Serco Group plc annual review and accounts 2001

serco

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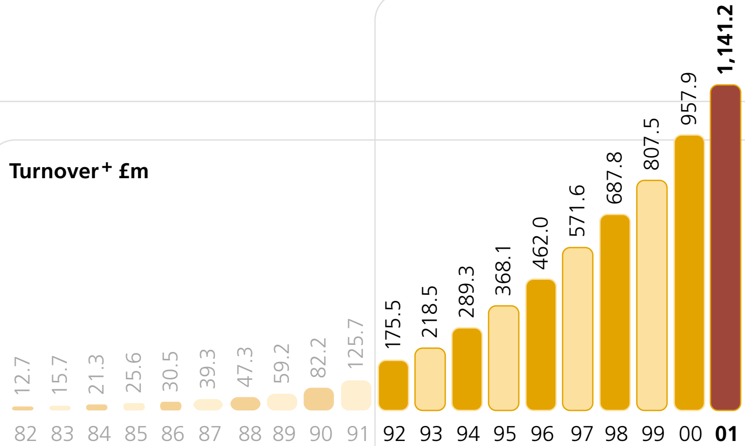

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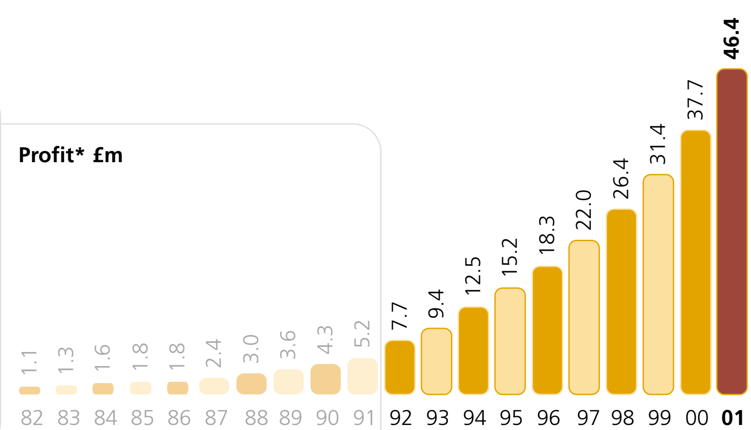


* before amortisation of goodwill

Financial highlights

Serco maintained excellent growth in sales and profits, exceeding the results targeted at the start of the year.

	2001	2000	%
Turnover	**£1,141.2m**	£957.9m	19.1
Profit before tax – pre goodwill	**£46.4m**	£37.7m	22.9
Earnings per share – pre goodwill	**8.46p**	6.78p	24.8
Dividend per share	**1.86p**	1.63p	14.1

Operating highlights

- 120 new contracts awarded
- 140 contracts successfully rebid or extended
- New business won totalling £1.4 billion
- Order book up from £5.8 billion to £6.2 billion
- New bid win rate over 70%; rebid retention rate over 90%
- Strong growth in continental Europe with new awards in Italy, Germany, Belgium and Sweden
- £69.4 million acquisition of AEA Technology's consulting business strengthens position in science
- New education business established with £35 million first-year turnover including contracts in Bradford and Walsall
- Started a 10-year, £160 million PFI contract to design, build and operate England's national Traffic Control Centre
- Preferred bidder status for two 12-year leisure contracts with Manchester City Council
- Major contracts renewed include the National Physical Laboratory, Docklands Light Railway and three European Space Agency contracts

A message from the Board

A robust business
Once again Serco maintained excellent growth in sales and profits, exceeding the results targeted at the start of the year. This performance was no mean achievement in a year clouded by uncertain economic conditions and the aftermath of 11 September. It emphasises the robustness of our business model and our broad spread of long-term contracts with high-quality customers across many sectors and countries.

A successful year
Turnover rose 19.1% to £1,141.2 million. Pre-tax profits were up 22.9% to £46.4 million before goodwill amortisation and 21.2% to £41.2 million after goodwill amortisation. Earnings per share rose 24.8% to 8.46p before goodwill and 22.1% to 7.14p after goodwill. Underlying pre-tax profits grew 21.1% to £45.6 million before goodwill and exceptional items.

The recommended final dividend of 1.29p per share makes a total for the year of 1.86p – an increase of 14.1% over 2000.

Strong organic growth resulted in 260 new business wins, rebids and contract extensions – a record number. Together, these increased our order book from £5.8 billion to £6.2 billion at the year-end. While our high-profile bids for new contracts attract most attention, one of the company's underlying strengths is the level of additional business that we win routinely each year through broadening the scope of rebids and extensions to contracts. Together, these committed future income streams give us the assurance of highly visible revenues and profits: over 82% of our planned revenue for the year ahead was already contracted at the beginning of 2002.

While maintaining strong sales growth, we continue to see increasing margins as returns begin to flow from our investment in private finance initiatives (PFIs). These will provide an increasing income stream to supplement our revenues from traditional contracts.

We continue to broaden our business into new areas – notably, in 2001, the education sector. We established a brand-new £35 million-a-year education business in the UK, winning major long-term contracts to partner with local education authorities in Bradford and Walsall. Local authorities are increasingly willing to develop more sophisticated structures in which we work with them as partners. For example, we have won a series of leisure management contracts where the length of the term recognises our commitment to invest in improved facilities. The largest was in Manchester, where we have been selected as preferred bidder to improve and operate 10 existing leisure centres as well as managing the new English Institute of Sport facilities after the 2002 Commonwealth Games.

New contracts started during the year included support services at two new PFI hospitals: Wishaw General, and Norfolk and Norwich University, where we took part in the UK's largest-ever transfer of hospital staff and patients. These two contracts, with terms of seven and 30 years respectively, have a combined annual turnover of £17 million.

We also began a new UK-wide partnership with the National Crime Squad. Justice has been a major growth sector for us and we now provide services to 66 UK law enforcement agencies, positioning us well for future growth.

Traffic management systems installed and operated by Serco cover over 18,300km of roads worldwide. We will be extending that figure with our 10-year, £160 million contract – started this year – to design, build and operate England's new national Traffic Control Centre.

We have maintained our strategy of developing and differentiating the business through international growth. During the year we made particular progress in continental Europe, where continuing investment brought us new opportunities and contract awards – notably in Belgium, Germany, Italy and Sweden.

In Italy, for example, following the previous year's contract with the national commission that oversees the Italian Stock Exchange and public companies, the regional government of Lombardy awarded us a six-year contract worth €22 million to manage its IT infrastructure. We now provide desktop PC management in seven countries – Belgium, France, Germany, Italy, the Netherlands, Spain, and the UK.

In Sweden we won our largest contract to date, worth SEK650 million, with the country's leading supermarket chain, ICA, providing facilities management for some 20 logistics centres nationwide.

Our German business won its first contract under the ministry of defence's outsourcing 'pilot project', worth €12.5 million, to provide IT training. We are currently bidding for further contracts under this initiative. We also won a three-year contract, worth €6.8 million a year, to provide facilities management to Asta Medica, a research division of the Degussa Huls chemical company.

Our businesses in North America and Asia Pacific continue to deliver strong operational performance, and have identified opportunities in more sophisticated forms of contracts including PFIs. Notable new business during the year included a 20-year aviation weather and ground electronics support contract for the NATO Flying Training in Canada programme, and another contract from BHP Billiton in Australia, to provide security, medical, fire and emergency response services to its principal steelworks.

Our expanding contract base represents an increasingly valuable source of organic growth – providing opportunities to rebid contracts, extend them and broaden their scope. In the UK, for example, we won important extensions to our contracts at the National Physical Laboratory (NPL), worth some £100 million including DTI and commercial income, and Docklands Light Railway, worth £72 million. We are also engaged in discussions with the Ministry of Defence Warship Support Agency to develop an interim partnering agreement and for the extension of the Marine Services ports contract by around two years until 2005 in return for a commitment to rationalise elements of Marine Service activities and reduce net costs of the outputs.

Internationally, we extended our manpower and support services contract for the Royal Australian Air Force, and won three significant rebids with the European Space Agency in Italy.

In 1997 we acquired the passenger rail assets of the Great Southern Railway (GSR) from the Australian government. Having managed GSR into profitability, we were able to make a one-off profit of £15.4 million by refinancing its rolling stock. This transaction has more than recouped our cash investment to date, while retaining a profitable and growing long-term future income stream. As stated in our interim report, this exceptional profit from the refinancing offset the cost of our unsuccessful bid to acquire National Air Traffic Services in the UK and the completion of our People and Technology investment programme.

We expect further gains to arise in future from refinancing PFI projects when the construction phase is complete and assets go into service. Our intention is to identify these to investors ahead of time. Our policy is also to share such gains with our customers, a principle that is reflected in recent UK government guidance on this issue.

Acquisitions

Acquisitions enable us to bring our proven management processes quickly to new sectors or customer groups. Our £2.6 million acquisition of Quality Assurance Associates in December 2000, for example, helped us to win our Bradford and Walsall education contracts in 2001.

In August 2001, for a consideration of £69.4 million, we acquired AEA Technology's consulting business, which provides science and safety based services to customers such as the UK Ministry of Defence, BNFL, British Energy and the UK Atomic Energy Authority. It substantially strengthens our position in science and enlarges our customer base in a field where both corporate and government clients are increasingly aware of the benefits of outsourcing. We now employ over 4,800 people in science activities.

The AEA Technology consulting business, renamed Serco Assurance, is performing well and delivering the expected benefits to our existing customer base and science activities. For example, the combination of a Serco Assurance software product with materials science expertise from NPL now enables us to provide a more complete technical service to gas turbine operators.

We made two smaller acquisitions during the year. In January we acquired The Hiser Group in Australia for

A$6 million and in June we bought Total IT Ltd in the UK for £1.175 million.

We will continue to make selective acquisitions where they enhance the Group's capability to address new markets.

People and Technology programme
During the year we completed our three-year People and Technology programme, involving total expenditure of some £15 million.

Through investment in people, primarily in training, we are strongly placed to seize the new kinds of opportunities that are emerging, as well as those we see today. During the year almost 1,800 people received management training through the Serco Best Practice Centre. We are proud to be the first UK-listed employer to receive recognition from the Institute of Directors, which means that some courses may lead to recognised external qualifications, upon successful completion of an examination.

Through investment in technology we can now work in a more integrated way than ever before, so that every part of the organisation shares the strengths, knowledge and experience of the whole group.

As part of the programme we have created Serco Capital, a group that works to structure the financing and project management we need to bid for larger and more complex public private partnership (PPP) projects. The team brings together expertise in financial modelling and structuring, project finance, investment management and tax in the UK, Australia and the US.

Social and environmental responsibility
As a company that earns most of its living by delivering public services, we have always taken corporate social responsibility (CSR) very seriously. During the year we formalised our approach to CSR and piloted it with a number of contract teams. Now being implemented across the organisation, this will give direct accountability for CSR to every contract manager and enable us to prove that we put our values into action. Each contract manager will be encouraged to nominate a CSR representative and develop a CSR programme. This will involve applying Serco values and guidelines to compile a comprehensive CSR plan embracing contract staff, local communities and the environment – supported by an action plan setting clear and realisable commitments.

This will allow us to report more consistently on CSR, while empowering our contract teams to set specific targets, engage their own particular stakeholders and celebrate their achievements.

The Corporate Assurance Group established in 2001 enables us to view CSR in its broader context. The group advises us on risk management, health, safety, environmental, quality and CSR throughout the business.

People
We recognise that Serco's success comes from the exceptional dedication of our people. Their energy, enthusiasm and imagination are the foundation of our business, adding value to our customers' operations and to the good causes we support. In our sixth year as a corporate member of Save the Children, we exceeded our fundraising target of £600,000 by some £20,000.

The aftermath of 11 September made exceptional demands on many of our people – particularly in our defence and air traffic control operations. We applaud their commitment.

Board changes
In October Betsy Bernard resigned as a non-executive director to reduce her external commitments on becoming President and CEO of AT&T's consumer division: we thank her for her contribution. In her place we welcomed Dr DeAnne Julius CBE, whose experience spans both public and private sectors. She was a founder member of the Bank of England's Monetary Policy Committee and is also a non-executive director of the Bank of England, Lloyds TSB and BP.

As we continue to take on more complex projects and broaden operations into new business areas around the world, it is our intention to consider a further non-executive appointment in due course to complement the existing skills and experience of the current Board team.

Further planned Board changes will take place in 2002.

In May, Richard White will retire after 31 years with the company, most recently as Executive Chairman and previously as Chief Executive. Richard has been instrumental in defining Serco's business model and operating philosophy and in positioning the business for continued growth. The whole Serco family wish him a long and happy retirement. As in the past the company has planned a succession. Kevin Beeston will succeed Richard as Executive Chairman, having been Chief Executive for the past three years and previously Finance Director. Kevin has been with Serco for 17 years and is well known to many of Serco's shareholders.

Christopher Hyman, currently Finance Director, will replace Kevin as Chief Executive. He has been with Serco for six years, for the past three as Finance Director, and is also well known to shareholders. Chris will be succeeded as Finance Director by Andrew Jenner, currently Corporate Finance Director, who has been with Serco for over five years, having previously worked for Unilever and Deloitte & Touche.

Competitive strength

We maintained our new bid win rate of over 70%. The key to this success is our ability to pursue opportunities selectively and apply our distinctive approach to outsourcing. Rather than simply delivering specified services we seek out opportunities where we can manage activities to deliver better results. We aim to identify opportunities at an early stage and to allocate significant resource to analyse commercial and financial structures and potential operational improvements. Our focus on what customers would like to get out of a contract – rather than what they want us to put in – gives us a powerful competitive edge.

We are effective managers of change. We can give our customers not only improved service but continuing improvement over time. That is how we were able to maintain our 2001 success rate of over 90% in contract rebids and renewals.

As part of our competitive stance, we encourage customers to work with us in seeking continuous improvement. To deliver these improvements, we continue to invest in refining our bidding, phase-in and management processes, aided by the Serco Institute and Serco Best Practice Centre.

Outlook

We have laid the foundations for continued future growth. Our forward earnings are highly visible and our margins have continued to grow. We remain a highly predictable business. Because we have already secured 82% of our forecast turnover for 2002 and a significant amount beyond, we continue to anticipate strong growth. And there is no let-up in new prospects: we are currently evaluating contract opportunities worth a total of some £15 billion.

In a world where the only certainty is change – driven by the rising expectations of consumers and governments, and by public demand for continuous improvement in the delivery of public services – Serco is an established leader in change management. Demand for our management and technical skills continues to grow as more sophisticated procurement strategies and commitment to PPPs evolve worldwide.

Over the past three years we have stepped-up our investment in technology and our management and financial capabilities. Now we plan further enhancement of our project management and systems integration capability as we build our global strength in the design and management of service solutions.

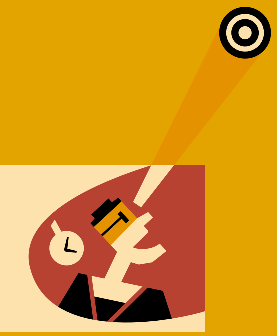
Our breadth of customer base and depth of capability are presenting us with ever increasing opportunities in the UK. Meanwhile, our successes in securing new contracts in continental Europe, together with encouraging evidence of PPP and PFI developments in the US and Australia, lead us to maintain our confidence in Serco's ability to deliver superior levels of growth into the future.

the view from here...

In little more than a decade, Serco has grown to become one of the world's largest outsourcing businesses.

We now have some 34,000 staff in 36 countries – principally in Europe, the Middle East, Asia Pacific and North America. Our customers are mainly national and local governments, and approximately 35% of our profits now come from outside the UK.

Since the company was floated on the London Stock Exchange in 1988, we have achieved average annual growth of over 20% in both sales and profits – largely by organic growth rather than acquisition.



Generally speaking, the larger a business grows, the harder it becomes to sustain growth rates of this magnitude. But Serco has a great advantage: as we take on new contracts, we gain new resources. So organic growth brings us a wealth of new skills, management talent, contacts and customer referrals. As a result, we believe we have the momentum to continue to grow for the foreseeable future.

How?
On the next two pages, we outline the key attributes of our business. And in the following pages we explain how they underpin vigorous expansion – in our past year's performance, and in our prospects for the years ahead.

A straightforward business model

At first sight Serco looks bewilderingly diverse, with contracts ranging from leisure centres to scientific research. In fact, it is fundamentally straightforward. To every project we bring the same things: our expertise in managing change, and our proven management processes for delivering continuing performance improvement. These processes are our product. We research and update them, document them and train our staff to use them. They are designed to change mindsets; to instil customer focus; and to provide unobtrusive but effective controls that leave contract managers free to run their businesses entrepreneurially.

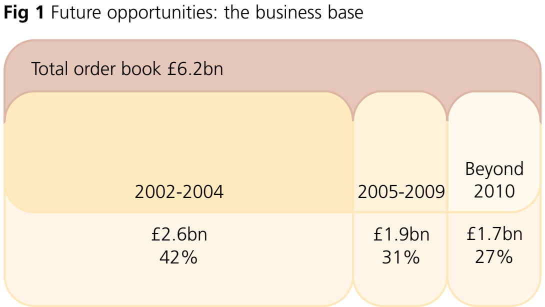
In the past year we have won 120 new contracts. They range from fleet maintenance to spacecraft engineering. In many cases our proven track record in managing complex science and technology operations was a crucial factor in our success. A key element was our ability to apply proven management processes to achieve a smooth phase-in, immediate improvement, and added value over the longer term.

Highly visible earnings and cash flows

We can plan for long-term growth because we can forecast with relative certainty. Future earnings and cash flows are highly visible. Our contracts are typically for 5-10 years, and our high success rate in winning renewals means that in practice they can last for decades. The income from them is dependable: over 90% of it comes from a wide range of government departments and programmes or international agencies, and the rest from major corporations.

In 2001 we maintained our success rate of over 90% in winning contract renewals, and increased the size of our order book from £5.8 billion to over £6.2 billion. At the start of 2002 we had already secured 82% of our forecast sales for the year, and some of our contracts are for terms extending as far ahead as 2031.

Fig 1 Future opportunities: the business base



Excellent growth prospects

Our markets continue to grow – at such a rate that we've been able to maintain double-digit annual growth while still addressing opportunities very selectively. We have taken care to grow at a measured pace, to avoid overstretching management or jeopardising our unique culture. We have focused on higher-value contracts that involve increasing technological and management complexity. Our international expansion has been based on building contracts and experience progressively, in countries to which our expertise is readily transferrable.

In 2001 we increased sales by 19.1% and profits by 22.9%. Despite an uncertain economic outlook in many of our geographic markets we see no slackening in the pace of demand growth. National and local governments look increasingly to outsourcing and PPPs as one way to deliver value to taxpayers. And major corporations also recognise the contribution outsourcing can make to building shareholder value.

Contracts that become businesses

The traditional way to manage a contract is to focus on the cost base. We look at contracts differently. From the bid stage onwards, we take a more rounded view: if it was a business, how would we improve it? Can we increase sales? Could we develop new revenue streams? What if we put in some investment? That's how our contract managers are trained and empowered to think. It's what enables them to keep adding value, constantly improving our performance year after year. It's also why about a third of our new business comes from broadening the scope of existing contracts: when we show customers what we can do, they invite us to do more.

The National Physical Laboratory is a prime example of our approach. We've continued to invest in new resources and facilities – and over the last six years we've increased revenues enough to employ an extra 100 scientists. The Cardiff call centre we established for a rail passenger enquiries contract has become a business in its own right: it added yet another contract in 2001, its fourth to date. And we've won a series of contracts to revitalise leisure centres in the UK and Sweden by investing in new facilities – as we've already done in Stockport, where we opened a Serco-branded health and fitness centre in 2001.

Strong management development
Our devolved structure helps us to develop more managers as we expand. As we take on new contracts, we constantly acquire new talent which we can develop and move through the organisation. Every contract is run by a manager who is effectively a managing director. Our style of operation is based on providing a framework of highly developed processes and controls, training managers to use them, then liberating them to run their businesses more entrepreneurially.

We have continued to enhance our management training and development processes. The Serco Best Practice Centre is now accredited by the Institute of Management in the UK: its courses and workshops meet nationally recognised standards and lead to Institute qualifications where relevant. To establish a pipeline of trained and accredited directors, the Centre is also working in the UK on a ground-breaking initiative with the Institute of Directors (IoD) to develop the IoD/Serco Certificate in Company Direction. We pioneered this initiative with the IoD and are the first UK-listed employer to offer such a qualification: it is tailored to the context of Serco's needs but assessed and recognised by the IoD.

A uniquely positive and collaborative culture
Serco's processes are underpinned by shared beliefs about how to treat customers, staff and neighbouring communities. We value our people's knowledge, ideas and potential to contribute. We give them support and ready access to anyone who can help with a problem or use an idea. We want them to speak their minds freely, take responsibility for solving problems, and enjoy their work. In their dealings with customers, we expect them to deliver to the spirit of our contracts, not just the letter. And we encourage them to build supportive relationships with local communities, as part of the value we add to our contracts.

In 2001 we formed our Corporate Assurance Group to support us in achieving our strategic goals and provide guidance to ensure compliance, improve business performance and reduce risk, while addressing the interests of shareholders, customers, staff and the wider community in an integrated way. And our approach to corporate social responsibility (CSR) enables every contract team to set its own CSR action plan – and to share its plans and progress with the rest of the organisation on the company's Our World intranet.

A passion for communicating best practice
As the organisation expands we want to excel at what we do, wherever we do it, without having to reinvent the wheel. So we are passionate about sharing ideas: we have invested substantially in global communications and knowledge management, and our businesses are using them with increasing enthusiasm. By making fuller use of the Group's collective experience, we can understand and manage risks better, deliver service improvements ahead of customer expectations and keep our competitive edge. The Serco Institute develops and refines our vision of the future; and the Serco Best Practice Centre makes increasing use of intranet and distance learning technologies to help our businesses form networks and share ideas and experience.

In 2001 we completed our investment in the People and Technology programme. This included creation of the Our World intranet, which puts people in touch with colleagues who can help them, enables them to form networks of colleagues with common interests, allows them to search banks of knowledge, and opens up internal job opportunities to the entire workforce worldwide. The investment has also included the creation of the Serco Best Practice Centre intranet and database. This enables all our people to tap the Group's distilled expertise on core processes such as bidding and phasing-in new contracts, and developing and rebidding existing ones. By honing our management processes in this way, as we grow and become still more diverse, we're ensuring that Serco remains a fundamentally straightforward business.

Welcome to Our World

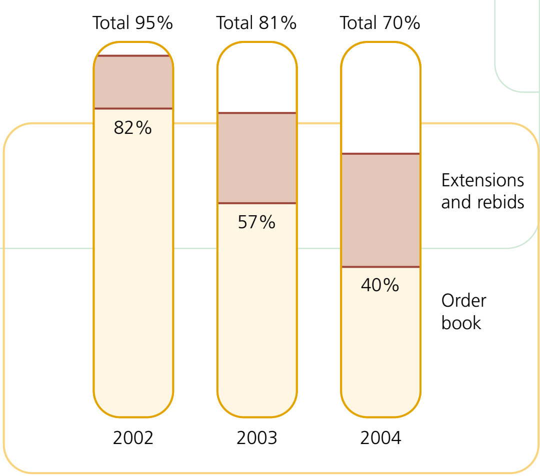
The Our World intranet is integrated to support every part of our business – by helping our 34,000 people to communicate more easily, share information seamlessly across the company and deliver service to our customers. It enables people to get in touch with colleagues who can help them, form networks of colleagues with common interests, and search banks of knowledge; it also opens up internal job opportunities to the entire workforce worldwide. But it doesn't replace face-to-face or voice contact – in fact, by putting people in touch with one another, it actually encourages personal communication.

Long delays not ahead

As international experts in traffic management systems, we're winning increasingly large and complex challenges. For example, we're currently creating a national Traffic Control Centre covering the whole of England's strategic motorway and trunk road network. We are building and operating it under a 10-year, £160 million PFI contract – with six years' PFI experience behind us, we're now well qualified to handle PFIs on this scale and to lead the provision of integrated solutions.

Forward view

Fig 2 The business base: forward order book 2002-2004



The size of our existing order book ensures that a large proportion of our income is already in place for years ahead. Our consistent success rate of over 90% in winning rebids and extensions as they become due gives us additional confidence in future growth.

In most of our markets, outsourcing is now a well-established practice. Sectors such as central and local government, defence and transport have become experienced buyers of services. Our customers are now keen to broaden the range of activities they outsource, and to structure contracts more ambitiously. As a result, the opportunities open to us are growing fast – in number, scale and complexity.

New areas are opening up. The strategic benefits of outsourcing have opened doors for us in areas once considered only appropriate for the public sector – such as justice and, more recently, education.

The value of our contracts is rising. A growing proportion of our work in the public sector comes from increasingly innovative forms of PPP. Some involve taking full or joint ownership of public assets, or leasing them for an agreed period. Others are PFIs – where we invest in the creation of assets such as buildings or infrastructure, which we then operate to deliver a public service. Even traditional contracts are becoming bigger and more complex – local councils, for example, are looking at whole packages of public services.

The length of our contracts is increasing – from typically three years a decade ago to five years or more today. For larger and more complex contracts, 10-25 years is now the norm.

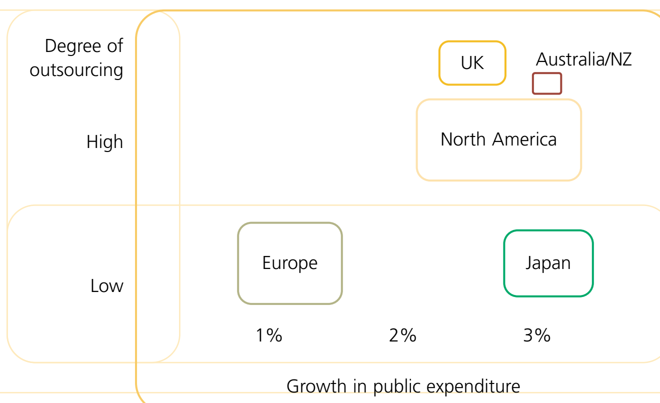
In the past, a large proportion of outsourcing contracts was for commodity activities where the management element was relatively small and entry costs were low. We developed appropriate management processes, and we've continued to develop them to meet the needs of an increasingly sophisticated market. Today, a growing proportion of contracts require skills in business re-engineering, IT, systems integration – and a willingness to share risk and reward. This trend will continue.

