

# serco



Annual report and accounts 2010

Bringing  
service to life



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Serco in brief

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A values-led and responsible business

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Operating Review

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Cross reference to a page with more information



Further information available online

## Who we are

Serco delivers essential frontline services that matter to millions of people around the world.

Our work for national and local governments involves us in the most important areas of public service, including transport, defence, science, employment, offender management, IT, BPO and education. Our private sector customers are industry leaders.

We have nearly 50 years' experience of helping our customers achieve their goals. Many want us to improve their productivity and service quality. Others need us to support their rapid growth. Governments face crucial issues such as economic stability and development, congestion, security, health and climate change. They value the innovation and passion we bring to these challenges and the collaborative, flexible and imaginative way we work.

Serco is a values-led company and our culture and ethos are at the heart of everything we do. We give our people real responsibility, so they can put their ideas into practice and make a difference for our customers and the public. Our approach has made us one of the world's leading service companies and our vision is to be the world's greatest.

Our focus on service means that our customers come back to us again and again. These long-term relationships help us to meet their changing needs and to do what we do best...

...bringing service to life.



More information on how we bring service to life is available on pages 26 to 51



## Serco in brief

### What we offer

We use our core capability – people-led service delivery and change management – to improve the quality and efficiency of essential frontline services. Because this capability is so widely applicable, we can operate in a broad and growing range of markets around the world.

We start by analysing a customer's problems and producing a bespoke solution, with improved people management at its heart. This means that we design organisations to remove bureaucracy, enhance processes, instil our values and free people to deliver their best.

Building long-term customer relationships is fundamental to us. We devolve responsibility to our contract directors, allowing them to anticipate and respond to customers' needs. The Serco Management System, which controls how we operate, ensures these actions are also in Serco's best interests.



For more on what we offer and how we work, see page 6



More information on the Serco Management System is available on our website

### Our vision and strategy

Our vision is to be the world's greatest service company.

Everyone in Serco discovers their own interpretation of 'greatest', which supports what they do every day. However, it is not about revenues, profitability or growth. It means being the best at what we do and how we do it – what we call 'bringing service to life'.

Our strategy for achieving this vision has four elements:

1

**Building a balanced portfolio:** We aim to reduce risk and increase opportunity by building a balanced contract portfolio, spread across markets. This reduces our exposure to market fluctuations, enables us to select the best opportunities whichever market they are in, and allows us to transfer expertise from one market to another.

2

**Delivering excellent service:** This means meeting – and often exceeding – customer expectations. We do this by having the responsible behaviours enshrined in our values at the heart of everything we do. This enables us to build long-term customer relationships, to expand the scope and scale of contracts during their life, retain contracts at rebid and win new contracts.



3

**Making strategic acquisitions:** While we are primarily focused on organic growth, we make acquisitions to gain skills which will be important for future growth and to enter markets where we see strong opportunities.

4

**Developing new models:** We respond to emerging opportunities by finding new ways to deliver services. This may mean collaboration between our divisions, bringing together skills and experience which few other companies can replicate, or partnering with our customer or the voluntary sector. Our ability to lead change keeps us at the forefront of our markets.



For more on our strategy, see pages 8 and 9

## Our track record of success

Implementing our strategy – and in particular our emphasis on bringing service to life for customers – leads directly to our financial success. The focus on service excellence underpins our win rates of 90% of rebids and one in two new bids, which in turn drive our revenue growth.

Since we listed in 1988, we have rapidly increased our revenue, primarily through organic growth. By securing higher margin contracts and managing our cost base, we have been able to increase our margins. At the same time, we have delivered significant improvements in our free cash flow.

Our success is recognised by others in the many awards we win for operational excellence.



For more on our recent performance, see the operating review on pages 26 to 51 and the finance review on pages 52 to 59

## The future

Customers around the world are looking for help in transforming the quality and efficiency of essential frontline services. This creates opportunities for Serco in new and existing markets and geographies.

Our confidence in our prospects is supported by the high revenue visibility provided by our order book, our existing pipeline of opportunities and the growth potential we see across our business.



For more on our markets and opportunities, see page 22



## How we performed – 2010 highlights

### Strong performance, portfolio of growth opportunities ahead

#### £5.6bn of contract awards spread internationally

- Service quality supports high win rates. Continue to win one in two new bids and 90% of rebids and extensions
- During 2010, signed £4.2bn of contracts and appointed preferred bidder for £1.4bn of contracts
- 40% of revenue generated outside the UK, with strong growth in the Americas and AMEAA

#### Strong financial performance

- Revenue growth of 9.0% (7.6% excluding currency)
- Adjusted operating profit margin increase of 19 basis points to 6.0% (16 basis points excluding currency)
- Group free cash flow exceptionally strong at £185.8m (2009: £137.3m)
- Total dividend up 17.6% to 7.35p, reflecting growth in earnings

### Substantial global demand for efficient delivery of essential frontline services

- Economic environment and reform of public services create opportunities in new and existing markets
- Customers seeking help to build, protect and improve frontline services and increase efficiency
- Headwinds in UK during 2011 as Government austerity measures and reforms are shaped
- Exposure to different economies through portfolio provides resilience and overall growth potential

### Reiterating guidance based on high revenue visibility and substantial pipeline of opportunities

- Order book of £16.6bn at 31 December 2010 (£17.1bn at 31 December 2009); visibility of 92% of planned revenue for 2011, 77% for 2012 and 66% for 2013
- Substantial £29bn pipeline of identified opportunities
- In 2011, expect good organic revenue growth and progress towards our 2012 margin guidance and continue to expect an increase in revenue to approximately £5bn and in Adjusted operating profit margin to approximately 6.3% by the end of 2012\*

\* excluding material acquisitions, disposals and currency effects, based on 2008 exchange rates

Note: Adjusted operating profit and Adjusted earnings per share shown above are before amortisation of acquired intangibles, as shown on the face of the Group's consolidated income statement and the accompanying notes.

Group free cash flow is free cash flow from subsidiaries and dividends received from joint ventures and is reconciled in Section 3 of the finance review.

Performance excluding currency has been calculated by translating non-Sterling revenue and earnings for the year to 31 December 2010 into Sterling at the average exchange rates for those currencies in 2009.

The order book is the value of future revenues based on all existing signed contracts. It excludes contracts at the preferred bidder stage and excludes Indefinite Delivery, Indefinite Quantity (IDIQ) contract vehicles where we are one of a number of companies able to bid for specific task orders within the IDIQ.

The pipeline is the estimated value of all future potential opportunities that are clearly defined and identifiable.

### News January–December



Merseyrail named as record breaking train operator

Serco Americas sends mobile hospital to support Haiti earthquake victims



Serco wins Operator and Service Excellence Award in Australia for Acacia Prison

Serco partnership to help the UK tackle climate change through offshore wind energy



National Awards for Outstanding Safety for Northern Rail and the National Nuclear Laboratory

Revenue (2009: £3,970m)	<b>£4,327m</b> +9.0%	Adjusted earnings per share (2009: 29.53p)	<b>34.69p</b> +17.5%
Adjusted operating profit (2009: £229.7m)	<b>£258.7m</b> +12.6%	Earnings per share (2009: 26.76p)	<b>31.88p</b> +19.1%
Operating profit (2009: £212.1m)	<b>£241.3m</b> +13.8%	Dividend per share (2009: 6.25p)	<b>7.35p</b> +17.6%
Profit before tax (2009: £177.1m)	<b>£213.9m</b> +20.8%	Group free cash flow (2009: £137.3m)	<b>£185.8m</b> +35.3%

Barclays Cycle Hire launches in London



First anniversary of Dubai Metro

Duncan Mackison, who leads our ACCESS joint venture with Glasgow City Council, named Outsourcing Professional of the Year in the UK



John Biggin, director of HMP & YOI Doncaster, named Guardian Public Servant of the Year

Serco voted UK's second Most Admired Company and Most Admired Services Company





## What we offer our customers

Serco is able to operate in a broad and growing range of markets because our core capability – people-led service delivery and change management – can be applied so widely.

**Our customers want more reliable, efficient and productive services. We start by analysing their problems and producing a bespoke solution, with improved people management at its heart.**

This means that we design organisations to:

- remove bureaucracy
- enhance processes
- instil our values, and
- free people to deliver their best.

In particular, we:

- use technology to increase efficiency
- invest throughout the contract's life, so our services keep pace with developments
- make the best use of our customers' assets, so we are as cost effective as possible, and
- share best practice and compare performance across contracts, to help us constantly improve.



For more on our business model, see pages 10 and 11

### Specialist and transferable skills

We combine our core capability with the specialist skills we need to deliver great service in each of our markets.

For example, we know exactly what it takes to run a safe and punctual metro system, to keep a customer's procurement costs on budget, to maximise a helicopter's time on the frontline and to ensure a laboratory delivers world-leading research.

We can transfer our specialist skills between markets, so that customers gain from expertise we have honed elsewhere, and we bring together unique combinations of skills from across Serco, to create innovative solutions to customers' problems.

### Focus on excellent service

Our focus is always on delivering excellent service for customers. We devolve responsibility to our contract directors, so they can act quickly and decisively to meet our customers' needs.

How we work is as important to us as what we do. The Serco Management System sets out our approach to everything from health and safety to our business ethics. And our Governing Principles (see page 12) underpin the thousands of decisions our people make each day, ensuring that we always act responsibly. Our culture and way of working frees our people to put their service ethos into action.

### Building long-term relationships

Our focus on excellent service comes with a passion for improvement. We are always looking to do better, to be more productive and to find new ways to help our customers.

We aim to build long-term and mutually beneficial relationships with our customers. The closer we are, the better we understand their goals. When our contracts come up for rebid or extension, we retain at least 90% of them, reflecting the value that we deliver for customers.

Our customers also frequently expand our contracts, as they see the benefits of our work first hand.



We have provided air traffic control services in Dubai since the 1960s.



Transferring capabilities from the UK has helped us succeed in the Australian home affairs market.



## Our business drivers



Improving health outcomes is a significant challenge for governments.



Our capabilities in traffic management help to reduce congestion.

### Increasing demand for high-quality services

Governments around the world face unrelenting demand for better services to the public. They must also address significant challenges, such as economic development and stability, congestion, security, health and climate change. At the same time, many governments face budget deficits which will take years to rectify.

The scale of these issues is encouraging governments to make transformational changes, driving innovation and broadening our markets.

Our private sector customers are also seeking help to improve their service quality, efficiency and productivity.

### Significant potential for market growth

Our markets are large but still have significant scope for growth. For example:

- in the UK, one of the world's most developed markets, the public services industry accounts for only £80bn out of total government spending of £620bn
- the US federal government services market accounts for around 10% of total federal government expenditure.

The number of markets we can address also expands as we broaden our skills, either by combining skills from around our business, through acquisitions or by partnering with other companies, the voluntary sector or our customers.

The scale of our markets means that we can be selective about the opportunities we bid for. It also means that our share of any one market does not affect our ability to grow.

### Our competitive environment

Competition is necessary for our markets to operate, as it:

- encourages customers to put services out to tender
- provides a benchmark to ensure they are getting best value, and
- drives innovation.

Because of the breadth of our business, we have a large number of competitors. However, while we see effective competitors in every market, no organisation competes with us in all of them and only a few operate in more than one.

Our competitors are mainly companies but they can include public-sector bodies. We have, for example, competed against government-owned railway companies and UK National Health Service Trusts.

As we enter new markets, we meet competitors who specialise in those areas. Competition in our established markets has remained steady as our customers focus on trusted providers.



For more on our prospects in our individual markets, see page 22

## Our strategy and key performance indicators (KPIs)

Each element of our strategy contributes to reducing our exposure to market fluctuations, strengthening our position in our markets and developing new skills and capabilities for the future.

We use the following KPIs to monitor our performance over time. They are split between financial and non-financial measures.

### Strategy

#### Description

#### Key achievements in 2010

### Building a balanced portfolio

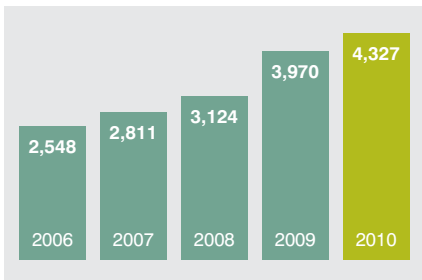
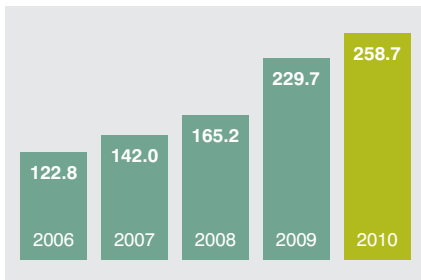
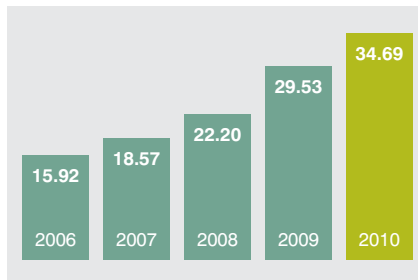
We aim to reduce risk and increase opportunities by building a balanced contract portfolio, spread across markets. This reduces our exposure to market fluctuations, enables us to select the best opportunities whichever market they are in, and allows us to transfer expertise from one market to another.

We benefited from the breadth of our portfolio during the year, with strong growth in AMEAA, the Americas and UK Civil Government offsetting other slower UK markets.

We continued to strengthen our portfolio with £4.2bn of contract wins, and were appointed preferred bidder for a further £1.4bn of contracts.

Transferring our skills around the world enabled us to enter new markets. We won our first home affairs contract in New Zealand, to manage the Mt Eden and Auckland Central Remand Prison, and were appointed preferred bidder for our first Australian health contract, at Fiona Stanley Hospital in Perth. We won a contract with a new customer in the US, the Department of Veterans Affairs, and were awarded a number of transport consultancy contracts in new countries, including Saudi Arabia.

### KPIs

Financial	Financial	Financial																																				
Revenue (£m)	Adjusted operating profit (£m)	Adjusted earnings per share (EPS) (p)																																				
Revenue represents the amounts due for the services we provided during the year, and includes our share of revenue from joint ventures.	Adjusted operating profit is our operating profit before the amortisation of intangibles arising on acquisition. We believe it is the most appropriate measure for assessing the profitability of our business.	Adjusted EPS is our profit for the financial year, excluding the post-tax charge for the amortisation of intangibles arising on acquisition, divided by the weighted average number of shares in issue during the year. Adjusted EPS provides a measure of shareholder return that is comparable over time. The details of the calculation are shown in note 12 to the financial statements.																																				
 <table><tr><th>Year</th><th>Revenue (£m)</th></tr><tr><td>2006</td><td>2,548</td></tr><tr><td>2007</td><td>2,811</td></tr><tr><td>2008</td><td>3,124</td></tr><tr><td>2009</td><td>3,970</td></tr><tr><td>2010</td><td>4,327</td></tr></table>	Year	Revenue (£m)	2006	2,548	2007	2,811	2008	3,124	2009	3,970	2010	4,327	 <table><tr><th>Year</th><th>Adjusted operating profit (£m)</th></tr><tr><td>2006</td><td>122.8</td></tr><tr><td>2007</td><td>142.0</td></tr><tr><td>2008</td><td>165.2</td></tr><tr><td>2009</td><td>229.7</td></tr><tr><td>2010</td><td>258.7</td></tr></table>	Year	Adjusted operating profit (£m)	2006	122.8	2007	142.0	2008	165.2	2009	229.7	2010	258.7	 <table><tr><th>Year</th><th>Adjusted EPS (p)</th></tr><tr><td>2006</td><td>15.92</td></tr><tr><td>2007</td><td>18.57</td></tr><tr><td>2008</td><td>22.20</td></tr><tr><td>2009</td><td>29.53</td></tr><tr><td>2010</td><td>34.69</td></tr></table>	Year	Adjusted EPS (p)	2006	15.92	2007	18.57	2008	22.20	2009	29.53	2010	34.69
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The 9% growth in the year represents good performance against our strategic objectives. Excluding currency effects, revenue growth was 7.6%.	Adjusted operating profit increased by 12.6% during 2010, representing an increase in margin of 19 basis points to 6.0%.	Adjusted EPS increased by 17.5%, to 34.69p per share.																																				

## Delivering excellent service

Delivering excellent service means meeting – and often exceeding – customer expectations. We do this by having the responsible behaviours enshrined in our values at the heart of everything we do.

This enables us to build long-term customer relationships, to expand the scope and scale of contracts during their life, retain contracts at rebid and win new contracts.

The quality of our service is reflected in our high bid win rates, which we maintained at 90% for rebids and extensions, and one in two for new bids.

During the year, we were named Britain's most-admired service company and the second most-admired company overall by Management Today. Other recognition included:

- the Operator and Service Excellence award in Australia
- 23 awards and commendations from the Royal Society for the Prevention of Accidents in the UK, and
- the Defense Enterprise Architecture Achievement Award and the 'None in a Million' Federal Aviation Administration award in the US.

## Making strategic acquisitions

While we are primarily focused on organic growth, we make acquisitions to gain skills which will be important for future growth and to enter markets where we see strong opportunities.

In 2010, we acquired RB Solutions, a successful provider in the UK revenues and benefits market. This strengthened our position in this market and enabled us to win five new contracts, including Dacorum Borough Council and Dudley Metropolitan Borough Council, to provide benefits processing services.

We also continued to gain from the acquisitions we have made in recent years, which have provided a strong platform for organic growth. For example, our US business, which we expanded with the acquisition of SI International in 2008, has delivered high organic growth.

## Developing new models

We respond to emerging opportunities by finding new ways to deliver services. This may mean collaboration between our divisions, bringing together skills and experience which few other companies can replicate, or it may mean partnering with our customer or the voluntary sector. Our ability to lead change keeps us at the forefront of our markets.

The partnering model we pioneered to deliver welfare to work services under the UK's Flexible New Deal – drawing on private and voluntary sector providers – will form the basis for the Government's new Work Programme. This is a tribute to the success of this model as well as a substantial opportunity for Serco.

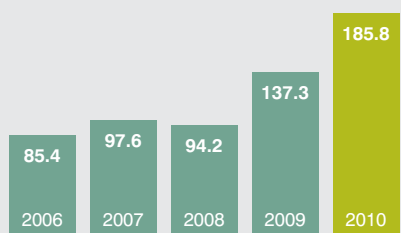
The success of the model at GSTS Pathology, our ground-breaking joint venture with Guy's and St Thomas' NHS Foundation Trust, was demonstrated when it became the UK's largest provider of pathology services during 2010, with the addition of King's College Hospital NHS Foundation Trust to the joint venture.

We also created a strategic partnership with Hertfordshire County Council. This will improve its service delivery and go beyond the scope of previous contracting models, by offering services to other public-sector bodies in the area, including district councils and the police authority.

## Financial

### Group free cash flow (£m)

Group free cash flow represents the free cash flow generated by our subsidiaries plus the dividends we receive from joint ventures. It represents the cash flow to which the Group has access. The calculation of Group free cash flow is shown in the finance review on page 54.



Group free cash flow increased by 35%.

## Non-financial

### Reportable incident rate (per 100,000 employees)

Reportable incidents include work-related fatalities, major injuries, injuries resulting in absences from work of more than three days, work-related diseases and near-miss accidents. The incident rate measures our success in providing a safe and secure working environment.



The reportable incident rate increased slightly during 2010 but remained substantially below earlier years.

## Non-financial

### Carbon dioxide emissions (tonnes of CO<sub>2</sub>/£m revenue)

Reducing our carbon dioxide emissions is a key aim for Serco. We measure our emissions in relation to our revenue, to take account of the growth in our business.



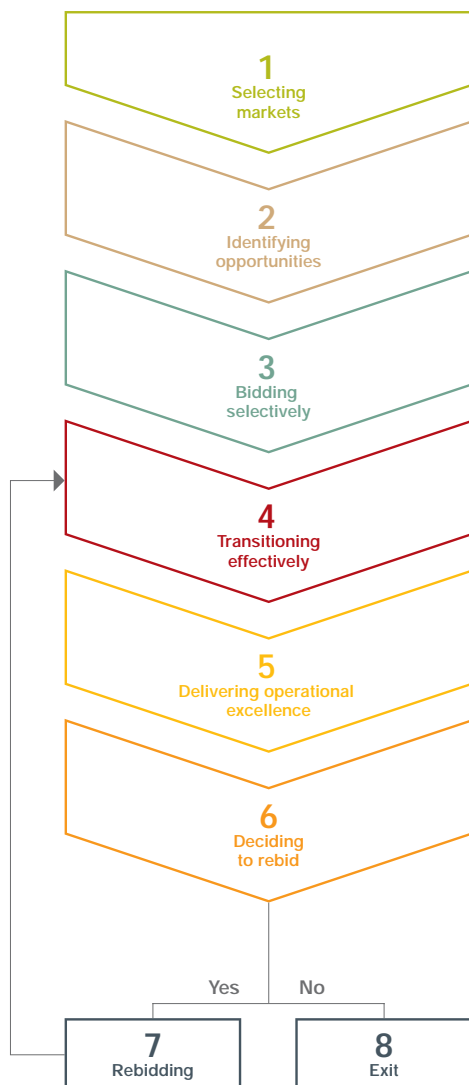
In 2010, we achieved a 7.3% reduction in tonnes of CO<sub>2</sub>/£m of revenue, compared to our 2008 baseline.

## Our business model

The Business Lifecycle Governance Process formalises our approach to value creation and managing the associated risks. It helps us to:

- determine the markets we want to be in
- bid successfully for contracts that add most value
- transition these contracts to deliver this value, and
- retain and grow them.

### Summary of the Business Lifecycle Governance Process



1

### Selecting markets

We look for markets that:

- are politically and economically stable
- offer multiple contracts and good growth
- provide appropriate margins and cash flow, and
- allow us to differentiate ourselves from the competition.

We also analyse many other factors, including:

- the market's drivers
- our understanding of the customers and the way they procure
- ethical and human-rights issues, and
- whether we can provide an attractive working environment for our people.

In new markets, we also consider our entry strategy and whether we need an innovative contracting model.

2

### Identifying opportunities

Once we know the market is attractive, we identify opportunities to pursue. We then test the quality of each opportunity, including:

- our understanding of the customer's business and vision
- their funding for the project, and
- how likely they are to procure.

We also compare opportunities against each other, to determine the best use of our resources.



3

### Bidding selectively

Bidding can be expensive and take many months, so we only bid for opportunities that meet our criteria and where we have a strong chance of winning.

The bidding stage has numerous steps, from our initial submission, to being shortlisted, to our final bid. During the process, we develop a detailed solution for the customer and test it thoroughly. At every step, we review the opportunity and confirm that we want to proceed.

Once the customer selects us, the final step is to negotiate and sign the contract.

4

### Transitioning effectively

Effectively transitioning a new contract is vital.

We ensure that we have the right planning and controls in place to start work seamlessly on day one, as we implement the solution we developed during bidding. We also transfer knowledge from the bid team to the contract management, and continue to strengthen our customer and stakeholder relationships.

5

### Delivering operational excellence

We aim to deliver operational excellence and continual improvement.

Devolving responsibility to our contract directors allows them to innovate and respond to our customers' needs. It also makes our business scalable, enabling us to manage a growing contract portfolio.

The Serco Management System sets out our control framework, ensuring we work safely and responsibly, and safeguarding the needs of our stakeholders and Serco. Every decision we make must be in line with our Governing Principles (see page 12).

Working in the right way helps us to build long-term relationships. This often leads to the customer expanding our contract during its life, which is important for our growth. It also positions us to win the contract at rebid.

6

### Deciding to rebid

As we near the end of a contract, we decide whether or not to rebid it.

Although we usually rebid, we occasionally decide to exit a contract. We might do this if, for example:

- the market has stopped growing or become too price competitive, or
- we can get a greater return elsewhere.

7

### Rebidding

Our long-term relationships and service quality help us retain around 90% of our contracts at rebid and extension.

We approach the rebid as if it were a new contract, designing ways to deliver even greater quality and productivity. Often the customer requests more services over a longer term, so a rebid can be considerably larger than the original contract.

Once we have secured the rebid, we return to the transition phase, bedding-in our innovations and any new services we have taken on.

8

### Exit

When we finish a contract, we do so in the right way.

Where appropriate, we work closely with the incoming contractor to protect the interests of both the customer and the people who will transfer from us when our contract ends. This is also important because we may have other contracts with the customer or want to work with them in the future.

## A values-led and responsible business

### A values-led business


Serco could not succeed without the skill and dedication of our people around the world. They embody our culture and live our values, which truly differentiate us from our competition and underpin the way we run the company.

Our values, which are encapsulated in our Governing Principles, are central to our culture and inform every decision we make. By living these values, we ensure that we deliver the excellent service on which our success depends.

### A responsible business

Our Governing Principles emphasise the importance of corporate responsibility to Serco. We want to be good corporate citizens but acting responsibly also makes sound business sense and is essential to our strategy. Only by working in the right way can we deliver excellent service, continue to build our balanced contract portfolio and attract the partners with whom we create new contracting models.

We divide corporate responsibility into four pillars – health and safety, people, community and the environment. Our work for our customers encompasses all four pillars, but there are many things we do which go beyond our contractual or legal requirements.

 Pages 64 to 67 give more details about our approach to corporate responsibility and how we performed during the year.

### Our Governing Principles



1

#### We foster an entrepreneurial culture

We are passionate about building innovative and successful Serco businesses. We succeed by encouraging and generating new ideas. We trust our people to deliver. We embrace change and, by taking measured risks, encourage creative thinking.



2

#### We enable our people to excel

Our success comes from our commitment and energy to go the extra mile. We are responsible to each other and can expect support when we need it most. We expect our people to achieve more by recognising and harnessing the power of individuals. We value people for their knowledge, ideas and potential to contribute.



3

#### We deliver our promises

We do what we say we will do to meet expectations. We only promise what we can deliver. If we make mistakes we put them right. We are clear about what we need to achieve and we expect to make a fair profit.



4

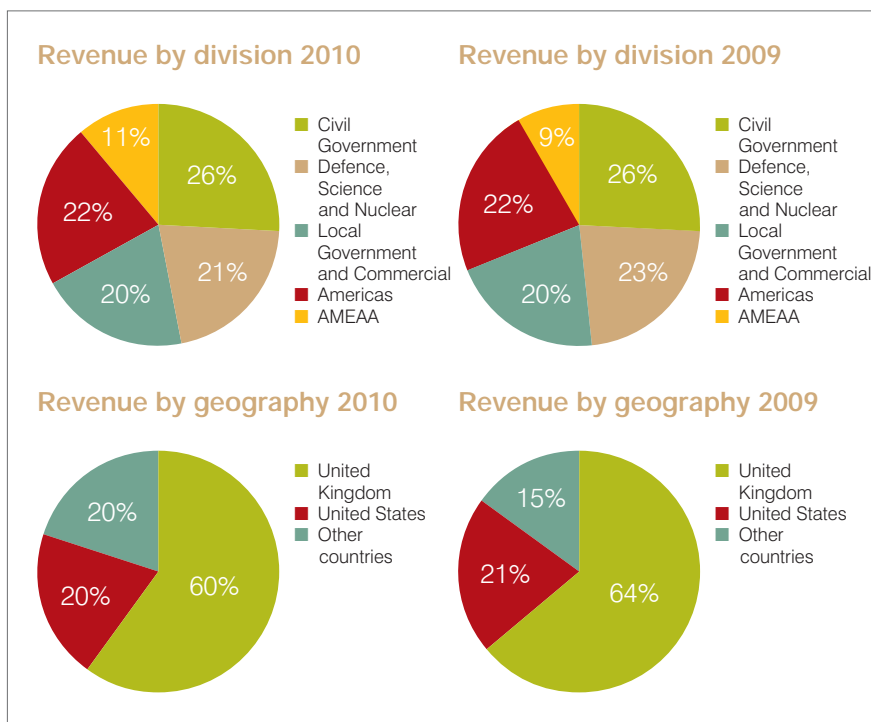
#### We build trust and respect

We build respect by operating in a safe, socially responsible, consistent and honest manner. We never compromise on safety and we always operate in an ethical and responsible manner. We listen. In doing so, we treat others as we would wish to be treated ourselves and challenge when we see something is wrong. We integrate with our communities.



## How Serco is structured

At the start of 2010, we created five new divisions based around our principal markets, so that we could maximise our focus on growth and opportunities, and maintain a flexible and devolved organisation which responds to our customers' needs.



### Civil Government



#### 2010 revenue

**£1,126.9m**  
+9.8% 2009: £1,026.3m

Civil Government includes our UK and European operations in home affairs (custodial, immigration and field services, and border security and control), transport (rail, metro and roads), welfare to work and health.

### Defence, Science and Nuclear



#### 2010 revenue

**£910.8m**  
-1.1% 2009: £921.2m

Defence, Science and Nuclear brings together our UK and European businesses providing operational support in the defence market, our science-based businesses, our energy market operations and our nuclear safety and assurance business.



### Local Government and Commercial



2010 revenue

£853.9m

+5.5%

2009: £809.2m

Local Government and Commercial incorporates our UK and European IT and business process outsourcing (BPO) operations, integrated and environmental services, leisure, education, consulting and commercial businesses.

### Americas



2010 revenue

£953.9m

+9.3%

2009: £872.6m

Americas provides professional, technology and management services focused on the US federal government, including every branch of the military, key civilian agencies and the intelligence community.

### AMEAA



2010 revenue

£481.2m

+41.2%

2009: £340.7m

AMEAA consists of our operations in Africa, Middle East, Asia (including Hong Kong and India) and Australasia, through which we provide a range of services including rail and metro transport, aviation, offender management, immigration, health, defence, BPO, local government and commercial.



More information on the services provided by each of our divisions is included in the operating review, which begins on page 26

## Chairman's Statement



**In my first statement since being appointed Chairman in May 2010, I thought I might give some initial impressions of our business.**

Since joining, I have sought to gain as broad as possible an exposure to and understanding of the diverse activities that now comprise Serco. Travelling around the United States, the Middle East, India and Australia, as well as extensively within the UK, I have visited over 30 of our sites across very different business streams such as defence, offender management, education, transport and health. Before being approached to join the Board of Serco, I obviously knew the name but had only limited awareness of the range of activities undertaken by the Group, from setting Greenwich Mean Time at the National Physical Laboratory to providing air traffic control services at Dubai International Airport.

Despite this diversity, what I have found are very strong unifying competencies and values that set the company apart. Having served for many years as a non-executive director of government departments, I recognise clearly the public service ethos – a deep-seated desire to make a difference – within the Serco staff I have met in prisons, schools and hospitals to name a few. Many businesses talk about guiding principles and publish

their values but it is much more demanding to ingrain these in the culture of the organisation, especially one employing some 70,000 people around the world, such that one sees them being lived each day in the decisions that management make, the service provided to customers, and the manner in which the business deals with its people.

Shortly after taking the chair, I attended our 2009 Pulse Awards that recognised individuals and teams who have excelled during the preceding year in living our Governing Principles, focused on achievements in innovation, commitment, impact and leadership. Those who won awards were impressive testament to the many at Serco for whom their job is much more than just turning up for work each morning. Examples were our staff at Lowdham Grange prison, whose projects helped forge new bonds between offenders and their children and thereby reduce the probability of re-offending, and those at our Family Services business unit in North America, who gave up weekends and holidays to build a Licensed Clinical Social Worker practice to help members of the US armed forces cope with issues such as post-traumatic stress disorder.

Complementing this ethos of public service, I have also found an equally strong entrepreneurial drive to deliver against objectives, create value and develop innovative solutions to problems. Serco has a 'can do' mentality but one built on the foundations of a strong management system that ensures rigorous analysis of potential opportunities and their inherent risks, meticulous implementation of the transition and transformation stages of new contracts, and effective governance of ongoing activities. In 2010 we implemented the Barclays Cycle Hire scheme for Transport for London; in just 11 months from being granted the contract to the launch on 30 July, we had 5,000 specially-designed bicycles in place across 315 sites, together with the supporting infrastructure and membership and billing systems.

Serco's breadth is, in my view, one of our great strengths. We now have significant interests outside the UK – our Americas business turned over £0.95bn in 2010, whilst in Australia we are a major employer. This geographic reach allows us to benefit from the strong economic growth being experienced in Australia, the Middle East

and India, to offset the more challenging environment of the UK and, to a lesser degree, the US. Equally our breadth of activities allows us to take advantage of developing thinking in different countries towards delivering services to the public, outsourcing and contracting. When proposing for new opportunities, we can reference existing successes elsewhere, a good example being the contribution our hospital services activities in the UK made to our selection as preferred bidder for the substantial Fiona Stanley hospital contract in Perth, Western Australia – our first major health activity in Australia. We recognise, in the way in which we have designed our management structure, the value that can be created by people across different parts of our business working together to share experience, skills and ideas. When visiting our immigration and offender management sites in Australia, I met employees with experience in our UK prisons and detention centres, some on secondment, others who had decided to take their careers forward in that region. Such inter-operability played a significant role in Serco being awarded a NZ\$300m prison management contract in New Zealand.

Whilst the financial crisis has imposed short-term constraints on Government spending in the UK, I am confident in our substantial pipeline of identified bid opportunities across the world and strong order book, hence maintaining our forward guidance. We have sought to be innovative in our thinking as to how to derive better service outcomes. An example is our approach to the welfare to work market in the UK, in which we partner with small companies and charities with vital local knowledge and expertise, to deliver tailored solutions to the needs of individual benefit recipients in order to get them back into work quickly and remain off benefit. The underlying need to deliver frontline public services more efficiently and economically will, I believe, create significant new opportunities for our business.

Our achievements in 2010, as discussed in detail by Chris Hyman in his Chief Executive's Statement, are ones of which Chris and his executive team, our wider management and employees can be justifiably proud. Growing our business by 9.0% and our profit before tax by 20.8% during this period demonstrates the resilience of our business model and the capability of our people. Against this

backdrop I am pleased to be able to propose a final dividend for 2010 of 5.15p per share, an increase of 17.0% on last year's final, which would bring our total dividend for 2010 to 7.35p per share, 17.6% up on 2009. Over the past five years, Serco has delivered a total shareholder return consistently ahead of the average for the FTSE 100.

Not only has the last year seen the retirement of Kevin Beeston, my predecessor as Chairman, but 2010 also marked the retirement of both Margaret Ford, our Senior Independent Director since 2003, and Tom Corcoran, who had been a Non-Executive Director for the last three years, bringing specific US insight to the Board. We owe much to all three for their contribution to the successful progress of Serco during their time on the Board, and in particular to Kevin who started with the company in 1985 and was progressively Finance Director, Chief Executive and Executive Chairman, prior to his assuming the role of Non-Executive Chairman in 2007. May I take this opportunity to extend them our best wishes for the future.

At the same time I would like to welcome Paul Brooks to our Board. In such a multi-faceted business, I believe it is important to plan ahead for succession to key roles, bringing individuals on to the Board early to allow them to learn the business ahead of assuming particular functions. David Richardson has chaired our Audit Committee since 2003 and will, therefore, come to the end of his allotted nine years in 2012. I am therefore delighted that Paul has agreed to join us and assume the role of audit chair following David's retirement. Paul is very well qualified for this, having been Group Chief Financial Officer of Experian, the FTSE 50 global information services company, since 2001. We will shortly return the Board to its previous size once we complete the current recruitment process.

As an employer of some 70,000 people across the world, Serco is deeply conscious of its responsibilities to the communities in which employees live and work, and we seek to support them in their involvement in activities to help those less fortunate than they. In this context I would like to say how delighted we all were to see the recent award of a CBE to Chris Hyman for both his charitable work and his business achievements. A summary of our approach to corporate responsibility, and some

examples of the contributions that we make, can be found in our Corporate Responsibility Review on our website. We are also very aware of the impact of what we do on our environment and considerations as to how best to lessen this impact are an integral part of the planning of each of our activities.

Serco is a learning organisation, seeking to improve what it does by listening to feedback from its stakeholders and its people. If we make mistakes, we put them right and learn from them. The Board is no exception and each year we undertake an evaluation of what the Board does and how it does it, this evaluation being facilitated externally every third year. As Chairman, I will also undertake an annual development review with each Director and my own performance will be appraised by my Board colleagues led by David Richardson, who takes over the role of Senior Independent Director.

May I finish by thanking everyone who has contributed to making Serco the business it is today: I am very proud to have been invited to become its Chairman.

**Alastair Lyons CBE**  
Chairman

## Chief Executive's Statement



**Our colleagues across the world deliver essential services and their achievements have led to a strong financial performance in very challenging times. We expect Serco's position in new, diverse and expanding international markets to deliver ongoing benefits. Our agility and capacity to innovate underpin our confidence in continued growth across all our regions.**

### Overview of the year

2010 was a successful year for Serco, thanks to the commitment of our people to delivering quality essential services that matter to millions of people. Our continued focus on excellent service for our customers resulted in high win rates and strong operational and financial performance in very challenging times.

### Strong financial performance

Serco delivered a strong financial performance in 2010, with revenue growth of 9.0% to £4,326.7m. Organic growth was 7.6%, excluding currency effects.

This growth demonstrated the capability, resilience and benefits of our portfolio, and our ability to develop new sectors and geographies as economic headwinds began to be felt in the UK. Revenue growth was particularly strong in AMEAA and we achieved a very good second half in the Americas. In the UK, good momentum from wins in 2009 drove growth in civil government markets while austerity measures began to be felt, particularly in the defence and local government markets.

Adjusted operating profit rose by 12.6% to £258.7m, reflecting a 19 basis point increase in Adjusted operating profit margin to 6.0% (16 basis points increase excluding currency).

The Group delivered exceptionally strong free cash flow of £185.8m, compared with £137.3m in 2009. Cash benefited by around £20m from asset sale proceeds, a particularly high level of joint venture dividends and low tax payments.

Our policy is to increase the total dividend each year broadly in line with the increase in underlying earnings. Adjusted earnings per share rose 17.5% to 34.69p per share. Reflecting this growth, the Board has proposed a final dividend of 5.15p per share, bringing the total dividend for the year to 7.35p, up 17.6% compared with the previous year. The final dividend will be paid, subject to shareholder approval, on 17 May 2011 to shareholders on the register on 11 March 2011.



## £5.6bn contract awards spread internationally

In 2010, we signed contracts valued at £4.2bn across a wide range of markets, and were appointed preferred bidder for a further £1.4bn of contracts. Our wins included significant contract extensions and expansions, as well as new contracts in existing and new geographies and sectors. The value of these wins does not include a number of Indefinite Delivery, Indefinite Quantity (IDIQ) contracts in the US, which we qualified for and which have a combined ceiling value of US\$4bn. These enable us to compete against other appointed companies for one or more of the specific task orders within the IDIQ.

Among the notable expansions and extensions to contracts during the year were:

- a two-year extension to our joint venture's Northern Rail contract, valued to Serco at approximately £530m
- a renewed and expanded ten-year £100m contract to provide services at RAF Halton and RAF High Wycombe
- a renewed and expanded US\$170m, five-year air traffic control contract with the US Federal Aviation Administration
- one renewed contract and one new contract with the US Navy to provide hazardous materials management, valued at approximately US\$84m over 3½ years and US\$88m over five years, respectively, and
- a renewed ten-year contract with the Royal Australian Navy for our 50:50 joint venture with P&O, valued to Serco at A\$250m.

We had a number of important contract wins during 2010. These included:

- a 25-year, £650m environmental services contract with Sandwell Metropolitan Borough Council
- a £415m, 26½ year contract to provide and operate a new prison at Belmarsh West, London
- a ten-year contract with King's College Hospital NHS Foundation Trust for our GSTS Pathology joint venture, valued at around £110m to Serco


- a £200m, eight-year strategic partnership with Hertfordshire County Council, and


- a five-year transportation management contract with the State of Georgia Department of Transportation, valued at US\$50m.

Transferring our skills and capabilities across our business helps us to expand into new geographies and sectors, and we had further success during 2010. Of particular note, we were:

- awarded our first home affairs contract in New Zealand, to manage the Mt Eden and Auckland Central Remand Prison, valued at up to NZ\$300m (£140m) over ten years, and
- appointed preferred bidder for our first contract in the Australian health market – a substantial ten-year contract to provide services at Fiona Stanley Hospital in Perth.

In addition there were many smaller contracts won by transferring capabilities, including a five-year contract with a new US customer, the Department of Veterans Affairs, to provide human capital solutions, and transport consultancy including a contract for the Makkah Metro in Saudi Arabia.

 For more details of these and other contract awards, see the operating review on pages 26 to 51

 For details of some of the many smaller and medium-sized contract wins, see our contract news updates

## Substantial global demand for efficient delivery of essential frontline services

The economic environment, reform of public services and nation building are driving strong demand for the efficient delivery of essential frontline services, creating opportunities for Serco in both new and existing markets. Our broad capabilities and track record of delivery allow us to support customers as they look for help in transforming the quality and efficiency of these services, and in tackling key challenges such as economic stability and development, congestion, security, health and climate change.



We launched the Barclays Cycle Hire scheme just 11 months after winning the contract.



We continue to grow our presence in the Australasian home affairs market.

## Chief Executive's Statement

In the UK, the Government's Comprehensive Spending Review has created a pressing need for public services to increase their efficiency in the face of reduced budgets and our markets are not immune. We signed a Memorandum of Understanding with the Cabinet Office in November to deliver cost savings on a number of contracts this year, further developing our strong partnership with the UK Government. While these savings are not material to the Group results, they combine with other headwinds, including the cancellation of one prison, the phasing out of the Business Link contracts and the pending developments in public service reform, to create a challenging environment in 2011.

The UK Government has stated that the public sector does not have to deliver the services it commissions. This is paving the way for the private and voluntary sectors to participate more fully in newer markets, such as welfare to work and offender rehabilitation, and for the development of new delivery models, such as mutual organisations. We also expect to see service providers increasingly paid for the results they deliver, a model with which we already have considerable experience, particularly in the Flexible New Deal contracts which are now planned to end in June 2011. These are to be replaced by the Work Programme framework and we have been selected as a bidder for contracts in seven of the 11 regions.

We continue to work positively with our customers in the UK as they look for solutions to their financial and operational challenges. We are confident that our opportunities to support those needs will become clearer later this year and we expect these to drive further growth. We are anticipating that a forthcoming parliamentary white paper on Open Public Services will outline in more depth how private and voluntary sector organisations could deliver additional UK public services.

Our international portfolio, spread across many expanding economies and markets, remains an important and proven element of our strategy. Our businesses outside the UK now account for 40% of our revenues and we are benefiting from the broader capabilities and contract portfolios we have developed in recent years. Our progress in establishing home markets in the US, Australia and the Middle East gives us strong

international platforms from which to grow organically and benefit from the potential for rapid expansion of those markets. We also see significant potential in India, where we have recently established our presence.

The US is the largest government contracting market in the world and our skills and capabilities, enhanced by those of our 2008 acquisition of SI International, enable us to participate successfully.

We are well positioned to grow our share of the addressable federal services market, which is valued at over US\$150bn per annum. While the Government is seeking to reduce expenditure in certain areas, such as large weapons programmes, we expect to see substantial opportunities in emerging priority areas such as IT infrastructure, cybersecurity, federal health and energy-efficient IT.

In Asia Pacific, we have an active bid pipeline, driven by the need for better infrastructure and services, in a fiscally conservative environment. Governments in Australia are aiming to return their budgets to surplus, helping to build a solid pipeline of opportunities in areas such as health, justice and defence.

In markets such as the Middle East and India, we continue to expect further opportunities arising from the demand for new services, including public transport systems, facilities management, education, health services and national security.

While we are primarily focused on organic growth, we will continue to acquire new skills and capabilities where they bring opportunities for growth in new markets and sectors, such as the US federal market and international BPO markets.

### Bringing service to life

During 2010, we set a new vision for Serco – to be the world's greatest service company.

Being the greatest is not about the size of our revenues, profits or growth. It means being the best at what we do and how we do it, so we deliver maximum benefit for our customers. Everyone in Serco discovers their own interpretation of 'greatest', which supports what they do every day – bringing service to life.



We are well positioned to grow our share of the addressable US federal services market.



We expect further opportunities in the Middle East arising from the demand for new services.

Bringing service to life describes what we do in two ways. It captures how we breathe new life into services, transforming their efficiency, productivity and effectiveness. And it recognises that the services we deliver make a difference to millions of lives around the world.

In this report, we have highlighted just a few examples of how we bring service to life. These examples typify our approach to service, the commitment and passion of our people and the outcomes we deliver for our customers.

### People

Serco has some 70,000 people delivering essential services around the world. Our success is not only the result of their hard work but also their commitment to our values and service ethos. I thank them for their outstanding contribution to Serco and to our customers in 2010.

We have a clear strategy for managing and developing our people, which in turn supports our overall strategy and vision: to be the world's greatest service company, we have to be the best at managing people.

Our people strategy is to:

- develop leaders who are fit for the future and who will thrive as Serco grows
- have people who bring service to life, who are fully integrated and engaged with Serco, and whom we can develop to achieve their full potential, and
- make it easier to manage our people, by continually enhancing our systems and processes.

We made further good progress against each part of this strategy in 2010.



For more information on our people, see pages 60 to 63

### Reiterating guidance

Our guidance reflects the growth potential we see across all our regions, supported by our high revenue visibility and substantial pipeline of opportunities.



Our Northern Rail joint venture was 2010 Train Operator of the year.

We have excellent visibility of future revenue due to the signed contracts that make up our order book, contracts we expect to extend and rebid, and contracts at the preferred bidder stage which we expect to sign. At 31 December 2010, our order book stood at £16.6bn, compared with £17.1bn at the end of 2009, reflecting our contract signings during year, the ending of our UK Flexible New Deal contracts and the cost savings on a number of contracts we have delivered to the UK Cabinet Office. We had visibility, at 31 December, of 92% of planned revenue for 2011, 77% for 2012 and 66% for 2013. Our pipeline of opportunities is currently £29bn.

For 2011, we expect good organic revenue growth and progress towards our 2012 margin guidance. Whilst this reflects the contracts we have won in 2010 and the opportunities we expect to see across our regions during 2011, we have also taken into account the headwinds in the UK. We expect the opportunities arising from the changed economic environment in the UK to begin to emerge from late 2011.

Prospects beyond the current year are encouraging and we continue to expect, by the end of 2012, an increase in revenue to approximately £5bn and in Adjusted operating profit margin to approximately 6.3%\*.

Christopher Hyman CBE  
Chief Executive

Note: \*excluding material acquisitions, disposals and currency effects, and based on 2008 exchange rates.



Serco's success is a result of the hard work, values and service ethos of our people.



We help UK councils increase recycling rates and reduce waste sent to landfill.

## Market opportunities and drivers

**At the start of 2010, we created five new divisions based around our principal markets. This allowed us to maximise our focus on growth and opportunities and maintain a flexible and devolved organisation which responds to our customers' needs.**

Both the sections on market opportunities and drivers, and the operating review, are presented according to these divisions:

- Civil Government
- Defence, Science and Nuclear
- Local Government and Commercial
- Americas, and
- AMEAA (Africa, Middle East, Asia, and Australasia).

Our markets offer a broad range of opportunities, as governments address substantial budget deficits and face continued pressure to improve public services. Some governments are implementing deficit reduction programmes and require ongoing efficiencies in the delivery of essential frontline services, which others are seeking to invest in creating or improving services. All are addressing significant challenges including unemployment and economic development, ageing and growing populations, migration, security, congestion and climate change.

Faced with this, governments are increasingly recognising the benefits of opening new areas of public service to competition. Studies have demonstrated that competition can reduce the cost of public services by 10-30% and stimulate innovation in delivery.

### UK

In the UK, the economic environment has created a pressing need for more efficient public services in the face of reduced budgets. In its Comprehensive Spending Review, the Government stated its intention to move from being a deliverer of services to becoming a procurer, and is now looking to promote choice, increase accountability and devolve powers away from the centre.

The competed public services market has potential to increase significantly in pursuit of efficiency; it was estimated in 2008 to be valued at some £80bn, representing only one third of the Government's expenditure on services.

We are anticipating headwinds in the current year whilst decisions on reform are resolved and customers develop their plans for future spending. However, a number of government reviews including those into defence and security, transport and welfare, and a forthcoming parliamentary white paper on Open Public Services, may result in new opportunities for the private and voluntary sector organisations to deliver services. We expect further clarity as the year progresses.

