accounts and our Divisional Performance Review (DPR) processes.

For each KPI we explain the definition, relevance to our strategy and the performance in 2016. We have made some changes to the KPIs presented in order to achieve comparability and consistency with our focus in the business and the guidance that we provide. Certain financial information has been restated for a change in accounting policy, as described in the Finance Review on page 43. The Finance Review also provides further detail on our use of Alternative Performance Measures (APMs). Information on our carbon emissions that was previously presented in this section can be found within our Corporate Responsibility Report on pages 71 and 72.

Definition
Trading Profit is defined as IFRS Operating Profit adjusted for (i) amortisation and impairment of intangibles arising on acquisition and (ii) exceptional items. Consistent with IFRS, it includes Serco's share of profit after interest and tax of its joint ventures. Underlying *Trading Profit excludes Contract and Balance Sheet Review* adjustments (principally Onerous Contract Provision (OCP) releases or charges), the beneficial treatment of depreciation and amortisation of assets held for sale, and other material one-time items as set out in the Finance Review. Trading Profit measures include discontinued operations for consistency with previous guidance.

Relevance to strategy
The level of absolute UTP and the relationship of UTP with revenue – i.e. the margin we earn on what our customers pay us – is at the heart of our 'profitable and sustainable' business objective, as well as being an output of 'winning good business' and 'executing brilliantly'. We describe on page 13 that the delivery of strategic success, after the completion of further transformation in the coming year, has potential to deliver revenue growth of 5–7% and trading margins of 5–6%.

Performance
A materially better outcome than expected at the start of the year, driven largely by non-repeating factors such as the successful resolution of a number of commercial issues. The £14m decline was a reduction of £4m excluding the £19m effect of discontinued operations that reflect the disposal of the private sector offshore BPO business at the end of 2015 and excluding the £9m net currency benefit. The underlying margin was flat at 2.7%.

Definition
Underlying EPS reflects the Underlying Trading Profit measure after deducting pre-exceptional net finance costs (including those for discontinued operations) and related tax effects. It excludes 'non-controlling interests' and divides the amount by the weighted average number of ordinary shares outstanding during the period in accordance with IFRS.

Relevance to strategy
EPS builds on the relevance of UTP, and further reflects the achievement of being 'profitable and sustainable' by taking into account not just our ability to grow revenue and margin but also the strength and costs of our financial funding and tax arrangements. EPS is therefore a measure of financial return for our shareholders.

Performance
The increase reflects the reduction in UTP being more than offset by the lower finance costs and tax charge, partially offset by the increase in the average number of shares as a consequence of the Rights Issue completed in April 2015.

Definition
Free Cash Flow is the net cash flow from operating activities before exceptional items as shown on the face of the Group's Consolidated Cash Flow Statement, adding dividends we receive from joint ventures and deducting net interest paid and net capital expenditure on tangible and intangible asset purchases.

Relevance to strategy
FCF is a further reflection on how 'sustainable' our profits are, as well as the sustainability of the overall business, by showing a measure of how much of our effort turns into cash to reinvest back into the business or to deploy in other ways. Furthermore, 'winning good business' should reflect that which generates appropriate cash returns, and 'executing brilliantly' should include appropriate management of our working capital cash flow cycles.

Performance
Cash generated from UTP was largely offset by the outflows related to loss-making contracts subject to OCPs. These cash outflows lessened year-on-year, as reflected in the lower rate of OCP utilisation. There was a working capital outflow of £25m as we continued to reduce the utilisation of the Group's receivables financing facility. Capital expenditure was lower, reflecting the benefit of the disposal of the private sector BPO business.

Definition
The estimated aggregate value at the end of the reporting period of new bid opportunities that have an estimated Annual Contract Value (ACV) of at least £10m or a Total Contract Value (TCV) of at least £100m, and which we expect to bid and to be adjudicated within a rolling 24-month timeframe. The TCV of individual opportunities is capped at £1bn. The value of re-bid and extension opportunities is specifically excluded so as to measure only 'new' growth opportunities. Also excluded is the potential value of framework agreements, prevalent in the Americas in particular where there are numerous arrangements classed as 'IDIQ' – Indefinite Delivery / Indefinite Quantity. This KPI was established and defined in 2013.

Relevance to strategy
The pipeline provides the key potential for 'winning good business' and therefore is a major input to being 'profitable and sustainable'. The size of the pipeline and our win-rate conversion of the bids within it will also ultimately be at the heart of successfully achieving a shift to the third and final stage of our turnaround plan – the 'Grow' stage.

Performance
A further net increase in the value of new growth opportunities reflects that the reductions from customer decisions made in the period have been more than offset by adding new opportunities, particularly in defence in US, justice in Australia, and expanded scope of Middle East transport opportunities. Our win rate on new bids improved to over 20% on a value basis and to over 50% on a volume basis.

Definition
Major incidents are classed as fatalities, fractures, amputations, dislocations, loss of sight, chemical and hot metal burns, electrical burns, unconsciousness caused by asphyxia or exposure to a harmful substance, and acute illness resulting from substance inhalation or ingestion.

Following a review of safety indicators and how rates are calculated, the decision was taken to change from reporting incident rates normalised by numbers of employees to frequency rates normalised by one million hours worked. We have therefore recalibrated our historical data. Data excludes the BPO operations sold in 2015, to provide meaningful comparison, and joint venture operations.

Relevance to strategy
Delivering excellent service to our customers, and therefore 'executing brilliantly', requires us to operate in the safest way possible. Safety also has a direct bearing on the commitment and engagement of our people, which is central to achieving 'a place people are proud to work'.

Performance
34 major incidents were reported in 2016, a 26% reduction against 2015. This resulted in a frequency rate of 0.27 per 1m hours worked which is a 20% improvement on 2015 and exceeds our target which was set at a 5% reduction against our 2015 actual performance. This shows good performance and reflects each of the Divisions' ongoing focus.

Definition
ROIC is calculated as UTP for the period divided by the invested capital balance. Invested capital represents the assets and liabilities considered to be deployed in delivering the trading performance of the business. Invested capital assets are: goodwill and other intangible assets; property, plant and equipment; interests in joint ventures; trade and other receivables; inventories; and assets classified as held for sale. Invested capital liabilities are trade and other payables (current and non-current) and liabilities classified as held for sale. For 2014, invested capital is calculated using the closing balance sheet position, given the impact of the Contract and Balance Sheet Review during that year; for all other years it is calculated as a two-point average of the opening and closing balance sheet positions.

Relevance to strategy
ROIC measures how efficiently the Group uses its capital to generate returns from its assets. To be a sufficiently 'profitable and sustainable' business, a return must be achieved that is appropriately above a cost of capital hurdle reflective of the typical returns required by our weighting of the use of equity and debt capital.

Performance
The reduction in UTP was only partially offset by a reduction in average invested capital, resulting in a modest reduction in ROIC. We expect an improvement in ROIC to be driven by the development in profit margin when we successfully complete the 'Transform' stage of the turnaround and make progress with the 'Grow' phase.

Definition
We partner with Aon Hewitt to run Viewpoint, our global employee engagement survey. This covers all employees, excluding our joint ventures, and focuses on three key areas: whether people say positive things about working at Serco ('say'), people's intention to stay with Serco ('stay') and their intention to give discretionary effort ('strive'). Our engagement score shows how many employees exhibit strong levels of all three of these areas when we survey.

Relevance to strategy
Employee engagement reflects 'a place people are proud to work', which is crucial to delivering outstanding customer service and achieving our strategic aims.

Performance
2016's Viewpoint survey, which is based on the response of over 30,000 employees, showed a further improvement in our global score. The score also increased for all categories – employees, managers and leaders – and is now at the highest level since we started measuring it in 2011. The Viewpoint results were cascaded to the organisation in Q4 2016 and we have a global plan of activity in place for 2017 to sustain and drive further employee engagement, led by our Executive Committee.

Principal Risks and Uncertainties

Risk management approach

Serco faces many risks and uncertainties which we mitigate and manage through our risk management policy, standard, and risk management lifecycle processes; these align to the guidance contained within the UK Corporate Governance Code and form part of the Serco Management System (SMS). They seek to ensure that we identify, review and report risks at all levels of our business, reflecting the nature of the activities being undertaken at that level, the inherent business and operational risks, and the level of control considered necessary to protect our interests and those of our stakeholders.

The risk management lifecycle includes six key processes that aim to manage the key risks of our operations. They ensure we have a consistent approach to identifying, analysing, monitoring and reporting risks and a mechanism for providing assurance that the risk mitigation in place is effective.

Risks are reported both 'bottom-up', whereby business and operational risks are communicated upwards to the Divisional CEOs and the Executive Committee, and 'top down', whereby an assessment of the principal risks by the Executive Committee is cascaded downward via the Divisional Risk Directors to ensure Divisional risk registers are focusing on key risk drivers that are considered most important to the organisation from a strategic perspective.

The Group Risk Register sets out the principal risks facing the Group and is reported to the Board on a quarterly basis via the newly formed Risk Committee. This focuses on risk related matters across the Group, reflecting the maturity and changing focus of the Board Committees to embed policies and procedures put in place as part of the Corporate Renewal Programme (see page 80).

Principal risks

On an annual basis the Executive Committee reviews the principal risks facing the Group to ensure they remain current, taking into consideration the various Divisional risk registers and any emerging risks that would threaten the execution of Serco's strategy, business model, future performance, solvency and liquidity.

The resulting principal risks are reviewed and endorsed by the Risk Committee, and each risk is classified as strategic, financial, operational, people, hazard, legal and compliance. They are described on the following pages, together with the relevant strategic business objectives, key risk drivers, the Group-wide material controls which have been put in place to mitigate the principal risks, and the mitigation and contingency actions to improve the effectiveness of the controls.

The risks are considered within the timeframe of three years which is the same time period that has been used in the Viability Statement (see page 24). The Viability Statement takes into account the principal risks in its assessment.

Risk appetite

In 2016, the Executive Committee undertook an exercise to assess the risk appetite for each of the principal risks. The risk appetite represents the nature and amount of risk that the Group is willing to accept and facilitates decision-making as to the level of resource that should be expended to mitigate the principal risks.

Risk appetite statements were developed which were reviewed and endorsed by the Risk Committee. During 2017, these statements will be used to define the risk tolerance levels throughout the business, and along with our Values, Code of Conduct and mandatory ethics training will provide clarity on the risk culture of the Group.

STRATEGIC RISKS

Failure to grow profitably

Failure to win material bids or renew material contracts profitably, or a lack of opportunities in our chosen markets, will restrict growth and may have an adverse impact on Serco's long-term financial viability.

Our business is linked to changes in the economy, fiscal and monetary policy, political stability and leadership, budget priorities, and the perception and attitude of governments and the wider public to outsourcing, which could result in decisions not to outsource services or lead to delays in placing work.

Key risk drivers:

Lack of opportunities in chosen markets – market sectors do not have a favourable policy of private sector provision of public services, reducing pipeline opportunities.

External factors reducing the pipeline of opportunities – changes such as the Brexit decision may make it more difficult for us to win EU government contracts.

Not accessing opportunities due to inability to qualify – lack of critical skills and references, and a value proposition for the markets in which we compete, may put Serco at a disadvantage with our competitors.

Inability to meet customer and solution requirements during design, implementation and delivery – executing our bids in an unsatisfactory manner by not understanding the strategic needs of the customer, mispricing bids, developing unworkable solutions, and misunderstanding risks, may prevent us from achieving our growth ambitions.

Mitigation:

Material controls:

- Serco Group Strategy
- Serco Management System (SMS)
- Business Lifecycle Review Team (BLRT) Process
- Sector-specific Centres of Excellence (CoEs) and Value Propositions
- Serco Operating Model
- Annual Talent Review and Succession Planning process
- Standardised Divisional Performance Reporting (DPR) process

Current mitigation actions:

- Ongoing Group Strategy reviews by Executive Committee and Board
- Ongoing delivery of Group and Divisional transformation programmes
- Embedding of DPR process with Divisional monthly reviews of KPIs

Future actions:

- Additional changes to Group and Divisional overhead and shared service structures implemented as part of transformation programmes
- Review of BLRT process to ensure lessons learned and price-to-win competitive analysis are formally embedded
- Review of CoE business model to assess requirement for cross-divisional bid teams

Principal Risks and Uncertainties continued

STRATEGIC RISKS CONTINUED

Failure to build our reputation or act with integrity

Failure to build our reputation or act with integrity will mean that customers will be less likely to give us new business or renew existing business. It will also impact our ability to attract and retain high-quality people.

Operating effectively but without integrity will generate mistrust and scrutiny; conversely, acting with integrity but operating ineffectively will raise uncertainty in our ability to sustain and grow our business. Both are key to building our reputation.

Key risk drivers:

Stakeholders' perception of Serco – a poor perception of Serco may result in an inability to build relationships.

Stakeholders' expectations are not understood – an inability to identify changes in stakeholder expectations may result in the failure of key relationships.

Our ways of working do not align with our Values – staff or third parties being unaware of and/or not reflecting our Values may result in unacceptable business conduct, and unethical or illegal behaviour.

Deliberate breach of law and / or regulations – staff and third parties inappropriately incentivised to behave in a certain manner may result in a breach of laws and regulations.

Direct or indirect contribution to human rights abuse – staff either directly or indirectly contributing to human rights abuses may result in a breach of laws/regulations.

Inappropriate response to an incident – if we do not respond in an honest and collaborative way with key stakeholders, then we may fail to protect our reputation.

Mitigation:

Material controls:

- Our Values and Code of Conduct
- External stakeholder engagement
- Serco Management System (SMS)
- Business conduct and ethics tools
- Serco Essentials training
- Third party ethical due diligence procedure
- Speak Up process
- Performance/incentive schemes

Current mitigation actions:

- Refresh of Our Values
- Refresh of Incident Management Procedure
- Review of Crisis Communication Manual
- Media training for key spokespeople
- Development of Human Rights policy, standard and procedures
- Development of Gifts and Hospitality tool and Conflict of Interest tool
- Values Gate in Personal Development Review (PDR)
- Update of 3rd party ethical due diligence procedure
- Due diligence checks on customers and suppliers
- Development of Anti-Bribery and Corruption (ABC) Framework and ABC risk checklist tool

Future actions:

- Embedding of Serco Values
- Embedding of ABC Framework and checklist tool
- Development of stakeholder relationships in key markets

Failure to transform and deliver the Group strategy

We aim to transform the business so as to become the best-managed business in each of our chosen sectors. If due to a number of internal and external factors, we fail to successfully implement the Group-wide transformation programmes, we may fail to deliver our strategy to become a sufficiently profitable and growing business.

We have put in place transformation programmes to achieve lasting change in the way Serco operates across Finance, IT, and the Corporate Shared Services (CSS).

Key risk drivers:

Failure to implement on time – either as a result of financial pressures or poor programme management, we do not implement the Group transformation programmes on time.

Non-delivery of required benefits – we fail to achieve the expected benefits due to poor programme management and/or solution design.

Severe disruption to the business – we fail to coordinate and prioritise the various programme activities due to poor integration across activities and inadequate programme management, and we negatively impact on Business As Usual activities.

Lack of staff engagement – due to ineffective communication or the setting of unrealistic or unclear expectations, we fail to gain staff buy-in.

Failure to effect merger and acquisition activities and disposals – we do not identify and effect M&A activities or effect the intended disposals, and fail to achieve the anticipated portfolio and capital position.

Mitigation:

Material controls:

- Group Transformation Programme Management Office (PMO) and Programme Governance Boards
- Standardised Divisional Performance Reporting (DPR) process
- Business Planning Cycle Reviews
- Group and Programme Workstream Communication Plans

Current mitigation actions:

- Group Programme Management Office (PMO) and Programme Governance Boards in place
- Business cases developed and signed off, and benefits tracking monitored by Group Finance and Group Transformation PMO, and reported through the DPR process
- Group and Programme Workstream and Communication Plans developed

Future actions:

- Ongoing review and updates to Group Strategy
- Review/benchmark cost of CSS services

FINANCIAL RISKS

Financial control failure and Finance IT system failure

Financial control failure or prolonged loss of financial IT systems may result in the failure to create a suitable capital structure, an inability to make critical financial transactions, accurately report timely financial results and meet contractual financial reporting obligations and a heightened risk of error and fraud.

In addition, poor quality data will lead to an inability to forecast accurately and may lead to poor business decisions; therefore, leading to financial instability, potential business losses and negative reputational impact.

Key risk drivers:

Not setting the right tone from the top – if we do not set the right tone from the top, we may fail to embed the finance policy, processes and controls.

Poor financial processes – if processes are poorly designed, then inaccuracies and fraud may occur.

Inadequate financial controls within the business – if controls are inadequate we may fail to provide adequate protection from sabotage of systems, fraud and error.

Inadequate financial controls within Treasury – a lack of a control framework for treasury-related activities may result in insufficient liquidity.

Loss of finance IT systems and critical financial roles – if finance IT systems and roles become unavailable, we will not make financial transactions, and meet contractual and reporting obligations.

Impact of Transformation Programme activities – programme activities may lead to an unstable financial control environment due to an increased workload on the finance community.

Failure of Finance Transformation Programme – we do not transform the finance processes and controls, and fail to deliver expected benefits.

Mitigation:

Material controls:

- Group Finance Strategy
- Serco Management System (SMS) – finance processes and controls
- Shared Service Centre (SSC) Customer Boards
- Process Improvement Forums
- Financial Assurance Programme
- Finance Academy
- Standardised financial platform (i.e. SAP)
- Testing of Business Continuity Plans (BCPs) and back-up systems
- Global Finance Transformation Programme Management Office (PMO) and Programme Governance Boards

Current mitigation actions:

- Embedding of Group Finance strategy, policy and standards
- Global Finance Transformation Programme workstreams
- Cyber Defence and Cyber Hardening Programme delivering enhanced core IT security infrastructure, processes and controls
- Group IT Transformation Programme
- Business impact assessments for finance function and systems and updates to BCPs and Disaster Recovery (DR) plans
- Creation of Corporate Shared Service (CSS) Crisis Management Team

Future actions:

- Review of BCP contractual compliance, and customer approval of updated BCPs and testing schedules
- Global Finance Transformation Programme continues to improve effectiveness of CSS
- Backfill/resourcing pool to be established to cover finance transformational activity

OPERATIONAL RISKS

Major information security breach

A major information security breach resulting in the loss or compromise of sensitive information (including personal or customer) or wilful damage resulting in the loss of service, causing significant reputational damage, financial penalties and loss of customer confidence.

Due to the nature of the services we provide, our technology and operational systems will be subject to threats from both internal and external breaches. We implement effective controls proportionate to the level of sensitivity of the information we are protecting, and where 'things go wrong', we act swiftly to minimise the impact of any breach and carry out remedial actions to prevent further breaches immediately.

Key risk drivers:

Non-compliant systems – if our systems are non-compliant with regulatory requirements for sensitive information, we are susceptible to breaches and penalties.

Non-compliance with policies and standards – if staff do not comply with Serco policies and standards, then they may accidentally release sensitive information to third parties.

Inadequate protection of sensitive information – if we do not identify sensitive information and protect and test the vulnerability of the systems, then we are potentially exposed to a breach.

Inadequate incident monitoring and response – if we do not monitor our systems and remediate and repel attacks, then we may fail to minimise the impact of any breach.

Unauthorised use of systems – if we do not implement effective personnel vetting and access restriction processes and controls, then unauthorised use of our systems may occur.

Poor perception of Serco's capabilities – if we are perceived to be vulnerable to cyber attack, we may lose customer confidence.

Mitigation:

Material controls:

- Serco Management System (SMS)
- Global Information Assurance Board and Enterprise Architecture Boards
- Enhanced IT security infrastructure, process and controls
- Global Security Operations Centre and Computer Security Incident Response Teams
- Serco Essentials training
- Cyber security awareness training
- My HR – standardised HR processes and corporate HR system
- Third party due diligence checks
- Privilege User Management (PUM) process
- Cyber Essentials Plus (CES+) certificate successfully renewed January 2017

Current mitigation actions:

- Embedding of Information Security policies and standards
- Cyber Defence and Hardening Programme delivering enhanced core IT security infrastructure processes and controls and Global Security Operations Centre
- Roll out of PUM process in Americas
- Enhancement of the information security on-boarding process for new IT suppliers as part of refreshed supplier risk management

Future actions:

- Improvements to IT asset registers
- Feedback and monitoring of activities to drive user awareness and behaviour

Principal Risks and Uncertainties continued

OPERATIONAL RISKS CONTINUED

Misreporting of performance

Misreporting operational, regulatory and financial performance, both internally and externally – particularly deliberate misreporting – will result in loss of confidence from our stakeholders and put at risk our long-term viability.

If the misreporting is deliberate, it may constitute fraud, and the Group may be subject to litigation, inquiries or investigations that could divert management time and resources, and result in penalties, sanctions, variation or revocation of permissions and authorisations, suspension or debarment from doing business with government customers.

Key risk drivers:

Poor culture – if staff do not align with our Values, and are inappropriately incentivised due to operational targets and/or performance incentives, then deliberate misreporting may occur.

Lack of compliance with processes and controls – if staff do not comply with finance processes and financial controls, then deliberate or unintentional misreporting may occur.

Lack of clarity on contract performance obligations – if there is lack of clarity between Serco and the customer on contract performance obligations, then accidental misreporting may occur.

Misunderstanding of performance reporting requirements – if staff are not aware of reporting requirements and are not trained to use systems, then accidental misreporting may occur.

Poor oversight of Joint Venture (JV) systems – if we have insufficient oversight of JV partner systems, and insufficient assurance provided to the JV Board, then we may be unaware of deliberate or accidental misreporting of performance.

Mitigation:

Material controls:

- Our Values and Code of Conduct
- Serco Management System (SMS)
- Serco Essentials training
- Leadership Development Programme
- Contract Manager training
- Business Lifecycle Review Team (BLRT) process
- Contract Management Application (CMA)
- Speak Up process
- Governance of JVs and minority consortiums

Current mitigation actions:

- Refresh of Serco Values and communication to business
- Roll out of Contract Management Application (CMA) across material contracts
- Reinforce messaging around use of the Speak Up process
- Widespread adoption and training of financial processes and controls as part of the Global Finance Transformation Programme
- Values Gate included In Personal Development Review (PDR)

Future actions:

- Embedding of Serco Values
- Further roll out of CMA globally
- Analyse, review and benchmarking of Speak Up results

PEOPLE RISKS

Failure to attract and retain key resources and skills fit for the future

If our current leaders are not able to meet the needs of the business either due to lack of capability or skills, or there are not enough qualified leaders, this may result in the business not being able to deliver the strategy and impacts on the long-term viability of the business.

A robust framework of people, processes, systems and controls to enable attraction, selection, recruitment and retention of leaders is required in order to meet our business objectives.

Key risk drivers:

Ineffective planning – inadequate planning for management succession may result in a failure to provide sufficient leaders.

Inability to attract people – uncompetitive reward packages may result in failure to attract suitable leaders.

Inability to select people – inadequate selection processes may result in failure to select the right candidate.

Ineffective on-boarding – inadequate on-boarding, in a timely fashion may result in failure to recruit the right candidate.

Inability to retain leaders – inadequate reward reviews and incentives structure may result in failure to motivate our leaders.

Insufficient talent pipeline – if we do not identify skillsets and potential successors, then we may fail to build a talent pipeline.

Lack of leadership capability – if we do not develop leadership capability, then our leaders may not be fit for the future.

Lack of leadership engagement – if we do not effectively engage with our leaders, then we may not retain them.

Mitigation:

Material controls:

- Serco Management System (SMS)
- Centres of Excellence (CoEs) and Functional Talent Boards
- Annual Talent Review and Succession Planning process
- My HR system – standardised HR processes and corporate HR system
- Serco Leadership Model
- Personal Development Review (PDR) process
- Performance/incentive schemes
- Viewpoint – Serco's employee engagement survey

Current mitigation actions:

- Embedding of Serco Leadership Model including library of Success Profiles and Leadership Development Programme
- Piloting of Employee Profile tool to support delivery of CoE and Functional Talent Boards
- Implementation of resourcing/talent partnerships in Sector CoEs to support annual Talent Reviews and Succession Planning
- Delivery of UK HR Shared Service Centre on-boarding transformation workstream
- Implementation of Global On-boarding Virtual Team

Future actions:

- Leadership Levelling Review to determine the right size and shape of the leadership population
- Market competitiveness review of reward packages
- Embedding of refreshed Serco Values
- Continuous improvement and quality control for Divisional and functional Executive Management Team succession plans

HAZARD RISKS

Catastrophic event

An event as a result of Serco's actions or Serco's failure to effectively respond to an event that results in loss of life and/or significant serious injuries and/or material property or asset damage and/or Serco not being able to bid or operate in a strategic market and/or geography. This may also result in reputation damage, financial impact (fines by regulators, suspension of operating licences, compensation etc.), and criminal and civil action against the Company or individuals.

Key risk drivers:

Lack of capability and experience – if our chosen market sectors are not aligned to our capability and experience, then a failure to operate optimally may result in an event.

Lack of safety cultural alignment – a safety culture which does not reflect our Values and fails to engage our staff may result in an event.

Inadequate policies, standards and procedures – if procedures/systems are not aligned with industry standard or customer expectations, an unacceptable level of safety management may occur.

Insufficient safety management oversight – devolved compliance of regulations to sector-specific SMEs without appropriate safety management oversight may result in safety management systems which are not fit for purpose.

External factors resulting in changes in the contract operational environment – a lack of identification and assessment of external risks may result in poor mitigation of and/or response to an event.

Inadequate response to a catastrophic event – if our contingency plans do not provide an adequate response to an event then escalation of an event or prolonged disruption may occur.

Mitigation:

Material controls:

- Serco Group Strategy
- Serco HSE Strategy
- Serco Management System (SMS)
- Business Lifecycle Review Team (BLRT) process
- Third party ethical due diligence procedure
- Serco Essentials training
- Assure – Serco's incident and compliance reporting system
- Standardised Divisional Performance Reporting (DPR) process
- Adequate insurance policies

Current mitigation actions:

- Review definition and scope of catastrophic event and implement continuous improvement of mitigating controls within the SMS
- Ethical due diligence checks on our existing customers and suppliers
- Improvements to compliance checks for third parties
- Update to the Serco Incident Reporting Scale (SIRS)
- Review of business continuity and crisis management plans to establish consistent approach

Future actions:

- Validation and alignment of understanding of catastrophic event risks across the business
- Assess current adequacy of insurance cover for identified catastrophic event risks

Principal Risks and Uncertainties continued

LEGAL AND COMPLIANCE RISKS

Contract non-compliance and contract non-performance

Not meeting our contractual obligations through either non-compliance with contractual requirements and/or failure to meet agreed service levels due to non-performance may result in significant performance penalties, onerous contract provisions, loss of potential new bids/re-bids and early termination of contracts.

If we fail to negotiate contracts that can be delivered at the right price, or we do not put in place solutions that deliver our contractual obligations, we are more likely to suffer from poor performance and compliance challenges and potential loss-making contracts.

Key risk drivers:

Ineffective and inconsistent bid and contract governance – may result in a lack of understanding of accountabilities and responsibilities.

Non-compliance with Policies and Standards – staff failing to follow required processes, controls and governance may result in contract non-compliance and non-performance.

Lack of visibility of contract compliance and performance – may result in an inability to predict contract non-performance and make timely interventions.

Poor understanding of contract obligations – may result in staff failing to acknowledge and act on obligations.

Lack of service definition and capability to deliver – may result in an inability to deliver contractual obligations.

Contract requirements and pricing too onerous / severe to perform – may result in an inability to meet our contractual obligations.

Set up for failure as contract assets not as expected – lack of due diligence of assets may result in higher than anticipated ongoing costs.

Not learning from prior contract issues – may result in an inability to learn from our failures and successes.

Unforeseen changes in contract assumptions – may result in a misunderstanding/misalignment of our contractual obligations with the customer.

Changes in law/regulations – see Material Legal and Regulatory Failure risk on following page.

Mitigation:

Material controls:

- Serco Management System (SMS)
- Investment Committee
- Business Lifecycle Review Team (BLRT) process
- Contract Manager training
- Sector-specific Centres of Excellence (CoEs)
- Contract Management Application (CMA)
- Contract Performance Measurement Tool
- Standardised Divisional Performance Reporting (DPR) process
- Targeted contract reviews and management interventions

Current mitigation actions:

- Embedding of new SMS standards and procedures within contracts
- Setting up of process for CoEs to collate lessons learned and establish knowledge bank
- Transfer of Contract Performance Measurement Tool into CMA
- Roll-out of CMA across all material contracts

Future actions:

- Review and update of BLRT process to address gaps identified in lessons learned
- Continued roll-out of CMA and online documentation storage across contracts globally
- Review of processes in place for targeted contract reviews and management interventions
- Review and update of Contract Manager Training

LEGAL AND COMPLIANCE RISKS

Material legal and regulatory compliance failure

The complexity and constantly changing legal and regulatory environment we operate in across our sectors and geographies creates challenges to ensuring that we are compliant at all times to all laws and regulations. Failure to comply materially with these laws and regulations may cause significant loss and damage to the Group including reputational damage, potential loss of licences and authorisations, as well as prejudicing future bids.

Legal proceedings may be costly and if they are not determined in the Group's favour may divert management attention away from the running of the business for a prolonged period. Uninsured losses or financial penalties resulting from any current or threatened legal actions may have a material adverse effect on the Group.

Key risk drivers:

Lack of policy and guidance – may result in a failure to manage Group-wide material legal and regulatory requirements.

Staff non-compliance with policies and standards – may result in compliance failures for Group-wide material legal and regulatory requirements.

Failure to identify and keep up to date with all material legal and regulatory requirements – may result in key subject matter experts within the business not remaining up to date and we then fail to comply with material legal and regulatory obligations.

Inadequate assurance processes – may result in an inability to confirm compliance with legal and regulatory requirements.

Lack of legal and regulatory expertise within the business – may result in lack of identification and support of legal and regulatory risks.

Inadequate provision for material legal and regulatory risks in contracts – may result in the failure to provide adequate legal support for material legal and regulatory risks.

Contract exit legal/regulatory requirements not being met – may result in possible legal action and diversion of management attention.

SFO investigation – we remain under investigation by the UK Serious Fraud Office (SFO). In November 2013, the SFO opened an investigation into our Group's Electronic Monitoring Contract. We are cooperating fully with the SFO's investigation but it is not possible to predict the outcome. However, in the event that the SFO decides to prosecute, the range of possible adverse outcomes is any one or a combination of the following:

(i) that the SFO prosecutes the individuals and / or the Serco Group companies involved, who may defend the action successfully or be convicted. This may result in significant financial penalties, an impact on existing contracts and Serco being subject to a period of discretionary debarment from future contracts with UK Government entities; or

(ii) that the SFO and the relevant Serco entities enter into a deferred prosecution agreement (DPA) – which may result in significant financial penalties and a period of discretionary debarment from future contracts with UK Government entities. Such debarment would be discretionary in the sense that a contracting authority may consider it not to be relevant to a given bid or re-bid, or that Serco has provided sufficient evidence that it has addressed any issues identified in a DPA, or be limited in time under the terms of the Public Contract Regulations 2015.

Upon any such conviction or DPA, the amount of additional work given to the Group may be reduced, and the Group may be subject to enhanced scrutiny with respect to its other contracts and further actions beyond those being implemented under the Corporate Renewal Programme may need to be taken.

If the Group faces any criminal convictions, debarment consequences or enters into a DPA, any such outcome could result in significant fines and have a material adverse impact on the Group's ability to contract with the UK Government and on its reputation, which would, in turn, materially adversely affect its business, financial condition, operations and prospects.

In addition, a criminal conviction of a Serco entity or of one or more of the Group's current or former employees would in certain circumstances allow the Ministry of Justice to re-open the £64.3m settlement agreed and paid in 2013 in respect of certain issues arising under the Electronic Monitoring Contract. In those limited circumstances, the UK Government may seek additional payments from Serco.

We will continue to cooperate with the SFO's investigation.

Mitigation:

Material controls:

- Serco Management System (SMS)
- Serco Essentials training
- Third party ethical due diligence procedure
- External monitoring – automatic alerts on material enterprise-wide legal and regulatory requirements
- Legal case tracker
- Compliance Assurance Programme (CAP) reviews
- Business Lifecycle Review Team (BLRT) process

Current mitigation actions:

- Updates to SMS including: Human Rights Policy, Modern Slavery Act 2015, Use of Force and Firearms, Market Abuse Regulations (MAR), and third party ethical due diligence, and BLRT process
- Development of Global Data Protection Regulations Programme
- Identification of SMS policy owners and subject matter experts
- Due diligence checks on our existing customers and suppliers
- Development of new Anti-Bribery and Corruption (ABC) Frameworks
- Development of Dawn Raid procedure

Future actions:

- Development of master list of material legal and regulatory requirements by SMS policy owners
- Gap analysis of subject matter expert capability within the Divisions for contract-specific legal and regulatory requirements
- Process to ensure dissemination of automated alerts to the business

Viability Statement

In accordance with provision C2.2 of the UK Corporate Governance Code published by the Financial Reporting Council in September 2014, the Directors have assessed the prospects of the Group over the three-year period to 31 December 2019.

The Directors believe that a three-year period is appropriate for Serco since it reflects the fact that the Group has limited visibility of contract bidding opportunities beyond three years, which could be exacerbated by the recent political changes in the United Kingdom and the United States, and that approximately 40% of current year revenue relates to contracts where the contract term potentially comes to an end within three years. Furthermore, the Group is in the early stages of implementing a new strategy to improve its performance.

Assessing the longer term viability of any company at this early stage of a new strategy implementation is inevitably a challenge, particularly given the recent history of the Group, as explained in previous shareholder communications, and the onerous contracts which exist.

The Board and the Group Risk Committee continue to monitor the principal risks facing the Group, including those that would threaten the execution of its strategy, business model, future performance, solvency and liquidity. Management and mitigations of those principal risks have been taken into consideration when considering the future viability of the Group. The Group's principal risk review, as set out on pages 16 to 23, considers the impact of these principal risks and the mitigating controls that are in place.

In assessing the prospects of the Group over the three-year period, the Directors have also considered the Group's current financial position as well as its financial projections in the context of the Group's debt facilities and associated covenants. These financial projections are based on a bottom-up Budget exercise for 2017 and 2018 which has been approved by the Board, and a more top down view aligned to the Group's strategic objectives for 2019.

The Group continues to deliver on the strategic priorities it set out at the time of the Rights Issue and is continuing to embed these into the business. It is expected that revenue growth and margin improvements will be seen in the latter years of the five-year plan, although this is dependent in part on the external market as well as our ability to win new contracts whilst reducing the cost base. The Group's Balance Sheet has been strengthened significantly following the Rights Issue and sale of the private sector offshore BPO business, and net debt as at December 2016 was at £109.3m. The sales pipeline is improving although net revenue attrition is still possible which could impact on profit and cash generation. The Group is also bidding on some significant contract opportunities where the ability to deliver good-quality services whilst maintaining reasonable pricing and commercial terms are key to ensuring their long-term profitability. The Group's base projections indicate that debt facilities and projected headroom are adequate to support the Group over the next three years. In testing the headroom available under the key sensitives modelled, the Directors have assumed that the Group refinances the portion of the revolving credit facility (RCF) maturing in April 2019 under similar terms.

The Group's financial plan has been stress-tested against key sensitivities which could materialise as a result of the crystallisation of one or many of the Group's principal risks, the objective being that the future viability of the Group is tested against severe but plausible scenarios. It is unlikely, but not impossible, that the crystallisation of a single risk would test the future viability of the Group; however, unsurprisingly, and as with many companies, it is possible to construct scenarios where either multiple occurrences of the same risk, or single occurrences of different significant risks, could put pressure on the Group's ability to meet its financial covenants. At this point, the Group would look to address the issue by exploring a range of options including, amongst others, a temporary or permanent renegotiation of the financial covenants, disposals of parts of the Group's operations to reduce net debt and/or raising additional capital in the form of equity, subordinated debt or other such instruments.

Subject to these risks and on the basis of the analysis undertaken, the Directors have a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over the three-year period of their assessment. In doing so, it is recognised that such future assessments are subject to a level of uncertainty that increases further out in time and, therefore, future outcomes cannot be guaranteed or predicted with certainty. The Directors have made the following key assumptions in connection with this assessment:

- There is no significant unexpected contract attrition of existing work that becomes due for extension or re-bid over the next three years;
- There is no significant reduction in scale of existing contract operations as a result of policy or other changes;
- There is no significant deterioration in new bid win rates from those anticipated;
- The Group is able to complete the execution of its strategy, including further transformation in 2017 and making progress to revenue growth and margin improvement from 2018 onwards; and
- The Group is not subject to any material penalties or direct and indirect costs and / or losses arising from the current SFO investigation.

Chief Executive's Review

The results for 2016 show that the execution of our five-year plan remains on track. Trading in 2016 was better than we expected at the start of the year, although this was in large part due to the resolution of a number of commercial matters in the first half, which will not recur; trading in the second half was in line with the guidance we gave at the time of our half-year results.

Operationally, we have had a busy year: across key contracts our service delivery has improved; we have reduced operating costs by some £450m whilst improving employee engagement; at year-end, the value of our pipeline of new opportunities was up 30%, notwithstanding a 40% increase in order intake; and we have cleanly exited the private sector BPO business. These are the first fruits of the 'transformation' phase of our plan, which we are now about half-way through.

Our view of likely performance in 2017 remains unchanged from previous guidance. The road back to prosperity was always going to be long and winding, with many potholes and boulders, but we are making good progress.

- Revenue[2], including discontinued operations, declined 13% to £3,048m, comprising an 11% organic decline from net contract attrition and an 8% reduction from disposals, partially offset by a 6% currency benefit.
- Underlying Trading Profit[3] declined by £14m to £82m; discontinued operations (the exit of private sector BPO) reduced profits by £19m; net currency benefits were £9m; allowing for these, the reduction was £4m.
- Trading Profit[3] was £18m higher than Underlying Trading Profit due principally to £14m net reduction in future liabilities and losses on onerous contracts.
- Underlying EPS[4] increased 20% to 4.13p, benefitting from reduced finance costs and a lower effective tax rate.
- Reported Operating Profit up £46m, and EPS up 15.36p; operating exceptional charges on continuing operations were £56m (2015: £110m); including discontinued operations, total exceptional charges net of tax were £68m (2015: £217m).
- Free Cash Flow[5] was negative £33m, similar to 2015 outflow of £36m.
- Closing Net Debt increased by £46m to £109m; however, Net Debt : EBITDA leverage of 0.7x, was similar to last year and below our medium term target of 1–2x.
- Continued progress reducing burden of loss-making contracts: OCP utilisation of £84m in 2016, £30m lower than 2015.
- Order intake increased by 40% with £2.5bn total value of signed contracts; including Serco's share of the value of the AWE updated contract, order intake was £3.2bn, an increase of some 80% on the prior year; 35 contract awards were worth more than £10m each.
- Pipeline of larger new bid opportunities ended the year at £8.4bn, a year-on-year increase of £1.9bn or 30%.
- Operating costs reduced by more than £450m, and in proportion to the scale of revenue reduction; this includes overheads and shared services savings of over £50m.
- Guidance for 2017 unchanged – at current foreign exchange rates, we anticipate Revenue of approximately £3.1bn and Underlying Trading Profit of between £65m and £70m.

How we performed

Year ended 31 December	2016	2015[1]
Revenue – continuing and discontinued operations[2]	£3,047.8m	£3,514.6m
Reported Revenue (continuing operations only)	£3,011.0m	£3,177.0m
Underlying Trading Profit[3]	£82.1m	£95.9m
Reported Operating Profit / (Loss) (after exceptional items; continuing operations only)[3]	£42.2m	(£3.8m)
Underlying EPS, basic[4]	4.13p	3.44p
Reported EPS, basic (after exceptional items; continuing and discontinued operations)	(0.11p)	(15.47p)
Free Cash Flow[5]	(£33.0m)	(£35.5m)
Net Debt (including that for assets and liabilities held for sale)	£109.3m	£62.9m

Notes to summary table of financial results:

(1) The results for year ended 31 December 2015 have been restated for a change in accounting policy related to foreign exchange movements on investment and financing arrangements. This provides more relevant information about the impact of underlying transactions and, within net debt, now takes account of the currency hedging in place. This is particularly relevant at a time when we have had significant currency volatility, and, helpfully, more closely aligns our reported net debt with our debt covenant definitions. This change in accounting policy has the following effects: reduces Trading and Operating Profit measures by £0.1m, with an equal and opposite impact recognised within Net Finance Costs; reduces Free Cash Flow (FCF) by £19.3m, with an equal and opposite impact recognised below FCF; and reduces closing net debt at 31 December 2015 by £14.6m, to reflect the hedging effect of derivative financial instruments designed to mitigate the effect of foreign exchange movements on our net debt. Further detail on the restatement is included in the Finance Review on page 43.

(2) Revenue is as defined under IFRS, which excludes Serco's share of revenue of its joint ventures and associates. Revenue including that from discontinued operations is shown for consistency with previous guidance. Reported Revenue excludes revenue from discontinued operations of £36.8m (2015: £337.6m). Organic revenue growth is the change at constant currency in Revenue after adjusting to exclude the impact of acquisitions or disposals. Change at constant currency is calculated by translating non-Sterling values for the year to 31 December 2016 into Sterling at the average exchange rate for the year ended 31 December 2015.

(3) Trading Profit is defined as IFRS Operating Profit adjusted for (i) amortisation and impairment of intangibles arising on acquisition and (ii) exceptional items; it includes the impact of discontinued operations. Consistent with IFRS, it includes Serco's share of profit after interest and tax of its joint ventures and associates. Underlying Trading Profit additionally excludes Contract and Balance Sheet Review adjustments (principally Onerous Contract Provision (OCP) releases or charges), as well as the beneficial treatment of depreciation and amortisation of assets held for sale, and other material one-time items such as the pension scheme settlement in the first half of 2016 and the profit on early exit from a UK local authority contract that occurred in the second half of 2015. A reconciliation of Underlying Trading Profit to Reported Operating Profit is as follows:

Year ended 31 December £m	2016	2015
Underlying Trading Profit	**82.1**	**95.9**
Include: non-underlying items		
Onerous contract and Balance Sheet Review adjustments	14.2	20.9
Benefit from non-depreciation and non-amortisation of assets held for sale	0.5	11.7
Other one-time items	3.5	9.0
Trading Profit	**100.3**	**137.5**
Amortisation and impairment of intangibles arising on acquisition	(5.1)	(4.9)
Operating Profit Before Exceptional Items (continuing and discontinued operations)	95.2	132.6
Exclude: Operating Loss/(Profit) Before Exceptional Items from discontinued operations	3.3	(26.5)
Reported Operating Profit Before Exceptional Items (continuing operations only)	98.5	106.1
Operating Exceptional Items (continuing operations only)	(56.3)	(109.9)
Reported Operating Profit (after exceptional items; continuing operations only)	**42.2**	**(3.8)**

(4) Underlying EPS reflects the Underlying Trading Profit measure after deducting pre-exceptional net finance costs (including those for discontinued operations) and related tax effects.

(5) Free Cash Flow is the net cash flow from operating activities before exceptional items as shown on the face of the Group's Consolidated Cash Flow Statement, adding dividends we receive from joint ventures and associates, and deducting net interest paid and net capital expenditure on tangible and intangible asset purchases.

Reconciliations and further detail of financial performance are included in the Finance Review on pages 42 to 63. This includes full definitions and explanations of the purpose and usefulness of each non-IFRS Alternative Performance Measure (APM) used by the Group. The consolidated financial statements and accompanying notes are on pages 139 to 207.

Chief Executive's Review continued

Revenue and Trading Profit

Reported Revenue was £3,011m (2015: £3,177m); this measure excludes Serco's share of revenue from joint ventures and associates of £481m (2015: £737m) and from discontinued operations (our private sector BPO division) of £37m (2015: £338m). Revenue including discontinued operations was £3,048m (2015: £3,515m). Net currency movements provided a £189m benefit. At constant currency and adjusting for disposals, the organic revenue decline was 11%, driven by the phased transfer of contracts such as that for the Defence Science and Technology Laboratory (DSTL), and the end of contracts for Suffolk Community Healthcare, the National Citizen Service, Thurrock Council BPO services, US National Benefits Centre and the Virginia Department of Transportation (VDOT). There was limited growth elsewhere to offset these declines.

Trading Profit was £100.3m (2015: £137.5m) and Underlying Trading Profit was £82.1m (2015: £95.9m), resulting in an Underlying Trading Profit margin of 2.7% (2015: 2.7%). The £18.2m difference between Trading Profit and Underlying Trading Profit is accounted for by three items. First, we have excluded from Underlying Trading Profit the net release of £14.2m (2015: £20.9m) of future cost provisions identified in our regular review of Onerous Contract Provisions (OCPs) and other Contract and Balance Sheet Review items. This reflects the net effect of numerous charges and releases against individual contracts and provisions; the only significant individual movements were an increased charge on the Ontario Driver Examination Services contract and a net release on the COMPASS contract for UK asylum seeker support services. While the net £14.2m release is excluded from our underlying measures, it reflects continued good progress in reducing future liabilities, with a net £9.6m related to OCPs and a net £4.6m related to other Contract and Balance Sheet Review items. The second item of difference is that we have excluded from Underlying Trading Profit the benefit of a one-time pension settlement of £3.5m negotiated as part of the early exit from the Thurrock contract. Third, and in accordance with the statutory accounting treatment of assets held for sale, depreciation and amortisation charges related to assets held for sale are excluded from the Group accounts; the positive impact of this accounting treatment of £0.5m (2015: £11.7m) has therefore been excluded from our measure of Underlying Trading Profit.

As with the comparable year, Underlying Trading Profit benefited from the utilisation of OCPs, which have the effect of neutralising losses on previously identified onerous contracts; the £84m utilised in the year was slightly lower than our expectations of around £90m at the start of the year, and was materially lower than the £114m utilised in 2015; again, this reflects progress at an operational level in reducing the level of losses on onerous contracts. The closing balance of OCPs now stands at £220m, versus the initial £447m charge two years ago.

The £14m reduction in Underlying Trading Profit reflects the £19m reduction in profits related to the exit of our private sector BPO operations, partially offset by a favourable £9m currency movement. Allowing for these items, Underlying Trading Profit was similar to the prior year, decreasing by approximately £4m. The profit performance was stronger than we initially anticipated, in large part due to the successful resolution of a number of commercial matters in the first half of the year that will not repeat.

Reported Operating Profit, including discontinued operations, and before exceptional items, was £95.2m (2015: £132.6m), which reflects Trading Profit as described above, after additionally charging amortisation and impairment of intangibles arising on acquisition of £5.1m (2015: £4.9m).

Finance, tax and exceptional costs

Pre-exceptional net finance costs, including discontinued operations, were £12.6m (2015: £31.9m). The reduction in cost arises from average net debt being some £300m lower in 2016 than in 2015, as a result of the Rights Issue in April 2015 and the BPO disposal proceeds received at the end of December 2015. As a consequence of these two fund-raising activities, we were able to redeem early £225m of US Private Placement debt in 2015 and a further £117m in February 2016. Cash net interest paid was £19.0m (2015: £32.7m).

Within net finance costs is a net credit of £4.7m (2015: £4.9m) related to the strong funding position of Serco's pension schemes; the pension scheme net balance sheet asset, before tax, increased to £133m (2015: £116m); on an estimated actuarial basis, the main Group scheme has a deficit of £34m (2015: £28m).

Pre-exceptional tax costs, including discontinued operations, were materially lower in the year at £15.9m (2015: £36.6m). Excluding the tax credit on non-underlying items of £8.5m (2015: cost of £6.1m), the underlying effective tax cost was £24.4m (2015: £30.5m) implying an underlying effective rate of 35% (2015: 48%) based upon £69.5m of Underlying Trading Profit less pre-exceptional net finance costs. The rate reflects the tax charges at locally prevailing rates in the international divisions (which tend to be higher than the UK's rate), while in the UK there was no deferred tax credit taken against losses made in the year; the resulting effective rate was significantly lower than expectations at the start of the year given the increased proportion of Serco's profit before tax generated by consolidating our share of joint venture and associate earnings which have already been taxed. Net cash tax paid was £5.6m (2015: £2.7m).

Whilst we expect our cash tax rate to be reasonably predictable in future periods, our underlying effective tax rate is likely to be volatile until we are able to show sufficient profitability in our UK business to be able to recognise on our balance sheet the very significant UK tax asset arising from losses in 2014 and 2015 principally as a result of the Contract and Balance Sheet Review. For 2017, an underlying effective tax rate potentially reverting to approximately 50% is anticipated, reflecting predominantly the smaller proportion of joint venture and associate earnings and relatively higher UK losses. We expect future years' effective tax rate will be high until UK tax losses can be recognised.

Including discontinued operations, the Group incurred operating exceptional costs of £70.5m, exceptional finance costs of £0.4m and tax credits on exceptional items of £3.1m; in aggregate, net exceptional costs were therefore £67.8m (2015: £217.2m). The principal exceptional items were goodwill impairment of £17.8m reflecting the liabilities taken on with the purchase of a subcontractor to the COMPASS operations, a £13.9m impairment to the carrying value of a joint venture investment, restructuring costs of £18.3m and a charge of £10.7m related to the transfer of employees from the Serco defined pension scheme back to the Principal Civil Service Pension Scheme (PCSPS). The balance of operating exceptional costs reflected losses on disposals, together with the movement in the carrying value of assets held for sale and for indemnities provided on prior business disposals. The £217.2m of charges in 2015 included £168.3m impairment of goodwill and other assets, and £32.8m of exceptional finance costs relating to the Rights Issue and debt refinancing.

Reported Loss for the year

The Reported Loss for the year, as presented at the bottom of the Group's Consolidated Income Statement on page 37, was £1.1m (2015: loss of £153.1m). This reflects the measures described above: Reported Operating Profit, including discontinued operations, and before exceptional items, of £95.2m (2015: £132.6m); pre-exceptional net finance costs, including discontinued operations, of £12.6m (2015: £31.9m); pre-exceptional tax costs, including discontinued operations, of £15.9m (2015: £36.6m); and exceptional costs, net of tax, of £67.8m (2015: £217.2m).

Earnings Per Share (EPS)

Underlying EPS, which reflects the Underlying Trading Profit measure after deducting pre-exceptional finance costs (including those for discontinued operations) and related tax effects, was 4.13p (2015: 3.44p). The increase reflects the reduction in Underlying Trading Profit being more than offset by the lower finance costs and tax charge. There is a partial offset to these factors from the movement in the weighted average number of shares in issue which increased to 1,088.3m shares (2015: 986.5m shares) as a consequence of the 2015 Rights Issue. EPS before exceptional items, including those for discontinued operations, were 6.12p (2015: 6.55p); including the impact of exceptional items, Reported EPS was loss per share of 0.11p (2015: loss per share of 15.47p).

Cash Flow and Net Debt

Free Cash Flow was negative £33.0m (2015: negative £35.5m). Cash generated from Underlying Trading Profit was largely offset by the outflows related to loss-making contracts subject to Onerous Contract Provisions. These cash outflows lessened year-on-year, as reflected in the lower rate of OCP utilisation. There was a working capital outflow of £24m, largely due to a £22m reduction in the utilisation of the Group's receivables financing facility; at the end of 2015 the £30m facility was fully utilised, compared to £8m utilisation at the end of 2016. Capital expenditure was substantially lower at £32m (2015: £73m), reflecting the benefit of the disposal of the private sector BPO business, which was a substantial consumer of capital investment.

Closing net debt at 31 December 2016 increased to £109.3m, having been £62.9m at the start of the year; the increase includes the Free Cash outflow, together with a £40m cash outflow related to exceptional items, partially offset by £19m of net receipts from disposals. There was an adverse gross currency translation effect on net debt of £42m, predominantly reflecting the Group's US Private Placement debt, however this was offset by a £47m favourable movement on hedging instruments. The closing net debt of £109m compares to a daily average of £119m (2015: £444m) and a peak net debt of £183m (2015: £859m).

At the closing balance sheet date, our leverage for covenant purposes was 0.7x EBITDA, which compares with the requirement in our debt covenants to be less than 3.5x. Excluding from EBITDA non-underlying items, predominantly the benefit of the net movement on OCPs and other Contract and Balance Sheet Review items, the underlying leverage ratio was 0.8x EBITDA. This is below our medium term target range of 1–2x, but at this stage in our strategy implementation, we are content for it to be so.

Chief Executive's Review continued

Dividends

The Board is not recommending the payment of a dividend in respect of the 2016 financial year. The Board's appraisal of the appropriateness of dividend payments takes into account the Group's underlying earnings, cash flows and financial leverage, together with the requirement to maintain an appropriate level of dividend cover and the prevailing market outlook. Although the Board is committed to resuming dividend payments as soon as it believes it prudent to do so, in assessing whether we should resume dividend payments in respect of 2016, we have been mindful of the fact that our forecasts for 2017 anticipate a reduction in earnings, a free cash outflow and an increase in net debt; furthermore, we are only part-way through our recovery. In these circumstances, the Board believes that it would not be prudent to resume dividend payments in respect of 2016.

The Revenue and Trading Profit performances are described further in the Divisional Reviews. More detailed analysis of earnings, cash flow, financing and related matters are described further in the Finance Review.

Summary of operating performance and strategy implementation

The better than anticipated financial performance in 2016 has been accompanied by improving operational delivery and good progress on implementing our strategy and transformation.

With over 500 contracts worldwide, there are always going to be some with operational issues; however, there are many fewer now than there were two years ago, and relationships with customers, particularly in the UK, have strengthened notably. Good progress has been made on our loss-making contracts, with improved operational delivery and reduced losses on several important contracts, reflected both in lower in-year OCP utilisation (£30m lower in 2016 than in 2015) and a net reduction in anticipated future losses of £9.6m. We regard our OCPs as a portfolio of exposures, and at each period end each contract and provision is carefully assessed; some contracts need additional provisions, others see releases if our assessment of future losses reduces. In 2016 there were a number of movements, both positive and negative, across the contract base. No new contracts have been judged to be materially onerous. The only two significant movements on pre-existing OCPs were on COMPASS (UK asylum seeker support services) and DES (Driver Examination Services, Ontario Canada); on COMPASS, a £33.9m OCP release resulted from the latest estimates of efficiencies, forecasts and contract terms, although this was partially offset by a £14.0m OCP recognised on acquisition of a subcontractor; on DES, there was a £29.5m increase in estimates of the future costs associated with the IT system implementation and ongoing management of this contract. Our contract supporting Lincolnshire County Council is running broadly in line with our expectations set when we took a large additional provision in 2015, and the major elements of this IT implementation are now in service. Within the other smaller movements, although the in-year losses of the Prisoner Escort and Custody Services (PECS) contract in the UK were reduced, we have changed our view of the likely contract duration, and the future-years OCP balance has been increased; OCPs with an improved view of future losses include the Armidale Class Patrol Boats (ACPB) contract in Australia, and the contracts for HMP Ashfield and the Future Provision of Marine Services (FPMS) in the UK.

Our joint venture with Abellio as operator of Northern Rail ended smoothly with the transfer of the franchise to a new provider on 31 March 2016, and the winding up of the joint venture produced a favourable financial outcome. There were also several contracts that we had expected to end early in the year but ran on longer; these included the VDOT and US Army transition assistance contracts.

We were delighted to announce that the UK Government's review of the arrangements for operating the Atomic Weapons Establishment (AWE) concluded successfully during the year, and led to an updated contract being agreed with the Ministry of Defence. The stronger performance outcome for the contract year to 31 March 2016 and later-than-expected timing of the change in joint venture shareholding arrangements also improved the profit contribution received by Serco in the year.

We achieved our target for cost savings of over £50m in 2016 from central support functions and other overheads. The programme delivered savings from reducing the number of management layers, implementing better procurement and driving greater efficiency in the operation of shared services. Within our guidance for 2017 is the expectation that we can deliver around £20m of additional savings from the next set of transformation actions.

Following the various disposals and transfers related to Serco's exit of the private sector BPO market, there were losses and stranded costs related to the residual UK onshore private sector BPO contracts. As a result of good work to mitigate the financial impact of these exits, the loss from discontinued operations at £4.6m was approximately half our original expectations, and we anticipate no material residual effect in 2017.

At the same time as we have been reducing operating costs, we have been investing in building the capability of the business. As previously reported, we are using Centres of Excellence (CoEs) to develop Group-wide propositions and capabilities in our core markets, with an initial launch of CoEs in the Health, Justice & Immigration and Transport sectors which are improving the sharing of skills, best practice and intellectual property across our businesses. The teams working directly and as part of the CoE virtual network are reporting good early progress, particularly in strengthening our proposition development and bidding, and the largest contract award during the year – Barts Health NHS Trust – drew heavily on CoE capability and support.

We have continued to invest in IT systems enhancements and improvements. During the year, we rolled out our Success Factors recruitment system which delivers world-class recruitment capability for the organisation; enhanced Finance management tools to improve balance sheet reconciliations and Treasury management; implemented new Cyber Security management systems to harden our IT networks; launched a 'guided buying' system that delivers best pricing through a standardised catalogue; and we introduced internal collaboration tools which help our newly formed CoEs share data and information globally. Our next developments include further investments in IT security, payroll and workforce management systems.

Serco employs 47,000 people, the vast majority delivering services to customers. It is often said that the customer experience will never exceed the employees' and attracting, motivating and engaging employees will be central to our success. We were therefore delighted to see the latest results of our global employee engagement survey, managed independently by Aon Hewitt, and which received over 30,000 responses. Engagement scores increased for all categories – employees, managers and leaders – and stood at the highest level since we started to measure it in 2011 and is dramatically improved from the low in 2014. It was particularly pleasing to note that the engagement score of the leadership population improved 17 percentage points year-on-year to over 70%.

Contract awards, order book, rebids and pipeline

Contract awards

As anticipated, the market was relatively quiet with few major bidding outcomes announced. Notwithstanding this, the Group signed contracts with a total value of £2.5bn during the year, an increase of 40% on 2015; as we do not consolidate our share of joint venture and associate revenue, this excludes the estimated £0.7bn value of Serco's share of the AWE updated contract for the next three years. There were 35 contract awards worth more than £10m each. The value of new business won was approximately 40% of the total value signed, with the balance represented by securing extensions or successfully rebidding existing work.

The largest new contract signed in 2016 was with Barts Health NHS Trust for facilities management services to their hospitals. Whilst the value over the maximum 10-year term is approximately £600m, we have recognised within Serco's wins and order book figures only the estimated £450m value of our initial seven-year period. The second largest new contract was for the new 'icebreaker' Antarctic Supply and Research Vessel for the Australian Department of the Environment, where Serco will project manage the four-year design and build phase and then operate and maintain the vessel for an initial ten-year period; within our order book, and future revenues, we will not include the value of the ship itself. The third largest new contract was to upgrade the High Altitude Electromagnetic Pulse (HEMP) Protection of Ballistic Missile Early Warnings Systems supporting the US Air Force at Thule Air Base in Greenland. Of the other major new bids decided during the year, we were unsuccessful in the tender to operate the Clyde and Hebrides Ferry Services on behalf of Transport Scotland, in two bids to operate UK local authority environmental services and to provide processing services to two US Departments of State. Smaller new bids won included two for the European Space Agency, transport operations support for the State of Louisiana, numerous US Navy ship and shore defence equipment modernisation task orders, and contracts for airport facilities management and defence base operational support in the Middle East.

Chief Executive's Review continued

Of rebids and extensions secured, the largest was for Acacia prison in Western Australia for a further five years, and the second largest was for two further years to continue providing defence base support services at Goose Bay, Canada. Others included: the COMPASS extension for an additional 21 months; extending our support to the UK military satellite network, the Anglia Support Partnership healthcare shared services and several environmental services contracts; and in the Middle East for our operations for Australian Defence Force logistics and base support, healthcare facilities management in Saudi Arabia and Baghdad Air Navigation Services.

Win rates by volume were over 50% for new bids and over 90% for rebids and extensions. Win rates by value saw some modest improvement to over 20% for new work given the balance of outcomes on larger bids, and approximately 80% for securing existing work.

Order book

The Group's order book, excluding the discontinued Global Services division, now stands at an estimated £9.9bn, very similar to the £10.0bn reported at the end of 2015. There is £2.5bn of revenue in the order book for 2017, equivalent to over 80% visibility of our £3.1bn revenue guidance. The secured order book is £1.7bn for 2018 and £1.3bn for 2019.

Rebids

Through to the end of 2019, across the Group there are around 50 contracts in our order book with annual revenue of over £5m where an extension or rebid will be required, representing current annual revenue of over £1.3bn in aggregate or around 40% of the Group's forecast revenue for 2017 of £3.1bn. Contracts that could potentially end at some point by the end of 2017 have aggregate annual revenue of around £200m. In 2018, this increases to around £400m, with the greater amount driven in particular by the US Affordable Care Act contract becoming due for full rebid in that year, and with the next largest being Northern Isles Ferries. In 2019, it is around £700m, with Australian immigration services, COMPASS, PECS and the Dubai Metro also all expected to become due for rebid or potential extension.

Pipeline

Our pipeline is defined as new bid opportunities with estimated Annual Contract Value (ACV) of at least £10m or a Total Contract Value (TCV) of at least £100m, and which we expect to bid and to be adjudicated within a rolling 24-month timeframe. The TCV of individual opportunities is capped at £1bn. The definition does not include rebids and extension opportunities. It is therefore a relatively small proportion of the total universe of opportunities, many of which either have annual revenues less than £10m, or are likely to be decided beyond the next 24 months, or are rebids and extensions. It should also be remembered that in the Americas in particular, we have numerous arrangements which are classed as 'IDIQ' – Indefinite Delivery / Indefinite Quantity – which are essentially framework agreements under which the customer issues task orders one at a time; whilst the ultimate value of such a contract may be very large and run over many years, the value is only recorded in our order book as individual task orders are contracted, and few of them would appear in the pipeline as they tend to be individually less than £10m and contracted on short lead times.

Following several years of decline in the value of the bid pipeline, in 2015 it began to grow again from its nadir of around £5bn, increasing to £6.5bn at the end of 2015, and stood at £8.4bn at the end of 2016. During 2016, £3bn came out of the pipeline reflecting wins and losses during the year, but this has been more than offset by adding new opportunities, particularly in defence in the US and justice in Australia. There are now around 30 bids in the pipeline, with the ACV averaging approximately £30m and a contract length averaging close to 10 years. Key opportunities in the pipeline are described further in the Divisional Reviews.

While our pipeline definition reflects bid decisions due over the next 24 months, it is important to note that over 80% of the current pipeline is expected to have bids adjudicated within the next 12 months. This is an unusually high degree of "front loading", and, if customers stick to their timescales, it is unlikely that we will be able to replace the around £7bn of bids that are likely to drop out of the pipeline during the year. We therefore think it likely that the value of the reported pipeline will drop in 2017; provided we win some of the bids that are to be decided this year, this is not a matter of concern: progress on growing our pipeline should not be expected to be a smooth progression given the effects of individual timings and scales of major bids.

Risks associated with the outcome of the UK's referendum on EU membership

Serco reported a year ago on the potential risk to its business if Britain left the EU. Following the outcome of the referendum we have further considered the risks and opportunities presented by Brexit.

First, we currently have contracts worth over £100m a year with European public bodies such as the European Commission, the European Space Agency and the European Central Bank; many of these contracts are executed by our subsidiaries based in continental Europe, and tenders are subject to strict European competition and bidding rules which should give us protection against unfair discrimination. So we think that these risks are likely to be capable of mitigation.

Secondly, we must consider how Brexit might affect our business with the British Central Government, which accounts for about a quarter of our revenue. Here, the picture is hard to discern. The senior Civil Service were, even before the Brexit vote, facing a major challenge implementing an agenda of reform designed to deliver the future efficiencies required to achieve the Government's plans to balance expenditure with income by the end of the decade. In addition to these tasks, the Civil Service is facing what is probably the most significant and wide-ranging changes in policy and delivery that it has seen since the post-war Atlee government, which created the NHS and nationalised swathes of UK industry. At the moment, the focus is on supporting the Government in its Brexit negotiations, but very quickly attention will have to turn to designing and then implementing new policy across swathes of British administration: Immigration, Customs, Agriculture, Fisheries, Food, Research, Education, Energy, Environment, to name a few. In addition, equivalent European regulatory bodies will have to be created and staffed in the UK. This is going to be a huge test for the Civil Service, and it is currently unclear how it will be delivered, or how much support they will want from the private sector in this task.

The third area of possible impact would be in terms of our labour costs. Only 3% of our employees in the UK are Continental EU nationals, so the direct impact should be minimal. However, if there are severe restrictions on EU citizens working in the UK, this may have a wider impact on labour availability and cost.

Overall, we think that Brexit offers both risks and opportunities for Serco. However, the picture is unlikely to become clear in the short-term. In the meantime, our long-term contracts and our role in providing critical public services should give us some protection from short-term vicissitudes. Most importantly, our strong presence in North America, the Middle East and Australia diversify our risk and give us choices as to where we invest our resources.

Guidance and outlook

In 2016, better trading performance and currency movements in the first half of the year led us to increase full-year guidance in both our May and August updates. This reflected primarily the successful resolution of a number of commercial matters and other factors not expected to repeat in subsequent periods, together with the benefit of foreign exchange movements. In December 2016, having completed our budget review process, we updated that our expectations for 2017 were unchanged on an underlying basis from those previously described, though an adjustment was required for the potential benefit of foreign exchange movements.

At current foreign exchange rates, our 2017 budget implies revenue of approximately £3.1bn and Underlying Trading Profit of between £65m and £70m, and with a weighting to the second half. Given that the first half of 2016 benefitted from a number of non-recurring items, Underlying Trading Profit in the first half of 2017 is expected to be significantly lower than the comparator period.

Chief Executive's Review continued

In regard to our budget and guidance, we reiterate that the range of potential outcomes for 2017 is significantly wider, both to the upside and downside, given Serco's low margins and the sensitivity of our profits to even small changes in revenues or costs. Furthermore, and as described in more detail in the Divisional Reviews, the outcome of major bids in our pipeline, and the timing and nature of arrangements made for the replacement of the Affordable Care Act in the US, could have a material impact on our business both in the immediate and longer term.

The trading outlook for 2018 will clearly come more into focus as we progress through 2017 in terms of bid activity and our other transformation actions. Our guidance is for margins to reduce in 2017, but we would expect to show some modest improvement year-on-year in 2018. Our path of margin improvement reflects the lag effect of delivering the net benefit of transformation efficiencies and the time it takes for new work to begin and deliver operational leverage of the cost base.

Although our cash tax rates are reasonably predictable, our accounting effective tax rates are likely to remain volatile; in 2015 the accounting underlying effective tax rate was 48%, in 2016 35%, and we expect it could revert back to around 50% in 2017. This will depend on the precise mix of profits and losses we see by jurisdiction. Any increase in our accounting tax rates will of course have an amplifying effect on the reduction in EPS caused by the lower Underlying Trading Profit expected in 2017.

Regarding cash flows for 2017, we expect our Underlying Trading Profit forecast will be broadly offset by the cash outflow on onerous contracts, given OCP utilisation budgeted of approximately £80m. With cash outflows for interest and tax forecast to be broadly similar to 2016, this would result in a Free Cash outflow at similar levels to the £33m seen in 2016, assuming all other cash effects are neutral such as the effect of joint ventures, capital expenditure versus depreciation, and of course working capital. The outcomes of new bids and rebids, and the associated timing of any change in operations, would impact these assumptions, particularly working capital. There will also continue to be a level of cash outflow on exceptional costs, potentially at a similar level to 2016, given further restructuring to support our transformation. In all, we therefore estimate that closing net debt at the end of 2017 could increase to between £150m and £200m, equivalent to leverage for covenant purposes of between 1.2x and 1.7x EBITDA.