As we move up the size and complexity curve, the potential rewards are greater. The activities we manage are more critical to the customer's mission, and there is a greater proportion of transferred risk. We look for contracts where we can influence and control risk through sound management. We have a dedicated Director of Risk, provide clear policy, guidance and support through the Corporate Assurance Group, and give managers explicit responsibility for assessing and managing all forms of risk. This will help us to stay ahead in a fast-evolving market.

We are responsible bidders. We have refined our assessment processes, aiming to ensure that we weigh risks accurately, avoid unmanageable risks and make realistic undertakings. This is important to both customers and shareholders. As contracts become larger, longer and more complex, the cost and risk of bidding increases. We continue to be extremely selective about the contracts we bid for, because we intend to maintain our success rates of over 70% on new bids and over 90% on renewals.

Long range view

Fig 3 Public sector opportunities



The size of each outline represents current public spending. The potential opportunities are huge: for example, UK public spending is currently some £200 billion a year, of which Serco accounts for just £650 million – or 0.3%.

Source: OECD, EIU, Lazard

As customers gain confidence in our ability to deliver substantial cost and performance benefits, they are making bolder demands on our skills. For example, they are asking us to provide mission-critical assets, as in PFI projects; to take responsibility for generating revenue from service users; or to develop new revenue streams from the capabilities we manage.

These developments have not just broadened our potential market. They have laid the foundation for a new generation of business based on sophisticated partnerships with governments and corporations to convert policy intent into practical programmes that deliver better results. And they open the way for new and exciting applications of our proven management processes.

Changing technology, faster business cycles and the increasing importance of knowledge as a source of advantage are producing fundamental changes in the way organisations shape themselves. They are rearranging their structures around flows of information and products. And they are grouping tasks and functions flexibly so that they can change rapidly in response to new opportunities or needs. This trend favours outsourcing, but the pace of change means that fixed contracts quickly become outdated. What's needed is a way of adapting contracts in line with the demands of the supply or value chain of which they form a part.

Analysis by the Serco Institute points to three solutions, each representing a substantial potential market for us:

Corporate engineering/re-engineering
Serco, alone or in a consortium, takes the responsibility (and investment risk) for creating or re-engineering an organisation, delivering services to a defined set of end users. Our rewards – and our control of risks – would normally come from ownership of the organisation or its assets, in addition to any task contracts we might be awarded. Examples of this kind of relationship are already appearing, in PFIs and more complex PPPs involving private sector equity participation.

Collaborative ventures
Serco enters alliances of customers, suppliers and other stakeholders who join forces to achieve growth or substantial and continuous improvement in a service delivery system. Payment is based on the overall results achieved, so we are rewarded for the ideas and know-how we contribute rather than the people and systems – though we might also have contracts to supply specific services. We are already seeing interest in this approach in UK local government.

Design and management of complex organisational networks
Serco combines the above two approaches to solve complex service delivery problems. Early examples are likely to be small, involving research studies and pilot schemes, while we gain the knowledge and experience to progress to larger-scale projects.

Over the medium to longer term, we expect growing opportunities for all three approaches. We are researching how they can be applied and the management processes they will entail, and this research is already influencing our strategic decisions for the medium term.

The Serco Best Practice Centre, which captures and exploits our own best practice, will continue to support these new opportunities as well as contributing to the performance of our existing business. Our investment in knowledge sharing through the People and Technology programme is preparing us for operations that rely on the ability of Serco teams and ventures to draw on the Group's accumulated intellectual capital. And our decision to enter the UK education market is one recent example of our resolve to embrace new generations of business.

Serco is well positioned to take full advantage of the new opportunities emerging worldwide, as partnership becomes the contractual mechanism of choice for our major customers and as business networks begin to replace conventional supply chains. We will maintain a market-leading position through our ability to anticipate customers' changing needs and our readiness to deliver brand-new types of services.

Legal partners

Serco is becoming an important partner to the UK justice system. In an extraordinary year, we've completed our phase-in of the strategic partnership with the National Crime Squad, opened a new command and control system in the UK's largest county police force, and provided the technology for an international operation against internet crime. We have stepped in at short notice to support a national intelligence system serving 66 police forces and agencies, winning a five-year contract to support it. And our custodial business, Premier Custodial Group, opened a prison and a detention centre under PFI contracts.

CSR on track

Our award-winning National Rail Enquiry Service call centre in Cardiff is one of two sites where we've been piloting our new approach to corporate social responsibility. Staff there have developed initiatives – based on our corporate values – to make it a better place to work, to support charities and the local community including a nearby school, and to protect and restore the environment. A recent article in the journal of the Transport Salaried Staffs' Association commended the centre's staff relations in an article headed 'Serco proves that not all call centres are the same'.

A responsible view

As a large international business we have clear responsibilities to a broad range of stakeholders including shareholders, customers, staff and society at large. We recognise that our actions today will affect our world tomorrow. We are committed to supporting environmental progress and safe working conditions; and, as a business focused on public services, we have particular duties to the communities we serve. Our responsible conduct and public service ethos have been crucial in maintaining our high rates of contract wins and renewals. We will continue to earn the trust of governments and the public alike, and to make this a key differentiator for Serco.

Respect for customers, suppliers and neighbours is part of our culture. All our contract managers are directly accountable for the quality of our relationships with local stakeholders and for workplace safety. At Group level we have senior managers responsible for a range of specific assurance, governance and social issues. But we recognise the need for continuous improvement. As our relationships with customers become more autonomous and output-based, it's important to ensure appropriate control and safe working practices while handling stakeholder and social issues with ever greater sensitivity and imagination.

Like most businesses, we've developed companywide policies and practices in relation to social responsibility, quality, risk, health and safety, and the environment – but in the past we've considered these issues piecemeal. In 2001 we took a major step forward by forming a Corporate Assurance Group to take an integrated view across all our operations. This team seeks to ensure that we are managing risk effectively and operating efficiently in all these areas – meeting the standards that the law requires, stakeholders expect and we demand of ourselves. It reports directly to the Chief Executive to advise on policy, oversee implementation and develop guidance on best practice.

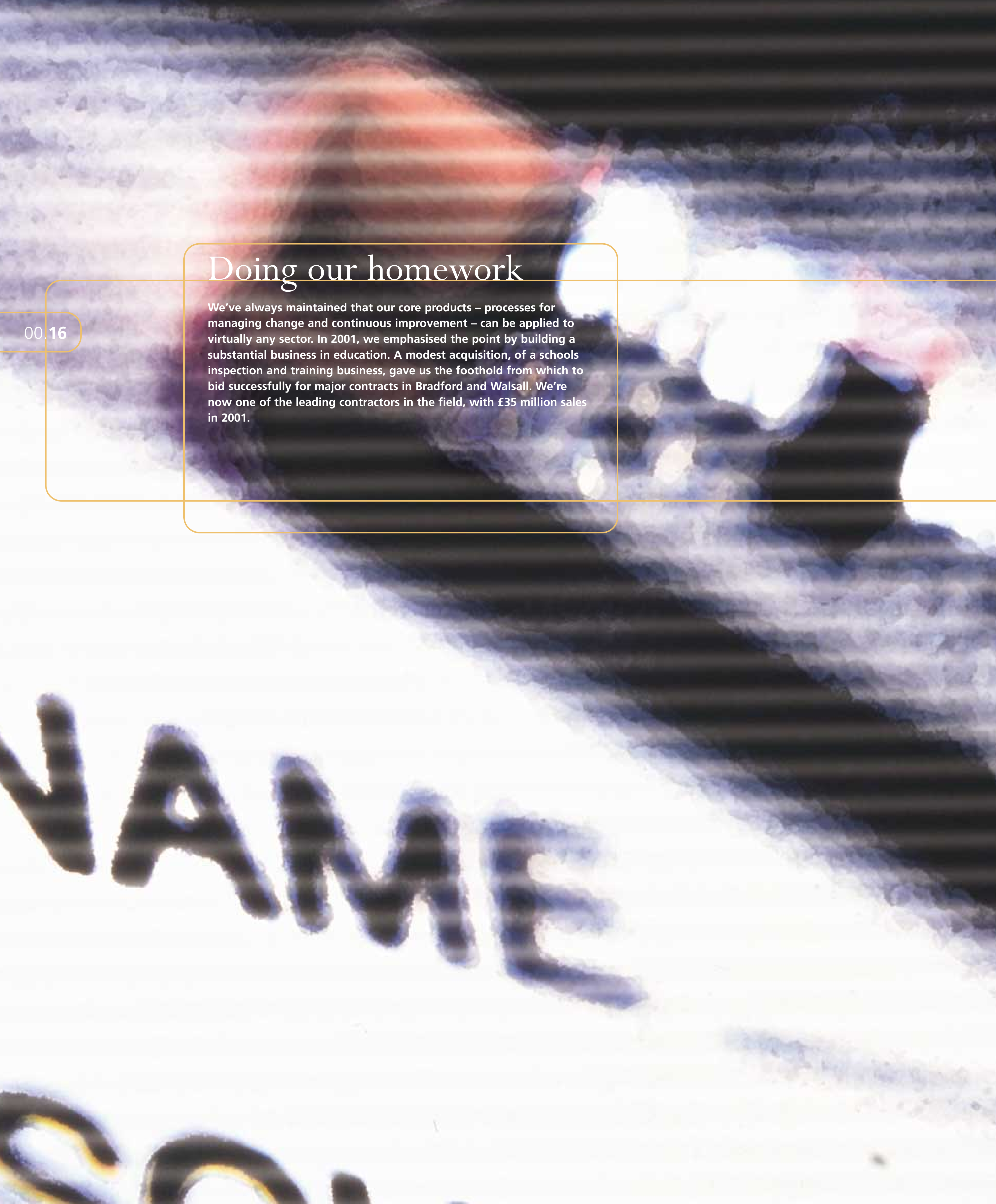
Each Serco contract management team has responsibility for both assurance and social responsibility. Its managers are backed and advised by over 125 highly skilled professionals worldwide. Appropriate management systems and procedures are defined in each regional business unit and managed where they can best be controlled – at contract level.

We are currently introducing a formal approach to staff, community and environmental initiatives, integrated with our existing review and reporting processes. Each contract will apply Serco's values and guidelines to develop its own action plan under three headings: our people, our communities and our environment. To share experience – and foster peer pressure to achieve high standards – all contracts will be encouraged to publish their action plans and progress reports on the Our World intranet.

We take pride in the recognition that our contract teams earn for their activities. In 2001 the Atomic Weapons Establishment won its first Sector Award from the Royal Society for the Prevention of Accidents, for the best health and safety performance in the UK's public service and national defence sectors. Doncaster prison won a Five Star Health and Safety Award from the British Safety Council (BSC) for the second time in three years and, also for the second time, was one of only 35 operations to receive the BSC Sword of Honour. Other awards included a Roy Castle Good Air Award in Stockport, the Annual Environmental Award of the Association of Professional Engineers and Geoscientists of Newfoundland, and an Ease of Access, Service and Employment award for the Docklands Light Railway. Many of our operations gained ISO certifications for quality or environmental management, and some of these are reported in the business review beginning on page 30. Our businesses and contracts now have over 90 ISO certificates worldwide.

Doing our homework

We've always maintained that our core products – processes for managing change and continuous improvement – can be applied to virtually any sector. In 2001, we emphasised the point by building a substantial business in education. A modest acquisition, of a schools inspection and training business, gave us the foothold from which to bid successfully for major contracts in Bradford and Walsall. We're now one of the leading contractors in the field, with £35 million sales in 2001.



United Kingdom

Principal sectors

Civil government, defence, transport, science and technology

Sales 2001

£794.2 million

The business and its markets
In the UK we cover a broad spectrum of activities, predominantly for central and local government. Successive UK governments' radical approach to public policy has enabled us to establish a record of innovation in delivery of public services. We have built some six years' experience in PPPs and this gives us a powerful platform from which to advise government agencies and tender for PPPs internationally.

Key sectors and contracts

Defence
We provide task management, operational and logistic support to all three UK services. Over 700 Serco people provide property management and base support at 50 sites, and we operate some 140 marine vessels. We provide simulator training for the RAF's support helicopter fleet, using facilities built under a PFI in which we are a partner. With partners we operate the UK's Atomic Weapons Establishment. And we led the PFI consortium that designed, built, financed and now operates the Joint Services Command and Staff College.

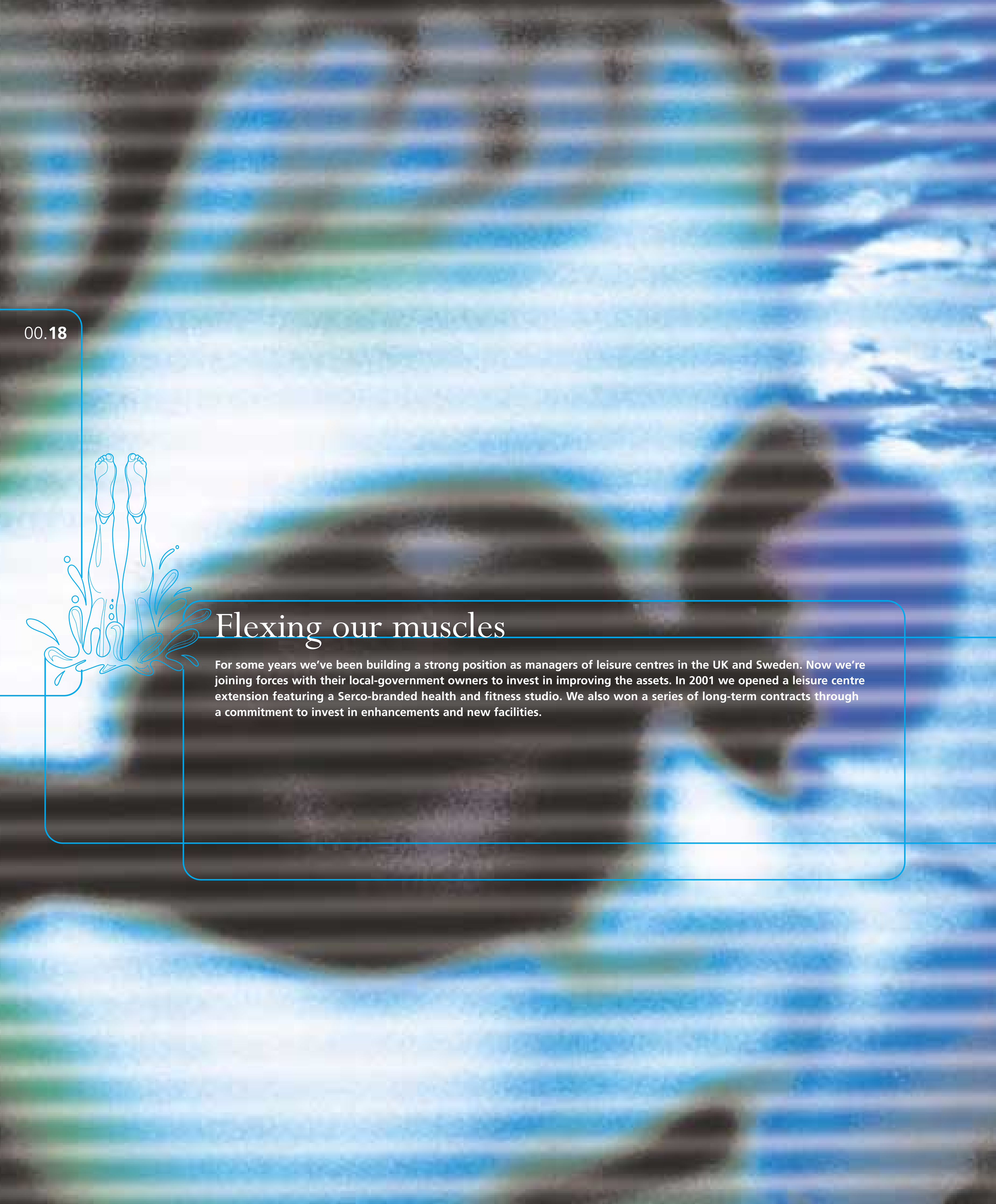
Civil government
With over 25 years' experience across a range of public services – including justice, education and local government services – we are in the forefront of the trend towards private provision of ever more complex and specialist services. Our contracts include PFI projects to build and operate hospitals and prisons, and a strategic partnership on IT and communications with the National Crime Squad in England and Wales. Premier Custodial Group, our joint venture with Wackenhut Corrections Corporation, operates court escort and prisoner custody areas, offender electronic monitoring areas and seven custodial contracts. As partner to the Walsall and Bradford local education authorities we provide a range of functions including training and inspection, consultancy, professional development and support services to schools.

Transport
We provide integrated transport solutions including air and road traffic management systems and are currently building the Highways Agency's new Traffic Control Centre for England. We operate complete rail franchises for the Docklands Light Railway and Manchester Metrolink, maintain railway property and infrastructure including nearly 1,800km of track, provide rail passenger information services from our Cardiff call centre and undertake infrastructure and rolling stock testing.

Science and technology
Our first-ever contract, which we have held since 1964, was to maintain the Ballistic Missile Early Warning System site at RAF Fylingdales. We have maintained a strong position in high-tech contracts ever since. Today, we operate the government's National Physical Laboratory, where we have increased third-party revenues and worked with the DTI in making significant infrastructure improvements. We are also the UK's largest provider of nuclear safety, reliability and performance engineering services.

Strategy and outlook
The UK market has undergone a period of high growth, and PFIs and PPPs are now a well-established method of procuring public services. The market is still growing. Indeed, growth is coming from two sources: firstly, the trend in procurement is towards the larger and more sophisticated projects that we find most attractive; and secondly, private sector provision of public services is becoming increasingly acceptable, increasing the opportunities in areas that have not historically been outsourced.

Our focus is therefore to evolve with the market and maintain leadership in areas that require greater technological or management skills. In all these areas, we expect the UK to be a pacesetter for international developments.



Flexing our muscles

For some years we've been building a strong position as managers of leisure centres in the UK and Sweden. Now we're joining forces with their local-government owners to invest in improving the assets. In 2001 we opened a leisure centre extension featuring a Serco-branded health and fitness studio. We also won a series of long-term contracts through a commitment to invest in enhancements and new facilities.

Our science formula

We've acquired AEA Technology's consulting business (renamed Serco Assurance) to strengthen our fast-growing position in science – a field where we've become one of the UK's leading employers. We're now operating on a scale where an acquisition like this provides important synergies as we bring together skills, products and customers. Already, Serco Assurance and colleagues at the National Physical Laboratory have developed a joint service to gas turbine operators.

IT's a growth business

Having established our credibility with the European Space Agency and European Commission, we now have a growing business across Europe in outsourcing IT. New clients in 2000 included the Dutch government and CONSOB, the body that oversees the Italian Stock Exchange. In 2001 the regional government of Lombardy in Italy outsourced its IT infrastructure to us – and the German ministry of defence awarded us a contract to set up and run two IT training centres.

Europe and the Middle East

Principal sectors

Air traffic services, civil government, defence, transport, science, commercial

Sales 2001

£139.5 million

The business and its markets
Our business in Europe (excluding the UK) was originally focused on IT support and facilities management, which are still growth areas for us. More recently, the rapid pace of reform in public services across the region has presented a growing range of opportunities. Our businesses in Belgium, France, Ireland, Italy, Sweden and Germany have been steadily broadening their range of services. Interest in PPPs has spread across Europe and will accelerate our growth. In the Middle East we have a long-established business providing communications support and aeronautical and airport technical services.

Key sectors and contracts

Defence
Our increasingly successful relationship with the German ministry of defence has significant potential because the ministry has begun a programme of innovative procurement projects. It recently awarded us a contract to set up and run two IT training centres.

Civil government
Our services to local and national governments extend from buildings management to a range of technical services including decontamination at a nuclear power station. We are Sweden's largest private provider in the public leisure centre market.

Transport
We are extending our light rail and traffic management expertise into continental Europe and will operate the new 11-station Copenhagen Metro, opening in October 2002. Current road transport projects include a traffic and travel information and management system in Stockholm.

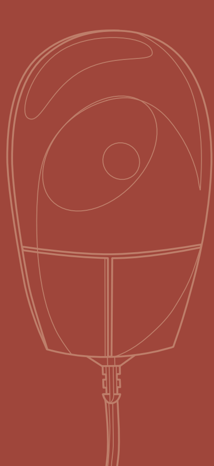
IT support
We are long-established operators in this market, which has become increasingly sophisticated: the emphasis is shifting from contracts specifying tasks or manpower to those specifying a common level of IT service across an organisation. For example, we provide support to the European Commission's IT infrastructure supporting over 15,000 users in three countries. Last year we won an IT infrastructure contract for the regional government of Lombardy in Italy, and three out of three IT rebids for the European Space Agency (ESA).

Science and technology
Since we first worked for ESA in the 1970s we have become a major supplier to the agency – providing a range of spacecraft engineering, scientific, IT, project management and support services at sites across Europe. In Germany we provide technology-related services in defence and aerospace, and install fibre optic cable for commercial customers.

Air traffic services
We began providing airport services including air traffic control (ATC) in Bahrain in the 1940s. Now we have contracts for primary air traffic services across the Middle East including ATC, engineering, meteorological services, aeronautical information services, ATC training and aviation systems development.

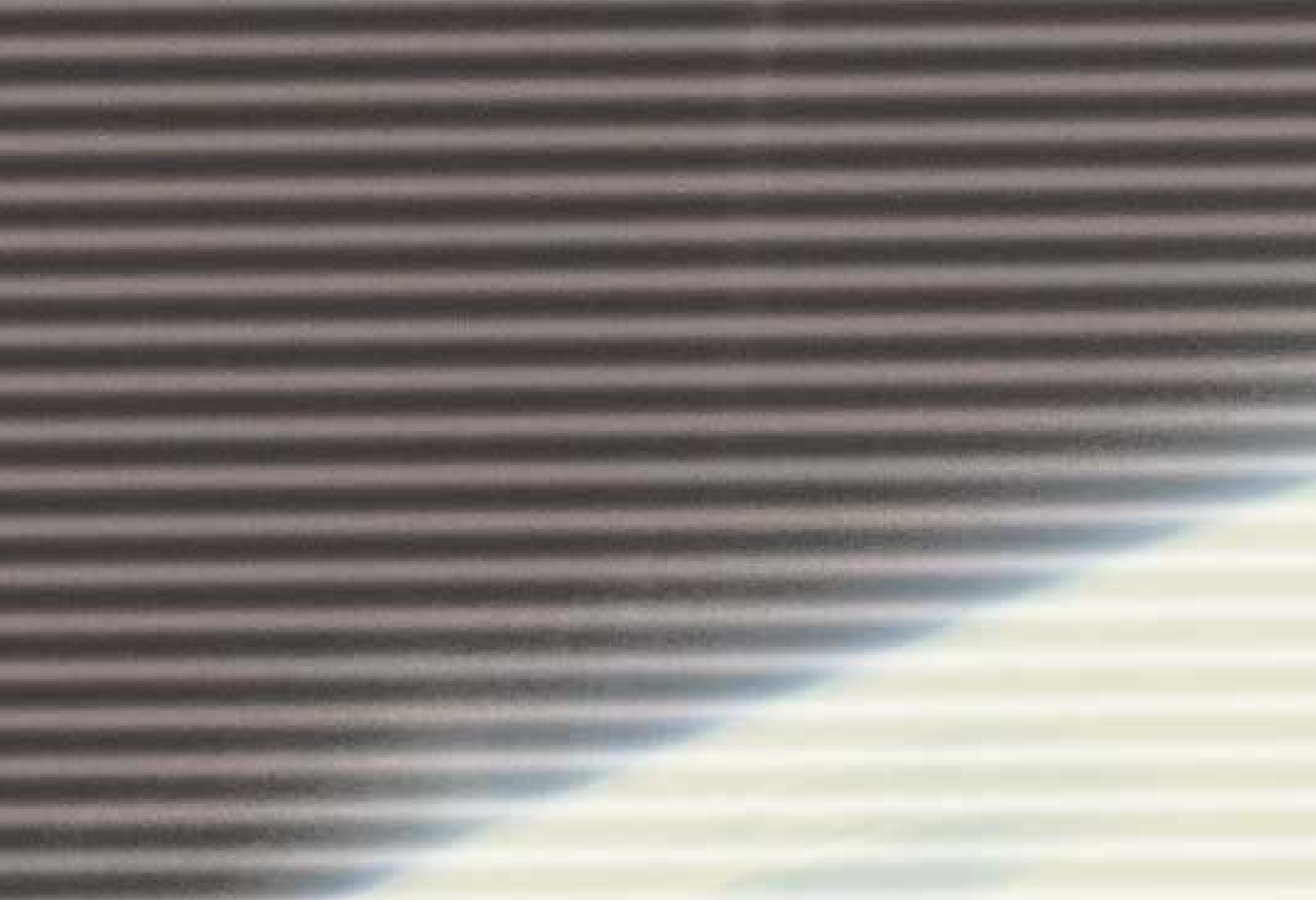
Strategy and outlook
After several years of slow growth, debate around the reform of public services is now being translated into action across Europe. Governments are starting to apply global best practice in public procurement to deliver value for money and service improvements. As a result, we expect Europe to enter a period of growth.

We are positioning Serco as an expert adviser on PPP and PFI structures and the provider of choice for complex, single source solutions requiring integration of people, technology, assets and finance. Our unique international experience of managing these types of contract, coupled with our strong European presence, positions us well to play a leading role in this emerging market.



Expanding universe

We began providing technical support to the European Space Agency in 1971. Since then, we've steadily expanded the relationship. We've won many contracts by providing outstanding service – and exceptional breadth of capability. How many other companies could provide scientific research, spacecraft engineering, IT and space project management services – as well as buildings maintenance, support for the purchasing and cost analysis functions, and a general service helpdesk?



