

SERCO GROUP PLC  
ANNUAL REVIEW & ACCOUNTS  
2002



**Sercos Group plc – our mission:**

“to stay at the forefront of the outsourcing revolution in our chosen markets through the commitment, innovation and calibre of our people, the quality of our management processes and the strength of our corporate culture and values”

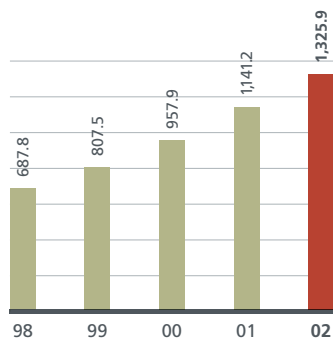


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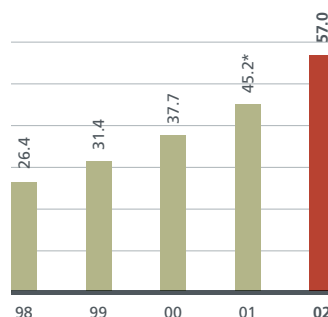
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## Financial & operating highlights



**TURNOVER £m**  
Including joint ventures



**PROFIT £m**  
Before amortisation of goodwill

	2002	Restated 2001*	
TURNOVER	<b>£1,325.9m</b>	£1,141.2m	up 16.2%
PROFIT BEFORE TAX – pre-goodwill	<b>£57.0m</b>	£45.2m	up 26.3%
EARNINGS PER SHARE – pre-goodwill	<b>9.58p</b>	8.25p	up 16.1%
DIVIDEND PER SHARE	<b>2.08p</b>	1.86p	up 11.8%

\* The 2001 accounts have been restated after the adoption of UITF Abstract 34 *Pre-contract costs* in 2002.

### Serco delivers 15th successive year of double-digit growth

#### Excellent organic growth

- 64% of turnover growth from existing contract base

#### Robust cash performance

- 75% of EBITDA converted to cash

#### Continued success in winning contracts

- Contract wins totalling £1.2bn
- 122 new contracts awarded
- A further 180 contracts successfully rebid or extended, maintaining our 90% success rate
- In January 2003 we won our largest-ever contract award: a 15-year extension to the Atomic Weapons Establishment contract, adding over £1bn to our forward order book

#### Substantial range of future opportunities

- Currently addressing a further £12bn of opportunities

#### Continuing high visibility of revenues

- 91% of 2003 turnover secured
- Order book stands at £7.1bn

# WHAT SORT of BUSINESS ARE we? a

Serco is one of the world's largest outsourcing businesses, operating in Europe, the Middle East, Asia Pacific and North America. Nearly a third of our turnover comes from outside the UK.

Our core products are the skills and processes for organisational design and change management. We are focused on the public sector – which represents 90% of our business – and have a strong public service ethos. In partnership with our customers and staff we aim to enhance service levels and operational efficiency by shortening decision-making chains, reducing bureaucracy and achieving continuous improvement.

We apply our skills in an extraordinarily diverse range of fields. We run world-class scientific establishments and railways, maintain offices and spacecraft, manage schools, prisons and motorway systems, test military assets and control air traffic. In every case, our job is to make our customers' operations more efficient. We can do this by managing existing facilities, projects and systems. Or we can create entirely new facilities – raising finance, designing and procuring them, then operating them.



### A growth business

Since flotation in 1988 we've averaged over 20% annual growth in both sales and profits. And we've achieved this largely by organic growth rather than by acquisition.

### A predictable business

Our future earnings and cash flows are highly visible. Our contracts run typically for 5-10 years, and in practice our high renewal rate means they can last for decades. Our forward order book currently stretches to 2028. The income from our contracts is highly dependable: some 90% comes from governments and international agencies, the rest from major corporations.

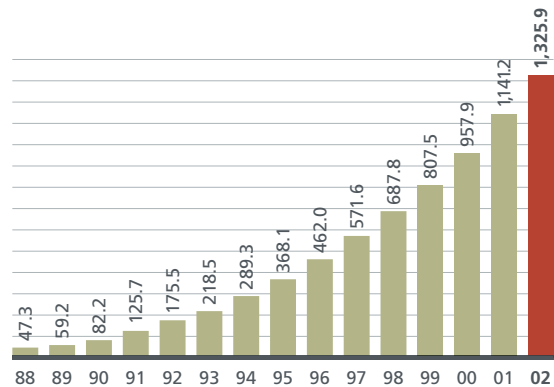
### A diverse business

Our contracts are spread across many countries worldwide and a remarkable range of activities. This diversity brings three key benefits:

- Broader exposure to growth opportunities – we can direct funds and people into those that offer the best returns.
- Better risk management – downturns in individual markets and geographies can be offset by growth in others, and we can use our established skills to drive business performance while developing new skills for emerging markets.
- Better product development – we develop competencies and centres of excellence around the world, and share best practice across the whole portfolio.

### A versatile business

Our management processes are designed to exploit the benefits of diversity. We've developed the Serco Management



**TURNOVER £m**  
Including joint ventures

System as a common framework for all our contracts, in whatever field of activity. It allows contract managers a high degree of autonomy while maintaining consistency of culture, values and standards – and provides an effective mechanism for monitoring and control. The Serco Best Practice Centre and Serco Our World intranet ensure that every contract has access to what we learn.

#### **A change business**

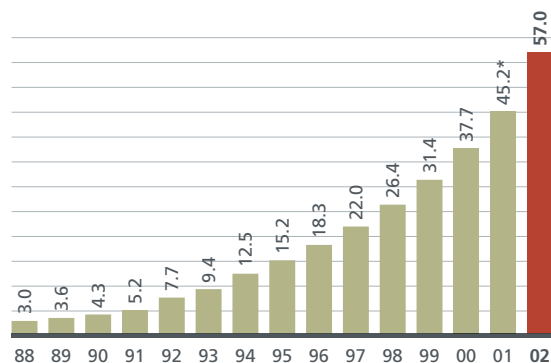
Our core task is to manage positive change within organisations, making them more efficient and improving the service they deliver. Serco's management processes are specifically designed to help plan and manage change. We instil customer focus, reduce bureaucracy, encourage staff to take on broader roles – and have well-developed techniques for measuring progress.

#### **An innovative business**

We don't see change as a one-off exercise: we focus on continuously adding value to customers' operations over time. So we're never content with the status quo. The relentless pursuit of constant improvement is part of our culture – and underpins our success rate of over 90% on contract rebids and extensions.

#### **An entrepreneurial business**

One way to manage an outsourcing contract is to focus on cost cuts. From the bid stage onwards, we take a more rounded view: if it was a business, how would we improve it? Can we extend our range of services? 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



#### **PROFIT £m**

*Before amortisation of goodwill*

*Over the last 15 years the group has achieved compound average annual growth in excess of 23% in turnover and profit. The majority of this growth has been through additions to our contract portfolio with little impact through acquisitions.*

\* The 2001 accounts have been restated after adoption of UITF 34 *Pre-contract costs* in 2002.

to keep adding value, constantly improving our performance. It's also why a significant proportion of our new business in any year comes from broadening the scope of existing contracts: if we show customers what we can do, they often invite us to do more.

**A public service business**

As our national and local government customers would expect, we have a strong public service ethos. This is not the same as a public sector ethos: we believe passionately that private sector companies bring distinct benefits to the task of delivering public services. In the words of the recent UK Confederation of British Industry (CBI) Statement of Intent on public private partnerships, which we helped to formulate, a public service ethos revolves around 'customer service, a sense of duty, fairness, openness and accountability'.

**An ethical and transparent business**

We deliver public services, and we change the way people work. In both capacities we touch people's lives and we recognise our responsibility to act ethically and sensitively. Our culture is open and collaborative: we aim to form productive partnerships with both staff and customers. We recognise our responsibilities to investors, too: we aim to communicate clearly and transparently with them and to account for our performance straightforwardly.

**A socially engaged business**

We also recognise our role in the wider community. We do not believe Serco can or should stand apart from the societies in which it operates: we aim to engage positively with local communities and to minimise our impact on the environment. Accountability for corporate social responsibility at a local level is part of every contract manager's job.



# what kind of a year HAVE we HAD? a

## CHAIRMAN'S STATEMENT

Sero has delivered another impressive performance – our 15th successive year of strong and profitable growth. In addition we have already secured 91% of our planned revenue for 2003 and 80% of our planned revenue for 2004.

Our markets remain buoyant. Our forward order book continues to grow and, at £7.1bn, is roughly 5.5 times last year's turnover. We are currently addressing a further £12bn of opportunities across a range and scale of activities that ensures we can continue to bid selectively.

Our portfolio approach to a wide range of public sector markets has provided a strong platform during this period of difficult global economic conditions. We remain confident of achieving double-digit growth both this year and over the longer term.



I am delighted to report another excellent performance – our 15th successive year of strong and profitable growth. Turnover was up 16.2% and pre-tax profits rose 26.3% before goodwill, maintaining our record of consistently high growth. In delivering this growth we have continued to convert a high proportion of profits into cash while funding the working capital required to bid successfully and implement new business activities and contracts. This is a very satisfying result for a year that proved unsettling for the support services sector in the UK.

Our vigorous organic growth reflects Serco's key strengths: our long term contract base, ability to enhance customers' operations continuously, and long experience of delivering outsourced public services across a wide range of markets. We have a well-diversified portfolio, rigorous risk management processes integrated with the way we do business, and a selective approach to bidding.

Contract wins during the year totalled £1.2bn. We won 122 new contracts, achieving our target of winning over half of new bids. In addition, we were awarded 180 rebids or extensions to existing contracts, maintaining our success rate of over 90% in this area.

#### Financial performance

Turnover grew 16.2% to £1.3bn. Pre-tax profits were up 26.3% to £57m before goodwill amortisation and by 22.2% to £48.9m

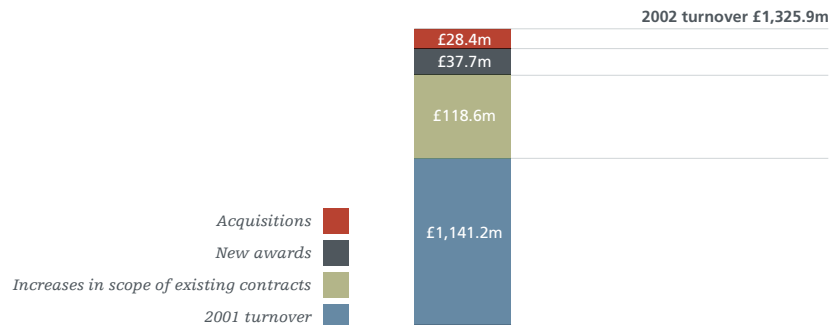
after goodwill amortisation. There were no exceptional items in 2002.

Earnings per share rose 16.1% to 9.58p before goodwill and 10.4% to 7.66p after goodwill.

Cash generation remains robust, with 75.1% of group EBITDA (Earnings Before Interest, Tax, Depreciation and Goodwill Amortisation) converted into cash.

We raised £117.4m through an international placing of new shares in March. This was partly to refinance the September 2001 acquisition of AEA Technology's nuclear consulting business – now successfully integrated into Serco Assurance – and partly to strengthen the balance sheet to facilitate future growth. Since flotation in 1988 Serco has raised new equity totalling £161m – less than our acquisition costs of £180m over the same period. Apart from this, we have funded our growth from under £50m to over £1.3bn annual sales entirely from internally-generated cash flow.

More sophisticated forms of contract inevitably mean more complex financial statements. In response, we have introduced Financial Review sections to our annual and interim results announcements and continue to extend our commentary on relevant aspects of accounting and corporate governance. To help investors better understand our Private Finance Initiative



**2002 TURNOVER GROWTH**  
Including joint ventures

(PFI) projects we have also published *Our Approach to PFIs*. The latest edition, updated in September 2002, is available on our website at [www.serco.com](http://www.serco.com) or on request.

### Dividend

The recommended final dividend of 1.44p per share gives a cumulative dividend for the year of 2.08p – an increase of 11.8% over 2001. It is proposed that the dividend will be paid on 13 May 2003 to shareholders on the register on 28 February 2003 (record date).

### Pensions

The recent poor performance of the equity markets has impacted the group's defined benefit pension schemes. A valuation at 31 December 2002 has identified a net deficit of £73.6m in accordance with FRS 17 on our defined benefit schemes. This will result in additional funding and an additional profit and loss charge of £9m per annum. Notwithstanding this increase in contributions, we remain on course to achieve good growth going forward.

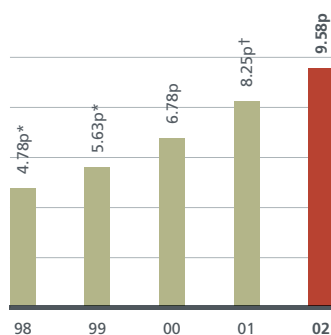
### Operational performance

Our business is made up of five distinct areas: defence (which accounted for 27% of 2002 sales), transport (27%), civil government (27%), science (9%) and private sector clients (10%). Within these sectors, revenues from PFI contracts accounted for 12% of total sales.

The year was characterised by strong organic growth built on solid foundations: a track record of effectiveness that attracts and convinces new customers, strategic alliances with partners who enhance our capability and credibility, and an approach to working with customers that encourages partnerships, extensions and broadening of relationships. As in the past, a significant part of our turnover growth has come from add-ons and extensions to existing contracts.

Major contract awards in 2002 included an innovative partnership with the UK's Ministry of Defence (MOD) Warship Support Agency to manage the Devonport, Portsmouth and Clyde marine services contract. This three-year partnership, worth up to £110m, builds on an earlier contract we have had since 1996. We also won a partnership contract to provide communications and information technology services to the Defence Scientific and Technical Laboratory, worth some £10m annually for up to eight years.

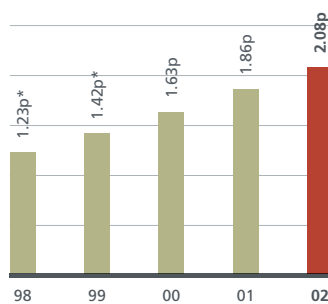
As a member of the Paradigm Secure Communications team, which was selected in February 2002 as preferred bidder to provide and operate Skynet 5 global military satellite communications services, Serco will be providing network and facilities management. This is the largest UK MOD PFI to date, potentially worth some £220m to Serco over 15 years, and good progress continues to be made towards contract signature.



**BASIC EARNINGS PER SHARE**  
*Before amortisation of goodwill*

\* Restated to reflect the capitalisation issue on 5 April 2000.

† Restated after the adoption of UITF Abstract 34 in 2002.



**DIVIDEND PER SHARE**

As in any year there were a few disappointments – principally our unsuccessful bid to manage the Army Training Estate and Essex County Council's decision not to pursue the outsourcing of educational services. But disappointment over the Essex decision was tempered by continuing growth for our education business in Walsall: the local council transferred a further 300 staff to us, tripling the value of our contract to £100m over the remaining 5½ years. This followed a very favourable review of our performance by Ofsted, the education regulator, which led to a decision to transfer the majority of Walsall's Local Education Authority activities to Serco.

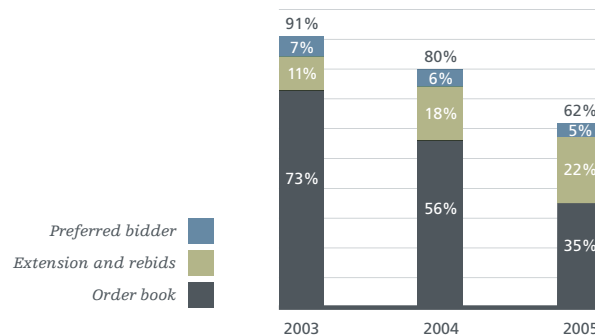
This was one of many cases where strong performance was rewarded with substantial contract extensions. Others included the National Crime Squad, which more than doubled the size of our partnership contract to support its IT operations and to design and develop its Intelligence Management System. In the US, the Federal Aviation Administration significantly broadened our role: we are already one of its largest private providers of air traffic control services, and it has now awarded us a contract to provide weather observation services.

The largest addition of all – indeed, the largest contract ever awarded to the group – was announced in January this year:

a 15-year extension to the contract under which we manage the UK's Atomic Weapons Establishment (AWE) in partnership with Lockheed Martin and British Nuclear Fuels (BNFL). The contract will now run until 2025, adding over £1bn to our forward order book.

Our stature as a light rail operator continues to grow. For an unprecedented second year running we won the UK Rail Operator of the Year award, recognising our operational excellence and innovative customer service on London's Docklands Light Railway (DLR). We intend to build on our achievements with the DLR, Manchester Metrolink and Copenhagen Metro by selectively addressing additional rail operating opportunities. We have formed a joint venture with NedRailways, the international arm of Dutch national rail operator Nederlandse Spoorwegen, to pursue some of these.

In the UK our strategy is to build on our contract base and to expand into new areas. While continuing to grow in our traditional markets, we seek out contracts that require greater managerial or technological sophistication, with structures that focus on outputs rather than specified inputs. We continue to bid for selected PFIs and expect our PFI projects to deliver sustained long term benefits both to the public and to our investors. They and their associated service contracts



**NEAR TERM CONFIRMED ORDER BOOK  
AS AT FEBRUARY 2003**

*Percentage of planned revenue for the year.*

will provide an income stream to supplement our revenues from traditional contracts. Under the auspices of the CBI public services strategy board, we have joined other public service providers in a programme to promote better understanding of the benefits of public private partnerships. This aims to stress their importance and effectiveness in obtaining value for money and diversity in public service delivery.

Our commitment to international diversification – with 30% of our current business turnover overseas – is one of the factors that differentiates us in our sector. But the sheer scale of opportunities open to us in the UK means that we have to be selective. In Europe we see particular opportunities in Italy and Germany, and are making encouraging progress in both. In the Middle East our activities and profile continue to develop well. In Asia Pacific we are focusing principally on Australia and New Zealand, where state governments continue to develop policies on public private partnerships. In North America we see public private partnerships emerging in both the US and Canada: these countries potentially represent a major long term market for our skills and experience.

To concentrate management and financial resources on the most promising opportunities and markets at home and abroad, we continue to review our business portfolio.

This enables us to sharpen our focus on contracts offering superior growth, margins and cash generation, and may lead to minor divestments of certain activities.

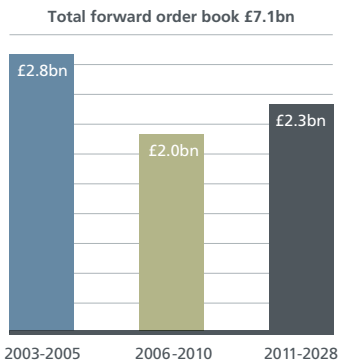
**Risk management**

One of the keys to Serco’s consistently robust performance is its management system and control framework. Our operations are diversified across some 600 contracts and a range of business sectors. Few contracts represent more than 2% of our turnover and the largest represents only 7%.

The high degree of autonomy that we give to our contract managers is balanced by rigorous monitoring and unobtrusive but effective controls. In 2001 we set up our Corporate Assurance Group (CAG) to integrate our approach to assessing business risks and improving controls, and to ensure that we safeguard the interests of shareholders, customers, staff and the wider community. Reporting directly to the Board, CAG is proving a valuable asset in risk management.

**Corporate social responsibility**

Although Serco is a private sector business, we earn our living predominantly by delivering public services. We need to demonstrate a public service ethos, as a pre-requisite of our partnership with public sector customers.



LONG TERM ORDER BOOK AS AT FEBRUARY 2003

We take our corporate social responsibility (CSR) seriously. Under our corporate governance framework every contract manager is directly accountable for CSR performance. We have established a global network of CSR champions to raise general awareness and support initiatives that range from developing an alternative water supply for Goose Bay residents in Canada to collecting tonnes of stationery for schools and orphanages in Kabul. We continue to refine our approach and are currently developing a new structure for charitable giving. This is designed to support initiatives by our contracts and individual employees, direct resources towards the communities where we work and recognise the personal commitment of Serco people.

#### **People**

Serco's continuing success comes from the outstanding dedication of our people and their personal identification with what they do. In a MORI survey of a cross section of staff, 95% regarded their work as 'more than just a job'. Other positive indications – given our drive for continuous improvement and evolution to meet customer needs – were that around three quarters said they understood workplace objectives and the need for change, and two thirds actively supported the change process. We are grateful for all our people's energy, enthusiasm and imagination – which add value both to our business and to our customers' operations.

We continue to build constructive relationships with trade unions. In the UK we support the Partnership Institute launched by the Trades Union Congress (TUC) to foster co-operative relationships between employers and unions.

We have formed a number of 'working partnerships' with unions at contract level and are investigating further opportunities.

To support and sustain our growth, we attach great importance to training and developing our managers. During the year the Serco Best Practice Centre provided courses and workshops around the world, and our global intranet played an important role by giving people access to training and development online. In a ground-breaking partnership with the UK's Institute of Directors (IoD) we have developed a joint IoD/Serco Certificate in Company Direction assessed and recognised by the IoD. The first 19 Serco managers were awarded the qualification during the year.

#### **Outlook**

The committed future income streams from our contracts give us the assurance of highly visible revenues and profits. At the time of writing we have already secured 91% of our planned revenue for 2003 and 80% of our planned revenue for 2004.

Our forward order book continues to grow. On 31 December it stood at £6.1bn, and it now stands at £7.1bn – roughly 5.5 times last year's turnover. We are currently addressing over £12bn of opportunities and our markets are buoyant. Both at home and abroad, opportunities are emerging at a rate which continues to allow us to bid selectively.

Our portfolio approach to a wide range of public sector markets has provided a strong growth platform during this period of difficult global economic conditions. We remain confident of achieving double-digit growth both this year and over the longer term.

# WHAT do the NUMBERS MEAN?



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## FINANCIAL REVIEW

This year's results show a business that's growing well and increasingly profitable. Turnover increased by 16.2% and pre-tax profit before goodwill amortisation was up 26.3%. Earnings per share rose by 16.1%. Cash flow performance was robust. We converted 136% of operating profit and 75% of Group EBITDA into cash.



## 1 PROFIT AND LOSS ACCOUNT

2002 was another year of strong performance which is further analysed in figure 1 opposite.

### 1.1 Turnover

Total turnover increased by 16.2% to £1,325.9m. This includes a contribution of £43.3m (2001 – £12.1m) from Serco Assurance (formerly the nuclear consulting division of AEA Technology), which was acquired in September 2001.

### 1.2 Gross profit

Gross profit of £150m increased by 20.9% and represents a return on group turnover of 13.7% (2001 – 13.6%).

### 1.3 Pre-tax profit

Pre-tax profit before goodwill amortisation increased 26.3% to £57m.

### 1.4 Underlying pre-tax profit

There were no exceptional items in 2002. In order to allow comparison of the year on year results, the growth in underlying pre-tax profit is shown in figure 2 opposite.

Underlying pre-tax profit grew 20.1% to £54.9m. Underlying profits are stated after:

- A £2.1m (2001 – £0.5m) contribution from Serco Assurance
- A prior year adjustment of £1.2m in 2001 made on the adoption of Urgent Issue Task Force (UITF) Abstract 34 in 2002; this is explained in greater detail in *Bid costs*
- A net contribution in 2001 of £0.2m from three one-off items.

### 1.5 Tax

The tax charge for 2002 was £16.6m (2001 – £13.0m), representing an effective tax rate of 34.0% (2001 – 32.5%). The increase in the effective rate is largely as a result of an increased year on year level of goodwill amortisation.

### 1.6 Earnings per share

Taking into account the above and the increased capital base resulting from the equity placing in March, earnings per share before goodwill amortisation grew by 16.1% to 9.58p.

## 2 DIVIDENDS

The proposed final dividend of 1.44p per share gives a cumulative dividend for 2002 of 2.08p, an 11.8% increase on 2001.

## 3 SHARE PLACEMENT

In March £117.4m (net of fees) was successfully raised through an international bookbuilt placing of 39.5m new shares representing 9.9% of Serco's issued share capital. This enabled the Serco Assurance acquisition finance to be repaid and the Balance Sheet to be strengthened to facilitate future growth.

Since flotation in 1988 Serco has raised new equity totalling £161m, roughly equivalent to our acquisition costs of £180m over the same period. Apart from this, we have funded our growth from under £50m to over £1.3bn of annual sales entirely from internally generated resources.



FIGURE 1 PROFIT AND LOSS ACCOUNT

	2002 £m	Restated* 2001 £m	Change %
Total turnover	1,325.9	1,141.2	16.2
Group turnover	1,097.3	913.7	
Joint venture turnover	228.6	227.5	
Gross profit	150.0	124.0	20.9
Other administrative expenses	(112.8)	(97.6)	
Exceptional items	–	5.2	
Joint venture profit	23.9	18.7	
Group interest	(4.1)	(5.1)	
Profit before goodwill and tax	57.0	45.2	26.3
Goodwill	(8.1)	(5.1)	
Profit before tax	48.9	40.1	
Tax	(16.6)	(13.0)	
Profit after tax	32.3	27.1	
Effective tax rate	34%	32.5%	
Average number of shares	421.8m	389.6m	
Earnings per share before goodwill	9.58p	8.25p	16.1
Earnings per share after goodwill	7.66p	6.94p	

FIGURE 2 UNDERLYING PRE-TAX PROFIT

	2002 £m	Restated* 2001 £m	Change %
Reported pre-tax profit before goodwill amortisation	57.0	45.2	26.3
2001 Acquisition: Serco Assurance	(2.1)	(0.5)	
Prior year adjustment: UITF Abstract 34	–	1.2	
Net one-off items	–	(0.2)	
Underlying pre-tax profit before goodwill amortisation	54.9	45.7	20.1

\* The 2001 accounts have been restated after the adoption of UITF Abstract 34 *Pre-contract costs* in 2002 (see *Bid costs* on page 19 for more information).

FIGURE 3 CASH FLOW

	2002 £m	Restated* 2001 £m
Operating profit before one-off items	29.1	21.3
Non-cash items – Depreciation and goodwill	23.6	18.3
Group EBITDA	52.7	39.6
Working capital movement	(13.1)	(13.9)
Operating cash flows before one-off items	39.6	25.7
Pension payment	(15.5)	–
Exceptional items	–	6.1
Dividends from joint ventures	11.1	9.6
Interest and taxation	(11.9)	(12.0)
Capital expenditure	(23.6)	(17.6)
Disposals of tangible assets	8.1	4.6
Other items	1.9	(7.5)
Free cash flow	9.7	8.9
Acquisitions/disposals	(10.3)	(73.6)
Share issues	117.9	2.0
Other financing	(3.8)	(11.9)
Dividends paid	(8.3)	(6.7)
Net cash flow	105.2	(81.3)
Closing cash/(overdraft)	69.4	(35.8)
Long term loans	(47.4)	(45.6)
Other loans and finance leases	(15.7)	(12.1)
Recourse net cash/(debt)	6.3	(93.5)

\* The 2001 accounts have been restated after the adoption of UITF Abstract 34 *Pre-contract costs* in 2002 (see *Bid costs* on page 19 for more information).

## 4 CASH FLOW

During the year there was a net cash inflow of £105.2m. This inflow was after a one-off payment of £15.5m into the Serco Pension and Life Assurance Scheme in February and includes £117.4m from a share placing in March. This cash inflow contributed to the reduction in Group net debt/funds, excluding non-recourse PFI debt, from £(93.5)m to £6.3m respectively, as detailed in figure 3 opposite.

### 4.1 Operating cash flow before one-off items

Operating cash flow, before one-off items, was up 54% to £39.6m (2001 – £25.7m), which converts 136% (2001 – 121%) of our operating profit into cash.

We believe that, as operating profit is calculated after deducting goodwill and depreciation, the appropriate measure for operating cash flow performance is the conversion of Group EBITDA before one-off items into operating cash flows. For 2002 this was 75.1% (2001 – 64.9%).

The working capital movement reflects the strong level of organic growth shown by the Group in 2002 and equates to approximately one month's incremental turnover, reflecting the typical invoicing cycle of our contracts.

### 4.2 Joint ventures

Serco has two types of joint ventures: those which represent traditional operating contracts, such as the Atomic Weapons Establishment (AWE) and Premier Custodial Group (PCG); and those reflecting Serco's equity stakes of up to 50% in PFI Special Purpose Companies (SPCs).

Dividends received from joint ventures during 2002 of £11.1m (2001 – £9.6m) represents a 67% (2001 – 76%) conversion of profit of joint ventures, after tax, into cash.

### 4.3 Capital expenditure

Capital expenditure, excluding investment in PFI SPCs, for the year was £23.6m (2001 – £17.6m). As a proportion of Group turnover this expenditure represents 2% and has remained at a similar level to previous years.

### 4.4 Net debt

In addition to the recourse debt shown in figure 3, the Group has a non-recourse loan to fund the construction of the Traffic Control Centre (see Private Finance Initiatives on page 18). At the end of 2002 this loan was £29.7m (2001 – £14.1m). Non-recourse debt is excluded from the Group's banking facility covenants but is presented as a liability in the Group's Balance Sheet.

## 5 PENSIONS

In 2002, two of Serco's pension schemes were accounted for as defined benefit schemes.

The total 2002 pension charge for Serco was £29.1m (2001 – £19.5m), with the two UK defined benefit schemes having a cost of £12.5m (2001 – £9.3m).

FRS 17 *Retirement Benefits* was issued in November 2000 to replace SSAP 24 for accounting periods ending on or after 22 June 2003. In July 2002 the Accounting Standards Board delayed the introduction of FRS 17 until 2005, following an

announcement by the International Accounting Standards Board that it would also issue a new standard.

For 2002 we have continued to apply the transitional rules and disclosures. FRS 17 requires the market value of assets and liabilities for defined benefit schemes to be calculated and included in the Balance Sheet. At 31 December 2002 we estimate there was a net deficit of £73.6m in relation to the defined benefit schemes and an asset base of approximately £294.4m, whilst the Minimum Funding Rate (MFR) funding level was 100%. Long term company contribution rates will increase by approximately £9m per annum from 2003.

In February 2003 we merged Serco's two defined benefit pension schemes to achieve cost and investment efficiencies. To assist this process £15.5m was injected into the Serco Pension and Life Assurance Scheme in February 2002 to achieve a similar funding level for both schemes. The investment profile of the merged scheme will be kept under continuous review to match the asset and liability profiles.

## 6 PRIVATE FINANCE INITIATIVES

### 6.1 Disclosure

The document *Our Approach to PFIs*, which was originally issued in 2001, was updated in September 2002 and provides a summary of our accounting for PFIs. It is available on our website [www.serco.com](http://www.serco.com) or on request.

### 6.2 PFI profile

For 2002 PFIs contributed £154m to turnover and £17.7m to profit before tax for the year, of which £110.4m of the turnover and £6.4m of the profit related to the operating contracts, and £43.6m of the turnover and £11.3m of the profit to Serco's share of the SPCs.

### 6.3 SPC funding

SPC funding is via long term loans which are non-recourse to Serco.

- Our share of non-recourse debt of joint venture SPCs at the end of 2002 is £206.7m. This is included as a liability within investments in joint ventures on our Balance Sheet.
- Traffic Information Services (TIS) Limited is the first SPC where Serco has chosen to own 100% of the equity. This SPC has the contract to deliver the Traffic Control Centre contract. A non-recourse loan of £29.7m to fund the asset, currently in the course of construction, is included in long term creditors in the Balance Sheet. Construction completion is anticipated in early 2004, when the non-recourse loan will equate to approximately £60m.
- In June 2002 the lenders to the Joint Services Command and Staff College PFI agreed to change the terms of the senior debt. This transaction had no effect on profit but allowed £6.7m of cash to be paid from the SPC to Serco by way of dividend and loan.

## **7 REVIEW OF JOINT VENTURE ACCOUNTING AND CONTROLS**

In March 2002, in recognition of the perceived uncertainties arising from certain joint venture accounting practices in the US, the Board undertook a specific review, including asking Deloitte & Touche to undertake an independent review of our accounting procedures and internal controls over our joint ventures. This review confirms the Board's view that all our joint ventures exist for genuine commercial reasons, are correctly accounted for and that our controls and disclosures are appropriate.

## **8 BID COSTS**

UITF Abstract 34 *Pre-contract costs* was issued in May 2002 for accounting periods ending on or after 22 June 2002. UITF Abstract 34 requires all bid costs to be expensed up to the point where award of a contract is 'virtually certain'. Bid costs incurred after this point may be capitalised. At 31 December 2001 we had £1.2m of bid costs capitalised in relation to contracts for which we had not reached preferred bidder status. Applying the Abstract has resulted in a small prior year adjustment to treat these capitalised costs as expensed in 2001. Having made this adjustment, our accounting policies now fully comply with UITF Abstract 34.

## **9 DEFERRED TAXATION**

Financial Reporting Standard (FRS) 19 *Deferred Taxation* was issued in December 2000 for accounting periods ended on or after 23 January 2002. FRS 19 requires full provision to be made for deferred tax assets and liabilities arising from timing differences between the recognition of gains and losses in the financial statements and their recognition in a tax computation.

The tax charge for the year has been calculated in accordance with FRS 19. The adoption of FRS 19 has not had a material effect on the tax charge, as the Group did not have a material level of unprovided deferred tax liabilities or unrecognised deferred tax assets.

## **10 TREASURY POLICIES**

### **10.1 Treasury management**

The Group's tax and treasury function is responsible for managing the Group's exposure to financial risk. It operates within policies approved and reviewed by the Board, which include controls on the use of financial instruments. The Group reviews the credit quality of counterparties and limits individual aggregate credit exposures accordingly.

### 10.2 Liquidity management

The Group funds its operations through bilateral bank credit facilities and a long term US Private Placement of loan notes ('the US Notes'). Borrowings under the bank facilities are floating rate, unsecured obligations with covenants and obligations typical of these types of arrangements.

At the end of 2002 committed bank credit facilities totalled £50m, a further £111m annually renewable uncommitted bank facilities were undrawn. The committed bank facilities mature in November 2005. The US Notes mature in December 2007.

### 10.3 Foreign exchange risk

Due to the nature of the Group's business, which in general does not involve a significant amount of cross-border trade, the Group is not exposed to material foreign currency transaction risk, as sales and costs are approximately matched within overseas operations.

The Group does not hedge the sterling equivalent of the net assets of its overseas operations on the grounds that the market value of these businesses does not represent a significant proportion of the market value of the Group and because foreign exchange differences are unlikely to have a material effect on the consolidated net asset value of the Group.

The US Notes were issued in US dollars but the principal obligation has been swapped into sterling consistent with the risk profile set out above.

### 10.4 Interest rate risk

The Group's exposure to interest rate fluctuations on its borrowings and deposits is selectively managed, using interest rate swaps. The element of the US Notes that has not been swapped into floating rates is considered to offer adequate protection from interest rate fluctuations in the current market and given the Group's current low level of net debt. All shorter term debt is maintained at floating rates of interest.

# WHAT have we BEEN doing and WHERE?

## BUSINESS REVIEW

One of our greatest business strengths is our diversity – we apply our management skills across a broad range of activities and geographic markets around the world.

In addition to maintaining our 90% rebid win rate, during the year we continued to extend our capabilities, winning new contracts and forming new partnerships across our principal markets in defence, transport, civil government, science and the private sector. We maintained strong growth in the UK, made good headway in our priority markets in Europe and the Middle East, broadened our base in North America, and consolidated our position in Asia Pacific.



In the following pages we review the year's activities by sector and provide an overview of our operations and markets worldwide.

### **DEFENCE**

Defence, our longest-established market, accounted for 27% of sales in 2002.