### Civil Government

Welfare is an area of significant UK Government expenditure. The Work Programme is Britain's biggest employment programme for decades and will also be the first major move to a system of payment by results. The contracts are substantially larger, longer and have greater scope than the current Flexible New Deal contracts, as they will extend support to other groups including the 2.5 million people claiming Incapacity Benefit. The Work Programme will be let through framework agreements to allow for faster and more flexible procurement, and will adopt the model we have successfully pioneered of subcontracting frontline delivery to networks of providers. There is also potential for other employment-related support services contracts to be let through this framework over the next five years, including subsequent contracts that attract European Social Fund support.

In home affairs, the first three existing public-sector prisons are being market-tested in 2011. We also see opportunities arising from the drive to manage the existing prison estate more effectively, reduce re-offending and improve the efficiency of probation, where a £1.6bn market is opening up. In addition, we are well placed to help with the proposed move to more community sentences for offenders, for example through our capabilities in electronic monitoring and rehabilitation of offenders.

The UK health budget is approximately 20% of government spending, at more than £100bn per annum, and reforms are focused on greater efficiency and improved



Serco has made a successful start in the growing welfare to work market.



We see opportunities to grow our pathology joint venture.



outcomes. We see opportunities to grow our pathology joint venture and provide facilities management and support services to healthcare establishments and GP commissioners. We will also look at further opportunities to manage NHS hospitals and expand in offender healthcare.

### **Defence, Science and Nuclear**

In the UK defence market, the Government has moved to a 'National Security' policy with the publication of the Strategic Defence and Security Review (SDSR) in October 2010, bringing together a number of markets in which we currently have presence and are increasing our potential. The SDSR also identified target reductions to the number of civil servants and the armed forces over the next five years, involving new ways of working and a more radical approach to the delivery of both back-office services and procurement. Implementation of these changes is likely to provide opportunities for Serco to support the Ministry of Defence (MOD) in change management, transition and the provision of complex integrated services. We are one of two bidders awaiting the decision on the Recruiting Partnering Project for the Army, and one of three bidders on the Future Outsourced Activities Programme for Royal Navy recruits.

In wider security and civil resilience markets, we are pursuing opportunities such as the long-term provision of outsourced training services to the London Fire and Emergency Planning Authority.

The UK's scientific establishments have a critical role in addressing challenges such as economic recovery, climate change and national and energy security. We are in a strong position to contribute given our experience of managing the National Physical Laboratory, the National Nuclear Laboratory, the Atomic Weapons Establishment and our nuclear assurance business. Our partnership with the MOD on the Chemical, Biological, Radiological and Nuclear Protection Delivery Team also enables us to bid for further partnerships within the MOD.

In the energy sector, the UK Government faces significant challenges in securing the country's long-term needs while tackling climate change. Our participation ranges from delivering regulatory and technical services in the nuclear new-build programme to reducing the radar interference of windfarms. We are

also exploring how we can apply our operations and maintenance capability in critical national infrastructure to the wider renewable energy market and establishing a Centre for Carbon Measurement.

### **Local Government and Commercial**

In UK local government, councils are under significant pressure from reductions in central government grants, a freeze on council tax increases, reductions in business rates and increased service demands from citizens. This is driving interest in strategic partnering, service sharing, process re-engineering, personalisation of services and in some areas, engagement with the voluntary sector. We are currently in discussions with more than 20 local authorities about how we can help them to transform service delivery. Our successful bids into Enfield Borough Council, Hertfordshire County Council and Sandwell Metropolitan Borough Council are examples of how we have applied our broad and deep capabilities. We are committed to partnering with the voluntary sector and small and medium-sized enterprises, to develop solutions which address our customers' needs.

We are also engaging actively with a number of local authorities to discuss models for the outsourcing of education and children's services, in the wake of the spending review and Education white papers. Our partnership models, offering shared revenue and profit, have been well received. We anticipate a number of opportunities coming to market in 2011.

We are seeing a revolution in the way health services are delivered, increased opportunities to build on our integrated facilities management offering to acute hospital trusts and reaching into middle office services such as human resources and finance. Our success in transferring these skills as part of our proposition for Fiona Stanley Hospital in Australia, where we are preferred bidder, demonstrates the value of our experience.



UK councils are looking for help with transforming service delivery.



The scientific establishments we run will help the UK Government address challenges such as climate change and energy security.

## Market opportunities and drivers

### Americas

The US market, which is the largest government contracting market in the world, offers Serco opportunities in both the federal defense and federal civilian markets.

In the US federal services market, of which our addressable share is valued at US\$150bn per annum out of a total of US\$300bn, we expect the increasing reliance on information technology to continue to present significant opportunities for Serco. IT is essential for successful government operations and we expect increasing demand in areas where we have strong capabilities, such as systems engineering, cybersecurity, program management, command and control, and logistics systems modernisation.

Additionally, the federal government continues to face workforce shortages and to rely on contractors. Serco expects to grow in managed services including human capital management, military personnel support services, records management, business process outsourcing and logistics supply operations. With our scale, capabilities and past performance, we are well positioned to bid and win larger contracts.

We qualified on a number of Indefinite Delivery, Indefinite Quantity (IDIQ) contract vehicles, where we are one of a number of companies able to bid for specific task orders within the IDIQ. Notable examples awarded during 2010 included a five-year personnel support services IDIQ contract with the US Army, allowing us to compete with 16 other awardees for up to US\$2.6bn of task orders. We are also eligible to compete with 11 other awardees for task orders within a studies and analysis IDIQ contract with the US Army, amounting to US\$1.3bn over five years. In addition, we, along with 13 other companies, are signed up to a five-year Recruiting and Retention IDIQ contract for up to US\$274m of task orders, to provide program analysis, information technology, counselling and training with the US Army.

Since the year end, the US Navy's Space and Naval Warfare Systems Command has named Serco as one of four winners for an IDIQ contract to support the Navy in the installation and testing of Command, Control, Communications, Computers, Intelligence, Surveillance and Reconnaissance (C4ISR) systems. The contract has a ceiling value of US\$1.4bn over a three-year base period, with a two-year option period.

### AMEAA

In Australia and New Zealand, there is a growing range of opportunities.

In the justice sector, we are seeing a number of new-build and existing prisons being put to the market, as governments challenge the traditional approach.

We also continue to pursue the emerging health market in both Australia and Hong Kong, as governments encourage the private and voluntary sectors to challenge traditional service delivery models for the build, finance and operation of hospitals.

Our defence strategy in Australia continues to develop, with opportunities in areas such as logistics and garrison support. The Government's Strategic Reform Programme will support the creation of some of these opportunities, through reviews of warehousing, distribution and equipment maintenance.

Serco's operations in the Middle East centre on the United Arab Emirates. This region remains buoyant for Serco as governments progress with infrastructure and public service projects in transport, education and health. We continue to build on our core markets in the region, particularly in facilities management, transport and aviation, and are well placed to move into new markets of health, education and defence with a strong pipeline of opportunities for the foreseeable future.

In India, we continue to develop our presence in the domestic BPO market. In addition, our Global Transport team is shaping significant opportunities in both the Middle East and India including rail, road and traffic management, marine services and aviation.



The US is the world's largest government contracting market.



Transport is one of the markets where we see further opportunities in the Middle East.



# Bringing service to life...

The Barclays Cycle Hire scheme, London



# ...in transport

During 2010, we launched a brand new way of travelling round the streets of London – the Barclays Cycle Hire scheme. In just a few months, the distinctive bikes have become an integral part of the city's streetscape. By the end of the year, customers had made 2.15 million journeys and the scheme had 112,000 registered members. In a survey, 91% of members said they were happy with the service, which we deliver on behalf of Transport for London.

Barclays Cycle Hire is the first such scheme in the UK and demonstrates our ability to take on new challenges for our customers. We were able to draw on operational, financial, commercial and transition expertise from around Serco to launch the service within just 11 months of signing the contract. This success was reflected in Serco being highly commended at the Mayor's Procurement Awards 2010.

The scheme has made a big difference to the lives of those travelling around London but we have also been able to make life better for the

communities we work in, by creating jobs in areas of London with high unemployment. We placed our call centre in Enfield and our operations centre in Islington, and then recruited around three quarters of our 280 staff through JobCentre Plus, which helps people of working age get off welfare and into work.

We are also helping young people into work with our apprenticeships. In total, we have 27 apprentices aged 18 to 25. They are learning mechanical and engineering skills, undertaking routine maintenance and keeping our bikes roadworthy. The next step is for them to train to become qualified mechanics.

There will be further benefits for customers and more scope for job creation as Barclays Cycle Hire extends towards east London in readiness for the 2012 Olympics. The planned expansion will increase the area covered to 65km<sup>2</sup>, with around 8,000 hire bikes available from 600 docking stations.



The operating review outlines contract wins which are significant because of their value or their contribution to our business development. We also won numerous other smaller and medium-sized contracts, details of some of which can be found on our website at [www.serco.com](http://www.serco.com).



Further information available online

### Our work in Civil Government covers the home affairs, health, transport and welfare to work sectors.

In home affairs, we are the UK's leading private provider of custodial accommodation, operating four prisons with a fifth, Belmarsh West, under construction. We also run a young offender institution and a secure training centre. We provide court escort and custody services as well as electronic monitoring of offenders and individuals released on bail. We run two immigration removal centres and provide immigration control, case management, homeland security and technology services.

In health, our groundbreaking pathology joint venture with Guy's and St Thomas' and King's College Hospital NHS Foundation Trusts combines their clinical excellence with our management expertise. We are one of the UK's leading providers of occupational health services, supporting the health and well-being of over 450,000 of our customers' employees nationwide. We are also the leading independent provider of custodial health services, providing for thousands of people in custody across the UK. We deliver unscheduled care services in Cornwall, providing reliable access to doctors and appropriate medical assistance outside normal working hours.

We are a key provider of transport in the UK through our rail, metro, road and ferry services. With our partner Abellio we run both Northern Rail, the UK's largest train franchise, and Merseyrail, the UK's most punctual train operator. In London, we operate the Docklands Light Railway, the Woolwich Ferry and the East London Traffic Control System. We designed, implemented and operate Transport for London's award-winning Barclays Cycle Hire scheme. We deliver national motorway traffic infrastructure services, install and maintain road safety cameras, and run the National Traffic Control Centre.

We began operations as a leading prime contractor of welfare to work services in October 2009. Since then, our delivery network has helped approximately 18,000 long-term unemployed people into

employment. We have been awarded a place on the framework to deliver the Government's new Work Programme in seven regions, the maximum number that could be awarded to one organisation.

### 2010 Performance

Civil Government's revenue grew 9.8% to £1,126.9m (2009: £1,026.3m) and represented 26% of Group revenue in both 2010 and 2009. The growth, which was particularly strong considering the change in accounting for Train Operating Company track access charges, which reduced revenue by £26.5m, derived principally from the large contracts awarded in 2009 which became operational during 2010. These included the Flexible New Deal contracts under the welfare to work programme, which started in October 2009, and the Barclays Cycle Hire scheme in London. We also benefited from contract wins during 2010 such as the expansion, in September, of the GSTS Pathology joint venture to include King's College Hospital NHS Foundation Trust.

### Transport – Rail and Metro

We run three of the best performing train operating contracts in the UK.

Both Northern Rail and Merseyrail, joint ventures with Abellio, continued to deliver strong operating performances.

Northern Rail achieved 90.8% punctuality as of the last period and overall satisfaction in the National Passenger Survey was 82% – unchanged from the previous year. It has recently been awarded Train Operator of the Year in the Rail Business Awards, recognising the investment made by Serco and Abellio above and beyond the franchise requirements. In addition, Northern Rail received two top national awards and four commendations in the Railway Industry Innovation Awards, as well as the top transport title from the Royal Society for the Prevention of Accidents for the second year running.



We are a key provider of transport services in the UK including traffic management.



The Docklands Light Railway carried more than 75 million passengers in 2010.

Merseyrail was the UK's most punctual railway during 2010, with 95.2% of trains on time over the year, and was also the highest-rated train operating company, with a 93% satisfaction rating in the independent National Passenger Survey.

On the Docklands Light Railway, the roll out of a full three-carriage service has increased capacity by 50%. Customer satisfaction was 95.4% for overall service and 96.3% for safety and security in the fourth quarter of 2010. Increased service reliability resulted in 97.1% of trains running to schedule, on the most recent figures. Passenger numbers grew again in 2010, and were 9.3% higher at 75.2 million journeys.

Northern Rail signed a two-year extension to its franchise, on the same terms as its existing contract. Serco's share of the extension to September 2013 is valued at approximately £530m.

In Rail Technology, we have completed our contracted development work on the Asset Inspection Train for the London Underground and, following earlier delays, now look forward to the final handover.

We launched Barclays Cycle Hire for Transport for London. By the end of the year, over 110,000 members had registered and the scheme is also now available to casual users. In total, over 2 million journeys have been made to date and in a survey, 91% of members said they were happy with the service. The scheme's success has resulted in plans to extend it towards east London in readiness for the 2012 Olympics, increasing the area covered to 65km<sup>2</sup>. Around 8,000 hire bikes will be available from 14,400 docking points, spread across 600 docking stations.



We are the UK's leading independent provider of custodial health services.



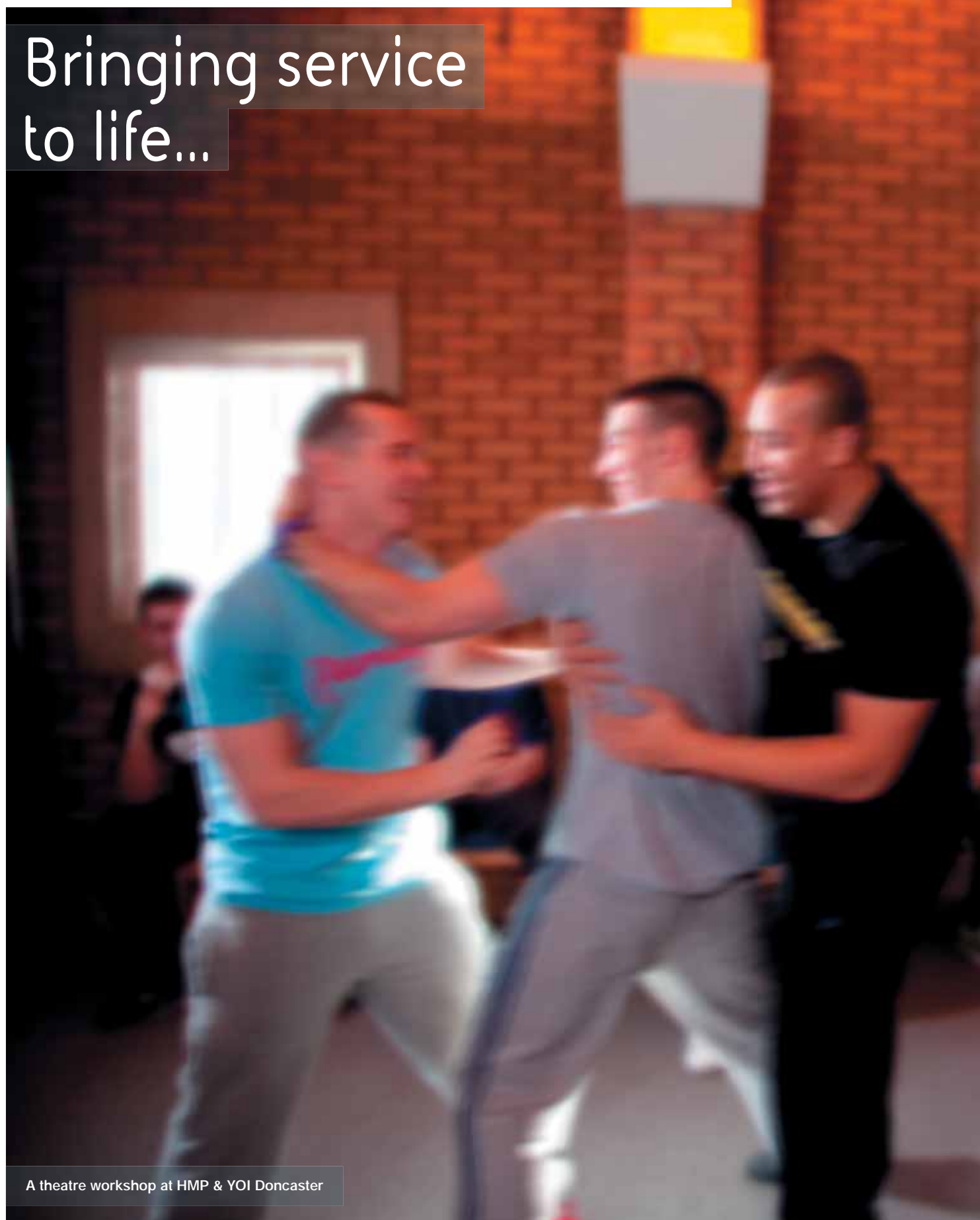
Our Merseyrail joint venture is the UK's most punctual railway.



The Barclays Cycle Hire scheme saw more than 2 million journeys in just five months.



# Bringing service to life...



A theatre workshop at HMP & YOI Doncaster



A photograph of a middle-aged man with a grey beard and mustache, wearing a dark grey suit, a white shirt, and a red tie with small white dots. He is standing in front of a brick wall. In the background, a person is blurred, and there is a window. The text "...in offender management" is overlaid on the image in a white, sans-serif font.

## ...in offender management

HMP & YOI Doncaster holds an offender on average for just 12-16 weeks, making its population one of the hardest to rehabilitate. When John Biggin took over as the prison's director, he was prepared for the challenge. "I had a vision for the prison and the difference it could make to people's lives," he says.

John sharpened the prison's focus on reducing re-offending, introducing innovative schemes and a zero tolerance for violence and drugs. Research shows that offenders with strong family ties are six times less likely to re-offend, so new fathers now have a separate visiting area, helping them to bond with, feed and bathe their babies. Visits take place outside in summer and the prison arranges family activities.

A new directorate brings outside groups into the prison, helping Doncaster achieve more without extra funding. One example is the theatre work with the Central School of Speech and Drama. "Our restorative justice project gave the men a real insight into

their impact on victims," says John. "When they performed in the houseblocks, the audience also got the message."

To help offenders re-enter the community, Doncaster's team helps them access housing, benefits, employment or training. Charity Catch22 provides round-the-clock mentoring after an offender leaves prison.

John's initiatives have produced a sharp drop in violence, drug use and smuggling by visitors. The next step will be payment by results, with part of our revenue at Doncaster dependent on reduced re-offending six months after release.

In recognition of his achievements, John was voted the 2010 Guardian Public Servant of the Year. Underpinning his success is Serco's way of working. "I was encouraged to have a vision and to realise it," he says. "Serco gave me the chance to get Doncaster ahead of the game."

**Home Affairs**

We signed a contract with the Ministry of Justice to provide and operate a new prison at Belmarsh West, London. The contract has a value to us of approximately £415m over 26½ years. The prison will be built by our construction partner Skanska, with equity and debt finance secured from third parties, and is on track to be completed in the first half of 2012. Belmarsh West is the first UK prison contract to be awarded to an alliance of the private and voluntary sectors. With our partners, Turning Point and Catch22, we will focus on cost-effective care and successful rehabilitation, creating an environment that prepares those in our care for release.

We were disappointed to be informed that, having been appointed preferred bidder to provide and operate a further prison at Maghull, the project would not go ahead as a result of the Comprehensive Spending Review. We fully understand the decision and look forward to working with the Government on its proposals to deliver innovative, effective rehabilitation to reduce re-offending.

We were awarded a number of contract extensions, including a two-year extension, valued at £38m, to our contract to run Colnbrook Immigration Removal Centre, and a three-year, £32m extension to our contract to manage Yarl's Wood Immigration Removal Centre. We were also awarded an additional two years for our electronic monitoring contract for Scotland, valued at around £10m, and signed a one-year extension to our electronic monitoring contract for England and Wales, valued at an additional £38m of revenue at current levels.

In border security and control, the Home Office has announced the termination of its e-Borders contract with Raytheon, the prime supplier of this advanced border control and security services programme to the UK Border Agency. As a subcontractor on the programme, we are continuing to fulfil our obligations to operate key parts of the existing service, and continue to work with the UK Border Agency on how we can best support them in the future on the e-Borders programme.

We were delighted that John Biggin, director of HMP & YOI Doncaster, was named Public Servant of the Year at the Guardian Public Service Awards. This is the first time a private sector employee has received such an award. We also received a British Safety Council Five Star Health and Safety Audit Award for HMP Dovegate, and recognition in the Healthcare 100 awards for our work at Yarl's Wood Immigration Removal Centre.

**Welfare to Work**

We have made a successful start in the welfare to work market. As prime contractor, under our three Flexible New Deal (FND) contracts with the Department for Work and Pensions (DWP), we help people claiming Jobseeker's Allowance, who have been unemployed for more than 12 months, to find sustainable work. We achieve this through our unique model of subcontracting to networks of successful providers, including private, public and voluntary sector organisations. Since the start of these contracts in October 2009, we have enabled nearly 18,000 people to move back into employment.

These existing FND contracts, and all other existing back-to-work schemes, will now end in June 2011 and be replaced by the Work Programme, which will be substantially larger, longer and have greater scope. It will extend support to additional groups including those who have been unemployed for less than 12 months and those claiming incapacity benefits. Contracts are being tendered for in 2011 and let through a new framework on which we are placed in seven out of eleven available regions across the UK. Each region is made up of between one and three Contact Package Areas, in which there will be at least two suppliers. This offers the opportunity for us to substantially extend our footprint in the market.

Our welfare to work team has expanded into an adjacent market, winning a number of contracts, valued in aggregate at around £19m, to implement Job Deal which helps ex-offenders find jobs. The programme is jointly funded by the European Social Fund and the DWP, and is managed by the National Offender Management Service.



We extended our electronic monitoring contracts for England and Wales, and Scotland.



We have helped nearly 18,000 people into employment through our welfare to work contracts.



Serco is the UK's leading private provider of custodial accommodation.



Our joint venture is now the UK's largest provider of pathology services.

## Health

King's College Hospital NHS Foundation Trust (King's) joined GSTS Pathology, our joint venture with Guy's & St Thomas' NHS Foundation Trust, and awarded it a contract to provide pathology services. This will result in incremental revenue to Serco of approximately £110m over ten years. King's has one of the largest integrated automated laboratories in Europe and will further enhance the range of tests available to GSTS Pathology's customers.

GSTS Pathology is now the UK's largest pathology service provider and has achieved considerable success in improving service levels. Among a wide range of improvements, cervical cancer screening times and the turnaround times for some forms of diabetic monitoring tests have been halved. We have achieved even better results for HIV genotyping assays, reducing the time taken from 28 to 10 days.





# Bringing service to life...

The depth maintenance facility at RNAS Culdrose



A photograph of two men in blue Serco uniforms standing in a large industrial hangar. They are both looking down at a white sheet of paper held by the man on the left. The man on the left is bald with glasses and a goatee. The man on the right has short brown hair. Both uniforms have 'serco' logos. The background shows the interior of a hangar with structural beams and a blurred aircraft.

## ...in UK defence

Royal Naval Air Station Culdrose, in Cornwall, UK, is Europe's largest military helicopter unit. Serco has a crucial role, helping to maximise the time those helicopters are available for deployment.

We have two contracts at Culdrose. Under our multi-activity contract with the Fleet Air Arm of the Navy Command, our wide range of services includes supporting the Sea King helicopters used in search and rescue missions and providing jet pilots for training exercises. Our second contract is to provide a deep maintenance facility for Merlin helicopters on behalf of their manufacturer, AgustaWestland.

Serco began operating at Culdrose in 1996. Since then, our services have grown substantially. From 26 employees at the start, we now have more than 350 at the base. As one indication of the scale of our work, we deliver 10 million litres of fuel each year, ensuring the helicopters are ready to fly.

Our services are mission-critical, so we form a team with our customers, to ensure they get what they need. We then employ people with a real depth of knowledge and the service ethos to make this happen.

We encourage innovation to overcome our customers' issues. For example, Peter Morrissey, an aircraft welder on the Merlin support contract, invented a new way to repair Merlin exhausts when spare parts were in short supply. By preventing the need for slow and costly off-site repairs, Peter made sure the helicopters were available for the Royal Navy and saved more than £2.6m over four years.

The outcome of our approach is that helicopters spend more time on the frontline and we get excellent feedback from our customers. As well as receiving numerous awards and commendations, the Culdrose team scored an average of nine out of ten in a recent Ministry of Defence customer satisfaction survey.

### Defence, Science and Nuclear (DSN) delivers services to the UK and German governments.

In the UK, we provide training, engineering and operational support to the Royal Air Force, and the aviation arms of the British Army and Royal Navy. We also support the Royal Navy's three main UK bases and operate and maintain strategic assets such as secure satellite communications, the Defence Academy of the United Kingdom, the Emergency Planning College and the UK's ballistic missile early warning system at RAF Fylingdales. We provide systems engineering, safety assurance and risk management services, and support the essential defence and force protection research carried out at the Defence Science and Technology Laboratory.

In Germany, we have supported the German armed forces for over 40 years, delivering training, logistics and operational support services. We also provide facilities management, prison and IT services to commercial companies and the German Government.

We manage the National Physical Laboratory, one of the world's major scientific establishments. With our partners Battelle and the University of Manchester, we also manage the National Nuclear Laboratory, one of the UK's leading technology service providers and a centre of excellence in nuclear non-proliferation.

We have an integral role in the UK defence and civil nuclear industries. Our joint venture with Lockheed Martin and Jacobs Engineering manages the UK Atomic Weapons Establishment (AWE), which provides the warheads for the UK's nuclear deterrent. In addition we have provided nuclear safety advice to the Royal Navy's submarine fleet for nearly half a century.

We also offer specialist technical support to the UK's civil nuclear industry, providing safety, environmental, risk and asset management advice and operational solutions. We support the operation of over 20 nuclear reactors.

### 2010 Performance

DSN's revenue reduced by 1.1% to £910.8m (2009: £921.2m) which represented 21% of Group revenue (2009: 23%). This decline reflected a slowdown in advance of the UK election and the Strategic Defence and Security Review during 2010, both in decision making and in major contract awards.

Key awards last year included a renewed and expanded multi-activity contract valued at £100m over ten years, to provide services at RAF Halton, which we have served since 1997, and RAF High Wycombe, the home of Headquarters Air Command. At RAF Brize Norton, the main gateway for British military personnel on overseas operations, the Ministry of Defence (MOD) awarded us a contract for up to six years to deliver essential support services, worth approximately £35m. We have supported the RAF there since 1997 and this contract confirms and reinforces our position supporting the MOD's Programme Future Brize, which will see RAF Brize Norton develop into the core Air Transport and Air Re-fuelling station.

Utilising our scientific capabilities, our joint venture to manage and operate AWE continues to achieve excellent delivery against key milestones. The AWE transformation programme is delivering significant benefits, working with the MOD to reduce costs while maintaining performance levels. In addition, we have delivered the Project Orion laser facility, a world-leading high energy density physics experimental facility, on time and to the MOD's requirements. We are delighted that a team from AWE has been awarded a Commendation by the MOD's Chief Scientific Advisor, for work on collaborative arms verification with Norway.

Bridging the defence and energy markets, a new eight-year contract with the MOD, valued at around £20m to Serco, will help the UK tackle climate change through off-shore wind energy. As prime contractor, we are working with Lockheed Martin to introduce radar technology that resists interference from wind farms, removing a significant obstacle to the roll out of off-shore wind power across the UK. This new technology has already been commended for innovation at the 2010 National Buying & Selling Energy Awards.



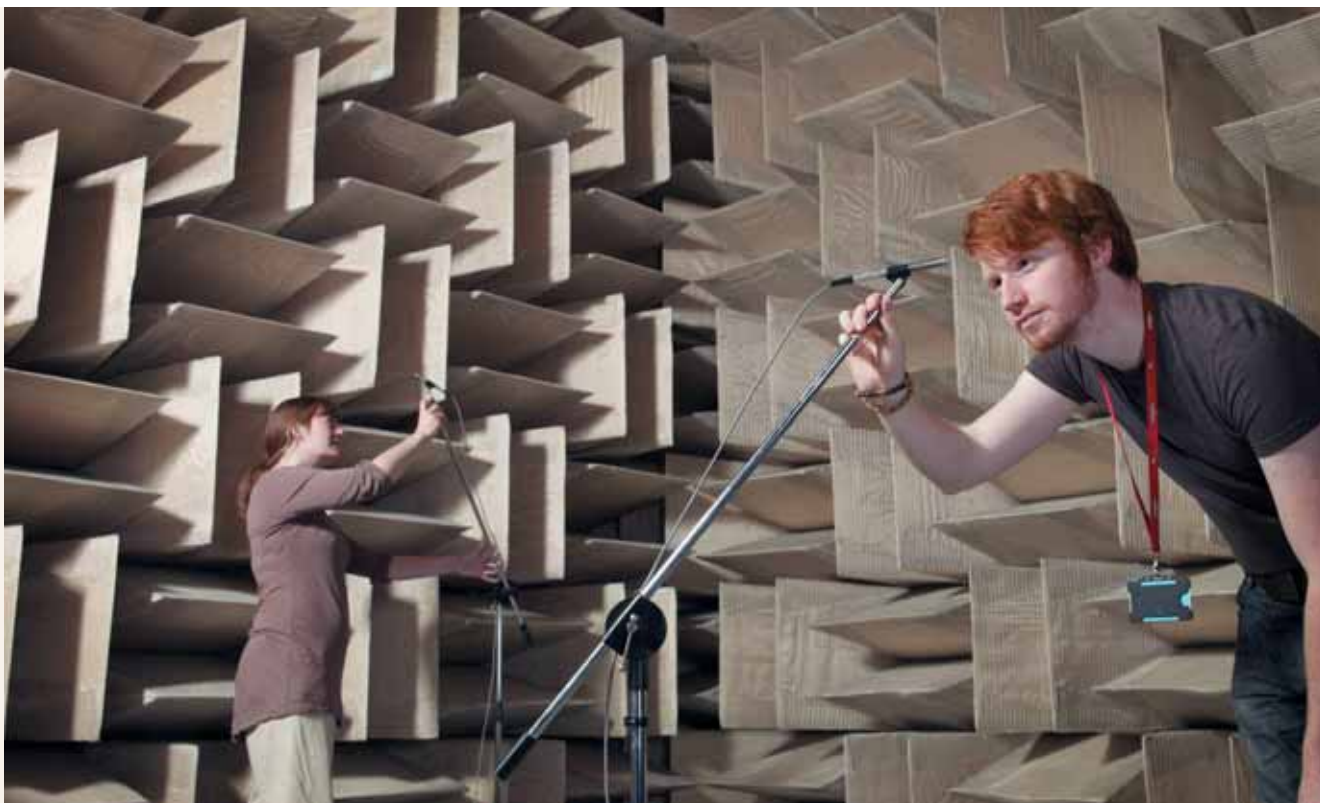
Serco has supported the RAF at Brize Norton since 1997.



We manage scientific establishments, including the world-leading National Physical Laboratory.



We enable the Royal Navy to move in and out of port at its three main UK bases.



The National Physical Laboratory grew its commercial revenues to more than 30% of its overall income.

In the civil energy market, Westinghouse appointed Serco as its lead nuclear safety advisor in the UK. Serco's role is to lead a team of experts to help Westinghouse complete Step 4 of the Generic Design Assessment for the AP1000, a critical stage in the reactor design approval process being conducted by the UK Nuclear Regulators which is due to complete in 2011. The contract is strategically important for Serco, coming at the beginning of a new era for nuclear energy in the UK.

Our European defence operations secured over £50m in new business and renewals of existing contracts, including several with the German Ministry of Defence. This included the planning and installation of communications and laboratory equipment and a contract to deliver deployable network solutions.

In the expanding training market, we secured a 15-year contract worth more than £55m to manage and operate the Emergency Planning College (EPC) on behalf of the Cabinet Office, placing us at the heart of UK civil resilience and positioning us well for future opportunities. We manage all services at the EPC, including training delivery and support, sales and marketing, finance, estate management, ICT and security.

National Physical Laboratory (NPL) commercial revenues have expanded and they now represent more than 30% of its overall income. This includes orders from the environmental and sustainability sectors, responding to environmental legislation and the growing sustainability agenda. Customers include E.ON, BP, Veolia Environment and the Department of Food and Rural Affairs. The business case for a Centre for Carbon Measurement has been developed and is being considered with our stakeholder community. It will support national and international efforts to understand and mitigate climate change through accelerating the development of the low-carbon technology sector. NPL also received the highest recognition after a paper co-authored by NPL scientists was cited in support of the Nobel Prize in Physics.



# Bringing service to life...

# ...in local government

## Technology helps councils increase their efficiency and improve service to citizens.

Serco has delivered information and communication technology (ICT) services to the London Borough of Enfield since 1999. In 2010, we signed a new contract with Enfield to provide ICT services for up to nine years. Under this contract, we provide IT support, operate the council's IT network, data centre and helpdesk, and deliver programme management for projects.

The contract guarantees 20% cost savings for Enfield. We will realise these efficiencies by introducing new services, such as helping council employees increase their effectiveness through flexible and mobile working.

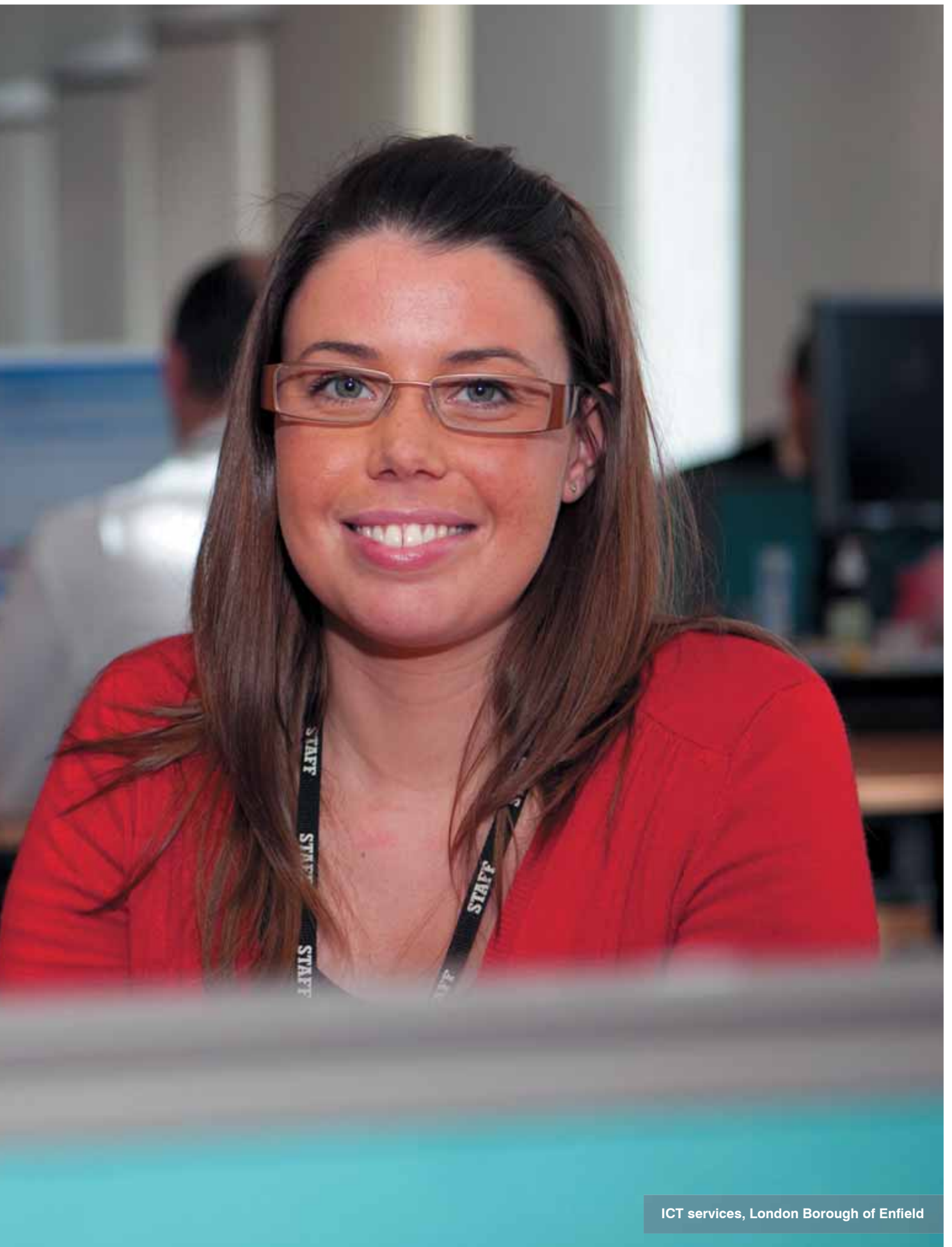
We will also help the council transform the way it interacts with the local community, increasing access to services and improving the council's ability to offer a more focused and personalised approach.

As part of this, Enfield – like all local authorities – wants more citizens to access its services online. This reduces costs and makes services available quickly and easily to users, at a time that suits them. Enabling safe and secure access is vital. That is why Enfield has adopted a pioneering new service we have created in partnership with Microsoft and identity management specialists GB Group.

Users will only have to register their details the first time they use the system. Once their identity has been verified, they are issued with a unique electronic identity 'token' for all their online transactions with the council.

"We are incredibly pleased with the potential benefit this service provides to our citizens, in terms of secure access and safe transactions," says Councillor Andrew Stafford, Cabinet Member for Finance at Enfield. "It marks a step change in our approach to using technology to improve the customer experience and to save money, which we can use to protect frontline services."





ICT services, London Borough of Enfield

**In the UK, Local Government and Commercial (LG&C) delivers essential services for more than 100 local authorities, helping them to serve their communities.**

We improve services for our customers, increasing productivity and delivering better outcomes for them and the public. We listen, so we can innovate and tailor our solutions to meet our customers' aspirations, building long-term strategic partnerships in the process.

Our solutions meet a wide range of local government's current and emerging needs, with services covering streetscene, waste management and recycling, e-government, leisure, education and children's services, economic development and enterprise support, and information and communications technology (ICT).

We also implement service transformation programmes, employing technology to deliver more effective, efficient and responsive services.

Our business in the private sector is dominated by multi-service facilities management contracts, delivering a range of services from helpdesk operations to buildings maintenance, reception services, catering, cleaning, chauffeur services and stores management – in fact, any activity that is non-core for our customers.

#### **2010 Performance**

The revenue of LG&C increased by 5.5% to £853.9m (2009: £809.2m), which represented 20% of Group revenue in both 2010 and 2009.

Growth was driven by a number of 2009 wins which became operational during 2010, including a full range of environmental services for the London Borough of Bexley; expanding our presence in integrated services markets with the Plymouth Hospitals NHS Trust and Airbus; as well as support services for The European Space Agency and Peterborough City Council's ICT services. This performance was robust given Business Link services, provided for the London and

South East Regional Development Agencies, were reduced in scope and some customers delayed decisions on discretionary project work following the outcome of the Comprehensive Spending Review.

#### **IT & BPO**

We signed a new contract with Hertfordshire County Council to deliver a ground-breaking strategic partnership. The contract, due to commence in April 2011, is valued at up to £200m over eight years and will achieve efficiency savings for the Council of at least £25m. We will provide front and back office operations including ICT services, business processes such as finance, payroll and human resources, and support services such as facilities management, customer contact centres and occupational health. These services will also be offered to other public sector bodies in the area, including Hertfordshire's ten district councils and the county's police authority. The new contract builds on our 18-year track record of working with the Council and is significantly larger than the existing £8m per annum service.

We successfully rebid our contract to provide ICT support services to the London Borough of Enfield. The new contract will deliver guaranteed cost savings of 20% for the Council, improve services for its employees and improve communication and interaction with residents. The initial five-year contract is valued at £24m, with an option to extend for a further four years.

The replacement of Regional Development Agencies with Local Enterprise Partnerships and related funding cuts will see our regional Business Link services close by the end of 2011. Although there may be new opportunities with the introduction of business support programmes from national and local government, it is not yet clear when these will start to emerge.

In March 2010, we acquired RB Solutions, a successful provider in the revenues and benefits market. This gave us an additional capability in this market, enabling us to win five new contracts including Dacorum Borough Council and Dudley Metropolitan Borough Council, to provide benefits processing services.



Technology helps councils improve efficiency and service quality.



We help UK councils increase recycling rates and reduce the waste sent to landfill.

We secured two contracts with the European Space Agency (ESA) valued at €35m over the first three years, strengthening our position as a leading service provider to Europe's space and technology agencies. Under the first contract, we are leading a consortium to provide operations and maintenance to ESA's Earth Observation programme. The second is an expansion of an existing contract, covering engineering and management support for the ESA Earth Observation payload data ground segment.

We were delighted that Duncan Mackison, who leads our highly-successful ACCESS joint venture with Glasgow City Council, was named Outsourcing Professional of the Year by the National Outsourcing Association.

### Integrated and Environmental Services

Sandwell Metropolitan Borough Council awarded us its new 25-year Waste Improvement Plan contract, valued at around £650m. We are providing refuse and recycling collection services, street cleansing services and delivering waste processing and disposal, including the construction of a new waste transfer station. Our innovative approach will increase recycling rates and significantly reduce the amount of waste sent to landfill. This will help the Council meet Government recycling targets and reduce costs such as landfill taxes.

Norfolk and Norwich University Hospital extended our contract for a further five years until 2016. The extension, under which we will continue to provide a full range of integrated non-clinical support services, is valued at £75m.

We also began our contract to provide facilities management services to the new Forth Valley Royal Hospital in Scotland, one of the most modern and well-equipped hospitals in Europe. Our services include operating and maintaining a team of robotic vehicles, which help to keep patient areas free of trolleys and other related items, reduce infection risks and free up our staff to focus on patients' priorities. The contract is valued at £600m over 30 years.



Our education contracts continue to deliver good results for pupils.

### Education

Our education services contracts in Bradford and Walsall continued to perform well. We were delighted that our Bradford contract continues to deliver significant improvements. At Key Stage two, 73% of pupils are now achieving Level 4 or higher in English and Maths (combined), equivalent to the national average. At GCSE level, more than twice as many of the district's 16-year-olds gained 5 A\*-C grades in 2010 (71.9%) compared with 2001 (34.3%) when Serco was asked to manage education services in Bradford. In July our ten-year contract with Bradford Council comes to an end and we will transfer the responsibility for all education services back to the Council.

In Walsall we are continuing to see significant improvements at both Key Stage two and four. At Key Stage two, pupils are achieving above national averages in 'Level four and above' for English and Maths, and at Key Stage four, improvements in the most important measure of five good GCSEs including English and Maths continue to outpace national improvements by some margin.



We are a leading provider to Europe's space and technology agencies.



Norfolk and Norwich University Hospital extended our integrated support services contract for a further five years.



# Bringing service to life...

## ...in US defence

**When the US Navy becomes involved in conflict or provides humanitarian aid, they send temporary hospitals to wherever they are needed.** Our logistics team, based in Williamsburg, Virginia, works with the US Navy Expeditionary Medical Support Command to make this happen.

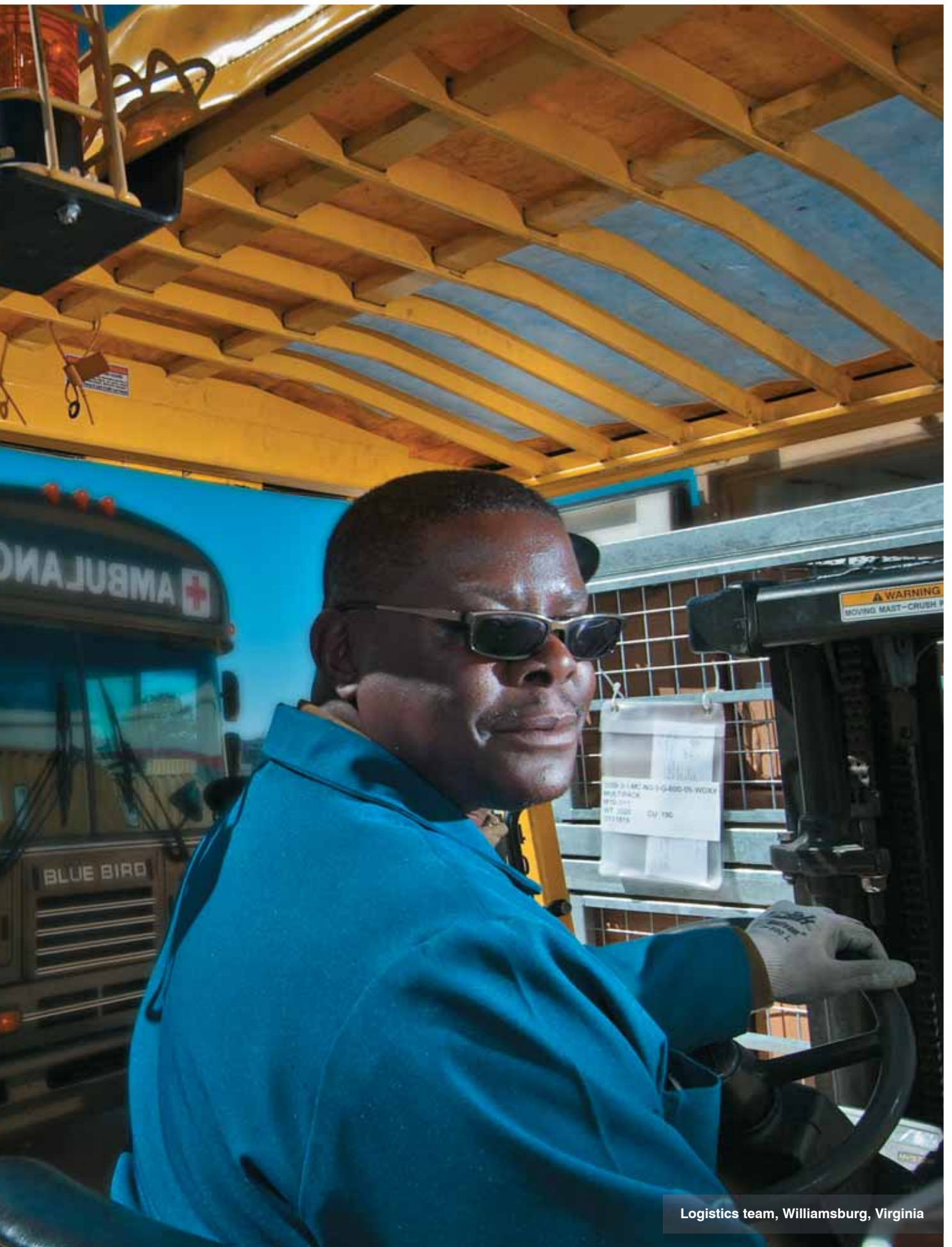
Having a clean, modern hospital for Navy doctors to work in means that lives are saved and communities have somewhere to go for their urgent medical needs. These hospitals might be meeting military requirements in isolated areas of Afghanistan or responding to humanitarian crises in the aftermath of natural disasters. Because they have to be prepared for many different situations, the equipment our team organises includes everything from ambulances and generators to scalpels and CT-scanners.

As well as an eye for detail, the ability to respond quickly is vital. Just days after the earthquake struck Haiti, our team had assembled 16,000 items of supplies, to set up a 150-bed hospital.

We also maintain and repair the high-tech equipment used to give more complex medical attention. Items like life-support machines, laboratory equipment and refrigerators for blood all need looking after as they leave one field hospital, pass back through our warehouses and then go on to their next destination.

Less than a year after our contract began we have been given a Bravo Zulu award by our customer's Commanding Officer. Bravo Zulu refers to the signal flags of the letters B and Z. When flown together from a Navy ship's mast, they traditionally mean 'well done'.





Logistics team, Williamsburg, Virginia

**We are a leading provider of professional, technology and management services focused on the US federal government. We provide mission-critical services to every branch of the US military, key federal civilian agencies and the intelligence community. We are ranked in the top 30 US federal government contractors.**



Our logistics team in Williamsburg, Virginia, equips temporary hospitals for the US Navy.



We help the US military with its critical communications.



We support the US Navy's procurement, handling and disposal of hazardous materials.

We apply our award-winning enterprise architecture to define, design and satisfy defense agencies' Command, Control, Communications, Computer and Intelligence requirements. We provide communication system installations for the US Navy's fleet and are one of the largest systems contractors for the US Air Force Space Command, supporting a wide range of military satellite systems.

Our support for wounded soldiers ensures they have the medical attention, benefits and services they need. We help soldiers transition to civilian life and provide personnel and family services to two million soldiers and their families. We designed software and provide systems, data centers and call centers to support four million government employees with their retirement plans. We issue more than 1.2 million identification cards to defense personnel.

We process over 20 million visa transactions each year for the Department of State and manage more than 62 million active records and handle applications received by the Department of Homeland Security US Citizenship and Immigration Services. We have installed detection systems in over 100 locations in 30 countries, to help prevent a nuclear threat from entering the US.