Under control

We're continuing to grow our position in North American aviation services, particularly air traffic control (ATC). We're a leading provider of civil ATC services to the Federal Aviation Administration, for whom we now operate 58 towers across the US. Last year we signed a long-term military contract to provide a range of services including meteorology, flight planning and ground electronics for the NATO Flying Training in Canada programme. We also extended our contracts to run the City of Oshawa's airport in Canada and provide ATC for Southern California International Airport.

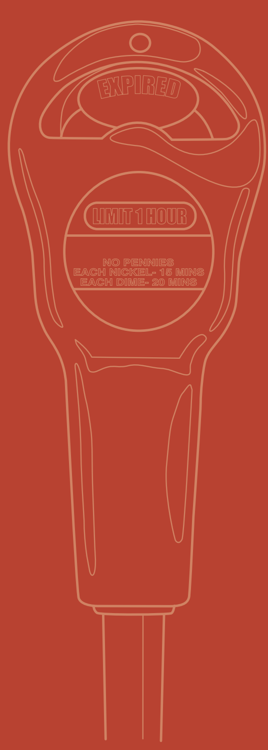
North America

Principal sectors

Air traffic control, defence, fleet services, revenue services, tourism and leisure

Sales 2001

£65.5 million



The business and its markets
Having entered the North American market in 1993, we have steadily built businesses in the US, Canada and Bermuda. We provide a broad range of services in the federal, state and local government sectors, concentrating on ATC operations and management, managed fleet services, and multi-activity base operations for the defence forces.

In the US and Canada the financial imperatives for significant change in procurement processes are beginning to manifest themselves in all sectors of government. PPP and PFI opportunities are beginning to emerge in both countries and have the potential to be major sources of future growth. We are well positioned to develop opportunities locally but will also draw on our extensive international experience to help us submit winning solutions.

Key sectors and contracts

Defence
We provide a wide range of base support services. Examples include Wright-Patterson US Air Force Base – where we provide vehicle operations and maintenance for a community of 23,000 and thousands of visitors each year – and a full multi-activity contract employing 400 staff for the Canadian Department of National Defence at Goose Bay.

Civil government
We undertake parking management, enforcement and meter collection services. We manage municipal vehicle fleets. And we operate leisure facilities such as the multi award-winning ecological visitor centre at Hopewell Rocks in New Brunswick, Canada, where we are rewarded from the revenues we generate.

Fleet maintenance
Vehicle fleet maintenance is a growth activity for us in several sectors, particularly defence, utilities and civil government. In Seminole County, Florida, we manage over 1,600 county vehicles and items of municipal equipment.

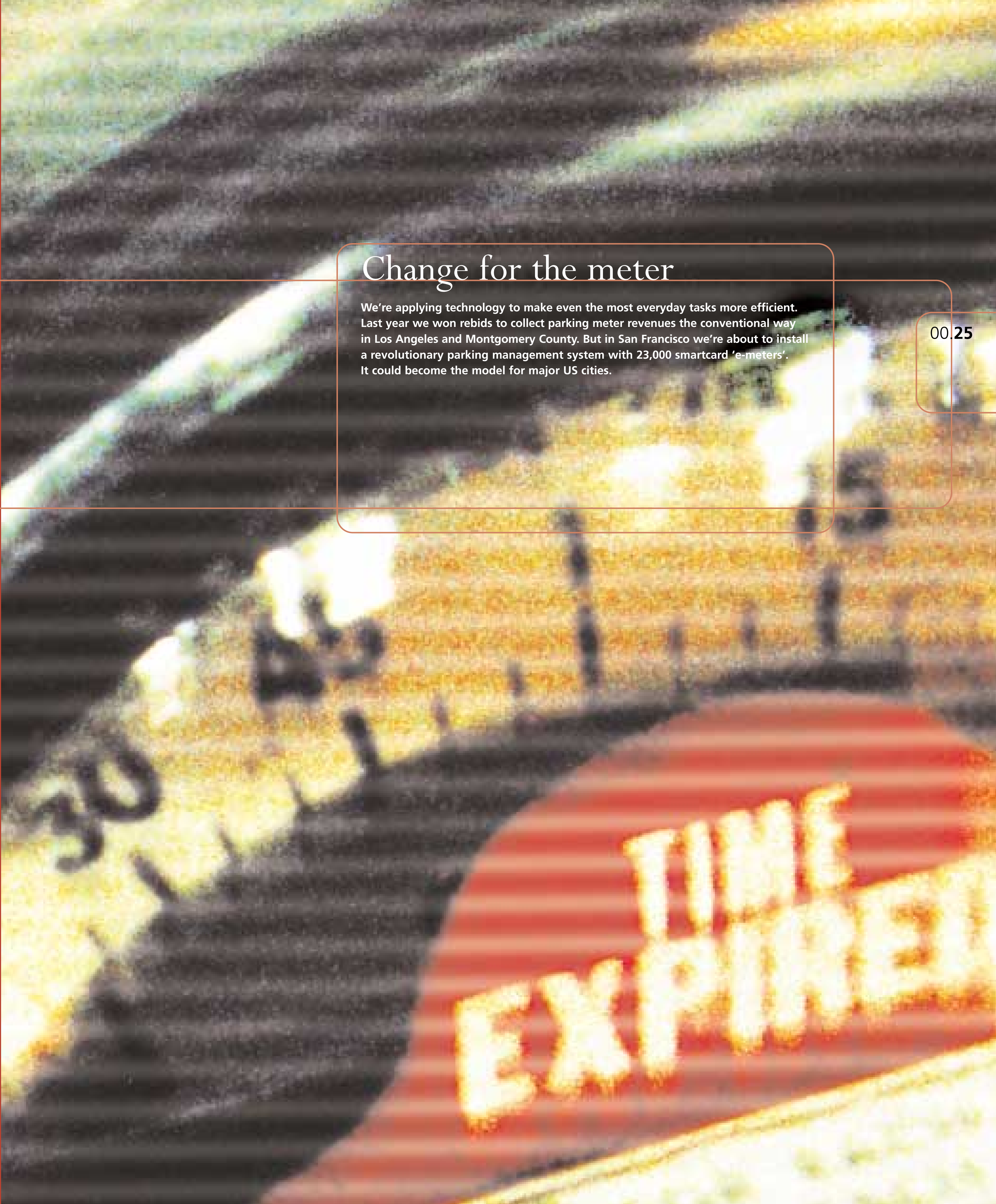
Air traffic control
We are a leading private operator across the US, where we now operate 58 ATC towers. We also provide services at military facilities in Canada and at Bermuda's international airport.

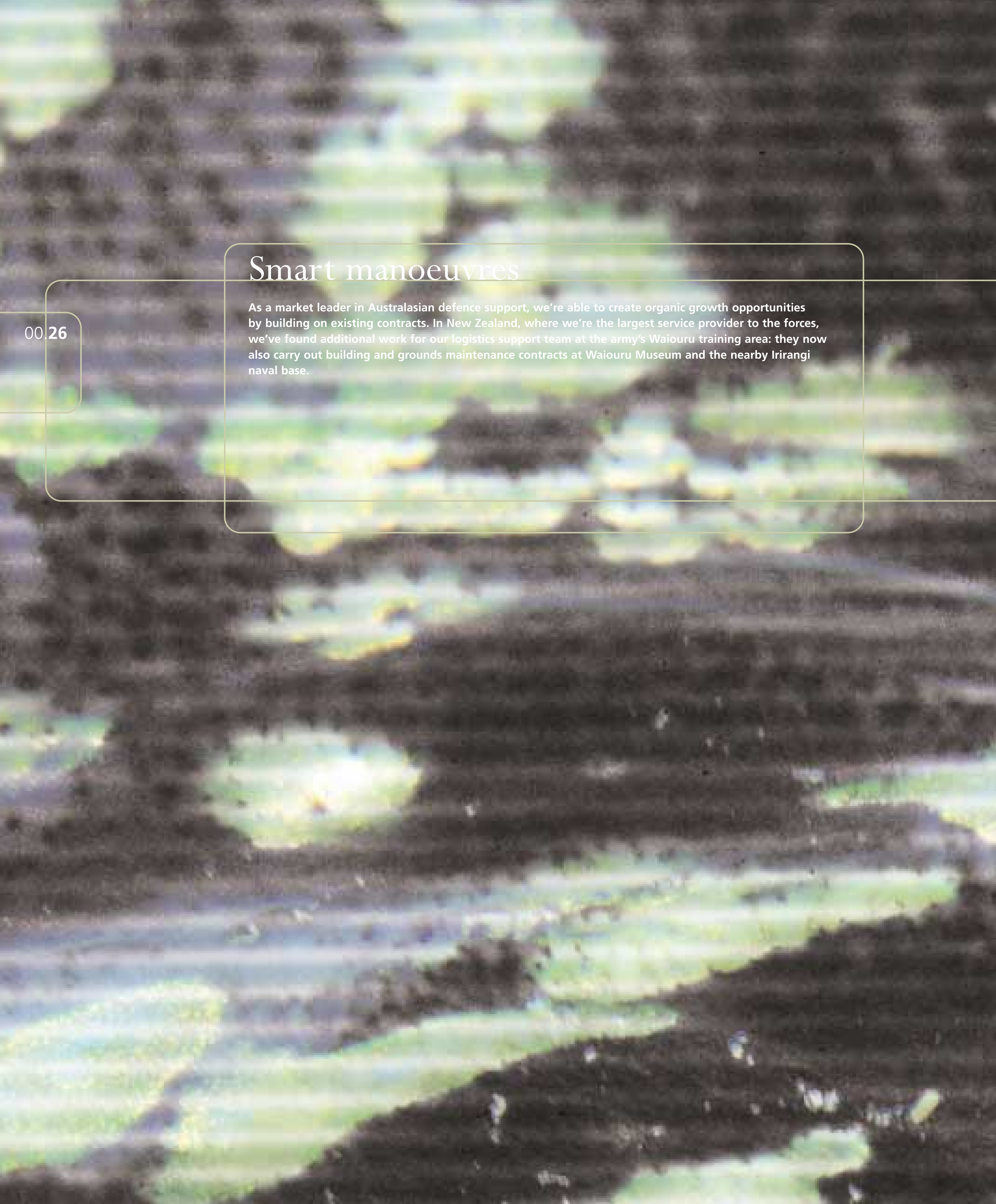
Strategy and outlook
Following a number of years of investment, we now have a solid business base and are seeing the start of growth in North America. In Canada, early opportunities are appearing from provincial governments, particularly in Ontario and the newly elected government of British Columbia. In the US we see opportunities emerging at federal, state and local government levels. The defence sector in particular is looking to be a source of PPPs and PFIs and early opportunities are emerging in the provision of training facilities and equipment linked to long-term contracts.

We are steadily building business in our established areas but are also targeting emerging contracts of the kind that Serco has been developing and winning so successfully in the UK. In support of this longer-term aim we have formed strategic alliances with prominent partners including Lockheed Martin and continue to seek further strategic relationships.

Change for the meter

We're applying technology to make even the most everyday tasks more efficient. Last year we won rebids to collect parking meter revenues the conventional way in Los Angeles and Montgomery County. But in San Francisco we're about to install a revolutionary parking management system with 23,000 smartcard 'e-meters'. It could become the model for major US cities.





Smart manoeuvres

As a market leader in Australasian defence support, we're able to create organic growth opportunities by building on existing contracts. In New Zealand, where we're the largest service provider to the forces, we've found additional work for our logistics support team at the army's Waiouru training area: they now also carry out building and grounds maintenance contracts at Waiouru Museum and the nearby Irirangi naval base.

Asia Pacific

Principal sectors

Civil government, defence, transport

Sales 2001

£142.0 million

The business and its markets
As well as large, broadly based operations in Australia and New Zealand we have a foothold in Singapore. After buying-out our joint venture partners during the year we also have full ownership of our Hong Kong business.

Conventional outsourcing contracts are growing in size and scope, and the Australian government is keen to outsource corporate services. Meanwhile, PPP opportunities are beginning to emerge in Australia, New Zealand and Japan.

Key sectors and contracts

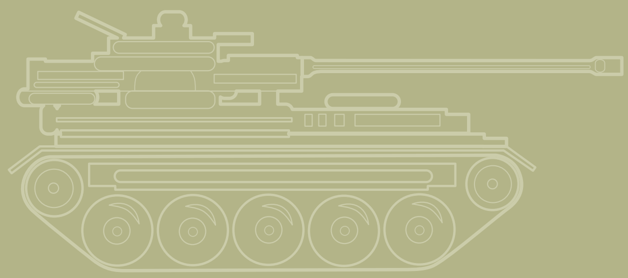
Defence
We are a market leader in Australasian defence support. In Australia we provide 50% of all garrison support services and our port service contract for the navy is seen as a case study for future PFIs. In New Zealand we are by far the largest service provider to the forces: activities include a NZ$60 million support services contract at the army's principal training area at Waiouru.

Civil government
Our services include maintaining buildings and open spaces, warehousing and distribution, hospital support and water and wastewater services. Major contracts include Q Stores warehousing and distribution in New South Wales and infrastructure maintenance for the government in Western Australia.

Transport
In Adelaide we have contracts to operate half the bus services and manage the airport. We plan, manage and maintain road infrastructure in Auckland. And we build and support traffic management systems for Sydney's trunk roads. Great Southern Railway was loss-making when we bought it from the Australian government four years ago. Since then we have brought it into profit, with sales up 21% in 2001 alone, and realised significant gains by refinancing the rolling stock.

Strategy and outlook
Asia Pacific has been a market with many traditional contract opportunities but little growth in more complex projects. However, we have been fostering interest in PPPs for some time by advising government agencies in Australia and New Zealand. Early opportunities are now appearing – such as Australia's patrol boat PFI project, for which we have formed a consortium with P&O Marine. We are also seeing a programme of PFIs and privatisation emerging in Japan. As a result, we expect the region to enter a period of gradual but accelerating growth, particularly for more sophisticated contracts.

Our strategy is therefore to continue to build our traditional business in the region while shaping the market for future growth in areas where our experience gives us competitive advantage. Our broadly-based operations throughout Australia, New Zealand, Singapore and Hong Kong – together with our growing presence in Japan – position us well to build on existing relationships in preparation for the steady flow of projects we now see emerging.

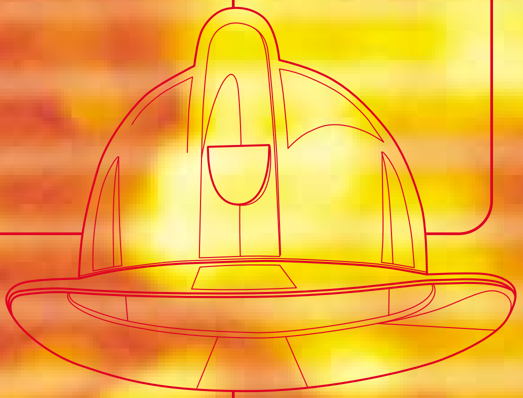


Running water

We're major providers of water and wastewater services in Australia and New Zealand. In Victoria we recently renewed a contract which has put us at the leading edge of the Australian water industry. In partnership with our client, Coliban Water, we've helped to consolidate water operations serving 55 cities, towns and villages in an area of 16,550km^2. The proven success of this innovative project has made it an attractive model for other areas.

Forging deeper alliances

In the private sector, as with governments, we're boosting organic growth by building strong customer relationships that lead to additional contracts. Last year we signed our third contract with BHP Billiton, Australia's largest resource business, and enhanced our level of partnership with the company. The new contract, covering security, medical, fire and emergency response services at Port Kembla steelworks, is an alliance agreement under which we will invest in new technology and share the benefits of improved service and efficiency.



Business review

In 2001 we achieved record levels of organic growth across a range of sectors, winning significant new business worldwide. Common themes across the business included growing diversity, increasing applications of technology and larger, more complex management contracts.

Civil government

Justice

The phase-in of our groundbreaking strategic partnership with the National Crime Squad (NCS) for England and Wales, which began in September 2000, is progressing to plan. We have recruited almost 100 staff at six sites for this 10-year contract worth over £65 million. As well as introducing core services on schedule we have installed a new helpdesk and training facility, and provided critical support to form the new National High-Tech Crime Unit, a partnership between the NCS, the National Criminal Intelligence Service and HM Customs and Excise.

To help the NCS fight online child pornography we worked with partner Imagis Technologies to develop a facial recognition system using Imagis' ID-2000 software. This was used in the 'Landmark' operation in November 2001, which led to arrests and the seizure of computers in 19 countries.

In January 2001 we were asked to intervene at short notice to support a critical national intelligence system serving 66 police forces and other law enforcement agencies throughout the UK. After providing necessary remedial work we have now successfully secured a five-year contract from January 2002.

Since September we have been providing development, maintenance and support services to the command and control system in a new £7.5 million facility for the Hampshire Constabulary. The system is capable of handling over 3,000 incidents an hour and supports 63 workstations in the main control room, plus eight training seats and a further five workstations for strategic command. Since the system was delivered we have been appointed preferred bidder for a similar contract to deliver a command and control system for Merseyside Police.

We have maintained and updated radio communications systems for North Yorkshire Police since 1991 and Thames Valley Police since 1992. During the year we successfully rebid both contracts, which require 24-hour support.

We work with the majority of UK police forces providing managed services for the supply, installation and maintenance of Gatsometer enforcement cameras. The government has announced its intention to allow the police to reinvest speeding fine revenues into the development and acquisition of new camera technology and resources. We are well placed to benefit from the expansion of this market and Lancashire County Council has already appointed us to install up to 250 more fixed speed enforcement sites over two and a half years. Our continuing development of the technology, including colour digital and automatic numberplate recognition systems, will stimulate further growth.

Our technology development unit completed and delivered an upgrade to the secure telephone system used by government agencies. To meet demand in the justice, defence and civil communications sectors we also launched a digital telephone voice encryption system and a computer disk encryption package.

Premier Custodial Group (PCG) is our UK joint venture with Wackenhut Corrections Corporation. In July it opened HMP Dovegate, a new 800-bed prison and therapeutic community facility in Staffordshire, under a 25-year private finance initiative (PFI) contract. Dovegate's 200-bed high-security therapeutic treatment facility is the first in the UK for 30 years and the only one to be privately developed and managed.

In September, PCG opened a new immigration centre in Dungavel, Scotland. This houses up to 150 detainees seeking permission to stay in the UK. It was completed to a challenging schedule. The centre has a 90-bed adult facility and a 60-bed family unit. PCG is contracted to manage the centre for five years.

PCG broke more new ground by winning a contract from Staffordshire Police to provide detention custody assistants. This staff support contract for a police authority opens up a new market which is expected to increase substantially as police forces seek to return police officers to operational duties.

The Northern Ireland Court Service awarded us a new three-year contract for technical facilities management of 25 properties throughout Northern Ireland. This was the first time these activities have been outsourced to the private sector.

In Western Australia we extended our Offender Management Facilities contract for the Department of Justice, which includes maintenance services to prisons and detention centres in Perth and maintenance of electronic security systems in regional prisons.

Doncaster prison became the first correctional facility to gain ISO 14001 certification for environmental management systems. It also received the British Safety Council's Five Star Health & Safety Award and Sword of Honour, both for the second time. In the US, our fleet maintenance operation for Washington DC's Metropolitan Police Department won the Blue Seal Award from the National Institute for Automotive Service Excellence.

Education

In December 2000 we acquired Quality Assurance Associates, a major UK provider of school inspection and leadership development services, for £2.6 million. By combining its expertise with our own change management skills we have won two major new contracts, making us one of the leading operators in a fast-emerging market: support for UK local education authorities (LEAs). We are strongly committed to this socially important work, and have already built an education business with a turnover of £35 million in its first full year.

In Bradford we are providing education services to the local council and schools under a 10-year contract involving almost 1,200 staff. It is the largest private sector contract of its kind yet awarded in the UK. We are supporting all state-maintained schools across the Bradford district and providing additional help where needed to raise pupils' levels of attainment.

In Walsall we are working in partnership with the LEA to deliver strategic management and school improvement services; the five-year contract involves around 100 staff.

We are also exploring new kinds of partnerships with LEAs that engage our skills and share responsibility for delivering performance improvements. The Department for Education and Skills (DfES) is encouraging new ways of working between public and private sectors, and the Serco Institute has been collaborating with the London Borough of Tower Hamlets in a DfES-funded project to see how the LEA and schools in the borough might benefit from our management processes.

As well as working with LEAs we also provide training, consultancy and inspection services to schools. We are a significant supplier of inspection services for the Office for Standards in Education (Ofsted) and provide leadership and management training and consultancy services directly to schools. We are the provider, in conjunction with the Welsh Assembly Government, of the Leadership Programme for Service Headteachers in Wales.

Health

We are involved with two PFI-built UK hospitals which opened during the year.

The £148 million Wishaw General Hospital in Lanarkshire, which opened on time in May, has over 600 beds. We are providing support services there for the first seven years, employing around 350 staff.

The £229 million Norfolk & Norwich University Hospital was handed over to the National Health Service (NHS) in September, and the transfer of staff and patients was completed on time in December. It was the largest transfer of staff and patients to a new NHS facility ever undertaken. As partners in the PFI to build and operate the 953-bed acute hospital, we are providing facilities management services for 30 years. This will include procuring support services through market testing every five years.

An unusual cross-sector initiative helped us win rebids on our wheelchair repair and maintenance contracts with the NHS in South West London and North West Surrey. Under the Premier Custodial Group initiative to provide meaningful work opportunities, inmates at Lowdham Grange prison are refurbishing wheelchairs. This has enabled us to work with our NHS customers to enhance volume, reliability and cost control.

Leisure

We are building an increasingly strong position in leisure centre management, mainly in the UK and Sweden. Serco-run leisure facilities now welcome almost 7.5 million visitors a year.

In Sweden we successfully rebid our Linköping leisure centre contract and won a third at Växjö, making us the country's largest private sector provider in the public leisure centre market.

Our strength in the UK was confirmed by the award of preferred bidder status for two 12-year contracts with

Manchester City Council. It is anticipated that these contracts will commence on 1 April 2002 and involve over 200 people. We will improve and operate 10 existing leisure centres as well as operating the new English Institute of Sport facilities after the 2002 Commonwealth Games, which are being held in Manchester in July. Together with our established contract at the Manchester Aquatics Centre, this makes us responsible for almost all the council's indoor leisure centres. It is planned that we will operate the sites for 10 years, after enhancing them during an interim period of about two years.

We also won a new contract to run the prestigious Basingstoke Aquadrome, a state-of-the-art leisure complex opening in Spring 2002.

In the autumn we opened a £500,000 extension to the Grand Central Pools complex that we have run for Stockport Metropolitan Borough Council since 1993. The extension includes Isospa, Serco's first own-branded health and fitness centre. In recognition of this investment, the council has extended our contract until 2011.

We gained a similar 10-year extension to our Tenterden leisure centre contract in return for a planned £500,000 investment programme, and a three-year contract for a second site. South Northamptonshire District Council awarded us a 15-year rebid at three sites, where we will invest some £1 million. Aylesbury Vale District Council extended our contract at the Swan Pool and Leisure Centre for 10 years.

We also negotiated a 20-year management contract from early 2003 for an exciting new aquatics centre in St Helier, Jersey – part of a comprehensive development of the island's waterfront.

Our Hopewell Rocks eco-tourism site in New Brunswick, Canada, won the Society of American Travel Writers Phoenix Award for outstanding conservation and restoration.

Other public services

In Australia we extended two major contracts with state governments: a warehousing and distribution contract for the New South Wales Government's Q Stores and a facilities management contract with the Western Australia Department of Housing and Works. Together these contracts are worth over A$34 million a year and employ 130 staff.

We maintained our presence in the Australasian water utilities sector with a series of contract extensions. These included our contract to operate and maintain the water and wastewater system in the Coliban area of Victoria: over the initial contract period we successfully consolidated water operations serving 55 cities, towns and villages. The proven success of this innovative project has made it an attractive model for other areas. We also extended our contract with City West Water to operate and maintain water and wastewater facilities in Melbourne's city centre, inner and western suburbs.

In New Zealand we won a second extension of our contract with Stratford District Council, covering facilities management of council properties, parks and water, wastewater and sewage operations. We also extended our contract for cleaning and maintenance of North Shore City's wastewater treatment plant. Franklin District Council reappointed us to maintain its stormwater system and 700km of roads. Our performance for Wellington City Council won us an additional contract to provide building maintenance services for the city. New Zealand's fire service called us in to refurbish fire appliances throughout the country. And, after adding a second contract, we now maintain over 500 parks and open spaces in Manukau City.

In the UK we began a new seven-year professional property and construction services contract with the London Borough of Richmond. This brought us an additional 25 specialist staff and complements our existing work for the nearby boroughs of Merton and Kingston upon Thames.

Drawing on our marine services experience in the defence sector, we won a 10-year contract from the Natural Environment Research Council to operate and maintain three marine research vessels based in Plymouth.

At the Driver and Vehicle Licensing Agency (DVLA) we won a rebid to run the Select Marks business, selling personalised vehicle registrations.

The Oil and Pipelines Agency extended our contract to operate and maintain its 2,000km national oil pipeline ring-main system. This feeds aviation fuel to the UK's major civilian and military airports, including Heathrow, Gatwick and Stansted. We have held the contract since 1994 in partnership with Gulf Interstate Engineering of Houston, Texas.

Hertfordshire County Council intends to extend our contract to maintain its fleet of 650 vehicles and plant until 2004; we also won our three-year rebid with a possible two-year extension to maintain Watford Borough Council's vehicle fleet.

We won a new five-year contract with the Scottish Executive to provide cleaning and associated services at various locations across Scotland, including the islands of Benbecula and Skye. We also tendered successfully to renew our contract with the Scottish Executive to provide similar services in Edinburgh. These bids were awarded as a combined single contract.

Our IT support activities continue to expand: we now provide desktop PC management to users in Belgium, France, Germany, Italy, the Netherlands and Spain. In Italy, the regional government of Lombardy awarded us a six-year contract to outsource its IT infrastructure, including helpdesk, server administration, technical support to end-users, and the supply and upgrading of hardware. We are supporting over 3,000 workstations and there is scope to increase both user numbers and the range of services. Phone and electronics manufacturer Ericsson extended our contracts to provide all IT support for its Italian R&D organisation, employing about 1,000 people. And as an approved Lotus Business Partner we carried out software projects for clients such as CNEL (the National Committee for Labour Economy), the Italian Ministers Council and ATAC (the Rome bus company).