Defence and security activity has increased in all our regions. In the UK the Chancellor's 2002 Comprehensive Spending Review will raise defence spending by £3.5bn to £32.8bn in 2005/06 – the largest planned real-terms increase in 20 years.

Serco is a major provider of services to the UK Ministry of Defence (MOD), which has been in the forefront of developing cost-effective ways to outsource defence support activities. We are encouraged by the Defence Logistics Organisation's declared intention of moving from 'provider to decider' on delivery of services, and expect MOD spending on outsourcing to double, reaching £6.5bn by 2010. We are also a leading provider of services to the Australian and New Zealand forces.

Our strategy is to retain and expand our existing business, leveraging our core capabilities into new but related areas and selected major bid opportunities. We currently hold over £2.5bn worth of defence contracts and see no shortage of future opportunities.

The defence sector accounted for our largest-ever business win at the start of this year. In January 2003 the MOD agreed a 15-year extension to our contract for managing the Atomic Weapons Establishment (AWE) in partnership with Lockheed Martin and BNFL. Since we began the original 10-year contract in 2000 we have delivered all milestones on time, surpassed 13 out of 16 performance targets and won the UK's

top award for industrial safety performance at the site. The extension, until 2025, brings the total contract value for Serco to over £1.7bn and will enable AWE to raise external capital if required for investment to continue developing the site as a world-class scientific facility with safety at the heart of its mission. Meanwhile, investments at AWE during the year included installation of the UK's most powerful computer, which has cut program run time from two months to 15 minutes for some applications.

In February 2002 the Paradigm Secure Communications team was selected as preferred bidder for the largest defence PFI to date – to provide Skynet 5 global military satellite communications services to the UK armed forces. Serco will provide network and facilities management services including spacecraft and network operations, network maintenance, training, supply management and through-life buildings and facilities maintenance under a contract potentially worth £220m to us over 15 years. Our team has already commenced the implementation of our phase-in plan and good progress continues to be made towards contract award.

The Warship Support Agency signed a partnering agreement with our Serco Denholm joint venture – 90% owned by Serco – to manage the Devonport, Portsmouth and Clyde marine services contract. This three-year partnership, worth up to £110m, builds on an earlier contract awarded in 1996. The aim is to reduce overall costs by generating new solutions for long term provision of marine services.

Our strength in IT seat management at scientific and secure sites helped us win a five-year contract with the Defence Scientific and Technical Laboratory. We will



provide communications and information services to this agency, which currently has over 3,000 staff at sites across the UK. The contract has options for three one-year extensions and additional scope, which together could take the value from a baseline £30m to as much as £80m.

We successfully strengthened our position in services to electronic warfare operations, with an MOD contract to provide multi-activity services to the Electronic Warfare Tactics Range at RAF Spadeadam. And in a competitive rebid we won a further five-year contract from NATO to provide engineering services to its Multi-service Electronic Warfare Support Group at Yeovilton. This is the latest extension to a contract we first won in 1984 and competitively rebid in 1998.

At HMND Clyde we began a partnership with Babcock Naval Services who now operate the site. Under a five-year contract worth £26m we will provide a one-stop shop for estate management services.

We won three important MOD rebids with a total operational value of over £30m. At RAF Halton we have a wide-ranging contract that extends through general engineering and management of the armoury to cleaning and media services. On Ascension Island we provide a comprehensive range of engineering, supply and support functions for the RAF. At Wattisham Station, where we provide air traffic services, maintenance and helicopter simulator services to the Army Air Corps, the new contract gives us a broader role including airfield management.

At RAF Northolt, where we provide technical services, we expanded our contract to include the Visiting Aircraft Servicing Section – which routinely handles royalty,

international VVIPs and senior military and political visitors. The award decision is a strong endorsement of our performance at Northolt.

In joint venture with SKE Support Services we successfully rebid our contract to maintain over 400 vehicles and provide transport services at Wright-Patterson Air Force Base in Ohio.

In Germany we are continuing to maintain our good relationship with the Bundeswehr – Germany’s ministry of defence. Early in 2002 the secretary of defence opened the first of two IT training centres that we equipped and are now operating under a three-year €8.1m contract. The centres have already trained some 3,000 soldiers and civilians, achieving above-average results in externally-assessed examinations. This pilot project has helped to convince officials of the benefits of involving the private sector in non-core Bundeswehr activity, and a third centre has recently been opened in Bonn.

Meanwhile, we have won two new German defence IT contracts – to help introduce a pilot resource management system for the Material Support Command and develop integrated quality assurance for the Army Logistics Information System. And we are bidding to provide training support services at the Armoured Training Centre in Munster – the Panzertruppenschule.

Among a number of contract extensions in Australia we added a further year, worth over AUS\$10.5m, to the manpower and personnel service contract under which we provide engineers, technicians, aviation logistics specialists and managers to the Royal Australian Air Force at bases across the country.

## TRANSPORT

The transport sector has been a strong source of growth for us in recent years, primarily in the UK and Australia. In 2002 it accounted for 27% of sales.

Governments around the world are continuing to invest in technology and services for 'joined-up' transport systems that balance different modes of travel and make better use of public transport. The UK government plans to increase transport spending by 12% annually in real terms, to reach £11.6bn in 2005/06, and we have continued to win new and extended contracts supporting its integrated transport policy.

Information is the key to transport integration, and during the year we secured a contract with the BBC to provide its national and regional travel information services covering all road, rail, air and sea networks. Our broadcast service centre began operations in January 2003 and we are now working to develop new travel information services using the internet, interactive TV, mobile phones and digital radio.

On the roads we secured the contract to equip the UK's first toll motorway, the 27-mile M6 Toll Road, with a £4m communications and traffic management system. It is due to open in late 2003. The phase-in of a new contract to maintain equipment on the motorways in the south east of England was completed on time to start services in February 2003. Early in 2003 Glasgow City Council awarded us an initial 1½-year contract to supply and install a fully integrated system for management and operation of buses running on Quality Bus Corridors in the city. The system will include technology for vehicle location, fleet management and real-time passenger information. Once it is installed we will be contracted to maintain it for at least five years.

We won several rebids to maintain urban traffic management and control systems and national motorway communications systems in England, Scotland and Northern Ireland. We are now the market leader in maintaining technology on the English motorways, with contracts covering over half the system. We also re-secured the contract to sell, through our Swansea-based telesales operation, Select Registrations on behalf of the Driver and Vehicle Licensing Agency.

Our PFI to establish the Highways Agency's Traffic Control Centre continues to make good progress. Construction of the control centre itself was completed on time and on budget, and the fit-out, roll-out of roadside equipment and systems testing are all well underway. As part of this contract, we have been operating the Midlands Driver Information System since January 2002, which has released a valuable police resource.

We operate London's Docklands Light Railway (DLR) and the Metrolink light rail system in Manchester, where we helped keep the city moving during the 2002 Commonwealth Games by running more frequent services over longer hours to meet increased demand. At the 2002 National Rail Awards, Serco Docklands won the Best Rail Operator award for an unprecedented second year running. As operator of the DLR, which carried 44m passengers last year, we have earned a reputation for innovation in passenger service and information. "Few railway businesses have such an impact on community life," said the judges.

We remain at the cutting edge of providing solutions to complex technical problems for our customers. We have been working with Network Rail (effectively the successor to Railtrack) under an £11m contract to develop a new-generation track measuring vehicle to inspect the UK's main lines on a two-weekly cycle. The ability to measure and

monitor track condition at high speed within normal train operating patterns will have considerable benefits on heavily-used rail routes. The New Measurement Train enters service this spring and two additional monitoring vehicles will be added later.

Network Rail has also given us two short term contract extensions. A £7.5m 15-month extension continues our infrastructure-monitoring contract until April 2003, and a £4m four-month extension to our multi-purpose vehicles contract will cover this year's weedspraying season – during which we will treat about 18,000 miles of track.

Our Cardiff Call Centre, which provides rail passenger information, became the first business in Wales to achieve NVQ Centre of Excellence status for in-house training. And in January 2003, at the Welsh Contact Centre Awards, Serco won both the Best Training Initiative and the e-commerce Most Innovative Use of Technology awards.

Our rail testing business continues to broaden its capabilities to become a one-stop shop for testing and engineering acceptance of rail vehicles. During the year it received accreditation from Railway Safety as a Vehicle Acceptance Body.

In joint venture partnership with SNC Lavalin, we are one of two consortia currently bidding for the Phase 3 network expansion of the Manchester Metrolink – a 25-year concession. The concession will design, build, operate and maintain at least three new extensions to the network while also operating and maintaining the existing system. And in support of our plans to bid for selected UK rail franchises, we have formed a joint venture with NedRailways, the international arm of the Dutch national rail operator, Nederlandse Spoorwegen.

This is currently bidding for the Wales and Borders and Merseyrail Electrics franchises.

The first phase of the Copenhagen Metro was completed on time and formally opened by the Queen of Denmark in October. We are leading the joint venture that operates the system, under a contract worth over DKK500m. The automated, driverless light rail system initially serves an 11-station, 13.9km route with some 180 staff, rising eventually to 300 as we open extensions. Passenger numbers are expected to rise from 60,000 to 120,000 a day by May 2003.

In Hong Kong, where our transport work is focused on traffic management, we successfully rebid our contract to manage, operate and maintain the Aberdeen Tunnel.

In Australia we further enhanced our tourism business for Great Southern Railway by establishing the groundwork to extend The Ghan train service to Darwin from late 2003. In Perth, where we successfully rebid our public transport information call centre contract, we were also selected as preferred bidder to provide facilities management of bus-related infrastructure.

In the US we have extended our relationship with the Federal Aviation Administration (FAA) to include weather observation as well as air traffic control (ATC) services. The FAA has awarded us a five-year contract to operate weather observation stations at seven medium to large airports, with five more to follow in January 2004.

In the Middle East we successfully rebid our contract with the United Arab Emirates – held since 1986 – to provide ATC and engineering services at the Emirates Area Control Centre in Abu Dhabi.

Further growth in our airport business will come from an investment in South Africa signed in November. Our 50:50 joint venture with Equity Alliance has acquired a 51% interest in Apron Services Pty, a government-owned airline ground handling company supporting three international and three domestic airports in South Africa. It has contracts with 53 airlines. This investment of £4m will provide an opportunity to develop our services in civil aviation and a platform for exploring other market opportunities in South Africa.

#### **CIVIL GOVERNMENT**

This is our most rapidly-evolving market, with opportunities emerging in sectors such as justice, education and healthcare where outsourcing is relatively new. In 2002, civil government contracts (excluding the transport and science sectors, which are reported as separate segments) accounted for 27% of sales.

##### **Justice**

Our activity in this field is currently focused on the UK, where the criminal justice budget for England and Wales is £14.7bn this year, rising to £18.3bn over three years. We estimate our current addressable market at about £1.3bn, covering intelligence, operational support, demand management and technology services. There is major potential for working with police forces in England and Wales to identify non-core activities that can be outsourced, allowing operational staff to concentrate on policing and investigation.

The custodial market continues to expand – opportunities include prison PFI tenders, secure training centres for juvenile offenders and development of new immigration accommodation centres over the next five years. Electronic tagging and monitoring of offenders is a current and rapidly-growing non-custodial market which could receive a further

boost if the UK adopts proposals for weekend and night-time prison sentences enabling offenders to retain normal employment.

In 2001 we stepped in at short notice to support a critical national intelligence system serving the UK's 66 police forces and other agencies. Our response proved effective, and in 2002 we were awarded a five-year contract to maintain and support the system.

Building on our growing reputation for services to police forces, we won a contract from Merseyside Police to provide and support its new command and control system. The pilot system went live very successfully in November and full operations will begin in March 2003. Other forces for whom we operate command and control systems include the Hampshire and Isle of Wight Constabulary – which has now appointed us to support the system with a full business continuity and disaster recovery solution.

We are the UK market leader in providing road safety cameras. During the year we won contracts to supply and install over 300 additional camera locations in Lancashire and West Yorkshire.

Our development work continues on the National Crime Squad (NCS) Operations and Intelligence Management System and we have delivered the first modules, including the Evidence Management System. We have added several enhancements to the original contract. These include opening and managing a new 39,000ft<sup>2</sup> seized assets store, introducing a secure knowledge management system and providing the IT and communications infrastructure for the newly-formed Immigration Crime Teams. We will provide support services to these teams in line with the main NCS contract.

Premier Custodial Group (PCG) continues to perform well. The business now comprises five prisons, one secure training centre, one immigration detention centre and court escort and electronic tagging activities. There have been some performance issues at HMP Ashfield Young Offenders Institution, which we are working through and are well on the way to being resolved.

As previously reported we are pursuing through the courts a contractual right to acquire full control of PCG following our partner's merger with Group 4 Falck: the court's decision is expected in the middle of this year.

#### **Education**

In the UK, this market has expanded and evolved rapidly over the past year. Opportunities for working in partnership with local education authorities (LEAs) continue to emerge. Over the longer term we believe schools will gain increasing autonomy to purchase the services currently provided or bought by LEAs. The education budget for England will rise by 6% a year in real terms to reach £58bn over three years – when spending per pupil will be 50% higher in real terms than in 1997. We have been developing an extended range of services for schools to enhance our market position. Our turnover in education is currently over £75m a year and in the UK we are one of the sector's leading service providers.

Our education business is not only with LEAs. In April, for example, we retained and expanded a contract worth over £3m a year to inspect more than 200 schools annually for the UK education inspectorate, Ofsted.

Our progress in Walsall, where we have provided services to 129 schools on behalf of the LEA since 2001, has demonstrated how our effective management drives strong organic growth.

In April 2002, Ofsted commended our service quality in Walsall and our progress in restructuring and redefining school support services. After reviewing the remaining services provided by the LEA, Ofsted recommended that these, too, should be outsourced. The result was a threefold expansion of our contract from September: over the remaining 5½ years it will be worth some £100m to us. A further 300 Walsall Council staff transferred to Serco in January this year.

Ofsted has also recognised the significant progress made by our educational partnership with Bradford Council. The performance targets set by the contract are demanding and there is much work still to do before we can meet them all. But already government figures show above-average improvement in Bradford schools since we arrived and in the primary school league tables Bradford is the third most improved LEA in the country.

Outside the UK, our activities in the education sector include managing and maintaining school and university facilities in Australia and Sweden. Last year we won a new contract to provide facilities management, teaching assistants and administrative support to a new 1,200-pupil secondary school in Hong Kong which opened in September.

Our strategic focus on organic growth means that when we make acquisitions we tend to buy complementary capabilities rather than capacity. The acquisition in 2000 of Quality Assurance Associates in the UK – the basis for our fast-growing education business – was a case in point. In December 2002 we acquired CCM Software Services for an initial consideration of £8.6m. CCM produces, maintains, updates and operates scheduling, resource allocation and finance systems that complement our existing school management and improvement products to make a unique integrated toolkit. Its customers

include a rapidly growing number of schools, universities and colleges and nearly all the secondary schools in Ireland.

This year we have launched Serco Learning, which brings the CCM products together with our existing portfolio of virtual learning environment, leadership training and consultancy products. Together, these put us in a unique position to work with schools on all areas of development.

#### **Health**

The majority of our activity is currently in the UK, where we are involved in two of the first wave of hospital PFIs – Norfolk and Norwich University Hospital and Wishaw General Hospital, both now operational. New UK markets are emerging in information technology and clinical service provision as well as a variety of support service partnerships. Outside the UK we provide hospital support services in Hong Kong and Australia.

In June we broadened our capabilities by acquiring SDC Consulting, a leading provider of strategic consultancy services to NHS customers. This enables us to grow into both existing and emerging health markets by developing a new solutions business that combines a strengthened consultancy and advisory practice with participation in clinical and non-clinical support service partnerships. The government has recognised our capabilities by making Serco one of only eight private companies approved to support underperforming NHS trusts identified in the NHS franchise programme – a role similar to the one we are playing with local education authorities.

Our track record at three hospitals in Hong Kong won us contracts to provide cleaning and non-clinical services at two more: the Tseung Kwan O Hospital and the busy 1,265-bed United Christian Hospital. During the year our efforts were

recognised by the Hong Kong government, which rewarded us with a prestigious Caring Company award.

#### **Other public services**

In addition to the principal areas described above we also provide a wide range of other services – both behind the scenes and in direct contact with the public.

In the UK we won a 10-year rebid and expansion of our environmental services contract with Canterbury City Council, worth £53m. The new contract represents a deeper level of partnership with the council – and includes operating the call centre which is the customer's first point of contact, taking 50,000 calls a year on a wide range of council services.

Our local council services business made further headway in January 2003, when we won Woking Borough Council's ground maintenance and street cleaning services. Subject to contract, we will work from a dedicated depot in the Woking area, with contract management and support from our existing operation in Winchester. This partnership contract is expected to be worth at least £25m over 10 years, with additional revenue depending on the service and extension options that the borough exercises.

In Belgium three contracts further strengthened our relationships with major European institutions. The European Commission (EC), already an established IT customer, awarded us a new contract to provide IT support. The European Parliament chose us to provide IT services to its members and their offices in both Brussels and Strasbourg. We also successfully rebid our 'complete life cycle' computer services contract with the EC's Directorate General for Regional Policy.

In New Zealand, Wellington City Council awarded us a contract to provide planned and responsive maintenance services for

over 30 buildings ranging from high profile council offices, museums and libraries to retail and office buildings. Our developing relationship with Manukau City Council has earned us an additional contract each year since 1999. In 2002 we won two further contracts to maintain its playgrounds, structures and asset management of buildings, bringing total annual revenue from the city to over NZ\$7.6m. Impressed by our track record, Rodney District Council awarded us a NZ\$17.2m five-year contract to manage parks, reserves and coastal areas.

In Australia we successfully rebid our property management contract, worth AUS\$22.2m over five years, covering all the justice buildings in Perth and all education buildings in south Perth.

Hong Kong is planning a sophisticated meter system covering all its on-street parking. This will use reloadable smartcard technology compatible with the island's Octopus transport and cash transaction card. Our joint venture with Wilson Parking will design, install and maintain the system using dual language technology that we have developed, under a seven-year contract worth almost HK\$87.9m. In Singapore we have carved out a niche with the government as a provider of accommodation management services. Last year we gained a further contract, as managing agent for 411 housing units.

In the US we extended our contract in San Francisco to install and manage over 25,000 parking meters, to run for a further five years. All our US government contracts begin and end with an environmental baseline study, which we can provide in-house through Serco Environmental Services. We also market these services externally, and recently won a contract – indemnified by the Canadian government – to conduct a major baseline study on the largest non-commercial bulk fuel storage tank farm in North America.

## **SCIENCE**

Management of government scientific undertakings is a relatively recent but fast-emerging sector, in which Serco was an early entrant and has established a strong competitive position. Our science contracts now account for 9% of sales. We aim to be recognised by governments around the world as one of the best private sector partners for the management of scientific organisations, programmes and consulting services.

UK government investment in science, engineering and technology (SET) supports innovation and competitiveness in the economy, as well as defence, health, safety and environmental management. Government SET expenditure is increasing and we expect it to exceed £8bn in 2003/04.

In the UK we have demonstrated our capabilities in managing highly complex science-based organisations such as the National Physical Laboratory (NPL) under partnership contracts with government – delivering services that range from prize-winning international research to support for small business. We have also built a strong position in nuclear safety and aim to support government in its management of nuclear liabilities: government spending in this area under a long term programme is estimated to be over £30bn. We believe our UK experience provides a model that can be applied in other countries as they involve the private sector in delivering public science services.

In the run-up to a rebid at NPL, our contract has been further extended – taking our original five-year contract into its eighth year. Together with Laing, our construction partner, we are currently developing world-class new science facilities at NPL. After some early setbacks, construction is now well advanced and we are working closely with the

Department of Trade and Industry and Laing to resolve all outstanding issues. Meanwhile, we have launched major new national facilities, including a centre to secure accuracy in radiation therapy for cancer sufferers and a laboratory developing innovative measurement techniques for bioscience.

Serco Assurance (formerly the nuclear consulting division of AEA Technology) has substantially augmented our offering in nuclear safety. Now integrated with our science business, it is performing in line with expectations and generating new opportunities.

In May Serco Assurance won a new contract to support the BNFL Magnox Reactor Services Organisation with a range of technical services, in a consortium led by Mitsui Babcock. The consortium will provide 85% of the external technical support to the organisation's six operating Magnox nuclear power stations; this is the first time such a contract has been let in the UK civil nuclear industry. The value to Serco will be about £10m over three years, with a possible two-year extension.

More recent projects have included testing superalloys for ALSTOM Power in Sweden, environmental studies for a low-level radioactive effluent pipeline, simulation studies of corrosion in Magnox boilers, specialist computer modelling work for the Swedish radioactive waste disposal agency and a variety of environmental protection projects. Contract extensions included two three-year contracts from the UK MOD to provide research and support services aimed at detecting and managing battlefield radioactivity hazards. We also extended a contract with Network Rail under which we are developing asset management information technology, which we have already applied to London Underground and Yorkshire Electricity.

#### **PRIVATE SECTOR**

The private sector accounted for 10% of sales in 2002. Because of the scope available to us in the public sector, this market has not been a primary focus so far, but it does provide opportunities which we address selectively.

Our existing business consists mainly of multi-service facilities management contracts for blue-chip clients. Microsoft, for example, recently added five years to our facilities management contract covering its seven properties in Ireland. It also awarded a one-year contract for support services, with a view to integrating it with the remaining four years of the facilities management contract.

We increased the scope of our work with Ilford – one of the world's leading photographic imaging businesses – by taking over the field force of specialist technicians that supports its equipment across Europe and the US. This gave us the opportunity to develop a new Asset and Equipment Services (AES) business. In August 2002 we finalised agreement with Imation, one of the leaders in removable data storage, to transfer its field services and field technician staff to our AES business in Germany and the Netherlands. Together, these contracts have given us a stable platform for addressing the field service market and possibly creating further opportunities elsewhere in the world.

In the Middle East, our new Serco Gulf joint venture won a 10-year contract to deliver engineering and other support services to the Dubai Ports, Customs and Free Zone Corporation at Jebel Ali, Port Rashid and other locations in Dubai. This is a ground-breaking contract that should provide a springboard to other government contracts in this expanding marketplace – initially in Dubai and eventually in the rest of the United Arab Emirates and other Gulf countries.

We continued to grow our relationship with BHP Steel in Australia, building on our original protective and emergency services contract at its Port Kembla steelworks. Last year we added fire and transport services, and are now responsible for fire equipment inspection and maintenance and personnel transport movement at all BHP Steel operations in the Illawarra region of New South Wales.



# WHERE DO WE operate?

Our operations are widely distributed across selected markets in the UK, continental Europe, the Middle East, Asia Pacific and North America. The range of our activities varies from region to region. We are finding increasing opportunities to transfer expertise.



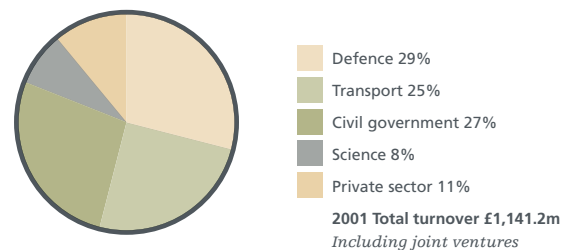
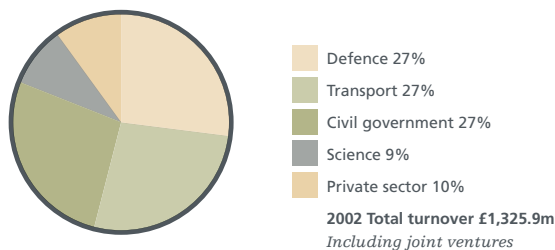
### United Kingdom

SALES 2002: £930.5m – up 17%

The UK provides some 70% of our business and remains an exciting market for us. Our expertise and proven track record, combined with a receptive marketplace, enable us to continue innovating to develop value for money solutions for both government and industry across a wide range of activities.

#### Key sectors

- **Defence:** Since we began maintaining the Ballistic Missile Early Warning System site at RAF Fylingdales in 1964, we have built a business that now encompasses UK contracts ranging from helicopter simulator training to managing, with our partners, the Atomic Weapons Establishment. We are a market leader in task management, operational and logistic support to the UK armed services.
- **Civil government:** We have over 25 years' experience in delivering public services – across a range of activities that now spans justice, education, health and local authority services. We are in the forefront of the trend towards private provision of public services through ever more sophisticated and output-oriented contracts.
- **Transport:** We have built strong positions in both road and rail transport; for example, we are national Rail Operator of the Year and a market leader in fields as diverse as road traffic management systems, passenger information and rail infrastructure maintenance. We 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:** We have had our roots in science and technology since the original Fylingdales radar contract. Today we manage scientific establishments including the National Physical Laboratory and are also the UK's largest provider of nuclear safety and performance services.



**Continental Europe and Middle East**

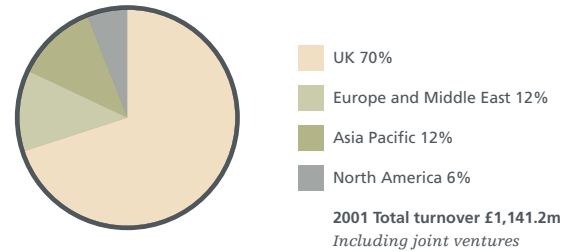
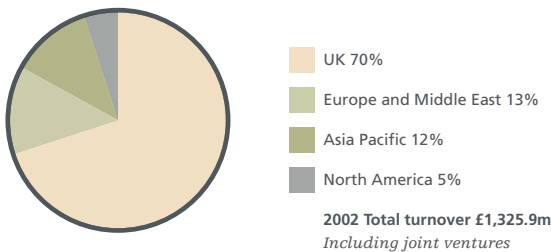
SALES 2002: £170.6m – up 22%

From our roots in IT support contracts in Italy, Belgium and the Netherlands, through our defence and government services business in Germany to our aeronautical and airport technical services expertise in the Middle East, we have an increasingly diverse business.

**Key sectors**

- **Defence:** Our involvement in the defence sector on the European mainland is relatively new, but we have established increasingly important relationships with the German ministry of defence and the Dutch navy.
- **Civil government:** Our services to local and national governments extend from buildings management to a range of technical services including development of safety cases for nuclear facilities.
- **Transport:** We are extending our light rail and traffic management expertise into continental Europe and have had particular success in Scandinavia. We operate the newly-opened Copenhagen Metro and Stockholm’s Central Technical System, which facilitates traffic management and the dissemination of traffic and travel information for the region.

- **IT support:** This was our original core activity in Europe and remains a growth area. We now provide support to the IT infrastructure of the European Commission, serving users in four countries. Other customers include the European Space Agency (ESA), European Parliament and Italian regional and central government.
- **Science and technology:** We first worked for ESA in the 1970s and have become one of the agency’s major suppliers – providing a range of spacecraft engineering, scientific, IT, project management and support services at sites across Europe. Other customers include the European Particle Physics Laboratory, CERN, close to Geneva.
- **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 region – including ATC, engineering, meteorological services, aeronautical information services, ATC training and aviation systems development.



**GEOGRAPHIC SEGMENTAL ANALYSIS – TOTAL GROUP**

### Asia Pacific

SALES 2002: £155.1m – up 9%

As well as large, broadly based operations in Australia and New Zealand we have operations in Hong Kong and a foothold in Singapore.

#### Key sectors

- **Defence:** We are a major player in defence support in Australia and New Zealand. 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 public private partnerships. In New Zealand we are the largest service provider to the forces. Looking ahead, we aim to build on our highly successful defence maritime services joint venture with P&O.
- **Civil government:** Our services include maintaining buildings and open spaces, warehousing and distribution, hospital support and water and wastewater services. Major contracts include providing civil, mechanical and electrical engineering services to City West Water in Melbourne, covering some 260,000 properties including Victoria's largest petrochemical and manufacturing facilities.
- **Transport:** In Australia we operate bus services, manage and maintain road infrastructure, build and support traffic management systems and manage airports. We own Great Southern Railway, which we have restored to profit since we bought it from the Australian government. In Hong Kong we have a number of road tunnel and parking management contracts.
- **Health:** We provide support services to a growing number of hospitals in Hong Kong and Australia.

### North America

SALES 2002: £69.9m – up 7%

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 air traffic control operations and management, managed fleet services, and multi-activity base operations for the defence forces.

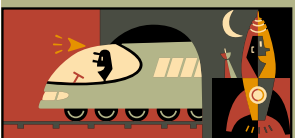
#### Key sectors

- **Defence:** We provide a wide range of base support services. For example, at Wright-Patterson US Air Force Base we provide vehicle operations and maintenance for a community of 23,000 and thousands more visitors each year. In Canada we have a full multi-activity contract employing over 300 staff for the Department of National Defence at Goose Bay.
- **Civil government:** We are growing our business with state and local governments across a wide range of services. For example, we undertake parking management, enforcement and meter collection services, manage municipal vehicle fleets, conduct environmental studies and operate leisure facilities such as the multi award-winning ecological visitor centre at Hopewell Rocks in Canada.
- **Transport:** We are a leading private air traffic control operator across the US, where we now operate 58 ATC towers. We also provide meteorology and other services at civil and military airports in the US, Canada and Bermuda. 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.

## INSIDE STORY

WHERE  
DO WE  
operate?

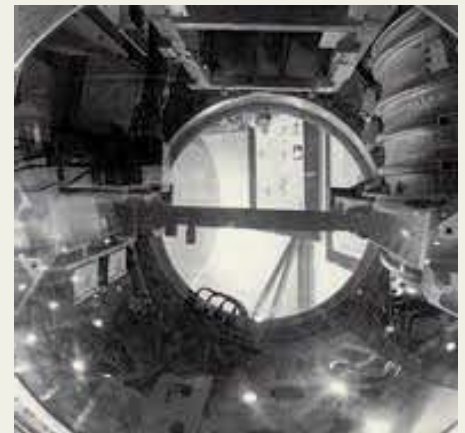
Wherever we operate, we apply the same skills and processes for managing change and maintaining continuous improvement. These skills and processes can be successfully brought to bear on virtually any kind of contract or activity – as these two very different examples demonstrate. In Australia, we used them to transform a rail business rapidly after acquiring ownership – while in Europe we’ve used them to evolve and develop our IT services to the European Space Agency over more than two decades of technological change...



# Exceeding expectations – in six languages

## European Space Agency IT

We've been providing technical services support to the European Space Agency (ESA) for over 20 years – since we were part of RCA. Our activities today include spacecraft engineering and scientific research projects. They also include activities that may not be rocket science, but are no less important to the organisation's effectiveness – such as supporting ESA's 3,500 computer users.



**W**e won our first ESA computer operations contract in 1980, when computing was all about mainframes: our operators worked in computer rooms and network centres at ESA's four major sites in Holland, Germany, Italy and France.

Over time, computers changed beyond all recognition, yet service contracts stayed much the same. They specified the number of people we should supply, and the hours they should work. Working this way, we provided a reliable service and our role at ESA grew. Now our contractual relationship has taken a significant step forward. A few years ago the agency moved away from specifying the detailed inputs to the contract; instead, it defines the outputs it needs and looks for best value and innovation in delivering them.

In 1999 we began our first service level agreement (SLA) contract for ESA, providing a range of IT services. We determined how best to deliver the services, then successfully tendered against other bidders' solutions.

Four years on, this approach has exceeded the agency's expectations. Applying our 'IT seat management' approach, we now support 3,500 ESA users at 15 sites in nine countries – as well as 5,000 external users of ESA applications.

We've built a pan-European operation providing desktop support, network management, email and document management with libraries and databases, and applications infrastructure support. We design and install systems, maintain them, help people use them, and resolve any problems that arise. For first-line support we have 23

experienced call agents operating a multilingual service desk in Frascati, Italy, and there's a permanent force of technicians and engineers at nine of the 15 sites. In addition to the base services defined in the SLA, we provide a wide range of additional services from system management and database administration, to graphic design.

The contract has proved an important and innovative step for both ESA and Serco. Its flexibility has been a boon for such a diverse user population – which ranges from scientists and engineers to administrative staff. With user satisfaction running at over 98.5% we're exceeding our contractual service targets. ESA recognised this achievement by extending the original three-year contract by a further two years. And to confirm our quality credentials, our ESA team achieved ISO 9001-2000 accreditation in 2002.

WHERE  
DO WE  
operate?

# Turning the trains around

## Great Southern Railway

Five years ago, the Australian national passenger railway service was losing around AUS\$25m a year. Today, it's a profitable business. And it already has over 11,000 people lining up for its latest service – which doesn't even launch until late 2003.



**W**e acquired the operation from the Australian government in 1997 as part of a consortium, buying out our partners in 1999. We've built it into a world-class tourism business operating three long-distance services. The Indian Pacific spans the continent from east to west, linking Sydney and Perth. The Overland links Adelaide and Melbourne, while The Ghan runs from Adelaide to Alice Springs – and on to Darwin from late 2003, to complete a north-south route across the continent.

The turnaround was based on rethinking the business from a marketing point of view. We

renamed it Great Southern Railway (GSR). We refurbished the carriages and the service to turn an Indian Pacific or The Ghan journey into a real travel experience. We created a range of products, from the budget-priced Red Kangaroo Class to the premium Gold Kangaroo Service and prestige heritage carriages.

We expanded sales distribution across the world, appointing GSR sales managers in the UK and US. And we made Indian Pacific and The Ghan journeys the centrepiece of our own Trainways packaged holiday operation – now one of Australia's fastest-growing holiday programmes. GSR retail outlets in Melbourne, Adelaide and Sydney support a wide network of travel agents and our own international call centre.

The result has been a dramatic growth in sales, with passenger revenue up 39% since we took over the business. Despite the aftermath of September 11 and the Bali bombing, GSR again achieved record sales in 2002. Growth will be further stimulated this year by the opening of the Alice Springs-Darwin link, allowing The Ghan to become a coast-to-coast service. Over 11,000 people have already joined the Top End Club to gain priority access to tickets on the new route in its first 12 months of operation. In just a few years we've transformed a burden on the taxpayer into an internationally acclaimed, customer-focused and profitable business.