Concluding thoughts

We continue to make good progress implementing our strategy through the three stages of our plan to 'Stabilise – Transform – Grow' which we set out in detail in early 2015. Our overarching objective is to make Serco a world-class international supplier of services to Government in our chosen sectors of Defence, Justice & Immigration; Transport, Health and Citizen Services. We completed the stabilisation of the business in 2014 and 2015. Since then, we have been transforming the business: reducing our operating costs, investing in systems, processes and people, building compelling service propositions and improving the quality of our operational delivery to customers. We start 2017 with a very healthy pipeline of new opportunities, but also with a lot of work yet to be done to successfully complete the 'Transform' stage of our plan. Armed with a strong balance sheet, skilled and committed colleagues, and a good track record of delivery against our objectives over the last two years, I remain confident that we are heading in the right direction.

Rupert Soames
Group Chief Executive
Serco – and proud of it.

Divisional Reviews

Serco's continuing operations are reported as five divisions: UK Central Government (CG); UK & Europe Local & Regional Government (LRG); the Asia Pacific region (AsPac); the Middle East; and the Americas. The Global Services division consists of Serco's residual private sector BPO operations, which for statutory reporting purposes are classified as discontinued operations following the previously announced strategic exit from this market and the subsequent disposal in December 2015 of the Intelenet business. Serco presents alternative measures to include the Revenue and Trading Profit of these discontinued operations for consistency with previous guidance. Reflecting statutory reporting, Serco's share of revenue from its joint ventures and associates is not included in revenue, while Serco's share of joint ventures and associates' profit after interest and tax is included in Trading Profit. As previously disclosed and for consistency with guidance, Serco's Underlying Trading Profit measure excludes Contract and Balance Sheet Review adjustments (principally OCP releases or charges), the benefit from not depreciating and amortising assets held for sale, and other one-time items such as those related to the early exit from the Thurrock contract.

Year ended 31 December 2016 £m	CG	LRG	AsPac	Middle East	Americas	Corporate costs	Sub-total continuing	Global Services	Total
Revenue including discontinued operations	678.6	696.5	619.7	324.8	691.4	–	3,011.0	36.8	3,047.8
Change	(9%)	(23%)	+14%	+11%	0%	–	(5%)	(89%)	(13%)
Change at constant currency	(9%)	(25%)	+2%	(1%)	(11%)	–	(11%)	(89%)	(19%)
Organic change at constant currency	(9%)	(25%)	+4%	(1%)	(11%)	–	(11%)	n/a	n/a
Discontinued operations adjustment*	–	–	–	–	–	–	–	(36.8)	(36.8)
Revenue	678.6	696.5	619.7	324.8	691.4	–	3,011.0	–	3,011.0
Underlying Trading Profit/(Loss)	52.2	(6.5)	24.9	16.6	43.0	(43.5)	86.7	(4.6)	82.1
Change	(2%)	n/a	+110%	(12%)	(3%)	(15%)	+6%	n/a	(14%)
Change at constant currency	(2%)	n/a	+85%	(20%)	(13%)	(15%)	(4%)	n/a	(23%)
Margin	7.7%	(0.9%)	4.0%	5.1%	6.2%	n/a	2.9%	(12.5%)	2.7%
Contract and Balance Sheet Review adjustments	42.7	(7.4)	9.3	2.2	(36.6)	3.2	13.4	0.8	14.2
Benefit from not depreciating and amortising assets held for sale	–	–	–	–	–	–	–	0.5	0.5
Other one-time items	–	3.5	–	–	–	–	3.5	–	3.5
Trading Profit/(Loss)	94.9	(10.4)	34.2	18.8	6.4	(40.3)	103.6	(3.3)	100.3
Amortisation of intangibles arising on acquisition	(0.3)	–	(2.0)	–	(2.8)	–	(5.1)	–	(5.1)
Discontinued operations adjustment*	–	–	–	–	–	–	–	3.3	3.3
Operating profit/(loss) before exceptionals	94.6	(10.4)	32.2	18.8	3.6	(40.3)	98.5	–	98.5

* Statutory reporting only includes the post-tax result of discontinued operations as a single line in the Consolidated Income Statement.

Year ended 31 December 2015 £m	CG	LRG	AsPac	Middle East	Americas	Corporate costs	Sub-total continuing	Global Services	Total
Revenue including discontinued operations	742.1	905.8	544.7	291.4	693.0	–	3,177.0	337.6	3,514.6
Discontinued operations adjustment*	–	–	–	–	–	–	–	(337.6)	(337.6)
Revenue	742.1	905.8	544.7	291.4	693.0	–	3,177.0	–	3,177.0
Underlying Trading Profit/(Loss)	53.1	4.7	11.9	18.9	44.3	(51.3)	81.6	14.3	95.9
Margin	7.2%	0.5%	2.2%	6.5%	6.4%	n/a	2.6%	4.2%	2.7%
Contract and Balance Sheet Review adjustments	7.1	(28.2)	46.9	8.5	(17.3)	3.3	20.3	0.6	20.9
Benefit from not depreciating and amortising assets held for sale	–	–	–	–	–	–	–	11.7	11.7
Other one-time items	–	9.0	–	–	–	–	9.0	–	9.0
Trading Profit/(Loss)	60.2	(14.5)	58.8	27.4	27.0	(48.0)	110.9	26.6	137.5
Amortisation of intangibles arising on acquisition	–	(1.1)	(1.2)	–	(2.5)	–	(4.8)	(0.1)	(4.9)
Discontinued operations adjustment*	–	–	–	–	–	–	–	(26.5)	(26.5)
Operating profit/(loss) before exceptionals	60.2	(15.6)	57.6	27.4	24.5	(48.0)	106.1	–	106.1

* Statutory reporting only includes the post-tax result of discontinued operations as a single line in the Consolidated Income Statement.

The trading performances and outlook are described for each division on the following pages. Reconciliations and further detail of financial performance are included in the Finance Review on pages 42 to 63. This includes full definitions and explanations of the purpose of each non-IFRS Alternative Performance Measure (APM) used by the Group. The consolidated financial statements and accompanying notes are on pages 139 to 207.

Divisional Reviews continued

UK Central Government

The UK Central Government division includes our UK operations in Defence, Justice & Immigration and Transport.

Revenue for 2016 was £678.6m (2015: £742.1m), a decline of 9%; reported revenue excludes that from our joint venture and associate holdings at AWE, Merseyrail and previously Northern Rail, with these representing the vast majority of the Group's activity in joint ventures and associates. The principal driver of the revenue reduction was the phased transfer back of services that Serco had previously been providing to the Defence Science and Technology Laboratory (DSTL), together with the end of the Defence Business Services arrangement, the loss of two small defence support contracts, and the ending of transitional support provided in 2015 regarding the supply of Electronic Monitoring equipment. There was limited growth elsewhere to offset contract attrition, with the largest being higher revenue on the COMPASS programme relating to increased numbers of asylum seekers under our care and the full-year impact of the Caledonian Sleeper contract which Serco began operating on 31 March 2015.

Underlying Trading Profit was £52.2m (2015: £53.1m), representing an implied margin of 7.7% (2015: 7.2%). Trading Profit includes the profit contribution (from which tax and interest have already been deducted) of joint ventures and associates; if the £439m proportional share of revenue from joint ventures and associates was also included and if the £7.3m share of interest and tax cost was excluded, the overall divisional margin would have been 5.3% (2015: 4.1%). The joint venture and associate profit contribution of £31.3m was £2.5m lower than 2015, reflecting the end of the Northern Rail franchise in March 2016 and the lower shareholding of AWE from the second half of the year. Outside of joint ventures and associates, Underlying Trading Profit increased by 8% to £20.9m, with the profit impact from contract attrition more than offset by increased profitability on continuing contracts and reductions in overheads. Within Underlying Trading Profit there was £37m of OCP utilisation (2015: £57m), which served to offset the Division's loss-making contracts principally COMPASS, Caledonian Sleeper and PECS. The reduced level of OCP utilisation reflects improving operational and financial performance on each of these loss-making contracts.

Contract and Balance Sheet Review adjustments resulted in a £42.7m net release, arising from reductions in our estimates of future liabilities. This was driven by a release of £34m for COMPASS, reflecting updated forecasts and the terms of the contract extension; this was partially offset by the OCP arising on the acquisition of sub-contractor operations. Other releases included those related to further improvements on the FPMS contract, the transfer of the secure escorting services contract for the Youth Justice Board which removed future losses, and the outcome of the re-pricing of the HMP Ashfield contract. Partially offsetting these was a charge to increase the PECS OCP to reflect an updated assumption that the customer will exercise one of three extension years, and some increased cost assumptions on the Caledonian Sleeper contract. After the Contract and Balance Sheet Review adjustments, Trading Profit was £94.9m (2015: £60.2m).

UK Central Government represented around £300m of the Group's aggregate total value of signed contracts during the year, which was driven by rebids and extensions including the 21-month COMPASS extension, the successful rebid to continue operating the London Cycle Hire scheme for at least a further five years, and smaller awards such as the Skynet 5 secure military satellite communications network contract and our testing support for the German Air Force fleet of Eurofighters. The only major new bid pipeline decision during the year was the tender to operate the Clyde and Hebrides Ferries Services; Serco was unsuccessful in this competition, with the operations remaining with the incumbent CalMac Ferries Limited.

An updated contract was also agreed in March 2016 between the Ministry of Defence and the joint venture partners of AWE Management Limited (AWE ML), setting out a framework through to 2025 and the programme of activity and pricing through to 2019. This followed the conclusion of the UK Government's review of the efficiency, effectiveness and value for money of the operations and contracting model for AWE. As part of the arrangements, the joint venture partners agreed that Lockheed Martin would take a majority shareholding in the joint venture, and the shareholdings of both Jacobs and Serco reduced accordingly from 33.3% to 24.5% from the beginning of September 2016. If Serco's new share of associate revenue were consolidated, the agreement for the next three year's pricing would be equivalent to an additional signed contract value for Serco of approximately £700m.

For 2017, we expect a low-to-mid single digit revenue decline based upon the net effect of known contract wins and losses and other assumed revenue movements. There will be a significantly greater reduction in profitability, reflecting the end of the Northern Rail joint venture and the commercial settlement benefits that arose from this in 2016, and the reduction in the contributions from AWE.

Of existing work where an extension or rebid will be required at some point before the end of 2019, there are ten contracts with annual revenue of over £5m within the UK Central Government division; in aggregate, these represent approximately 30% of the current level of annual revenue for the division. The largest of these are the Northern Isles Ferries operations that would become due for potential extension or rebid in 2018, PECS which is now assumed to be rebid in 2019 if further extension options are not exercised by the customer, and COMPASS also in 2019.

Our pipeline of major new bid opportunities due for decision within the next 24 months includes the Defence Fire & Risk Management Organisation, the operation of an immigration removal centre, immigration escorting for the Home Office, and the Hades Programme to provide various support services to the Ministry of Defence. Over the longer term, we continue to expect reform and improvement to the prison system, and for further opportunities in Defence and other areas to emerge as the UK Government continues its efforts to save cost and improve public services.

UK & Europe Local & Regional Government

The UK & Europe Local & Regional Government division (LRG) includes our UK Health and UK and European Citizen Services sectors. The Health business provides primarily non-clinical support services to hospitals; the Citizen Services business provides environmental and leisure services, as well as a wide range of other front, middle and back-office services to Local Authorities, and IT services to European institutions.

Revenue for 2016 was £696.5m (2015: £905.8m), a decline of 23%. At constant currency, the organic decline was 25%. The principal drivers of the revenue reduction were: the end of the Suffolk Community Healthcare and National Citizen Services contracts which had previously been heavily loss-making and were not rebid; changes to two health procurement contracts which are continuing but where we no longer recognise as revenue the cost of goods purchased on behalf of our customers; the full-year impact of the early exit from the Thurrock BPO services contract; the ending of certain infrastructure support services to private sector customers; and the reducing scale of the Child Maintenance Group operations. There was limited in-year revenue growth elsewhere to offset the effect of these planned contract ends and reductions.

There was an Underlying Trading Loss of £6.5m (2015: profit of £4.7m), representing a margin of -0.9% (2015: +0.5%). There was a reduction in profit contribution from contract attrition, and certain areas of cost investment to deliver longer term efficiencies more than offset other contract profitability improvements and cost savings during the year. In addition, there were £3m of impairments and write-downs on a European agency contract. Within Underlying Trading Profit there was £23m of OCP utilisation (2015: £11m non-exceptional), with the increase reflecting the losses on the Lincolnshire County Council operations as costs peaked with the implementation of the new ERP system; the contract is running broadly in line with expectations and the major elements of the IT implementation are now in service.

Contract and Balance Sheet Review adjustments resulted in a £7.4m net charge, reflecting a number of small adjustments in assumptions on OCP contracts. Separately, there was a one-time profit of £3.5m arising from a pension scheme settlement relating to the early exit from the Thurrock Council services in the previous year. After these adjustments and one-time profit, the Trading Loss was £10.4m (2015: Trading Loss of £14.5m).

LRG represented around £750m of the Group's aggregate total value of signed contracts during the year. The largest award reflects the initial seven-year value, estimated at £450m, for new services to Barts Health NHS Trust to deliver facilities management services across their hospitals. Of other major new bid pipeline decisions during the year, Serco was unsuccessful on a smaller health facilities management opportunity and two bids for environmental services. Other new but smaller wins included contact centre services for the Department of Work & Pensions. Successful rebids or extensions included: the Anglia Support Partnership healthcare shared services operations; environmental services for Woking Borough, Charnwood Borough and Canterbury City councils; regional employment support services for the Skills Funding Agency; contact centre and digital services support for Public Health England; and our support to institutions such as the European Space Agency and CERN.

Divisional Reviews continued

For 2017, we expect a low-to-mid single digit revenue decline based upon the net effect of known contract wins and losses and other revenue movements including the change to the two health procurement contracts. Growth from the start of the major new contract for Barts is expected to be offset by other reductions. We expect that the division should though make progress on its profitability in 2017, as we see more benefits start to come through from actions to secure sustainable longer term improvements in efficiencies.

Of existing work where an extension or rebid will be required at some point before the end of 2019, there are 12 contracts with annual revenue of over £5m within the LRG division; in aggregate, these represent approximately 20% of the current level of annual revenue for the division; this excludes Glasgow ACCESS which is an assumed expiry in March 2018.

Our pipeline of major new bid opportunities due for decision within the next 24 months includes further tenders for environmental services and hospital facilities management bids. We continue to evaluate developments in the other sectors of operation within LRG, including other Citizen Services work and to expand our European business providing various operational support to government agencies.

AsPac

Operations in the Asia Pacific division include Justice, Immigration, Defence, Health, Transport and Citizen Services in Australia, New Zealand and Hong Kong. Serco's operations in Australia are by far the largest element of the division; the country represents approximately 20% of total Revenue for the Group.

Revenue for 2016 was £619.7m (2015: £544.7m), an increase of 14%. In Australian dollars, the main currency for operations of the division, revenue for the year was equivalent to approximately A$1,140m (2015: A$1,106m). The movements in local currencies against Sterling increased revenue by £64m or 12%, while the impact of disposals (the Great Southern Rail business disposed in May 2015) reduced revenue by £10m or 2%; the organic growth at constant currency was therefore 4%. There were some increases in revenue in relation to the renegotiation of the Armidale Class Patrol Boat (ACPB) contract as well as scope increases to existing services such as Citizen Services contact centre operations and the expansion of Acacia prison. Revenue from Australian immigration services was broadly flat.

Underlying Trading Profit was £24.9m (2015: £11.9m), representing a margin of 4.0% (2015: 2.2%). The improvement in profitability included: a favourable currency movement of £3m; a loss on the Mount Eden Correctional Facility contract in 2015 that was offset in 2016 by the subsequent OCP; and progress on cost efficiencies that more than offset other cost and margin pressures. Within Underlying Trading Profit there was £12m of OCP utilisation (2015: £20m), with significantly lower losses on the ACPB contract partially offset by increased utilisation on the Mount Eden contract.

Contract and Balance Sheet Review adjustments resulted in a £9.3m net release, driven by revised assumptions on the residual period of operation of the ACPB contract, which concludes in 2017. After these adjustments, Trading Profit was £34.2m (2015: £58.8m).

AsPac represented around £600m of the Group's aggregate total value of signed contracts during the year. The largest new order, valued at approximately £160m, was to project manage the design and build phase, and subsequently operate, the new 'icebreaker' Antarctic Supply and Research Vessel for the Australian Department of the Environment. There was also the extension of two corrections contracts with the Queensland and Western Australian governments, valued in total at approximately £200m, and the successful rebid of hospital facilities management services in Hong Kong.

For 2017, our expectations are an approximate 10% revenue decline on an organic basis, based upon the net effect of known contract wins and losses and other assumed revenue movements. This is driven by the loss of the ACPB, Mount Eden and Western Australia Court Security and Custodial Services contracts. The estimated currency benefit based on current exchange rates would largely offset the forecast organic decline.

Of existing work where an extension or rebid will be required at some point before the end of 2019, there are seven contracts with annual revenue of over £5m within the AsPac division; in aggregate, these represent approximately 50% of the current level of annual revenue for the division; this high proportion reflects that the Australia onshore immigration services contract requires rebid or extension at the end of 2019, with this accounting for over 30% of current divisional revenue.

Our pipeline of major new bid opportunities due for decision within the next 24 months now includes three prison bids and additional opportunities in case management and defence support services. Looking beyond, further potential opportunities in Justice, Citizen Services, Defence, Transport and non-clinical health services are expected to be developed over time.

Middle East

Operations in the Middle East division include Transport, Defence, Health and Citizen Services.

Revenue for 2016 was £324.8m (2015: £291.4m), an increase of 11%. The strengthening of local currencies against Sterling provided growth of £36m or 12%; the organic decline at constant currency was 1%. There was revenue growth from increased volumes on a defence logistics contract, expanded healthcare support services and at the Dubai Metro; these were broadly offset by reduced revenue on the Dubai Air Navigation Services contract and a small number of other operations reducing in scope or ending.

Underlying Trading Profit was £16.6m (2015: £18.9m), representing a margin of 5.1% (2015: 6.5%). There was some improvement in profitability from higher defence logistics volumes and the £1.4m favourable currency movement; these were more than offset by the impact of other contract scope reductions and attrition, together with significant investment in business development and bidding the major rail opportunities in the region. Within Underlying Trading Profit, OCP utilisation was immaterial.

Contract and Balance Sheet Review adjustments resulted in a £2.2m net release. After these adjustments, Trading Profit was £18.8m (2015: £27.4m).

The Middle East represented over £200m of the Group's aggregate total value of signed contracts during the year. Although no major new bid pipeline decisions were due, smaller awards included a new contract to maintain and support a large part of Dubai Airport buildings and infrastructure, and further contracts for defence base support and healthcare facilities management in the region. Amongst rebids and extensions secured were further extensions for Middle East Logistics and Base Support (MELABS) to the Australian Defence Force in the region, healthcare facilities management in Saudi Arabia and Abu Dhabi, and Baghdad Air Navigation Services.

For 2017, there is a relatively modest net effect expected from already known contract wins and losses. However, progress on retaining existing work, and particularly the cost to progress and the outcomes of the major new bid opportunities in the region, will ultimately determine financial performance in the coming year.

Of existing work where an extension or rebid will be required at some point before the end of 2019, there are ten contracts with annual revenue of over £5m within the Middle East division; in aggregate, these represent more than half of the current level of annual revenue for the division. There is a high proportion of work to secure in 2019, when the Dubai Metro, MELABS and Cleveland Clinic Abu Dhabi contracts each require extending or rebidding.

Our pipeline of major new bid opportunities due for decision within the next 24 months includes three major light rail and tram operations in the region; in aggregate, these represent approximately 30% of the value of the Group's pipeline. There are other smaller opportunities in defence training and support services and in non-clinical health facilities management support in the current pipeline, and the Transport, Defence, Health and other Citizen Services including integrated facilities management continue to be potentially high growth markets in the region.

Americas

Our Americas division provides professional, technology and management services focused on Defence, Transport, and Citizen Services. The US federal government, including the military, civilian agencies and the national intelligence community, are our largest customers. We also provide services to the Canadian Government and to some US state and municipal governments.

Revenue for 2016 at £691.4m was broadly flat (2015: £693.0m). In US dollars, the main currency for operations of the division, revenue for the year was equivalent to approximately US$944m (2015: US$1,061m). The strengthening of local currencies against Sterling increased revenue by £74m or 11%, with the organic decline at constant currency also being 11%. The principal drivers of the revenue reduction were the loss of the rebid for record processing at the National Benefits Centre and the transition back to the customer of the VDOT operations, together with a number of other smaller contract ends, or reductions in the volume of workload or task orders. There was limited growth elsewhere to offset these reductions.

Divisional Reviews continued

Underlying Trading Profit was £43.0m (2015: £44.3m), representing a margin of 6.2% (2015: 6.4%). The decline was driven by contract attrition and areas of cost investment, which was only partially offset by a £4.6m favourable currency movement and other cost efficiencies. Within Underlying Trading Profit there was £9m (2015: £10m) of OCP utilisation on the completed VDOT contract and the Ontario Driver Examination Services contract.

Contract and Balance Sheet Review adjustments resulted in a £36.6m net charge. This was driven by the £29.5m revision to estimates of future costs and foreign exchange impacts associated with the existing OCP for the IT systems implementation and ongoing management of the Ontario Driver Examination Services contract; in addition to the increase in the OCP there was an £8.8m charge reflecting a reduction in the accrued revenue balance for the contract. After the Contract and Balance Sheet Review adjustments, Trading Profit was £6.4m (2015: £27.0m).

Americas represented over £600m of the Group's aggregate total value of signed contracts during the year. Awards for new work included a US Air Force High Altitude Electromagnetic Pulse (HEMP) Protection of Ballistic Missile Early Warnings Systems radar facility upgrade contract at Thule Air Base in Greenland, and a support contract for the US State of Louisiana Department of Transportation (LADOT) Motorist Assistance Program. Defence task orders awarded during the year, driven by our ship and shore/base modernisation services, totalled over US$260m, which includes expanding our recently awarded support services to the US Naval Facilities Engineering Command (NAVFAC). Our bids to support passport processing for the Department of State and data reporting for the Department of Health and Human Services were unsuccessful. Amongst rebids, Serco secured its operations to continue providing site support services at the 5 Wing Canadian Forces Base in Goose Bay, Canada, valued at C$115m for the initial two-year period.

For 2017, our expectations are low-to-mid single digit revenue growth on an organic basis, based upon the net effect of known contract wins and losses and other assumed revenue movements. The estimated currency benefit based on current exchange rates would increase this to potentially 10-15% growth. The outcome for 2017 could however materially change depending on developments affecting our contract supporting the US Affordable Care Act (ACA); these operations accounted for approaching 30% of divisional revenue in 2016, and we currently forecast them to be broadly flat in 2017; whilst margins on this contract are lower than the average for the Division, the contract recovers a material amount of overhead costs and large reductions in chargeable direct labour could create challenges to reduce overheads in line with revenues. At the time of reporting, apart from knowing that under the new Administration changes will be made, there is no consensus in either Congress or the Administration as to what form these changes will take, and what provision will be made for the more than 24 million people who have received health insurance coverage through the ACA.

Of existing work where an extension or rebid will be required at some point before the end of 2019, there are eight contracts with annual revenue of over £5m within the Americas division; in aggregate, these represent around 50% of the current level of annual revenue for the division; this high proportion reflects that our contract supporting the ACA requires the final option year to be exercised though to 30 June 2018 and then would be required to be rebid; the Global Installation Contract covering areas of our defence ship modernisation work also requires securing in 2019.

Our pipeline of major new bid opportunities due for decision within the next 24 months includes important opportunities to provide various support functions to the US Navy, as well as other bids in transport operational support, Citizen Services processing and immigration services that have been added over the year. Whilst particular uncertainty exists with regard to the future of the ACA potentially in 2017 and more so beyond, under the new US administration other areas of public service support may generate further improvement in market conditions over time.

Dan Allen, Chief Executive Officer of the Americas division, has informed the business of his intention to retire from work in mid-2017. Dan joined Serco in 2013 and we thank him for the successful leadership and direction he has provided, and wish him well for the future.

Corporate Costs

Corporate costs relate to typical central function costs of running the Group, including executive, governance and support functions such as HR, finance and IT. Where appropriate, these costs are stated after allocation of recharges to operating divisions. The costs of Group-wide programmes and initiatives are also incurred centrally.

Corporate costs in 2016, before Contract and Balance Sheet Review adjustments, were £43.5m (2015: £51.3m), with the 15% reduction including the benefit of actions taken to deliver savings and improve the efficiency of our overall operating model.

Contract and Balance Sheet Review adjustments resulted in a £3.2m net release. After these adjustments, Corporate Costs within Trading Profit were £40.3m (2015: £48.0m).

Global Services (discontinued operations)

The Global Services division consists of Serco's private sector BPO business, performing middle and back office functions across customer contact, transaction and financial processing. As part of Serco's previously announced strategy to exit non-core markets and to focus on the provision of public services, Serco has been exiting these operations. On 31 December 2015, the transaction to dispose of the majority of the offshore private sector BPO operations was completed; the businesses sold contributed over £300m of revenue and £23m of Underlying Trading Profit in 2015, and were sold for a gross consideration of approximately £250m. There were two smaller associated transactions relating to operations in the Middle East, both of which were completed in 2016. The remaining private sector operations, which are predominantly UK onshore operations, are being exited either by further disposals, transfers, early termination or running-off the contracts over their remaining contractual period.

For statutory reporting purposes, the Global Services division is classified as discontinued operations, therefore only the post-tax result of these operations is included as a single line in the reporting of the Group's Income Statement. However, for consistency with previous guidance, Serco's underlying measures include the Revenue and Trading Profit of these discontinued operations.

Revenue was £36.8m (2015: £337.6m), with the decline reflecting the disposals and exits in 2015 and 2016.

The Underlying Trading Loss for 2016 was £4.6m (2015: Underlying Trading Profit of £14.3m). The loss in 2016 reflects the residual contract losses up to the point of exit together with the effect of 'stranded' shared service centre costs and other overheads previously absorbed by the Global Services division. Within Underlying Trading Profit, there was £3m of OCP utilisation.

Contract and Balance Sheet Review adjustments resulted in a £0.8m net release. As the division included assets designated as held for sale, there is a benefit of not charging depreciation and amortisation of £0.5m. After these Contract and Balance Sheet Review adjustments and held for sale benefits, the Trading Loss was £3.3m.

Over the course of 2016, we ran ahead of our plans to mitigate the losses and stranded costs, which were initially anticipated to be approximately £10m in 2016. The Freeman Grattan Holdings and BrightHouse contracts together with the associated Sheffield facilities were transferred to a new provider during the first half of the year; the Aegon contract together the associated Lytham St Annes facilities were transferred in the second half. Our only remaining contract is that for direct home shopping company JD Williams. For 2017, no material residual financial effect is therefore forecast.

Finance Review

Underlying Trading Profit at £82m was £14m lower than 2015, driven by a £19m reduction in the results generated from discontinued operations. Closing Net Debt of £109m was lower than expected and represented a year-on-year increase of £46m, reflecting the impact of loss making contracts. Revenue from continuing and discontinued operations was £467m lower at £3.0bn.

For the year ended 31 December	2016 £m	2015 (restated*) £m
Revenue from continuing and discontinued operations	3,047.8	3,514.6
Exclude revenue from discontinued operations	(36.8)	(337.6)
Reported Revenue (continuing activities only)	3,011.0	3,177.0
Underlying Trading Profit*	82.1	95.9
Onerous contract and Balance Sheet Review adjustments	14.2	20.9
Benefit from non-depreciation and non-amortisation of assets held for sale	0.5	11.7
Other one-time items	3.5	9.0
Trading Profit on continuing and discontinued operations*	100.3	137.5
Other expenses – amortisation and impairment of intangibles arising on acquisition	(5.1)	(4.9)
Operating profit before exceptional items on continuing and discontinued operations*	95.2	132.6
Exclude operating loss / (profit) before exceptional items arising on discontinued operations	3.3	(26.5)
Operating profit before exceptional items*	98.5	106.1
Exceptional profit / (loss) on disposal of subsidiaries and operations	2.9	(2.6)
Other exceptional operating items	(59.2)	(107.3)
Exceptional operating items	(56.3)	(109.9)
Reported operating profit / (loss)*	42.2	(3.8)
Investment revenue	9.3	6.1
Finance costs*	(21.9)	(38.9)
Exceptional finance costs	–	(32.8)
Total net finance costs*	(12.6)	(65.6)
Profit / (loss) before tax	29.6	(69.4)
Tax on profit before exceptional items	(15.8)	(17.9)
Tax on exceptional items	3.1	0.4
Tax charge	(12.7)	(17.5)
Profit / (loss) for the year from continuing operations	16.9	(86.9)
Loss for the year from discontinued operations	(18.0)	(66.2)
Loss for the year	(1.1)	(153.1)

* As explained below, profit measures down to reported operating profit have been restated following the change in accounting policy to exclude foreign exchange movements on investment and financing arrangements, including them instead in net finance costs.

For the year ended 31 December	2016	2015
Underlying trading margin from continuing and discontinued operations	2.7%	2.7%
Underlying earnings per share from continuing and discontinued operations	4.13p	3.44p
Earnings per share before exceptional items from continuing and discontinued operations	6.12p	6.55p
Loss per share from continuing and discontinued operations	(0.11p)	(15.47p)

Change in accounting policy for foreign exchange movements on investment and financing activities

In order to provide more relevant information about the impact of the underlying transactions of trading operations, the accounting policy regarding the classification of foreign exchange movements on investment and financing arrangements has been changed. These movements are now excluded from Trading Profit and included instead within net finance costs. As a result of this change in accounting policy, the prior year income statement and cash flow statement have been restated, together with the definition of Net Debt which now includes derivatives relating to Net Debt components. The impact of this restatement has been to decrease Trading Profit in the year by £1.2m (2015: decrease by £0.1m), with an equal and opposite impact recognised within net finance costs, decrease Free Cash Flow by £47.0m (2015: decrease by £19.3m), with an equal and opposite impact recognised below Free Cash Flow, and decrease Net Debt by £18.1m (2015: decrease by £14.6m). No restatements have been made to the comparative periods for 2014 and prior in the Key Performance Indicators section of the Strategy Report and the five year record included as an appendix to the Consolidated Financial Statements. Further details are provided in note 2 to the Consolidated Financial Statements.

Alternative Performance Measures (APMs) and other related definitions

APMs used by the Group are reviewed below to provide a definition and reconciliation from each non-IFRS APM to its IFRS equivalent, and to explain the purpose and usefulness of each APM.

In general, APMs are presented externally to meet investors' requirements for further clarity and transparency of the Group's financial performance. The APMs are also used internally in the management of our business performance, budgeting and forecasting, and for determining Directors' remuneration and that of other management throughout the business.

APMs are non-IFRS measures. Where additional revenue is being included in an APM, this reflects revenues presented elsewhere within the reported financial information, except where amounts are recalculated to reflect constant currency. Where items of profits or costs are being excluded in an APM, these are included elsewhere in our reported financial information as they represent actual profits or costs of the Group. As a result, APMs allow investors and other readers to review different kinds of revenue, profits and costs and should not be used in isolation. Other commentary within the Strategic Report, including the other sections of this Finance Review, as well as the Consolidated Financial Statements and their accompanying notes, should be referred to in order to fully appreciate all the factors that affect our business. We strongly encourage readers not to rely on any single financial measure, but to carefully review our reporting in its entirety.

The methodology applied to calculating the APMs has not changed during the year for any measure, but the APMs do reflect the impact of the prior year restatement.

Reported Revenue at constant currency

Reported Revenue, as shown on the Group's Consolidated Income Statement on page 139, reflects revenue translated at the average exchange rates. In order to provide a comparable movement on the previous year's results, Reported Revenue is recalculated by translating non-Sterling values for the year to 31 December 2016 into Sterling at the average exchange rate for the year ended 31 December 2015.

For the year ended 31 December	2016 £m
Reported Revenue at constant currency (continuing activities only)	2,823.0
Foreign exchange differences	188.0
Reported Revenue at reported currency (continuing activities only)	3,011.0

Finance Review continued

Organic Revenue at constant currency

Reported Revenue may include revenue generated by businesses acquired during a particular year and/or generated by businesses sold during a particular year up to the date of disposal. In order to provide a comparable movement which ignores the effect of both acquisitions and disposals on the previous year's results, Reported Revenue is recalculated by excluding the impact of any acquisitions or disposals. For 2016, no adjustment is required as no acquisitions generated third party revenues and all disposals are included in discontinued operations. Therefore organic revenue growth is calculated by comparing Reported Revenue at constant currency with Prior Year Organic Revenue at reported currency.

Prior Year Organic Revenue at reported currency is calculated as follows:

For the year ended 31 December	2015 £m
Organic Revenue at reported currency	3,166.6
Impact of any acquisitions or disposals on Reported Revenue at reported currency	10.4
Reported Revenue at reported currency (continuing activities only)	3,177.0

Revenue from continuing and discontinued operations

Reported Revenue, as shown on the Group's Consolidated Income Statement on page 139, reflects only that from continuing operations, with the post tax result of discontinued operations consolidated as a single line at the bottom of the Consolidated Income Statement. Discontinued operations reflect the former Global Services division which consisted of our private sector BPO operations. The alternative measure includes discontinued operations for the benefit of consistency with previously reported results and to reflect the overall change in scale of the Group's operations. The alternative measure allows the performance of the discontinued operations themselves, and their impact on the Group as a whole, to be evaluated on measures other than just the post tax result.

For the year ended 31 December	2016 £m	2015 £m
Revenue from continuing and discontinued operations	3,047.8	3,514.6
Exclude revenue from discontinued operations	(36.8)	(337.6)
Reported Revenue (continuing activities only)	3,011.0	3,177.0

Revenue from continuing operations, including share of joint ventures and associates

Reported Revenue, as shown on the Group's Consolidated Income Statement on page 139, excludes the Group's share of revenue from joint ventures and associates, with Serco's share of profits in joint ventures and associates (net of interest and tax) consolidated within Reported Operating Profit as a single line further down the Consolidated Income Statement. The alternative measure includes the share of joint ventures and associates for the benefit of reflecting the overall change in scale of the Group's ongoing operations, which is particularly relevant for evaluating Serco's presence in market sectors such as Defence and Transport. The alternative measure allows the performance of the joint venture and associate operations themselves, and their impact on the Group as a whole, to be evaluated on measures other than just the post tax result.

For the year ended 31 December	2016 £m	2015 £m
Revenue from continuing operations, including share of joint ventures and associates	3,491.8	3,914.2
Exclude share of revenue from joint ventures and associates	(480.8)	(737.2)
Reported Revenue (continuing activities only)	3,011.0	3,177.0

Trading Profit

The Group uses Trading Profit as an alternative measure to Reported Operating Profit, as shown on the Group's Consolidated Income Statement on page 139, by making three adjustments. Trading Profit is a metric used to determine the performance and remuneration of the Executive Directors.

Firstly, Trading Profit excludes exceptional items, being those considered material, non-recurring and outside of the normal operating practice of the Company to be suitable of separate presentation and detailed explanation.

Secondly, amortisation and impairment of intangibles arising on acquisitions are excluded, because these charges are based on judgements about the value and economic life of assets that, in the case of items such as customer relationships, would not be capitalised in normal operating practice.

Thirdly, the Trading Profit of discontinued operations is included, since as with our alternative measure of revenue, this benefits from consistency with previously reported results, reflects the overall change in scale of the Group's operations and takes account of the performance of the discontinued operations themselves. This allows their impact on the Group as a whole to be evaluated on measures other than just the post tax result.

For the year ended 31 December	2016 £m	2015 (restated*) £m
Underlying Trading Profit*	82.1	95.9
Include OCP charges and releases	9.6	(3.0)
Include Contract and Balance Sheet Review adjustments	4.6	23.9
Include benefit from non-depreciation and amortisation of assets held for sale	0.5	11.7
Include other one-time items	3.5	9.0
Trading Profit*	100.3	137.5
Include operating exceptional items (continuing operations only)	(56.3)	(109.9)
Include amortisation and impairment of intangibles arising on acquisition	(5.1)	(4.9)
Exclude Trading Loss / (Profit) from discontinued operations	3.3	(26.5)
Reported Operating Profit / (Loss) (continuing activities only)*	42.2	(3.8)

* Profit measures down to Reported Operating Profit have been restated following the change in accounting policy to exclude foreign exchange movements on investment and financing arrangements, including them instead in net finance costs.

Underlying Trading Profit (UTP)

The Group uses a further alternative measure, Underlying Trading Profit, to make adjustments for unusual items that occur within Trading Profit and remove the impact of historical issues. UTP therefore provides a measure of the underlying performance of the business in the current year. For 2016 and 2015 there were four items excluded from UTP.

Firstly, the releases and charges on all OCPs are excluded. OCP charges and releases reflect the future multiple year cost of delivering onerous contracts and do not relate to the current year cost of operating the contract. It should be noted that, as for Reported Operating Profit, UTP benefits from OCP utilisation (of £84.2m in 2016 and £114.1m in 2015) which neutralises the in year losses on previously identified onerous contracts, therefore it is only the initial or subsequent charges or releases of OCPs that are adjusted for.

Secondly, those items relating to Contract and Balance Sheet Review are excluded as they arise from changing estimates on the outcome of historical issues which were originally identified during the 2014 review. Both OCP adjustments and Contract and Balance Sheet Review adjustments are identified and separated from the APM in order to give clarity of the underlying performance of the Group and to separately disclose the progress made on these items. Contract and Balance Sheet Review adjustments are expected to be insignificant in future periods and will no longer be reported separately in 2017 and beyond unless they are individually material.

Thirdly, the benefit of depreciation and amortisation charges not being taken in the Group accounts in relation to assets held for sale are excluded. Such charges are still being taken in the subsidiary accounts to reflect the reduction in value of the underlying assets, and we consider it relevant to show the effect this would have on the Group performance measure.

Finally, any other significant items that have a one-time financial impact are excluded, which for the periods under review are the benefit of a profit on early exit of a UK local authority contract in 2015 and the associated one-time pension settlement in 2016. These one-time items are distinct from exceptional items in that they have arisen from normal contract exit conditions. However, consistent with the treatment of the gain from early contract exit recorded in 2015, these items are adjusted through UTP to provide a comparable measure.

Underling trading margin is calculated as UTP divided by revenue from continuing and discontinued operations.

Finance Review continued

UTP at constant currency

UTP disclosed above has been translated at the in year average foreign exchange rates. In order to provide a comparable movement on the previous year's results, UTP is recalculated by translating non-Sterling values for the year to 31 December 2016 into Sterling at the average exchange rate for the year ended 31 December 2015.

For the year ended 31 December	2016 £m
Underlying Trading Profit at constant currency	73.4
Foreign exchange differences	8.7
Underlying Trading Profit at reported currency	82.1

Earnings Per Share (EPS) from continuing and discontinued operations before exceptional items

EPS from continuing and discontinued operations, as shown on the Group's Consolidated Income Statement on page 139, includes exceptional items charged or credited to the income statement in the year. EPS before exceptional items aids consistency with historical results and is a metric used in assessing the performance and remuneration of the Executive Directors.

For the year ended 31 December	2016 pence	2015 pence
EPS from continuing and discontinued operations before exceptional items	6.12	6.55
Impact of exceptional items	(6.23)	(22.02)
Reported EPS from continuing and discontinued operations, basic	(0.11)	(15.47)

Underlying EPS from continuing and discontinued operations

Reflecting the same adjustments made to Reported Operating Profit to calculate UTP as described above, and including the related tax effects of each adjustment, an alternative measure of EPS is presented below. This aids consistency with historical results, and enables performance to be evaluated before the unusual or one-time effects described above.

For the year ended 31 December	2016 earnings £m	2016 per share	2015 earnings (restated*) £m	2015 per share (restated*)
Underlying Trading Profit*	82.1	7.54p	95.9	9.72p
Investment revenue, continuing and discontinued operations	9.3	0.85p	8.2	0.83p
Finance costs, continuing and discontinued operations*	(21.9)	(2.01p)	(40.1)	(4.07p)
Tax on underlying profit after finance costs	(24.4)	(2.24p)	(30.5)	(3.09p)
Non-controlling interests	(0.1)	(0.01p)	0.5	0.05p
Underlying EPS, basic	45.0	4.13p	34.0	3.44p
Include OCP charges and releases	9.6	0.88p	(3.0)	(0.30p)
Include Contract and Balance Sheet Review adjustments	4.6	0.42p	23.9	2.42p
Include benefit from non-depreciation and amortisation of assets held for sale	0.5	0.05p	11.7	1.19p
Include other one-time items	3.5	0.32p	9.0	0.92p
Include amortisation and impairment of intangibles arising on acquisition	(5.1)	(0.47p)	(4.9)	(0.50p)
Include tax impact of non-underlying items	8.5	0.78p	(6.1)	(0.62p)
Remove impact of exceptional items, net of tax	(67.8)	(6.23p)	(217.2)	(22.02p)
Reported loss per share from continuing and discontinued operations, basic	(1.2)	(0.11p)	(152.6)	(15.47p)

* Profit measures down to Reported Operating Profit have been restated following the change in accounting policy to exclude foreign exchange movements on investment and financing arrangements, including them instead in net finance costs.

Free Cash Flow (FCF)

We present an alternative measure for cash flow to reflect net cash inflow from operating activities before exceptional items, which is the measure shown on the Consolidated Cash Flow Statement on page 143, but adjusting this IFRS measure to include dividends we receive from joint ventures and associates and deducting net interest paid and net capital expenditure on tangible and intangible asset purchases. FCF is considered relevant to reflect the cash performance of business operations after meeting usual obligations of financing and tax. It is therefore a measure that is before all other remaining cash flows, being those related to exceptional items, acquisitions and disposals, other equity-related and debt-related funding movements, and foreign exchange impacts on financing and investing activities. FCF is therefore a measure to assess the cash flow generated by the business and aids consistency for comparison to historical results. FCF is a metric used to determine the performance and remuneration of the Executive Directors.

For the year ended 31 December	2016 £m	2015 (restated*) £m
Free Cash Flow*	(33.0)	(35.5)
Exclude dividends from joint ventures and associates	(40.0)	(32.5)
Exclude net interest paid	18.7	31.3
Exclude capitalised finance costs paid	0.3	1.4
Exclude purchase of intangible and tangible assets net of proceeds from disposal	31.6	72.5
Cash flow from operating activities before exceptional items*	(22.4)	37.2
Exceptional operating cash flows	(39.9)	(56.6)
Cash flow from operating activities*	(62.3)	(19.4)

* Free Cash Flow has been restated following the change in accounting policy to exclude foreign exchange movements on investment and financing arrangements.

UTP cash conversion

FCF as defined above includes interest and tax cash flows. In order to calculate an appropriate cash conversion metric equivalent to UTP, Trading Cash Flow is derived from the FCF by excluding tax and interest items. UTP cash conversion therefore provides a measure of the efficiency of the business in terms of converting profit into cash before taking account of the impact of interest, tax and exceptional items.

For the year ended 31 December	2016 £m	2015 (restated*) £m
Free Cash Flow*	(33.0)	(35.5)
Add back:		
Tax paid	5.6	2.7
Non-cash R&D expenditure	0.4	0.7
Interest received	(1.4)	(3.4)
Interest paid	20.1	34.7
Capitalised finance costs paid	0.3	1.4
Trading Cash Flow*	(8.0)	0.6
Underlying Trading Profit*	82.1	95.9
Underlying Trading Profit cash conversion* **	N/A	0.6%

* As explained above, FCF and UTP have been restated, resulting in a restatement of Trading Cash Flow and the Underlying Trading Profit cash conversion.

** No Underlying Trading Profit cash conversion is given in 2016 as a negative Trading Cash Flow has arisen.

Net Debt including assets held for sale

We present an alternative measure to bring together the various funding sources that are included on the Group's Consolidated Balance Sheet on page 142 and the accompanying notes regarding loans receivable and funding sources within assets held for sale. Net Debt is a measure to reflect the net indebtedness of the Group and includes all cash and cash equivalents and any debt or debt like items, including any derivatives entered into in order to manage risk exposures on these items.

For the year ended 31 December	2016 £m	2015 (restated*) £m
Cash and cash equivalents	177.8	323.6
Loans receivable	22.9	19.9
Loans payable	(299.9)	(381.9)
Obligations under finance leases	(28.2)	(43.8)
Derivatives relating to Net Debt	18.1	14.6
Net Debt (excluding assets and liabilities held for sale)*	(109.3)	(67.6)
Net Debt balances within assets held for sale	–	4.7
Net Debt (including that for assets and liabilities held for sale)*	(109.3)	(62.9)

* Net Debt has been restated to include derivative financial instruments that relate to other components of Net Debt.

Finance Review continued

Pre-tax Return on Invested Capital (ROIC)

ROIC for the year ended 31 December 2016 is a measure used to assess the efficiency of the resources used by the Group and is a metric used to determine the performance and remuneration of the Executive Directors. ROIC is calculated based on UTP and Trading Profit using the Income Statement for the year and a two point average of the opening and closing balance sheets. The composition of Invested Capital and calculation of ROIC are summarised in the table below.

For the year ended 31 December	2016 £m	2015 (restated*) £m	2014 £m
Non-current assets			
Goodwill	577.9	509.9	541.5
Other intangible assets	83.6	89.8	118.8
Property, plant and equipment	69.3	73.2	38.4
Interest in joint ventures and associates	14.4	13.8	1.6
Trade and other receivables	44.4	50.2	38.1
Current assets			
Inventory	22.4	26.4	31.2
Trade and other receivables	543.5	519.7	498.8
Assets classified as held for sale	–	39.8	564.7
Total invested capital assets	1,355.5	1,322.8	1,833.1
Current liabilities			
Trade and other payables	(524.5)	(548.8)	(581.9)
Assets classified as held for sale	–	(32.5)	(219.9)
Non-current liabilities			
Trade and other payables	(16.8)	(18.3)	(29.7)
Total invested capital liabilities	(541.3)	(599.6)	(831.5)
Invested Capital	814.2	723.2	1,001.6
Two point average of opening and closing Invested Capital	768.7	862.4	
Trading Profit*	100.3	137.5	
ROIC%*	13.0%	15.9%	
Underlying Trading Profit*	82.1	95.9	
Underlying ROIC%*	10.7%	11.1%	

* Profit measures have been restated following the change in accounting policy to include foreign exchange movements on investment and financing arrangements in net finance costs. As a result, TP, ROIC, UTP and Underlying ROIC have been restated.

Overview of Financial Performance

Revenue

Reported Revenue declined by 5% in the year to £3,011.0m (2015: £3,177.0m), an 11% reduction in constant currency.

Revenue including that arising from operations classified as discontinued declined by 13% in the year to £3,047.8m (2015: £3,514.6m). Commentary on the revenue performance of the Group is provided in the Chief Executive's Review and the Divisional Reviews sections.

Trading Profit

Trading Profit for the year was £100.3m (2015 restated: £137.5m), a 27% reduction year-on-year which includes the Trading Loss arising on discontinued operations of £3.3m (2015: profit of £26.6m). Commentary on the trading performance of the Group is provided in the Chief Executive's Review and the Divisional Reviews sections.

Underlying Trading Profit

UTP was £82.1m (2015 restated: £95.9m), down 14%. At constant currency UTP was £22.5m lower than 2015 at £73.4m, with a movement of £18.9m relating to the results of discontinued operations. Commentary on the underlying performance of the Group is provided in the Chief Executive's Review and the Divisional Reviews sections.

Excluded from UTP were net releases from OCPs of £9.6m (2015: net charges of £3.0m) following the annual reassessment undertaken as part of the budgeting process. Also excluded from UTP were net releases of £4.6m (2015: net releases of £23.9m) relating to other provisions and accruals for items identified during the 2014 Contract and Balance Sheet Review. UTP also excludes the benefit arising from the non-depreciation of assets classified as held for sale. In 2016, depreciation and amortisation of £0.4m and £0.1m respectively (2015: £10.0m and £1.7m) was not charged to Reported Operating Profit on assets held for sale.

Other one-time items excluded from UTP relate to the early exit of a UK local authority contract in 2015 in lieu of anticipated profits in future years, net of direct costs, impairments and other charges. During 2016 the other one-time profit recorded relates to a pension scheme settlement in respect of the same contract that was agreed in the year.

Discontinued operations

The Global Services division, representing private sector BPO operations, was classified as a discontinued operation in 2015. The completion of the sale of the majority of the offshore private sector BPO business occurred in December 2015. Disposal of one of the two remaining elements of the offshore business was completed in March 2016 and the final element completed in December 2016. The residual UK onshore private sector BPO operations have been sold, or have been exited early with the exception of one business where completion is expected within the next twelve months.

Finance Review continued

The results of discontinued operations were as follows:

For the year ended 31 December	2016 £m	2015 £m
Revenue	36.8	337.6
Underlying Trading (Loss) / Profit	(4.6)	14.3
Onerous contract and Balance Sheet Review adjustments	0.8	0.6
Benefit from non-depreciation and non-amortisation of assets held for sale	0.5	11.7
Trading (Loss) / Profit	(3.3)	26.6
Amortisation and impairment of intangibles arising on acquisition	–	(0.1)
Operating (loss) / profit before exceptional items	(3.3)	26.5
Exceptional (loss) / gain on disposal of subsidiaries and operations	(2.8)	5.4
Other exceptional operating items	(11.4)	(83.0)
Exceptional operating items	(14.2)	(77.6)
Operating loss	(17.5)	(51.1)
Investment revenue	–	2.1
Finance costs	–	(1.2)
Exceptional finance costs	(0.4)	–
Total net finance costs	(0.4)	0.9
Loss before tax	(17.9)	(50.2)
Tax on (loss) / profit before exceptional items	(0.1)	(18.7)
Tax on exceptional items	–	2.7
Tax charge	(0.1)	(16.0)
Net loss on discontinued operations (attributable to equity owners of the Company) as presented in the income statement	(18.0)	(66.2)

Joint ventures and associates – share of results

In 2016 the most significant joint ventures and associates in terms of scale of operations were AWE Management Limited, Merseyrail Services Holding Company Limited and Northern Rail Holdings Limited, with dividends of £19.6m (2015: £17.8m), £7.3m (2015: £7.2m) and £10.0m (2015: £5.9m) respectively received from these companies. Total revenues generated by these three businesses were £968.1m (2015: £978.3m), £150.3m (2015: £155.1m) and £132.7m (2015: £585.3m) respectively. The Northern Rail franchise ended on 31 March 2016. From September 2016 there was a change in the AWE Management Limited shareholding structure, with the Group's shareholding reducing from 33.3% to 24.5% by way of a return of shares, for which the Group was paid an amount equal to the reduction in the net investment held of £1.6m and therefore no profit or loss on disposal was made.

While the revenues and individual line items are not consolidated in the Group Consolidated Income Statement, summary financial performance measures for our proportion of the aggregate of all joint ventures and associates are set out below for information purposes.

For the year ended 31 December	2016 £m	2015 £m
Revenue	480.8	737.2
Operating profit	40.7	42.6
Net finance costs	(0.6)	(0.4)
Income tax expense	(6.7)	(5.2)
Profit after tax	33.4	37.0
Dividends received from joint ventures and associates	40.0	32.5

Exceptional items

Exceptional items are non-recurring items of financial performance that are outside normal operations and are material to the results of the Group either by virtue of size or nature. As such, the items set out below require separate disclosure on the face of the income statement to assist in the understanding of the performance of the Group. A number of small items also arose in 2016 following changes in estimates to items historically treated as exceptional.

Exceptional items have arisen on both the continuing and discontinued operations of the Group. Exceptional items arising on discontinued operations are disclosed on the face of the Consolidated Income Statement within the profit or loss attributable to discontinued operations. Those arising on continuing operations are disclosed on the face of the Consolidated Income Statement within exceptional operating items.

For the year ended 31 December	2016 £m	2015 £m
Exceptional items arising on continuing operations		
Exceptional profit / (loss) on disposal of subsidiaries and operations	2.9	(2.6)
Other exceptional operating items on continuing operations		
Impairment of goodwill	(17.8)	(87.5)
Restructuring costs	(17.2)	(19.7)
Aborted transaction costs	(0.1)	(1.7)
Costs associated with UK Government review	(0.1)	(1.2)
Release of UK frontline clinical health contract provisions	0.6	2.8
Settlement of defined benefit pension obligations	(10.7)	–
Impairment of interest in joint venture and related loan balances	(13.9)	–
Other exceptional operating items	(59.2)	(107.3)
Exceptional operating items arising on continuing operations	(56.3)	(109.9)
Exceptional items arising on discontinued operations		
Exceptional (loss) / gain on disposal of subsidiaries and operations	(2.8)	5.4
Other exceptional operating items on discontinued operations		
Restructuring costs	(1.1)	(2.2)
Impairment of goodwill	–	(65.9)
Movements in indemnities provided on business disposals	(13.7)	–
Movement in the fair value of assets transferred to held for sale	3.4	(14.9)
Other exceptional operating items	(11.4)	(83.0)
Exceptional operating items arising on discontinued operations	(14.2)	(77.6)
Exceptional operating items arising on continuing and discontinued operations	(70.5)	(187.5)
Exceptional finance costs – continuing	–	(32.8)
Exceptional finance costs – discontinued	(0.4)	–
Total exceptional finance costs in continuing and discontinued operations	(0.4)	(32.8)
Tax credit on exceptional items – continuing	3.1	0.4
Tax credit on exceptional items – discontinued	–	2.7
Total tax impact of exceptional items in continuing and discontinued operations	3.1	3.1
Total operating and financing exceptional items in continuing and discontinued operations	(67.8)	(217.2)

Finance Review continued

Exceptional loss on disposals of continuing operations
There were no material disposals of continuing operations in the year. The profit on disposal of £2.9m mainly relates to a net credit of £2.5m on transactions completed in prior years, which includes cash of £4.5m as a result of deferred consideration payments received which had previously been provided for.

Other exceptional operating items arising on continuing operations
In 2016, goodwill of £17.8m arose following the acquisition of Orchard & Shipman (Glasgow) Limited, the Group's subcontractor on the COMPASS contract, providing accommodation to asylum seekers in Scotland and Northern Ireland on behalf of the Home Office. This goodwill was then immediately impaired as the CGU is forecast to be loss making and therefore the asset cannot be supported. The annual impairment testing of CGUs has identified no other impairment of goodwill. In 2015, the Americas CGU was impaired by £87.5m, due primarily to a higher level of contract attrition than previously forecast and the associated impact on future cash flows. Given the significant size of the impairment charge and that it is not part of the normal trading performance of the business it was considered appropriate to treat as exceptional in the year.

In 2016, a charge of £17.2m (2015: £19.7m) arose in relation to the restructuring programme resulting from the Strategy Review. This included redundancy payments, provisions, external advisory fees and other incremental costs. Due to the nature and scale of the impact of the transformation stage of our Strategy Review, the incremental costs associated with this programme were considered to be exceptional in the prior year and have been treated consistently in 2016. Non-exceptional restructuring charges are incurred by the business as part of normal operational activity, which in the year totalled £6.7m (2015: £13.8m).

The disposal of the Environmental and Leisure businesses was aborted in 2015 and during 2016 costs related to the aborted transaction were finalised, resulting in a charge of £0.1m (2015: £1.7m).

In 2016 there were exceptional costs totalling £0.1m (2015: £1.2m) associated with the UK Government reviews and the programme of Corporate Renewal, reflecting the related external costs. These costs were treated as exceptional when the matter first arose and consistent treatment is applied in the current year.

In 2016 there were releases of provisions of £0.6m (2015: £2.8m) which were previously charged through exceptional items in relation to the exit of the UK Frontline Clinical Health contracts.

Following the finalisation of the Revised Fair Deal, a number of employees are being transferred from the Serco Pension and Life Assurance Scheme (SPLAS) back to the Principal Civil Service Pension Scheme. This transfer was finalised in December 2016 at which point all obligations of SPLAS to pay retirement benefits for these individuals were eliminated and as a result a settlement charge of £10.7m arose. This has been treated as an exceptional item in the year as a result of the transaction being material in size and nature and being outside of the normal course of business. The charge of £10.7m is an accounting charge only, the cash impact of the settlement which will be paid in future periods, is estimated at £3.0m and is offset by future savings in contributions resulting from the transfer.

A review of a joint venture's cash flow projections has led to the impairment of certain equity interests and associated receivables balances, totalling £13.9m. The impairment is outside of the normal course of business and of a significant value, and is therefore considered to be an exceptional item.

Exceptional profit or loss on disposal of discontinued operations
The loss on disposal of discontinued operations of £2.8m (2015: profit of £5.4m) relates to the sale of offshore and UK onshore private sector BPO operations. The majority of the offshore BPO operations were sold in 2015 with the separate disposal of operations in the Middle East completing in 2016. The UK onshore business has been sold or transferred to various different purchasers with a final element remaining at the year end which is expected to be sold in 2017.

Other exceptional operating items arising on discontinued operations
In 2016 a charge of £1.1m (2015: £2.2m) has arisen in discontinued operations in relation to the restructuring programme resulting from the Strategy Review. This includes redundancy payments, provisions and other charges relating to the exit of the UK private sector BPO business, external advisory fees and other incremental costs.

During 2015, an impairment test of the Global Services business was conducted based on the fair value measurement, with reference to offers received less costs of disposal. The impairment testing identified a non-cash exceptional impairment of goodwill relating to discontinued operations of £65.9m.

A charge of £13.7m has arisen in 2016 in relation to the movement in the value of indemnities provided on business disposals made in previous years. This relates to changes in exchange rates where indemnities were provided in foreign currencies, and increases to provisions for interest and penalties on any indemnities. The original disposal of the business was treated as exceptional and these revisions have been treated on a consistent basis.

The value of assets held for sale increased by £3.4m in 2016, reflecting the changing estimate of the likely proceeds and movements of the assets held for sale since the prior balance sheet date. In 2015 the held for sale assets were impaired by £14.9m through exceptional items.

Exceptional finance costs

A charge of £0.4m was incurred as a result of early payments to the US Private Placement (USPP) Noteholders following the disposal of the offshore private sector BPO business. These charges are treated as exceptional finance costs as they are directly linked to the restructuring resulting from the Strategy Review. Similar charges arose in 2015 which, together with the costs related to the preservation of the Group's existing finance facilities, totalled £32.8m.

Tax impact of exceptional items

The tax impact of exceptional items in continuing and discontinued operations was a tax credit of £3.1m (2015: £3.1m).

Pre exceptional finance costs and investment revenue on continuing and discontinued operations

Investment revenue of £9.3m (2015: £8.2m) includes interest accruing on net retirement benefit assets of £4.7m (2015: £4.9m), interest earned on deposits and other receivables of £3.6m (2015: £3.2m) and the movement in discounting of other receivables of £1.0m (2015: £0.1m).

Finance costs of £21.9m (2015 restated: £40.1m) includes interest incurred on the USPP loans and the Revolving Credit Facility of £15.6m (2015: £24.7m), facility fees and other charges of £3.5m (2015: £7.2m), interest payable on finance leases of £1.6m (2015: £2.5m), the movement in discount on provisions of £2.4m (2015: £5.6m) and a credit for foreign exchange on financing activities of £1.2m (2015: £0.1m). The last of these items was previously included in Reported Operating Profit and therefore represents a restatement on the previously reported results.

Tax charge

In 2016, we recognised a total tax charge of £12.8m (2015: £33.5m), being £12.7m (2015: £17.5m) on continuing operations profit of £29.6m (2015: loss of £69.4m) and £0.1m (2015: £16.0m) on discontinued operations losses of £17.9m (2015: £50.2m). Of this amount, a £3.1m credit (2015: £0.4m credit) arises on exceptional items on continuing operations.

In respect of the results of our continuing operations, the profit on pre-exceptional items of £98.5m (2015: £106.1m) less pre-exceptional finance costs of £12.6m (2015: £32.8m) is £85.9m (2015: £73.3m), which suffers a tax charged of £15.8m (2015: £17.9m), giving a tax rate of 18.4% (2015: 24.4%).

The principal reasons why the tax rate on profit before exceptional items and tax from continuing operations at 18.4% is lower than the UK standard corporation tax rate of 20% are due to higher rates of tax on profits arising on our international operations, together with the absence of any deferred tax credit for losses incurred in the UK (which includes the result of UK divisions and the majority of corporate costs) offset by the impact of our joint ventures whose post-tax results are included in our pre-tax profit.

The tax charge on discontinued operations' losses and the tax credit on exceptional losses of £70.8m have only attracted small amounts of tax because these costs and losses are largely generated in the UK, where deferred tax assets are not being recognised due to insufficient UK taxable profits in the foreseeable future.

Finance Review continued

For the year ended 31 December	Pre exceptional 2016 £m	Pre exceptional 2015 £m
Underlying Trading Profit	82.1	95.9
Net finance costs from continuing operations	(12.6)	(32.8)
Net finance costs from discontinued operations	–	0.9
Total net finance costs from continuing and discontinued operations	(12.6)	(31.9)
Underlying Trading Profit less net finance costs from continuing and discontinued operations	69.5	64.0
Tax charge on Underlying Trading Profit less net finance costs from continuing and discontinued operations	(24.4)	(30.5)
Underlying effective tax rate	35.2%	47.7%

The tax charge on an underlying basis, reflecting Underlying Trading Profit of £82.1m net of finance costs of £12.6m, was £24.4m, representing an underlying effective tax rate of 35.2% (2015: 47.7%).

The effective tax rate in 2016 (35.2%) is lower than 2015 (47.7%) at an Underlying Trading Profit less finance costs level. This is primarily due to reduced UK finance expenses during this period which have not given rise to a tax credit as no UK deferred tax asset was recognised on them.

Our tax charge in future years will continue to be materially impacted by our accounting for UK deferred taxes. To the extent that future UK tax losses are incurred and are not recognised, our effective tax rate will be higher than prevailing standard corporation tax rates as we will not be able to recognise the associated tax benefits arising. When our UK business returns to sustainable profitability our existing UK tax losses will be recognised or utilised, and the effective rate will be reduced.

Contingent tax assets

At 31 December 2016, the Group has gross estimated unrecognised deferred tax assets of £1.04bn (£187m net), which are potentially available to offset against future taxable profits. These principally relate to tax losses of £824m. Of these tax losses, £697m have arisen in the UK business (net £118m).

A £10.0m UK tax asset has been recognised at 31 December 2016 (2015: £10.5m) on the basis of forecast utilisation against future taxable profits.

Taxes paid

Net corporate income tax of £10.5m was paid during the year, relating primarily to our operations in AsPac (£5.8m), Europe (£2.3m), Middle East (£1.5m) and Americas (£0.9m). The Group's UK operations have transferred tax losses to its profitable joint ventures and associates in return for cash payments from the joint ventures and associates giving a cash tax inflow in the UK of £4.8m. In addition there were small cash tax refunds where we have overpaid tax in previous periods. This results in an overall tax paid figure in our cash flow statement of £5.6m.

The amount of tax paid (£5.6m) differs from the tax charge in the period (£12.8m) mainly due to the effect of future expected cash tax outflows for which a charge has been taken in the current period and the impact of the time lag on receipts of cash from joint ventures and associates for losses transferred to them.

Further detail is shown below of taxes that have been paid during the year.

Total tax contribution

Our tax strategy of paying the appropriate amount of tax in the countries in which we operate means that we pay a variety of taxes across the globe. In order to increase the transparency of our tax profile, we have shown below the cash taxes that we have paid across our regional markets.

In total during 2016, Serco globally contributed £586.6m of tax to governments in the jurisdictions in which we operate.

Taxes by category

For the year ended 31 December 2016	Taxes borne £m	Taxes collected £m	Total £m
Total of corporate income tax	10.5	0.1	10.6
Total of VAT and similar	8.1	161.7	169.8
Total of people taxes	109.6	294.6	404.2
Total other taxes	1.9	0.1	2.0
Total	130.1	456.5	586.6

Taxes by region

For the year ended 31 December 2016	Taxes borne £m	Taxes collected £m	Total £m
UK & Europe	76.1	252.8	328.9
AsPac	24.2	122.2	146.4
North Americas	27.2	79.4	106.6
Middle East	2.6	2.1	4.7
Total	130.1	456.5	586.6

Corporation tax, which has historically been the only cost to be separately disclosed in our Financial Statements, is only one element of our tax contribution. For every £1 of corporate tax paid directly by the group (tax borne), we bear £11.35 in other business taxes. The largest proportion of these is in connection with employing our people.

In addition, for every £1 of tax that we bear, we collect a further £3.50 on behalf of national governments (taxes collected). This amount is directly impacted by the people that we employ and the sales that we make.

Finance Review continued

Dividends

The Board is not recommending the payment of a dividend in respect of the 2016 financial year. The Board's appraisal of the appropriateness of dividend payments takes into account the Group's underlying earnings, cash flows and financial leverage, together with the requirement to maintain an appropriate level of dividend cover and the prevailing market outlook. Although the Board is committed to resuming dividend payments as soon as it believes it prudent to do so, in assessing whether we should resume dividend payments in respect of 2016, we have been mindful of the fact that our forecasts for 2017 anticipate a reduction in earnings, a free cash outflow and an increase in net debt; furthermore, we are only part-way through our recovery. In these circumstances, the Board believes that it would not be prudent to resume dividend payments in respect of 2016.

Share count and earnings per share

The weighted average number of shares for EPS purposes was 1,088.3m at 31 December 2016 (2015: 986.5m). EPS before exceptional items from both continuing and discontinued operations was 6.12p per share (2015: 6.55p), including the impact of exceptional items EPS was a loss of 0.11p (2015: loss of 15.47p). Underlying EPS was 4.13p per share (2015: 3.44p).

Cash flows

The UTP of £82.1m (2015: £95.9m) converts into a trading cash outflow of £8.0m (2015: inflow of £0.6m). UTP reduced by £13.8m and led to an £8.6m reduction in Trading Cash Flows. The low conversion was primarily due to the cash outflows arising on the utilisation of contract provisions of £84.2m which is excluded from UTP but included in Trading Cash Flows.

The table below shows the operating profit and FCF reconciled to movements in Net Debt. FCF for the year was an outflow of £33.0m compared to an outflow of £35.5m in 2015 (restated). Commentary on the FCF performance of the Group is provided in the Chief Executive's Review and the Divisional Reviews sections.

The movement in Net Debt including assets and liabilities held for sale is an increase of £46.4m in 2016 compared to a decrease of £608.6m for 2015, arising from three key areas:

- The proceeds from the Rights Issue of £530.3m in 2015.
- A reduction of the net cash inflows from acquisitions and disposals of subsidiaries of £165.7m to £19.2m due to a significant portion of the private sector business disposal completing in 2015.
- An offsetting reduction in the cash outflows on exceptional items of £48.2m to £40.2m in 2016, due primarily to the payment of exceptional finance costs of £31.8m in 2015. The majority of the exceptional cash payments in 2016 relate to the break and exit costs of the residual UK private sector BPO operations and restructuring claims and costs arising on the implementation of the outcome of the Strategy Review.