Our work includes overseeing the pre-classification of all US patents. We also provide web-based support for USA.gov and other e-government initiatives.

We manage 65 Federal Aviation Administration control towers and have received five safety and excellence awards. Our transportation business includes a contract with the Georgia Department of Transportation to manage, install and maintain its intelligent transportation system.

### 2010 Performance

Revenue grew 9.3%, (8% excluding currency effects) to £953.9m (2009: £872.6m). This represented 22% of Group revenue both in 2010 and 2009. Growth in the second half of the year was very strong following lower growth in the first half, largely reflecting a particularly strong prior period. This strong organic growth arose from new task orders in both federal defence and civilian contracts, including program management work for an intelligence agency and the Canadian Driver Examination Services, as it recovered the backlog following strike action. We also benefited in the second half from 109 task orders valued at US\$80m under the Government-wide single-award IDIQ for Command, Control, Computer, Communications, Intelligence, Information Technology, Surveillance and Reconnaissance (C4I2TSR).

A key focus during the year was to increase collaboration between our business units and leverage our wide range of capabilities across our customer base. Several of our business units came together to win new work with the Department of Veterans Affairs, valued at approximately US\$20m over its first one-year base period with additional funding expected for the four option years. We will provide programme management; a knowledge management-based web portal with job hiring tools, e-Learning elements and simulations, videos and chat rooms; mobile web technologies; a call centre; and career coaching.

Other examples of integrated working include expanding the use of our 'Command, Control, Communications and Computer' skills across all branches of the military, the Department of Homeland Security and the intelligence community. We are also using our enterprise architecture capabilities to support more Department of Defense agencies and commands, exploring opportunities to use our economic cost analysis expertise with the US Air Force and the intelligence community, and looking to expand our logistics support to additional military customers.

Many government agencies use IDIQ contract vehicles, where we are one of a number of companies able to bid for task orders. To leverage our position fully, we have increased resources to respond to key opportunities under these vehicles, which include Alliant, HRsolutions, Seaport-e, Office of Personnel Management's Training and Management Assistance Program and several General Services Administration



department schedules, including facilities management and IT. We have also strengthened our business development team, reflecting our greater concentration on larger prime contracts.

Other awards included the renewal of a single award IDIQ (where there are no other awardees) contract with the US Navy's Commander, Fleet and Industrial Supply Centers to support the procurement, management, issuance and disposal of hazardous materials (HAZMAT). The contract has a six-month base period with three one-year option periods and is valued at approximately US\$84m, including the options. We also received a new single award IDIQ contract to perform HAZMAT management services and provide consolidated HAZMAT reutilisation and inventory management to the US Navy's Fleet and Industrial Supply Center Norfolk. The contract has a one-year base period with four one-year option periods and is valued at approximately US\$88m, if all option years are exercised.

The Naval Operational Logistics Support Center awarded us a new single-award IDIQ contract to provide program management and technical services. The contract has a one-year base period and four one-year options, with a ceiling value of US\$44m if all option years are exercised.

We strengthened our position on major US Government programs through an award by the US Army of an IDIQ contract to compete for task orders supporting the Assistant Secretary of the Army Manpower and Reserve Affairs. We are among 12 awardees on this US\$1.3bn contract, allowing us to compete for work in areas such as business planning and research and evaluation. The contract has a five-year term, comprising a one-year base period and four one-year option periods.

Within the civilian arena we were awarded a contract to provide air traffic control services to the Federal Aviation Administration Contract Tower Program, valued at approximately US\$170m over five years. We are also contracted to provide comprehensive management, installation and maintenance of the Georgia Department of Transportation's intelligent transportation system, valued at approximately US\$50m over five years.



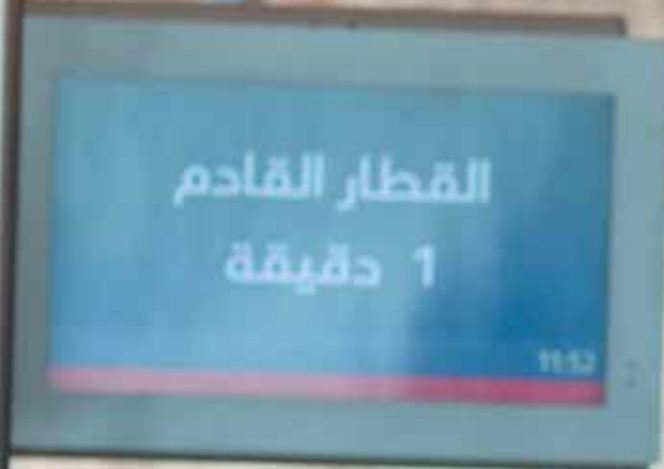
We provide air traffic control services at 65 towers for the Federal Aviation Administration.

We were pleased to receive the 2010 Defense Enterprise Architecture Achievement Award, for supporting the Air Force Space Command's Joint Space Operations Center Mission System programme. We also won the 'None in a Million' Federal Aviation Administration award for achieving – for the second time – one million error-free operations at Goodyear, Arizona air traffic control, as well as the Bravo Zulu Award for exceptional work on behalf of the Navy Expeditionary Medical Support Command, for relief efforts in Haiti.



We run Georgia's intelligent transportation system.

# Bringing service to life...



The Dubai Metro, United Arab Emirates





## ...in metro services

The Serco-run Dubai Metro launched in September 2009 and has grown rapidly. During 2010, it carried 38.8 million passengers and expanded from 10 stations to 26. Despite this level of change, the Metro's performance has been exceptional for a new system. During 2010, we achieved availability and punctuality of 99.6% and 97.9% respectively, and in December, 100% of trains hit their punctuality targets.

Managing growth while delivering to the highest standards requires the right processes and procedures, and a partnership approach to working with our customer and contractors. Ultimately, though, it is our culture and our people's desire to improve that make the difference.

Our internal performance 'attribution' process is an important tool here. We investigate every train delay so we know what caused it and why. We then develop actions and plans to prevent a recurrence or reduce its impact. We repeat this process every day.

Some issues may be escalated to our management forum and become part of broader initiatives, such as our 'zero delay days'. These campaigns select one issue, such as delays caused by platform screen doors, and aim to have one day where none occurs. We then measure our performance and feed back to our people, so they understand that what they do has a positive impact.

We also embrace other sources of feedback. The Metro is subject to a number of surveys including the Government's Dubai Excellence programme, which focuses on world-class customer service. We also ask our customer – the Dubai Roads and Transport Authority – for its views on how we are doing. This is essential for us to improve our performance further.

Carefully managing network projects and the system's growth is vital, with a further 19 stations due in 2011. Our project team treats our operational team as its customer, so that everyone focuses on maintaining our service standards as new stations open.

### AMEAA includes our businesses in Africa, the Middle East, Asia and Australasia.

In Australia, New Zealand and Hong Kong, we have contracts in defence, offender management, immigration, transport, health, infrastructure services and consulting. Our two defence joint ventures make us a key partner of the Australia Defence Force. We have the only contract in New Zealand for a privately operated prison and our two Australian prisons have received numerous awards and positive independent inspections. In 2010 we successfully transitioned additional immigration sites, with an increase from five to 23. We own and operate Great Southern Rail in Australia and we are the largest tunnel operator in Hong Kong. In 2011, we will enter the Australian health market through a contract at Fiona Stanley Hospital.

The Middle East is home to some of Serco's oldest contracts in aviation, which continue to expand as the region's air traffic grows. We are the largest international player in surface transport in the region. Most notably, we operate the Dubai Metro, the world's largest and most-advanced driverless light rail system and the first of its kind in the Gulf and Middle East. Our Technology business serves the telecommunications, marine and biomedical sectors. We have also expanded our facilities management (FM) business, recently winning a contract to provide integrated FM services at the New York University in Abu Dhabi.

India is the second fastest growing economy in the world and presents opportunities for Serco. Our BPO operation delivers value-driven products in the banking, insurance, telecom and retail sectors. We also see demand for new services in India, particularly in transport and healthcare as we leverage our global experience to build local capability for these markets.

### 2010 Performance

Revenue grew 41.2% to £481.2m (2009: £340.7m) and represented 11% of Group revenue, up from 9% in 2009. Excluding the impact of currency, particularly given the strong Australian dollar, growth was 26%.

This high revenue growth reflects the contracts that became operational during late 2009 and early 2010, in our markets in Australia, the Middle East and India.

In home affairs in Australia, we continue to work with the Australian Department of Immigration and Citizenship to transform its immigration services, while expanding capacity to support the increasing number of people in our care. Serco has been recognised for the transformation we have achieved, our humane approach, the constructive mood in the centres and the positive relationship between our employees and the people in our care.

In defence, our 50:50 joint venture with P&O Maritime Services renewed its contract, valued at A\$250m to us, to provide harbour and offshore services to the Royal Australian Navy for ten years.

We expanded into a new market when we were appointed preferred bidder for a substantial ten-year contract at Fiona Stanley Hospital in Perth. When it opens in 2014, the 783-bed hospital will be a major tertiary hospital for the area. We will provide all non-clinical services, including managed equipment services, transport, procurement, sterilisation and clerical services, drawing on our extensive experience of hospital support contracts in the UK.



We expanded our air traffic control and airside engineering services in Dubai.



Our joint venture with P&O Maritime Services renewed its contract with the Royal Australian Navy.



In India, our BPO operation is developing products for banking, insurance, telecom and retail customers.





Great Southern Rail runs The Ghan, Australia's iconic transcontinental railway

We were delighted to win the Operator and Service Provider Excellence Award at the prestigious National Infrastructure Awards. The award recognises our high standards at Acacia, Western Australia's only privately-operated prison. Borallon Correctional Centre was awarded two Minister's Awards for Excellence for its innovative recycling project and health initiatives.

In December, we entered another new market when we were appointed preferred bidder to manage the Mt Eden and Auckland Central Remand Prison in New Zealand. The contract, signed in February 2011 to commence in August 2011, includes rehabilitation and reintegration programmes for prisoners, as well as logistics and infrastructure management. The six-year contract has an option for a further four years, and is valued at around NZ\$300m over the full ten years.

In the Middle East, the Dubai Metro has continued to achieve high levels of service, with availability and punctuality at 99.6% and 97.9% respectively for the year. 38.8 million passengers used the Metro during 2010 and a further 16 stations opened, bringing the total to 26. We also expanded our presence in Dubai through a five-year, £15m contract to operate and maintain the 5.4km Palm Jumeirah Monorail.

We were delighted to play our part in the opening of Dubai's second airport, Dubai World Central – Al Maktoum International, where we provide air traffic control and airside engineering services. This is an addition, valued at around £3.5m per annum, to our existing contract with Dubai Airports Company, which dates back to the 1960s, with a value of approximately £250m.

Elsewhere in the Middle East, we won a one-year, £10.5m contract to deliver operations and maintenance consultancy services to the Al Mashaaer Al Mugaddassah Metro Southern Line in Makkah, Kingdom of Saudi Arabia.

India continues to present excellent opportunities for the future. Our BPO operation is developing value-driving products for banking, insurance, telecom and retail customers.



The Dubai Metro delivered exceptional service levels in 2010.



We focus on the dignity, respect and well-being of everyone we care for in 23 Australian immigration centres.

# Bringing service to life...

# ...in immigration management

Controlling borders is a key task for governments. In Australia, we support the Department of Immigration and Citizenship through our contract to manage immigration centres throughout the country.

Unrest in countries such as Afghanistan, Iran and Sri Lanka has seen the number of people in our care surge to unprecedented levels. At the end of 2010, there were around 6,500 people in detention, more than four times the number when we began the contract. The five facilities we ran have expanded to 23.

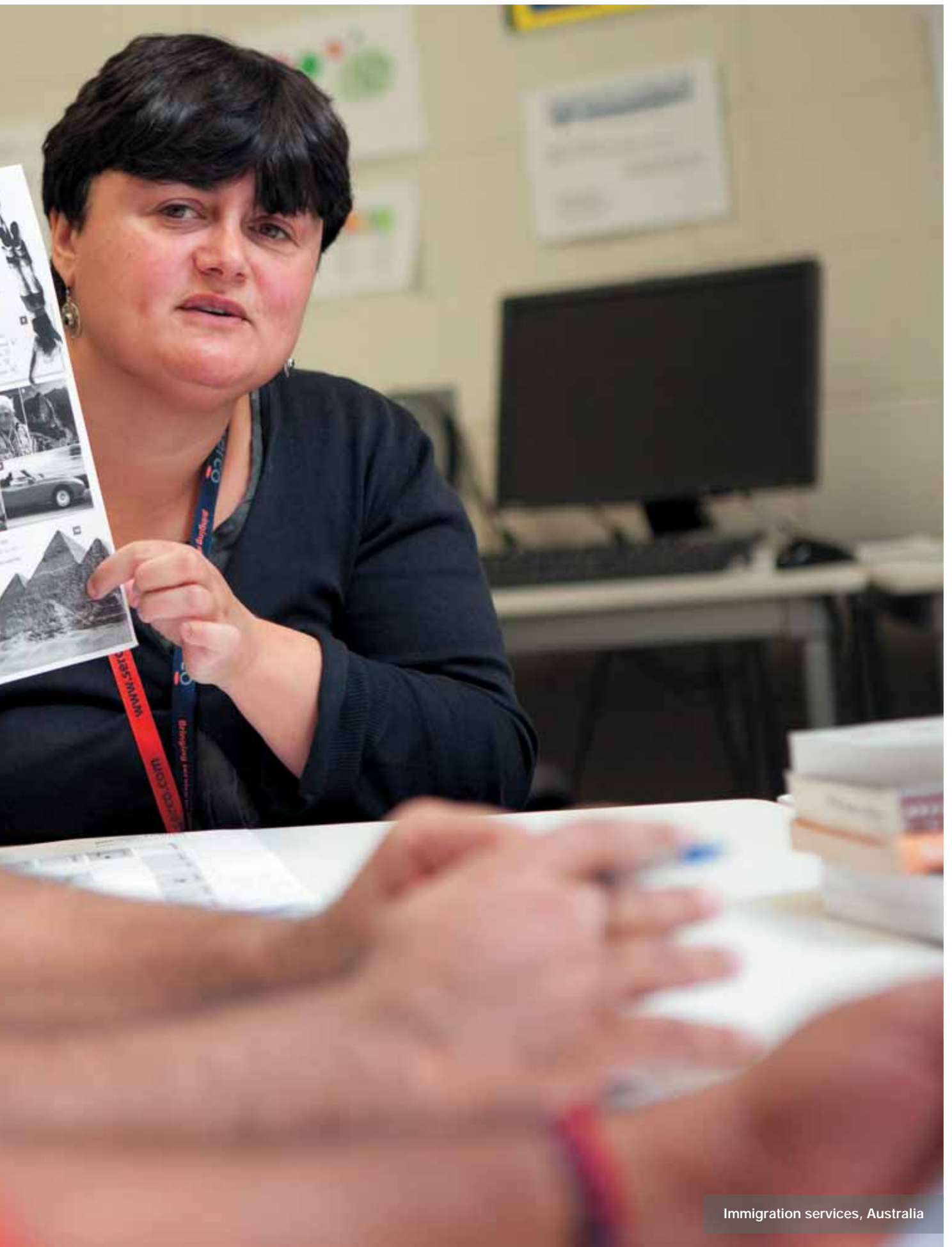
Coping with this increase in demand for our services has required flexibility, innovation and plenty of hard work. We created a commissioning team, so we could react quickly when new facilities were opened, and called on the support of our Civil Government colleagues in the UK. This allowed our contract management team to concentrate on the smooth operation of all the centres.

The number of people we employ has also risen sharply, requiring us to spend more than A\$1m on training. We have lived up to our commitment to employ local people, including more Indigenous Australians.

Working in the right way has always been a fundamental part of what we do, so we ensured that we did not compromise on our decency agenda – focusing on the dignity, respect and well-being of the people in our care. For example, every client is allocated a client support officer to look after their needs while they stay with us. We also provide activities such as English lessons, sport, art and living skills classes. Serco exceeds the contract's requirements for providing these activities and programmes.

We have received recognition from visitors for the transformation we have achieved, along with our humane approach, the constructive mood and the positive relationship between our employees and the people in our care.





Immigration services, Australia

## Finance Review



### Overview

Our business delivered a strong financial performance in 2010, with revenue growing 9.0% and adjusted operating profit increasing by 12.6%. Our adjusted operating margin increased by 19 basis points. Adjusted EPS grew by 17.5% to 34.69p. Free cash flow grew by 35.3% to £185.8m, and Group recourse net debt reduced by £84.1m to £303.6m.

### 1. Income statement

Serco's income statement for the year is summarised in Figure 1 below. This includes the results of joint ventures which are proportionately consolidated.

Figure 1: Income statement

Year ended 31 December	2010 £m	2009 £m	Increase
Revenue	4,326.7	3,970.0	9.0%
Gross profit	644.3	586.8	9.8%
Administrative expenses	(385.6)	(357.1)	8.0%
Adjusted operating profit	258.7	229.7	12.6%
Investment revenue and finance costs	(27.4)	(35.0)	
Adjusted profit before tax	231.3	194.7	18.8%
Amortisation of acquired intangibles	(17.4)	(17.6)	
Profit before tax	213.9	177.1	20.8%
Tax	(57.1)	(46.9)	21.7%
Profit for the year	156.8	130.2	20.4%
Effective tax rate	26.7%	26.5%	
Adjusted earnings per share	34.69p	29.53p	17.5%
Earnings per share	31.88p	26.76p	19.1%
Dividend per share	7.35p	6.25p	17.6%

### **1.1 Revenue**

Revenue grew by 9.0% to £4,326.7m (7.6% excluding currency effects). Organic revenue growth, excluding currency effects, was 7.6% and reflects the growth of existing contracts and the contribution of new contracts started in 2009 and 2010.

### **1.2 Adjusted operating profit**

Adjusted operating profit increased by 12.6% to £258.7m representing an adjusted operating profit margin of 6.0%. Adjusted operating profit margin increased by 19 basis points (16 basis points excluding currency effects).

### **1.3 Investment revenue and finance costs**

Investment revenue and finance costs totalled a net cost of £27.4m (2009: £35.0m), a decrease of £7.6m. The decrease excluding currency effects was £7.4m. The principal reasons for this decrease were reduced average borrowings during the year, lower interest rates and a decrease in the net pension finance cost.

### **1.4 Adjusted profit before tax**

Adjusted profit before tax was £231.3m, an increase of 18.8%. Excluding currency effects the adjusted profit before tax margin was 5.3%, an increase of 40 basis points.

### **1.5 Tax**

The tax charge of £57.1m (2009: £46.9m) represents an effective rate of 26.7%, compared with 26.5% in 2009. The slight increase in the rate is principally due to changes in the mix of taxable profits across the Group.

### **1.6 Earnings per share (EPS)**

Adjusted EPS rose by 17.5% to 34.69p. EPS grew by 19.1% to 31.88p. EPS and adjusted EPS are calculated on an average share base of 491.5m during the year (2009: 486.6m). The increase in the average share base principally resulted from a full weighting of shares issued during 2009.

## Finance Review

**2. Dividend**

Serco's policy is to increase the total dividend each year broadly in line with the increase in underlying earnings. The Board has proposed a final dividend of 5.15p per share, representing an increase on the 2009 final dividend of 17.0%, and bringing the total dividend for the year to 7.35p, a growth of 17.6%. The final dividend will be paid, subject to shareholder approval, on 17 May 2011 to shareholders on the register as at 11 March 2011.

**3. Cash flow**

The Group generated an exceptionally strong free cash performance with an inflow of £185.8m (2009: £137.3m), an increase of 35.3%. This included benefits of around £20m from asset sales proceeds, a particularly high level of joint venture dividends and low tax payments.

Figure 2 analyses the cash flow. As in previous years, we have designed the analysis to show the underlying cash performance of the Group – the cash flows generated by subsidiaries plus the dividends received from joint ventures. It therefore differs from the consolidated cash flow on page 108, which proportionately consolidates the cash flows of joint ventures. The adjustment line in Figure 2 reconciles the movement in Group cash to the consolidated cash flow.

*Figure 2: Cash flow*

Year ended 31 December	2010 £m	2009 £m
Operating profit excluding joint ventures	176.7	150.6
Non cash items	79.2	75.4
Group EBITDA	255.9	226.0
Working capital movement	(30.6)	(27.2)
Group operating cash flow	225.3	198.8
Interest	(25.2)	(31.5)
Tax	(24.0)	(26.5)
Net expenditure on tangible and intangible assets	(41.8)	(49.8)
Dividends from joint ventures	51.5	46.3
<b>Group free cash flow</b>	<b>185.8</b>	<b>137.3</b>
Disposal of investments/subsidiaries	–	0.6
Acquisition of subsidiaries	(2.3)	(15.4)
Financing	(188.1)	(36.8)
Special pension contribution	(20.0)	–
Dividends paid	(32.3)	(25.9)
Group net (decrease)/increase in cash and cash equivalents	(56.9)	59.8
Adjustment to include joint venture cash impacts	8.7	14.1
Net (decrease)/increase in cash and cash equivalents	(48.2)	73.9

Note: Group EBITDA is earnings from subsidiaries (excluding joint ventures) before interest, tax, depreciation, intangible amortisation and other non cash items.



### **3.1 Group operating cash flow**

Group operating cash flow of £225.3m (2009: £198.8m) reflects a conversion of Group EBITDA into cash of 88.0% (2009: 88.0%). The working capital movement of £30.6m reflects the requirements of a growing business.

### **3.2 Interest**

Net interest paid was £25.2m, compared to £31.5m in 2009 reflecting the reduction in Group recourse net debt since 2009 and lower interest rates.

### **3.3 Tax**

Tax paid was £24.0m (2009: £26.5m). The reduction in tax paid during 2010 is due to increases in accelerated capital allowances and other timing differences in the period, additional tax relief on the December 2010 special pension contribution and tax refunds received during the year. In 2011, we expect the cash tax rate to trend closer to our effective tax rate. This is principally as a result of a higher proportion of overseas taxable profits which more than offsets the benefit of the tax relief on the special pension contribution.

### **3.4 Net expenditure on tangible and intangible assets**

Net expenditure on tangible and intangible assets in the year was £41.8m (2009: £49.8m). Gross expenditure, excluding disposals, was £51.1m (2009: £52.3m) representing 1.4% of Group revenue excluding joint ventures (2009: 1.6%).

On 30 June 2010, as part of forming a strategic partnership with Patni Computer Systems Ltd. (Patni), a leading global provider of Information Technology services and business solutions, to provide services in education and e-learning in the UK and Irish markets, we disposed of a Learning software product to Patni. Cash realised from the sale was £7.0m and profit on disposal of this asset was £1.4m.

In 2011, we are planning to invest around £20m in the implementation of SAP for HR across the Group.

### **3.5 Dividends from joint ventures**

Dividends received from joint ventures totalled £51.5m (2009: £46.3m), reflecting an uncharacteristically high conversion rate of joint ventures' profit after tax and non controlling interests into dividends. This high rate reflected the impairment charge of £4.2m resulting from our exit from the non-core South African joint venture Equity Aviation. Excluding this, the conversion rate of dividends from joint ventures was approximately 95%. In 2011, we expect the conversion rate to be closer to the normal rate of 80-90%.

### **3.6 Financing**

The movement in financing resulted primarily from repayments on our bank facilities and non recourse debt.

#### 4. Net debt

Figure 3 analyses Serco's net debt.

*Figure 3: Net debt*

At 31 December	2010 £m	2009 £m
Group – cash and cash equivalents	204.0	253.7
Group – loans	(482.6)	(619.1)
Group – obligations under finance leases	(25.0)	(22.3)
<b>Group recourse net debt</b>	<b>(303.6)</b>	<b>(387.7)</b>
Joint venture recourse net cash	66.1	58.2
<b>Total recourse net debt</b>	<b>(237.5)</b>	<b>(329.5)</b>
Group non recourse debt	(23.7)	(29.0)
<b>Total net debt</b>	<b>(261.2)</b>	<b>(358.5)</b>

##### 4.1 Group recourse net debt

Group recourse net debt decreased by £84.1m to £303.6m.

Cash and cash equivalents includes encumbered cash of £10.9m (2009: £11.2m). This is cash securing credit obligations and customer advance payments.

##### 4.2 Group non recourse debt

The Group's debt is non recourse if no Group company other than the relevant borrower has an obligation to repay the debt under a guarantee or other arrangement. The debt is excluded from all of our credit agreements and other covenant calculations, and therefore has no impact on the Group's ability to borrow.

Group non recourse debt reduced by £5.3m to £23.7m, as a result of £7.6m payments made in line with the debt repayment schedule on debt relating to our Driver Examination Services contract in Canada, offset by £2.3m increase in non recourse debt due to exchange movements.

## 5. Pensions

The Group operates a number of defined benefit schemes and defined contribution schemes.

At 31 December 2010, the net liability included in the balance sheet arising from our defined benefit pension scheme obligations was £83.0m (2009: £113.6m), on a pension scheme asset base of £1.5bn.

*Figure 4: Defined benefit pension schemes*

At 31 December	2010 £m	2009 £m
Group schemes – non contract specific	(76.1)	(120.0)
Contract specific schemes:		
– reimbursable	(123.4)	(144.3)
– not certain to be reimbursable	(26.7)	(29.9)
Net retirement benefit liability	(226.2)	(294.2)
Intangible assets arising from rights to operate franchises and contracts	8.9	11.4
Reimbursable rights debtor	123.4	144.3
Deferred tax assets	10.9	24.9
Net balance sheet liabilities	(83.0)	(113.6)

The total pension charge included in operating profit for the year ended 31 December 2010, including the proportionate share of joint ventures, increased to £106.5m (2009: £92.4m). Within this charge, the Group's contributions to UK and other defined contribution pension schemes increased to £76.0m (2009: £64.8m). The service charge relating to the Group's defined benefit schemes was £30.5m (2009: £27.6m), and the movement was principally as a result of changes to the discount rate and inflation assumptions as at the end of 2009 and increases in payroll.

Serco has three main types of scheme which are accounted for as defined benefit pension schemes. Each type has its own accounting treatment under International Financial Reporting Standards. These are:

- Non contract specific – schemes which do not relate to specific contracts or franchises. For these schemes, we charge the actuarial gain or loss for the year to the consolidated statement of comprehensive income (the SOCI);
- Reimbursable – schemes where we have a right of full cost reimbursement and therefore include both the pension scheme deficit and offsetting reimbursable rights debtor in the balance sheet; and
- Not certain to be reimbursable – schemes relating to specific contracts or franchises, where the deficit will pass back to the customer or on to the next contractor at the end of the contract. For these schemes, we charge the actuarial gain or loss on our share of the deficit for the year to the SOCI, recognise a recoverable intangible asset on the balance sheet at the start of the contract or franchise and amortise the intangible asset to the income statement over the contract or franchise life.

## Finance Review

Serco has limited commercial risk in relation to the contract specific schemes, due to either the right of cost reimbursement or because the deficit will, in general, pass back to the customer or on to the next contractor at the end of the contract. Among our non contract specific schemes, the largest is the Serco Pension and Life Assurance Scheme (SPLAS). At 31 December 2010, SPLAS had a deficit of £16.4m (2009: deficit of £54.7m). This deficit, which is calculated under IAS 19 using market rates at the period end, reflects the effect of the market conditions on investment returns in the year and the net impact of a decrease in inflation assumptions offset by a decrease in the applicable discount rate.

We have now completed the regular triennial review of SPLAS. The actuarial deficit of SPLAS used in the review and calculated using prudent long-term valuation assumptions, was £141m at 6 April 2009 and was approximately £93m at 31 December 2010. Following this review, the Group agreed with the Trustees to make a cash contribution of £60m to the scheme, with £20m paid in December 2010 and £40m in January 2011. We continue to review the level of benefits and contributions under the scheme in the light of our business needs and changes to pension legislation.

Figure 5 shows the sensitivity of the liabilities of our pension schemes to changes in discount rates and to adjustments in the actuarial assumptions for the rate of inflation, members' salary increases and life expectancies.

*Figure 5: Pension assumption sensitivities*

	Assumption	Change in assumption	Change in liability
Discount rate	5.4%	+ 0.5% – 0.5%	– 9% + 10%
Price inflation	3.1% (RPI) and 2.6% (CPI)	+ 0.5% – 0.5%	+ 8% – 7%
Salary	3.5%	+ 0.5% – 0.5%	+ 2% – 2%
Longevity	20.8 – 24.5*	Increase by one year	+ 3%

\* Post retirement mortality range for male and female, current and future pensioners.



## 6. Treasury

The Group's bank credit facilities comprise a £400.0m syndicated revolving credit facility, a syndicated amortising term loan for US Dollar 396.4m and bilateral revolving credit facilities for £35.0m and EUR 12.5m. The syndicated revolving credit facility matures in September 2013 whilst the syndicated term loan is repayable between September 2011 and September 2013. The bilateral facilities mature in December 2011 and April 2012 respectively. In relation to the syndicated term loan, the next scheduled repayment of US Dollar 138m is due in September 2011. As at 31 December 2010, £329.8m had been drawn down on these combined facilities (2009: £457.7m). Excluding the effects of currency on the US Dollar denominated debt, the equivalent draw down would have been £320m.

In addition to the bank credit facilities, Serco has loan notes in issue under a private placement of £117.7m, which will be repaid evenly from 2011 to 2015. All of the credit facilities of the Group detailed above are unsecured.

## 7. Going concern

The directors have acknowledged the guidance 'Going Concern and Liquidity Risk: Guidance for Directors of UK Companies 2009', published by the Financial Reporting Council in October 2009. Whilst the current economic environment remains uncertain, the broad base of our contract portfolio and with over 90% of our customers being government bodies, the Group is well placed to manage its business risks (as discussed in the section 'Principal Risks and Uncertainties') successfully and has adequate resources to continue in operational existence for the foreseeable future.

The Group's revenues are largely derived from long-term contracts with governments which, historically, have been largely unaffected by changes in the general economy. The contract portfolio is spread across a number of markets, sectors and geographies such that a downturn in any one segment is unlikely to affect the Group as a whole. In addition, with an order book of £16.6bn and high visibility of future revenue streams (92% in 2011; 77% in 2012 and 66% in 2013), the Group is well placed to manage its business risks despite the current uncertain economic climate.

In September 2008, the Group secured medium-term financing by entering into a five year syndicated revolving credit facility and bilateral facilities. Including the term loan and US private placements, the Group has in excess of £816m of committed credit facilities. As at 31 December 2010, the headroom on the facilities was approximately £369m. The next repayment on these facilities falls due in September 2011 for an amount of US Dollar 138m. The Group fully expects to meet this repayment through internally generated cash flows. Based on the information set out above, the Directors believe that it is appropriate to prepare the financial statements on a going concern basis.

**Andrew Jenner**  
Finance Director

## People

**Serco's rapid growth means that we have a continually increasing number of employees around the world. We have therefore created a clear framework for managing and developing our people, so that we can help them be as good as they can be and deliver great service to our customers.**

Our people strategy has three main components. We want to:

- develop leaders who are fit for the future and who will thrive as Serco grows
- have people who bring service to life, who are fully integrated and engaged with Serco, and who we can develop to achieve their full potential, and
- make it easier to manage our people, by continually enhancing our systems and processes.

#### Developing our leaders

As a devolved and fast-growing organisation, Serco has a high demand for capable and motivated leaders who have the potential to grow with us. They are responsible for managing operations, securing our growth and creating the environment in which our people can do what they do best: serve customers with passion and skill. The way they lead is as important as what they deliver.

We have created a leadership model known as H<sup>3</sup> – Heart, Head and Hands. These components describe how great leaders in Serco behave, with an emphasis on our Governing Principles and our customers. The components of the model are summarised below:

**Heart.** This covers our leaders' motives and demonstration of our Governing Principles. We want them to create our culture through personal example and have the courage to stand by their convictions.

**Head.** This relates to intellectual and personal capacity. We want leaders who can solve complex problems, take a long-term view, inspire and influence others, focus on outcomes, innovate, be resilient and be adaptable to a situation's needs.

**Hands.** This covers skills, knowledge and experience. We want our leaders to be skilled at shaping and delivering the plans and capabilities that will drive our performance and growth.

Behind each of these components is a further set of criteria, which explain the desired behaviours and the standards against which we appraise our leaders' performance.

During 2010, we extended the H<sup>3</sup> model to managers beyond our leadership group. We also completed our global talent review, which we began in 2009. This involved every business unit around the world identifying its current and future leaders, enabling us to create comprehensive succession plans and talent pipelines to support our growth. As part of this, we have built a customised talent database and established cross-divisional talent pools in our corporate functions. For example, we have a global talent pool in finance and a UK-wide pool in business development.

2010 also saw us introduce or expand a range of other initiatives to help our leaders develop. For example, we rolled out the Management Foundations programme, developed by our Civil Government business, to other parts of our business, initially the UK divisions and corporate functions. Management Foundations will be accredited by the Chartered Management Institute and helps our people to be values-led managers.

We also introduced a broad range of toolkits for talent and performance management, which are available through the online Serco Business Academy. The Business Academy aims to make learning accessible to all of our people.





### **Integrating, engaging and developing our people**

We are dependent on the skill and enthusiasm of our people. They enable us to deliver great service to our customers and are ultimately responsible for the strength of our reputation and our ability to grow. We therefore need to integrate new joiners, effectively engage with all our people and help them achieve their potential. We also recognise outstanding achievements through our global Pulse Awards.

#### **Integrating new people**

Serco's growth means that several thousand people join us every year. We typically find that they bring with them a service ethos that matches our own, given that a large proportion of our employees also began their careers delivering services in the public sector. Our approach to managing contracts liberates our people to put this ethos into action.

The best method of spreading our values is for our people to see them in action. Our leaders have a key role to play, by making decisions in accordance with our values. We also prioritise communication with our people, particularly in the transition phase after we have won a contract, so that they understand Serco and the way we work.

Our approach – and the outcome – is the same around the world. While there are always cultural differences between countries, our values are universal and our people embrace them wherever they are based.

To help new joiners become part of Serco, we have developed the Welcome Experience. This is a range of materials and events which ensure that joining Serco is welcoming and engaging, and is in addition to any induction at a local level.



# People

The new materials we have created include:

- Discover Serco Passports, which help guide and direct new people. We have one for leaders and another for managers, with a third version being developed for all employees
- the People Pack, which helps new leaders understand the importance of their role and the tools available to enable them to be a great leader
- Discover Serco e-learning, which is available for any new employee through the Serco Business Academy, and
- Discover Serco contract visits.

## Engaging with our people

We once again undertook our annual global employee survey, called Viewpoint. This gives us important insights into how we can run Serco better, particularly at a local level, resulting in greater engagement with our people and enhanced service for customers. We were pleased that the response rate to the survey rose and are working to drive actions that arise from the feedback we receive.

We introduced a number of innovations in 2010 to improve engagement with existing and potential new employees, such as:

- our US Serco Scholars program, which provides educational grants to the children of employees
- payroll giving in North America and India
- the UK Bike4work scheme, to encourage people to use environmentally friendly forms of transport when travelling to and from work, as well as getting fitter, and
- enhancing the recruitment section of our website, both to raise the calibre of recruits and to improve the visitor experience.

We continued our relationship with David MacLeod and Nita Clarke, following the 2009 launch of their review Engaging for Success, which examined employee engagement and how to enable it. Our Civil Government division has also carried out research on establishing links between employee engagement and business performance.

## Developing our people

Enabling our people to excel is one of our Governing Principles, meaning their development is key. That development ranges from informal on-the-job training through to specialist and technical training. Increasingly we are moving to a “blended learning” approach, with an appropriate balance of face-to-face and web-based learning.

During the year, we enhanced our performance management process, creating new toolkits for managers and leaders to enable them to become even better at setting objectives, creating development plans and reviewing performance. This will allow us to set individual objectives for our people and to manage them in line with those objectives. We have also developed a performance calibration process, enabling us to identify high achievers and those who need help to improve their performance.

## Recognising achievement

Our Pulse Awards are designed to celebrate the very best qualities and achievements of Serco people, our customers and partners. The awards are closely linked to our Governing Principles. They recognise people who excel at innovation, inspire through their leadership, demonstrate outstanding commitment and make an exceptional impact on communities, the environment or in areas such as safety and ethics. In 2010, we recognised 152 individuals and teams with an award.

## Managing our people

We continually look to improve our efficiency, including the ways we manage our people. Our aim is to have intuitive, easy to use tools, processes and systems which make it easier to manage our growing workforce and deliver even higher levels of productivity and service as a result.

We are therefore developing a new platform, called ‘Empower – Transforming People Management’, which will transform how we manage people across our business. This is our first ever global change programme and builds on a successful pilot we undertook in our Dubai Metro contract. The programme commenced in January 2011 and will complete in 2012.





## Objectives and performance

2010 Objective	Result	Comment
To develop leaders who are fit for the future	Ongoing	We profiled 200 of our most senior leaders. Career and development planning is under way and will be incorporated into the 2011 objective setting and appraisal process. This process has been extended to our emerging leaders. We undertook succession planning across the whole business and our divisions have focused on developing their talent pipeline.
To engage and motivate employees to bring service to life	Ongoing	An online module called 'Discover Serco' was launched company-wide during 2010. We have also developed an online induction toolkit which launched on our internet in January 2011. The company-wide Viewpoint Survey was conducted again in 2010 and 78% of employees responded, an increase of 2 percentage points over 2009. Work has progressed to link engagement to performance and contributed to the UK Government-sponsored task force on employee engagement.
To make it easier to manage people	Ongoing	We invested in a new platform, as described in 'Managing our people' above

The new platform will give us a standard approach to managing people, with a common set of processes for each part of the employee lifecycle. This is supported by a suite of self-service online tools for both managers and employees, such as starters and leavers forms, annual leave requests and rostering tools for shift working, which will enable us to plan more efficiently and increase utilisation but also take into account each employee's preferences. The platform will also streamline and standardise our approach to recruitment and help us to manage absenteeism in a more consistent and effective way.

The outcome will be a simpler and more effective system, freeing up time for our managers to focus on delivering to customers. The platform will also support our growth, for example by enabling us to transition contracts more quickly and effectively.

### 2011 Objectives

- To make it easier to manage people. The focus will be to develop and implement the programme called 'Empower – Transforming People Management'.
- To develop leaders who are fit for the future. We will be looking to further embed the talent review and succession-planning process across a wider proportion of our management population.
- To engage and motivate employees to bring service to life. We will continue to research and analyse the link between engagement and performance.



## Corporate responsibility

**Achieving our vision to be the world's greatest service company requires us to work in the right way and to meet our responsibilities to our customers, the public, our employees, our partners and suppliers. As a result, corporate responsibility (CR) is part of who we are and how we behave.**

We divide our approach into four pillars – people, health and safety, community and the environment. Our work for our customers encompasses all of these areas, but there are many things we do which go beyond our contractual or legal requirements.

Our approach to managing our responsibilities is summarised below. We also publish a Corporate Responsibility Review each year, which gives more details of our activities and the way we embed CR in our business.

#### Our people

Pages 60 to 63 explain our people strategy, our 2010 initiatives to improve the ways in which we develop, engage, motivate and manage them, and our objectives for 2011.

#### Health and safety

Our aspiration is zero harm to our people and customers. This means we set high standards – often above our legal requirements – so that we do everything we can to prevent incidents.

Embedded in the Serco Management System, our framework for how we manage our business, are our health and safety policies and standards. We audit ourselves against these standards, building on good practice and addressing performance that falls short.

Some of the biggest challenges we face are routine risks to health and safety. Slips, trips and falls are the most common incidents and prevention requires diligence and dedication. This year saw a number of notable achievements.

The UK's National Physical Laboratory, for example, logged more than 1.6 million working hours without a reportable injury. Our contract at BlueScope Steel in Illawarra, Australia, reported 1.1 million such hours. In the Americas, our Lost Days Incident Rate has dropped 10% year-on-year, continuing our strong and improving safety record in the region.

Serious incidents are rare. When they do happen, we learn from them. In April 2010, Serco was found guilty of breaching the Health and Safety at Work etc Act 1974, for failing to ensure that automatic trains did not hit unauthorised persons on the tracks at the Docklands Light Railway in London. This finding followed the death of Robert Carter at All Saints Station in 2007. Immediately after the incident, we undertook thorough reviews of the circumstances and implemented new procedures so that this particular type of accident could be avoided in the future.

Looking forward, we will continue to strengthen our safety culture through leadership, oversight, stakeholder engagement and effective policies, systems and processes. To support the achievement of our safety targets, our priorities are:

- to reduce the amount of lost time due to incidents, through active rehabilitation
- offering a consistent level of occupational health support to all Serco employees
- monitoring KPIs for musculoskeletal, mental and behavioural and reportable diseases
- a continued focus on reducing reportable incidents
- developing systems and processes to manage and monitor near-misses
- embedding a single health, safety and environmental management system and standard operating procedures across all of our operations, and
- ensuring competency in health and safety management and consistent training standards.



Our contract at BlueScope Steel, Australia, logged 1.1 million working hours without a reportable injury.



Apprentices at our contract with the London Borough of Newham learn new skills which prepare them for the future.

## Objectives and performance

2010 Objective	Result	Comment
To continue focusing on reducing reportable incidents, (RIs) to achieve our target of a 30% reduction in our staff RI rate by the end of 2012 against the 2008 benchmark of 998. The target for 2010 was a 20% reduction to 799.	Target met	Our RI rate was 711 per 100,000 employees. This achieves our 2010 target and is only 1.2% short of our 2012 target. It also demonstrates good performance against external benchmarks. The UK's Labour Force Survey for all-industries benchmark is 820 per 100,000.
To reduce the amount of lost time as a result of incidents, through active rehabilitation. Our challenging target is for a 50% reduction by the end of 2012 against 2008 baseline (average 15 days).	Target off track	At an average of 18.6 days in 2010 we are not on track, having shown a year on year increase in lost time. This partly reflects an increase in higher-risk business operations. Significant management effort is being put in to redress this situation, with a focus on: early intervention to rehabilitate employees and help them back to work; more timely handling of long-term disability cases; and root-cause analysis.
To develop systems and processes to manage and monitor near-miss events more effectively. Our target is to establish a baseline for future improvements for 2012.	Target on plan	Work is ongoing to establish the systems and processes to deliver this.

### 2011 Objectives

- To continue focusing on reducing the amount of time lost as a result of incidents, to achieve our target. We aim to be back on trajectory to reach our target of a 50% reduction in lost time per incident (against the 2008 benchmark) by 2012.
- To continue focusing on reducing reportable incidents. Based on current performance, we have revised our target to 599 to reflect a 40% reduction in staff RI rate by 2012 against the 2008 benchmark.
- To develop systems and processes to manage and monitor near-miss events more effectively. Our target remains to establish a baseline for future improvements for 2012.



Divers inspecting pontoons at our marine services contract in Davenport, UK.



Fire training delivered by Serco at the International Fire Training Centre in the UK.

## Corporate responsibility

### Community

The work we do often directly serves our local communities. Many of our people also live in these communities and we want them to be proud of what we give back to society. Whether it is money or management skills, work experience or interview training to help young people find jobs, there are hundreds of projects run by Serco people that enhance our reputation as an organisation and, quietly and without fanfare, improve life for local people.

How we offer support is largely down to our divisions and contracts. They are in the best position to understand the needs of their communities, how those needs align with our customers' objectives and how they relate to our employees.

The result is a wide range of activities, from fundraising for the Royal Flying Doctor Service in Australia or for orphans in India, to providing student work placements at HMP & YOI Doncaster in the UK.



At HMP & YOI Doncaster, we help offenders strengthen bonds with their families.



We encourage offenders to take part in community projects at Acacia Prison, Australia.

We also encourage our businesses to think long-term. For example, in the US we have worked with the Military Child Education Coalition since 2007 and in the UK we have supported Project Search since 2008. Project Search, which involves our customer – the Norfolk and Norwich University Hospital – and other organisations, helps people with learning difficulties to develop their confidence and skills in the workplace.

During the last three years we have provided work placements to 35 students and 9 people have found employment in the hospital. We have now expanded the programme to three more of our UK hospital contracts.

Overall, we are committed to investing 1% of our pre-tax profits every year in projects to help our communities. This year we have donated £2,271,575, which represents 1.1%.

### Objectives and performance

2010 Objective	Result	Comment
To provide employment opportunities for the long-term unemployed and young people.	On plan	We expanded Project Search from one UK hospital to four. This is a partnership with the National Health Service and other organisations to help people with learning difficulties into the workplace. We initiated a project in our UK divisions to identify work placement opportunities for students and to encourage the creation of new and meaningful opportunities. A survey identified current practice and data to help future planning. This will be an ongoing objective.
To build trust in the communities in which we operate, through responsible business operations and behaviour.	On plan	During 2010 we were able to better identify our current UK practices in relation to working with the voluntary sector. In December 2010, we participated in a pilot project to help build the capacity of Black and Asian Minority organisations in Manchester (see case study in the Marketplace section of our 2010 Corporate Responsibility Review).
To continue to invest in the communities in which we work and serve.	Target met	We invested £2,271,575 into society, which equates to 1.1% of our pre-tax profits in 2010.

#### 2011 Objectives

- To continue to invest 1% of our pre-tax profits into society
- To continue to promote the theme of employability
- To continue to develop our relationships with charities, social enterprise and community organisations
- To promote employee volunteering
- To promote payroll giving.



## Environment

Our zero-harm aspiration applies as much to the environment as it does to health and safety. Our policy places a clear responsibility on everyone in Serco to minimise our environmental impact.

This policy has three drivers. The first is ethical: safeguarding the planet for current and future generations is the right thing to do. Second, irreproachable environmental credentials are now a commercial imperative. The third driver is financial.

Reflecting our devolved nature, the best place to manage our impact is locally. For example, in the United Arab Emirates we are a member of the Emirates Environmental Group, which encourages tree planting and recycling. In Australia, through our actions, use of potable water in Melbourne's parks and gardens dropped by 75%.

However, as we have developed our Group strategy we have had to understand our overall impact as a business. Given the sheer range and diversity of our work this has been a challenge. To address it, in 2010 we introduced Acco2unt carbon management software. This gives us the data we need and helped us to join the best-performing 10% of FTSE 350 organisations, according to the Carbon Disclosure Project.

We can now see where we generate carbon dioxide emissions, which helps us to prioritise areas for action. We set ourselves the objective of achieving Carbon Trust Standard certification, which required us to demonstrate:

- a minimum of 2.5% year-on-year reduction in our carbon footprint relative to revenue, for two consecutive years
- effective carbon measurement, and
- effective carbon management at all sites.

It was a considerable task, but in January 2011 we reached our target. This makes us one of only 530 companies so far – of around 5,000 required to participate in the Carbon Reduction Commitment Energy Efficiency Scheme (CRC) – to have Carbon Trust Standard certification.

The certification covers all of Serco's UK sites required to participate in the CRC, and will enhance our score and placement in the CRC Performance League Table, to be published by the Environment Agency in October 2011.

One challenge in meeting our aspirations is that we often share our customers' facilities. Without full control over our workplace, we are unable to capture information relating to our impact and we are limited in the measures we can put in place to reduce our footprint. In those instances, we work with our customers to reduce impact.

Improvement does not come overnight or by edict, but gradually, through the efforts of thousands of people around the world, united by the conviction that this is worth doing – and doing well.

## Objectives and performance

2010 Objective	Result	Comment
To achieve a 10% reduction in CO <sub>2</sub> tonnes/£m revenue by end 2010, against the 2008 benchmark.	Target missed	In the UK, we achieved a reduction of 7.26% in CO <sub>2</sub> tonnes/£m against 2008. We were pleased to achieve the UK's Carbon Trust Standard, requiring a 2.5% year-on-year reduction in CO <sub>2</sub> emissions.
To embed a single environmental management system and operating procedures across all operations.	Target met	The environmental management system is an integral part of our revised Serco Management System (launched 2011) and applies globally.
To implement a carbon accounting system to ensure accurate consumption reporting on energy, fuel used for business, travel, waste and water.	Target met	The Greenstones Acco2unt enterprise system went live in the UK in 2010 and will be implemented across the rest of our business in 2011.

### 2011 Objectives

- To achieve a 15% reduction in CO<sub>2</sub> tonnes/£m revenue against the 2008 benchmark by end of 2012
- To retain the Carbon Trust Standard.

## Resources

**Business relationships****Customers**

Our ability to develop long-term relationships with our customers is a central part of our business model. Day-to-day responsibility for meeting our customers' needs lies with our contract directors. Our approach to working with our customers is set out in our Governing Principles (see page 12), which aim to empower our contract directors and ensure that we deliver high-quality service.