CLP14

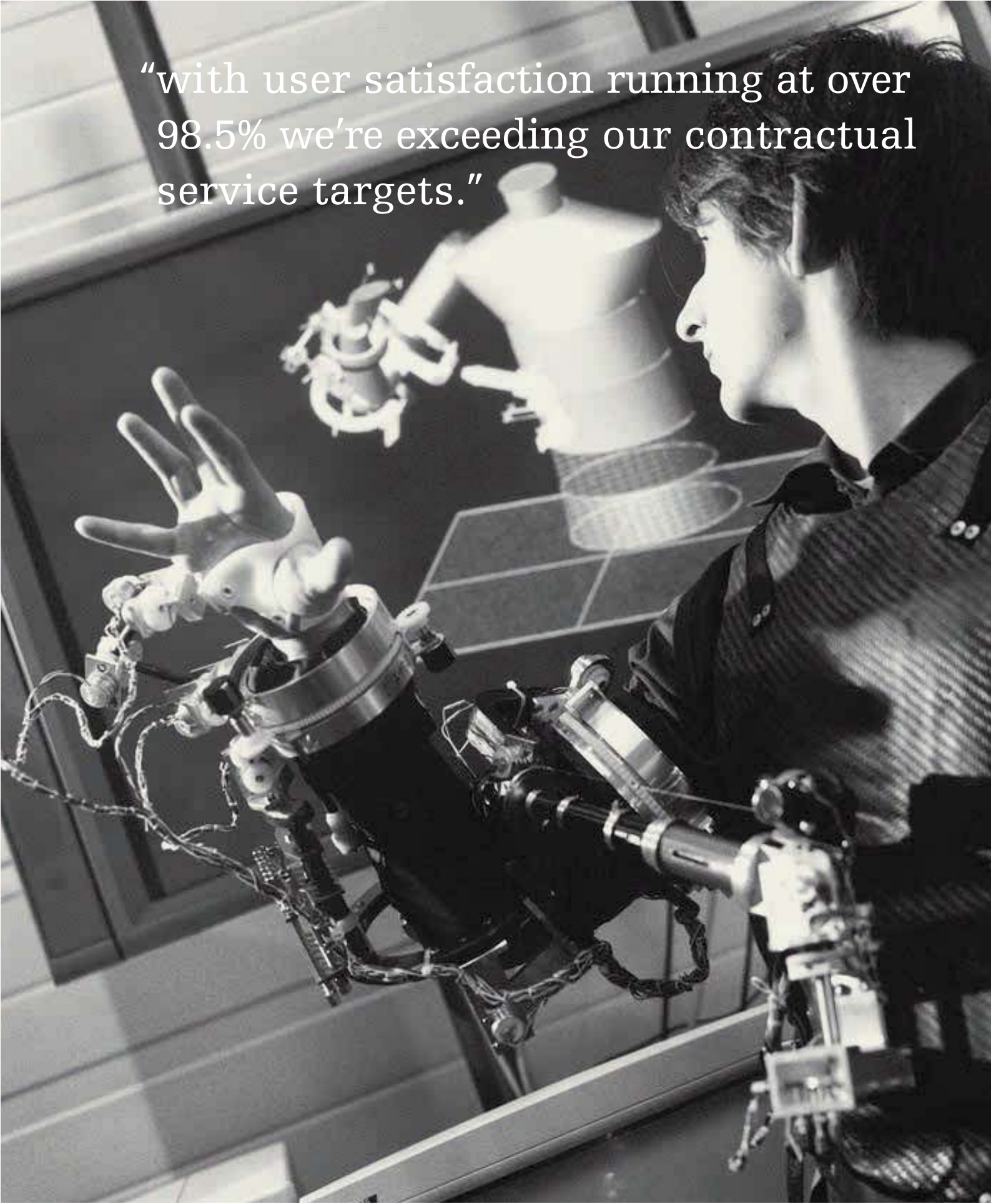
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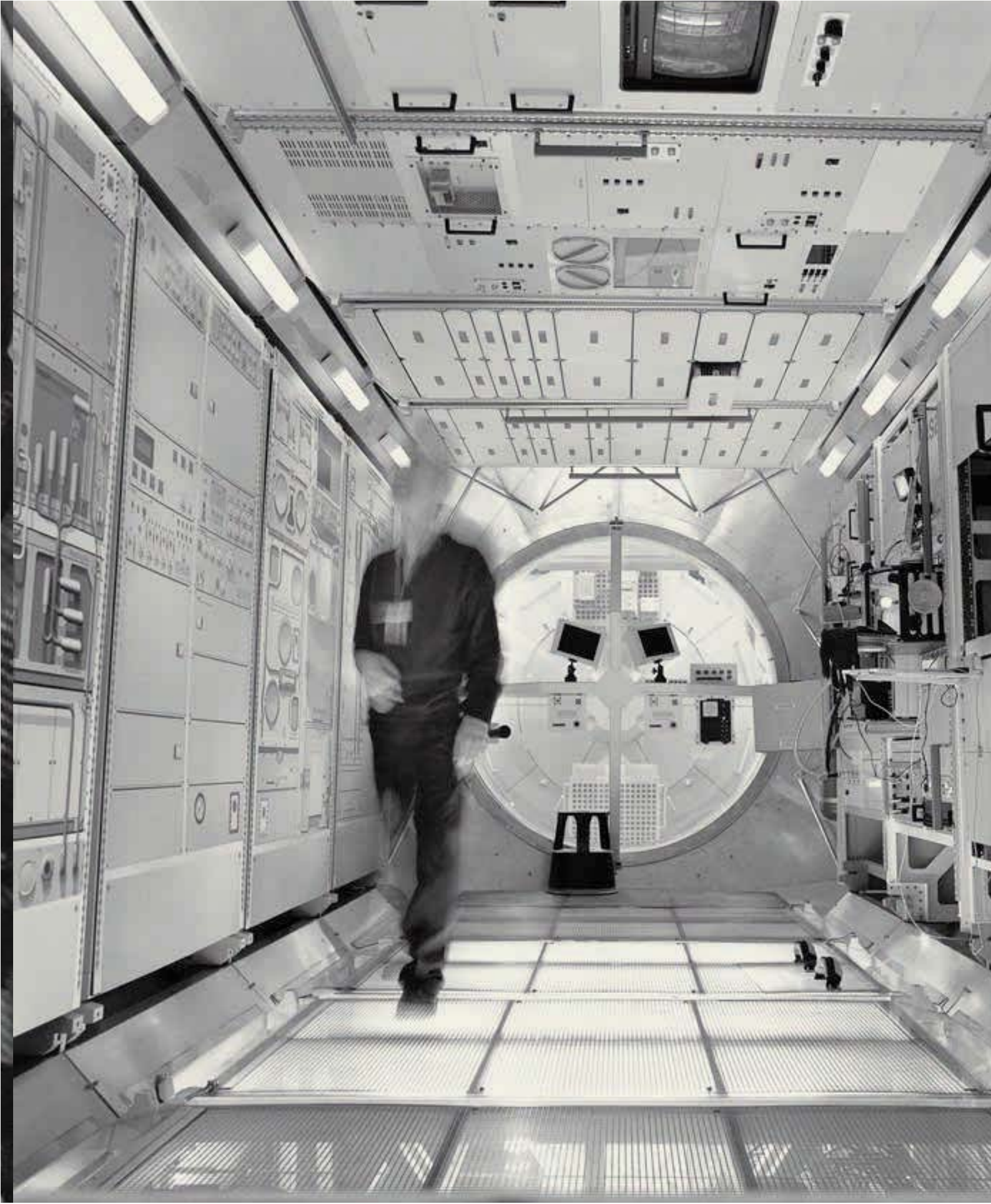


THE  
GHAN



“with user satisfaction running at over 98.5% we’re exceeding our contractual service targets.”





# what ARE OUR opportunities for growth? a

The market for outsourced public services is expanding worldwide. In a marketplace that is so large and growing so fast we have to be highly selective in the opportunities we choose to pursue. Our strategy is to maintain a balanced portfolio of businesses, ensuring an appropriate mix of new opportunities and strong organic growth to maintain our success in the future.

At present we are focusing on selected opportunities in the UK, Italy and Germany, North America, the Middle East, Australia and New Zealand. Given the scale of our addressable market and the diversity of sectors in which we are active, we have developed clear criteria for determining specific focus areas. The criteria we've developed for selecting key targets in a worldwide marketplace will shape the way Serco evolves in the future.



**Our vision**

Our vision is to become the leading global outsourcing company. To achieve this, we are pursuing and helping to shape multi-activity service contract opportunities with governments around the world as they seek to harness commercial expertise and private finance to manage public services better and more efficiently.

**Key geographic markets**

Around the world the public and budgetary pressure on governments to improve service delivery and cost efficiency is ever-growing. As a result, more and more of our key geographic markets are looking to the private sector for support. To maximise our growth potential we are not only responding to conditions in the most favourable markets, but working in partnership with government bodies to create new opportunities based on long term relationships. The relative attractiveness and development rate of these opportunities will vary from one geographical market to another.

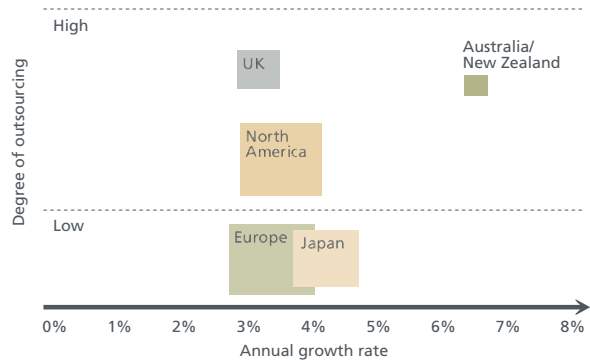
**United Kingdom**

The UK remains our core market and continues to demand innovation in the delivery of public services: we are seeing

more opportunities than ever for developing long term relationships with our customers to deliver complex outcomes. The government’s Comprehensive Spending Review will take annual spending by government departments from £240bn in 2002 to £301bn in 2005/06 – a 25% uplift in three years. Coupled with the stated aim of improving public services, this presents us with a wealth of opportunity over the next few years. The principal beneficiaries will be the justice, education, health and defence sectors in which we have tremendous strengths and significant experience. We fully support the government’s reform agenda and continue to enhance our core skills and capabilities in organisational change and the transformation of public service delivery.

While aiming to enhance our reputation for trusted, consistent service delivery, we also intend to be recognised as a reliable strategic partner for government in the design, build and implementation of world-class public services.

Because our customers are now looking for support at earlier stages in the development of sophisticated contract models, we are establishing a new public sector strategic consultancy service. This integrates our existing capability with a newly



**GROWTH IN PUBLIC EXPENDITURE**

Source: EIU Country forecasts, inflation adjusted; Europe based on Germany, France, Italy and Spain. £

Size of the boxes represents total government expenditure 2002 (US\$bn).

formed team to support clients as they develop strategies for organisational reform, transformation of public service delivery and creation of cost-effective supporting infrastructure. It will deliver sustainable value by establishing long term relationships based on realistic organisational process and fiscal designs and achievable business transformation planning. By applying its expertise not only in the UK but worldwide, it will benefit our reputation and operations throughout the group.

The consultancy team will be backed by specialist programme delivery units drawn from within Serco to provide practical solutions that meet requirements for change and operational performance improvement, information management, infrastructure regeneration and project management.

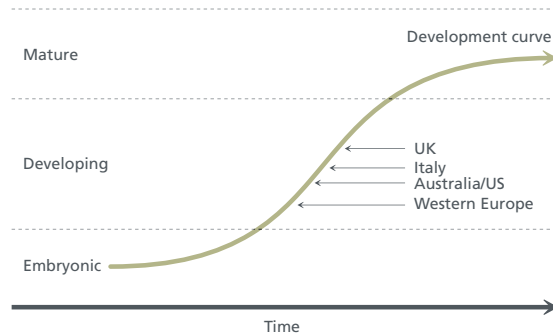
**Continental Europe and Middle East**

The diverse European markets in which we operate are evolving rapidly. Financial, political and social imperatives are driving governments towards new models for the delivery of public services, requiring greater private sector involvement in both funding and providing services. Germany and Italy are key markets where we are well positioned for growth –

and our portfolio of contracts with a number of European agencies gives us additional capability and credibility. In Germany, significant steps are being made in the education, defence and transport sectors. In Italy, the outsourcing of non-core government services is now the norm. In the Middle East, our solid contract base in aerospace and air traffic services is providing a platform for diversification and growth – as evidenced by our recent contract to deliver engineering and other support services to the Dubai Ports, Customs and Free Zone Corporation.

**Asia Pacific**

The Australian defence outsourcing market – in which we are a market leader – is maturing, but a programme of defence and civil PFIs is beginning to emerge as Australian states come under increasing budgetary pressure. The New Zealand government has begun to pursue public private partnerships in transportation and to look at wider applications for private finance. In Japan, pressure for reform of public finances has led to the introduction of PFI-driven opportunities. We continue to monitor these markets closely: our strategy is to focus on selected opportunities where our experience will have the greatest impact.



**MARKET DEVELOPMENT**

*Relative position of key markets on the development curve.*

**North America**

The US government has recently announced a major reform of procurement policy. Over the next two years federal agencies will have to open up 50% of their activities to private sector competition, and this will rise eventually to 100%. This directive will effectively market-test over 800,000 government posts. In 2002 the US government spent over US\$80bn on services, including information technology, base operations and engineering services, and we expect annual growth of at least 12% in the federal sector. Major growth will be seen in the Departments of Defense and Homeland Security, where the combined 2003 budget is likely to exceed \$400bn and further significant growth is expected over the coming years. In Canada federal, provincial and municipal governments are using public private partnerships to solve budgetary gaps and to improve public services, particularly in the health and transportation sectors. British Columbia (BC) has created a new central agency, Partnerships BC, to drive this process. North America remains the world's largest outsourcing market and so demands careful and constant attention from us.

**Selecting and balancing opportunity**

A core part of our strategy is to maintain not only a wide geographic presence but also a broad base of core skills and expertise. This diversity protects us against downturns in individual markets, and balances maturity in one with the growth of another. It means we can draw on a wide portfolio of management competencies and core skills that enable us to compete effectively for the most demanding contracts. And it also exposes us to more growth opportunities than we can possibly pursue – so an important function of our annual planning is to select the right opportunities.

Our selection processes are rigorous and designed to help us balance the portfolio, maintain our focus on opportunities most likely to deliver success and provide the best return to shareholders. Our confidence in our growth planning and forecasting is founded on the ability to make considered decisions about each opportunity, be it a new market entry or a single contract, based on robust assessments of the financial and strategic benefits.

INSIDE STORY

what  
ARE OUR  
opportunities  
for  
growth?

One area where we see clear opportunities for growth is rail transport. In the UK, Scandinavia and Australia we're building an impressive track record – and demonstrating a variety of options for reducing the cost of public transport to the taxpayer. London's award-winning Docklands Light Railway (DLR) is a case in point...



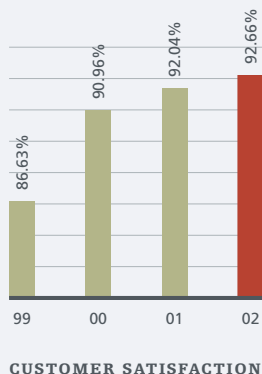
what  
ARE OUR  
opportunities  
for  
growth?

# Best in Britain – twice running

## Docklands Light Railway

An urban metro isn't just a piece of transport infrastructure. It's part of the way people live. It's how they go to work, how they get to the shops, how they have a night out. If you want to run it properly, you have to engage with the way people run their lives.

That's what the National Rail Awards judges had in mind when they named us Best UK Rail Operator last year, for the second year running. They didn't just commend our service intervals or the cleanliness of our trains. "The DLR is as much part of East London as Bow Bells," they said.



**F**ive years ago, when we took over the franchise, that certainly wasn't the case. Since then we've stepped-up service frequency and capacity. We've cut delays by 70% and vehicle failures by 40% to beat the franchise target of 96% reliability. And because people know they can trust the service, they use it more. The number of passengers has more than doubled, from 20m to over 44m.

Being able to run our own show is an advantage. We're responsible for the whole business, including operation and maintenance of the trains, structures, tracks and automatic signalling. We've also been able to increase non-core revenue through innovations in areas such as advertising, retail and promotions – increasing the value of the franchise and ultimately reducing the public cost of supporting DLR services.

One key to our success is the close partnership with our customer, Docklands Light Railway Ltd. This ensures the effective use of resources to deliver the best possible services to the travelling public.

The second factor is the way we've built the DLR into the life of the community. First we made it frequent and reliable. Then we made sure everyone knew about it, by taking real-time train information out of the stations and into the community. Our innovations have included displaying train arrival countdowns in public buildings and office lifts around individual stations, and making accurate arrival information instantly available on the internet and mobile phones.

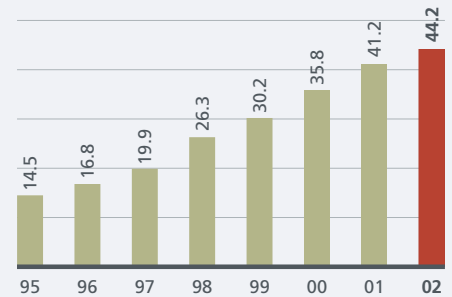




We've also built strong links with local organisations, from schools to businesses and charities. We provide free travel for some local primary schools, community groups and special needs organisations. We support vital local initiatives such as an ethnic community centre, a toddler care centre, a children's hospice and a drop-in centre for the unemployed. We sponsor the Women in Docklands business networking organisation and the Round The Island Road Race for charity. You can see school children's art on DLR trains, the Salvation Army making weekly collections on DLR concourses, and secondary school teams in DLR-sponsored football kit. In these and many other ways we've woven the DLR into the fabric of community life.

Behind the scenes we've supported crucial infrastructure investment; for example, by integrating a second-generation computer-based signalling system. And our public face has been enhanced by multi-skilled staff who have the training and empowerment to deliver friendly and helpful service.

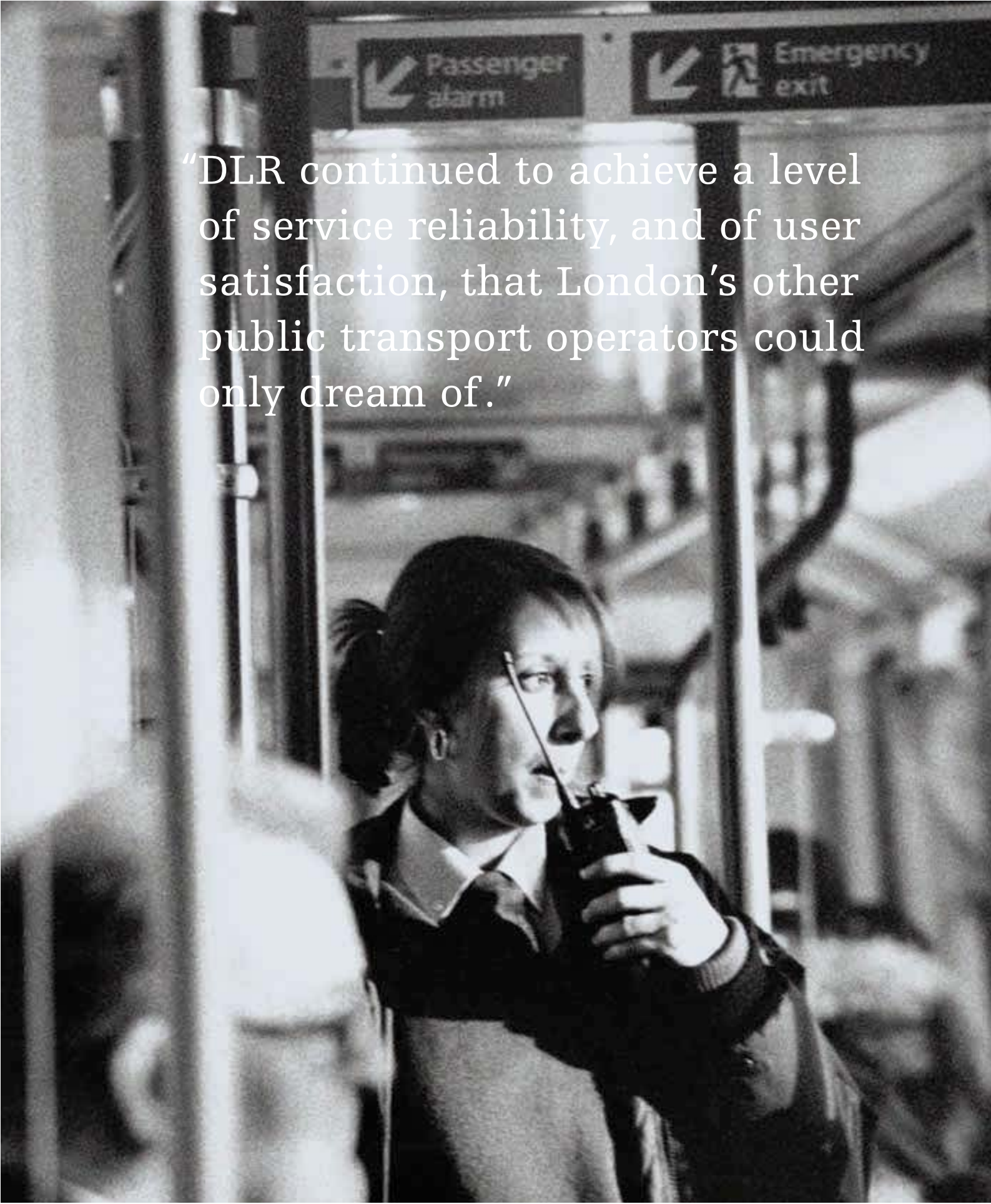
That combination of qualities – in people, technology and communication – is what's made the delivery of the DLR service special. This was reflected by the London Transport Users Committee in its 2001/02 annual report: "[The DLR] continued to achieve a level of service reliability, and of user satisfaction, that London's other public transport operators could only dream of."



**HOW PASSENGER NUMBERS HAVE GROWN**

*Since Serco took over in 1997 passenger numbers have doubled to 44.2m.*





“DLR continued to achieve a level of service reliability, and of user satisfaction, that London’s other public transport operators could only dream of.”



# where DO WE stand on PFIs? a

We're enthusiastic participants in the Private Finance Initiative (PFI). We've been involved in PFIs since 1995 and believe they can benefit investors and taxpayers alike. In early 2003 the National Audit Office reported that government 'has obtained a much higher degree of price certainty and timely delivery of good quality build assets' with PFI than under traditional methods of procurement. And the benefits extend far beyond the construction phase. Throughout the life of their operating contracts, PFIs are about diversity, culture change and innovation in the delivery of specified service outputs.



PFIs fit well with our ability to deliver sophisticated service contracts based on long term relationships. The concept is gathering momentum internationally, and we'll continue to bid selectively for PFIs that meet our business criteria. But PFI is just one of the many successful models for public private partnership in which we're involved. We expect PFIs to be a valuable component in our balanced portfolio of contracts, but by no means a dominant one – at present, they account for about 12% of our business.

**What's so good about PFIs?**

PFIs were launched by the UK government in 1992. The basic principle is that public authorities contract-out not only the operation of major capital assets but also the creation of the assets themselves – combining financing, design, construction and operation into a single contract package.

In principle, PFIs offer a 'win-win' result. Government and taxpayers should enjoy early access to new assets, more

efficient procurement and value for money than with traditional methods – and innovation and diversity in service delivery. Integrating design and service elements from project inception should lead to better operational facilities and more accurately targeted investment. Uncertainties are reduced because the delays and cost overruns, so often associated with public procurement, should be cut or eliminated by better project definition and financial control. Risks are transferred from the taxpayer to contractors, who are appropriately rewarded through returns on their investment in line with the risk profile, and through contracts for building and operating the assets.

**How do they fit with our strategy?**

In strategy terms, we see PFIs essentially as a means to an end – the end being sophisticated, long term operating contracts. Operating contracts are our core business, and PFIs have a part to play in a portfolio diversified across many different sectors, geographies and contract models.

We have been involved in 13 PFIs to date. Our total committed investment in them is £21m, of which we had actually invested £12.4m at 31 December 2002. They have only recently started to contribute to group profitability as the first projects have moved into the operational phase. In 2002, PFIs contributed in total £154m to turnover (12% of the total).

To manage our PFI investments we have established a dedicated investment division, Serco Capital. This functions independently from the operating divisions so that we can price and manage operating and investment returns separately.

**What makes them good for Serco?**

Every PFI project is different: there's an onus on bidding companies to assess the costs and risks accurately and to secure appropriate terms.

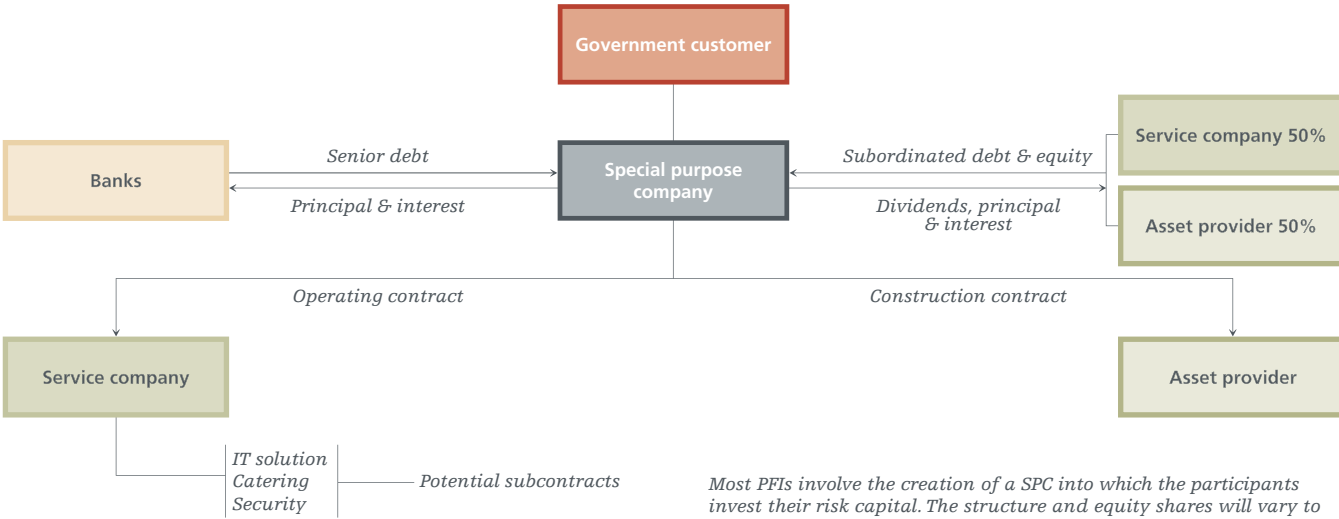
Some contractors have expressed disappointment with PFIs. Our enthusiasm for the model is based on extensive experience of

PFIs and good relationships with experienced partners. We were in on the ground floor and we've developed the appropriate skills. As a result we can address new opportunities selectively and bid judiciously – anticipating potential pitfalls such as high bid costs and delays, and factoring them into our calculations.

We fully recognise that PFIs are only profitable if you deliver the goods – but we are already building a successful track record that speaks for itself. Over the next few years we hope to leverage that record internationally as other countries follow the UK's example in developing their own PFI programmes.

**What returns do we get on our PFI investments?**

The Special Purpose Company (SPC) set up to run the project earns fees from the customer: in turn it pays dividends on our equity in the SPC and interest on any subordinated debt we lend to it. After-tax returns anticipated on equity and lending will vary according to the perceived risk profile, but are currently 15-20% on capital invested.



**TYPICAL PFI STRUCTURE**

Most PFIs involve the creation of a SPC into which the participants invest their risk capital. The structure and equity shares will vary to suit the project, but this is how a typical SPC would look. The arrows indicate cash flows.

The SPC raises senior debt funding from the capital markets which is non-recourse to its shareholders. In other words, this debt does not represent a risk to the shareholding companies.

**What returns do we get on the operating contracts?**

We're keen to invest in PFI projects where the risk and cash flow profiles are acceptable. But our primary objective is to gain the associated long term operating contracts, which increase the visibility of our future revenues and cash flows and enhance our order book position. In general we seek to minimise our investment outlay in relation to the size of the operating contract.

As the service contractor we derive sales and margin on the operating contract in the same way as with non-PFI contracts. The return will be in proportion to the levels of risk on each project and will generally be higher than our average margin on sales.

**Any other benefits?**

In some cases, there are opportunities to share in other sources of income; for example, at the Traffic Control Centre we will sell traffic information to commercial organisations providing traffic information services.

Once the construction stage is complete, the reduction in risk may provide an opportunity to make a one-off capital gain from refinancing. It is our policy to share any such gains with the customer.

Full details of the way we approach, manage and account for PFIs are given in the report *Our Approach to PFIs*, available at [www.serco.com](http://www.serco.com) or on request.

**PFI PROJECTS**

Project	Serco equity stake	Serco equity investment £m	Serco subordinated debt investment £m	Start of operating contract	Value of operating contract <sup>†</sup> £m	Duration of operating contract (years)
Joint Services Command and Staff College	50%	2.9	–	Aug 2000	168	28
Medium Support Helicopter Aircrew Training Facility	2%	0.2	–	Oct 1997	36	18
National Physical Laboratory	50%	2.2	–	Jan 2002	50	25
Traffic Control Centre	100%	3.4	5.2	Jan 2004	130	10
Manchester Metrolink	26%	0.2	1.7	May 1997	153	17
Norfolk & Norwich University Hospital	5%	0.1	1.6	Aug 2001	270	30
Wishaw General Hospital	–	–	–	May 2001	42	7
HMP Dovegate*	50%	0.7	2.8	Aug 2001	300	25
HMP Kilmarnock*	50%			Apr 1999	175	25
HMP Lowdham Grange*	50%			Feb 1998	175	25
HMP YOI Ashfield*	50%			Oct 1999	175	25
Hassockfield Secure Training Centre*	50%			Sep 1999	45	15
<b>TOTAL</b>		<b>9.7</b>	<b>11.3</b>			

Our interest in another PFI, the Defence Helicopter Flying School, has been sold.

\* Operating contracts within joint ventures.

† Excluding inflation increases and contract extensions.



INSIDE STORY  
where DO  
WE  
stand  
on PFIs?

Since 1995 we've embarked on 13 PFI projects – of which 11 are now in the operational phase and generating revenue for us under long term service contracts. They're working well for us, and for our customers – as evidenced by these two examples...



where DO  
WE  
stand  
on PFIs?

## 'A textbook PFI' say auditors

Joint Services Command & Staff College

The Joint Services Command & Staff College (JSCSC) is emerging as a model PFI. It has won praise from the public spending watchdog, and also from the people who use it. Many visitors actually write to tell us how impressed they are – sometimes to their great surprise. One colonel told us we had “converted a dinosaur into a disciple of PFI”.



**T**he JSCSC replaced three separate services colleges at Greenwich, Camberley and Bracknell. It now carries out all command and staff training for the UK armed forces, from junior to advanced and higher levels, as well as for officers from some 50 countries worldwide.

It's a large complex that cost £120m to create. Standing on a 100-acre site, it includes some 45,000m<sup>2</sup> of floor space, 290 family houses and a range of sports facilities.

It was built by a joint venture owned by Serco and Equion, and funded largely by non-recourse

debt capital – our equity investment in the joint venture was just £2.9m. The construction was subcontracted to Laing. After a two-year construction phase Serco took over the site in August 2000. We're now running it under a 28-year facilities and task management contract employing 345 people and currently worth around £8m a year.

Making a success of the venture was important for Serco, and also for the whole PFI concept. When the JSCSC entered its operational phase it was one of the most ambitious PFIs to date. Even in the defence sector – a pioneer in this field – no previous PFI had combined education,

housing, training support, mess accommodation and such elaborate IT systems.

The audio visual (AV) system is one of the largest integrated presentation and AV facilities ever built in the UK. The IT network – serving military, academic and administrative offices, eight major lecture theatres and 67 syndicate rooms – supports not only conventional applications but also battlefield communications, wargaming and other military activities. The War Studies department alone has a Dean and 36 lecturers subcontracted from Kings College London, and we run the world's second largest war studies library.



## Flying start for a 30-year partnership

### Norfolk & Norwich University Hospital

The new Norfolk & Norwich University Hospital was completed 20 weeks ahead of schedule, replacing one that was originally built in 1771, that may not seem so much like a flying start. It's a key benefit that PFIs can achieve.



The £229m first phase was England's largest PFI hospital project – a 953-bed complex begun in January 1998 and completed within budget in summer 2001. With 3,500 rooms and over 100,000m<sup>2</sup> of floor space, it replaced two older hospitals on a single 63-acre greenfield site. The landscaped grounds include 2,300 parking spaces and 65,000 trees and shrubs.

The aim was to let the Norfolk & Norwich University Hospital NHS Trust concentrate on its core activity of delivering healthcare. So the new

hospital was designed in partnership with the Trust but built by Octagon Healthcare – a special purpose company uniting Serco, 3i, Barclays, Innisfree Partners and Laing. It was financed by its five shareholders and a consortium of 18 banks.

Octagon has now begun a 30-year partnership with the Trust to provide non-clinical services including building and ground maintenance, catering, car park management, portering, IT, security, cleaning, laundry, waste disposal and telephones. We're providing all these services

Crucially for a pioneering PFI, the JSCSC has been a widely recognised success. It has delivered the expected benefits on time and on budget. After due scrutiny, the National Audit Office declared it a 'textbook example' of how a PFI should work. And our operating contract team have maintained a culture of success; for example, they won full certification to the ISO 9000 quality management standard in just seven months – five months ahead of the contractual requirement.



# Partnership

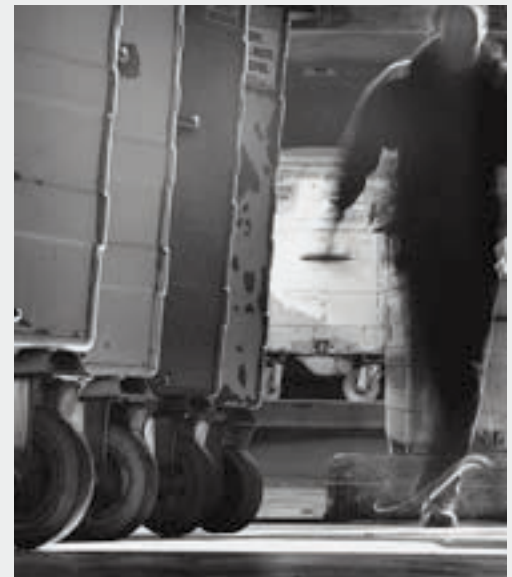
... ahead of schedule. When you're  
... much, but speedy delivery is one of the

... under a contract to Octagon, currently valued  
... at £12m a year.

Talking to the Financial Times Anna Dugdale,  
the Trust's Director of Resources, described the  
working relationship with Serco as excellent.  
"We're open and honest about our business  
needs and they're open and honest about theirs.  
We try to meet halfway across the table."

The transfer to the new building took just  
seven weeks. A second phase adding two

wards with 144 beds has been completed  
ahead of schedule. And the Trust has achieved  
not only the highest Patient Environmental  
Action Team rating but also teaching hospital  
status. So the complex is now the Norfolk &  
Norwich University Hospital – and an object  
lesson in healthcare PFIs.



“crucially for a pioneering PFI, the JSCSC has been a widely recognised success. It has delivered the expected benefits on time and on budget.”





# how do we RUN OUR business?

Serco is one business with a single vision, strategy and values. But it consists of over 600 separate contracts – each operated with a high degree of autonomy, as if it were a business in its own right. In other words, we aim for the best of both worlds: coherent direction at the centre and customer focus at the contract level, supported by a framework of effective controls. To achieve that, we've developed a unique management structure and methodology.



### Our structure devolves decision-making

Our fundamental aims are to focus on customers' requirements, grow the business judiciously and respond effectively to changing market conditions. We need to do these things while ensuring that we protect the interests of shareholders, investors, our people and the communities we work in. And we need a system that works across a business that's technically diverse and geographically spread.

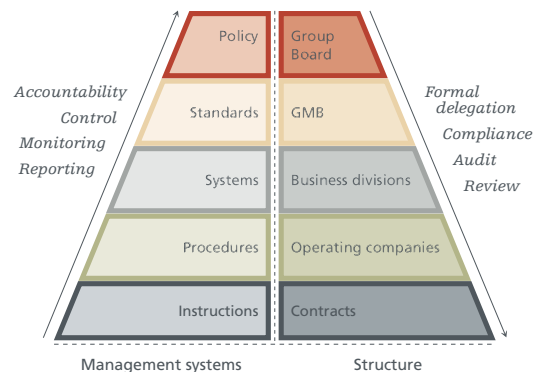
To achieve customer focus, we want to make decisions as close to the point of delivery as possible. So we devolve management responsibility – while providing clear direction about our objectives and values, and a common set of business controls. This means decisions, tasks and responsibilities can be undertaken by the people best placed to do so within a framework that's fully understood.

At the top of the organisation, the Group Board sets strategy and objectives, taking legal and regulatory

responsibility for the company's activities and protecting the interests of shareholders and relevant stakeholders.