For the year ended 31 December	2016 £m	2015 (restated*) £m
Operating profit / (loss) on continuing operations*	42.2	(3.8)
Operating loss on discontinued operations	(17.5)	(51.1)
Remove exceptional items	70.5	187.5
Operating profit before exceptional items on continuing and discontinued operations*	95.2	132.6
Less: profit from joint ventures and associates	(33.4)	(37.0)
Movement in provisions	(118.4)	(116.0)
Other non-cash movements*	63.9	83.6
Operating cash inflow before movements in working capital, exceptional items and tax*	7.3	63.2
Working capital movements	(23.7)	(22.6)
Tax paid	(5.6)	(2.7)
Non-cash R&D expenditure	(0.4)	(0.7)
Cash flow from operating activities before exceptional items*	(22.4)	37.2
Dividends from joint ventures and associates	40.0	32.5
Interest received	1.4	3.4
Interest paid	(20.1)	(34.7)
Capitalised finance costs paid	(0.3)	(1.4)
Purchase of intangible and tangible assets net of proceeds from disposals	(31.6)	(72.5)
Free Cash Flow*	(33.0)	(35.5)
Net cash inflow on acquisition and disposal of subsidiaries	19.2	184.9
Proceeds from Rights Issue	–	530.3
Purchase of own shares net of share option proceeds	–	4.4
Other movements on investment balances	0.7	(1.3)
Capitalisation and amortisation of loan costs	(0.7)	(0.6)
Unwind of discounting and capitalisation of interest on loans receivable	2.9	–
Non-recourse loan disposals, repayments and advances	–	24.0
New, acquired and disposed finance leases	(0.5)	0.5
Exceptional items	(40.2)	(88.4)
Cash movements on hedging instruments*	47.0	19.3
Foreign exchange loss on Net Debt*	(41.8)	(29.0)
Movement in Net Debt including assets and liabilities held for sale*	(46.4)	608.6
Assets held for sale movement in Net Debt	4.7	(44.2)
Net Debt at 1 January*	(67.6)	(632.0)
Net Debt at 31 December*	(109.3)	(67.6)
Net Debt at 1 January including assets and liabilities held for sale*	(62.9)	(671.5)
Net Debt at 31 December including assets and liabilities held for sale*	(109.3)	(62.9)

* Operating profit, other non-cash movements, cash movements on hedging instruments, foreign exchange loss on Net Debt and Net Debt have been restated following the change in accounting policy regarding foreign exchange movements on investment and financing arrangements and the change in definition of Net Debt to include derivative financial instruments that relate to other components of Net Debt. The sub totals including Free Cash Flow have changed as a result. See note 2 to the Consolidated Financial Statements for further details.

Finance Review continued

Net Debt

As at 31 December	Including assets and liabilities held for sale 2016 £m	Including assets and liabilities held for sale (restated*) 2015 £m
Cash and cash equivalents	177.8	328.8
Loans receivable	22.9	19.9
Other loans	(299.9)	(381.9)
Obligations under finance leases	(28.2)	(44.3)
Derivatives relating to Net Debt components*	18.1	14.6
Net Debt	(109.3)	(62.9)

* As explained above, Net Debt has been restated to include derivative financial instruments that relate to other components of Net Debt.

Average Net Debt as calculated on a daily basis for the year ended 31 December 2016 was £119.4m (2015 restated: £444.1m, pre Rights Issue impact), compared with the opening and closing positions of £62.9m and £109.3m respectively. Peak Net Debt was £182.9m (2015 restated: £858.6m, pre rights issue impact).

Treasury operations and risk management

The Group's operations expose it to a variety of financial risks that include liquidity, the effects of changes in foreign currency exchange rates, interest rates and credit risk. The Group has a centralised treasury function whose principal role is to ensure that adequate liquidity is available to meet the Group's funding requirements as they arise and that the financial risk arising from the Group's underlying operations is effectively identified and managed.

Treasury operations are conducted in accordance with policies and procedures approved by the Board and are reviewed annually. Financial instruments are only executed for hedging purposes - speculation is not permitted. A monthly report is provided to senior management outlining performance against the treasury policy and the treasury function is subject to periodic internal audit review.

Liquidity and funding

As at 31 December 2016, the Group had committed funding of £770m, comprising £290m of private placement notes and a £480m revolving credit facility with a syndicate of banks which was undrawn. In addition, the Group had a receivables financing facility of £30.0m of which £7.7m was utilised at the year end (2015: £30.0m).

Following the disposal of the majority of the private sector BPO business, the Group was required to offer the net disposal proceeds to the debt holders in prepayment. As a result of this process, £117m ($167m) of private placement notes were repaid at par on 16 February 2016.

Interest rate risk

Given the nature of the Group's business, we have a preference for fixed rate debt to reduce the volatility of net finance costs. Our treasury policies require us to maintain a minimum proportion of fixed rate debt as a proportion of overall Net Debt and for this proportion to increase as the ratio of EBITDA to interest expense falls. As at 31 December 2016, more than 100% of the Group's Net Debt was at fixed rates. Interest on the revolving credit facility is at floating rate, however it was undrawn.

Foreign exchange risk

The Group is subject to currency exposure on the translation to Sterling of its net investments in overseas subsidiaries. The Group manages this risk where appropriate by borrowing in the same currency as those investments. Group borrowings are predominantly denominated in Sterling and US Dollar. The Group manages its currency flows to minimise foreign exchange risk arising on transactions denominated in foreign currencies and uses forward contracts where appropriate to hedge net currency flows.

Credit risk

Cash deposits and in-the-money financial instruments give rise to credit risk on the amounts due from counterparties. The Group manages this risk by adhering to counterparty exposure limits based on external credit ratings of the relevant counterparty.

Debt covenants

The principal financial covenant ratios are consistent across the private placement loan notes, receivables financing facility and the Group's £480m revolving credit facility, with a maximum Consolidated Total Net Borrowings (CTNB) to covenant EBITDA of 3.5 times and minimum covenant EBITDA to net finance costs of 3.0 times, tested semi-annually. A reconciliation of the basis of calculation is set out in the table below.

For the year ended 31 December	2016 £m	2015 (restated*) £m
Operating profit before exceptional items on continuing and discontinued operations*	95.2	132.6
Remove:		
Joint venture and associate post-tax profits	(33.4)	(37.0)
Foreign exchange credit on investing and financing arrangements*	1.2	0.1
Add:		
Dividends from joint ventures and associates	40.0	32.5
Amortisation and impairment of other intangible assets	26.9	40.5
Depreciation of property, plant and equipment	24.8	28.9
Impairment of property, plant and equipment	0.7	2.1
Share based payment expense	9.7	9.8
Covenant EBITDA	165.1	209.5
Net finance costs on continuing and discontinued operations*	12.6	31.9
Add: Foreign exchange credit on investing and financing arrangements*	1.2	0.1
Other adjustments	3.3	(0.6)
Covenant net finance costs	17.1	31.4
Recourse Net Debt (including assets and liabilities held for sale)*	109.3	62.9
Loans receivable, foreign exchange adjustments and other items	5.5	28.8
CTNB	114.8	91.7
CTNB / covenant EBITDA (not to exceed 3.5x)	0.7x	0.4x
Covenant EBITDA / covenant net finance costs (at least 3.0x)	9.7x	6.7x

* As explained above, operating profit and net finance costs have been restated following the change in accounting policy regarding foreign exchange movements on investment and financing arrangements. These adjustments have been reversed in order to maintain the definition of EBITDA and net finance costs per the covenant. CTNB is consistent with the new definition of Net Debt and is unaffected by the change in accounting policy.

Finance Review continued

Net assets summary

As at 31 December	2016 £m As reported*	2015 £m Including assets held for sale	2015 £m Adjustment for assets held for sale	2015 £m As reported
Non-current assets				
Goodwill	577.9	517.7	(7.8)	509.9
Other intangible assets	83.6	90.2	(0.4)	89.8
Property, plant and equipment	69.3	74.1	(0.9)	73.2
Other non-current assets	73.0	72.0	(0.2)	71.8
Deferred tax assets	50.8	42.2	–	42.2
Retirement benefit assets	150.4	127.1	–	127.1
	1,005.0	923.3	(9.3)	914.0
Current assets				
Inventories	22.4	26.4	–	26.4
Trade and other current assets	548.4	549.7	(20.6)	529.1
Current tax	11.0	11.3	(4.7)	6.6
Cash and cash equivalents	177.8	328.8	(5.2)	323.6
	759.6	916.2	(30.5)	885.7
Assets classified as held for sale	–	–	39.8	39.8
Total current assets	759.6	916.2	9.3	925.5
Total assets	1,764.6	1,839.5	–	1,839.5
Current liabilities				
Trade and other current liabilities	(525.1)	(558.6)	7.4	(551.2)
Current tax liabilities	(25.9)	(14.3)	0.1	(14.2)
Provisions	(172.3)	(191.2)	22.6	(168.6)
Obligations under finance leases	(12.3)	(16.3)	0.5	(15.8)
Loans	(9.7)	(132.2)	–	(132.2)
	(745.3)	(912.6)	30.6	(882.0)
Amounts classified as held for sale	–	–	(32.5)	(32.5)
Total current liabilities	(745.3)	(912.6)	(1.9)	(914.5)
Non-current liabilities				
Other non-current liabilities	(16.8)	(18.3)	–	(18.3)
Deferred tax liabilities	(30.5)	(22.3)	–	(22.3)
Provisions	(249.4)	(315.0)	1.9	(313.1)
Obligations under finance leases	(15.9)	(28.0)	–	(28.0)
Loans	(290.2)	(249.7)	–	(249.7)
Retirement benefit obligations	(17.7)	(11.5)	–	(11.5)
	(620.5)	(644.8)	1.9	(642.9)
Total liabilities	(1,365.8)	(1,557.4)	–	(1,557.4)
Net assets	398.8	282.1	–	282.1

* No amounts were included in held for sale as at 31 December 2016.

The breakdown of the Group's net assets is summarised above, showing the impact of the assets and liabilities held for sale for each line item in the prior year.

At 31 December 2016 the balance sheet had net assets of £398.8m, a movement of £116.7m from the closing net asset position of £282.1m as at 31 December 2015. The increase in net assets is mainly due to the following movements:

- An increase in goodwill by £68.0m caused by movements in foreign exchange rates. Total goodwill of £401.2m relates to non-UK cash generating units.
- A decrease in provisions of £60.0m. Further details on the provision balance is provided below.
- An increase in trade and other current assets and liabilities of £45.4m due in part to the unwinding of the forfeiting facility of £22.3m and other working capital movements, including foreign exchange movements in non-UK businesses.
- An increase in Net Debt of £46.4m due to the working capital movements noted above offset by cash generated from operations.
- An increase in the assets reflecting the Group's retirement benefit obligations of £17.1m, due to the performance of liability driven investments.

Provisions

The total of current and non-current provisions, excluding provisions related to businesses held for sale, has decreased by £60.0m since 31 December 2015. The movement is due to a decrease in contract provisions of £81.9m offset by an increase in non-contract provisions of £21.9m. The increase in non-contract provisions is primarily due to the provision for the exceptional defined benefit scheme settlement cost of £10.7m and an £8.7m increase in employee provisions due to the ongoing Strategic Review restructuring programme.

Movements in contract provisions, including those related to businesses held for sale since the 31 December 2015 balance sheet date, are as follows:

	Onerous Contract Provisions £m	Other contract provisions £m	Total contract provisions including assets held for sale £m	Held for sale adjustment £m	Total contract provisions as reported £m
At 1 January 2016	(299.9)	(13.2)	(313.1)	11.0	(302.1)
Arising on acquisition	(14.0)	–	(14.0)	–	(14.0)
Charged to income statement – trading	(56.1)	(0.5)	(56.6)	–	(56.6)
Charged to income statement – exceptional	(0.6)	–	(0.6)	0.6	–
Released to income statement – trading	65.7	7.6	73.3	(8.4)	64.9
Released to income statement – exceptional	0.6	–	0.6	–	0.6
Utilised during the year	84.2	0.9	85.1	(3.1)	82.0
Unwinding of discount	(2.4)	–	(2.4)	–	(2.4)
FX	(11.6)	0.3	(11.3)	(0.1)	(11.4)
Transfer to trade payables	11.5	–	11.5	–	11.5
Reclassifications	2.4	4.9	7.3	–	7.3
At 31 December 2016	(220.2)	–	(220.2)	–	(220.2)

Finance Review continued

The balance of OCPs at 31 December 2016 was £220.2m (2015: £299.9m). Our OCP balances are subject to ongoing review and a full bottom-up assessment of the forecasts that form the basis of the OCPs is conducted as part of the annual budgeting process. The overall net release of OCPs was £9.6m in 2016 and utilisation was £84.2m.

In 2016, additional charges have been made in respect of future losses on a number of onerous contracts totalling £56.7m. This increase related to revisions to existing OCPs of £53.2m and new provisions raised on two contracts totalling £3.5m, with the new provisions relating to contracts which have been operating for a number of years. Of the total charge, £0.6m relates to contracts included in the held for sale businesses and are included within exceptional items, consistent with previous treatment. No further exceptional OCP charges or releases are expected in the future.

Included within additional charges made to existing OCPs was £29.5m relating to our Ontario Driver Examination Services contract. This contract is to provide multiple services, including administering driver examinations and the implementation and roll out of an IT system across multiple locations. The contract was initially identified as onerous during the 2014 Contract and Balance Sheet Review. In 2016 delays and cost overruns relating to the IT system implementation have resulted in higher forecast implementation costs. Furthermore, the future performance of the system has also been reassessed and this has resulted in a reduction to the expected future operational efficiencies and savings forecast to be achieved following the system implementation. These factors combined have increased the expected total future losses of the contact, resulting in both the increase to the OCP of £29.5m and an additional in year charge of £8.8m arising from the cost overruns and programme delays experienced during the year.

An additional £7.1m in respect of the Prisoner Escort and Custody Services (PECS) contract has been charged. It was previously anticipated that the contract, which has up to three extension years, would not be extended in its current form but our expectation now is that it will be extended for one of the potential three extension years.

There was also an additional £6.8m charge in the year in respect of updating the assumptions regarding the operational and maintenance costs of running the Caledonian Sleepers contract.

In 2016, releases to the income statement from OCPs totalling £66.3m were made, including £0.6m in respect of provisions previously charged to exceptional items.

Included within the releases in the year was £33.9m in respect of the COMPASS contract that reflected the updated forecast assumptions around service user volumes and accommodation costs, and the impact from the terms agreed with the customer as part of the contract extension. We had previously included assumptions for the impact of the extension in the COMPASS OCP and the updated view of reduced losses on this contract reflect the improved terms under which we will operate under the extension. On 1 December 2016 Serco acquired Orchard & Shipman (Glasgow) Limited, a subcontractor on the COMPASS contract that provided services to the Scotland and Northern Ireland regions. On acquisition an OCP of £14.0m was recognised as part of the opening balance sheet of Orchard & Shipman, which following the acquisition is included in the provision for future losses to be incurred by the Group.

In the year, a £11.9m release was recorded in respect of the contract to operate and maintain the fleet of Armidale Class Patrol Boats (ACPB) for the Royal Australian Navy. This release arose following both better than forecast trading under the contract as re-negotiated in November 2015, and the latest assessment of any post contract costs after the operations are transferred to the new contractor on 30 June 2017.

There were also a number of other smaller releases, notably in respect of HMP Ashfield and the Future Provision of Marine Services contract.

During the year a settlement was reached with the customer in respect of HMAS Bundaberg, the vessel operating under the ACPB contract which was destroyed by fire in 2014. The provision relating to this claim was transferred to creditor and debtor balances within working capital, given that the amounts owed to the customer and the associated insurance receivable are more certain and therefore did not meet the criteria to be included within the provisions balance.

Contract and Balance Sheet Review items

There were adjustments arising in 2016 on items identified during the Contract and Balance Sheet Review in 2014. These adjustments relate to a number of items including:

- The releases of other provisions and accruals of £13.4m where liabilities have either been settled for less than the amount provided or accrued, or have lapsed due to the passage of time.
- A charge of £8.8m reflecting a reduction in the accrued revenue for the Ontario Driver Examination Services contract resulting from the impact of long-term contract accounting.

The overall net improvement to Trading Profit from OCPs and Contract and Balance Sheet Review adjustments was £14.2m in 2016. The cumulative net improvement to Trading Profit from OCPs and Contract and Balance Sheet Review items from 2015 and 2016 is £35.1m which represents 5% of the original total taken through Trading Profit.

Angus Cockburn
Group Chief Financial Officer

22 February 2017

Corporate Responsibility

To be successful, we must operate in a responsible manner.

We deliver public services. Taxpayers expect them to be effective; governments expect them to be efficient and improved; society expects them to be delivered ethically, safely and with respect for people and the environment.

We strive to constantly fulfil these expectations, recognising our responsibilities and seeking to earn the trust and respect of all public service stakeholders.

For a business founded and focused on the delivery of public services – contributing to the lives of thousands of citizens every year – corporate responsibility is not an initiative. It is, and must always be, inextricably embedded in all that we do.

We believe that true success in providing public services around the world – for us, for our customers and for society – requires commitment to a social as well as commercial contract. We can only achieve a sustainable business model by doing the very best for governments and society, not just within our contracts, but beyond them.

To better reflect our commitment to corporate responsibility, in 2016 we refreshed our strategy and clarified our ambition, "to be a trusted partner of governments, delivering superb public services that transform outcomes and make a positive difference for our fellow citizens".

Underpinning this ambition are three key principles, which frame and shape our approach and our activities:

1) A public service ethos is inherent, and essential, to our work;

2) How we deliver within our contracts is as important as what we deliver; and

3) Our public service ethos is not limited to the perimeter of our contracts.

During 2016, we have built on these foundations, reviewing and refreshing our Values; strengthening our governance and risk management processes; and introducing new areas of focus.

We have also continued to make progress against the long-term objectives we have set for sustainable development, but we are never complacent. We recognise that there is still work to be done to ensure that as a business we always uphold our public service ethos and meet our responsibilities to our stakeholders and the wider community.

Here, we share a summary of our approach to managing corporate responsibility, along with our initiatives and performance for 2016. We measure how we perform on four key areas of focus for the business: Our People, including how we support the communities we work in; Compliance with Ethical Standards; Health and Safety; and Our Environmental Impacts.

A more detailed corporate responsibility report for the year is available on our website: www.serco.com

Our Values
Trust, Care, Innovation, Pride.
First and foremost, we live by our Values.

They are at the heart of the behaviours we expect in our business. While our Code of Conduct defines 'what' we expect, our Values define the 'how.'

We have worked with our employees to review our Values alongside the review of our strategy, refreshing and simplifying them to ensure they remain current, relevant, and easily and consistently understood. We have also put systems and processes in place to ensure that they are consistently applied across our organisation.

Trust
We work hard to earn trust and respect.

We deliver on our promises; are open, straightforward and honest; do the right thing; and take personal responsibility for getting things done.

Building Trust will sustain the business we have and build the business we want in the future.

Care
We care deeply about the services we provide and the communities we serve, and we look after each other.

We work together to deliver high-quality public services, often of great importance to the nation and the communities we serve.

We take care of each other, and those we serve, and we aim to make a positive difference to people's lives.

Demonstrating Care will make a positive difference to people's lives and ensure we look after each other.

Innovation
We aspire to be better than anyone else at what we do.

We continuously improve our ways of working, and try new ideas, big and small.

We share our knowledge and experience and embrace change, knowing that if we don't provide innovation and value for money to our customers, our competitors will.

Driving Innovation will differentiate us from our competitors and add value to our customers.

Pride
We want to be proud of what we do.

We know that the work we do is important, and we take pride in doing it well.

We value energy and enthusiasm, skill and experience, and an ability to make hard work fun.

We contribute both as individuals and as part of a team.

Being Proud of what we do acknowledges that we are doing things well and making a real difference.

Embedding our Values
Our Values were launched globally at the start of 2016 and rolled out across the business in all regions, supported by a comprehensive suite of communication and education tools. The Divisions have worked hard to embed the Values, designing and launching campaigns and initiatives which aim to integrate the Values into existing ways of working and bring the Values to life.

The Values have also been incorporated across the Serco Management System (SMS), our Code of Conduct and other existing channels, publications and resources. We have also updated our annual employee engagement survey with the Values, which has enabled us to measure how successfully they have been embedded across the organisation.

Corporate Responsibility continued

Our approach

To us, being a responsible business means ensuring that we:

- comply with the law as well as meet the standards we have set for ourselves;
- deliver on our commitments and are open and transparent;
- engage and motivate our people, act safely and with respect for the environment and the communities we work in;
- understand and minimise business risk and achieve appropriate financial returns;
- act swiftly to rectify error, learn from our mistakes and strive for improvement.

By being responsible, we will support the communities we serve, earn trust and respect, strengthen our reputation and brand, enhance our financial performance and create sustainable value for our shareholders.

Managing corporate responsibility

The Serco plc Board has ultimate responsibility for the Group's business strategy, including Corporate Responsibility (CR), and for setting the Group's culture, values and ethical standards. Mike Clasper, a Non-Executive Director, takes responsibility at Board level for CR and chairs Serco's Corporate Responsibility Committee (CRC) which has oversight of our approach to CR, its governance and the standards and policies in place. More information on the CRC can be found in the Corporate Governance Report on page 92.

Ed Casey, Group COO, is a member of the CRC, and is responsible for promoting the Group's approach to CR and its effective implementation, as agreed with the Executive Committee.

Each CR element has a designated Group Lead, responsible for engaging with Divisional Chief Executives to develop CR strategy, objectives and performance indicators relevant to their business operations and strategy, and monitor and report on performance.

Serco Management System

The Serco Management System (SMS) is the Group's management framework, describing how we do business. It defines the rules which govern the way we operate and deliver our strategy and the way we behave.

The elements that make up the SMS are regularly reviewed to ensure they are up-to-date and meet our needs as well as relevant laws and regulatory requirements in the countries where we operate.

All our employees complete appropriate SMS training when they join Serco and are required to comply with these standards at all times. Failure to comply with the SMS can have significant consequences for individuals, managers or the Company as a whole.

You can find out more about the SMS at: www.serco.com/about/sms

Our Code of Conduct

Our Code of Conduct sets out in a concise way the rules, standards and behaviours that are expected from everyone who works for and on behalf of Serco, irrespective of their role and location. Together with our Values and our policies and standards, it is an integral component in the SMS.

All Serco employees are expected to know, use and live our Code.

To support them, we make sure everyone who works for or with us understands our Code and knows how to apply it. We provide confidential resources and support for everyone to get advice or report Code violations.

We deal effectively with any concerns about conduct and put improvements in place quickly after we have identified them.

In 2017 we will look to incorporate the work on defining behaviours, which forms part of the roll-out of our refreshed Values, into the Code.

You can find out more about our Code of Conduct at: https://codeofconduct.serco.com

Ensuring ethical standards

Ethical issues remain a business risk in certain regions and industry sectors where we operate or may operate in the future.

We therefore have a framework of Divisional and regional managers, who are responsible for the governance and development of our ethics and compliance programmes, on issues including business integrity and values, anti-bribery and corruption and human rights.

Human rights and slavery

We seek to respect and uphold the human rights of individuals in all aspects of our operations wherever we operate. Our Human Rights Group Standard demonstrates this commitment and sets out expectations for individual and corporate behaviour across our business in regards to human rights.

We recognise our responsibility to understand the human rights risks in our business – including those relating to slavery and human trafficking – and any potential impacts associated with the services we provide, the customers we work with and the suppliers we use. We are committed to the fair and appropriate treatment of our employees and those who are in the facilities we manage or benefit from the services we provide.

We use International Human Rights Standards such as the United Nations Guiding Principles on Business and Human Rights (2011) (UN Guiding Principles) as frameworks to assist our decision-making and constructive engagement.

In view of the introduction of the Modern Slavery Act in the UK and in recognition of our responsibility to understand potential human rights impacts associated with the services we provide, we have completed a Company-wide ethics, compliance and human rights risk assessment, including the risk of slavery and human trafficking taking place in our business and across our direct supply chain.

The findings show a low risk of slavery and human trafficking taking place in our direct business operations. However, we recognise the need to continue to review performance, particularly in our direct supply chain.

During the year we have also reviewed our training on protecting human rights, and the prevention of slavery and human trafficking in particular.

All employees are made aware of our commitment to human rights. In recognised high-risk areas, specific training on slavery and human trafficking is also undertaken.

In 2017 we will build on our existing slavery and human trafficking training and look to share best practice whilst putting more effective guidance in place regarding risk assessments for slavery and human trafficking.

You can review our 2016 Slavery and Human Trafficking Statement on our website: www.serco.com

Third party due diligence

Our Business Conduct and Ethics Group Standard sets the global requirement for due diligence in the engagement of third parties. This includes, but is not limited to, customers, suppliers, agents and other third parties. It details the process that must be followed to seek to ensure that the values and practices of anyone working with us are aligned to our own, and to proactively identify and seek to mitigate any risks inherent in a potential partnership or agreement before proceeding into any arrangement. For suppliers where a potential issue has been raised or they operate in high risk areas, we assess the issues and where appropriate undertake enhanced due diligence.

Once we have made an agreement, we seek to monitor for changes or misconduct so that we remediate any incidents that may occur.

In 2016, we introduced a consistent global approach to due diligence. In 2017 we will continue to build on this to seek greater assurance from those selected suppliers in specific risk areas of their commitment to ensuring that slavery and human trafficking is not within their supply chain. We will also update our procedure for taking on new suppliers.

Suppliers and partners

Our suppliers play a key role in achieving our business performance and we recognise the importance of selecting suppliers who are committed to ethical standards and business practices compatible with ours.

We have a Procurement and Supply Chain function to deliver consistent procurement processes in the selection and management of suppliers; to manage the risk through appropriate procurement strategies and supplier selection criteria, ensuring that sourcing initiatives are fair and ethical to both Serco and participating suppliers; and to ensure compliance with laws and regulations, our ethical standards, Code of Conduct and human rights throughout our supply chain.

Our Supplier Code of Conduct, which supplements our employee Code, applies to all our suppliers, including their facilities. It formalises our practices and makes clear that we expect all our suppliers to behave in a manner compatible with our own standards.

As with our suppliers, we seek to ensure that our joint venture partners meet the standards we have set ourselves and continue to enhance our systems and processes to this end.

Corporate Responsibility continued

Our People

Our services are delivered through people: we are entirely dependent on their skills and commitment to deliver the services our customers expect. They are the single greatest contributor to our reputation.

People flourish when they are engaged, inspired and motivated to give their best.

We value diversity and work to create an inclusive and fair environment for all.

To support our colleagues and ensure they are able to achieve their potential and work to the best of their ability, we have policies, systems and processes for recruiting, developing, rewarding, reviewing and managing them. These reflect our Values, comply with labour and employment laws and regulations wherever we work, are aligned appropriately with local tradition and culture, and help to build trust in our working relationships.

Leadership and development

We run a series of programmes aimed at developing the skills and capabilities our business needs and talent programmes which help to identify, select and develop high-potential talent across our operations for future leadership roles, including work to encourage female application and selection.

In 2016 we introduced a five-day residential course at Oxford University, Saïd Business School, which over the next four years will see some 400 people pass through a course, developed by and exclusively for Serco, to help build a cadre of managers who are aligned, and have developed specific insights into issues such as strategy, leadership, operational excellence and account management.

In 2017 we will continue to identify opportunities to expand the scope of our leadership pipeline and associated development programmes.

Engagement

We know that engaged employees deliver a better service for our customers, and are more productive and fulfilled in their roles, driving higher levels of business performance.

We measure employee engagement annually through our Viewpoint employee survey and use the survey results to set an annual engagement roadmap which aims to drive improvements in engagement.

In 2016 we focused on the key drivers of engagement as per our 2015 results (Connection to Serco, Learning and Development, Taking Action on Employee Feedback, and Recognition) and targeted improvements in these areas across our Divisions.

Our 2016 Viewpoint survey showed a 1% improvement in employee engagement, continuing a positive trend that our employees' experience of working for Serco is improving, as they are seeing positive changes in the way we manage our business and serve our customers.

Leadership engagement has increased by 17% to the highest level in five years. Our leaders are feeling more confident about the future direction of Serco. They also feel recognised and supported in their development.

Diversity and inclusion

We want to be a place people are proud to work. Creating a diverse and inclusive workplace to attract and retain talented people from all backgrounds and cultures plays an important part in how we will achieve this.

We are proud of our approach to diversity to date, and our Viewpoint findings confirm that our employees believe we value diversity as an organisation. However, in recognition of the increased focus on gender and equal pay legislation in some of the regions where we operate, we have refreshed our approach and updated our goals as follows: to attract, develop and retain employees from the broadest possible talent pool; create an inclusive environment with zero tolerance to any form of discrimination; promote equality of opportunity and diversity within the communities where we operate; and develop service delivery innovation through a culture of inclusion, enhancing collaboration and encouraging employees with a broad range of perspectives, experiences and styles to share ideas.

Each Division has developed their own three-year diversity and inclusion strategy and plan aligned to these goals.

Our focus moving into 2017 is to ensure appropriate measurement and monitoring of Divisional delivery, with clear and robust data.

Gender diversity data

At 31 December 2016, the numbers of men and women employed by Serco were as follows:

	Number		Percentage	
	Male	Female	Male	Female
Directors	7	2	78%	22%
Senior managers	58	12	83%	17%
Employees	25,989	18,784	58%	42%
Total	26,054	18,798	58%	42%

At 31 December 2016, we had gender information on 94% of employees.
(Source: Serco global HR systems, figures provided on a total headcount basis; excludes joint ventures.)

Recognition

We believe it is important to highlight and celebrate the people who bring our Values to life, who enable our organisation to succeed and encourage us all to follow the example they set.

Our global employee recognition programme is the Serco Pulse Awards, which showcases behaviours that exemplify our Values. Employees are nominated by their colleagues for Divisional Awards and these award winners are put forward for Global Pulse Awards. In 2016 105 people were selected for Divisional Pulse Awards, of whom approximately one quarter will go on to receive Global Pulse Awards, to be announced in 2017.

Our Divisions also develop and implement local recognition schemes.

Further details of our performance against our People Key Performance Indicators can be found in the table on page 72.

Our performance

This section provides an overview of our performance in key areas during the year. More detailed information is available in our CR report at www.serco.com

Compliance with ethical standards

To enable compliance with our Code of Conduct, policies and standards, and to ensure behaviours meet our expectations, every employee is required to participate in our 'Serco Essentials' compliance training programme when joining Serco and complete a training refresh annually. Managers are also required to complete a more detailed 'Serco Essentials plus' training programme.

In addition, to help employees to take the correct course of action in a given situation, we have a suite of ethics tools to enhance our existing systems and processes. This currently includes:

- SayNo Toolkit.
- Gifts and Hospitality Register.
- Speak Up.
- Anti-Bribery and Corruption (ABC) Toolkit.

In 2017 we will review all our ethics training courses to ensure they remain up-to-date and expand our suite of ethics tools.

Anti-bribery and corruption

No matter what 'local custom' may be, all forms of bribery and corruption, and even the smallest facilitation payment, are forbidden. Our policy is one of zero tolerance.

In 2016, our focus has been on strengthening our Anti-Bribery and Corruption (ABC) governance, controls and business compliance, working to ensure that the procedures already in place are adequate, and seeking to improve and enhance them.

In 2017 we will continue to build on and strengthen our procedures.

Speak Up

Where our people believe they have information which demonstrates malpractice, wrongdoing or a violation of our Code of Conduct or Values, they are required to raise the issue and bring it to management attention. Our whistleblowing service 'Speak Up' is available to all Serco employees, enabling them to raise concerns in confidence and without fear of reprisal.

64% of our employees feel confident that appropriate action would be taken if they raised an issue or reported unethical behaviour and 70% of employees currently feel they can report unethical conduct without fear.

Of the Speak Up cases closed in 2016, 97% were investigated (representing 100% of all cases appropriately and sufficiently informed to enable investigation). 53% of cases resulted in some corrective action being taken, 16% resulted in disciplinary action being taken, and a further 6% resulted in one or more employees being dismissed. 64% of the cases were closed within three months of the issue being raised.

Recognising the need to continually improve, in 2017 we will upgrade our case management system and ensure consistent standards of investigation across all Divisions.

Community

We are privileged to be able to make a positive difference to the lives of thousands of people, every day. For us, our care for our communities is indistinct from the services we deliver to our customers. At the same time, our community engagement and investment helps us to better understand community needs, and operate existing contracts more effectively, particularly where we are delivering services directly to the public.

Our community activity is as diverse as our business, and managed locally. Our Divisions and individual contracts are best placed to understand the needs of the communities in which they operate, how these align with the aims of customers and how they relate to our employees.

For details of our community engagement initiatives, see our CR report, available on our website at www.serco.com

Corporate Responsibility continued

Health and Safety

Our aspiration is zero harm.

Strong health and safety performance seeks to ensure the safety of our people and protects our reputation. Wherever they work and whatever their role, our people must adhere to stringent health and safety procedures. These procedures are embedded in the SMS and are the minimum standards that apply. A core element of this is understanding the safety risks we face as a business.

We operate in a number of heavily regulated, safety-critical areas, which place stringent requirements upon us. We seek to have the systems in place to deliver these requirements, as reflected in the regulatory approvals and licences we operate under. This also means that we have regular regulatory oversight. Together, these factors give us our controls framework for managing our Health, Safety and Environment (HSE) responsibilities.

Our HSE strategy

Our global strategic objectives are:

- to drive improvement and focus on safety culture to increase leader and employee engagement, which we will measure through our Viewpoint employee engagement survey;
- to raise visibility and apply a consistent approach to the management and reporting of third party incidents, particularly in regard to contractors;
- to review and improve consistency in approach to how incidents are managed and reported, with specific emphasis on lessons learned and the sharing of these across the organisation; and
- to drive improvement and focus on environmental issues and management to support delivery of the Group's environmental target.

In 2016 we have pursued these objectives in all regions, undertaking a range of initiatives to raise awareness and understanding of HSE issues and introducing new reporting processes, tools and capabilities to improve our performance.

Our areas of focus in 2017 will include: the ongoing deployment of the new safety climate tool; embedding our new reporting process; reviewing our online incident management reporting tool; and building on our work in 2016 to improve the capture of near-miss events.

Our HSE Performance

During 2016 we continued the work started in 2015 to better define the key indicators we use and how rates are calculated. This has resulted in publication of a revised Incident Management and Reporting Group Standard Operating Procedure. We also replaced reporting incident rates normalised by numbers of employees with frequency rates normalised by one million hours worked. As a result, our historical data and 2016 targets have been recalibrated.

In 2015 we sold the majority of our private sector offshore BPO business which operated in a low safety risk environment, resulting in lower safety rates across all key indicators. To provide data that is meaningful and comparable, we have restated our historical data to exclude the disposed operations. The data also excludes joint venture operations.

Safety performance in 2016 has improved consistently across all Divisions and indicators, with the exception of serious physical assaults.

Lost Time Incidents

Lost time incidents (LTIs) relate to any work-related occurrences incurring one full lost working day or more, and provide a general overview of safety performance. In 2016 the number of LTIs reduced by 21%, compared to 2015, to 459, the lowest number of incidents reported in the last five years. This positive performance is reflected in the Lost Time Incident Frequency Rate (LTIFR), which fell 14% and exceeded our target which was set at a 5% reduction against a 2015 baseline. When physical assault events are removed, manual handling and slips, trips and falls continue to be the main cause of incidents.

In regard to LTIs which are classified as major incidents, the overall number fell by 26% during the year. This is reflected in the frequency rate (Major Incident Frequency Rate (MIFR) per one million hours worked) at 0.27, a 20% improvement on 2015 and ahead of our target of a 5% reduction against a 2015 baseline.

Divisions will continue to drive a range of initiatives appropriate to the safety risks of their operations to drive continuous safety improvement. To monitor this we have set the following targets for 2017 based on our actual 2016 performance:

- To reduce our Lost Time Incident Frequency Rate per one million hours worked by 10%.
- To reduce our Major Incident Frequency Rate per one million hours worked by 15%.

Physical assaults

We recognise the risks of the different environments in which we operate, some of which can result in our staff being assaulted. In particular custodial and immigration operations in the UK and Asia Pacific are challenging environments. Here they complete detailed risk assessments, regularly review controls and drive initiatives to better understand and manage this risk.

A number of initiatives have been implemented, including: review of location-specific violence and anti-social behaviour strategies; increased communications; shared learnings; strategic threat assessments; improved security to intercept illicit items; improved staff-prisoner relationships; review of intervention and de-escalation techniques.

Overall the number of physical assaults reported in 2016 has decreased by 14% to 625 compared to 2015, resulting in a 5.7% improvement in the physical assault frequency rate. Whilst the overall number of assaults has reduced, the percentage that are classified as serious has significantly increased in 2016. This may partly be due to better definition but also reflects that when interventions are happening they appear to be more violent. The serious physical assault frequency rate has nearly doubled, compared to 2015, to 0.93 and fails to meet the target improvement set at 5%.

We will continue to develop a range of initiatives to drive reductions in assaults and particularly serious physical assaults. To monitor this we have set the following targets for 2017 based on our actual 2016 performance:

- To reduce our Physical Assault Frequency Rate per one million hours worked by 6%.
- To reduce our Serious Physical Assault Frequency Rate per one million hours worked by 10%.

Our environmental impact

We recognise our responsibility to ensure that any adverse impact on the environment is reduced, or where possible, eliminated by applying the most appropriate management systems at contract level – whether designed by our customers or by us.

The SMS sets out how we will deliver our environmental commitment, aligned to the ISO14001:2015 standard on environmental management.

Across more than two thirds of our business, we are working on our customers' premises and are therefore not in direct control of the environment in which we operate. That is why collaborative working with our customers on environmental issues is important.

Our activities are typically managed locally, and we undertake a wide range of initiatives focused on reducing our carbon emissions intensity, improving energy and fuel efficiency, improving our waste management processes and promoting biodiversity.

Carbon disclosure

In 2016, we responded again to the Carbon Disclosure Project FTSE350 (CDP) request for information, achieving a score of 'B '.

Greenhouse gas emissions

Our reporting year for greenhouse gas emissions (scope 1 and 2 covering direct emission sources such as fuel combustion, company vehicles, fugitive emissions, purchased electricity, heat and steam) is one quarter behind our financial year, namely 1 October 2015 to 30 September 2016. We quantify and report to ISO 14064-1 2012, using an operational control approach to defining our organisational boundary. The classification of reporting boundaries is set out in detail in our Basis of Reporting 2016 document, available on our website, www.serco.com

We report all material emission sources for which we consider ourselves responsible and have set our materiality threshold at 5%.

Our Environmental Performance
2014 and 2015 restatement

When our 2015 data was verified it identified a number of factors which are significant enough to require the restatement of our 2014 and 2015 GHG emissions (see 2016 Corporate Responsibility Report).

To address these factors in 2016 we have invested significantly in our data collection processes and systems to ensure independent ISO 14064-3 verification prior to data publication.

2016 performance

Our corporate target for 2016 was to reduce our carbon emissions intensity (which we calculate as tonnes of CO_2e per FTE) by 3% for the frontline operations against our 2015 performance. Our actual intensity rate at 5.98 showed an increase against 2015 which meant we fell short of our target by 18%. Contributing factors to our 2016 performance have been increased marine oil CO_2e (15%) and energy-intensive contracts (eg leisure centres), a reduction in FTE count and further improvements to data capture and reporting.

Whilst our intensity rate has shown an increase overall, our actual carbon emissions have improved year-on-year with a reduction of 2.4% over the last 12 months. When a longer view is taken we have reduced our actual carbon emissions by 27% against our emissions in 2013. See table on page 72 for further details.

Recognising the evolving profile of our business and sale of the private sector offshore BPO business at the end of 2015, we will use 2017 to review our approach to target setting in terms of absolute / intensity based and target longevity. We have not set a specific target reduction for 2017 whilst the review is completed.

In addition we propose to look at increasing the scope of our reporting on scope 3 (indirect emissions due to Serco's activities) emissions in future.

Corporate Responsibility continued

Corporate Responsibility Key Performance Indicators

		2012	2013	2014	2015	2016	Var %
Ethics and compliance							
Upheld cases of anti-competitive behaviour	Number	0	0	0	0	0	–
Upheld cases of corrupt behaviour	Number	0	0	0	0	0	–
Upheld cases of human rights violations	Number	0	0	0	0	0	–
Our people							
Female employees in total workforce	%	44.5	40.9[1]	44.4	42.6	41.9	–
Proportion of days lost to sickness	%	2.25	2.83	3.25	3.17	3.2	–
Staff turnover[2]	%	26.9	31.5	31.0	32.8	33.8	–
Health and safety							
Lost Time Incident Frequency Rate	Per 1m hours worked	5.97	5.12	4.81	5.79	4.98	14.04
Major Incident Frequency Rate	Per 1m hours worked	0.53	0.25	0.33	0.34	0.27	19.58
Physical Assault Frequency Rate	Per 1m hours worked	6.31	5.11	7.04	7.19	6.78	5.72
Serious physical assaults	Per 1m hours worked			0.38	0.49	0.93	-91.96
Prosecutions[3]	Number	0	0	1	0	0	–
Environment							
CO_2 emissions	tonnes	n/a	398,519	343,717	298,986	291,883	2.4
Headcount intensity	tCO_2e/1,000 FTE	n/a	7.27	6.32	5.16	5.98	-15.89
Scope 1 emissions	tCO_2e	n/a	187,217	173,441	162,198	182,819	-12.71
Scope 2 emissions	tCO_2e	n/a	211,302	170,276	136,789	109,064	20.27
Prosecutions, fines or notices	Number	0	0	0	0	0	–

Notes:

The performance analysis is based on reported data as at 17 February 2017. Additional data may arise after this date. Where this occurs, numbers will be corrected in the following year's table. There have been some adjustments to reflect late reporting of data in regards to 2015 data.

All data excludes JVs and historical BPO data to enable a like-for-like comparison. Our private sector offshore BPO business was sold in December 2015.

The People figures shown above are representative only of employees for whom the relevant data is available. Current levels are in line with benchmark targets for the geographies and markets in which we operate, however we continue to try to improve them. Annual targets are managed at local and regional levels.

1. Gender data in 2013 excludes Serco Asia Pacific.
2. The current trend in turnover is driven by the planned reconfiguration and reduction of our global workforce, in line with Group strategy.
3. 2014 health and safety prosecution relates to an incident in 2011.

Approved by the Board and signed on its behalf by:

DE

David Eveleigh
Secretary

22 February 2017

Directors' Report

Corporate Governance Report

Board of Directors

Sir Roy Gardner (71)
Chairman

A N R C E GR

Appointed to the Board:
June 2015 (Chair since July 2015)

Key skills and experience:
Previously Chairman of Compass Group PLC, Chief Executive of Centrica plc, Managing Director of GEC-Marconi Limited and a Director of GEC plc, Non-Executive Director of Willis Group Holdings Limited and Laporte plc, Non-Executive Chairman of Manchester United, Plymouth Argyle Football Club and Connaught plc

Fellow of the Chartered Association of Certified Accountants, the Royal Aeronautical Society, the Royal Society of Arts and the City and Guilds Institute

Previously Chairman of the Advisory Board of the Energy Futures Lab at Imperial College, London and Chairman of the Apprenticeship Ambassadors Network

Current External Commitments:
Chairman at Mainstream Renewable Power Limited

Senior Independent Director at William Hill plc

Senior Adviser to Credit Suisse

Rupert Soames (57)
Group Chief Executive

A N R C E GR

Appointed to the Board:
May 2014

Key skills and experience:
Previously Chief Executive at Aggreko plc, and Chief Executive of Misys plc Banking and Securities Division

Senior Independent Director of Electrocomponents plc until July 2016 and a member of their Remuneration, Nomination and Audit Committees

Studied Politics, Philosophy and Economics at Oxford University and was President of the Oxford Union

Visiting Fellow at Oxford University

Current External Commitments:
None

Angus Cockburn (53)
Group Chief Financial Officer

A N R C E GR

Appointed to the Board:
October 2014

Key skills and experience:
Previously Chief Financial Officer and Interim Chief Executive at Aggreko plc, Managing Director at Pringle of Scotland, senior finance positions at PepsiCo Inc. including Regional Finance Director for Central Europe

Honorary Professor at the University of Edinburgh

Current External Commitments:
Non-Executive Director at GKN plc and a member of their Audit, Remuneration and Nomination Committees

Edward J. Casey, Jr (58)
Group Chief Operating Officer

A N R C E GR

Appointed to the Board:
October 2013 as Acting Chief Executive Officer. Group Chief Operating Officer from May 2014

Key skills and experience:
Joined Serco in 2005 as Chief Executive Officer of the Americas Division

Prior to Serco, worked for nine years in the energy business and over ten years in investment banking and private equity

Until December 2016 a Director at Talen Energy Corporation and a member of their Audit Committee and the Compensation, Governance and Nominating Committee

Current External Commitments:
None

Key (Red highlight denotes Chairman)

- A Member of the Audit Committee
- N Member of the Nomination Committee
- R Member of the Remuneration Committee
- C Member of the Corporate Responsibility Committee
- E Member of the Executive Committee
- GR Member of the Group Risk Committee

Mike Clasper CBE (63)
Non-Executive Director and Senior Independent Director

A N R C E GR

Appointed to the Board:
March 2014

Key skills and experience:
Previous roles have included Group Chief Executive of BAA plc, Chairman of HMRC and Senior Independent Director of ITV plc

MA in Engineering from Cambridge University

Honorary Doctorate from Sunderland University

Current External Commitments:
Chairman of Coats Group and Which? Limited

President of the Chartered Management Institute

Governor of the Royal Shakespeare Company

Ralph D. Crosby, Jr (69)
Non-Executive Director

A N R C E GR

Appointed to the Board:
June 2011

Key skills and experience:
Previously Chairman and Chief Executive of EADS North America and President of Northrop Gruman Corporation's Integrated Systems Sector

Served as an officer in the US Army

MA in Public Administration from Harvard, MA in International Relations from the Graduate Institute of International Studies in Switzerland, and a BSc from the United States Military Academy at West Point, New York

Current External Commitments:
Non-Executive Director at American Electric Power Co Inc.

Non-Executive Director at Airbus Group S.E.

Member of the Board of Directors and Executive Committee of the Atlantic Council of the United States

Rachel Lomax (71)
Non-Executive Director

A N R C E GR

Appointed to the Board:
March 2014

Key skills and experience:
Deep experience of government and economic policy

Deputy Governor, Monetary Stability, Bank of England and a member of the Monetary Policy Committee

Permanent Secretary, departments for Transport, Work and Pensions and the Welsh Office

Senior posts at the Cabinet Office, HM Treasury and World Bank, Washington

Current External Commitments:
Senior Independent Director at HSBC Holdings plc and Chair of the Conduct and Values Committee

Non-Executive Director of Heathrow Airport Holdings Limited

Director at SETL Development Limited

Member of the Supervisory Board of Arcus European Infrastructure Fund

Trustee/Board Member of Imperial College, London, Ditchley Foundation, and Breugel

Angie Risley (58)
Non-Executive Director

A N R C E GR

Appointed to the Board:
April 2011

Key skills and experience:
Previously Group HR Director at Lloyds Banking Group, an Executive Director of Whitbread plc, a member of the Low Pay Commission and a Non-Executive Director of Biffa plc and Arriva plc

Current External Commitments:
Group Human Resources Director of J Sainsbury plc and a member of the Sainsbury's Operating Board

Non-Executive Director of Sainsburys Bank

John Rishton (58)
Non-Executive Director

A N R C E GR

Appointed to the Board:
September 2016

Key skills and experience:
Previous roles have included Chief Executive of Rolls Royce Group plc, Chief Executive and President of the Dutch international retailer, Royal Ahold NV (and prior to that, its Chief Financial Officer) and Chief Financial Officer of British Airways plc

Fellow of the Chartered Institute of Management Accountants

Current External Commitments:
Non-Executive Director at Unilever plc

Non-Executive Director at Informa plc

Non-Executive Director at Associated British Ports

Directors' Report

Corporate Governance Report

Chairman's Governance Overview

This report sets out how Serco is governed and the key activities of the Board of Directors in promoting effective governance during 2016. Further information on how the Company complied with the UK Corporate Governance Code during 2016 is set out on pages 94 and 95.

Dear Shareholder

On behalf of the Board, I am pleased to present the Corporate Governance Report for the year ended 31 December 2016. As in previous years, we report against the UK Corporate Governance Code (the Code) issued by the Financial Reporting Council (FRC) and I am pleased to report that our high standards of compliance with the Code remain. The Board believes that good governance is key to the long-term success of the Company and we shall continue to pursue the 'comply or explain' approach.

Corporate governance overview

As a public services company, strong governance and integrity, underpinned by strong values, are key. The Board's role is to demonstrate leadership in those areas. This year we have refreshed our Values, helped determine and update the strategic objectives and policies of the Company and set these changes within an enhanced risk framework which establishes clear parameters and controls. We have given necessary focus to corporate responsibility with further actions and achievements in areas including corporate renewal, health and safety and human rights. As we move through the Transformation stage of the Company's strategy, the various key decisions and matters that are reserved for approval by the Board have been reviewed – be it Board roles or major bids, financial results or governance issues – all included within a clear governance framework that I have sought to enhance this year.

Focus on new business pipeline and key bids

During the year, the Board and I have spent time actively supporting the Executive management team in their detailed review of the Company's bidding activity. The Board has remained focused on ensuring that the Group's risk management and internal control systems are effective in underpinning robust decision-making on major bids. At the same time, the Board has continued to evaluate the performance of existing contracts and has focused with management on the lessons to be learned from existing Onerous Contract Provisions.

Contract visits

I and many of my fellow Board members have enjoyed the opportunity to visit many of Serco's contracts and to see, first hand, the excellent day-to-day service provision offered by our contract teams. The visits have given the Board a deeper level of understanding of the risks and opportunities faced by our contract teams on a daily basis, together with the Company-wide challenges regarding the scale and variety of our operations.

Changes in the Board

In July 2016, Tamara Ingram stepped down from the Board following her appointment as Chief Executive Officer of J. Walter Thompson Company LLC and her relocation to the US. I would like to thank Tamara for her valued contribution during her time on the Board. A considered selection process to appoint a successor to Tamara remains underway and further details regarding this process are set out in the Nomination Committee report on page 90.

During the year, Malcolm Wyman notified the Board of his intention to step down with effect from 31 October 2016. Malcolm joined the Board in January 2013 and in May 2013 became Chair of the Audit Committee. The Board is extremely appreciative of the significant contribution that Malcolm has made to the Company during a crucial time, securing a good foundation upon which to build a successful future, and more recently during the process of appointing a new External Auditor for the Group. The Board is greatly indebted to the time and energy Malcolm put into this role.

John Rishton joined the Board as Non-Executive Director in September 2016 to enable a handover with Malcolm before John became Chair of the Audit Committee on 1 November 2016. John has extensive executive and non-executive experience and the Board is already feeling the benefit of his considerable knowledge and track record in a range of industries. John is proving to be a valuable addition to the Board in the areas that are key to further strengthening Serco. More detail regarding the selection process that led to John's appointment is set out on page 90.

Continuity and diversity

The appointment of John Rishton and the continuing process to appoint a successor to Tamara Ingram are part of a well-managed and progressive process of non-executive succession planning, with the aim that the Board as a whole will continue to be diverse and secure deeper knowledge across the geographies and sectors in which Serco operates. I am also conscious that, as the Company continues to implement its new strategy, we must ensure sufficient continuity, institutional expertise and corporate memory within the Board. The Board notes the recommendations of the recent Hampton-Alexander Review of Women in Leadership Positions and the Parker Report into Ethnic Diversity on Boards, and notes that we continue to value all types of diversity as a vital component of a balanced, dynamic and effective Board. As such, over time, when we recruit new members to the Board we expect to address the issue of diversity in general and particularly to increase the percentage of women on the Board (currently 22%).

Effectiveness

In view of the changes to the Board, it was determined that the 2016 evaluation of the Board's effectiveness would be best served by being conducted internally, taking into account the principal themes raised in the 2015 externally facilitated evaluation. The 2016 review concluded positively that members of the Board were committed to spending more time on Board discussions, as well as becoming more involved in the development of the strategy and greater focus on risk. The induction process was praised and it was acknowledged that, together with ongoing training, this was considered important in understanding the Company's key strategic priorities and emerging issues. It is the intention of the Board to carry out an external evaluation in 2017, in line with the Code requirements and corporate governance best practice. Further detail is set out on page 79.

Shareholder engagement

The Board welcomes open, meaningful discussion with all of our shareholders. I have met with several of our largest shareholders during the year and Angie Risley, Chair of the Remuneration Committee, has separately met with a number of advisory bodies and institutional shareholders to discuss our approach to remuneration. I hope shareholders will also take the opportunity to meet with Board members at the 2017 AGM.

Sir Roy Gardner
Chairman

What the Board has achieved in 2016

- Supported Rupert Soames and the other Executive Directors in the Company's strategy update
- Focused on ongoing performance of the Group
- Reviewed and challenged management on the progress of the Company's business development pipeline
- Focused on and reviewed a number of key individual material bids
- Appointed a new Non-Executive Director and Audit Committee Chair
- Spent time with the Divisional management teams and met regularly with senior management responsible for the delivery of the Company's key opportunities and existing contracts, including a number of contract visits in the UK, Australia, New Zealand, Hong Kong and the US
- Oversaw the introduction of a new Group Risk Committee and the strengthening of the Company's risk management processes to ensure this was given appropriate attention at Board level
- Refocused the scope and composition of the Board Oversight Committee as the Corporate Responsibility Committee, chaired by the Senior Independent Director, Mike Clasper
- Effectively re-tendered, transitioned and replaced the Group's External Auditor

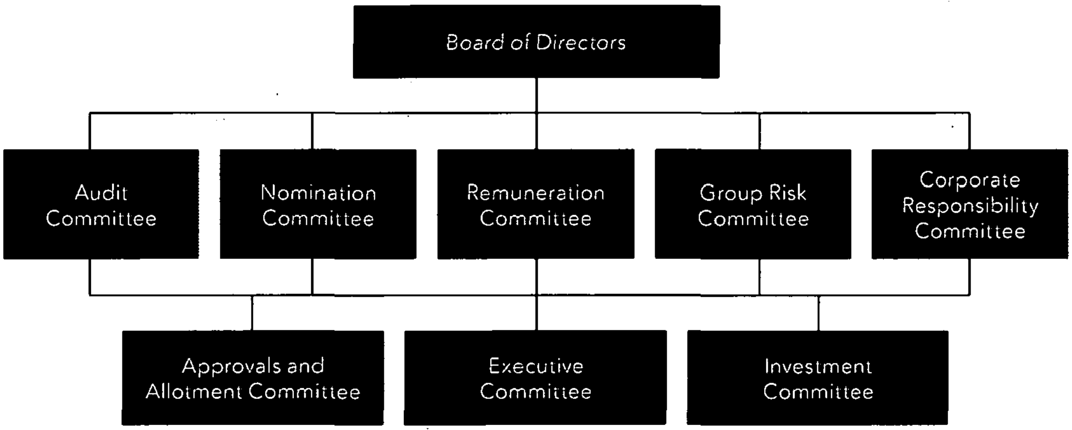
Board priorities for 2017

- Continue to support and challenge improvements in contract execution and cost efficiency, together with seeking to ensure the utilisation of capabilities across the wider Group
- Ongoing review and challenge of the bid pipeline and new business opportunities, together with the development of the Centres of Excellence
- Continued focus on enhancing risk management
- Focus on Board and Senior Management succession planning, including a further Board appointment
- Support an effective external Board evaluation process
- Further embedding of the Serco Values within the culture of the Company
- Continue to drive improvements in Health and Safety and, specifically, to challenge measures put in place to support the reduction in physical assaults in prisons
- Further review of Divisional operations as the Board continues to focus its time on ensuring the ongoing transformation and strengthening of the Group

Corporate Governance Report

Board and Governance

Board and Governance structure



Board of Directors

Committee comprised solely of Board members

Committee comprised of Executive Board members and senior management

Board attendance

	Board	Audit	Remuneration	Nomination	Corporate Responsibility and Risk[1]	Board Oversight[1]	Risk[1]	Corporate Responsibility[1]
Number held[2]	9	6	6	2	2	2	2	2
Edward J. Casey, Jr	9	–	–	–	–	2	–	2
Mike Clasper	9	6	3(3)	2	2	–	2	2
Angus Cockburn	9	–	–	–	–	–	–	–
Ralph D. Crosby, Jr	9	–	–	–	–	2	–	–
Sir Roy Gardner	9	–	6	2	2	2	–	2
Tamara Ingram[3]	1(4)	–	1(3)	–	1(2)	–	–	–
Rachel Lomax	8	5(6)	–	–	2	–	2	–
John Rishton[4]	4(4)	1(1)	2(2)	–	–	–	–	–
Angie Risley	8	–	6	2	–	–	–	2
Rupert Soames	9	–	–	–	2	–	–	–
Malcolm Wyman[5]	4(6)	5(5)	4(4)	–	–	2 (2)	1(1)	–

Numbers in brackets denote the maximum number of meetings which could have been attended.

Notes

(1) In February 2016, the Board approved the retirement of the Board Oversight Committee and the Corporate Responsibility and Risk Committee, and the establishment in their place of the Group Risk Committee and the Corporate Responsibility Committee. Further details on the revised remit and membership of these committees is set out on pages 80 and 92.

(2) Of the meetings detailed within the table, the following were convened on an ad hoc basis: one Board meeting; two Audit Committee meetings; and one Remuneration Committee meeting. Given the inherent short notice of these meetings some Directors were, on occasion, unable to attend but were fully briefed on all matters discussed.

(3) Tamara Ingram stood down from the Board on 31 July 2016.

(4) John Rishton was appointed to the Board and the Audit and Remuneration Committees on 13 September 2016. John joined the Group Risk Committee on 6 January 2017.

(5) Malcolm Wyman stood down from the Board on 31 October 2016.

In addition to the above, Rupert Soames, Angus Cockburn and Ed Casey attended all Executive Committee meetings held during 2016 and formed the quorum of Investment Committee and Approvals and Allotment Committee meetings as required.

Board evaluation

It is the Board's policy to invite external evaluation of the Board and its Committees and the roles of individual Directors at least every three years.

The 2016 Board evaluation process was conducted internally, led by the Chairman and facilitated by the Company Secretary. The evaluation covered a numbers of areas including: Board structure, Committees and their operation; induction and development; interaction with the business; and risk management and internal control.

All Board members provided their thoughts to the Company Secretary as part of a questionnaire format and a detailed discussion was then held at the September Board meeting to consider the matters raised.

The results of the evaluation concluded that, overall, the Board operates effectively within a collegiate and challenging environment. In addition, the Board welcomed the revised Committee structures and, in particular, the establishment of the Group Risk Committee.

A review of the progress of the 2015 objectives arising out of the external evaluation process conducted by Coletta Tumelty, together with a summary of findings and proposed initiatives relating to the recent evaluation, is set out below:

2015 Evaluation Recommendations	2016 Actions Taken
Consideration be given to the composition and remit of the Board Oversight Committee and the Corporate Responsibility and Risk Committee following the work undertaken to embed the policies and procedures put in place as part of the Corporate Renewal Programme and the Board's recognition of the need for an enhanced focus on risk-related matters across the Company.	In February 2016, the Board approved the retirement of the Corporate Responsibility and Risk Committee and the Board Oversight Committee, and the establishment of the Group Risk Committee and the Corporate Responsibility Committee.
Ensure adequate Board time is scheduled to consider strategy for growth and differentiation.	Following the appointment of Kate Steadman, Group Strategy Director, in February 2016, the Board met on several occasions to review the direction of the Group strategy update which was undertaken by Executive Management throughout 2016 and formed part of the Capital Markets Day presentation made in December 2016.
That the Board receive a presentation of the talent strategy, a risk assessment and succession plan for all Board roles and executive roles in the top two tiers below CEO.	In March, 2016 the Nomination Committee and then the Board as a whole reviewed a detailed talent and succession strategy for the Board and key Executive Committee roles. It was agreed that this process be extended to further Executive-level roles and become an annual exercise.
That Board materials be standardised to ensure they consistently and adequately cover matters of operational and performance significance to the Board.	Materials for Board meetings were reviewed to seek to ensure information was delivered in an accurate, consistent, and more standard manner throughout 2016. Further work is now being undertaken to ensure the same level of consistency at Committee level.

Recommendations for 2017

- Management will facilitate further Board and Committee focus on strategy and growth to build upon the strategy work undertaken to date.
- Further discussion on succession planning, particularly at an Executive Committee level, will be built into the forward agenda for the Nomination Committee and the Board.
- A continued focus will be placed on the timely delivery of relevant, good-quality, Board papers.
- Further direct engagement between Board members and the business will be facilitated through contract visits and smaller group engagements.
- The Board will be given more visibility of Divisional and Functional management below Board and Executive Committee level.
- Further focus and enhancement of the Group Risk Committee and Corporate Responsibility Commitee.

In advance of the scheduled external evaluation of the Board in 2017, a number of options and priorities will be looked at to support continued transparency and best practice.

Corporate Governance Report

Group Risk Committee Report

In February 2016, the Board approved the establishment of a new Group Risk Committee. as part of a broader reorganisation of Board Committees. This change reflected the importance that the Board attaches to improving its oversight of risk-related matters across the Company and to strengthening the Company's capabilities for assessing and managing risk.

During the course of the year the Company appointed a new Group Risk and Compliance Director. The Committee has spent some time in considering his first assessment of the maturity of the Company's risk management and agreeing a forward work programme. This focuses on systematically reviewing the Group's top risks and overseeing progress in embedding the risk management framework across the Company. The Committee has made a good start in tackling this demanding agenda, beginning with detailed work clarifying risk definitions, appetites and tolerances. The Committee regularly reviews the Company's top risks, changing risk profiles and emerging trends and the effectiveness of existing controls and risk mitigants. In addition, a regular series of technical and regional deep dives has commenced with a review of Catastrophic Risk and the approach to risk management in the Americas.

Rachel Lomax
Chair of the Group Risk Committee

Committee's responsibilities

The Committee advises the Board on the Company's overall risk appetite, tolerance and strategy, taking account of the current and prospective macroeconomic and financial environments. The key responsibilities of the Committee are:

- Overseeing the effectiveness of the Company's risk management framework, including the assessment of the principal risks facing the Company and the action being taken by management to mitigate risks that are outside the Company's risk appetite;
- Challenging and advising the Board on the current risk exposures of the Company and future risk strategy, and reviewing regular risk management reports from management which enable the Committee to consider the process for risk identification and management;
- Assessing how key Group risks are controlled and monitored by management;
- In conjunction with the Audit Committee, reviewing the Company's overall risk assessment processes that inform the Board's decision-making, ensuring both qualitative and quantitative metrics are used; and
- Reviewing the Company's capability to identify and manage emerging risks, in conjunction with the other Board Committees as appropriate.

Detailed terms of reference for the Committee can be found at www.serco.com/about/the-board-and-governance

Membership and attendees

The Committee was comprised solely of Non-Executive Directors during the year and as at the date of this report the members of the Committee were Rachel Lomax (Chair), Mike Clasper and John Rishton. Meetings of the Committee are attended by the Chairman, Chief Executive, the Chief Operating Officer, the Group General Counsel and Company Secretary and the Group Risk and Compliance Director.

Activities of the Committee during 2016

During the year the Committee's key activities included:

- Receiving detailed updates regarding the Company's principal risks, detailing key changes and trends, and emerging risks;
- Challenging and supporting the new Group Risk and Compliance Director in his work plan for improving enhancing and embedding the risk management framework;
- Agreeing the focus and scope of the quarterly Committee meetings and a detailed forward agenda for the Committee;
- Undertaking an in-depth review of Catastrophic Risk, one of the Company's principal risks, and reviewing how the risk is currently managed and the activities being undertaken to better define, understand and mitigate this risk; and
- Receiving a presentation from members of the Serco Americas Executive Team charged with risk management to better understand the Division's risk management processes and, as a part of this presentation, undertaking a detailed review on one of the Division's principal risks – Major Information Security Breach.

2017 priorities and focus

During 2017, the Committee will focus on undertaking detailed deep-dive reviews into other Group principal risks and will meet with each Divisional team to better understand their approach to risk management.

Serco's approach to managing business risks and internal control

Serco has an internal control framework which includes financial, operational, compliance and risk management controls. These are designed to manage and minimise risks that would adversely affect services to our customers and to safeguard shareholders' investments, our assets, our people and our reputation (collectively 'business risks').

Internal controls and key processes are defined within the Serco Management System (SMS) together with clear definitions of those individuals responsible for ensuring compliance. To provide management assurance that these controls are effective, a 'three lines of defence' compliance model has been implemented to test business compliance. The Group's Compliance Assurance Programme defines and reports on second line of defence compliance activity and the Internal Audit Programme defines and reports on third line of defence compliance activity.

First line of defence – We seek to minimise the probability and impact of business risks through the consistent implementation of the SMS, seeking to ensure that appropriate processes and controls are in place, and that appropriately trained staff seek to ensure that customer, legal and regulatory requirements are being adhered to, and if not that adequate plans are in place to mitigate. In 2016, we repeated the SMS self-assessment process to enable Contract Managers and other Leaders to self-assess their compliance with the SMS and increase awareness of SMS requirements. In doing so, self-assessment recipients have developed action plans to address any gaps. While SMS controls are designed to mitigate and minimise business risks, these risks cannot be completely eliminated. Consequently, while SMS controls can provide reasonable assurance against mis-statement or loss, this cannot be absolute.

Roles and responsibilities – Functions and Divisions within the Company are responsible for identifying and managing risks in line with SMS Policy and Standards and implementing associated controls.

Second line of defence – A Group Compliance Assurance Programme has been implemented which seeks to ensure that a consistent approach is applied across the Company in assuring compliance with key controls. Serco Group have mandated minimum requirements for each Division to include in their Compliance Assurance Plans in order to address principal risks which include a minimum sample of completed SMS self-assessments to be validated. The quality and robustness of the Compliance Assurance Programme is currently under further development in order to improve its effectiveness.

Roles and responsibilities – The Group Risk and Compliance Function is responsible for managing the SMS and for the development and implementation of policies and standards associated with Risk Management and Compliance Assurance. The Function is the custodian of the Group's Risk Register and provides risk management oversight, assurance and challenge. It is also custodian of the Group Compliance Assurance Programme, ensuring it is risk based and that material controls, mitigating the Group principal risks, are being effectively implemented.

Third line of defence – Together with external audits undertaken across the Company, Internal Audit provides an independent assessment of the design and operating effectiveness of the Company's governance, risk management and control frameworks that are in place to manage risk. The Internal Audit team carries out an annual programme of risk-based audits reporting findings to the Audit Committee. The audit programme is approved by the Audit Committee and is continually revised throughout the year to ensure it remains focused on appropriate areas. The in-house Internal Audit team uses PwC as a co-sourced resource where appropriate.

Roles and responsibilities – The Group Head of Internal Audit reports functionally to the Chair of the Audit Committee and is responsible for the delivery of the Internal Audit programme, ensuring that it is risk-based and aligned with the overall strategy of the Company.

These three lines of defence are overseen and challenged by the Executive Committee (and the Board), which undertake a quarterly review of the Group Risk Register and review individual risks as required. The Board has overall responsibility for risk management and internal control (and is supported in these duties by the Group Risk Committee) and formally reviews the findings of the overall Internal Audit programme.

The Board confirms that there has been a focus on the three lines of defence for the year under review and up to the date of approval of the 2016 Annual Report and Accounts.

Corporate Governance Report

Audit Committee Report

Following my appointment as Chairman of the Audit Committee in November 2016, I am pleased to present the Committee's report for the year ended 31 December 2016. I would firstly like to echo the comments of Sir Roy Gardner within this Annual Report and thank Malcolm Wyman for the significant commitment and energy he demonstrated during his tenure as Chairman of the Committee and to personally thank him for the time he gave to me in ensuring an orderly handover before he stepped down from the Board.

The Audit Committee has a fundamental role to play in reviewing, monitoring and challenging the effectiveness of the Company's financial reporting and internal control processes. The Committee is made up solely of Non-Executive Directors to allow it to fulfil this role and in 2016 has focused on supporting and challenging management to reach balanced judgements on Onerous Contract Provisions (OCPs), the financial reporting control environment and the use of Alternative Performance Measures (APMs) in the Company's published financial statements.

This review and challenge has taken several forms. The Committee considered whether the Company had robust systems and procedures in place for monitoring OCPs. To support this, the Committee also reviewed the Group's accounting systems, policies and procedures. Taking these into consideration, the Committee reviewed the judgements made by management to confirm that the financial statements produced during the year were reliable and provided the 'true and fair view' expected. The Committee also reviewed the Group's financial risk management processes and associated internal controls supported by Internal Audit and the External Auditor.