In the US, Louisville Gas and Electricity appointed us for five years to manage its 1,300 vehicle fleet, with a contractual challenge to develop further outsourcing opportunities within the company. This is our ninth fleet maintenance contract in the US, where we now maintain over 6,000 vehicles. Among them are the buses serving over 30 schools in Portsmouth, Virginia: the quality of our service delivery there has just won us reappointment for a further 10 years.

In Los Angeles we won a rebid to collect revenues from some 41,000 parking meters. We also won a similar, smaller rebid in Montgomery County. And in San Francisco we will soon be pioneering the next generation of street parking technology: we recently signed a contract to install and run a parking management system with 23,000 smartcard-based 'e-meters'.

We continue to find novel ways of applying Serco technology. In EUR, an area in Rome where we manage parks and gardens, we used remote sensing to make an inventory of all the trees and shrubs, and carried out phytopathological analysis to prepare maintenance plans for future years.

Defence

We are the largest provider of defence outsourcing in the UK and the market leader in Australian defence support.

After a series of short-term extensions, we gained a three-year extension to our land ranges test and evaluation support contract with QinetiQ, which operates the ranges for the UK's Ministry of Defence. The contract – employing 250 staff at Shoeburyness, Essex and Eskmeals, Cumbria – complements our work at four of QinetiQ's air and sea ranges.

We successfully rebid our contract with RAF Strike Command to provide multi-activity support services on Ascension Island for a further five years, and broadened the scope of the contract. RAF Strike Command also awarded us a three-year support services contract at its Spadeadam range, which trains aircrew in electronic warfare countermeasures.

We won a rebid for our support services multi-activity contract at RAF Halton, known as the 'Gateway to the RAF' for its role in training new recruits. The new contract is for four years with options to extend for up to three more.

In the past couple of years we have substantially expanded our engineering support role at Wattisham Station, where we had 13 staff in 1999. During 2001 we took on responsibility for 7 Air Assault Battalion REME's quality assurance, aircraft fleet control and vibration analysis cell, also adding another two depth servicing lines for Lynx aircraft – virtually doubling our staff from 32 to 60.

We are engaged in discussions with the Ministry of Defence Warship Support Agency to develop an interim partnering agreement and for the extension of the Marine Services ports contract, by around two years until 2005, in return for a commitment to rationalise elements of Marine Services activities and reduce net costs of the outputs. If successful, this would represent an innovative partnering opportunity. A further opportunity to bid for a longer term partnering arrangement incorporating the eventual replacement of the bulk of the Marine Services vessels through a PPP should follow.

At the UK's Atomic Weapons Establishment (AWE), where we and our partners have a 10-year management contract, we are continuing discussions on a 15-year extension and PPP that will enable us to invest in new facilities. Meanwhile, investment in a new supercomputer will make AWE one of the world's 10 most powerful computing sites. Since we began our contract, AWE has received commendations from the Nuclear Installations Inspectorate, the Environment Agency and RoSPA – which gave it one of only 16 sector awards, rating it the country's best company for health and safety in both the public service and defence sectors.

Our test systems business broadened and extended its contract to develop and provide systems for testing the avionics on the Royal Navy's new Merlin helicopter. It also won new contracts to provide computerised verification of aircraft weapons systems, and to develop a system that automatically monitors use of communications equipment across Britain for the Radiocommunications Agency.

In June we bought Total IT Ltd in the UK for £1.175 million. This IT consultancy and project management company has further expanded the base from which we are growing our own IT consultancy business.

The German ministry of defence awarded us a new three-year contract to operate two IT training centres, where our 25 staff will develop and run the courses and issue qualifications. We also won a contract worth almost €1.1 million to build and deliver 29 satellite receiver containers for the German forces. These installations, in standard-sized shipping containers, will feed TV and radio programmes into military accommodation and recreation areas. The ever-increasing mobility of European forces is expected to lead to further orders, and we have also attracted enquiries from the commercial sector.

In Australia we extended the manpower and personnel services contract under which we provide some 250 skilled technicians and managers to support the Royal Australian Air Force at bases across the country.

In New Zealand we have built on our army logistics support contract at Waiouru by using staff from our team there to carry out building and grounds maintenance contracts at Waiouru Museum and the Irirangi naval base. The air force extended our contract for technical services at Ohakea Base and hospitality services at Woodbourne Base.

We signed a 20-year contract to provide aviation technical services for the NATO Flying Training in Canada programme. This followed an interim contract we had held since 1999.

Our environmental services business successfully rebid its contract with the Department of National Defence for remediation projects in Goose Bay, Labrador. In 2001 we received an award from the Association of Professional Engineers and Geoscientists of Newfoundland for this work.

We also received RoSPA Occupational Safety Gold Awards at two of our UK Defence operations and ISO 9001:2000 accreditation at sites in Australia, Canada, New Zealand and the UK. In Australia we were only the second company to meet this new standard.

Transport

Rail transport

As operator of London's Docklands Light Railway (DLR) we were named National Rail Operator of the Year in 2001, after winning the Best Light Rail/Metro Operator award in 2000. Managing Director Jim Gates was named Docklands Business Person of the Year.

Since becoming operator of the DLR in 1997 we have consistently invested in improving train services and passenger information. Today, both reliability and customer satisfaction are at record levels. In August we gained a two-year extension from 2004 until 2006, enabling us to help our client, Docklands Light Railway Ltd (part of Transport for London) integrate an extension to London City Airport. Annual passenger numbers have more than doubled to 40 million since 1997 and are expected to reach 60 million by 2006. We now share revenue growth with the client and will operate without subsidy from April 2004. We are currently investing £1.6 million in an improved asset management system, depot capacity for additional rolling stock, and enhanced telecommunications.

After four successful rebids we retained our leadership in property maintenance for Railtrack. Our contracts for five of Railtrack's seven geographic zones, plus its Spacia North commercial letting business, represent a combined turnover of some £38 million, with 340 staff maintaining over 1,850 stations, signal boxes and other buildings. For this work we have won comprehensive Award of Assurance certification covering quality, environmental and safety management to ISO 9000, ISO 14000 and ISO 18001. Manchester Metrolink, which we operate, opened its first ‘secure by design’ park and ride facility in June. The 450-space car park not only offers customers easy access from car to tram, but also provides 24-hour security, full CCTV coverage, bright lighting levels and disabled car spaces with direct access to the platforms.

In Australia, our wholly-owned Great Southern Railway (GSR) business increased sales by 21%. Construction began on the new 1,410km Alice Springs to Darwin Rail Link. When this is complete in 2004, GSR will extend its tourist train service, The Ghan, all the way to Darwin.

The new Copenhagen Metro opens in October 2002. As operator under a contract worth DKK541 million a year, we are already testing IT systems, control rooms and trains. The 11-station, 13.9km Metro will be a fully automatic, driverless light rail system linking Ørestad and Copenhagen Airport to the City of Copenhagen. It will start with some 160 staff, rising eventually to 300 as extensions to the system open.

Since winning our contract for the UK’s National Rail Enquiry Scheme in 1997, we have introduced new technology to improve responsiveness and added new services. In 2001 we extended the original London, East Anglia and South East region contract and added another, covering the Southern region. This has increased our call volume by 20% to some 21 million calls a year. Our Cardiff call centre, which handles these contracts and others for ScotRail and the Association of Train Operating Companies, achieved ISO 9001 accreditation in 2001.

Respecting and empowering people is fundamental to the way we do business. We were pleased to see this recognised in a recent article in TSSA Journal, the magazine for members of the Transport Salaried Staffs’ Association. This commended our Cardiff call centre for its personnel policies – citing staff involvement in decisions and the centre’s family-friendly and flexible working arrangements. It also praised our balanced recruitment strategy, which embraces socially excluded groups among the region’s ethnic minorities. The article concurs with Serco’s view that ‘working to a strong values base can lead to both business success and a good working environment’.

Our expanding rail testing business increased its support for Railtrack – doubling its rail grinding capacity, increasing track quality monitoring from 44,000 miles a year to more than 90,000 miles, and working on an important pilot project to measure track geometry from service trains. We were named preferred bidder to supply and operate a new high-speed track monitoring service for Railtrack and won a number of other important contracts, including the testing of Virgin’s new tilting trains and Plasser & Theurer maintenance vehicles.

Road transport

Traffic management systems installed and operated by Serco now cover over 18,300km of roads worldwide.

We have begun a 10-year, £160 million PFI contract with the UK Highways Agency to design, build and operate its national Traffic Control Centre (TCC). The contract builds on our existing relationship with the Agency and draws on our proven international expertise in supplying and operating intelligent road systems. The TCC will make it possible to view and manage England’s strategic motorways and trunk roads as an integrated network, directing traffic flows to reduce congestion. As operator, we will distribute traffic and travel information through existing and new media channels.

As part of the TCC contract we took over from the police the operation of the Midlands Driver Information System. This network of traffic monitoring equipment and roadside message signs, which alerts motorists to road problems between London and the Midlands, will be absorbed into the TCC. We successfully rebid – for a fourth term – our contract for maintaining communications and traffic monitoring and control equipment on the motorways in the South West of England. We have held this Highways Agency contract since 1984.

We renewed our contract to maintain traffic signals and information systems in London, where we have worked continuously for over 20 years.

In Sweden we commissioned and completed formal takeover of Phase 1 of the Stockholm Traffic and Travel Information and Management System. This complex system gives the city’s authorities an extensive traffic and travel management facility; the project has also given us valuable experience which we are deploying on the TCC project.

In New Zealand we won our third successive contract to operate and maintain the Christchurch Lyttelton Road Tunnel, which we have run since 1994.

In North America our award-winning performance over the initial contract term won us renewal of our contract for examination and registration services with the West Virginia Division of Motor Vehicles.

Air transport

Our air traffic controllers manage 496,216km^2 of airspace in five countries. At many of the Middle East's major international airports we provide air traffic control (ATC) and engineering maintenance support. This year we won a three-year renewal of our contract at Abu Dhabi and Al Ain International Airports. This covers all air traffic services including ATC, aeronautical information and meteorology. We also extended our ATC, electronic engineering and aeronautical information contract covering the whole of the United Arab Emirates Flight Information Region with a staff of over 70.

In North America we again increased the number of ATC towers that we operate for the US Federal Aviation Administration, from 56 to 58. We extended our contracts to run the City of Oshawa's airport in Canada and to provide air operations and maintenance services in Bermuda.

In the UK and Europe we provide a range of airfield technical services including ATC, associated equipment maintenance, airfield operations and rescue and firefighting services at 19 sites. During the year we renewed or expanded our contracts at six of these locations. We also began implementing our aviation safety management system at all sites, with target completion well ahead of the Civil Aviation Authority's requirements.

Science and technology

We now employ over 4,800 people in science activities and we continue to extend our capabilities. We are particularly interested in expanding sectors such as electronics, biotechnology, energy efficiency and the environment, where there is greatest potential to increase commercial revenues.

At the UK's National Physical Laboratory (NPL) we secured a two-year extension to our operating contract and continued to develop the laboratory's business. The extension will be worth some £100 million to Serco, including revenues from DTI programmes and commercial contracts. We are also part of a PFI consortium developing a substantial new laboratory for NPL, to which some 100 staff have already transferred. During 2001 NPL launched a number of new initiatives including an internet-based service that makes calibration simpler, faster and cheaper for industrial customers. New facilities included a centre providing calibration services vital for successful radiation treatment of cancer, and improved anechoic chambers for antenna calibration.

Telecommunications is one of the many sectors in which NPL's work has a major impact. This year we received a contract to lead a national photonics programme, which will sustain the UK's leading position in measurement for the fast-developing optical communications industry. We also undertook important work to underpin studies of mobile phone safety.

NPL has become a trusted R&D partner for a number of industrial companies such as Anritsu, the Japanese instrumentation company, with whom we have developed new standards in fibre optic measurement.

Serco Assurance, the business we acquired from AEA Technology, won over £8 million of new contracts and extensions in its first four months with us. These included technical and consultancy work on nuclear submarines for the Ministry of Defence, safety and technical support at nuclear sites and power stations, and creation of the National Drugs Treatment Monitoring System for the Department of Health.

We are long-established providers of IT and scientific services to the European space industry. New contracts won during the year included our first science study for EUMETSAT, to provide a detailed analysis of performance and product accuracy of the Gome-2 instrument to be flown on its Metop polar orbiting weather satellites.

The European Space Agency (ESA) awarded us a contract for atmospheric science studies. We also won a large number of other contracts for spacecraft engineering, scientific, IT, project management and support services at ESA sites in Germany, Holland, Italy and Spain. Projects we are supporting include Europe's first moon mission, SMART-1, first satellite navigation programme, Galileosat, and largest satellite, ENVISAT.

Our German business became one of the first companies in Germany to win accreditation to the new ISO 9001:2000 quality standard.

Private sector
Our work for the private sector consists mainly of facilities management in the UK, Ireland, mainland Europe and Australasia.

In the UK, GlaxoSmithKline awarded us a two-year extension to our facilities management contract at its Ware manufacturing site.

Our facilities management business in Ireland continued to grow well. The Boots Company showed its satisfaction with our performance over the previous four years by awarding us a three-year rolling contract covering 74 stores throughout the country. We won a new one-year contract from retailer Champion Sports Group for 33 retail outlets, and successfully renegotiated our contract with IBM for the facilities management of its Dublin Technology Campus, involving almost 140 staff.

Sweden's leading supermarket chain, ICA, awarded us a five-year contract involving over 80 staff to provide facilities management for some 20 logistics centres throughout Sweden. Worth a total of SEK650 million, this is our largest contract in Sweden.

In France, we successfully rebid our second-oldest French contract, worth €1.6 million a year, to provide a further five years' facilities management for Andra, the national agency for monitoring nuclear waste.

In Belgium, Coca-Cola awarded us a new three-year facilities management contract for its 28,000m^2 office building in Brussels and has already asked us to provide additional services.

In Germany we won a new three-year facilities management support contract with Asta Medica, a research division of the Degussa Huls chemical company. Worth €6.8 million a year, this involved transferring some 40 staff from the company.

We also won a series of contracts to install fibre optic cable: a 40km telecommunications network in Düsseldorf and Neuss for Metromedia, multimedia links at the Nürburgring racetrack for WIGE-MIC Media Service, and a 50km installation for mobile phone companies along part of the new Frankfurt-Cologne high-speed rail link.

Our growing relationship with BHP Billiton, Australia's largest resource company, has won us another contract with the company. Based at its main steelworks site in Port Kembla, this five-year contract to provide security, medical, fire and emergency response services involves 50 staff. It is an alliance agreement, requiring technology investment in new access control and monitoring systems and a substantial culture change programme, in which we share the benefits of improved service and efficiency.

BHP New Zealand Steel, which extended our building maintenance contract, also awarded us a certificate of excellence for outstanding safety performance.

We extended two substantial facilities management contracts in New Zealand. One covers all 4,000 sites owned and leased by Telecom New Zealand. The other covers seven of the country's premier office sites owned by AMP NZ Office Trust.

In January we acquired The Hiser Group in Australia to strengthen our technology usability business. The A$6 million deal brought us one of the world's most respected consultancies in user interface design and usability.

In the past our presence in Bermuda has been confined to air operations and maintenance services. Our initiative to build commercial business there was rewarded with a five-year facilities management contract from Bank of Butterfield, which includes managing all the bank's properties across the island.

Financial review

Financial performance
2001 was another year of strong performance. We maintained our record of consistent growth in sales and profit.

Total sales increased 19.1% to £1,141.2 million. This includes a contribution of £12.1m from Serco Assurance (formerly AEA Technology Nuclear Consulting Division) which was acquired in September 2001. Turnover excluding Serco Assurance increased by 17.9%.

Gross margin of £124 million represents a return on sales of 13.6%, up from 13.3% in 2000.

Pre tax profit increased 22.9% to £46.4 million before goodwill amortisation. Underlying pre tax profit before goodwill amortisation grew 21.1% to £45.6 million.

Underlying profit is stated after adjusting for a contribution of £0.5 million from Serco Assurance and for the following non-recurring items:

- £10.2 million cost of the unsuccessful NATS acquisition.
- £5 million investment to complete our People and Technology programme.
- £15.4 million profit from refinancing the rolling stock of Great Southern Railway.

The tax charge for the year was £13.4 million (2000 – £11.1 million) representing an effective tax rate of 32.5% (2000 – 32.5%).

The above resulted in a growth in earnings per share before goodwill amortisation of 24.8% to 8.46p, and by 22.1% to 7.14p after goodwill amortisation.

Acquisitions
The acquisition of Serco Assurance was completed on 10 September 2001 for £69.4 million. Since acquisition it has performed in line with our expectations and has been successfully integrated into our science business. Serco Assurance's pre tax and goodwill profit contribution for 2001 of £0.5 million, is after financing and phase-in costs.

Goodwill additions during 2001 amounted to £77.6 million of which £72.8 million related to the acquisition of Serco Assurance. Total goodwill amortised in 2001 was £5.1 million (2000 – £3.7 million). The Group amortises goodwill over 20 years.

Dividends
The proposed final dividend of 1.29p per share gives a cumulative dividend for 2001 of 1.86p, a 14.1% increase on 2000.

Cash
During 2001 there was a net cash outflow of £81.3 million after paying £77.1 million in respect of acquisitions and £10 million on purchasing shares for the staff share option scheme.

Operating cash flow remained strong in 2001 at £15.5 million which compares to an operating profit of £12.3 million. Dividends of £9.6 million from joint ventures have been received during 2001, up from £7.5 million in 2000. Retained profit from joint ventures for the year ended 31 December 2001 was £12.6 million.

Private finance initiatives (PFIs)
The document 'Our Approach to PFIs' which we issued with our Interim Results and is available on our website www.serco.com provides a summary of the accounting for PFIs.

Special Purpose Companies (SPCs) funding is provided by long term loans which are non-recourse to Serco.

- Our share of non-recourse debt of joint venture SPCs at the end of 2001 is £220.6 million. This is included within our share of joint venture liabilities shown on the balance sheet.
- Traffic Information Services (TIS) Limited is the only SPC where Serco owns 100% of the equity. This SPC has the contract to deliver the Traffic Control Centre contract. A non-recourse loan of £14.1 million to fund the asset, currently in the course of construction, is included in long term creditors in the balance sheet.

For 2001 our PFIs, including the associated operating contracts, contributed 11% of the Group's turnover and 24% of pre tax profit.

Pensions

Financial Reporting Standard (FRS) 17 "Retirement Benefits" was issued in November 2000 and will replace SSAP24 for accounting periods ending on or after 22 June 2003. For the year ended 2001 we are applying the transitional rules and disclosures. FRS 17 requires the market value of assets and liabilities to be calculated for defined benefit schemes and to be included on the balance sheet. As at 31 December 2001 there is a small net deficit of £3.6 million in relation to the defined benefit schemes. As the asset base of the schemes is £298 million, this deficit is not regarded as being material to the Group. The pension charge under FRS 17 for 2001 would not have been materially different to the SSAP24 pension charge that is included in our 2001 profit and loss account.

Presentation of results

As in the past we have included a pro forma profit and loss account to assist in analysing the Group's results.

Results for 2000 have been restated to allow effective comparison with the results for 2001 in two areas. Neither has any impact on the Group's profit or cash:

- In accordance with industry practice £9.1 million of joint venture turnover shown in the 2000 Accounts, representing the finance income element of the capital repayment from PFIs, has been restated and shown as joint venture interest receivable.

- A new segmental analysis has been provided which provides a more detailed representation of the results of the Group by market sector.

Contents

Serco Group plc annual accounts 2001

Directors, Secretary and Advisers

Executive Chairman	Richard White
Directors	Kevin Beeston Ralph Hodge CBE* Christopher Hyman Rhidian Jones* DeAnne Julius CBE* Iestyn Williams
Secretary	Julia Cavanagh
Registered Office	Dolphin House Windmill Road Sunbury-on-Thames Middlesex TW16 7HT
Auditors	Deloitte & Touche Chartered Accountants Hill House 1 Little New Street London EC4A 3TR
Principal Bankers	Barclays Bank plc 54 Lombard Street London EC3P 3AH
	The Royal Bank of Scotland plc 135 Bishopsgate London EC2M 3UR
Investment Bankers	Lazard Brothers & Co Limited 21 Moorfields London EC2P 2HT
	Morgan Stanley & Co Ltd 25 Cabot Square Canary Wharf London E14 4QA
Stockbrokers	Cazenove & Co Ltd 12 Tokenhouse Yard London EC2R 7AN
	Merrill Lynch International Merrill Lynch Financial Centre 2 King Edward Street London EC1A 1HQ
Solicitors	Allen & Overy One New Change London EC4M 9QQ
Registrar	Lloyds TSB Registrars The Causeway Worthing West Sussex BN99 6DA

* Non-executive

Corporate Governance Report

Introduction
The Board of Serco Group plc ("the Company") is committed to achieving good standards of corporate governance, integrity and business ethics for all its activities around the world. The Company supports the principles of good governance and code of best practice as appended to the Listing Rules of the Financial Services Authority ("the Combined Code"). This report sets out how the Company applies the Combined Code.

The Board and its Directors
The Board currently comprises seven Directors: Kevin Beeston, Ralph Hodge, Christopher Hyman, Rhidian Jones, DeAnne Julius, Richard White and Iestyn Williams. Their profiles and roles are set out on page 49.

It is the opinion of the Board that the Non-executive Directors are independent of management and free from any business or other relationships which could materially interfere with the exercise of their independent judgement. The Non-executive Directors provide a strong independent element on the Board and bring experience at a senior level of international business operations and strategy, economic and international affairs. The senior independent Non-executive Director is Rhidian Jones. The numbers and skills of both Executive and Non-executive Directors are reviewed periodically by the Board to ensure appropriate succession and balance.

The Board is responsible to the shareholders of the Company and meets regularly to discuss and decide on issues of strategy, performance and control. There is a formal schedule of matters specifically reserved for decision by the Board, including but not limited to, submission of contract tenders, material acquisitions and disposals and corporate objectives. The Board is provided with appropriate information and access to senior employees to enable it to discharge its duties. The adequacy of information provided is regularly reviewed.

All Directors have access to the Company Secretary, who is responsible for ensuring that Board procedures and applicable rules and regulations are observed. The Board has established a procedure whereby Directors wishing to do so in the furtherance of their duties, may take independent professional advice at the Company's expense.

In accordance with the Company's Articles of Association, one third of the Board are required to retire by rotation each year so that over a three-year period all Directors will have retired from the Board and faced re-election.

Board Committees
The Board has delegated authority to a number of committees to deal with matters in accordance with written terms of reference. The chairman of each of the committees provides a report of any meeting of that committee at the next Board Meeting, and the chairmen of the four standing committees are present at the Annual General Meeting to answer questions from shareholders.

Brief details relating to each of the standing committees are set out below:

The Audit Committee
The Audit Committee is comprised of all three Non-executive Directors and is chaired by Rhidian Jones. The Committee meets on at least two occasions each year to examine and consider matters relating to the affairs of the Group. These matters include examination of the Company's Annual Accounts and review of the internal financial control procedures in place for controlling the Group's business, as well as compliance with accounting standards and generally accepted accounting principles.

In addition, the fees and objectivity of the Company's auditors and other external accounting advisers are considered by members of the Committee.

Detailed presentations to the Committee are made, on request, but no less than annually, by the Company's internal and external auditors. The presence of the Finance Director and other senior executives from the Group may be requested, but the Committee has access to the auditor's advice without the presence of the Executive Directors.

The Remuneration Committee
The Remuneration Committee is comprised of all three Non-executive Directors and is chaired by Ralph Hodge. The Committee meets on at least two occasions each year to examine and consider matters relating to the remuneration of Executive Directors and their terms and conditions of service. The recommendations of this Committee, as adopted by the Board, are set out in the Remuneration Report on pages 51 to 56.

The Training Committee
The Training Committee is comprised of Ralph Hodge, Christopher Hyman, Rhidian Jones, DeAnne Julius and Iestyn Williams. The Committee is chaired by Iestyn Williams and meets at least once a year to examine and consider the training needs of Directors and senior executives. The induction programme for new Directors provides a comprehensive familiarisation programme including a formal statement of the Board's role and schedule of reserved matters, powers delegated to the standing committees, the Company's corporate governance framework and the latest financial information together with site visits and meetings with key management throughout the organisation. Directors are encouraged to attend appropriate training courses at the Company's expense.

The Nomination Committee
The Nomination Committee is comprised of the Executive Chairman together with the three Non-executive Directors. The Committee, which is chaired by Richard White, meets as required to examine and consider proposed changes to the Board.

The members of the Committee consult with the other members of the Board before submitting final recommendations for approval by the whole Board.

The Company and its Shareholders
The Board remains committed to ongoing dialogue with its institutions and private shareholders. This year has seen the continuation of the Company's programme of site visits attended by institutional investors and analysts designed to facilitate a greater understanding of the operations of the Company, additionally, two Private Finance Initiative ("PFI") workshops and one guidance publication have been provided to aid a more comprehensive explanation of the Company's approach to PFIs.

Formal presentations are made to institutional investors and brokers' analysts after the release of the interim and final results, and individual meetings were held during the year following any specific requests.

During the year the Company has re-launched its website including an investor centre which provides regular and detailed information on the Company. Electronic communication of data is available for all investors on request. The Company has also introduced a Dividend Re-investment Plan ("DRIP") which provides the opportunity for shareholders to elect to receive dividend payments in the form of shares rather than cash. Details of the DRIP can be found on the Company's website.

The principal methods of communication with private investors remain the Interim Statement, the Annual Review and Accounts, the Annual Review and Summary Financial Statement, the Annual General Meeting and the Company's website.

Internal Control and Risk Management
The Company 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 the Company's assets and reputation. The Board of Directors has overall responsibility for the system and for reviewing its effectiveness; the role of management is to implement internal control and risk management processes appropriate to the business sector in which they operate. Such systems are designed to manage 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 there is an ongoing process for evaluating and managing any significant risks faced by the Group, and that this process has been in place for the year under review and up to the date of approval of the Annual Report. This process is regularly reviewed by the Board and is consistent with the Internal Control: Guidance for Directors on the Combined Code.