The Global Management Board includes some Group Board members, the divisional chief executives and other key senior executives. It meets quarterly as the forum for decisions that influence the direction of the business and reviews performance, strategy and governance in the business divisions. It exercises leadership in directing the company to achieve its strategic objectives. Key members of this board form a smaller Executive Team that meets monthly to monitor and progress key aspects of the operational business.

Beneath the Global Management Board, Serco is organised into business divisions running a number of operating companies that deliver services to sector-specific customers under more than 600 contracts (diagram below). These management layers, right up to Group Board level, are tightly interconnected by giving dual responsibilities to key managers at each level:



### SERCO GROUP MANAGEMENT STRUCTURE

*The group structure devolves decision-making downwards towards our customers, while the Serco Management System ensures an upward line of accountability and control to the Group Board. Layers are tightly interlinked by key managers with dual responsibilities.*



- Chief executives of business divisions hold specific responsibilities for their divisions and share responsibility with the Global Management Board for group performance in line with the strategy they have formulated and agreed with the Group Board. Each division sets its own strategy for contributing to the achievement of group objectives and is managed by its own board.
- Managing directors of operating companies hold specific responsibilities for their companies and also share responsibility with the chief executive and senior management team of their business division for divisional performance.
- Contract managers have specific responsibilities for their contract and also share responsibility for their operating company's performance with its management team.

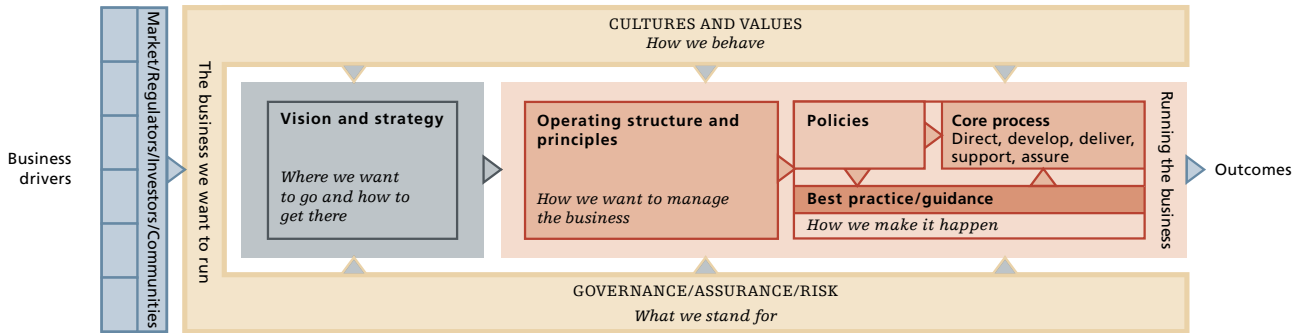
We want contract management teams to run their operations like businesses, addressing customer needs and opportunities responsively and entrepreneurially.

So we give each contract its own board, including 'non-executives' from elsewhere in the group. This helps to replicate the group's governance processes throughout the organisation. It also enables us to share technical and management expertise across the group and give contract management teams a catalyst for innovation, continuing service improvement and contract review. The contract board takes a strategic role – reviewing and evaluating opportunities, strengths, weaknesses and risks, and feeding back into group strategy generation. It also has an important assurance and corporate governance role.

**Our system ensures accountability**

We have developed and refined the Serco Management System over many years to provide a framework for all our activities. It spells out the rights and obligations of managers at all levels, so that the organisation can behave consistently across its global portfolio of contracts while maintaining its business diversity and devolved management style.

Each business division is responsible for operating within the framework defined by the management system.



THE SERCO MANAGEMENT SYSTEM

They do this by establishing and operating appropriate systems, processes and procedures to apply group policy and monitor their compliance with it.

The Serco Management System is built around two principal elements:

- ‘The business we want to run’ is formulated by the Global Management Board, decided on by the Executive Team and interpreted within the group vision and strategy. It sets the shared values defining the ‘individual’ behaviours expected from every employee and the shared operating principles defining the ‘corporate’ behaviours of every Serco business. These elements reflect external influences including market pressures, regulatory demands and the expectations of investors and the communities with which we interact.
- ‘Running the business’ is the responsibility of the Global Management Board and reflected in the business divisions’ operational strategies. It is defined by the group operating structure, principles and core processes that explain ‘how we make things happen’. These provide a business framework setting the boundaries and expectations placed on each business division, and a common set of processes for each business to adapt and apply.

**INSIDE STORY****how do we  
RUN OUR  
business?**

With an increasing number of customers we're developing the traditional contractual relationship into something far more flexible and collaborative. These 'partnership' contracts are all about responsiveness, innovation and being fast on our feet. They don't lend themselves to being run from a distant head office. They work because of the empowerment our management system delegates to individual contract teams – the people working on the spot. Here's an example, where our responsiveness has more than doubled the size of our role in a little over two years...



# Partners in crimefighting

## National Crime Squad

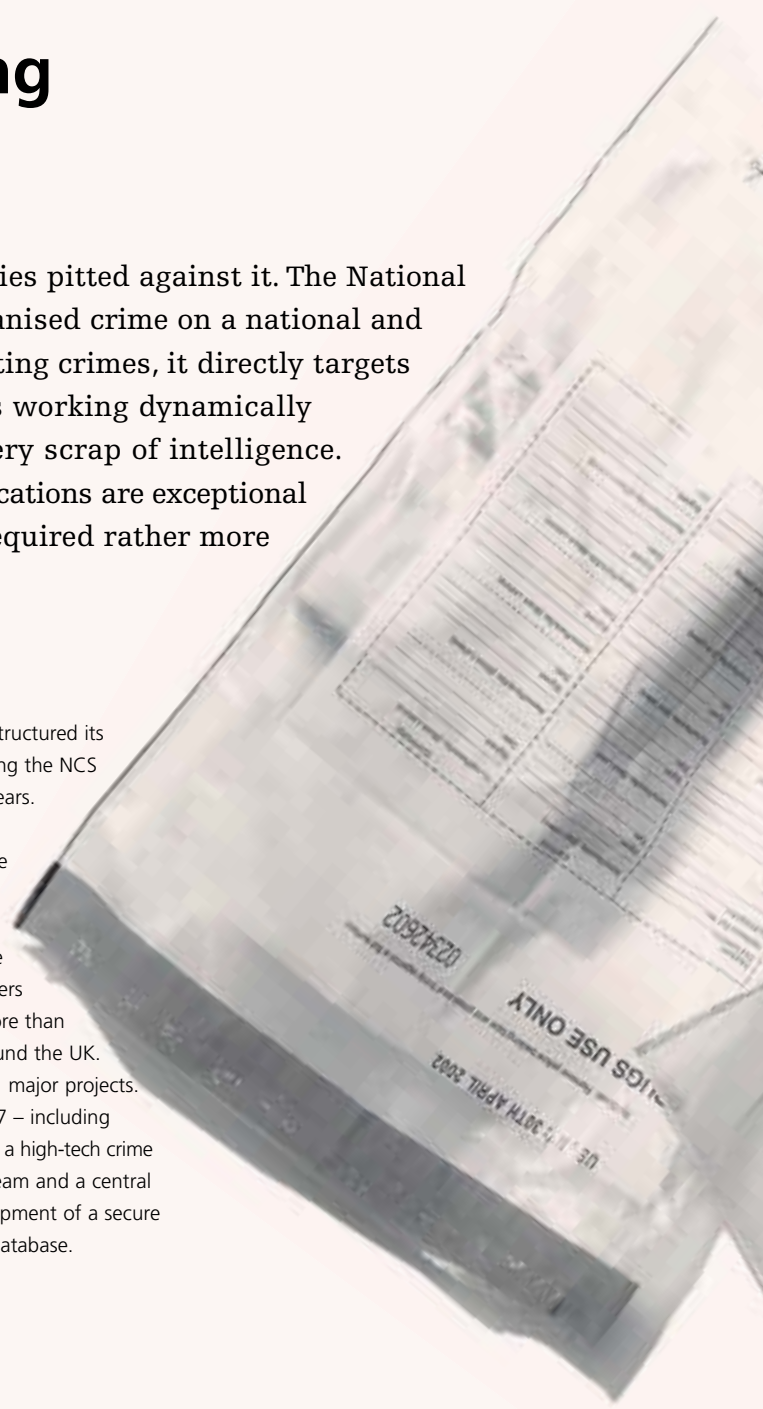
As crime grows more sophisticated, so do the agencies pitted against it. The National Crime Squad (NCS) was formed in 1998 to fight organised crime on a national and international level. Rather than reactively investigating crimes, it directly targets the people involved in organised crime. That means working dynamically and flexibly, making fast and productive use of every scrap of intelligence. The demands the NCS makes on its IT and communications are exceptional and fast-evolving. So outsourcing these activities required rather more than a conventional support contract.

**I**nstead, the NCS formed a strategic partnership with Serco. There's a formal agreement underpinning the relationship – but it doesn't stipulate fixed inputs or outputs. It's a flexible framework for a close, co-operative working relationship that won't get overtaken by events or wrongfooted when the goalposts move.

Fighting organised crime is an unpredictable business: our shared aim is to meet the squad's business objectives as they evolve, using new ideas and technologies as they emerge. What's important on a day to day basis is mutual trust and a shared determination to get results. Within the partnership structure we're able to make best use of the expertise on both sides, sharing jointly-developed intellectual property and financial gains

– for example, when we restructured its mobile phone contract, saving the NCS around £750,000 over 10 years.

Since September 2000 we've developed the partnership flexibly and professionally to deliver reliable and secure services to some 1,330 officers and 420 support staff at more than 30 low-profile locations around the UK. At the start we identified 11 major projects. This has already grown to 57 – including support for the formation of a high-tech crime unit, an immigration crime team and a central intelligence unit, and development of a secure image analysis system and database.



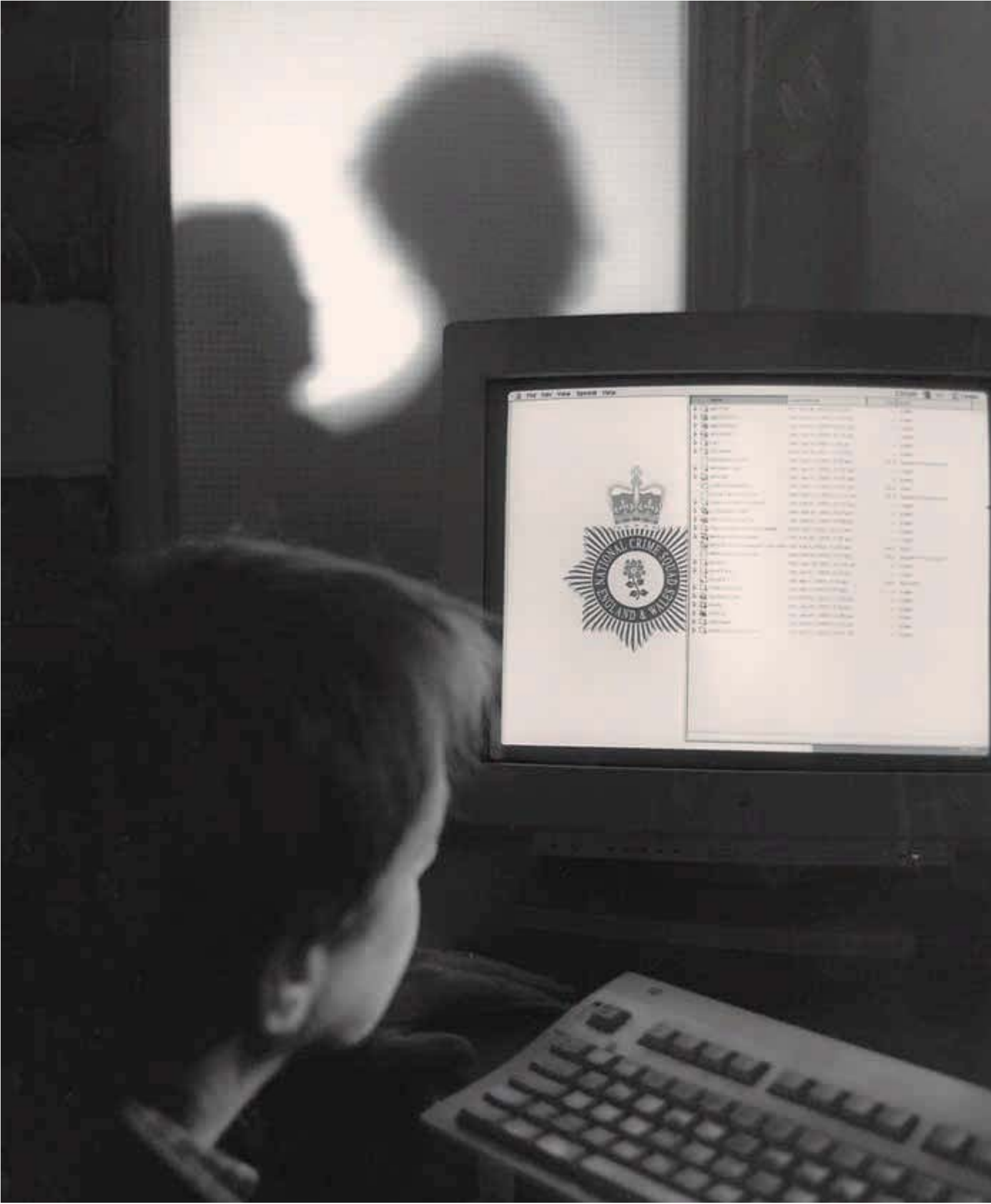


The relationship allows us and NCS to vary our roles and responsibilities: we work as a single team, and incentives are structured to encourage innovation on both sides. We also have the opportunity to enhance the contract by initiating new services that broaden its scope and add value for both Serco and the NCS.

You can't run a contract like this by remote control. It works because we have an organisation that's able to devolve responsibility to the contract manager. He has the empowerment, the training and the tools to make decisions on the spot – finding the best ways to meet NCS

business objectives and develop the customer relationship, while keeping tabs on performance and reporting back to the centre so that the group maintains effective financial controls.

It works for us, and it works for the customer. As the NCS stated in its last annual report: "Serco provides us with significant help in developing vital support services... A thorough post-implementation review concluded that the contract was delivering value for money and that much more has been achieved than would have been the case if the partnership had not been in place."



# HOW do WE manage our responsibilities TO stakeholders? a

Our strategy and values don't exist in isolation. They're shaped by the way we understand and balance the interests and expectations of our stakeholders. If you want to do this effectively and responsibly, you can't do it piecemeal. So we set up a Corporate Assurance Group to oversee all aspects of our responsibilities to stakeholders – from managing risk to safeguarding the environment.



**Who are our stakeholders?**

As the size and diversity of our business grows, so does the number of interested parties. But they generally fall into one of six groups:

- Shareholders
- Customers
- Our people and their representatives
- Business partners and suppliers
- Neighbours and local communities
- Regulators and legislators.

**Balancing stakeholder interests**

We're committed to dealing fairly with all stakeholders, not just shareholders or customers. Alongside making a profit – which ensures our continuing viability – we aim to deliver value to all these groups in a socially responsible and environmentally sustainable manner.

We're realistic. We know we can't please all these people all the time. But we recognise our responsibility to strike a broadly acceptable balance.

Open and candid dialogue with stakeholders is one of the foundations of our management style. To build on it,

we aim to stimulate internal awareness of issues raised, encourage responsive action and change, and report progress back to the relevant stakeholders.

**Corporate governance and internal control**

The Board has identified a set of key business processes for which it shares responsibility with senior managers throughout the group. These processes and their associated internal controls are regularly reviewed by the Audit Committee and internal auditors, who report back to the Board.

The Corporate Assurance Group (CAG) gives us a one-stop shop for addressing the interests of all stakeholders in an integrated way. It ensures that:

- Our policies and management systems reflect the cultural and ethical values we've adopted
- We comply with national laws and regulations
- We protect the safety and wellbeing of staff, customers, the wider community and the environment
- We identify risks and manage them proactively
- We protect the value and integrity of our reputation, products, services and tangible and intellectual assets.



The CAG's work includes helping our operating businesses to maintain effective and efficient business processes, giving advice and guidance on assurance matters, and raising awareness and understanding through education and training. It reports to the Group Board quarterly or more frequently if need be, advising on policy and ways of achieving best assurance practice throughout the organisation.

**Risk management**

We define risk as the possibility of failure to achieve key business goals; and we define these goals in relation to our stakeholders' objectives. Taking and managing risk is a central part of our business, and balancing risks and opportunities is a key management responsibility. We have robust processes for identifying, analysing and managing risks and minimising the impact of undesired and unexpected events. All parts of the business have appropriate risk and crisis management plans that meet defined policy standards.

**Safety management**

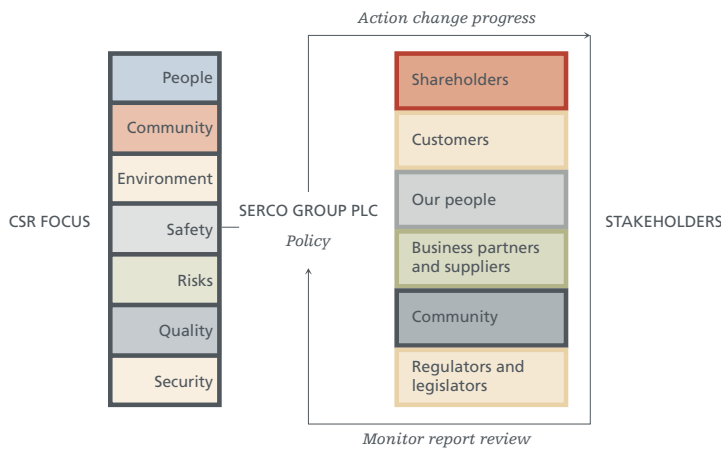
As well as taking care of our staff, we also have to protect customers and the public in many of our activities.

The group directors take ultimate responsibility for health and safety, delegated through the divisional chief executives and directors, who ensure effective implementation of health and safety policy through documented management systems.

We give staff appropriate – and regularly updated – training to protect their own and others' health and safety. Each division also provides occupational health and welfare support.

**Community**

Our approach to corporate social responsibility (CSR) delegates responsibility for community involvement through the business divisions to individual contract managers. It aims to encourage staff at all levels to engage with local community initiatives, and channels support from the company through staff volunteers. Each business division develops and maintains processes for applying the community involvement aspects of our CSR model, setting targets and reviewing performance for each operating company and contract. Some examples of our community and environmental initiatives are listed on pages 70-72.



**AN INTEGRATED APPROACH**

*We aim to keep all stakeholder groups in the loop, and to address all stakeholder-related issues in an integrated way.*

**Environment**

Everyone in Serco is responsible for minimising our impact on the environment. We aim to reduce environmental harm, minimise use of energy and other resources, and apply sustainable development principles. Each business division is responsible for developing management systems to meet group environmental policy and relevant statutory or regulatory requirements. All divisions conduct regular reviews to update their understanding of their environmental risks and impacts.

Individual contracts may also engage with stakeholders at local level to help them determine goals and priorities. At the Atomic Weapons Establishment (AWE), for example, we set up an independent consultation exercise led by a firm of environmental consultants working with Lancaster University. During 2002 the programme sought stakeholders' views through a variety of channels including public meetings, a website and a series of workshops involving regulators, local Chambers of Commerce, heritage and conservation groups, anti-nuclear groups, employees,

trade unions, government departments and others. The project team's findings were published in December, in a 68-page report containing 45 detailed recommendations. The report can be seen on the consultation website at [www.pascalea.com](http://www.pascalea.com), where AWE has undertaken to publish its response by the end of March 2003.

**Quality**

Quality matters – in the services and products we supply to customers, and in our internal processes. Our management systems enable us to assess and manage quality, and deliver continual improvement. We obtain external quality certification where appropriate.

**Security and asset protection**

One of management's major responsibilities is the security of Serco and its customers, staff and assets, including intangibles such as intellectual property. Our risk management process includes measures to review and protect these assets, address the implications of interruption to business and ensure appropriate insurance cover.

**INSIDE STORY**  
HOW do WE  
manage our  
responsibilities  
TO  
stakeholders?

Because we see customers as stakeholders, our relationships don't stand still. Our marine services contract with the Warship Support Agency (WSA) has evolved from a conventional structure to a partnership that will help shape future procurement policy. But what hasn't changed is our concern for the wellbeing of other stakeholders – employees and neighbouring communities...



# Providing services responsively – and responsibly

Warship Support Agency

Our Serco Denholm joint venture provides a wide range of waterborne port services for the WSA at Devonport, Portsmouth and on the Clyde. We operate and maintain some 140 Ministry of Defence (MOD) vessels including tugs, passenger vessels, torpedo recovery and minelaying vessels and a variety of fuel, ammunition, stores and tank cleaning lighters. Originally we operated these vessels under MOD regulations. Now, after bringing them up to Lloyds Classification Society maintenance standards, we charter them from the MOD and operate them under Marine Safety Agency rules.



**A**ll our customers have expressed great satisfaction with our service since we won the original contract in 1996. The new £110m three-year contract, negotiated between August and November 2002, will take our service into its tenth year. But the new contract is fundamentally different. It's designed to prepare the way for a future public private partnership and PFI procurement programme and involves us in developing an innovative partnering arrangement with the WSA.

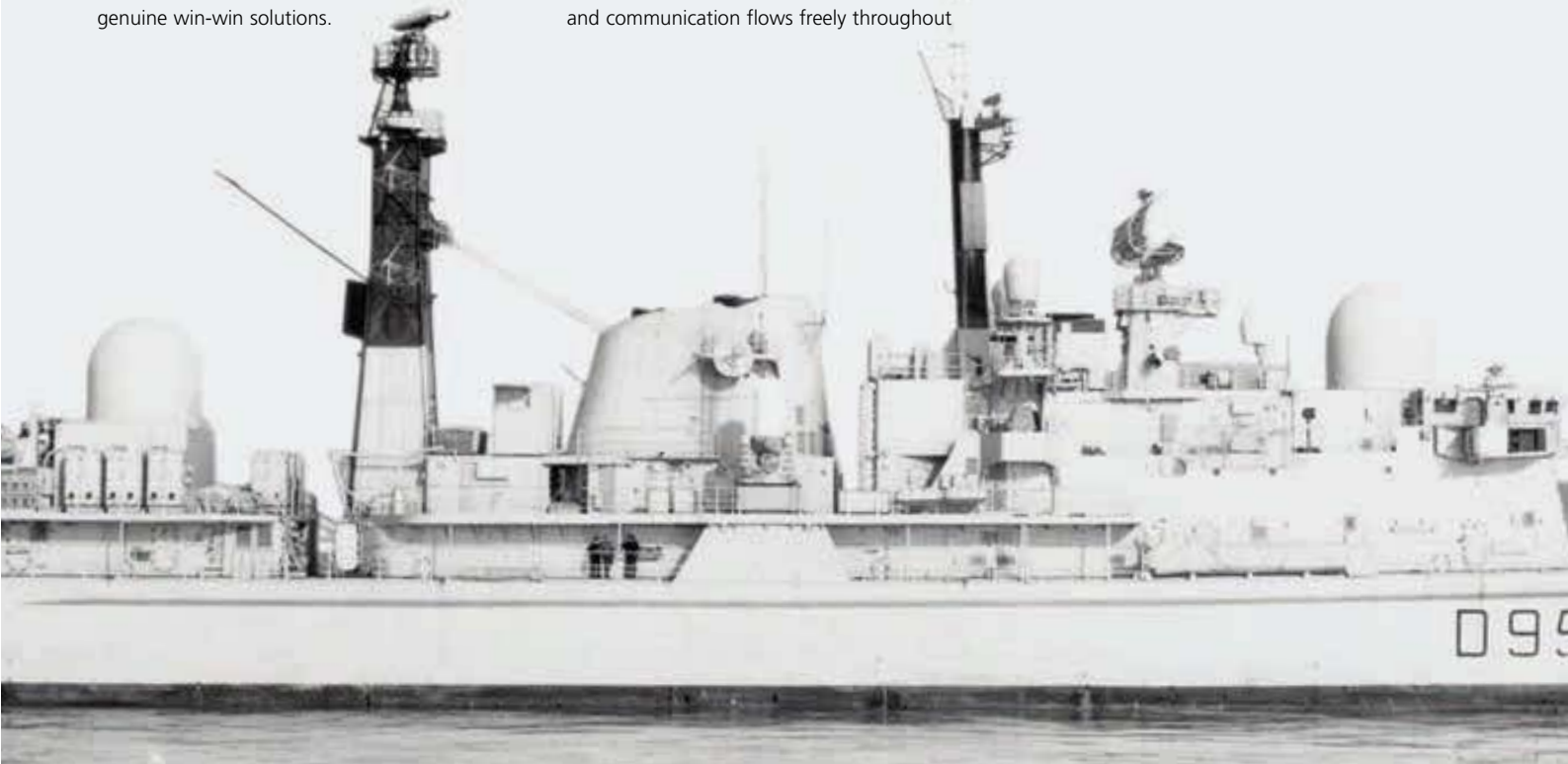
Over the next three years we'll be working closely with the WSA – in consultation with employees and their representatives – to devise radical new ways of providing the MOD with marine services that will reduce costs over the long term. Our ability to establish this kind of relationship reflects the way customers trust Serco to balance the long term interests of stakeholders and seek genuine win-win solutions.

The contract also requires a sensitive and responsible approach to the wellbeing of other stakeholders – our own employees, MOD personnel and neighbouring communities – as we transport fuel and explosives in the marine environment.

Our safety management system integrates operational maritime safety, occupational safety and health and environmental protection along with quality management principles. It addresses both marine and onshore legislation, meets the Code for ship safety and pollution prevention, and is certified to ISO 9001-2000 by Lloyds Register.

It's based on stringent hazard identification and risk assessment processes, and underpinned by comprehensive training programmes for all staff at the three ports. Everyone is involved in safety, and communication flows freely throughout

the organisation. Regular internal audits provide assurance to management at all levels. A centralised information reporting system provides a vehicle for problem solving and spreads best practice rapidly across all parts of the operation. Management reviews at contract and support office levels provide the structure for setting objectives and implementing new initiatives for improvement.



HOW do WE  
manage our  
responsibilities  
TO  
stakeholders?





“our safety management system integrates operational maritime safety, occupational safety and health and environmental protection along with quality management principles.”







### **Instilling the values**

Change management is one of our core capabilities, and we constantly refine our processes for inspiring culture change as we phase-in new contracts.

We do this through the Serco Best Practice Centre (SBPC), which works not only with our own businesses but also with their partners. At Wishaw General Hospital, for example, we worked with the local management team on workshops designed to embed the Serco culture and values. This helped the new organisation to get off to a successful start and meet some exceptional performance targets. In the Middle East recently, the SBPC staged workshops with a prospective joint venture partner so we could share insights into each other's businesses and processes. This enabled us to develop a novel business solution based on a clear understanding of our differing capabilities.

With new contracts, we can begin winning hearts and minds even before the phase-in starts. During 2002 we developed a Serco Orientation CD-Rom to help people gain a firmer grasp of what we are and how we work – particularly if they're about to join Serco under a new contract phase-in.

It can be sent anywhere, and early feedback suggests that it's a successful way to start building relationships and helping people to see where they fit in, what we can achieve together and how they can contribute within the Serco culture.

### **Gaining the skills**

Distance-learning, using CD-Roms or our intranet, is just one of many channels we use, from highly structured training environments to broader based learning on the job. We aim to identify and use the most effective method for the individual, the business and the skills being taught.

Whatever the method, the key criterion is relevance: can people apply their newly acquired skills back at work? Hence our enthusiasm for linking performance reviews and learning activity. Research in 2002 found that the majority of people who attended our training workshops used their newly acquired skills back at work within a very short time, and that their attendance at the workshop was part of a wider development plan. We encourage contract managers to work with their management teams on devolving responsibility and developing their own successors: individual learning is a crucial part of this process.

As Serco becomes increasingly global, distance learning is likely to become more important. We're currently investing in solutions that will enable us to deploy and track learning in geographically diverse locations – enabling us to reach all our people, everywhere. Combined with effective diagnostic tools, including performance appraisal and development centres, this will ensure we deliver learning solutions that meet today's business needs and help us anticipate future needs.

### **Learning to lead**

One such forward-looking solution is the senior management programme we've developed with the Institute of Directors (IoD). Combining the best available external expertise with our own experience and capability, the programme is underpinned by external assessment that may lead to Chartered Director status.

Initiatives like this reflect our desire to provide the combination of personal and business capability that makes great business leadership. In a business like ours, with its relatively flat hierarchy and high degree of autonomy at contract management level, it's essential to help our managers acquire real leadership ability and inspire it in others. We continue to develop tools to help all our teams identify potential and develop capability.

**INSIDE STORY**  
HOW do WE  
DEVELOP  
OUR  
people?

On all our contracts, continuous improvement is part of the package. We constantly ask ourselves: "Is there a better way to do this? Or should we be doing something else instead?" We're passionate about innovation, and always willing to work with quality partners who can enhance our capability. It's an approach that works well for our customers – and equally well when we apply it internally. In the past year, it's helped to transform the way we develop our future top managers...



## Directors in the pipeline

Institute of Directors

Nobody in Serco is too senior to need training. In a fast-changing world, we believe lifelong learning is a business necessity. Towards the end of 2001, we reviewed the various options for developing our current and future senior managers and decided we needed something new. The result was a unique programme we've developed with the Institute of Directors (IoD).

**B**y combining the best external capability with our internal expertise and external assessment we believe we've come up with a programme that provides excellence, rigour – and relevance to our unusual corporate structure, culture and management system.

It consists of three sections. In the first, delegates study and discuss the role of the company and the director, and relevant aspects of law, strategic business direction and finance. This is followed by an exam leading to the IoD/Serco Certificate in Company Direction.

The second section covers marketing strategy, human resources, leading change and board decision-making. A second exam leads to the IoD/Serco Diploma in Company Direction. The final section can lead to becoming a Chartered Director. This requires candidates to demonstrate relevant experience and pass an interview with the IoD.

So far, 19 of our senior managers have passed the Certificate programme in two groups and 15 have gone on to study for the Diploma. The third Certificate group and first Diploma group will get their examination results in June.

Initially we've provided the programme in the UK only, but we've been working with the IoD on a version for European colleagues and are planning further international variants.

Serco is the first UK-listed company to develop such a programme, and IoD Chairman Christopher Beale has been impressed by our determination to set a benchmark in top management development. "It's been a very exciting time," he says. "The results have been extremely positive and it's been great to work so closely with such a forward-thinking organisation."

Getting the programme up and running has taken considerable investment of company resources and personal time by committed individuals. But it sends out a clear signal both inside and outside the business that we're a meritocracy intent on establishing a pipeline of management talent leading all the way to the boardroom. We believe we're already beginning to reap the rewards in management motivation, business performance, differentiation and competitive advantage.

*"The quality of the lecturers was really high and they brought a wide range of external experiences into their programme content. Having an externally recognised awarding body does make a difference: you know you have to reach a national standard, not just an internal benchmark. I found the whole experience intellectually demanding, challenging but really enjoyable."* LUCY ADAMS, CHANGE DIRECTOR, SERCO RAIL



Assessment

1	2	3
High potential person identified to attend IoD / Serco company direction programme	Active two-way review process undertaken to create personal development plans linked to an annual appraisal	Appropriate candidates selected to participate in programme

Serco / IoD programme modules

January	February	March	June
Role of company board and directors	Strategic business direction	Finance for non-finance directors Revision day and exam	Results

IoD TIMELINE

*“The course has dramatically enhanced my understanding of why it’s so important to embrace change to constantly enhance the company’s competitive position. It’s boosted my confidence and I’m now providing better leadership of my division. What’s more, I think this confidence boost has also brought out improvement in my management team’s performance.”* **DAMIAN McHALE**, DIVISIONAL DIRECTOR, TRANSPORT SYSTEMS



*Next page: “The strategic business direction and finance modules made me ask some difficult questions about the way I manage and lead and the way I measure performance. The combination of Serco and IoD was good. Networking with other Serco people was valuable and provided the opportunity to apply the course material directly to Serco – while the IoD gave the course standing outside Serco.”* **DR MARTYN SENÉ**, HEAD OF CENTRE FOR ACOUSTICS & IONISING RADIATION, NATIONAL PHYSICAL LABORATORY



# can a private SECTOR company have a public service ETHOS?

Delivering public services has always been our business. We began in the 1960s by providing technical maintenance services, but since then we've moved from the backroom to the forefront of service delivery. We're now running people's buses and trains, managing their hospitals and helping to educate their children. That requires a special kind of relationship with our customers. We need to understand their values. We need to make 'partnership' something more than a slogan. We need to deliver private sector efficiency with a public service ethos. Our business depends on it.



Public service is 90% of our business. If we couldn't convince our customers that we understand what public service is all about, we wouldn't still be here. And we'll only succeed in the future if we and our employees continue to deliver not only high-quality services and value for money, but also the values and passions that motivate public sector managers.

#### **We believe in accountability**

Public sector agencies are spending taxpayers' money. They demand a high level of performance assessment and accountability. We've always welcomed this heightened scrutiny because it focuses everyone's attention on customer satisfaction. We're happy to work with open books, as we do with a number of existing clients.

The public expects those involved in delivering public services to have high ethical standards. As well as applying our code of ethics, we foster the kind of climate that ensures it's observed. The culture is open, people communicate freely and there are clear channels for voicing concerns.

#### **We believe in safety first**

We work in fields such as education, healthcare, justice, transport, defence and science. Inevitably, many of our activities involve a responsibility for the safety of the public as well as our staff. And because we take a long view, we don't see a conflict between safety and profits: ultimately, a responsible approach to safety is the only way to safeguard profits. In fields from food hygiene to nuclear safety, governments trust us not just to maintain existing standards but to improve on them. Last year, for example, our rail division launched a collaborative investigation with the Institute for Occupational Ergonomics at the University of Nottingham to study track workers and identify the factors influencing safety culture and working behaviour. The findings have been welcomed by staff, union representatives and Network Rail alike, and action plans are being developed to address the issues raised.

#### **We believe in people**

Public sector customers expect us to treat our employees fairly and equitably. In the complicated business of taking-over and change-managing hundreds of different

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These are just some examples of community initiatives from our CSR programme:

#### **Huntington, West Virginia, US**

*Serco is involved in a programme that helps local people get back into employment by providing work experience. Of the 13 interns who have worked with Serco on the programme to date, including five last year, seven have gone on to full-time employment with us. Our contract manager is now a member of the Goodwill Business Advisory Board Council.*

#### **Serco Group (HK) Limited, Hong Kong**

*Our Hong Kong hospital contracts provide job opportunities for people with disabilities, employing them on the same terms and conditions as other members of staff. This won us a prestigious Caring Company award from the Hong Kong Government.*

#### **Afghanistan Stationery Appeal, UK**

*After Serco employees from Rolleston working with the British Military in Afghanistan saw that local children lacked the basic tools for their*

*education, we launched a worldwide appeal for stationery. With the aid of the British Forces, over two tonnes of stationery were distributed to schools and refugee camps in and around Kabul.*

#### **RAF Northolt, UK**

*Our team at Northolt developed a training and lifelong learning programme for ramp handlers. Serco Aerospace Training Unit at RNAS Yeovilton, which developed the initial generic course for new employees at RAF Brize Norton and Northolt, is now the National Vocational Qualification (NVQ) co-ordination centre. In conjunction with on-job training and assessment, we train people to NVQ Level 2, helping them develop specialist skills linked to their area of work.*

#### **Goose Bay, Canada**

*We identified a need in the local community for an alternative clean water supply. We're working with the Canadian Government to develop a new supply, and it's expected to be complete in Spring 2003. We're also providing a scholarship to the College of the North Atlantic and helping fund a programme that raises high school students' awareness of business and its needs.*

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public service teams, we couldn't claim it's always been plain sailing. Or that we never make mistakes. But we do have generally excellent relations with staff and their unions. We're involved in the TUC's Partnership Initiative, which fosters closer relationships between employers and unions.