The Code invites the Committee to report on the significant issues considered during the year. Full details are contained on the opposite page. I would also highlight that my initial focus as Committee Chairman has been on:

- Financial Reporting Controls; and
- Meeting with the Finance Leadership team and understanding the risks and opportunities surrounding the current Finance Transformation Programme.

During 2017, the Committee will focus on supporting management in the continued delivery of the finance transformation project and will challenge the continued use of APMs as the Company begins to move away through the Transform phase of the Company's strategy.

John Rishton
Chair of the Audit Committee

Key areas of focus

Issue and Significance	How the Committee addressed this	Comments and Conclusion
Contract performance, including Onerous Contract Provisions (OCPs)		
As part of the 2014 Strategy Review, the Contract and Balance Sheet Review led to the establishment of material OCPs.	The Committee has regularly reviewed and challenged Management's assumptions and main areas of judgement in relation to the performance of the Company's key contracts, with particular focus on material OCP positions and, with the support of the External Auditor, agreed that, while accounting for OCPs remained an area of judgement, the view formed by Management regarding each individual material OCP and the aggregate view was considered reasonable. As part of their review, the Committee also considered how the assessment of OCPs reflected other key judgements made by Management in respect of asset impairments, deferred tax asset recognition and future liquidity and viability.	The Committee agreed with Management and the External Auditor that the overall level of provision was appropriate when taking into account the range of possible outcomes. The Committee also concluded that the assumptions and judgements made by Management in the calculation of OCPs were consistent with those prepared by Management for forecasting future profitability and cash flows.
Use of Alternative Performance Measures (APMs)		
The Company's performance measures continue to include some measures which are not defined or specified under IFRS. In particular, following its introduction in 2015, Management continued to use Underlying Trading Profit, as a key measure to review current performance against the prior year by removing the impact of adjustments to OCPs, charges and releases of other items identified during the 2014 Contract and Balance Sheet Review and other significant non-trading items.	The Committee noted the guidance issued by the Financial Reporting Council in relation to the use of APMs and, supported by the challenge of the External Auditor, considered whether the performance measures used by Management provided a meaningful insight into the results of the Company for its shareholders. The Committee then also reviewed the treatment of items considered as being exceptional and requiring separate disclosure. With the support of the External Auditor, the Committee reviewed the proposed disclosure of APMs in both the 2016 Half and Full Year results and the 2016 Annual Report ahead of their approval by the Board.	The Committee agreed with Management and the External Auditor that Underlying Trading Profit continued to be a reasonable basis for the comparison of the performance of the business. The Committee also continued to support the judgements made by management regarding the items considered as being exceptional and requiring separate disclosure. The Committee concluded that, in relation to the Half and Full Year 2016 results and the 2016 Annual Report, clear and meaningful descriptions had been provided for the APMs used. It was also concluded that the relationship between these measures and the statutory IFRS measures was clearly explained and supported the considered understanding of the financial statements.
Accounting for Foreign Exchange on Non-Trading Items		
During the year, Management recommended changes to the Company's accounting policy for foreign exchange gains and losses on investing and financing activities, including movements on derivatives that have been taken out to hedge foreign exchange movements on the Group's external debt and inter-company debt. Such transactions are no longer included in Operating Profit, they are instead included in Net Finance Costs. The proposed changes impacted the Company's Operating Profit by £1.2m and reduced Free Cash Flow by £47m and required a restatement of the results for 2015 to ensure comparability.	The Committee reviewed in detail with Management and the External Auditor the proposed changes to the accounting definition of Operating Profit. The Committee challenged the basis for the change in accounting policy and the timing of this change, together with the long-term applicability of the change. A detailed review of the impact of the changes on the draft 2016 financial statements was then undertaken by the Committee with the support of Management and the External Auditor.	Following their considered review, the Committee supported the proposal by Management to change the Company's accounting policy to exclude foreign exchange gains and losses on investing and financing items from Operating Profit and include instead within Net Finance Costs.

Corporate Governance Report

Audit Committee Report continued

Key areas of focus continued

Issue and Significance	How the Committee addressed this	Comments and Conclusion
Goodwill Impairment		
A key area of judgement made by Management in recent years has been in the assessment of the holding value of goodwill. In 2014 and 2015 significant impairments of goodwill were recorded but no such charges arose in 2016 in respect of pre-existing business purchases. However, an impairment charge of £17.8m did arise following the acquisition of a business in the year. Core to the assessment of the value of goodwill is Management's estimate of future cash flows, which is dependent on circumstances both within and outside of their control, and discount rates that are adjusted to reflect the risks specific to individual assets.	The methodology and the results of the impairment testing were presented to the Committee and were subject to scrutiny and review. The Committee placed particular focus on changes in discount rates applied and ensuring that the underlying cash flows are consistent with the Board-approved forecasts. The Committee also reviewed the disclosures included in the financial statements to ensure that they provide an appropriate level of information to users.	The Committee were satisfied that the assumptions underlying the impairments made in the year were appropriate. Following review of the disclosures in the financial statements, the Committee concluded that the disclosures were transparent, appropriate and in compliance with financial reporting requirements.
Defined Benefit Pension Schemes		
The Group's defined benefit pension scheme obligations are an area of Management focus, in particular regarding the identification of obligations arising from customer contracts and the calculation of financial impact of any such liabilities.	The Committee considered both the process undertaken by Management to finalise the assumptions for the main schemes, and how these assumptions benchmark against the market. Advice was taken from independent actuaries on the appropriateness of the assumptions used. During the year, Management have undertaken a review of the Group's obligations with regards to the Local Government Pension Scheme based on a detailed contract-by-contract assessment and the findings of this review were presented to the Committee.	Following review, the Committee concluded that the process followed was appropriate and the resulting conclusions reached and calculations performed were appropriately balanced.

Committee governance

Role of the Committee

The Committee supports the Board in fulfilling its responsibilities in respect of: overseeing the Company's financial reporting processes; reviewing, challenging and approving significant accounting judgements proposed by management; the way in which management ensures and monitors the adequacy of financial and compliance controls; the appointment, remuneration, independence and performance of the Group's External Auditor and the independence and performance of Internal Audit.

Details of the work carried out by the Committee in accordance with its terms of reference and in addressing significant issues are reported to the Board as a matter of course by the Chairman of the Committee and are described in this report. The terms of reference for the Committee can be found at www.serco.com/about/the-board-and-governance

Committee membership

The Committee is comprised solely of independent Non-Executive Directors. Mike Clasper and Rachel Lomax were members of the Committee throughout 2016. Malcolm Wyman was Chairman of the Committee until his retirement from the Board on 31 October 2016 and John Rishton joined the Committee on his appointment to the Board in September 2016 and became Chairman of the Committee on 1 November 2016. During his tenure, Malcolm Wyman, a Chartered Accountant, was determined by the Committee to have 'recent and relevant financial experience' as required by the Code and on his appointment, John Rishton, a Fellow of the Chartered Institute of Management Accountants, was also considered to have recent and relevant financial experience.

Meetings are normally attended by the Chairman, the Chief Financial Officer, the Group Financial Controller, the Head of Internal Audit, the General Counsel and Company Secretary and representatives of the External Auditors. The Committee retain time at the end of each meeting to meet separately without management present and invite the Head of Internal Audit and the External Auditor to attend for part of this session.

Performance review

The Audit Committee's performance was assessed as part of the Board's annual effectiveness review. It was concluded that the Committee operated effectively.

Activities of the Committee during the year

The Committee has an annual forward agenda developed from its terms of reference with standing items considered at each meeting in addition to any specific matters arising and topical business or financial items on which the Committee has chosen to focus. The work of the Committee in 2016 principally fell into three main areas:

Accounting, tax and financial reporting

- Reviewing the integrity of the half-year and annual financial statements and the associated significant financial reporting judgements and disclosures;
- Considering the liquidity risk and the basis for preparing the half-year and annual financial statements on a going concern basis, and reviewing the related disclosures in the Annual Report and Accounts;
- Considering the provisions of the Code regarding going concern and viability statements and reviewing emerging practice and investor comment as well as the Group's Viability Statement;
- Reviewing updates on accounting matters and new accounting standards, including the new accounting standard on revenue (IFRS15);
- Reviewing the processes to assure the integrity of the Annual Report and Accounts as well as reviewing:
  - the management representation letter to the External Auditor;
  - the findings and opinions of the External Auditor;
  - the disclosures in relation to internal controls and the work of the Committee;
  - that the information presented in the Annual Report and Accounts, when taken as a whole, is fair, balanced and understandable and contains the information necessary for shareholders to assess the Company's performance, business model and strategy;
  - the effectiveness of the disclosure controls and procedures designed to ensure that the Annual Report and Accounts complies with all relevant legal and regulatory requirements; and
  - the process designed to ensure the External Auditor is aware of all 'relevant audit information', as required by Sections 418 and 419 of the Companies Act 2006.

Corporate Governance Report

Audit Committee Report continued

Internal controls

- Assessing the effectiveness of the Group's internal control environment and making recommendations to the Board;
- Assessing the findings and directing the work of the Group's financial assurance function;
- Considering reports from Internal Audit;
- In conjunction with the Group Risk Committee, considering the level of alignment between the Company's key risks and Internal Audit programme;
- Reviewing the adequacy of resources of the Internal Audit function and considering and approving the scope of the Internal Audit programme;
- Considering the effectiveness of Internal Audit;
- Supporting the appointment of an external co-source partner to Internal Audit; and
- Considering reports from the External Auditor on their assessment of the control environment.

External Auditor

- Overseeing the external audit tender process and making a recommendation to the Board on the appointment of a new External Auditor (Further detail is set out in page 89).
- Considering and approving the audit approach and scope of the audit undertaken by KPMG as External Auditor and the fees for the same;
- Agreeing reporting materiality thresholds;
- Reviewing reports on audit findings;
- Considering and approving letters of representation issued to KPMG; and
- Considering the independence of KPMG and their effectiveness, taking into account:
  - non-audit work undertaken by the External Auditor;
  - feedback from a survey targeted at various stakeholders; and
  - the Committee's own assessment.

Financial controls

The Company aims to have a strong and regularly monitored control environment that minimises financial risk and, as part of the Committee's responsibilities, it reviews the effectiveness of systems for internal financial control and financial reporting. Where relevant, the Committee also works with the Group Risk Committee to consider financial risk management.

Financial control risk is monitored through the Group Principal Risk, Financial Control and Financial IT Systems Failure processes. The Committee has reviewed this risk during 2016 and has focused in particular on:

- The impact of the Company's ongoing finance transformation programme, with briefings received at every Committee meeting on the progress of the programme;
- The progress of the business continuity work being undertaken by the Corporate Shared Services team, which included impact on the Company's finance systems;
- Work being undertaken with Deloitte LLP to develop a set of integrated assurance maps to document key financial control risks being managed by the Divisions and Business Units and the assurance activity undertaken to mitigate those risks;
- Reviews of the controls and judgements on the Group's balance sheet; and
- Management's review of the adequacy of the Group Finance functions first and second lines of defence.

Following review and challenge, the Committee believes that, to the best of their knowledge and belief, the financial control framework and the monitoring of this framework has worked effectively during the year, and that in cases of non-compliance, no critical, severe or significant risk has existed to the Company. The Committee was also encouraged to note that where weaknesses in the financial control framework were identified they continued to be addressed.

Viability Statement

During the course of 2016, the Committee, along with the Board, has received a number of detailed updates on comments made by the FRC and the Investment Association regarding the first viability statements published by companies in 2015 and 2016. The Committee has reviewed the 2015 Viability Statement and the draft 2016 Viability Statement in light of these comments, notably regarding the period, risk prioritisation and stress testing, and remains of the view that the statement made regarding the Company's viability in 2015 continues to be an accurate assessment of the Company's viability as at 31 December 2016.

The Viability Statement is set out on page 24.

Independent assurance

The Company's Independent assurance structure is formed of Internal Audit and External Audit.

Internal Audit

Internal Audit provides assurance to the Board, Audit Committee and management, and in particular:

- Provides objective, independent assurance and advice to management and the Audit Committee on the design and operating effectiveness of the governance and internal control processes in place to identify and manage business risks; and
- As part of the Company's integrated approach to risk, assurance and audit, acts as a 'third line of defence' through its coordinating role in monitoring the effectiveness of both management controls and other assurance activities in addressing business risk.

Internal Audit gives particular regard to the ongoing evaluation of the efficacy of the Company's financial controls and reporting processes. During 2016, and following a tender process, PricewaterhouseCoopers LLP were appointed as co-source partner to Internal Audit, replacing KPMG.

External Auditor

The Audit Committee manages the relationship with the Company's External Auditor, on behalf of the Board. The Competition & Markets Authority's 2014 Order on mandatory use of competitive tender processes and audit committee responsibilities requires mandatory tendering of the external audit contract every ten years and it has been the practice of the Audit Committee to keep the assessment of the need to tender the auditor under ongoing review. In line with this practice, in 2016 the Committee recommended that the Company undertake a tender for external audit services. As Deloitte LLP would not have been able to be appointed as External Auditor to serve beyond 2020 due to the new legislation, Deloitte agreed that they would not participate in the tender process and full details of the process followed are set out below. As a result of this tender, KPMG were appointed by the Board as the Group's External Auditor in May 2016, and will be subject to appointment by the Company's shareholders at the AGM in 2017.

The Committee has assessed the new External Auditor with input received from management associated with audits undertaken in Group finance and in the Divisions. The feedback received was reviewed by management and reported to the Committee. In addition, the Committee reviewed the Financial Reporting Council's Audit Quality Review Team report on the 2015/16 inspection of KPMG. After taking these reports into consideration, together with the External Auditor's report on their approach to audit quality and transparency, the Committee concluded that the auditor demonstrated appropriate qualifications and expertise and remained independent of the Company, and that the audit process was effective.

The Committee also reviewed the External Auditor's engagement letter and determined the remuneration of the External Auditor in accordance with the authority given to it by shareholders. The Committee considered the External Auditor's remuneration to be appropriate.

It is proposed that KPMG be appointed as External Auditor of the Company at the next AGM in May 2017 and, if so appointed, that they will hold office until the conclusion of the next general meeting of the Company at which accounts are laid. Further details are set out in the Notice of Annual General Meeting which is available at www.serco.com/investors

The Company will continue the practice of the rotation of the audit engagement partner at least every five years, and all other partners and senior management will be required to rotate at least every seven years.

The Independent Auditor's report to shareholders is set out on pages 134 to 138.

Corporate Governance Report

Audit Committee Report continued

Non-audit fees

The Committee believes that non-audit work may only be undertaken by the External Auditor in limited circumstances. The Committee monitors the non-audit fees. In 2016 the non-audit fees paid to KPMG were £1.3m, £0.5m of which arose prior to appointment. The majority of the fees related to either tax advisory, compliance services or other investigation-related matters.

Focus is given to ensuring that engagement for non-audit services does not: (i) create a conflict of interest; (ii) place the auditor in a position to audit their own work; (iii) result in the auditor acting as a manager or employee; or (iv) put the auditor in the role of advocate for the Company.

The Committee regularly reviews the nature of non-audit work performed by the Extenal Auditor and the volume of that work. An analysis of fees paid in respect of audit and non-audit services provided by the External Auditor for the past two years is disclosed on page 169. Having undertaken a review of the non-audit services provided during the year, the Committee is satisfied that these services were provided efficiently by the External Auditor as a result of their existing knowledge of the business and did not prejudice their independence or objectivity.

External Audit Tender

2015 was a challenging year for the Company, having recently undertaken a detailed Contract and Balance Sheet Review together with a Rights Issue and a debt refinancing, against the background of a significant write down of over £1.3bn of onerous contract provisions, goodwill and intangibles. Against the backdrop of this considerable work programme and the appointment of a new executive team, the Board recognised the strong support required, and received, from Deloitte as External Auditor and agreed with the Committee that it was appropriate to keep Deloitte in place until the completion of the audit of the 2015 financial year.

It has been the practice of the Audit Committee to keep the assessment of the need to tender the auditor under ongoing review and in line with new regulations brought into force from the EU and the Competition & Markets Authority regarding external audit tenders and the mandatory change in external auditors. Therefore, the Committee recommended, and the Board subsequently approved, the decision to undertake a tender process for external audit services, shortly after the completion of the 2015 audit.

The tender process and the Committee's involvement in that process is outlined below:

Tender participants: PricewaterhouseCoopers LLP, KPMG LLP and Ernst & Young LLP were all invited to participate in the tender process. The tender process was limited to the 'Big 4' due to the considered lack of the capacity of smaller audit firms to carry out the audit of such a complex international company. It was also agreed that Deloitte would not be invited to tender in light of the longevity of their current appointment.

Tender documentation: The Committee reviewed and approved Request For Proposal documentation and a data pack to be issued to all participants which provided detailed information to support the submission of quality and accurate bids by participants.

Carousel day: Each participant then had the opportunity to spend time with various management stakeholders to obtain a more detailed understanding of the Company and existing management processes and challenges to better inform their tender submission. These meetings included time with Group Finance, Tax and Treasury, Internal Audit, Risk, General Counsel and Company Secretarial, IT, the UK businesses and the Chief Financial Officer.

Selection Committee: The bids submitted following the Carousel Day were subject to review by a Selection Committee. This Committee was led by the then Chair of the Audit Committee, Malcolm Wyman, and was comprised of the remaining members of the Audit Committee, the Chief Financial Officer and the Group Financial Controller. The firms all then met with the Selection Committee to present their proposals with a question and answer session then led by the members of the Audit Committee present on the Selection Committee.

Criteria: The Selection Committee reviewed the tender submissions and scored them independently based upon quality, strength and relevant sector experience of the proposed team, depth of the team and the wider organisation in the industries and geographies relevant to the Company, cultural fit, the proposed approach to the transition plan and wider audit and the potential for audit efficiencies and fee savings.

Outcome: The Selection Committee recommended KPMG as the preferred supplier among the final candidates as they had the appropriate geographic spread and depth and the relevant technical knowledge to best support the Company as External Auditor. The Board ratified the decision of the Selection Committee and announced the decision to the London Stock Exchange.

Corporate Governance Report

Nomination Committee Report

The Committee has taken note of the Financial Reporting Council discussion paper on UK Board Succession Planning and has challenged itself during 2016 to ensure that the Committee is playing an effective role in advising the Board on succession matters.

The Committee supports the discussion paper's recommendation that the Committee should regularly evaluate the senior management team and have a broader oversight of talent management within the Group, and has spent time this year with the Executive Directors reviewing succession plans for the Group Executive Management team.

Following the decision by Malcolm Wyman and Tamara Ingram to stand down from the Board, Committee members have devoted considerable time in and outside of Committee meetings to the search and selection process for new Non-Executive Directors and I would like to thank them for the dedication they have shown to this process.

Sir Roy Gardner
Chair of the Nomination Committee

Committee's responsibilities

The Committee leads the process for Board appointments and makes recommendations to the Board in this regard. In fulfilling this role, the Committee evaluates the balance of skills, experience, independence and knowledge on the Board and, in the light of this evaluation, prepares a description of the role and capabilities required for every appointment.

The Board values diversity and when recruiting new Board members the issue of diversity is addressed by the Committee, with particular regard to the percentage of women on the Board (which currently stands at 22%).

The key responsibilities of the Committee are:

- Reviewing the size, structure and composition of the Board;
- Recommending membership of Board Committees;
- Undertaking succession planning for the Chairman, Group Chief Executive and other Directors;
- Searching for candidates for the Board, and recommending Directors for appointment;
- Determining the independence of Directors;
- Assessing whether Directors are able to commit enough time to discharge their responsibilities;
- Reviewing induction and training needs of Directors; and
- Recommending the process and criteria for assessing the effectiveness of the Board and Board Committees and the contribution of the Chairman and individual Directors to the effectiveness of the Board and helping to implement these assessments.

Detailed terms of reference for the Committee can be found at www.serco.com/about/the-board-and-governance

Membership and attendees

As at 31 December 2016, the Committee was comprised only of Non-Executive Directors and the members of the Committee were Sir Roy Gardner (Chair), Mike Clasper and Angie Risley. Meetings of the Committee are normally attended by the Chief Executive, the Group HR Director, and the Group General Counsel and Company Secretary.

Activities of the Committee during 2016

During the year the Committee's key activities included:

- **The appointment of a new Audit Committee Chair** – The Committee focused heavily during the year on the search for, selection and appointment of a suitable successor to Malcolm Wyman as Chair of the Audit Committee following the decision by Malcolm to retire from the Board. The services of external search consultant, Korn Ferry, were retained to assist in identifying potential candidates. Korn Ferry is independent and a signatory to the Voluntary Code of Conduct on gender diversity and best practice (the Voluntary Code). The Committee as a whole agreed the specification and considered the candidate shortlist and met separately with candidates before unanimously recommending the appointment of John Rishton to the Board.

- **Initial work on the appointment of a new Non-Executive Director** – Following the resignation of Tamara Ingram and the consideration of succession planning for the remaining Non-Executive Directors, a considered search commenced to appoint an additional Non-Executive Director to the Board. In instigating this search, particular consideration has been given to succession planning for the Remuneration Committee members. The services of an external search consultant, Lygon Group, have been retained to assist in identifying potential candidates. Lygon Group is independent and is also a signatory to the Voluntary Code. The Committee agreed the specification and continues to consider the candidate shortlist and expects to recommend a suitable candidate to the Board later this year.
- **Reviewing Board succession planning** – The Committee held a meeting during the year to specifically consider Board succession. With the support of the Group HR Director, the Committee reviewed the succession processes put in place by the HR team and also considered the immediate, emerging and long-term succession plan for each key Board role. This took into account discussion on background, experience, sector knowledge, functional knowledge and consideration of good practice guidelines in relation to Board appointments and diversity.
- **Reviewing the process for Executive Committee succession planning** – The Committee received an overview of the existing processes in place for Executive Committee succession planning and received a briefing from the Group HR Director on the current talent pipeline for each executive role, ahead of their wider planned review of succession plans for each key Executive Committee role during 2017.

2017 priorities and performance review

The Committee's performance was assessed as part of the Board's annual effectiveness review. It was concluded that the Committee operated effectively. During 2017, the Committee will continue to focus on succession planning and supporting the diverse composition of the Board.

Corporate Governance Report

Corporate Responsibility Committee Report

In February 2016, the Board approved the retirement of the Board Oversight Committee and the Corporate Responsibility and Risk Committee, and the establishment in their place of the Group Risk Committee and the Corporate Responsibility Committee. This change reflected the maturity and changing focus of the Board Committees following the work undertaken to embed the policies and procedures put in place as part of the Corporate Renewal Programme. It is clear that there continues to be significant progress in the delivery and embedding of the Programme which has been and remains key to the turnaround of the Group. As part of the broadening of the Committee and the maturity of the Corporate Renewal Programme, Lord Gold stood down from the Committee as the independent third-party member, having finished a further review into Serco's approach to governance and ethics. I would like to take the opportunity to thank him for his guidance, oversight and commitment to Serco from 2013 until 2016.

I was pleased to be asked by Sir Roy Gardner to Chair the Corporate Responsibility Committee because I believe that in all our actions, we must ensure that our stakeholders are proud to be associated with Serco and that it is crucial that we only do business where we can 'do the right things in the right way' in the eyes of our customers and also the public. In support of this the Corporate Responsibility Committee will continue to develop and consider its remit around the four key areas of Health and Safety, People, Ethics and the Corporate Responsibility Framework, and I look forward to reporting back to shareholders on our progress.

Mike Clasper
Senior Independent Director and Chair of the Corporate Responsibility Committee

Committee's responsibilities

The Committee reviews and scrutinises the Company's continued approach to Corporate Renewal matters and also focuses on forward-looking corporate responsibility matters. It is intended that over time, the Committee's focus will shift more fully to corporate responsibility once the Corporate Renewal Programme workstreams become fully embedded in the Company's culture and can be considered as 'business as usual'. The Board has agreed that the Committee's focus on Corporate Responsibility will have four main aspects:

- Health and Safety – while overall Health and Safety will remain a matter reserved to the Board, the Committee is charged with considering the Company's approach to Health and Safety in practice and will review in detail any key trends and patterns of behaviour that emerge, escalating any matters of importance to the full Board.
- People – the Committee will consider the Company's policies relating to its people and matters of relevance to its management of people, such as the Viewpoint survey and the Company's Human Rights policy.
- Ethics – the Committee will consider Speak Up reports and the approach to its whistleblowing processes and any relevant metrics or themes arising in relation to the Group's whistleblowing, bribery or fraud processes. Where relevant these matters will be considered in conjunction with the Group Audit Committee or the Group Risk Committee.
- Corporate Responsibility Framework – the Committee will provide oversight, guidance and challenge on the implementation of the Company's Corporate Responsibility Framework and will consider related policies and strategies on how the Company conducts its business and guards its reputation, including on such matters as human rights and slavery.

Detailed terms of reference for the Committee can be found at www.serco.com/about/the-board-and-governance

Membership and Attendees

The Committee comprised both Executive and Non-Executive Directors during the year and as at 31 December 2016 the members of the Committee were Mike Clasper (Chair), Ed Casey, Sir Roy Gardner and Angie Risley. Meetings of the Committee are normally attended by the Group General Counsel and Company Secretary, the Director Business Compliance and Ethics, and the Managing Director, Group Operations.

Activities of the Committee during 2016

During the year the Committee's key activities included:

- Reviewing Lord Gold's report into the progress made by the Company in embedding ethical behaviour as part of the Corporate Renewal Programme and discussing the findings with Lord Gold;
- Agreeing the proposed remit and focus of the Committee;
- Considering the Company's Health and Safety performance and reviewing regular health, safety and environment reports including lessons learnt and action plans from particular incidents;
- Reviewing the continued progress of the Corporate Renewal Programme including the training programmes, SMS self-assessment process, compliance assurance and contract management performance and reporting;
- Receiving briefings on the Company's management of ethical conduct and ethical issues; and
- Receiving a briefing on the Culture Index included within the annual Viewpoint employee engagement survey to monitor the ongoing culture of the Company.

2017 priorities and focus

During 2017, the Committee will focus on undertaking detailed deep-dive reviews into key areas of its remit to ensure that the appropriate focus, control and rigour remain in place throughout the Company.

Corporate Governance Report

Compliance with the UK Corporate Governance Code

For the year ended 31 December 2016, the Company has complied fully with the UK Corporate Governance Code which can be found at www.frc.org.uk

The notes below are intended to assist with the evaluation of the Group's compliance during 2016, although they should be read in conjunction with the Corporate Governance Report as a whole.

A. Leadership

A.1 The Role of the Board
The Board is responsible to Serco's shareholders for promoting the long-term success of the Company and the operation of effective governance arrangements. It oversees and agrees the Group's strategy and ensures that necessary resources are available, and that the appropriate risk management controls, processes and culture are in place to deliver it. As well as oversight, responsibility for financial performance, internal control and risk management of the Group, there is a clear schedule of matters reserved to the Board which is published on our website at www.serco.com/about/the-board-and-governance

The Board meets formally on a regular basis. All Directors are expected to attend all Board and relevant Committee meetings in addition to general meetings of the Company, including the AGM. Details of the number of meetings held during 2016 and the Directors' attendance are shown on page 78.

All Directors are covered by the Group's Directors' and Officers' Insurance policy.

A.2 Division of responsibilities
The roles of the Chairman and Chief Executive are separate and full descriptions, including key responsibilities of each, are published at www.serco.com

Sir Roy Gardner, the Chairman, leads and is responsible for the balance and composition of the Board and its Committees, and ensures its effectiveness in all aspects of its role. Rupert Soames, the Chief Executive, leads the business to develop and deliver the Group's strategy and business plans as agreed with the Board.

A.3 The Chairman
The Chairman manages the Board and, in consultation with the Company Secretary, sets the Board's agenda for the year. Meetings are arranged to ensure sufficient time is available for the discussion of all items. The Chairman facilitates open and constructive dialogue during the meetings. The Chairman was independent on appointment.

A.4 Non-Executive Directors
Non-Executive Directors are urged to challenge constructively and help develop proposals on strategy, scrutinise the performance of management in meeting agreed goals and objectives, and monitor the reporting of performance. They are responsible for determining the remuneration of the Executive Directors and have a key role in the appointment and succession planning of Executive roles.

Mike Clasper was Senior Independent Director throughout 2016. The responsibilities of the Senior Independent Director include meeting major shareholders as an alternative contact to the Chairman, Group Chief Executive or Group Chief Financial Officer. The role is clearly established and a description of the key responsibilities is published at www.serco.com

The Chairman meets with the Non-Executive Directors without the Executive Directors present. At least annually the Non-Executive Directors, led by the Senior Independent Director, meet without the Chairman present.

During the year, the Directors had no unresolved concerns about the running of the Company or any proposed action. It is Company policy that any such unresolved concern must be recorded in the Board minutes.

B. Effectiveness

B.1 Composition of the Board
There are currently five Non-Executive Directors, in addition to the Chairman and three Executive Directors on the Board.

During the year as part of the Board's internal evaluation process, the Board reviewed the overall balance of skills, experience, independence and knowledge of Board and Committee members and their diversity, including gender.

The Board considers all of its Non-Executive Directors to be independent and free of any business relationships that could compromise the exercise of independent and objective judgement. In accordance with the Code, the Board undertakes an annual review of the independence of its Non-Executive Directors.

B.2 Appointments to the Board
John Rishton was appointed as a Non-Executive Director on 13 September 2016. The appointment was led by the Nomination Committee, who recommended John's appointment to the Board. Further details regarding the process for John's appointment are available in the report of the Nomination Committee on page 90.

B.3 Commitment
The time commitment of Non-Executive Directors is defined on appointment and regularly evaluated. The Board is satisfied that the current external commitments of its Chairman, Senior Independent and other Non-Executive Directors do not conflict with their duties and time commitments as Directors of the Company. It is the Company's policy to allow each Executive Director to accept one non-executive directorship of another company.

B. Effectiveness continued

B.4 Development
A full, formal and tailored induction programme is provided to all Directors appointed to the Board, which takes into account their qualifications and experience.

The Chairman reviews and agrees Directors' training and development needs.

During 2016, the Board received briefings from their advisers of relevant topics designed to update Directors' skills and knowledge in particular areas. A number of the Non-Executive Directors also undertook a programme of individual contract visits and Divisional management meetings to support familiarity with the Group's operations, and visit reports were shared with all Board members.

B.5 Information and support
The Directors have full access to the advice and services of the Company Secretary and may obtain independent professional advice at the Company's expense if they believe it may be required in the furtherance of their duties.

The Company Secretary is responsible to the Board on a number of issues and full details on the Company Secretary's responsibilities are published at www.serco.com/about/the-board-and-governance. The appointment and removal of the Company Secretary is a matter for the Board as a whole.

The Chairman, in conjunction with the Company Secretary, ensures that all Board members receive timely, accurate and effective information.

B.6 Evaluation
In 2016, performance evaluations of the Board, its Committees and individual Directors were carried out internally. Further details of the evaluation can be found on page 79.

Following the evaluation, the Directors concluded that the Board and its Committees operated effectively and that each Director contributes effectively and demonstrates commitment to their role.

External evaluation last took place in early 2015 and it is the Board's intention to carry out an externally facilitated evaluation in 2017.

B.7 Election / Re-election
Each Director is subject to election at the first AGM following their appointment, and re-election at each subsequent AGM. Accordingly John Rishton will stand for election at the 2017 AGM. The Directors unanimously recommend the election/re-election of all Board members at the 2017 AGM. Full biographical details for all Directors can be found on pages 74 and 75.

C. Accountability

C.1 Financial and business reporting
A statement of the Directors' responsibilities regarding the financial statements, including the status of the Company as a going concern, is set out on pages 129 and 130, with an explanation of the Group's strategy and business model together with the relevant risks and performance metrics set out on pages 8 to 23.

A further statement is provided on page 132 confirming that the Board considers that the Annual Report and Accounts, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the Company's performance, business model and strategy.

The Audit Committee report on pages 82 to 89 sets out the details of the Committee's responsibility for ensuring the integrity of the financial reporting process and the key matters considered during the year in respect of its oversight of financial and business reporting.

C.2 Risk management and internal control
The Board, through the Group Risk Committee, has carried out a robust assessment of the principal risks facing the Company, including those that would threaten its business model, future performance, solvency or liquidity. Further details about these risks and how they are managed and mitigated can be found on pages 16 to 23. The Viability Statement on page 24 explains how the Directors have assessed the prospects of the Company and concluded that they have a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment.

The Board determines the Company's risk appetite and has established risk management and internal control systems. At least annually, the Board undertakes a review of their effectiveness. Further details are set out on pages 16 to 17 and 80 to 81.

C.3 Audit Committee and Auditors
The Audit Committee report on pages 82 to 89 sets out details of the composition of the Committee, including the expertise of members, and outlines how the Committee discharged its responsibilities during 2016.

The Board has delegated a number of responsibilities to the Audit Committee, including oversight of the Group's financial reporting processes and management of the External Auditor. Full details are set out in the terms of reference for the Committee, published at www.serco.com

D. Remuneration

D.1 The level and components of remuneration
The Remuneration Report on pages 96 to 125 outlines the activities of the Committee during 2016 and sets out the Company's Directors' Remuneration Policy table, including relevant remuneration components and how they support the achievement of the strategic objectives of the Group. The Annual Remuneration Report outlines the implementation of remuneration during 2016 (including salary, bonus and share awards).

The Remuneration Policy will be put to a binding shareholder vote at the AGM in 2017 in accordance with the requirements of the UK Companies Act. The Board believes that the Group's proposed Remuneration Policy has a responsible approach to Directors' pay and that the Remuneration Policy as proposed is appropriate and fit for purpose.

D.2 Procedure
The Board has delegated a number of responsibilities to the Remuneration Committee, including the setting of the Group's overall remuneration policy and strategy, as well as the remuneration arrangements for the Executive Directors and the Executive Committee. Full details are set out in the terms of reference for the Committee published at www.serco.com and the activities of the Committee are set out in the Directors' Remuneration Report on pages 96 to 125.

No Director is involved in setting his or her own remuneration.

E. Relations with shareholders

E.1 Dialogue with shareholders
The Board recognises that meaningful engagement with its institutional and retail shareholders is integral to the continued success of the Company. The Executive Directors and the Investor Relations team regularly meet with analysts and major investors to maintain effective dialogue. The Chairman is available and has met with a number of major investors. Throughout 2016 the Board has sought actively to engage with shareholders through meetings, presentations and roadshows.

E.2 Constructive use of the AGM
The AGM will be held on 11 May 2017 and is an opportunity for shareholders to vote in person on certain aspects of Group business. The Board values the AGM as an opportunity to meet with those shareholders able to attend and to take their questions. The Notice of AGM is made available to all shareholders either electronically or, where requested, in hard copy and is available at www.serco.com.

In April 2016 the FRC published a new UK Corporate Governance Code (the "New Code") following the implementation of the *European Union's Audit Regulation* and Directive. The Company will report against the New Code in respect of the 2017 financial year.

Remuneration Report

Dear Shareholder

On behalf of your Board, I am pleased to present our Directors' Remuneration Report for the financial year ended 31 December 2016.

This introduction provides the context for the Committee's decision-making during the year, and summarises the key points from the Report, including those relating to the future policy, performance and incentive plan outcomes and the Committee activities.

Context

In 2013 and 2014, the Company went through a period of crisis, during which many members of the management team left the business. In 2014 a new management team was appointed; some £1.3bn of provisions and write-downs were taken; and in early 2015, as part of a Rights Issue which raised £550m the new management set out a three-phase strategy to turn Serco around. The first phase – Stabilisation – involved rebuilding the core of the business, including the balance sheet; the second phase – Transformation – started in 2015 and is set to run to early 2018. The third phase – Growth – starts in 2018.

Our performance in 2016

As reported in the Chairman's Statement on page 4 substantial progress has been made in 2016 in the delivery of the Transformation phase, as set out in our Strategic Report on page 13. Customer confidence and trust has been rebuilt, as evidenced by a 30% increase in our bid pipeline and a 40% increase in our order intake in 2016; employee engagement has increased; costs have been reduced by some £450 million, and trading performance has been stronger than expected at the beginning of the year. All this has been reflected in a strong share price performance during the year. There is more work to do, and 2017 will be a critical year for the management team as they drive towards the completion of the Transformation phase.

Shareholder engagement and planned changes to policy

Included within this Report is our Directors' Remuneration Policy (the "Policy"). Under the regulations, our Remuneration Policy is required to be presented to shareholders for re-approval by shareholders every three years, and therefore together with our Annual report on Directors' Remuneration, will be voted on by shareholders at our Annual General Meeting, ("AGM") on 11 May 2017.

The requirement to put the Policy back for a vote comes at a time when the business is at a critical stage of its turnaround, with the Transformation stage just over half-way through. The Committee has therefore considered the extent to which the current Policy remains aligned to the ongoing transformation, and has also looked ahead to what may be required in 2018 and beyond to support the next key phase in the delivery of the business strategy, which will be the Growth phase. The Committee has also given consideration to how well the Policy is aligned to wider market practice and to more recent corporate governance developments.

Our aim is to focus on value creation and share ownership to align executives with the completion of the strategic business transformation and delivery of the outcomes committed to shareholders. The current Policy focuses management on maximizing earnings and returns on invested capital in each year. The current focus on rewarding long-term success for consistently delivering progress, in line with or above investor expectations, is key to ensuring Serco retains the high calibre individuals who were appointed in 2014 to turn Serco around, and to develop and deliver our five-year plan. We have consulted with our major shareholders and the large majority of those who responded supported the continuation of the current arrangements.

The Committee is therefore asking shareholders to approve the renewal of the current Policy for a single year, with a view to doing a further review of Policy during 2017 and putting a new three year Policy to shareholders at the AGM in 2018.

The single-year extension to the current Policy allows a new Policy to be aligned to the strategic requirements of the third phase of our turnaround, which starts in 2018. The Committee also recognise that since the Policy was overwhelmingly approved by shareholders in 2014, certain aspects of the current arrangements have been overtaken by evolving market practice. In particular having two long-term incentive vehicles (a Performance Share Plan and a Deferred Bonus Plan), with one of these being based on a share matching arrangement, is not universally supported. The Committee wishes therefore to conduct a further review during the course of 2017 to design a new Policy, which, amongst other considerations, will result in the share matching element being removed. The timing of this will also provide the Committee with the opportunity to give full consideration to the emerging corporate governance policies and best practice guidelines, including the Government's White Paper expected to be released in late Spring 2017.

I and the Committee believe it is important to continue to maintain effective channels of communication with our shareholders. The Committee takes the views of shareholders very seriously and these views have been influential in shaping our policy and practice.

The Committee will therefore be asking shareholders to approve the renewal of the existing Policy at the AGM in 2017 for a single year, with a further review to be undertaken and a new three-year Policy to be developed and put to shareholders ahead of being tabled for approval at the AGM in May 2018.

Remuneration outcomes in respect of the 2016 financial year

Long-term incentives

The long-term incentive awards made under the PSP in 2014 were based on targets set prior to the Rights Issue and, in line with good practice, were not adjusted. As a result of the issues identified through the Contract and Balance Sheet Review in 2014, and the subsequent impact on Group performance, the element of the long-term incentives granted to the new Executive Directors both on joining and in 2014, that are based on the financial targets being tested as at 31 December 2016, will lapse as a result of the financial targets attached to these awards not being achieved.

Short-term incentives

For the 2016 financial year, the Group Bonus Plan (the Plan) in which Executive Directors participate was focused on three core measures which comprised 70% of the overall opportunity: Group Revenue, Group Trading Profit and Group Free Cash Flow. The remaining 30% of the opportunity is based on role-specific objectives related to the delivery of the business transformation.

Financial performance has been strong; on both Trading Profit and Free Cash Flow the achievements of the business were in excess of the stretching targets set by the Committee at the beginning of the year and therefore these components have been earned in full. The level of Revenue achieved over the period was above threshold and as such 33% of this component of the bonus was awarded.

The financial bonus outcomes have been calculated after appropriate adjustments were made (agreed at the beginning of the year as part of the target-setting process and in line with the approach disclosed in respect of 2015). The Committee has once again spent considerable time reviewing the Trading Profit calculation for bonus purposes, initially working with management to determine a robust approach to decision-making, informed by a review of each individual contract and cross-referencing to information shared with the Audit Committee. This year the external auditors verified the extraction of the figures for bonus purposes from the audited information, followed by a formal sign-off by the Audit Committee prior to decisions being made by the Remuneration Committee. As a result of the rigour applied to this process, the Committee is satisfied that the annual bonus out-turn fairly reflects management performance in the year and that the transparency regarding this introduced in the 2015 DRR has continued in respect of 2016.

Performance against role-specific objectives has also been strong. Each of the Executive Directors has between 8 and 12 objectives aligned to our 4 priorities: Winning Good Business, Executing Brilliantly, Making Serco a Place People are Proud to Work, and Making Serco Profitable and Sustainable. 2016 has been a successful year; the Transformation phase of the strategy is well underway; the pipeline of new prospects has grown substantially, as has order intake. The Viewpoint Engagement score amongst the Leadership population is up 17 percentage points. The performance of each member of the Executive team is subject to a detailed review against their objectives as part of the decision-making on any bonus to be awarded in respect of non-financial elements.

After thorough consideration, as a result of the achievement of strong financial and non-financial performance over the year against the targets set, a bonus award of 82.3% of maximum (123.5% of salary) has been determined for Rupert in respect of 2016 performance. The corresponding bonus amounts for Angus and Ed are 81.6% of maximum (106.0% of salary) and 80.1% of maximum (120.1% of salary) respectively.

There was unanimous support for the decision to make these bonus awards to reflect the contribution that each member of the team has made to strengthen the business and position it for success.

The Committee is mindful of the importance of open and timely disclosure of bonus targets and the role they play in the Committee's ability to explain to Shareholders the decisions made. The Committee has also kept under review the commercial sensitivity of targets as the Company progresses through transformation. We are pleased to continue with our disclosure practice in disclosing targets in the year to which they relate. The targets, and the assessment of performance against them, for the 2016 Plan are therefore disclosed in this year's Report on page 112.

We intend to consult further with shareholders on the quality of our disclosure as part of the full review of remuneration to be undertaken during the course of 2017.

Remuneration Report continued

Approach for 2017

Salary reviews – no change

Base salaries, for our Executive Directors were set in a way which reflected the needs of the business at the time they were appointed in 2014; shareholders gave overwhelming support to their appointment and subsequently to their remuneration. No increases have been made to base salary since the individuals were appointed in 2014 and no changes are planned for 2017; for the third consecutive year, with effect from 1 April 2017, the salaries for the Executive Directors will remain unchanged.

Short-term incentives – no change

The target and maximum bonus opportunity will remain at 75% target /150% maximum of salary for Rupert Soames and Ed Casey, and 65% target /130% maximum of salary for Angus Cockburn. 70% of the bonus will continue to be based on financial measures, which are Revenue (20% weighting), Trading Profit (40% weighting) and Free Cash Flow (40% weighting). The remaining 30% will once again be individually set and based on key strategic goals related to the delivery of the business transformation.

Long-term incentives – no change

The Committee intends to make the next set of Performance Share Plan (PSP) and Deferred Bonus Plan (DBP) awards in 2017 in accordance with the current policy approved in May 2014. The performance measures will remain the same as those used for the 2016 awards with the PSP targets based on aggregate EPS, relative TSR and average ROIC with an equal weighting on each. The DBP has served the business well in reducing the amount of annual bonus paid as cash, and providing a mechanism by which the Executive Directors may invest a significant proportion of their annual bonus earned in respect of past performance, with the opportunity to earn a matching award based on future EPS performance. The choice of performance measure has incentivised executives to consistently deliver earnings in line with or above investor expectations during a challenging business transformation. Our major shareholders confirmed their continued support for this to ensure the new Executives appointed to deliver the business turn around are focused on leading the business back into sustainable growth.

Committee changes

The Committee was delighted to welcome Mike Clasper and John Rishton as Non-Executive Directors (NEDs) to the Committee on 1 August 2016 and 13 September 2016 respectively. Both Mike and John bring extensive knowledge across a range of industries and are already proving to be a great addition to the Remuneration Committee.

Closing remarks

2016 has been a year of significant progress in delivering the turnaround. I believe that the Remuneration Committee has rigorously made the necessary decisions to ensure that reward is clearly linked to performance and shareholder interests, and that any incentive payments awarded reflect what has been delivered. Serco has a highly effective executive management team and a clear strategy to transform the business and position it for success in attractive markets. We will continue to engage with shareholders to ensure that our leadership team are rewarded appropriately to incentivise them to complete the Transformation and move forward to restoring the growth, margins and returns of the business.

Angie Risley
Chair of the Remuneration Committee

At a glance: implementation of Remuneration Policy for 2017 and key decisions for 2016

The table below summarises:

- How key elements of the Remuneration Policy presented here, and once approved to apply from the 2017 AGM, will be implemented in 2017; and
- Key decisions taken by the Remuneration Committee in relation to the remuneration of Directors in respect of the 2016 financial year.

Implementation of Remuneration Policy for 2017

Element	CEO (Rupert Soames)	CFO (Angus Cockburn)	COO (Ed Casey)
Base salary from 1 April 2017	£850,000	£500,000	$1,061,690
Pension	30% of salary	30% of salary	30% of salary including cost of participation in US 401k plan
Annual bonus	Max 150% of salary On-target 75% of salary	Max 130% of salary On-target 65% of salary	Max 150% of salary On-target 75% of salary
Annual bonus measures[1]	• 70% financial targets: 40% Trading Profit, 40% Free Cash Flow and 20% Revenue. • 30% non-financial targets linked to key strategic goals. • Annual bonuses are subject to a Trading Profit underpin.		
Deferred Bonus Plan (DBP)	Directors are eligible to participate in the 2017 DBP in line with the Policy approved at the AGM in 2014. A maximum of 50% of the 2016 bonus (paid in 2017) can be deferred to purchase investment shares. Each individual investment share purchased will be matched (on a gross investment basis) by a maximum of two 'matching' shares.		
DBP measures[2]	Vesting of awards made under the DBP will be determined by reference to the Group's EPS performance measured over three years.		
Performance Share Plan (PSP)	Maximum 200% of salary	Maximum 175% of salary	Maximum 175% of salary
PSP measures[2]	Awards granted under the PSP in 2017 will be subject to Group performance over a three year period ending 31 December 2019: • 1/3rd Aggregate EPS – Statutory Earnings Per Share (EPS) before exceptional items (adjusted to reflect tax paid on a cash basis), measured as an aggregate over the three-year performance period. • 1/3rd Relative TSR – Total Shareholder Return (TSR) when ranked relative to companies in the FTSE 250 (excluding investment trusts). • 1/3rd Average ROIC – Pre-tax Return on Invested Capital (ROIC), measured as an average over the three-year performance period.		
Holding requirement	Vested shares from the PSP must be held for two years post vesting (after payment of tax).		
Shareholding requirement	200% of salary	150% of salary	150% of salary
Malus and clawback	• Malus provisions will apply to the PSP and DBP awards during the three-year performance period prior to vesting. • Clawback provisions will apply to the annual bonus plan. • Clawback provisions will apply during the two-year post-vesting holding period to shares arising from PSP awards. • Clawback provisions will apply to matching shares awarded under the DBP.		
Changes to the previously approved policy	The requirement to put the Policy back for a vote comes at a time when the business is at a critical stage of its turnaround, with the Transformation stage just over half-way through. The Committee is asking shareholders to approve the renewal of the current Policy for a single year, with a view to doing a complete review of the Policy during 2017, and putting a new three-year Policy to shareholders at the AGM in 2018.		

1. The Committee deems the specific details of the performance measures and targets to be commercially sensitive as they are intrinsically linked to the forward looking strategy of the business. Full disclosure will be provided in the Annual Report on Remuneration for the year in which final performance is assessed provided these details are no longer considered sensitive.
2. The Committee sets the performance targets in respect of the PSP and DBP immediately prior to the grant of the award and therefore these are not yet determined. Details of the performance targets will be disclosed in the Annual Report on Remuneration for the year in which the awards are made.

Remuneration Report continued

Key decisions made in respect of Directors' remuneration in 2016

Executive Directors

Element	**CEO (Rupert Soames)**	**CFO (Angus Cockburn)**	**COO (Ed Casey)**
1 April 2017 salary review	No change	No change	No change
2016 Bonus outcome:			
• Currency value	£1,049,325	£530,075	$1,274,824
• % of salary	123.5%	106.0%	120.1%
• % of maximum	82.3%	81.6%	80.1%
2014 PSP vesting (EPS performance condition for the period ending 31 December 2016)	Nil	Nil	Nil
Non-Executive Directors			
Chairman fee effective 1 July 2016	£250,000 (no change)		

Illustration of application of Remuneration Policy in 2017

The following charts illustrate the value that may be delivered to Executive Directors under different performance scenarios for the year ending 31 December 2017. Also shown, for comparison, is the actual value delivered in the year ended 31 December 2016 (excluding the value received from buy-out awards vesting in the year).

Rupert Soames (£'000s)

Angus Cockburn (£'000s)

Ed Casey (US$'000s)

The scenarios in the above graphs are defined as follows:

- Fixed elements of remuneration
  - Base salary as applicable from 1 April 2017
  - Estimated value of benefits to be provided in 2017 in line with the Remuneration Policy (based on the value of actual benefits provided in 2016)
  - Pension contribution/cash supplement equal to 30% of salary
- Annual bonus, deferred bonus plan and performance share plan participation as set out in the Policy table. In all cases, Target performance results in delivery of 50% of maximum opportunity. The Deferred Bonus Plan and Performance Share Plan values reflect the "face value" at grant of shares that could be received for Target and Maximum performance.
- The maximum matching award level under the DBP assumes maximum deferral and a 2:1 match against a maximum bonus.

In this section

This report has been drafted in compliance with the disclosure requirements of the UK Corporate Governance Code and the requirements of the UKLA Listing Rules. This Report also complies with the provisions of the Companies Act 2006 and the Large and Medium-sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013.

Directors' Remuneration Policy

In this section, the Committee presents the Remuneration Policy report for shareholder vote at the 2017 AGM.

As set out in the Chair's Letter, given where the Company is with the business transformation, the Committee deemed it was not appropriate to make changes to the Remuneration Policy at this time. The Company is still in the process of completing the transformation and delivering on the objectives committed, and communicated, to shareholders. There is strong agreement that there is a need to ensure stability within our Remuneration Policy, until such time as the transformation is nearing completion. The Committee will therefore be asking shareholders to re-approve the existing Policy at the AGM in 2017.

As set out in the Chair's letter, it is intended that the Policy will be subject to a review with further consultation with our major shareholders during the latter part of 2017 and a revised Policy tabled at the AGM in May 2018.

In the tables and narrative below, we have set out details of each element that may comprise the remuneration package of a Director, what the opportunity is under that element, and importantly how each element supports the business and aligns the interests of the Directors with the wider stakeholders, including shareholders, in the Company.

The approved Directors' Remuneration Policy as applicable to remuneration for the year ending 31 December 2016 is displayed on the Company's website, in the investor area.

Remuneration Policy

Serco's Remuneration Policy supports the achievement of the Company's long-term strategic objectives. Serco's approach to executive remuneration is designed to:

- Support Serco's long-term future growth, strategy and values;
- Align the financial interests of executives and shareholders;
- Provide market-competitive reward opportunities for performance in line with expectations and deliver significant financial rewards for sustained out-performance;
- Enable Serco to recruit and retain the best executives with the required skills and experience in all our chosen markets;
- Be based on a clear rationale which participants, shareholders and other stakeholders are able to understand and support.

We approach Executive Directors' remuneration on a total reward basis to provide the Remuneration Committee with a view of total remuneration rather than just the competitiveness of the individual elements. Analysis is conducted by looking at each of the different elements of remuneration (including salary, annual bonus, performance share plan and pension) in this context. This ensures that in applying the Remuneration Policy executive pay is sufficient to achieve the goals of the Remuneration Policy without paying more than is necessary. The leverage of fixed:variable pay also ensures that significant reward is only delivered for exceptional performance.

This remuneration framework is echoed throughout the organisation with the approach to pay for the wider workforce reflecting these core principles where appropriate.

Remuneration Report continued

Future policy table

The remuneration package for Executive Directors' consists of base salary, annual bonus, long-term share-based incentives, pension and other benefits. The Company's policy is to ensure that a significant proportion of the package is related to performance, with the relevant performance measures completely aligned to the core requirements of a successful business transformation.

The following table sets out each element of reward and how it supports the Company's short and long-term strategic objectives. Whilst the table is focused on Executive Directors, the table set out on page 106 provides further information of how pay policies are set for the broader employee population.

How the element supports our strategic objectives	Operation of the element	Maximum potential value and payment at threshold	Performance metrics used, weighting and time period applicable
Base Salary			
To help recruit and retain executives of the necessary calibre to execute Serco's strategic objectives and to recognise an individual's experience, responsibility and performance. To ensure base salaries are competitive in the market in which the individual is employed.	Pay levels are designed to be competitive and fair, and reflect the skills and performance of individuals. Salaries are benchmarked from time to time against salaries for the Company's relevant peer group, with the market positioning dependent on the scale of challenges intrinsic to the individual's role and the individual's ability, and experience. In some circumstances there may be phased movement to that market positioning. Salaries are reviewed annually and any changes are effective from 1 April in the financial year.	Over the policy period, base salaries for Executive Directors will be set at an appropriate level within the peer group and will normally increase at no more than the greater of inflation and salary increases made to the general workforce in the jurisdiction the Executive Director is based in. Higher increases may be made in exceptional circumstances, for example when there is a change in role or responsibility.	Unchanged since appointment
Benefits			
To provide a competitive level of benefits.	Serco pays the cost of providing the benefits on a monthly basis or as required for one-off events such as receiving financial advice. A range of benefits may be provided to Executive Directors. These include, but are not limited to, company car or car allowance, private medical insurance, permanent healthcare insurance, life cover, annual allowance for independent financial advice, and voluntary health checks every two years. Relocation benefits will be provided in a manner that reflects individual circumstances and Serco's relocation benefits policy. For example, relocation benefits could include temporary accommodation for the Executive and dependents, education costs for dependents and tax equalisation. Benefits are reviewed annually against market practice and are designed to be competitive.	The maximum opportunity for benefits is defined by the nature of the benefits and the cost of providing them. As the cost of providing such benefits varies based on market rates and other factors, there is no formal maximum monetary value.	None

How the element supports our strategic objectives	Operation of the element	Maximum potential value and payment at threshold	Performance metrics used, weighting and time period applicable
Annual Bonus			
Incentivise executives to achieve specific, predetermined goals that are aligned to the business strategy during a one-year period. Reward ongoing stewardship and contribution to core values.	The Committee sets objectives at the start of each performance year. The annual performance measures and objectives are determined with reference to the Group's overall strategy and annual business plan and priorities for the year. At the end of the performance year the bonus result is determined by the Committee based on performance against the objectives and targets set. Annual bonuses are paid after the end of the financial year to which they relate. There is an optional deferral of 50% of the total earned bonus into Serco shares under the Deferred Bonus Plan. On change of control, the Committee may pay bonuses on a pro-rata basis measured on performance up to the date of change of control.	Maximum bonus opportunity: • 150% of salary for CEO • 130% of salary for CFO • 150% of salary for COO On-target bonus: • 75% of salary for CEO • 65% of salary for CFO • 75% of salary for COO Threshold bonus is 20% of maximum bonus opportunity.	Bonus is earned on the basis of achievement of a mix of financial and non-financial objectives of which at least 50% are financial. Financial measures are based on the Company's Key Performance Indicators (KPIs) and the non-financial measures are based on key strategic objectives. Performance is measured over the financial year. The Committee has discretion to vary the weighting of performance metrics over the life of this Remuneration Policy. Also the Committee has discretion in exceptional circumstances to vary performance measures part-way through a performance year if there is a significant event (such as a major transaction or transition in role) which causes the Committee to believe the original performance conditions are no longer appropriate.
Deferred Bonus Plan (DBP)			
This plan is to incentivise executives to achieve superior longer term returns for shareholders and to align executives to shareholder interests through an increased shareholding.	Executive Directors can elect to defer, for three financial years, up to 50% of their net annual bonus by purchasing investment shares. Each individual investment share purchased will be matched (on a gross investment basis) by up to a maximum of two 'matching' shares granted as conditional share awards. Dividend equivalents are accrued in respect of matching shares awarded and are delivered as additional shares to the extent that the matching award vests. In circumstances such as fraud, misconduct and/or misstatement by a participant, the Company will be entitled to withhold before the vesting date the value of any shares to be released or the payment of cash equivalents under the DBP. On a change of control, awards vest pro-rata for time and performance up to the date of change of control unless the Committee decides otherwise. As provided in the plan rules approved by shareholders, the Committee has discretion to adjust awards in the event of, for example, corporate restructuring or capital events.	For maximum performance, each investment share is matched by two matching shares. 25% of the matching award vests for threshold performance.	EPS is the sole measure to determine the vesting of matching shares. The performance condition is measured over three years, awards vest at the end of the three year period to the extent that the performance condition is met. In exceptional circumstances the Committee retains discretion to change performance measures and targets and the weightings attached to performance measures part-way through the performance period if there is a significant event (for example a major transaction) which causes the committee to believe the original measures, weightings or targets are no longer appropriate. The Committee has discretion to vary the proportion of awards that vest, to ensure that the outcomes are fair and appropriate and reflect the underlying financial performance of the Group.

Remuneration Report continued

How the element supports our strategic objectives	Operation of the element	Maximum potential value and payment at threshold	Performance metrics used, weighting and time period applicable
Performance Share Plan (PSP)			
To drive achievement of longer term objectives, increase shareholder value aligned closely to creating shareholders' interests.	Awards of nominal cost options / conditional shares normally made annually. Dividend equivalents are accrued in respect of PSP shares awarded and are delivered as additional shares to the extent that the PSP award vests. The Committee, at its discretion may attach a post-vesting holding period for awards. In circumstances such as fraud, misconduct and/or misstatement by a participant, the Company will be entitled to withhold before the end of the holding period the value of any shares to be released or the payment of cash equivalents under the PSP. On a change of control, awards vest pro-rata for time and performance up to the date of change of control unless the committee decides otherwise. As provided in the plan rules approved by shareholders, the Committee has discretion to adjust awards in the event of, for example, corporate restructuring or capital events.	Face value on grant of 200% of base salary for the CEO and 175% for the CFO and COO. 25% of the award vests for threshold performance rising on a straight-line basis to full vesting for maximum performance.	Vesting is dependent on at least two performance conditions chosen from: • EPS • Relative TSR • Absolute Share Price or TSR The measures are independent and are measured over three years. The weighting of each is determined prior to award. The Committee has discretion to adopt other measures following consultation with major shareholders. In exceptional circumstances the Committee retains discretion to change performance measures and targets and the weightings attached to performance measures part-way through the performance period if there is a significant event (such as a major transaction) which causes the committee to believe the original measures, weightings or targets are no longer appropriate. The Committee has discretion to vary the proportion of awards that vest, to ensure that the outcomes are fair and appropriate and reflect the underlying financial performance of the Group.
Pension			
To provide pension related benefits to encourage executives to build savings for retirement.	Executive Directors may participate in the Group defined contribution pension plan. US employees are eligible to join the Serco 401k plan. Employer contributions are reviewed against local market practices annually. Executive Directors may choose to receive some or all of their employer pension contribution in cash to invest as they see fit.	Rupert Soames and Angus Cockburn receive a cash allowance in lieu of pension equal to 30% of base salary. Ed Casey participates in the US 401k plan and receives a cash allowance in lieu of pension equal to 30% of base salary less the cost of participation in the US 401k plan.	None
Shareholding Requirement			
To support long-term commitment to the Company and the alignment of employee interests with those of shareholders.	Unvested awards that are subject to performance conditions are not taken into account in determining an Executive Director's shareholding for these purposes. Share price is measured as at the end of the relevant financial year. Executives are required to retain in shares 50% of the net value of any performance shares vesting or options exercised until they satisfy the shareholding requirement.	The shareholding guidelines are 200% of salary for the CEO, and 150% of salary for the CFO and COO. The Committee has the discretion to increase the shareholding requirements of the Executive Directors.	None

Notes to the policy table:

Performance measures and targets

The table below sets out a rationale for the performance conditions applicable to the Annual Bonus, Deferred Bonus Plan and Performance Share Plans, and how targets are set.

Element	Performance measures and rationale	How targets are set
Annual bonus	• Financial and non-financial performance measures. • The Committee selects the financial measures based on the Company's current Key Performance Indicators (KPIs). • Non-financial measures are individually set and based on key strategic goals.	• The performance targets are determined annually by the Committee, taking into account analyst consensus and the Company's forecasts.
Deferred Bonus Plan	• EPS is the sole measure to determine the vesting of matching shares and has been selected as the performance measure for the DBP as it is a key performance indicator both for the Company and its major shareholders. • The Committee believes EPS can be directly influenced by executive decision-making while also reflecting shareholder value, thus aligning the Directors' with the interests of shareholders.	• EPS targets are set in reference to analyst forecasts, Company business plans, and levels of EPS required to support our share price goals. The Committee takes care to ensure that specific EPS targets are suitably stretching. • Relative TSR performance is measured against the constituents of the FTSE 250 as at the date of grant. As Serco is a constituent of the FTSE 250 it is felt that comparisons to the TSR performance of other companies in this Index provides a good measure of the relative performance of Serco. • Absolute share price and TSR targets are set to reflect what the Committee determines as stretch growth, taking into account recent price performance as well as growth forecasts and the economic environment to ensure targets are consistent with achievable levels of stretch financial performance. • The Committee consults with a selection of the largest shareholders and the voting guidance services when determining targets for the Company's long-term incentive arrangements.
Performance Share Plan	• Performance targets will be based on a combination of performance conditions including at least two of the following; EPS, Relative TSR, Absolute share price. • As set out above, EPS is an important measure of shareholder value which can also be influenced by executive decision making. • Relative TSR reflects our performance relative to other companies in which investors could chose to invest. • Absolute share price or TSR targets drive the longer term improvement in our returns to shareholders. • The rationale for the share price measure is to ensure that a full award is not delivered unless shareholders benefit from a significant increase in value over the three year performance period.	

Malus and clawback

Malus and clawback provisions apply to awards under the PSP and DBP, and clawback provisions also apply to the annual bonus. Under the Policy, the Committee, at its discretion, may reduce or cancel (malus) or recover some or all of awards granted to Executive Directors in certain circumstances. Under the malus provisions the Committee may reduce or prevent vesting of an unvested PSP or DBP award in circumstances including but not limited to: material misstatement of the Group's audited financial results; material or misleading results announcement prior to vesting; or a clear and material contravention of the Company's ethics and values on the part of the participant or a team member, team, business area or profit centre for which the participant is responsible.

In the most serious of these circumstances the Committee may also invoke the clawback provisions against vested awards under the PSP, DBP and annual bonus. The clawback must be implemented within five years of the grant of the relevant PSP and DBP awards, and within two years in respect of bonus awards paid in cash.

Remuneration Report continued

Use of discretion

The Committee will operate the annual bonus plan, DBP and PSP according to their respective rules, as approved by Shareholders, and in accordance with the Listing Rules, where applicable. The Committee retains discretion, consistent with market practice, in a number of areas with regard to the operation and administration of these plans.

These include, but are not limited to:

- The participants;
- The timing of grant of an award;
- The vehicle of an award;
- The size of an award;
- The determination of vesting or bonus payment;
- Discretion required when dealing with a change of control or restructuring of the Group;
- Determination of the treatment of leavers based on the rules of the plan and the appropriate treatment chosen;
- Adjustments required in certain circumstances (e.g. rights issues, corporate restructuring events and special dividends); and
- The annual review of performance measures and weighting, and determining the performance measures for the awards granted from year to year.

In relation to the PSP, DBP and annual bonus plan, the Committee retains the ability, in exceptional circumstances, to change performance measures, targets and/or the relative weighting of performance measures part-way through a performance period if there is a significant event (such as a major transaction or, in the case of the bonus only, a transition in role) which causes the Committee to believe the original performance conditions are no longer appropriate. In exercising this discretion the Committee will determine that the original conditions are no longer appropriate and the amendment is required so that the conditions achieve their original purpose and are not materially less difficult to satisfy. Any use of the above discretions would, where relevant, be explained in the Annual Report on Remuneration.

In exceptional circumstances the Committee also has discretion to vary the proportion of awards that vest, to ensure that the outcomes are fair and appropriate and reflect the underlying financial performance of the Group.

Considerations of employment conditions elsewhere in the Group

The Remuneration Policy described here applies specifically to Executive Directors of the Group. The Committee believes that the structure of management reward at Serco should be linked to Serco's strategy and performance. The table below explains how this philosophy has been cascaded below Executive Directors to achieve alignment with the remuneration strategy across the organisation.

Element	Difference in Remuneration Policy for other employees
Base salary	• The same principles and considerations that are applied to Executive Directors are, as far as possible, applied to all employees.
Benefits	• Serco also has provisions for market-aligned benefits for all employees.
Pension	• The Group operates a number of defined benefit schemes and defined contribution schemes. Individuals who exceed certain pension tax allowances may be offered cash allowances in lieu of pension benefits.
Annual bonus	• Approximately 370 members of the Global Leadership Team are eligible for a bonus award under The Leadership Team Bonus Scheme.
Deferred Bonus Plan (DBP)	• Members of the Executive Committee are invited to participate in the DBP on the same terms as the Executive Directors.
Performance Share Plan (PSP)	• Annual awards under the PSP are made to approximately 370 employees in the Global Leadership Team.

Although the Committee does not consult directly with employees on the Directors' Remuneration Policy, the Committee does consider the general base salary increase, remuneration arrangements and employment conditions for the broader employee population when determining the Remuneration Policy for the Executive Directors.

Considerations of shareholder views

We have consulted with our largest shareholders and received support for the continuation of the current arrangements at least in the short-term whilst the major elements of the Transformation phase are executed during 2017. The Committee believes it is important to continue to maintain effective channels of communication with our shareholders. The Committee takes the views of shareholders very seriously and these views have been influential in shaping our policy and practice. With the Policy subject to further change, we intend to engage in further consultation with our major shareholders during the latter part of 2017 and a revised Policy will be tabled at the AGM in May 2018.

Approach to recruitment remuneration

Our overarching remuneration principles continue to apply in recruiting new hires or promotions to the Board – that is that we seek to offer a package that is sufficient to attract, retain and motivate while aiming to pay no more than is necessary. We take into account that, as a global business, Serco operates in diverse markets and geographies and many of its competitors for talent are outside the UK.

When hiring a new Executive Director, the Committee will typically align the remuneration package with the above Remuneration Policy incorporating all elements as set out above.

The recruitment policy also includes the additional provision of benefits in kind, pensions and other allowances, such as relocation, education and tax equalisation in line with Serco policies as may be required in order to achieve a successful recruitment. The policy for recruitment also includes benefits that are either not significant in value or are required by legislation. It is anticipated that any new Executive Director would be offered either a pension contribution and/or a pension allowance equal to 30% of base salary.

As summarised below, the Remuneration Policy provides for a maximum combined total incentive under bonus, PSP and DBP of 500% of salary in any one year (assuming maximum bonus, maximum investment in the DBP and maximum achievement of all PSP and DBP performance conditions).

Element of remuneration	Maximum percentage of salary
Maximum variable pay:	500%
normally comprising:	
• Annual bonus	150%
• Long-term incentives	350%

Note: Maximum percentage of salary for annual bonus and long-term incentives excludes compensation for awards forfeited.

This is the maximum level of incentives excluding any to compensate for entitlements forfeited that will apply to new recruits. Different performance conditions may apply for new recruits from those set out in the Policy, depending on the particular circumstances at the time (which could, for example, include the appointment of an interim Executive Director).