The Company has had a full time Risk Director in place for a number of years now, and as a member of the recently formed Corporate Assurance Group, has the responsibility to oversee and review the internal control and risk policies, procedures and management framework within the Group and to develop guidance, training material and management training to ensure the current and future needs of the business are met.

The Board has issued a Risk Management Policy that establishes a requirement for all business units to operate appropriate and effective risk management processes and to report on risk to the Board at regular intervals. These embedded processes are designed to support the Company's strategic direction and business objectives. They place clear responsibility for risk management where it can best be managed and the Company endeavours to ensure that the appropriate infrastructure, controls, systems, staff, training and processes are in place. Some of the key risk management controls are set out below:

- Executive Directors agree marketing, sales and financial targets and budgets with the business units on an annual basis. Progress against these targets is reviewed at formal quarterly meetings attended by the business unit management and senior Company management who act in the capacity of Non-executive Directors for that unit. This process is replicated at an individual contract level by the use of "contract boards".
- Sound project management and change implementation disciplines are applied to all major development projects including new contract phase-ins, acquisitions, new technology applications and other major initiatives.
- Contract and project managers are responsible for establishing and maintaining a risk register that identifies and assesses key risks, and documents risk reduction and mitigation measures. Risk data is reviewed and consolidated to produce business unit risk registers that are reviewed quarterly. The Group risk register is derived from the business unit reports and identifies the key risks facing the Group including certain risks that are managed directly at a Group level. A review of the Group risk register is undertaken at the Board Meeting on a quarterly basis.
- Safety specialists in the Company's aviation, rail, defence and nuclear businesses report regularly to the Board and are charged with maintaining and further developing the very high standards of safety expected in these industries. Additionally, all business units have clearly defined health, safety and environmental management systems.
- There is a clearly defined framework for reviewing and approving all bids, acquisitions, capital projects and expenditure within the Group.
- The Group maintains appropriate insurance cover and reviews the adequacy of the cover at regular intervals.
- Each business unit has an audit committee which meets at least once a year and focuses on risk and internal controls. The Risk Director reports to the Board on any material findings.

During 2001, Grant Thornton and Pannell Kerr Forster have continued to provide an internal audit function within the Group. Their programme has been designed to address internal control and risk management processes and the recommendations of the Turnbull Report. This year they have also been asked to focus on process controls and risk management in the bidding process. Additionally Deloitte & Touche were commissioned to perform a separate review of joint ventures and accounting policies. Their findings are reported to business units, the Audit Committee and the Board.

Corporate Assurance Group

During 2001, the Group established the Corporate Assurance Group to support the Company in relation to the development of best practice and the co-ordination of corporate governance, risk management, safety management systems, health and safety and environmental management.

The role of the Corporate Assurance Group is to ensure:

- that policies and management systems reflect the cultural and ethical values of the Company;
- compliance with national laws and regulations;
- the safety and well-being of the Group's staff, customers, the wider community and the environment;
- that risks have been identified and are proactively managed; and
- protection of the value and integrity of the Group's reputation, products and services and tangible and intellectual assets.

The Corporate Assurance Group reports to the Board on a quarterly basis providing analyses of performance against previously established targets and also advises the Board regarding policy and future activities to enhance best practice around the organisation.

Corporate Governance Report

The Corporate Assurance Group sponsors two specialist Groups:

- A Risk Oversight Group, chaired by the Risk Director and comprising technical specialists with internal control, risk management, audit and compliance responsibilities together with a number of members of senior management. The terms of reference of the Risk Oversight Group include co-ordinating the risk, safety management and internal control activities of the Group, reviewing the strategic risks faced by the Group and ensuring the assignment of designated managers to manage significant risks. The Group meets twice a year and provides reports to the Board to supplement those provided by operational management.
- An Aviation Safety Oversight Group, chaired by the Aviation Safety Director and comprising the aviation safety managers from the Group's aviation business units world-wide. The Group is responsible for overseeing the implementation of the aviation safety management system across the Group's aviation activities world-wide, and for transferring best-practice between the aviation operating companies. The Group meets twice a year and reports to the Board as appropriate.

A Committee chaired by Ralph Hodge and comprising members of the Corporate Assurance Group, Rail management and other senior managers from the business has met during the year to consider matters relating to rail safety, and to recommend the transfer of best practice within the Group. It is anticipated that this work will be continued via a Rail Safety Oversight Group to be established in 2002.

Going Concern
The Directors confirm they have a reasonable expectation that the Group has adequate resources to continue in operational existence for the foreseeable future and therefore continue to adopt the going concern basis in preparing the Annual Review and Accounts.

Compliance during 2001
With exception of the contractual notice periods for the Executive Directors, the Company has fully complied with the provisions stated in Section 1 of the Combined Code.

Contractual Notice Periods
Notice periods for Executive Directors are reviewed on an annual basis. The Remuneration Committee and the Board continue to believe that notice periods for existing Executive Directors should remain at two years. However, in recognition of the recommendations set out in Provision B.1.7 of the Combined Code, the Remuneration Committee and Board have confirmed their intention to include a notice period of twelve months in service contracts for any Executive Directors appointed to the Board in future periods.

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

Julia Cavanagh
Secretary

Dolphin House
Windmill Road
Sunbury-on-Thames
Middlesex
TW16 7HT

4 March 2002

Report of the Directors

Annual Review and Accounts
The Directors of the Company have pleasure in presenting the Annual Review and Accounts of the Group for the year ended 31 December 2001.

Activities
The Company is a holding company which operates via its subisidiaries and its joint ventures to provide facilities management, systems engineering services and equity investment management.

The review of the business for the year ended 31 December 2001 can be found in the Business Review on pages 30 to 37.

Share Capital
The authorised and issued share capital of the Company, together with the details of shares issued during the year are shown in note 21 of the Financial Statements.

During the year the Company via its Employee Share Ownership Trust purchased 3,310,129 Ordinary Shares of 2p each to satisfy options granted under employee incentive schemes. The value of these shares is included within investment in own shares on the consolidated Balance Sheet.

Dividends and Transfers to Reserves
An interim dividend of 0.57p (2000 – 0.50p) per Ordinary Share was paid on 12 October 2001. The Directors recommend a final dividend of 1.29p (2000 – 1.13p) per Ordinary Share, which if approved by the Annual General Meeting, will be paid on 10 May 2002, to those shareholders on the register on 15 March 2002. After dividends, retained profits of £20,568,000 will be transferred to reserves.

Substantial Shareholdings
At the close of business on 22 February 2002 (being the latest practical date prior to the printing of the Report of the Directors), the Company had received notifications of the following substantial interests representing over 3% of the issued share capital:

FMR Corp. and Fidelity International Limited 7.11%.

In the case of non-material interests representing 10% or more of the issued share capital, the Company had received the following notification:

Merrill Lynch Investment Managers Limited 14.48%.

Changes to the Board
The current Directors of the Company are listed on page 42 and their profiles are provided on page 49.

The following change has been made to the Board during the year. Betsy Bernard resigned as a Non-executive Director to reduce her external commitments on becoming President and CEO of AT&T's Consumer division and Dr DeAnne Julius was appointed with effect from the same date. Dr Julius was a founder member of the Bank of England's Monetary Policy Committee and is also a Non-executive Director of the Bank of England, Lloyds TSB and BP. In accordance with the Company's Articles of Association Dr Julius will be subject to election by shareholders at the forthcoming Annual General Meeting.

Directors' Interests
With the exception of the Executive Directors' service contracts and Non-executive Directors' letters of appointment, there were no contracts in which Directors had an interest.

Details of the Directors' interests in the Ordinary Shares and options over Ordinary Shares of the Company are set out in the Remuneration Report on pages 52 to 54.

Annual General Meeting
The fifteenth Annual General Meeting of the Company will be held at the National Physical Laboratory, Teddington, Middlesex, TW11 0LW on 3 May 2002 at 11.00 am.

The Notice of the Annual General Meeting, together with relevant notes and proxy card will be circulated to shareholders at the end of March 2002.

Report of the Directors

Employment Policies
The Board is committed to maintaining a working environment where staff are individually valued and recognised.

The Group is proud of its record of managing employee relations. It believes that the structures of individual and collective consultation and negotiation are best developed at a local level. Over many years of working constructively with trade unions it has been seen that effective partnership delivers concrete improvements to business performance, terms and conditions of employment and employee involvement. Where our employees choose not to belong to a trade union, employee communication forums such as works councils exist to involve employees in our business.

The Board understands its responsibility to encourage and assist in the employment, training, promotion and personal career development of all employees without prejudice. Our commitment to learning is reflected in the range of courses we offer our employees – from face-to-face to computer-based applications. In the past year we have run 'in house' courses on more than 20 diverse subjects, and have recently accredited some of these through the Institute of Management and the Institute of Directors.

The Group gives proper consideration to applications for employment received from the disabled and offers employment when suitable opportunities arise. If employees become disabled during their service with the Group, wherever practicable, arrangements are made to continue their employment and training.

Participation by staff in the success of the Group is encouraged by the availability of Share Save Schemes, and a Share Option Plan for senior staff which effectively aligns their interests with those of shareholders by requiring that options may only be exercised conditional upon performance criteria being achieved.

Health, Safety and Environmental Policies
The Group recognises and accepts its responsibilities for health, safety and the environment ("H,S&E"). A full-time H,S&E Director, a member of the Corporate Assurance Group, is responsible for the development and monitoring of H,S&E policies, procedures and control systems and reports to the Board via the Chief Executive. The Chief Executive is the director responsible for H,S&E matters on behalf of the Board.

The Corporate Assurance Group is supported by dedicated H,S&E teams in each business unit, which provide advice and support on H,S&E issues. The Group employs approximately 125 people worldwide who spend the majority of their time on H,S&E management. The majority of this expertise is deployed where it is most effective at support office and contract levels. All Company employees share responsibility for continuously improving our performance in relation to H,S&E management.

Regular H,S&E meetings are held and attended by business unit Managing Directors or their nominated representatives. A Group H,S&E Conference is held annually with representatives from around the world. In order to maintain a high level of H,S&E awareness, great emphasis is placed on training in all related subjects and regular in-house and external courses are provided for staff at all levels of the organisation.

To ensure compliance with all relevant legislation and Company standards in operation throughout the Group, there is a comprehensive audit system. This system is embedded within the management systems and procedures defined within each regional business. Detailed audit reports are produced, best practice is shared, corrective action identified if relevant and remedial action promptly implemented. In addition the business units are frequently audited by regulatory authorities.

Creditor Payment Policies
The Company requires each of its business units to negotiate and agree terms and conditions of 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 agreed terms and the way in which disputes are to be settled. Payment is to be made in accordance with these terms.

The Group's average creditor payment terms in 2001 were 27 days (2000 – 31 days); Company 34 days (2000 – 29 days).

Donations
Charitable donations totalling £116,000 (2000 – £103,000) were made during the year. There were no political contributions made by the Group.

Auditors
Deloitte & Touche 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.

Report of the Directors

Directors Profiles

Kevin Stanley Beeston FCMA (39) Chief Executive
Kevin joined Serco in 1985 and has since held a number of financial and commercial roles. In 1992 he became Finance Director of the newly acquired International Aeradio Limited and later its Managing Director. He became Chairman and Chief Executive of Serco International Limited in 1994 and in 1996 he was appointed Finance Director of the Group. He was appointed Chief Executive in April 1999.

Ralph Noel Hodge CBE BEng (Hons) (67) Non-executive Director
Ralph is Chairman of the Water Research Council, a Non-executive of British Ceramic Tiles and ORC (Inc) and Chairman of Professional Pre-Selection Services. He was previously Non-executive Chairman of Enron Europe Limited, Chief Executive of ICI Chemicals and Polymers and a Non-executive Director of the Halifax Building Society. He was appointed to the Board of Serco on 5 April 1999, and is Chairman of the Board's Remuneration Committee.

Christopher Rajendran Hyman CA (SA) (38) Finance Director
Christopher joined Serco in 1994 as Finance Director for Serco Europe, the division specialising in providing services to European government agencies. He was appointed Group Company Secretary with additional responsibility for corporate finance in 1996. He was appointed Finance Director of the Group in April 1999. During the year Christopher has also been fulfilling the role of Chief Executive of Serco's Global Projects business and has been instrumental in developing new processes and capabilities at the leading edge of the Group's activities.

Rhidian Huw Brynmor Jones MA FCIS FIMgt (58) Senior Non-executive Director
Rhidian is an experienced corporate finance lawyer and Head of the Corporate Department of solicitors Nabarro Nathanson. He is also Non-executive Deputy Chairman of Britannia, the UK's second largest building society. Before training as a solicitor at Herbert Smith he worked in commerce and industry, including seven years in a senior finance and property role at Granada. He was appointed a Serco Non-executive Director in 1996, having previously served on the Board from 1987 to 1994. He is Chairman of the Board's Audit Committee.

DeAnne Shirley Julius CBE PhD (Econ) (52) Non-executive Director
DeAnne sits on the Court of the Bank of England, having been a member of its Monetary Policy Committee from its formation in 1997 until June 2001. Previously she held senior strategy positions with British Airways and Royal Dutch Shell. Before moving to the UK from America, DeAnne spent seven years with the World Bank developing infrastructure projects in Asia and Africa. She is a Non-executive Director of Lloyds TSB, BP and was appointed to the Board of Serco on 29 October 2001.

Richard David White BSc (Hons) (52) Executive Chairman
Richard joined the business in 1970, when it was part of RCA. He worked in both operations and marketing roles, becoming Director of Government Services in 1984. After the management buyout from RCA in 1987 he became the new company's Managing Director and subsequently Chief Executive, taking particular responsibility for developing Serco's marketing strategy and operational philosophy. He was appointed Executive Chairman in April 1999.

Iestyn Milton Williams BA (50) Executive Director
Iestyn joined RCA in 1978 and became Director of Personnel six years later. After the management buyout in 1987 he became Personnel Director of Serco. Since then he has been involved in building the business in Asia Pacific and later spent two years as Chairman of Serco North America before returning to the UK in 1998. More recently he has spent his time developing new business, first in the expansion of the Group's activities in Europe, and for the last year leading the Group's entry into the growing education sector.

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

Cavanagh

Julia Cavanagh
Secretary

Dolphin House
Windmill Road
Sunbury-on-Thames
Middlesex
TW16 7HT

4 March 2002

Directors' Responsibilities

Company Law requires the Directors to prepare Accounts and Notes for each financial year, which give a true and fair view of the state of affairs of the Company and the Group as at the end of the financial year and of the profit or loss of the Group for that period. In preparing those Accounts and Notes the Directors are required to:

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

The Directors are responsible for keeping proper accounting records, which disclose with reasonable accuracy at any time the financial position of the Company and the Group and enable them to ensure that the Accounts and Notes comply with the Companies Act 1985. They are also responsible for the Company's system of internal control, for safeguarding the assets of the Company and the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

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

Julia Cavanagh
Secretary

Dolphin House
Windmill Road
Sunbury-on-Thames
Middlesex
TW16 7HT

4 March 2002

Remuneration Report

Introduction
The following report details the remuneration policy and actual remuneration of the Directors of the Company for the year ended 31 December 2001, as determined by the Remuneration Committee (the "Committee") and adopted by the Board. In preparing this report consideration has been given to the provisions set out in Schedule B of the Combined Code.

Composition
The Committee is comprised solely of the three Non-executive Directors and is chaired by Ralph Hodge. Its terms of reference are in line with the requirements of the Combined Code.

Remuneration Policy
The Committee recommends to the Board a framework for Executive Directors' remuneration and determines the individual remuneration arrangements for each of the Executive Directors. The Committee aims to maintain a Remuneration Policy which is consistent with the Company's business and culture and takes account of the need to provide competitive and market related terms and conditions.

Executive Directors' remuneration comprises short term rewards such as salary and benefits and long term elements such as pensions, life assurance and share-based incentives. The share-based incentives are linked to performance criteria which effectively align the interests of Directors with those of the Company's shareholders. It is not the Group's policy to pay cash bonuses except in exceptional circumstances.

Business and Accountability
The members of the Committee meet on at least two occasions each year to examine and consider matters relating to the remuneration of Executive Directors as well as the terms and conditions of their service with the Company.

The Committee operates in accordance with written terms of reference which are determined by the Board and take into account best practice in remuneration policies.

In developing the Company's remuneration policy, or when setting an individual Director's remuneration, the Committee consults with the Executive Chairman and the Chief Executive. In addition, the Committee retains firms of external specialists, who regularly advise on market trends and competitive packages.

The conclusions of the Committee meetings are presented by the Chairman of the Committee at the next Board Meeting. The Committee and the Board do not currently consider the placing of the remuneration policy of the Company before shareholders at the Annual General Meeting to be necessary, however, the Chairman of the Committee is available at that Meeting to take questions from shareholders in respect of matters outlined in this report.

Executive Directors' Remuneration
The details of the Directors' short and long term rewards are set out on pages 52 to 55.

1. Salaries and Benefits

The salaries and benefits of the Directors are as follows:

Names	Basic Salary £	Fees £	Others £	Benefits £	Total Remuneration Excluding Pensions 2001 £	Total Remuneration Excluding Pensions 2000 £
K S Beeston	**350,000**	**–**	**–**	**1,239**	**351,239**	287,536
B J Bernard	**–**	**22,916**	**–**	**–**	**22,916**	828
R N Hodge	**–**	**27,500**	**11,000**	**–**	**38,500**	20,208
C R Hyman	**300,000**	**–**	**–**	**992**	**300,992**	244,901
R H B Jones	**–**	**27,500**	**–**	**–**	**27,500**	26,458
D S Julius	**–**	**4,718**	**–**	**–**	**4,718**	–
R D White	**350,000**	**–**	**–**	**2,433**	**352,433**	331,128
I M Williams	**300,000**	**–**	**–**	**3,886**	**303,886**	246,315
Total	**1,300,000**	**82,634**	**11,000**	**8,550**	**1,402,184**	1,157,374

Notes:
On 29 October 2001 D S Julius was appointed as a Non-executive Director and B J Bernard retired. During the year R N Hodge received fees of £11,000 in relation to additional days worked as Chairman of an internal Rail committee.

2. Directors' Shareholdings

The Directors' interests in the shares of the Company were as follows:

	Ordinary Shares of 2p each fully paid 1 January 2001	**31 December 2001**
K S Beeston	107,140	**98,713**
R N Hodge	2,010	**2,010**
C R Hyman	15,879	**21,382**
R H B Jones	46,500	**46,500**
D S Julius	–*	**–**
R D White	2,217,012	**1,432,750**
I M Williams	2,501,670	**2,387,323**

*at date of appointment

3. Share-based Incentives

Long-term share-based incentives are awarded to Directors under the Serco Group plc 1996 Long Term Incentive Scheme as amended on 5 April 2000 ("LTIS") and the Serco Group plc 1998 Executive Option Plan ("EOP").

Awards made under the LTIS, which are structured as options with a zero exercise price, 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 growth in the Company's earnings per share before FRS 10 (Accounting for Goodwill and Intangible Assets) ("EPS") over the performance period of three financial years.

Full vesting will only occur if the cumulative EPS growth is at least 64%. Awards will partially vest where the cumulative EPS growth is at least 35% and will continue to vest on a straight line basis for each percentage increase in EPS growth over the three year period until full vesting is achieved at a cumulative growth rate of 64%. Except in exceptional circumstances awards must be made to employees prior to the commencement of the performance period to which they relate.

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. If the compound annual growth in EPS is less than 10%, none of the options may be exercised. If the compound annual growth in EPS is more than 15%, all of the options may be exercised. Where compound annual growth is between 10% and 15%, a proportion of the options may be exercised.

3. Share-based Incentives **(continued)**

i) Serco Group plc 1996 Long Term Incentive Scheme ("LTIS")
The total share options granted under the LTIS to Directors are as follows:

		Number of options at 1 January 2001	Granted during period	Exercised during period	Lapsed during period	Balance at 31 December 2001	Exercise Price £	Market price on exercise date £	Value realised on exercise £	End of performance period	Date of expiry of option
K S Beeston	3 Yr Award	38,736	–	–	–	38,736	Nil	–	–	31.12.02	04.04.10
	3 Yr Award	51,885*	–	–	–	51,885*	Nil	–	–	31.12.03	23.11.10
	3 Yr Award	–	54,676*	–	–	54,676*	Nil	–	–	31.12.04	15.11.11
B J Bernard	–	–	–	–	–	–	–	–	–	–	–
R N Hodge	–	–	–	–	–	–	–	–	–	–	–
C R Hyman	3 Yr Award	32,868	–	–	–	32,868	Nil	–	–	31.12.02	04.04.10
	3 Yr Award	44,474*	–	–	–	44,474*	Nil	–	–	31.12.03	23.11.10
	3 Yr Award	–	46,865*	–	–	46,865*	Nil	–	–	31.12.04	15.11.11
R H B Jones	–	–	–	–	–	–	–	–	–	–	–
D S Julius	–	–	–	–	–	–	–	–	–	–	–
R D White	3 Yr Award	48,516	–	–	–	48,516	Nil	–	–	31.12.02	04.04.10
	3 Yr Award	51,885*	–	–	–	51,885*	Nil	–	–	31.12.03	23.11.10
	3 Yr Award	–	48,172	–	–	48,172	Nil	–	–	31.12.04	15.11.11
I M Williams	3 Yr Award	156,930	–	156,930	–	–	Nil	4.15	651,260	01.01.99	01.01.03
	Add' Award	78,462	–	78,462	–	–	Nil	4.15	325,617	01.01.99	01.01.03
	3 Yr Award	86,796	–	86,796	–	–	Nil	4.15	360,203	01.01.00	01.01.04
	Add' Award	43,398	–	43,398	–	–	Nil	4.15	180,102	01.01.99	01.01.04
	3 Yr Award	32,868	–	–	–	32,868	Nil	–	–	31.12.02	04.04.10
	3 Yr Award	44,474*	–	–	–	44,474*	Nil	–	–	31.12.03	23.11.10
	3 Yr Award	–	46,865*	–	–	46,865*	Nil	–	–	31.12.04	15.11.11

The scheme is an unapproved scheme for Inland Revenue purposes.

No awards have been exercised by the Directors since the end of the financial year.

* Approximately 13.5% of the options granted under the LTIS during the year 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 LTIS options.

Remuneration Report

3. Share-based Incentives (continued)

ii) Serco Group plc 1998 Executive Option Plan ("EOP")
Total share options granted under the EOP to Directors are as follows:

		Number of options at 1 January 2001	Granted during period	Exercised during period	Lapsed during period	Balance at 31 December 2001	Market price on exercise date £	Exercise Price £	Value realised on exercise £	Date from which exercisable	Date of expiry of option
K S Beeston	Approved	13,788	–	–	–	13,788	–	2.18	–	21.05.01	20.05.08
	Unapproved	68,922	–	–	–	68,922	–	2.18	–	21.05.01	20.05.05
	Unapproved	76,734	–	–	–	76,734	–	2.45	–	01.04.02	31.03.06
	Unapproved	58,764	–	–	–	58,764	–	4.26	–	05.04.03	04.04.07
	Unapproved	–	91,321*	–	–	91,321*	–	4.35	–	28.03.04	27.03.08
B J Bernard	–	–	–	–	–	–	–	–	–	–	–
R N Hodge	–	–	–	–	–	–	–	–	–	–	–
C R Hyman	Approved	13,788	–	–	–	13,788	–	2.18	–	21.05.01	20.05.08
	Unapproved	25,290	–	–	–	25,290	–	2.18	–	21.05.01	20.05.05
	Unapproved	40,812	–	–	–	40,812	–	2.45	–	01.04.02	31.03.06
	Unapproved	49,830	–	–	–	49,830	–	4.26	–	05.04.03	04.04.07
	Unapproved	–	78,275*	–	–	78,275*	–	4.35	–	28.03.04	27.03.08
R H B Jones	–	–	–	–	–	–	–	–	–	–	–
D S Julius	–	–	–	–	–	–	–	–	–	–	–
R D White	Approved	13,788	–	–	–	13,788	–	2.18	–	21.05.01	20.05.08
	Unapproved	119,448	–	–	–	119,448	–	2.18	–	21.05.01	20.05.05
	Unapproved	123,612	–	–	–	123,612	–	2.45	–	01.04.02	31.03.06
	Unapproved	73,572	–	–	–	73,572	–	4.26	–	05.04.03	04.04.07
	Unapproved	–	91,321*	–	–	91,321*	–	4.35	–	28.03.04	27.03.08
I M Williams	Approved	13,788	–	–	–	13,788	–	2.18	–	21.05.01	20.05.08
	Unapproved	78,990	–	–	–	78,990	–	2.18	–	21.05.01	20.05.05
	Unapproved	86,076	–	–	–	86,076	–	2.45	–	01.04.02	31.03.06
	Unapproved	49,830	–	–	–	49,830	–	4.26	–	05.04.03	04.04.07
	Unapproved	–	78,275*	–	–	78,275*	–	4.35	–	28.03.04	27.03.08

The Scheme is an approved scheme for Inland Revenue purposes but has an unapproved schedule. No options have been exercised by the Directors since the end of the financial year.

* Approximately 13.5% of the options granted as unapproved options under the EOP during the year 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 unapproved options.

4. Pensions and Life Assurance

The Executive 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 Note 31. In the event of death in service, each scheme provides for a lump sum payment as well as a dependants' pension.

The accrued pension benefits of Executive Directors are as follows:

	Increase in pension during the year £	Transfer value of increase £	Total accrued pension at year end £ p.a.
K S Beeston	16,578	93,480	86,644
C R Hyman	3,400	16,350	22,018
R D White	13,201	139,460	165,092
I M Williams	13,170	132,480	119,052

Notes to pension benefits:

i) The total accrued pension shown is that which would be paid annually on retirement, based on service to the end of this year. The increase in accrued pension during the year excludes any increase in inflation.

ii) The transfer value of the increase in accrued pension has been calculated on the basis of actuarial advice in accordance with Actuarial Guidance Note GN11, less Directors' contributions.

iii) Members have the option to pay Additional Voluntary Contributions: neither the contributions nor the resulting benefits are included in the above table.

iv) 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.

v) C R Hyman received an additional benefit from an arrangement to which the Company contributes 15% of remuneration in excess of the Permitted Maximum under the Inland Revenue approved Scheme.