We welcomed the UK's Transfer of Undertakings Protection of Employment (TUPE) regulations when they were first introduced, and when we take over staff under a new contract we've earned a reputation for acting decently and responsibly, avoiding non-voluntary redundancies except as a last resort.

When we take over public sector contracts we often inherit complexity in terms and conditions of employment. Wherever possible our preferred approach is to sit down and talk to employees themselves, or their representatives, and develop terms and conditions to make them relevant and appropriate to today's business circumstances.

We operate in many countries, jurisdictions and cultures. But wherever we work we apply the same principles of equal opportunity, honouring the rights of the individual and

fostering partnership and trust in every relationship. Not just because that's a good thing to do, but because our competitive edge depends on attracting, developing and motivating the best people. We train and develop our people as well as we can. We empower our people to do what it takes to deliver noticeably superior service.

#### **We believe in social responsibility**

Apart from our responsibilities to staff and customers, we recognise our wider social obligations. We try to interact beneficially with everyone who's affected by our operations. We believe that responsiveness to all our stakeholders' interests creates greater business success – through improved customer satisfaction, greater commitment on the part of employees, and an enhanced reputation in the community at large.

Doing business with honesty, integrity, openness and professionalism means applying the same standards in our dealings with the wider community. Our approach to Corporate Social Responsibility (CSR) takes account of our diversity and devolved structure and ensures that wherever in the world we work we apply the same standards and values.

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Ray Friel Centre, Ontario, Canada

*Our team at the Ray Friel recreational centre supports the non-profit making Cumberland Resource Centre (CRC) by donating free activities and programmes to families in its shelters. On selected dates we also donate all revenue from wave swim admissions to the CRC, host local food drives, offer any members of the community free access to the facility and donate non-perishable food.*

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Joint Services Command and Staff College, Shrivenham, UK

*We provide scholarships for English language courses to the wives of international officers attending courses at the college. This helps them integrate with the local community at Shrivenham.*

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RAF Donna Nook, Lincolnshire, UK

*Serco staff regularly help manage thousands of grey seals that colonise the weapons range in the winter, often assisting in the capture and release of injured seals and abandoned pups. RAF Donna Nook is the first MOD property to be designated as a National Nature Reserve.*

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Frankston, Victoria, Australia

*We sponsored and co-designed Frankston Framed, an event that gave young photographers an opportunity to capture life in their community on camera. The project involved the whole community in recording life from the beach to the ballet school.*

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Serco Schrobhausen, Germany

*In 2002 we participated in a regular information exchange event where companies in the community introduce local students and graduates to the commercial world.*

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Corporate Assurance Group, Hampshire, UK

*In October 2002 our Corporate Assurance Group (CAG) held its annual conference in the UK. In partnership with Future Forests, a UK-based environmental organisation, CAG calculated the CO<sub>2</sub> created by participants travelling to the conference and offset it by planting 55 fruit trees in one of the poorest regions of Mexico.*

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Each business division has processes and procedures for applying our CSR model, setting targets and reviewing performance in every operating company and contract. A global network of CSR Champions manages the application of our CSR process, regularly reviewing and reporting on its effectiveness.

And every contract manager has responsibility for community involvement – not just through taking part in local initiatives but through the way the contract itself is run. Hence the judges' comments in naming us Rail Operator of the Year for the Docklands Light Railway: "Few railway businesses have such an impact on community life, proving that the journey can be much more than a means to an end."

#### **We believe in the long term**

Partnerships aren't about making a quick profit and moving on. They're about building trust and mutual benefit that lasts

over the long term. They're also about being willing to pick up a challenge. When we went into education, we didn't look for soft options. We took on two of the UK's toughest areas, in Walsall and Bradford. By rising to the challenge we've built a marketable track record and earned valuable commendations from Ofsted, community stakeholders and our customers.

#### **We believe in delivering more**

We want our customers to see us as partners in achieving the outcomes they want. And as our 90% success rate in contract extensions and renewals suggests, we don't just meet their expectations. We raise them. We aim to keep adding value throughout the life of a contract, through constant innovation. The next improvement may come from one big change, or from attention to a dozen little details. But we'll continue to ask ourselves how we can do things even better: that's part of our culture.

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#### School of Army Aviation, Middle Wallop, UK

*Work experience in the Serco-operated air traffic control (ATC) tower is popular with local schools. Demand has been so great that we've developed a package which provides real training and gives an insight into a career in ATC.*

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#### Atomic Weapons Establishment (AWE), Berkshire, UK

*Our joint venture at AWE has a very active community programme. One scheme helps 50 local schools to promote scientific and technological excellence. Each school is linked to a member of AWE staff who has a particular interest in that school: for example, as a parent or school governor.*

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#### Serco Best Practice Centre, Hampshire, UK

*The SBPC is helping Woking College to redevelop its internet site. The new site will provide information that's more pertinent to students and will have special access features for disabled groups.*

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#### Serco Metrolink, Manchester, UK

*Serco Metrolink has piloted a school mentoring programme where members of staff are trained with Bolton and Bury Education Partnership to mentor 12-16 year olds.*

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**INSIDE STORY**  
can a private  
**SECTOR**  
company have  
a public service  
**ETHOS?**

On the face of it, we have a conventional business relationship with Walsall Metropolitan Borough Council. As supplier, we have a contract to deliver educational support and management services. But through that contract our responsibilities extend to the wider Walsall community. We're supporting headteachers at the borough's 129 schools... teachers... boards of governors... 51,000 pupils and adult learners... parents. The fact is, we're serving an entire population – and need to act accordingly.



can a private  
**SECTOR**  
company have  
a public service  
**ETHOS?**

# Working with a community of customers

Walsall Metropolitan Borough Council

To support Walsall's schools effectively, we can bring our business skills to bear in many ways – improving administration, finance and asset management. We can introduce new ideas in time management, staff support and measurement of results that enhance a school's effectiveness. We have a duty to be bold, challenge the status quo and add real value. But we'll only truly succeed if we build meaningful partnerships with all our customers. And ultimately that means everyone in the community with an interest in education.





**O**ur education operation in Walsall began in July 2001, with a School Improvement and Strategic Management contract. This involved taking over some 100 people from the existing Local Education Authority (LEA). In December 2002 we took on most of the rest of the LEA's functions, along with another 300 staff.

With their help, our broad goal is to make Walsall a first-class education and learning community. We want to raise aspirations and achievement, and increase social cohesion and inclusion through our policies and service delivery. To do this effectively, we're steadily extending our links into the wider community.

To anchor these efforts firmly in the day to day reality of our schools, we need excellent communication with and between teachers and

school supporting staff. So we've increased communication channels using the internet, emails, a telephone help desk, headteacher breakfast briefings and weekly drop-in management surgeries.

We're strengthening schools' links with business and community organisations such as the Walsall Lifelong Learning Alliance, the Black Country School Improvement Partnership, the Learning and Skills Council, the Children and Young People's Strategic Partnership and Connexions.

We've joined individuals in the local community and agencies such as the police and social services in an initiative to reduce truancy and juvenile linked crime. Over 12 months it achieved both objectives and earned Jubilee medals for all participants.

And we've made sure we don't work in an ivory tower. Our main office in Walsall is attached to

a local primary school. It's not off-limits to teachers or pupils – in fact, we're helping the children to take care of our garden as part of a nature project.

This joined-up approach helped win praise from Ofsted for our work in Walsall. In turn, Ofsted's recommendation has led to a substantial expansion of our role there – and greatly strengthens our hand as we bid for education contracts elsewhere. Clear evidence that, for a public service business, community involvement is an integral element in achieving commercial success.





"for a public service business, community involvement is an integral element in achieving commercial success."







# Serco group plc ANNUAL accounts 2002



## Directors, Secretary and Advisers

**Chairman** Kevin Beeston

**Directors** Ralph Hodge CBE\*  
Christopher Hyman  
Andrew Jenner  
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  
London

**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 Ltd  
21 Moorfields  
London EC2P 2HT

Morgan Stanley & Co Ltd  
25 Cabot Square  
Canary Wharf  
London E14 4QA

**Stockbrockers** 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 Director

† Senior Non-Executive Director

# Corporate Governance Report

## Introduction

The Board of Serco Group plc (the "Company") is committed to achieving high 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. Reference has also been made to the Higgs' Review of the Role and Effectiveness of Non-Executive Directors (the "Higgs Review") and the Smith Report on Audit Committees Combined Code Guidance (the "Smith Report") where appropriate.

## The Board and its Directors

The Board currently comprises seven Directors: Kevin Beeston, Ralph Hodge, Christopher Hyman, Andrew Jenner, Rhidian Jones, DeAnne Julius and Iestyn Williams. Excluding the Chairman, the Board comprises an equal number of Executive and Non-Executive Directors. The Company continues to believe in the need for a full time Executive Chairman who is responsible for the effective operation of the Board, oversight of corporate governance and assurance activities and the Company's relationship with the City and key stakeholders. This role is distinct from that of the Chief Executive who focuses on the operational strategy and delivery of the business. The Directors' profiles are set out on pages 85 to 88.

The Board continues to believe that the Non-Executive Directors are independent of management and free from any business or other relationship which could materially interfere with the exercise of their independent judgement. They bring a wide range of experience to the Board including international business operations, strategy and economics. The senior Non-Executive Director is Rhidian Jones. Rhidian has met with shareholders in the past, upon request, and continues to be available to do so as required. Rhidian has expressed his desire to retire from the Board at the end of April 2004 when his current term of appointment expires. The Company is currently seeking a fourth Non-Executive Director and is proposing to commence the search for an additional Non-Executive Director with relevant financial experience to replace Rhidian as Chairman of the Audit Committee on his retirement. The Non-Executive Directors meet on an informal basis during the year without the presence of the Executive Directors.

During the year the Board met six times at varying locations, and took the opportunity to combine the formal business of the Company with site visits and divisional presentations and discussions. There is a formal schedule of matters reserved for the Board including the responsibility for leading and directing the affairs of the Group. During the year a strategy conference was held, hosted by the Chairman, and attended by the Board and 20 key senior managers of the Group. The Chairman has held individual meetings with the Directors to evaluate the performance of the Board and identify any areas for review. His report will be presented to the Board in February 2003.

All Directors have access to the Company Secretary and independent professional advice at the Company's expense. The Company Secretary has the responsibility for ensuring that Board procedures are followed. The appointment and removal of the Company Secretary is one of the matters reserved for the Board. The Company Secretary is also Secretary to all the Board Committees. The information provided to the Board is reviewed by the Chairman and the Company Secretary on a regular basis, to ensure that it remains appropriate and adequate and enables the Directors to discharge their duties.

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 terms of reference are reviewed annually. It is proposed that once a fourth Non-Executive Director has been appointed the Non-Executive Directors will not be required to sit on every Committee. The Chairmen of the Board committees attend the Annual General Meeting to answer questions from shareholders.

**Board Committees (continued)****Global Management Board**

The Board has delegated responsibility for the day to day management of the business to the Global Management Board ("GMB"). The GMB meets formally on a quarterly basis and more frequently if required. Matters discussed by the GMB which require formal approval are submitted to the Approvals and Allotment Committee details of which are provided below. Further details relating to the ongoing management of the business can be found in the section 'How do we run our business?' provided in the Annual Review section of the Annual Review and Accounts.

**Audit Committee**

The Audit Committee, which comprises the three Non-Executive Directors and is chaired by Rhidian Jones, met twice during the year. At the meetings, attended by the internal and external auditors and by invitation the Finance Director, matters relating to the integrity of the financial statements of the Company, the accounting policies adopted, significant financial reporting judgements made and the role of the internal auditors were discussed. Discussions were also held regarding the business risk auditing activities undertaken by the Company's internal audit providers, Grant Thornton and Pannell Kerr Forster. The members of the Committee have access to the Company's auditors without the presence of the Executive Directors. During the year, the Committee has reviewed the independence, objectivity and effectiveness of the external auditors, their terms of engagement and remuneration, and has also approved a policy with regard to the engagement of external auditors in the provision of non-audit services. The Company has identified alternative providers of non-audit services. The members of the Committee receive updates on accounting standards and generally accepted accounting principles on a quarterly basis as part of the Finance Director's report to the Board, and also on a half yearly basis from the external auditors.

**Remuneration Committee**

The Remuneration Committee comprises the three Non-Executive Directors and is chaired by Ralph Hodge. The Committee met five times during the year to deal with matters relating to remuneration and undertook a comprehensive review of the Executive Directors remuneration. The details of the Company's remuneration policies and the results of the review are detailed in the Remuneration Report on pages 90 to 99. Remuneration of senior executives in the Company is considered and approved by the Remuneration Committee of the GMB, which comprises the Executive Chairman, Chief Executive and Chief Operating Officer and is advised by the Human Resource & Change Director. In the event that any member of the GMB Remuneration Committee is conflicted by the business to be discussed, his place may be taken in that instance by another member of the GMB.

**Training Committee**

The Training Committee comprises Iestyn Williams, its Chairman, Christopher Hyman and the three Non-Executive Directors. It meets once per year to consider the training needs of all Directors and the Company Secretary. The induction programme for new Directors provides a comprehensive familiarisation programme including the role of the Board and its Committees, the Company's corporate governance framework and latest financial statements, together with site visits and meetings with senior management around the Group. The induction programme and the individual development needs of the Executive Directors, in relation to their new roles, were reviewed by the Committee during the year. All Directors and the Company Secretary are encouraged to attend relevant training courses at the Company's expense.

**Nomination Committee**

The Nomination Committee comprises Kevin Beeston and the three Non-Executive Directors. The Company believes that the Executive Chairman should remain as the Chairman of the Committee in order to discharge his responsibility for the effective functioning of the Board. The Committee meets to discuss proposed changes to and development of the Board, but has also carried out a review of succession planning for the Directors. A similar review is also being undertaken for senior executives by members of the GMB. The members of the Committee consult with other members of the Board prior to submitting final recommendations for approval by the whole Board.

**Approvals and Allotment Committee**

This Committee meets as required and comprises the Executive Directors, the Chief Operating Officer and Strategic Development Director, with any two Executive Directors forming a quorum. The business of the Committee is varied and ranges from bid approval to approval to release share options. Matters requiring formal approval following consideration by the GMB can also be approved by this Committee.

### **The Company and its Shareholders**

The Board remains committed to ongoing dialogue with its institutional and private shareholders. This year has seen the continuation of the Company's programme of site visits and strategy presentations attended by institutional investors and analysts designed to facilitate a greater understanding of the Company. As part of the review of Executive Directors' remuneration undertaken by the Remuneration Committee, Ralph Hodge sought the opinion of the six largest shareholders (representing 35% of the share register) and the ABI prior to making a recommendation for approval by the Board and shareholders at the forthcoming Annual General Meeting. The senior Non-Executive Director is also available to shareholders on request.

Formal presentations are made to institutional investors and brokers' analysts after the release of the interim and final results. Individual requests for meetings have been satisfied by the Executive Chairman and the Finance Director, although the other Directors are available as required.

During the year the Company increased its on-line communication with a web cast of the interim results presentation and an on-line interview with the Executive Chairman on its website [www.serco.com](http://www.serco.com). It is proposed that a web cast will be repeated for the final results presentation. During the year the Company has also introduced a programme of quarterly trading updates in line with best practice and the recommendations of the Financial Services and Markets Act.

The principal methods of communication with private investors remains the News Announcements, Interim Report, the Annual Review and Accounts, the Annual Review and Summary Financial Statement, the Annual General Meeting and the Company's website [www.serco.com](http://www.serco.com).

### **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. Whilst the Board has overall responsibility for the Company's system of internal control and for reviewing its effectiveness, it is the role of management to implement the policies on risk and control. The Group's risk management process identifies the key risks facing each business and reports to the Board on how those risks are being managed. The Board confirms that this process has been in place for the year under review and up to the date of approval of the Annual Report. These processes are reviewed annually by the Board and conform to the guidance set out in Internal Control: Guidance for Directors on the Combined Code (the "Turnbull Report"). Such a system however can only be designed to mitigate, rather than eliminate, the risk of failure to achieve business objectives, and can only provide reasonable, and not absolute, assurance against material misstatement or loss.

The Company has a full time Risk Director who is a member of the Corporate Assurance Group ("CAG"). CAG was formed in 2001 with specific responsibility to oversee and review the internal control and risk management 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.

CAG sponsors three specialist groups:

- An Assurance Network, chaired by the Assurance Director, and comprising senior assurance representatives from across the Group. During the year this network met four times to review Company policy and procedures and the development, integration and dissemination of the Serco Management System that defines how the Company operates.
- A Risk Oversight Group, chaired by the Risk Director, comprising assurance representatives from across the Group, met twice during the year to discuss the Group risk register and key risk controls. This group provides additional assurance in relation to the system of internal control and risk management and enhances the Board's ability to discharge its responsibilities in relation to internal control.
- An Aviation Oversight Group, chaired by the Aviation Safety Director and comprising the aviation safety representatives from across the Group met twice during the year. This group has been responsible for the implementation of the aviation safety management system across the Group, and for transferring best practice across the world.

Following a review of rail safety undertaken during 2001 and chaired by Ralph Hodge, a Rail Safety Oversight Group commenced operations during the year. It is proposed that a formal group holding regular meetings is established during 2003.

**Internal Control and Risk Management (continued)**

During the year CAG hosted a conference attended by almost 100 assurance representatives from around the world. Presentations were received from internal and external speakers, including the Executive Chairman and Senior Non-Executive Director, on varying aspects of assurance and attendees took the opportunity to network and discuss best practice during informal sessions held as part of the meeting.

A further explanation of the role of CAG can be found in the Annual Review and Accounts section 'How do we manage our responsibilities to stakeholders?'

During the year the Serco Management System, including the Company's risk management standard, was rolled out across the business. The business divisions and their operating companies are following processes and procedures to implement the system, including the risk management standard, in ways that are appropriate to the type of business being undertaken. Divisional Chief Executives and company Managing Directors have the responsibility and authority to implement the system and monitor its operation within their businesses. As part of this process CAG has reviewed and revised all company policies. These policies were authorised by the Board in December. Supporting company standards and guidance have also been produced.

The risk management process requires that at each level in the organisation risk registers are maintained that identify the key risks, the probability of those risks occurring, their potential impact and the actions being taken to mitigate the risks. Risks are ranked using a scoring system across the business. Risk registers are maintained at a contract, company, divisional and Group level and are reviewed at least quarterly and more frequently as required. The Group risk register identifies the key risks facing the business including risks that are managed directly at a Group level. The Group risk register is updated regularly and discussed at quarterly Board meetings. Each Group risk is assigned an owner at Board level.

While operational risk can never be eliminated, the Company endeavours to minimise the impact by ensuring that appropriate infrastructure, controls, systems, staff and processes are in place. Some of the key management controls are set out below:

- The principles of clear delegation of authority and segregation of duties are fully reflected in the Company's operating processes;
- Comprehensive process development and business acquisition review programmes have been established to ensure that our services and products meet customer expectations, performance criteria, operational effectiveness, regulatory requirements, investment returns and profitability;
- Sound project management and change implementation disciplines are applied to all major development projects including new contract phase-ins, acquisitions, new technology applications, change programmes and other major initiatives;
- The commitment and capability of staff is critical for the effective management of operational risk. Ongoing training and career development constantly improve the skills of our workforce. Selective recruitment, succession planning and other human resource policies and practices are in place to ensure that staff skills are aligned with the needs of the organisation;
- Safety management systems in the Company's aviation, rail, defence, nuclear and marine businesses have been addressed by the appointment of safety specialists for each area who report directly to the Board and are charged with maintaining and further developing the very high standards of safety expected in these industries. Occupational health, safety and environmental protection are addressed by qualified and experienced staff in each business unit;
- The operational risk framework tracks key risk indicators. These include analysis of business planning and variance, customer satisfaction and retention data, staff turnover and satisfaction levels, occupational health and safety incidents and error and exception reporting;
- The Company maintains insurance policies to provide protection from losses arising from circumstances such as damage or destruction of physical assets, theft and legal liability for third party loss. The adequacy of the insurance cover is reviewed at regular intervals.

During 2002, Grant Thornton and Pannell Kerr Forster, the Company's internal auditors, had their term extended for a further three years. As part of the continually evolving approach to business risk auditing the Company has developed, in association with Grant Thornton, a risk matrix designed to profile relative risk across the contracts and support functions of the Group, thereby ensuring that the audit focus is retained in the key risk areas as well as a more general approach to the rest of the business. Both Grant Thornton and Pannell Kerr Forster reported to the Audit Committee during the year.

**Internal Control and Risk Management (continued)**

In addition to contracts held in Serco's name, the Group has material investments in a number of joint ventures and associated companies. Where these investments are not wholly managed by Serco, the Group can influence, but not control, management practices. Serco representatives within these companies ensure that the processes and procedures for identifying and managing risk are appropriate for the business and that internal controls exist and are regularly monitored. Employees from the Company's joint ventures are invited to participate in the risk oversight group and were invited to attend the CAG conference held in October 2002.

**Going Concern**

The Directors confirm that 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.

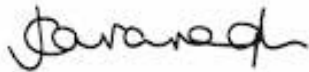
**Compliance during 2002**

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

**Contractual Notice Periods**

As detailed in the Remuneration Report, a number of recommendations have been made for shareholder consideration in relation to Executive Directors' remuneration. Following approval of the relevant resolutions at the forthcoming Annual General Meeting, the Executive Directors' service contracts will be amended to incorporate the changes. At this time the notice period for all Executive Directors will be reduced from 24 to 12 months in line with the notice period operational for those directors appointed after 1 January 2002.

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



**Julia Cavanagh**  
Secretary

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

19 February 2003

## 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 2002.

### **Activities**

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

The review of the business for the year ended 31 December 2002 can be found in the Business Review on pages 21 to 30.

### **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 Accounts.

### **Dividends and Transfers to Reserves**

An interim dividend of 0.64p (2001 – 0.57p) per Ordinary Share was paid on 11 October 2002. The Directors recommend a final dividend of 1.44p (2001 – 1.29p) per Ordinary Share, which if approved by the Annual General Meeting, will be paid on 13 May 2003, to those shareholders on the register at the close of business on 28 February 2003. After dividends, retained profits of £22,861,000 will be transferred to reserves.

### **Substantial Shareholdings**

At close of business on 18 February 2003 (being the latest practical date prior to the signing of the Report of the Directors), the Company had received notifications of the following substantial interests representing over 3% of the issued capital:

Legal & General Group plc – 3.84%  
Morley Fund Management Limited – 4.99%

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 – 10.85%

### **Changes to the Board**

The current Directors of the Company are listed on page 76 and their profiles are provided on pages 85 and 88.

As detailed in the 2001 Annual Review and Accounts, Richard White retired as Executive Chairman following the Annual General Meeting on 3 May 2002. Kevin Beeston was appointed Executive Chairman, Christopher Hyman was appointed Chief Executive and Andrew Jenner was appointed Finance Director. In accordance with the Company's Articles of Association, Andrew Jenner 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 any Director has an interest.

Details of the Directors' interests in the Ordinary Shares and options over the Ordinary Shares of the Company are set out in the Remuneration Report on pages 94 to 96.



### **Annual General Meeting**

The sixteenth Annual General Meeting of the Company will be held at the Queen Elizabeth II Conference Centre, London on 6 May 2003 at 11.00am.

The Notice of the Annual General Meeting, together with relevant notes and proxy card are circulated with this document.

### **Employment Policies**

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

The Group is committed to ensuring equal opportunity, honouring the rights of the individual and fostering partnership and trust in every working relationship. We maintain a safe working environment that provides appropriate remuneration and benefits, training, personal development and compliance with employment laws and regulations of the countries within which we operate. The Group recognises the United Nations Universal Declaration of Human Rights and implements appropriate policies and processes to meet the requirements of the declaration.

The Group remains proud of its record of managing employee relations and continues to believe that the structures of individual and collective consultation and negotiation are best developed at a local level. Over the years the Group has demonstrated that working with trade unions and creating effective partnerships allows improvements to be delivered in business performance as well as terms and conditions of employment. Where employees choose not to belong to a trade union, employee communication forums such as works councils exist to ensure involvement of staff within the business.

The Board understands its responsibility to encourage and assist in the employment, training, promotion and personal career development of all employees without prejudice. Included within the Annual Review is a section entitled 'How do we develop our people?' which provides an insight into the work of the Best Practice Centre and its development of an Institute of Directors programme within the United Kingdom.

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 scheme for senior staff which effectively aligns their interests with those of shareholders by requiring that performance criteria are achieved prior to exercise.

### **Health, Safety and Environmental Policies**

The Group recognises and accepts its responsibility for health, safety and the environment ("H,S&E"). A full time Company H,S&E Adviser, a member of the Corporate Assurance Group ("CAG"), is responsible for the development and monitoring of H,S&E policies, procedures and control systems and reports to the Board via the Executive Chairman. The Executive Chairman is the director responsible for H,S&E matters on behalf of the Board. H,S&E is also formally reported to the Global Management Board on a quarterly basis as part of the Corporate Assurance Report.

The Group is committed to maintaining a safe and healthy working environment in all places that the Company operates, for our staff, our customers, members of the public and any other third party. The Group recognises that it is everyone's responsibility for reducing injury and illness at work. Equally the Group is committed to the protection of the environment, recognising everyone's responsibility for minimising the impact that we have on it. This commitment extends to all our activities, wherever they take place, which have the potential to adversely affect the environment. The Group aims to reduce environmental harm, minimise the use of energy and other resources and ensure that the principles of sustainable development are operated throughout the range of activities in which we are engaged.

**Health, Safety and Environmental Policies** (continued)

CAG is supported by dedicated H,S&E teams in each business unit, either in contracts or the support office, which provide advice and support on H,S&E issues. All employees share responsibility for continuously improving the Company's performance in relation to H,S&E management.

Regular H,S&E meetings are held and representatives from the business units attended the CAG Conference held in October 2002. In order to maintain a high level of H,S&E awareness, great emphasis is placed on training both in relation to specific H,S&E matters but also in the overall context of assurance within the Company.

To ensure compliance with all relevant legislation and Company standards as detailed in the Serco Management System, there is a comprehensive audit system. 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 for payment for the supply of capital and revenue items just as keenly as they negotiate prices and other commercial matters. Suppliers are made aware of the terms and the way in which disputes are to be settled. Payment is then made in accordance with those terms.

The Group's average creditor payment terms in 2002 were 29 days (2001 – 27 days); Company 29 days (2001 – 34 days).

**Donations**

Charitable donations totalling £94,859 (2001 – £116,000) were made during the year. In addition there were a number of community initiatives and support provided in kind to charitable and voluntary organisations made by contract and support office staff.

During the year the Company made no political donations and intends to continue this policy.

The Political Parties and Referendums Act 2000 (the "Act") became effective in December 2000 and requires companies to obtain shareholder approval before incurring European Union ("EU") political expenditure. The Group may need, as part of its business, to contact politicians and political parties within the EU on a non-partisan basis in order to make them aware of industry views, technology and trends. As the Act defines EU political organisations and political expenditure widely, the Directors are proposing to seek shareholder authority to incur such expenditure at its Annual General Meeting in May 2003.

**Auditors**

Deloitte & Touche have expressed their willingness to continue in office as auditors and a resolution to re-appoint them will be proposed at the forthcoming Annual General Meeting.

## Directors' Profiles

### **Kevin Stanley Beeston FCMA (40)** Executive Chairman

Kevin joined Serco in 1985 and has since held a number of financial and commercial roles. He was Finance Director of the Group from 1996 to 1999 and Chief Executive from 1999 to 2002. He was appointed Executive Chairman in May 2002. He is a member of the CBI's President's Committee and Deputy Chairman of the CBI's Public Services Strategy Board.

### **Ralph Noel Hodge CBE BEng (Hons) (68)** Non-Executive Director

Ralph is Chairman of the Water Research Council, and a Non-Executive of British Ceramic Tiles and ORC (Inc). 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) (39)** Chief Executive

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. In 2000 Christopher was given additional responsibility as Chief Executive of a new Serco division, Serco Global Projects and has been instrumental in developing new processes and capabilities at the leading edge of the Group's activities. He was appointed Chief Executive in May 2002.

### **Andrew Mark Jenner ACA (34)** Finance Director

Andrew joined Serco in 1996 as Group Financial Controller, having previously worked for Unilever. He was appointed Corporate Finance Director with additional responsibility for Treasury activities in 1999. He was appointed Finance Director of the Group in May 2002. Andrew has primary responsibility along with the Executive Chairman for the Company's relationship with shareholders and the City.

### **Rhidian Huw Brynmor Jones MA FCIS FCMI (59)** Senior Non-Executive Director

Rhidian is an experienced corporate finance lawyer and was Head of the Corporate Department of solicitors Nabarro Nathanson until retiring from that firm in May last year. He is also a Non-Executive Director of Britannia, the UK's second largest building society, and a policy adviser on company law to ICSA. 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.





**From left to right:**

*Kevin Beeston*

*DeAnne Julius*

*Christopher Hyman*

*Andrew Jenner*

*Ralph Hodge*

*Rhidian Jones*

*Julia Cavanagh*  
*(Company Secretary)*

*Iestyn Williams*

*With thanks to Rushall JMI School, Walsall.*

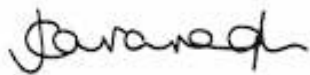
**Directors' Profiles** (continued)**DeAnne Shirley Julius CBE PhD (Econ) (53)** Non-Executive Director

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, Roche and was appointed to the Board of Serco on 29 October 2001.

**Iestyn Milton Williams BA (51)** 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. In 1995 he was 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. Since then he has spent his time developing new business, first in the expansion of the Group's activities in Europe, and for the last two years leading the Group's entry into the education sector. Iestyn is also a Non-Executive Director of Law at Work Ltd and Dolphin Schools Ltd.

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



**Julia Cavanagh**  
Secretary

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

19 February 2003

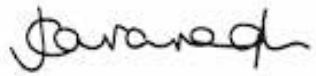
## Directors' Responsibilities

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; and
- State whether applicable accounting standards have been followed.

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

19 February 2003

## Remuneration Report

### Introduction

During the year the Remuneration Committee (the "Committee") commissioned a review of Executive Directors' remuneration, the first external benchmarking exercise undertaken since 1999, and the first review of base salary levels since September 2000. The recommendations of the review which are included in detail in the Remuneration Report detailed below are based on a remuneration philosophy grounded in the following four principles: total rewards should be market competitive; incentive plans should be used to reinforce a high performance culture; the interests of Directors and shareholders should be aligned as far as reasonably possible, and the reward structure should be easily understood by all. In revising the remuneration framework the Committee consulted with the Company's six largest institutional investors, representing approximately 35% of the shareholder base, and the ABI before making its recommendations.

The following report details the remuneration policy, the actual remuneration of the Directors of the Company for the year ended 31 December 2002 and the proposed changes to elements of the remuneration framework to be introduced during 2003, as determined by 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 and the new requirements for the disclosure of Directors' remuneration under the Directors' Remuneration Report Regulations 2002. Reference has also been made to the Higgs Review where it is deemed appropriate.

### Composition and Terms of Reference of the Remuneration Committee

The Committee is comprised of all three Non-Executive Directors; Ralph Hodge (Chairman), Rhidian Jones and DeAnne Julius. It operates in accordance with written terms of reference which are determined by the Board and takes into account best practice and the requirements of the Combined Code. The Executive Chairman and Human Resource & Change Director may attend the meetings of the Committee by invitation.

### Advisers to the Remuneration Committee

During the year, the Committee has been advised by Neil Hayward, Human Resource & Change Director and Mercer Human Resource Consulting ("Mercer") who were appointed by the Committee following a competitive tendering process. Advice has been sought from Mercer on matters surrounding remuneration policy and philosophy, benchmarking exercises for both individual Executive Directors and remuneration packages based on current market trends. Support was also provided in relation to the consultation exercise with the major institutional investors. Advice on legislation and best practice in this area has also been provided by the Company's legal advisers Allen & Overy.

### Remuneration Policy and Practice

The members of the Committee met five times during the year to consider matters relating to the remuneration of Executive Directors as well as the terms and conditions of their service with the Company. Recommendations to the Board following the extensive review process were made within a framework based on the four key principles detailed above.

Executive Directors remuneration comprises a combination of short and long term rewards as explained below and then detailed on pages 94 to 99. All aspects of Executive Directors' remuneration are performance related with the exception of base salary, pensions and life assurance.

#### i) Salaries and Benefits

##### Base Salary

Salary changes were introduced in September 2002 following the remuneration review to reflect market conditions, and take account of a pay freeze agreed by Executive Directors since September 2000. Base salaries were increased by 10% for full time Executive Directors and will be reviewed annually in September on an ongoing basis. During the year Iestyn Williams elected to work part time (three days per week) and the reduction in his base salary is a direct reflection of that decision.



## Remuneration Policy and Practice (continued)

### i) Salaries and Benefits (continued)

#### Bonus Schemes

Following the remuneration review, the Committee has recommended to the Board that the Company introduce a deferred bonus scheme for full time Executive Directors with effect from 2003. The maximum value of this bonus will be 40% of base salary and will be awarded on the basis that the Company achieves earnings per share growth before FRS 10 (Goodwill Amortisation) ("EPS") of RPI +10% in that financial year. The bonus will reduce to 20% on a straight-line basis for EPS growth in excess of RPI +5%. No payment will be made if EPS growth falls below that level. Participants can elect to defer, for three financial years, up to 100% of the bonus earned to purchase shares in the Company. The shares purchased will be matched by the Company if stretching performance targets are met. Achievement of the performance criteria will be measured by comparing Serco's total shareholder return ("TSR") to that of the constituent companies in the FTSE 350 over the three year period. No matching will occur for below median performance, matching will be made on a one for two basis for median performance increasing to a one for one matching for top quartile performance. An explanation of TSR and the use of the FTSE 350 as a comparator group is provided below.

Approval to implement this plan will be sought from shareholders at the Company's Annual General Meeting.

Following discussions with Mercer, the Remuneration Committee approved an interim cash only bonus plan for the financial year 2002 for full time Executive Directors which will provide a maximum benefit of 50% of salary dependent on EPS growth. If EPS growth is below 10% none of the bonus will be available, at 10%, 25% bonus will be available increasing on a straight-line basis for EPS growth between 10% and 15%, with a maximum bonus available for growth of more than 15%. This bonus will be determined following sign off of the 2002 Annual Review and Accounts by the external auditors. The Executive Directors have agreed to use 50% of any net bonus received to purchase shares at market value in the Company. It is proposed to replace this scheme with the deferred bonus scheme following shareholder approval at the Annual General Meeting in May 2003.

#### TSR and the FTSE 350

The Committee has recommended the introduction of TSR as a performance measure in the light of current practice and following the consultation process with institutional investors. TSR is defined as the return shareholders would receive if they held a notional number of shares, and received dividends on those shares over a three year time period. It measures the percentage growth in the company's share price together with the value of any dividends paid, assuming that the dividends are re-invested into the company's shares. TSR performance is being measured against the FTSE 350 as the Company has been unable to identify a large or appropriate enough peer group against which to compare its performance more directly, and at present the Company is positioned in the middle of the FTSE 350. The relevance of measuring performance against this group of companies will be reviewed on a regular basis by the Committee.