Remuneration Report continued

In determining appropriate base salary on hiring a new Executive Director, the Committee will take into account all factors it considers relevant, including their experience and calibre, current total remuneration, levels of remuneration for companies in the Committee's chosen peer group, and the remuneration required to attract the best candidate for Serco. The Committee will seek to ensure that the arrangement is in the best interests of the Company and its shareholders without paying more than is necessary. New promotes or recruits to the Board may on occasion have their salaries set below the targeted policy level while they become established in their role. In such cases, salary increases may be higher than inflation or the general UK workforce increase until the targeted market positioning is achieved. Where it is necessary to compensate a candidate for entitlements and/or unvested long-term incentive awards from an existing employer that are forfeited, the Committee will seek to match the quantum, structure and timeframe of the award with that of the awards forfeited. In determining the form and quantum of replacement awards, the Committee will consider whether existing awards are still subject to performance requirements, and the extent to which those are likely to be met, with the aim of providing an opportunity of broadly equivalent value. The principle will be to seek to replace awards that remain significantly at risk for performance at the candidate's current employer with awards subject to performance at Serco, and to seek to make any other replacement awards in the form of Serco shares, subject to appropriate vesting or holding requirements. Any compensation for awards forfeited is not taken into account in determining the maximum incentive award level.

Where a new Executive Director is an internal promotion, the Committee has discretion to allow the new Executive Director to continue to benefit from existing awards granted, or benefit entitlements (such as pension), that were in place prior to appointment to the Board.

The policy on the recruitment of new Non-Executive Directors is to apply the same remuneration elements as for the existing Non-Executive Directors. It is not intended that day rates or benefits in kind be offered outside of those in the Remuneration Policy for NEDs, although in exceptional circumstances such remuneration may be required in currently unforeseen circumstances.

The Committee will include in future Annual Reports on Remuneration details of the implementation of the recruitment policy in respect of any such recruitment to the Board.

Service contracts and loss of office payments

The policy for service contracts for new Directors is shown in the table below. The Committee may under this policy at any time, with the agreement of a Director, alter aspects of their existing contracts so that they are in line with the policy for new Directors.

Specific provisions are in place for Ed Casey in that the notice period is 12 months from the Company (as is usual policy), and 4 months from the Director to more closely align with US employment practice.

Copies of the Directors' service contracts and letters of appointment are available for inspection at the Company's registered office. Service contracts outline the components of remuneration paid to the individual but do not prescribe how remuneration levels may be adjusted from year to year.

The date of appointment for each Director is shown in the table on page 110.

Provision for Executive Directors	Detailed terms
Notice period	• 12 months' notice from the Company • 12 months' notice from the Director
Termination payment	• Payment in lieu of notice comprising: – Base salary – Pension allowance – Selected benefits • All of the above would be paid in instalments in accordance with the Director's contractual payment schedule, subject to an obligation on the part of the Director to mitigate his loss. Payments will either reduce or cease completely, in the event that the Director gains new employment/remuneration. • In the event of a compromise or severance agreement, the Committee may make payments it considers reasonable in settlement of potential legal claims. It may include in such payments reasonable reimbursement of professional fees incurred by the Director in connection with such agreements and reasonable payments in respect of restrictive undertakings. • The Committee may agree that if a Director steps down from the Board then for a transitional period, notice (including payment in lieu of notice) would continue to be based on the equivalent of up to twelve months' based on their rate of salary and benefits while a Director, payable in instalments and subject to mitigation. • The reimbursement of repatriation costs or fees for professional or outplacement advice may also be included in the termination package, as deemed reasonable by the Committee.
Treatment of annual bonus on termination	• No payment unless employed on date of payment of bonus except for 'good leavers': defined as death, disability, redundancy and other circumstances at the Committee's discretion. • 'Good leavers' are entitled to a bonus pro-rated to the period of service during the year, subject to the outcome of the performance metrics and paid at the usual time. • The Committee has discretion to reduce the entitlement of a 'good leaver' in line with performance and the circumstances of the termination.
Treatment of unvested performance shares or options and unvested matching deferred share awards on termination under plan rules[1]	• All awards lapse except for 'good leavers': ill-health, injury or disability, death, redundancy, retirement, change of control (as defined in the plan rules) and other circumstances at the Committee's discretion (to the extent that they allow 'good leaver' treatment for particular awards). • For 'good leavers' vesting is pro-rated on a time basis and is dependent on the achieved performance over the performance period. • The Committee has the discretion to vary the level of vesting to reflect the individual performance, and may, depending on the circumstances of the departure, allow some awards to vest while lapsing others.
Change of control	• Where the Director leaves the Company following a change of control, whether or not he is dismissed or he elects to leave on notice, he will be entitled to receive a payment equivalent to up to one year's remuneration. • Bonuses may be paid on a pro-rata basis measured on performance up to the date of change of control. • PSP awards vest pro-rata for time and performance up to the date of change of control unless the Committee decides otherwise.
Exercise of discretion	• Intended only to be used to prevent an outcome that is not consistent with performance. The Committee's determination will take into account the particular circumstances of the Executive Director's departure and the recent performance of the Company.

1. Whilst unvested Awards will normally lapse, the Committee may in its absolute discretion allow for Awards to continue until the normal vesting date and be satisfied, subject to achievement of the performance conditions. In such circumstances, Awards vesting will normally be prorated on a time apportioned basis, unless the Committee determines otherwise.

Any such discretion in respect of leavers would only be applied by the Committee to 'good leavers' where it considers that continued participation is justified, for example, by reference to past performance to the date of leaving, or by the requirement to achieve an orderly transition. The claw-back provisions would continue to apply in the event that such discretion were exercised.

Provision for NEDs	Detailed terms
Letters of appointment	• Appointed for initial three-year term. • Appointment may be terminated on three months' written notice. • All Non-Executive Directors are subject to annual re-election.
Loss of office policy	• No compensation or other benefits are payable on early termination.

Remuneration Report continued

Remuneration Policy for the Chairman and Non-Executive Directors

In accordance with the Company's policy, the fees of the Chairman and the Non-Executive Directors, which are determined by the Board, are set at a level which is designed to attract individuals with the necessary experience and ability to make a substantial contribution to the Group's affairs. The Chairman and Non-Executive Directors' letters of appointment are available for inspection at the Company's registered office.

How the element supports our strategic objectives	Operation of the element	Maximum potential value and payment at threshold	Performance metrics used, weighting and time period applicable
Fees To attract Non-Executive Directors with the necessary experience and ability to make a substantial contribution to the Group's affairs.	The fees of the Chairman are determined and approved by the Remuneration Committee (excluding Chairman) and fees of the Non-Executive Directors, are determined and approved by the Board as a whole. The Chairman receives a base fee. The following fees are paid to Non-Executive Directors in addition to their base fee: • Senior Independent Director fee • Committee Chairmanship fee • Committee Membership fee Fees are reviewed on an annual basis against a relevant peer group and taking into consideration market practice.	Over the policy period, base fees for current Non-Executive Directors will be set at an appropriate level within the peer group and increases will typically be broadly in line with market. The base fees or fees for specific Non-Executive Directors roles may be reviewed at any time based on the anticipated responsibility and time commitment involved. Current fee levels are shown on page 117.	Non-Executive Director fees are not performance-related.
Benefits	An allowance is payable to directors for attendance at meetings outside their country of residence where such meetings involve intercontinental travel. In addition, reasonable travel and business related expenses are paid.		N/A

Non-Executive Directors are not entitled to receive incentives and pension.

Non-Executive Directors are encouraged to hold shares in the Group but are not subject to a shareholding requirement.

Dates of Director's Service Contracts / Letters of Appointment

Director	Date of appointment to the Board
Rupert Soames	8 May 2014
Angus Cockburn	27 October 2014
Ed Casey	25 October 2013
Roy Gardner	1 June 2015
Angie Risley	1 April 2011
Ralph D. Crosby Jnr	30 June 2011
Malcolm Wyman[1]	1 January 2013
Mike Clasper	3 March 2014
Tamara Ingram[2]	3 March 2014
Rachel Lomax	3 March 2014
John Rishton[3]	13 September 2016

1. Malcolm Wyman stepped down from the Board and left the Company on 31 October 2016.
2. Tamara Ingram stepped down from the Board and left the Company on 31 July 2016.
3. John Rishton was appointed to the Board on 13 September 2016.

All Directors are put forward annually for re-election at the AGM.

Annual report on remuneration

The implementation of the Remuneration Policy for year ended 31 December 2016

The Remuneration Policy for the year ended 31 December 2016 was consistent with the policy approved by shareholders at the AGM in 2014.

Single Figure – Directors' remuneration (audited information)

Executive Directors' single figure

The following table shows a single total figure of remuneration in respect of qualifying services for 2016 for each Executive Director, together with comparative figures for 2015. Details of NEDs' fees are set out in the next section.

		Rupert Soames		Angus Cockburn		Ed Casey[5]	
		2016	2015	2016	2015	2016	2015
Salary and fees	£	850,000	850,000	500,000	500,000	771,552	694,324
Taxable benefits[1]	£	24,258	18,154	40,310	18,154	102,541	20,836
Bonus[2]	£	1,049,325	1,103,130	530,075	562,380	926,440	869,849
Long-Term Incentives[3]	£	37,983	29,209	30,559	N/A	–	–
Pension[4]	£	255,000	255,000	150,000	150,701	228,376	205,517
Total	£	2,216,566	2,255,493	1,250,944	1,231,235	2,028,909	1,790,526

1. The value of the UK taxable benefits relate to the provision of independent financial advice, provision of a car or car allowance (fully inclusive of all scheme costs including insurance and maintenance), health care, private medical assessments and expatriate benefits. Ed Casey's 2016 benefits relate primarily to his expatriate status, including costs of £80,527 for accommodation while in the UK. Where Serco settles the PAYE and NIC liability in respect of benefits provided, the value of the benefit has been grossed up at the individual's marginal tax rate.
2. Performance bonuses earned in the period under review, but not paid until the following financial year. During the year Rupert Soames and Angus Cockburn participated in the DBP by deferring 50% of their 2015 bonuses via the purchase of Investment Shares. Any deferral of the 2016 bonuses, payable in 2017, will take place during 2017 and be reported in the 2017 DRR.
3. Includes the gain on vesting of recruitment awards (conditional share awards) vesting in 2016 for Rupert Soames and Angus Cockburn. These awards were granted in compensation for non-performance based awards forfeited by Rupert Soames and Angus Cockburn on joining Serco, therefore no performance conditions applied to the vesting of these awards however these shares were not included in the single figure value for the year of grant. Rupert Soames' award over 29,628 shares vested on 6 August 2016 at a share price of £1.282 (being the share price on the last trading day prior to vest). Angus Cockburn's award over 23,837 shares vested in full on 5 August 2016 at a share price of £1.282. The 2014 awards granted under the PSP that were subject to EPS performance in the period to 31 December 2016, did not vest as the performance condition was not met (further details are provided below). The 2015 LTI value for Rupert Soames relates to a non-performance recruitment award (conditional share award) that vested on 16 April 2015 (19,911 shares with a share price of £1.47 on the date of vest). This was not included in the relevant single figure value for the year of grant.
4. The pension amount includes payments made in lieu of pension, calculated as a percentage of base salary, from which the Executive Directors make their own pension arrangements. Ed Casey's value includes the Serco contribution to his 401K plan.
5. Ed Casey's remuneration is paid in US dollars and has been converted into GBP using the average exchange rate over the relevant financial year. For the purpose of the 2016 single figure USD1 = GBP 0.72672. For the purpose of the 2015 single figure USD1 = GBP 0.65398. The increase in the GBP value of Ed Casey's base salary and pension is due to the exchange rate difference between 2015 and 2016. His 2016 base salary and pension were unchanged from 2015 (salary USD 1,061,690, with an employer 401K contribution of USD 7,950 and cash alternative of USD 306,306). His 2016 bonus is USD 1,274,824 (USD 1,330,085 in 2015).

The annual base salaries of the Executive Directors for the year ended 31 December 2016 were:

Director	Base salary	Effective Date	Increase
Rupert Soames	£850,000	8 May 2014	N/A
Angus Cockburn	£500,000	27 October 2014	N/A
Ed Casey	$1,061,690	1 April 2014	N/A

Remuneration Report continued

Variable pay outcomes (audited information)

Performance-related annual bonus

For 2016, the Executive Director bonus was based on achieving a mix of financial and non-financial objectives which were weighted 70:30. The financial measures were based on Trading Profit (40%), Free Cash Flow (40%) and Revenue (20%) and the non-financial measures were individually set and based on key strategic goals. Payments under the 2016 annual bonus were subject to an Underlying Trading Profit underpin (after adjustment for in-year Onerous Contract Provisions (OCP) items) of £50.0m.

The Remuneration Committee reviewed the achievements against the targets for the year and the proposed annual incentive payments for the Executive Directors. The tables below show the achievement against the financial and non-financial measures.

Financial performance

Performance Measure	Weighting for 2016 (% maximum bonus opportunity)	Threshold target (£m)	Maximum target (£m)	Actual performance (£m)	Achievement against measure (% maximum opportunity for this measure)
Revenue	14%	£2,802	£3,004	£2,859	33%
Free Cash Flow	28%	- £54.9	- £44.5	- £33.0	100%
Trading Profit	28%	£50.0	£59.2	£73.7	100%

Non-financial performance

Weighting for 2016 (% maximum opportunity)	30%

	Rupert Soames	Angus Cockburn	Ed Casey
Achievement against measure (% maximum opportunity for this measure)	72.5%	70.0%	65.0%

Overall 2016 bonus outcome

	Rupert Soames	Angus Cockburn	Ed Casey
Total bonus payable as % of maximum	82.3%	81.6%	80.1%
Bonus opportunity as % of salary	150%	130%	150%
Bonus amount achieved as % of salary	123.5%	106.0%	120.1%
Bonus amount earned	£1,049,325	£530,075	$1,274,824

Note: All Executive Directors are entitled to participate in the Deferred Bonus Plan (the DBP) in 2017, up to a maximum of 50% of the bonus determined in respect of 2016 performance.

For FY16, the Group Bonus Plan (the Plan) in which Executive Directors participate was focused on three core measures which comprised 70% of the overall opportunity: Group Revenue, Group Trading Profit and Group Free Cash Flow. The remaining 30% of the opportunity is based on role-specific objectives related to the delivery of the business transformation.

Financial performance has been strong; on both Trading Profit and Free Cash Flow the achievements of the business over the year were in excess of the stretching targets set by the Committee at the beginning of the year and therefore these components have paid out in full. The level of Revenue achieved over the period was between threshold and maximum and as such 33% of this component of the bonus was awarded.

The financial bonus outcomes have been calculated after appropriate adjustments were made (agreed at the beginning of the year as part of the target-setting process and in line with the approach disclosed in respect of 2015). The Committee has once again spent considerable time reviewing the Trading Profit calculation for bonus purposes, initially working with management to determine a robust approach to decision-making, informed by a review of each individual contract and with cross-referencing to information shared with the Audit Committee. This year the process was further strengthened by involving the Company's external auditors in verifying the extraction of figures appearing in the accounts and those tabled for bonus purposes, followed by a formal sign-off by the Audit Committee on the numbers used to determine bonus payments prior to decisions being made by the Committee. As a result of the rigour applied to this process, the Committee is satisfied that the annual bonus out-turn fairly reflects management performance in the year and that the transparency regarding this introduced in the 2015 DRR has continued in respect of 2016.

Trading Profit of £100.3m is adjusted by the Committee to arrive at a figure for Trading Profit for bonus purposes; shareholders were consulted on the principles behind these adjustments in 2015, and the bonus outcome for 2015 reflected these principles, the purpose of which is to ensure that management are measured against their in-year performance and are not given credit for gains for which they have not materially influenced. The first adjustment is to put Trading Profit into constant currency, so that it is consistent with the targets set at the beginning of the year; this is a £5.7m reduction. The Committee then considers items to properly reflect management effort and in-year operational performance. The Committee has concluded that a total of £20.9m should be adjusted out of Trading Profit in constant currency to arrive at a calculation of Trading Profit for bonus purposes.

The table below sets out the adjustments made by the Committee between Trading Profit and Trading Profit for bonus purposes in 2016.

	2016 (£m)
Trading profit	100.3
Constant currency adjustment	(5.7)
Trading profit at constant currency	94.6
Adjustment for bonus purposes	(20.9)
Trading profit for bonus purposes	73.7

The Revenue and Free Cash Flow actual performances reflect constant currency and includes discontinued operations, making them consistent with the basis on which the targets were set.

Remuneration Report continued

Non-Financial Performance

Rupert Soames	
Rupert's objectives focused on:	
• Improving Business Development performance to rebuild the pipeline, with focus on both new business wins and total wins including re-competes and extensions. • Supporting Divisions in dealing with commercial issues and managing key customer relationships. • Leading the delivery of the on-going transformation plan with agreed in-year savings. • Demonstrating effective leadership of both the management team and the Group as a whole, continuing to improve employee engagement through embedding a performance culture, ensuring there is clear understanding of what leadership means in Serco supported by appropriate development. • Lead effective development of the strategic plan "refresh" with agreement of the Board to its implementation. • Support the Chairman to ensure the effective working of the Board.	The Committee deemed performance to be very strong. Rupert has continued to show highly effective and visible leadership throughout 2016, and over the course of the last 12 months has delivered essential elements of the 'Transform' stage of our turnaround. This included completing the rationalisation of our portfolio to achieve a strategic focus on public services in five sectors and four geographies; continued progress in reducing the burden of loss-making contracts; rebuilding our business development capacity, which has supported an increase in our pipeline of larger new bid opportunities. Furthermore, significant progress has been made in building differentiated capabilities and strengthening our sector propositions, which includes the successful development of our three Centres of Excellence covering Health, Transport and Justice & Immigration. Rupert has refreshed Serco's values to Trust, Care, Innovation and Pride, which sit at the very core of how the business operates. The Committee have also been able to monitor that the values have been embedded successfully though our annual 'Viewpoint' employee engagement survey with further increases in employee engagement, which is a key determinant of the future success of the business. The Chairman regards the support Rupert has provided to him in ensuring the effective operation of the Board to be first class. Based on Rupert's achievement the Committee has awarded above target but below maximum performance for the non-financial element relating to these objectives.

Angus Cockburn	
Angus's objectives focused on:	
• Managing the tender process for new external auditors and ensuring the effective handover from Deloitte; completing the internal audit tender and successful transition to the new firm, and developing the strategy for Internal Audit Reviews. • Completing the returns of cash to private placement noteholders. • Improving the effectiveness and efficiency of the finance function through the Global Finance Transformation (GFT) with a number of key milestones agreed at the start of the year. • Work with the Group Strategy Function to ensure that there is a five-year plan for each line of business.	The Committee deemed Angus's performance to be very strong against all objectives. Examples of successes include the tender process for new auditors, which was deemed to have been very well executed in a short timeframe; clear plans to transition from Deloitte to KPMG were executed seamlessly. A new Internal Audit strategy was developed and a new outsource partner, PWC, were appointed. The Internal Audit Strategy was approved by Audit Committee. Cash return to noteholders was executed successfully. Significant improvements have been made in contract finance reporting and overall efficiency of the finance function. The creation of a Global Finance Community has taken real shape this year. In addition, Angus worked closely with Group Strategy and delivered a five-year financial plan to support the strategy. This plan was designed in such a way that it can also be used for impairment reviews and viability assessment. Further examples of successes include the quality of engagement with investors and analysts ending with the successful Capital Markets event. Based on Angus's achievement the Committee has awarded above target but below maximum performance for the non-financial element relating to these objectives.

Ed Casey	
Ed's objectives focused on:	
• Improving Business Development performance to rebuild the pipeline, with focus on both new business wins and total wins including re-competes and extensions. • Continue to refine Risk Management process and work to embed as part of our operational approach to running the business. • Continue to improve our internal governance compliance to achieve more consistent operational performance, ensuring each Division has a robust Compliance & Assurance programme that has been reviewed and approved by Group. • Re-dedicate business to "zero harm" HS&E culture and implement necessary changes to effect change. Deliver consistent measures across the Group, and a reduction in accident rates. • Deliver agreed Transformation Plan to continue to improve quality and efficiency of internal shared services and achieve savings targets to ensure sustained competitiveness of the business.	The Committee deemed Ed's performance to be very strong against all objectives. Ed has been a driving force behind the improvement in pipeline and level of bid activity in 2016; Centres of Excellence have gained traction and have made a significant positive impact on Business Development and positioning for future growth. The quality and consistency of Business Development has improved and win rates have also shown improvement. The new risk operating model and training were delivered and the Group Risk Committee reporting has been significantly refreshed to reflect the Committee's needs. The implementation of the Contract Management Application is a significant achievement and will give the Company a tool to help improve how we manage our contracts. Much has been accomplished in 2016 to re-focus the Company on safety and strengthen the culture of "zero harm". For example, AsPac have trialled innovative training for Musculoskeltal Disorder Prevention and Resilience, and Mental Health First Aid to improve workplace injury prevention. In the UK, a new HSE call centre service was developed to coordinate reporting accidents, incidents and near misses. In terms of the Transformation Plan, savings delivered exceeded targets set at the start of the year; there is clear evidence of transformation taking place in all Shared Services (Procurement, HR, IT and Finance). Based on Ed's achievement the Committee has awarded above target but below maximum performance for the non-financial element relating to these objectives.

Performance Share Plan (PSP)

The LTI amount included in the 2016 single total figure of remuneration includes the element of the PSP award which was awarded in 2014, vesting subject to EPS performance in the period to 31 December 2016. Achievement against the measure is shown in the table below:

Performance condition	Weighting	Threshold – 25% vesting	Maximum – 100% vesting	Actual	Percentage of max achieved
Adjusted EPS. 25% of the award vests for threshold performance, rising on a straight-line basis to 100% at maximum performance.	1/6	22p	26p	7.07p	0%

The awards made to the Executive Directors subject to this performance condition were as follows:

2014 PSP share awards	Date of grant	No of shares awarded	No of shares vesting	Vesting date	Value of vesting £
Rupert Soames	27 June 2014	96,066	0	27 June 2017	£0
Ed Casey	27 June 2014	70,558	0	27 June 2017	£0
Angus Cockburn	31 October 2014	60,891	0	31 October 2017	£0

Remuneration Report continued

Single Figure – Non-Executive Directors' remuneration (audited information)

Non-Executive Directors' remuneration consists of cash fees paid monthly with increments for positions of additional responsibility. In addition, an inter-continental travel allowance and reasonable travel and related business expenses are paid. No bonuses are paid to Non-Executive Directors. Non-Executive Directors' fees are not performance-related.

Non-Executive Directors are encouraged to hold shares in the Group but are not subject to a shareholding requirement.

The fees and terms of engagement of Non-Executive Directors are reviewed on an annual basis, taking into consideration market practice and are approved by the Board.

	Board fee (including Chairmanship fees) (£)		Allowances[1] (£)		Taxable benefits[2] (£)		Total (£)	
	2016	2015	2016	2015	2016	2015	2016	2015
Sir Roy Gardner[3]	250,000	129,167	–	5,000	21,600	14,400	271,600	148,567
Mike Clasper[4]	90,083	88,000	–	5,000	–	–	90,083	93,000
Ralph D. Crosby Jnr	50,000	50,000	30,000	35,000	8,954	–	88,954	85,000
Tamara Ingram[5]	36,750	63,000	–	5,000	–	–	36,750	68,000
Rachel Lomax[6]	70,000	70,000	–	5,000	–	–	70,000	75,000
Angie Risley[7]	60,000	60,000	–	5,000	–	–	60,000	65,000
Malcolm Wyman[8]	56,250	67,500	5,000	–	6,831	–	68,081	67,500
John Rishton[9]	19,583		–	–	–	–	19,583	–
Total	632,667	527,667	35,000	60,000	37,385	14,400	705,052	602,067

1. £5,000 is payable for each occasion that requires inter-continental travel outside of the Director's country of residence.
2. Taxable benefits in 2016 relate to taxable travel and subsistence expenses reimbursed in connection with attendance at Board meetings (2015 £nil). Roy Gardner also received secretarial services in 2016 of £21,600 (£14,400 in 2015).
3. Sir Roy Gardner is Chairman of the Board, Chairman of the Nomination Committee and a Member of the Remuneration and Corporate Responsibility Committees.
4. Mike Clasper is Senior Independent Director, Chairman of the Corporate Responsibility Committee and a Member of Audit, Remuneration, Nomination and Group Risk Committees.
5. Tamara Ingram was a Member of the Corporate Responsibility and Remuneration Committees. She stepped down from the Board on 31 July 2016.
6. Rachel Lomax is Chairman of the Group Risk Committee and a Member of Audit Committee.
7. Angie Risley is Chairman of Remuneration Committee and a Member of Nomination and Corporate Responsibility Committees.
8. Malcolm Wyman was Chairman of Audit Committee and a Member of the Group Risk, Nomination and Remuneration Committees. He stepped down from the Board on 31 October 2016.
9. John Rishton joined the Board on 13 September 2016 and is Chairman of the Audit Committee and a Member of the Remuneration Committee and Group Risk Committees.

Annual NED fees

Role	Base fee 1 April 2016 £	Base fee 1 April 2015 £	Percentage change
Chairman	250,000	250,000	No change
Senior Independent Director	25,000	25,000	No change
Board fees	50,000	50,000	No change
Audit Committee Chairmanship	12,500	12,500	No change
Audit Committee Membership	5,000	5,000	No change
Group Risk Committee (previously Corporate Responsibility & Risk Committee) Chairmanship	15,000	15,000	No change
Group Risk Committee (previously Corporate Responsibility & Risk Committee) Membership	8,000	8,000	No change
Remuneration Committee Chairmanship	10,000	10,000	No change
Remuneration Committee Membership	5,000	5,000	No change
Allowance for travel to international meetings	5,000	5,000	No change

No additional fee is payable for Chair or Members of the Corporate Responsibility Committee or Nomination Committee.

Performance graph and table

This graph shows the value as at 31 December 2016, of a £100 investment in Serco on 31 December 2008 compared with £100 invested in the FTSE 250 index on the same date. It has been assumed that all dividends paid have been reinvested. The TSR level shown at 31 December each year is the average of the closing daily TSR levels for the 30-day period up to and including that date. The Company chose the FTSE 250 index as the comparator for this graph as Serco has been a constituent of that index throughout the period.

Serco Performance Graph

Remuneration Report continued

CEO's pay in last eight financial years

Year ended 31 December	Group CEO	CEO single figure remuneration (£)	Annual bonus outcome (as % of maximum opportunity)	LTI vesting outcome (as % of maximum opportunity)
2009	Christopher Hyman	3,625,830	90%	295.42%
2010	Christopher Hyman	2,646,894	91%	168.77%
2011	Christopher Hyman	2,826,038	81%	80%
2012	Christopher Hyman	2,582,185	72%	63.60%
2013	Christopher Hyman	893,451	N/A	0%
	Ed Casey	294,782	74%	0%
2014	Ed Casey	1,605,064	71%	0%
	Rupert Soames	747,655	0%	N/A
2015	Rupert Soames	2,255,493	87%	100%[1]
2016	Rupert Soames	2,216,566	82%	23.6%

1. Rupert Soames had a non-performance recruitment award which vested in full in 2015.

Percentage change in CEO's remuneration

The table below shows the percentage change in the salary, benefits and bonus of the CEO compared to that for the average UK employee. The UK employee sub-set of the Company's global employee population has been chosen as the group which provides the most appropriate comparator; this comprises some 23,000 of the 47,520 employees Serco employs worldwide. Inflation and local pay practices form a key driver in the salary and benefits provided in each location, and as the CEO is based in the UK we have chosen employees within the same country.

	Salary	Benefits[2]	Bonus
CEO	0%	34%	-5%
Average change for all other UK employees	3.23%[1]	-3%	44%[3]

1. This represents the change in pay for employees employed throughout the period to exclude the impact of changes in the mix of our employee population.
2. The nature of benefits provided to employees in 2016 compared to 2015 remains the same. The percentage change represents a reduction in the cost to the Company of the benefits over the period. The increase in CEO's benefits, although a high percentage, relates to a £6,100 increase in taxable benefits, representing 0.2% of his total pay.
3. The bonus element is shown for those employees eligible for such payments. These are calculated each year in March, after the publication of the Remuneration Report, so the figures shown here for employees are for bonuses paid in 2016, related to the 2015 performance, whereas the figure for the CEO relates to a calculation of the bonus earned, but not yet paid, related to performance in 2016.

Relative importance of spend on pay

The table below details the percentage change in dividends and overall expenditure on pay compared with the previous financial year.

Serco considers overall expenditure on staff pay in the context of the general finances of the Company. This includes the determination of the annual salary increase budget, the annual grant of shares and annual bonus for the business.

	2016 vs 2015	2016	2015
Dividend per share	0%	nil	nil
Overall expenditure on wages and salaries	-0.5%	1,516.0	1,523.3

Dividend per share, and Overall expenditure on wages and salaries have the same meaning as in the Notes to the Company Financial Statements.

Pensions (audited information)

As at 31 December 2016, there were no Executive Directors actively participating in or accruing additional entitlement in the Serco Pension and Life Assurance Scheme which is a defined benefits scheme.

Payments for loss of office (audited information)

There were no loss of office payments in 2016.

Payments to Past Directors (audited information)

No payments were made in the year to past Directors.

Awards made in 2016

Deferred Bonus Plan (DBP) (audited information)

The table below summarises the Matching Share Awards granted to Executive Directors' in 2016 in relation to their participation in the DBP.

Executive Directors received a Matching Share Award (in the form of a conditional share award) on a 2:1 basis in respect of their gross bonus deferred (i.e. for every one Investment Share that could have been purchased from the gross bonus deferred, two Matching Shares are granted). Matching Share Awards granted in 2016 vest subject to Aggregate EPS over the three year performance period ending 31 December 2018. 25% of the Matching Share Award will vest for threshold performance (Aggregate EPS of 7.5p), rising on a straight-line basis to 100% vesting for maximum performance (Aggregate EPS of 9.1p or above).

The definition of EPS is Statutory Earnings Per Share before exceptional items (adjusted to reflect tax paid on a cash basis).

Directors	Basis of Award (% salary)	Grant date	Market price at award (p)[1]	Face value (£)[2]	Percentage vesting at threshold performance	Number of shares	Performance period end date
Rupert Soames	130%	03 May 2016	95.5	1,103,129	25%	1,154,540	31 December 2018
Angus Cockburn	112%	03 May 2016	95.5	562,380	25%	588,589	31 December 2018

1. Closing share price on 3 May 2016.
2. Calculated using the closing share price on the date of grant.

Pre-vesting malus and post-vesting clawback is applicable to these awards.

Remuneration Report continued

Performance Share Plan (PSP) (audited information)

In 2016 the Executive Directors received awards equivalent to 200% of salary for the CEO and COO and 175% for the CFO.

The awards will vest at the end of the performance period, if the Executive Directors are still in employment with Serco and to the extent that the performance conditions have been met.

Performance measure	Weighting of measure	Performance target	Performance period end date
Aggregate EPS	1/3rd	Statutory Earnings Per Share (EPS) before exceptional items (adjusted to reflect tax paid on a cash basis) of 7.5p (threshold, 25% vesting) to 9.1p (maximum, 100% vesting), measured as an aggregate over the three-year performance period.	31 December 2018
Relative TSR	1/3rd	Total Shareholder Return (TSR) of median (threshold, 25% vesting) to upper quartile (maximum, 100% vesting) when ranked relative to companies in the FTSE 250 (excluding investment trusts), measured from the 30-day period following the announcement of the Company's 2015 results to the 30-day period following announcement of the Company's 2018 results.	30 days following the announcement of the Company's 2018 results.
Average ROIC	1/3rd	Pre-tax Return on Invested Capital (ROIC) of 8.4% (threshold, 25% vesting) to 10.2% (maximum, 100% vesting), measured as an average over the three-year performance period.	31 December 2018

The structure for vesting is the same for all measures and no shares vest where performance is below Threshold.

Each element of the PSP award is subject to a post-vesting holding requirement that takes the total term of the award (i.e. performance period plus holding period) to a minimum of five years. Pre-vesting malus and post-vesting clawback is also applicable to these awards.

Directors	Type of interest awarded[1]	Basis of award (% salary)	Grant date	Market price at award (p)[2]	Face value (£)[3]	Percentage vesting at threshold performance	Number of shares	Performance period end date
Rupert Soames	Nominal Cost Option	200%	06 April '16	96.05	1,700,000	25%	1,769,911	See above
Angus Cockburn	Nominal Cost Option	175%	06 April '16	96.05	875,000	25%	910,983	See above
Ed Casey	Conditional Share Award	175%	06 April '16	96.05	1,314,717	25%	1,368,783	See above

1. Rupert Soames and Angus Cockburn received grants in the form of nominal cost options with a 2 pence per share exercise price. Due to US tax treatment of discounted options Ed Casey's award was made in the form of a conditional share award.
2. Closing share price on 5 April 2016.
3. Calculated using the closing share price on the day immediately prior to the grant date.

Statement of voting at the general meeting

At the previous AGMs, votes on the Remuneration Report were cast as follows:

	For % Number	Against % Number	Withheld % Number
2015 Annual Report on Remuneration	96.68%	3.32	N/A
	814,337,337	27,947,300	610,006
2014 Annual Report on Remuneration	98.87%	1.13%	N/A
	760,294,709	8,671,241	24,080
2013 Annual Report on Remuneration	99.61%	0.39%	N/A
	367,080,126	1,442,674	2,302,116
2013 Remuneration Policy	98.08%	1.92%	N/A
	358,418,242	7,033,412	5,373,262
2012 Remuneration Report	95.82%	4.18%	N/A
	346,071,397	15,084,901	5,923,160
2011 Remuneration Report	93.72%	6.28%	N/A
	351,474,463	23,547,217	8,299,355

Note: A 'Vote Withheld' is not a vote in law and is not counted in the calculation of the proportion of votes 'For' or 'Against' a Resolution.

External appointments

The Board believes that the Group can benefit from its Executive Directors holding appropriate Non-Executive Directorships of companies or independent bodies. Such appointments are subject to the approval of the Board. Fees are retained by the Executive Director concerned.

During the year, Rupert Soames and Angus Cockburn served as Non-Executive Directors of Electrocomponents plc and GKN plc respectively. Rupert Soames stepped down as a Non-Executive Director of Electrocomponents plc on 20 July 2016. Ed Casey served as a Director of Talen Energy Corporation until 6 December 2016 when he stepped down as a Non-Executive Director of this company. Fees payable in the year were £31,369, £60,000 and USD105,000 plus deferred stock with a face value of USD130,000 respectively.

No other fee-paying external positions were held by the Executive Directors.

Remuneration Report continued

Directors' shareholding and share interests (audited information)

Current shareholdings are summarised in the table below. Shares are valued for these purposes at the year-end price, which was 143.3p per share at 31 December 2016.

Name	Share ownership requirements (% of salary)[1]	Number of shares owned outright (including connected persons) at 31 December 2016 (or date of resignation)[2]	Shares: Subject to performance conditions[3]	Shares: Not subject to performance conditions[4]	Share options[5]: Subject to performance conditions[6]	Total share interests at 31 December 2016 Not subject to performance conditions
Rupert Soames	200%	1,066,603	1,812,828	58,988	3,972,972	6,911,391
Ed Casey	150%	125,840	2,676,619	–	–	2,802,459
Angus Cockburn	150%	336,857	588,589	65,748	2,197,194	3,188,388
Roy Gardner	N/A	45,000	N/A	N/A	N/A	45,000
Mike Clasper	N/A	56,000	N/A	N/A	N/A	56,000
Ralph D. Crosby Jnr	N/A	–	N/A	N/A	N/A	–
Tamara Ingram	N/A	–	N/A	N/A	N/A	–
Rachel Lomax	N/A	40,000	N/A	N/A	N/A	40,000
Angie Risley	N/A	20,508	N/A	N/A	N/A	20,508
Malcolm Wyman	N/A	–	N/A	N/A	N/A	–
John Rishton	N/A	–	N/A	N/A	N/A	–

1. Rupert Soames has met his contractual shareholding investment of 200% of salary by the second anniversary of appointment. Angus Cockburn has invested 25% on joining Serco and is on track to have invested 150% of salary by the third anniversary of appointment. Despite this, based on the share price at 31 December 2016, neither Rupert nor Angus have met their shareholding guidelines as set out above. Ed Casey has not met his shareholding guideline.
2. Includes shares owned by connected persons. There were no changes in Directors' interests in the period 1 January 2017 and the date of this report.
3. Includes awards made to Ed Casey under the Performance Share Plan and awards made to Rupert Soames and Angus Cockburn under the Deferred Bonus Plan. All awards are in the form of conditional share awards.
4. These are the special recruitment awards that were made to Rupert Soames and Angus Cockburn in compensation for non-performance-based awards that were forfeited in connection with them joining Serco (as disclosed in the 2014 DRR). These awards are in the form of conditional share awards.
5. All options are in the form of nominal cost options subject to a 2 pence per share exercise price. There are no interests in the form of share options that are not subject to performance conditions, nor are there any share options that are vested but unexercised and no share options were exercised during the year.
6. Includes awards under the Performance Share Plan and the special recruitment awards that were made to Rupert Soames and Angus Cockburn in compensation for performance-based awards that were forfeited in connection with them joining Serco (as disclosed in the 2014 DRR). These are all nominal cost options with a 2 pence per share exercise price.

Other shareholding information

Shareholder dilution

Awards granted under the Company share plans are met either by the issue of new shares or by shares held in trust when awards vest. The Committee monitors the number of shares issued under its various share plans and their impact on dilution limits. The relevant dilution limits established by the Investment Association (formerly the ABI) in respect of all share plans is 10% in any rolling ten-year period and in respect of discretionary share plans is 5% in any rolling ten-year period. Based on the Company's issued share capital at 31 December 2016, our dilution level was within these limits.

The Group has an employee share ownership trust which is administered by an independent trustee and which holds ordinary shares in the Company to meet various obligations under the share plans.

The Trust held 10,540,181 and 9,864,986 ordinary shares at 1 January 2016 and 31 December 2016 respectively.

The Remuneration Committee

The Committee determines the overall Remuneration Policy for senior management and the individual remuneration of the Directors and the members of the Executive Committee. This includes the base salary, bonus, long-term incentives, pensions and terms of employment (including those terms on which service may be terminated). The Committee also determines the remuneration of the Chairman.

Terms of reference

The terms of reference of the Committee, a copy of which can be found on the Group's website, are reviewed annually to ensure that they remain appropriate. Details of the Directors' attendance at meetings of the Committee can be found in the Corporate Governance Report on page 78.

Members of the Committee

All members of the Committee are independent. Non-Executive Directors of the Group are initially appointed for a three-year term, and that appointment may be terminated on three months' written notice.

Remuneration Report continued

Remuneration Committee members and attendees

The Committee met five times during 2016.

Remuneration Committee members during 2016	Position	Comments
Angie Risley	Chairman of Remuneration Committee from 14 May 2012	
Roy Gardner	Member from 1 June 2015	
Malcolm Wyman	Member from 1 January 2013	Resigned from the Board on 31 October 2016
Tamara Ingram	Member from 3 March 2014	Resigned from the Board on 31 July 2016
Mike Clasper	Member from 1 August 2016	Joined as an interim member in 2016
John Rishton	Member from 13 September 2016	Joined the Board on 13 September 2016

Remuneration Committee attendees during the year	Position	Comments
Rupert Soames	CEO	Attended by invitation
Ed Casey	COO	Attended by invitation
Angus Cockburn	CFO	Attended by invitation
Geoff Lloyd	Group HR Director	Attends as an executive responsible for advising on the Remuneration Policy
Tara Gonzalez	Group HR Director, Reward	Attends as an executive responsible for advising on the Remuneration Policy
David Eveleigh	Group General Counsel & Company Secretary	Attends as the secretary to the Committee
Steve Williams (until June 2016) Rebecca Dunn (from June 2016)	Deputy Company Secretary	Attends as the secretary to the Committee

No person is present during any discussion relating to their own remuneration arrangements.

Summary of the Committee's activities during the financial year

Meeting	*Regular items*	*Ad hoc items*
February	Considered base pay of Executive Directors and members of the Executive Committee; considered previous year's performance against targets and confirmation of any bonus payable; review of achievement of performance conditions for the LTI vesting in respect of awards made in 2013; set performance targets and objectives for 2016; review the draft of the 2015 Remuneration Report.	
March	Reviewed and approved the performance measures for the LTI awards for 2016 awards and agree grant policy.	Considered the feedback from shareholder consultation.
May	Considered requirement for review of comparator groups for benchmarking packages; considered timing of future Policy Review aligned to current status of business transformation.	Reviewed wider employee arrangements and conditions across the Group.
August	Briefing on market trends and Corporate Governance update; update on in-flight share awards.	
December	Reviewed performance of the Executive Directors against bonus objectives; reviewed proposed approach to structure of the Remuneration Report; reviewed Committee Terms of Reference; reviewed the Committee's annual programme of work.	

Advisers to the Remuneration Committee

The Committee has been advised during the year by PricewaterhouseCoopers LLP (PwC). PwC were selected as advisers to the Committee through a competitive tendering process in 2012 and no conflicts of interest were identified. PwC have provided advice throughout the year mainly around the following key executive reward areas:

- Advice on the review of Remuneration Policy.
- Support in reviewing the Directors' Remuneration Report.
- Informing the Committee on market practice and governance issues.
- Assistance with general and technical reward queries.

The advisers attended each meeting of the Remuneration Committee. Consulting services have also been provided to the Group by PwC in relation to pay and benefits data.

Fees paid to PwC as advisers to the Committee during the year totalled £39,500, fees are charged on an hourly rate basis.

PwC are members of the Remuneration Consultants' Group, which oversees the voluntary code of conduct in relation to executive consulting in the UK.

The Committee reviews the objectivity and independence of the advice it receives from PwC each year. It is satisfied that PwC is providing robust and professional advice. In the course of its deliberations, the Committee considers the views of the Chief Executive on the remuneration and performance of the other members of the Executive Committee.

Approved by the Board of Directors and signed on its behalf by:

David Eveleigh
Secretary

22 February 2017

Directors' Report

Annual Report and Accounts

The Directors present the Annual Report and Accounts of the Group for the year ended 31 December 2016. Comparative figures used in this report are for the year ended 31 December 2015 unless otherwise stated. The Corporate Governance Report, including the Remuneration Report, set out on pages 74 to 125 forms part of the Statutory Directors' Report.

The Chairman's Statement on pages 4 to 5 and the Chief Executive's Review and Divisional Reviews on pages 26 to 41 report on the activities during the year and likely future developments. The information in these reports which is required to fulfil the requirements of the Business Review is incorporated in this Directors' Report by reference.

Articles of Association

The rules relating to the appointment and replacement of Directors are contained in the Company's Articles of Association. Changes to the Articles of Association must be approved by the shareholders in accordance with the legislation in force from time to time.

Share capital

The issued share capital of the Company, together with the details of shares issued during the year, is shown in note 34 to the Consolidated Financial Statements.

The powers of the Directors to issue or buy back shares are restricted to those approved at the Company's Annual General Meeting.

At the Annual General Meeting in May 2016, pursuant to Section 570 of the Companies Act 2006, shareholders approved the issue of shares for cash up to 5% of the existing issued share capital and an additional 5% (only to be used in connection with an acquisition or specified capital investment) in each case without the application of pre-emption rights. The authority granted continues until the earlier of the AGM planned to be held in May 2017 or close of business on 30 June 2017.

Rights attaching to shares

Each ordinary share of the Company carries one vote at general meetings of the Company. There are no restrictions on the transfer of ordinary shares in the capital of the Company other than certain restrictions which may from time to time be imposed by law. In accordance with the Listing Rules of the Financial Conduct Authority, certain employees are required to seek the approval of the Company to deal in its shares.

The Company is not aware of any agreement between shareholders that may result in restrictions on the transfer of securities and / or voting rights.

Authority for the purchase of shares

As at the date of this report authority granted at the Company's AGM in May 2016 remains in force, as set out in the 2016 Notice of Meeting which is available on the Company's website.

Dividends

No interim dividend was paid in respect of the 2016 financial year (2015: nil). The Directors do not recommend a final dividend to be paid for 2016 (2015: nil).

Directors

The current members of the Board together with biographical details of each Director are set out on pages 74 and 75.

On 31 July 2016, Tamara Ingram retired as Non-Executive Director of the Company. On 6 September 2016, the Company announced that Malcolm Wyman would also be retiring his position as Non-Executive Director with effect from 31 October 2016. John Rishton subsequently joined the Board as Non-Executive Director with effect from 13 September 2016. He became a member of the Audit Committee on appointment and subsequently replaced Malcolm as Chair of the Audit Committee from 1 November 2016. John will stand for election at the 2017 AGM.

As in previous years, and in accordance with the UK Corporate Governance Code, all other Directors will stand for re-election at the AGM in May 2017.

Directors' interests

With the exception of the Executive Directors' service contracts and the Non-Executive Directors' letters of appointment, there are no contracts in which any Director has an interest.

Certain change of control conditions are included in the service contracts of Directors which provide compensation or reduction of notice periods in the event of a change of control of the Company.

Details of the Directors' interests in the ordinary shares and options over the ordinary shares of the Company as at 31 December 2016 are set out in the Directors' Remuneration Report on pages 96 to 125. Between 1 January 2017 and the date of this report there were no changes in Directors' interests in ordinary shares and options.

Directors' indemnities

Directors' and officers' insurance cover has been established for all Directors to provide cover against their reasonable actions on behalf of the Company. As permitted under the Articles of Association and in accordance with best practice, deeds of indemnity have been executed indemnifying each of the Directors and Company Secretary of the Company in respect of their positions as officers of the Company as a supplement to the Directors' and officers' insurance cover. The indemnities, which constitute a qualifying third party indemnity provision as defined by Section 234 of the Companies Act 2006, remain in force for all current Directors and the Company Secretary of the Company.

Branch offices

In certain jurisdictions, the Group will operate through a branch of one of its subsidiary companies.

Significant agreements that take effect, alter or terminate upon a change of control

Given the Business to Government nature of many of the services provided by the Company and its subsidiaries, many agreements contain provisions entitling the other parties to terminate them in the event of a change of control, which can be triggered by a takeover of the Company. The following agreements are those individual agreements which the Company considers to be significant to the Group as a whole that contain provisions giving the other party a specific right to terminate them if the Company is subject to a change of control:

Material contracts

- Australian Immigration Services: On 11 December 2014, Serco Australia Pty Limited entered into a contract with the Commonwealth of Australia (acting through the Department of Immigration and Border Protection) for the provision of detention services at all onshore immigration facilities in Australia. The contract has an initial five-year term, with two two-year extension options available. In the event of a change in control or ownership of Serco Australia Pty Limited, which in the reasonable opinion of the Commonwealth adversely affects the Company's ability to perform the Services, the contract may be terminated by the Commonwealth.
- AWE: Serco Holdings Limited is a shareholder in AWE Management Limited (the 'AWE JV'). Serco Holdings Limited's joint venture partners and the other shareholders in the AWE JV are UK subsidiary companies of Lockheed Martin Corporation and Jacobs Engineering Group. The AWE JV oversees the design, development, maintenance and manufacture of warheads for the UK's strategic nuclear deterrent. This work is carried out by the AWE JV under a management and operation contract with the Secretary of State for Defence (the 'AWE Contract'). The AWE Contract was entered into on 1 December 1999 and has a 25-year term. Under the terms of the AWE Contract, any change in shareholding or the identity of a shareholder in the AWE JV requires the consent of the Secretary of State for Defence. In the event that there is a change of control of Serco Holdings Limited, it is required to transfer its entrire shareholding in the AWE JV to the Serco Group or another wholly owned subsidiary of the Serco Group prior to such change of control. In the event that there is a change of control of Serco Holdings Limited without its entire shareholding in the AWE JV first being transferred to another member of the Serco Group or if there is a change of control of the Serco Group then the other shareholders in the AWE JV are entitled (subject to the approval of the Secretary of State and applicable regulatory approvals) to purchase the AWE JV shares and loans held by Serco Holdings Limited and any other member of the Serco Group.
- CMS Eligibility Support Services (ESS): On 1 July 2013, Serco Inc. entered into a contract with the United States of America (acting through the Centers for Medicare and Medicaid Services (CMS)) for the provision of support for the Health Care Exchanges implemented to provide affordable health insurance and insurance affordability programs. The contract had an initial base term of one year, with four options of one year each. In the event of a change in control or ownership of Serco Inc., which in the reasonable opinion of the U.S. Government adversely affects the Company's ability to perform the services, the contract may be terminated by the U.S. Government.
- SSA: In order to bid and perform on certain classified contracts involving US national security, Serco Inc. was required to mitigate its foreign ownership through a Special Security Agreement (SSA) between the US Government, Serco Inc., and Serco Group plc. The effective date of the SSA is 18 June 2008. The U.S. Department of Defense may terminate Serco's SSA in the event of the sale of the Corporation to a company or person not under Foreign Ownership, Control or Influence (FOCI).

Directors' Report continued

Financing facilities

- Revolving credit facility: the Company has a £480,000,000 revolving credit facility dated 28 March 2012 (amended and restated 12 March 2015) with the Bank of America Securities Limited, Barclays Bank PLC, Commonwealth Bank of Australia, Credit Agricole Corporate and Investment Bank, DBS Bank Limited, HSBC Bank PLC, J.P. Morgan Limited, Lloyds TSB Bank PLC, The Bank of Tokyo-Mitsubishi UFJ Limited and The Royal Bank of Scotland PLC as mandated lead arrangers, and Barclays Bank PLC as Facility Agent. The facility provides funds for general corporate and working capital purposes, and bonds to support the Group's business needs. The facility agreement provides that in the event of a change of control of the Company each lender may, within a certain period, call for the prepayment of the amounts owed to it and cancel its commitments under the facility.
- US notes: the Company has notes outstanding under three US Private Placement Note Purchase Agreements (the 'USPP Agreements') dated 9 May 2011, 20 October 2011 and 13 May 2013, respectively. The total amount of the notes outstanding under the three USPP Agreements was $357,042,884 at 31 December 2016, and their maturity is between 9 May 2018 and 14 May 2024. Under the terms of the USPP Agreements, if a change of control of the Company occurs it is required to offer to prepay the entire principal amount of the notes together with interest to the prepayment date but without payment of any make-whole amount.

Share plans

The Company's share plans contain provisions in relation to a change of control. Outstanding options and awards may vest and become exercisable on a change of control of the Company, in accordance with the rules of the plans.

Annual General Meeting

The Annual General Meeting (AGM) of the Company will be held at Clifford Chance LLP, 10 Upper Bank Street, Canary Wharf, London, E14 5JJ on 11 May 2017 at 11.00am.

Financial risk policies

A summary of the Group's treasury policies and objectives relating to financial risk management, including exposure to associated risks, is on pages 186 to 192.

Employment policies

The Board is committed to maintaining a working environment where staff are individually valued and recognised. Group companies and Divisions operate within a framework of human resources policies, practices and regulations appropriate to their own market sector and country of operation, whilst subject to Group-wide policies and principles.

Diversity

The Group is committed to ensuring equal opportunity, honouring the rights of the individual, and fostering partnership and trust in every working relationship. Policies and procedures for recruitment, training and career development promote diversity, respect for human rights and equality of opportunity regardless of gender, sexual orientation, age, marital status, disability, race, religion or other beliefs and ethnic or national origin.

The Group promotes diversity so that all employees are able to be successful regardless of their background. The Group gives full consideration to applications for employment, career development and promotion received from the disabled, and offers employment when suitable opportunities arise. If employees become disabled during their service with the Group, arrangements are made wherever practicable to continue their employment and training.

The Group recognises the importance of protecting human rights. We seek to respect and uphold the human rights of individuals in all aspects of our operations wherever we operate. Our Human Rights Group Standard demonstrates this commitment and the significance of human rights for a diverse global organisation. It also sets out expectations for individual and corporate behaviour across our business in regards to human rights. We use International Human Rights Standards such as the United Nations Guiding Principles on Business and Human Rights (2011) (UN Guiding Principles) as frameworks to assist our decision-making and constructive engagement; to identify, assess, and manage adverse human rights impacts; and to integrate and act on findings, track responses, monitor effectiveness and communicate how impacts are addressed.

Engagement

The Group remains proud of its record of managing employee relations and continues to believe that the structure of individual and collective consultation and negotiation is best developed at a local level. Over the years, the Group has demonstrated that working with trade unions and creating effective partnerships allows improvements to be delivered in business performance as well as in employment terms and conditions. Where employees choose not to belong to a trade union, employee communication forums such as works councils exist to ensure involvement of staff within the business. The Group has been proactive in providing employees with information on matters of concern to them as employees. These mechanisms ensure employees' views are considered in decision-making and that they have a common awareness of Group strategy, matters of concern to them and the financial and economic factors affecting the performance of the Company.

Participation by staff in the success of the Group is encouraged by the availability of long-term incentive arrangements for senior management, which effectively aligns their interests with those of shareholders by requiring that Company-level financial performance criteria are achieved as a condition of vesting.

Corporate responsibility

The Group recognises that operating in a responsible manner helps drive Serco's success. Our commitment to corporate responsibility is supported by defined policies embedded in our Serco Management System. More information on Corporate Responsibility, including greenhouse gas emission reporting, can be found in the Strategic Report on pages 64 to 72.

Research and development

Serco undertakes a limited amount of research and development (R&D), given that our primary business model is the delivery of public services through our people. In 2016, we spent £3.6m on R&D on IT-related projects, compared to £4.3m in 2015.

Political donations

During the year neither the Company nor the Group made political donations and they intend to continue with this policy. However, it is possible that certain routine activities may unintentionally fall within the broad scope of the Companies Act provisions relating to political donations and expenditure. As in previous years, the Company will therefore propose to shareholders that the authority granted at the AGM in May 2016 regarding political donations be renewed. Details will be included in the notice of AGM.

Within the US business there exists a Political Action Committee (PAC), which is funded entirely by employees and their spouses. The Serco PAC and its contributions are administered in strict accordance with regulatory requirements. Employee contributions are entirely voluntary and no pressure is placed on employees to participate. Under US law, an employee-funded PAC must bear the name of the employing company.

Financial statements

At the date of this report, as far as each Director is aware, there is no relevant audit information of which the Group's Auditor is unaware. Each Director has taken all the steps that he or she ought to have taken as a Director in order to make himself or herself aware of any relevant audit information and to establish that the Group's Auditor is aware of that information.

Auditor

The Company undertook a formal competitive tender exercise for external audit services during 2016, as detailed in the 2015 Notice of Annual General Meeting. As a result of this tender process KPMG LLP ('KPMG') was appointed as the Company's External Auditor by the Board on 27 May 2016 and Deloitte LLP resigned as Auditor on the same date.

The appointment of KPMG for the 2017 financial year will be subject to shareholder approval at the next AGM in May 2017. Further details are set out in the Notice of Meeting sent to shareholders.

Going concern

In assessing the basis of preparation of the financial statements for the year ended 31 December 2016, the Directors have considered the principles of the Financial Reporting Council's 'Guidance on Risk Management, Internal Control and Related Financial and Business Reporting, 2014'; namely assessing the applicability of the going concern basis, the review period and disclosures. The Group's principal debt facilities at the year-end comprised a £480m revolving credit facility, and £290m of US private placement notes. As at 31 December 2016, the Group had £770m of committed credit facilities and committed headroom of £647m.

Assessment of going concern

The Directors have undertaken a rigorous assessment of going concern and liquidity taking into account financial forecasts. In order to satisfy ourselves that we have adequate resources for the future, the Directors have reviewed the Group's existing debt levels, the committed funding and liquidity positions under our debt covenants, and our ability to generate cash from trading activities.

Review period

In undertaking this review the Directors have considered the business plans which provide financial projections for the foreseeable future. For the purposes of this review, we consider that to be the period ending 30 June 2018. The Directors have also reviewed the principal risks considered on pages 16 to 23 of the Strategic Review and taken account of the results of sensitivity testing.

Directors' Report continued

Going concern continued

Assessment

The Directors have a reasonable expectation that the Company and the Group will be able to operate within the level of available facilities and cash for the foreseeable future and accordingly believe that it is appropriate to prepare the financial statements on a going concern basis.

Interests in voting rights

At 31 December 2016 the Company had been notified under Rule 5 of the Disclosure and Transparency Rules of the Financial Conduct Authority of the following holdings of voting rights in its shares:

Notifying person	Number of shares (millions) at date of notification	% held at date of notification	Nature of holding
Azvalor Asset Management S.G.I.I.C., S.A.	33.3	3.04	Direct
Blackrock Inc	18.4	1.67	Indirect
	16.0	1.45	Securities Lending
	20.8	1.89	Contract for Difference
		5.01	Total
Lancaster Investment Management LLP	54.7	4.98	Swap
Majedie Asset Management Limited	56.0	5.09	Direct
Marathon Asset Management LLP	68.3	5.31	Indirect
Morgan Stanley (Institutional Securities Group and Global Wealth Management)	1.2	0.11	Direct
	38.0	3.46	Right of Recall
	19.5	1.76	Swap
		5.33	Total
MSD Partners, L.P.	109.9	10.0	Indirect
Orbis Group	54.5	4.96	Indirect
Tameside MBC re: Greater Manchester Pension Fund	34.1	3.11	Direct

Notes:

Between 1 January 2017 and the date of this report, the Company has been advised of the following changes of interests in shares:

- on 19 January 2017 Azvalor Asset Management S.G.I.I.C, S.A. notified that their interest in voting rights had fallen below 3%;
- on 16 February 2017, Morgan Stanley (Institutional Securities Group and Global Wealth Management) notified that their interest in voting rights had fallen below 3%. On 17 February 2017 Morgan Stanley notified that their interest in voting rights was 5.10% and on 20 February 2017 that their interest stood at 5.11%

Index of Directors' Report disclosures

The information required to be disclosed in the Directors' Report can be found in this Annual Report on the pages listed below. Pursuant to Listing Rule 9.8.4C, the information required to be disclosed in the Annual Report under Listing Rule 9.8.4R is marked with an asterisk (*).

Approved by the Board of Directors and signed on its behalf by:

DE

David Eveleigh
Secretary

22 February 2017

Directors' Responsibility Statement

The Directors are responsible for preparing the Annual Report and financial statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare financial statements for each financial year. Under that law the Directors are required to prepare the Group financial statements in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union and Article 4 of the IAS Regulation and have elected to prepare the Parent Company financial statements in accordance with Financial Reporting Standard 101 Reduced Disclosure Framework. Under company law the Directors must not approve the accounts unless they are satisfied that they 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 the Parent Company financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and accounting estimates that are reasonable and prudent;
- state whether Financial Reporting Standard 101 Reduced Disclosure Framework has 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 preparing the Group financial statements, International Accounting Standard 1 requires that Directors:

- 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 IFRS are 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
- make an assessment of the Company's ability to continue as a going concern.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The Directors are responsible for the maintenance and integrity of the corporate and financial information included on the Company's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Responsibility statement

We confirm that to the best of our knowledge:

1. The financial statements, prepared in accordance with International Financial Reporting Standards as adopted by the EU, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Company and the undertakings included in the consolidation taken as a whole.

2. The Strategic Report includes a fair review of the development and performance of the business and the position of the Company and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face.

3. The Annual Report and financial statements, taken as a whole, are fair, balanced and understandable and provide the information necessary for shareholders to assess the Company's performance, business model and strategy.

By order of the Board

Rupert Soames Group Chief Executive	Angus Cockburn Group Chief Financial Officer

22 February 2017

Financial Statements

Independent Auditor's Report
to the members of Serco Group plc only

Our opinion on the financial statements is unmodified	We have audited the financial statements of Serco Group Plc for the year ended 31 December 2016 set out on pages 139 to 216. In our opinion: • the financial statements give a true and fair view of the state of the Group's and of the parent company's affairs as at 31 December 2016 and of the Group's loss for the year then ended; • the Group financial statements have been properly prepared in accordance with International Financial Reporting Standards as adopted by the European Union; • the parent company financial statements have been properly prepared in accordance with UK Accounting Standards, including FRS 101 Reduced Disclosure Framework; and • the financial statements have been prepared in accordance with the requirements of the Companies Act 2006; and, as regards the group financial statements, Article 4 of the IAS Regulation.
Our assessment of risks of material misstatement	In arriving at our audit opinion above on the financial statements the risks of material misstatement that had the greatest effect on our audit, in decreasing order of audit significance, were as follows:

***Revenue £3,011.0m** (2015: £3,177.0m), **operating profit £42.2m** (2015: loss of £3.8m) **and Onerous Contract Provisions of £220.2m** (2015: £302.1m)*

Refer to page 83 (Audit Committee Report), pages 146 and 147 (accounting policy), page 154 (key judgements) and page 185 (provisions note in the financial statements)

Why is it a risk?

The contractual arrangements that underpin the measurement and recognition of revenue by the Group can be complex, with significant judgements involved in the assessment of current and future financial performance. The key judgements impacting the recognition of revenue and resulting operating profit include:

- Interpretations of terms and conditions in relation to the required service obligations in accordance with contractual arrangements;
- The allocation of revenue and costs to performance obligations where multiple deliverables exist;
- Assessment of stage of completion and cost to complete, where percentage completion accounting is used;
- Consideration of the Group's performance against contractual obligations and the impact on revenue and costs of delivery;
- The recognition and recoverability assessments of contract related assets, including those recognised as direct incremental costs prior to service commencement.

Where an onerous contract provision is required, judgement is required in assessing the level of provision, including estimated cost to complete taking into account contractual obligations to the end of the contract, extension periods and customer negotiations.

Our response

Our audit procedures included the following:

We tested the design and implementation of the controls over the Group's monitoring and review processes of contract performance and costs. This included attendance at a sample of monthly Divisional and Business Unit Performance Reviews used to assess operational and financial performance, and performing walkthroughs on a sample of contracts to identify the key stages of the Group's Business Lifecycle Gate process.

We have also inspected accounting papers prepared by the Group to support key contract judgements and onerous contract provisions, and assessed compliance with relevant accounting standards.

Contracts were selected for substantive audit procedures based on qualitative factors, such as commercial complexity, and quantitative factors, such as financial significance and profitability that we considered to be indicative of risk. Our audit testing for the contracts selected included the following:

- We inspected the contract agreements to challenge the method of revenue recognition adopted by the Group including, where relevant, the allocation of revenue across contractual obligations and compared these to the policy adopted by the Group
- Where percentage of completion is used, we re-calculated the stage of completion to inform our assessment of the appropriate amount of revenue and profit to recognise and compared this to the amounts recorded by the Group
- We assessed whether the revenue recognition methodology applied was consistent with accounting standards
- We inspected a sample of correspondence with customers and third parties, in instances where contractual variations and claims have arisen, to inform our assessment of the revenue and costs recorded up to the balance sheet date
- We visited key contract locations to inform our assessment of operational and financial risks.

For onerous and potentially onerous contracts identified through application of quantitative selection criteria, our procedures also included:

- We compared contract level forecast revenues and costs to Group budgets and forecasts approved by the directors
- We challenged key assumptions made by the Group in preparing these forecasts, including those in relation to revenue growth and cost reductions, vouching to external evidence where possible and obtaining supporting plans where appropriate
- We assessed the contractual terms and conditions to identify the key obligations of the contract to inform our challenge of completeness of forecast costs and cost accruals recorded at the balance sheet date
- We compared the contract forecasts to historic and in year performance to assess the historical accuracy of the forecasts
- We assessed the mathematical accuracy of the models used to forecast contract revenues and costs
- We compared the forecast margin to the cumulative margin recognised up to the balance sheet date to assess whether provisions for loss-making contracts had been appropriately recorded and, in the case of profitable contracts, that margin recognised to date did not exceed the forecast.

For selected contract related assets, representing capitalised bid and phase in costs, our procedures included:

- We assessed whether these had been recognised in accordance with the Group's accounting policy and relevant accounting standards
- We inspected actual and forecast contractual cash flows and profits to assess whether these supported the carrying value of the assets
- We inspected the underlying contracts to inform our assessment of the forecast cash flows, and compared actual cash flows to forecasts to assess reasonableness
- We compared the amortisation period with the duration of the contract and checked that the amortisation had been calculated correctly.

Independent Auditor's Report continued
to the members of Serco Group plc only

Goodwill £577.9m (2015: £509.9m)

Refer to page 84 (Audit Committee Report), page 150 (accounting policy), page 154 (key judgements) and pages 175 to 177 (Goodwill note in the financial statements)

Why is it a risk?	Our response
The Group has recognised a carrying value of £577.9m allocated across six cash generating units, as shown in Note 19. There is inherent uncertainty involved in forecasting the future cash flows of each CGU, including the variability in forecast contract income due to contract attrition and new contract wins or extensions, the impact of the Group's transformation programme to reduce operating costs and changes in market conditions. Judgement is also required for the selection of an appropriate discount rate. In the year ended 31 December 2015, the carrying value of goodwill associated with the Americas division was written down by £87.5m to its recoverable value based on the discounted future cash flows. As a result, the carrying value of goodwill for the Americas division will be sensitive to a deterioration in the division's projections or an increase in the discount rate applied.	Our procedures included the following: • We tested the principles and mathematical integrity of the Group's discounted cash flow model. • With the assistance of our valuation specialists, we challenged the growth rate and discount rate for each CGU used in the impairment calculation by comparing the Group's assumptions to external data. • We compared the forecast cash flows against budgets and historic actual performance to test for historic accuracy. We challenged forecast assumptions around new contract wins or extensions, contract attrition, cost reductions and the allocation of central costs. • We tested the sensitivity of the impairment calculation to changes in the underlying assumptions. • We considered whether the forecast cash flow assumptions used in the goodwill impairment calculation were consistent with the assumptions used to calculate the expected loss on onerous contract provisions, the recognition of deferred tax assets and the Director's assessment of going concern and viability. • We also assessed whether the Group's disclosures about the sensitivity of outcomes reflected the risks inherent in the valuation of goodwill.

Retirement benefit surplus £150.4m (2015: £127.1m)

Refer to page 84 (Audit Committee Report), page 150 (accounting policy), page 155 (key judgements) and pages 192 to 199 (Retirement benefit schemes note in the financial statements)

Why is it a risk?	Our response
Significant estimates are made in valuing the Group's retirement benefit surplus in respect of the Serco Pension Life Assurance Scheme (SPLAS), including mortality, price inflation, discount rates and future increases in salary and pension. Small changes in the assumptions and estimates used to value the Group's net pension surplus would have a significant effect on the Group's financial position. As the Group's main defined benefit scheme is in a net surplus of £150.4m at 31 December 2016 (2015: £127.1m), judgement is required to determine if it is appropriate to recognise an asset. Judgement is also required to determine if pension obligations associated with contract arrangements meet the definition of defined benefit or defined contribution schemes, and whether an associated asset or liability is required to be accounted for by the Group.	Our procedures in respect of the Group's main scheme (SPLAS) included the following: • We performed procedures to test the completeness and accuracy of data provided by the Group to the scheme actuaries. This involved selecting a sample of scheme participants to compare data provided to the actuaries to underlying employment records held by the Group and the Scheme Administrator. • We challenged the key assumptions used to calculate the valuation of the Group's net pension surplus with input from our actuarial specialists, comparing the discount rate, inflation rate, salary increases, pension increase rates and life expectancy assumptions used against externally derived data. • We challenged the basis of the Group's judgement that it has an unconditional right of refund based on our assessment of the scheme rules and advice provided by external actuaries. • We assessed the Group's disclosure in respect of the sensitivity of the surplus to changes in the key assumptions. In respect of contract related pension obligations, we challenged the judgements made by the Group in assessing whether defined benefit liabilities have been recognised in accordance with contractual terms. Our procedures included assessment of the underlying contract agreements and consideration of legal advice obtained by the Group.