Service Contracts and Compensation

Each Executive Director has a service contract with the Company, and these service contracts will be available for inspection prior to and after the Company's Annual General Meeting.

The Company can terminate such service contracts by giving two years' notice to an Executive Director. It is the opinion of the Remuneration Committee and the Board that it is appropriate for existing Executive Directors to retain a two year notice period, however new appointments to the Board will have a notice period of twelve months.

Compensation for early termination of a service contract is not addressed in the contracts. The Remuneration Committee considers and determines the level of compensation on a case by case basis, taking into account the circumstances surrounding termination and the individual's responsibility to mitigate loss.

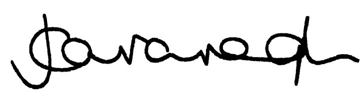
Remuneration Report

Non-executive Directors' Appointment and Fees
The Non-executive Directors of the Company are appointed for a three year term, and that appointment may be terminated on three months written notice. Renewal of appointments are not automatic, and Non-executive Directors are required to retire and stand for re-election in accordance with the Company's Articles of Association.

The Non-executive Directors of the Company have no personal financial interest in the matters determined by the Committee, no potential conflicts of interest arising from cross-directorships and no involvement in the day to day running of the Group.

The fees and terms of engagement of Non-executive Directors are reviewed on a regular basis and approved by the Board.

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



Julia Cavanagh
Secretary

Dolphin House
Windmill Road
Sunbury-on-Thames
Middlesex
TW16 7HT

4 March 2002

Independent Auditors' Report to the Members of Serco Group plc

We have audited the financial statements of Serco Group plc for the year ended 31 December 2001 which comprise the profit and loss account, the balance sheets, the cash flow statement, the statement of total recognised gains and losses and the related notes 1 to 32. These financial statements have been prepared under the accounting policies set out therein.

Respective responsibilities of Directors and Auditors
As described in the statement of Directors' Responsibilities, the Company's Directors are responsible for the preparation of the financial statements in accordance with applicable United Kingdom law and accounting standards. Our responsibility is to audit the financial statements in accordance with relevant United Kingdom legal and regulatory requirements, auditing standards, and the Listing Rules of the Financial Services Authority.

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

We review whether the Corporate Governance Statement reflects the Company's compliance with the seven provisions of the Combined Code specified for our review by the Listing Rules and we report if it does not. We are not required to consider whether the Board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the Group's corporate governance procedures or its risk and control procedures.

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

Basis of audit opinion
We conducted our audit in accordance with United Kingdom auditing standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the financial statements and of whether the accounting policies are appropriate to the circumstances of the Company and the Group, consistently applied and adequately disclosed.

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

Opinion
In our opinion the financial statements give a true and fair view of the state of affairs of the Company and the Group as at 31 December 2001 and of the profit of the Group for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

Deloitte & Touche
Chartered Accountants and Registered Auditors

Hill House
1 Little New Street
London
EC4A 3TR

4 March 2002

Notes: An audit does not provide assurance on the maintenance and integrity of the website, including controls used to achieve this, and in particular on whether any changes may have occurred to the financial statements since first published. These matters are the responsibility of the directors but no control procedures can provide absolute assurance in this area.

Legislation in the United Kingdom governing the preparation and dissemination of financial statements differs from legislation in other jurisdictions.

Proforma Summary Consolidated Profit and Loss Account

For the year ended 31 December 2001

	Note	2001 £'000	Restated 2000 £'000
Turnover: Group and share of joint ventures	2	**1,141,203**	957,917
Less: share of joint ventures	2	**(227,510)**	(185,874)
Group turnover – continuing operations	2	**913,693**	772,043
Cost of sales		**(789,686)**	(669,361)
Gross profit		**124,007**	102,682
Administrative expenses		**(87,549)**	(74,601)
Exceptional item: Cost of unsuccessful NATS acquisition		**(10,187)**	–
Exceptional item: GSR refinancing		**15,356**	–
Share of operating profit in joint ventures - including group joint venture costs and joint venture interest		**9,820**	13,172
Profit before group interest and goodwill		**51,447**	41,253
Net group interest	4, 5	**(5,092)**	(3,543)
Profit on ordinary activities before taxation – pre amortisation of goodwill		**46,355**	37,710
Amortisation of goodwill		**(5,123)**	(3,681)
Profit on ordinary activities before taxation	6	**41,232**	34,029
Taxation on profit on ordinary activities	7	**(13,399)**	(11,059)
Profit on ordinary activities after taxation		**27,833**	22,970
Dividends	8	**(7,265)**	(6,387)
Retained profit for the financial year	23	**20,568**	16,583

The basis of preparation of this statement and the prior year restatement is set out in Note 1.

Statutory Consolidated Profit and Loss Account

For the year ended 31 December 2001

	Note	2001 Group £'000	2001 Joint Ventures £'000	2001 Total £'000	2000 Group £'000	Restated 2000 Joint Ventures £'000	Restated 2000 Total £'000
Turnover: Group and share of joint ventures – continuing operations	2	**913,693**	**227,510**	**1,141,203**	772,043	185,874	957,917
Less: share of joint ventures	2	**–**	**(227,510)**	**(227,510)**	–	(185,874)	(185,874)
Group turnover	2	**913,693**	**–**	**913,693**	772,043	–	772,043
Cost of sales		**(789,686)**	**–**	**(789,686)**	(669,361)	–	(669,361)
Gross profit		**124,007**	**–**	**124,007**	102,682	–	102,682
Administrative expenses		**(92,672)**	**–**	**(92,672)**	(78,282)	–	(78,282)
Amortisation of goodwill		**(5,123)**	**–**	**(5,123)**	(3,681)	–	(3,681)
Other administrative expenses		**(87,549)**	**–**	**(87,549)**	(74,601)	–	(74,601)
Exceptional item: Cost of unsuccessful NATS acquisition		**(10,187)**	**–**	**(10,187)**	–	–	–
Other operating costs relating to joint ventures		**–**	**(8,888)**	**(8,888)**	–	(7,654)	(7,654)
Operating profit – continuing operations		**21,148**	**(8,888)**	**12,260**	24,400	(7,654)	16,746
Exceptional item: GSR refinancing		**15,356**	**–**	**15,356**	–	–	–
Share of operating profit in joint ventures		**–**	**17,374**	**17,374**	–	19,802	19,802
Interest receivable	4	**2,207**	**17,102**	**19,309**	1,212	9,213	10,425
Group		**2,207**	**–**	**2,207**	1,212	–	1,212
Share of joint ventures		**–**	**17,102**	**17,102**	–	9,213	9,213
Interest payable and similar charges	5	**(7,299)**	**(15,768)**	**(23,067)**	(4,755)	(8,189)	(12,944)
Group		**(7,299)**	**–**	**(7,299)**	(4,755)	–	(4,755)
Share of joint ventures		**–**	**(15,768)**	**(15,768)**	–	(8,189)	(8,189)
Profit on ordinary activities before taxation	6	**31,412**	**9,820**	**41,232**	20,857	13,172	34,029
Taxation on profit on ordinary activities	7			**(13,399)**			(11,059)
Profit on ordinary activities after taxation				**27,833**			22,970
Dividends	8			**(7,265)**			(6,387)
Retained profit for the financial year	23			**20,568**			16,583

	Note	2001	2000
Earnings per Share ("EPS") of 2p each:	9		
Basic EPS, after amortisation of goodwill		**7.14p**	5.85p
Basic EPS, before amortisation of goodwill		**8.46p**	6.78p
Diluted EPS, after amortisation of goodwill		**7.12p**	5.79p
Diluted EPS, before amortisation of goodwill		**8.43p**	6.72p

The basis of preparation of this statement and the prior year restatement is set out in Note 1.

Consolidated Balance Sheet

At 31 December 2001

	Note	2001 £'000	2000 £'000
Fixed assets			
Intangible asset	10	**141,170**	68,662
Tangible assets	11	**48,724**	40,269
Investments in joint ventures	12	**30,510**	27,688
Share of gross assets		**322,338**	305,588
Share of gross liabilities		**(291,828)**	(277,900)
Investment in own shares	12	**18,983**	9,680
		239,387	146,299
Current assets			
Stocks	13	**35,838**	25,942
Debtors: Amounts due within one year	14	**200,898**	158,532
Debtors: Amounts due after more than one year	14	**76,105**	32,197
Cash at bank and in hand	17	**34,812**	80,098
		347,653	296,769
Creditors: Amounts falling due within one year			
Bank loans and overdrafts	16	**70,647**	34,601
Trade creditors		**58,034**	56,902
Other creditors including taxation and social security	15	**100,621**	76,630
Accruals and deferred income		**128,629**	88,386
Proposed dividend	8	**5,026**	4,425
		362,957	260,944
Net current (liabilities)/assets		**(15,304)**	35,825
Total assets less current liabilities		**224,083**	182,124
Creditors: Amounts falling due after more than one year	16	**68,570**	47,121
Provisions for liabilities and charges	18	**25,636**	26,078
Net assets		**129,877**	108,925
Capital and reserves			
Called up share capital	21	**7,903**	7,877
Share premium account	22	**73,656**	70,121
Capital redemption reserve		**143**	143
Profit and loss account	23	**48,175**	30,784
Equity shareholders' funds	20	**129,877**	108,925

These Accounts and Notes were approved by the Board of Directors on 4 March 2002 and signed on behalf of the Board:

Richard White Executive Chairman **Christopher Hyman** Finance Director

Company Balance Sheet

At 31 December 2001

	Note	2001 £'000	2000 £'000
Fixed assets			
Tangible assets	11	**1,682**	1,221
Investments in subsidiaries	12	**35,598**	30,314
		37,280	31,535
Current assets			
Amounts owed by subsidiary companies due within one year		**–**	822
Amounts owed by subsidiary companies due after more than one year		**148,183**	110,576
Debtors	14	**14,820**	7,870
Cash at bank and in hand		**–**	45,273
		163,003	164,541
Creditors: Amounts falling due within one year			
Bank loans and overdrafts	16	**30,245**	32,005
Trade creditors		**757**	1,317
Other creditors including taxation and social security	15	**1,077**	5,695
Accruals and deferred income		**5,098**	7,682
Proposed dividend	8	**5,026**	4,425
		42,203	51,124
Net current assets		**120,800**	113,417
Total assets less current liabilities		**158,080**	144,952
Creditors: Amounts falling due after more than one year	16	**41,420**	41,420
Net assets		**116,660**	103,532
Capital and reserves			
Called up share capital	21	**7,903**	7,877
Share premium account	22	**73,656**	70,121
Capital redemption reserve		**143**	143
Profit and loss account	23	**34,958**	25,391
Equity shareholders' funds		**116,660**	103,532

These Accounts and Notes were approved by the Board of Directors on 4 March 2002 and signed on behalf of the Board:

Richard White Executive Chairman **Christopher Hyman** Finance Director

Consolidated Cash Flow Statement

For the year ended 31 December 2001

	Note	2001 £'000	2000 £'000
Operating profit pre NATS costs		**22,447**	16,746
Exceptional item: Cost of unsuccessful NATS acquisition		**(10,187)**	–
Operating profit		**12,260**	16,746
Depreciation and goodwill amortisation		**18,283**	15,419
(Increase)/decrease in working capital		**(15,059)**	13,369
Net cash inflow from operating activities before PFI asset expenditure		**15,484**	45,534
Expenditure on PFI asset under construction*		**(13,733)**	–
Net cash inflow from operating activities after PFI asset expenditure	24	**1,751**	45,534
Dividends received from joint ventures		**9,645**	7,477
Returns on investment and servicing of finance			
Interest received		**578**	950
Interest paid		**(6,182)**	(4,755)
Net cash outflow from returns on investments and servicing of finance		**(5,604)**	(3,805)
Taxation			
UK corporation tax paid		**(3,196)**	(2,856)
Overseas tax paid		**(3,221)**	(2,797)
Tax paid		**(6,417)**	(5,653)
Capital expenditure and financial investment			
Purchase of tangible fixed assets		**(17,626)**	(15,332)
Sale of tangible fixed assets		**4,569**	862
Exceptional item: GSR refinancing		**16,343**	–
Security deposit on PFI asset under construction		**(6,000)**	–
Net cashflows with joint ventures		**(1,945)**	6,505
Purchase of own shares		**(9,964)**	(10,000)
Net cash outflow from capital expenditure and financial investment		**(14,623)**	(17,965)
Acquisitions and disposals			
Acquisitions	12	**(77,106)**	(4,409)
Net cash/(overdraft) acquired with acquisitions		**3,558**	(73)
Subscription for shares in joint ventures	12	**(38)**	(4,963)
Proceeds from disposal of shares in joint ventures		**–**	1,271
Net cash outflow from acquisitions and disposals		**(73,586)**	(8,174)
Equity dividends paid			
Dividends paid		**(6,664)**	(5,816)
Net cash outflow from equity dividends paid		**(6,664)**	(5,816)
Net cash (outflow)/inflow before financing		**(95,498)**	11,598
Financing			
Issue of Ordinary Share Capital		**2,001**	818
Debt due within one year: Increase/(decrease) in other loans		**100**	(28)
Debt due beyond one year: Increase in:		**14,850**	186
Other loans		**750**	186
Non recourse debt financing PFI asset*		**14,100**	–
Capital element of finance lease repayments		**(2,785)**	(2,264)
Net cash inflow/(outflow) from financing		**14,166**	(1,288)
(Decrease)/increase in cash		**(81,332)**	10,310
Balance at 1 January		**45,497**	35,187
Balance at 31 December		**(35,835)**	45,497

*PFI asset under construction financed by non recourse loan.

Consolidated Statement of Recognised Gains and Losses

For the year ended 31 December 2001

	2001 **£'000**	2000 £'000
Profit on ordinary activities after taxation	**27,833**	22,970
Currency translation differences on foreign currency net investments	**(1,917)**	(1,155)
Exercise of Share Scheme Options	**(1,260)**	(5,305)
Total recognised gains and losses relating to the year	**24,656**	16,510

Notes to the Accounts

For the year ended 31 December 2001

1. Accounting policies

These Accounts have been prepared in accordance with applicable accounting standards, and the particular accounting policies adopted are detailed below:

Restatement

The 2000 Accounts have been restated in respect of joint venture turnover, joint venture operating profit and joint venture interest costs to recognise the "finance income" element of the capital repayment on PFIs within interest receivable.

The segmental analysis in Notes 2 and 3 has been restated to reflect a different business split. The new segmental analysis provides a more detailed representation of the results.

The creditors analysis in Note 16 has been restated to show the Group's borrowings from the US Private Placement in other loans instead of bank loans and overdrafts.

Proforma summary consolidated profit and loss account

To aid in the understanding of the results of the Group and its joint ventures a Proforma Summary Profit and Loss Account has been included as an alternative presentation. The results are derived directly from the Statutory Profit and Loss Account, and explanations have been given on the face of the Proforma Summary Profit and Loss Account where appropriate.

Accounting convention

These Accounts have been prepared under the historical cost convention.

Basis of consolidation

The Group Accounts consolidate the Accounts of the Company, its subsidiaries and share of joint ventures made up to 31 December of each year, for the periods they are owned by Serco Group plc.

Depreciation

Depreciation is provided on a straight line basis at rates which, in the opinion of the Directors, 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 rate produced by lease term
Machinery	15% – 20%
Motor vehicles	18% – 50%
Furniture	10%
Office equipment	20% – 33%
Leased equipment	The higher of the rate produced by either lease term or useful life

Stocks

Stocks are stated at the lower of cost and net realisable value. Cost includes an appropriate proportion of direct material and labour.

Long term contracts

Long term contract balances represent costs incurred on specific contracts, net of amounts transferred to cost of sales in respect of work recorded as turnover by reference to the value of the work carried out to date. No profit is recognised until the contract has advanced to a stage where the total profit can be assessed with reasonable certainty. Advance payments are included in creditors to the extent that they exceed the related work in progress.

Deferred taxation

Deferred taxation is calculated under the liability method. Deferred taxation is accounted for in full on timing differences relating to pension and other post retirement benefits. Taxation deferred or accelerated by reason of other timing differences is accounted for to the extent that it is probable that a liability or asset will crystallise in the forseeable future.

Fixed asset investments: Subsidiaries

Investments held as fixed assets are stated at cost less provision for any impairment in value.

Fixed asset investments: Joint ventures

In the consolidated accounts, investments in joint ventures are accounted for using the gross equity method of accounting in accordance with Financial Reporting Standard 9 ("FRS 9") – Associates and Joint Ventures.

The Group Consolidated Profit and Loss Account includes the Group's share of joint ventures' operating profits and interest, and the attributable taxation. In the Consolidated Balance Sheet, the investments in the joint ventures which include several PFIs are shown as the Group's share of the net assets of the joint ventures. The share of net assets is split between gross assets and gross liabilities.

In the Proforma Summary Consolidated Profit and Loss Account operating costs relating to joint ventures have been included within "Share of profits arising from joint ventures – including group joint venture costs and joint venture interest".

1. Accounting policies (continued)

Fixed asset investment: Own shares
Investment in own shares represents shares in Serco Group plc held by the Serco Group plc 1998 Employee Share Ownership Trust ("the Trust"). The dividends on these shares have been waived.

The Trust is a discretionary trust for the benefit of the employees and shares are held to satisfy the Group's liabilities to employees for share options and long term incentive plans. The net cost to the Group of these schemes is charged to the Profit and Loss Account over the period to which they relate.

Goodwill
Goodwill arising on acquisitions is capitalised in the Balance Sheet in accordance with Financial Reporting Standard 10 ("FRS 10") – Goodwill and Intangible Assets. Amortisation of goodwill is provided on a straight line basis over a period of 20 years, which, in the opinion of the Directors is a period not exceeding the economic useful life of the asset.

Basis of translation of foreign currencies
Transactions of UK companies denominated in foreign currencies are translated into Sterling at the rate ruling at the date of the transaction. Amounts receivable and payable in foreign currencies at the Balance Sheet date are translated at the rates ruling at that date and any differences arising are taken to the Profit and Loss Account.

The Accounts of overseas subsidiary companies and associated undertakings are translated into Sterling at the closing rates of exchange at the Balance Sheet date and the difference arising from the translation of the opening net investment and matched long term foreign currency borrowings is taken directly to reserves. The Profit and Loss Account is translated using average exchange rates.

Accounting for PFI Contracts
During any period of initial asset construction within a Public Private Partnership (PPP) project (including Private Finance Initiative (PFI) projects) in which Serco has a majority equity investment, costs incurred as a direct consequence of financing, designing and constructing the asset are shown as 'assets in the course of construction' within current assets. Where PPP concession agreements transfer limited risks and rewards associated with ownership to the contractor, the asset is transferred to debtors as 'amounts receivable under PPP contracts' on completion of the asset construction.

Revenues received from the customer are apportioned between capital repayments and operating revenue. The 'finance income' element of the capital repayment is shown within interest receivable.

Pension costs: Defined benefit schemes
Retirement benefits to employees of Group companies except in Germany, are funded by contributions from Group companies and employees. Payments are made to trust funds which are financially separate from the Group in accordance with periodic calculations by consulting actuaries. The expected cost to the Group of providing defined benefit pensions is charged to the Profit and Loss Account so as to spread the cost of pensions over the service lives of employees in the schemes, in such a way that the cost is a substantially level percentage of payroll cost, with experience surpluses and deficits being amortised on a straight line basis.

In Germany retirement benefits to employees are accrued for by Serco GmbH & Co. KG. The expected cost to the company for providing defined benefit pensions is calculated in accordance with periodic valuations by consulting actuaries.

The Group has adopted the transitional disclosure requirements of FRS 17. For further information see Note 31.

Turnover
Turnover represents net sales of goods and services to third parties together with investment related income.

Leases
Assets obtained under finance leases are capitalised at their fair value on acquisition and depreciated over the shorter of their estimated useful lives or lease term. The finance charges are allocated over the period of the lease in proportion to the capital element outstanding. Rentals on assets under operating leases are charged to the Profit and Loss Account in equal annual amounts.

2. Segmental Report

In 2000, the results of the Group were analysed under three classes of business: Facilities Management; Systems Engineering; and Investments. These accounts include new segmental analysis which provides a more detailed representation of the results and financial position of the Group. The 2000 results have been restated accordingly. It should be noted however that the Company pursues all projects on their individual merits regardless of sector.

Classes of Business **2001**	**Group** **£'000**	**Joint Ventures** **£'000**	**Total** **£'000**
Turnover			
Civil Government	202,605	107,917	310,522
Defence	218,001	115,349	333,350
Transport	275,888	4,244	280,132
Science	87,404	–	87,404
Private sector	129,795	–	129,795
Total	**913,693**	**227,510**	**1,141,203**
Profit before taxation and other costs			
Civil Government	13,271	5,169	18,440
Defence	11,312	11,996	23,308
Transport	14,179	209	14,388
Science	4,907	–	4,907
Private sector	6,778	–	6,778
Total	**50,447**	**17,374**	**67,821**
Other costs			
Common costs			(22,877)
Exceptional item: Cost of unsuccessful NATS acquisition			(10,187)
Exceptional item: GSR refinancing			15,356
Amortisation of goodwill			(5,123)
Net interest – Group			(5,092)
Net interest – Joint ventures			1,334
Total			**41,232**
Net assets			
Civil Government			33,517
Defence			36,282
Transport			27,044
Science			903
Private sector			14,246
			111,992
Unallocated assets			17,885
Total			**129,877**

2. Segmental Report (continued)

Classes of Business

Restated 2000	Group £'000	Joint Ventures £'000	Total £'000
Turnover			
Civil Government	159,772	57,787	217,559
Defence	212,968	120,041	333,009
Transport	215,509	3,024	218,533
Science	77,131	–	77,131
Private sector	106,663	5,022	111,685
Total	**772,043**	**185,874**	**957,917**
Profit before taxation and other costs			
Civil Government	9,917	2,419	12,336
Defence	10,780	16,104	26,884
Transport	10,260	1,069	11,329
Science	2,630	–	2,630
Private sector	5,437	210	5,647
Total	**39,024**	**19,802**	**58,826**
Other costs			
Common costs			(18,597)
Amortisation of goodwill			(3,681)
Net interest – Group			(3,543)
Net interest – Joint ventures			1,024
Total			**34,029**
Net assets			
Civil Government			26,836
Defence			34,697
Transport			19,003
Science			1,081
Private sector			10,004
			91,621
Unallocated assets			17,304
Total			**108,925**

2. Segmental Report (continued)

Geographical segments

2001	Group £'000	Joint Ventures £'000	Total £'000
Turnover			
United Kingdom	618,559	175,641	794,200
Rest of Europe and Middle East	130,608	8,876	139,484
Asia Pacific	103,414	38,588	142,002
North America	61,112	4,405	65,517
Total	**913,693**	**227,510**	**1,141,203**
Profit before taxation and other costs			
United Kingdom	26,988	14,068	41,056
Rest of Europe and Middle East	10,041	720	10,761
Asia Pacific	8,597	1,871	10,468
North America	4,821	715	5,536
Total	**50,447**	**17,374**	**67,821**
Other costs			
Common costs			(22,877)
Exceptional item: Cost of unsuccessful NATS acquisition			(10,187)
Exceptional item: GSR refinancing			15,356
Amortisation of goodwill			(5,123)
Net interest – Group			(5,092)
Net interest – Joint ventures			1,334
Total			**41,232**
Net assets			
United Kingdom			64,563
Rest of Europe and Middle East			9,278
Asia Pacific			30,919
North America			7,232
			111,992
Unallocated assets			17,885
Total			**129,877**

Note: Turnover is shown by geographical origin. Turnover analysed by geographical destination is not materially different.

2. Segmental Report (continued)

Geographical segments

Restated 2000	Group £'000	Joint Ventures £'000	Total £'000
Turnover			
United Kingdom	490,786	121,305	612,091
Rest of Europe and Middle East	124,140	13,327	137,467
Asia Pacific	96,872	42,095	138,967
North America	60,245	9,147	69,392
Total	**772,043**	**185,874**	**957,917**
Profit before taxation and other costs			
United Kingdom	16,476	16,449	32,925
Rest of Europe and Middle East	10,017	552	10,569
Asia Pacific	8,482	1,316	9,798
North America	4,049	1,485	5,534
Total	**39,024**	**19,802**	**58,826**
Other costs			
Common costs			(18,597)
Amortisation of goodwill			(3,681)
Net interest – Group			(3,543)
Net interest – Joint ventures			1,024
Total			**34,029**
Net assets			
United Kingdom			49,901
Rest of Europe and Middle East			8,972
Asia Pacific			24,573
North America			8,175
			91,621
Unallocated assets			17,304
Total			**108,925**

Note: Turnover is shown by geographical origin. Turnover analysed by geographical destination is not materially different.

3. Information regarding Directors and employees

		2001 £'000	2000 £'000
a)	Directors' remuneration:		
	Fees as Directors	**83**	70
	Other emoluments	**1,319**	1,268
	Total remuneration excluding pensions	**1,402**	1,338

Refer to the Remuneration Report on pages 52 to 56.
The prior year comparative includes Directors who did not serve in 2001.