### ii) Share Based Incentives

Long term share based incentives are awarded to Executive Directors under the Serco Group plc 1996 Long Term Incentive Scheme (as amended on 5 April 2000) (the "LTIS") and the Serco Group plc 1998 Executive Option Plan (the "EOP"). The performance conditions relating to each of the schemes is set out below.

#### Long Term Incentive Scheme ("LTIS")

Awards made under the LTIS, which are structured as options with a zero exercise price, may be exercised after the third anniversary of grant. Awards made to Executive Directors are calculated at 64% of salary at the time of grant. For awards made in relation to performance periods commencing up to and including 1 January 2002, the extent to which an award vests (and therefore becomes exercisable) is measured by reference to growth in the Company's 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%. EPS was initially selected as the appropriate performance criteria for the scheme as it is visible, easily understood and audited on an annual basis.

**Remuneration Policy and Practice (continued)****ii) Share Based Incentives (continued)**

Following the remuneration review, the Committee has recommended for approval by shareholders at the forthcoming Annual General Meeting, a revision to the performance criteria under which the LTIS currently operates. It is proposed that for future awards made under the LTIS, achievement of the performance criteria will be measured by comparing Serco's TSR to that of the constituent companies in the FTSE 350. No awards will vest for below median performance, 40% will vest for median performance, increasing on a straight-line basis to full vesting for top quartile performance. A justification of the selection of TSR and use of the FTSE 350 as a comparator group together with an explanation of the terms is provided above.

Except in exceptional circumstances, awards are made to employees prior to the commencement of the performance period to which they relate.

**Executive Option Plan ("EOP")**

Options granted under the EOP may be exercised after the third anniversary of grant, dependent upon the achievement of a financial performance target over three years. Grants made to Executive Directors are based on 100% of salary as at 31 December prior to grant. For grants made in relation to performance periods commencing up to and including 1 January 2002 the extent to which an option vests (and therefore becomes exercisable) is measured by reference to the growth in the Company's EPS. 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. EPS was initially selected as the appropriate performance criteria for the scheme as it is visible, easily understood and audited on an annual basis.

The Committee has recommended for approval by shareholders a revision to the performance criteria under which the EOP currently operates. It is proposed that for options granted for performance periods commencing 1 January 2003 or later, achievement of the performance criteria will be measured by reference to the Company's growth in EPS relative to RPI. If the compound annual growth in EPS is less than RPI +5%, none of the options may be exercised. If compound annual growth in EPS is more than RPI +10%, all the options may be exercised. Where compound growth is between RPI +5% and RPI +10%, a proportion of the options may be exercised. The decision to measure compound EPS growth against an RPI index rather than by reference to a peer group of companies was made, as no group of a suitable size or composition could be identified. The decision to retain EPS as the relevant performance measure for this scheme was based on two factors; firstly this scheme applies broadly within the Company to over 800 senior staff and therefore simplicity and visibility is important; and secondly it is considered by the Committee to be an appropriate performance measure with a degree of balance against the TSR measures applied in other aspects of remuneration design.

**iii) 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 to the Accounts. In the event of death in service, each scheme provides for a lump sum payment as well as a dependants' pension.

**iv) Service Contracts and Compensation**

Each Executive Director has a rolling service contract with the Company and these service contracts will be available for inspection prior to the start and after the Company's Annual General Meeting. Following approval of the shareholder resolutions in relation to Executive Remuneration, the service contracts will be amended to reflect the revised conditions. The service contracts will also be amended to reflect a reduction in notice period from 24 months to 12 months, thereby bringing all Executive Directors' notice periods in line. Executive Directors appointed since 1 January 2002 already operate with a one year notice period. This change will rectify the one area of non-compliance by the Company in relation to the current Combined Code.

## Remuneration Policy and Practice (continued)

### iv) Service Contracts and Compensation (continued)

Compensation for early termination of a service contract is not currently addressed in the contracts. The 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. Under the new service agreements being proposed for Executive Directors following the Annual General Meeting, the Company reserves the right to make a payment in lieu of notice. In addition, where a Director leaves the Company following a change of control, either because he is dismissed or he elects to leave on notice, he will receive a payment equivalent to one year's remuneration. The service agreements do not provide for termination payments to be made in any other circumstances.

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

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

Name of Director	Date of contract/ letter of appointment	Unexpired term and notice period at 31 December 2002
<b>Executive Directors:</b>		
K S Beeston	29 March 1996	Refer to note a) below
C R Hyman	1 April 1999	Refer to note a) below
A M Jenner	3 May 2002	Rolling contract with 12 month notice period
I M Williams	1 April 1999	Refer to note a) below
R D White	29 March 1996	None
<b>Non-Executive Directors:</b>		
R N Hodge	5 April 2000	3 months unexpired at 31 December 2002, now extended to 4 April 2004
R H B Jones	1 September 2002	16 months
D S Julius	29 October 2001	22 months

#### Notes:

- Executive Directors have a rolling contract with a 24 month notice period which will be reduced to 12 months following approval of the shareholder resolutions at the Annual General Meeting in May 2003.
- Compensation to Executive Directors for early termination of a service contract is not currently addressed in the contracts. The Committee considers and determines the level of compensation on a case by case basis.
- Non-Executive Directors have a three month notice period and no compensation or other benefits are payable on early termination.

#### Non-Executive Directors

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.

As at 31 December 2002, 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 an annual basis and approved by the Board. Following the publication of the Higgs Review, the Board will consider the recommendation to make additional payments to Chairmen of the Board Committees. The Board does not believe that the partial payment of fees in shares is appropriate and will therefore continue to make cash only payments. Non-Executive Directors' fees are not performance related.

## 1 Salaries and Benefits

The total salaries, fees and benefits paid to or receivable by each person who served as a Director at any time during the year, are as follows:

Names	Total basic salary £	Fees £	Bonuses £	Total estimated value of any other non-cash benefits £	Total remuneration excluding pensions 2002 £	Total remuneration excluding pensions 2001 £
K S Beeston	361,667	–	192,500	1,286	555,453	351,239
R N Hodge	–	37,125	–	–	37,125	38,500
C R Hyman	344,732	–	242,500	1,029	588,261	300,992
A M Jenner	136,694	–	115,500	686	252,880	–
R H B Jones	–	30,125	–	–	30,125	27,500
D S Julius	–	30,125	–	–	30,125	4,718
R D White	119,487	–	–	2,310	121,797	352,433
I M Williams	210,000	–	–	1,286	211,286	303,886
<b>TOTAL</b>	<b>1,172,580</b>	<b>97,375</b>	<b>550,500</b>	<b>6,597</b>	<b>1,827,052</b>	<b>1,379,268</b>

Notes:

On 3 May 2002 A M Jenner was appointed as Finance Director and R D White retired as Executive Chairman.

With effect from April 2002, I M Williams has worked for the Company on a part time basis.

In addition to the 2002 bonus, C R Hyman received a discretionary bonus during the year.

R N Hodge received fees of £7,000 in relation to additional days worked as chairman of an internal rail safety committee.

Section 1 is subject to audit by Deloitte & Touche.

## 2 Directors' Shareholdings

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

	Ordinary Shares of 2p each fully paid 1 January 2002	Ordinary Shares of 2p each fully paid 31 December 2002
K S Beeston	98,713	106,520
R N Hodge	2,010	2,010
C R Hyman	21,382	29,394
R H B Jones	46,500	55,000
A M Jenner	1,722*	9,529
D S Julius	–	5,000
I M Williams	2,387,323	2,387,323

\* at date of appointment

### 3 Share Based Incentives

The total share options granted to each person who has served as a Director of the Company at any time in the financial year are as follows:

i) Serco Group plc 1996 Long Term Incentive Scheme ("LTIS")

The total share options granted under the LTIS to such Directors are as follows:

		Number of shares under option at 1 January 2002 (or, if later, the date of appointment as Director)	Granted during period	Exercised during period	Lapsed unexercised during period	Number of shares under option at 31 December 2002 (or, if earlier, cessation date as Director)	Exercise price £	Market price at grant £	Value realised on exercise £	Date exercisable	Date of expiry of option
K S Beeston	3 Yr Award	38,736	–	–	–	38,736	Nil	4.26	–	31.12.02	04.04.10
	3 Yr Award	51,885*	–	–	–	51,885	Nil	4.90	–	31.12.03	23.11.10
	3 Yr Award	54,676*	–	–	–	54,676	Nil	4.65	–	31.12.04	15.11.11
R N Hodge	–	–	–	–	–	–	–	–	–	–	–
C R Hyman	3 Yr Award	32,868	–	–	–	32,868	Nil	4.26	–	31.12.02	04.04.10
	3 Yr Award	44,474*	–	–	–	44,474	Nil	4.90	–	31.12.03	23.11.10
	3 Yr Award	46,865*	–	–	–	46,865	Nil	4.65	–	31.12.04	15.11.11
A M Jenner	–	–	–	–	–	–	–	–	–	–	–
R H B Jones	–	–	–	–	–	–	–	–	–	–	–
D S Julius	–	–	–	–	–	–	–	–	–	–	–
R D White	3 Yr Award	48,516	–	–	–	48,516†	Nil	4.26	–	31.12.02	04.04.10
	3 Yr Award	51,885*	–	–	–	51,885†	Nil	4.90	–	31.12.03	23.11.10
	3 Yr Award	48,172	–	–	–	48,172†	Nil	4.65	–	31.12.04	15.11.11
I M Williams	3 Yr Award	32,868	–	–	–	32,868	Nil	4.26	–	31.12.02	04.04.10
	3 Yr Award	44,474*	–	–	–	44,474	Nil	4.90	–	31.12.03	23.11.10
	3 Yr Award	46,865*	–	–	–	46,865	Nil	4.65	–	31.12.04	15.11.11

\* Approximately 13.5% of the options granted under the LTIS 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.

† At date of retirement from the Board

The Scheme is an unapproved scheme for Inland Revenue purposes.

No payment was made for the grant of the awards, no awards have had terms varied during the period, and no awards have been exercised by the Directors since the end of the financial year.

The performance criteria to which the exercise of awards under the LTIS is conditional are as set out on pages 91 and 92.

For each share under an LTIS option that is unexpired at the end of the financial year, the market price at the end of the financial year was £1.53 and the highest and lowest market prices during the financial year were £4.00 and £1.325 respectively.

### 3 Share Based Incentives (continued)

#### ii) Serco Group plc 1998 Executive Option Plan ("EOP")

The total share options granted under the EOP to such Directors are as follows:

		Number of shares under option at 1 January 2002 (or, if later, the date of appointment as Director)	Granted during period	Exercised during period	Lapsed unexercised during period	Balance at 31 December 2002 (or, if earlier, cessation date as Director)	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
	Unapproved	-	152,035*	-	-	152,035	-	2.64	-	03.05.05	02.05.09
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
	Unapproved	-	130,316*	-	-	130,316	-	2.64	-	03.05.05	02.05.09
A M Jenner	Approved	4,134†	-	-	-	4,134	-	2.18	-	21.05.01	20.05.08
	Approved	8,574†	-	-	-	8,574	-	2.45	-	01.04.02	31.03.09
	Unapproved	7,422†	-	-	-	7,422	-	2.45	-	01.04.02	31.03.06
	Unapproved	12,336†	-	-	-	12,336	-	4.26	-	05.04.03	04.04.07
	Unapproved	18,524†*	-	-	-	18,524	-	4.35	-	28.03.04	27.03.08
	Unapproved	-	78,189*	-	-	78,189	-	2.64	-	03.05.05	02.05.09
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
Unapproved	-	130,316*	-	-	130,316	-	2.64	-	03.05.05	02.05.09	

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

† At date of retirement from the Board

‡ At date of appointment

**3 Share Based Incentives (continued)**

ii) Serco Group plc 1998 Executive Option Plan (continued)

The Scheme is an approved scheme for Inland Revenue purposes but has an unapproved schedule.

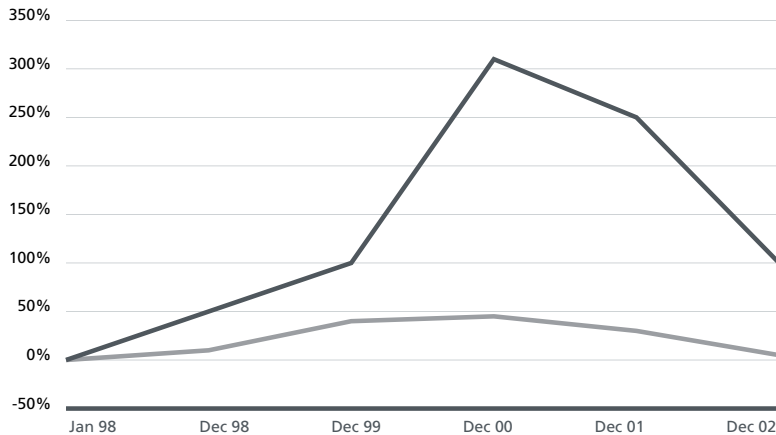
No payment was made for the grant of the options, no options have had terms varied during the period, and no options have been exercised by the Directors since the end of the financial year.

The performance criteria to which the exercise of options under the EOP is conditional are as set out on page 92.

For each share under an EOP option that is unexpired at the end of the financial year, the market price at the end of the financial year was £1.53 and the highest and lowest market prices during the financial year were £4.00 and £1.325 respectively.

Section 3 is subject to audit by Deloitte & Touche.

**4 Performance Graph – Serco five year TSR vs FTSE 350 index**



CUMULATIVE TSR PERFORMANCE

— Serco  
— FTSE 350 index

*Provided by Mercer Human Resource Consulting.*

This graph demonstrates the performance of Serco’s total shareholder return (“TSR”) in relation to the FTSE 350 index over the past five years.

As detailed earlier, TSR is defined as the return shareholders would receive if they held a notional number of shares, and received dividends on those shares over a period of time. It measures the percentage growth in the company’s share price together with the value of any dividends paid, assuming that the dividends are re-invested into the company’s shares.

## 5 Pensions

The Directors receive pension and life assurance benefits consistent with those provided by other leading companies. The details of the defined benefit schemes operated by the Group are set out in 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 all Directors under defined benefit scheme are as follows:

	Transfer value of accrued benefits as at 31 December 2002 £	Transfer value of accrued benefits as at 31 December 2001 £	Increase in transfer value between 2001 report and 31 December 2002 £	Gross increase in accrued pension during the year £	Increase in accrued pension during the year, net of inflation £	Value of net increase in accrual over the year £	Total accrued pension at year end £ p.a.
K S Beeston	539,342	449,414	72,622	18,429	16,956	86,139	105,073
C R Hyman	100,212	84,132	1,568	3,495	3,265	4,723	17,010
A M Jenner	11,025	–	2,446	2,430	2,430	2,446	2,430
R D White	2,532,643	1,581,562	942,425	14,680	11,873	137,195	179,772
I M Williams	1,141,718	1,009,305	122,107	13,270	11,246	107,721	132,322

### Notes to pension benefits:

- a) The total accrued pension shown is that which would be paid annually on retirement, based on service to the end of this year, or date of retirement in the case of R D White. The increase in accrued pension during the year is shown both as a gross increase and excluding any increase in inflation.
- b) Transfer values have been calculated in accordance with version 1.5 of the Guidance Note GN11 issued by the actuarial profession. The difference between the transfer values at the beginning and end of the year includes the effect of fluctuations in the transfer value due to factors beyond the control of the Company and the Directors, such as stock market movements. It is calculated after deducting Directors' contributions.
- c) The value of the net increase in accrual represents the incremental value to the director of his service during the year, calculated on the assumption that his service terminated at the year-end. It is based on the accrued pension increase net of inflation after deducting the Director's contribution.
- d) Members have the option to pay Additional Voluntary Contributions; neither the contributions nor the resulting benefits are included in the above table.
- e) 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.
- f) In the case of R D White, who retired on 5 July 2002, the increase in transfer value between 2001 and the year-end is a result of the different actuarial valuation approach for a retired member as opposed to an active member, and as the result of his benefits having to be restricted by Inland Revenue limits. These effects have been accentuated as a result of R D White having retired before age 60.

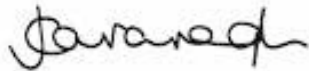


**5 Pensions (continued)**

- g) C R Hyman also benefits from a defined contribution arrangement to which the Company contributes 15% of remuneration in excess of the Permitted Maximum under the Inland Revenue approved Scheme. Company contributions paid under this arrangement during the year amounted to £33,247.

Section 5 is subject to audit by Deloitte & Touche.

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



**Julia Cavanagh**  
Secretary

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

19 February 2003

## 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 2002 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. We have also audited the information in the part of the Directors' Remuneration Report that is described as having been audited.

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

### **Respective responsibilities of Directors and Auditors**

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. They are also responsible for the preparation of the other information contained in the annual report including the Directors' Remuneration Report. Our responsibility is to audit the financial statements and the part of the Directors' Remuneration Report described as having been audited in accordance with relevant United Kingdom legal and regulatory requirements and auditing standards.

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements and the part of the Directors' Remuneration Report described as having been audited have been properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the Report of the Directors 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 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 of the Financial Services Authority 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 including the unaudited part of the Directors' Remuneration Report 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 and the part of the Directors' Remuneration Report described as having been audited. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the 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 and the part of the Directors' Remuneration Report described as having been audited are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion, we also evaluated the overall adequacy of the presentation of information in the financial statements and the part of the Directors' Remuneration Report described as having been audited.

**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 2002 and of the profit of the Group for the year then ended; and
- the financial statements and the part of the Directors' Remuneration Report described as having been audited have been properly prepared in accordance with the Companies Act 1985.



**Deloitte & Touche**  
Chartered Accountants and Registered Auditors  
London

19 February 2003

Neither an audit nor a review provides assurance on the maintenance and integrity of the website, including controls used to achieve this, and in particular whether any changes may have occurred to the financial information 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 information differs from legislation in other jurisdictions.

## Consolidated Profit and Loss Account

For the year ended 31 December 2002

	Note	2002 Group £'000	2002 Joint Ventures £'000	2002 Total £'000	Restated 2001 Group £'000	Restated 2001 Joint Ventures £'000	Restated 2001 Total £'000
<b>TURNOVER: GROUP AND SHARE OF JOINT VENTURES - CONTINUING OPERATIONS</b>							
Less: Share of joint ventures	2	1,097,278	228,670	1,325,948	913,693	227,510	1,141,203
Group turnover	2	–	(228,670)	(228,670)	–	(227,510)	(227,510)
Cost of sales	2	1,097,278	–	1,097,278	913,693	–	913,693
		(947,313)	–	(947,313)	(789,686)	–	(789,686)
<b>GROSS PROFIT</b>							
Administrative expenses		149,965	–	149,965	124,007	–	124,007
Amortisation of intangible assets		(120,862)	–	(120,862)	(102,753)	–	(102,753)
Other administrative expenses		(8,098)	–	(8,098)	(5,123)	–	(5,123)
Other administrative expenses		(112,764)	–	(112,764)	(97,630)	–	(97,630)
Exceptional item: Unsuccessful NATS acquisition		–	–	–	(10,187)	–	(10,187)
Operating profit-continuing operations		29,103	–	29,103	11,067	–	11,067
Exceptional item: GSR refinancing		–	–	–	15,356	–	15,356
Share of operating profit in joint ventures		–	21,883	21,883	–	17,374	17,374
Interest receivable	4	1,422	16,894	18,316	2,207	17,102	19,309
Group		1,422	–	1,422	2,207	–	2,207
Share of joint ventures		–	16,894	16,894	–	17,102	17,102
Interest payable and similar charges	5	(5,486)	(14,875)	(20,361)	(7,299)	(15,768)	(23,067)
Group		(5,486)	–	(5,486)	(7,299)	–	(7,299)
Share of joint ventures		–	(14,875)	(14,875)	–	(15,768)	(15,768)
<b>PROFIT ON ORDINARY ACTIVITIES BEFORE TAXATION</b>							
Taxation on profit on ordinary activities	6	25,039	23,902	48,941	21,331	18,708	40,039
	7			(16,639)			(13,012)
<b>PROFIT ON ORDINARY ACTIVITIES AFTER TAXATION</b>							
Dividends	8			32,302			27,027
				(9,441)			(7,265)
<b>RETAINED PROFIT FOR THE FINANCIAL YEAR</b>							
	23			22,861			19,762
<b>EARNINGS PER SHARE ("EPS") PER ORDINARY SHARE OF 2P EACH</b>							
Basic EPS, after amortisation of goodwill	9			7.66p			6.94p
Basic EPS, before amortisation of goodwill				9.58p			8.25p
Diluted EPS, after amortisation of goodwill				7.63p			6.91p
Diluted EPS, before amortisation of goodwill				9.54p			8.22p

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

## Consolidated Balance Sheet

At 31 December 2002

	<i>Note</i>	2002 £'000	Restated 2001 £'000
<b>FIXED ASSETS</b>			
Intangible assets	10	147,473	141,170
Tangible assets	11	62,479	48,724
Investments in joint ventures	12	35,883	30,510
Share of gross assets		317,831	322,338
Share of gross liabilities		(281,948)	(291,828)
Investment in own shares	12	18,207	18,983
		<b>264,042</b>	<b>239,387</b>
<b>CURRENT ASSETS</b>			
Stocks	13	38,744	35,838
Debtors: Amounts due within one year	14	220,042	199,705
Debtors: Amounts due after more than one year	14	108,932	76,105
Cash at bank and in hand	17	71,774	34,812
		<b>439,492</b>	<b>346,460</b>
<b>CREDITORS: AMOUNTS FALLING DUE WITHIN ONE YEAR</b>			
Bank loans and overdrafts	16	2,386	70,647
Trade creditors		74,377	58,034
Other creditors including taxation and social security	15	93,843	100,621
Accruals and deferred income		136,766	128,629
Proposed dividend	8	6,184	5,026
		<b>313,556</b>	<b>362,957</b>
<b>NET CURRENT ASSETS/(LIABILITIES)</b>		<b>125,936</b>	<b>(16,497)</b>
<b>TOTAL ASSETS LESS CURRENT LIABILITIES</b>			
Creditors: Amounts falling due after more than one year	16	87,588	68,570
Provisions for liabilities and charges	18	34,533	25,249
<b>NET ASSETS</b>		<b>267,857</b>	<b>129,071</b>
<b>CAPITAL AND RESERVES</b>			
Called up share capital	21	8,697	7,903
Share premium account	22	190,791	73,656
Capital redemption reserve		143	143
Profit and loss account	23	68,226	47,369
<b>EQUITY SHAREHOLDERS' FUNDS</b>	20	<b>267,857</b>	<b>129,071</b>

These Accounts and Notes were approved by the Board of Directors on 19 February 2003 and signed on behalf of the Board:

Kevin Beeston Executive Chairman

Andrew Jenner Finance Director

## Company Balance Sheet

At 31 December 2002

	<i>Note</i>	2002 £'000	2001 £'000
<b>FIXED ASSETS</b>			
Tangible assets	11	2,309	1,682
Investments in subsidiaries	12	141,418	35,598
		<b>143,727</b>	<b>37,280</b>
<b>CURRENT ASSETS</b>			
Amounts owed by subsidiary companies due after more than one year		111,426	148,183
Debtors: Amounts due within one year	14	21,669	14,820
Debtors: Amounts due after more than one year	14	1,297	–
Cash at bank and in hand		17,753	–
		<b>152,145</b>	<b>163,003</b>
<b>CREDITORS: AMOUNTS FALLING DUE WITHIN ONE YEAR</b>			
Bank loans and overdrafts	16	–	30,245
Trade creditors		1,066	757
Other creditors including taxation and social security	15	688	1,077
Accruals and deferred income		6,395	5,098
Proposed dividend	8	6,184	5,026
		<b>14,333</b>	<b>42,203</b>
<b>NET CURRENT ASSETS</b>		<b>137,812</b>	<b>120,800</b>
<b>TOTAL ASSETS LESS CURRENT LIABILITIES</b>			
Creditors: Amounts falling due after more than one year	16	43,784	41,420
Provisions for liabilities and charges	18	335	–
<b>NET ASSETS</b>		<b>237,420</b>	<b>116,660</b>
<b>CAPITAL AND RESERVES</b>			
Called up share capital	21	8,697	7,903
Share premium account	22	190,791	73,656
Capital redemption reserve		143	143
Profit and loss account	23	37,789	34,958
<b>EQUITY SHAREHOLDERS' FUNDS</b>		<b>237,420</b>	<b>116,660</b>

These Accounts and Notes were approved by the Board of Directors on 19 February 2003 and signed on behalf of the Board:

**Kevin Beeston** Executive Chairman

**Andrew Jenner** Finance Director

## Consolidated Cash Flow Statement

For the year ended 31 December 2002

	<i>Note</i>	2002 £'000	Restated 2001 £'000
Operating profit before cost of unsuccessful NATS acquisition		29,103	21,254
Exceptional item: Cost of unsuccessful NATS acquisition		–	(10,187)
Operating profit		29,103	11,067
Depreciation and amortisation of goodwill		23,632	18,283
Net increase in working capital		(13,124)	(13,866)
One-off pension fund contribution		(15,500)	–
<b>NET CASH INFLOW FROM OPERATING ACTIVITIES BEFORE PFI ASSET EXPENDITURE</b>		<b>24,111</b>	<b>15,484</b>
Expenditure on PFI asset under construction*		(14,950)	(13,733)
Net cash inflow from operating activities after PFI asset expenditure	24	9,161	1,751
Dividends received from joint ventures		11,095	9,645
<b>RETURNS ON INVESTMENT AND SERVICING OF FINANCE</b>			
Interest received		1,223	578
Interest paid		(7,362)	(6,182)
Net cash outflow from returns on investments and servicing of finance		(6,139)	(5,604)
<b>TAXATION</b>			
Tax paid		(5,738)	(6,417)
<b>CAPITAL EXPENDITURE AND FINANCIAL INVESTMENT</b>			
Purchase of tangible and intangible fixed assets		(23,596)	(17,626)
Sale of tangible fixed assets		8,125	4,569
Exceptional item: GSR refinancing		–	16,343
Security deposit on PFI asset under construction		–	(6,000)
Net cashflows with joint ventures		1,235	(1,945)
Purchase of own shares		–	(9,964)
Net cash outflow from capital expenditure and financial investment		(14,236)	(14,623)
<b>ACQUISITIONS AND DISPOSALS</b>			
Acquisitions	12	(11,353)	(77,106)
Net cash acquired with acquisitions		397	3,558
Subscription for shares in joint ventures	12	(370)	(38)
Proceeds on disposal of joint ventures		1,030	–
Net cash outflow from acquisitions and disposals		(10,296)	(73,586)
<b>EQUITY DIVIDENDS PAID</b>			
Dividends paid		(8,283)	(6,664)
Net cash outflow from equity dividends paid		(8,283)	(6,664)
Net cash outflow before financing		(24,436)	(95,498)
<b>FINANCING</b>			
Issue of Ordinary Share Capital		117,929	2,001
Debt due within one year: (Decrease)/increase in other loans		(300)	100
Debt due beyond one year: Increase in:		15,624	14,850
Other loans		24	750
Non-recourse debt financing PFI asset *		15,600	14,100
Capital element of finance lease repayments		(3,594)	(2,785)
Net cash inflow from financing		129,659	14,166
Increase/(decrease) in cash		105,223	(81,332)
Balance at 1 January		(35,835)	45,497
<b>BALANCE AT 31 DECEMBER</b>		<b>69,388</b>	<b>(35,835)</b>

\*PFI asset under construction financed by non-recourse loan

## Consolidated Statement of Total Recognised Gains and Losses

For the year ended 31 December 2002

	2002 £'000	Restated 2001 £'000
Profit on ordinary activities after taxation	32,302	27,027
Currency translation differences on foreign currency net investments	(1,911)	(1,917)
Total recognised gains and losses for the year	30,391	25,110
Prior year adjustment (see Note 1)	(806)	
Total gains and losses recognised since last annual report and financial statements	29,585	



# Notes to the Accounts

For the year ended 31 December 2002

## 1 Accounting policies

These Accounts have been prepared in accordance with applicable UK accounting standards, and the particular accounting policies adopted are detailed below. These have all been applied consistently with the exception of bid costs which is explained in the restatement below.

### Accounting convention

These Accounts have been prepared under the historical cost convention.

### Basis of consolidation

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

### Restatement

The 2001 Accounts have been restated to reflect the impact of the Urgent Issues Task Force Abstract 34 ("UITF 34") – Pre-Contract Costs; eliminating £1,193,000 of bid costs, previously disclosed within debtors, and the associated tax effect of £387,000. The impact of this adjustment in the 2002 Accounts is a reduction in amortisation of bid costs of £400,000.

The Profit and Loss Account has been restated to reclassify 'Other operating costs relating to joint ventures' within 'Other administrative expenses'.

### Accounting for PFI Contracts

Within Public Private Partnership ("PPP") projects (including Private Finance Initiative ("PFI") projects), where the concession agreement transfers limited risks and rewards associated with ownership to the contractor, the costs incurred during the period of initial asset construction, as a direct consequence of financing, designing and constructing the asset, are shown as 'assets in the course of construction' within current assets. On completion of the asset construction phase the asset is transferred to debtors as 'amounts receivable under PPP contracts'.

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.

Serco has one Special Purpose Company – Traffic Information Services (TIS) Limited, where the results are fully consolidated. All other SPCs are classified as joint ventures and accounted for using the gross equity method.

### 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 average 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.

**1 Accounting policies (continued)****Pension costs: Defined contribution schemes**

Contributions for the year in respect of defined contribution schemes are charged to the Profit and Loss Account. Differences between charges accruing during the year and cash payments are included as either accruals or prepayments in the Balance Sheet.

The Group has adopted the transitional disclosure requirements of Financial Reporting Standard 17 ("FRS 17") – Retirement Benefits. For further information see Note 31.

**Turnover**

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

**Goodwill**

Goodwill arising on acquisitions is capitalised in the Consolidated 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.

**Current Tax**

Current tax, including UK Corporation Tax and foreign tax, is provided at amounts expected to be paid (or recovered) using the tax rates and laws that have been enacted or substantially enacted at the Balance Sheet date.

**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 Group's share of the net assets of its joint ventures, which includes several PFIs, is included under the heading 'investments in joint ventures'. The share of net assets is split between gross assets and gross liabilities.

**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. Investment in own shares is stated at cost less provision for impairment.

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 performance period during which the benefits are earned by employees.

**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.

## 1 Accounting policies (continued)

### 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.

### Pre-contract costs

All bid costs are expensed through the Profit and Loss Account up to the point where contract award is virtually certain in accordance with UITF 34. Bid costs incurred after this point are then capitalised within debtors. On contract award these bid costs are amortised through the Profit and Loss Account on a straight-line basis over the contract period.

### Deferred taxation

The charge for taxation takes account of taxation deferred because of differences between the timing of recognition of certain items for taxation purposes and for accounting purposes. Deferred tax is recognised in respect of all timing differences that have originated but not reversed at the Balance Sheet date where the transactions or events that give rise to an obligation to pay more or less tax in the future have occurred by the Balance Sheet date. A deferred tax asset is recognised only when it is considered more likely than not that it will be recovered.

Deferred tax is recognised on a non-discounted basis using tax rates in force at the Balance Sheet date. Financial Reporting Standard 19 ("FRS 19") – Deferred Tax has been adopted for the first time in these financial statements and there is no material effect on the comparative figures.

### 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 any 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.

## 2 Segmental Report

Classes of Business	Group £'000	Joint Ventures £'000	Total £'000
<b>2002</b>			
<b>TURNOVER</b>			
Civil Government	267,127	89,220	356,347
Defence	228,579	134,654	363,233
Transport	347,815	4,796	352,611
Science	115,603	–	115,603
Private sector	138,154	–	138,154
<b>TOTAL</b>	<b>1,097,278</b>	<b>228,670</b>	<b>1,325,948</b>
<b>PROFIT BEFORE TAXATION AND OTHER COSTS</b>			
Civil Government	17,796	5,287	23,083
Defence	13,259	15,956	29,215
Transport	15,126	640	15,766
Science	9,845	–	9,845
Private sector	6,909	–	6,909
<b>TOTAL</b>	<b>62,935</b>	<b>21,883</b>	<b>84,818</b>
<b>OTHER COSTS</b>			
Common costs			(25,734)
Amortisation of intangible assets			(8,098)
Net interest – Group			(4,064)
Net interest – Joint ventures			2,019
<b>PROFIT ON ORDINARY ACTIVITIES BEFORE TAXATION</b>			<b>48,941</b>
<b>NET ASSETS</b>			
Civil Government			43,269
Defence			53,400
Transport			45,716
Science			69,771
Private sector			31,679
<b>TOTAL</b>			<b>243,835</b>
Unallocated assets			24,022
<b>TOTAL</b>			<b>267,857</b>

**2 Segmental Report (continued)**

Classes of Business	Group £'000	Joint Ventures £'000	Restated Total £'000
<b>2001</b>			
<b>TURNOVER</b>			
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
<b>TOTAL</b>	<b>913,693</b>	<b>227,510</b>	<b>1,141,203</b>
<b>PROFIT BEFORE TAXATION AND OTHER COSTS</b>			
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
<b>TOTAL</b>	<b>50,447</b>	<b>17,374</b>	<b>67,821</b>
<b>OTHER COSTS</b>			
Common costs			(24,070)
Exceptional item: Cost of unsuccessful NATS acquisition			(10,187)
Exceptional item: GSR refinancing			15,356
Amortisation of intangible assets			(5,123)
Net interest: Group			(5,092)
Net interest: Joint ventures			1,334
<b>PROFIT ON ORDINARY ACTIVITIES BEFORE TAXATION</b>			<b>40,039</b>
<b>NET ASSETS</b>			
Civil Government			33,517
Defence			36,282
Transport			27,044
Science			903
Private sector			14,246
<b>TOTAL</b>			<b>111,992</b>
Unallocated assets			17,079
<b>TOTAL</b>			<b>129,071</b>

## 2 Segmental Report (continued)

Geographical segments	Group £'000	Joint Ventures £'000	Total £'000
<b>2002</b>			
<b>TURNOVER</b>			
United Kingdom	752,247	178,207	930,454
Rest of Europe and Middle East	163,218	7,341	170,559
Asia Pacific	116,671	38,406	155,077
North America	65,142	4,716	69,858
<b>TOTAL</b>	<b>1,097,278</b>	<b>228,670</b>	<b>1,325,948</b>
<b>PROFIT BEFORE TAXATION AND OTHER COSTS</b>			
United Kingdom	35,065	19,029	54,094
Rest of Europe and Middle East	12,895	625	13,520
Asia Pacific	9,503	1,750	11,253
North America	5,472	479	5,951
<b>TOTAL</b>	<b>62,935</b>	<b>21,883</b>	<b>84,818</b>
<b>OTHER COSTS</b>			
Common costs			(25,734)
Amortisation of intangible assets			(8,098)
Net interest: Group			(4,064)
Net interest: Joint ventures			2,019
<b>PROFIT ON ORDINARY ACTIVITIES BEFORE TAXATION</b>			<b>48,941</b>
<b>NET ASSETS</b>			
United Kingdom			142,821
Rest of Europe and Middle East			43,951
Asia Pacific			40,057
North America			17,006
<b>TOTAL</b>			<b>243,835</b>
Unallocated assets			24,022
<b>TOTAL</b>			<b>267,857</b>

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

**2 Segmental Report (continued)**

Geographical segments	Group £'000	Joint Ventures £'000	Restated Total £'000
<b>2001</b>			
<b>TURNOVER</b>			
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
<b>TOTAL</b>	<b>913,693</b>	<b>227,510</b>	<b>1,141,203</b>
<b>PROFIT BEFORE TAXATION AND OTHER COSTS</b>			
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
<b>TOTAL</b>	<b>50,447</b>	<b>17,374</b>	<b>67,821</b>
<b>OTHER COSTS</b>			
Common costs			(24,070)
Exceptional item: Cost of unsuccessful NATS acquisition			(10,187)
Exceptional item: GSR refinancing			15,356
Amortisation of intangible assets			(5,123)
Net interest: Group			(5,092)
Net interest: Joint ventures			1,334
<b>PROFIT ON ORDINARY ACTIVITIES BEFORE TAXATION</b>			<b>40,039</b>
<b>NET ASSETS</b>			
United Kingdom			64,563
Rest of Europe and Middle East			9,278
Asia Pacific			30,919
North America			7,232
<b>TOTAL</b>			<b>111,992</b>
Unallocated assets			17,079
<b>TOTAL</b>			<b>129,071</b>

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

### 3 Information regarding Directors and Employees

	2002 £'000	2001 £'000
a) Directors' remuneration:		
Fees as Directors	97	83
Other emoluments	1,730	1,319
Total remuneration excluding pensions	1,827	1,402

The prior year comparative includes Directors who did not serve in 2002.