We maintain relationships at all levels with our customers, so they are aware of how we can help them and we can anticipate their changing needs and identify opportunities at an early stage. These relationships lie with our divisional and Group leaders.

Our reputation with our existing customers is also vital in winning new work. Many factors influence our reputation, including:

- the quality of our service
- our values and public-service ethos
- our capacity to innovate, and
- our engagement with our employees and other stakeholders, such as local communities.

We believe that our high rebid and new bid win rates demonstrate the strength of our reputation with new and existing customers.

**Suppliers**

Effective procurement significantly contributes to achieving our vision and delivering effective service to our customers. We aim to be professional in all our dealings with suppliers and to establish mutually beneficial relationships, in which suppliers want repeat business with us and have us as their 'customer of choice'.

We have a dedicated procurement and supply chain team which is responsible for putting this approach into practice. As part of this, they continue to enhance our systems and processes for choosing and managing our suppliers. This helps us to maximise the value of our supplier relationships, makes it quicker and cheaper for us to transact with them, and assists with understanding and monitoring areas such as environmental impact before our people make a decision to buy.

Our businesses have many common purchasing needs. For this reason, we aim to work with carefully chosen preferred suppliers, enabling us to achieve better terms and conditions and make the most of our economies of scale. Our teams are also able to procure locally when appropriate, drawing on the expertise of our divisional procurement specialists to manage the process effectively.

We continue to focus on developing our relationships with all of our suppliers, including small and medium-sized enterprises (SMEs). In 2011, we will be looking at ways to enhance this further. We have a longstanding programme in place to improve the way we work with our suppliers. Following the public attention on our relationships with our suppliers in November 2010, we looked again at the improvement programme we had in place and introduced a number of additional steps, including support to SMEs who often supply the specialist or local knowledge we need to deliver services to our customers.

Serco is a member of Minority Supplier Development UK, a not-for-profit organisation which provides a direct link between companies and ethnic-minority businesses, to enable the building of mutually beneficial business relationships.

### *Joint venture partners*

Serco has a number of joint ventures with commercial partners and customers.

Our joint ventures with Abellio run Northern Rail, which is the country's largest train franchise, and Merseyrail, the UK's most punctual train operator.

AWE Management Limited, our highly successful joint venture with Lockheed Martin and Jacobs Engineering Group Inc., manages the UK's Atomic Weapons Establishment.

In Australia, DMS Maritime, our joint venture with P&O Maritime Services, is a key partner for the Australian Defence Force (ADF) and other agencies. In partnership with Sodexo, we also deliver garrison support services to the ADF through Serco Sodexo Defence Services Pty Limited.

We also have successful joint ventures with customers. We created GSTS Pathology with Guy's and St Thomas' NHS Foundation Trust, to transform its pathology services. In 2010, King's College Hospital NHS Foundation Trust also became a partner in the joint venture. ACCESS is our joint venture with Glasgow City Council, designed to streamline and maximise the use of the Council's property and ICT assets.

Strong relationships, based on mutual trust and respect and clarity of roles, are essential ingredients if a joint venture is to deliver excellent customer service. Our divisional management teams are responsible for relationships with our joint venture partners, supported by members of the Group Executive Committee and Board as appropriate. This includes holding regular strategy and review meetings with our partners.

### *Strategic partners*

We often deliver services as part of a consortium, either as prime contractor or as a subcontractor. This allows us to bring together companies with the skills to meet the precise requirements of a bid.

Our values and the open and honest way in which we work also make us an attractive partner for voluntary-sector organisations, who often lack the scale and experience to access major government programmes. Examples include:

- our model for providing welfare to work services in the UK, which utilises a network of commercial and voluntary-sector partners, and
- our contract to run Belmarsh West prison, in alliance with voluntary-sector partners Turning Point and Catch22.

Responsibility for relationships with our strategic partners lies with the relevant contract and divisional management.

## Principal risks and uncertainties

### Serco has a well-established and embedded system of internal control, including financial, operational and compliance controls and risk management, designed to safeguard shareholders' investments and our assets and reputation.

The Board has overall responsibility for our internal control system and for reviewing its effectiveness, and has delegated to management the implementation of policies on risk and control.

Risk management is fundamental to how we manage the business. We have developed robust systems and processes to identify and manage the key risks facing each of our businesses and the Group as a whole, and all parts of the business have appropriate risk and crisis management plans that meet defined policy standards.

During the year we have implemented the recommendations resulting from the risk management review completed in 2009. This has seen the establishment of the Group Risk Management Committee, a formal Committee of the Executive Committee, which provides governance and oversight of risk. Further, we have changed and improved the approach to the assessment of risk as well as standardising and enhancing the reporting format.

These enhancements to our risk management processes have been incorporated within our risk management policies, systems and processes which conform to the Combined Code's requirements and form part of the Serco Management System (SMS). A comprehensive review of the SMS was completed in 2010. The revised SMS has been approved and reissued by the Board.

Such systems and processes, however, can only be designed to mitigate, rather than eliminate, the risk of failure to achieve business objectives, and can only provide reasonable and not absolute assurance, against misstatement or loss. The Board confirms that this process has been in place for the year under review and up to the date of approval of the annual report and accounts.

### Our approach to risk within the Serco Management System

The SMS sets out policy standards, systems and processes that identify, review and report risks at all levels of our business and in the Group as a whole with the aim of safeguarding our shareholders' investments and our assets and reputation. At each level within our business, risk management processes reflect the nature of the activities being undertaken and the business and operational risks inherent in them, and therefore the level of control considered necessary to protect our interests and those of our stakeholders.

These risk management processes were subject to comprehensive review during 2010, as part of a broader review of the SMS. This ensures that they reflect the nature of the activities we undertake and the business and operational risks inherent in them, and therefore the level of control we consider necessary to protect our interests and those of our stakeholders.

These controls and processes fall into four main areas: Identification, Assessment, Planning and Control, and Monitoring, so that we:

- identify business objectives that reflect the interests of all stakeholders, and the risks associated with the achievement of these objectives
- regularly assess our exposure to risk, including through the regular measurement of key risk indicators
- control and reduce risk as far as reasonably practicable or achievable through cost-effective risk treatment options
- identify new risks as they arise and remove those risks that are no longer relevant

### Risk identification

In identifying the potential risks associated with the achievement of our business objectives, we consider both external factors arising from the environment within which we operate, and internal risks arising from the nature of our business, its controls and processes, and our management decisions.



Once identified, we document risks in risk registers, which are maintained at a contract, business unit, programme, divisional and Group level. These risk registers change as new risks emerge and existing risks diminish, so that the registers reflect the current key risks. We review risk registers at least quarterly and more frequently as required. The Group Risk Management Committee reviews the Group risk register quarterly ahead of formal review by the Board.

#### **Risk assessment**

We assess the potential effect of each identified risk on the achievement of our business objectives and wider stakeholder interests. To do so, we use a risk scoring system based on our assessment of the probability of a risk materialising and the effect if it does. This is assessed from three perspectives:

- the risk's significance to the achievement of our business objectives
- the risk's significance to society, including on public safety and the environment, and
- our ability to influence, control and mitigate the risk.

Analysis of our key risks allows us to assess the probability of disruption to our business objectives, and highlights critical areas that require management attention. In 2010 an updated risk assessment matrix has been implemented, providing improved clarity in the definition of probability assessment.

#### **Risk planning and control**

We assign each identified and assessed risk to a risk owner, who is responsible for controlling and managing it and developing a robust and effective plan to reduce or mitigate the risk. Risk owners are required to report to the Board on specific risks. The Board may ask for additional information or request an audit to provide additional assurance.

Risk reduction involves taking early management action to remove or reduce identified risks before they can affect the contract or project. We consider options to eliminate, reduce or control the risks as part of the risk identification and analysis process.

Risk mitigation involves us identifying appropriate measures, including contingency plans, to reduce the severity of the impact of the risks, should they occur. This includes developing crisis management plans in response to risks whose potential impact warrants a specific management process.

The SMS requires every contract to develop a risk management plan reflecting assessed risks and supported by appropriate measures and contingency plans to mitigate the impact of the risks.

#### **Risk monitoring**

Changes in our external environment, internal structures, and management decisions may all affect the nature and extent of the risks to which the Group is exposed.

Our risk monitoring process therefore regularly monitors changes to our business and the external environment, to ensure that we respond appropriately to reduce the impact of emerging risks.

#### **Principal risks**

The Group risk register identifies the principal risks facing the business, including those that are managed directly at a Group level. They are managed through a formal process. This identifies the business objectives and the interests of shareholders and other stakeholders that are likely, directly or indirectly, to influence the business's performance and its value.

The Group's key stakeholders include, but are not limited to, shareholders, customers, suppliers, staff, trade unions, government, regulators, banks and insurers. The way we operate as a responsible company recognises the interests of the community in areas such as social, environmental and ethical impact, as described under Corporate Responsibility on pages 64 to 67.

The most significant risks relate to our reputation, and to operational and financial performance. A number of our risks reflect social, environmental and ethical issues, but these do not currently represent significant threats to our strategy.

## Principal risks and uncertainties

Summarised on the following pages are the key risks we have identified that could have a material impact on our reputation, our operations, or our financial performance.

We also have material investments in a number of joint ventures, where we have joint control over management practices. Our representatives within these companies ensure that their processes and procedures for identifying and managing risk are appropriate and that internal controls exist and are regularly monitored.

We keep reputational and emerging risks under active review and inform the Board of changes. Emerging risks cover longer-term risks that could represent a threat to our activities but which are not yet sufficiently defined to be included as active risks. Examples of these risks include climate change and changes in key markets.

### Managing and mitigating risk

Our risk management process enables us to understand our operational risk profile. While operational risk can never be eliminated, we endeavour to minimise the impact by the consistent implementation of the SMS, ensuring that appropriate infrastructure, controls, systems, staff and processes are in place.

Some of our key management and control techniques defined in the SMS are set out below:

- our operating processes fully reflect the principles of clear delegation of authority and segregation of duties
- our Group Risk Management Committee meets quarterly to ensure that risks, internal control and business assurance are effectively managed and reviewed
- comprehensive business review processes ensure we meet customer expectations, regulatory requirements, and performance criteria including operational effectiveness, investment returns, cash flow requirements and profitability
- we monitor and regularly review key performance indicators. These include analysis of business performance and variances from plan, occupational health and safety incidents, and error and exception reporting
- selective recruitment, succession planning and other human resource policies and practices ensure that staff skills are aligned with Serco's current and future needs
- we maintain insurance policies against losses arising from circumstances such as damage or destruction of physical assets, theft, legal liability for third-party loss and professional advice. We review the adequacy of our insurance cover at regular intervals
- our Investment Committee meets regularly to ensure appropriate governance and the management of risk associated with larger or higher risk bids, acquisitions, disposals and areas of significant capital expenditure
- we apply robust project management and change implementation disciplines to all major projects including new contract transitions, acquisitions, new technology applications, change programmes and other major initiatives
- the Directors' Report describes our approach to health, safety and environmental protection. Qualified and experienced staff in each business unit provide advice and support on health, safety and environmental issues and undertake regular audits
- we have safety specialists in our aviation, rail, defence, nuclear and marine businesses who report to the Board and maintain and further develop the very high standards expected in these industries
- the Chief Information Officer is responsible for ensuring that systems and processes are in place to ensure the confidentiality, integrity and availability of sensitive information and the associated information systems that support our business activities

- our Ethics Committee has responsibility for the review of ethical issues that may arise from our current and future activities
- the Company Secretary manages a confidential reporting service, to which staff can report illegal, dangerous, dishonest or unethical activities. This process was enhanced and relaunched at the end of 2010
- we have crisis and business continuity plans in place to manage crisis events, both within divisions and the Group.

### Internal audit

An integral part of risk management is assurance that the controls identified to manage risks are operating and effective. The Head of Internal Audit is responsible for delivery of the assurance strategy, ensuring our assurance programme remains aligned to test the key controls managing the Group's risks. Internal audit is delivered at three levels across the business:

- Group internal audit
- functional internal audit, and
- divisional internal audit.

The Head of Internal Audit leads the Group internal audit programme, which is independently delivered by KPMG LLP. Its findings are reported directly to the Group Audit Committee. In addition to the audits conducted by KPMG, the Head of Internal Audit supplements the programme by conducting periodic special reviews as requested by the Serco Group plc Board or Executive Committee from time to time.

The functional internal audit programme supplements the Group internal audit programme. It addresses finance processes and controls, through a centrally provided audit programme delivered by divisional management on a peer to peer basis, as well as audit programmes completed by Group functional specialists covering health, safety and environment, and IT systems and security policy compliance.

In addition to these programmes, each operating division maintains a divisional risk register, from which we develop a divisional internal audit programme. This programme selects a number of contracts for review based on certain key risks. These reviews are completed through a self-assessment programme focused on testing the controls which manage and mitigate these key risks. Divisional audit committees, which track and report on the progress of the divisional internal audit programme, meet three times a year.

The Head of Internal Audit oversees the internal audit process, as well as acting as the conduit for sharing best practice, and flagging emerging risks to ensure each part of the business benefits from the wider scale of the Group's assurance activity.

In addition to internal audit, many parts of our business are subject to other reviews of their controls by third parties, including industry regulators, ISO Standards, customers and other external audits. This third-party scrutiny significantly increases the scope of auditing conducted across the Group each year.

The Board confirms that the actions it considers necessary are being taken to remedy the failings and weaknesses which it has determined to be significant from its review of the internal controls across the Group. The Board confirms that it has not been advised of material weaknesses in financial reporting as part of the review of the internal control system.

## Principal risks and uncertainties

## Market risks

Risk	Significant change in Government policies, expenditure levels and budgetary constraints		
Description/Comment	Impact	Mitigation	
<p>As a major proportion of Serco's customers are governments and governmental agencies, a substantial part of the business is dependent on government policies, budget priorities and regulatory or political constraints, in particular those regarding maintaining and improving public infrastructure, which could have a significant impact on the size, scope, timing and duration of contracts and orders under them and therefore on the level of business that we may win. As such, these businesses are susceptible to changes in government, government policy, budget allocations and the political environment, primarily in the UK and the US. Any reduction in such government expenditure and funding could result in a suspension, cancellation, termination or non-renewal of contracts. Revenues may also be adversely affected by changes to the UK Government's or US Government's policy in respect of outsourcing.</p>	<ul style="list-style-type: none"> <li>• Reduction in market opportunities</li> <li>• Changes to terms of existing or new contracts</li> <li>• Failure to meet growth or profit expectations</li> </ul>	<ul style="list-style-type: none"> <li>• Business strategy</li> <li>• Diverse business across geographies and markets</li> <li>• Business significantly focused on developed markets with strong and established legal systems providing protection to changes in contract terms</li> </ul>	

Risk	Failure to win a strategic or significant bid or rebid		
Description/Comment	Impact	Mitigation	
<p>Failure to win material bids or renew material contracts could restrict growth opportunities for the future or have an adverse impact on Serco's business, financial condition and results of operations. Further, a significant number of Serco's contracts with the UK Government, the US Government and other public sector customers, including renewals and extensions of previous contracts, are awarded through formal competitive bidding processes. Competitive bidding processes present a number of risks, including substantial cost and management time and effort to prepare bids and proposals for contracts that may not be won. In addition, there is often a long period between a successful competition tender offer and entering into definitive contractual documentation and financial close, and in some cases financial close may not occur.</p>	<ul style="list-style-type: none"> <li>• Failure to meet growth or profit expectations</li> <li>• Significant financial loss or cost overrun</li> <li>• Damage to reputation resulting in loss of existing or new business</li> <li>• Impact on strategic objectives</li> </ul>	<ul style="list-style-type: none"> <li>• Business Lifecycle Governance process embedded in SMS</li> <li>• Governance structure managed through Investment Committee, programme and project boards, divisional and contract boards</li> <li>• Business strategy and targets managed through internal boards</li> <li>• Regular review and monitoring of risk registers</li> <li>• Gate review and formal sign-off process</li> </ul>	



## Operational risks

Risk	Any harm to the Company's reputation could adversely impact business	
Description/Comment	Impact	Mitigation
The Company is dependent on maintaining its reputation in each jurisdiction in which it operates in order to maintain and grow its business. It is exposed to the risk that litigation, misconduct, operational failures and negative publicity could harm its reputation. In addition, the Company's reputation could also be adversely affected if its services, or the services performed by its subcontractors, do not perform as expected. Any harm to its reputation could have a material adverse effect on its business, financial condition and results of operations.	<ul style="list-style-type: none"> <li>● Failure to meet growth or profit expectations</li> <li>● Significant financial loss or cost overrun</li> <li>● Loss of contract revenue related to operations and service charges</li> <li>● Damage to reputation resulting in loss of existing or new business</li> <li>● Impact on strategic objectives</li> </ul>	<ul style="list-style-type: none"> <li>● Robust bidding and contract review process including financial, technical and commercial reviews</li> <li>● Governance structure managed through Investment Committee, programme and project boards, divisional and contract boards</li> <li>● Business strategy and targets</li> <li>● Regular review and monitoring of risk registers</li> <li>● Gate review and formal sign-off process</li> <li>● Quality management systems</li> </ul>

Risk	Failure of significant programmes, including operating within agreed fixed costs	
Description/Comment	Impact	Mitigation
Serco has a number of complex programmes which it is contracted to deliver for the customer. These are often let on a fixed price basis irrespective of the actual costs incurred, and therefore if costs exceed the contract ceiling the Company may not be able to obtain full reimbursement. Further, some projects require delivery in accordance with specified milestones on agreed dates. Significant adverse financial consequences can be imposed where milestones are not met or a project is not delivered on time. The length and complexity of such projects mean that management estimates can be particularly difficult to make and could turn out to be inaccurate.	<ul style="list-style-type: none"> <li>● Failure to meet growth or profit expectations</li> <li>● Significant financial loss or cost overrun</li> <li>● Loss of contract revenue related to operations and service charges</li> <li>● Damage to reputation resulting in loss of existing or new business</li> <li>● Impact on strategic objectives</li> </ul>	<ul style="list-style-type: none"> <li>● Robust bidding and contract review process including financial, technical and commercial reviews</li> <li>● Governance structure managed through Investment Committee, programme and project boards, divisional and contract boards</li> <li>● Robust cost accounting</li> <li>● Internal audit</li> <li>● Business strategy and targets</li> <li>● Regular review and monitoring of risk registers</li> <li>● Gate review and formal sign-off process</li> <li>● Quality management systems</li> </ul>

Risk	Failure to deliver operational efficiency	
Description/Comment	Impact	Mitigation
To deliver our commitments we must ensure that we have efficient operations. Our operational efficiency programme facilitates delivery of operational change and sustainable margin improvement. Failure to deliver may impact our ability to deliver business commitments.	<ul style="list-style-type: none"> <li>● Erosion of profit</li> <li>● Impact on competitiveness</li> <li>● Damage to reputation resulting in loss of existing or new business</li> <li>● Failure to meet customer expectations and business strategy</li> </ul>	<ul style="list-style-type: none"> <li>● Business strategy and supporting plans</li> <li>● Internal governance structure</li> <li>● Business review</li> <li>● Internal audit</li> <li>● LEAN/Continuous Improvement programme</li> <li>● Quarterly management reporting</li> </ul>

## Principal risks and uncertainties

## Operational risks continued

Risk	Major information security breach		
Description/Comment	Impact	Mitigation	
<p>Serco must comply with restrictions on the use of confidential and classified data and provide for secure transmission of such information. This is a heightened risk particularly with respect to government contracts due to the sensitive and confidential nature of government data. Despite controls to ensure the confidentiality of such information, Serco may breach restrictions or be subject to attack from computer programmes that attempt to penetrate its network security and misappropriate confidential information.</p>	<ul style="list-style-type: none"> <li>● Damage to reputation resulting in loss of existing or new business (disqualification from future tenders, contract termination, etc.)</li> <li>● Impact on strategic objectives</li> <li>● Costly to rectify and potential for dilution of shareholder returns</li> <li>● Criminal and civil action</li> <li>● Contract and business external accreditations withdrawn</li> <li>● Significant media attention and future scrutiny</li> </ul>	<ul style="list-style-type: none"> <li>● Information Systems policy, systems and embedded governance structure</li> <li>● Think Privacy campaign to raise awareness and strengthen control processes</li> <li>● User and data management including data encryption, information classification, data cleansing and password controls</li> <li>● ISO 27000 certification</li> <li>● Internal and external audit</li> </ul>	

Risk	Major IT failure or prolonged loss of critical IT systems		
Description/Comment	Impact	Mitigation	
<p>The IT Strategy is focused on standardising common processes, establishing common business systems and enabling ways of working by providing and embedding tools that support what we do. Within this the Company has defined enterprise applications. These are key information technology based business systems within Serco. They include SAP for Finance, Procurement and Human Resources; Payroll, Risk Management, Safety Assurance, email, intranet and Nimbus Control for Process Excellence systems. Failings in the systems have the potential to seriously impact the management of the business.</p>	<ul style="list-style-type: none"> <li>● Damage to reputation resulting in loss of existing or new business</li> <li>● Impact on strategic objectives</li> <li>● Inability to meet contract requirements or perform core business processes</li> <li>● Costly to rectify and potential for dilution of shareholder returns</li> <li>● Significant media attention and future scrutiny</li> </ul>	<ul style="list-style-type: none"> <li>● Information policies and systems and governance structure</li> <li>● Data recovery capability designed into systems and periodically tested</li> <li>● Design out single points of failure</li> <li>● Server and system performance monitoring and reporting</li> <li>● Capacity management</li> <li>● Data back-up and business continuity plans in place</li> </ul>	

## Governance risks

Risk	Significant incident of bribery or corrupt practice		
Description/Comment	Impact	Mitigation	
<p>Serco's operations are principally in the UK, the US, Europe, the UAE, Australia and India. Certain of our businesses carry out work in other countries such as Canada, Costa Rica, Hong Kong, Afghanistan, Iraq and China. Operating in international markets brings with it inherent risks including bribery and corruption, particularly in certain developing nations. We recognise that proposed UK legislation around bribery and corruption will establish more stringent legal requirements.</p>	<ul style="list-style-type: none"> <li>● Legal action and fines against the Company</li> <li>● Disbarment from tender lists</li> <li>● Damage to reputation resulting in loss of existing or new business</li> <li>● Significant media attention and future scrutiny</li> </ul>	<ul style="list-style-type: none"> <li>● Policies and systems embedded in SMS</li> <li>● Code of Conduct</li> <li>● Ethics Committee</li> <li>● Speak Up process</li> <li>● Ethics and compliance programme and training</li> <li>● Risk assessment</li> <li>● Third-party contracts</li> </ul>	

Risk		
Major accident or incident		
Description/Comment	Impact	Mitigation
It is possible that a major catastrophic event, such as a major train derailment or air traffic accident, could occur at one of the projects in relation to which Serco has provided professional design, construction, engineering or support services. Such a catastrophic event could result in the personal injury or death of one or more employees of the Company, employees of other subcontractors working on the project or members of the public, significant, actionable environmental harm, and/or extensive damage to third-party property. In the event that such a catastrophic event is found or perceived to be caused by the negligence of Serco, it could subject the Company to claims for personal injury, wrongful death, property damage by customers, subcontractors, governments, employees or members of the public, which could lead to the payment of extensive damages and result in significant adverse publicity and reputational harm. Such adverse publicity and reputational harm could lead to a loss of business.	<ul style="list-style-type: none"> <li>Deaths or serious injuries to employees or third parties</li> <li>Major environmental damage</li> <li>Severe financial impact (fine by regulators, suspension of operating licence, compensation, clean up, etc.)</li> <li>Loss of business (disqualification from future tenders, contract termination, etc.)</li> <li>Contract and business external accreditations withdrawn</li> <li>Significant media attention/future scrutiny</li> <li>Criminal and civil action against Company or individuals</li> </ul>	<ul style="list-style-type: none"> <li>Robust management systems subject to external, regulatory and internal audit</li> <li>System certification and regulatory approval</li> <li>Formal oversight through Group Risk Management Committee, Health Safety and Environment Oversight Group, divisional and internal boards</li> <li>Crisis management and business continuity plans in place</li> <li>Insurance</li> <li>Strategy, objectives, targets and regular reporting</li> <li>Formal assurance structure operating within defined competencies</li> <li>Staff induction and training</li> </ul>

Risk		
Significant changes in energy and carbon costs and reporting requirements		
Description/Comment	Impact	Mitigation
We must understand our environmental impacts, manage them and measure our performance to demonstrate improvement. Fuel poverty is likely to significantly impact energy prices. Increases in energy costs are conservatively estimated at 10% per year for many years to come. We need to make sure we are managing our consumption to minimise the cost and reduce our carbon emissions. We also need to recognise and respond to increasing legislation. For example the UK Government's Carbon Reduction Commitment.	<ul style="list-style-type: none"> <li>Legal action and fines against the Company</li> <li>Significant financial loss</li> <li>Disbarment from tender lists</li> <li>Damage to reputation resulting in loss of existing or new business</li> <li>Significant media attention and future scrutiny</li> </ul>	<ul style="list-style-type: none"> <li>Environmental policy and systems</li> <li>Environment Oversight Group</li> <li>Aspects and impacts assessment</li> <li>ISO 14001</li> <li>Carbon Trust Standard</li> <li>Reporting methodology and systems</li> <li>Environmental strategy objectives and targets</li> </ul>

Risk		
Compliance with complex laws and regulations		
Description/Comment	Impact	Mitigation
Serco must comply with laws and regulations relating to the formation, administration and performance of government contracts that affect how it does business and may impose added costs. Further, it is required to obtain environmental and safety permits from various government authorities which require periodic renewal or review of their conditions. Failure to comply with any of these regulations could result in civil and criminal penalties and administrative sanctions, including termination of contracts, forfeiture of profits, harm to its reputation, suspension of payments, fines and suspension or debarment from doing business with government.	<ul style="list-style-type: none"> <li>Substantial monetary damages or criminal violations</li> <li>Damage to reputation resulting in loss of existing or new business</li> <li>Disbarment from tender lists</li> <li>Significant media attention and future scrutiny</li> </ul>	<ul style="list-style-type: none"> <li>Policies and systems embedded in SMS</li> <li>Code of Conduct</li> <li>Risk assessment</li> <li>Third-party contracts</li> <li>System certification and regulatory approval</li> <li>Internal board and governance structure</li> <li>Staff induction and training</li> </ul>

## Principal risks and uncertainties

## People risks

Risk	Failure to attract and retain senior management and other key employees		
Description/Comment	Impact	Mitigation	
<p>The success of the Company depends on the efforts, abilities, experience and expertise of the senior management teams and on recruiting, retaining, motivating, effectively communicating with and developing highly skilled and competent people at all levels of the organisation. There can be intense competition for personnel from other companies and organisations and there may at any time be shortages in the availability of appropriately skilled people at all levels within Serco. Further, the Company cannot guarantee the retention of such key executives and technical personnel. The failure of the Company to retain and/or recruit additional or substitute senior managers and/or other key employees could have a material adverse effect on its business.</p>	<ul style="list-style-type: none"> <li>● Increased cost in recruitment activity and time taken to fill roles</li> <li>● Instability and loss of business continuity</li> <li>● Dilution of brand and values</li> <li>● Reduced employee engagement through loss of compelling leadership</li> <li>● Strengthen competitors (loss of leaders to them)</li> <li>● Impact on business – risk of not achieving level of planned growth</li> </ul>	<ul style="list-style-type: none"> <li>● People policies and systems, strategy and targets supported by governance structure including Remuneration Committee</li> <li>● Succession planning</li> <li>● Leadership model</li> <li>● Annual external (independent) remuneration review</li> <li>● Job structure and grading system</li> <li>● Talent database and leadership development programme</li> <li>● Employment engagement strategy including annual staff survey</li> </ul>	

Risk	Failure to manage union/industrial relations		
Description/Comment	Impact	Mitigation	
<p>A significant number of Serco's employees are members of trade unions in the United Kingdom and a number are members of trade unions in the United States and other countries. These include operations where a failure to manage relationships may result in industrial action by Serco staff in high-profile business operations, i.e. where there will be significant reputational damage, client or media attention. Some sectors of the business are subject to union recognition agreements. The Company maintains a number of relationships with trade unions and staff through work councils and other bodies.</p>	<ul style="list-style-type: none"> <li>● Failure to deliver contractual requirements</li> <li>● Instability and loss of business continuity</li> <li>● Dilution of brand and values</li> <li>● Reduced employee engagement</li> <li>● Damage to reputation resulting in loss of existing or new business</li> <li>● Significant media attention and future scrutiny</li> </ul>	<ul style="list-style-type: none"> <li>● Policies and systems embedded in SMS</li> <li>● Industrial Relations strategy</li> <li>● Industrial Relations Working Group</li> <li>● Stakeholder management of key relationships</li> <li>● Annual external (independent) remuneration review</li> <li>● Job structure and grading system</li> <li>● Employment engagement strategy</li> </ul>	

## Finance risks

Risk	The impairment of goodwill could adversely impact reported results		
Description/Comment	Impact	Mitigation	
<p>Goodwill accounts for approximately one-third of the Serco Group's recorded total assets as at 31 December 2010. Serco evaluates goodwill for impairment annually, or more frequently when evidence of potential impairment exists. Any decrease in expected cash flows or a deterioration in market conditions could require Serco to record future impairment charges that could have a material impact on the financial position and results of operations.</p>	<ul style="list-style-type: none"> <li>● Inability to meet profit expectations</li> <li>● Damage to reputation and shareholder confidence</li> <li>● Impact on strategic objectives</li> </ul>	<ul style="list-style-type: none"> <li>● Internal board and governance structure</li> <li>● Strategic plans</li> <li>● Business plans</li> <li>● Business Lifecycle Governance process</li> <li>● Financial review and reporting</li> </ul>	



Risk	Additional funding requirements for pension schemes	
Description/Comment	Impact	Mitigation
Serco operates defined benefit pension schemes for qualifying employees of its subsidiaries in the UK and other European countries. In addition, we have interests in joint ventures, which operate defined benefit schemes for qualifying employees. The nature of a defined benefit scheme means that the funding levels of the schemes are subject to factors outside Serco's control which could create or impact a deficit in the scheme at future actuarial valuations. If the deficit in the scheme increases at future actuarial valuations, the Group may be required to make additional cash contributions to the schemes in the future, preventing the use of cash for other purposes, which could have a material impact on the Group's business, financial condition and results of operations over the long term.	<ul style="list-style-type: none"> <li>● Inability to meet profit expectations</li> <li>● Increase in cash contributions to our pension schemes</li> </ul>	<ul style="list-style-type: none"> <li>● Actuarial assessment of scheme liabilities</li> <li>● Appropriate investment management</li> <li>● HR policy, systems and governance structure including Remuneration Committee and Board of Pension Trustees</li> <li>● Annual external (independent) remuneration review</li> <li>● Industrial Relations strategy</li> <li>● Independent measurement of asset returns</li> <li>● Internal audit</li> </ul>

Risk	Fluctuations in foreign currency exchange rates that are not effectively hedged	
Description/Comment	Impact	Mitigation
The international nature of Serco's business means it is exposed to fluctuations in foreign currency exchange rates in relation to various currencies, primarily the US dollar, the Australian dollar and the Euro, arising from the translation of earnings. In addition, some of Serco's bank debt is denominated in currencies other than pound Sterling.	<ul style="list-style-type: none"> <li>● Material effect on the Group's future results of operations and financial position</li> </ul>	<ul style="list-style-type: none"> <li>● The Group hedges short-term transaction risks that are material in value</li> <li>● Management of translational risk by the part currency matching of borrowings with the net assets of overseas subsidiaries</li> </ul>

Risk	Fluctuations in interest rates	
Description/Comment	Impact	Mitigation
Historically, Serco has financed its operations partly through cash flow generated by bank debt. Adverse movements in interest rates could therefore impact profitability and net assets.	<ul style="list-style-type: none"> <li>● Inability to meet profit expectations</li> <li>● Impact on competitiveness</li> <li>● Impact net assets</li> </ul>	<ul style="list-style-type: none"> <li>● Fixed rate debt instruments and interest rate derivatives that swap floating for fixed rates</li> </ul>

# Corporate Governance Report

## Introduction

In managing the affairs of the Group, the Board of Serco Group plc is committed to achieving high standards of corporate governance, integrity and business ethics for all its activities around the world. A fundamental part of the Group's corporate governance processes is the Business Conduct and Ethics Standard that the Company and Group have adopted.

Throughout 2010 Serco Group plc complied fully with the provisions of Section 1 of the 2008 Combined Code on Corporate Governance issued by the Financial Reporting Council (the Code). The paragraphs below, together with the 'Our performance' section on pages 16 to 79 and the Remuneration Report on pages 92 to 103, provide details of how the Company has applied the principles and complies with the provisions of the Code.

In May 2010 the Financial Reporting Council published a new code, the UK Corporate Governance Code (the Governance Code) which replaces the Code for financial years beginning on or after 29 June 2010. The FRC has stated that changes have been made to help company boards to become more effective and more accountable to shareholders. In light of the Governance Code we are reviewing and will introduce additional elements of governance and internal control processes as appropriate. For example, the Board has decided that all Directors should stand for re-election on an annual basis, commencing at the Company's Annual General Meeting in May 2011.

## The Board of Directors

### Board composition

Currently the Board has six members: the Chairman, two Executive Directors and three Non-Executive Directors. Two Non-Executive Directors retired at the end of 2010; as at the date of this report one new Non-Executive Director has been appointed and an externally-led recruitment process is ongoing for at least one other. No individual or group of individuals dominates the Board's decision-making. The Board considers all of the Non-Executive Directors to be independent. In coming to this conclusion the Board has determined that each Director is independent in character and judgement and there are no relationships or circumstances which are likely to affect, or could appear to affect, the Directors' judgements.

Each Director brings a valuable range of experience and expertise to the Board. The profiles of all Directors can be found on pages 90 and 91.

### The role of the Board

The Board has responsibility for the overall management and performance of the Group, the approval of its long-term objectives and commercial strategy and for ensuring that any necessary corrective action is taken promptly. Reporting to the Board, the Governance function is tasked by the Group to develop and oversee corporate processes for the identification and management of business risks and the appropriate application of the Serco Management System (SMS) and corporate responsibility activities throughout the Group. The 'Our performance' section on pages 16 to 79 details the internal control and risk policies, procedures and management framework adopted by the Group. The Corporate Responsibility Review is available online at [www.serco.com](http://www.serco.com) and illustrates how Serco's approach to corporate assurance and responsibility translates from the Board into everyday working practices.

### Conflicts of interest

The Company's Articles of Association, as approved by shareholders at the Company's 2010 annual general meeting, include provisions reflecting recommended practice concerning conflicts of interest. The Board has in place procedures for Directors to report any potential or actual conflicts to the other members of the Board for their authorisation where appropriate. In deciding whether to authorise a conflict or potential conflict of interest only non-interested Directors (i.e. those that have no interest in the matter under consideration) will be able to take the relevant decision; in taking the decision the Directors must act in a way they consider, in good faith, will be most likely to promote the Company's success. In addition, the Directors may impose conditions or limitations when giving authorisation if they think this is appropriate.

The process of reviewing conflicts disclosed, and authorisations given, is repeated at least annually. Any conflicts or potential conflicts considered by the Board and any authorisations given are recorded in the Board minutes and in a Register of Directors' Conflicts which is maintained by the Company Secretary.

### Reserved and delegated authorities

There is a formal schedule of matters reserved to the Board. This schedule, which is reviewed annually, includes approval of:

- Group strategy
- Annual financial and operating plans
- Major capital expenditure, acquisitions or divestments
- Annual and half-year financial results
- Satisfying itself as to the integrity of financial information
- Dividend policy
- Ensuring adequate succession planning for the Board and senior management and appointing and removing Directors, the Company Secretary and Committee members
- Treasury policy
- Review of the effectiveness of the Group's system of internal control and risk management process
- Training and development of the Board and the Company Secretary.

Other specific responsibilities are delegated to Board Committees which operate within clearly defined terms of reference. Details of the responsibilities delegated to the Committees are given on pages 83 and 84.

#### *Information flow*

Senior executives below Board level attend certain Board meetings at which they make presentations on the results and strategies of their divisional units and functional areas of the Group. Board members are given appropriate documents in advance of each Board meeting and each Committee meeting, as appropriate.

Historically, Board meetings have been held four times a year over two days at a time; from 2011 onwards an additional two Board meetings will be held for one day each which will focus on strategy development for both the Group and individual divisions. Board meetings are structured to allow open discussion of the strategy, trading and financial performance and risk management of the Group. Board and Committee meetings are held at varying locations and the opportunity is used to combine the formal business of the Board with site visits and divisional presentations and discussions. Additional Board meetings are scheduled as required.

The attendance of individual Directors at Board meetings held during the year is shown in the table on page 82.

#### *Company Secretary and independent advice*

The Company Secretary is responsible for advising the Board on all corporate governance matters, ensuring both that all Board procedures are followed and good information flow and facilitating induction programmes for Directors. All Directors have access to the advice and services of the Company Secretary.

The Board has approved a procedure for Directors to take independent professional advice, if necessary, at the Company's expense.

#### *Chairman and Chief Executive*

The roles of the Chairman and the Chief Executive are separately held and the division of their responsibilities is clearly established, set out in writing, and agreed by the Board.

As Chairman, Alastair Lyons is responsible for:

- Ensuring the effectiveness and successful operation of the Board, its agenda and processes
- Promoting the highest standards of corporate governance and ensuring appropriate communication with shareholders on these standards and the Group's overall performance
- Ensuring appropriate Director training and development takes place
- Board succession planning.

The Chief Executive, Christopher Hyman, is responsible for:

- The formation and implementation of the Group's global strategy
- Delivery of the Group's business plan
- Providing motivation and leadership to the operating divisions, chairing the Executive Committee and setting its style and tone
- Setting the overall policy and direction of Serco's business operations, investments and other activities within a framework of prudent and effective risk management and ensuring that divisions and functions control those risks satisfactorily
- Providing leadership and representation of the Group with major customers, shareholders and industry organisations.

#### *Senior Independent Director*

Following the retirement of Margaret Ford, who served as Senior Independent Director throughout 2010, David Richardson was appointed to that role in January 2011. As part of this role, David is available to shareholders if they have any issues or wish to discuss any aspects of the Company's business without the Executive Directors or Chairman present.

#### *External directorships for Executive Directors*

The Board considers that Executive Directors can gain valuable experience and knowledge through appropriate and limited non-executive appointments in other listed companies or independent sector organisations. The Board is careful to ensure that any such appointments do not compromise the effective management of the Group and that these are approved in advance of any appointments being taken up. Details of the fees received by Executive Directors for external appointments can be found in the Remuneration Report on page 96.

#### *Significant other commitments of the Chairman*

Alastair Lyons is non-executive Chairman of Admiral Group plc, Deputy Chairman and Senior Independent Director of Bovis Homes Group PLC, Senior Independent Director of Phoenix Group Holdings, and a non-executive director of the Towergate Insurance Group.

The Board believes that Alastair holds a well-balanced portfolio of positions which allow him to perform his duties as Chairman appropriately.

#### *Re-election of Directors*

The Company's Articles of Association stipulate that each Director shall retire (but be eligible for re-election) at the annual general meeting held in the third calendar year following the year in which he or she was elected or last re-elected by the Company. Any Directors appointed by the Board since the last annual general meeting must stand for re-election at the next annual general meeting. Any Non-Executive Directors, excluding the Chairman, who have served for more than nine years will be subject to annual re-election.

In accordance with provisions contained within the Governance Code and applying to the Company from 2011, all Directors will be retiring and standing for re-election at the 2011 Annual General Meeting. Their names are set out in the Notice of Annual General Meeting. Furthermore, all Directors standing for re-election will do so on an annual basis at each subsequent annual general meeting.

# Corporate Governance Report

## The Non-Executive Directors

### Independence

All the Non-Executive Directors are independent of management and have no cross-directorships or significant links which could materially interfere with the exercise of independent judgement.

### Term of appointment

All Non-Executive Directors are appointed for an initial term of three years. Thereafter, subject to satisfactory performance, they may serve one or two additional three-year terms, with a thorough review of their continued independence and suitability to continue as Non-Executive Directors being undertaken if they are to remain on the Board for more than nine years. The terms and conditions of the appointment of the Directors are summarised in the Remuneration Report on page 97 and are available on request from the Company Secretary.

### Meetings of Non-Executive Directors

Non-Executive Directors meet separately (without the Chairman or Executive Directors being present) at least once a year principally to appraise the Chairman's performance. This meeting is chaired by the Senior Independent Director. This took place in 2010 in respect of Kevin Beeston's tenure as Chairman of the Company. The performance of the current Chairman will be assessed on completion of his first year in position in 2011.

### Board meetings and attendance

From 2011 the Board will hold its meetings on a bi-monthly basis with ad hoc meetings in between if required. The frequency and content of Board meetings are reviewed by the Board annually.

The attendance of the individual Directors at Board and Committee meetings of which they were members during 2010 was as follows:

	Board (5 meetings)	Audit (3 meetings)	Remuneration (4 meetings)	Nomination (2 meetings)
Kevin Beeston	2 (2)	n/a	n/a	- (1)
Alastair Lyons	4 (4)	n/a	n/a	1 (1)
Tom Corcoran	5	3	3	2
Christopher Hyman	5	n/a	n/a	n/a
Andrew Jenner	5	n/a	n/a	n/a
Leonard V. Broese van Groenou	5	3	4	2
Margaret Ford	5	3	4	2
David Richardson	5	3	4	2

Notes:

1. n/a means that the specified Director is not a member of that Committee, although he or she may attend meetings at the invitation of the Chairman of the Committee.
2. Where a number is given in brackets against a Director's attendance, this is the number of meetings which took place during their tenure.

## Board effectiveness

### Induction

On joining the Board, Directors are given background information describing the Company and its activities. They receive an induction pack which includes information on all the governance processes of the Group, the roles and responsibilities of the Board, Committees and other management teams and a range of other appropriate information about the Group, its activities and its advisors. Meetings are arranged with a range of key people from across the Group on a structured basis to assist with a Director's induction. Visits are also arranged, where possible, to a number of contracts around the country. In 2010 Alastair Lyons completed an exceptionally thorough programme of meetings and site visits, both in the UK and overseas, meeting management and employees of the Group as well as other key external stakeholders such as the external auditors and Company brokers.

### Continued professional development

During 2010 the Board members were all engaged in a range of training and professional development activities. In October 2010, the Audit Committee attended an internal workshop to gain an in depth understanding of the Group-wide Internal Audit approach, its effectiveness and relationship with the wider governance framework including the SMS and Risk Management methodology.

The Board considers the training needs of the Executive and Non-Executive Directors plus the Company Secretary. All Board members are encouraged to attend relevant training courses at the Company's expense. The development needs of the Directors and the Company Secretary fall within the remit of the Chairman who reviews and agrees these individually.



### *Performance evaluation*

The Group recognises the importance of a comprehensive evaluation process for the Board and ensures that comments and recommendations are considered carefully and implemented where appropriate to ensure its continued development. A formal evaluation has been undertaken of the performance of the Board and its Committees during 2010. The evaluation was performed in November 2010 by all Directors through the completion of an evaluation questionnaire followed by one-to-one meetings as appropriate. Matters covered by the Board questionnaire included: the effectiveness and frequency of board meetings; risk and risk management; Group strategy; the structure and composition of the Board including diversity and the skill-set and experience of its members; stakeholder engagement; and a traditional analysis of its strengths, weakness, opportunities and threats. There was general agreement that, overall, the Board and its Committees continued to operate effectively throughout the period. It was noted that the Board was in a transitional period, both in terms of being led by a new Chairman and the recruitment of new Non-Executive Directors following retirements, and the effective induction and integration of the latter were cited as key determinants of the continuing successful operation of the Board.

The Directors continue to believe the openness and experience of the Board members are key strengths. Directors feel well informed and believe that key issues such as risk and strategy are very well managed within rigorous processes, with sufficient opportunity for challenge and debate. The increased number of Board meetings proposed from 2011 onwards was noted as a development that would further strengthen the robustness of the Company's stewardship and deepen the understanding by, and communication between, Board members.

The gender imbalance of the Board, following the retirement of Margaret Ford, was noted as part of the evaluation. The Board is fully supportive of the emphasis placed on diversity, in particular gender diversity, within the Governance Code and this is a focus in the current recruitment of Non-Executive Directors to the Board.

The use of an external facilitator was considered for the evaluation of the Board and all its Committees. However, as the Board had undergone a number of changes during 2010 it was considered to be more appropriate to undertake an externally facilitated evaluation in 2011. Further, it is the Board's intention to comply with the requirements of the Governance Code and carry out such an external evaluation at least once every three years.

In addition, an evaluation of the Chairman's performance led by the Senior Independent Director (taking into account the views of both the Non-Executive and Executive Directors) was carried out during the year for Kevin Beeston and will be for the new Chairman, Alastair Lyons, during 2011.

### **Board Committees**

The Board has delegated authority to a number of permanent Committees to deal with matters in accordance with written terms of reference. The terms of reference for all Committees are reviewed on a regular basis by the Board to ensure they are still appropriate and reflect any changes in good practice and governance; these are available online at [www.serco.com](http://www.serco.com).

Committees are authorised to obtain outside legal or other independent professional advice if they consider it necessary.

### *The Audit Committee and Audit Committee Report*

**Membership:** The Audit Committee consists solely of independent Non-Executive Directors. It is chaired by David Richardson and comprises Leonard V. Broese van Groenou and, since February 2011, Paul Brooks. Margaret Ford and Tom Corcoran served on the Committee throughout 2010.

The Chairman of the Committee has recent and relevant experience for this role. The Audit Committee met three times during the year. At the invitation of the Committee, the Finance Director, the Head of Internal Audit, KPMG LLP (the Group's internal audit providers), and Deloitte LLP (the external auditor) attend meetings. The Committee meets with each of the internal auditors, external auditor and the Head of Internal Audit separately at least once a year. All Directors have access to the minutes of the Audit Committee meetings.

**Responsibilities:** The main responsibilities of the Audit Committee are:

- To monitor the integrity of the financial statements of the Company, including interim management statements, and any formal announcements relating to the Company's financial performance, reviewing significant financial reporting judgements contained in them
- To monitor and review the internal audit programme and ensure that the internal audit function is adequately resourced and has appropriate standing with the Company
- To review management's and the internal auditors' reports on the effectiveness of systems for internal financial control, financial reporting and risk management
- To consider the appointment, reappointment and removal of the external auditor and assess independence and objectivity of the external auditor, ensuring that key partners are rotated at appropriate intervals and relevant UK professional and regulatory requirements are taken into account
- To recommend the audit fee to the Board and pre-approve any fees in respect of non-audit services provided by the external auditor and to ensure that the provision of non-audit services does not impair the external auditor's independence or objectivity
- To discuss with the external auditor, before the audit commences, the nature and scope of the audit and to review the auditor's quality control procedures and steps taken by the auditor to respond to changes in regulatory and other requirements
- To oversee the process for selecting the external auditor and make appropriate recommendations through the Board to the shareholders to consider at the annual general meeting.

Additionally, in accordance with the Combined Code, the Committee is responsible for a formal whistle-blowing policy and procedure which applies throughout the Group. Responsibility for the operation of this policy has been delegated to the Company Secretary.

# Corporate Governance Report

Members of the Audit Committee have received updates on accounting standards and generally accepted accounting practice on a quarterly basis as part of the Finance Director's report to the Board, and also on a half-yearly basis from the external auditor.

During 2010 the Audit Committee discharged fully its responsibilities listed above and, in doing so, considered the following:

- Corporate Governance Report and statement of Directors' Responsibilities for inclusion in the 2009 Annual Review and Accounts
- 2010 Half-year Report and Auditor's report thereon
- 2010 external audit fees
- Review of and enhancement to the whistle-blowing process
- Assessment of the Audit Committee
- 2010 internal audit programme and the proposed 2011 programme
- The continuing independence of the external auditor.

**Non-audit services:** The Committee has reconfirmed its policy on the provision of audit and non-audit services by Deloitte LLP. It determined three categories of services: Approved (e.g. audit and related assurance services), Permitted (e.g. tax compliance and due diligence) and Not Permitted (e.g. design/implementation of financial information systems and quasi management services). The Committee, the Company, and Deloitte LLP all monitor compliance with the policy and review at each meeting the fees earned and the estimates for the year.

The Group has complied with the policy throughout the year. Where appropriate, non-audit services have been provided by companies other than Deloitte LLP to safeguard auditor objectivity and independence.