Our application of materiality and an overview of the scope of our audit	**Materiality** Materiality for the Consolidated Financial Statements as a whole was set at £5m, determined with reference to a benchmark of Group Profit Before Tax and Exceptional Items of £85.9m (of which it represents 5.8%). We reported to the Audit Committee any corrected or uncorrected identified misstatements exceeding £0.38m, in addition to other identified misstatements that warranted reporting on qualitative grounds. **Scope of our audit** The Group operates through a number of legal entities which form reporting components which are primarily based on geographic regions. Audits for Group reporting purposes were performed over 7 of the 9 components. These 7 components represent approximately 98.6% of the Group's Revenue, 98.7% of Group profit before tax and 99.1% of Group total assets. The Group audit team instructed component auditors as to the significant areas to be covered, including the significant risks detailed above and the information to be reported back. The Group audit team approved component materiality levels, which ranged from £2.0m to £3.6m having regard to the mix of size and risk profile of the Group across the components. The work on all components was performed by component auditors. The Group team visited all 7 component locations, including during the risk assessment phase. Video and telephone conference meetings were also held with these component auditors throughout the audit process covering planning and fieldwork. During these visits and meetings the findings reported to the Group audit team were discussed in more detail with component auditors, the Group audit team conducted reviews of the component auditors' work, and any further work required by the Group audit team was then performed by the component auditor.
Our opinion on other matters prescribed by the Companies Act 2006 is unmodified	*In our opinion:* • the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006; and • the information given in the Strategic Report and the Directors' Report for the financial year is consistent with the financial statements. Based solely on the work required to be undertaken in the course of the audit of the financial statements and from reading the Strategic report and the Directors' report: • *we have not identified material misstatements in those reports; and* • in our opinion, those reports have been prepared in accordance with the Companies Act 2006
We have nothing to report on the disclosures of principal risks	Based on the knowledge we acquired during our audit, we have nothing material to add or draw attention to in relation to: • the directors' statement of longer-term viability on pages 24 and 25, concerning the principal risks, their management, and, based on that, the directors' assessment and expectations of the group's continuing in operation over the 3 years to 31 December 2019; or • the disclosures in note 2 of the financial statements concerning the use of the going concern basis of accounting.

Independent Auditor's Report continued

to the members of Serco Group plc only

We have nothing to report in respect of the matters on which we are required to report by exception	Under ISAs (UK and Ireland) we are required to report to you if, based on the knowledge we acquired during our audit, we have identified other information in the annual report that contains a material inconsistency with either that knowledge or the financial statements, a material misstatement of fact, or that is otherwise misleading. In particular, we are required to report to you if: • we have identified material inconsistencies between the knowledge we acquired during our audit and the directors' statement that they consider that the annual report and financial statements taken as a whole is fair, balanced and understandable and provides the information necessary for shareholders to assess the group's position and performance, business model and strategy; or • the Audit Committee Report does not appropriately address matters communicated by us to the audit committee. Under the Companies Act 2006 we are required to report to you if, in our opinion: • adequate accounting records have not been kept by the parent company, or returns adequate for our audit have not been received from branches not visited by us; or • the parent company financial statements and the part of the Directors' Remuneration Report to be audited are not in agreement with the accounting records and returns; or • certain disclosures of directors' remuneration specified by law are not made; or • we have not received all the information and explanations we require for our audit. Under the Listing Rules we are required to review: • the directors' statements, set out on pages 129 and 24 to 25, in relation to going concern and longer-term viability; and • the part of the Corporate Governance Statement on pages 94 and 95 relating to the company's compliance with the eleven provisions of the 2014 UK Corporate Governance Code specified for our review. We have nothing to report in respect of the above responsibilities.
Scope and responsibilities	As explained more fully in the Directors' Responsibilities Statement set out on page 132, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. A description of the scope of an audit of financial statements is provided on the Financial Reporting Council's website at www.frc.org.uk/auditscopeukprivate. This report is made solely to the company's members as a body and is subject to important explanations and disclaimers regarding our responsibilities, published on our website at www.kpmg.com/uk/auditscopeukco2014a, which are incorporated into this report as if set out in full and should be read to provide an understanding of the purpose of this report, the work we have undertaken and the basis of our opinions.

Stephen Wardell
(Senior Statutory Auditor) for and on behalf of
KPMG LLP, Statutory Auditor Chartered Accountants
15 Canada Square,
London, E14 5GL

22 February 2017

Consolidated Income Statement
For the year ended 31 December

Continuing operations	Note	2016 £m	2015 (restated*) £m
Revenue	10	3,011.0	3,177.0
Cost of sales		(2,767.6)	(2,849.1)
Gross profit		243.4	327.9
Administrative expenses			
General and administrative expenses*		(173.2)	(254.0)
Exceptional profit / (loss) on disposal of subsidiaries and operations	9	2.9	(2.6)
Other exceptional operating items	11	(59.2)	(107.3)
Other expenses – amortisation and impairment of intangibles arising on acquisition		(5.1)	(4.8)
Total administrative expenses		(234.6)	(368.7)
Share of profits in joint ventures and associates, net of interest and tax	7	33.4	37.0
Operating profit / (loss)*		42.2	(3.8)
Operating profit before exceptional items*		98.5	106.1
Investment revenue	14	9.3	6.1
Finance costs*	15	(21.9)	(38.9)
Exceptional finance costs	11	-	(32.8)
Total net finance costs*		(12.6)	(65.6)
Profit / (loss) before tax		29.6	(69.4)
Tax on profit / (loss) before exceptional items	16	(15.8)	(17.9)
Tax credit on exceptional items	16	3.1	0.4
Tax charge		(12.7)	(17.5)
Profit / (loss) for the year from continuing operations		16.9	(86.9)
Loss for the year from discontinued operations	4	(18.0)	(66.2)
Loss for the year		(1.1)	(153.1)
Attributable to:			
Equity owners of the Company		(1.2)	(152.6)
Non controlling interests		0.1	(0.5)
Earnings per share (EPS)			
Basic EPS from continuing operations	18	1.55p	(8.78p)
Diluted EPS from continuing operations	18	1.50p	(8.78p)
Basic EPS from discontinued operations	18	(1.66p)	(6.69p)
Diluted EPS from discontinued operations	18	(1.66p)	(6.69p)
Basic EPS from continuing and discontinued operations	18	(0.11p)	(15.47p)
Diluted EPS from continuing and discontinued operations	18	(0.11p)	(15.47p)

* General and administrative expenses and net finance costs have been restated following the change in accounting policy regarding foreign exchange movements on investment and financing arrangements. See note 2.

Consolidated Statement of Comprehensive Income

For the year ended 31 December

	Note	2016 £m	2015 £m
Loss for the year		(1.1)	(153.1)
Other comprehensive income for the year:			
Items that will not be reclassified subsequently to profit or loss:			
Net actuarial gain / (loss) on defined benefit pension schemes*	33	9.0	(15.8)
Actuarial gain / (loss) on reimbursable rights*	33	2.9	(0.4)
Tax relating to items not reclassified*	16	(1.7)	4.1
Share of other comprehensive income in joint ventures and associates	7	14.8	5.0
Items that may be reclassified subsequently to profit or loss:			
Net exchange gain / (loss) on translation of foreign operations**		80.3	(40.9)
Fair value gain on cash flow hedges during the year**		2.3	2.2
Share of other comprehensive income in joint ventures and associates	7	1.0	2.6
Total other comprehensive income / (expense) for the year		108.6	(43.2)
Total comprehensive income / (expense) for the year		107.5	(196.3)
Attributable to:			
Equity owners of the Company		107.1	(195.9)
Non controlling interest		0.4	(0.4)

* Recorded in retirement benefit obligations reserve in the Consolidated Statement of Changes in Equity.

** Recorded in hedging and translation reserve in the Consolidated Statement of Changes in Equity.

Consolidated Statement of Changes in Equity

	Share capital £m	Share premium account £m	Capital redemption reserve £m	Retained earnings £m	Retirement benefit obligations reserve £m	Share based payment reserve £m	Own shares reserve £m	Hedging and translation reserve £m	Total shareholders' equity £m	Non controlling interest £m
At 1 January 2015	11.0	327.9	0.1	(306.0)	(89.0)	71.4	(64.5)	(18.9)	(68.0)	1.8
Total comprehensive expense for the year	–	–	–	(145.0)	(12.1)	–	–	(38.8)	(195.9)	(0.4)
Issue of share capital*	11.0	–	–	519.3	–	–	–	–	530.3	–
Shares transferred to option holders on exercise of share options	–	–	–	–	–	(0.3)	4.7	–	4.4	–
Transfer on disposal	–	–	–	0.2	(0.2)	–	–	–	–	–
Expense in relation to share based payments	–	–	–	–	–	9.8	–	–	9.8	–
Change in non controlling interest	–	–	–	–	–	–	–	–	–	0.1
At 31 December 2015	22.0	327.9	0.1	68.5	(101.3)	80.9	(59.8)	(57.7)	280.6	1.5
Total comprehensive income for the year	–	–	–	14.6	10.2	–	–	82.3	107.1	0.4
Shares transferred to option holders on exercise of share options	–	–	–	–	–	(7.7)	7.7	–	–	–
Transfer on disposal	–	–	–	–	–	–	–	–	–	–
Expense in relation to share based payments	–	–	–	–	–	9.7	–	–	9.7	–
Change in non controlling interest	–	–	–	–	–	–	–	–	–	(0.5)
At 31 December 2016	22.0	327.9	0.1	83.1	(91.1)	82.9	(52.1)	24.6	397.4	1.4

* During the prior year the Group raised £530.3m via a Rights Issue. A cash box structure was used in such a way that merger relief was available under Companies Act 2006, section 612 and thus no share premium needed to be recorded. As the redemption of the cash box entity's preference shares was in the form of cash, the transaction was treated as qualifying consideration and the premium is therefore considered to be a realised profit.

Consolidated Balance Sheet

	Note	At 31 December 2016 £m	At 31 December 2015 £m
Non-current assets			
Goodwill	19	577.9	509.9
Other intangible assets	20	83.6	89.8
Property, plant and equipment	21	69.3	73.2
Interests in joint ventures and associates	7	14.4	13.8
Trade and other receivables	23	44.4	50.2
Derivative financial instruments	32	14.2	7.8
Deferred tax assets	17	50.8	42.2
Retirement benefit assets	33	150.4	127.1
		1,005.0	914.0
Current assets			
Inventories	22	22.4	26.4
Trade and other receivables	23	543.5	519.7
Current tax assets		11.0	6.6
Cash and cash equivalents	25	177.8	323.6
Derivative financial instruments	32	4.9	9.4
		759.6	885.7
Assets classified as held for sale	40	–	39.8
		759.6	925.5
Total assets		1,764.6	1,839.5
Current liabilities			
Trade and other payables	26	(524.5)	(548.8)
Derivative financial instruments	32	(0.6)	(2.4)
Current tax liabilities		(25.9)	(14.2)
Provisions	29	(172.3)	(168.6)
Obligations under finance leases	27	(12.3)	(15.8)
Loans	28	(9.7)	(132.2)
		(745.3)	(882.0)
Liabilities directly associated with assets classified as held for sale	40	–	(32.5)
		(745.3)	(914.5)
Non-current liabilities			
Trade and other payables	26	(16.8)	(18.3)
Deferred tax liabilities	17	(30.5)	(22.3)
Provisions	29	(249.4)	(313.1)
Obligations under finance leases	27	(15.9)	(28.0)
Loans	28	(290.2)	(249.7)
Retirement benefit obligations	33	(17.7)	(11.5)
		(620.5)	(642.9)
Total liabilities		(1,365.8)	(1,557.4)
Net assets		398.8	282.1
Equity			
Share capital	34	22.0	22.0
Share premium account	35	327.9	327.9
Capital redemption reserve		0.1	0.1
Retained earnings		83.1	68.5
Retirement benefit obligations reserve		(91.1)	(101.3)
Share based payment reserve		82.9	80.9
Own shares reserve		(52.1)	(59.8)
Hedging and translation reserve		24.6	(57.7)
Equity attributable to owners of the Company		397.4	280.6
Non controlling interest		1.4	1.5
Total equity		398.8	282.1

The financial statements were approved by the Board of Directors on 22 February 2017 and signed on its behalf by:

RS ×   AC ×

Rupert Soames
Group Chief Executive

Angus Cockburn
Group Chief Financial Officer

Consolidated Cash Flow Statement
For the year ended 31 December

	Note	2016 £m	2015 (restated*) £m
Net cash (outflow) / inflow from operating activities before exceptional items*		(22.4)	37.2
Exceptional items		(39.9)	(56.6)
Net cash outflow from operating activities*	39	(62.3)	(19.4)
Investing activities			
Interest received		1.4	3.4
(Decrease) / increase in security deposits		(0.4)	0.3
Dividends received from joint ventures and associates		40.0	32.5
Proceeds from disposal of property, plant and equipment		0.6	0.8
Proceeds from disposal of intangible assets		0.1	0.9
Proceeds on disposal of subsidiaries and operations		19.4	165.6
Acquisition of subsidiaries, net of cash acquired		(0.2)	(0.2)
Purchase of other intangible assets		(15.1)	(37.5)
Purchase of property, plant and equipment		(17.2)	(36.7)
Net cash inflow from investing activities		28.6	129.1
Financing activities			
Interest paid		(20.1)	(34.7)
Exceptional finance costs paid		(0.3)	(31.8)
Capitalised finance costs paid		(0.3)	(1.4)
Repayment of loans		(135.5)	(447.0)
Decrease / (increase) in loans to joint ventures and associates		1.1	(1.6)
Capital element of finance lease repayments		(17.0)	(18.8)
Cash gains from hedging instruments*		47.0	19.3
Rights Issue net proceeds		–	530.3
Proceeds from issue of other share capital and exercise of share options		–	4.4
Net cash (outflow) / inflow from financing activities*		(125.1)	18.7
Net (decrease) / increase in cash and cash equivalents		(158.8)	128.4
Cash and cash equivalents at beginning of year		323.6	180.1
Net exchange gain / (loss)		7.8	(2.1)
Cash reclassified to assets held for sale		5.2	17.2
Cash and cash equivalents at end of year	25	177.8	323.6

* Net cash outflow from operating activities and net cash (outflow) / inflow from financing activities have been restated following the change in accounting policy regarding foreign exchange movements on investment and financing arrangements. See note 2.

Notes to the Consolidated Financial Statements

1. General information

Serco Group plc (the Company) is a company incorporated in the United Kingdom under the Companies Act 2006. The address of the registered office is Serco House, 16 Bartley Wood Business Park, Bartley Way, Hook, Hampshire, RG27 9UY.

These consolidated financial statements comprise the Company and its subsidiaries (together referred to as the Group) and are presented in pounds Sterling because this is the currency of the primary economic environment in which Serco operates. All amounts have been rounded to the nearest one hundred thousand pounds, foreign operations are included in accordance with the policies set out in note 2.

2. Significant accounting policies

Basis of accounting

These consolidated financial statements on pages 139 to 217 have been prepared in accordance with International Financial Reporting Standards adopted for use in the European Union (IFRS) and therefore comply with the requirements set out in Article 4 of the EU IAS regulation.

The financial statements have been prepared on the historical cost basis, except for the revaluation of financial instruments. Historical cost is generally based on the fair value of the consideration given in exchange for goods and services. The following principal accounting policies adopted have been applied consistently in the current and preceding financial year except as stated below.

Prior year restatement: Change in accounting policy

In order to provide more relevant information about the impact of the underlying transactions of trading operations, the accounting policy regarding the classification of foreign exchange movements on investment and financing arrangements has been changed. The new policy is to include foreign exchange movements on investment and financing arrangements within investment revenue or finance costs as relevant. Such transactions include foreign exchange movements on non Sterling cash and financing arrangements, related derivative financial instruments and any income or costs associated with such balances. As a result of this change in accounting policy, the prior year income statement and cash flow statement have been restated, together with the Net Debt definition applied in note 28 which has been changed to include derivative financial instruments that relate to other components of Net Debt. No restatement is required to the balance sheet as a result of the change in policy.

The impact on the relevant line items in the consolidated financial statements and Net Debt for the year ended 31 December 2015 is as follows:

Consolidated income statement	2015 as previously stated £m	Adjustment £m	2015 as restated £m
General and administrative expenses	(253.9)	(0.1)	(254.0)
Finance costs	(39.0)	0.1	(38.9)

Consolidated cash flow statement	2015 as previously stated £m	Adjustment £m	2015 as restated £m
Net cash outflow from operating activities	(0.1)	(19.3)	(19.4)
Net cash (outflow) / inflow from financing activities	(0.6)	19.3	18.7

Analysis of Net Debt	At 31 December 2015 as previously stated £m	Adjustment £m	At 31 December 2015 as restated £m
Cash and cash equivalents	323.6	–	323.6
Loan receivables	19.9	–	19.9
Loans payable	(381.9)	–	(381.9)
Obligations under finance leases	(43.8)	–	(43.8)
Derivatives relating to Net Debt	–	14.6	14.6
	(82.2)	14.6	(67.6)

Going concern

The Directors have a reasonable expectation that the Company and the Group will be able to operate within the level of available facilities and cash for the foreseeable future and accordingly believe that it is appropriate to prepare the financial statements on a going concern basis.

In assessing the basis of preparation of the financial statements for the year ended 31 December 2016, the Directors have considered the principles of the Financial Reporting Council's 'Guidance on Risk Management, Internal Control and Related Financial and Business Reporting, 2014'; namely assessing the applicability of the going concern basis, the review period and disclosures. The Directors have undertaken a rigorous assessment of going concern and liquidity, taking into account financial forecasts. In order to satisfy themselves that they have adequate resources for the future, the Directors have reviewed the Group's existing debt levels, the committed funding and liquidity positions under our debt covenants, and our ability to generate cash from trading activities. The Group's current principal debt facilities at the year end comprised a £480m revolving credit facility, and £290m of US private placement notes. As at 31 December 2016, the Group had £770m of committed credit facilities and committed headroom of £647m.

In undertaking this review the Directors have considered the business plans which provide financial projections for the foreseeable future. For the purposes of this review, we consider that to be the period ending 30 June 2018. The Directors have also reviewed the principal risks considered on pages 16 to 23 of the Strategic Report and taken account of the results of sensitivity testing.

Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Company and entities controlled by the Company up to 31 December each year. Control is achieved when the Company:

(i) has the power over the investee;

(ii) is exposed, or has rights to variable returns from its involvement with the investee; and

(iii) has the ability to use its power to affect the returns.

The Company reassesses whether or not it controls an investee if facts and circumstances indicate that there are changes to one or more of the three elements of control listed above.

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 accounting policies into line with those used by the Group. All intra-Group transactions, balances, income and expenses are eliminated on consolidation.

Non controlling interests represent the portion of profits or losses and net assets in subsidiaries that is not held by the Group and is presented within equity in the consolidated balance sheet, separate from equity of shareholders of Serco Group plc.

Adoption of new and revised standards

None of the changes to IFRS that became effective in the current reporting have had a significant impact on the Group's financial statements.

New standards and interpretations not applied

At the date of authorisation of these financial statements, the following changes to IFRS have not been applied in these financial statements but could potentially have a significant impact:

(i) IFRS 9 *Financial Instruments* has been endorsed by the EU and will be effective from 1 January 2018.

This standard replaces IAS 39 and introduces new requirements for classifying and measuring financial instruments and puts in place a new hedge accounting model that is designed to be more closely aligned with how entities undertake risk management activities when hedging financial and non-financial risk exposures.

IFRS 9 will impact both the measurement and disclosure of financial instruments and the total value of financial instruments at 31 December 2016 was £413.9m of assets (2015: £545.9m) and £413.4m of liabilities (2015: £521.7m), further detail of which can be found in note 32. However, it is not practicable to provide a reasonable estimate of the effect of this standard until a detailed review has been completed. The quantitative impact of the adoption of IFRS 9 will be disclosed prior to the adoption of this new standard.

Notes to the Consolidated Financial Statements continued

2. Significant accounting policies continued

New standards and interpretations not applied continued

(ii) IFRS 15 *Revenue From Contracts With Customers* has been endorsed by the EU and will be effective from 1 January 2018.

This new standard supersedes: IAS 11 *Construction contracts*; IAS 18 *Revenue*; IFRIC 13 *Customer loyalty programmes*; IFRIC 15 *Agreements for the construction of real estate*; IFRIC 18 *Transfers of assets from customers*; and SIC-31 *Revenue – Barter transactions involving advertising services*.

The new standard is intended to bring greater transparency and comparability to financial reporting.

IFRS 15 could result in a delay of revenues and profits over those previously recognised, in particular with respect of percentage to completion accounting and where elements of revenues associated with transition activities (also referred to as 'phase in') have been recognised in the early stages of contracts. A project to assess the full impact of the new standard is in its final stages but it is not possible to provide the quantum of any such impact at this time. It is not anticipated that the standard will be adopted early, which would be permitted on endorsement by the EU.

Under the transition rules IFRS 15 will be applied retrospectively to the prior period in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, subject to the following expedients:

- for contracts that have completed prior to 1 January 2018 and that begin and end within the same annual reporting period have not been restated;
- for contracts that have completed prior to 1 January 2018 the transaction price at the date the contract was completed has been applied for contracts that have variable consideration; and
- the amount of the transaction price allocated to the remaining performance obligations and an explanation of when that amount is expected to be recognised as revenue has not been disclosed for the prior period.

The cumulative effect of initially applying the standard will be shown as an adjustment to brought forward retained earnings as at 1 January 2017.

(iii) IFRS 16 *Leases* is pending EU endorsement, which is expected prior to the effective date of 1 January 2019.

The standard replaces IAS 17 *Leases* and has been introduced in order to improve the comparability of financial statements through developing an approach that is more consistent with the conceptual framework definitions of assets and liabilities.

The key change will be in respect of leases currently classified as operating leases. Under the new standard leases will be recognised on the balance sheet as liabilities with corresponding assets being created, grossing up the balance sheet but with no net effect on net assets at the start of the lease. The income statement impact will be a new interest charge arising from the rate implicit in the liability and as currently the full impact is a charge to operating profit, the change will result in an improvement to operating results.

We have not quantified the likely impact of the new standard, the transition approach to be taken or concluded whether it will be adopted early, which is allowed from the date IFRS 15 is adopted. The quantitative impact of the adoption of IFRS 16 will be disclosed prior to the adoption of this new standard.

Fair value

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, regardless of whether that price is directly observable or is estimated using another valuation technique. There are certain transactions in these financial statements which are similar to fair value, but are determined by the treatment set out in their respective standards. These are share based payment transactions that are within the scope of IFRS 2 *Share based Payment*, leasing transactions that are within the scope of IAS 17 *Leases*, or the calculation of net realisable value under IAS 2 *Inventories* or value in use under IAS 36 *Impairment of Assets*.

Revenue recognition

Revenue is measured as the fair value of the consideration received or receivable and represents amounts due for goods and services provided in the normal course of business, net of discounts, VAT and other sales related taxes. Calculating the fair value of revenue typically does not require a high level of judgement, the exceptions to this are the following areas:

- Uncontracted variations or claims. Where work has been performed outside of the normal contracting framework at the request of the customer or a claim has been made for work performed but is in dispute, judgement is required in order to determine whether there is sufficient certainty that the Group will be financially compensated. Revenue is only recognised to the extent that they have been orally agreed by the customer or are virtually certain of being received and revenue recognised in this manner is not considered to be significant to the Group's results.
- Payments by results contracts. When returns are directly linked to performance, through cost savings or other customer driven key performance indicators over a period of time an estimate is made of the likelihood of achieving the necessary level of performance when the period covers a financial year end. Revenue is only recognised when we can be reasonably certain of achieving the required level of performance and such payment mechanisms do not represent a significant proportion of annual revenue.
- Long-term contracts. Revenue and profit is recognised for certain long-term project based contracts based on the stage of completion of the contract activity. The assessment of the stage of completion requires the exercise of judgement and is measured by the proportion of costs incurred compared to the estimated whole life contract costs, except where whole life contract costs exceed the contract value, in which case the excess is expensed immediately.

While each of these areas requires a high level of judgement, only long-term contract accounting could have a significant impact on the Group's financial results or position. However, the only revenues associated with these contracts are earned on loss making contracts with onerous loss provisions and as a result we do not identify this as a separate item for disclosure in note 3.

Revenue recognition: Repeat service based contracts
Revenue on repeat service based contracts is recognised as services are provided in line with the transfer of control to the customer. Where initial contract costs (phase in costs) are paid for by the customer, revenue is recognised when the related costs are incurred.

Revenue recognition: Long-term project based contracts
The Group has a limited number of long-term contracts for the provision of complex, project-based services. Where the outcome of such long-term project based contracts can be measured reliably, revenue and costs are recognised by reference to the stage of completion of the contract activity at the balance sheet date in accordance with IAS 18 *Revenue* and IAS 11 *Construction Contracts*. This is normally measured by the proportion of contract costs incurred for work performed to date compared to the estimated total contract costs, but where a more accurate basis is available that alternative methodology is used. Contract costs include a rational allocation of overheads.

Where the outcome of a long-term project based contract cannot be estimated reliably, contract revenue is recognised to the extent that it is probable that contract costs will be recovered. Contract costs are recognised as expenses in the period in which they are incurred.

When it is probable that the total contract costs will exceed total contract revenue, the expected loss is recognised as an expense immediately. Such amounts are not discounted.

Revenue recognition: Other
Sales of goods are recognised when goods are delivered and title has passed.

Interest income is accrued on a time basis, by reference to the principal outstanding and at the effective interest rate applicable, which is the rate that exactly discounts estimated future cash receipts through the expected life of the financial asset to that asset's net carrying amount.

Dividend income from investments is recognised when the right to receive payment has been established.

Bid costs and phase in costs
All bid costs are expensed through the income statement up to the point where contract award (or full recovery of costs) is virtually certain, being the point at which the Group has at least reached preferred bidder status. Bid costs incurred after this point are then capitalised within trade and other receivables. On contract award these bid costs are amortised through the income statement over the contract period by reference to the stage of completion of the contract activity at the balance sheet date. Bid costs are only capitalised to the extent that it is expected that the related contract will generate sufficient future economic benefits to at least offset the amortisation charge.

Phase in costs that are incremental and directly related to the initial set up of contracts are capitalised within trade and other receivables and are recognised on a straight line basis over the life of the contract, except where they are specifically reimbursed as part of the terms of the contract when they are recognised in line with the associated revenue.

Determining whether bid and phase in costs are recoverable involves a high level of judgement as it requires a forecast to be prepared for the expected future profitability of the contract, taking into account the likely future costs and revenues associated with the services not yet performed. The level of bid and phase in costs can be seen in note 23.

Operating profit
Operating profit is not a measure defined by IFRS and the Group considers this to include the profits and losses from continuing operations prior to corporation tax, interest revenue and finance costs.

Foreign currencies
Transactions in currencies other than Sterling are recorded at the rates of exchange 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. Gains and losses arising on retranslation are included in the net profit or loss for the period, except for exchange differences arising on non-monetary assets and liabilities where the changes in fair value are recognised directly in equity through the consolidated statement of comprehensive income (SOCI).

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. Exchange differences arising, if any, are recognised directly within equity in the Group's hedging and translation reserve. Such translation differences are recognised as income or 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.

2. Significant accounting policies continued

Business combinations

Acquisitions of subsidiaries and businesses are accounted for using the acquisition method. The consideration for each 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. Acquisition related costs are recognised in profit or loss as incurred.

Where applicable, the consideration for the acquisition includes any asset or liability resulting from a contingent consideration arrangement, measured at its acquisition date fair value. Subsequent changes in fair values are adjusted against the cost of acquisition where they qualify as measurement period adjustments (which is subject to a maximum of one year). All other subsequent changes in the fair value of contingent consideration classified as an asset or liability are accounted for in accordance with the relevant accounting standards. Changes in the fair value of contingent consideration classified as equity are not recognised.

The acquiree's identifiable assets, liabilities and contingent liabilities that meet the conditions for recognition under IFRS 3 (2008) *Business Combinations* are recognised at their fair value at the acquisition date, except where a different treatment is mandated by another standard.

Assets classified as held for sale

Non-current assets and disposal groups 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 only met when the sale is highly probable, the asset or disposal group is available for immediate sale in its present condition and the Group expects the sale to be completed within one year. Amounts classified as held for sale are measured as the lower of the carrying amount and fair value less cost to sell.

Assessing whether the criteria are met requires judgement, in particular with regards to whether the subject of the assessment is in a suitable condition for sale. In addition, the calculation of the value of any goodwill to be allocated to the sale is dependent on an assessment of the likely sales proceeds and the likely structure of the transaction.

Investments in joint ventures and associates

A joint venture is an arrangement whereby the owning parties have joint control and rights over the net assets of the arrangement. The Group's investments in joint ventures are incorporated using the equity method of accounting.

Under the equity method, an investment in an associate or a joint venture is initially recognised in the consolidated balance sheet at cost and adjusted thereafter to recognise the Group's share of the profit or loss and other comprehensive income of the associate or joint venture. Any excess of the cost of acquisition over the Group's share of net fair value of the identifiable assets, liabilities and contingent liabilities of the joint venture recognised at the date of acquisition is recognised as goodwill. Goodwill is included within the carrying value amount of the investment and is assessed for impairment as part of that investment. Any excess of the Group's share of the net fair value of the identifiable assets, liabilities and contingent liabilities over the cost of acquisition, after reassessment, is recognised immediately in profit or loss. Where the Group entity transacts with a joint venture, profits and losses are eliminated to the extent of the Group's interest in the arrangement.

Determining whether joint control exists requires a level of judgement, based upon specific facts and circumstances which exist at the year end. Details of the unconsolidated joint ventures are provided in notes 6 and 7.

An associate is an entity over which the Group has significant influence and that is neither a subsidiary nor an interest in a joint venture. Significant influence is the power to participate in the financial and operating policy decisions of the investee but is not control or joint control. The results and assets and liabilities of associates are also incorporated in these financial statements using the equity method of accounting.

Goodwill

Goodwill is measured as the excess of the fair value of purchase consideration over the fair value of the net assets acquired and is recognised as an intangible asset when control is achieved. Negative goodwill is recognised immediately in the income statement. Fair value measurements are based on provisional estimates and may be subject to amendment within one year of the acquisition, resulting in an adjustment to goodwill.

Goodwill itself does not generate independent cash flows and therefore, in order to perform required tests for impairment, it is allocated at inception to the specific cash generating units (CGUs) or groups of CGUs which are expected to benefit from the acquisition.

On the disposal of a business which includes all or part of a CGU, any attributable goodwill is included in the determination of the profit or loss on disposal. Where part of a CGU with goodwill is sold, the attributable amount is calculated based on the future discounted cash flows leaving the Group as a proportion of the total CGU future discounted cash flows.

The fair values associated with material business combinations are valued by external advisers and any amount of consideration which is contingent in nature is evaluated at the end of each reporting period, based on internal forecasts.

Other intangible assets

Material intangible assets are grouped into classes of similar nature and use and separately disclosed. Other intangible assets are amortised from the date of completion.

Customer relationships can arise on the acquisition of subsidiaries and represent the incremental value expected to be gained as a result of existing contracts in the purchased business. These assets are amortised over the average length of the related contracts.

Licences comprise premiums paid for the acquisition of licences, while franchises represent costs incurred in obtaining franchise rights arising on the acquisition of franchises. These are amortised on a straight-line basis over the life of the respective licence or franchise.

Software and IT represent computer systems and processes used by the Group in order to generate future economic value through normal business operations. The underlying assets are amortised over the period from which the Group expects to benefit, which is typically between three to eight years.

Development expenditure is capitalised as an intangible asset only if all of certain conditions are met, with all research costs and other development expenditure being expensed when incurred. The period of expected benefit, and therefore period of amortisation, is typically between three and eight years. The capitalisation criteria are as follows:

- an asset is created that can be separately identified, and which the Group intends to use or sell;
- the finalisation of the asset is technically feasible and the Group has adequate resources to complete its development for use or sale;
- it is probable that the asset created will generate future economic benefits; and
- the development cost of the asset can be measured reliably.

Property, plant and equipment

Assets held for use in the rendering of services, or for administrative purposes, are stated in the balance sheet at cost, net of accumulated depreciation and any provision for impairment. Assets are grouped into classes of similar nature and use and separately disclosed except where this is not material.

Depreciation is provided on a straight line basis at rates designed to reduce the assets to their residual value over their estimated useful lives.

The principal annual rates used are:

Freehold buildings	2.5%
Short leasehold assets	The higher of 10% or the rate produced by the lease term
Machinery	15% – 20%
Motor vehicles	10% – 50%
Furniture	10%
Office equipment	20% – 33%
Leased equipment	The higher of the rate produced by the lease term or useful life

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 the income statement. Given that there is limited history of material gains or losses on disposal of fixed assets, the level of judgement involved in determining the depreciation rates is not considered to be significant.

2. Significant accounting policies continued

Asset impairment

The Group reviews the carrying amounts of its tangible and intangible assets (including goodwill) at each reporting period, together with any other assets under the scope of IAS 36 *Impairment of Assets*, in order to assess whether there is any indication that those assets have suffered an impairment loss. As the impairment of assets has been identified as both a key source of estimation uncertainty and a critical accounting judgement, further details around the specific judgements and estimates can be seen in note 3.

If any indication of impairment exists, the recoverable amount of the asset is estimated in order to determine if there is any impairment loss. Goodwill is assessed for impairment annually, irrespective of whether there are any indicators of impairment. Where the asset does not generate cash flows that are independent from other assets, the Group estimates the recoverable amount of the CGU to which the asset belongs.

Recoverable amount is defined as 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 with reference to pre-tax discount rates that reflect the risks specific to the asset for which the estimates of future cash flows have not been adjusted.

If the recoverable amount is estimated to be less than the carrying amount of the asset, the carrying amount is impaired to its recoverable amount. Impairment losses recognised in respect of CGUs are allocated first to reduce the carrying amount of any goodwill allocated to the CGU and then to reduce the carrying amount of the other assets in the CGU on a pro-rata basis.

An impairment loss in respect of goodwill is not reversed. In respect of other assets, impairment losses recognised in prior periods are assessed at each reporting date for indications that the loss has decreased or no longer exists. Where an impairment loss subsequently reverses, the carrying amount 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, net of depreciation or amortisation, had no impairment loss been recognised in prior years.

Impairment losses and reversals are recognised immediately within administrative expenses within the income statement unless it is considered to be an exceptional item.

Retirement benefit costs

Payments to defined contribution pension schemes are charged as an expense as they fall due.

For defined benefit pension schemes, the cost of providing benefits is determined using the projected unit credit actuarial cost 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 the income statement and are presented in the SOCI.

Both current and past service costs are the amounts recognised in the income statement, reflecting the expense associated with the individuals. Current service cost represents the increase in the present value of the scheme liabilities expected to arise from employee service in the current period. Past service cost is recognised immediately to the extent that the benefits are already vested. Gains and losses on curtailments or settlements are recognised in the income statement in the period in which the curtailment or settlement occurs.

The retirement benefit obligation recognised in the balance sheet represents the present value of the defined benefit obligation as adjusted for unrecognised past service costs, 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 (which is only recognised to the extent that the Group has an unconditional right to receive it) and reductions in future contributions to the scheme. To the extent that an economic benefit is available as a reduction in future contributions and there is a minimum funding requirement required of the Group, the economic benefit available as a reduction in contributions is calculated as the present value of the estimated future service cost in each year, less the estimated minimum funding contributions required in respect of the future accrual and benefits in that year.

Calculation of the amounts recognised in the consolidated financial statements in respect of defined benefit pension schemes requires a *high level of judgement, as further explained in note 3.*

Defined benefit obligations arising from contractual obligations

Where the Group takes on a contract and assumes the obligation to contribute variable amounts to the defined benefit pension scheme throughout the period of the contract, the Group's share of the defined benefit obligation less its share of the pension scheme assets that it will fund over the period of the contract is recognised as a liability at the start of the contract with a corresponding amount being recognised as an intangible asset. The intangible asset, which reflects the Group's right to manage and operate the contract, is amortised over the contract period. The Group's share of the scheme assets and liabilities is calculated by reducing the scheme assets and liabilities by a franchise adjustment. The franchise adjustment represents the estimated amount of scheme deficit that will be funded outside the contract period. Subsequent actuarial gains and losses in relation to the Group's share of pension obligations are recognised within Other Comprehensive Income.

Derivative financial instruments and hedging activities

The Group enters into a variety of derivative financial instruments to manage the exposure to interest rate, foreign exchange risk and price risk, including currency swaps, foreign exchange forward contracts, interest rate swaps and commodity future contracts. Further details of derivative financial instruments are given in note 32.

Derivatives are initially recognised at fair value at the date a derivative contract is entered into and are subsequently re-measured to their fair value at each balance sheet date. The resulting gain or loss is recognised in profit or loss immediately unless the derivative is designated and effective as a hedging instrument, in which event the timing of the recognition in profit or loss depends on the nature of the hedge relationship. The Group designates certain derivatives as either hedges of the fair value of recognised assets or liabilities (fair value hedges) or hedges of highly probable forecast transactions or hedges of firm commitments (cash flow hedges).

At the inception of the hedge relationship, the Group documents the relationship between the hedging instrument and the hedged item, along with its risk management objectives and its strategy for undertaking various hedge transactions. Both at the inception of the hedge and on a periodic basis, the Group assesses whether the hedging instrument that is used in a hedging relationship is highly effective in offsetting changes in fair values or cash flows of the hedged item.

A derivative is presented as a non-current asset or a non-current liability if the remaining maturity of the instrument is more than 12 months and it is not expected to be realised or settled within 12 months. Derivatives, which mature within 12 months, are presented as current assets or current liabilities.

Details of the fair values of the derivative instruments used for hedging purposes and movements in the hedging and translation reserve in equity are detailed in the SOCI and described in note 32.

Fair value hedges

Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in profit or loss immediately, together with any changes in the fair value of the hedged item that is attributable to the hedged risk. The change in the fair value of the hedging instrument and the change in the hedged item attributable to the hedged risk are recognised in the line of the income statement relating to the hedged item.

Hedge accounting is discontinued when the Group de-designates the hedging relationship, the hedging instrument expires or is sold, terminated, exercised, or no longer qualifies for hedge accounting. The adjustment to the carrying amount of the hedged item arising from the hedged risk is amortised to profit or loss from that date.

Cash flow hedges

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges are deferred in equity. The gain or loss relating to the ineffective portion is recognised immediately in profit or loss. Amounts accumulated in equity are reclassified to profit or loss in the periods when the hedged item affects profit or loss, in the same line of the income statement as the recognised hedged item.

Hedge accounting is discontinued when the Group de-designates the hedging relationship, the hedging instrument expires or is sold, terminated, exercised, or no longer qualifies for hedge accounting. Any cumulative gain or loss deferred in equity at that time remains in equity and is recognised when the forecast transaction is ultimately recognised in profit or loss. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was deferred in equity is recognised immediately in profit or loss.

Notes to the Consolidated Financial Statements continued

2. Significant accounting policies continued

Tax

The tax expense represents the sum of current tax expense and deferred tax expense.

Current tax expense 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 provided, using the liability method, on temporary differences at the balance sheet date between the tax bases of assets and liabilities and their carrying amounts for accounting purposes.

Deferred tax liabilities are generally recognised for all taxable temporary differences. Deferred tax assets are generally recognised for all deductible temporary differences, carry forward of unused tax credits and unused tax losses, to the extent that it is probable that taxable profits will be available against which these items can be utilised.

Deferred tax assets and liabilities are not recognised if the temporary difference arises from goodwill or from the initial recognition of an asset and liability in a transaction other than a business combination and, at the time of the transaction, affects neither the tax profit nor the accounting profit.

Deferred tax liabilities are recognised for taxable temporary differences arising on investments in subsidiaries, 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 utilised.

Deferred tax is measured at the tax rates that are expected to apply in the period when the liability is settled or the asset is realised, based upon tax rates and legislation that have been enacted or substantively enacted at the balance sheet date. Deferred tax is charged or credited in the income statement, except where it relates to items charged or credited directly to equity, in which case the deferred tax is also recognised 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 tax authority where the Group intends to settle its current tax assets and liabilities on a net basis.

Share based payment

Where the fair value of share options requires the use of a valuation model, fair value is measured by use of Binomial Lattice, Black Scholes or Monte Carlo Simulation models depending on the type of scheme, as set out in note 37. The expected life used in the models has been adjusted, based on management's best estimate, for the effects of non transferability, exercise restrictions, and behavioural considerations. Where relevant, the value of the option has also been adjusted to take account of market conditions applicable to the option.

Inventories

Inventories are stated at the lower of cost and net realisable value and comprise service spares, parts awaiting installation and work in progress for projects undertaken for customers where payment is received on completion. Cost comprises direct materials and, where applicable, direct labour costs that have been incurred in bringing the inventories to their present location and condition.

Trade receivables

Trade receivables are recognised initially at cost (being the same as fair value) and subsequently at amortised cost less any provision for impairment, to ensure that amounts recognised represent the recoverable amount.

A provision for impairment arises where there is evidence that the Group will not be able to collect amounts due, which is achieved by creating an allowance for doubtful debts recognised in the income statement within administrative expenses. Determining whether a trade receivable is impaired requires judgement to be applied based on the information available at each reporting date. Key indicators of impairment include disputes with customers over commercial positions, or where debtors have significant financial difficulties such as historic default of payments or information that suggests bankruptcy or financial reorganisation are a reasonable possibility. The majority of contracts entered into by the Group are with government organisations or are blue chip private sector companies and therefore historic levels of default are relatively low and as a result the risks associated with this judgement are not considered to be significant.

When a trade receivable is expected to be uncollectible, it is written off against the allowance for doubtful debts. Subsequent recoveries of amounts previously provided for or written off are credited against administrative expenses.

Cash and cash equivalents

Cash and cash equivalents comprise cash in hand and balances with banks and similar institutions, which are readily convertible to known amounts of cash and which are subject to insignificant changes in value and have a maturity of three months or less from the date of acquisition. This definition is also used for the consolidated cash flow statement.

Leases

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.

Assets held under finance leases are recognised as assets of the Group at fair value or, if lower, at the present value of minimum lease payments determined at the inception of the lease. The corresponding liability to the lessor 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 to the income statement, unless they are directly attributable to a qualifying asset, in which case they are capitalised in accordance with the Group's general policy on borrowing costs (see below).

Total rentals payable under operating leases are charged to the income statement on a straight-line basis over the term of the relevant lease.

Loans

Loans are stated at amortised cost using the effective interest-rate method. Accrued interest is recorded separately from the associated borrowings within current liabilities.

Loans are described as non recourse loans and classified as such only if no Group company other than the relevant borrower has an obligation, under a guarantee or other arrangement, to repay the debt.

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 as an expense in the period in which they are incurred.

Provisions

Provisions are recognised when the Group has an obligation to make a cash outflow as a result of a past event. Provisions are measured at the best estimate of the expenditure required to settle the obligation at the balance sheet date when settlement is considered to be likely.

Onerous contract provisions (OCPs) arise when the unavoidable costs of meeting contractual obligations exceed the remuneration expected to be received. Unavoidable costs include total contract costs together with a rational allocation of shared costs that can be directly linked to fulfilling contractual obligations which have been systematically allocated to OCPs on the basis of key cost drivers except where this is impracticable, where contract revenue is used as a proxy to activity. The provision is calculated as the lower of the termination costs payable for an early exit and the expected net cost over the remaining contract period. Where a customer has an option to extend a contract and it is likely that such an extension will be made, the expected net cost arising during the extension period, is included within the calculation. However, where a profit can be reasonably expected in the extension period, no credit is taken on the basis that such profits are uncertain given the potential for the customer to either not extend or offer an extension under lower pricing terms. Further details of the judgements can be seen in note 3.

Net investments in foreign operations

Exchange differences arising on monetary items that form part of the Group's net investment in foreign operations are initially recognised in equity and accumulated in the hedging and translation reserve and reclassified from equity to profit or loss on disposal of the net investment.

Dividends payable

Dividends are recorded in the Group's consolidated financial statements in the period in which they are declared, appropriately authorised and no longer at the discretion of the Company.

Segmental information

Segmental information is based on internal reports about components of the Group that are regularly reviewed by the Group's Chief Operating Decision Maker (CODM) in order to allocate resources to the segments and to assess their performance. The CODM is considered to be the Board of Directors as a body.

Segmental revenue is analysed on an external basis. Inter-segment revenue is not presented as it is not significant in the context of revenue as a whole. Net finance costs are not presented for each operating segment as they are reviewed on a consolidated basis by the CODM.

Specific corporate expenses are allocated to the corresponding segments. Segment assets comprise goodwill, other intangible assets, property, plant and equipment, inventories, trade and other receivables (excluding corporation tax recoverable) and any retirement benefit asset. Segment liabilities comprise trade and other payables and retirement benefit obligations.

3. Critical accounting judgements and key sources of estimation uncertainty

In the process of applying the Group's accounting policies, which are described in note 2 above, management has made the following judgements that have the most significant effect on the amounts recognised in the financial statements. As described below, many of *these areas of judgement also involve a high level of estimation uncertainty.*

Prior year restatement: Change in accounting policy

The accounting policy regarding the classification of foreign exchange movements in relation to investment and financing arrangements was changed in the year. Judgement was applied in reaching the conclusion that it provides more relevant financial results to exclude these amounts from the underlying transactions of trading operations. Further details are provided in note 2.

Use of Alternative Performance Measures: Operating profit before exceptional items

IAS 1 requires material items to be disclosed separately in a way that enables users to assess the quality of a company's profitability. In practice, these are commonly referred to as 'exceptional' items, but this is not a concept defined by IFRS and therefore there is a level of judgement involved in arriving at an Alternative Performance Measure which excludes such exceptional items. We consider items which are material, non-recurring and outside of the normal operating practice of the company to be suitable for separate presentation. Further details can be seen in note 11.

The segmental analysis of continuing operations in note 5 includes the additional performance measure of Trading Profit on continuing operations which is reconciled to reported operating profit in that note. The Group uses Trading Profit as an alternative measure to reported operating profit by making several adjustments. Firstly, Trading Profit excludes exceptional items, being those we consider material, non-recurring and outside of the normal operating practice of the company to be suitable of separate presentation and detailed explanation. Secondly, amortisation and impairment of intangibles arising on acquisitions are excluded, because these charges are based on judgments about the value and economic life of assets that, in the case of items such as customer relationships, would not be capitalised in normal operating practice. The CODM reviews the segmental analysis for continuing operations together with discontinued operations.

Provisions for onerous contracts

Determining whether provisions are required for loss making contracts requires significant judgements to be made regarding the ability of the company to maintain or improve operational performance. Judgements can also be made regarding the outcome of matters dependent on the behaviour of the customer in question or other parties involved in delivering the contract.

The level of uncertainty in the estimates made, either in determining whether a provision is required, or in the calculation of a provision booked, is linked to the complexity of the underlying contract and the form of service delivery.

In the current year material revisions have been made to historic provisions, which have led to a charge to contract provisions of £56.6m and releases of £65.5m. All of these revisions have resulted from triggering events in the current year, either through changes in contractual positions or changes in circumstances which could not have been reasonably foreseen at the previous balance sheet date. To mitigate the level of uncertainty in making these estimates Management regularly compares actual performance of the contracts against previous forecasts and considers whether there have been any changes to significant judgements. A detailed bottom up review of the provisions is performed as part of the Group's formal annual budgeting process.

The individual provisions are discounted where the impact is assessed to be material. Discount rates used are calculated based on the estimated risk free rate of interest for the region in which the provision is located and matched against the ageing profile of the provision. Rates applied are in the range of 1.16% and 3.30%.

Impairment of assets

Identifying whether there are indicators of impairment for assets involves a high level of judgement and a good understanding of the drivers of value behind the asset. At each reporting period an assessment is performed in order to determine whether there are any such indicators, which involves considering the performance of our business and any significant changes to the markets in which we operate. The total value of assets which are covered by this assessment process (after previous impairments) is £1,340.9m, which is the maximum exposure related to this judgement. We mitigate the risk associated with this judgement by putting in place processes and guidance for the finance community and internal review procedures.

Determining whether assets with impairment indicators require an actual impairment involves an estimation of the expected value in use of the asset (or CGU to which the asset relates). The value in use calculation involves an estimation of future cash flows and also the selection of appropriate discount rates, both of which involve considerable judgement. The future cash flows are derived from approved forecasts, with the key assumptions being revenue growth, margins and cash conversion rates. Discount rates are calculated with reference to the specific risks associated with the assets and are based on advice provided by external experts. Our calculation of discount rates are performed based on a risk free rate of interest appropriate to the geographic location of the cash flows related to the asset being tested, which is subsequently adjusted to factor in local market risks and risks specific to Serco and the asset itself. Discount rates used for internal purposes are post tax rates, however for the purpose of impairment testing in accordance with IAS 36 *Impairment of Assets* we calculate a pre tax rate based on post tax targets.

A key area of focus in recent years has been in the impairment testing of goodwill as a result of the pressure on the results of the Group. While no further impairment of pre existing goodwill was noted in 2016, an impairment charge of £17.8m did arise following the acquisition of a business in the year. Further details are provided in note 19.

Deferred tax

Deferred tax assets are recognised for unused tax losses to the extent that it is probable that taxable profit will be available against which the losses can be utilised. Significant management judgement is required to determine the amount of deferred tax assets that can be recognised, based upon the likely timing and the level of future taxable profits.

As at the balance sheet date, the Group has unused tax losses of £893.5m (2015: £890.1m) available for offset against future profits. A deferred tax asset has been recognised in respect of £69.1m (2015: £59.9m) of such losses of which £58.8m (net £10.0m) relates to losses incurred in the UK and £10.3m (net £0.3m) which relates to other jurisdictions.

Recognition has been based on forecast future taxable profits. No deferred tax asset has been recognised in respect of the remaining losses (net £147.0m) as it is not probable that there will be future taxable profits available.

Further details on taxes are disclosed in note 17.

Current tax

Liabilities for tax contingencies require management judgement and estimates in respect of tax audits and also tax exposures in each of the jurisdictions in which we operate. Management is also required to make an estimate of the current tax liability together with an assessment of the temporary differences that arise as a consequence of different accounting and tax treatments. Key judgement areas include the correct allocation of profits and losses between the countries in which we operate and the pricing of intercompany services. Where management conclude that a tax position is uncertain, a current tax liability is held for anticipated taxes that are considered probable based on the current information available.

These liabilities can be built up over a long period of time but the ultimate resolution of tax exposures usually occurs at a point in time, and given the inherent uncertainties in assessing the outcomes of these exposures, these estimates are prone to change in future periods. It is not currently possible to estimate the timing of potential cash outflows, but on resolution, to the extent this differs from the liability held, this will be reflected through the tax charge/(credit) for that year. Each potential liability and contingency is revisited on an annual basis and adjusted to reflect any changes in positions taken by the company, local tax audits, the expiry of the statute of limitations following the passage of time and any change in the broader tax environment. The total current tax liability at December 2016 was £25.9m (2015: £14.2m).

On the basis of the currently available information, the Group does not anticipate a material change to the estimated liability in the coming year.

Retirement benefit obligations

Identifying whether the Group has a retirement benefit obligation as a result of contractual arrangements entered into requires a level of judgement, largely driven by the legal position held between the Group, the customer and the relevant pension scheme. The Group's retirement benefit obligations and other pension scheme arrangements are covered in note 33.

The calculation of retirement benefit obligations is dependent on material key assumptions including discount rates, mortality rates, inflation rates and future contribution rates (see note 33). The value of net retirement benefit obligations at the balance sheet date is an asset of £132.7m (2015: £115.6m). Details of the impact of changes in assumptions relating to retirement benefit obligations are disclosed in note 33.

In accounting for the defined benefit schemes, the Group has applied the following principles:

- Asset recognised for Serco Pension and Life Assurance Scheme (SPLAS) is based on the assumption that the full surplus will ultimately be available to the Group as a future refund of surplus.
- No foreign exchange item is shown in the disclosures as the non UK liabilities are not material.
- No pension assets are invested in the Group's own financial instruments or property.

4. Discontinued operations

The Global Services division, representing UK onshore and offshore private sector BPO operations, was classified as a discontinued operation in 2015. The completion of the sale of the majority of the offshore private sector BPO business occurred on 31 December 2015. Disposal of one of the two remaining elements of the offshore business was completed in March 2016 and the final element completed in December 2016. The UK onshore private sector BPO businesses have been sold, or have been exited early with the exception of one business where the sale process is ongoing and completion is expected within the next twelve months.

The results of the discontinued operations were as follows:

For the year ended 31 December	2016 £m	2015 £m
Revenue	36.8	337.6
Expenses	(40.1)	(311.1)
Operating (loss) / profit before exceptional items	(3.3)	26.5
Exceptional (loss) / profit on disposal of subsidiaries and operations	(2.8)	5.4
Other exceptional operating items	(11.4)	(83.0)
Operating loss	(17.5)	(51.1)
Investment revenue	–	2.1
Finance costs	–	(1.2)
Exceptional finance costs	(0.4)	–
Loss before tax	(17.9)	(50.2)
Tax charge on loss before exceptional items	(0.1)	(18.7)
Tax credit on exceptional items	–	2.7
Net loss attributable to discontinued operations presented in the income statement	(18.0)	(66.2)
Attributable to:		
Equity owners of the Company	(18.1)	(66.0)
Non controlling interests	0.1	(0.2)

Included above are items classified as exceptional as they are considered to be material, non recurring and outside of the normal course of business. These are summarised as follows:

For the year ended 31 December	2016 £m	2015 £m
Exceptional items arising on discontinued operations		
Exceptional (loss) / profit on disposal	(2.8)	5.4
Other exceptional operating items		
Restructuring costs	(1.1)	(2.2)
Impairment of goodwill	–	(65.9)
Movements in indemnities provided on business disposals	(13.7)	–
Movement in the fair value of assets transferred to held for sale	3.4	(14.9)
Other exceptional operating items	(11.4)	(83.0)
Exceptional operating items arising on discontinued operations	(14.2)	(77.6)

In 2016 a charge of £1.1m (2015: £2.2m) has arisen in discontinued operations in relation to the restructuring programme resulting from the Strategy Review. This includes redundancy payments, provisions and other charges relating to the exit of the UK private sector BPO business, external advisory fees and other incremental costs.

During 2015, an impairment test of the Global Services business was conducted based on a level 3 fair value measurement, with reference to offers received less costs of disposal. The impairment testing identified a non cash exceptional impairment of goodwill relating to discontinued operations of £65.9m.

A charge of £13.7m has arisen in 2016 in relation to the movement in the value of indemnities provided on business disposals made in previous years. This relates to changes in exchange rates where indemnities were provided in foreign currencies and increases to provisions for interest and penalties on any indemnities.

The value of assets held for sale increased by £3.4m in 2016, reflecting the changing estimate of the likely proceeds and movements of the assets held for sale since the prior balance sheet date. In 2015 the held for sale assets were impaired by £14.9m.

A charge of £0.4m was incurred as a result of early payments to the US Private Placement (USPP) Noteholders following the disposal of the offshore private sector BPO business. These charges are treated as exceptional finance costs as they are directly linked to the restructuring resulting from the Strategy Review. Similar charges arose in 2015 which, together with the costs related to the preservation of the Group's existing finance facilities, totalled £32.8m.

The net assets at the date of disposal of discontinued operations were:

	Offshore £m	**UK onshore £m**
Goodwill	8.0	–
Property, plant and equipment	1.0	–
Trade and other receivables	3.8	2.5
Cash and cash equivalents	5.6	–
Trade and other payables	(4.2)	1.2
Minority interest disposed	(0.5)	–
Net assets disposed	13.7	3.7

The loss on disposal of discontinued operations is calculated as follows:

	Offshore £m	**UK onshore £m**	**Total £m**
Consideration	15.2	3.5	18.7
Less:			
Net assets disposed	(13.7)	(3.7)	(17.4)
Disposal related costs	(0.5)	(1.4)	(1.9)
Loss on disposal of discontinued operations prior to reserve recycling	1.0	(1.6)	(0.6)
Recycling of gains on translation of foreign operations	(2.2)	–	(2.2)
Exceptional loss on disposal	(1.2)	(1.6)	(2.8)

Notes to the Consolidated Financial Statements continued

4. Discontinued operations continued

The net cash inflow arising on disposal of discontinued operations and the impact on Net Debt is as follows:

	Offshore £m	UK onshore £m	Total £m
Cash consideration	15.2	2.0	17.2
Less:			
Cash and cash equivalents disposed	(5.6)	–	(5.6)
Disposal related costs	(0.5)	(1.4)	(1.9)
Net cash flow on disposal and movement in Net Debt	9.1	0.6	9.7

The net cash flows resulting from the discontinued operations were as follows:

For the year ended 31 December	2016 £m	2015 £m
Net cash inflow from operating activities before exceptional items	5.5	67.7
Exceptional items	–	(1.5)
Net cash inflow from operating activities	5.5	66.2
Net cash inflow from investing activities	12.5	93.5
Net cash outflow from financing activities	(11.4)	(26.5)
Net increase in cash and cash equivalents attributable to discontinued operations	6.6	133.2

5. Segmental information

The Group's operating segments reflecting the information reported to the Board in 2016 under IFRS 8 *Operating Segments* are as set out below.

Reportable segments	Operating segments
UK Central Government	Services for sectors including Defence, Justice & Immigration and Transport delivered to UK Government and devolved authorities;
UK & Europe Local & Regional Government	Services for sectors including Health and Citizen Services delivered to UK & European public sector customers;
AsPac	Services for sectors including Defence, Justice & Immigration, Transport, Health and Citizen Services in the Asia Pacific region including Australia, New Zealand and Hong Kong;
Middle East	Services for sectors including Defence, Transport and Health in the Middle East region;
Americas	Services for sectors including Defence, Transport and Citizen Services delivered to US federal and civilian agencies, selected state and municipal governments and the Canadian Government; and
Corporate	Central and head office costs.

Each operating segment is focused on a narrow group of customers in a specific geographic region and is run by a local management team which report directly to the CODM on a regular basis. As a result of this focus, the sectors in each region have similar economic characteristics and are aggregated at the operating segment level in these financial statements. The accounting policies of the reportable segments are the same as the Group's accounting policies described in note 2.

Geographic information

Year ended 31 December	Revenue 2016 £m	Non-current assets* 2016 £m	Revenue 2015 £m	Non-current assets* 2015 £m
United Kingdom	1,244.9	444.7	1,529.2	259.2
United States	632.9	309.1	632.0	347.7
Australia	593.1	146.0	514.7	125.5
Middle East	324.8	19.7	291.3	16.2
Other countries	215.3	20.4	209.8	34.0
Total	3,011.0	939.9	3,177.0	782.6

* Non-current assets exclude financial instruments, deferred tax assets and loans to joint ventures and associates and include held for sale assets. There are no held for sale items in 2016. 2015 includes held for sale assets of £1.2m

Revenues from external customers are attributed to individual countries on the basis of the location of the customer.

Information about major customers

The Group has three major governmental customers which each represent more than 10% of Group revenues. The customers' revenues were £1,233.7m for the UK Government across the UK Central Government and UK & Europe Local & Regional Government segments, £623.1m for the US Government within the Americas segment, and £581.4m for the Australian Government within the AsPac segment.

In 2015 the Group had two major governmental customers which each represented more than 10% of Group revenues. The customers' revenues were £1,480.9m for the UK Government across the UK Central Government and UK & Europe Local & Regional Government segments, and £558.5m for the US Government within the Americas segment.

The following is an analysis of the Group's revenue, results, assets and liabilities by reportable segment:

Year ended 31 December 2016	CG £m	LRG £m	AsPac £m	Middle East £m	Americas £m	Corporate £m	Total £m
Revenue	678.6	696.5	619.7	324.8	691.4	–	3,011.0
Result							
Trading profit / (loss) from continuing operations	94.9	(10.4)	34.2	18.8	6.4	(40.3)	103.6
Amortisation and impairment of intangibles arising on acquisition	(0.3)	–	(2.0)	–	(2.8)	–	(5.1)
Operating profit / (loss) before exceptional items	94.6	(10.4)	32.2	18.8	3.6	(40.3)	98.5
Exceptional profit / (loss) on disposal of subsidiaries and operations	(0.1)	4.5	0.4	–	–	(1.9)	2.9
Other exceptional operating items	(11.1)	(14.8)	(0.9)	–	–	(32.4)	(59.2)
Operating profit / (loss)	83.4	(20.7)	31.7	18.8	3.6	(74.6)	42.2
Investment revenue							9.3
Finance costs							(21.9)
Profit before tax							29.6
Tax charge							(15.8)
Tax on exceptional items							3.1
Profit for the year from continuing operations							16.9

Notes to the Consolidated Financial Statements continued

5. Segmental information continued

Year ended 31 December 2016	CG £m	LRG £m	AsPac £m	Middle East £m	Americas £m	Corporate £m	Total £m
Supplementary information							
Share of profits in joint ventures and associates, net of interest and tax	31.3	–	2.0	–	–	0.1	33.4
Depreciation of plant, property and equipment	(2.1)	(12.9)	(4.5)	(0.9)	(3.1)	(1.3)	(24.8)
Impairment of plant, property and equipment	(0.3)	–	(0.4)	–	–	–	(0.7)
Total depreciation and impairment of plant, property and equipment	(2.4)	(12.9)	(4.9)	(0.9)	(3.1)	(1.3)	(25.5)
Amortisation of intangible assets arising on acquisition	(0.3)	–	(1.3)	–	(2.8)	–	(4.4)
Impairment and write down of intangible assets arising on acquisition	–	–	(0.7)	–	–	–	(0.7)
Amortisation of other intangible assets	(0.1)	(0.5)	(3.3)	(0.7)	(1.5)	(15.7)	(21.8)
Total amortisation and impairment of intangible assets	(0.4)	(0.5)	(5.3)	(0.7)	(4.3)	(15.7)	(26.9)
Segment assets							
Interests in joint ventures and associates	12.3	–	1.7	0.4	–	–	14.4
Other segment assets	168.7	298.3	252.1	108.7	428.8	228.6	1,485.2
Total segment assets	181.0	298.3	253.8	109.1	428.8	228.6	1,499.6
Unallocated assets							265.0
Consolidated total assets							1,764.6
Segment liabilities							
Segment liabilities	(279.1)	(163.8)	(182.8)	(79.3)	(140.7)	(139.7)	(985.4)
Unallocated liabilities							(380.4)
Consolidated total liabilities							(1,365.8)

Year ended 31 December 2015 (restated*)	CG £m	LRG £m	AsPac £m	Middle East £m	Americas £m	Corporate £m	Total £m
Revenue	742.1	905.8	544.7	291.4	693.0	–	3,177.0
Result							
Trading profit / (loss) from continuing operations* **	60.2	(14.5)	58.8	27.4	27.0	(48.0)	110.9
Amortisation and impairment of intangibles arising on acquisition	–	(1.1)	(1.2)	–	(2.5)	–	(4.8)
Operating profit / (loss) before exceptional items*	60.2	(15.6)	57.6	27.4	24.5	(48.0)	106.1
Exceptional profit / (loss) on disposal of subsidiaries and operations	0.5	0.3	(2.6)	–	–	(0.8)	(2.6)
Other exceptional operating items	(0.2)	(1.7)	(1.3)	(1.8)	(87.5)	(14.8)	(107.3)
Operating profit / (loss)*	60.5	(17.0)	53.7	25.6	(63.0)	(63.6)	(3.8)
Investment revenue							6.1
Finance costs*							(71.7)
Loss before tax							(69.4)
Tax charge							(17.9)
Tax on exceptional items							0.4
Loss for the year from continuing operations							(86.9)

* Administrative expenses included within Trading Profit and operating profit has been restated following the change in accounting policy regarding foreign exchange movements on investment and financing arrangements which has also resulted in a restatement of finance costs. See note 2.

** Trading profit / (loss) is defined as operating (loss) / profit before exceptional items and amortisation and impairment of intangible assets arising on acquisition.

Notes to the Consolidated Financial Statements continued

5. Segmental information continued

Year ended 31 December 2015	CG £m	LRG £m	AsPac £m	Middle East £m	Americas £m	Corporate £m	Total £m
Supplementary information							
Share of profits in joint ventures and associates, net of interest and tax	33.8	1.5	0.8	–	0.1	0.8	37.0
Depreciation of plant, property and equipment	(1.9)	(13.3)	(5.4)	(1.1)	(3.0)	(1.4)	(26.1)
Impairment of plant, property and equipment	(1.6)	–	–	–	(0.4)	–	(2.0)
Total depreciation and impairment of plant, property and equipment	(3.5)	(13.3)	(5.4)	(1.1)	(3.4)	(1.4)	(28.1)
Amortisation of intangible assets arising on acquisition	–	(1.1)	(1.2)	–	(2.5)	–	(4.8)
Amortisation of other intangible assets	(0.4)	(2.0)	(1.5)	(0.7)	(1.1)	(18.0)	(23.7)
Impairment and write down of other intangible assets	–	(9.0)	–	–	–	–	(9.0)
Total amortisation and impairment of intangible assets	(0.4)	(12.1)	(2.7)	(0.7)	(3.6)	(18.0)	(37.5)
Segment assets*							
Interests in joint ventures and associates	4.4	6.5	0.4	0.2	2.3	–	13.8
Other segment assets	173.5	306.1	232.5	100.3	379.3	196.6	1,388.3
Total segment assets	177.9	312.6	232.9	100.5	381.6	196.6	1,402.1
Unallocated assets, including assets held for sale							437.4
Consolidated total assets							1,839.5
Segment liabilities*							
Segment liabilities	(340.0)	(188.9)	(194.1)	(74.7)	(108.6)	(154.0)	(1,060.3)
Unallocated liabilities, including liabilities held for sale							(497.1)
Consolidated total liabilities							(1,557.4)

* Segment assets and liabilities have been restated to reflect a consistent presentation of usage.

6. List of principal undertakings

The following are considered to be the principal undertakings of the Group as at the year end:

Principal subsidiaries		2016	2015
United Kingdom	Serco Limited	100%	100%
Australia	Serco Australia Pty Limited	100%	100%
USA	Serco Inc.	100%	100%

Principal joint ventures and associates		2016	2015
United Kingdom	AWE Management Limited	24.5%	33.3%
United Kingdom	Merseyrail Services Holding Company Limited	50%	50%
United Kingdom	Northern Rail Holdings Limited	50%	50%

A full list of subsidiaries and related undertakings is included in the Appendix on pages 214 to 216 which form part of the financial statements.

7. Joint ventures and associates

The Group has certain arrangements where control is shared equally with one or more parties and accounts for these arrangements as joint ventures. AWE Management Limited (AWEML) was formerly a joint venture but in August 2016 there was a change in the AWEML shareholding structure, with the Group's shareholding reducing from 33.3% to 24.5% by way of a return of shares and Lockheed Martin taking a majority holding. The Group was compensated for the reduction in share ownership of 8.8% through receipt of a dividend of the same amount which existed at the date of reduction. Subsequent to the change in share ownership AWEML has been accounted for as an associate as we continue to have significant influence, and therefore continue to account for the investment through equity accounting. The remainder of the arrangements are each a separate legal entity and legal ownership and control are equal with all other parties, there are no significant judgements required.

AWEML, Merseyrail Services Holding Company Limited (MSHCL) and Northern Rail Holdings Limited (NRHL) were the only equity accounted entities which were material to the Group during the year. Dividends of £19.6m (2015: £17.8m), £7.3m (2015: £7.2m) and £10.0m (2015: £5.9m) respectively were received from these companies in the year. The Northern Rail franchise ended on 31 March 2016.