		2001 £'000	2000 £'000
b)	Employee costs including Directors:		
	Wages and salaries	**399,447**	358,707
	Social security costs	**36,376**	33,612
	Other pension costs (Note 31)	**19,544**	17,851
	Long Term Incentive Scheme costs	**661**	320
		456,028	410,490

		2001	Restated 2000
c)	Number of persons employed by Serco Group plc and its subsidiaries		
	Average number of persons employed in the provision of services:		
	Civil Government	**6,738**	5,878
	Defence	**6,491**	6,342
	Transport	**4,653**	4,021
	Science	**1,460**	1,425
	Private sector	**2,445**	2,223
	Non-specific	**116**	167
		21,903	20,056

4. Interest receivable

	2001 £'000	Restated 2000 £'000
Short term deposits	**1,484**	606
Loans to joint ventures	**723**	606
Total Group	**2,207**	1,212
Share of joint ventures' interest	**17,102**	9,213
	19,309	10,425

5. Interest payable and similar charges

	2001 £'000	2000 £'000
On liabilities repayable within five years:		
Group bank loans and overdrafts	**4,246**	1,665
Share of joint ventures' interest	**–**	10
	4,246	1,675
On liabilities repayable after five years:		
Group bank loans and overdrafts	**3,053**	3,090
Share of joint ventures' interest	**15,768**	8,179
	18,821	11,269
	23,067	12,944

6. Profit on ordinary activities before taxation

	2001 £'000	2000 £'000
Profit on ordinary activities before taxation is after charging:		
Rentals under operating leases:		
Land and buildings	**11,790**	10,028
Plant and machinery	**17,586**	16,640
Depreciation on tangible assets:		
Owned	**10,861**	9,788
Held under finance leases	**2,299**	1,950
Finance lease interest on operational assets	**454**	357
Amortisation of goodwill	**5,123**	3,681
Auditors' remuneration:		
Deloitte & Touche	**444**	397
Other auditors	**125**	82
Other fees paid to Deloitte & Touche:		
Transaction support	**659**	–
Tax	**544**	485
Other	**432**	424

7. Taxation on profit on ordinary activities

	2001 £'000	2000 £'000
The taxation charge on the results of the year is made up as follows:		
United Kingdom corporation taxation	**3,010**	1,646
Double tax relief	**(349)**	–
Overseas taxation:		
Operating income	**2,777**	2,038
Exceptional item: GSR refinancing	**1,219**	–
Deferred taxation	**(117)**	(336)
Adjustment in respect of prior years:		
United Kingdom corporation taxation	**292**	(576)
Overseas taxation	**–**	(274)
Deferred taxation	**501**	157
Share of joint ventures' taxation charge	**6,066**	8,404
	13,399	11,059

The effective tax charge for the year is higher than the United Kingdom corporation tax rate principally as a result of disallowed expenditure and the high effective tax rates of PFI businesses.

8. Dividends

	2001 £'000	2000 £'000
Interim dividend of 0.57p per share on 392,551,903 Ordinary Shares (2000 – 0.50p on 391,169,280 Ordinary Shares) of 2p each fully paid – paid 12 October 2001	**2,238**	1,956
Proposed final dividend of 1.29p per share on 389,613,782 Ordinary Shares (2000 – 1.13p on 391,591,141 Ordinary Shares) of 2p each fully paid – proposed payment on 10 May 2002	**5,026**	4,425
	7,264	6,381
2000 final dividend of 1.13p on 50,212 shares issued between 31 December 2000 and 6 April 2001 (record date)	**1**	–
1999 final dividend of 0.98p on 658,230 shares relating to shares issued between 31 December 1999 and 17 March 2000 (record date)	**–**	6
	7,265	6,387

A dividend waiver is effective for those shares held on behalf of the Company by its Employee Share Ownership Trust.

9. Earnings per Ordinary Share

Basic and diluted earnings per Ordinary Share after goodwill have been calculated in accordance with Financial Reporting Standard 14 – Earnings Per Share. Earnings per share is shown both before and after goodwill to assist in the understanding of the impact of FRS 10 on the Group Accounts.

The calculation of basic earnings per Ordinary Share after goodwill is based on profits of £27,833,000 for the year ended 31 December 2001 (2000 – £22,970,000) and the weighted average number of 389,552,980 (2000 – 392,825,780) Ordinary Shares of 2p each in issue during the year.

The calculation of basic earnings per Ordinary Share before goodwill is based on profits of £32,956,000 (adjusted for the effect of goodwill amortisation of £5,123,000) for the year ended 31 December 2001 (2000 – £26,651,000 as adjusted for goodwill amortisation of £3,681,000) and the weighted average number of 389,552,980 (2000 – 392,825,780) Ordinary Shares of 2p each in issue during the year.

The calculation of diluted earnings per Ordinary Share after goodwill is based on profits of £27,833,000 for the year ended 31 December 2001 (2000 – £22,970,000) and the weighted average number of 391,115,673 (2000 – 396,763,939) Ordinary Shares of 2p each assuming that the options are all exercised.

The calculation of diluted earnings per Ordinary Share before goodwill is based on profits of £32,956,000 (adjusted for the effect of goodwill amortisation of £5,123,000) for the year ended 31 December 2001 (2000 – £26,651,000 as adjusted for goodwill amortisation of £3,681,000) and the weighted average number of 391,115,673 (2000 – 396,763,939) Ordinary Shares of 2p each assuming that the options are all exercised.

10. Intangible asset: Goodwill

	Group £'000
Cost:	
At 1 January 2001	75,258
Additions during the year	77,631
At 31 December 2001	**152,889**
Accumulated amortisation:	
At 1 January 2001	6,596
Charge for the year	5,123
At 31 December 2001	**11,719**
Net book value:	
At 31 December 2001	**141,170**
At 31 December 2000	68,662

11. Tangible assets

Group	Freehold land and buildings £'000	Short leasehold building improvements £'000	Machinery, motor vehicles, furniture and equipment £'000	Total £'000
Cost:				
At 1 January 2001	8,519	7,949	87,533	104,001
Reclassifications	–	533	(533)	–
Subsidiaries acquired	–	126	4,272	4,398
Capital expenditure	1,225	1,933	24,557	27,715
Disposals	(1,970)	(338)	(16,549)	(18,857)
Foreign exchange differences	(207)	(75)	(1,434)	(1,716)
At 31 December 2001	**7,567**	**10,128**	**97,846**	**115,541**
Accumulated depreciation:				
At 1 January 2001	2,296	3,297	58,139	63,732
Reclassifications	–	20	(20)	–
Subsidiaries acquired	–	53	3,038	3,091
Provided during the year	266	1,046	11,848	13,160
Disposals	(282)	(304)	(11,650)	(12,236)
Foreign exchange differences	(46)	(38)	(846)	(930)
At 31 December 2001	**2,234**	**4,074**	**60,509**	**66,817**
Net book value:				
At 31 December 2001	**5,333**	**6,054**	**37,337**	**48,724**
At 31 December 2000	6,223	4,652	29,394	40,269

The cost of assets held by the Group under finance leases at 31 December 2001 was £18,905,000 (2000 – £11,517,000). The accumulated depreciation provided for those assets at 31 December 2001 was £6,903,000 (2000 – £6,900,000).

Company	Short leasehold building improvements £'000	Machinery, motor vehicles, furniture and equipment £'000	Total £'000
Cost:			
At 1 January 2001	643	2,082	2,725
Transfers from subsidiary undertakings	103	200	303
Capital expenditure	372	427	799
Disposals	(1)	(85)	(86)
At 31 December 2001	**1,117**	**2,624**	**3,741**
Accumulated depreciation:			
At 1 January 2001	200	1,304	1,504
Transfers from subsidiary undertakings	40	52	92
Provided during the year	116	417	533
Disposals	(1)	(69)	(70)
At 31 December 2001	**355**	**1,704**	**2,059**
Net book value:			
At 31 December 2001	**762**	**920**	**1,682**
At 31 December 2000	443	778	1,221

12. Investments held as fixed assets

		Company £'000
a)	Shares in subsidiary companies at cost:	
	At 1 January 2001	30,314
	Equity subscription for shares in Serco Limited	1,238
	Acquisition of remaining 50% of Serco Group (Hong Kong) Limited	2,760
	Acquisition of Total IT Limited	1,286
	At 31 December 2001	**35,598**

		Group £'000
b)	Group investments in joint ventures:	
	At 1 January 2001	27,688
	Dividends receivable	(9,645)
	Acquisitions	38
	Foreign exchange translation difference	(213)
	Retained profits	12,642
	At 31 December 2001	**30,510**

		Group £'000
c)	Investment in own shares:	
	At 1 January 2001	9,680
	Additions	10,000
	Amortisation	(661)
	Exercise of options	(36)
	At 31 December 2001	**18,983**

Investment in own shares represents 5,557,033 shares in Serco Group plc held by the Employee Share Ownership Trust ("ESOP") (1.4% of current allotted share capital). The market value of shares held by the ESOP Trust at 31 December 2001 was £20,283,170. 52,308 were allotted during the year of which 9,864 were allotted at £4.26 and 42,444 at nil value.

d) A list of the principal undertakings of Serco Group plc is shown in Note 32. All the subsidiaries of the Group have been consolidated.

e) At 31 December 2001, Group companies had branches in Abu Dhabi, Antarctica, Ascension Island, Bahrain, Chile, Dubai, France, Korea, Ras Al Khaimah, Saudi Arabia, Sharjah and Switzerland.

12. Investments held as fixed assets (continued)

f) All the subsidiaries of Serco Group plc and the joint venture undertakings are engaged in the provision of services with the exception of Serco Investments Limited and certain other holding companies, which manage equity investments.

	2001 £'000	2000 £'000
g) The aggregate of the Group's share in the assets and liabilities of joint ventures is:		
Share of fixed assets	**54,147**	41,144
Share of current assets	**268,191**	264,444
	322,338	305,588
Share of liabilities due within one year	**62,817**	60,107
Share of liabilities due after more than one year	**229,011**	217,793
	291,828	277,900
Share of net assets	**30,510**	27,688

Premier Custodial Group made a significant contribution during 2001 contributing turnover of £76,655,000 and profit before tax of £6,388,000. The tax charge was £2,058,000.

Within the share of net assets at 31 December 2001 the following amounts are included for Premier Custodial Group.

	2001 £'000
Fixed assets	4,737
Current assets	122,059
	126,796
Liabilities due within one year	19,467
Liabilities due after more than one year	96,807
	116,274
Share of net assets	10,522

h) Acquisitions:

All acquisitions made during the year have been accounted for using the acquisition method of accounting. The goodwill arising on all acquisitions made in the year is being amortised over a period of 20 years.

i) Serco Assurance

The Nuclear Consulting division of AEA Technology plc was acquired by Serco Limited on 10 September 2001 for cash consideration of £69,400,000. The business now trades under under the name "Serco Assurance". Acquisition costs of £797,000 were incurred.

The fair value of net liabilities was £2,574,000 after taking account of revaluation adjustments of £298,000 which have been made in order to reflect the estimated realisable value of acquired work in progress. Other adjustments amounting to £1,811,000 principally relate to onerous contracts acquired with the business.

The goodwill arising on consolidation is £72,771,000.

12. Investments held as fixed assets (continued)

h) Acquisitions (continued)

ii) Hiser Group Pty Limited

All the issued share capital of Hiser Group Pty Limited was acquired by Serco Group Pty Limited on 2 January 2001, for a cash consideration of £2,007,000. Acquisition costs of £256,000 were incurred.

The fair value of assets and liabilities are considered to be the same as the book value. The goodwill arising on consolidation is £2,377,000.

iii) Total IT Limited

All the issued share capital of Total IT Limited was acquired by Serco Group plc on 26 June 2001, for a cash consideration of £275,000, the issue of 74,535 Serco Group plc shares (equivalent £300,000) and deferred consideration comprising loan notes to the value of £600,000. Acquisition costs of £111,000 were incurred.

The fair value of assets and liabilities are considered to be the same as the book value. The goodwill arising on consolidation is £1,282,000.

iv) Serco Group (Hong Kong) Limited (formerly Serco Guardian (FM) Limited)

The remaining 50% of shares of Serco Group (Hong Kong) Limited were acquired by Serco Group plc on 28 September 2001 for a cash consideration of £2,530,000. Acquisition costs of £230,000 were incurred.

The fair value of assets and liabilities are considered to be the same as the book value. The goodwill arising on consolidation is £1,201,000.

v) Subscriptions for shares in joint ventures

During the year the Group made subscriptions and further equity injections in joint ventures all of which have been accounted for by the gross equity method of accounting. The details of each transaction are as follows:

Further equity injections were made in Laser (Teddington Holding) Limited by Serco Investments Limited during 2001 for a total cash amount of £38,000.

As part of the acquisition of the remaining 50% of shares of Serco Group (Hong Kong) Limited on 28 September 2001, 50% of the Ordinary Share Capital of Hong Kong Parking Limited was acquired. The net asset value on acquisition was £1,252,000.

vi) Partnerships UK

£1,500,000 was invested in Partnerships UK on 11 April 2001. Serco has a 3.3% stake in the company.

13. Stocks

	Group	
	2001	2000
	£'000	£'000
Service spares	**10,093**	11,529
Long term contract balances	**25,745**	14,413
	35,838	25,942

14. Debtors

	Group		Company	
	2001 **£'000**	2000 £'000	**2001** **£'000**	2000 £'000
a) Amounts due within one year:				
Amounts recoverable on contracts	**151,535**	121,526	**–**	–
Other debtors	**21,224**	16,317	**14,747**	7,795
Prepayments and accrued income	**19,148**	11,843	**73**	75
Amounts owed by joint ventures	**4,257**	3,940	**–**	–
Building held for re-sale	**4,734**	4,906	**–**	–
	200,898	158,532	**14,820**	7,870

	Group		Company	
	2001 **£'000**	2000 £'000	**2001** **£'000**	2000 £'000
b) Amounts due after more than one year:				
Amounts recoverable on contracts	**11,847**	9,451	**–**	–
Other debtors	**14,131**	3,246	**–**	–
Pensions prepayment (Note 31)	**26,460**	9,212	**–**	–
Amounts owed by joint ventures	**9,567**	10,288	**–**	–
PFI asset in the course of construction*	**14,100**	–	**–**	–
	76,105	32,197	**–**	–
Total debtors	**277,003**	190,729	**14,820**	7,870

Included in amounts recoverable on contracts is £14,710,000 (2000 – £15,913,000) in respect of items procured on behalf of customers. This is offset by an amount of £12,038,000 (2000 – £13,499,000) in trade creditors and an amount of £1,611,000 (2000 – £2,886,000) in accruals.

* PFI asset in the course of construction is in relation to the Traffic Control Centre contract. The balance includes £367,000 of capitalised interest. The corresponding non recourse loan is included within bank loans greater than one year (note 16).

15. Other creditors including taxation and social security

	Group		Company	
	2001 **£'000**	2000 £'000	**2001** **£'000**	2000 £'000
Obligations under finance leases	**2,557**	1,852	**–**	–
Corporation tax	**4,418**	3,501	**–**	–
Other taxes and social security costs	**30,464**	24,697	**631**	616
Other creditors	**47,689**	28,838	**446**	79
Amounts owed to joint ventures	**14,864**	17,213	**–**	5,000
Other loans	**629**	529	**–**	–
	100,621	76,630	**1,077**	5,695

16. Creditors: Amounts falling due after more than one year

		Group		Company	
		2001 £'000	Restated 2000 £'000	**2001 £'000**	Restated 2000 £'000
a)	Bank loans and overdrafts	**70,647**	34,601	**30,245**	32,005
	Obligations under finance leases	**11,385**	4,081	**–**	–
	Other loans	**60,371**	45,421	**41,420**	41,420
	Total loans	**142,403**	84,103	**71,665**	73,425
	Less: amounts included in creditors falling due within one year	**73,833**	36,982	**30,245**	32,005
	Amounts falling due after more than one year	**68,570**	47,121	**41,420**	41,420

		Group		Company	
		2001 £'000	Restated 2000 £'000	**2001 £'000**	Restated 2000 £'000
b)	Analysis of loan repayments due:				
	Bank loans and overdrafts:				
	Within one year or on demand	**70,647**	34,601	**30,245**	32,005
	Obligations under finance leases:				
	Within one year or on demand	**2,557**	1,852	**–**	–
	Between one and two years	**2,543**	1,456	**–**	–
	Between two and five years	**3,826**	713	**–**	–
	After five years	**2,459**	60	**–**	–
	Other loans:				
	Within one year or on demand	**629**	529	**–**	–
	Between one and two years	**1,618**	257	**–**	–
	Between two and five years	**14,681**	3,169	**–**	–
	Non recourse debt to fund PFI asset*	**14,100**	–	**–**	–
	Other	**581**	3,169	**–**	–
	After five years	**43,443**	41,466	**41,420**	41,420
		142,403	84,103	**71,665**	73,425

* The non recourse debt to fund a PFI asset is in relation to the Traffic Control Centre contract. The PFI asset under construction is shown in current assets (note 14).

c) All loans are unsecured, with the exception of the non recourse debt to fund the Traffic Control Centre PFI asset, which is secured against the Group's equity commitment and contract cash flows.

d) Finance lease obligations are secured by retention of title to the relevant assets.

17. Treasury policies and risk management

The principal risks arising from the Group's financing activities are interest rate risk and foreign currency risk. Treasury operations are conducted within a framework of policies and guidelines reviewed and authorised by the Board. There has been no change during the year or since the year end to the major financial risks faced by the Group or the Group's approach to the management of these risks.

As permitted by Financial Reporting Standard 13 – "Derivatives and other Financial Instruments: Disclosures" short term debtors and non interest bearing short term creditors and loans from joint ventures have been excluded from the following disclosure other than the disclosure of the currency profile of financial assets and liabilities.

The fundamental purpose of interest rate and foreign currency financial instruments entered into is to hedge long term and short term financial borrowings, the details of which are set out below.

Interest rate risk

The Group borrows at both fixed and floating rates of interest. The Group's exposure to interest rate fluctuations on its borrowing is managed by using interest rate swaps and forward rate agreements. At 31 December 2001 after taking account of interest rate swaps, the proportion of the Group's fixed rate borrowings was 23.4%.

Foreign currency risk

The Group has a significant investment in overseas subsidiaries. The Group's policy is not to hedge net assets of overseas subsidiaries as they represent a small proportion of the market value of the Group.

Business units are required to hedge their material trading transactions (sales and purchases in currencies other than their functional currency) by using forward contracts. There were no material debtors or creditors as at 31 December 2001 with unmatched transactional exposure.

Financial assets and liabilities

i) Assets

31 December 2001	Sterling £'000	Australian Dollar £'000	US Dollar £'000	Euro £'000	Other currencies £'000	**Total £'000**
Cash and short term deposits	12,782	2,450	5,670	11,282	2,628	**34,812**
Long term interest-bearing loans to joint ventures	8,817	750	–	–	–	**9,567**
Other long term debtors**	64,564	1,363	611	–	–	**66,538**
Total long term assets	**73,381**	**2,113**	**611**	**–**	**–**	**76,105**

31 December 2000	Sterling £'000	Australian Dollar £'000	US Dollar £'000	Euro £'000	Other currencies £'000	Total £'000
Cash and short term deposits	59,813	1,891	4,952	8,179	5,263	80,098
Long term interest-bearing loans to joint ventures	6,576	3,606	106	–	–	10,288
Other long term debtors	16,720	2,306	1,888	–	995	21,909
Total long term assets	23,296	5,912	1,994	–	995	32,197

** Includes £14.1 million PFI asset under construction.

17. Treasury policies and risk management (continued)

ii) Liabilities

31 December 2001	Total liabilities £'000	Floating rate liabilities £'000	Fixed rate liabilities £'000	Fixed Rate Liabilities: Weighted average interest rate %	Fixed Rate Liabilities: Weighted average time for which rate is fixed Years
Sterling*	98,077	98,077	–	–	–
Australian Dollar	2,451	2,451	–	–	–
US Dollar	41,420	8,038	33,382	7.34	6
Euro	455	455	–	–	–
Total (Note 16)	**142,403**	**109,021**	**33,382**		

31 December 2000	Total liabilities £'000	Floating rate liabilities £'000	Fixed rate liabilities £'000	Fixed Rate Liabilities: Weighted average interest rate %	Fixed Rate Liabilities: Weighted average time for which rate is fixed Years
Sterling	5,469	5,469	–	–	–
Australian Dollar	2,047	2,047	–	–	–
US Dollar	44,582	14,997	29,585	7.64	7
Euro	32,005	32,005	–	–	–
Total (Note 16)	84,103	54,518	29,585		

The Maturity of the Group's financial liabilities at 31 December 2001 and 31 December 2000:

31 December 2001	Maturing within one year £'000	Maturing between one and two years £'000	Maturing between two and five years £'000	Maturing after more than five years £'000	**Total £'000**
Sterling*	72,677	3,216	17,778	4,406	**98,077**
Australian Dollar	701	945	730	75	**2,451**
US Dollar	–	–	–	41,420	**41,420**
Euro	455	–	–	–	**455**
Total	**73,833**	**4,161**	**18,508**	**45,901**	**142,403**

31 December 2000	Maturing within one year £'000	Maturing between one and two years £'000	Maturing between two and five years £'000	Maturing after more than five years £'000	Total £'000
Sterling	2,535	558	2,369	7	5,469
Australian Dollar	894	986	167	–	2,047
US Dollar	1,548	169	1,346	41,519	44,582
Euro	32,005	–	–	–	32,005
Total	36,982	1,713	3,882	41,526	84,103

* Includes £14.1 million non recourse debt to fund PFI asset.

17. Treasury policies and risk management **(continued)**

iii) Fair Values

The book value and fair value of the Group's financial assets and liabilities at 31 December 2001 and 31 December 2000 were:

	2001			2000		
	Book value £'000	**Fair value £'000**	**Unrecognised gain/(loss) £'000**	Book value £'000	Fair value £'000	Unrecognised gain/(loss) £'000
Assets						
Cash and short term deposits	**34,812**	**34,812**	**–**	80,098	80,098	–
Amounts owed by joint ventures	**9,567**	**9,567**	**–**	10,288	10,288	–
Other long term debtors**	**66,538**	**66,538**	**–**	21,909	21,909	–
Total	**76,105**	**76,105**	**–**	32,197	32,197	–
Liabilities						
Long term borrowing:						
Sterling*	**25,400**	**25,400**	**–**	2,934	2,934	–
Australian Dollar	**1,750**	**1,750**	**–**	1,153	1,153	–
US Dollar	**41,420**	**48,991**	**(7,571)**	43,034	46,439	(3,405)
Total	**68,570**	**76,141**	**(7,571)**	47,121	50,526	(3,405)
Short term borrowing:						
Sterling	**72,677**	**72,677**	**–**	2,535	2,535	–
Australian Dollar	**701**	**701**	**–**	894	894	–
US Dollar	**–**	**–**	**–**	1,548	1,548	–
Euro	**455**	**455**	**–**	32,005	32,005	–
Derivatives held to manage the currency and interest rate profile	**–**	**(4,492)**	**4,492**	–	(3,231)	3,231
Total	**73,833**	**69,341**	**4,492**	36,982	33,751	3,231

* Includes £14.1 million non recourse debt to fund PFI asset.

** Includes £14.1 million PFI asset under construction.

The fair value of the interest rate swaps, foreign currency contracts and US Dollar denominated long term fixed rate debt, with a carrying amount of USD70,000,000, have been determined by reference to prices available from the markets on which the instruments involved are traded.

Gains and losses on hedges

The Group uses interest rate swaps to manage its interest rate profile. Changes in the fair value of instruments used as hedges are not recognised in the financial statements until the hedged position matures. There were no unrecognised gains or losses brought forward that were charged to the Profit and Loss account during the period. There was an unrecognised gain of £4,492,000 (2000 – £3,231,000) on the interest rate swaps as at 31 December 2001, as set out in the previous table. The unrecognised gain is not expected to be recognised in the Profit and Loss account in the next period.

17. Treasury policies and risk management (continued)

iii) Fair Values (continued)

Borrowing facilities

Serco Group plc had facilities of £50,100,000 committed and £73,556,000 uncommitted that were unused as at 31 December 2001. Committed facilities are renewable every five years with the exception of a 3 year £90,000,000 facility which expires 9 September 2004. Uncommitted facilities are renewable annually.

18. Provisions for liabilities and charges

Group	Balance 1 January 2001 £'000	Usage £'000	Charged to the profit and loss account £'000	Foreign exchange differences £'000	**Balance 31 December 2001 £'000**
Pensions provision	23,829	(326)	130	(630)	**23,003**
Deferred taxation	2,249	–	384	–	**2,633**
	26,078	(326)	514	(630)	**25,636**

19. Deferred taxation

	Group	
	2001 £'000	2000 £'000
The amounts of deferred taxation provided in the accounts are:		
Capital allowances in excess of depreciation	**332**	178
Overseas timing differences	**692**	38
Other timing differences	**1,609**	2,033
	2,633	2,249
Potential amounts of deferred taxation for which no credit has been taken:		
Depreciation in advance of capital allowances	**317**	(546)
Overseas timing differences	**(2,916)**	(3,341)
Other timing differences	**(625)**	(295)
	(3,224)	(4,182)

20. Reconciliation of movements in shareholders' funds

	2001 £'000	2000 £'000
Profit on ordinary activities after taxation	**27,833**	22,970
Dividends	**(7,265)**	(6,387)
	20,568	16,583
Currency translation differences on foreign currency net investments	**(1,917)**	(1,155)
New capital subscribed	**3,561**	7,174
Exercise of share scheme options	**(1,260)**	(5,305)
Net increase in shareholders' funds	**20,952**	17,297
Opening shareholders' funds	**108,925**	91,628
Closing shareholders' funds	**129,877**	108,925

21. Called up share capital

		2001 £'000	2000 £'000
a)	Authorised 550,000,000 (2000 – 550,000,000) Ordinary Shares of 2p each	**11,000**	11,000

		2001 £'000	2000 £'000
b)	Called up, allotted and fully paid: 395,170,815 (2000 – 393,864,463) Ordinary Shares of 2p each	**7,903**	7,877

c) Ordinary Shares of 2p each allotted in the year:

During the year 1,189,973 Ordinary Shares of 2p each were allotted to the holders of options or their personal representatives, 4,944 were allotted at £2.02, 737,178 at £2.175, 32,106 at £2.45, 29,159 at £3.81 and 383,586 at nil value.