**Auditor's independence:** The independence, objectivity and effectiveness of the external auditor have been examined by the Committee and discussions were held regarding their terms of engagement and remuneration. The appointment of Senior Statutory Auditor is rotated every five years. As such the 2010 audit will be the first of Richard Knights' tenure following his appointment to the role at the end of Nigel Mercer's in 2010. There are no contractual obligations that restrict the Company's current choice of external auditor. The Committee recommended to the Board that Deloitte LLP be proposed for reappointment at the forthcoming 2011 Annual General Meeting. This recommendation has been accepted and will be proposed to shareholders.

### *The Nomination Committee*

**Membership:** The Nomination Committee is chaired by Alastair Lyons and comprises David Richardson, Leonard V. Broese van Groenou and Paul Brooks. The Committee met twice during 2010. Margaret Ford and Tom Corcoran served on the Committee throughout 2010 and Kevin Beeston was also a member during his tenure in 2010.

**Responsibilities:** Matters considered during the year included succession and contingency planning, Board structure and composition and the appointment of successors to Kevin Beeston, Margaret Ford and Tom Corcoran.

The Committee has responsibility for the identification and nomination, for the approval of the Board, of candidates to fill board vacancies as and when they arise, engaging external search consultants as and when necessary.

The Nominations Committee completed a robust tender process which resulted in relevant firms of external executive search consultants being engaged for the appointment of the new Chairman and new Non-Executive Directors. In consultation with the chosen search consultants, specifications were drawn up of the roles and attributes were identified that were felt to be essential for their effective performance, including what would be considered acceptable in terms of time commitment.

### *The Remuneration Committee*

Details of the Remuneration Committee and its policies together with the Directors' remuneration, emoluments and interests in the Company's share capital are set out in the Remuneration Report on pages 92 to 103.

### *Executive Committees*

Throughout 2010, a new Executive Committee has operated, which is chaired by the Chief Executive and comprises 11 other members, including the Group Finance Director, Regional Chief Executives and other selected Corporate function heads. The Committee has delegated responsibility from the Board to ensure the effective direction and control of the business and to deliver the Group's long-term strategy and goals. The Committee met ten times during the year to review the Group's activities and discuss management and operational issues. Representatives from across the Serco business were invited to the meetings, as appropriate, to discuss aspects of their business or give presentations on specific topics.

### *Relationship with shareholders*

The Company's relationship with shareholders is given a high priority. The Annual report and accounts is available to all shareholders both in hard copy and online at [www.serco.com](http://www.serco.com).

We no longer produce a printed report of our half-year results. Instead, a letter summarising these results is issued to shareholders and a copy of the full stock exchange announcement is available on request.

Regular trading updates are published ahead of close periods and before the annual general meeting by press release. In addition, press releases and stock exchange announcements are made regarding significant contracts or transactions. All trading announcements are also posted on the Group's website [www.serco.com](http://www.serco.com).

### Annual general meeting

Individual shareholders have the opportunity at the annual general meeting to question the Chairman and, through him, the Chairs of the various Board Committees and other Directors. Details of the meeting are set out in the notice of annual general meeting which is sent to shareholders and which contains the text of the resolutions to be proposed and explanatory notes. For the first time, in 2010 shareholders attending the AGM were invited to vote by means of a poll. A poll reflects the number of voting rights exercisable by each member and is considered by the Board to be a more democratic method of voting. Such poll voting will again take place at the 2011 AGM. Shareholders are advised of the total number of votes lodged for each resolution, in the categories 'for' and 'against' together with the number of 'votes withheld'. This information is also posted on the Group's website [www.serco.com](http://www.serco.com).

### Institutional investors

The Chief Executive and Finance Director have regular dialogue with institutional investors. The Chairman also meets with institutional investors from time to time as appropriate. The Company's investor relations programme and day-to-day activities are managed by the Head of Investor Relations. As part of the role of Senior Independent Director, David Richardson is also available to meet shareholders, as Margaret Ford was throughout her tenure, should it be required.

The Board receives an investor relations report at each meeting. This reviews share price movements and valuation, changes in the share register, the Company's recent and planned investor relations activities, communication with shareholders, analyst recommendations and significant news from the market and support services sector. The report ensures that the Board has a clear understanding of the Company's investor relations performance.

### Group website

The Group website [www.serco.com](http://www.serco.com) is a primary source of information on the Group. The site includes an area tailored for investors, including information such as an archive of all reports, announcements, presentations and webcasts, share price tools, the terms of reference for all Board Committees, the Corporate Responsibility Review, and information on voting at the annual general meeting. It also has a link directly to the Company's registrars, allowing shareholders to view their shareholding online and to vote on the resolutions set out in the notice of annual general meeting.

### Business conduct

Serco Group operates within a management system that defines the policies, standards and processes to be applied wherever we operate. Integral to this is our policy on Business Conduct and Ethics that applies to all business divisions, operating companies and business units throughout the world. This policy outlines the Group's position on a wide range of ethical and legal issues including conflicts of interest, financial inducements, human rights and legal and regulatory compliance. It applies to Directors and to all employees regardless of their position or location. Recognising that ethical dilemmas may arise in a growing company the Group has an ethics consultation process that is to be followed to determine the Group's position on particular issues. To support this process an Ethics Committee, comprising members of the executive team with a quorum of three and chaired by the Marketing Director, meets as required, usually monthly. As the leadership of the Company, the executive team will make any fine judgements about what it considers acceptable or otherwise.

In 2010 Serco undertook a review of its whistle-blowing service and introduced a new, outsourced, Ethics Hotline for employees to report any concerns they may have, or report any wrongdoing, that they do not feel able to raise with their line manager, human resources colleagues or through other reporting channels. In addition to the Hotline, which is available toll-free worldwide in several languages, employees can also make reports via email or the internet. The Company Secretary investigates independently any issues raised and reports back to the Board. Reports can be made anonymously and without fear of retaliation. The Group maintains a position of impartiality with respect to party politics. Accordingly, it does not contribute funds to any political party. It does, however, contribute to the public debate of policy issues that may affect it in the countries in which it operates.

### Internal control and risk management

Further to the comments above regarding Governance, details of the Group's internal control and risk management processes are contained in pages 70 to 79 of the 'Our performance' section. The Board confirms that the actions it considers necessary have been taken to remedy any failings and weaknesses which it has determined to be significant from its review of the Group's internal controls and risk management processes.

### Going concern

The Directors have acknowledged the guidance on going concern and financial reporting published by the Financial Reporting Council in October 2009. This is discussed in the Finance Review starting on page 52.

Approved by the Board of Directors and signed on its behalf by:



Joanne Roberts  
Secretary  
1 March 2011

## Directors' Report

### Annual report and accounts

The Directors have pleasure in presenting the Annual report and accounts of the Group for the year ended 31 December 2010. Comparative figures used in this report are for the year ended 31 December 2009. The Corporate Governance Report set out on pages 80 to 85 forms part of the Statutory Directors' Report.

### Activities

Serco Group plc is a holding company which operates via its subsidiaries and its joint ventures to improve services by managing people, processes, technology and assets more effectively. Serco supports governments, agencies and companies who seek a trusted partner with a solid track record of providing assured service excellence. Our people offer operational, management and consulting expertise in the aviation, BPO, defence, education, environmental services, facilities management, health, home affairs, information and communications technology, knowledge services, local government, science and nuclear, transport, welfare to work and the commercial sectors.

The Chairman's Statement and the remainder of the 'Our performance' section on pages 16 to 79 report on the activities during the year, post balance sheet events, 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.

### Share capital

The issued share capital of the Company, together with the details of shares issued during the year is shown in note 28 to the Consolidated Financial Statements.

The powers of the Directors to issue or buy back shares are restricted to that approved at the Company's annual general meeting.

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.

### Dividends

An interim dividend of 2.20p (2009: 1.85p) per ordinary share was paid on 15 October 2010. The Directors recommend a final dividend of 5.15p (2009: 4.40p) per ordinary share which, if approved by shareholders at the Annual General Meeting, will be paid on 17 May 2011 to those shareholders on the register at the close of business on 11 March 2011.

### Substantial shareholdings

As at the date of this Report the Company had been notified under Rule 5 of the Disclosure Rules and Transparency Rules of the Financial Services Authority of the following holdings of voting rights in its shares:

	Number of shares (millions)	% held
Morstan Nominees Limited	25.1	5.11
Capital Research and Management Company	25.0	5.08
AXA S.A.	25.0	5.07
Lloyds Banking Group plc	24.2	4.96
Fidelity International Limited	23.9	4.93
Baillie Gifford & Co	24.0	4.92
Newton Investment Management Limited	23.6	4.85
Legal & General Group plc	19.5	3.99
Ignis Investment Services Limited	15.5	3.15

The Directors are unaware of any restrictions on transfer of securities in the Company or on voting rights. There are also no known agreements between holders of the Company's securities which may result in such restrictions.

### Directors

The current members of the Board together with biographical details of each Director are set out on pages 90 and 91.

At the conclusion of the Company's annual general meeting in May 2010, Kevin Beeston retired from the Board and Alastair Lyons was appointed Non-Executive Chairman of Serco Group plc.

On 31 December 2010 Margaret Ford and Tom Corcoran retired from their positions as Non-Executive Directors of the Company.

On 26 January 2011, the Company announced the appointment of Paul Brooks as a Non-Executive Director of the Company with effect from 1 February 2011. Paul's experience and knowledge will complement the skills and knowledge of the other Board members. It is the intention that Paul will take over as Audit Committee Chairman on the eventual retirement of David Richardson.



### 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 in control conditions are included in the service contracts of Directors which provide compensation or reduction of notice periods in the event of a change in control of the Company.

Details of the Directors' interests in the ordinary shares and options over the ordinary shares of the Company are set out in the Remuneration Report on pages 92 to 103.

### Annual general meeting

The Annual General Meeting of the Company will be held at the Institution of Engineering and Technology (IET), Savoy Place, London WC2R 0BL on 9 May 2011 at 11.00am.

The Notice of Annual General Meeting together with explanatory notes is sent to shareholders with this Report.

### 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 136 to 142.

### 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 principles.

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 equality of opportunity regardless of gender, sexual orientation, age, marital status, disability, race, religion or other beliefs and ethnic or national origin.

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 remains proud of its record of managing employee relations and continues to believe that the structure of individual and collective consultation and negotiation are 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 terms and conditions of employment. 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.

Participation by staff in the success of the Group is encouraged by the availability of sharesave schemes, a share option scheme and a long term incentive plan for senior management, which effectively aligns their interests with those of shareholders by requiring that performance criteria are achieved prior to exercise.

### Corporate responsibility

The Group maintains a focus on corporate responsibility through a structure model that is applied across the business. Our corporate responsibility model focuses on our people, safety, the environment and the communities we serve. This model forms an integral part of our management system and is supported by defined policies in all of the areas it covers. These are applied within the context of our policies on Business Conduct and Ethics. Activities are reported quarterly as part of our internal assurance reporting process.

Further information on our approach to corporate responsibility and how we have delivered our commitments is contained in the Corporate Responsibility Review which is available online at [www.serco.com](http://www.serco.com). This site also provides an overview of our approach to corporate responsibility, our management system and our policies.

### Creditor payment policies

The Group requires each of its business units to negotiate and agree terms and conditions for payment for the supply of capital and revenue items just as keenly as they negotiate prices and other commercial matters.

Suppliers are made aware of the terms and the way in which disputes are to be settled. Payment is then made in accordance with those terms.

The Group's average creditor payment terms in 2010 were 31 days (2009: 32 days).

## Directors' Report

### Donations

The Group continues to encourage all staff to participate in their local communities and has a process to assess both the value and type of investment on a worldwide basis. This measure is based upon the Business in The Community (BiTC) reporting format.

The value of this investment in 2010 at £2,271,575 (2009: £1,746,261) represents 1.06% of the Group's pre-tax profit.

During the year neither the Company nor the Group made political donations and they intend to continue with this policy. 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 auditors are unaware. Each Director has taken all the steps that he ought to have taken as a Director in order to make himself aware of any relevant audit information and to establish that the Group's auditors are aware of that information.

### Auditors

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

Approved by the Board of Directors and signed on its behalf by:



Joanne Roberts  
Secretary  
1 March 2011

# Directors' Responsibilities

The Directors are responsible for preparing the Annual report, Directors' Report, Directors' Remuneration Report and the 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 by the International Accounting Standard (IAS) Regulation to prepare the Group financial statements under International Financial Reporting Standards (IFRS) as adopted by the European Union. The Group financial statements are also required by law to be properly prepared in accordance with the Companies Act 2006 and Article 4 of the IAS Regulation.

IAS 1 requires that IFRS financial statements present fairly for each financial year the Group's financial position, financial performance and cash flows. This requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the International Accounting Standards Board's 'Framework for the Preparation and Presentation of Financial Statements'. In virtually all circumstances, a fair presentation will be achieved by compliance with all applicable IFRSs.

This requires Directors to:

- properly select and apply accounting policies;
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- provide additional disclosures when compliance with the specific requirements in IFRSs are insufficient to enable users to understand the impact of particular transactions, other events and conditions on the Group's financial position and financial performance; and
- make an assessment of the company's ability to continue as a going concern.

The Directors have elected to prepare the parent company financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (UK Accounting Standards and applicable law). The parent company financial statements are required by law to give a true and fair view of the state of affairs of the company and of the profit or loss of the company for that period. In preparing these financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgments and estimates that are reasonable and prudent;
- state whether applicable UK accounting standards have been followed; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

The Directors are responsible for keeping proper 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 parent company 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 to the best of our knowledge:

- the financial statements, prepared in accordance with the applicable set of accounting standards, 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; and
- the management report, which is incorporated into the Directors' 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 they face.

Approved by the Board of Directors and signed on its behalf by:



Joanne Roberts  
Secretary  
1 March 2011

## Directors' profiles



Alastair Lyons



Christopher Hyman



Andrew Jenner



David Richardson



Leonard V. Broese van Groenou



Paul Brooks

### Alastair Lyons CBE (57)

Job title: Chairman

**Appointment:** Alastair was appointed a Non-Executive Director of Serco Group plc in March 2010, becoming Chairman at the conclusion of the Company's AGM in May 2010.

**Responsibilities:** Alastair is responsible for the effective operation of the Board and oversight of corporate governance. He is Chair of the Nomination Committee.

**Experience:** In his executive career Alastair was Group Finance Director and subsequently Chief Executive of the National & Provincial Building Society. When the society was acquired in 1996 by Abbey National he joined the Abbey National main Board as Managing Director of its Insurance Division.

In 1997 he became Chief Executive of the pensions specialist NPI where he led its demutualisation and acquisition by AMP, subsequent to which he joined NatWest in 1999 as Director of Corporate Projects.

A chartered accountant with an MA in economics from Trinity College Cambridge, Alastair has been a non-executive director of, successively, the Department for Work & Pensions and the Department for Transport.

**External appointments:** Alastair has been Chairman of Admiral Group plc, the direct motor insurer, since 2000; in 2008 he was appointed Deputy Chairman of Bovis Homes Group PLC, one of the UK's leading quoted house builders; in March 2010 he was appointed Senior Independent Director and Audit Chair of Phoenix Group Holdings, the UK's largest closed life and pension fund consolidator; and in February 2011 he was appointed Non-Executive Director of the Towergate Insurance Group.

### Christopher Rajendran Hyman CBE (47)

Job title: Chief Executive

**Appointment:** Christopher was appointed Chief Executive of Serco Group plc in 2002.

**Responsibilities:** Christopher is responsible for the formation and implementation of the Group's global strategy, as well as the day-to-day management of the business operations and our relationship with the City and key stakeholders. He provides leadership and representation of the Group with major customers, shareholders and industry organisations.

**Experience:** Christopher graduated from Natal University in Durban, South Africa and qualified as a chartered accountant, serving with Arthur Andersen and Ernst & Young before joining Serco in 1994 as the European Finance Director. He was appointed Group Company Secretary in 1996, Corporate Finance Director in 1997 and Group Finance Director in April 1999.

**External appointments:** Christopher is chairman of the Prince of Wales' charity In Kind Direct, and a Trustee of the Africa Foundation. He is also a Trustee Director of the Board for Business in the Community, a member of the UK Commission for Employment and Skills and is Chairman of The Prince's Seeing is Believing Programme. In the 2010 Queen's Birthday Honours Christopher was awarded a CBE for his services to Business and Charity.



**Andrew Mark Jenner (42)**

**Job title:** Finance Director

**Appointment:** Andrew was appointed Group Finance Director in May 2002.

**Responsibilities:** Andrew is responsible for the Group's financial management, reporting and control, operational efficiency and risk management and assurance. He shares responsibility with the Chief Executive for our relationship with our key stakeholders and the City.

**Experience:** Andrew, a chartered accountant, joined Serco in 1996 as Group Financial Controller, having previously worked for Unilever and Deloitte & Touche LLP. He became Corporate Finance Director with additional responsibility for treasury activities in 1999 before joining the Board in 2002.

**External appointments:** Andrew is a Non-Executive Director of Galliford Try plc, one of the UK's leading construction and house-building groups and is Chairman of its Audit Committee.

**David Richardson (59)**

**Job title:** Senior Independent Director

**Appointment:** David joined Serco as a Non-Executive Director in June 2003.

**Responsibilities:** David is Chair of the Audit Committee and a member of the Remuneration and Nomination Committees.

**Experience:** David, a chartered accountant, has previously held the position of Finance Director of Whitbread, where his roles in a 20-year career have included eight years as Strategy Director. David was instrumental in transforming Whitbread from a brewing and pubs company into a market leader in hotels, restaurants and leisure clubs. Until September 2010 David also served as a Non-Executive Director of Tomkins plc.

**External appointments:** David is the Chairman of Forth Ports plc and Director of the Supervisory Board of World Hotels AG.

**Leonard V. Broese van Groenou (64)**

**Job title:** Non-Executive Director

**Appointment:** Leonard joined Serco as a Non-Executive Director in April 2006.

**Responsibilities:** Leonard is Chair of the Remuneration Committee and a member of the Audit and Nomination Committees.

**Experience:** Leonard was previously Vice-President Human Resources and member of the corporate executive committee of Pennsylvania-based Air Products, a New York listed company serving customers in technology, energy, healthcare and industrial markets worldwide where he served for nearly 30 years. His career at Air Products spanned numerous international roles including financial control, business planning, operational management and human resources.

**External appointments:** Leonard is the Chairman of the Netherlands Benevolent Society.

**Paul Brooks (57)**

**Job title:** Non-Executive Director

**Appointment:** Paul joined Serco as a Non-Executive Director in February 2011.

**Responsibilities:** Paul is a member of the Audit and Nomination Committees.

**Experience:** Paul qualified as a chartered accountant with KPMG, having graduated from Cambridge University with an economics degree. He joined Experian in 1999 as Finance Director of its former International Division and has been Chief Financial Officer of Experian since October 2001. He was appointed to its board of directors in July 2006.

**External appointments:** Paul is an Executive Director of Experian plc.

## Remuneration Report

### Introduction

The following report details the remuneration policy and the actual remuneration of the Directors of the Group for the year ended 31 December 2010. In preparing this report, consideration has been given to the disclosure requirements of the 2008 Combined Code and of the Companies Act 2006. A resolution to approve this report will be proposed at the Annual General Meeting on 9 May 2011.

### The Remuneration Committee

The Remuneration Committee (the Committee) consists solely of independent Non-Executive Directors. It is chaired by Leonard V. Broese van Groenou and through 2010 comprised Margaret Ford, David Richardson and Tom Corcoran. Margaret Ford and Tom Corcoran retired from the Board along with the Committees of Serco Group plc on 31 December 2010.

The Chairman of the Company and the Executive Directors may attend meetings of the Committee at its discretion and as appropriate. They are not in attendance when their own remuneration arrangements are discussed.

The Committee met four times during the year. 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 meet best practice. Details of the Directors' attendance at the Committee meetings can be found in the Corporate Governance Report on page 82.

The Committee determines the overall remuneration policy for senior management and the individual remuneration of the Chairman and the Executive Directors. This includes base salary, bonus, long-term incentives, pensions, benefits and terms of employment (including those terms on which service may be terminated).

### Advisors to the Remuneration Committee

The Committee has been advised by Towers Watson (originally appointed in May 2008). They have provided advice to the Committee throughout the year on the overall remuneration policy and philosophy. Consulting services have also been provided to the Group by Towers Watson in relation to retirement benefits and pay data. In this regard the Committee is satisfied that any potential conflicts are appropriately managed. The Committee has also carefully reviewed the voluntary code of conduct in relation to executive consulting in the UK. Fees paid to Towers Watson during the period totalled £122,000, the majority of which related to services provided for executive remuneration. During the year the Committee considered and approved the terms of engagement and remuneration of the advisors.

The Group Human Resources Director, Geoff Lloyd, also provides advice and guidance to the Committee.

### Remuneration policy

In 2008 the Committee carried out a comprehensive triennial review of executive remuneration and of the principles which form the basis of the Company's remuneration policy. As a result of the review, changes were made to both the structure and the levels of remuneration for the Executive Directors. These were detailed in the 2009 Annual Review and Accounts. During 2011 a further triennial review will be carried out and any changes will be set out in detail in next year's report.

Serco's remuneration policy adopts the following principles which are that executive remuneration should:

- 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 in all our chosen markets;
- Be based on a clear rationale which participants, shareholders and other stakeholders are able to understand and support.

In setting the remuneration of the Executive Directors, in particular the non-financial objectives relating to the annual bonus scheme, the Remuneration Committee is able to consider corporate performance on safety, environmental, social and corporate governance matters. The Committee retains discretion to reduce bonuses or the vesting of awards under the share plans if performance in these areas is unsatisfactory.

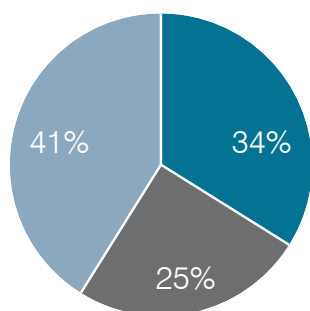
## The elements of remuneration

### Composition

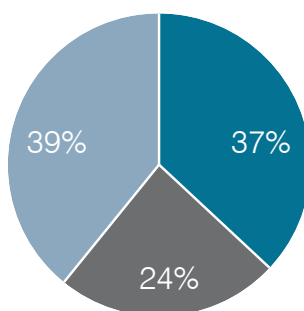
The remuneration package for Executive Directors consists of base salary, annual bonus, long-term share-based incentives, pension and other benefits. The Group's policy is to ensure that a significant proportion of the package is related to performance.

The relative proportions of the performance-related and fixed elements of remuneration (excluding pension and other benefits) for Executive Directors - assuming 'on-target' remuneration - is shown below.

#### Remuneration for Chief Executive



#### Remuneration for Finance Director



■ Base salary  
■ Performance-related annual bonus  
■ Performance-related long-term incentives (expected value)

### Base salary

The Committee's policy is to set the base salaries of the Executive Directors so as to ensure that total target remuneration is competitive. Base salaries are normally reviewed annually. The Committee takes note of relative pay and employment conditions within the comparator group and the Company when determining salaries.

The Committee is satisfied that the size profile of the companies in Towers Watson's database is representative of the companies in the FTSE 51 to 130. It also believes that it is important that the same sources of market data are used across the Company to ensure consistency.

The Committee considered carefully whether base salaries for Christopher Hyman and Andrew Jenner should be increased in 2010, having particular regard to the following:

- Serco's continuing strong performance in 2009 and 2010 including its growth in international markets, since salaries were last increased with effect from September 2008. In 2009 earnings per share increased by 30.6% and in the first half of 2010 by 19.9%;
- the strong personal contribution of both individuals towards the creation of value for shareholders;
- the current difficult economic environment;
- relative salary levels in the comparator group;
- the increased scope of the role of the Finance Director resulting from an internal reorganisation that means he is now also responsible for the Group's operational efficiency agenda.

A comprehensive explanation of the business performance during the year has been provided in the 'Our performance' section on pages 16 to 79.

With effect from 1 September 2010, the salaries of the Executive Directors were increased to £700,000 and £412,500 respectively, an increase of 8.5% in both cases.

To ensure that pay and conditions across the Group are taken into account when making decisions on Executive Directors' pay, the Remuneration Committee was briefed about the overall decisions on base salaries and pay bill increases for Serco's Executive Committee and employees across the Group. The Remuneration Committee is satisfied that the principles and considerations that were applied to Executive Directors are, as far as possible, applied to all employees. Pay levels are designed to be competitive, fair and to reflect the skills and performance of individual employees. Individual pay increases in excess of those granted to the Executive Directors were awarded to various employees for reasons including promotion and increased scope of role.

The impact of these increases on the competitive market position of total remuneration (including pension) is to maintain the competitive position established at the time of the last triennial review.

# Remuneration Report

## Annual bonus

Bonus is earned on the basis of achievement of a mix of financial and non-financial objectives which are weighted 80% and 20% respectively. Payment for target performance is at 75% of base salary for the Chief Executive and 65% of base salary for the Finance Director.

Financial measures are based on the Serco Group results and the non-financial measures are individually set. The three financial measures for 2010 were based on turnover, adjusted profit before tax and amortisation, and cash conversion. These measures reflect the growth and margin improvement strategies of the business. The standards of performance set are designed to be stretching. The non-financial goals set for 2010 assessed performance against a number of strategically important objectives for each individual.

The maximum annual bonus opportunity is 150% of base salary for the Chief Executive and 130% of base salary for the Finance Director. On the basis of Serco's performance in 2010, annual awards of 136.8% and 117.52% of salary have been determined. The Executive Directors delivered a financial performance that exceeded each of the quantitative targets. Serco's financial performance for the year is described in more detail in the 'Our performance' section starting on page 16. The Executive Directors also delivered strongly against their personal objectives to implement the Group's strategy, introduce new management structures and ensure performance of key contracts. Further, the new Chairman was inducted into the business during the period.

The bonus objectives for 2011 have been set on a similar basis.

Annual bonuses are not pensionable.

## Share-based remuneration

Long-term share incentives are awarded to Executive Directors under the Serco Group plc Deferred Bonus Plan (DBP) and the Serco Group plc Performance Share Plan (PSP). All grants and awards are made pursuant to the rules of the applicable plans and in accordance with the Model Code and policies in relation to the treatment of leavers have been adopted. The measurement of the performance targets is undertaken by Mercer for the DBP and the PSP, and in relation to the Earnings Per Share (EPS) element of the targets, is audited by Deloitte LLP. The conditions relating to the plans are detailed below.

### Deferred Bonus Plan

Executive Directors can elect to defer, for three financial years, up to 50% of the bonus earned by purchasing shares in the Company pursuant to the terms of the DBP. The shares purchased will be matched by the Company if stretching performance targets are met.

The two performance measures are independent and each determines the vesting of half of the matching shares. The measures are TSR compared to the companies in the FTSE 51 to 130 (excluding investment trusts) and EPS growth. Relative TSR and EPS growth carry equal weight in respect of the matching shares awarded under the DBP. The structure for vesting is the same for both measures.

#### TSR element:

- No matching shares will be awarded if the Group does not meet or exceed the median TSR of the comparator group
- An award of matching shares of one half of the gross value of the bonus deferred will vest for median or threshold performance
- An award of matching shares with a value of two times the gross value of the deferred bonus vest for upper quartile or superior performance at the top end of the range.

#### EPS element:

- If the annual compound growth in EPS does not meet 9% (threshold) then no matching shares will vest
- If compound growth in EPS is at 9% (threshold) then 25% of this part of the matching award will vest
- For compound growth in EPS of between 9% (threshold) and 14% (maximum) then this part of the award will vest on a straight line basis to 100%.

For the award made under the DBP and the PSP in 2009, the structure for vesting for the first year of the performance period is annual growth in EPS of 13% at threshold to 19% at maximum.

The definition of EPS is basic EPS excluding material acquisitions, disposals, currency movements and before amortisation of acquired intangibles.

The Committee has discretion to vary the proportion of awards that vest under the DBP to ensure that the outcomes are fair and appropriately reflect the underlying financial performance of the Group.

In 2010 both the Chief Executive and the Finance Director elected to defer 50% of their earned bonus into the DBP.



#### *Performance Share Plan*

The PSP awards granted to the Executive Directors are calculated at a face value on grant of 200% of base salary for the Chief Executive and 175% of base salary for the Finance Director.

The shares will normally only vest at the end of a three-year period, if the Executive Directors are still in employment with Serco and two performance measures have been met. The two measures, which are independent, are TSR compared to the companies in the FTSE 51 to 130 (excluding investment trusts) and EPS growth. Relative TSR performance determines the vesting of 70% of the shares and EPS growth the remainder. Greater weight has been placed on relative TSR to underscore the importance of longer term alignment with shareholders' interests. The structure for vesting is the same for both measures. The shares will vest in full only if Serco's performance is upper quartile or, in the case of EPS growth, superior and at the top end of the range. Median or threshold performance will trigger the vesting of 25% of the award. Performance between median/threshold and upper quartile/superior will be on a straight-line basis.

Dividends will be reinvested and distributed under both plans only in respect of shares that vest at the end of the performance period.

The Committee has discretion to vary the proportion of awards that vest under the Plans, to ensure that the outcomes are fair and appropriately reflect the underlying financial performance of the Group.

The Committee considered the ongoing appropriateness of relative TSR and EPS as the performance measures for long-term share-based plans and agreed that no changes should be made at this point in time. This will be reviewed once again as part of the triennial review for executive remuneration which, as referenced above, will commence in 2011.

Prior to 2009 share-based incentive awards were made under the Serco Group plc 2006 Long Term Incentive Plan (LTIP) and the Serco Group plc 2005 Executive Option Plan (EOP); the conditions relating to these plans are detailed below.

#### *Long Term Incentive Plan (LTIP)*

The LTIP awards granted to Executive Directors were calculated at 100% of salary at the time of grant. The vesting of awards depends on the Group's TSR measured relative to the top 250 companies in the FTSE, as ranked by market capitalisation, excluding those in certain sectors such as oil and gas and financial services.

The Committee has discretion to vary the proportion of awards that vest if it considers that the TSR performance measure does not appropriately reflect the underlying financial performance of the Group.

The final award under this plan completed its performance period on 31 December 2010, the Group's TSR performance relative to its comparator group was between median and upper quartile, and therefore 68.77% of the awards will vest.

There is no re-testing under the LTIP.

#### *Executive Option Plan (EOP)*

Options granted under the EOP may be exercised after the third anniversary of grant, depending upon the achievement of a financial performance target over three years. The options are granted at market value and awards made to Executive Directors were based on 100% of salary as at the 31 December prior to grant.

Achievement of the performance is measured by reference to the Group's EPS performance relative to the Retail Price Index (RPI) over the three-year performance period.

The vesting of the grants is based on the following schedule:

- If the level of EPS growth is less than RPI + 5% per annum, none of the options may be exercised
- If the level of EPS growth is equal to RPI + 5% per annum, 40% of the options may be exercised
- If the level of EPS growth is equal to RPI + 10% per annum, all of the options may be exercised
- For an EPS growth of between RPI + 5% and RPI + 10% per annum, a proportion of the options between 40% and 100% may be exercised.

For the final option grant under this plan which completed its performance period on 31 December 2010, the Group's EPS growth was 22.73% per annum over the three-year performance period which resulted in all options vesting. The level at which maximum vesting would occur was 12.69% per annum.

#### *Savesave Scheme*

The Group operates a Savesave Scheme. No performance conditions are attached to options granted under the Scheme as it is an all-employee scheme. Options granted to Scheme participants are normally set at a discount of 10% to the market value of shares at grant. None of the Directors participate in the Savesave Scheme.

## Remuneration Report

### Share ownership policy

The share ownership requirement for the Chief Executive is two times base salary and one times base salary for the Finance Director. Executive Directors are required to retain in shares 50% of the net value of any performance shares or options exercised until they satisfy the shareholding requirement.

At the end of the year, by reference to the share price at that date, Executive Directors' share ownership levels were as follows:

	Ordinary shareholding at 31 December 2010 (555.5p)		Ordinary shareholding at 31 December 2009 (530p)	
	No. of shares	% of salary	No. of shares	% of salary
Chief Executive	777,889	617%	735,510	604%
Finance Director	289,574	390%	198,075	276%

### Pensions, life assurance and other benefits

Serco operates both defined benefit and defined contribution pension schemes. The Executive Directors participate in the Serco Pension and Life Assurance Scheme (SPLAS). This is a funded, defined benefit scheme, which provides for a target pension of two-thirds of pensionable salary following a full career. Members contribute to the scheme at rates varying according to the section of the scheme.

From 1 January 2007 Serco also introduced SMART whereby all members were given the option to have their pension contributions paid by salary sacrifice. Under this arrangement the member makes no normal pension contributions, Serco makes additional contributions to SPLAS equal to those that the member would otherwise have made and the member's contractual pay is reduced by the amount of these contributions. Both Christopher Hyman and Andrew Jenner opted to have their contributions paid by SMART.

Kevin Beeston's pension benefits accrued prior to 6 April 2006 exceeded the new Lifetime Allowance, which came into force at that date, and he opted to cease paying contributions and accruing benefits in the pension scheme after 6 April 2006. Kevin Beeston retired at the conclusion of the Company's 2010 AGM on 11 May 2010.

Christopher Hyman opted to cease accruing benefits in the pension scheme after 1 April 2010 and Andrew Jenner has opted to cease accrual after 31 December 2010.

Since 1 April 2010 Christopher Hyman has been in receipt of a cash allowance equal to 33% of his base salary in lieu of further pension provision. From 1 January 2011 Andrew Jenner will also receive a cash allowance equal to 33% of his base salary in lieu of pension provision. The Executive Directors remain entitled to lump sum and widow's pension benefits should they die before retirement and while still employed by Serco.

The Executive Directors receive a range of other benefits which comprise 25 days' holiday per year, a car, private medical insurance, private health insurance, life cover, an annual allowance for independent financial advice, and voluntary health checks every two years.

### Service contracts and compensation

Each Executive Director has a rolling service contract and these contracts will be available for inspection prior to the start of and after the Company's annual general meeting.

The service contracts have a notice period of 12 months. The Company reserves the right to make a payment in lieu of notice. In addition, where a 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. The service contracts do not provide for termination payments to be made in any other circumstances.

There have been no payments made during the year in relation to compensation for loss of office.

A summary of details relating to each Director who served during the year is provided below:

Name of Director	Date joined Company	Date of appointment to the Board	Date of contract	Unexpired term at 31 December 2010
Christopher Hyman	30 August 1994	1 April 1999	10 June 2009	Rolling contract of 12 months' notice period
Andrew Jenner	4 November 1996	3 May 2002	10 June 2009	Rolling contract of 12 months' notice period

### 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.

Andrew Jenner served as a non-executive director of Galliford Try plc during the year. Fees payable in the year were £38,000.

No other fee-paying external positions were held by any of the Executive Directors.

### The Chairman and Non-Executive Directors

The Group's policy is that the fees of the Chairman and the Non-Executive Directors, which are determined by the Board, are set at a level which will attract individuals with the necessary experience and ability to make a substantial contribution to the Group's affairs.

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. The renewal of appointments is not automatic, and Non-Executive Directors are required to retire and stand for re-election in accordance with the Company's Articles of Association and the UK Corporate Governance Code (and formerly the Combined Code).

As at 31 December 2010, the Non-Executive Directors of the Group had no personal financial interest in the matters determined by the Board, there are no conflicts of interest arising from cross-directorships and no involvement in the day-to-day running of the Group. The Non-Executive Directors do not participate in the Group's incentive or pension schemes, or receive other benefits except as described.

#### Current fee structure

Non-Executive Directors' remuneration consists of cash fees paid monthly with increments for positions of additional responsibility. In addition, 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.

The standard annual fees payable for the Chairman and Non-Executive Directors during the financial year under review are shown in the table below.

	1 January 2010 to 11 May 2010	
	£	
Chairman (1)	230,000	
	11 May 2010 to date	
	£	
Chairman (2)	250,000	
	1 January 2010 to date	
	£	
Board member	50,000	
Senior Independent Director	10,000	
	1 January to 30 June 2010	1 July 2010 to date
	£	£
Audit Committee Chairmanship	10,000	12,500
Remuneration Committee Chairmanship	10,000	10,000

(1) Prior to leaving Kevin Beeston received a range of other benefits which included a car, private medical insurance, private health insurance, life cover, an annual allowance for independent financial advice, and voluntary health checks every two years.

(2) Alastair Lyons' remuneration consists of cash fees paid monthly. In addition, reasonable travel and related business expenses are paid. No bonuses are payable.

A summary of details relating to each Non-Executive Director who served during the year is provided below:

	Date of appointment to the Board	Date of letter of appointment	Unexpired term at 31 December 2010 (3)
<b>Chairman:</b>			
Kevin Beeston (1)	29 February 1996	1 September 2007	-
Alastair Lyons (2) (4)	16 March 2010	15 March 2010	28 months
<b>Non-Executive Directors (4):</b>			
Margaret Ford (5)	8 October 2003	7 October 2003	-
Leonard V. Broese van Groenou	3 April 2006	20 February 2006	15 months
David Richardson	2 June 2003	29 May 2003	17 months
Tom Corcoran (5)	3 December 2007	3 December 2007	-

(1) Kevin Beeston retired from the Board of Serco Group plc at the conclusion of the Company's 2010 annual general meeting on 11 May 2010.

(2) Alastair Lyons was appointed as Chairman at the conclusion of the annual general meeting on 11 May 2010, and up until this date served as a Non-Executive Director.

(3) The unexpired term relates to the current contract and is subject to shareholder approval.

(4) Non-Executive Directors have a three-month notice period and no compensation or other benefits are payable on early termination.

(5) Margaret Ford and Tom Corcoran retired from the Board of Serco Group plc on 31 December 2010.

# Remuneration Report

## Directors' remuneration

This section has been audited by Deloitte LLP.

The remuneration of the Directors for the year ended 31 December 2010 was as follows:

	Note	Remuneration £	Fees £	Bonus £	Total estimated value of any non cash benefits £	Allowance £	Total remuneration excluding pensions 2010 £	Total remuneration excluding pensions 2009 £
Kevin Beeston	1,2	162,378	Nil	Nil	23,898	Nil	186,276	286,693
Alastair Lyons	6	Nil	199,038	Nil	Nil	Nil	199,038	Nil
Christopher Hyman	1,3,4,5	663,333	Nil	957,600	72,279	165,688	1,858,900	1,578,682
Andrew Jenner	1,3,4	390,833	Nil	484,770	72,692	Nil	948,295	887,843
Leonard V. Broese van Groenou	6	Nil	60,000	Nil	Nil	Nil	60,000	56,700
Margaret Ford	6,7	Nil	60,000	Nil	Nil	Nil	60,000	56,700
David Richardson	6	Nil	61,250	Nil	Nil	Nil	61,250	56,700
Tom Corcoran	6,7	Nil	50,000	Nil	Nil	Nil	50,000	46,700
<b>Total</b>		<b>1,216,544</b>	<b>430,288</b>	<b>1,442,370</b>	<b>168,869</b>	<b>165,688</b>	<b>3,423,759</b>	<b>2,970,018</b>

Notes:

1. The value of the non cash benefits relates to the provision of a car allowance (fully inclusive of all scheme costs including insurance and maintenance) and private healthcare.
2. Kevin Beeston retired from the Board of Serco Group plc at the conclusion of the Company's 2010 annual general meeting on 11 May 2010.
3. The bonuses shown include performance bonuses earned in the period under review, but not paid until the following financial year.
4. Remuneration is shown gross of salary sacrificed under the SMART scheme. See page 96.
5. The allowance comprises payments made to Christopher Hyman in lieu of pension, calculated as a percentage of base salary, from which he makes his own pension arrangements. (See page 96 for further details.)
6. In addition, reasonable travel and related business expenses are paid but are not subject to UK income tax.
7. Margaret Ford and Tom Corcoran retired from the Board of Serco Group plc on 31 December 2010.

## Directors' shareholdings

The Directors' interests in the shares of the Company are detailed in the following table.

	Note	Ordinary shares of 2p each fully paid at 31 December 2010 or date of cessation if earlier	Ordinary shares of 2p each fully paid at 1 January 2010 or if later the date of appointment as Director
	1		
Kevin Beeston	2	25	293,925
Alastair Lyons		15,000	Nil
Leonard V. Broese van Groenou		5,375	5,375
Margaret Ford	3	1,766	14,841
Christopher Hyman	4,5	777,889	735,510
Andrew Jenner	4	289,574	198,075
David Richardson		15,000	15,000
Tom Corcoran	3	4,000	4,000

Notes:

1. Ordinary shares are beneficial holdings which include the Directors' personal holdings and those of their spouses and minor children.
2. Kevin Beeston retired from the Board of Serco Group plc at the conclusion of the Company's 2010 annual general meeting on 11 May 2010.
3. Margaret Ford and Tom Corcoran retired from the Board of Serco Group plc on 31 December 2010.
4. 80,682 of Christopher Hyman's and 43,969 of Andrew Jenner's shares are held in trust on their behalf under the terms of their participation in the Deferred Bonus Plan. Provided such shares remain in trust for three years and subject to certain performance conditions, they are also granted an award over matching shares equivalent to two times the gross bonus initially used for the share purchase.
5. Security has been granted to Christopher Hyman's bank over 85,564 ordinary shares held in his name.

## Share-based incentives

This section has been audited by Deloitte LLP.

The total share options granted to each person who has served as a Director of the Company at any time in the financial year were as follows:

### (i) Serco Group plc Deferred Bonus Plan (DBP)

Conditional rights to receive matching shares over Serco Group plc's ordinary shares under the DBP held by Directors at 31 December 2010 were as follows:

	Awards held at 1 January 2010	Date of award	Market price at award (pence)	Granted during the period	Awards held at 31 December 2010	Performance period	Vesting date
Christopher Hyman	130,754	12 Jun 2009	404	-	130,754	1 Jan 2009 – 31 Dec 2011	12 Jun 2012
	-	29 Mar 2010	602	144,666	144,666	1 Jan 2010 – 31 Dec 2012	29 Mar 2013
Andrew Jenner	76,232	11 Jun 2009	408	-	76,232	1 Jan 2009 – 31 Dec 2011	11 Jun 2012
	-	29 Mar 2010	602	73,865	73,865	1 Jan 2010 – 31 Dec 2012	29 Mar 2013

Notes:

1. The awards shown in the table are the maximum number of shares that can vest under the performance conditions.
2. The performance conditions attached to the awards are described on page 94.
3. No awards vested or were exercised during the period.

### (ii) Serco Group plc Performance Share Plan (PSP)

The conditional rights to Serco Group plc ordinary shares under the PSP held by Directors at 31 December 2010 were as follows:

	Awards held at 1 January 2010	Date of award	Market price at award (pence)	Granted during the period	Awards held at 31 December 2010	Performance period	Earliest vesting date	Latest exercise date
Christopher Hyman	315,789	22 Jun 2009	408	-	315,789	1 Jan 2009 – 31 Dec 2011	22 Jun 2012	21 Jun 2019
	-	6 Apr 2010	604	213,750	213,750	1 Jan 2010 – 31 Dec 2012	6 Apr 2013	5 Apr 2020
Andrew Jenner	162,790	22 Jun 2009	408	-	162,790	1 Jan 2009 – 31 Dec 2011	22 Jun 2012	21 Jun 2019
	-	6 Apr 2010	604	110,190	110,190	1 Jan 2010 – 31 Dec 2012	6 Apr 2013	5 Apr 2020

Notes:

1. Awards take the form of nominal cost options.
2. Awards made are calculated at a face value on grant of 200% and 175% of base salary for the Chief Executive and Finance Director respectively.
3. The performance conditions attached to the awards are described on page 95.
4. No awards vested or were exercised during the period.



# Remuneration Report

## (iii) Serco Group plc 2006 Long Term Incentive Plan (LTIP)

The LTIP has been replaced by the PSP. The last award under the LTIP was made in November 2007. The conditional rights to Serco Group plc ordinary shares under the LTIP held by Directors at 31 December 2010 were as follows:

	Awards held at 1 January 2010	Date of award	Market price on grant (pence)	Vested during the period	Market price on vesting (pence)	Awards held at 31 December 2010 or date of cessation if earlier	Performance period	Earliest vesting date	Latest exercise date
Kevin Beeston	145,205	29 Nov 2006	373	283,760	565	-	1 Jan 2007 – 31 Dec 2009	31 Dec 2009	28 Nov 2016
Christopher Hyman	145,205	29 Nov 2006	373	283,760	565	-	1 Jan 2007 – 31 Dec 2009	31 Dec 2009	28 Nov 2016
	122,874	12 Nov 2007	456	-	-	122,874	1 Jan 2008 – 31 Dec 2010	31 Dec 2010	11 Nov 2017
Andrew Jenner	89,589	29 Nov 2006	373	175,075	565	-	1 Jan 2007 – 31 Dec 2009	31 Dec 2009	28 Nov 2016
	75,699	12 Nov 2007	456	-	-	75,699	1 Jan 2008 – 31 Dec 2010	31 Dec 2010	11 Nov 2017

### Notes:

- Awards take the form of nominal cost options.
- Awards made are calculated at 100% of salary at the time of grant.
- The TSR performance condition is measured relative to the top 250 companies in the FTSE, as ranked by market capitalisation, excluding those in certain sectors which are not comparable with the Group.
- No awards were granted or lapsed during the period.
- The performance conditions attached to the awards which vested on 31 December 2009 achieved performance between upper quartile and upper decile resulting in 195.42% of the award vesting.
- On 31 December 2010 the performance conditions attached to the awards made on 12 November 2007 were satisfied. Performance between median and upper quartile was achieved resulting in 68.77% of the award vesting.
- Awards held by Kevin Beeston relate to his tenure as an Executive Director prior to September 2007. Kevin Beeston retired from the Board of Serco Group plc at the conclusion of the Company's 2010 annual general meeting on 11 May 2010.
- The aggregate of the total theoretical gains on options exercised by Directors during 2010 amounted to £4.19 million. This is calculated by reference to the difference between the closing mid-market price of the shares on the date of exercise and the exercise price of the options, disregarding whether such shares were sold or retained on exercise, and is stated before tax. Of the 742,595 options exercised, 103,042 shares were retained.