Summarised financial information of AWEML, MSHCL, NRHL and an aggregation of the other equity accounted entities in which the Group has an interest is as follows:

31 December 2016

Summarised financial information	AWEML (100% of results) £m	MSHCL (100% of results) £m	NRHL (100% of results) £m	Group portion of material joint ventures and associates* £m	Group portion of other joint venture arrangements and associates* £m	Total £m
Revenue	968.1	150.3	132.7	437.5	43.3	480.8
Operating profit	72.9	18.9	13.2	37.4	3.3	40.7
Net investment revenue / (finance costs)	0.2	(1.3)	0.1	(0.5)	(0.1)	(0.6)
Income tax (charge) / credit	(11.3)	(3.7)	(3.4)	(6.8)	0.1	(6.7)
Profit from continuing operations	61.8	13.9	9.9	30.1	3.3	33.4
Other comprehensive income	–	34.0	0.8	17.4	(1.6)	15.8
Total comprehensive income	61.8	47.9	10.7	47.5	1.7	49.2
Non-current assets	1,097.0	12.5	–	275.1	3.2	278.3
Current assets	149.3	32.8	14.2	60.1	16.0	76.1
Current liabilities	(133.9)	(31.9)	(10.7)	(54.2)	(14.0)	(68.2)
Non-current liabilities	(1,095.2)	(0.9)	–	(268.7)	(3.1)	(271.8)
Net assets	17.2	12.5	3.5	12.3	2.1	14.4
Proportion of group ownership	33% / 24.5%	50%	50%	–	–	–
Carrying amount of investment	4.2	6.3	1.8	12.3	2.1	14.4

* Total results of the entity multiplied by the respective proportion of Group ownership.

Notes to the Consolidated Financial Statements continued

7. Joint ventures and associates continued

Supplementary material	AWEML (100% of results) £m	MSHCL (100% of results) £m	NRHL (100% of results) £m	Group portion of material joint ventures and associates* £m	Group portion of other joint venture arrangements and associates* £m	Total £m
Cash and cash equivalents	72.4	21.1	14.5	35.4	4.7	40.1
Current financial liabilities excluding trade and other payables and provisions	(7.0)	(2.3)	(0.5)	(3.1)	(0.9)	(4.0)
Non-current financial liabilities excluding trade and other payables and provisions	–	(0.6)	–	(0.3)	(3.0)	(3.3)
Depreciation and amortisation	–	(2.3)	(1.7)	(2.1)	(1.0)	(3.1)
Interest income	0.2	–	0.1	0.2	–	0.2
Interest expense	–	(1.3)	–	(0.6)	(0.1)	(0.7)

* Total results of the entity multiplied by the respective proportion of Group ownership.

The financial statements of MSHCL are for a period which is different from that of the Group, being for the 52 week period ended 7 January 2017. The 52 week period reflects the joint venture's internal reporting structure and is sufficiently close so as to not require adjustment to match that of the Group. The results of NRHL reflect the period of trading to the end of the franchise on 31 March 2016, together with the results from the ongoing post contract negotiations.

Excluded from the amounts disclosed in this note is an exceptional impairment of £13.9m of the equity interest and associated receivables balances of a joint venture.

Certain employees of the groups headed by AWEML and MSHCL are members of sponsored defined benefit pension schemes. Given the significance of the schemes to understanding the position of the entities the following key disclosures are made:

Main assumptions: 2016	AWEML	MSHCL
Rate of salary increases (%)	2.3%	2.3%
Inflation assumption (CPI %)	2.3%	2.3%
Discount rate (%)	2.7%	2.7%
Post-retirement mortality:		
Current male industrial pensioners at 65 (years)	22.8	N/A
Future male industrial pensioners at 65 (years)	24.9	N/A

Retirement benefit funding position (100% of results)	£m	£m
Present value of scheme liabilities	(2,556.0)	(275.7)
Fair value of scheme assets	1,460.9	171.1
Net amount recognised	(1,095.1)	(104.6)
Members' share of deficit	–	62.8
Franchise adjustment*	–	41.8
Related asset, right to reimbursement	1,095.1	–
Net retirement benefit obligation	–	–

* The franchise adjustment represents the amount of scheme deficit that is expected to be funded outside the contract period.

AWEML is not liable for any deficiency in the defined benefit pension scheme under current contractual arrangements. The deficit reflected in the financial statements of MSHCL covers only that portion of the deficit that is expected to be funded over the term of the franchise arrangement the entity operates under. In addition, the defined benefit position reflects an adjustment in respect of funding required to be provided by employees.

31 December 2015

Summarised financial information	AWEML (100% of results) £m	NRHL (100% of results) £m	Group portion of material joint ventures and associates* £m	Group portion of other joint venture arrangements and associates* £m	Total £m
Revenue	978.3	585.3	618.7	118.5	737.2
Operating profit	61.2	19.4	30.1	12.5	42.6
Net investment revenue / (finance costs)	0.4	0.4	0.3	(0.7)	(0.4)
Income tax expense	(5.9)	(3.5)	(3.7)	(1.5)	(5.2)
Profit from continuing operations	55.7	16.3	26.7	10.3	37.0
Other comprehensive income	–	11.9	5.9	1.7	7.6
Total comprehensive income	55.7	28.2	32.6	12.0	44.6
Non-current assets	464.2	10.3	159.9	17.3	177.2
Current assets	358.8	97.2	168.2	35.7	203.9
Current liabilities	(342.6)	(93.4)	(160.9)	(32.7)	(193.6)
Non-current liabilities	(461.7)	(3.8)	(155.8)	(17.9)	(173.7)
Net assets	18.7	10.3	11.4	2.4	13.8
Proportion of group ownership	33%	50%	–	–	–
Carrying amount of investment	6.2	5.2	11.4	2.4	13.8

* Total results of the entity multiplied by the respective proportion of Group ownership.

Supplementary material	AWEML (100% of results) £m	NRHL (100% of results) £m	Group portion of material joint ventures and associates* £m	Group portion of other joint venture arrangements and associates* £m	Total £m
Cash and cash equivalents	111.4	44.9	59.6	21.1	80.7
Current financial liabilities excluding trade and other payables and provisions	(5.6)	(4.3)	(4.0)	(2.2)	(6.2)
Non-current financial liabilities excluding trade and other payables and provisions	(0.1)	(1.3)	(0.7)	(3.3)	(4.0)
Depreciation and amortisation	–	(4.6)	(2.2)	(2.3)	(4.5)
Interest income	0.4	0.5	0.4	0.1	0.5
Interest expense	–	(0.1)	(0.1)	(0.8)	(0.9)

* Total results of the entity multiplied by the respective proportion of Group ownership.

The financial statements of NRHL are for the 52 week period ended 9 January 2016.

7. Joint ventures and associates continued

Key disclosures with respect of the defined benefit pension schemes of material joint ventures and associates:

Main assumptions: 2015	AWEML	NRHL
Rate of salary increases (%)	2.2%	3.0%
Inflation assumption (CPI %)	2.2%	2.1%
Discount rate (%)	4.0%	3.9%
Post-retirement mortality:		
Current male industrial pensioners at 65 (years)	22.7	N/A
Future male industrial pensioners at 65 (years)	25.4	N/A

Retirement benefit funding position (100% of results)	AWEML £m	NRHL £m
Present value of scheme liabilities	(1,649.6)	(918.3)
Fair value of scheme assets	1,188.0	682.6
Net amount recognised	(461.6)	(235.7)
Members' share of deficit	–	94.3
Franchise adjustments*	–	141.3
Related asset, right to reimbursement	461.6	–
Net retirement benefit obligation	–	(0.1)

* The franchise adjustment represents the amount of scheme deficit that is expected to be funded outside the contract period.

The Northern Rail defined benefit pension scheme used a mortality rate multiplier of 98% based on the S1 normal males (heavy) table, adjusted for the geographic location of members.

8. Acquisitions

On 1 December 2016 the Group acquired 100% of the issued share capital of Orchard & Shipman (Glasgow) Limited for £1, obtaining full control. Orchard & Shipman (Glasgow) Limited was a financially distressed subcontractor on our COMPASS contract and the business was acquired with the sole purpose of ensuring the continued delivery of this essential service to asylum seekers in Scotland and Northern Ireland.

The amounts recognised in respect of the identifiable assets acquired and the liabilities assumed are as set out in the table below:

	Book value £m	Fair value adjustments £m	Provisional fair value £m
Property, plant and equipment	0.2	(0.2)	–
Trade and other receivables	0.8	–	0.8
Cash and cash equivalents	0.1	–	0.1
Trade and other payables	(4.2)	–	(4.2)
Onerous contract provisions	(1.4)	(12.6)	(14.0)
Property provisions	(0.5)	–	(0.5)
Total identifiable assets	(5.0)	(12.8)	(17.8)
Goodwill			17.8
Acquisition date fair value of consideration transferred			–

Goodwill represents the premium associated with preventing a disruption to our service users and the financial impact of penalties associated with that disruption, taking into account the pre-existing onerous contract held by O&S for services provided to Serco, which will now be performed by Serco up to the expected contract end date. All of the service users in the region are housed in properties leased by Orchard & Shipman (Glasgow) Limited and the only way of guaranteeing control of those leases was by means of the acquisition of the legal entity. As the contract is loss making no value is ascribed to these lease arrangements and all goodwill arising on acquisition is immediately impaired. The onerous contract provision (OCP) of £14.0m included in the fair value of the acquisition net assets represents the best estimate of Orchard & Shipman (Glasgow) Limited's contractual obligations up to the expected contract end date. An element of this provision was previously included in the Group's existing OCP and an amount of £3.6m is included in amounts released in note 29.

No acquisition related costs were incurred.

Orchard & Shipman (Glasgow) Limited contributed no external income to the Group's revenue for the year between the date of acquisition and the balance sheet date as the prime contract with the customer exists in another Group company, and therefore Group revenue would have been no higher if the acquisition had been completed on the first day of the financial year. As the business relates entirely to a loss making contract, the existence of the onerous contract provision results in no profit or loss in the period since acquisition and no profit or loss would have arisen had the acquisition taken place on 1 January 2016.

9. Disposals

There were no material disposals of continuing operations in the year. Disposals relating to discontinued operations are included in note 4. As explained in note 7 during the year the Group surrendered 8.8% of the share capital of AWE Management Limited, resulting in a reduction in interests in joint ventures and associates of £1.6m in return for consideration of an equal amount.

The profit on disposal of £2.9m arose from a profit of £0.4m on the disposal of a 10% investment as it was no longer required to be held under the terms of the relevant contract, and a profit of £2.5m relating to transactions completing in prior years, including cash of £4.5m as a result of deferred consideration payments received which had previously been impaired.

10. Revenue

An analysis of the Group's revenue is as follows:

Year ended 31 December	2016 £m	2015 £m
Revenue as disclosed in the consolidated income statement	3,011.0	3,177.0
Investment revenue (note 14)	9.3	6.1
Operating lease income	0.8	0.8
Total revenue as defined in IAS 18	3,021.1	3,183.9

11. Exceptional items

Exceptional items are non recurring items of financial performance that are outside normal operations and are material to the results of the Group either by virtue of size or nature. As such, the items set out below require separate disclosure on the face of the income statement to assist in the understanding of the underlying performance of the Group.

In the year exceptional items have arisen on both the continuing and discontinued operations of the Group. Exceptional items arising on discontinued operations are disclosed on the face of the income statement within the loss attributable to discontinued operations, those arising on continuing operations are disclosed on the face of the income statement within exceptional operating items. Further information regarding the exceptional items arising on discontinued operations can be seen in note 4.

Exceptional gain / (loss) on disposal of subsidiaries and operations
The exceptional net gain / (loss) on disposals is included in note 9.

Other exceptional operating items arising on continuing operations

For the year ended 31 December	2016 £m	2015 £m
Impairment of goodwill	(17.8)	(87.5)
Restructuring costs	(17.2)	(19.7)
Aborted transaction costs	(0.1)	(1.7)
Costs associated with UK Government review	(0.1)	(1.2)
Release of UK frontline clinical health contract provisions	0.6	2.8
Settlement of defined benefit pension obligations	(10.7)	–
Impairment of interest in joint ventures and associates, and related loan balances	(13.9)	–
Other exceptional operating items	(59.2)	(107.3)

Goodwill is tested for impairment annually or more frequently if there are indications that there is a risk that it could be impaired. The recoverable amount of each cash generating unit (CGU) is based on value in use calculations derived from forecast cash flows based on past experience, adjusted to reflect market trends, economic conditions, the Group's strategy and key risks. These forecasts include an estimated level of new business wins and contract attrition and an assumption that the final year forecast continues into perpetuity at a CGU specific terminal growth rate. The terminal growth rates are provided by external sources and are based on the long-term inflation rates of the geographic market in which the CGUs operate and therefore do not exceed the average long-term growth rates forecast for the individual markets.

Notes to the Consolidated Financial Statements continued

11. Exceptional items continued

In 2016, goodwill of £17.8m arose following the acquisition of Orchard & Shipman (Glasgow) Limited, the Group's subcontractor on the COMPASS contract providing accommodation to asylum seekers in Scotland and Northern Ireland on behalf of the Home Office. This goodwill was immediately impaired as the CGU is forecast to be loss making and therefore the asset cannot be supported. The annual impairment testing of CGUs has identified no other impairment of goodwill. In 2015 the Americas CGU was impaired by £87.5m, due primarily to a higher level of contract attrition than previously forecast and the associated impact on future cash flows. Given the significant size of the impairment charge and that it is not part of the normal trading performance of the business it was considered appropriate to treat as exceptional in the year.

In 2016, a charge of £17.2m (2015: £19.7m) arose in relation to the restructuring programme resulting from the Strategy Review. This included redundancy payments, provisions, external advisory fees and other incremental costs. Due to the nature and scale of the impact of the transformation phase of the Strategy Review the incremental costs associated with this programme were considered to be exceptional in the prior year and have been treated consistently in 2016. Non exceptional restructuring charges incurred by the business as part of normal operational activity totalled £6.7m in the year (2015: £13.8m).

The disposal of the Environmental and Leisure businesses was aborted in December 2015 and during the current period costs related to the aborted transaction were finalised, resulting in a charge of £0.1m (2015: £1.7m).

In 2016 there were exceptional costs totalling £0.1m (2015: £1.2m) associated with the UK Government review and the programme of Corporate Renewal, reflecting the related external costs. This reflected external costs related to this review and the Corporate Renewal Programme, which were treated as exceptional when the matter first arose and consistent treatment has been applied in the current year.

In 2016 there were releases of provisions of £0.6m (2015: £2.8m) which were previously charged through exceptional items in relation to the exit of the UK Frontline Clinical Health contracts.

Following the finalisation of the Revised Fair Deal, a number of employees are being transferred from SPLAS back to the Principal Civil Service Pension Scheme. This transfer was finalised in December 2016 at which point all obligations of SPLAS to pay retirement benefits for these individuals were eliminated and as a result a settlement charge of £10.7m arose. This has been treated as an exceptional item in the year as a result of the transaction being material in size and nature and being outside of the normal course of business. The charge of £10.7m is an accounting charge only, the cash impact of the settlement which will be paid in future periods, is estimated as £3.0m and is offset by future savings in contributions resulting from the transfer.

A review of a joint venture's cash flow projections has led to the impairment of £13.9m of the equity interest and associated receivables balances. The impairment is outside of the normal course of business and of a significant value, and is therefore considered to be an exceptional item.

Exceptional finance costs

The exceptional finance costs charged in 2015 of £32.8m arose as a result of costs being incurred in 2015 to preserve the existing finance facilities, after an agreement was reached in December 2014 for the Group to defer its December 2014 covenant test until May 2015.
In addition, payments were made to the US Private Placement (USPP) Noteholders as a result of early settlement following the Group refinancing. Total charges of £32.8m had been treated as exceptional items as they were outside of the normal financing arrangement of the Group and were significant in size.

Tax impact of above items

The tax impact of these exceptional items was a tax credit of £3.1m (2015: £0.4m). Further details are provided in note 16.

12. Operating profit

Operating profit is stated after charging / (crediting):

Year ended 31 December	2016 £m	2015 (restated*) £m
Research and development costs	3.6	4.3
Exceptional goodwill impairment (note 11)	17.8	87.5
Loss on disposal of property, plant and equipment	0.4	1.5
Loss on disposal of intangible assets	0.8	1.7
Depreciation and impairment of property, plant and equipment	25.5	28.1
Amortisation and impairment of intangible assets – arising on acquisition	5.1	4.8
Amortisation, write down and impairment of intangible assets – other	21.8	32.7
Exceptional net (gain) / loss on disposal of subsidiaries and operations (note 9)	(2.9)	2.6
Staff costs (note 13)	1,526.8	1,532.2
Allowance for doubtful debts credited to income statement	(0.1)	(6.8)
Net foreign exchange charge*	0.7	0.1
Movement on non-designated hedges and reclassified cash flow hedges*	(0.6)	0.3
Lease payments recognised through operating profit	99.5	104.4
Operating lease income from sub-leases (note 10)	(0.8)	(0.8)

* Net foreign exchange charges have been restated as a result of the change in treatment of foreign exchange items on investing and financing items as explained in note 2.

Amounts payable to by the Company and its subsidiary undertakings in respect of audit and non-audit services to the Company's Auditor are shown below.

Year ended 31 December	2016 £m	2015 £m
Fees payable to the Company's Auditor for the audit of the Company's annual accounts	0.8	0.9
Fees payable to the Company's Auditor and their associates for other services to the Group:		
– audit of the Company's subsidiaries pursuant to legislation	0.5	0.6
Total audit fees	1.3	1.5
– Audit–related assurance services	0.2	0.2
– Tax compliance services	0.1	–
– Tax advisory services	0.2	0.2
– Other services	0.3	2.6
Total non-audit fees	0.8	3.0

The 2016 fees represent those paid to the current Auditor since appointment in May 2016. The 2015 fees represent fees paid to the previous Auditor.

During 2016, prior to appointment, non audit fees of £0.5m (tax advisory services £0.2m, internal audit services £0.1m and other services £0.2m), were paid to KPMG LLP, bringing the total non audit fees paid to KPMG LLP during the year to £1.3m.

Fees payable to the Company's Auditor for non-audit services to the Company are not required to be disclosed separately because the consolidated financial statements are required to disclose such fees on a consolidated basis.

Details of the Company's policy on the use of auditors for non-audit services and how the auditor's independence and objectivity was safeguarded are set out in the Audit Committee Report on page 88. No services were provided pursuant to contingent fee arrangements.

Notes to the Consolidated Financial Statements continued

13. Staff costs

The average monthly number of full time equivalent employees (including Executive Directors) for continuing operations comprised:

Year ended 31 December	2016 number	2015 number
UK Central Government	10,081	10,182
UK & Europe Local & Regional Government	10,791	11,357
Americas	8,115	9,727
AsPac	8,929	8,885
Middle East	4,347	3,996
Unallocated	913	1,094
	43,176	45,241

Aggregate remuneration on continuing operations comprised:

Year ended 31 December	2016 £m	2015 £m
Wages and salaries	1,332.3	1,337.5
Social security costs	100.3	100.7
Other pension costs (note 33)	84.6	85.1
	1,517.2	1,523.3
Share based payment expense (note 37)	9.6	8.9
	1,526.8	1,532.2

14. Investment revenue

Year ended 31 December	2016 £m	2015 £m
Interest receivable on other loans and deposits	3.6	1.1
Net interest receivable on retirement benefit obligations (note 33)	4.7	4.9
Movement in discount on other debtors	1.0	0.1
	9.3	6.1

15. Finance costs

Year ended 31 December	2016 £m	2015 (restated*) £m
Interest payable on obligations under finance leases	1.6	2.5
Interest payable on other loans	15.6	24.7
Facility fees and other charges	3.5	6.2
Movement in discount on provisions	2.4	5.6
	23.1	39.0
Foreign exchange on financing activities*	(1.2)	(0.1)
	21.9	38.9

* Finance costs have been restated as a result of the change in treatment of foreign exchange items on investing and financing items as explained in note 2.

16. Tax

16 (a) Income tax recognised in the income statement

Year ended 31 December Continuing operations	Before exceptional items 2016 £m	Exceptional items 2016 £m	Total 2016 £m	Before exceptional items 2015 £m	Exceptional items 2015 £m	Total 2015 £m
Current income tax						
Current income tax charge / (credit)	12.1	(1.3)	10.8	4.5	(0.4)	4.1
Adjustments in respect of prior years	3.6	–	3.6	6.0	–	6.0
Deferred tax						
Current year charge / (credit)	1.2	(1.8)	(0.6)	12.7	–	12.7
Adjustments in respect of prior years	(1.1)	–	(1.1)	(5.3)	–	(5.3)
	15.8	(3.1)	12.7	17.9	(0.4)	17.5

The tax expense for the year can be reconciled to the profit in the consolidated income statement as follows:

Year ended 31 December	Before exceptional items 2016 £m	Exceptional items 2016 £m	Total 2016 £m	Before exceptional items 2015 £m	Exceptional items 2015 £m	Total 2015 £m
Profit / (loss) before tax	85.9	(56.3)	29.6	73.3	(142.7)	(69.4)
Tax calculated at a rate of 20.00% (2015: 20.25%)	17.1	(11.2)	5.9	14.9	(28.9)	(14.0)
Expenses not deductible for tax purposes*	5.1	9.2	14.3	3.8	(0.2)	3.6
UK unprovided deferred tax**	(3.9)	–	(3.9)	17.8	8.3	26.1
Other unprovided deferred tax	0.3	(0.7)	(0.4)	(14.9)	25.1	10.2
Effect of the use of unrecognised tax losses	(3.1)	–	(3.1)	(0.3)	(4.9)	(5.2)
Overseas rate differences	4.6	–	4.6	3.2	0.2	3.4
Other non taxable income	(0.1)	(0.4)	(0.5)	–	–	–
Adjustments in respect of prior years	2.5	–	2.5	0.7	–	0.7
Adjustments in respect of equity accounted investments	(6.7)	–	(6.7)	(7.3)	–	(7.3)
Tax charge / (credit)	15.8	(3.1)	12.7	17.9	(0.4)	17.5

* Relates to costs that are not allowable for tax deduction under local tax law. Non deductible expenses in relation to exceptional items relate mainly to capital expenses, such as the impairments that are not deductible for tax.

** Arises due to timing differences between when an amount is recognised in the income statement and when the amount is subject to UK tax. In the current year, the Group has received tax deductions for amounts which have been charged to the income statement in previous periods in connection with items such as fixed assets.

The income tax charge / (credit) for the year is based on the blended UK statutory rate of corporation tax for the period of 20.00% (2015: 20.25%). Taxation for other jurisdictions is calculated at the rates prevailing in the respective jurisdictions.

16. Tax continued

16 (b) Income tax recognised in the SOCI

Year ended 31 December	2016 £m	2015 £m
Current tax		
Taken to retirement benefit obligations reserve	–	0.1
Deferred tax		
Taken to retirement benefit obligations reserve	(1.7)	4.0
	(1.7)	4.1

17. Deferred tax

Deferred income taxes are calculated in full on temporary differences under the liability method using local substantively enacted tax rates.

The movement in net deferred tax assets during the year was as follows:

	2016 £m	2015 £m
At 1 January – asset	(19.9)	(28.2)
Income statement credit	(2.0)	3.7
Items recognised in equity and in other comprehensive income	1.7	(4.2)
Eliminated on disposal of subsidiary	–	5.5
Exchange differences	(0.1)	3.3
Reclassified to assets held for sale	–	–
At 31 December – asset	(20.3)	(19.9)

The movement in deferred tax assets and liabilities during the year was as follows:

	Temporary differences on assets / intangibles £m	Share based payment and employee benefits £m	Retirement benefit schemes £m	OCPs £m	Tax losses £m	Other temporary differences £m	Total £m
At 1 January 2016	26.8	(9.7)	17.8	(28.3)	(10.8)	(15.7)	(19.9)
(Credited) / charged to income statement (note 16a)	0.9	(0.5)	(1.5)	14.7	0.6	(16.2)	(2.0)
Items recognised in equity and in other comprehensive income (note 16b&c)	–	–	1.7	–	–	–	1.7
Exchange differences	8.8	(1.8)	(0.4)	(4.2)	(0.1)	(2.4)	(0.1)
At 31 December 2016	36.5	(12.0)	17.6	(17.8)	(10.3)	(34.3)	(20.3)

Of the amount credited to the income statement, £0.3m (2015: £0.3m) has been taken to costs of sales in respect of the R&D Expenditure credit. Other temporary differences include a deferred tax asset of £0.1m in respect of derivative financial instruments (2015: £nil).

The movement in deferred tax assets and liabilities during the previous year was as follows:

	Temporary differences on assets / intangibles £m	Share based payment and employee benefits £m	Retirement benefit schemes £m	OCPs £m	Tax losses £m	Other temporary differences £m	Total £m
At 1 January 2015	7.5	(9.5)	21.7	(30.5)	(10.7)	(6.7)	(28.2)
(Credited) / charged to income statement (note 16a)	17.3	(0.5)	0.3	1.1	(0.1)	(14.4)	3.7
Items recognised in equity and in other comprehensive income (note 16b&c)	–	–	(4.2)	–	–	–	(4.2)
Eliminated on disposal of subsidiary	–	–	–	–	–	5.5	5.5
Exchange differences	2.0	0.3	–	1.1	–	(0.1)	3.3
At 31 December 2015	26.8	(9.7)	17.8	(28.3)	(10.8)	(15.7)	(19.9)

Deferred income 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 the deferred income taxes relate to the same fiscal authority. The following is the analysis of the deferred tax balances (after offset) for financial reporting purposes:

	2016 £m	2015 £m
Deferred tax liabilities	30.5	22.3
Deferred tax assets	(50.8)	(42.2)
	(20.3)	(19.9)

The total deferred tax asset held by the Group at 31 December 2016 amounts to £50.8m (2015: £42.2m). The total deferred tax liability held by the Group at 31 December 2016 amounts to £30.5m (2015: £22.3m). Amounts held for sale on the balance sheet include £nil in respect of deferred tax assets (2015: £nil) and £nil in respect of deferred tax liabilities (2015: £nil).

As at the balance sheet date, the group (excluding assets held for sale) has unused tax losses of £893.5m (2015: £890.1m) available for offset against future profits. A deferred tax asset has been recognised in respect of £69.1m (2015: £59.9m) of such losses of which £58.8m (net £10.0m) relates to losses incurred in the UK and £10.3m (net £0.3m) which relates to other jurisdictions. Recognition has been based on forecast future taxable profits. No deferred tax asset has been recognised in respect of the remaining losses (net £147.0m) as it is not probable that there will be future taxable profits available. In the summer of 2016, UK Government announced a reduction in the UK corporation tax rate from 20% to 19% effective from April 2017 and a reduction down to 18% from April 2020. Measures enacted during 2016 cut the rate further from April 2020 to 17%. These decreases do not affect the amount of current income tax recognised at 31 December 2016 although it will reduce the Group's future current tax charge accordingly. The deferred tax balance at 31 December 2016 has been calculated reflecting these rates. An expected change in the UK loss utilisation laws in 2017 is estimated to reduce the value of the recognised deferred tax asset by £3.7m.

Losses of £0.1m (2015: £105.5m) expire within 5 years, losses of £0.2m (2015 £0.2m) expire within 6–10 years, losses of £8.6m (2015 £nil) expire within 20 years and losses of £884.6m (2015 £784.4m) may be carried forward indefinitely.

At the balance sheet date, the Group has no held for sale assets. At 2015 there were £7.3m of unused tax losses that were available for offset against future profits in held for sale assets. No deferred tax asset was recognised in respect of these losses as it was not probable that there will be future taxable profits available.

18. Earnings per share

Basic and diluted earnings per ordinary share (EPS) have been calculated in accordance with IAS 33 *Earnings per Share*.

The calculation of the basic and diluted EPS is based on the following data:

Number of shares	2016 millions	2015 millions
Weighted average number of ordinary shares for the purpose of basic EPS	1,088.3	986.5
Effect of dilutive potential ordinary shares: Share options	37.3	–
Weighted average number of ordinary shares for the purpose of diluted EPS	1,125.6	986.5

At 31 December 2016 options over 246,818 (2015: 560,060) shares were excluded from the weighted average number of shares used for calculating diluted earnings per share because their exercise price was above the average share price for the year and they were, therefore, anti-dilutive.

The dilutive shares of 37.3m (2015: 26.5m) are applied in the continuing only EPS calculation. Due to the loss making position of continuing and discontinued combined, and discontinued only, the dilutive impact has not been calculated in 2016 and 2015, nor for 2015 continuing.

Earnings per share continuing and discontinued

Basic EPS	Earnings 2016 £m	Per share amount 2016 pence	Earnings 2015 £m	Per share amount 2015 pence
Earnings for the purpose of basic EPS	(1.2)	(0.11)	(152.6)	(15.47)
Effect of dilutive potential ordinary shares	–	–	–	–
Diluted EPS	(1.2)	(0.11)	(152.6)	(15.47)
Basic EPS excluding exceptional items				
Earnings for the purpose of basic EPS	(1.2)	(0.11)	(152.6)	(15.47)
Add back exceptional items	70.9	6.51	220.3	22.33
Add back tax on exceptional items	(3.1)	(0.28)	(3.1)	(0.31)
Earnings excluding exceptional operating items for the purpose of basic EPS	66.6	6.12	64.6	6.55

Earnings per share continuing

Basic EPS	Earnings 2016 £m	Per share amount 2016 pence	Earnings 2015 £m	Per share amount 2015 pence
Earnings for the purpose of basic EPS	16.9	1.55	(86.6)	(8.78)
Effect of dilutive potential ordinary shares	–	(0.05)	–	–
Diluted EPS	16.9	1.50	(86.6)	(8.78)
Basic EPS excluding exceptional items				
Earnings for the purpose of basic EPS	16.9	1.55	(86.6)	(8.78)
Add back exceptional items	56.3	5.17	142.7	14.47
Add back tax on exceptional items	(3.1)	(0.28)	(0.4)	(0.04)
Earnings excluding exceptional operating items for the purpose of basic EPS	70.1	6.44	55.7	5.65

Earnings per share discontinued

Basic EPS	Earnings 2016 £m	Per share amount 2016 pence	Earnings 2015 £m	Per share amount 2015 pence
Earnings for the purpose of basic EPS	(18.1)	(1.66)	(66.0)	(6.69)
Effect of dilutive potential ordinary shares	–	–	–	–
Diluted EPS	(18.1)	(1.66)	(66.0)	(6.69)
Basic EPS excluding exceptional items				
Earnings for the purpose of basic EPS	(18.1)	(1.66)	(66.0)	(6.69)
Add back exceptional items	14.6	1.34	77.6	7.87
Add back tax on exceptional items	–	–	(2.7)	(0.28)
Earnings excluding exceptional operating items for the purpose of basic EPS	(3.5)	(0.32)	8.9	0.90

19. Goodwill

	Cost £m	Accumulated impairment losses £m	Carrying amount £m
At 1 January 2015	673.2	(131.7)	541.5
Exchange differences	17.6	(7.8)	9.8
Impairment (exceptional)	–	(87.5)	(87.5)
Transfer to held for sale	108.3	(62.2)	46.1
At 1 January 2016	799.1	(289.2)	509.9
Exchange differences	109.6	(41.6)	68.0
Acquisitions	17.8	–	17.8
Impairment (exceptional)	–	(17.8)	(17.8)
At 31 December 2016	926.5	(348.6)	577.9

Further details of the exceptional impairment can be seen in note 11.

19. Goodwill continued

Movements in the balance since the prior year end can be seen as follows:

	Goodwill balance 31 December 2015 £m	Additions 2016 £m	Exchange differences 2016 £m	Impairment 2016 £m	Goodwill balance 31 December 2016 £m	Headroom on impairment analysis 2016 £m	Headroom on impairment analysis 2015 £m
UK Central Government							
Justice & Immigration	49.6	–	–	–	49.6	126.3	59.3
Orchard & Shipman (Glasgow) Limited	–	17.8		(17.8)	–		–
UK & Europe Local & Regional Government							
UK Health	60.6	–	–	–	60.6	3.2	2.3
Direct Services & Europe	63.7	–	2.8	–	66.5	99.0	83.5
Americas	232.0	–	45.9	–	277.9	66.5	–
AsPac	94.7	–	17.7	–	112.4	203.2	161.6
Middle East	9.3	–	1.6	–	10.9	114.7	134.2
	509.9	17.8	68.0	(17.8)	577.9	612.9	440.9

Included above is the detail of the headroom on the CGUs existing at the year end which reflects where future discounted cash flows are greater than the underlying assets and includes all relevant cash flows, including where provisions have been made for future costs and losses.

The addition and impairment arises on acquisition of Orchard & Shipman (Glasgow) Limited. See note 8.

The key assumptions applied in the impairment review are set out below:

	Discount rate 2016 %	Discount rate 2015* %	Terminal growth rates 2016 %	Terminal growth rates 2015 %
UK Central Government				
Justice & Immigration	10.0	10.3	2.0	2.0
UK & Europe Local & Regional Government				
UK Health	10.1	10.1	2.0	2.0
Direct Services & Europe	11.6	10.1	2.0	2.0
Americas	10.7	10.3	2.4	2.4
AsPac	10.9	10.7	2.4	2.4
Middle East	10.6	9.7	2.2	2.1

Discount rate

Pre-tax discount rates, derived from the Group's post-tax weighted average cost of capital have been used in discounting the projected cash flows. These rates are reviewed annually with external advisers and are adjusted for risks specific to the market in which the CGU operates.

Short-term growth rates

The annual impairment test is performed immediately prior to the year end, based initially on five year cash flow forecasts approved by senior management. Short-term revenue growth rates used in each CGU five year plan are based on internal data regarding our current contracted position, the pipeline of opportunities and forecast growth for the relevant market.

Short-term profitability and cash conversion is based on our historic experiences and a level of judgement is applied to expected changes in both. Where businesses have been poor performers in recent history, turnaround has only been assumed where a detailed and achievable plan is in place and all forecasts include cash flows relating to contracts where onerous contract provisions have been made.

Terminal growth rates

The calculations include a terminal value based on the projections for the fifth year of the short-term plan, with a growth rate assumption applied which extrapolates the business into perpetuity. The terminal growth rates are based on long-term inflation rates of the geographic market in which the CGUs operate and therefore do not exceed the average long-term growth rates forecast for the individual markets. These are provided by external sources.

Sensitivity analysis

Sensitivity analysis has been performed for each key assumption, a 1% movement in discount rates and a 1% movement in terminal growth rates are considered to be reasonably possible. The only CGU impacted by a reasonably possible change in a key assumption is Health. The breakeven point of Health goodwill impairment is a 0.2% increase in discount rate or a 0.3% decrease in terminal growth rate.

Serco operates a contract supporting the US Affordable Care Act (ACA) with eligibility processing services to those seeking health insurance. These operations accounted for nearly 30% of the Americas divisional revenue in 2016, and we currently forecast them to be broadly flat in 2017. The contract requires the final option year to be exercised in H1 of 2017 in order to extend through to 30 June 2018 at which point we would be required to rebid the contract. Particular uncertainty exists with regard to the future of the ACA. At the time of reporting, apart from knowing that under the new US President's Administration changes will be made to the ACA, there is no consensus in neither Congress nor the Administration as to what form these changes will take, and what provision will be made for the more than 24 million people who have received their health insurance coverage through the ACA. Whilst margins on this contract are lower than the average for the Americas division, the contract recovers a material amount of overhead costs and large reductions in chargeable direct labour could create challenges to reduce overheads in line with revenues. The timing and nature of arrangements made for the replacement of the Affordable Care Act in the US could therefore have a material impact on the business both in the immediate and longer term. However, at present, the impact on future revenues and profitability cannot be reliably estimated.

20. Other intangible assets

	Acquisition related		Other		
	Customer relationships £m	Licences and franchises £m	Software and IT £m	Internally generated development expenditure £m	Total £m
Cost					
At 1 January 2016	51.9	1.0	110.2	59.1	222.2
Additions from internal development	–	–	14.0	1.1	15.1
Disposals	–	(0.7)	(12.9)	(2.6)	(16.2)
Reclassification from held for sale assets	6.2	0.1	–	–	6.3
Reclassification from / (to) other intangible asset categories	0.3	(0.1)	3.3	(3.5)	–
Research and Development expenditure credit	–	–	–	(0.2)	(0.2)
Exchange differences	9.2	–	6.0	1.8	17.0
At 31 December 2016	67.6	0.3	120.6	55.7	244.2
Accumulated amortisation and impairment					
At 1 January 2016	33.1	0.9	62.9	35.5	132.4
Impairment charge	0.7	–	–	–	0.7
Amortisation charge – internal development	–	–	17.0	4.8	21.8
Amortisation charge – external	4.4	–	–	–	4.4
Disposals	–	(0.7)	(12.0)	(2.6)	(15.3)
Reclassification from held for sale assets	6.2	0.1	–	–	6.3
Exchange differences	6.0	–	3.7	0.6	10.3
At 31 December 2016	50.4	0.3	71.6	38.3	160.6
Net book value					
At 31 December 2016	17.2	–	49.0	17.4	83.6

Notes to the Consolidated Financial Statements continued

20. Other intangible assets continued

	Acquisition related		Other			
	Customer relationships £m	Licences and franchises £m	Software and IT £m	Internally generated development expenditure £m	Pension related intangibles £m	Total £m
Cost						
At 1 January 2015	116.8	1.6	146.9	67.3	15.7	348.3
Eliminated on disposal	–	–	(0.2)	(2.7)	–	(2.9)
Additions from internal development	–	–	10.2	14.0	–	24.2
Additions from external acquisition	–	–	7.8	–	–	7.8
Disposals	(26.8)	–	(51.9)	(14.7)	(6.2)	(99.6)
Reclassification from / (to) held for sale assets	(38.5)	(0.6)	(3.8)	(2.8)	(9.5)	(55.2)
Reclassification from / (to) other intangible asset categories	–	–	1.3	(1.3)	–	–
Reclassification to property, plant and equipment	–	–	(0.3)	–	–	(0.3)
Research and Development expenditure credit	–	–	–	(0.8)	–	(0.8)
Exchange differences	0.4	–	0.2	0.1	–	0.7
At 31 December 2015	51.9	1.0	110.2	59.1	–	222.2
Accumulated amortisation and impairment						
At 1 January 2015	76.3	1.4	100.5	35.6	15.7	229.5
Eliminated on disposal	–	–	(0.2)	(0.2)	–	(0.4)
Impairment charge	–	–	–	9.0	–	9.0
Amortisation charge – internal development	–	–	12.7	7.4	–	20.1
Amortisation charge – external	4.8	0.1	3.6	–	–	8.5
Disposals	(26.1)	–	(51.0)	(14.0)	(6.2)	(97.3)
Reclassification from / (to) held for sale assets	(22.2)	(0.6)	(2.6)	(2.4)	(9.5)	(37.3)
Reclassification to property, plant and equipment	–	–	(0.3)	–	–	(0.3)
Exchange differences	0.3	–	0.2	0.1	–	0.6
At 31 December 2015	33.1	0.9	62.9	35.5	–	132.4
Net book value						
At 31 December 2015	18.8	0.1	47.3	23.6	–	89.8

Included in Software and IT and other internally generated development expenditure is an amount of £8.7m (2015: £11.8m) in respect of leased intangibles.

Customer relationships are amortised over the average length of contracts acquired. The Group is carrying £17.2m (2015: £18.8m) in relation to Customer relationships. Amortisation of intangibles arising on acquisition consists of amortisation in relation to Customer relationships and Licences and franchises and totals £4.4m (2015: £4.9m).

The net book value of internally generated intangible assets as at 31 December 2016 was approximately £17.4m (2015: £23.6m) in development expenditure and £36.9m (2015: £36.5m) in software and IT, of which £nil (2015: £0.2m) is classified as held for sale.

21. Property, plant and equipment

	Freehold land and buildings £m	Short-leasehold assets £m	Machinery, motor vehicles, furniture and equipment £m	Total £m
Cost				
At 1 January 2016	4.0	29.8	209.7	243.5
Additions	–	1.8	15.6	17.4
Reclassification from held for sale assets	–	0.9	0.2	1.1
Disposals	–	(3.2)	(31.8)	(35.0)
Exchange differences	–	3.1	15.5	18.6
At 31 December 2016	4.0	32.4	209.2	245.6
Accumulated depreciation and impairment				
At 1 January 2016	2.3	20.7	147.3	170.3
Charge for the year – impairment	–	–	0.7	0.7
Charge for the year – depreciation	0.2	3.0	21.6	24.8
Reclassification from held for sale assets	–	(0.2)	(0.2)	(0.4)
Disposals	–	(2.9)	(30.9)	(33.8)
Exchange differences	–	2.2	12.5	14.7
At 31 December 2016	2.5	22.8	151.0	176.3
Net book value				
At 31 December 2016	1.5	9.6	58.2	69.3

21. Property, plant and equipment continued

	Freehold land and buildings £m	Short-leasehold assets £m	Machinery, motor vehicles, furniture and equipment £m	Total £m
Cost				
At 1 January 2015	5.7	42.3	117.6	165.6
Additions	–	1.1	15.0	16.1
Reclassification (to) / from other plant, property and equipment categories	(0.9)	0.9	–	–
Reclassification from intangible assets	–	0.3	–	0.3
Reclassification (to) / from held for sale assets	–	(2.8)	128.1	125.3
Disposals	(0.1)	(9.2)	(22.1)	(31.4)
Eliminated on disposal	(0.7)	(2.7)	(24.7)	(28.1)
Exchange differences	–	(0.1)	(4.2)	(4.3)
At 31 December 2015	4.0	29.8	209.7	243.5
Accumulated depreciation and impairment				
At 1 January 2015	3.1	30.8	93.3	127.2
Charge for the year – impairment	–	0.1	1.9	2.0
Charge for the year – depreciation	0.2	2.8	22.6	25.6
Reclassification (to) / from other plant, property and equipment categories	(0.2)	0.2	–	–
Reclassification from intangible assets	–	0.3	–	0.3
Reclassification (to) / from held for sale assets	–	(2.0)	77.0	75.0
Disposals	(0.1)	(8.7)	(20.1)	(28.9)
Eliminated on disposal	(0.7)	(2.7)	(23.9)	(27.3)
Exchange differences	–	(0.1)	(3.5)	(3.6)
At 31 December 2015	2.3	20.7	147.3	170.3
Net book value				
At 31 December 2015	1.7	9.1	62.4	73.2

The carrying amount of the Group's Machinery, motor vehicles, furniture and equipment includes an amount of £27.9m (2015: £36.5m) in respect of assets held under finance leases, of which £nil (2015: £nil) is classified as held for sale.

The carrying amount of the Group's short-leasehold assets includes an amount of £0.2m (2015: £0.3m) in respect of assets held under finance leases.

22. Inventories

	2016 £m	2015 £m
Service spares	17.0	15.7
Parts awaiting installation	1.0	5.8
Work in progress	4.4	4.9
	22.4	26.4

Total inventories held by the Group at 31 December 2016 amount to £22.4m (2015: £26.4m) and include £22.4m (2015: £26.4m) shown above and £nil (2015: £nil) included within amounts held for sale on the balance sheet.

23. Trade and other receivables

Trade and other receivables: Non-current	2016 £m	2015 £m
Amounts owed by joint ventures and associates	–	7.2
Loans receivable (note 28)	22.4	19.5
Other investments	0.6	3.4
Other receivables	21.4	20.1
	44.4	50.2

Trade and other receivables: Current	2016 £m	2015 £m
Trade receivables	192.8	173.6
Accrued income and other unbilled receivables	228.4	225.5
Prepayments	56.3	57.6
Amounts recoverable on long-term contracts (note 24)	2.7	2.3
Amounts owed by joint ventures and associates	0.6	0.8
Loans receivable (note 28)	0.5	0.4
Security deposits	0.1	0.2
Other receivables	62.1	59.3
	543.5	519.7

Total trade and other receivables held by the Group at 31 December 2016 amount to £587.9m (2015: £590.7m) and include £587.9m (2015: £569.9m) shown above and £nil (2015: £20.8m) included within amounts held for sale on the balance sheet.

The Group has a receivables financing facility of £30.0m (2015: £30.0m), of which £7.7m had been utilised at 31 December 2016 (31 December 2015: £30.0m utilised).

The management of trade receivables is the responsibility of the operating segments, although they report to Group on a monthly basis on debtor days, debtor ageing and significant outstanding debts. The average credit period taken by customers is 23 days (2015: 20 days) and no interest is charged on overdue amounts.

Each customer has an external credit score which determines the level of credit provided. However, the majority of our customers have a sovereign credit rating as a result of being government organisations. Of the trade receivables balance at the end of the year, £71.4m is due from agencies of the UK Government, the Group's largest customer, £48.6m from the Australian Government, £37.6m from the Government of the United Arab Emirates, and £16.5m from the US Government. There are no other customers who represent more than 5% of the total balance of trade receivables. Of the trade receivables balance at the end of 2015, £39.6m was due from agencies of the UK Government. The maximum exposure to credit risk in relation to trade receivables at the reporting date is the fair value of trade receivables. The Group does not hold any collateral as security.

As at 31 December 2016, a total of £2.8m (2015: £1.4m) of trade receivables held by the Group were considered to be impaired and include £2.8m (2015: £1.4m) shown below and £nil (2015: £nil) included within amounts held for sale. Impairments to trade receivables are based on specific estimated irrecoverable amounts and provisions on outstanding balances greater than a year old unless there is firm evidence that the balance is recoverable. The total amount of the provision for the Group was £3.6m as of 31 December 2016 (2015: £11.3m) and included £3.6m (2015: £11.3m) as shown below and £nil (2015: £nil) of provision for trade receivables held for sale.

23. Trade and other receivables continued

Ageing of trade receivables	2016 £m	2015 £m
Neither impaired nor past due	143.0	99.0
Not impaired but overdue by less than 30 days	34.2	56.3
Not impaired but overdue by between 30 and 60 days	4.0	7.8
Not impaired but overdue by more than 60 days	12.4	20.4
Impaired	2.8	1.4
Allowance for doubtful debts	(3.6)	(11.3)
	192.8	173.6

Of the total overdue trade receivable balance, 53.2% (2015: 35.5%) relates to the UK, US or Australian governments, and a further 15.7% (2015: 34.4%) relates to the government of the United Arab Emirates. The total allowance for doubtful debts is greater than the assets identified as impaired due to provision being made for partial impairment of balances held within one of the ageing categories.

Movements on the Group allowance for doubtful debts	2016 £m	2015 £m
At 1 January	11.3	23.5
Net charges and releases to income statement	(0.1)	(6.8)
Utilised	(8.2)	(2.8)
Exchange differences	0.6	0.8
Reclassified to held for sale	–	(3.4)
At 31 December	3.6	11.3

Included in the other receivables balance at the end of the year is a further £19.2m (2015: £72.1m) due from agencies of the UK Government.

Included within current other receivables are capitalised bid costs of £7.8m (2015: £9.0m) and phase in costs of £13.8m (2015: £19.6m) that are realised as a part of the normal operating cycle of the Group. These assets represent up-front investment in contracts which are expected to provide benefits over the life of those contracts. Movements in the period were as follows:

	2016 £m
At 1 January	28.6
Additions	4.7
Amortisation	(13.8)
Exchange differences	2.1
At 31 December	21.6

Capitalised bid costs of £nil (2015: £nil) and phase in costs of £nil (2015: £0.3m) are held within assets held for sale.

24. Long-term contracts

Contracts in progress at the balance sheet date	2016 £m	2015 £m
Amounts due from long-term project based contract customers included in trade and other receivables	2.7	2.3
Amounts due to long-term project-based contract customers included in provisions	(10.0)	–
	(7.3)	2.3
Long-term project based contract costs incurred plus recognised profits less recognised losses to date	226.3	109.9
Less: progress payments	(233.6)	(107.6)
	(7.3)	2.3

As at 31 December 2016, the Group had £nil (2015: £nil) of contract retentions held by customers.

25. Cash and cash equivalents

	Sterling 2016 £m	Other currencies 2016 £m	Total 2016 £m	Sterling 2015 £m	Other currencies 2015 £m	Total 2015 £m
Customer advance payments*	–	1.0	1.0	–	3.1	3.1
Other cash and short-term deposits	149.4	27.4	176.8	293.7	26.8	320.5
Total cash and cash equivalents	149.4	28.4	177.8	293.7	29.9	323.6

* Customer advance payments totalling £1.0m (2015: £3.1m) are encumbered cash balances. A further £nil (2015: £nil) of encumbered cash has been reclassified as held for sale.

Cash and cash equivalents (which are presented as a single class of assets on the face of the balance sheet) comprise cash at bank and other short-term highly liquid investments with a maturity of three months or less.

Total cash and cash equivalents held by the Group at 31 December 2016 amount to £177.8m (2015: £328.8m) and include £177.8m (2015: £323.6m) shown above and £nil (2015: £5.2m) included within amounts held for sale on the balance sheet.

26. Trade and other payables

Trade and other payables: Current	2016 £m	2015 £m
Trade payables	84.7	93.6
Other payables	92.9	96.4
Accruals	292.2	303.1
Deferred income	54.7	55.7
	524.5	548.8

The average credit period taken for trade purchases is 32 days (2015: 28 days).

Trade and other payables: Non-current	2016 £m	2015 £m
Other payables	16.8	18.3

Total trade and other payables held by the Group at 31 December 2016 amount to £541.3m (2015: £574.5m) and include £541.3m (2015: £567.1m) shown above and £nil (2015: £7.4m) included within amounts held for sale on the balance sheet.

27. Obligations under finance leases

Amounts payable under finance leases	Minimum lease payments 2016 £m	Present value of minimum lease payments 2016 £m	Minimum lease payments 2015 £m	Present value of minimum lease payments 2015 £m
Within one year	13.1	12.3	17.0	15.8
Between one and five years	16.8	15.9	28.7	27.4
After five years	–	–	0.6	0.6
	29.9	28.2	46.3	43.8
Less: future finance charges	(1.7)	–	(2.5)	–
Present value of lease obligations	28.2	28.2	43.8	43.8
Less: amount due for settlement within one year (shown within current liabilities)	(12.3)	(12.3)	(15.8)	(15.8)
Amount due for settlement after one year	15.9	15.9	28.0	28.0

Total obligations under finance leases held by the Group at 31 December 2016 amount to £28.2m (2015: £44.3m) and include £28.2m (2015: £43.8m) shown above and £nil (2015: £0.5m) included within amounts held for sale on the balance sheet.

Finance lease obligations are secured by the lessors' title to the leased assets.

The Directors estimate that the fair value of the Group's lease obligations approximates their carrying amount.

Notes to the Consolidated Financial Statements continued

28. Loans

	Total 2016 £m	Total 2015 £m
Loans are repayable as follows:		
On demand or within one year*	9.2	131.9
Between one and two years	34.2	–
Between two and five years	137.5	62.5
After five years	96.1	167.6
	277.0	362.0
Less: assets classified as held for sale	–	–
Less: amount due for settlement within one year (shown within current liabilities)	(9.7)	(132.2)
Less: amounts shown in receivables (note 23)	22.9	19.9
Amount due for settlement after one year	290.2	249.7

* Included in loans repayable on demand or within one year are loan receivable amounts of £0.5m (2015: £0.4m).

	Carrying amount 2016 £m	Fair value 2016 £m	Carrying amount 2015 £m	Fair value 2015 £m
Other loans	299.9	289.7	381.9	379.0
Loan receivables	(22.9)	(22.9)	(19.9)	(19.9)
	277.0	266.8	362.0	359.1

The fair values are based on cash flows discounted using a market rate appropriate to the loan. All loans are held at amortised cost.

Analysis of Net Debt	At 1 January 2016 £m	Cash flow £m	Reclassified as held for sale £m	Acquisitions** £m	Disposals £m	Exchange differences £m	Non cash movements £m	At 31 December 2016 £m
Cash and cash equivalents	323.6	(153.7)	–	0.1	–	7.8	–	177.8
Loan receivables	19.9	–	–	–	–	0.1	2.9	22.9
Loans payable	(381.9)	135.8	–	–	–	(52.8)	(1.0)	(299.9)
Obligations under finance leases	(43.8)	16.7	(0.2)	–	–	(0.4)	(0.5)	(28.2)
Derivatives relating to Net Debt	14.6	–	–	–	–	3.5	–	18.1
	(67.6)	(1.2)	(0.2)	0.1	–	(41.8)	1.4	(109.3)

	At 1 January 2015 (restated*) £m	Cash flow £m	Reclassified as held for sale £m	Acquisitions** £m	Disposals £m	Exchange differences (restated*) £m	Non cash movements £m	At 31 December 2015 (restated*) £m
Cash and cash equivalents	180.1	128.8	17.2	–	(0.4)	(2.1)	–	323.6
Loan receivables	1.0	(0.6)	–	–	–	–	19.5	19.9
Loans payable	(797.3)	449.0	(0.8)	–	–	(30.8)	(2.0)	(381.9)
Obligations under finance leases	(26.5)	9.3	(26.7)	–	–	–	0.1	(43.8)
Derivatives relating to Net Debt*	10.7	–	–	–	–	3.9	–	14.6
	(632.0)	586.5	(10.3)	–	(0.4)	(29.0)	17.6	(67.6)

* Net Debt has been restated to include derivative financial instruments that relate to other components of Net Debt. See note 2.

** Acquisitions represent the net cash / (debt) acquired on acquisition.

Total net debt held amounts to £109.3m (2015: £62.9m) of which £109.3m (2015: £67.6m) is shown above and £nil (2015: £4.7m (asset)) is included within amounts held for sale on the balance sheet.

29. Provisions

	Employee related £m	Property £m	Contract £m	Other £m	Total £m
At 1 January 2016	36.4	18.3	302.1	124.9	481.7
Acquisitions	–	0.6	14.0	–	14.6
Reclassified to trade and other payables	–	–	(11.5)	(8.3)	(19.8)
Charged to income statement – exceptional	0.4	–	–	22.7	23.1
Charged to income statement – other	25.6	4.4	56.6	23.7	110.3
Released to income statement – exceptional	(0.2)	–	(0.6)	–	(0.8)
Released to income statement – other	(5.3)	(0.3)	(64.9)	(17.2)	(87.7)
Utilised during the year	(17.5)	(6.2)	(82.0)	(17.7)	(123.4)
Reclassification	–	(2.9)	(7.3)	4.9	(5.3)
Transfer from assets held for sale	–	–	–	3.3	3.3
Eliminated on disposal of subsidiary	–	–	–	(1.7)	(1.7)
Unwinding of discount	–	0.1	2.4	–	2.5
Exchange differences	5.7	1.2	11.4	6.6	24.9
At 31 December 2016	45.1	15.2	220.2	141.2	421.7
Analysed as:					
Current	13.7	4.3	79.2	75.1	172.3
Non-current	31.4	10.9	141.0	66.1	249.4

Total provisions held by the Group at 31 December 2016 amount to £421.7m (2015: £506.2m) and include £421.7m (2015: £481.7m) shown above and £nil (2015: £24.5m) included within amounts held for sale on the balance sheet.

Contract provisions relate to onerous contracts which will be utilised over the life of each individual contract, up to a maximum of 8 ¼ years from the balance sheet date. The present value of the estimated future cash outflows required to settle the contract obligations as they fall due over the respective contracts has been used in determining the provision. The individual provisions are discounted where the impact is assessed to be material. Discount rates used are calculated based on the estimated risk free rate of interest for the region in which the provision is located and matched against the ageing profile of the provision. Rates applied are in the range of 1.16% and 3.30%.

A full analysis is performed at least annually of the future profitability of all contracts with marginal performances and of the balance sheet items directly linked to these contracts.

Due to the significant size of the balance and the inherent level of uncertainty over the amount and timing of the related cash flows upon which onerous contract provisions are based, if the expected operational performance varies from the best estimates made at the year end, a material change in estimate may be required. The key drivers behind operational performance is the level of activity required to be serviced, which is often directed by the actions of the UK Government, and the efficiency of Group employees and resources.

Employee related provisions are for long-term service awards and terminal gratuities liabilities which have been accrued and are based on contractual entitlement, together with an estimate of the probabilities that employees will stay until retirement and receive all relevant amounts. There are also amounts included in relation to restructuring. The provisions will be utilised over various periods driven by local legal or regulatory requirements, the timing of which is not certain.

Property provisions relate to leased properties which are either underutilised or vacant and where the unavoidable costs associated with the lease exceed the economic benefits expected to be generated in the future. The provision has been calculated based on the discounted cash outflows required to settle the lease obligations as they fall due, with the longest running lease ending in April 2039.

Other provisions are held for indemnities given on disposed businesses, legal and other costs that the Group expects to incur over an extended period, in respect of past events. These costs are based on past experience of similar items and other known factors and represent management's best estimate of the likely outcome and will be utilised with reference to the specific facts and circumstances, with the majority expecting to be settled by 31 December 2021.

Notes to the Consolidated Financial Statements continued

30. Capital and other commitments

Capital expenditure contracted but not provided	2016 £m	2015 £m
Property, plant and equipment	10.4	9.3
Intangible assets	5.6	6.9

Of the above, £nil (2015: £nil) in relation to property, plant and equipment commitment is associated with assets which have been reclassified as held for sale.

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

	2016 £m	2015 £m
Within one year	66.9	36.9
Between one and five years	127.6	64.1
After five years	126.1	12.3
	320.6	113.3

Of the above, £nil (2015: £0.5m) is associated with assets which have been reclassified as held for sale. Of this £nil (2015: £0.3m) is due within one year, £nil (2015: £0.2m) is due between one and five years, and £nil (2015: £nil) is due after five years.

31. Contingent liabilities

The Company has guaranteed overdrafts, finance leases, and bonding facilities of its joint ventures and associates up to a maximum value of £20.4m (2015: £21.1m). The actual commitment outstanding at 31 December 2016 was £17.9m (2015: £20.8m).

The Company and its subsidiaries have provided certain guarantees and indemnities in respect of performance and other bonds, issued by its banks on its behalf in the ordinary course of business. The total commitment outstanding as at 31 December 2016 was £252.1m (2015: £211.8m).

As we have disclosed before, we are under investigation by the Serious Fraud Office. In November 2013, the UK's Serious Fraud Office announced that it had opened an investigation, which remains ongoing, into the Group's Electronic Monitoring Contract.

We are cooperating fully with the Serious Fraud Office's investigation but it is not possible to predict the outcome. However, disclosed in the Principal Risks and Uncertainties in this Report is a description of the range of possible outcomes in the event that the Serious Fraud Office decides to prosecute the individuals and /or the Serco entities involved.

The Group is aware of other claims and potential claims which involve or may involve legal proceedings against the Group. The Directors are of the opinion, having regard to legal advice received and the Group's insurance arrangements, that it is unlikely that these matters will, in aggregate, have a material effect on the Group's financial position.

32. Financial risk management

32 (a) Fair value of financial instruments

i) Hierarchy of fair value

The classification of the fair value measurement falls into three levels, based on the degree to which the fair value is observable. The levels are as follows:

Level 1: inputs derived from unadjusted quoted prices in active markets for identical assets or liabilities;

Level 2: inputs are inputs, other than quoted prices included within Level 1, that are observable for the asset or liability, either directly or indirectly; and

Level 3: inputs are unobservable inputs for the asset or liability.

Based on the above, the derivative financial instruments held by the Group at 31 December 2016 and the comparison fair values for loans and finance leases, are all considered to fall into Level 2. Market prices are sourced from Bloomberg and third party valuations. The valuation models incorporate various inputs including foreign exchange spot and forward rates and interest rate curves. There have been no transfers between levels in the year.

The Group held the following financial instruments which fall within the scope of IAS 39 *Financial Instruments: Recognition and Measurement* at 31 December:

	Carrying amount (measurement basis)		Comparison fair value	Carrying amount (measurement basis)		Comparison fair value
	Amortised cost 2016 £m	Fair value – Level 2 2016 £m	Level 2 2016 £m	Amortised cost 2015 £m	Fair value – Level 2 2015 £m	Level 2 2015 £m
Financial assets						
Financial assets – current						
Cash and bank balances	177.8	–	177.8	323.6	–	323.6
Derivatives designated as FVTPL						
Forward foreign exchange contracts	–	4.5	–	–	6.6	–
Derivative instruments in designated hedge accounting relationships						
Cross currency swaps	–	–	–	–	2.6	–
Forward foreign exchange contracts	–	0.4	–	–	0.2	–
Loans and receivables						
Trade receivables (note 23)	192.8	–	192.8	173.6	–	173.6
Loan receivables (note 23)	0.5	–	0.5	0.4	–	0.4
Security deposits (note 23)	0.1	–	0.1	0.2	–	0.2
Amounts owed by joint ventures and associates (note 23)	0.6		–	0.8	–	0.8
Financial assets – non-current						
Derivative instruments in designated hedge accounting relationships						
Cross currency swaps	–	14.2	–	–	7.8	–
Loans and receivables						
Loan receivables (note 23)	22.4	–	22.4	19.5	–	19.5
Other investments (note 23)	0.6	–	0.6	3.4	–	3.4
Amounts owed by joint ventures and associates (note 23)	–	–	–	7.2	–	7.2
Financial liabilities – current						
Derivatives designated as FVTPL						
Forward foreign exchange contracts	–	(0.6)	–	–	(2.4)	–
Financial liabilities at amortised cost						
Trade payables (note 26)	(84.7)	–	(84.7)	(93.6)	–	(93.6)
Loans (note 28)	(9.7)	–	(9.7)	(132.2)	–	(132.2)
Obligations under finance leases (note 27)	(12.3)	–	(12.3)	(15.8)	–	(15.8)
Financial liabilities – non-current						
Financial liabilities at amortised cost						
Loans (note 28)	(290.2)	–	(280.1)	(249.7)	–	(246.8)
Obligations under finance leases (note 27)	(15.9)	–	(15.9)	(28.0)	–	(28.0)

The Directors estimate that the carrying amounts of cash, trade receivables and trade payables approximate to their fair value due to the short-term maturity of these instruments.

32. Financial risk management continued

32 (a) Fair value of financial instruments continued

i) Hierarchy of fair value continued

The fair values of loans and finance lease obligations are based on cash flows discounted using a rate based on the borrowing rate associated with the liability.

The fair value of derivatives is calculated using a discounted cash flow approach applying discount factors derived from observable market data to actual and estimated future cash flows. Credit risk is considered in the calculation of these fair values.

ii) Fair value of derivative financial instruments

The fair valuation of derivative financial instruments results in a net asset of £18.5m (2015: net assets of £14.8m) comprising non-current assets of £14.2m (2015: £7.8m), current assets of £4.9m (2015: £9.4m), current liabilities of £0.6m (2015: £2.4m) and non-current liabilities of £nil (2015: £nil).

	1 January 2016 £m	Movement in fair value of derivatives designated in hedge accounting relationships £m	Movement in fair value of derivatives not designated in hedge accounting relationships £m	31 December 2016 £m
Currency swaps	10.4	3.8	–	14.2
Forward foreign exchange contracts	4.4	0.2	(0.3)	4.3
	14.8	4.0	(0.3)	18.5

	1 January 2015 £m	Movement in fair value of derivatives designated in hedge accounting relationships £m	Movement in fair value of derivatives not designated in hedge accounting relationships £m	31 December 2015 £m
Currency swaps	6.8	3.6	–	10.4
Forward foreign exchange contracts	(11.6)	0.1	15.9	4.4
	(4.8)	3.7	15.9	14.8

The fair value of financial liabilities at fair value through profit and loss is £0.6m (2015: £2.4m) and relates to derivatives that are not designated in hedge accounting relationships. The fair value of the derivatives and their credit risk adjusted fair value are not materially different, and are approximately equal to the amount contractually payable at maturity due to the short tenor of the instruments.

32 (b) Financial risk

The Board is ultimately responsible for ensuring that financial and non-financial risks are monitored and managed within acceptable and known parameters. The Board delegates authority to the executive team to manage financial risks. The Group's treasury function acts as a service centre and operates within clearly defined guidelines and policies that are approved by the Board. The guidelines and policies define the financial risks to be managed, specify the objectives in managing these risks, delegate responsibilities to those managing the risks and establish a control framework to regulate treasury activities to minimise operational risk.

32 (c) Liquidity risk

i) Credit facilities

The Group maintains committed credit facilities to ensure that it has sufficient liquidity to maintain its ongoing operations. As at 31 December, the Group's committed bank credit facilities and corresponding borrowings were as follows:

	Currency	Amount 2016 £m	Drawn 2016 £m	Utilised for bonding facility 2016 £m	Total facility available 2016 £m
Syndicated revolving credit facility	Sterling	480.0	–	–	480.0

	Currency	Amount 2015 £m	Drawn 2015 £m	Utilised for bonding facility 2015 £m	Total facility available 2015 £m
Syndicated revolving credit facility	Sterling	480.0	–	9.0	471.0

On 31 March 2016, £368m of the Group's £480m revolving credit facility was extended to April 2020. The remaining £112m matures in April 2019.

In addition to the banking facility the Group has outstanding US private placements of £290.2m which will be repaid as bullet repayments between 2018 and 2024.

In addition to the bank and private placement facilities the Group has a £30.0m receivables financing facility (2015: £30.0m) of which £7.7m (2015: £30.0m) was drawn at year end.

ii) Maturity of financial liabilities
The Group's financial liabilities will be settled on both a net and a gross basis over the remaining period between the balance sheet date and the contractual maturity date. The amounts disclosed below are the contractual undiscounted cash flows based on the earliest date on which the Group can be required to pay.

At 31 December 2016	On demand or within one year £m	Between one and two years £m	Between two and five years £m	After five years £m	Total £m
Trade payables (note 26)	84.7	–	–	–	84.7
Obligations under finance leases (note 27)	13.1	8.9	7.9	–	29.9
Loans* (note 28)	9.7	34.2	139.5	118.7	302.1
Future loan interest	15.0	14.2	35.9	12.4	77.5
Derivatives settled on gross basis:					
Outflow	392.0	25.8	17.8	–	435.6
Inflow	(396.9)	(34.3)	(23.1)	–	(454.3)
	117.6	48.8	178.0	131.1	475.5

* Loans are stated gross of capitalised finance costs.

At 31 December 2015	On demand or within one year £m	Between one and two years £m	Between two and five years £m	After five years £m	Total £m
Trade payables (note 26)	93.6	–	–	–	93.6
Obligations under finance leases (note 27)	17.0	13.1	15.6	0.6	46.3
Loans* (note 28)	132.2	–	64.9	187.6	384.7
Future loan interest	14.6	12.6	33.1	19.1	79.4
Derivatives settled on gross basis:					
Outflow	291.8	3.6	67.2	–	362.6
Inflow	(298.8)	(3.7)	(75.2)	–	(377.7)
	250.4	25.6	105.6	207.3	588.9

* Loans are stated gross of capitalised finance costs.

Gross cash flows in the table above relating to forward foreign exchange contracts total £394.6m (inflows) and £390.1m (outflows) on demand or within one year and £nil (inflows) and £nil (outflows) between one and two years (2015: £274.0m (inflow) and £269.7m (outflow) on demand or within one year and £0.7m (inflows) and £0.7m (outflows) between one and two years).

Total loans on demand or within one year for the Group amount to £9.7m (2015: £132.2m) at December 2016 of which £9.7m (2015: £132.2m) is included above and £nil (2015: £nil) is classified as held for sale.

32. Financial risk management continued

32 (d) Foreign exchange risk

i) Transactional

It is the Group's policy to hedge material transactional exposures using forward foreign exchange contracts to fix the functional currency value of non-functional currency cash flows. At 31 December 2016, there were no material unhedged non-functional currency monetary assets or liabilities, firm commitments or highly probable forecast transactions.

ii) Translational

Where possible the Group will raise external funding to match the currency profile of its foreign operations, in order to mitigate translation exposure. If matched funding is not possible, currency derivatives may be used to protect against movements in foreign exchange.

iii) Hedge accounting

For the purposes of hedge accounting, hedges are classified as either fair value hedges, cash flow hedges or hedges of net investments in foreign operations. Page 151 details the Group's accounting policies in relation to derivatives qualifying for hedge accounting under IAS 39.

At 31 December 2016, the Group held cross currency swaps designated as cash flow hedges against $69.5m of the US Dollar private placements. Fixed interest cash flows denominated in US Dollars are exchanged for fixed interest cash flows denominated in Sterling.