In addition to the above, 74,535 Ordinary Shares of 2p each were allotted as consideration for the acquisition of Total IT Limited on 26 June 2001. 44,844 Ordinary Shares of 2p each were also allotted on 19 December 2001 as deferred consideration relating to the acquisition of Serco QAA (formerly Quality Assurance Associates Limited) made in December 2000.

d) Options in respect of Ordinary Shares of 2p each:

i) In January 1996, 1,210,392 options in respect of Ordinary Shares of 2p each were granted in accordance with the rules of the 'Serco Group plc 1996 Long Term Incentive Scheme'. At 31 December 2001 no options remain.

ii) In January 1997, 1,439,622 options in respect of Ordinary Shares of 2p each were granted in accordance with the rules of the 'Serco Group plc 1996 Long Term Incentive Scheme'. At 31 December 2001 there remained 54,000 options which are exercisable at nil value in accordance with the rules of the Scheme.

iii) 3,341,346 options in respect of Ordinary Shares of 2p each were granted in May and September 1998 in accordance with the rules of the 'Serco Group plc 1998 Executive Option Plan'. At 31 December 2001 there remained 1,951,391 options which are exercisable at a price of £2.175 each and 13,458 at £2.02 each in accordance with the rules of the Scheme.

iv) On 1 April 1999, 3,461,664 options in respect of Ordinary Shares of 2p each were granted in accordance with the rules of the 'Serco Group plc 1998 Executive Option Plan'. At 31 December 2001 there remained 3,016,368 options which are exercisable at a price of £2.45 each in accordance with the rules of the scheme.

v) On 31 March 2000, 4,511,988 options in respect of Ordinary Shares of 2p each were granted as part of the 1996 Sharesave Scheme, 3,595,595 options were held by employees on 31 December 2001. The options are exercisable at any time between 1 May 2003 and 31 October 2003 at a price of £3.81 each in accordance with the rules of the scheme.

vi) On 5 April 2000, 2,524,836 options in respect of Ordinary Shares of 2p each were granted in accordance with the rules of the 'Serco Group plc 1998 Executive Option Plan'. At 31 December 2001 there remained 2,420,958 options which are exercisable at a price of £4.26 each in accordance with the rules of the Scheme.

21. Called up share capital (continued)

d) Options in respect of Ordinary Shares of 2p each (continued)

vii) On 5 April 2000, 219,900 options in respect of Ordinary Shares of 2p each were granted in accordance with the rules of the '1996 Serco Group plc Long Term Incentive Scheme as amended by the company on 5 April 2000'. At 31 December 2001 there remained 196,752 options which are exercisable at a nil value in accordance with the rules of the scheme.

viii) 37,677 options in respect of Ordinary Shares of 2p each were granted in August and November 2000, in accordance with the rules of the 'Serco Group plc 1998 Executive Option Plan'. As at 31 December 2001 there remained 26,268 options which are exercisable at a price of £5.825 and 8,878 options which are exercisable at a price of £4.90 each in accordance with the rules of the scheme.

ix) On 24 November 2000, 259,351 options in respect of Ordinary Shares of 2p each were granted in accordance with the rules of the '1996 Serco Group plc Long Term Incentive Scheme as amended by the Company on 5 April 2000'. At 31 December 2001 there remained 240,055 options which are exercisable at nil value in accordance with the rules of the Scheme.

x) On 20 March 2001, 2,851,962 options in respect of Ordinary Shares of 2p each were granted in accordance with the rules of the 'Serco Group 1998 Executive Option Plan'. As at 31 December 2001 there remained 2,803,343 options which are exercisable at a price of £4.07 each in accordance with the rules of the Scheme.

xi) On 27 March 2001, 603,144 options in respect of Ordinary Shares of 2p each were granted in accordance with the rules of the 'Serco Group 1998 Executive Option Plan'. As at 31 December 2001 there remained 600,838 options which are exercisable at a price of £4.35 each in accordance with the rules of the Scheme.

xii) On 16 November 2001, 248,374 options in respect of Ordinary Shares of 2p each were granted in accordance with the rules of the '1996 Serco Group plc Long Term Incentive Scheme as amended by the Company on 5 April 2000'. At 31 December 2001 no options had been exercised or lapsed. These options have been granted in respect of a three year performance period starting 1 January 2002 and are exercisable at nil value in accordance with the rules of the Scheme.

e) The market price of Serco Group plc Ordinary Shares of 2p each as at 31 December 2001 was £3.65. The market price of these shares ranged from £2.40 to £5.825 during the year.

22. Share premium account

	£'000
Balance at 1 January 2001	70,121
Share Premium on issue of shares for the acquisition of Total IT Limited	299
Deferred consideration relating to the acquisition of Serco QAA Limited	171
Share premium on issue of shares upon exercise of options	3,065
Balance at 31 December 2001	**73,656**

23. Profit and loss account

	£'000
Group	
Balance at 1 January 2001	30,784
Retained profit transferred to reserves	20,568
Currency translation differences on foreign currency net investments	(1,917)
Exercise of share scheme options	(1,260)
Balance at 31 December 2001	**48,175**

The profit and loss account includes a goodwill charge of £41,578,000 under the accounting policy applicable prior to the implementation of FRS 10.

Company
As permitted by Section 230 of the Companies Act 1985, the profit and loss account of the Parent Company is not presented as part of these accounts. The consolidated profit for the financial year includes the Parent Company profit of £17,406,000 which includes dividends of £18,560,000 received from subsidiary companies.

A final ordinary dividend of £5,026,000 is proposed which together with the interim dividend of £2,238,000 and the payment in relation to the 2000 final dividend caused by the movement in the number of shares in issue of £1,000 leaves a profit of £10,141,000 which has been added to reserves brought forward of £25,391,000. This, along with a foreign exchange charge of £574,000, results in reserves carried forward of £34,958,000.

24. Reconciliation of operating profit to net cash inflow from operating activities

	2001 £'000	2000 £'000
Operating profit pre NATS costs	**22,447**	16,746
Exceptional item: Cost of unsuccessful NATS acquistion	**(10,187)**	–
Operating profit	**12,260**	16,746
Depreciation	**13,160**	11,738
Goodwill amortisation	**5,123**	3,681
(Profit)/loss on sale of tangible assets	**(1,236)**	313
(Increase)/decrease in stocks	**(8,932)**	1,094
Increase in debtors	**(57,416)**	(25,657)
Increase in creditors	**53,578**	37,099
(Decrease)/increase in provisions	**(1,053)**	520
Net cash inflow from operating activities before PFI asset expenditure	**15,484**	45,534
Expenditure on PFI asset in the course of construction	**(13,733)**	–
Net cash inflow from operating activities after PFI asset expenditure	**1,751**	45,534

25. Analysis of net debt

	Restated Balance 1 January 2001 £'000	Cash flow £'000	Other non-cash changes £'000	**Balance 31 December 2001 £'000**
Cash at bank and in hand	80,098	(45,286)	–	**34,812**
Overdrafts	(34,601)	(36,046)	–	**(70,647)**
Cash net of overdrafts	45,497	(81,332)	–	**(35,835)**
Non recourse debt to fund PFI asset	–	(14,100)	–	**(14,100)**
Other loans due after more than one year	(44,892)	(750)	–	**(45,642)**
Other loans due within one year	(529)	(100)	–	**(629)**
Finance leases	(4,081)	2,785	(10,089)	**(11,385)**
Net debt	(4,005)	(93,497)	(10,089)	**(107,591)**

Notes to the Accounts

For the year ended 31 December 2001

26. Reconciliation of (decrease)/increase in cash to movement in net debt

	2001 £'000	2000 £'000
(Decrease)/increase in cash	**(81,332)**	10,310
Cash (outflow)/inflow from debt and lease financing	**(12,165)**	2,106
Change in net debt resulting from cash flows	**(93,497)**	12,416
New finance leases	**(10,089)**	(2,055)
Movement in net debt in the period	**(103,586)**	10,361
Net debt at 1 January	**(4,005)**	(14,366)
Net debt at 31 December	**(107,591)**	(4,005)

27. Major non-cash transactions

During the year the Group entered into finance lease arrangements in respect of assets with a total capital value at the inception of the leases of £10,089,000 (2000 – £2,055,000).

During the year £1,260,000 (2000 – £5,305,000) has been charged to the profit and loss reserve in respect of shares issued under employee share incentive schemes.

28. Contingent liabilities

The Group has given indemnities to banks totalling £43,626,000 of which £14,356,000 is in respect of performance bonds issued in the ordinary course of business. The remainder is primarily in respect of financial guarantees.

29. Capital and other commitments

	Group		Company	
	2001 £'000	2000 £'000	**2001 £'000**	2000 £'000
Capital expenditure contracted but not provided	**1,244**	1,172	**–**	–

There is a commitment of £45 million in relation to the Traffic Control Centre PFI asset under construction (included in current assets), which will be funded by non recourse bank debt.

During the year ending 31 December 2002 the Group is to make the following payments in respect of operating leases:

	Land and buildings £'000	Other £'000
Leases which expire:		
Within one year	2,777	4,504
Between one and five years	3,115	15,655
After five years	4,372	3,318
	10,264	23,477

30. Related parties

Directors

The Directors of Serco Group plc had no material transactions with the Group during the year other than service contracts and Directors' liability insurance. Details of the Directors' remuneration is disclosed in the Remuneration Report.

Joint ventures

The following material transactions took place between the Group and its joint ventures during 2001:

	2001 £'000	2000 £'000
Net loans during the year	**2,131**	8,431
Net trading	**2,671**	2,848
Royalties and management fees receivable	**2,448**	2,429
Dividends receivable	**9,645**	6,768
	16,895	20,476

The following receivable balances relating to joint ventures were included in the Group Balance Sheet:

	2001 £'000	2000 £'000
Amounts due within one year:		
Loans	**–**	196
Trading balance	**342**	760
Royalties and management fees	**3,915**	2,984
	4,257	3,940
Amounts due after more than one year:		
Loans	**9,567**	10,288

The following payable balances relating to joint ventures were included in the Group Balance Sheet:

	2001 £'000	2000 £'000
Amounts payable within one year:		
Loans	**14,165**	17,213
Trading balance	**699**	–
	14,864	17,213

Details of Group investments in joint ventures and other principal undertakings are given in Note 32.

31. Pension schemes

The Group has continued to account for pensions in accordance with SSAP 24. Full adoption of the requirements of FRS 17 'Retirement Benefits' will not be mandatory for the Group until the year ended 31 December 2003. The transitional disclosures required by FRS 17 are set out in Part (B) of this note which shows the net pension deficit in accordance with FRS 17 at 31 December 2001 was £3.6 million on an asset base of £298 million.

(A) SSAP 24 Disclosure

The net pension charge in accordance with SSAP 24 for the year ended 31 December 2001 was £19,544,000 (2000 – £17,851,000). The Group operates or is a member of a number of pension schemes as follows:

a) Serco Pension and Life Assurance Scheme ("SPLAS")

This is a pre-funded defined benefit scheme.

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.

Actuarial assessments covering expenses and contributions are carried out by independent qualified actuaries, with the last such review being carried out as at 6 April 1999. The average contribution rate is currently 18% for the scheme.

The projected unit method was adopted for the actuarial valuation of the Scheme for accounting purposes. The main actuarial assumptions used to value liabilities are:

Investment yield	8.0% p.a.
Salary growth	6.0% p.a. (including 0.5% in respect of promotion)
Increase in LEL offset	3.5% p.a. (SPLAS section only)
Price inflation	3.5% p.a.
Equity dividend growth	3.5% p.a.
Pension increases (in excess of GMP)	3.5% p.a. (for Serco Alternative Pension Scheme and Services section)
	3.0% p.a. (for SPLAS section accrual after 6/4/97)
	0.5% p.a. (for SPLAS section accrual prior to 6/4/97)

The Scheme is assessed to be fully funded on a current funding level basis based on a market value of assets of £145,881,000 at 6 April 1999. Liabilities for this purpose are calculated using the basis for determining individual cash equivalents for active members and deferred pensioners and by estimating the cost of purchasing annuity policies for pensioners.

The actuarial value of the assets represented 81% of the ongoing liabilities of the Scheme. Variations from the normal costs are amortised for accounting purposes over a fifteen year period as a constant monetary amount.

Employer pension contributions paid into the Scheme during the year were £9,760,000 (2000 – £8,861,000), of which £652,000 related to special contributions in respect of a discretionary increase to pensions in payment awarded during the year (2000 – £640,000) and £810,000 of contributions in respect of augmentations (2000 – £nil). A £15,000,000 contribution which is included in accruals and prepayments at 31 December 2001 was paid in February 2002.

At 31 December 2001 a prepayment of £17,360,000 (2000 – £1,550,000) in respect of the Scheme was included in the Balance Sheet. £8,950,000 was charged to the Profit and Loss Account in respect of the Scheme (2000 – £7,995,000).

31. Pension schemes (continued)

b) The Serco-IAL Pension Scheme

This is a pre-funded defined benefit scheme.

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.

Actuarial assessments covering expenses and contributions are carried out by independent qualified actuaries, with the last such review being carried out as at 31 March 2001. On the assumptions adopted for accounting purposes and based on a market value of assets of £104,037,000 at 31 March 2001, the actuarial value of the assets represented 110% of the ongoing past service liabilities of the Scheme as at that date. The current contribution rate is 17.8% for the scheme.

For accounting purposes, the projected unit method has been adopted and the main actuarial assumptions used to value liabilities are:

Investment return	6.0% p.a.
Salary growth (excluding salary scale)	4.5% p.a.
Pension increases	2.5% p.a.

The past service surplus in excess of the prepayment as at 31 March 2001 is being amortised for accounting purposes over a nine year period as a constant monetary amount.

Employer pension contributions paid into the Scheme during the year were £1,738,000 (2000 – nil).

An amount of £300,000 (2000 – £87,000) has been charged to the 2001 Profit and Loss Account in respect of the Scheme and a prepayment of £9,100,000 (2000 – £7,662,000) has been included in the Balance Sheet as at 31 December 2001.

c) Serco GmbH & Co. KG Pension arrangement

The German pension arrangement comprises two elements; an unfunded defined benefit arrangement and an unfunded hybrid scheme.

Actuarial assessments covering liabilities are carried out by independent qualified accountants, with the last such review being carried out as at 23 December 1999 and updated as at 31 December 2001 by a qualified independent actuary.

The projected unit method was adopted for the actuarial valuation of the arrangement. The main actuarial assumptions used in the valuation for accounting purposes were:

Discount rate	6.0% p.a.
Salary growth	3.0% p.a
Price inflation	1.0% p.a.

The Profit and Loss charge for the year was £130,000 (2000 – £520,000) and a provision of £23,003,000 (2000 – £23,829,000) has been included in the Balance Sheet as at 31 December 2001 of which £17,466,000 relates to the hybrid element of the scheme and £5,537,000 to the defined benefit element of the scheme.

31. Pension schemes (continued)

d) Serco Superannuation Fund

The defined benefit element of the scheme was established in Australia on 1 April 1993 to provide equivalent benefits for members transferring from the AWA Defence Industries Superannuation Fund, a defined benefit scheme.

Actuarial assessments covering expenses and contributions relating to the defined benefit element of the Scheme are carried out by independent qualified actuaries with the last such valuation being carried out as at 31 December 2000. The attained age method was used for the actuarial valuation of the Scheme as at 31 December 2000. This method was chosen to produce a level employer contribution rate as a proportion of members' salaries over the expected future working lives of the existing members, as the defined benefit element of the Scheme was closed to new members with effect from 1 April 1993.

The main actuarial assumptions used in the actuarial valuation for accounting purposes this year were:

Average long-term interest rate (net of investments and administration expenses and investment tax)	8.0% p.a.
Average long term allowance for salaries increases	5.5% p.a.

The defined benefit element of the Scheme was assessed to be fully funded on a current funding level based on a market value of assets of £1,385,000 (A$3,938,000) at 31 December 2000 with a ratio of market value of assets to current funding level liabilities of 107%.

The actuarial value of assets of the defined benefit element of the Scheme represented 115% of its ongoing liabilities at 31 December 2000. The pension cost calculated under the attained age method will amortise the above surplus over the expected future working lives of the existing members which have an average value of 11 years.

Employer pension contributions paid into the Scheme and charged to the 2001 Profit and Loss Account relating to the defined benefit element of the scheme was £104,000 (2000 – £117,000).

e) The NPL Management Limited Pension Scheme

This is a pre-funded defined benefit scheme. The Company accounts for this scheme as a defined contribution scheme since at re-bid 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.

Actuarial assessments covering expenses and contributions are carried out by independent qualified actuaries. The funding policy is to contribute such variable amounts as will achieve 100% funding on a projected unit basis. The last review was carried out as at 6 April 1998.

A review has been carried out as at 6 April 2001. Although this review has not yet been finalised the Company has increased its contribution rate to 20.8% of Pensionable Pay in line with the provisional results.

The main actuarial assumptions proposed in the valuation were:

Investment return	6.50% p.a. (5.0% for current pensioners)
Salary growth	4.25% p.a. (plus promotional scale)
Price inflation	2.25% p.a.
Pension increases	2.25% p.a.

The market value of assets represented 93% of the ongoing liabilities of the Scheme.

Employer pension contributions charged to the 2001 Profit and Loss Account were £1,634,000 (2000 – £1,730,000).

31. Pension schemes (continued)

f) The Serco Shared Cost Section of the Railways Pension Scheme ("RPS")

This is a pre-funded defined benefit scheme. The Company accounts for this scheme as a defined contribution scheme since at re-bid 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.

Actuarial assessments covering expenses and contributions are carried out by independent qualified actuaries. The funding policy is to contribute such variable amounts as will achieve 100% funding on a projected unit basis. The last review was carried out at 31 December 1998.

The main actuarial assumptions used in the valuation were:

Investment return	6.75% p.a.
Salary growth	4.50% p.a. (plus promotional scale)
Dividend growth	3.75% p.a.
Pension increases	3.00% p.a.

The actuarial value of assets represented 133% of the ongoing liabilities of the scheme. The current contribution rate is 7.5% of Section Pay.

Employer pension contributions charged to the 2001 Profit and Loss Account during the year were £634,000 (2000 – £527,000).

g) Serco Metrolink Pension Scheme

This is a pre-funded defined benefit scheme. The Company accounts for this scheme as a defined contribution scheme as at re-bid 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.

Actuarial assessments covering expenses and contributions are carried out by independent qualified actuaries. The funding policy is to contribute such variable amounts as will achieve 100% funding on a projected unit basis. The last review was carried out as at 1 September 1998.

The main actuarial assumptions used in the valuation were:

Investment return	9.0% p.a.
Salary growth	7.0% p.a.
Equity dividend growth	5.0% p.a.
Pension increases	4.0% p.a.

The actuarial value of assets represented 101% of the ongoing liabilities of the scheme. The current contribution rate is 8.2%.

Employer pension contributions charged to the 2001 Profit and Loss Account were £225,000 (2000 – £241,000).

h) Docklands Light Railway Pension Scheme

This is a pre-funded defined benefit scheme with Docklands Light Railway Limited being the principal employer. Serco accounts for this scheme as a defined contribution scheme, since at re-bid 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.

31. Pension schemes (continued)

h) Docklands Light Railway Pension Scheme (continued)

Actuarial assessments covering expenses and contributions are carried out by independent qualified actuaries. The funding policy is to contribute such variable amounts as will achieve 100% funding on a projected unit basis. The last review was carried out as at 1 April 1998. The main actuarial assumptions used in the valuation this year were:

Investment return	8.5% p.a.
Salary growth	6.5% p.a. (including promotional scale)
Pension increases	4.0% p.a.
Dividend yield	3.0% p.a.

The actuarial value of assets represented 100% of the ongoing liabilities of the scheme. The current contribution rate is 11.0%.

Employer pension contributions paid into the Scheme and charged to the 2001 Profit and Loss Account were £1,181,000 (2000 – £921,000).

i) Other defined contribution schemes

The Group paid employer contributions of £6,386,000 (2000 – £5,713,000) into UK and Australian defined contribution schemes and foreign state pension schemes.

(B) FRS 17 Disclosure

The net pension deficit for the funded UK pension schemes at 31 December 2001 under FRS17 is £3,614,000. The profit and loss reserves under FRS17 would have been as follows:

	2001 £'000
Profit and loss reserve	48,175
Deficit in relation to SPLAS scheme, net of deferred taxation	(5,740)
Surplus in relation to Serco IAL scheme, net of deferred taxation	2,126
Net pension deficit	(3,614)
Profit and loss reserve adjusted	44,561

a) Serco Pension and Life Assurance Scheme ("SPLAS")

The disclosures required under the transitional arrangements within FRS 17 have been based on the most recent full actuarial valuation as at 6 April 1999 updated to 31 December 2001 by independent qualified actuaries. The financial assumptions used at 31 December 2001 were:

Rate of increase in salaries	4.00% p.a.
Rate of increase in deferred pensions	2.25% p.a.
Rate of increase in pensions in payment	2.25% p.a.
Discount rate	5.83% p.a.
Inflation assumption	2.50% p.a.

31. Pension schemes **(continued)**

a) Serco Pension and Life Assurance Scheme ("SPLAS") (continued)

The Scheme's assets and the expected rates of return as at 31 December 2001 were:

	% p.a	£'000
Equities	7.25	119,600
AA corporate bonds	5.83	15,500
Gilts	5.00	21,000
Cash and Other	4.00	15,800
Total market value of assets		171,900
Present value of scheme liabilities		(180,100)
Deficit in the Scheme		(8,200)
Related deferred tax asset		2,460
Net pension liability		(5,740)

b) The Serco IAL Scheme

The disclosures required under the transitional arrangements within FRS 17 have been based on the most recent full actuarial valuation as at 31 March 2001 updated to 31 December 2001 by independent qualified actuaries. The financial assumptions used at 31 December 2001 were:

Rate of increase in salaries	4.00% p.a.
Rate of increase in pensions	
– RPI	2.50% p.a.
– LPI	2.25% p.a.
– discretionary	2.25% p.a.
Discount rate	5.83% p.a.
Inflation assumption	2.50% p.a.

The Scheme's assets and the expected rates of return as at 31 December 2001 were:

	% p.a	£'000
Equities	7.25	59,694
UK bonds	5.18	31,336
Property	6.54	7,329
Cash and other assets	4.00	78
Annuity policies	5.83	28,100
Total market value of assets		126,537
Present value of scheme liabilities		(123,500)
Surplus in the Scheme		3,037
Related deferred tax liability		(911)
Net pension asset		2,126

(c) The balance sheet position for all of the other Group Pension Schemes is the same in accordance with FRS17 as for SSAP 24.

32. List of principal undertakings

The companies listed below are, in the opinion of the Directors, the principal undertakings of Serco Group plc. The percentage of equity capital directly or indirectly held 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

United Kingdom	Serco Limited	100%
	Serco-Denholm Limited	90%
	Serco Europe Limited	100%
	Serco-IAL Limited	100%
	Serco Railtest Limited	100%
	Serco Systems Limited	100%
	Serco Research & Development Limited	100%
	NPL Management Limited	100%
	Serco Docklands Limited	100%
	Rakmulti Technology Limited	100%
	Serco QAA Limited	100%
	Traffic Information Services (TIS) Limited	100%
Rest of Europe		
Belgium	Serco Belgium S.A.	100%
Denmark	Metro Service A/S	67%
France	Serco France Sarl	100%
Germany	Serco International GmbH	100%
	Serco Services GmbH	100%
Ireland	Serco Services Ireland Limited	100%
Italy	Serco s.r.l.	100%
Guernsey	Serco Insurance Co. Limited	100%
Luxembourg	Serco Facilities Management S.A.	100%
The Netherlands	Serco Facilities Management BV	100%
Spain	Serco Gestion de Negocias SL	100%
Sweden	Serco Sverige AB	100%
Switzerland	Serco Facilities Management S.A.	100%
Asia Pacific		
Australia	Serco Group Pty Limited	100%
	Serco Australia Pty Limited	100%
	Great Southern Railway Limited	100%
New Zealand	Serco Group NZ Limited	100%
Hong Kong	Serco Group (Hong Kong) Limited (formerly Serco Guardian (FM) Limited)	100%
Other		
Canada	Serco Facilities Management, Inc.	100%
USA	Serco Group, Inc.	100%
	Serco, Inc.	100%
	Serco Management Services, Inc. (Delaware)	100%
	Barton ATC, Inc.	100%
	Serco Management Services, Inc. (Tennessee)	100%
	JL Associates, Inc.	100%

32. List of principal undertakings (continued)

Joint venture undertakings

United Kingdom	Premier Custodial Group Limited	50%
	Kilmarnock Prison Services Limited	50%
	Lowdham Grange Prison Services Limited	50%
	Medomsley Holdings Limited	50%
	Pucklechurch Custodial Services Limited	50%
	Moreton Prison Services Limited	50%
	Serco Gulf Engineering Limited	50%
	Defence Management Watchfield Limited	50%
	Laser (Teddington) II Limited	50%
	Altram (Manchester) Limited	26%
	Serco-Denholm Shipping Company Limited	50%
	AWE Management Limited	33%
	Serco Fleet Services Limited	50%
Asia Pacific		
Australia	Defence Maritime Services Pty Limited	50%
	Serco Sodexho Defence Services Pty Limited	50%
New Zealand	Serco Sodexho Defence Services Limited	50%
Other		
Bahrain	Aeradio Technical Services WLL	49%
Bermuda	BAS-Serco Limited	40%
Cyprus	Serco Kalisperas	50%
Dubai	International Aeradio (Emirates) LLC	49%
Saudi Arabia	Key Communications Development Co Limited	N/A
Singapore	Serco Guthrie Pte Ltd	50%
Turkey	Elektronik Sistemler Destek Sanavi ve Ticaret AS	51%

Full details of related undertakings will be attached to the Company's Annual Return to be filed with the Registrar of Companies.

Calendar of events

3 May
Annual General Meeting

10 May
Proposed payment of final dividend

September
Proposed announcement of interim results

October
Proposed payment of interim dividend

AGM
The Notice to the Annual General Meeting together with the relevant notes and proxy card will be sent to shareholders at the end of March 2002.

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did you know...

we now employ over **4,800** people in science activities.

to date we've completed **3,628** contract years and have **2,066** contract years still to run. So our current contract pipeline is equivalent to more than half the work we've ever done.

our air traffic controllers manage **496,216km^2** of airspace – in five countries.

Serco-run leisure facilities welcome almost **7,500,000** visitors a year in the **UK, Canada and Sweden** – equivalent to the population of Greater London.

traffic management systems installed and operated by Serco cover over **18,300km** of roads worldwide.

we provide secure computer and software support services to **66** UK law enforcement agencies.

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