(iv) Serco Group plc 1998 and 2005 Executive Option Plan (EOP)

Options over Serco Group plc ordinary shares granted under the EOP and held by Directors at 31 December 2010 were as follows:

	Awards held at 1 January 2010	Exercised during period	Awards held at 31 December 2010 or date of cessation if earlier	Market price on exercise date (pence)	Exercise price (pence)	Date from which exercisable	Date of expiry of options
Kevin Beeston	120,798	120,798	-	591	439	19 Mar 2010	18 Mar 2017
Christopher Hyman	78,275*	-	78,275	-	435	28 Mar 2004	27 Mar 2011
	116,373*	-	116,373	-	264	3 May 2005	2 May 2012
	289,515*	-	289,515	-	153	6 May 2006	5 May 2013
	219,320*	-	219,320	-	217	3 Mar 2007	2 Mar 2014
	183,404	-	183,404	-	235	29 Apr 2008	28 Apr 2015
	147,492	-	147,492	-	339	5 May 2009	4 May 2016
	120,798	-	120,798	-	439	19 Mar 2010	18 Mar 2017
	123,076	-	123,076	-	455	27 Feb 2011	26 Feb 2018
Andrew Jenner	18,524*	18,524	-	574	435	28 Mar 2004	27 Mar 2011
	69,824*	-	69,824	-	264	3 May 2005	2 May 2012
	173,709*	-	173,709	-	153	6 May 2006	5 May 2013
	133,178*	-	133,178	-	217	3 Mar 2007	2 Mar 2014
	116,885	-	116,885	-	235	29 Apr 2008	28 Apr 2015
	88,495	-	88,495	-	339	5 May 2009	4 May 2016
	74,530	-	74,530	-	439	19 Mar 2010	18 Mar 2017
	75,824	-	75,824	-	455	27 Feb 2011	26 Feb 2018

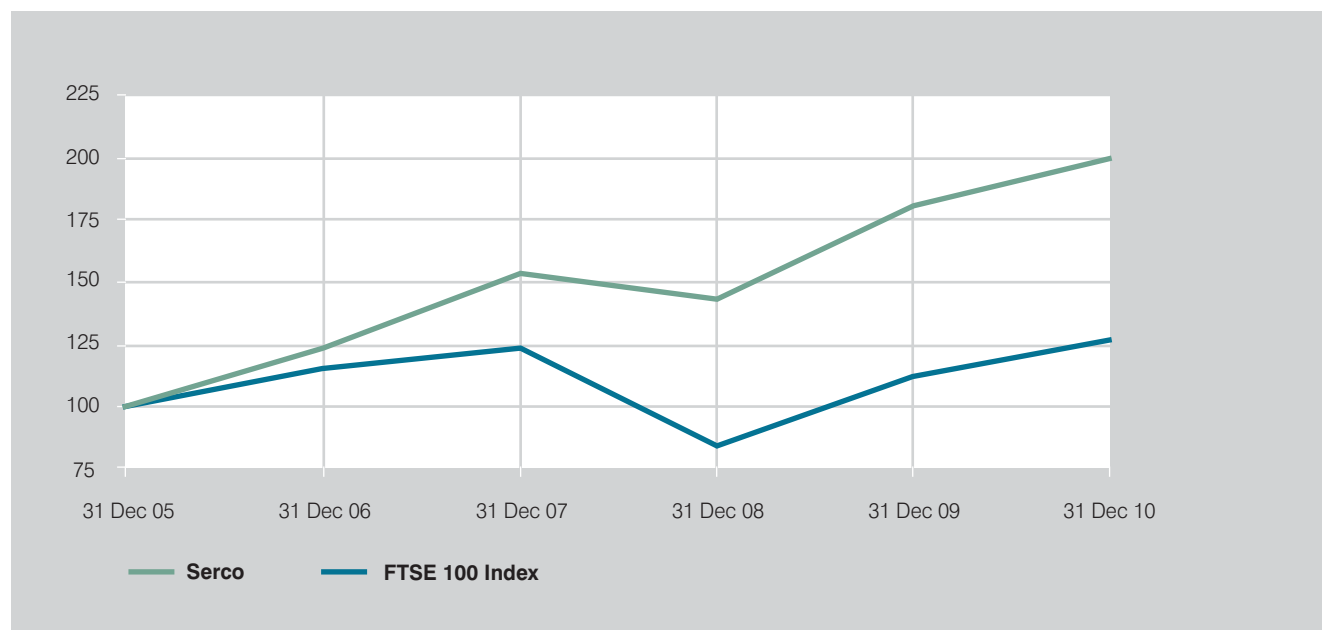
Notes:

1. The final award to Executive Directors under this plan was made in February 2008.
2. The awards shown in the table are the maximum number of shares that can vest under the performance conditions.
3. The extent to which an award will vest is measured by reference to the Group's Earnings Per Share (EPS) performance relative to the Retail Price Index (RPI) over the three-year performance period.
4. For those options marked with an (\*) approximately 14.67% (13.50% for prior year grants) of the options granted under the Plan represent supplementary options, granted for the sole purpose of compensating participants for agreeing to bear the Company's liability to employers' National Insurance Contributions upon the exercise of the underlying Plan awards. These options can only be exercised in conjunction with and to the extent of the underlying option.
5. No payment was made for the grant of the awards.
6. Grants of options under the EOP are calculated at 100% of salary at the time of grant.
7. The market price of the Company's ordinary shares at the close of business on 31 December 2010 was 555.5p and the range during the year to 31 December 2010 was 493.9p to 651p.
8. No grants were made during the year.
9. For options granted which completed their performance period on 31 December 2010, the Group's EPS growth was 22.73% per annum over the three-year performance period which resulted in 100% options vesting. The level at which maximum vesting would occur was 12.69% per annum.
10. Awards held by Kevin Beeston relate to his tenure as an Executive Director prior to September 2007. Kevin Beeston retired from the Board of Serco Group plc at the conclusion of the Company's 2010 annual general meeting on 11 May 2010.
11. The aggregate of the total theoretical gains on options exercised by Directors during 2010 amounted to £0.2 million. This is calculated by reference to the difference between the closing mid-market price of the shares on the date of exercise and the exercise price of the options, disregarding whether such shares were sold or retained on exercise, and is stated before tax. The 139,322 options exercised, were all sold.

## Remuneration Report

### Comparison of total shareholder returns

Serco Group plc total shareholder return (TSR) vs FTSE 100 Total Return Index  
Value of investment of £100 on 31 December 2005



In drawing this graph, 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's TSR is compared to that of the FTSE 100 Index, which is a broad equity market index of which it is a constituent.

As detailed earlier, TSR is defined as the return shareholders would receive if they held a notional number of shares, and received dividends on those shares over a period of time. It measures the percentage growth in the Company's share price together with the value of any dividends paid, assuming that the dividends are reinvested into the Company's shares.

## Pensions and life assurance

This section has been audited by Deloitte LLP.

The Directors receive pension and life assurance benefits consistent with those provided by other leading companies.

The details of the defined benefit schemes operated by the Group are set out in the note on page 143. In the event of death in service, the Serco Supplementary Death Benefit Scheme provides for a lump sum payment.

The accrued pension benefits of all Directors under the Serco Pension and Life Assurance Scheme, which is a defined benefit scheme, are as follows:

	Transfer value of accrued benefits at 31 December 2010 (1) £	Transfer value of accrued benefits at 31 December 2009 (2) £	Director's contributions for the year (3) £	Increase in transfer value during the year (4) = (1)-(2)-(3) £	Gross increase in accrued pension during the year (5) £ p.a.	Increase in accrued pension during the year, net of inflation (6) £ p.a.	Value of increase in accrual over the year (7) £	Total accrued pension at year end (8) £ p.a.
Kevin Beeston	3,659,422	3,564,341	-	95,081	8,000	-	-	287,460
Christopher Hyman	1,744,001	1,702,542	-	41,459	14,536	9,626	134,386	121,268
Andrew Jenner	929,133	857,573	-	71,560	14,893	12,141	148,113	74,730

### Notes:

- The total accrued pension shown is that which would be paid annually on retirement, based on pensionable service to the end of this year for Andrew Jenner, or to the date of ceasing accrual in the scheme for Kevin Beeston and Christopher Hyman. The increase in accrued pension during the year is shown both as a gross increase and excluding any increase in respect of inflation.
- The increase in the accrued pension of Andrew Jenner allows for both the increase in his final pensionable salary over the year and for the accrual of a further year's pensionable service as a result of a further year's active membership of the scheme.
- The increase in accrued pension for Christopher Hyman allows for the increase in his final pensionable salary and the accrual of an extra three months' pensionable service until 1 April 2010 when he ceased accruing benefits in the scheme.
- With effect from 1 April 2010 Christopher Hyman opted to receive a cash alternative equal to 33% of his base pay (excluding bonuses) in lieu of any further pension provision. Christopher remains entitled to lump sum and widow's pension benefits should he die before retirement and whilst employed by Serco.
- The pension of Kevin Beeston increased in line with inflation until his retirement from the Board at the conclusion of the Company's AGM on 11 May 2010. The increase net of inflation shown in (6) is therefore zero.
- Transfer values have been calculated in accordance with the current transfer value regulations. The assumptions to be used for calculating transfer values have been reviewed by the Trustees during the year and updated to reflect changes in long term expectations for inflation and improvements in life expectancy. The net impact of these changes has resulted in lower transfer values than would have applied with the previous assumptions. However, market movements over the year have acted to increase transfer values. The difference between the transfer values at the beginning and end of the year, shown in (4), includes not only the effect of the increase in accrual and salaries and changes in the transfer value assumptions, but also the effect of fluctuations in the transfer value due to factors beyond the control of the Company and the Directors, such as stock market movements.
- The value of the net increase in accrual represents the incremental value to the Director of his service during the year or the date the Director left the scheme. In the case of Andrew Jenner the value of the net increase is calculated on the assumption that his service terminated at the year end. It is based on the increase in the accrued pension, net of inflation based on the increase in Retail Prices Index.
- The transfer values disclosed do not represent the sum paid or payable to the individual Director. Instead, they represent a potential liability of the pension scheme.
- Both Directors who were active members of the scheme have opted to have their contributions paid by the Company under a salary sacrifice arrangement and hence no contributions were paid by the Directors during the year.
- Kevin Beeston left Serco employment and ceased being a Director on 11 May 2010. His total accrued pension is his deferred pension at that date.
- Andrew Jenner ceased to be a member of the pension scheme with effect from 31 December 2010, opting to receive a cash alternative equal to 33% of his base pay (excluding bonuses) in lieu of any further pension provision. Andrew remains entitled to lump sum and widow's pension benefits should he die before retirement and whilst employed by Serco.

## Share dilution

Awards granted under the Serco Group plc 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 Association of British Insurers in respect of all share plans (10% in any rolling ten year period) and discretionary share plans (5% in any rolling ten-year period) were, based on the Company's issued share capital at 31 December 2010, 5.95% and 4.61% respectively.

The Group has an employee benefit trust which is administered by an independent trustee and which holds ordinary shares in the Company to meet various obligations under the share plans. In April 2010 a loan of £23 million was made to the Employee Benefit Trust in order to finance the purchase of shares to satisfy the ongoing liabilities under the Company's employee share plans.

The Trust held 3,436,547 and 4,710,201 ordinary shares at 1 January 2010 and 31 December 2010 respectively.

Approved by the Board of Directors and signed on its behalf by:



**Joanne Roberts**  
Secretary  
1 March 2011

# Independent Auditor's Report

## Independent Auditor's Report to the members of Serco Group plc

We have audited the Group Financial Statements of Serco Group plc for the year ended 31 December 2010 which comprise the Consolidated Income Statement, the Consolidated Statement of Comprehensive Income, the Consolidated Statement of Changes in Equity, the Consolidated Balance Sheet, the Consolidated Cash Flow Statement and the related notes 1 to 36. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

## Respective responsibilities of Directors and Auditor

As explained more fully in the Directors' Responsibilities Statement, the Directors are responsible for the preparation of the Group financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the Group financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

## Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Group's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Directors; and the overall presentation of the financial statements.

## Opinion on the Group Financial Statements

In our opinion the Group Financial Statements:

- give a true and fair view of the state of the Group's affairs as at 31 December 2010 and of its profit for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006 and Article 4 of the IAS Regulation.

## Opinion on other matters prescribed by the Companies Act 2006

In our opinion the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the Group Financial Statements.

## Matters on which we are required to report by exception

We have nothing to report in respect of the following:

Under the Companies Act 2006 we are required to report to you if, in our opinion:

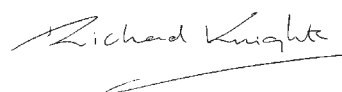
- certain disclosures of Directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

Under the Listing Rules we are required to review:

- the Directors' statement contained within the Corporate Governance Report in relation to going concern; and
- the part of the Corporate Governance Statement relating to the company's compliance with the nine provisions of the June 2008 Combined Code specified for our review; and
- certain elements of the report to shareholders by the Board on Directors' remuneration.

## Other matter

We have reported separately on the parent Company Financial Statements of Serco Group plc for the year ended 31 December 2010 and on the information in the Directors' Remuneration Report that is described as having been audited.



**Richard Knights** (Senior Statutory Auditor)  
for and on behalf of Deloitte LLP  
Chartered Accountants and Statutory Auditor  
London, United Kingdom  
1 March 2011



# Consolidated Income Statement

For the year ended 31 December

	Note	2010 £m	2009 £m
<b>Continuing operations</b>			
Revenue	4,5	4,326.7	3,970.0
Cost of sales		(3,682.4)	(3,383.2)
<b>Gross profit</b>		644.3	586.8
Administrative expenses		(385.6)	(357.1)
<b>Adjusted operating profit</b> - before amortisation of intangibles arising on acquisition		258.7	229.7
Other expenses - amortisation of intangibles arising on acquisition	14	(17.4)	(17.6)
<b>Operating profit</b>	5,6	241.3	212.1
Investment revenue	8	3.9	2.7
Finance costs	9	(31.3)	(37.7)
<b>Profit before tax</b>		213.9	177.1
Tax	10	(57.1)	(46.9)
<b>Profit for the year</b>		156.8	130.2
Attributable to:			
Equity holders of the parent		156.7	130.2
Non-controlling interest		0.1	-
<b>Earnings per share (EPS)</b>			
Basic EPS	12	31.88p	26.76p
Diluted EPS	12	31.35p	26.45p

# Consolidated Statement of Comprehensive Income

For the year ended 31 December

	Note	2010 £m	2009 £m
<b>Profit for the year</b>		156.8	130.2
<b>Other comprehensive income for the year:</b>			
Net actuarial gain/(loss) on defined benefit pension schemes <sup>1</sup>	26	49.9	(259.0)
Actuarial (loss)/gain on reimbursable rights <sup>1</sup>	26	(38.4)	117.1
Net exchange gain/(loss) on translation of foreign operations <sup>2</sup>		19.0	(9.9)
Fair value gain/(loss) on cash flow hedges during the year <sup>2</sup>		1.7	(6.3)
Tax (charge)/credit on items taken directly to equity <sup>3</sup>	10	(1.7)	45.2
Recycling of cumulative net hedging reserve <sup>2</sup>		0.3	0.2
<b>Total comprehensive income for the year</b>		187.6	17.5
Attributable to:			
Equity holders of the parent		187.5	17.5
Non-controlling interest		0.1	-

<sup>1</sup> Recorded in Retirement benefit obligations reserve in the Consolidated Statement of Changes in Equity.

<sup>2</sup> Recorded in Hedging and translation reserve in the Consolidated Statement of Changes in Equity.

<sup>3</sup> Of the tax (charge)/credit, a debit of £4.3m (2009: credit of £39.6m) was recorded in the Retirement benefit obligations reserve; a debit of £0.6m (2009: credit of £1.4m) was recorded in the Hedging and translation reserve; a credit of £3.2m (2009: £4.2m) was recorded in the Share-based payment reserve.

# Consolidated Statement of Changes in Equity

For the year ended 31 December

	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 equity £m	Non-controlling interest £m
At 1 January 2009	9.7	301.1	0.1	339.8	(47.7)	40.0	(19.7)	61.9	685.2	0.1
Total comprehensive income for the year	-	-	-	130.2	(102.3)	4.2	-	(14.6)	17.5	-
Shares transferred to option holders on exercise of share options	0.1	3.0	-	-	-	(1.8)	9.1	-	10.4	-
Dividends paid	-	-	-	(25.9)	-	-	-	-	(25.9)	-
Expense in relation to share-based payment	-	-	-	-	-	7.2	-	-	7.2	-
Purchase of own shares for employee benefit trust (ESOP)	-	-	-	-	-	-	(2.4)	-	(2.4)	-
<b>At 1 January 2010</b>	<b>9.8</b>	<b>304.1</b>	<b>0.1</b>	<b>444.1</b>	<b>(150.0)</b>	<b>49.6</b>	<b>(13.0)</b>	<b>47.3</b>	<b>692.0</b>	<b>0.1</b>
Total comprehensive income for the year	-	-	-	156.7	7.2	3.2	-	20.4	187.5	0.1
Shares transferred to option holders on exercise of share options	0.1	2.6	-	-	-	(2.9)	8.5	-	8.3	-
Dividends paid	-	-	-	(32.3)	-	-	-	-	(32.3)	(0.2)
Expense in relation to share-based payment	-	-	-	-	-	8.8	-	-	8.8	-
Purchase of own shares for employee benefit trust (ESOP)	-	-	-	-	-	-	(23.0)	-	(23.0)	-
<b>At 31 December 2010</b>	<b>9.9</b>	<b>306.7</b>	<b>0.1</b>	<b>568.5</b>	<b>(142.8)</b>	<b>58.7</b>	<b>(27.5)</b>	<b>67.7</b>	<b>841.3</b>	<b>-</b>

# Consolidated Balance Sheet

At 31 December

	Note	2010 £m	2009 £m
<b>Non-current assets</b>			
Goodwill	13	899.5	898.4
Other intangible assets	14	145.0	164.4
Property, plant and equipment	16	135.4	129.2
Trade and other receivables	19	156.7	181.4
Deferred tax assets	22	38.1	48.0
Derivative financial instruments	25	3.5	2.5
		<b>1,378.2</b>	<b>1,423.9</b>
<b>Current assets</b>			
Inventories	18	65.4	65.9
Trade and other receivables	19	790.2	720.9
Cash and cash equivalents	20	279.3	319.4
Derivative financial instruments	25	3.9	1.4
		<b>1,138.8</b>	<b>1,107.6</b>
<b>Total assets</b>		<b>2,517.0</b>	<b>2,531.5</b>
<b>Current liabilities</b>			
Trade and other payables	24	(805.5)	(771.6)
Current tax liabilities		(19.5)	(14.1)
Obligations under finance leases	23	(7.1)	(6.0)
Loans	21	(159.5)	(110.7)
Derivative financial instruments	25	(2.4)	(5.5)
		<b>(994.0)</b>	<b>(907.9)</b>
<b>Non-current liabilities</b>			
Trade and other payables	24	(22.2)	(23.1)
Obligations under finance leases	23	(19.3)	(18.0)
Loans	21	(354.6)	(543.2)
Derivative financial instruments	25	(5.2)	(1.7)
Retirement benefit obligations	26	(226.2)	(294.2)
Provisions	27	(39.6)	(42.3)
Deferred tax liabilities	22	(14.6)	(9.0)
		<b>(681.7)</b>	<b>(931.5)</b>
<b>Total liabilities</b>		<b>(1,675.7)</b>	<b>(1,839.4)</b>
<b>Net assets</b>		<b>841.3</b>	<b>692.1</b>
<b>Equity</b>			
Share capital	28	9.9	9.8
Share premium account	29	306.7	304.1
Capital redemption reserve		0.1	0.1
Retained earnings		568.5	444.1
Retirement benefit obligations reserve	30	(142.8)	(150.0)
Share-based payment reserve	30	58.7	49.6
Own shares reserve	30	(27.5)	(13.0)
Hedging and translation reserve	30	67.7	47.3
<b>Equity attributable to equity holders of the parent</b>		<b>841.3</b>	<b>692.0</b>
<b>Non-controlling interest</b>		<b>-</b>	<b>0.1</b>
<b>Total equity</b>		<b>841.3</b>	<b>692.1</b>

The Financial Statements were approved by the Board of Directors on 1 March 2011 and signed on its behalf by:



Christopher Hyman  
Chief Executive



Andrew Jenner  
Finance Director

# Consolidated Cash Flow Statement

For the year ended 31 December

	Note	2010 £m	2009 £m
<b>Net cash inflow from operating activities</b>	31	<b>241.0</b>	<b>235.1</b>
<b>Investing activities</b>			
Interest received		3.3	2.1
Disposal of investments/business undertakings		-	0.6
Proceeds from disposal of property, plant and equipment		6.1	3.7
Proceeds from disposal of intangible assets		7.3	-
Acquisition of subsidiaries, net of cash acquired	15	(2.1)	(14.7)
Purchase of other intangible assets		(20.9)	(17.3)
Purchase of property, plant and equipment		(35.4)	(38.9)
<b>Net cash outflow from investing activities</b>		<b>(41.7)</b>	<b>(64.5)</b>
<b>Financing activities</b>			
Interest paid		(27.9)	(33.6)
Dividends paid	11	(32.3)	(25.9)
Non-controlling interest dividends paid		(0.2)	-
Cash inflow from matured derivative financial instruments		1.6	-
Repayment of loans		(167.8)	(66.8)
Repayment of non recourse loans		(7.6)	(6.5)
New loan advances		10.1	33.8
Capital element of finance lease repayments		(8.7)	(5.7)
Purchase of own shares for employee benefit trust (ESOP)		(23.0)	(2.4)
Proceeds from issue of share capital and exercise of share options		8.3	10.4
<b>Net cash outflow from financing activities</b>		<b>(247.5)</b>	<b>(96.7)</b>
<b>Net (decrease)/increase in cash and cash equivalents</b>		<b>(48.2)</b>	<b>73.9</b>
<b>Cash and cash equivalents at beginning of year</b>		<b>319.4</b>	<b>250.8</b>
Net exchange gain/(loss)		8.1	(5.3)
<b>Cash and cash equivalents at end of year</b>	20	<b>279.3</b>	<b>319.4</b>

# Notes to the Consolidated Financial Statements

## 1. General information

Serco Group plc (the Group) 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 (the Financial Statements) are presented in pounds Sterling because this is the currency of the primary economic environment in which the Group operates. Foreign operations are included in accordance with the policies set out in note 2.

## 2. Significant accounting policies

### Basis of accounting

These Financial Statements on pages 105 to 160 have been prepared in accordance with International Financial Reporting Standards (IFRSs) adopted for use in the European Union and therefore the Group financial statements comply with Article 4 of the EU IAS regulation.

The Financial Statements have been prepared on the historical cost basis. The following principal accounting policies adopted have been applied consistently in the current and preceding financial year except as stated below.

As discussed in more detail in the Finance Review, these Financial Statements have been prepared on the going concern basis.

### Adoption of new and revised Standards

In the current year, the following new and revised Standards and Interpretations have been adopted and have affected the amounts reported in these Financial Statements.

#### *IFRS 3 (2008) Business Combinations*

IFRS 3 (2008) includes a number of significant changes to the accounting for business combinations. All acquisition costs are now required to be expensed as incurred, rather than capitalised as part of the cost of acquisitions. Any changes to the cost of an acquisition resulting from an event taking place after the date of acquisition, including those arising from adjustments to contingent consideration, are required to be recognised in the income statement rather than in goodwill. Any adjustments to contingent consideration in respect of acquisitions made prior to 1 January 2010 will continue to be accounted for under IFRS 3 (2004).

#### *Amendments to IAS 27 Consolidated and Separate Financial Statements*

The amendments to IAS 27 affect the treatment of acquisitions and disposals achieved in stages, and focus on whether or not this results in a change in control. Acquisitions and disposals that do not result in a change in control are accounted for within reserves, and goodwill is not re-measured. Where control is lost, all assets, liabilities and non-controlling interests are derecognised, and the resulting gain or loss, after any proceeds, is recognised in profit or loss.

The following new and revised Standards and Interpretations have been adopted in the current year. Their adoption has not had any significant impact on the amounts reported in these Financial Statements but may impact the accounting for future transactions and arrangements.

#### *IAS 28 (2008) Investments in Associates*

The revisions to IAS 28 require that where there is a loss of significant influence over an associate, the investor measures any investment retained in the former associate at fair value, with any consequential gain or loss recognised in the income statement.

#### *Amendment to IAS 39 Financial Instruments: Recognition and Measurement: Eligible Hedged Items*

This amendment provides clarification on two aspects of hedge accounting: identifying inflation as a hedged risk or portion, and hedging with options.

#### *IFRS 1 (revised) First-time Adoption of International Financial Reporting Standards and Amendments to IFRS 1 Additional Exemptions for First-time Adopters*

These amendments provide additional exemptions on first-time adoption of IFRS, in relation to oil and gas assets and leases.

#### *Amendments to IFRS 2 Group Cash-settled Share-based Payment Transactions*

These amendments provide clarification on the scope of IFRS 2, as well as the accounting for group cash-settled share-based payment transactions in the separate financial statements of the entity receiving the goods or services when another group entity of shareholder has the obligation to settle the award.

#### *IFRIC 17 Distribution of Non-cash Assets to Owners*

This Interpretation provides guidance on the appropriate accounting treatment when an entity distributes assets other than cash as dividends to its shareholders.

#### *IFRIC 18 Transfers of Assets from Customers*

This Interpretation addresses the accounting by recipients for transfers of property, plant and equipment from customers and concludes that when the item of property, plant and equipment transferred meets the definition of an asset from the perspective of the recipient, the recipient should recognise the asset at its fair value on the date of the transfer, with the credit being recognised as revenue in accordance with IAS 18.

#### *Improvements to IFRSs (April 2009)*



# Notes to the Consolidated Financial Statements

## 2. Significant accounting policies (continued)

### Basis of consolidation

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

The results of subsidiaries and joint ventures 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 and joint ventures to bring accounting policies used 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 profit or loss and net assets in subsidiaries that is not held by the Group and is presented within equity in the consolidated balance sheet, separately from parent shareholders' equity.

### Changes in segmental information

From the start of 2010 the Group repositioned its business to maximise the focus on growth and opportunities and to ensure that it maintains a flexible and devolved organisation which is responsive to its customers' needs. From 1 January 2010, the Group reorganised its business into five new divisions, focused on the Group's principal markets: Civil Government; Local Government and Commercial; Defence, Science and Nuclear; Americas; and AMEAA. The key changes arising from its previous segments are as follows:

Civil Government, the UK and Europe Healthcare, Home Affairs and Welfare to Work business, is included in the new Civil Government division; the UK and Europe Consulting, Education, Integrated Services, IT and BPO businesses are part of the new Local Government and Commercial division; and the Civil Government businesses in North America and the rest of the world are allocated to the Americas and AMEAA divisions respectively.

Defence has transferred to Defence, Science and Nuclear, with the exception of those businesses operating in the geographical regions of Americas and AMEAA.

Transport has been transferred to Civil Government, with the exception of businesses operating in the geographical regions of Americas and AMEAA.

Science has transferred to Defence, Science and Nuclear.

As a consequence of these changes, previously published financial information has been restated.

### 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 (which is subject to a maximum of one year) adjustments. 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 Business Combinations are recognised at their fair value at the acquisition date, except where a different treatment is mandated by another standard.

Goodwill arising on acquisition is recognised as an asset at the date that control is acquired. Goodwill is measured as the excess of the sum of the consideration transferred, the amount of any non-controlling interest and the fair value of any previously held equity interest in the acquired entity, over the net of the acquisition date amounts of the identifiable assets and liabilities acquired.

If, after reassessment, the Group's interest in the net fair value of the acquiree's identifiable net assets exceeds the sum of the consideration transferred, the amount of any non-controlling interest and the fair value of any previously held equity interest in the acquired entity, the excess is recognised immediately in the income statement.

Any adjustments to contingent consideration in respect of acquisitions made prior to 1 January 2010 will continue to be reflected in goodwill in accordance with IFRS 3 (2004).

## 2. Significant accounting policies (continued)

### Goodwill

Goodwill arising on consolidation represents the excess of the cost of acquisition over the Group's interest in the fair value of the identifiable assets and liabilities of a subsidiary, associate or jointly-controlled entity, at the date of acquisition. Goodwill is initially recognised as an asset at cost and is subsequently measured at cost less any accumulated impairment losses. Goodwill which is recognised as an asset is reviewed for impairment at least annually. Any impairment is recognised immediately in profit or loss and is not subsequently reversed.

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

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

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

### Investments in joint ventures

The Group's investments in joint ventures are reported in the financial statements using the proportionate consolidation method, whereby the Group's share of each of the assets, liabilities, income and expenses of its joint ventures is combined line by line with similar items in the Group's financial statements or reported as separate line items within the Group's financial statements.

### 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.

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 building improvements	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.

# Notes to the Consolidated Financial Statements

## 2. Significant accounting policies (continued)

### Other intangible assets

Customer relationships represent the value of contracts acquired on the acquisition of subsidiaries and are amortised over the average length of contracts.

Development expenditure is capitalised as an intangible asset only if all of the following conditions are met:

- an asset is created that can be separately identified;
- it is probable that the asset created will generate future economic benefits; and
- the development cost of the asset can be measured reliably.

Purchased software and development expenditure is amortised over the period in which the Group is expected to benefit. This period is between three to eight years, or the length of the contract if longer. Provision is also made for any impairment. All other development expenditure is written off as incurred. Assets under the course of construction are not depreciated.

Licences comprise premiums paid for the acquisition of licences, which are amortised on a straight-line basis over the life of the licence.

Franchises represent costs incurred in obtaining franchise rights and franchise goodwill arising on the acquisition of franchises. These are amortised on a straight-line basis over the life of the franchise.

Pension related intangibles represent assets arising in relation to the Group's right to manage and operate contracts where there is a defined benefit pension scheme and it is not virtually certain that contributions will be recovered from the customer but where the Group's obligation to contribute to the scheme ends when the contract ends. The intangible assets represent the Group's share of scheme net liabilities on the date that contracts commence and are amortised on a straight-line basis over the contract life.

### Impairment of tangible and intangible assets

Annually, the Group reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Where the asset does not generate cash flows that are independent from other assets, the Group estimates the recoverable amount of the CGU to which the asset belongs. A CGU is the smallest group of assets that generates cash inflows from continuing use that are largely independent of the cash flows of other assets or groups of assets. For the purpose of impairment testing, the goodwill acquired in a business combination is allocated to cash-generating units that are expected to benefit from the synergies of the combination.

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

If the recoverable amount of an asset (or CGU) is estimated to be less than its carrying amount, the carrying amount of the asset (or CGU) is reduced to its recoverable amount. An impairment loss is recognised as an expense immediately. Impairment losses recognised in respect of CGUs are allocated first to reduce the carrying amount of any goodwill allocated to the units and then to reduce the carrying amount of the other assets in the unit (group of units) 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 of the asset (or CGU) 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 for the asset (or CGU) in prior years. A reversal of an impairment loss is recognised as income immediately.

Impairment losses and reversals are included within administrative expenses within the consolidated income statement.

### Revenue recognition

Revenue is measured at 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.

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 shareholders' rights to receive payment have been established.

Revenue on repeat service-based contracts is recognised as services are provided.

Revenue from long-term project-based contracts is recognised in accordance with the Group's accounting policy below.

## 2. Significant accounting policies (continued)

### Long-term project-based and repeat service contracts

The Group has a 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 measured by the proportion of contract costs incurred for work performed to date compared to the estimated total contract costs, except where this would not be representative of the stage of completion. Variations in contract work, claims and incentive payments are included to the extent that they have been agreed with the customer, or are virtually certain of being received.

Where the outcome of a long-term project-based contract cannot be estimated reliably, contract revenue is recognised to the extent of contract costs that are probable to 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.

All bid costs are expensed through the income statement up to the point where contract award (or full recovery of costs) is virtually certain. 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. Phase in costs directly related to phase in programmes of contracts are treated as an integral part of contract costs and are recognised on a straight-line basis over the life of the contract.

### 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 in order to allocate resources to the segments and to assess their performance.

Items excluded from segments comprise corporate expenses. 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. Liabilities comprise trade and other payables and retirement benefit obligations.

### Inventories

Inventories are stated at the lower of cost and net realisable value and comprise service spares, parts awaiting installation and long-term project-based contract balances. Cost comprises direct materials and, where applicable, direct labour costs that have been incurred in bringing the inventories to their present location and condition.

### 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 against income, 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 income on a straight-line basis over the term of the relevant lease.

### 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. Non-monetary assets and liabilities carried at fair value that are denominated in foreign currencies are translated at the rate prevailing on the date when the fair value was determined. 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 in the consolidated statement of comprehensive income (SOC).

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.

# Notes to the Consolidated Financial Statements

## 2. Significant accounting policies (continued)

### 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.

### 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.

The current service cost represents the increase in the present value of the plan 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, and is amortised on a straight-line basis over the average period until the benefit becomes vested. Gains and losses on curtailments or settlements are recognised 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 and reductions in future contributions to the plan.

The economic benefit from refunds is only recognised to the extent that the Group has an unconditional right to receive a refund.

To the extent that an economic benefit is available as a reduction in contributions and there is a minimum funding requirement, the economic benefit available as a reduction in contributions is calculated at the present value of:

- a) the estimated future service cost in each year; less
- b) the estimated minimum funding contributions required in respect of the future accrual and benefits in that year.

### 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 and it is not virtually certain that the contributions will be recovered from the customer, 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 amount of scheme deficits 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 outside the income statement and are presented in the SOCI.

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 and it is virtually certain that the contributions will be recovered from the customer, the Group's share of the defined benefit obligation less its share of the pension scheme assets are recognised as a liability at the start of the contract with a corresponding amount being recognised as a financial asset at fair value, being the fair value of the reimbursable rights. In the consolidated income statement, the expense relating to the defined benefit plan is presented net of the amount recognised for reimbursement. Subsequent actuarial gains and losses in relation to the Group's share of pension obligations are recognised outside the income statement and are presented in the SOCI. The change in fair value of the reimbursable rights that is not presented in the income statement is reported in the SOCI.

### Multi-employer pension schemes

Multi-employer pension schemes are classified as a defined contribution pension scheme or a defined benefit pension scheme under the terms of the scheme.

When sufficient information is not available to use defined benefit accounting for a multi-employer defined benefit pension scheme, the Group accounts for the scheme as if it were a defined contribution scheme.



## 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 and joint ventures, except where the Group is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

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

### Research and development costs

Expenditure on research is recognised as an expense in the period in which it is incurred. Development costs are expensed in the period in which the costs are incurred unless the criteria for capitalisation is met (see other intangible assets policy).

### Share-based payment

The Group has applied the requirements of IFRS 2 Share-based Payment (amended January 2008). In accordance with the transitional provisions, IFRS 2 has been applied to all grants of equity instruments after 7 November 2002 that were not fully vested as of 1 January 2005.

The Group makes equity-settled share-based payments to certain employees and operates an HMRC approved Save As You Earn (SAYE) share option scheme open to eligible employees which allows the purchase of shares at a discount. These are measured at fair value at the date of grant. The fair value is expensed on a straight-line basis over the vesting period, based on the Group's estimate of shares that will eventually vest. SAYE options are treated as cancelled when employees cease to contribute to the scheme, resulting in an acceleration of the remainder of the related expense.

Where the fair value of share options requires the use of a valuation model, fair value is measured by use of the Binomial Lattice or Monte Carlo Simulation models depending on the type of scheme, as set out in note 33. 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.

### Trade receivables

Trade receivables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method, less provision for impairment. A provision for impairment of trade receivables is established when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of the contract. Significant financial difficulties of the debtor, probability that the debtor will enter bankruptcy or financial reorganisation, and default or delinquency in payments are considered indicators that a trade receivable is impaired. The amount of the provision is based on management's best estimate of the likelihood of the recoverable amount. The carrying amount of the asset is reduced through the use of an allowance for doubtful debts and the amount of the loss is recognised in the income statement within administrative expenses. When a trade receivable is uncollectible, it is written off against the allowance for doubtful debts. Subsequent recoveries of amounts previously written off are credited against administrative expenses.

# Notes to the Consolidated Financial Statements

## 2. Significant accounting policies (continued)

### 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. This definition is also used for the consolidated cash flow statement.

### Dividends

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.

### Loans

Loans are initially stated at the amount of the net proceeds after deduction of issue costs. The carrying amount of loans hedged by derivatives is increased by the finance cost in respect of the accounting period and reduced by payments made in the period. Loans which are unhedged 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.

### Derivative financial instruments and hedging activities

The Group enters into a variety of derivative financial instruments to manage the exposure to interest rate and foreign exchange risk, including foreign exchange forward contracts and interest rate swaps. Further details of derivative financial instruments are given in note 25.

Derivatives are initially recognised at fair value at the date a derivative contract is entered into and are subsequently remeasured to their fair value at each balance sheet date. A derivative with a positive fair value is recognised as a financial asset whereas a derivative with a negative fair value is recognised as a financial liability. 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 or firm commitments (fair value hedges), hedges of highly probable forecast transactions or hedges of foreign currency risk of firm commitments (cash flow hedges), or hedges of net investments in foreign operations.

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. Other derivatives are presented as current assets or current liabilities.

### Embedded derivatives

Derivatives embedded in other financial instruments or other host contracts are treated as separate derivatives when their risks and characteristics are not closely related to those of the host contracts and the host contracts are not measured at fair value through profit or loss.

### Hedge accounting

The Group designates certain hedging instruments, which include derivatives, embedded derivatives and non-derivatives in respect of foreign exchange risk, as either fair value hedges, cash flow hedges, or hedges of net investments in foreign operations. Hedges of foreign exchange risk on firm commitments are accounted for as cash flow hedges.

At the inception of the hedge relationship, the entity 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. Furthermore, at the inception of the hedge and on an ongoing basis, the Group documents 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.

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 25.

### 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 revokes 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.

## 2. Significant accounting policies (continued)

### *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 deferred in equity are recycled 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. However, when the forecast transaction that is hedged results in the recognition of a non-financial asset or a non-financial liability, the gains and losses previously deferred in equity are transferred from equity and included in the initial measurement of the cost of the non-financial asset or non-financial liability.

Hedge accounting is discontinued when the Group revokes 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.

### *Hedges of net investments in foreign operations*

Hedges of net investments in foreign operations are accounted for similarly to cash flow hedges. Any gain or loss on the hedging instrument relating to the effective portion of the hedge is recognised in equity and accumulated in the hedging and translation reserve. The gain or loss relating to the ineffective portion is recognised immediately in profit or loss and is included in the 'net exchange gain/loss on translation of foreign operations' line item.

Gains and losses on the hedging instrument relating to the effective portion of the hedge accumulated in the foreign currency translation reserve are reclassified to profit or loss in the same way as exchange differences relating to the foreign operations.

### *Provisions*

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

### *New standards and interpretations not applied*

At the date of authorisation of these Financial Statements, the following Standards and Interpretations which have not been applied in these Financial Statements were in issue but not yet effective (and in some cases had not yet been adopted by the EU):

- IAS 24 (revised) Related Party Disclosures
- Amendment to IAS 32 Financial Instruments: Presentation: Classification of Rights Issues
- Amendments to IFRS 1 Limited Exemption from Comparative IFRS 7 Disclosures for First-time Adopters
- Amendments to IFRS 7 Financial Instruments Disclosures
- IFRS 9 Financial Instruments
- Amendment to IFRIC 14 Prepayment of a Minimum Funding Requirement
- IFRIC 19 Extinguishing Financial Liabilities with Equity Instruments
- Improvements to IFRSs (May 2010)

The Directors do not anticipate that the adoption of these standards and interpretations will have a material impact on the Group's financial statements in the period of initial application, with the exception of amounts reported and disclosures in respect of the Group's financial assets and financial liabilities on adoption of IFRS 9. However, it is not practicable at this stage to provide a reasonable estimate of the effect.

## Notes to the Consolidated Financial Statements

### 3. Critical accounting judgements and key sources of estimation uncertainty

#### Critical judgements in applying the Group's accounting policies

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 (apart from those involving estimations which are dealt with below).

#### Revenue and profit recognition of long-term project-based contracts

Revenue and profit is recognised for certain long-term project-based contracts based on the stage of completion of the contract activity. This is measured by the proportion of costs incurred to estimated whole-life contract costs except where this would not be representative of the stage of completion.

#### Key sources of estimation uncertainty

The key assumptions concerning the future, and other key sources of estimation uncertainty at the balance sheet date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year, are discussed below.

#### Impairment of goodwill

Determining whether goodwill is impaired requires an estimation of the value in use of the cash-generating units to which goodwill has been allocated. The value in use calculation involves an estimation of the future cash flows of cash-generating units and also the selection of appropriate discount rates, which involves judgement, to calculate present values (see note 13). The carrying value of goodwill is £899.5m (2009: £898.4m) at the balance sheet date.

#### Retirement benefit obligations

The calculation of retirement benefit obligations is dependent on material key assumptions including discount rates, future returns on assets and future contribution rates (see note 26). The value of retirement benefit obligations at the balance sheet date is £226.2m (2009: £294.2m). Details of the impact of changes in assumptions relating to retirement benefit obligations are disclosed in the Finance Review (page 52).

### 4. Revenue

An analysis of the Group's revenue is as follows:

	2010 £m	2009 £m
Rendering of services	4,103.5	3,824.0
Revenue from long-term project-based contracts	223.2	146.0
Revenue as disclosed in the Consolidated Income Statement	4,326.7	3,970.0
Investment revenue (note 8)	3.9	2.7
Total revenue as defined in IAS 18	4,330.6	3,972.7

### 5. Segmental information

Information reported to the Chief Operating Decision Maker for the purposes of resource allocation and assessment of segment performance focuses on the categories of customer identified using their respective markets. Details of the different products and services provided by each operating segment are included in the Our business and Our performance sections of this report. From 1 January 2010, the Group has reapportioned its business into five new divisions. The Group's reportable operating segments under IFRS 8 Operating Segments are:

Reportable Segments	Operating Segments
Civil Government	UK and Europe civil government and transport;
Defence, Science and Nuclear	UK and Europe defence and science-based businesses;
Local Government and Commercial	UK and Europe IT and BPO, integrated services, education and commercial businesses;
Americas	US defence, intelligence and federal civil government agencies operations, and Canadian operations; and
AMEAA	Africa, Middle East, Asia (including Hong Kong and India) and Australasia.

The accounting policies of the reportable segments are the same as the Group's accounting policies described in note 2.

## 5. Segmental information (continued)

The following is an analysis of the Group's revenue and results by operating segment in the year ended 31 December 2010.

### Reportable segments

Year ended 31 December 2010

	Civil Government £m	Defence, Science and Nuclear £m	Local Government and Commercial £m	Americas £m	AMEAA £m	Total £m
<b>Revenue</b>	<b>1,126.9</b>	<b>910.8</b>	<b>853.9</b>	<b>953.9</b>	<b>481.2</b>	<b>4,326.7</b>
<b>Result</b>						
Segment result	66.4	77.3	53.1	64.0	32.0	292.8
Corporate expenses						(51.5)
<b>Operating profit</b>						<b>241.3</b>
Investment revenue						3.9
Finance costs						(31.3)
<b>Profit before tax</b>						<b>213.9</b>
Tax						(57.1)
<b>Profit for the year</b>						<b>156.8</b>
<b>Capital expenditure*</b>						
Goodwill	-	-	1.9	-	1.2	3.1
Property, plant and equipment: segments	3.7	8.4	11.3	1.4	10.4	35.2
Property, plant and equipment: corporate						0.2
						35.4
Intangible assets: segments	0.2	1.3	1.8	4.9	3.5	11.7
Intangible assets: corporate						9.2
						20.9
<b>Depreciation and amortisation</b>						
Depreciation: segments	7.2	2.6	15.1	4.8	9.1	38.8
Depreciation: corporate						0.6
						39.4
Amortisation of intangibles arising on acquisition:						
segments	0.2	-	2.7	13.9	0.6	17.4
Amortisation – other: segments	3.6	1.7	5.3	1.3	1.2	13.1
Amortisation – other: corporate						13.1
						43.6
<b>Segment assets</b>						
Reportable segment assets	292.2	408.0	533.5	694.5	251.0	2,179.2
Corporate assets						9.0
						2,188.2
<b>Segment liabilities</b>						
Reportable segment liabilities	(243.0)	(313.3)	(176.0)	(133.5)	(85.8)	(951.6)
Corporate liabilities						(102.3)
						(1,053.9)

\* stated on a cash basis: including acquisitions but excluding finance leases



## Notes to the Consolidated Financial Statements

## 5. Segmental information (continued)

## Reportable segments

Restated

Year ended 31 December 2009

	Civil Government £m	Defence, Science and Nuclear £m	Local Government and Commercial £m	Americas £m	AMEAA £m	Total £m
<b>Revenue</b>	1,026.3	921.2	809.2	872.6	340.7	3,970.0
<b>Result</b>						
Segment result	45.0	77.9	47.0	61.8	24.1	255.8
Corporate expenses						(43.7)
<b>Operating profit</b>						212.1
Investment revenue						2.7
Finance costs						(37.7)
<b>Profit before tax</b>						177.1
Tax						(46.9)
<b>Profit for the year</b>						130.2
<b>Capital expenditure*</b>						
Goodwill	5.1	-	1.1	-	-	6.2
Property, plant and equipment: segments	9.4	2.2	13.2	3.9	8.9	37.6
Property, plant and equipment: corporate						2.4
						40.0
Intangible assets: segments	2.0	0.9	2.5	4.1	1.1	10.6
Intangible assets: corporate						6.9
						17.5
<b>Depreciation and amortisation</b>						
Depreciation: segments	8.3	2.7	12.7	7.1	2.8	33.6
Depreciation: corporate						0.8
						34.4
Amortisation of intangibles arising on acquisition:						
segments	0.3	-	2.6	14.2	0.5	17.6
Amortisation – other: segments	3.7	1.7	5.3	1.3	1.2	13.2
Amortisation – other: corporate						9.7
						40.5
<b>Segment assets</b>						
Reportable segment assets	284.4	447.4	538.7	661.2	197.2	2,128.9
Corporate assets						30.0
						2,158.9
<b>Segment liabilities</b>						
Reportable segment liabilities	(242.2)	(340.6)	(207.8)	(105.7)	(54.0)	(950.3)
Corporate liabilities						(138.6)
						(1,088.9)

\* stated on a cash basis: including acquisitions but excluding finance leases

## 5. Segmental information (continued)

	2010 £m	2009 £m
<b>Segment assets comprise:</b>		
Goodwill	899.5	898.4
Other intangible assets	145.0	164.4
Property, plant and equipment	135.4	129.2
Trade and other receivables – non-current	156.7	181.4
Inventories	65.4	65.9
Trade and other receivables – current excluding Corporation tax recoverable (note 19)	786.2	719.6
	<b>2,188.2</b>	<b>2,158.9</b>
	2010 £m	2009 £m
<b>Segment liabilities comprise:</b>		
Trade and other payables – current	(805.5)	(771.6)
Trade and other payables – non-current	(22.2)	(23.1)
Retirement benefit obligations	(226.2)	(294.2)
	<b>(1,053.9)</b>	<b>(1,088.9)</b>

## Geographic information

	Revenue 2010 £m	Non-current assets* 2010 £m	Revenue 2009 £m	Non-current assets* 2009 £m
United Kingdom	2,586.4	707.9	2,541.9	734.9
United States	880.3	463.2	819.2	404.8
Other countries	860.0	165.5	608.9	233.7
<b>Total</b>	<b>4,326.7</b>	<b>1,336.6</b>	<b>3,970.0</b>	<b>1,373.4</b>

\* Non-current assets exclude financial instruments and deferred tax assets

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 two major governmental customers which each represent more than 10% of Group revenues. The customers' revenues were respectively £2,418.3m (2009: £2,351.6m) across all reported segments other than Americas and AMEAA and £850.5m (2009: £796.1m) within the Americas segment.

## Notes to the Consolidated Financial Statements

## 6. Operating profit

Operating profit is stated after charging/(crediting):

	2010 £m	2009 £m
Net foreign exchange losses/(gains)	1.8	(3.4)
Research and development costs	62.3	47.1
Loss on disposal of property, plant and equipment	0.8	2.0
Depreciation and impairment of property, plant and equipment (note 16)	39.4	34.4
Amortisation of intangible assets – arising on acquisition (note 14)	17.4	17.6
Amortisation and impairment of intangible assets – other (note 14)	26.2	22.9
Impairment of goodwill (note 13)	4.2	-
Staff costs (note 7)	1,837.3	1,694.0
Allowance for doubtful debts charged to income statement (note 19)	2.2	1.4
Fair value adjustment on financial instruments		
- recycling of amounts on discontinued cash flow hedges (note 25(d))	0.3	0.2
- forward foreign exchange contracts: non-designated hedges (note 25(a))	(1.4)	3.0
Operating lease payments	128.6	104.5
Operating lease income	-	(0.1)

Amounts payable to Deloitte LLP and their associates by the Company and its subsidiary undertakings in respect of audit and non-audit services are shown below.

	2010 £m	2009 £m
Fees payable to the Company's Auditor for the audit of the Company's annual accounts	0.9	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	0.7	0.7
Total audit fees	1.6	1.6
Other services pursuant to legislation	0.1	0.1
- tax services	0.2	0.2
- other services	0.3	0.3
Total non-audit fees	0.6	0.6

Other services relate to consulting services provided to the Group.

## 7. Staff costs

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

	2010 Number	2009 Number
Civil Government	11,313	11,540
Defence, Science and Nuclear	8,516	9,182
Local Government and Commercial	11,477	11,400
Americas	10,192	10,286
AMEAA	17,014	15,036
Unallocated	287	266
<b>Total</b>	<b>58,799</b>	<b>57,710</b>

Average monthly numbers of employees for joint ventures are included on a proportionately consolidated basis in the table above.