	2002 £'000	2001 £'000
b) Employee costs including Directors:		
Wages and salaries	444,693	399,447
Social security costs	36,713	36,376
Other pension costs (Note 31)	29,096	19,544
Long Term Incentive Scheme costs	776	661
	511,278	456,028

	2002	2001
c) Number of persons employed by Serco Group plc and its subsidiaries		
Average number of persons employed in the provision of services:		
Civil Government	7,138	6,738
Defence	6,251	6,491
Transport	4,442	4,653
Science	1,665	1,460
Private sector	2,999	2,445
Non-specific	202	116
	22,697	21,903

### 4 Interest receivable

	2002 £'000	2001 £'000
Short term deposits	818	1,484
Loans to joint ventures	604	723
Total Group	1,422	2,207
Share of joint venture interest	16,894	17,102
	18,316	19,309



**5 Interest payable and similar charges**

	2002 £'000	2001 £'000
Bank loans and overdrafts	5,486	7,299
Share of joint venture interest	14,875	15,768
	<b>20,361</b>	<b>23,067</b>

**6 Profit on ordinary activities before taxation**

	2002 £'000	2001 £'000
Profit on ordinary activities before taxation is after charging:		
Rentals under operating leases:		
Land and buildings	12,599	11,790
Plant and machinery	20,686	17,586
Depreciation on tangible assets:		
Owned	12,307	10,861
Held under finance leases	3,227	2,299
Finance lease interest on operational assets	721	454
Amortisation of goodwill and intangible assets	8,098	5,123
Auditors' remuneration:		
Deloitte & Touche	514	444
Other auditors	175	125
Other fees paid to Deloitte & Touche:		
Bid support	1,170	659
Tax	490	544
Other	595	432
Other fees paid to other accountancy firms:		
Internal audit	152	183
Other	555	391

## 7 Taxation on profit on ordinary activities

	2002 £'000	Restated 2001 £'000
The taxation charge on the profit for the year is made up as follows:		
United Kingdom Corporation Tax	1,654	3,010
Double tax relief	–	(349)
Overseas taxation:		
Operating income	1,950	2,777
Exceptional item: GSR refinancing	–	1,219
Deferred taxation	4,120	(504)
Adjustment in respect of prior years:		
United Kingdom Corporation Tax	(750)	292
Overseas taxation	(37)	–
Deferred taxation	2,375	501
Share of joint ventures' taxation charge	7,327	6,066
	<b>16,639</b>	<b>13,012</b>

The current tax recognised for the year is higher than the United Kingdom corporation tax rate of 30%. The main reasons for this are set out below:

	2002 £'000	Restated 2001 £'000
Profit on ordinary activities before taxation multiplied by the UK Corporation Tax rate of 30%	14,682	12,012
Effect on the reported tax charge of:		
Expenses not deductible for tax purposes (primarily goodwill amortisation)	3,463	4,450
Tax allowances in excess of depreciation	(1,828)	(2,610)
Other short term timing differences	(1,953)	(2,109)
Unrelieved tax losses and higher tax rates on overseas earnings	255	2,458
Tax exempt income and the effect of the use of unrecognised tax losses	(634)	(519)
Tax incentives including Tonnage Tax and Research & Development Tax Credits	(3,054)	(959)
Current tax charge for the year	10,931	12,723
Deferred tax	6,495	(3)
Adjustment in respect of prior years	(787)	292
Taxation on profit on ordinary activities	<b>16,639</b>	<b>13,012</b>

## 8 Dividends

	2002 £'000	2001 £'000
Interim dividend of 0.64p per share on 429,260,960 Ordinary Shares (2001 – 0.57p on 392,551,903 Ordinary Shares) of 2p each fully paid – paid 11 October 2002	2,747	2,238
Proposed final dividend of 1.44p per share on 429,448,207 Ordinary Shares (2001 – 1.29p on 389,613,782 Ordinary Shares) of 2p each fully paid – proposed payment on 13 May 2003	6,184	5,026
	<b>8,931</b>	7,264
2001 final dividend of 1.29p on 39,547,465 shares issued between 31 December 2001 and 13 March 2002 (record date)	510	–
2000 final dividend of 1.13p on 50,212 shares relating to shares issued between 31 December 2000 and 6 April 2001 (record date)	–	1
	<b>9,441</b>	7,265

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 (“FRS 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 £32,302,000 for the year ended 31 December 2002 (2001 restated – £27,027,000) and the weighted average number of 421,813,107 (2001 – 389,552,980) 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 £40,400,000 (adjusted for the effect of goodwill amortisation of £8,098,000) for the year ended 31 December 2002 (2001 restated – £32,150,000 adjusted for the effect of goodwill amortisation of £5,123,000) and the weighted average number of 421,813,107 (2001 – 389,552,980) 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 £32,302,000 for the year ended 31 December 2002 (2001 restated – £27,027,000) and the weighted average number of 423,288,423 (2001 – 391,115,673) 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 £40,400,000 (adjusted for the effect of goodwill amortisation of £8,098,000) for the year ended 31 December 2002 (2001 restated – £32,150,000 adjusted for the effect of goodwill amortisation of £5,123,000) and the weighted average number of 423,288,423 (2001 – 391,115,673) Ordinary Shares of 2p each assuming that the options are all exercised.

**10 Intangible assets**

	Goodwill £'000	Other £'000	Group Total £'000
Cost:			
At 1 January 2002	152,889	–	152,889
Additions during the year	13,029	1,775	14,804
Adjustments to goodwill capitalised on acquisitions prior to 1 January 2002	(403)	–	(403)
<b>AT 31 DECEMBER 2002</b>	<b>165,515</b>	<b>1,775</b>	<b>167,290</b>
Accumulated amortisation:			
At 1 January 2002	11,719	–	11,719
Charge for the year	7,777	321	8,098
<b>AT 31 DECEMBER 2002</b>	<b>19,496</b>	<b>321</b>	<b>19,817</b>
Net book value:			
<b>AT 31 DECEMBER 2002</b>	<b>146,019</b>	<b>1,454</b>	<b>147,473</b>
At 31 December 2001	141,170	–	141,170

Other intangible assets comprise a £1,775,000 premium for the acquisition of two, five-year, licences and are amortised over the licence life.

**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 2002	7,567	10,128	97,846	115,541
Subsidiaries acquired	–	–	838	838
Transfer from asset held for resale	5,532	–	–	5,532
Capital expenditure	63	3,749	25,619	29,431
Disposals	(5,535)	(214)	(5,799)	(11,548)
Foreign exchange differences	405	73	1,916	2,394
<b>AT 31 DECEMBER 2002</b>	<b>8,032</b>	<b>13,736</b>	<b>120,420</b>	<b>142,188</b>
Accumulated depreciation:				
At 1 January 2002	2,234	4,074	60,509	66,817
Subsidiaries acquired	–	–	483	483
Provided during the year	181	1,153	14,200	15,534
Disposals	–	(175)	(4,458)	(4,633)
Foreign exchange differences	143	17	1,348	1,508
<b>AT 31 DECEMBER 2002</b>	<b>2,558</b>	<b>5,069</b>	<b>72,082</b>	<b>79,709</b>
Net book value:				
<b>AT 31 DECEMBER 2002</b>	<b>5,474</b>	<b>8,667</b>	<b>48,338</b>	<b>62,479</b>
At 31 December 2001	5,333	6,054	37,337	48,724

The cost of assets held by the Group under finance leases at 31 December 2002 was £24,977,000 (2001 – £18,905,000). The accumulated depreciation provided for those assets at 31 December 2002 was £9,168,000 (2001 – £6,903,000).

**11 Tangible assets (continued)**

Company	Short leasehold building improvements £'000	Machinery, motor vehicles, furniture and equipment £'000	Total £'000
Cost:			
At 1 January 2002	1,117	2,624	3,741
Transfers from subsidiary undertakings	1,161	2,329	3,490
Transfers to subsidiary undertakings	(1,049)	(1,897)	(2,946)
Capital expenditure	36	1,054	1,090
Disposals	-	(27)	(27)
<b>AT 31 DECEMBER 2002</b>	<b>1,265</b>	<b>4,083</b>	<b>5,348</b>
Accumulated depreciation:			
At 1 January 2002	355	1,704	2,059
Transfers from subsidiary undertakings	365	1,398	1,763
Transfers to subsidiary undertakings	(323)	(1,160)	(1,483)
Provided during the year	151	566	717
Disposals	-	(17)	(17)
<b>AT 31 DECEMBER 2002</b>	<b>548</b>	<b>2,491</b>	<b>3,039</b>
Net book value:			
<b>AT 31 DECEMBER 2002</b>	<b>717</b>	<b>1,592</b>	<b>2,309</b>
At 31 December 2001	762	920	1,682

The cost of assets held by the Company under finance leases at 31 December 2002 was £872,000 (2001 – £Nil). The accumulated depreciation provided for those assets at 31 December 2002 was £71,307 (2001 – £Nil).

**12 Investments held as fixed assets**

	Company £'000
a) Shares in subsidiary companies at cost:	
At 1 January 2002	35,598
Transfer of investments from Group companies	115,890
Transfer of investments to Group companies	(29,437)
Equity subscriptions for shares in Group companies	22,908
Redemption of Serco Australia Pty Ltd preference shares	(3,541)
<b>AT 31 DECEMBER 2002</b>	<b>141,418</b>

**12 Investments held as fixed assets (continued)**

	Group £'000
b) Group investments in joint ventures:	
At 1 January 2002	30,510
Dividends receivable	(11,095)
Acquisitions	370
Disposals	(139)
Foreign exchange translation difference	(338)
Share of profits after tax	16,575
<b>AT 31 DECEMBER 2002</b>	<b>35,883</b>
	Group £'000
c) Investment in own shares:	
At 1 January 2002	18,983
Amortisation	(776)
<b>AT 31 DECEMBER 2002</b>	<b>18,207</b>

Investment in own shares represents 5,414,630 (2001 – 5,557,033) shares in Serco Group plc held by the Employee Share Ownership Trust (the "Trust") equal to 1.25% of current allotted share capital (2001 – 1.4%). The market value of shares held by the Trust at 31 December 2002 was £8,284,384 (2001 – £20,283,170). 142,403 shares were allotted during the year, all of which were at nil value (2001 – 52,308, of which 9,864 were allotted at £4.26 and 42,444 at nil value).

d) Joint ventures:

The Group's share of its joint ventures is summarised as follows:

	AWE* £'000	PCG† £'000	Other £'000	2002 Total £'000	2001 Total £'000
Turnover	91,386	52,504	84,780	228,670	227,510
Profit before tax	7,801	4,993	11,108	23,902	18,708
Tax	(1,832)	(2,070)	(3,425)	(7,327)	(6,066)
Fixed assets	–	2,288	31,278	33,566	54,147
Current assets	21,861	124,266	138,138	284,265	268,191
	21,861	126,554	169,416	317,831	322,338
Liabilities due within one year	17,660	17,518	27,313	62,491	62,817
Liabilities due after more than one year	1,066	94,446	123,945	219,457	229,011
	18,726	111,964	151,258	281,948	291,828
Net assets	3,135	14,590	18,158	35,883	30,510

\* Atomic Weapons Establishment Management Ltd

† Premier Custodial Group Ltd

Adjustments have been made to joint venture results to ensure they are consistent with Group accounting policies.

**12 Investments held as fixed assets (continued)**

- e) A list of the principal undertakings of Serco Group plc is shown in Note 32. All the subsidiaries of the Group have been consolidated.
- f) At 31 December 2002, Group companies had branches in Abu Dhabi, Bahrain, Chile, Dubai, Korea, Ras Al Khaimah, Saudi Arabia, Sharjah and Switzerland.
- g) The subsidiaries of Serco Group plc and its joint venture undertakings are primarily engaged in the provision of services with the exception of Serco Investments Limited and certain other holding companies, which manage equity investments.
- 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) CCM Software Services Limited

All the issued share capital of CCM Software Services Limited was acquired by Serco International Limited on 3 December 2002 for cash consideration of £8,647,000 and deferred cash consideration, contingent on achievement of certain financial targets post acquisition, valued at £2,068,000. Acquisition costs of £515,000 were incurred.

The fair value of net assets acquired was £631,000 after taking account of adjustments of £448,000 required to recognise obligations for which no liability had been booked at the date of acquisition.

The goodwill arising on consolidation is £10,599,000.

## ii) Other acquisitions

The issued share capital of Euromedic Ltd and the assets and liabilities of SDC, a partnership, were acquired by Serco Holdings Ltd on 13 March 2002 and 31 May 2002 respectively for a total cash consideration of £2,088,000 and deferred cash consideration, contingent on achievement of certain financial targets post acquisition, valued at £223,000. Acquisition costs of £103,000 were incurred.

The fair values of assets and liabilities acquired are considered to be the same as their book values. The total goodwill arising on consolidation is £2,430,000.

**13 Stocks**

	Group 2002 £'000	Group 2001 £'000
Service spares	10,065	10,093
Long term contract balances	28,679	25,745
	<b>38,744</b>	<b>35,838</b>

**14 Debtors**

	Group 2002 £'000	Restated Group 2001 £'000	Company 2002 £'000	Company 2001 £'000
a) Amounts due within one year:				
Amounts recoverable on contracts	168,820	150,342	–	–
Other debtors	18,425	21,224	21,089	14,747
Prepayments and accrued income	30,131	19,148	580	73
Amounts owed by joint ventures	2,666	4,257	–	–
Building held for re-sale	–	4,734	–	–
	<b>220,042</b>	<b>199,705</b>	<b>21,669</b>	<b>14,820</b>
b) Amounts due after more than one year:				
Amounts recoverable on contracts	18,412	11,847	–	–
Other debtors	16,297	14,131	1,297	–
Pensions prepayment (Note 31)	28,350	26,460	–	–
Amounts owed by joint ventures	12,033	9,567	–	–
PFI asset in the course of construction*	33,840	14,100	–	–
	<b>108,932</b>	<b>76,105</b>	<b>1,297</b>	<b>–</b>
<b>TOTAL DEBTORS</b>	<b>328,974</b>	<b>275,810</b>	<b>22,966</b>	<b>14,820</b>

Included in amounts recoverable on contracts is £7,978,000 (2001 – £14,710,000) in respect of items procured on behalf of customers. This is offset by an amount of £8,792,000 (2001 – £12,038,000) in trade creditors and an amount of £945,000 (2001 – £1,611,000) in accruals.

\* The impact on the Group Accounts of the PFI asset in the course of construction in relation to the Traffic Control Centre contract is summarised as follows:

	Balance at 1 January 2002 £'000	Movement during the year £'000	Balance at 31 December 2002 £'000
Balances in relation to asset in course of construction:			
PFI asset in the course of construction excluding capitalised interest	13,733	18,355	32,088
Interest included in PFI asset in the course of construction	367	1,385	1,752
Total PFI asset in the course of construction	14,100	19,740	33,840
Cash	–	270	270
Other debtors	–	1,447	1,447
Accruals and deferred income	–	(4,852)	(4,852)
	14,100	16,605	30,705
Funded by:			
Non-recourse loan	(14,100)	(15,600)	(29,700)
Profits retained within Special Purpose Company	–	(1,005)	(1,005)
	(14,100)	(16,605)	(30,705)



**15 Other creditors including taxation and social security**

	Group 2002 £'000	Group 2001 £'000	Company 2002 £'000	Company 2001 £'000
Obligations under finance leases	4,836	2,557	267	–
Corporation Tax	2,195	4,418	–	–
Other taxes and social security costs	31,432	30,464	304	631
Other creditors	38,034	47,689	117	446
Amounts owed to joint ventures	16,974	14,864	–	–
Other loans	372	629	–	–
	<b>93,843</b>	<b>100,621</b>	<b>688</b>	<b>1,077</b>

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

	Group 2002 £'000	Group 2001 £'000	Company 2002 £'000	Company 2001 £'000
a) Bank loans and overdrafts	2,386	70,647	–	30,245
Obligations under finance leases	15,291	11,385	792	–
Other loans	77,505	60,371	43,259	41,420
Total loans	<b>95,182</b>	<b>142,403</b>	<b>44,051</b>	<b>71,665</b>
Less: amounts included in creditors falling due within one year	7,594	73,833	267	30,245
Amounts falling due after more than one year	<b>87,588</b>	<b>68,570</b>	<b>43,784</b>	<b>41,420</b>

	Group 2002 £'000	Group 2001 £'000	Company 2002 £'000	Company 2001 £'000
b) Analysis of loan repayments due:				
Bank loans and overdrafts:				
Within one year or on demand	2,386	70,647	–	30,245
Obligations under finance leases:				
Within one year or on demand	4,836	2,557	267	–
Between one and two years	4,667	2,543	525	–
Between two and five years	4,291	3,826	–	–
After five years	1,497	2,459	–	–
Other loans:				
Within one year or on demand	372	629	–	–
Between one and two years	1,687	1,618	–	–
Between two and five years	70,735	14,681	43,259	–
Non-recourse debt to fund PFI asset	25,200	14,100	–	–
Other	45,535	581	43,259	–
After five years	4,711	43,443	–	41,420
Non-recourse debt to fund PFI asset	4,500	–	–	–
Other	211	43,443	–	41,420
	<b>95,182</b>	<b>142,403</b>	<b>44,051</b>	<b>71,665</b>

c) 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 set and reviewed by the Board. There has been no material 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 ("FRS 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 disclosures 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 monetary assets and liabilities, 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 long term borrowings is managed by using interest rate swaps and forward rate agreements. At 31 December 2002, after taking account of interest rate swaps, the proportion of the Group's fixed rate borrowings was 66.6% (2001 – 33.3%).

### Foreign currency risk

The Group's policy is not to hedge the net assets of overseas subsidiaries as they represent a small proportion of the market value of the Group and because exchange rate fluctuations thereon are unlikely to have a material effect on the consolidated net asset 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 2002 with unhedged transactional exposure.

### Financial assets and liabilities

#### i) Assets

	Sterling £'000	Euro £'000	Australian Dollar £'000	US Dollar £'000	Other currencies £'000	Total £'000
<b>31 December 2002</b>						
Cash and short term deposits	43,024	13,468	2,009	2,868	10,405	71,774
Long term interest-bearing loans to joint ventures	8,009	–	4,024	–	–	12,033
Other long term debtors	87,918	7,285	1,696	–	–	96,899
<b>TOTAL LONG TERM ASSETS</b>	<b>95,927</b>	<b>7,285</b>	<b>5,720</b>	<b>–</b>	<b>–</b>	<b>108,932</b>
<b>31 December 2001</b>						
Cash and short term deposits	12,782	11,282	2,450	5,670	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
<b>Total long term assets</b>	<b>73,381</b>	<b>–</b>	<b>2,113</b>	<b>611</b>	<b>–</b>	<b>76,105</b>

Included in the above is £4,095,000 (2001 – £4,117,000) of loans to joint ventures which carry a fixed interest rate of 13.0% for a weighted average period of 13 years (2001 – 14 years). All other interest-bearing assets are held at floating rates of interest. Of total short term debtors 79% (2001 – 93%) is denominated in Sterling.

## 17 Treasury policies and risk management (continued)

### ii) Liabilities

31 December 2002	Total liabilities £'000	Floating rate liabilities £'000	Fixed rate liabilities £'000	Fixed Rate Liabilities	
				Weighted average interest rate %	Weighted average time for which rate is fixed Years
Sterling	44,586	14,886	29,700	5.46	3
Australian Dollar	3,075	3,075	–	–	–
US Dollar	46,885	13,182	33,703	7.33	5
Euro	636	636	–	–	–
<b>TOTAL</b>	<b>95,182</b>	<b>31,779</b>	<b>63,403</b>		

31 December 2001	Total liabilities £'000	Floating rate liabilities £'000	Fixed rate liabilities £'000	Fixed Rate Liabilities	
				Weighted average interest rate %	Weighted average time for which rate is fixed Years
Sterling	98,077	83,977	14,100	5.46	3
Australian Dollar	2,451	2,451	–	–	–
US Dollar	41,420	8,038	33,382	7.34	6
Euro	455	455	–	–	–
<b>Total</b>	<b>142,403</b>	<b>94,921</b>	<b>47,482</b>		

Of total short term creditors 80% (2001 – 81%) is denominated in Sterling.

The maturity of the Group's financial liabilities at 31 December 2002 and 31 December 2001:

31 December 2002	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	4,105	3,884	30,677	5,920	44,586
Australian Dollar	768	1,255	829	223	3,075
US Dollar	2,085	1,215	43,520	65	46,885
Euro	636	–	–	–	636
<b>TOTAL</b>	<b>7,594</b>	<b>6,354</b>	<b>75,026</b>	<b>6,208</b>	<b>95,182</b>

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	17,777	4,407	98,077
Australian Dollar	701	945	730	75	2,451
US Dollar	–	–	–	41,420	41,420
Euro	455	–	–	–	455
<b>Total</b>	<b>73,833</b>	<b>4,161</b>	<b>18,507</b>	<b>45,902</b>	<b>142,403</b>

## 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 2002 and 31 December 2001 were:

	2002 Book value £'000	2002 Fair value £'000	2001 Book value £'000	2001 Fair value £'000
<b>ASSETS</b>				
Cash and short term deposits	71,774	71,774	34,812	34,812
Long term loans to joint ventures	12,033	12,033	9,567	9,567
Other long term debtors	96,899	96,899	66,538	66,538
Derivatives held to manage currency and interest rate risk	–	1,716	–	4,492
<b>TOTAL</b>	<b>108,932</b>	<b>110,648</b>	<b>76,105</b>	<b>80,597</b>
<b>LIABILITIES</b>				
Long term borrowing:				
Sterling	40,481	40,481	25,400	25,400
Australian Dollar	2,307	2,307	1,750	1,750
US Dollar	44,800	49,091	41,420	48,991
<b>TOTAL</b>	<b>87,588</b>	<b>91,879</b>	<b>68,570</b>	<b>76,141</b>
Short term borrowing:				
Sterling	4,105	4,105	72,677	72,677
Australian Dollar	768	768	701	701
US Dollar	2,085	2,085	–	–
Euro	636	636	455	455
<b>TOTAL</b>	<b>7,594</b>	<b>7,594</b>	<b>73,833</b>	<b>73,833</b>

Foreign currency assets which are hedged using forward foreign exchange contracts are translated at the contracted rates.

The fair value of other foreign currency contracts, interest rate swaps, and the US\$70,000,000 loan notes, have been determined by reference to prices available from the markets on which the instruments involved are traded.

#### Gains and losses on hedges

Changes in the fair value of financial instruments used as hedges are not recognised until the hedged position matures. There was an unrecognised gain of £1,716,000 (2001 – gain of £4,492,000) on hedges as at 31 December 2002. The unrecognised gain is not expected to be recognised in the Profit and Loss Account in the next period.

#### Borrowing facilities

The Group had committed bank credit facilities of £50,000,000 at 31 December 2002. The Group also had annually renewable uncommitted bank facilities totalling £111,000,000, all of which were undrawn at 31 December 2002.

**18 Provisions for liabilities and charges**

Group	Restated Balance 1 January 2002 £'000	Utilised £'000	Charged to the profit and loss account £'000	Foreign exchange differences £'000	Balance 31 December 2002 £'000
Pensions provision	23,003	(463)	1,663	1,605	25,808
Deferred taxation	2,246	–	6,495	(16)	8,725
	25,249	(463)	8,158	1,589	34,533

Company	Balance 1 January 2002 £'000	Utilised £'000	Charged to the profit and loss account £'000	Foreign exchange differences £'000	Balance 31 December 2002 £'000
Deferred tax	–	–	335	–	335

**19 Deferred taxation**

	Group 2002 £'000	Restated Group 2001 £'000	Company 2002 £'000	Company 2001 £'000
The amounts of deferred taxation provided in the accounts are:				
Tax allowances in excess of depreciation	2,650	332	(77)	–
Overseas timing differences	1,967	692	–	–
Other timing differences	4,108	1,222	412	–
	8,725	2,246	335	–
Potential amounts of deferred taxation for which no credit has been taken:				
Overseas timing differences	(2,767)	(3,224)	–	–
	(2,767)	(3,224)	–	–

**20 Reconciliation of movements in shareholders' funds**

	2002 £'000	Restated 2001 £'000
Profit on ordinary activities after taxation	32,302	27,027
Dividends	(9,441)	(7,265)
	22,861	19,762
Currency translation differences on foreign currency net investments	(1,911)	(1,917)
New capital subscribed	117,929	3,561
Exercise of share scheme options	(93)	(1,260)
Net increase in shareholders' funds	138,786	20,146
Opening shareholders' funds as previously stated	129,877	108,925
Prior year adjustment	(806)	–
Opening shareholders' funds as restated	129,071	108,925
Closing shareholders' funds as restated	267,857	129,071

## 21 Called up share capital

	2002 £'000	2001 £'000
a) Authorised 550,000,000 (2001 – 550,000,000) Ordinary Shares of 2p each	11,000	11,000
b) Called up, allotted and fully paid: 434,862,837 (2001 – 395,170,815) Ordinary Shares of 2p each	8,697	7,903

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

During the year 289,581 Ordinary Shares of 2p each were allotted to the holders of options or their personal representatives.

Of these, 147,178 were allotted using newly issued shares, 2,628 were allotted at £2.0208\*, 104,796 at £2.175, 38,706 at £2.45\*, and 1,048 at £3.81.

The remaining 142,403 were allotted at nil value using shares purchased in the market and held in trust.

In addition to the above, 39,500,000 Ordinary Shares of 2p each were allotted under a share placement on 12 March 2002 at £3.05. 44,844 Ordinary Shares of 2p each were also allotted on 19 December 2002 as deferred consideration relating to the acquisition of Serco QAA (formerly Quality Assurance Associates Limited) made in December 2000.

\*Restated to reflect the capitalisation issue on 5 April 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 2002 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 2002 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 2002 there remained 1,606,259 options which are exercisable at a price of £2.175 each and 10,830 at £2.0208\* 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 2002 there remained 2,385,474 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. 2,577,092 options were held by employees on 31 December 2002. 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 2002 there remained 2,368,224 options which are exercisable at a price of £4.2542\* 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 2002 there remained 148,236 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 2002 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 2002 there remained 188,169 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 plc 1998 Executive Option Plan'. As at 31 December 2002 there remained 2,700,200 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 plc 1998 Executive Option Plan'. As at 31 December 2002 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 2002 there remained 200,202 options which are exercisable at nil value in accordance with the rules of the Scheme.
- xiii) On 3 May 2002, 5,986,743 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'. As at 31 December 2002 there remained 5,914,886 options which are exercisable at a price of £2.64 each in accordance with the rules of the Scheme.
- xiv) On 3 May 2002, 55,600 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 2002 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 a nil value in accordance with the rules of the Scheme.
- xv) On 6 September 2002, 5,428,691 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'. As at 31 December 2002 there remained 5,327,309 options which are exercisable at a price of £1.645 each in accordance with the rules of the Scheme.

\*Restated to reflect the capitalisation issue on 5 April 2000.

- e) The market price of Serco Group plc Ordinary Shares of 2p each as at 31 December 2002 was £1.53. The market prices of these shares ranged from £4.00 to £1.325 during the year.

## 22 Share premium account

Group and Company	£'000
Balance at 1 January 2002	73,656
Deferred consideration relating to the acquisition of Serco QAA Limited	69
Share premium on issue of shares upon exercise of options	422
Share placement (net of £3,041,000 expenses)	116,644
<b>BALANCE AT 31 DECEMBER 2002</b>	<b>190,791</b>

## 23 Profit and loss account

Group	£'000
At 31 December as previously stated	48,175
Prior year adjustment	(806)
Balance at 1 January 2002 as restated	47,369
Retained profit transferred to reserves	22,861
Currency translation differences on foreign currency net investments	(1,911)
Exercise of share option schemes	(93)
<b>BALANCE AT 31 DECEMBER 2002</b>	<b>68,226</b>

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 £14,219,000, which includes dividends of £24,874,000 received from subsidiary companies.

A final ordinary dividend of £6,184,000 is proposed, which together with the interim dividend of £2,747,000 and the payment in relation to the 2001 final dividend caused by the movement in the number of shares in issue of £510,000, leaves a profit of £4,778,000 which has been added to reserves brought forward of £34,958,000. This, along with a foreign exchange charge of £1,947,000, results in reserves carried forward of £37,789,000.



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

	2002 £'000	Restated 2001 £'000
Operating profit before cost of unsuccessful NATS acquisition	29,103	21,254
Exceptional item: Cost of unsuccessful NATS acquisition	–	(10,187)
Operating profit	29,103	11,067
Depreciation	15,534	13,160
Amortisation of goodwill and intangible fixed assets	8,098	5,123
Profit on sale of tangible fixed assets	(1,948)	(1,236)
Increase in stocks	(2,906)	(8,932)
Increase in debtors	(41,870)	(56,223)
Increase in creditors	30,795	53,578
Increase/(decrease) in provisions	2,805	(1,053)
One off pension fund contribution	(15,500)	–
<b>NET CASH INFLOW FROM OPERATING ACTIVITIES BEFORE PFI ASSET EXPENDITURE</b>	<b>24,111</b>	<b>15,484</b>
Expenditure on PFI asset in the course of construction	(14,950)	(13,733)
Net cash inflow from operating activities after PFI asset expenditure	9,161	1,751

**25 Analysis of net debt**

	Balance 1 January 2002 £'000	Cash flow £'000	Other non-cash changes £'000	Balance 31 December 2002 £'000
Cash at bank and in hand	34,812	36,962	–	71,774
Overdrafts	(70,647)	68,261	–	(2,386)
Cash net of overdrafts	(35,835)	105,223	–	69,388
Other loans due after more than one year	(45,642)	(24)	(1,767)	(47,433)
Other loans due within one year	(629)	300	(43)	(372)
Finance leases	(11,385)	3,594	(7,500)	(15,291)
Recourse net cash	(93,491)	109,093	(9,310)	6,292
Non-recourse debt to fund PFI asset	(14,100)	(15,600)	–	(29,700)
Net debt	(107,591)	93,493	(9,310)	(23,408)

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

	2002 £'000	2001 £'000
Increase/(decrease) in cash	105,223	(81,332)
Cash inflow from non-recourse debt financing PFI asset	(15,600)	(14,100)
Cash outflow from debt and lease financing	3,870	1,935
Change in net debt resulting from cash flows	93,493	(93,497)
Non cash changes from other debt and lease financing	(9,310)	(10,089)
Movement in net debt in the year	84,183	(103,586)
Net debt at 1 January	(107,591)	(4,005)
Net debt at 31 December	(23,408)	(107,591)

## 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 £7,610,000 (2001 – £10,089,000).

During the year £93,000 (2001 – £1,260,000) has been charged to the profit and loss reserve in respect of shares issued under employee share incentive schemes.

Other non-cash movements with respect to other loans relate to foreign exchange.

## 28 Contingent liabilities

The Group has given indemnities in respect of overseas credit facilities and lease payments amounting to £7,426,000 (2001 – £7,590,000).

In addition to this, the Group has given indemnities in respect of performance guarantees, letters of credit and import duty guarantees issued on its behalf in the ordinary course of business, which are not expected to result in any material financial loss.

## 29 Capital and other commitments

	Group 2002 £'000	Group 2001 £'000	Company 2002 £'000	Company 2001 £'000
Capital expenditure contracted but not provided	8,595	1,244	–	–

There is a commitment of £30 million in relation to the Traffic Control Centre PFI asset under construction, which will be funded by non-recourse bank debt.

During the year ending 31 December 2003 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	1,965	4,199
Between one and five years	7,015	16,690
After five years	4,464	4,264
	13,444	25,153

### 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.

#### Joint ventures

The following material transactions took place between the Group and its joint ventures during 2002:

	2002 £'000	2001 £'000
Net loans during the year	1,797	2,131
Net trading	1,800	2,671
Royalties and management fees receivable	2,302	2,448
Dividends receivable	11,095	9,645
	<b>16,994</b>	<b>16,895</b>

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

	2002 £'000	2001 £'000
Amounts due within one year:		
Loans	2,140	–
Trading balance	287	342
Royalties and management fees	239	3,915
	<b>2,666</b>	<b>4,257</b>
Amounts due after more than one year:		
Loans	12,033	9,567
	<b>12,033</b>	<b>9,567</b>

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

	2002 £'000	2001 £'000
Amounts payable within one year:		
Loans	16,974	14,165
Trading balance	–	699
	<b>16,974</b>	<b>14,864</b>

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 2005. The transitional disclosures required by FRS 17 are set out in Part (B) of this note which shows the Group's pension deficit in accordance with FRS 17 at 31 December 2002 was £73.6 million (2001 - £3.6 million) on an asset base of £294.4 million (2001 - £298.4 million).

#### A) SSAP 24 Disclosure

The net pension charge in accordance with SSAP 24 for the year ended 31 December 2002 was £29,096,000 (2001 - £19,544,000). 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.

The latest formal valuation of the scheme was carried out as at 6 April 1999. The figures included in the accounts are based on a formal valuation, which is currently being carried out as at 6 April 2002. During 2002 there has been a fall in general stock market values and a bulk transfer was received from the AEA Technology Pension Scheme. The figures in the Profit and Loss Account and the Balance Sheet prepayment have been determined in accordance with the requirements of SSAP 24. 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	7.0% p.a. (5.5% post retirement)
Salary growth	3.75% p.a.
Price inflation	2.5% p.a.
Pension increases	2.5% p.a.

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 £12,300,000 (2001 - £9,760,000), of which £500,000 related to special contributions in respect of a discretionary increase to pensions in payment awarded during the year (2001 - £652,000) and £600,000 of contributions in respect of augmentations (2001 - £810,000). A £15,000,000 contribution which was included in accruals and prepayments at 31 December 2001 was paid in February 2002.

At 31 December 2002 a prepayment of £17,450,000 (2001 - £17,360,000) in respect of the Scheme was included in the Balance Sheet. £12,210,000 was charged to the Profit and Loss Account in respect of the Scheme (2001 - £8,950,000).

### 31 Pension schemes (continued)

#### A) SSAP 24 Disclosure (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 at a constant monetary amount.

Employer pension contributions paid into the Scheme during the year were £2,125,000 (2001 – £1,738,000).

An amount of £325,000 (2001 – £300,000) has been charged to the 2002 Profit and Loss Account in respect of the Scheme and a prepayment of £10,900,000 (2001 – £9,100,000) has been included in the Balance Sheet as at 31 December 2002.