The profile of these cross currency swaps held by the Group in the current and prior year is as follows:

	2016 Receivable			2015 Receivable		
Maturity	Notional amount US Dollar m	US Dollar interest rate %	Payable Sterling interest rate %	Notional amount US Dollar m	US Dollar interest rate %	Payable Sterling interest rate %
May 2016	–	–	–	31.5	3.6	4.3
May 2018	41.0	4.4	4.9	63.0	4.4	4.9
October 2019	28.5	3.8	4.1	44.1	3.8	4.1

The Group also held a number of forward foreign exchange contracts designated as cash flow hedges. These derivatives are hedging highly probable forecast foreign currency trade payments in the UK business. The net notional amounts are summarised by currency below:

	2016 £m	2015 £m
Sterling	(7.0)	(10.8)
US Dollar	3.2	–
Euro	4.2	11.0

All derivatives designated as cash flow hedges are highly effective and as at 31 December 2016 a net fair value loss of £0.5m (2015: £2.7m) has been deferred in the hedging reserve. During the course of the year to 31 December 2016, £3.4m (2015: £0.6m) of fair value gains were transferred to the hedging reserve and £1.1m (2015: £2.8m) reclassified to the consolidated income statement.

iv) Currency sensitivity

The Group's currency exposures in respect of monetary items at 31 December 2016 that result in net currency gains and losses in the income statement and equity arise principally from movement in US Dollar and Euro exchange rates. The impact of a 10% movement is summarised below:

	Pre-tax profits gain / (loss) 2016 £m	Equity gain / (loss) 2016 £m	Pre-tax profits gain / (loss) 2015 £m	Equity gain / (loss) 2015 £m
US Dollar	(0.1)	–	0.3	(0.7)
Euro	–	(0.5)	–	1.0
	(0.1)	(0.5)	0.3	0.3

32 (e) Interest rate risk

The Group's policy is to minimise the impact of interest rate volatility on earnings to provide an appropriate level of certainty to cost of funds. Exposure to interest rate risk arises principally on changes to US Dollar and Sterling interest rates.

i) Interest rate management

An analysis of financial assets and liabilities exposed to interest rate risk is set out below:

Financial assets	Floating rate 2016 £m	Fixed rate 2016 £m	Weighted average interest rate 2016 %	Floating rate 2015 £m	Fixed rate 2015 £m	Weighted average interest rate 2015 %
Cash and cash equivalents	177.8	–	–	323.6	–	–
Other loan receivables	0.5	22.4	7.0	0.4	19.5	7.0
	178.3	22.4		324.0	19.5	

Financial liabilities	Floating rate 2016 £m	Fixed rate 2016 £m	Weighted average interest rate 2016 %	Floating rate 2015 £m	Fixed rate 2015 £m	Weighted average interest rate 2015 %
Non recourse Sterling loans	–	–	–	–	–	–
Sterling loans	–	–	–	–	–	–
US Dollar loans	–	290.2	5.2	–	374.6	5.10
Other loans	11.8	–	–	10.1	–	–
	11.8	290.2		10.1	374.6	

Total cash and cash equivalents held by the Group at 31 December 2016 amount to £177.8m (2015: £328.8m) and include £177.8m (2015: £323.6m) shown above and £nil (2015: £5.2m) included within amounts held for sale on the balance sheet.

Total floating rate and fixed rate loans held by the Group at 31 December 2016 amount to £11.8m (2015: £10.1m) and £290.2m (2015: £374.6m) respectively and include £11.8m (2015: £10.1m) and £290.2m (2015: £374.6m) shown above and £nil (2015: £nil) and £nil (2015: £nil) included within amounts held for sale on the balance sheet.

Exposure to interest rate fluctuations is mitigated through the issuance of fixed rate debt and the use of interest rate derivatives. Excluded from the above analysis is £28.2m (2015: £43.8m) of amounts payable under finance leases, which are subject to fixed rates of interest.

ii) Interest rate sensitivity

The effect of a 100 basis point increase in LIBOR rates on the net financial liability position at the balance sheet date, with all other variables held constant, would have resulted in an increase in pre-tax profit for the year to 31 December 2016 of £1.7m (2015: decrease in pre-tax loss of £3.2m).

32 (f) Credit risk

The Group's principal financial assets are cash and cash equivalents and trade and other receivables.

Credit risk is the risk that a counterparty could default on its contractual obligations. In this regard, the Group's principal exposure is to cash and cash equivalents, derivative transactions and trade receivables.

The Group's trade receivables credit risk is relatively low given that a high proportion of our customer base are Government bodies with strong sovereign, or sovereign like, credit ratings. However, where the assessed credit worthiness of a customer, Government or non-government, falls below that considered acceptable, appropriate measures are taken to mitigate against the risk of contractual default using instruments such as credit guarantees.

The Group's treasury function only transacts with counterparties that comply with Board policy. The credit risk is measured by way of a counterparty credit rating from any two recognised rating agencies. Pre-approved limits are set based on a rating matrix and exposures monitored accordingly. The Group also employs the use of set-off rights in some agreements.

The Group's policy is to provide guarantees for joint ventures and associates only to the relevant proportion of support provided by the partners. At 31 December 2016, the Company has issued guarantees in respect of certain joint ventures and associates as per note 31.

32. Financial risk management continued

32 (g) Capital risk

The Board's objective is to maintain a capital structure that supports the Group's strategic objectives, including but not limited to reshaping the portfolio through mergers, acquisitions and disposals. In doing so the Board seeks to manage funding and liquidity risk, optimise shareholder return and maintain an implied investment grade credit position. This strategy is unchanged from the prior year.

The Board reviews and approves at least annually a treasury policy document which covers, inter alia, funding and liquidity risk, capital structure and risk management. This policy details targets for committed funding headroom, diversification of committed funding and debt maturity profile.

The Group plans to maintain sufficient funds and distributable reserves to allow payments of projected dividends to shareholders.

The following table summarises the capital of the Group:

	2016 £m	2015 £m
Cash and cash equivalents	(177.8)	(323.6)
Loans	277.0	362.0
Obligations under finance leases	28.2	43.8
Equity	398.8	282.1
Capital	526.2	364.3

33. Retirement benefit schemes

33 (a) Defined benefit schemes

i) Characteristics and risks

The Group contributes to defined benefit schemes for qualifying employees of its subsidiaries in the UK and Europe. The normal contributions expected to be paid during the financial year ending 31 December 2017 are £9.7m (2016: £11.9m). Among our non contract specific schemes, the largest is the Serco Pension and Life Assurance Scheme (SPLAS). The most recent full actuarial valuation of this scheme was undertaken as at 5 April 2015 and resulted in an actuarially assessed deficit of £4.0m.

The assets of the funded schemes are held independently of the Group's assets in separate trustee administered funds. The trustees of the pension fund are required by law to act in the interest of the fund and of all relevant stakeholders in the scheme. The trustees of the pension fund are responsible for the investment policy with regard to the assets of the fund. The Group's major schemes are valued by independent actuaries annually using the projected unit credit actuarial cost method. This reflects service rendered by employees to the dates of valuation and incorporates actuarial assumptions primarily regarding discount rates used in determining the present value of benefits, projected rates of salary growth, and life expectancy of pension plan members. Discount rates are based on the market yields of high-quality corporate bonds in the country concerned. Pension assets and liabilities in different defined benefit schemes are not offset unless the Group has a legally enforceable right to use the surplus in one scheme to settle obligations in the other scheme and intends to exercise this right.

The schemes typically expose the Group to actuarial risks such as those set out below:

- Investment risk. The present value of the defined benefit schemes' liability is calculated using a discount rate determined by reference to high quality corporate bond yields and therefore if the return on plan assets is below this rate, a deficit will be created.
- Interest risk. A decrease in the bond interest rate will increase the scheme liability but this will be partially offset by an increase in the return of the plan's debt investments.
- Longevity risk. The present value of the defined benefit plan liability is calculated by reference to the best estimate of the mortality of plan participants both during and after their employment. An increase in the life expectancy of the plan participants will increase the plan's liability.
- Salary risk. The present value of the defined benef it scheme liability is calculated by reference to the future salaries of plan participants, as such, an increase in the salary of the plan participants will increase the plan's liability.

The defined benefit schemes are grouped together as follows:

- Contract specific. These are pre-funded defined benefit schemes. The Group has obligations to contribute variable amounts to the pension schemes over the terms of the related contracts. At rebid, any deficit or surplus would be expected to transfer to the next contractor. The Group has recognised as a liability the defined benefit obligation less the fair value of scheme assets that it will fund over the period of the contracts with a corresponding amount recognised as intangible assets at the start of the contracts. Subsequent actuarial gains and losses in relation to the Group's share of the pension obligations have been recognised in the SOCI. The intangible assets are amortised over the term of the contracts. Under contractual arrangements the Group sponsors a section of an industry wide defined benefit scheme, the Railways Pension Scheme (RPS), paying contributions in accordance with a Schedule of Contributions. There is no residual liability to fund a deficit at the end of the franchise period any costs are shared 60% by the employer and 40% by the members. The Group also makes contributions under Admitted Body status to a number of sections of the Local Government Pension Scheme for the period to the end of the relevant customer contracts. The Group will only participate in the Local Government Pension Schemes for a finite period up to the end of the contracts. The Group is required to pay regular contributions as decided by the respective Scheme Actuary and as detailed in each scheme's Schedule of Contributions. In addition, the Group may be required to pay some or all of any deficit (as determined by the respective Scheme Actuary) that is remaining at the end of the contract. In respect of this, the Group recognises a sufficient level of provision in these financial statements based on the IAS 19 valuation at the reporting date and contractual obligations.
- Non contract specific. These do not relate to any specific contract and consist of two pre-funded defined benefit schemes and an unfunded defined benefit scheme. Any liabilities arising are recognised in full and liabilities in relation to unfunded scheme amounts to £0.2m (2015: £0.3m). The unfunded scheme is the only non UK scheme. The funding policy for the pre-funded schemes is to contribute such variable amounts, on the advice of the actuary, as will achieve 100% funding on a projected salary basis. One of these schemes is SPLAS and the other is another section of the RPS.

ii) Partial settlement of SPLAS in the year

Following the finalisation of the Revised Fair Deal a number of employees are being transferred from SPLAS back to the Principal Civil Service Pension Scheme. This transfer was finalised in December 2016 at which point all obligations of SPLAS to pay retirement benefits for these individuals were eliminated and as a result a settlement charge of £10.7m arose, which was treated as an exceptional item in the year. The final administrative process and payment completed in January 2017 and as result the related assets and liabilities are retained in the balance sheet values disclosed in section iv) below.

iii) Balance sheet values

The assets and liabilities of the schemes at 31 December are:

	Contract specific 2016 £m	Non contract specific 2016 £m	Total 2016 £m
Scheme assets at fair value			
Equities	3.3	43.3	46.6
Bonds except LDI	0.7	20.2	20.9
Liability driven investments (LDI)	–	1,390.6	1,390.6
Gilts	–	72.4	72.4
Property	0.6	–	0.6
Cash and other	1.2	4.2	5.4
Annuity policies	–	20.0	20.0
Fair value of scheme assets	5.8	1,550.7	1,556.5
Present value of scheme liabilities	(12.0)	(1,418.0)	(1,430.0)
Net amount recognised	(6.2)	132.7	126.5
Franchise adjustment*	3.7	–	3.7
Members' share of deficit	2.5	–	2.5
Net retirement benefit asset	–	132.7	132.7
Net pension liability	–	(17.7)	(17.7)
Net pension asset	–	150.4	150.4
Deferred tax liabilities	–	(17.6)	(17.6)
Net retirement benefit asset (after tax)	–	115.1	115.1

* The franchise adjustment represents the amount of scheme deficit that is expected to be funded outside the contract period.

33. Retirement benefit schemes continued

33 (a) Defined benefit schemes continued

iii) Balance sheet values continued

	Contract specific 2015 £m	Non contract specific 2015 £m	Total 2015 £m
Scheme assets at fair value			
Equities	2.8	39.1	41.9
Bonds except LDI	0.3	-	0.3
Liability driven investments (LDI)	-	1,144.4	1,144.4
Gilts	-	68.1	68.1
Property	0.6	-	0.6
Cash and other	0.9	30.7	31.6
Annuity policies	-	22.0	22.0
Fair value of scheme assets	4.6	1,304.3	1,308.9
Present value of scheme liabilities	(7.7)	(1,188.7)	(1,196.4)
Net amount recognised	(3.1)	115.6	112.5
Franchise adjustment*	1.9	-	1.9
Members' share of deficit	1.2	-	1.2
Net retirement benefit asset	-	115.6	115.6
Net pension liability	-	(11.5)	(11.5)
Net pension asset	-	127.1	127.1
Deferred tax liabilities	-	(20.8)	(20.8)
Net retirement benefit asset (after tax)	-	94.8	94.8

* The franchise adjustment represents the amount of scheme deficit that is expected to be funded outside the contract period.

As required by IAS 19, the Group has considered the extent to which the pension plan assets should be classified in accordance with the fair value hierarchy of IFRS 13. Virtually all equity and debt instruments have quoted prices in active markets. Annuity policies and property assets can be classified as Level 3 instruments, and LDIs are classified as Level 2.

SPLAS has a Liability Driven Investment (LDI) strategy which aims to reduce volatility risk by better matching assets to liabilities. The main asset classes that make up the LDI investments are gilts and corporate bonds with inflation and interest swap overlays. The value of these investments vary in line with gilt yields, which has dropped from 1.75% p.a. to 2.55% p.a. during 2016 resulting in a decrease in these assets. In addition, LDI assets were transferred to a separate gilt portfolio in late December to back a longevity swap. The decrease in the value of LDI investments was less than the increase in scheme liabilities and the increase in gilt yields was less than the fall in yields of high quality corporate bonds resulting in a decrease in the surplus in the year.

iv) Values recognised in total comprehensive income in the year

The amounts recognised in the financial statements for the year are analysed as follows:

	Contract specific 2016 £m	Non contract specific 2016 £m	Total 2016 £m
Recognised in the income statement			
Current service cost – employer	0.4	7.4	7.8
Past service cost	–	0.4	0.4
Curtailment loss recognised	–	(1.9)	(1.9)
Administrative expenses and taxes	–	5.4	5.4
Recognised in arriving at operating profit	0.4	11.3	11.7
Interest income on scheme assets – employer	(0.1)	(49.0)	(49.1)
Interest on franchise adjustment	(0.1)	–	(0.1)
Interest cost on scheme liabilities – employer	0.2	44.3	44.5
Finance income	–	(4.7)	(4.7)
Included within the SOCI			
Actual return on scheme assets	0.9	285.2	286.1
Less: interest income on scheme assets	(0.2)	(49.0)	(49.2)
	0.7	236.2	236.9
Effect of changes in demographic assumptions	–	26.2	26.2
Effect of changes in financial assumptions	(3.5)	(279.3)	(282.8)
Effect of experience adjustments	–	28.7	28.7
Remeasurements recognised in the SOCI	(2.8)	11.8	9.0
Change in franchise adjustment	1.7	–	1.7
Change in members' share	1.2	–	1.2
Actuarial losses on reimbursable rights	2.9	–	2.9
Total pension gain recognised in the SOCI	0.1	11.8	11.9

Notes to the Consolidated Financial Statements continued

33. Retirement benefit schemes continued

33 (a) Defined benefit schemes continued

iv) Values recognised in total comprehensive income in the year continued

	Contract specific 2015 £m	Non contract specific 2015 £m	Total 2015 £m
Recognised in the income statement			
Current service cost – employer	1.5	8.4	9.9
Past service cost	–	0.4	0.4
Settlement gain recognised	(3.3)	–	(3.3)
Administrative expenses and taxes	–	4.6	4.6
Recognised in arriving at operating profit	(1.8)	13.4	11.6
Interest income on scheme assets – employer	(1.1)	(48.6)	(49.7)
Interest on franchise adjustment	–	–	–
Interest cost on scheme liabilities – employer	1.2	43.6	44.8
Finance income	0.1	(5.0)	(4.9)
Included within the SOCI			
Actual return on scheme assets	1.3	(18.5)	(17.2)
Less: *interest income on scheme assets*	(1.1)	(48.6)	(49.7)
	0.2	(67.1)	(66.9)
Effect of changes in demographic assumptions	–	(0.2)	(0.2)
Effect of changes in financial assumptions	1.5	42.7	44.2
Effect of experience adjustments	0.5	6.6	7.1
Remeasurements recognised in the SOCI	2.2	(18.0)	(15.8)
Change in franchise adjustment	(0.1)	–	(0.1)
Change in members' share	(0.3)	–	(0.3)
Actuarial losses on reimbursable rights	(0.4)	–	(0.4)
Total pension (loss) / gain recognised in the SOCI	1.8	(18.0)	(16.2)

Changes in the fair value of scheme liabilities are analysed as follows:

	Contract specific £m	Non contract specific £m	Total £m
At 1 January 2015	161.3	1,231.3	1,392.6
Current service cost – employer	1.5	8.4	9.9
Current service cost – employee	0.2	–	0.2
Past service costs	–	0.4	0.4
Scheme participants' contributions	0.3	0.6	0.9
Interest cost – employer	1.2	43.6	44.8
Interest cost – employee	0.1	–	0.1
Benefits paid	(0.8)	(46.5)	(47.3)
Effect of changes in demographic assumptions	–	0.2	0.2
Effect of changes in financial assumptions	(1.5)	(42.7)	(44.2)
Effect of experience adjustments	(0.5)	(6.6)	(7.1)
Arising on acquisition	7.8	–	7.8
Plan settlements	(34.4)	–	(34.4)
Disposal of scheme	(127.5)	–	(127.5)
At 31 December 2015	7.7	1,188.7	1,196.4
At 1 January 2016	7.7	1,188.7	1,196.4
Current service cost – employer	0.4	7.4	7.8
Current service cost – employee	0.3	–	0.3
Past service costs	–	0.4	0.4
Scheme participants' contributions	–	0.5	0.5
Interest cost – employer	0.2	44.3	44.5
Interest cost – employee	0.1	–	0.1
Benefits paid	(0.1)	(45.9)	(46.0)
Effect of changes in demographic assumptions	–	(26.2)	(26.2)
Effect of changes in financial assumptions	3.5	279.3	282.8
Effect of experience adjustments	–	(28.7)	(28.7)
Plan curtailments	–	(1.9)	(1.9)
At 31 December 2016	12.1	1,417.9	1,430.0

33. Retirement benefit schemes continued

33 (a) Defined benefit schemes continued

iv) Values recognised in total comprehensive income in the year continued

Changes in the fair value of scheme assets are analysed as follows:

	Contract specific £m	Non contract specific £m	Total £m
At 1 January 2015	134.4	1,361.8	1,496.2
Interest income on scheme assets – employer	1.0	48.6	49.6
Interest income on scheme assets – employee	–	–	–
Administrative expenses and taxes	–	(4.5)	(4.5)
Employer contributions	0.6	11.5	12.1
Contributions by employees	0.3	0.6	0.9
Benefits paid	(0.8)	(46.5)	(47.3)
Return on scheme assets less interest income	0.3	(67.2)	(66.9)
Arising on acquisitions	4.5	–	4.5
Plan settlements	(31.0)	–	(31.0)
Eliminated on disposal of a pension scheme	(104.7)	–	(104.7)
At 31 December 2015	4.6	1,304.3	1,308.9
At 1 January 2016	4.6	1,304.3	1,308.9
Interest income on scheme assets – employer	0.1	49.0	49.1
Interest income on scheme assets – employee	0.1	–	0.1
Administrative expenses and taxes	–	(5.4)	(5.4)
Employer contributions	0.3	11.9	12.2
Contributions by employees	0.2	0.5	0.7
Benefits paid	(0.1)	(45.9)	(46.0)
Return on scheme assets less interest income	0.7	236.2	236.9
At 31 December 2016	5.9	1,550.6	1,556.5

Changes in the franchise adjustment is analysed as follows:

	Total £m
At 1 January 2015	22.9
Taken to SOCI	(0.1)
Arising on acquisition of scheme	2.0
Eliminated on disposal of scheme	(22.9)
At 31 December 2015	1.9
At 1 January 2016	1.9
Interest on franchise adjustment	0.1
Taken to SOCI	1.7
At 31 December 2016	3.7

v) Actuarial assumptions

The average duration of the benefit obligation at the end of the reporting period is 17.7 years (2015: 16.7 years).

Assumptions in respect of the expected return on scheme assets are required when calculating the franchise adjustment for the contract-specific plans. These assumptions are based on market expectations of returns over the life of the related obligation. Due consideration has been given to current market conditions as at 31 December 2016 in respect to inflation, interest, bond yields and equity performance when selecting the expected return on assets assumptions.

The expected yield on bond investments with fixed interest rates is derived from their market value. The yield on equity investments contains an additional premium (an 'equity risk premium') to compensate investors for the additional anticipated risks of holding this type of investment, when compared to bond yields. Management have concluded that an appropriate equity risk premium is 4.6% (2015: 4.6%).

The overall expected return on assets is calculated as the weighted average of the expected returns for the principal asset categories held by the scheme.

Main assumptions	2016 %	2015 %
Rate of salary increases	2.80	2.80
Rate of increase in pensions in payment	2.30 (CPI) and 3.30 (RPI)	2.00 (CPI) and 3.00 (RPI)
Rate of increase in deferred pensions	2.30 (CPI) and 3.30 (RPI)	2.10 (CPI) and 3.10 (RPI)
Inflation assumption	2.30 (CPI) and 3.30 (RPI)	2.10 (CPI) and 3.10 (RPI)
Discount rate	2.70	3.80

Post retirement mortality	2016 years	2015 years
Current pensioners at 65 – male	22.5	22.6
Current pensioners at 65 – female	25.0	25.1
Future pensioners at 65 – male	24.2	24.4
Future pensioners at 65 – female	26.9	27.1

Management considers the significant actuarial assumptions with regards to the determination of the defined benefit obligation to be the discount rate, inflation, the rate of salary increases and mortality.

Sensitivity analysis is provided below, based on reasonably possible changes of the assumptions occurring at the end of the reporting period, assuming all other assumptions are held constant. The sensitivities have been derived in the same manner as the defined benefit obligation as at 31 December 2016 where the defined benefit obligation is estimated using the Projected Unit Credit method. Under this method each participant's benefits are attributed to years of service, taking into consideration future salary increases and the scheme's benefit allocation formula. Thus, the estimated total pension to which each participant is expected to become entitled at retirement is broken down into units, each associated with a year of past or future credited service.

The defined benefit obligation as at 31 December 2016 is calculated on the actuarial assumptions agreed as at that date. The sensitivities are calculated by changing each assumption in turn following the methodology above with all other things held constant. The change in the defined benefit obligation from updating the single assumption represents the impact of that assumption on the calculation of the defined benefit obligation.

	2016 £m	2015 £m
Discount rate – 0.5% increase	(116.5)	(98.6)
Discount rate – 0.5% decrease	132.5	111.3
Inflation – 0.5% increase	106.1	97.4
Inflation – 0.5% decrease	(87.6)	(88.2)
Rate of salary increase – 0.5% increase	7.8	10.4
Rate of salary increase – 0.5% decrease	(7.4)	(10.0)
Mortality – one year age rating	44.2	28.7

Management acknowledges that the method used of presuming that all other assumptions remaining constant has inherent limitation given that it is more likely for a combination of changes, but highlights the value of each individual risk and is therefore a suitable basis for providing this analysis.

33 (b) Defined contribution schemes

The Group paid employer contributions of £73.9m (2015: £75.7m) into UK and other defined contribution schemes and foreign state pension schemes.

Serco accounts for certain pre-funded defined benefit schemes relating to contracts as defined contribution schemes because the contributions are fixed until the end of the current concession and at rebid any surplus or deficit would transfer to the next contractor. Cash contributions are recognised as pension costs and no asset or liability is shown on the balance sheet.

Notes to the Consolidated Financial Statements continued

34. Share capital

Issued and fully paid	2016 £m	Number 2016 millions	2015 £m	Number 2015 millions
1,098,559,781 (2015: 549,265,547) ordinary shares of 2p each at 1 January	22.0	1,098.6	11.0	549.3
Issued on the exercise of share options and the Rights Issue	–	–	11.0	549.3
1,098,564,237 (2015: 1,098,559,781) ordinary shares of 2p each at 31 December	22.0	1,098.6	22.0	1,098.6

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

35. Share premium account

	2016 £m	2015 £m
At 1 January and 31 December	327.9	327.9

36. Reserves

36 (a) Retirement benefit obligations reserve

The retirement benefit obligations reserve represents the actuarial gains and losses recognised in respect of annual actuarial valuations for defined benefit retirement schemes, the fair value adjustments on reimbursable rights and the related movements in deferred tax balances.

36 (b) Share based payment reserve

The share based payment reserve represents credits relating to equity-settled share based payment transactions and any gain or loss on the exercise of share options satisfied by own shares.

36 (c) Own shares reserve

The own shares reserve represents the cost of shares in Serco Group plc purchased in the market and held by the Serco Group plc Employee Share Ownership Trust (ESOT) to satisfy options under the Group's share options schemes. At 31 December 2016, the ESOT held 9,864,986 (2015: 10,540,181) shares equal to 0.9% of the current allotted share capital (2015: 1.0%). The market value of shares held by the ESOT as at 31 December 2016 was £14.1m (2015: £10.1m).

36 (d) Hedging and translation reserve

The hedging and translation reserve represents foreign exchange differences arising on translation of the Group's overseas operations and movements relating to cash flow hedges.

	Hedging reserve £m	Translation reserve £m	Total £m
At 1 January 2015	(5.0)	(13.9)	(18.9)
Total comprehensive (expense) / income for the year	2.2	(41.0)	(38.8)
At 1 January 2016	(2.8)	(54.9)	(57.7)
Total comprehensive income for the year	2.3	80.0	82.3
At 31 December 2016	(0.5)	25.1	24.6

37. Share based payment expense

The Group recognised the following expenses related to equity-settled share based payment transactions:

	2016 £m	2015 £m
Long-term Incentive Scheme and Plan	–	–
Performance Share Plan	8.9	9.9
Deferred Bonus Plan	0.8	0.3
Sharesave 2012	–	(0.4)
	9.7	9.8

Executive Option Plan (EOP)

Options granted under the EOP may be exercised after the third anniversary of grant, dependent upon the achievement of a financial performance target over three years. The options are granted at market value and awards made to eligible employees are based on between 50% and 100% of salary as at 31 December prior to grant. If the options remain unexercised after a period of ten years from the date of grant, the options expire. Furthermore, options may be forfeited if the eligible employee leaves the Group before the options vest. Details of the movement in all EOP options are as follows:

	Number of options 2016 thousands	Weighted average exercise price 2016 £	Number of options 2015 thousands	Weighted average exercise price 2015 £
Outstanding at 1 January	187	3.77	336	4.16
Rights Issue adjustment	–	–	79	4.16
Exercised during the year	–	–	–	–
Lapsed during the year	(94)	3.39	(228)	4.48
Outstanding at 31 December	93	4.16	187	3.77

Of these options, 92,540 (2015: 187,308) were exercisable at the end of the year, with a weighted average exercise price of £4.16 (2015: £3.77).

The options outstanding at 31 December 2016 had a weighted average contractual life of 1.87 years (2015: 1.6 years).

The exercise prices for options outstanding at 31 December 2016 ranged from £3.88 to £4.55 (2015: £3.39 to £4.55).

The weighted average share price at the date of exercise approximates to the weighted average share price during the year, which was £1.13 (2015: £3.30).

The fair value of options granted under the EOP is measured by use of the Binomial Lattice model. The Binomial Lattice model is considered to be most appropriate for valuing options granted under this scheme as it allows exercise over a longer period of time between the vesting date and the expiry date. There were no new options granted under Executive Option Plan during the year and all shares are now vested.

There were no new options granted under Executive Option Plan during the year.

Notes to the Consolidated Financial Statements continued

37. Share based payment expense continued

Executive Option Plan (EOP) continued

Long-Term Incentive Scheme (LTIS) and Long-Term Incentive Plan (LTIP)

Awards made to eligible employees under the above schemes are structured as options with a zero exercise price. The extent to which an award vests (and therefore becomes exercisable) is measured by reference to the growth in the Group's earnings per share (EPS) or total shareholder return (TSR) over the performance period or service period conditions.

If the options remain unexercised after a period of ten years from the date of grant, the options expire. Furthermore, options may be forfeited if the eligible employee leaves the Group before the options vest. Details of the movement in all LTIS and LTIP options are as follows:

	Number of options 2016 thousands	Weighted average exercise price 2016 £	Number of options 2015 thousands	Weighted average exercise price 2015 £
Outstanding at 1 January	240	Nil	276	Nil
Rights Issue adjustment	–	Nil	64	Nil
Exercised during the year	(54)	Nil	(70)	Nil
Lapsed during the year	(70)	Nil	(30)	Nil
Outstanding at 31 December	116	Nil	240	Nil

Of these options, 115,818 (2015: 240,058) were exercisable at the end of the year. The options outstanding at 31 December 2016 had a weighted average contractual life of 0.65 years (2015: 1.3 years).

There were no new options granted under either LTIS or LTIP during the year.

Performance Share Plan (PSP)

Under the PSP, eligible employees have been granted options with an exercise price of two pence. Awards vest after the performance period of three to five years and are subject to the achievement of four performance measures with the exception of new non-performance awards granted in 2014. These non-performance options are only subject to continued employment on vesting dates which vary from six months to three years after the grant dates.

On the performance related awards, the primary performance measure is TSR and the second performance measure is based on EPS growth. Two additional measures on new grants in 2014 were Absolute Share Price and Strategic Objectives.

If the options remain unexercised after a period of ten years from the date of grant, the options expire.

	Number of options 2016 thousands	Weighted average exercise price 2016 £	Number of options 2015 thousands	Weighted average exercise price 2015 £
Outstanding at 1 January	23,771	0.02	10,743	0.02
Granted during the year	18,419	0.02	15,053	0.02
Rights Issue adjustment	–	–	2,565	0.02
Exercised during the year	(666)	0.02	(654)	0.02
Lapsed during the year	(7,039)	0.02	(3,936)	0.02
Outstanding at 31 December	34,485	0.02	23,771	0.02

Of these options, 133,470 (2015: 207,643) were exercisable at the end of the year. The options outstanding at 31 December 2016 had a weighted average contractual life of 7.5 years (2015: 7.8 years).

In the year, eight grants were made, of which three were non-performance conditional share awards. The remaining five performance based awards are with Earnings per Share (EPS), Total Shareholder Return (TSR) and Return on Invested Capital (ROIC) performance conditions each attached to 33.3% of options.

The options subject to market-based performance conditions (such as the TSR condition for these awards), were valued using the Monte Carlo Simulation model. The options subject only to non-market based performance conditions (such as the EPS and ROIC conditions) a Black-Scholes model has been used. This approach has also been used for the Awards made with no performance conditions attached to them.

The Monte Carlo Simulation model is considered to be the most appropriate for valuing options granted under schemes where there are changes in performance conditions by which the options are measured, such as for the Absolute Share Price or TSR based awards.

The Monte Carlo and Black-Sholes Models used the following inputs:

	2016
Weighted average share price	£0.98
Weighted average exercise price	£0.02
Expected volatility	47.3
Expected life	3 years
Risk free rate	0.45%

Expected volatility was determined by calculating the historical volatility of the Group's share price over the previous three 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.

The weighted average fair value of options granted under this scheme in the year is £0.89 (2015: £1.20).

Deferred Bonus Plan (DBP)

Under the DBP, eligible employees are entitled to use up to 50% of their earned annual bonus to purchase shares in the Group at market price. Provided they remain in employment for this period, the shares are retained for that period and the performance measures have been met, the Group will make a matching share award, up to a maximum of two times the gross bonus deferred.

	Number of options 2016 thousands	Weighted average exercise price 2016 £	Number of options 2015 thousands	Weighted average exercise price 2015 £
Outstanding at 1 January	906	Nil	351	Nil
Granted during the year	2,186	*Nil*	759	*Nil*
Rights issue adjustment	–	Nil	83	Nil
Lapsed during the year	(147)	Nil	(287)	Nil
Outstanding at 31 December	2,945	Nil	906	Nil

None of these options were exercisable at the end of the year (2015: none). The options outstanding at 31 December 2016 had a weighted average contractual life of 2.10 years (2014: 2.08 years).

There were 2,185,750 new options granted under the Deferred Bonus Plan in the year, with 100% of the deferred bonus subject to the same EPS performance conditions as the PSP.

The portion subject to EPS performance conditions was deemed to have a fair value equal to their face value less the present value of any dividend payments not received over the vesting period.

Expected volatility was determined by calculating the historical volatility of the Group's share price over the previous three 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.

The assumptions for options granted during the year with EPS performance conditions are:

	2016
Weighted average share price	£0.95
Weighted average exercise price	Nil
Expected volatility	47.4
Expected life	3 years
Risk free rate	0.64%

The weighted average fair value of options granted under this scheme in the year is £0.95 (2015: £1.36).

37. Share based payment expense continued

Sharesave 2012

The Sharesave 2012 scheme provides for a purchase price equal to the daily average market price on the date of grant less 10%. The options can be exercised for a period of six months following their vesting. Details of the movement in Sharesave 2012 options are as follows:

	Number of options 2015 thousands	Weighted average exercise price 2016 £	Number of options 2015 thousands	Weighted average exercise price 2015 £
Outstanding at 1 January	2,051	5.14	2,875	5.14
Exercised during the year	–	–	–	5.14
Rights issue adjustment	–	–	504	5.14
Lapsed during the year	(2,051)	5.14	(1,328)	5.14
Outstanding at 31 December	–	–	2,051	5.14

Of these options, none (2015: none) were exercisable at the end of the year. There were no outstanding options at 31 December 2016 (2015: weighted average contractual life of 0.4 years). Given that options granted under the Sharesave plan can be exercised at any time after vesting, management consider the Binomial Lattice model to be appropriate to value the options granted under this scheme. The Binomial Lattice model allows exercise over a window in time, from vesting date to expiry date and assumes option holders make economically rational exercise decisions.

There were no new options granted under Sharesave Plan in the year.

38. Related party transactions

Transactions between the Company and its wholly owned subsidiaries, which are related parties, have been eliminated on consolidation and are not disclosed in this note. Transactions between the Group and its joint venture undertakings and associates are disclosed below.

Transactions

During the year, Group companies entered into the following transactions with joint ventures and associates:

	Transactions 2016 £m	Current outstanding at 31 December 2016 £m	Non-current outstanding at 31 December 2016 £m
Sale of goods and services			
Joint ventures	0.5	0.1	–
Associates	6.2	0.5	–
Other			
Dividends received – joint ventures	20.4	–	–
Dividends received – associates	19.6	–	–
Receivable from consortium for tax – joint ventures	3.2	7.7	–
Total	49.9	8.3	–

AWE Management Limited (AWEML) was formerly a joint venture but in August 2016 there was a change in the AWE Management Limited shareholding structure, with the Group's shareholding reducing from 33.3% to 24.5% by way of a return of shares and Lockheed Martin taking a majority holding. Subsequent to the change in share ownership AWEML has been accounted for as an associate as we continue to have significant influence. In the prior year, the AWE transactions and outstanding balances were disclosed within joint ventures below.

Joint venture receivable and loan amounts outstanding have arisen from transactions undertaken during the general course of trading, are unsecured, and will be settled in cash. Interest arising on loans is based on LIBOR, or its equivalent, with an appropriate margin. No guarantee has been given or received. The only loan amounts owed by joint ventures or associates related to a single entity which have been provided for in full (see note 11).

	Transactions 2015 £m	Current outstanding at 31 December 2015 £m	Non-current outstanding at 31 December 2015 £m
Sale of goods and services			
Joint ventures	6.1	0.6	–
Other			
Dividends received – joint ventures	32.5	–	–
Loans and other receivables – joint ventures	–	0.8	7.2
Receivable from consortium for tax – joint ventures	4.2	9.3	–
Total	42.8	10.7	7.2

Remuneration of key management personnel

The Directors of Serco Group plc had no material transactions with the Group during the year other than service contracts and Directors' liability insurance.

The remuneration of 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*:

	2016 £m	2015 £m
Short-term employee benefits	11.9	8.4
Share based payment expense	4.7	1.1
	16.6	9.5

The key management personnel comprise the Executive Directors, Non-Executive Directors and members of the Executive Committee (2016: 20 individuals, 2015: 19 individuals).

Aggregate directors' remuneration

The total amounts for directors' remuneration in accordance with Schedule 5 to the Accounting Regulations were as follows:

	2016 £m	2015 £m
Salaries, fees, bonuses and benefits in kind	5.6	3.7
Amounts receivable under long-term incentive schemes	5.6	4.7
	11.2	8.4

None of the Directors are members of the company's defined benefit pension scheme.

One director is a member of the money purchase scheme.

Further information about the remuneration of individual directors is provided in the audited part of the Directors' Remuneration Report on pages 96 to 125.

Notes to the Consolidated Financial Statements continued

39. Notes to the consolidated cash flow statement

Reconciliation of operating profit to net cash inflow from operating activities

Year ended 31 December	2016 Before exceptional items £m	2016 Exceptional items £m	2016 Total £m	2015 Before exceptional items (restated*) £m	2015 Exceptional items £m	2015 Total (restated*) £m
Operating profit / (loss) for the year – continuing operations*	98.5	(56.3)	42.2	106.1	(109.9)	(3.8)
Operating (loss) / profit for the year – discontinued operations	(3.3)	(14.2)	(17.5)	26.5	(77.6)	(51.1)
Operating profit / (loss) for the year*	95.2	(70.5)	24.7	132.6	(187.5)	(54.9)
Adjustments for:						
Share of profits in joint ventures and associates	(33.4)	–	(33.4)	(37.0)	–	(37.0)
Share based payment expense	9.7	–	9.7	9.8	–	9.8
Exceptional impairment of goodwill	–	17.8	17.8	–	153.4	153.4
Exceptional impairment of property, plant and equipment	–	(0.8)	(0.8)	–	0.8	0.8
Exceptional impairment of intangible assets	–	0.3	0.3	–	(0.3)	(0.3)
Impairment and write down of intangible assets	0.7	–	0.7	11.5	–	11.5
Impairment of property, plant and equipment	0.7	–	0.7	2.1	–	2.1
Depreciation of property, plant and equipment	24.8	–	24.8	28.9	–	28.9
Amortisation of intangible assets	26.2	–	26.2	29.0	–	29.0
Exceptional profit on disposal of subsidiaries and operations	–	(0.1)	(0.1)	–	(2.8)	(2.8)
Loss on disposal of property, plant and equipment	0.4	–	0.4	0.1	–	0.1
Loss on disposal of intangible assets	0.8	–	0.8	1.5	–	1.5
Non cash R&D expenditure offset against intangible assets	0.2	–	0.2	0.8	–	0.8
Decrease in provisions	(118.4)	(1.1)	(119.5)	(116.0)	(9.5)	(125.5)
Other non cash movements*	0.4	–	0.4	(0.1)	–	(0.1)
Total non cash items	(54.5)	16.1	(38.4)	(32.4)	141.6	109.2
Operating cash inflow / (outflow) before movements in working capital	7.3	(54.4)	(47.1)	63.2	(45.9)	17.3
Decrease in inventories	1.3	–	1.3	5.6	–	5.6
Decrease in receivables	59.0	13.9	72.9	20.6	–	20.6
Decrease in payables	(84.0)	0.6	(83.4)	(48.8)	(10.7)	(59.5)
Movements in working capital	(23.7)	14.5	(9.2)	(22.6)	(10.7)	(33.3)
Cash generated by operations*	(16.4)	(39.9)	(56.3)	40.6	(56.6)	(16.0)
Tax paid	(5.6)	–	(5.6)	(2.7)	–	(2.7)
Non cash R&D expenditure	(0.4)	–	(0.4)	(0.7)	–	(0.7)
Net cash (outflow) / inflow from operating activities*	(22.4)	(39.9)	(62.3)	37.2	(56.6)	(19.4)

* Operating Profit has been restated following the change in accounting policy to include foreign exchange movements on investment and financing arrangements in net finance costs.

Additions to property, plant and equipment during the year amounting to £0.5m (2015: £5.2m) were financed by new finance leases.

40. Assets held for sale

As part of the Strategy Review, certain assets and liabilities were designated as non core and plans were put in place to dispose of them. As at 31 December 2016 the only business remaining to be sold is an onshore private sector BPO business, which is expected to be sold in 2016. It is not expected that any of the assets or liabilities will transfer to the purchaser on disposal based on the current expected deal structure and therefore the net assets transferred out of held for sale at 31 December 2016.

The balances included as held for sale are as follows:

	Note	At 31 December 2016 £m	At 31 December 2015 £m
Assets			
Goodwill	19	–	7.8
Other intangible assets	20	–	0.4
Property, plant and equipment	21	–	0.9
Other non-current assets	23	–	0.2
Current tax		–	4.7
Cash and cash equivalents	25	–	5.2
Other current assets	23	–	20.6
Assets classified as held for sale		–	39.8
Liabilities			
Other current liabilities	26	–	(7.4)
Current tax liabilities		–	(0.1)
Provisions	29	–	(24.5)
Obligations under finance leases	27	–	(0.5)
Liabilities directly associated with assets classified as held for sale		–	(32.5)

Company Balance Sheet

At 31 December	Note	2016 £m	2015 £m
Fixed assets			
Investments in subsidiaries	42	2,001.3	1,994.9
Current assets			
Debtors: amounts due within one year	43	4.5	3.1
Debtors: amounts due after more than one year	43	275.1	793.5
Derivative financial instruments due within one year	47	4.3	9.0
Derivative financial instruments due after more than one year	47	14.2	7.8
Current tax asset	43	3.7	-
Cash at bank and in hand		126.7	147.6
		428.5	961.0
Total assets		2,429.8	2,955.9
Creditors: amounts falling due within one year			
Trade and other payables	44	(66.9)	(248.4)
Borrowings	45	(9.7)	(132.2)
Provisions	46	(3.2)	(3.2)
Corporation tax liability		(0.1)	(0.1)
Derivative financial instruments	47	(0.6)	(0.9)
		(80.5)	(384.8)
Net current assets		348.0	576.2
Creditors: amounts falling due after more than one year			
Borrowings	45	(278.4)	(239.5)
Amounts owed to subsidiary companies		(1,043.5)	(1,265.7)
Deferred tax liability	48	-	-
Provisions	46	(41.1)	(27.9)
		(1,363.0)	(1,533.1)
Total liabilities		(1,443.5)	(1,917.9)
Net assets		986.3	1,038.0
Capital and reserves			
Called up share capital	49	22.0	22.0
Share premium account	50	327.9	327.9
Capital redemption reserve		0.1	0.1
Profit and loss account	51	633.8	673.6
Share based payment reserve	52	68.5	66.3
Own shares reserve		(52.1)	(59.8)
Hedging and translation reserve	54	(13.9)	7.9
Total shareholders' funds		986.3	1,038.0

The financial statements (registered number 02048608) were approved by the Board of Directors on 22 February 2017 and signed on its behalf by:

RS x

AC x

Rupert Soames
Group Chief Executive

Angus Cockburn
Group Chief Financial Officer

Notes to the Company Financial Statements

41. Accounting policies

The principal accounting policies adopted are set out below and have been applied consistently throughout the current and preceding year.

Basis of accounting

The Company meets the definition of a qualifying entity under FRS 100 (Financial Reporting Standard 100) issued by the Financial Reporting Council. The financial statements have therefore been prepared in accordance with FRS 101 (Financial Reporting Standard 101) 'Reduced Disclosure Framework' as issued by the Financial Reporting Council. The Company has not presented its own profit and loss account as permitted by Section 408 of the Companies Act 2006.

As permitted by FRS 101, the Company has taken advantage of the disclosure exemptions available under that standard in relation to share based payments, financial instruments, capital management, presentation of comparative information in respect of certain assets, presentation of a cash-flow statement, standards not yet effective, impairment of assets and related party transactions.

The financial statements have been prepared on the historical cost basis and on the going concern basis, except for the revaluation of certain financial instruments. Historical cost is generally based on the fair value of the consideration given in exchange for the goods and services. The principal accounting policies adopted are the same as those set out in note 2 to the consolidated financial statements, except as noted below.

Fixed asset investments

Investments held as fixed assets are stated at cost less provision for any impairment in value.

42. Investments held as fixed assets

Shares in subsidiary companies at cost	£m
At 1 January 2015	1,963.8
Options over parent's shares awarded to employees of subsidiaries	8.7
Impairment	(127.6)
Additions:	
Serco Holdings Limited	150.0
At 1 January 2016	1,994.9
Options over parent's shares awarded to employees of subsidiaries	6.4
At 31 December 2016	2,001.3

The Company directly owns 100% of the ordinary share capital of the following subsidiaries:

Name	% ownership
Serco Holdings Limited	100%

43. Debtors

Amounts due within one year	2016 £m	2015 £m
Current tax asset	3.7	–
Other debtors	4.5	3.1
	8.2	3.1

Amounts due after more than one year	2016 £m	2015 £m
Amounts owed by subsidiary companies	275.1	788.8
Amounts owed by joint ventures and associates of Serco Group	–	4.7
	275.1	793.5

Notes to the Company Financial Statements continued

44. Trade and other payables

	2016 £m	2015 £m
Amounts owed to subsidiary companies	51.6	237.4
Trade creditors	0.6	–
Accruals and deferred income	12.5	11.0
Other creditors including taxation and social security	2.2	–
	66.9	248.4

45. Borrowings

	2016 £m	2015 £m
Loans	288.1	371.7
Less: Amounts included in creditors falling due within one year – loans	(9.7)	(132.2)
Amounts falling due after more than one year	278.4	239.5
Loans:		
Within one year or on demand	9.7	132.2
Between one and two years	34.2	–
Between two and five years	125.8	52.4
After five years	118.4	187.1
	288.1	371.7

46. Provisions

	Employee related £m	Other £m	Total £m
At 1 January 2016	0.4	30.7	31.1
Charged to income statement – exceptional	–	13.5	13.5
Utilised	(0.3)	–	(0.3)
At 31 December 2016	0.1	44.2	44.3
Analysed as:			
Current	0.1	3.1	3.2
Non-current	–	41.1	41.1

Total provisions held by the Company at 31 December 2016 amount to £44.3m (2015: £31.1m).

Employee related provisions relate to restructuring. Other provisions are held for indemnities given on disposed businesses, legal and other costs that the Group expects to incur over an extended period, in respect of past events. These costs are based on past experience of similar items and other known factors and represent management's best estimate of the likely outcome.

47. Derivative financial instruments

	Assets 2016 £m	Liabilities 2016 £m	Assets 2015 £m	Liabilities 2015 £m
Currency swaps	14.2	–	10.4	–
Forward foreign exchange contracts	4.3	(0.6)	6.4	(0.9)
	18.5	(0.6)	16.8	(0.9)
Analysed as:				
Non-current	14.2	–	7.8	–
Current	4.3	(0.6)	9.0	(0.9)
	18.5	(0.6)	16.8	(0.9)

The Company holds derivative financial instruments in accordance with the Group's policy in relation to its financial risk management. Details of the disclosures are set out in note 32 of the Group's consolidated financial statements.

48. Deferred tax

The deferred tax asset not provided is as follows:

	2016 £m	2015 £m
Depreciation in excess of capital allowances	0.3	0.3
Short-term timing differences	2.3	2.8
Losses	23.5	30.1
At 31 December	26.1	33.2

49. Called up share capital

Issued and fully paid	2016 £m	Number 2016 millions	2015 £m	Number 2015 millions
1,098,559,781 (2015: 549,265,547) ordinary shares of 2p each at 1 January	22.0	1,098.6	11.0	549.3
Issued on the exercise of share options and the share placement	–	–	11.0	549.3
1,098,564,237 (2015: 1,098,559,781) ordinary shares of 2p each at 31 December	22.0	1,098.6	22.0	1,098.6

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

50. Share premium account

	2016 £m	2015 £m
At 1 January and 31 December	327.9	327.9

Notes to the Company Financial Statements continued

51. Profit and loss account

	2016 £m	2015 £m
At 1 January	673.6	364.8
Loss for the year	(39.8)	(210.5)
Issue of shares from Rights Issue	–	519.3
At 31 December	633.8	673.6

As permitted by Section 408 of the Companies Act 2006, the profit and loss account of the Company is not presented as part of these accounts.

52. Share based payment reserve

	2016 £m	2015 £m
At 1 January	66.3	56.9
Options over parent's shares awarded to employees of subsidiaries	6.4	8.7
Share based payment charge	3.3	1.1
Share options to holders on exercise	(7.5)	(0.4)
At 31 December	68.5	66.3

Details of the share based payment disclosures are set out in note 37 of the Group's consolidated financial statements.

53. Own shares

The own shares reserve represents the cost of shares in Serco Group plc purchased in the market and held by the Serco Group plc Employee Share Ownership Trust (ESOT) to satisfy options under the Group's share options schemes. At 31 December 2016, the ESOT held 9,864,986 (2015: 10,540,181) shares equal to 0.9% of the current allotted share capital (2015: 1.0%). The market value of shares held by the ESOT as at 31 December 2016 was £14.1m (2015: £10.1m).

54. Hedging and translation reserve

	2016 £m	2015 £m
At 1 January	7.9	18.2
Fair value loss on cash flow hedges during the period	0.4	2.1
Net exchange loss on translation of foreign operations	(22.2)	(12.4)
At 31 December	(13.9)	7.9

55. Contingent liabilities

The Company has guaranteed overdrafts, finance leases, and bonding facilities of its joint ventures and associates up to a maximum value of £20.4m (2015: £21.1m). The actual commitment outstanding at 31 December 2016 was £17.9m (2015: £20.8m).

The Company and its subsidiaries have provided certain guarantees and indemnities in respect of performance and other bonds, issued by its banks on its behalf in the ordinary course of business. The total commitment outstanding as at 31 December 2016 was £234.3m (2015: £191.6m).

In addition to this, the Company and its subsidiaries have provided performance guarantees and indemnities relating to performance bonds and letters of credit issued by its banks on its behalf, in the ordinary course of business. These are not expected to result in any material financial loss.

The Group is aware of claims and potential claims which involve or may involve legal proceedings against the Group. The Directors are of the opinion, having regard to legal advice received and the Group's insurance arrangements, that it is unlikely that these matters will, in aggregate, have a material effect on the Group's financial position.

56. Related parties

The Directors of Serco Group plc had no material transactions with the Company or its subsidiaries during the year other than service contracts and Directors' liability insurance. Details of the Directors' remuneration are disclosed in the Remuneration Report for the Group.

The Company is exempt under the terms of FRS 101 from disclosing related party transactions with entities that are 100% owned by Serco Group plc.

Appendix: List of Subsidiaries

Company name	Serco Group interest	Country of incorporation
Aeradio Technical Services WLL[4]	49%	Headquarters Building, Building # 1605, Road # 5141, Askar # 951, PO Box 26803 Manama, Kingdom of Bahrain
Antab Operations & Contracting LLC	60%	Office No. 31, 4th Floor, Amar 40 Building (No. 2444), 6987 King Abdulaziz Road, Al Masif, PO Box 50025, Riyadh 11523, Kingdom of Saudi Arabia
AWE Management Limited[3]	24.5%	Atomic Weapons Establishment, Aldermaston, Reading, Berkshire, RG7 4PR United Kingdom
BAS-Serco Limited	10%	Clarendon House, 2 Church Street, Hamilton, HM11, Bermuda
Braintree Clinical Services Limited	100%	Serco House, 16 Bartley Wood Business Park, Bartley Way, Hook, Hampshire, United Kingdom
CCM Software Services Ltd[2]	100%	135 Hillside, Greystones, Co Wicklow 216410, Ireland
Djurgardens Farjetrafik AB	50%	Svensksundsvagen 17, 111 49 Stockholm, Sweden
DMS Maritime Pty Limited	100%	Level 23, 60 Margaret Street, Sydney NSW 2000, Australia
Equity Aviation Holdings (Pty) Ltd[2]	50%	691 Umgeni Road, Durban 4001, South Africa
Equity Aviation Investment Holdings (Pty) Ltd	50%	Block F, 1st Floor, Gilloolys View, Osborn Lane, Bedfordview, Johannesburg 2000, South Africa
Hong Kong Parking Limited	40%	Room 2601, World Trade Centre, 280 Gloucester Road, Causeway Bay, 255257, Hong Kong
International Aeradio (Emirates) LLC – Abu Dhabi	49%	Office No. 503, 5th Floor, Al Muhairy Building, Zayed The First Street, PO Box 3164 Abu Dhabi, United Arab Emirates
International Aeradio (Emirates) LLC – Dubai	49%	19th Floor, Rolex Tower, Sheikh Zayed Road, PO Box 9197 Dubai, United Arab Emirates
JBI Properties Services Company LLC	49%	Al Jazira Club, 303, Tower A, Muroor Road (4th Street), PO Box 63737 Abu Dhabi, United Arab Emirates
Khadamat Facilities Management LLC	49%	The United Arab Emirates University, Al Jamea Street, Al Maqam District, PO Box 15551 Al Ain, United Arab Emirates
LOGTEC Inc.	100%	Suite 1000, 1818 Library Street, Reston VA 201901 United States
Merseyrail Services Holding Company Limited[3]	50%	Eversheds House, 70 Great Bridgewater Street, Manchester, Lancashire, M1 5ES United Kingdom
Northern Rail Holdings Limited[3]	50%	Eversheds House, 70 Great Bridgewater Street, Manchester, Lancashire, M1 5ES United Kingdom
Orchard & Shipman (Glasgow) Limited	100%	Serco House, 16 Bartley Wood Business Park, Bartley Way, Hook, Hampshire, United Kingdom
Priority Properties North West Limited	100%	Serco House, 16 Bartley Wood Business Park, Bartley Way, Hook, Hampshire, United Kingdom
Serco (Jersey) Limited	100%	13 Castle Street St Helier Jersey JE4 5UT, Jersey
Serco Australia Pty Limited[3]	100%	Level 23, 60 Margaret Street, Sydney NSW 2000, Australia
Serco Belgium S.A	100%	Avenue de Cortenbergh 60 – 1000 Brussels, Belgium
Serco Caledonian Sleepers Limited	100%	Basement And Ground Floor Premises, 1–5 Union Street, Inverness, IV1 1PP, Scotland, United Kingdom
Serco Canada Inc.	100%	330 Bay Street, Suite 400, Toronto, Canada M5H 2S8
Serco Citizen Services Pty Ltd	100%	Level 23, 60 Margaret Street, Sydney NSW 2000, Australia
Serco Consulting Bahrain WLL	100%	Suite 106, 10th Floor, Al Jasrah Tower, Building No. 95, Road 1702, Diplomatic Area, Manama, PO Box 3214, Kingdom of Bahrain
Serco Corporate Services Limited	100%	Serco House, 16 Bartley Wood Business Park, Bartley Way, Hook, Hampshire, United Kingdom
Serco Environmental Services Limited	100%	Serco House, 16 Bartley Wood Business Park, Bartley Way, Hook, Hampshire, United Kingdom
Serco Ferries (Guernsey) Crewing Limited	100%	4th Floor, West Wing, Trafalgar Court, Admiral Park, St Peter Port, GY1 2JA, Guernsey

Company name	Serco Group interest	Country of incorporation
Serco Ferries (HR) Limited	100%	Serco House, 16 Bartley Wood Business Park, Bartley Way, Hook, Hampshire, United Kingdom
Serco Geografix Limited	100%	Serco House, 16 Bartley Wood Business Park, Bartley Way, Hook, Hampshire, United Kingdom
Serco Gestion de Negocios SL	100%	c/o Torre Hernando Aseria Consultoria. Calle Ayala, 13 1°Dr, 28001 Madrid, Spain
Serco Group (HK) Limited	100%	Suite No1101 Sino Plaza, 255-257 Gloucester Road, Causeway Bay, 255257, Hong Kong
Serco Group Consultants (Shanghai) Company Limited[2]	100%	1206-A23, 12/F Shui On Plaza, No.333 Mid Huai Hai Road, Shanghai 200021, China
Serco Group Pty Limited	100%	Level 23, 60 Margaret Street, Sydney NSW 2000, Australia
Serco Holdings Limited[1]	100%	Serco House, 16 Bartley Wood Business Park, Bartley Way, Hook, Hampshire, United Kingdom
Serco Immigration Services SA	100%	Avenue Edmond Van Nieuwenhuyse 6 – 1160 Auderhem, Belgium
Serco Inc.[3]	100%	c/o Corporation Services Company, 830 Bear Tavern Rd, West Trenton, NJ 08628, United States
Serco Insurance Company Limited	100%	Maison Trinity, Trinity Square, St Peter Port Guernsey
Serco Integrated Transport Private Limited	100%	Office# 431, Level 4, Augusta Point, Sector 53 Golf Course Road, Gurgaon 122002, India
Serco International Limited	100%	Serco House, 16 Bartley Wood Business Park, Bartley Way, Hook, Hampshire, United Kingdom
Serco International S.à r.l	100%	Headstart, 7 rue Robert Stümper, L-2557 Luxembourg
Serco Leasing Limited	100%	Serco House, 16 Bartley Wood Business Park, Bartley Way, Hook, Hampshire, United Kingdom
Serco Leisure Operating Limited	100%	Serco House, 16 Bartley Wood Business Park, Bartley Way, Hook, Hampshire, United Kingdom
Serco Limited[3]	100%	Serco House, 16 Bartley Wood Business Park, Bartley Way, Hook, Hampshire, United Kingdom
Serco Listening Company Limited	100%	Serco House, 16 Bartley Wood Business Park, Bartley Way, Hook, Hampshire, United Kingdom
Serco Luxembourg S.A.	100%	17 Boulevard Royal 17, L – 2449 Luxembourg
Serco Manchester Leisure Limited	100%	Serco House, 16 Bartley Wood Business Park, Bartley Way, Hook, Hampshire, United Kingdom
Serco Nederland B.V.	100%	Kapteynstraat 1, 2201 BB Noordwijk ZH, Netherlands
Serco New Zealand (Asset Management Services) Limited	100%	Level 4, KPMG Centre, 18 Viaduct Harbour Avenue, Auckland Central, Auckland, 1010, New Zealand
Serco New Zealand Limited	100%	Level 4, KPMG Centre, 18 Viaduct Harbour Avenue, Auckland Central, Auckland, 1010, New Zealand
Serco New Zealand Training Limited	100%	Level 4, KPMG Centre, 18 Viaduct Harbour Avenue, Auckland Central, Auckland, 1010, New Zealand
Serco North America(Holdings), Inc.	100%	Corporation Trust Center, 1209 Orange Street, Wilmington, DE 19801, United States
Serco North America Limited	100%	Serco House, 16 Bartley Wood Business Park, Bartley Way, Hook, Hampshire, United Kingdom
Serco Paisa Limited	50%	Surrey, Ci Tower, St. George's Square, New Malden, Surrey, KT3 4TE United Kingdom
Serco PIK Limited	100%	Serco House, 16 Bartley Wood Business Park, Bartley Way, Hook, Hampshire, United Kingdom
Serco Pension Trustee Limited	100%	Serco House, 16 Bartley Wood Business Park, Bartley Way, Hook, Hampshire, United Kingdom
Serco Projects LLC	49%	Global Business Centre 2, Second Floor, Al Hitmi Village Building, C-Ring Road, PO Box 25422 Doha, State of Qatar

Appendix: List of Subsidiaries continued

Company name	Serco Group interest	Country of incorporation
Serco Regional Services Limited	100%	Serco House, 16 Bartley Wood Business Park, Bartley Way, Hook, Hampshire, United Kingdom
Serco Sarl	100%	15, rue Lumière 01630 Saint Genis Pouilly, France
Serco SAS	100%	15, rue Lumière 01630 Saint Genis Pouilly, France
Serco Saudi Arabia LLC	100%	Mazaya Tower, 1st Floor, King Saud Road, PO Box 366877, Riyadh 11393, Kingdom of Saudi Arabia
Serco Services GmbH	100%	Lise-Meitner-Strasse 10, 64293 Darmstadt, Germany
Serco Services Inc.	100%	Corporation Trust Center, 1209 Orange Street, Wilmington, DE 19801, United States
Serco Services Ireland Limited	100%	29 Earlsfort Terrace, Dublin 2, Ireland
Serco SpA	100%	Via Sciadonna 24/26, 00044 Frascati (Roma), Italy
Serco Sodexo Defence Services Pty Ltd	50%	Level 7, 301 Coronation Drive, Milton QLD 4064, Australia
Serco Switzerland SA	100%	86 bis Route de Frontenex, Case postale 6364, 1208 Geneva, Switzerland
Serco Traffic Camera Services (VIC) Pty Limited	100%	Level 23, 60 Margaret Street, Sydney NSW 2000, Australia
Serco-IAL Limited	100%	Serco House, 16 Bartley Wood Business Park, Bartley Way, Hook, Hampshire, United Kingdom
Service Glasgow LLP	50%	220 High Street, Glasgow, G4 0QW, Scotland, United Kingdom
VIAPATH Group LLP	33%	Francis House, 9 King's Head Yard, London, SE1 1NA, United Kingdom

1 Serco Holdings Limited is directly owned by Serco Group plc. All other subsidiaries and associated undertakings are held indirectly via Group companies.

2 Companies in liquidation as at 31 December 2016.

3 Companies key to the consolidated numbers, all of which are engaged in the provision of support services.

4 Companies with a non-controlling interest

Appendix: Supplementary Information
Five-year Record (unaudited)

	2016 £m	2015 (restated**) £m	2014 £m	2013 £m	2012 £m
Adjusted Revenue	3,529	4,252	4,753	5,140	4,910
Less: Share of revenue of joint ventures and associates	(481)	(737)	(798)	(856)	(853)
Revenue	3,048	3,515	3,955	4,284	4,057
Underlying Trading Profit*	82.1	95.9	113.2	257.4	310.7
OCP and Contract and Balance Sheet Review adjustments	14.2	20.9	(745.3)	–	–
Include benefit from non-depreciation and amortisation of assets held for sale	0.5	11.7	–	–	–
Include other one-time items	3.5	9.0	–	–	–
Trading Profit / (Loss)*	100.3	137.5	(632.1)	257.4	310.7
Amortisation and impairment of intangibles arising on acquisition	(5.1)	(4.9)	(23.7)	(21.4)	(24.1)
Operating profit / (loss) before exceptional items	95.2	132.6	(655.8)	236.0	286.6
Exceptional profit / (loss) on disposal of subsidiaries and operations	0.1	2.8	(5.4)	19.2	5.6
Other exceptional operating items	(70.6)	(190.3)	(656.1)	(109.7)	(5.0)
Operating (loss) / profit	24.7	(54.9)	(1,317.3)	145.5	287.2
Net finance costs	(12.6)	(31.9)	(36.7)	(37.2)	(42.2)
Exceptional finance costs	(0.4)	(32.8)	–	–	–
Exceptional other gain	–	–	–	–	51.1
(Loss) / profit before tax	11.7	(119.6)	(1,354.0)	108.3	296.1
Tax (charge) / credit	(12.8)	(33.5)	6.9	(9.9)	(39.0)
(Loss) / profit after tax	(1.1)	(153.1)	(1,347.1)	98.4	257.1
Recourse Net Debt	(109.3)	(82.2)	(642.7)	(725.1)	(606.9)
Net Debt	(109.3)	(82.2)	(642.7)	(745.4)	(632.0)

	Pence	Pence	Pence	Pence	Pence
(Loss) / earnings per share before exceptional items**	6.12	6.55	(107.43)	32.74	40.37
Basic (loss) / earnings per share**	(0.11)	(15.47)	(205.66)	20.12	52.22
Dividend per share	–	–	3.10	10.55	10.10

* Included in 2014 Trading Loss were charges totalling £745.3m arising from the Contract and Balance Sheet Review undertaken in 2014, with £718.0m charged to Adjusted Operating Profit and £27.3m charged to Management estimate of items relating to UK Government reviews.

** The 2015 general and administrative expenses and net finance costs have been restated following the change in accounting policy regarding foreign exchange movements on investment and financing arrangements. No changes have been made to the comparative periods for 2014 and prior as it is impracticable.

Shareholder Information

Our website

Our corporate website provides access to share price information as well as sections on managing your shareholding online, corporate governance and other investor relations information.

To access the website, please visit www.serco.com/investors

Managing your shares online

Shareholders can manage their holding online by registering to use our shareholder portal at www.shareview.co.uk. This service is provided by our Registrar, Equiniti, giving quick and easy access to your shareholding, allowing you to manage all aspects of your shareholding online, with a useful FAQ section.

Electronic communications

We encourage shareholders to consider receiving their communications electronically. Choosing to receive your communications electronically means you receive information quickly and securely and allows us to communicate in a more environmentally friendly and cost-effective way. You can register for this service online using our share portal at www.shareview.co.uk

Duplicate documents

Some shareholders find that they receive duplicate documentation due to having more than one account on the share register. If you think you fall into this group and would like to combine your accounts, please contact our Registrar, Equiniti.

Changes of address

To avoid missing important correspondence relating to your shareholding, it is important that you inform our Registrar, Equiniti, of your new address as soon as possible.

Sharegift

If you have a very small shareholding that is uneconomical to sell, you may want to consider donating it to Sharegift (Registered Charity no.10526886), a charity that specialises in the donation of small, unwanted shareholdings to good causes. You can find out more by visiting www.sharegift.org or by calling +44 (0) 207 930 3737.

Shareholder queries

Our share register is maintained by our Registrar, Equiniti.

Shareholders with queries relating to their shareholding should contact Equiniti directly using one of the methods listed opposite.

For more general queries, shareholders can look at our website at www.serco.com/investors

American Depositary Receipts (ADRs)

Serco has established a sponsored Level I ADR programme. Serco ADRs are traded on the US over-the-counter market (SCGPY).

For queries relating to your ADR holding, please contact our ADR depositary bank, Deutsche Bank Trust Company Americas.

Shareholder profile

	Number of holdings	% of holdings	Number of shares	% of shares
1 and 1,000	3,485	50.45	1,396,246	0.13
1,001 and 5,000	2,304	33.35	5,229,575	0.48
5,001 and 10,000	436	6.31	3,077,432	0.28
10,001 and 100,000	404	5.85	11,482,860	1.04
100,001 and 500,000	123	1.78	30,872,832	2.81
500,001 and 1,000,000	51	0.74	36,155,874	3.29
1,000,001 and 10,000,000	80	1.16	273,008,892	24.85
10,000,001+	25	0.36	737,340,526	67.12
Total	6,908	100.00	1,098,564,237	100.00

Useful Contacts

Registrar
Equiniti
Aspect House
Spencer Road
Lancing
West Sussex
BN99 6DA
United Kingdom

Telephone 0371 384 2932 (from within UK)
+44 (0)121 415 7047 (from outside UK)

Lines are open 8.30am to 5.30pm Monday to Friday.

Website www.shareview.co.uk

Shareholders can securely send queries via the website using the 'Help' section.

ADR depositary bank
Deutsche Bank Trust Company Americas
c/o American Stock Transfer & Trust Company
6201 15th Avenue
Brooklyn NY 11219
USA

Telephone +1 866 249 2593 (toll-free within USA)
+1 718 921 8124 (from outside USA)

Website www.adr.db.com
Email db@amstock.com

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Bank of America Merrill Lynch

Auditors
KPMG Chartered Accountants

Serco's registered office
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Hampshire
RG27 9UY
United Kingdom

Telephone +44 (0)1256 745 900

Email investors@serco.com

Registered in England and Wales No. 2048608

Group General Counsel and Company Secretary
David Eveleigh

Additional documents
The Annual Report is available for download in pdf format at www.serco.com/investors

Unsolicited mail and shareholder fraud
Shareholders are advised to be wary of unsolicited mail or telephone calls offering free advice, to buy shares at a discount or offering free company reports. To find more detailed information on how shareholders can be protected from investment scams visit www.fca.org.uk/consumers/scams/investment-scams/share-fraud-and-boiler-room-scams

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