Aggregate remuneration comprised:

	2010 £m	2009 £m
Wages and salaries	1,582.9	1,467.7
Social security costs	139.1	126.7
Other pension costs (note 26)	106.5	92.4
	<b>1,828.5</b>	<b>1,686.8</b>
Share-based payment expense (note 33)	8.8	7.2
<b>Total</b>	<b>1,837.3</b>	<b>1,694.0</b>

## 8. Investment revenue

	2010 £m	2009 £m
Interest receivable on other loans and deposits	3.9	2.7
	<b>3.9</b>	<b>2.7</b>

## 9. Finance costs

	2010 £m	2009 £m
Interest payable on non recourse loans	1.4	1.6
Interest payable on obligations under finance leases	2.2	1.8
Interest payable on other loans	23.7	26.8
Movement in discount on provisions and deferred consideration	1.2	1.2
Net interest payable on retirement benefit obligations (note 26)	2.8	6.3
	<b>31.3</b>	<b>37.7</b>

## Notes to the Consolidated Financial Statements

## 10. Tax

## 10 (a) Income tax recognised in the income statement

	2010 £m	2009 £m
<b>Current income tax</b>		
Current income tax expense	63.3	56.2
Adjustments in respect of prior years	(8.1)	(9.1)
<b>Deferred tax</b>		
Current year	2.5	(2.0)
Adjustments in respect of prior years	(0.6)	1.8
	57.1	46.9

The tax expense for the year can be reconciled to the profit in the Consolidated Income Statement as follows:

	2010 £m	2009 £m
<b>Profit before tax</b>	213.9	177.1
Tax calculated at a rate of 28% (2009: 28%)	59.9	49.6
Expenses not deductible for tax purposes	3.6	3.8
Unrelieved tax losses	2.5	2.1
Effect of the use of unrecognised tax losses	-	(0.4)
Impact of changes in statutory tax rates	0.8	-
Untaxed income	-	(0.9)
Overseas rate differences	3.2	3.4
Tax incentives	(4.2)	(3.4)
Adjustments in respect of prior years	(8.7)	(7.3)
<b>Tax charge</b>	57.1	46.9

## 10 (b) Income tax recognised in the SOCI

	2010 £m	2009 £m
<b>Current tax</b>		
Relating to cash flow hedges	-	0.3
Taken to Retirement benefit obligations reserve	(9.7)	(0.5)
Taken to Share-based payment reserve	(2.7)	(3.2)
<b>Deferred tax</b>		
Relating to cash flow hedges	0.6	(1.7)
Taken to Retirement benefit obligations reserve	14.0	(39.1)
Taken to Share-based payment reserve	(0.5)	(1.0)
	1.7	(45.2)

The income tax expense for the year is based on the UK statutory rate of corporation tax for the period of 28% (2009: 28%). The impact of changes in statutory tax rates relates principally to the reduction of the UK corporation tax rate from 28% to 27% from 1 April 2011, which was enacted on 27 July 2010. This change has resulted in a deferred tax charge arising from the reduction in the balance sheet carrying value of deferred tax assets to reflect the anticipated rate of tax at which those assets are expected to reverse. The UK Government has also indicated that it intends to enact future reductions in the main tax rate of 1% each year down to 24% by 1 April 2014. We estimate that the future rate changes would further reduce the UK deferred tax assets and liabilities recognised but the actual impact will be dependent on the deferred tax position at that time.



## 11. Dividends

	2010 £m	2009 £m
<b>Amounts recognised as distributions to equity holders in the year:</b>		
Final dividend for the year ended 31 December 2009 of 4.40p per share on 490.5 million ordinary shares (2009: Final dividend for the year ended 31 December 2008 of 3.52p per share on 481.1million ordinary shares)	21.6	16.9
Interim dividend for the year ended 31 December 2010 of 2.20p per share on 488.2 million ordinary shares (2009: Interim dividend for the year ended 31 December 2009 of 1.85p per share on 489.0 million ordinary shares)	10.7	9.0
	32.3	25.9
Proposed final dividend for the year ended 31 December 2010 of 5.15p per share on 488.5 million ordinary shares (2009: 4.40p on 490.5 million ordinary shares)	25.2	21.6

The proposed final dividend for 2010 is subject to approval by shareholders at the Annual General Meeting and has not been included as a liability in these Financial Statements. A dividend waiver is effective for those shares held on behalf of the Company by its Employee Share Ownership Trust (note 30).

## 12. Earnings per share

Basic and diluted earnings per ordinary share (EPS) have been calculated in accordance with IAS 33 Earnings per Share. EPS is shown both before and after amortisation of intangible assets arising on acquisition (note 14) to assist in the understanding of the underlying performance of the business.

The calculation of the basic and diluted EPS is based on the following data:

### Number of shares

	2010 Millions	2009 Millions
Weighted average number of ordinary shares for the purpose of basic EPS	491.5	486.6
Effect of dilutive potential ordinary shares: share options	8.4	5.6
Weighted average number of ordinary shares for the purpose of diluted EPS	499.9	492.2

### Earnings per share

	Earnings 2010 £m	Per share amount 2010 Pence	Earnings 2009 £m	Per share amount 2009 Pence
Earnings for the purpose of basic EPS being net profit attributable to the equity holders of the parent	156.7	31.88	130.2	26.76
Add back:				
Amortisation of intangible assets arising on acquisition, net of tax of £3.6m (2009: £4.1m)	13.8	2.81	13.5	2.77
Adjusted earnings before amortisation of intangible assets arising on acquisition	170.5	34.69	143.7	29.53
Earnings for the purpose of basic EPS	156.7	31.88	130.2	26.76
Effect of dilutive potential ordinary shares	-	(0.53)	-	(0.31)
Diluted EPS	156.7	31.35	130.2	26.45

At 31 December 2010 options over nil (2009: 894,000) 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.

## Notes to the Consolidated Financial Statements

## 13. Goodwill

	£m
At 1 January 2009	963.2
Additions	6.2
Reduction in deferred consideration payable on Infovision	(16.5)
Exchange differences	(54.5)
At 1 January 2010	898.4
Additions	3.1
Impairment	(4.2)
Reduction in deferred consideration payable on Infovision	(12.7)
Reduction in deferred consideration payable on Sandrunner	(1.0)
Exchange differences	15.9
<b>At 31 December 2010</b>	<b>899.5</b>

Goodwill is attributable to the excess of consideration over the fair value of net assets acquired and includes expected synergies, existing contracts, future growth prospects, staff knowledge, expertise and customer contacts.

Additions during the year include goodwill in respect of the acquisitions of RB Solutions Limited and the trade and liabilities of HyIT Knowledge Systems Private Limited (note 15).

During the year, the Group exited its remaining business in the non-core South African market, a joint venture providing aviation ground handling services, following the non-renewal of its license. Accordingly, an impairment charge of £4.2m has been recognised in the Consolidated Income Statement as an administrative expense. The recoverable amount is based on fair value less costs to sell. The impairment expense attributable to the joint venture's goodwill is allocated to Corporate Expenses in the Group's segmental information (note 5).

The goodwill acquired in business combinations is allocated, at acquisition, to the cash-generating units (CGUs) that are expected to benefit from that business combination. At the start of the financial year a group restructuring took place, including a combination of certain business units, triggering a re-assessment of the level at which cash inflows are largely independent of each other. Therefore, in accordance with IAS 36, the Group's CGUs were rationalised and this process incorporated the reallocation of some immaterial goodwill balances to the revised CGUs. Goodwill has been allocated to CGUs in the following operating segments:

	2010 £m	Restated 2009 £m
Civil Government	62.1	61.2
Defence, Science and Nuclear	105.5	106.9
Local Government and Commercial	295.5	295.3
Americas	408.2	395.7
AMEAA	28.2	39.3
<b>At 31 December</b>	<b>899.5</b>	<b>898.4</b>

The Group tests goodwill annually for impairment or more frequently if there are indications that goodwill might be impaired. The recoverable amount of each CGU is based on value in use calculations.

## Key assumptions

The value in use calculations use risk-adjusted cash flow projections based on financial plans approved by senior management covering a five-year period, and include a terminal value based on the projections for the final year of that plan, with an inflationary growth rate assumption applied. The key assumptions affecting the CGUs are discussed below.

## Short-term growth rates

Short-term revenue growth rates used in each CGU five-year plan are based on internal data regarding the current pipeline of opportunities and published industry forecasts for the relevant market. Further discussion of the Group's order book and pipeline is provided in the Our business and Our performance sections.

### 13. Goodwill (continued)

#### *Terminal growth rates*

The cash flows subsequent to the five-year period are based upon management's estimate of the growth rates of the sectors in which the CGUs operate. Where possible these have been derived with reference to external sources. The range of terminal growth rates applied to the CGUs within each operating segment are set out below:

	%
Civil Government	2.5
Defence, Science and Nuclear	2.5
Local Government and Commercial	2.5
Americas	3.0
AMEAA	2.5 - 7.0

These rates do not exceed the average long-term growth rates forecast for the individual market sectors.

#### *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 risk-adjusted cash flows. These rates are adjusted for risks specific to the market in which the CGU operates, including but not limited to: geographic and economic risks, contract length and customer type.

The range of pre-tax discount rates applied to the CGUs within each operating segment are disclosed below:

	%
Civil Government	9.2
Defence, Science and Nuclear	9.1 - 9.2
Local Government and Commercial	9.1
Americas	9.9
AMEAA	9.6 - 12.9

#### *Sensitivity analysis*

Sensitivity analysis has been performed for each key assumption and the Directors have not identified any reasonably possible material changes in the key assumptions that would cause the carrying value of goodwill to exceed the recoverable amount.

## Notes to the Consolidated Financial Statements

## 14. Other intangible assets

	Acquisition related		Other		
	Customer relationships £m	Licences and franchises £m	Software and development expenditure £m	Pension related intangibles £m	Total £m
<b>Cost</b>					
At 1 January 2010	71.7	69.5	133.9	26.6	301.7
Additions	-	2.9	22.8	-	25.7
Disposals	-	-	(23.2)	-	(23.2)
Exchange differences	1.7	5.9	1.0	-	8.6
<b>At 31 December 2010</b>	<b>73.4</b>	<b>78.3</b>	<b>134.5</b>	<b>26.6</b>	<b>312.8</b>
<b>Amortisation and impairment</b>					
At 1 January 2010	22.5	44.1	55.5	15.2	137.3
Charge for the year	9.9	7.5	23.7	2.5	43.6
Disposals	-	-	(17.4)	-	(17.4)
Exchange differences	0.3	3.9	0.1	-	4.3
<b>At 31 December 2010</b>	<b>32.7</b>	<b>55.5</b>	<b>61.9</b>	<b>17.7</b>	<b>167.8</b>
<b>Net book value</b>					
<b>At 31 December 2010</b>	<b>40.7</b>	<b>22.8</b>	<b>72.6</b>	<b>8.9</b>	<b>145.0</b>

	Acquisition related		Other		
	Customer relationships £m	Licences and franchises £m	Software and development expenditure £m	Pension related intangibles £m	Total £m
<b>Cost</b>					
At 1 January 2009	77.5	68.1	120.8	26.7	293.1
Arising on acquisition of a company	0.2	-	-	-	0.2
Additions	-	-	17.3	-	17.3
Disposals	-	(1.8)	(4.2)	-	(6.0)
Reclassifications to tangible assets	-	-	(0.5)	-	(0.5)
Exchange differences	(6.0)	3.2	0.5	(0.1)	(2.4)
<b>At 31 December 2009</b>	<b>71.7</b>	<b>69.5</b>	<b>133.9</b>	<b>26.6</b>	<b>301.7</b>
<b>Amortisation and impairment</b>					
At 1 January 2009	12.1	36.9	39.1	12.3	100.4
Charge for the year	10.9	6.7	19.9	3.0	40.5
Disposals	-	(1.8)	(4.2)	-	(6.0)
Exchange differences	(0.5)	2.3	0.7	(0.1)	2.4
<b>At 31 December 2009</b>	<b>22.5</b>	<b>44.1</b>	<b>55.5</b>	<b>15.2</b>	<b>137.3</b>
<b>Net book value</b>					
<b>At 31 December 2009</b>	<b>49.2</b>	<b>25.4</b>	<b>78.4</b>	<b>11.4</b>	<b>164.4</b>

Customer relationships are amortised over the average length of contracts acquired.

Amortisation of intangibles arising on acquisition consists of amortisation in relation to Customer relationships and Licences and franchises and totals £17.4m (2009: £17.6m).

The Group is carrying £72.6m (2009: £78.4m) in relation to Software and development expenditure which includes assets relating to the Group's SAP finance-related systems, of £42.7m (2009: £32.8m). The average amortisation period of these assets has six years (2009: five years) remaining. The Group is carrying £40.7m (2009: £49.2m) in relation to customer relationships of which the principal component is £34.0m (2009: £39.2m) relating to SI International, Inc. The remaining average life of these customer relationship intangible assets is approximately five years (2009: six years).

## 15. Acquisitions

During the year, the Group completed the following acquisitions which have been accounted for in accordance with IFRS 3 Business Combinations (2008).

### 15 (a) RB Solutions Limited:

On 17 February 2010, the Group acquired 100% of the share capital in RB Solutions Limited. Net assets acquired total £0.1m purchased for consideration of £1.5m of cash and £0.5m in deferred consideration paid on 17 August 2010.

The acquisition gives rise to £1.9m of goodwill relating to future opportunities in Local Government business process outsourcing. None of the goodwill recognised is expected to be deductible for corporate income tax purposes.

RB Solutions Limited is based in the UK and provides remote processing services to Local Government.

Costs of £0.3m have been expensed in relation to the acquisition and integration of RB Solutions Limited.

### 15 (b) HyIT Knowledge Systems Private Limited:

On 28 August 2010, the Group acquired the trade and liabilities of HyIT Knowledge Systems Private Limited. Net liabilities acquired were INR3,000 (£0.0m) for a purchase consideration of INR15.0m (£0.2m) of cash and INR77.2m (£1.0m) in deferred consideration to be paid contingent on future performance of the acquired trade and liabilities.

The acquisition gives rise to £1.2m of goodwill relating to future opportunities in the local Geo-Informatics market. None of the goodwill recognised is expected to be deductible for corporate income tax purposes.

HyIT Knowledge Systems Private Limited is based in Hyderabad, India providing client-site Geo-Informatics and technical support staffing services.

Due to the small size of the acquisitions, full IFRS 3 disclosures have not been presented.



## Notes to the Consolidated Financial Statements

## 16. Property, plant and equipment

	Freehold land and buildings £m	Short- leasehold building improvements £m	Machinery, motor vehicles, furniture and equipment £m	Total £m
<b>Cost</b>				
At 1 January 2010	7.4	47.1	265.2	319.7
Additions	-	2.4	44.5	46.9
Disposals	-	(0.1)	(22.2)	(22.3)
Exchange differences	(0.2)	1.4	10.2	11.4
<b>At 31 December 2010</b>	<b>7.2</b>	<b>50.8</b>	<b>297.7</b>	<b>355.7</b>
<b>Accumulated depreciation and impairment</b>				
At 1 January 2010	3.3	20.2	167.0	190.5
Charge for the year	0.2	5.6	33.6	39.4
Disposals	-	-	(15.4)	(15.4)
Exchange differences	-	0.5	5.3	5.8
<b>At 31 December 2010</b>	<b>3.5</b>	<b>26.3</b>	<b>190.5</b>	<b>220.3</b>
<b>Net book value</b>				
<b>At 31 December 2010</b>	<b>3.7</b>	<b>24.5</b>	<b>107.2</b>	<b>135.4</b>

	Freehold land and buildings £m	Short- leasehold building improvements £m	Machinery, motor vehicles, furniture and equipment £m	Total £m
<b>Cost</b>				
At 1 January 2009	7.6	39.0	246.4	293.0
Additions	0.1	11.0	39.6	50.7
Reclassification from intangible assets	-	-	0.5	0.5
Disposals	-	(2.6)	(32.7)	(35.3)
Arising on acquisition of subsidiaries	-	-	1.1	1.1
Exchange differences	(0.3)	(0.3)	10.3	9.7
<b>At 31 December 2009</b>	<b>7.4</b>	<b>47.1</b>	<b>265.2</b>	<b>319.7</b>
<b>Accumulated depreciation and impairment</b>				
At 1 January 2009	3.3	17.9	156.4	177.6
Charge for the year	0.2	4.9	29.3	34.4
Disposals	-	(2.0)	(27.6)	(29.6)
Exchange differences	(0.2)	(0.6)	8.9	8.1
<b>At 31 December 2009</b>	<b>3.3</b>	<b>20.2</b>	<b>167.0</b>	<b>190.5</b>
<b>Net book value</b>				
<b>At 31 December 2009</b>	<b>4.1</b>	<b>26.9</b>	<b>98.2</b>	<b>129.2</b>

The carrying amount of the Group's Machinery, motor vehicles, furniture and equipment includes an amount of £23.9m (2009: £22.1m) in respect of assets held under finance leases.

The carrying amount of the Group's Short-leasehold building improvements includes an amount of £2.3m (2009: £3.0m) in respect of assets held under finance leases.

## 17. Joint ventures

The Group's interests in joint ventures are reported in the consolidated financial statements using the proportionate consolidation method.

The effect of the Group's joint ventures on the Consolidated Income Statement and Consolidated Balance Sheet is as follows:

### Income statement

	2010 £m	2009 £m
Revenue	794.1	786.0
Expenses	(729.5)	(724.5)
Operating profit	64.6	61.5
Investment revenue	2.2	1.0
Finance costs	(0.5)	(0.5)
Profit before tax	66.3	62.0
Tax	(17.2)	(14.9)
Share of post-tax results of joint ventures	49.1	47.1

Operating profit is after allocating £0.7m (2009: £2.8m) of costs incurred by Group.

### Balance sheet

	2010 £m	2009 £m
Non-current assets	156.7	186.4
Current assets	173.4	145.4
Current liabilities	(146.0)	(129.8)
Non-current liabilities	(141.1)	(162.5)
Net assets	43.0	39.5

## 18. Inventories

	2010 £m	2009 £m
Service spares	29.8	22.6
Parts awaiting installation	7.4	18.0
Long-term project-based contract balances	28.2	25.3
	65.4	65.9

As at 31 December 2010, £nil (2009: £nil) of advances received from customers were included within Long-term project-based contract balances. As at 31 December 2010, the Group had £nil (2009: £nil) of contract retentions held by customers.

## Notes to the Consolidated Financial Statements

## 19. Trade and other receivables

	2010 £m	2009 £m
<b>Trade and other receivables: non-current</b>		
Amounts owed by joint ventures	4.7	2.7
Amounts recoverable on retirement benefit obligations (note 26)	123.4	144.3
Other debtors	28.6	34.4
	<b>156.7</b>	<b>181.4</b>
	2010 £m	2009 £m
<b>Trade and other receivables: current</b>		
Trade receivables	579.4	514.7
Other amounts recoverable on contracts	64.9	65.2
Prepayments and accrued income	96.7	81.4
Other debtors	45.2	58.3
	<b>786.2</b>	<b>719.6</b>
Corporation tax recoverable	4.0	1.3
	<b>790.2</b>	<b>720.9</b>

As of 31 December 2010, trade receivables of £4.2m (2009: £4.6m) were considered to be impaired. 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 amount of the provision was £4.2m as of 31 December 2010 (2009: £3.4m) primarily because our customers either have a sovereign credit rating being Government organisations or are blue chip private sector companies.

The ageing of trade receivables is as follows:

	2010 £m	2009 £m
Neither impaired nor past due	488.0	438.5
Not impaired but overdue by less than 30 days	56.9	40.9
Not impaired but overdue by between 30 and 60 days	14.0	11.8
Not impaired but overdue by more than 60 days	20.5	22.3
Impaired	4.2	4.6
Allowance for doubtful debts	(4.2)	(3.4)
	<b>579.4</b>	<b>514.7</b>

Movements on the Group allowance for doubtful debts are as follows:

	2010 £m	2009 £m
At 1 January	3.4	2.7
Charged to income statement	2.2	1.4
Utilised	(1.4)	(0.6)
Exchange differences	-	(0.1)
<b>At 31 December</b>	<b>4.2</b>	<b>3.4</b>

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.

## 20. Cash and cash equivalents

	Sterling 2010 £m	Other currencies 2010 £m	Total 2010 £m	Sterling 2009 £m	Other currencies 2009 £m	Total 2009 £m
Cash of project companies securing credit obligations*	-	7.3	7.3	-	4.3	4.3
Customer advance payments*	-	3.6	3.6	-	6.9	6.9
Other cash and short-term deposits	108.5	159.9	268.4	200.8	107.4	308.2
<b>Total cash and cash equivalents</b>	<b>108.5</b>	<b>170.8</b>	<b>279.3</b>	<b>200.8</b>	<b>118.6</b>	<b>319.4</b>

\* Cash of project companies and customer advance payments totalling £10.9m (2009: £11.2m) are encumbered cash balances.

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.

## 21. Loans

	Non recourse loans 2010 £m	Other loans 2010 £m	Total 2010 £m	Non recourse loans 2009 £m	Other loans 2009 £m	Total 2009 £m
Loans are repayable as follows:						
On demand or within one year	8.0	151.5	159.5	7.2	103.5	110.7
Between one and two years	7.9	114.3	122.2	7.3	145.8	153.1
Between two and five years	7.8	224.2	232.0	14.5	351.4	365.9
After five years	-	0.4	0.4	-	24.2	24.2
	<b>23.7</b>	<b>490.4</b>	<b>514.1</b>	<b>29.0</b>	<b>624.9</b>	<b>653.9</b>
Less: amount due for settlement within one year (shown within current liabilities)	(8.0)	(151.5)	(159.5)	(7.2)	(103.5)	(110.7)
<b>Amount due for settlement after one year</b>	<b>15.7</b>	<b>338.9</b>	<b>354.6</b>	<b>21.8</b>	<b>521.4</b>	<b>543.2</b>

The carrying amounts and fair values of the loans are as follows:

	Carrying amount 2010 £m	Fair value 2010 £m	Carrying amount 2009 £m	Fair value 2009 £m
Non recourse loans	23.7	25.3	29.0	31.3
Other loans	490.4	506.8	624.9	638.8
	<b>514.1</b>	<b>532.1</b>	<b>653.9</b>	<b>670.1</b>

The fair values are based on cash flows discounted using a rate based on the borrowing rate associated with the loan. All loans are held at amortised cost.

## Notes to the Consolidated Financial Statements

## 22. Deferred tax

Deferred income taxes are calculated in full on temporary differences under the liability method using local substantively enacted tax rates.

The gross movement on the deferred income tax account is as follows:

	2010 £m	2009 £m
At 1 January – (asset)/liability	(39.0)	5.9
Income statement charge/(credit) (note 10)	1.9	(0.2)
Items recognised in equity and in other comprehensive income (note 10)	14.1	(41.8)
Exchange differences	(0.5)	(2.9)
<b>At 31 December – asset</b>	<b>(23.5)</b>	<b>(39.0)</b>

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	Derivative financial instruments £m	Other temporary differences £m	Total £m
At 1 January 2010	22.6	(17.8)	(25.4)	(1.0)	(17.4)	(39.0)
(Credited)/charged to income statement	(5.6)	(8.7)	(2.1)	0.1	18.2	1.9
Items recognised in equity and in other comprehensive income	-	(0.5)	14.0	0.6	-	14.1
Exchange differences	0.3	(0.1)	-	-	(0.7)	(0.5)
<b>At 31 December 2010</b>	<b>17.3</b>	<b>(27.1)</b>	<b>(13.5)</b>	<b>(0.3)</b>	<b>0.1</b>	<b>(23.5)</b>

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	Derivative financial instruments £m	Other temporary differences £m	Total £m
At 1 January 2009	26.5	(18.7)	7.5	0.6	(10.0)	5.9
(Credited)/charged to income statement	(0.5)	1.5	6.2	0.1	(7.5)	(0.2)
Items recognised in equity and in other comprehensive income	-	(1.0)	(39.1)	(1.7)	-	(41.8)
Exchange differences	(3.4)	0.4	-	-	0.1	(2.9)
<b>At 31 December 2009</b>	<b>22.6</b>	<b>(17.8)</b>	<b>(25.4)</b>	<b>(1.0)</b>	<b>(17.4)</b>	<b>(39.0)</b>

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:

	2010 £m	2009 £m
Deferred tax liabilities	14.6	9.0
Deferred tax assets	(38.1)	(48.0)
	<b>(23.5)</b>	<b>(39.0)</b>

At the balance sheet date, the Group did not recognise deferred tax assets of £9.7m (2009: £5.6m) which principally relate to unused tax losses of £31.8m (2009: £26.1m). Losses of £1.3m (2009: £1.3m) expire within five years, losses of £11.0m (2009: £2.1m) expire within 6-10 years, losses of £12.6m (2009: £11.6m) expire within 15-20 years and losses of £6.9m (2009: £11.1m) may be carried forward indefinitely.

At the balance sheet date, the aggregate amount of temporary differences associated with undistributed earnings of subsidiaries for which deferred tax liabilities have not been recognised was £0.1m (2009: £0.4m). No liability has been recognised in respect of these differences because the Group is in a position to control the timing of the reversal of the temporary differences and it is probable that such differences will not reverse in the foreseeable future.



## 23. Obligations under finance leases

	Minimum lease payments 2010 £m	Present value of minimum lease payments 2010 £m	Minimum lease payments 2009 £m	Present value of minimum lease payments 2009 £m
Amounts payable under finance leases:				
Within one year	8.8	7.1	7.5	6.0
Between one and five years	20.5	18.2	17.6	15.3
After five years	1.3	1.1	3.0	2.7
	30.6	26.4	28.1	24.0
Less: future finance charges	(4.2)	-	(4.1)	-
Present value of lease obligations	26.4	26.4	24.0	24.0
Less: amount due for settlement within one year (shown under current liabilities)	(8.8)	(7.1)	(7.5)	(6.0)
<b>Amount due for settlement after one year</b>	<b>17.6</b>	<b>19.3</b>	<b>16.5</b>	<b>18.0</b>

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.

## 24. Trade and other payables

	2010 £m	2009 £m
<b>Trade and other payables: current</b>		
Trade creditors	203.8	197.7
Other creditors	152.4	126.4
Accruals and deferred income	449.2	447.0
Amounts owed to joint ventures	0.1	0.5
	805.5	771.6

The average credit period taken for trade purchases is 31 days (2009: 32 days).

	2010 £m	2009 £m
<b>Trade and other payables: non-current</b>		
Other creditors	22.2	23.1
	22.2	23.1

## Notes to the Consolidated Financial Statements

## 25. Financial risk management

## 25 (a) Fair value of financial instruments

## (i) Hierarchy of fair value

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 2010 £m	Fair value hierarchy - Level 2 2010 £m	2010 £m	Amortised Cost 2009 £m	Fair value hierarchy - Level 2 2009 £m	2009 £m
<b>Loans and receivables:</b>						
Trade receivables (note 19)	579.4		579.4	514.7		514.7
Other financial assets (note 25(e))	0.8		0.8	0.8		0.8
<b>Derivative financial assets:</b>						
Derivative financial instruments: current		3.9			1.4	
Derivative financial instruments: non-current		3.5			2.5	
<b>Financial liabilities at amortised cost:</b>						
Trade payables (note 24)	(203.8)		(203.8)	(197.7)		(197.7)
Loans (note 21)	(514.1)		(532.1)	(653.9)		(670.1)
<b>Derivative financial liabilities:</b>						
Derivative financial instruments: current		(2.4)			(5.5)	
Derivative financial instruments: non-current		(5.2)			(1.7)	

The Directors estimate that the carrying amounts of trade receivables and trade payables approximate to their fair value.

The fair values of loans are based on cash flows discounted using a rate based on the borrowing rate associated with the loan. All loans are held at amortised cost.

The fair values of derivative financial instruments are calculated based on a discounted cash flow analysis using appropriate quoted interest rates for the duration of the instruments as noted below:

- Currency swaps and interest rate swaps are measured at the present value of estimated future cash flows. The present value of foreign currency balances are converted at the year end exchange rate.
- Forward foreign exchange contracts are measured using quoted forward exchange rates matching the maturities of the contracts.
- Commodity contracts are measured at the present value of estimated cash flows with reference to quoted forward prices for Gas Oil.

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: derived from unadjusted quoted prices in active markets for identical assets or liabilities;
- Level 2: derived from other observable market data for the assets or liabilities; and
- Level 3: derived from valuation techniques using data that is not based on observable market data.

Based on the above, the derivative financial instruments held by the Group at 31 December 2010, are considered to fall into Level 2. There were no transfers between Level 1 and 2 during the year.

## 25. Financial risk management (continued)

### 25 (a) Fair value of financial instruments (continued)

#### (ii) Fair value of derivative financial instruments

The fair valuation of derivative financial instruments results in a net liability of £0.2m (2009: £3.3m), comprising non-current assets of £3.5m (2009: £2.5m), current assets of £3.9m (2009: £1.4m), current liabilities of £2.4m (2009: £5.5m) and non-current liabilities of £5.2m (2009: £1.7m).

	1 January 2010 £m	Movement in fair value of cash flow hedges £m	Movement in fair value of non- designated hedges £m	31 December 2010 £m
Currency swaps	(0.5)	1.5	-	1.0
Forward foreign exchange contracts	(2.3)	0.7	1.4	(0.2)
Interest rate swaps	(2.1)	(1.5)	-	(3.6)
Commodity futures contracts	1.6	1.0	-	2.6
	(3.3)	1.7	1.4	(0.2)

	1 January 2009 £m	Movement in fair value of cash flow hedges £m	Movement in fair value of non- designated hedges £m	31 December 2009 £m
Currency swaps	4.2	(4.7)	-	(0.5)
Forward foreign exchange contracts	2.2	(1.5)	(3.0)	(2.3)
Interest rate swaps	-	(2.1)	-	(2.1)
Commodity futures contracts	(0.4)	2.0	-	1.6
	6.0	(6.3)	(3.0)	(3.3)

### 25 (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.

## Notes to the Consolidated Financial Statements

## 25. Financial risk management (continued)

## 25 (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 credit facilities and corresponding borrowings were as follows:

	Currency	Amount 2010 Millions	Drawn 2010 £m	Undrawn 2010 £m	Total facility 2010 £m
Syndicated revolving credit facility	GBP	400.0	76.6	323.4	400.0
Syndicated term loan facility	USD	396.4	253.2	-	253.2
Bilateral revolving credit facility	GBP	35.0	-	35.0	35.0
Bilateral revolving credit facility	EUR	12.5	-	10.7	10.7
			329.8	369.1	698.9

	Currency	Amount 2009 Millions	Drawn 2009 £m	Undrawn 2009 £m	Total facility 2009 £m
Syndicated revolving credit facility	GBP	400.0	120.5	279.5	400.0
Syndicated term loan facility	USD	488.0	302.2	-	302.2
Bilateral revolving credit facility	GBP	35.0	35.0	-	35.0
Bilateral revolving credit facility	EUR	12.5	-	10.7	10.7
			457.7	290.2	747.9

The Group's bank credit facilities comprise a £400.0m syndicated revolving credit facility, a syndicated amortising term loan for US Dollar 396.4m and bilateral revolving credit facilities for £35.0m and Euro 12.5m. The syndicated revolving facility matures in September 2013 whilst the syndicated term loan is repayable between September 2011 and September 2013. The bilateral facilities mature in December 2011 and April 2012 respectively.

The banking facilities are unsecured and have financial and non-financial covenants and obligations typical of these arrangements.

The Group has outstanding private placements of £117.7m which amortise in equal annual instalments from 2011 to 2015. The private placements comprise a tranche of £83.0m and a tranche of US Dollar 55.0m, which is hedged by two cross currency swaps (note 25(d)).

## 25. Financial risk management (continued)

### 25 (c) Liquidity risk (continued)

#### (ii) Maturity of financial liabilities

The Group's financial liabilities will be settled on a net basis based on the remaining period at the balance sheet to 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.

	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 creditors	203.8	-	-	-	203.8
Obligations under finance leases	8.8	6.1	14.4	1.3	30.6
Loans	159.5	122.2	232.0	0.4	514.1
Future loan interest	16.0	11.4	11.2	0.3	38.9
Derivative financial liabilities	5.4	0.9	0.1	-	6.4
<b>At 31 December 2010</b>	<b>393.5</b>	<b>140.6</b>	<b>257.7</b>	<b>2.0</b>	<b>793.8</b>

	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 creditors	197.7	-	-	-	197.7
Obligations under finance leases	7.5	7.8	9.8	3.0	28.1
Loans	110.7	153.1	365.9	24.2	653.9
Future loan interest	26.0	20.5	28.3	1.2	76.0
Derivative financial liabilities	5.7	1.2	0.4	-	7.3
<b>At 31 December 2009</b>	<b>347.6</b>	<b>182.6</b>	<b>404.4</b>	<b>28.4</b>	<b>963.0</b>

The Group's derivative financial liabilities are settled on both a net and gross basis depending upon the terms of each derivative financial instrument. The maturity of the Group's undiscounted derivative financial liabilities is as follows:

	Currency swaps £m	Forward foreign exchange contracts £m	Interest rate swaps £m	Total £m
On demand or within one year	-	(2.4)	(3.0)	(5.4)
Between one and two years	-	(0.4)	(0.5)	(0.9)
Between two and five years	-	(0.1)	-	(0.1)
<b>At 31 December 2010</b>	<b>-</b>	<b>(2.9)</b>	<b>(3.5)</b>	<b>(6.4)</b>

	Currency swaps £m	Forward foreign exchange contracts £m	Interest rate swaps £m	Total £m
On demand or within one year	(0.1)	(1.9)	(3.7)	(5.7)
Between one and two years	-	(0.6)	(0.6)	(1.2)
Between two and five years	(0.1)	(0.6)	0.3	(0.4)
<b>At 31 December 2009</b>	<b>(0.2)</b>	<b>(3.1)</b>	<b>(4.0)</b>	<b>(7.3)</b>



# Notes to the Consolidated Financial Statements

## 25. Financial risk management (continued)

### 25 (d) Foreign exchange risk

#### (i) Transactional

The Group's business does not involve a significant amount of cross-border trade, and therefore, the Group is not exposed to substantial foreign currency transaction risk as sales and costs are closely matched within each overseas operation. Any material transactional exposures that do arise are hedged by Group treasury using forward foreign exchange contracts.

#### (ii) Translational

The foreign exchange exposure on the US Dollar tranche of the private placements has been fully hedged into Sterling. The exposure on US Dollar drawings under the bank facilities is hedged against the net investment in our US business.

Central funding of individual businesses gives rise to monetary assets and liabilities. The currency of funding is selected to ensure that any foreign exchange risk resides with Group. This risk is then managed by the Group's treasury function, using forward foreign exchange contracts and any natural hedge positions that may exist.

#### (iii) Forward foreign exchange contracts and currency swaps

The Group utilises currency derivatives to hedge significant future transactions and cash flows. The Group is party to a variety of foreign currency forward contracts and swap contracts in the management of its exchange rate exposures. These contracts are primarily denominated in the currencies of the Group's principal markets.

At 31 December 2010, the net total notional amount of outstanding forward foreign exchange and currency swap contracts to which the Group is committed is negative £59.6m (2009: positive £74.8m). These arrangements are mainly designed to address significant exchange exposures for the next five years (2009: six years).

#### Cash flow hedges

At 31 December 2010, the Group held a number of currency swaps designated as cash flow hedges against 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 currency swaps held by the Group is as follows:

Maturity	Notional amount 2010 USD m	Receivable USD interest rate 2010 %	Payable GBP interest rate 2010 %	Notional amount 2009 USD m	Receivable USD interest rate 2009 %	Payable GBP interest rate 2009 %
August 2015	35.0	5.7	5.7	35.0	5.7	5.7
August 2015	20.0	5.7	5.7	20.0	5.7	5.7

The Group also held a number of forward foreign exchange contracts designated as cash flow hedges with a notional amount of £29.5m (2009: £21.3m).

All currency derivatives designated as cash flow hedges are highly effective and the fair value gain of £2.2m (2009: £6.2m loss) has been deferred in equity. No balances in relation to ineffectiveness have been recognised in the Consolidated Income Statement. Amounts in the hedging reserve are recycled to the income statement as the hedged transactions affect the income statement. A loss of £0.3m (2009: £0.2m) has been included in the Consolidated Income Statement, and the remaining loss of £0.1m (2009: £0.4m) is expected to be recognised in the Consolidated Income Statement in future periods.

#### (iv) Hedges of net investments in foreign entities

The Group has US Dollar denominated borrowings, some of which have been designated as a hedge of part of the net investment in its acquired subsidiaries in the US, and Euro denominated borrowings, some of which have been designated as a hedge of part of the net investment in its subsidiaries in Europe. The carrying value of the designated borrowings was £338.5m (2009: £386.2m). The foreign exchange loss of £12.1m (2008: £47.0m gain) on translation into Sterling of the borrowings has been recognised within the Group's hedging and translation reserve. The hedge is highly effective. No amounts have been recognised in the Consolidated Income Statement.

#### (v) Currency sensitivity

The Group's currency exposures that result in net currency gains and losses in the income statement and equity arise principally from US Dollar and Canadian Dollar financial instruments. At 31 December 2010, if the US Dollar had weakened by 10% against Sterling, with all other variables held constant, post-tax profit for the year would have been £0.1m lower (2009: £0.1m) mainly as a result of movements on working capital. Equity would have been £30.6m higher (2009: £31.2m) mainly due to exchange gains on net investment hedges denominated in US Dollars. However, this would be predominantly offset by exchange losses on the retranslation of the net assets of the US subsidiaries. At 31 December 2010, if the US Dollar had weakened by 10% against the Canadian Dollar, with all other variables held constant, post-tax profit for the year would have been unaffected (2009: unaffected). Equity would have been £0.6m higher (2009: £0.6m) due to Canadian Dollar denominated non-current intercompany borrowings.

## 25. Financial risk management (continued)

### 25 (e) Interest rate risk

The Group's policy is to hedge core borrowing requirements to protect against adverse interest rate movements. 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	Fixed rate	Weighted average fixed interest rate received	Floating rate	Fixed rate	Weighted average fixed interest rate received
	2010 £m	2010 £m	2010 %	2009 £m	2009 £m	2009 %
Cash and cash equivalents	279.3	-		319.4	-	
Other financial assets	0.2	0.6	6.00	0.2	0.6	6.00
	279.5	0.6		319.6	0.6	

Financial liabilities	Floating rate	Fixed rate	Weighted average fixed interest rate paid	Floating rate	Fixed rate	Weighted average fixed interest rate paid
	2010 £m	2010 £m	2010 %	2009 £m	2009 £m	2009 %
Non recourse Canadian Dollar loans	-	23.7	5.27	-	29.0	5.27
Sterling loans	19.2	118.6	5.83	71.1	118.6	5.83
US Dollar loans	106.3	223.5	2.53	144.2	278.7	3.20
Other loans	22.8	-	9.1	12.2	0.1	12.00
	148.3	365.8		227.5	426.4	

Exposure to interest rate fluctuations is mitigated through the use of interest rate derivatives. Excluded from the above analysis is £26.4m of amounts payable under finance leases, which are subject to fixed rates of interest (2009: £24.0m).

#### (ii) Interest rate swaps

During 2009 the Group entered into interest rate swaps to manage its exposure to interest rate risk on US Dollar 450m debt by swapping floating for fixed interest rates. The profile of the interest rate swaps is as follows:

Maturity	Notional value	Payable USD weighted average interest rate	Receivable USD interest rate
	2010 USD m	2010 %	2010 %
March 2011	150	1.60	3 month USD LIBOR
March 2012	300	1.83	3 month USD LIBOR

Maturity	Notional value	Payable USD weighted average interest rate	Receivable USD interest rate
	2009 USD m	2009 %	2009 %
March 2011	150	1.60	3 month USD LIBOR
March 2012	300	1.83	3 month USD LIBOR

The swaps were designated as cash flow hedges and are highly effective. The fair value loss of £1.5m has therefore been deferred within equity (2009: £2.1m loss).

# Notes to the Consolidated Financial Statements

## 25. Financial risk management (continued)

### 25 (e) Interest rate risk (continued)

#### (iii) Interest rate sensitivity

The sensitivity analysis below shows the exposure to interest rates for both derivative and non-derivative financial liabilities at the balance sheet date and on average balances held throughout the past year. A 100 basis point increase in interest rates with all other variables held constant would have resulted in a gain on post-tax profit for the year to 31 December 2010 of £0.7m (2009: £0.3m). The gain on equity due to a 100 basis point movement would have been £2.1m (2009: £4.3m) due to movements in the fair value of derivative financial instruments held as cash flow hedges.

### 25 (f) Price risk

The Group is exposed to commodity price risk through its joint venture rail operations due to the volatility in the price of fuel.

The maturity profile of the three (2009: two) commodity derivatives used by the joint ventures to reduce this risk is as follows:

Maturity	Notional value 2010 Million litres	Payable fixed rate 2010 p per litre
January 2011 - September 2011	18.5	28.95
January 2011 - September 2011	10.8	39.70
January 2011 - September 2013	74.2	42.96

Maturity	Notional value 2009 Million litres	Payable fixed rate 2009 p per litre
January 2010 - September 2010	9.4	33.80
January 2010 - September 2011	44.9	28.95

All commodity derivatives were designated as cash flow hedges and were highly effective. During the year a gain of £1.0m (2009: £2.0m) has therefore been deferred within equity.

#### (i) Price risk sensitivity

An increase of US Dollar 0.2 per litre in the price of fuel at the balance sheet date would result in a gain of £7.1m in equity (2009: £3.5m). The sensitivity to changes in fuel prices resulting from changes in exchange rates is included within the currency sensitivity analysis (see note 25(d)).

### 25 (g) Credit risk

The Group's principal financial assets are cash and cash equivalents and trade and other receivables.

The Group's credit risk is relatively low because a high proportion of our customers have a sovereign or sovereign-like credit rating and the Group has a large number of counterparties and customers. External credit checks are completed for all new non Government customers before signing a contract above £100,000. Credit vetting for new Government body customers is performed by an internal review of the client's ability to pay and timeliness of payment. The review includes a consideration of the expected contract budget as well as economic and industry factors and the budget holders' position within the Government body. At quarterly intervals, a management credit worthiness review for all ongoing customers with material outstanding balances is undertaken, including an assessment to determine if there has been any deterioration in the customer's payment history and a review of the total credit authorised to the customer throughout the Group.

The Group's treasury function only transacts with counterparties that have, as a minimum, a long-term public rating from two recognised credit rating agencies of 'Single A'. It also ensures that no exposure to any one institution at any given time exceeds a pre-approved exposure limit.

### 25 (h) Capital risk

The Group's key objectives when managing capital are to ensure the Group has sufficient funds to meet current and future business requirements, to provide returns for shareholders and benefits for other stakeholders and to maintain an optimal capital structure.

Access to capital takes many forms and includes access to the equity market, debt capital market, and bank market. During 2010, the Group maintained sufficient debt facilities that ensured its objectives were met.

## 26. Retirement benefit schemes

The Group has accounted for pensions in accordance with IAS 19 Employee Benefits. The Group operates a number of defined benefit schemes and defined contribution schemes. The pension charge for the year ended 31 December 2010, including the proportionate share of joint ventures, was £106.5m (2009: £92.4m).

### 26 (a) Defined benefit schemes

The Group operates defined benefit schemes for qualifying employees of its subsidiaries in the UK and Europe. In addition, the Group has interests in joint ventures, which operate defined benefit schemes for qualifying employees.

The assets of the funded schemes are held independently of the Group's assets in separate trustee administered funds. 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 long-term expected rates of return for scheme assets. Discount rates are based on the market yields of high-quality corporate bonds in the country concerned. Long-term expected rates of return for scheme assets are based on published brokers' forecasts for each category of scheme assets. 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.

#### (i) Balance sheet values

The amounts recognised in the balance sheet are grouped together as follows:

##### *Contract specific – Virtually certain costs reimbursed*

The Group has an obligation to contribute to the pension scheme over the term of the contract. At rebid any deficit or surplus would transfer to the next contractor. Throughout the contract, it is virtually certain that the Group will be reimbursed the expenditure required to settle the defined benefit obligation. The Group's share of the defined benefit obligation less its share of the fair value of scheme assets that it will fund over the period of the contract has been recognised as a liability. The Group has recognised the right to reimbursement as a separate asset.

In the income statement, the expense relating to this defined benefit plan has been presented net of the amount recognised for the reimbursement, resulting in a nil charge to the income statement.

##### *Contract specific – Not certain costs reimbursed*

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 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.

##### *Non contract specific*

These consist of a pre-funded defined benefit scheme which does not relate to any specific contract (the funding policy is to contribute such variable amounts, on the advice of the actuary, as will achieve 100% funding on a projected salary basis) and an unfunded defined benefit scheme, both of which do not relate to any specific contract. Any liabilities arising are recognised in full.

#### (ii) Triennial funding valuation

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 6 April 2009 and resulted in an actuarially assessed deficit of £141m. Following this review, the Group agreed with the Trustees to make cash contributions of 30% of members' pensionable salaries until 2019, plus lump sum payments of £20m, which was paid in December 2010 and £40m, which was paid in January 2011. We continue to review the level of benefits and contributions under the scheme in light of our business needs and changes to pension legislation.

## Notes to the Consolidated Financial Statements

## 26. Retirement benefit schemes (continued)

## 26 (a) Defined benefit schemes (continued)

The assets and liabilities of the schemes at 31 December are:

	Virtually certain costs reimbursed 2010 £m	Not certain costs reimbursed 2010 £m	Non contract specific 2010 £m	Total 2010 £m
<b>Scheme assets at fair value</b>				
Equities	132.2	255.2	36.6	424.0
Bonds except LDI	56.1	45.1	16.6	117.8
Liability driven investments (LDI)	-	9.3	651.3	660.6
Gilts	-	33.8	1.1	34.9
Property	17.8	26.5	9.5	53.8
Cash and other	48.7	32.4	134.9	216.0
Annuity policies	-	1.0	25.1	26.1
Fair value of scheme assets	254.8	403.3	875.1	1,533.2
Present value of scheme liabilities	(378.2)	(510.4)	(951.5)	(1,840.1)
Net amount recognised	(123.4)	(107.1)	(76.4)	(306.9)
Members' share of deficit	-	26.7	1.5	28.2
Franchise adjustment	-	53.7	-	53.7
Effect of IFRIC 14	-	-	(1.2)	(1.2)
<b>Net pension liability</b>	<b>(123.4)</b>	<b>(26.7)</b>	<b>(76.1)</b>	<b>(226.2)</b>

## Related assets

Intangible assets (note 14)	-	8.9	-	8.9
Trade and other receivables (note 19)	123.4	-	-	123.4
	<b>123.4</b>	<b>8.9</b>	<b>-</b>	<b>132.3</b>

	Virtually certain costs reimbursed 2009 £m	Not certain costs reimbursed 2009 £m	Non contract specific 2009 £m	Total 2009 £m
<b>Scheme assets at fair value</b>				
Equities	143.6	230.0	41.4	415.0
Bonds except LDI	52.7	20.9	15.2	88.8
Liability driven investments (LDI)	-	-	493.6	493.6
Gilts	-	54.4	0.9	55.3
Property	16.4	20.4	8.9	45.7
Cash and other	11.8	26.3	193.2	231.3
Annuity policies	-	2.9	24.3	27.2
Fair value of scheme assets	224.5	354.9	777.5	1,356.9
Present value of scheme liabilities	(368.8)	(476.3)	(899.3)	(1,744.4)
Net amount recognised	(144.3)	(121.4)	(121.8)	(387.5)
Members' share of deficit	-	33.5	3.3	36.8
Franchise adjustment	-	58.0	-	58.0
Effect of IFRIC 14	-	-	(1.5)	(1.5)
<b>Net pension liability</b>	<b>(144.3)</b>	<b>(29.9)</b>	<b>(120.0)</b>	<b>(294.2)</b>

## Related assets

Intangible assets (note 14)	-	11.4	-	11.4
Trade and other receivables (note 19)	144.3	-	-	144.3
	<b>144.3</b>	<b>11.4</b>	<b>-</b>	<b>155.7</b>

Liabilities in relation to unfunded schemes included above amount to £48.7m (2009: £48.7m).

Certain of the Group's non contract specific schemes have 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 assumed expected rate of return is taken to be gilts +0.7% (2009: gilts +0.7%).



## 26. Retirement benefit schemes (continued)

### 26 (a) Defined benefit schemes (continued)

In some schemes, employee contributions vary over time to meet a specified proportion of the overall costs, including a proportion of any deficit. The liabilities recognised in the balance sheet for these schemes are net of the proportion attributed to employees. In addition, the amounts charged to the income statement for these schemes are net of the proportion attributed to employees. The amounts attributed to employees are shown separately in the reconciliation of changes in the fair value of scheme assets and liabilities.