##### 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 actuaries, with the last such review being carried out as at 23 December 1999 and updated as at 31 December 2002 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 £1,663,000 (2001 – £130,000) and a provision of £25,808,000 (2001 – £23,003,000) has been included in the Balance Sheet as at 31 December 2002 of which £20,271,000 (2001 – £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)

#### A) SSAP 24 Disclosure (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 were:

Average long term interest rate (net of investments and administration expenses and investment tax)	8.0% p.a.
Average long term allowance for salary 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 2002 Profit and Loss Account relating to the defined benefit element of the Scheme were £257,000 (2001 – £104,000).

##### 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, with the last such review being carried out as at 5 April 2001. The funding policy is to contribute such variable amounts as will achieve 100% funding on a projected unit basis.

The average contribution rate is currently 20.8% for the scheme.

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 2002 Profit and Loss Account were £1,903,000 (2001 – £1,634,000).

### 31 Pension schemes (continued)

#### A) SSAP 24 Disclosure (continued)

##### f) The Serco Shared Cost Section of the Railways 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 last such review being carried out as at 31 December 2001. The funding policy is to contribute such variable amounts as will achieve 100% funding on a projected unit basis.

The main actuarial assumptions used in the valuation were:

Investment return	6.3% p.a.
Salary growth	4.0% p.a. (plus promotional scale)
Price inflation	2.5% p.a.
Pension increases	2.5% p.a.

The actuarial value of assets represented 117% of the ongoing liabilities of the Scheme. The current contribution rate is 7.5%.

Employer pension contributions charged to the 2002 Profit and Loss Account during the year were £715,000 (2001 – £634,000).

##### 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 last such review being carried out as at 31 August 2001. The funding policy is to contribute such variable amounts as will achieve 100% funding on a projected unit basis.

The main actuarial assumptions used in the valuation were:

Investment return	6.5% p.a.
Salary growth	4.4% p.a.
Price inflation	2.4% p.a.
Pension increases	2.4% p.a.

The actuarial value of assets represented 82% of the ongoing liabilities of the Scheme. The current contribution rate is 8.2%.

Employer pension contributions charged to the 2002 Profit and Loss Account were £244,000 (2001 – £225,000).

### 31 Pension schemes (continued)

#### A) SSAP 24 Disclosure (continued)

##### 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.

Actuarial assessments covering expenses and contributions are carried out by independent qualified actuaries, with the last such review being carried out at 1 April 2001. The funding policy is to contribute such variable amounts as will achieve 100% funding on a projected unit basis. The main actuarial assumptions used in the valuation this year were:

Investment return	7.0% p.a.
Salary growth	5.0% p.a. (including promotional scale)
Pension increases	3.0% p.a.
Dividend yield	2.75% p.a.

The actuarial value of assets represented 96% of the ongoing liabilities of the Scheme. The current contribution rate is 15.2%.

Employer pension contributions charged to the 2002 Profit and Loss Account were £1,378,000 (2001 – £1,181,000).

##### i) Other defined contribution schemes

The Group paid employer contributions of £10,401,000 (2001 – £6,386,000) into UK and Australian defined contribution schemes and foreign state pension schemes.

#### B) FRS 17 Disclosure

The disclosures required under the transitional arrangements within FRS 17 have been based on the most recent full actuarial valuations of the Serco Pension and Life Assurance Scheme as at 6 April 1999 and the Serco-IAL Scheme as at 31 March 2001, updated to 31 December 2002 by independent qualified actuaries.

If the amounts had been recognised in the financial statements the net assets and the Profit and Loss Account would be as follows:

	2002 £'000	Restated 2001 £'000
Net assets excluding net, SSAP 24, pension assets	248,012	110,549
Net pension liability under FRS 17	(73,601)	(3,614)
Net assets including pension liabilities under FRS 17	174,411	106,935
	2002 £'000	Restated 2001 £'000
Profit and loss reserve	68,226	47,369
Reversal of SSAP 24 prepayments, net of deferred taxation	(19,845)	(18,522)
	48,381	28,847
(Deficit) in relation to SPLAS scheme, net of deferred taxation	(62,427)	(5,740)
(Deficit)/surplus in relation to Serco-IAL scheme, net of deferred taxation	(11,174)	2,126
Total pension deficit	(73,601)	(3,614)
Profit and loss reserve adjusted	(25,220)	25,233



**31 Pension schemes (continued)****B) FRS 17 Disclosure (continued)**

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

The financial assumptions used were:

	2002 % p.a.	2001 % p.a.
Rate of increase in salaries	3.85	4.00
Rate of increase in deferred pensions	2.25	2.25
Rate of increase in pensions in payment	2.25	2.25
Discount rate	5.47	5.83
Inflation assumption	2.35	2.50

The Scheme's assets and the expected rates of return as at 31 December 2002 were:

	2002 % p.a.	2002 £'000	2001 % p.a.	2001 £'000
Equities	7.00	134,319	7.25	119,600
AA corporate bonds	5.47	17,252	5.83	15,500
Gilts	4.50	28,264	5.00	21,000
Cash and other	4.00	–	4.00	15,800
Total market value of assets		179,835		171,900
Present value of scheme liabilities		(269,017)		(180,100)
Deficit in the Scheme		(89,182)		(8,200)
Related deferred tax asset		26,755		2,460
Net pension liability		(62,427)		(5,740)

The amount chargeable under FRS 17 to operating profit for the year ended 31 December 2002 would have been:

	£'000
Service cost	11,391
Past service cost	1,100
Total operating charge	12,491

Analysis of the net return on the pension scheme for the year ended 31 December 2002:

	£'000
Expected return on pension scheme assets	12,872
Interest on pension liabilities	(12,664)
Net return	208

**31 Pension schemes** (continued)

**B) FRS 17 Disclosure** (continued)

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

Analysis of amount recognisable in Statement of Total Recognised Gains and Losses ("STRGL") for the year ended 31 December 2002:

	£'000
Actual return less expected return on assets	(56,996)
Experience gains and losses on liabilities	(20,013)
Changes in assumptions	(3,990)
Actuarial loss recognised in STRGL	(80,999)

Movement in deficit during the year:

	£'000
Deficit in scheme at 31 December 2001	(8,200)
Movement in year:	
Current service cost	(11,391)
Contributions	12,300
Past service costs	(1,100)
Net return on assets	208
Actuarial loss	(80,999)
Deficit in scheme at 31 December 2002	(89,182)

History of experience gains and losses:

	2002 £'000
Difference between expected and actual return on scheme assets	(56,996)
Percentage of scheme assets	31.7%
Experience gains and losses on scheme liabilities	(20,013)
Percentage of scheme liabilities	7.4%
Total amount recognised in STRGL	(80,999)
Percentage of scheme liabilities	30.1%

**31 Pension schemes (continued)****B) FRS 17 Disclosure (continued)**

## b) The Serco-IAL Pension Scheme

The financial assumptions used were:

	2002 % p.a.	2001 % p.a.
Rate of increase in salaries	3.85	4.00
Rate of increase in pensions		
– RPI	2.35	2.50
– LPI	2.25	2.25
– discretionary	2.25	2.25
Discount rate	5.47	5.83
Inflation assumption	2.35	2.50

The Scheme's assets and the expected rates of return as at 31 December 2002 were:

	2002 % p.a.	2002 £'000	2001 % p.a.	2001 £'000
Equities	7.00	49,483	7.25	59,694
UK bonds	4.82	28,758	5.18	31,336
Property	6.24	7,690	6.54	7,329
Cash and other assets	4.50	908	4.00	78
Annuity policies	5.47	27,798	5.83	28,100
Total market value of assets		114,637		126,537
Present value of scheme liabilities		(130,600)		(123,500)
(Deficit)/surplus in the Scheme		(15,963)		3,037
Related deferred tax asset/(liability)		4,789		(911)
Net pension (liability)/asset		(11,174)		2,126

The amount chargeable under FRS 17 to operating profit for the year ended 31 December 2002 would have been:

	£'000
Service cost	2,300
Past service cost	–
Total operating charge	2,300

Analysis of the net return on the pension scheme for the year ended 31 December 2002:

	£'000
Expected return on pension scheme assets	7,900
Interest on pension liabilities	(7,000)
Net return	900

### 31 Pension schemes (continued)

#### B) FRS 17 Disclosure (continued)

##### b) The Serco-IAL Pension Scheme (continued)

Analysis of amount recognisable in STRGL for the year ended 31 December 2002:

	£'000
Actual return less expected return on assets	(16,100)
Experience gains and losses on liabilities	700
Changes in assumptions	(4,300)
Actuarial loss recognised in STRGL	(19,700)

Movement in surplus during the year:

	£'000
Surplus in scheme at 31 December 2001	3,037
Movement in year:	
Current service cost	(2,300)
Contributions	2,100
Past service costs	-
Net return on assets	900
Actuarial loss	(19,700)
Deficit in scheme at 31 December 2002	(15,963)

History of experience gains and losses:

	2002 £'000
Difference between expected and actual return on scheme assets	(16,100)
Percentage of scheme assets	14.0%
Experience gains and losses on scheme liabilities	700
Percentage of scheme liabilities	0.5%
Total amount recognised in STRGL	(19,700)
Percentage of scheme liabilities	15.1%

c) The Balance Sheet position for all of the other Group Pension Schemes is materially the same in accordance with FRS 17 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

<b>United Kingdom</b>	Serco Limited	100%
	Serco-Denholm Limited	90%
	Serco Europe Limited	100%
	Serco-IAL Limited	100%
	Serco Railtest Limited	100%
	Serco Systems Limited	100%
	NPL Management Limited	100%
	Serco Docklands Limited	100%
	Rakmulti Technology Limited	100%
	Serco QAA Limited	100%
	Traffic Information Services (TIS) Limited	100%
<b>Rest of Europe</b>		
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%
	CCM Software Services Ltd	100%
Italy	Serco s.r.l	100%
Guernsey	Serco Insurance Company 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%
<b>Asia Pacific</b>		
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	100%
<b>Other</b>		
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

<b>United Kingdom</b>		
	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%
<b>Asia Pacific</b>		
<b>Australia</b>		
	Defence Maritime Services Pty Limited	50%
	Serco Sodexho Defence Services Pty Limited	50%
<b>New Zealand</b>		
	Serco Sodexho Defence Services Limited	50%
<b>Other</b>		
<b>USA</b>		
	Serco – SKE	50%
<b>Bahrain</b>		
	Aeradio Technical Services WLL	49%
<b>Bermuda</b>		
	BAS-Serco Limited	40%
<b>Cyprus</b>		
	Serco Kalisperas	50%
<b>Dubai</b>		
	International Aeradio (Emirates) LLC	49%
<b>Saudi Arabia</b>		
	Key Communications Development Co Limited	49%
<b>Singapore</b>		
	Serco Guthrie Pte Ltd	50%
<b>Turkey</b>		
	Elektronik Sistemier 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.

## Investor and Shareholder Information

### **Registrar**

The Company's registrar is Lloyds TSB Registrars. They maintain our register of members and make the payment of dividends to our shareholders. Their address is:

Lloyds TSB Registrars, The Causeway, Worthing, West Sussex, BN99 6DA, UK

T +44 (0)870 600 3970

F +44 (0)870 600 3980

The Lloyds TSB Registrars shareholder website is at [www.shareview.co.uk](http://www.shareview.co.uk) (the "shareview website").

### **Shares in issue**

At 31 December 2002 there were 434,862,837 Serco Group plc Ordinary 2p Shares in issue.

### **Dividend mandate**

Dividends can be paid directly into shareholders' bank or building society accounts. If you want to take advantage of this facility, please complete the dividend mandate form attached to your dividend cheque, or contact our registrar by post or by fax.

The form is also available by visiting the shareview website.

### **Dividend re-investment plan**

The Serco dividend re-investment plan ("DRIP") gives shareholders the chance to re-invest their dividends in Serco Group plc shares instead of receiving cash.

If you participate in the scheme, your cash dividend will be paid directly to the registrar. The administrator will calculate the number of shares to which you are entitled and buy them on the stock market. Participants' share purchases are aggregated, so the dealing costs are relatively low; shares are then distributed to the participants.

To register, you simply have to complete a form and send it to our registrar. For further information about the DRIP please contact the registrar directly or look under the home page section on the shareview website.

**Investor and Shareholder Information** (continued)**Electronic mailing**

Where the law allows, you can now choose not to receive a paper copy of the documentation we send out. Instead we can send you an email notification every time a new shareholder document is posted on our site. This will include annual and interim reports and other shareholder communications. You can then view the document(s) on our website at [www.serco.com](http://www.serco.com).

To receive documents electronically you will need to register online with our registrar on its shareview website. This is a secure, straight forward online service operated free of charge by Lloyds TSB.

**Postal share dealing services**

Serco has arranged with Cazenove & Co Ltd a simple, low-cost method of buying and selling its shares by post, where shares are bought and sold on the day Cazenove receives instructions by post. For a dealing form, please contact the postal dealing department at Cazenove.

Cazenove & Co Ltd, 12 Tokenhouse Yard, London, EC2R 7AN, UK  
T +44 (0)20 7606 1768

The terms and conditions for this service are found on the last page of the form.

**Unsolicited mail**

We are legally obliged, whenever requested, to provide copies of our shareholder register to any third parties, so from time to time you may receive unsolicited mail. You can limit the amount of unsolicited mail you receive by contacting:

The Mailing Preference Service, Freepost 22, London, W1E 7EZ, UK

**Change of registered office**

On 7 May 2003 the registered office will move to:

Serco House, 16 Bartley Wood Business Park, Bartley Way, Hook, Hampshire, RG27 9UY, UK



Serco group plc  
SUMMARY  
financial  
STATEMENT  
2002



## Summary Financial Statement

### Introduction

The Summary Financial Statement has been produced to allow readers of the accounts an overview of the financial affairs of Serco Group plc and its subsidiaries (the "Group"), through the principal financial statements, without the need to refer to the more detailed Annual Review and Accounts. This Summary Financial Statement is only a summary of the Annual Review and Accounts, which contain the full annual accounts, other statutory information and the full Report of the Directors.

This Summary Financial Statement does not contain sufficient information to allow as full an understanding of the results and state of affairs of the Group as is provided by the full Annual Review and Accounts.

Shareholders have the right to receive, free of charge, a copy of the Annual Review and Accounts from the Company's Registered Office.

Shareholders who wish to receive, free of charge, full Annual Review and Accounts in place of the Summary Financial Statement for all future years, should write to the Company at the Registered Office.

### Summary Directors' Report

The Directors have pleasure in presenting this Summary Financial Statement for the year ended 31 December 2002.

### Results and dividends

The profit before tax on ordinary activities for the year ended 31 December 2002 was £48,941,000 (2001 Restated – £40,039,000).

An interim dividend of 0.64p per Ordinary Share was paid on 11 October 2002 (2001 – 0.57p). The Directors recommend a final dividend of 1.44p (2001 – 1.29p) per Ordinary Share which, if approved at the Annual General Meeting, will be paid on 13 May 2003, to those shareholders on the register at the close of business on 28 February 2003.

### Restatement

The 2001 accounts have been restated to reflect the impact of the Urgent Issues Task Force Abstract 34 ("UITF 34") – Pre-Contract Costs eliminating £1,193,000 of bid costs, previously disclosed within debtors, and the associated tax effect of £387,000. The impact of this adjustment in the 2002 accounts is a reduction in amortisation of bid costs of £400,000.

The Profit and Loss Account has been restated to reclassify 'Other operating costs relating to joint ventures' within 'Other administration expenses'.

### Business review and future activities

The 2002 business review is set out on pages 21 to 30.

### Directors

The following Directors served during 2002:

Kevin Beeston

Ralph Hodge (Non-Executive)

Christopher Hyman

Andrew Jenner (appointed 3 May 2002)

Rhidian Jones (Senior Independent Non-Executive)

DeAnne Julius (Non-Executive)

Richard White (resigned 3 May 2002)

Iestyn Williams

The total emoluments of Directors, excluding pensions, for the year ended 31 December 2002 were £1,827,000 (2001 – £1,402,000).

The prior year comparative includes Directors who did not serve in 2002.

### **Summary Directors' Remuneration Report**

During the year the Remuneration Committee (the "Committee") commissioned a review of Executive Directors' remuneration, the first external benchmarking exercise undertaken since 1999, and the first review of base salary levels since September 2000.

The recommendations of the review, which are included in detail in the Remuneration Report section of the Annual Review and Accounts, are based on a remuneration philosophy grounded in the following four principles: total rewards should be market competitive; incentive plans should be used to reinforce a high performance culture; the interests of Directors and shareholders should be aligned as far as reasonably possible; and the reward structure should be easily understood by all.

In revising the remuneration framework the Committee consulted with the Company's six largest institutional investors, representing approximately 35% of the shareholder base, and the ABI, before making its recommendations.

Executive Directors' remuneration comprises the following:

Base salary – which was reviewed in September 2002;

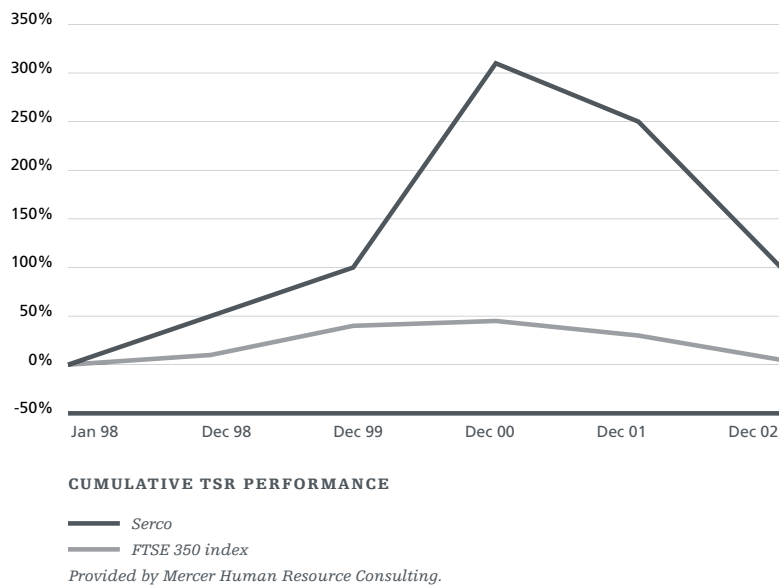
Annual Bonus – Full time Executive Directors will be entitled to receive a one off cash bonus up to 50% of salary depending on the earnings per share pre FRS 10 (Goodwill amortisation) ("EPS") growth of the Company during the 2002 financial year. The Company is expecting to introduce a deferred bonus scheme in 2003 following shareholder approval at the forthcoming Annual General Meeting. The maximum payment under this plan will be 40% depending on EPS growth relative to RPI. Participants can elect to defer, for three financial years, up to 100% of the bonus earned to purchase shares in the Company. Shares purchased will be matched by the Company, if stretching performance targets comparing the Company's total shareholder return ("TSR") growth versus the FTSE 350 are met;

Long Term Incentive Plan – Awards made under this plan are structured as options with a zero exercise price and may be exercised after the third year of grant. For awards made up to and including 1 January 2002 the performance criteria is measured by reference to EPS growth. Following shareholder approval, for awards made after this date, performance will be measured by reference to the Company's TSR growth versus the FTSE 350 over the three year period. The awards are granted at 64% of salary at the date of grant;

Executive Option Plan – Options granted under this scheme can be exercised after the third anniversary of grant. For grants made up to and including 1 January 2002 the performance criteria is measured by absolute growth in EPS over the performance period. Following shareholder approval, for grants made after this date, performance will be measured by reference to EPS growth compared to RPI over the three year period;

Pensions and Life Assurance – The Executive Directors receive pension and life assurance benefits consistent with those provided by other leading companies.

All aspects of Executive Directors' remuneration are performance related with the exception of base salary, pensions and life assurance.

**Summary Directors' Remuneration Report** (continued)**Performance Graph – Serco five year TSR vs FTSE 350 index**

This graph demonstrates the performance of Serco's TSR in relation to the FTSE 350 index over the past five years.

TSR is defined as the return shareholders would receive if they held a notional number of shares, and received dividends on those shares over a period of time. It measures the percentage growth in the company's share price together with the value of any dividends paid, assuming that the dividends are reinvested into the company's shares.

**Auditors**

The Auditors' Report on the Annual Review and Accounts of the Company and Group for the year ended 31 December 2002 was unqualified and did not contain a statement under either Section 237(2) or 237(3) of the Companies Act 1985.

**Independent auditors' statement to the members of Serco Group plc**

We have examined the Summary Financial Statement which comprises the summary directors' report, profit and loss account, balance sheet, cash flow statement and summary directors' remuneration report.

This report is made solely to the Company's members, as a body, in accordance with section 251 of the Companies Act 1985. Our work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, for our audit report, or for the opinions we have formed.

**Respective Responsibilities of Directors and Auditors**

The Directors are responsible for preparing the Summary Financial Statement in accordance with applicable United Kingdom law. Our responsibility is to report to you our opinion on the consistency of the Summary Financial Statement with the full annual accounts, the Report of the Directors and the Directors' Remuneration Report, and its compliance with the relevant requirements of section 251 of the Companies Act 1985 and the regulations made thereunder. We also read the other information contained in the Summary Financial Statement 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 Summary Financial Statement.

**Basis of opinion**

We conducted our work in accordance with bulletin 1999/6 The Auditors' Statement on the Summary Financial Statement issued by the United Kingdom Auditing Practices Board.

**Opinion**

In our opinion, the Summary Financial Statement is consistent with the full Annual Accounts, the Report of the Directors and the Directors' Remuneration Report of Serco Group plc for the year ended 31 December 2002 and Companies Act 1985, and the regulations made thereunder.



**Deloitte & Touche**  
Chartered Accountants and Registered Auditors  
London

19 February 2003

Neither an audit nor a review provides assurance on the maintenance and integrity of the website, including controls used to achieve this, and in particular whether any changes may have occurred to the financial information 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 information differs from legislation in other jurisdictions.

## Consolidated Profit and Loss Account

For the year ended 31 December 2002

	2002 Group £'000	2002 Joint Ventures £'000	2002 Total £'000	Restated 2001 Group £'000	Restated 2001 Joint Ventures £'000	Restated 2001 Total £'000
<b>TURNOVER: GROUP AND SHARE OF JOINT VENTURES - CONTINUING OPERATIONS</b>	<b>1,097,278</b>	<b>228,670</b>	<b>1,325,948</b>	<b>913,693</b>	<b>227,510</b>	<b>1,141,203</b>
Less: Share of joint ventures	–	(228,670)	(228,670)	–	(227,510)	(227,510)
Group turnover	1,097,278	–	1,097,278	913,693	–	913,693
Cost of sales	(947,313)	–	(947,313)	(789,686)	–	(789,686)
<b>GROSS PROFIT</b>	<b>149,965</b>	<b>–</b>	<b>149,965</b>	<b>124,007</b>	<b>–</b>	<b>124,007</b>
Administrative expenses	(120,862)	–	(120,862)	(102,753)	–	(102,753)
Amortisation of intangible assets	(8,098)	–	(8,098)	(5,123)	–	(5,123)
Other administrative expenses	(112,764)	–	(112,764)	(97,630)	–	(97,630)
Exceptional item: Unsuccessful NATS acquisition	–	–	–	(10,187)	–	(10,187)
Operating profit-continuing operations	29,103	–	29,103	11,067	–	11,067
Exceptional item: GSR refinancing	–	–	–	15,356	–	15,356
Share of operating profit in joint ventures	–	21,883	21,883	–	17,374	17,374
Interest receivable	1,422	16,894	18,316	2,207	17,102	19,309
Group	1,422	–	1,422	2,207	–	2,207
Share of joint ventures	–	16,894	16,894	–	17,102	17,102
Interest payable and similar charges	(5,486)	(14,875)	(20,361)	(7,299)	(15,768)	(23,067)
Group	(5,486)	–	(5,486)	(7,299)	–	(7,299)
Share of joint ventures	–	(14,875)	(14,875)	–	(15,768)	(15,768)
<b>PROFIT ON ORDINARY ACTIVITIES BEFORE TAXATION</b>	<b>25,039</b>	<b>23,902</b>	<b>48,941</b>	<b>21,331</b>	<b>18,708</b>	<b>40,039</b>
Taxation on profit on ordinary activities	–	–	(16,639)	–	–	(13,012)
<b>PROFIT ON ORDINARY ACTIVITIES AFTER TAXATION</b>	<b>–</b>	<b>–</b>	<b>32,302</b>	<b>–</b>	<b>–</b>	<b>27,027</b>
Dividends	–	–	(9,441)	–	–	(7,265)
<b>RETAINED PROFIT FOR THE FINANCIAL YEAR</b>	<b>–</b>	<b>–</b>	<b>22,861</b>	<b>–</b>	<b>–</b>	<b>19,762</b>
<b>EARNINGS PER SHARE (“EPS”) PER ORDINARY SHARE OF 2P EACH</b>						
Basic EPS, after amortisation of goodwill			7.66p			6.94p
Basic EPS, before amortisation of goodwill			9.58p			8.25p
Diluted EPS, after amortisation of goodwill			7.63p			6.91p
Diluted EPS, before amortisation of goodwill			9.54p			8.22p

The results for 2001 have been restated on the basis set out in the Summary Directors' Report.

## Consolidated Balance Sheet

At 31 December 2002

	2002 £'000	Restated 2001 £'000
<b>FIXED ASSETS</b>		
Intangible assets	147,473	141,170
Tangible assets	62,479	48,724
Investments in joint ventures	35,883	30,510
Share of gross assets	317,831	322,338
Share of gross liabilities	(281,948)	(291,828)
Investment in own shares	18,207	18,983
	<b>264,042</b>	<b>239,387</b>
<b>CURRENT ASSETS</b>		
Stocks	38,744	35,838
Debtors: Amounts due within one year	220,042	199,705
Debtors: Amounts due after more than one year	108,932	76,105
Cash at bank and in hand	71,774	34,812
	<b>439,492</b>	<b>346,460</b>
<b>CREDITORS: AMOUNTS FALLING DUE WITHIN ONE YEAR</b>		
Bank loans and overdrafts	2,386	70,647
Trade creditors	74,377	58,034
Other creditors including taxation and social security	93,843	100,621
Accruals and deferred income	136,766	128,629
Proposed dividend	6,184	5,026
	<b>313,556</b>	<b>362,957</b>
<b>NET CURRENT ASSETS/(LIABILITIES)</b>	<b>125,936</b>	<b>(16,497)</b>
<b>TOTAL ASSETS LESS CURRENT LIABILITIES</b>	<b>389,978</b>	<b>222,890</b>
Creditors: Amounts falling due after more than one year	87,588	68,570
Provisions for liabilities and charges	34,533	25,249
<b>NET ASSETS</b>	<b>267,857</b>	<b>129,071</b>
<b>CAPITAL AND RESERVES</b>		
Called up share capital	8,697	7,903
Share premium account	190,791	73,656
Capital redemption reserve	143	143
Profit and loss account	68,226	47,369
<b>EQUITY SHAREHOLDERS' FUNDS</b>	<b>267,857</b>	<b>129,071</b>

This Summary Financial Statement was approved by the Board of Directors on 19 February 2003 and signed on behalf of the Board:

**Kevin Beeston** Executive Chairman

**Andrew Jenner** Finance Director

## Consolidated Cash Flow Statement

For the year ended 31 December 2002

	2002 £'000	Restated 2001 £'000
Operating profit before cost of unsuccessful NATS acquisition	29,103	21,254
Exceptional item: Cost of unsuccessful NATS acquisition	–	(10,187)
Operating profit	29,103	11,067
Depreciation and amortisation of goodwill	23,632	18,283
Net increase in working capital	(13,124)	(13,866)
One-off pension fund contribution	(15,500)	–
<b>NET CASH INFLOW FROM OPERATING ACTIVITIES BEFORE PFI ASSET EXPENDITURE</b>	<b>24,111</b>	<b>15,484</b>
Expenditure on PFI asset under construction*	(14,950)	(13,733)
Net cash inflow from operating activities after PFI asset expenditure	9,161	1,751
Dividends received from joint ventures	11,095	9,645
<b>RETURNS ON INVESTMENT AND SERVICING OF FINANCE</b>		
Interest received	1,223	578
Interest paid	(7,362)	(6,182)
Net cash outflow from returns on investments and servicing of finance	(6,139)	(5,604)
<b>TAXATION</b>		
Tax paid	(5,738)	(6,417)
<b>CAPITAL EXPENDITURE AND FINANCIAL INVESTMENT</b>		
Purchase of tangible and intangible fixed assets	(23,596)	(17,626)
Sale of tangible fixed assets	8,125	4,569
Exceptional item: GSR refinancing	–	16,343
Security deposit on PFI asset under construction	–	(6,000)
Net cashflows with joint ventures	1,235	(1,945)
Purchase of own shares	–	(9,964)
Net cash outflow from capital expenditure and financial investment	(14,236)	(14,623)
<b>ACQUISITIONS AND DISPOSALS</b>		
Acquisitions	(11,353)	(77,106)
Net cash acquired with acquisitions	397	3,558
Subscription for shares in joint ventures	(370)	(38)
Proceeds on disposal of joint ventures	1,030	–
Net cash outflow from acquisitions and disposals	(10,296)	(73,586)
<b>EQUITY DIVIDENDS PAID</b>		
Dividends paid	(8,283)	(6,664)
Net cash outflow from equity dividends paid	(8,283)	(6,664)
Net cash outflow before financing	(24,436)	(95,498)
<b>FINANCING</b>		
Issue of Ordinary Share Capital	117,929	2,001
Debt due within one year: (Decrease)/increase in other loans	(300)	100
Debt due beyond one year: Increase in:	15,624	14,850
Other loans	24	750
Non-recourse debt financing PFI asset*	15,600	14,100
Capital element of finance lease repayments	(3,594)	(2,785)
Net cash inflow from financing	129,659	14,166
Increase/(decrease) in cash	105,223	(81,332)
Balance at 1 January	(35,835)	45,497
<b>BALANCE AT 31 DECEMBER</b>	<b>69,388</b>	<b>(35,835)</b>

\*PFI asset under construction financed by non-recourse loan



## Directors' Profiles

### **Kevin Stanley Beeston FCMA (40)**

#### *Executive Chairman*

Kevin joined Serco in 1985 and has since held a number of financial and commercial roles. He was Finance Director of the Group from 1996 to 1999 and Chief Executive from 1999 to 2002. He was appointed Executive Chairman in May 2002. He is a member of the CBI's President's Committee and Deputy Chairman of the CBI's Public Services Strategy Board.

### **Ralph Noel Hodge CBE BEng (Hons) (68)**

#### *Non-Executive Director*

Ralph is Chairman of the Water Research Council, and a Non-Executive of British Ceramic Tiles and ORC (Inc). 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) (39)**

#### *Chief Executive*

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. In 2000 Christopher was given additional responsibility as Chief Executive of a new Serco division, Serco Global Projects and has been instrumental in developing new processes and capabilities at the leading edge of the Group's activities. He was appointed Chief Executive in May 2002.

### **Andrew Mark Jenner ACA (34)**

#### *Finance Director*

Andrew joined Serco in 1996 as Group Financial Controller, having previously worked for Unilever. He was appointed Corporate Finance Director with additional responsibility for Treasury activities in 1999. He was appointed Finance Director of the Group in May 2002. Andrew has primary responsibility along with the Executive Chairman for the Company's relationship with shareholders and the City.

### **Rhidian Huw Brynmor Jones MA FCIS FCMI (59)**

#### *Senior Non-Executive Director*

Rhidian is an experienced corporate finance lawyer and was Head of the Corporate Department of solicitors Nabarro Nathanson until retiring from that firm in May last year. He is also a Non-Executive Director of Britannia, the UK's second largest building society, and a policy adviser on company law to ICSA. 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) (53)**

#### *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, Roche and was appointed to the Board of Serco on 29 October 2001.

### **Iestyn Milton Williams BA (51)**

#### *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. In 1995 he was 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. Since then he has spent his time developing new business, first in the expansion of the Group's activities in Europe, and for the last two years leading the Group's entry into the education sector. Iestyn is also a Non-Executive Director of Law at Work Ltd and Dolphin Schools Ltd.





**From left to right:**

*Kevin Beeston*

*DeAnne Julius*

*Christopher Hyman*

*Andrew Jenner*

*Ralph Hodge*

*Rhidian Jones*

*Julia Cavanagh*  
*(Company Secretary)*

*Iestyn Williams*

*With thanks to Rushall JMI School, Walsall.*

## Investor and Shareholder Information

### Registrar

The Company's registrar is Lloyds TSB Registrars. They maintain our register of members and make the payment of dividends to our shareholders. Their address is:

Lloyds TSB Registrars, The Causeway, Worthing, West Sussex, BN99 6DA, UK  
 T +44 (0)870 600 3970  
 F +44 (0)870 600 3980

The Lloyds TSB Registrars shareholder website is at [www.shareview.co.uk](http://www.shareview.co.uk) (the "shareview website").

### Shares in issue

At 31 December 2002 there were 434,862,837 Serco Group plc Ordinary 2p Shares in issue.

### Dividend mandate

Dividends can be paid directly into shareholders' bank or building society accounts. If you want to take advantage of this facility, please complete the dividend mandate form attached to your dividend cheque, or contact our registrar by post or by fax.

The form is also available by visiting the shareview website.

### Dividend re-investment plan

The Serco dividend re-investment plan ("DRIP") gives shareholders the chance to re-invest their dividends in Serco Group plc shares instead of receiving cash.

If you participate in the scheme, your cash dividend will be paid directly to the registrar. The administrator will calculate the number of shares to which you are entitled and buy them on the stock market. Participants' share purchases are aggregated, so the dealing costs are relatively low; shares are then distributed to the participants.

To register, you simply have to complete a form and send it to our registrar. For further information about the DRIP please contact the registrar directly or look under the home page section on the shareview website.

### Electronic mailing

Where the law allows, you can now choose not to receive a paper copy of the documentation we send out. Instead we can send you an email notification every time a new shareholder document is posted on our site. This will include annual and interim reports and other shareholder communications. You can then view the document(s) on our website at [www.serco.com](http://www.serco.com).

To receive documents electronically you will need to register online with our registrar on its shareview website. This is a secure, straight forward online service operated free of charge by Lloyds TSB.

### Postal share dealing services

Serco has arranged with Cazenove & Co Ltd a simple, low-cost method of buying and selling its shares by post, where shares are bought and sold on the day Cazenove receives instructions by post. For a dealing form, please contact the postal dealing department at Cazenove.

Cazenove & Co Ltd, 12 Tokenhouse Yard, London, EC2R 7AN, UK  
 T +44 (0)20 7606 1768

The terms and conditions for this service are found on the last page of the form.

### Unsolicited mail

We are legally obliged, whenever requested, to provide copies of our shareholder register to any third parties, so from time to time you may receive unsolicited mail. You can limit the amount of unsolicited mail you receive by contacting:

The Mailing Preference Service, Freepost 22, London, W1E 7EZ, UK

### Change of registered office

On 7 May 2003 the registered office will move to:

Serco House, 16 Bartley Wood Business Park, Bartley Way, Hook, Hampshire, RG27 9UY, UK



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

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F +44 (0)1932 755854

**Serco Group Pty Limited**  
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90 Arthur Street  
North Sydney  
NSW 2060  
Australia

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F +61 (0)2 9964 9924

**Serco Group, Inc.**  
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Suite 102 South  
Gibbsboro  
New Jersey 08026  
United States

T +1 856 346 8800  
F +1 856 346 8463

Serco Group plc is a company  
registered in England and Wales  
No. 2048608