The amounts recognised in the Financial Statements for the year are analysed as follows:

	Virtually certain costs reimbursed 2010 £m	Not certain costs reimbursed 2010 £m	Non contract specific 2010 £m	Total 2010 £m
<b>Recognised in the income statement</b>				
Current service cost – employer	9.7	15.5	14.7	39.9
Past service cost	-	-	0.3	0.3
Reimbursed to employer	(9.7)	-	-	(9.7)
<b>Recognised in arriving at operating profit</b>	<b>-</b>	<b>15.5</b>	<b>15.0</b>	<b>30.5</b>
Expected return on scheme assets – employer	(16.6)	(18.4)	(46.0)	(81.0)
Interest on franchise adjustment	-	(3.4)	-	(3.4)
Interest cost on scheme liabilities – employer	21.5	20.4	50.2	92.1
Reimbursed to employer	(4.9)	-	-	(4.9)
<b>Finance (income)/cost</b>	<b>-</b>	<b>(1.4)</b>	<b>4.2</b>	<b>2.8</b>
<b>Included within the SOCI</b>				
Actual return on scheme assets	24.1	35.7	81.7	141.5
Less: expected return on scheme assets	(16.6)	(25.3)	(47.4)	(89.3)
	7.5	10.4	34.3	52.2
Other actuarial gains/(losses)	13.8	3.7	(19.8)	(2.3)
<b>Actuarial gains recognised in the SOCI</b>	<b>21.3</b>	<b>14.1</b>	<b>14.5</b>	<b>49.9</b>
Change in IFRIC 14	-	-	0.3	0.3
Change in franchise adjustment	-	(7.7)	-	(7.7)
Change in members' share	-	(8.0)	(1.7)	(9.7)
Reimbursed to employer	(21.3)	-	-	(21.3)
<b>Actuarial losses on reimbursable rights</b>	<b>(21.3)</b>	<b>(15.7)</b>	<b>(1.4)</b>	<b>(38.4)</b>
<b>Total pension (cost)/income recognised in the SOCI</b>	<b>-</b>	<b>(1.6)</b>	<b>13.1</b>	<b>11.5</b>

## Notes to the Consolidated Financial Statements

## 26. Retirement benefit schemes (continued)

## 26 (a) Defined benefit schemes (continued)

	Virtually certain costs reimbursed 2009 £m	Not certain costs reimbursed 2009 £m	Non contract specific 2009 £m	Total 2009 £m
<b>Recognised in the income statement</b>				
Current service cost – employer	7.0	12.2	14.7	33.9
Past service cost	-	-	0.7	0.7
Reimbursed to employer	(7.0)	-	-	(7.0)
<b>Recognised in arriving at operating profit</b>	-	12.2	15.4	27.6
Expected return on scheme assets – employer	(12.2)	(14.3)	(35.3)	(61.8)
Interest on franchise adjustment	-	(1.1)	-	(1.1)
Interest cost on scheme liabilities – employer	16.1	15.6	41.4	73.1
Reimbursed to employer	(3.9)	-	-	(3.9)
<b>Finance cost</b>	-	0.2	6.1	6.3
<b>Included within the SOCI</b>				
Actual return on scheme assets	38.3	42.5	60.9	141.7
Less: expected return on scheme assets	(12.3)	(19.9)	(36.3)	(68.5)
Other actuarial gains and losses	26.0	22.6	24.6	73.2
	(85.2)	(89.4)	(157.6)	(332.2)
<b>Actuarial losses recognised in the SOCI</b>	(59.2)	(66.8)	(133.0)	(259.0)
Change in IFRIC 14	-	-	0.1	0.1
Change in franchise adjustment	-	39.3	-	39.3
Change in members' share	-	16.7	1.8	18.5
Reimbursed to employer	59.2	-	-	59.2
<b>Actuarial gains on reimbursable rights</b>	59.2	56.0	1.9	117.1
<b>Total pension cost recognised in the SOCI</b>	-	(10.8)	(131.1)	(141.9)

## 26. Retirement benefit schemes (continued)

### 26 (a) Defined benefit schemes (continued)

Cumulative actuarial losses recognised since 1 January 2004 are £42.0m (2009: losses of £53.5m).

Changes in the fair value of scheme liabilities are analysed as follows:

	Virtually certain costs reimbursed £m	Not certain costs reimbursed £m	Non contract specific £m	Total £m
At 1 January 2009	267.2	356.4	719.8	1,343.4
Current service cost – employer	7.0	12.2	14.7	33.9
Current service cost – employee	-	4.8	0.6	5.4
Past service costs	-	-	0.7	0.7
Scheme participants' contributions	2.5	0.7	1.1	4.3
Interest cost – employer	16.1	15.6	41.4	73.1
Interest cost – employee	-	6.0	1.1	7.1
Benefits paid	(9.2)	(8.8)	(33.4)	(51.4)
Actuarial gains and losses	85.2	89.4	157.6	332.2
Exchange differences	-	-	(4.3)	(4.3)
At 1 January 2010	368.8	476.3	899.3	1,744.4
Current service cost – employer	9.7	15.5	14.7	39.9
Current service cost – employee	-	6.2	0.5	6.7
Past service costs	-	-	0.3	0.3
Scheme participants' contributions	3.1	0.6	0.9	4.6
Interest cost – employer	21.5	20.4	50.2	92.1
Interest cost – employee	-	7.6	1.3	8.9
Benefits paid	(11.1)	(12.5)	(33.7)	(57.3)
Actuarial gains and losses	(13.8)	(3.7)	19.8	2.3
Exchange differences	-	-	(1.8)	(1.8)
<b>At 31 December 2010</b>	<b>378.2</b>	<b>510.4</b>	<b>951.5</b>	<b>1,840.1</b>

Changes in the fair value of plan assets are analysed as follows:

	Virtually certain costs reimbursed £m	Not certain costs reimbursed £m	Non contract specific £m	Total £m
At 1 January 2009	177.6	297.3	719.2	1,194.1
Expected return on scheme assets – employer	12.2	14.3	35.3	61.8
Expected return on scheme assets – employee	-	5.6	1.0	6.6
Employer contributions	15.4	17.9	29.1	62.4
Contributions by employees	2.5	6.0	1.6	10.1
Benefits paid	(9.2)	(8.8)	(33.4)	(51.4)
Actuarial gains and losses	26.0	22.6	24.6	73.2
Exchange differences	-	-	0.1	0.1
At 1 January 2010	224.5	354.9	777.5	1,356.9
Expected return on scheme assets – employer	16.6	18.4	46.0	81.0
Expected return on scheme assets – employee	-	6.9	1.4	8.3
Employer contributions	14.1	18.9	48.3	81.3
Contributions by employees	3.2	6.3	1.3	10.8
Benefits paid	(11.1)	(12.5)	(33.7)	(57.3)
Actuarial gains and losses	7.5	10.4	34.3	52.2
Exchange differences	-	-	-	-
<b>At 31 December 2010</b>	<b>254.8</b>	<b>403.3</b>	<b>875.1</b>	<b>1,533.2</b>

Employer contributions for non contract specific schemes in 2010 include a £20m special contribution paid in December 2010.

## Notes to the Consolidated Financial Statements

## 26. Retirement benefit schemes (continued)

## 26 (a) Defined benefit schemes (continued)

## History of experience gains and losses

	2010	2009	2008	2007	2006
<b>Experience adjustments arising on scheme assets:</b>					
Amount (£m)	52.2	73.2	(263.7)	1.4	45.8
Percentage of the fair value of scheme assets	3%	5%	(22)%	0%	4%
<b>Experience adjustments arising on scheme liabilities:</b>					
Amount (£m)	4.2	(58.2)	0.1	(5.1)	(13.1)
Percentage of the present value of scheme liabilities	0%	(3)%	0%	0%	(1)%
Fair value of scheme assets (£m)	1,533.2	1,356.9	1,194.1	1,342.8	1,186.8
Present value of scheme liabilities (£m)	(1,840.1)	(1,744.4)	(1,343.4)	(1,500.9)	(1,465.1)
Deficit (£m)	(306.9)	(387.5)	(149.3)	(158.1)	(278.3)

The normal contributions expected to be paid during the financial year ending 31 December 2011 are £59.6m (financial year ended 31 December 2010 £60.7m).

Assumptions in respect of the expected return on scheme assets 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 2010 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 returns of holding this type of investment, when compared to bond yields. Management have concluded that an appropriate equity risk premium is 4.1% (2009: 4.1%).

The overall expected return on assets is calculated as the weighted average of the expected returns for the principal asset categories held by scheme.

	2010 %	2009 %
<b>Main assumptions:</b>		
Rate of salary increases	3.50	3.70
Rate of increase in pensions in payment	2.60 (CPI) and 3.10 (RPI)	3.30
Rate of increase in deferred pensions	2.60 (CPI) and 3.10 (RPI)	3.30
Inflation assumption	2.60 (CPI) and 3.10 (RPI)	3.30
Discount rate	5.40	5.80
Expected rates of return on scheme assets:		
Equities	8.30	8.60
Bonds except LDI	5.40	5.80
LDI	4.90	5.20
Gilts	4.20	4.50
Property	5.45	5.75
Cash and other	0.50	0.50
Annuity policies	5.40	5.80
	2010 Years	2009 Years
<b>Post-retirement mortality:</b>		
Current pensioners at 65 – male	20.8	20.3
Current pensioners at 65 – female	23.3	23.2
Future pensioners at 65 – male	22.4	21.6
Future pensioners at 65 – female	24.5	24.4

## 26. Retirement benefit schemes (continued)

### 26 (a) Defined benefit schemes (continued)

#### The replacement of the retail prices index with the consumer prices index for retirement benefits

The UK Government announced in its June 2010 budget that when they publish the statutory increase figure in the future they will use the CPI measure of inflation rather than RPI. This was confirmed on 8 December 2010.

Certain of the Group's pension schemes reflect the lower liability where benefits are explicitly based on statutory increases in the Rules in 31 December 2010 pension liability figures. If this change had not occurred, the net liability of the pension schemes on the Group balance sheet would have been £59.2m greater. There is no impact on the operating profit of the current year due to applying the change.

### 26 (b) Defined contribution schemes

The Group paid employer contributions of £61.9m (2009: £49.4m) into UK and other defined contribution schemes, foreign state pension schemes and multi-employer schemes, including those of joint ventures.

#### Pre-funded defined benefit schemes treated as defined contribution

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.

## 27. Provisions

	Employee related £m	Property £m	Contract £m	Other £m	Total £m
At 1 January 2009	5.9	9.8	11.2	19.0	45.9
Charged to income statement	2.4	-	0.9	1.9	5.2
Released to income statement	-	-	(0.5)	-	(0.5)
Utilised during the year	(0.6)	(1.2)	(0.7)	(2.8)	(5.3)
Unwinding of discount	-	0.4	0.3	-	0.7
Exchange differences	-	(1.0)	(0.8)	(1.9)	(3.7)
At 1 January 2010	7.7	8.0	10.4	16.2	42.3
Charged to income statement	3.5	0.1	0.2	2.3	6.1
Released to income statement	-	(0.9)	(0.9)	(2.7)	(4.5)
Utilised during the year	(0.6)	(1.2)	(2.2)	(2.7)	(6.7)
Unwinding of discount	-	0.3	0.3	-	0.6
Exchange differences	0.4	0.3	0.2	0.9	1.8
<b>At 31 December 2010</b>	<b>11.0</b>	<b>6.6</b>	<b>8.0</b>	<b>14.0</b>	<b>39.6</b>

Employee related provisions relate to 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.

Property provisions relate to leased properties which are either under utilised or vacant and where the unavoidable costs associated with the lease exceed the economic benefits expected to be required. Management has calculated the provision based on the discounted cash outflows required to settle the lease obligations.

Contract provisions primarily relate to SI International, Inc. where, as required under IAS 37, a provision has been taken for a loss making onerous contract. Management has used the present value of the estimated future cash outflows required to settle the contract obligations in determining the provision.

Other provisions are held for legal and other costs that the Group expects to incur over an extended period. These costs are based on past experience of similar items and other known factors and represent management's best estimate of the likely outcome.

## Notes to the Consolidated Financial Statements

## 28. Share capital

	2010 £m	Number 2010 Millions	2009 £m	Number 2009 Millions
<b>Issued and fully paid:</b>				
490,912,075 (2009: 486,764,440) ordinary shares of 2p each at 1 January	9.8	490.9	9.7	486.8
Issued on the exercise of share options	0.1	2.3	0.1	4.1
<b>493,220,805 (2009: 490,912,075) ordinary shares of 2p each at 31 December</b>	<b>9.9</b>	<b>493.2</b>	<b>9.8</b>	<b>490.9</b>

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

During the year 2,308,730 (2009: 4,147,635) ordinary shares of 2p each were allotted to the holders of share-based awards or their personal representatives using newly listed shares.

## 29. Share premium account

	2010 £m	2009 £m
At 1 January	304.1	301.1
Premium on shares issued	2.6	3.0
<b>At 31 December</b>	<b>306.7</b>	<b>304.1</b>

## 30. Reserves

## 30 (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.

## 30 (b) Share-based payment reserve

The share-based payment reserve represents credits relating to equity-settled share-based payment transactions granted after 7 November 2002, but not fully vested as of 1 January 2005, and any gain or loss on the exercise of share options satisfied by own shares.

## 30 (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 (ESOP) to satisfy options under the Group's share options schemes. At 31 December 2010, the ESOP held 4,710,201 (2009: 3,436,547) shares equal to 1.0% of the current allotted share capital (2009: 0.7%). The market value of shares held by the ESOP as at 31 December 2010 was £26.2m (2009: £18.2m).

## 30 (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.



### 31. Notes to the consolidated cash flow statement

#### Reconciliation of operating profit to net cash inflow from operating activities

	2010 £m	2009 £m
<b>Operating profit for the year</b>	<b>241.3</b>	212.1
Adjustments for:		
Share-based payment expense	8.8	7.2
Depreciation of property, plant and equipment	39.4	34.4
Amortisation and impairment of intangible assets	43.6	40.5
Loss on disposal of property, plant and equipment	0.8	2.0
Profit on disposal of intangible assets	(1.5)	-
Impairment of goodwill	4.2	-
Movement in provisions	(5.1)	(0.6)
<b>Operating cash inflow before movements in working capital</b>	<b>331.5</b>	295.6
Decrease/(increase) in inventories	3.5	(15.1)
Increase in receivables	(43.4)	(31.1)
Increase in payables	10.0	24.8
Special contribution to defined benefit pension scheme (note 26)	(20.0)	-
<b>Cash generated by operations</b>	<b>281.6</b>	274.2
Tax paid	(40.6)	(39.1)
<b>Net cash inflow from operating activities</b>	<b>241.0</b>	235.1

Additions to fixtures and equipment during the year amounting to £10.0m (2009: £11.9m) were financed by new finance leases.

#### Analysis of net debt

	At 1 January 2010 £m	Cash flow £m	Acquisitions* £m	Exchange differences £m	Non cash movements £m	At 31 December 2010 £m
Cash and cash equivalents	319.4	(48.3)	0.1	8.1	-	279.3
Non recourse loans	(29.0)	7.6	-	(2.3)	-	(23.7)
Other loans	(624.9)	157.7	-	(21.8)	(1.4)	(490.4)
Obligations under finance leases	(24.0)	8.7	-	(1.1)	(10.0)	(26.4)
	(358.5)	125.7	0.1	(17.1)	(11.4)	(261.2)

	At 1 January 2009 £m	Cash flow £m	Acquisitions* £m	Exchange differences £m	Non cash movements £m	At 31 December 2009 £m
Cash and cash equivalents	250.8	73.0	0.9	(5.3)	-	319.4
Non recourse loans	(34.1)	6.5	-	(1.4)	-	(29.0)
Other loans	(713.6)	33.0	(2.5)	58.2	-	(624.9)
Obligations under finance leases	(17.2)	5.7	-	(0.6)	(11.9)	(24.0)
	(514.1)	118.2	(1.6)	50.9	(11.9)	(358.5)

\* Acquisitions represent the net cash/(debt) acquired on acquisition.

## Notes to the Consolidated Financial Statements

## 32. Capital and other commitments

	2010 £m	2009 £m
Capital expenditure contracted but not provided:		
- Property, plant and equipment	1.7	5.5

Included within the balances above is joint venture capital expenditure contracted but not provided in relation to property, plant and equipment of £nil (2009: £1.2m).

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:

	2010 £m	2009 £m
Within one year	112.0	106.7
Between one and five years	240.6	207.3
After five years	129.3	123.5
	481.9	437.5

Principal lease commitments are within the Civil Government segment, with future minimum lease payments totalling £231.1m (2009: £181.0m). These leases relate primarily to administrative and operational buildings, track and rolling stock within the train operating companies. The length of the leases is concurrent with the period of the franchises and the terms of the leases are fixed during this period.

### 33. Share-based payment expense

The Group recognised the following expenses related to equity-settled share-based payment transactions:

	2010 £m	2009 £m
Executive Option Plan	0.2	0.5
Long Term Incentive Scheme and Plan	2.5	4.5
Sharesave 2008	1.0	1.8
Transformational Share Scheme	0.2	0.1
Performance Share Plan	4.4	0.2
Deferred Bonus Plan	0.5	0.1
	8.8	7.2

#### 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 2010 Thousands	Weighted average exercise price 2010 £	Number of options 2009 Thousands	Weighted average exercise price 2009 £
Outstanding at 1 January	6,857	2.72	10,948	2.65
Granted during the year	-	-	88	3.88
Exercised during the year	(2,620)	2.79	(3,634)	2.50
Lapsed during the year	(280)	3.47	(545)	2.98
<b>Outstanding at 31 December</b>	<b>3,957</b>	<b>2.63</b>	<b>6,857</b>	<b>2.72</b>

Of these options 3,534,982 (2009: 5,992,295) were exercisable at the end of the year, with a weighted average exercise price of £2.42 (2009: £2.48).

The options outstanding at 31 December 2010 had a weighted average contractual life of 3.2 years (2009: 3.7 years).

The exercise prices for options outstanding at 31 December 2010 ranged from £1.39 to £4.55 (2009: £1.39 to £4.90).

The weighted average share price at the date of exercise approximates to the weighted average share price during the year, which was £5.81 (2009: £4.41).

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 Plans during the year.

## Notes to the Consolidated Financial Statements

## 33. Share-based payment expense (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 and may be exercised after the third anniversary of grant. 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 of three financial years.

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 2010 Thousands	Weighted average exercise price 2010 £	Number of options 2009 Thousands	Weighted average exercise price 2009 £
Outstanding at 1 January	5,623	Nil	8,214	Nil
Granted during the year	-	Nil	351	Nil
Exercised during the year	(1,786)	Nil	(2,383)	Nil
Lapsed during the year	(146)	Nil	(559)	Nil
<b>Outstanding at 31 December</b>	<b>3,691</b>	<b>Nil</b>	<b>5,623</b>	<b>Nil</b>

Of these options, 1,544,054 (2009: 896,487) were exercisable at the end of the year.

The options outstanding at 31 December 2010 had a weighted average contractual life of 6.8 years (2009: 7.6 years).

There were no grants of LTIP options during the year. During the prior year, two grants of LTIP options were made: one grant with TSR performance conditions, the other with EPS growth performance conditions. 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 TSR-based awards.

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.

For the LTIP options with EPS growth performance conditions, the fair value is considered to be their face value less the present value of any dividend payments not paid over the vesting period.

### 33. Share-based payment expense (continued)

#### Transformational Share Scheme

Awards made to eligible employees under the Transformational Share Scheme are structured as options with a £nil exercise price and are exercisable after the third anniversary of the grant.

The employee must exercise the options no later than 30 days after the vesting date. Furthermore, if the eligible employee leaves the Group before the options vest, the options may be forfeited.

	Number of options 2010 Thousands	Weighted average exercise price 2010 £	Number of options 2009 Thousands	Weighted average exercise price 2009 £
Outstanding at 1 January	86	Nil	39	Nil
Granted during the year	33	Nil	53	Nil
Exercised during the year	-	Nil	-	Nil
Lapsed during the year	-	Nil	(6)	Nil
<b>Outstanding at 31 December</b>	<b>119</b>	<b>Nil</b>	<b>86</b>	<b>Nil</b>

None of these options were exercisable at the end of the year (2009: none).

The options outstanding at 31 December 2010 had a weighted average contractual life of 0.8 years (2009: 1.3 years).

The fair value of options granted under the Transformational Share Scheme is considered to be equal to their face value as at the grant date less the present value of any dividend payments over the vesting period. This model is considered to be most appropriate for valuing options granted under this scheme as the options have a £nil exercise price and are not subject to any performance conditions.

The assumptions for determining the face value less any dividends are:

	2010	2009
Weighted average share price	590p	366p
Weighted average exercise price	Nil	Nil
Expected volatility	N/A	N/A
Expected life	3 years	2 years
Risk free rate	N/A	N/A
Expected dividends	1.0%	1.4%

## Notes to the Consolidated Financial Statements

## 33. Share-based payment expense (continued)

## 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 years and are subject to the achievement of two performance measures. The primary performance measure is TSR and the second performance measure is based on EPS growth.

	Number of options 2010 Thousands	Weighted average exercise price 2010 £	Number of options 2009 Thousands	Weighted average exercise price 2009 £
Outstanding at 1 January	479	Nil	-	Nil
Granted during the year	3,523	0.02	479	Nil
Exercised during the year	-	Nil	-	Nil
Lapsed during the year	(58)	Nil	-	Nil
<b>Outstanding at 31 December</b>	<b>3,944</b>	<b>0.02</b>	<b>479</b>	<b>Nil</b>

None of these options were exercisable at the end of the year (2009: none).

The options outstanding at 31 December 2010 had a weighted average contractual life of 9.2 years (2009: 9.5 years).

In the year, four grants were made with 70% of the options granted subject to TSR performance conditions and 30% subject to EPS growth performance conditions.

The options subject to TSR performance conditions were valued using the Monte Carlo Simulation model. The options subject to EPS growth performance conditions were deemed to have fair values equal to their face value less the present value of any dividend payments not received over the vesting period.

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 TSR-based awards.

The inputs into the Monte Carlo Simulation model for options granted during the year with TSR performance conditions are:

	2010	2009
Weighted average share price	615p	406p
Weighted average exercise price	2p	Nil
Expected volatility	28.9%	28.8%
Expected life	3 years	3 years
Risk free rate	1.9%	2.2%
Expected dividends	-	1.2%

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 growth performance conditions are:

	2010	2009
Weighted average share price	615p	406p
Weighted average exercise price	2p	Nil
Expected volatility	N/A	N/A
Expected life	3 years	3 years
Risk free rate	N/A	N/A
Expected dividends	-	1.2%



### 33. Share-based payment expense (continued)

#### 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 two performance measures (which are the same as the PSP scheme, being TSR and EPS growth) have been met, the Group will make a matching share award. For shares purchased by employees in 2010 the match was on a basis of two times the gross bonus deferred.

	Number of options 2010 Thousands	Weighted average exercise price 2010 £	Number of options 2009 Thousands	Weighted average exercise price 2009 £
Outstanding at 1 January	207	Nil	28	Nil
Granted during the year	219	Nil	207	Nil
Exercised during the year	-	Nil	(28)	Nil
Lapsed during the year	-	Nil	-	Nil
<b>Outstanding at 31 December</b>	<b>426</b>	<b>Nil</b>	<b>207</b>	<b>Nil</b>

None of these options were exercisable at the end of the year (2009: none).

The options outstanding at 31 December 2010 had a weighted average contractual life of 1.9 years (2009: 2.5 years).

In the year, one grant was made with 50% of the deferred bonus subject to TSR performance conditions and 50% subject to EPS growth performance conditions.

The portion subject to TSR performance conditions was valued using the Monte Carlo Simulation model. The portion subject to EPS growth 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.

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 TSR-based awards.

The inputs into the Monte Carlo Simulation model for options granted during the year with TSR performance conditions are:

	2010	2009
Weighted average share price	602p	404p
Weighted average exercise price	Nil	Nil
Expected volatility	28.9%	28.9%
Expected life	3 years	3 years
Risk free rate	1.8%	1.8% to 2.4%
Expected dividends	-	1.2%

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 growth performance conditions are:

	2010	2009
Weighted average share price	602p	404p
Weighted average exercise price	Nil	Nil
Expected volatility	N/A	N/A
Expected life	3 years	3 years
Risk free rate	N/A	N/A
Expected dividends	-	1.2%

## Notes to the Consolidated Financial Statements

## 33. Share-based payment expense (continued)

## Sharesave 2008

The Sharesave 2008 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 2008 options are as follows:

	Number of options 2010 Thousands	Weighted average exercise price 2010 £	Number of options 2009 Thousands	Weighted average exercise price 2009 £
Outstanding at 1 January	6,106	4.0	6,760	4.0
Granted during the year	-	Nil	-	Nil
Exercised during the year	(248)	4.0	(5)	4.0
Lapsed during the year	(379)	4.0	(649)	4.0
<b>Outstanding at 31 December</b>	<b>5,479</b>	<b>4.0</b>	<b>6,106</b>	<b>4.0</b>

Of these options, 16,278 (2009: none) were exercisable at the end of the year.

The options outstanding at 31 December 2010 had a weighted average contractual life of 1.2 years (2009: 2.1 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.

### 34. 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 are disclosed below, with the relevant proportion being eliminated on consolidation.

#### Trading transactions

During the year, Group companies entered into the following material transactions with joint ventures:

	2010 £m	2009 £m
Royalties and management fees receivable	2.0	1.6
Dividends receivable	51.5	46.3
	53.5	47.9

The following receivable balances relating to joint ventures were included in the Consolidated Balance Sheet:

	2010 £m	2009 £m
<b>Current:</b>		
Loans	0.1	0.6
	2010 £m	2009 £m
<b>Non-current:</b>		
Loans	3.5	2.2

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. No provisions are required for doubtful debts in respect of the amounts owed by the joint ventures.

#### 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:

	2010 £m	2009 £m
Short-term employee benefits	7.5	3.2
Post-employment benefits	0.8	0.4
Share-based payment expense	2.8	1.5
	11.1	5.1

The key management personnel comprise the Executive Directors, Non-Executive Directors and members of the Executive Committee (2010: 19 individuals, 2009: 9 individuals).

## Notes to the Consolidated Financial Statements

### 35. List of principal undertakings

The Company has taken advantage of the exemption under Section 410(2) of the Companies Act 2006 by providing information only in relation to undertakings whose results or financial position, in the opinion of the Directors, principally affected the financial statements.

A complete list of subsidiary and associated undertakings will be attached to the next Serco Group plc annual return to Companies House.

The percentage of equity capital held directly or indirectly by Serco Group plc is shown. The voting rights are the same as the percentage holding. The companies are incorporated and principally operate in the countries stated below.

Principal subsidiaries		2010	2009
United Kingdom	Serco Limited	100%	100%
	NPL Management Limited	100%	100%
Rest of Europe			
Germany	Serco GmbH	100%	100%
AMEAA			
Australia	Serco Australia Pty Limited	100%	100%
	Great Southern Rail Limited	100%	100%
North America			
USA	Serco Services Inc.	100%	100%
Joint venture undertakings		2010	2009
United Kingdom	AWE Management Limited	33%	33%
	Merseyrail Services Holding Company Limited	50%	50%
	Northern Rail Holdings Limited	50%	50%
AMEAA			
Australia	Serco Sodexo Defence Services Pty Limited	50%	50%

All joint ventures are accounted for using the proportionate consolidation method. All the subsidiaries of the Group have been consolidated.

All the principal subsidiaries of Serco Group plc and its joint venture undertakings are engaged in the provision of support services.

### 36. Contingent liabilities

The Company has guaranteed overdrafts, finance leases, and bonding facilities of its joint ventures up to a maximum value of £8.2m (2009: £7.0m). The actual commitment outstanding at 31 December 2010 was £5.6m (2009: £4.3m).

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.

# UK GAAP Audit Report – Parent Company

## Independent Auditor's report to the members of Serco Group plc

We have audited the parent Company Financial Statements of Serco Group plc for the year ended 31 December 2010 which comprise the Company Balance Sheet and the related notes 1 to 16. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

## Respective responsibilities of Directors and Auditor

As explained more fully in the Directors' Responsibilities Statement, the Directors are responsible for the preparation of the parent Company Financial Statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the parent Company Financial Statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

## Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the parent Company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Directors; and the overall presentation of the financial statements.

## Opinion on the parent Company Financial Statements

In our opinion the parent Company Financial Statements:

- give a true and fair view of the state of the parent Company's affairs as at 31 December 2010;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

## Opinion on other matters prescribed by the Companies Act 2006

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 Directors' Report for the financial year for which the financial statements are prepared is consistent with the parent Company Financial Statements.

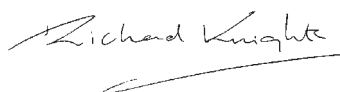
## Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us 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.

## Other matter

We have reported separately on the Group Financial Statements of Serco Group plc for the year ended 31 December 2010.



**Richard Knights** (Senior Statutory Auditor)  
for and on behalf of Deloitte LLP  
Chartered Accountants and Statutory Auditor  
London, United Kingdom  
1 March 2011

# Company Balance Sheet

At 31 December

	Note	2010 £m	2009 Restated* £m
<b>Fixed assets</b>			
Investments in subsidiary undertakings	3	812.1	805.5
		<b>812.1</b>	<b>805.5</b>
<b>Current assets</b>			
Amounts owed by subsidiary companies due after more than one year		585.3	758.8
Debtors: amounts due within one year	4	5.6	6.1
Debtors: amounts due after more than one year	4	15.6	14.6
Derivative financial instruments due within one year	7	2.2	0.5
Derivative financial instruments due after more than one year	7	1.8	1.4
Cash at bank and in hand		-	-
		<b>610.5</b>	<b>781.4</b>
<b>Creditors: amounts falling due within one year</b>			
Bank loans and overdrafts	6	(200.6)	(65.7)
Loans	6	(23.6)	(10.0)
Amounts owed to subsidiary companies		(45.7)	(223.1)
Trade creditors		(0.7)	(0.3)
Other creditors including taxation and social security	5	(1.6)	(1.1)
Derivative financial instruments	7	(2.1)	(5.2)
Accruals and deferred income		(10.1)	(4.7)
		<b>(284.4)</b>	<b>(310.1)</b>
<b>Net current assets</b>		<b>326.1</b>	<b>471.3</b>
<b>Total assets less current liabilities</b>		<b>1,138.2</b>	<b>1,276.8</b>
Creditors: amounts falling due after more than one year	6	(335.8)	(518.5)
Amounts owed to subsidiary companies		(243.0)	(251.1)
Provisions		(1.0)	-
Derivative financial instruments	7	(4.8)	(1.7)
<b>Net assets</b>		<b>553.6</b>	<b>505.5</b>
<b>Capital and reserves</b>			
Called up share capital	9	9.9	9.8
Share premium account	10	306.7	304.1
Capital redemption reserve		0.1	0.1
Own shares	11	(27.5)	(13.0)
Share-based payment reserve	12	38.7	32.8
Hedging and translation reserve	13	(0.4)	(1.5)
Profit and loss account	14	226.1	173.2
<b>Shareholders' funds</b>		<b>553.6</b>	<b>505.5</b>

\* Note 1

The Financial Statements of the Company (registered number 2048608) were approved by the Board of Directors on 1 March 2011 and signed on its behalf by:



Christopher Hyman  
Chief Executive



Andrew Jenner  
Finance Director



# Notes to the Company Financial Statements

## I. 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

These financial statements have been prepared in accordance with UK GAAP and applicable UK law.

### Accounting convention

These accounts have been prepared under the historical cost convention and on the going concern basis.

### Restatement

The prior year figures have been restated to reclassify the assets and liabilities of the Serco Group plc Employee Share Ownership Trust (ESOP) from amounts owed by subsidiary companies due within one year to an Own Share reserve. This has resulted in a decrease in both current debtors and reserves of £15.4m.

### Fixed asset investments

Investments held as fixed assets are stated at cost less provision for any impairment in value.

### Share-based payment

The Company has applied the requirements of FRS 20 Share-based Payment. In accordance with the transitional provisions, FRS 20 has been applied to all grants of equity instruments after 7 November 2002 that were not fully vested as of 1 January 2005.

The Company issues equity-settled share-based payments to certain employees and operates an Inland Revenue approved Save As You Earn (SAYE) share option scheme open to eligible employees which allows the purchase of shares at a discount. These are measured at fair value at the date of grant. The fair value is expensed on a straight-line basis over the vesting period, based on the Company's estimate of shares that will eventually vest.

Where the fair value of share options requires the use of a valuation model, fair value is measured by use of the Binomial Lattice or Monte Carlo Simulation models depending on the type of scheme. 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.

### Dividends

Dividends are approved by the Board of Directors, and recorded in the Company's financial statements in the period in which they are declared, appropriately authorised and no longer at the discretion of the Company.

# Notes to the Company Financial Statements

## I. Accounting policies (continued)

### Derivative financial instruments and hedging activities

Derivatives are initially accounted for and measured at fair value on the date a derivative contract is entered into and subsequently measured at fair value. The gain or loss on re-measurement is taken to the profit and loss account except where the derivative is a designated cash flow hedging instrument. The accounting treatment of derivatives classified as hedges depends on their designation, which occurs on the date that the derivative contract is committed to. The Company designates derivatives as:

- a hedge of the fair value of an asset or liability (fair value hedge);
- a hedge of the income/cost of a highly probable forecast transaction or commitment (cash flow hedge); and
- a hedge of a net investment in a foreign entity.

Gains and losses on fair value are recorded in the profit and loss account with the gain or loss on the hedged item attributable to the hedged risk.

Gains or losses on cash flow hedges that are regarded as highly effective are recognised in equity. Where the forecast transaction results in a financial asset or liability, only gains or losses previously recognised in equity are reclassified to profit or loss in the same period as the asset or liability affects profit or loss. Where the forecast transaction or commitment results in a non-financial asset or liability, any gains or losses previously deferred in equity are included in the cost of the related asset or liability if the forecast transaction or commitment results in future income or expenditure. Gains and losses deferred in equity are transferred to the profit and loss account in the same period as the underlying income or expenditure. The ineffective portion of the gain or loss on the hedging instrument is recognised in the profit and loss account.

For the ineffective portion of hedges or transactions that are not designated for hedge accounting under FRS 26, any change in assets or liabilities is recognised immediately in the profit and loss account. Where a hedge no longer meets the effectiveness criteria, any gains or losses deferred in equity are only transferred to the profit and loss account when the committed or forecast transaction is recognised in the profit and loss account. However, where cash flow hedge accounting has been applied for a forecast or committed transaction that is no longer expected to occur, then the cumulative gain or loss that has been recorded in equity at that time remains in equity and is recognised when the forecast transaction is ultimately recognised in the profit and loss account.

Where the Company hedges net investments in foreign entities through currency borrowings, the gains or losses on the translation of the borrowings are recognised in equity. Gains and losses accumulated in equity are included in the profit and loss account when the foreign operation is disposed of.

### Current tax

Current tax, including UK corporation tax, is provided at amounts expected to be paid (or recovered) using the tax rates and laws that have been enacted or substantially enacted at the balance sheet date.

### Deferred tax

The charge for taxation takes account of taxation deferred because of differences between the timing of recognition of certain items for taxation purposes and for accounting purposes. Deferred tax is recognised in respect of all timing differences that have originated but not reversed at the balance sheet date where the transactions or events that give rise to an obligation to pay more or less tax in the future have occurred by the balance sheet date. A deferred tax asset is recognised only when it is considered more likely than not that it will be recovered.

Deferred tax is recognised on a non-discounted basis using tax rates in force at the date the timing differences are expected to reverse.

## 2. Auditor's remuneration

Fees payable to the Company's Auditor for the audit of the Company's annual accounts of £10,000 (2009: £10,000) have been borne by another group company.

## 3. Investments held as fixed assets

	£m
<b>Shares in subsidiary companies at cost</b>	
At 1 January 2010	805.5
Options over parent's shares awarded to employees of subsidiaries	6.6
<b>At 31 December 2010</b>	<b>812.1</b>
	£m
<b>Shares in subsidiary companies at cost</b>	
At 1 January 2009	799.6
Options over parent's shares awarded to employees of subsidiaries	5.9
<b>At 31 December 2009</b>	<b>805.5</b>

Full details of the principal subsidiaries of Serco Group plc can be found in note 35 to the Group's Consolidated Financial Statements. The Company directly owns 100% of the ordinary share capital of the following subsidiaries except where stated.

Name	% ownership
Serco Holdings Limited	100%
Serco Group (HK) Limited	50%

## 4. Debtors

	2010 £m	Restated* 2009 £m
<b>Amounts due within one year</b>		
Amounts owed by subsidiary companies	-	0.2
Corporation tax recoverable	3.0	3.4
Other debtors	2.6	2.5
	<b>5.6</b>	<b>6.1</b>
<b>Amounts due after more than one year</b>		
Amounts owed by joint ventures	3.4	0.9
Other debtors	9.4	10.6
Deferred tax asset (note 8)	2.8	3.1
	<b>15.6</b>	<b>14.6</b>
	<b>21.2</b>	<b>20.7</b>

\* Note 1

## 5. Other creditors including taxation and social security

	2010 £m	2009 £m
Other creditors	1.6	1.1

## Notes to the Company Financial Statements

## 6. Creditors: amounts falling due after more than one year

	2010 £m	2009 £m
Loans	560.0	594.2
Less: amounts included in creditors falling due within one year – loans	(23.6)	(10.0)
Less: amounts included in creditors falling due within one year – bank loans & overdrafts	(200.6)	(65.7)
<b>Amounts falling due after more than one year</b>	<b>335.8</b>	<b>518.5</b>
Loans are repayable as follows:		
Within one year or on demand	224.2	75.7
Between one and two years	111.8	143.8
Between two and five years	224.0	351.1
After five years	-	23.6
	<b>560.0</b>	<b>594.2</b>

## 7. Derivative financial instruments

	Assets 2010 £m	Liabilities 2010 £m	Assets 2009 £m	Liabilities 2009 £m
Currency swaps	0.9	-	-	(0.5)
Interest rate swaps	-	(3.5)	1.1	(3.1)
Forward foreign exchange contracts	3.1	(3.4)	0.8	(3.3)
	<b>4.0</b>	<b>(6.9)</b>	<b>1.9</b>	<b>(6.9)</b>
Analysed as:				
Non-current	1.8	(4.8)	1.4	(1.7)
Current	2.2	(2.1)	0.5	(5.2)
	<b>4.0</b>	<b>(6.9)</b>	<b>1.9</b>	<b>(6.9)</b>

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 25 of the Group's Consolidated Financial Statements.

## 8. Deferred tax asset

	2010 £m	2009 £m
Capital allowances in excess of depreciation	0.2	-
Short term timing differences	2.6	3.1
	<b>2.8</b>	<b>3.1</b>

The movement in the deferred tax asset during the year was as follows:

	2010 £m	2009 £m
At 1 January	3.1	0.9
Charged to profit and loss account	(0.1)	(0.1)
Items taken directly to equity	(0.2)	2.3
<b>At 31 December</b>	<b>2.8</b>	<b>3.1</b>

## 9. Called up share capital

	2010 £m	Number 2010 Millions	2009 £m	Number 2009 Millions
<b>Issued and fully paid</b>				
490,912,075 (2009: 486,764,440) ordinary shares of 2p each at 1 January	9.8	490.9	9.7	486.8
Issued on the exercise of share options	0.1	2.3	0.1	4.1
<b>493,220,805 (2009: 490,912,075) ordinary shares of 2p each at 31 December</b>	<b>9.9</b>	<b>493.2</b>	<b>9.8</b>	<b>490.9</b>

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

During the year 2,308,730 (2009: 4,147,635) ordinary shares of 2p each were allotted to the holders of options or their personal representatives using newly listed shares.

## 10. Share premium account

	2010 £m	2009 £m
At 1 January	304.1	301.1
Premium on shares issued	2.6	3.0
<b>At 31 December</b>	<b>306.7</b>	<b>304.1</b>

## 11. 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 (ESOP) to satisfy options under the Group's share option schemes. At 31 December 2010, the ESOP held 4,710,201 (2009: 3,436,547) shares equal to 1.0% of the current allotted share capital (2009: 0.7%). The market value of shares held by the ESOP as at 31 December 2010 was £26.2m (2009: £18.2m).

## 12. Share-based payment reserve

	2010 £m	Restated* 2009 £m
At 1 January	32.8	27.4
Options over parent's shares awarded to employees of subsidiaries	6.6	5.9
Share-based payment expense	2.2	1.3
Share options to holders on exercise	(2.9)	(1.8)
<b>At 31 December</b>	<b>38.7</b>	<b>32.8</b>

\* Note 1

Details of the share-based payment disclosures are set out in note 33 of the Group's Consolidated Financial Statements

## 13. Hedging and translation reserve

	2010 £m	2009 £m
At 1 January	(1.5)	3.9
Fair value gain/(loss) on cash flow hedges during the period	0.5	(8.1)
Tax (charge)/credit on items taken directly to equity	(0.2)	2.3
Net exchange gain on translation of foreign operations	0.8	0.4
<b>At 31 December</b>	<b>(0.4)</b>	<b>(1.5)</b>

## Notes to the company financial statements

## 14. Profit and loss account

	2010 £m	Restated* 2009 £m
At 1 January	173.2	141.7
Profit for the year	85.2	57.4
Equity dividends	(32.3)	(25.9)
<b>At 31 December</b>	<b>226.1</b>	<b>173.2</b>

\* Note 1

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.

## 15. Contingent liabilities

The Company has provided certain financial guarantees and indemnities in respect of the loans, overdraft and bonding facilities, and other financial commitments of its subsidiaries. The total commitment outstanding as at 31 December 2010 was £126.0m (2009: £36.5m).

The Company has also guaranteed overdrafts, finance leases, and bonding facilities of its joint ventures up to a maximum value of £8.2m (2009: £7.0m). The actual commitment outstanding at 31 December 2010 was £5.6m (2009: £4.3m).

In addition to this, the Company has 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.

## 16. 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 8 Related Party Disclosure, from disclosing related party transactions with entities that are part of the Group. Full details of the transactions between Serco Group plc and its related parties can be found in note 34 to the Group's Consolidated Financial Statements.



## Supplementary information

### Five-year record

		2010	2009	2008	2007	2006
Revenue	£m	4,327	3,970	3,124	2,811	2,548
Adjusted operating profit	£m	258.7	229.7	165.2	142.0	122.8
Adjusted operating margin	%	5.98%	5.79%	5.29%	5.05%	4.82%
Profit before tax	£m	213.9	177.1	136.1	114.6	107.4
Group free cash flow	£m	185.8	137.3	94.2	97.6	85.4
Group recourse net debt	£m	(303.6)	(387.7)	(524.5)	(137.9)	(171.9)
Total net debt	£m	(261.2)	(358.5)	(514.1)	(162.3)	(205.9)
Adjusted earnings per share	pence	34.69p	29.53p	22.20p	18.57p	15.92p
Dividend per share	pence	7.35p	6.25p	5.00p	4.25p	3.60p

## Directors, Secretary and Advisors

### Chairman

Alastair Lyons CBE\*

### Directors

Leonard V. Broese van Groenou\*

Paul Brooks\*

Christopher Hyman CBE

Andrew Jenner

David Richardson\* ^

\*Non-Executive

^ Senior Independent Director

### Secretary

Joanne Roberts

### Registered Office

Serco House

16 Bartley Wood Business Park

Bartley Way

Hook

Hampshire

RG27 9UY

Serco Group plc is registered in  
England and Wales, No. 2048608

### Auditors

Deloitte LLP

2 New Street Square

London

EC4A 3BZ

### Investment Bankers

UBS Limited

1 Finsbury Avenue

London

EC2M 2PP

### Stockbrokers

J.P. Morgan Cazenove

125 London Wall

London

EC2Y 5AJ

Merrill Lynch International

2 King Edward Street

London

EC1A 1HQ

### Principal Bankers

HSBC Bank PLC

8 Canada Square

London

E14 5HQ

### Solicitors

Linklaters LLP

One Silk Street

London

EC2Y 8HQ

### Registrars

Equiniti

Aspect House

Spencer Road

Lancing

West Sussex

BN99 6DA

# Shareholder information

## Group website

Go to [www.serco.com](http://www.serco.com) to catch up on the current share price, latest news in the investors section and read the Annual report and accounts.

## Registrars

Administrative enquiries about the holding of Serco Group plc shares and enquiries in relation to the Serco Dividend Re-investment Plan (DRIP) should be directed to:

Equiniti  
Aspect House  
Spencer Road  
Lancing  
West Sussex  
BN99 6DA

Tel: 0871 384 2932

There is a text phone available on 0871 384 2255 for shareholders with hearing difficulties.

(Calls to both of these numbers are charged at 8p per minute from a BT landline. Other telephony provider costs may vary.)

Callers from outside the UK should use +44 (0) 121 415 7047.

Telephone lines are open 8.30am to 5.30pm Monday to Friday.

## Dividend re-investment plan

You can elect to receive future dividends as shares rather than cash by participating in the DRIP. To register, request further information, or to obtain a copy of the terms and conditions booklet and mandate form please contact Equiniti on 0871 384 2932. Alternatively, these can be downloaded from the website [www.shareview.co.uk](http://www.shareview.co.uk) by choosing the Dividend Re-investment Plan heading within the Product Centre section.

## Dividends paid direct to your bank account

- Avoid the risk of cheques being lost in the post
- No need to present cheques for payment
- Dividend credited to your account on payment date

To set up a dividend mandate or change your existing mandated details please register with the Shareholder Centre via the Shareview website or contact Equiniti on the number provided above.

## Global payment services

For overseas shareholders in certain countries, Equiniti offers an Overseas Payment Service by arrangement with Citibank Europe PLC. This service offers shareholders the ability to have their dividend converted into their local currency and sent electronically to their local bank account. To sign up for this service, please contact Equiniti on 0871 384 2932 (+44 (0) 121 415 7047 if calling from outside the UK). Alternatively you can download an application form and terms and conditions from the website [www.shareview.co.uk](http://www.shareview.co.uk).

## Electronic communication

You can register for electronic communications by visiting [www.shareview.co.uk](http://www.shareview.co.uk); you will need your shareholder reference number to sign up. After you have registered you will receive emails alerting you to communications as they become available. In response to our shareholders' commitment to electronic communication Serco is very proud to be a Corporate Member of the Woodland Trust, the UK's leading woodland conservation charity, helping them to plant and care for UK native woodland. During 2010 the Trust planted more than half a million native trees in the UK.

## Shareholder information

### Share dealing

Serco does not endorse any one service for the buying and selling of its shares. However, arrangements have been made with the following independent share dealing providers to offer all shareholders competitive charges.

Alternatively, if shareholders hold a share certificate they can also use any bank, building society or stockbroker offering share dealing facilities. Shareholders in any doubt about buying or selling their shares should seek professional financial advice.

### Shareview

A telephone and internet dealing service is available through Equiniti which provides a simple way of buying and selling Serco shares. Commission is 1.5% with a minimum charge of £25 for telephone dealing and 1% with a minimum charge of £20 for internet dealing. For telephone dealing call +44 (0) 845 6037 037 between 8.30am and 4.30pm, Monday to Friday, and for internet dealing log on to [www.shareview.co.uk/dealing](http://www.shareview.co.uk/dealing). You will need your 11 digit shareholder reference number which will be shown on either your share certificate or recent dividend tax voucher.

### Stocktrade

We have arranged a telephone sharedealing service with Stocktrade for purchases/sales of Serco shares. You should call 0845 601 0995 between 8.00am and 4.30pm, Monday to Friday and quote Low Co 330 (callers from outside the UK should call +44 (0)131 240 0508). Commission is charged at 0.5% on amounts to £10,000 and 0.2% on the excess thereafter, subject to a minimum charge of £17.50. Further details and other dealing options can be found at [www.stocktrade.co.uk/serco](http://www.stocktrade.co.uk/serco).

Please note that UK share purchases will be subject to 0.5% stamp duty. The above services are not available to US residents.

### Shareholder profile

The range and size of ordinary shareholding as at 31 December 2010 is set out below:

Range of shareholdings	Number of shareholders	%	Number of shares	%
1 - 1,000	3,998	49.96	1,714,237	0.35
1,001 – 5,000	2,680	33.49	6,024,751	1.22
5,001 – 10,000	464	5.80	3,296,423	0.67
10,001 – 100,000	536	6.70	16,392,113	3.32
100,001 – 500,000	201	2.51	48,989,397	9.93
500,001 – 1,000,000	45	0.56	32,053,535	6.50
1,000,001 – 10,000,000	67	0.84	183,878,496	37.28
10,000,001 and above	11	0.14	200,871,853	40.73
<b>Total</b>	<b>8,002</b>	<b>100</b>	<b>493,220,805</b>	<b>100</b>

## Financial calendar

	2011
Preliminary results announcement	2 March
Ex-dividend date	9 March
Record date	11 March
Last date for receipt/revocation of DRIP dividend mandates	20 April
Interim Management Statement	9 May
Annual General Meeting	9 May
Final dividend pay date	17 May*
Half-year results announcement	24 August**
Financial year-end	31 December

\* Subject to shareholder approval

\*\* Provisional



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**Serco Group plc**

Registered Office:

Serco House

16 Bartley Wood Business Park

Bartley Way

Hook

Hampshire RG27 9UY

T: +44 (0)1256 745 900

E: [generalenquiries@serco.com](mailto:generalenquiries@serco.com)

[www.serco.com](http://www.serco.com)