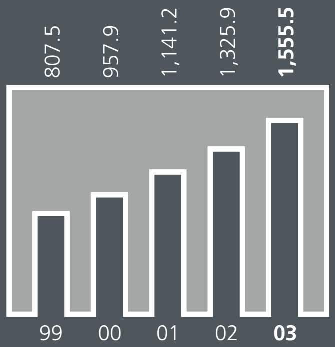
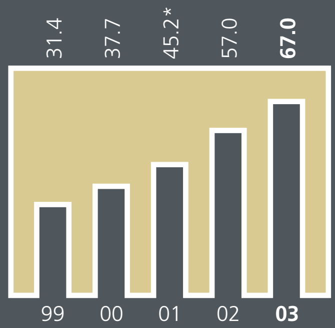
SERCO GROUP PLC ANNUAL REVIEW & ACCOUNTS 2003

Contents

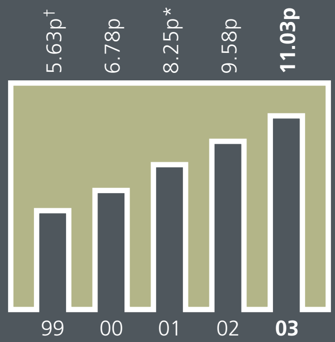
Serco Group plc Annual review & accounts



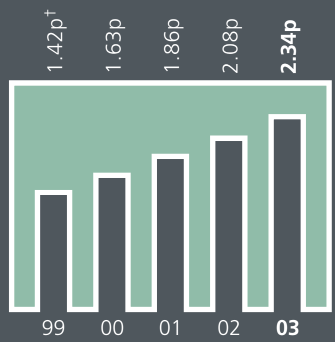
Turnover £m
including joint ventures



Profit £m
before amortisation of goodwill



Basic earnings per share
before amortisation of goodwill



Dividend per share

*Restated after the adoption of UITF 34 in 2002 †Restated to reflect the capitalisation issue on 5 April 2000

	2003	2002	
Turnover	**£1,555.5m**	£1,325.9m	up 17.3%
Profit before tax – pre-goodwill	**£67.0m**	£57.0m	up 17.4%
Earnings per share – pre-goodwill	**11.03p**	9.58p	up 15.1%
Profit before tax	**£52.9m**	£48.9m	up 8.0%
Earnings per share	**7.75p**	7.66p	up 1.2%
Dividend per share	**2.34p**	2.08p	up 12.5%

Note: Profit before tax – pre-goodwill is stated before the impact of FRS 10 *Goodwill Amortisation*, (£14.1m). Full details are provided in part one of the Finance review.

- **Strong sales and profits growth for 16th consecutive year**
  - 57% of incremental sales from existing contract base, with success rate in rebids and extensions continuing above 90%
  - 26% of incremental sales from new contract wins, with new bid success rate continuing above 50%
  - 27% underlying profit growth (before goodwill, exceptional items and incremental pension cost of £9m)

- **Significantly enhanced cash generation**
  - Free cash flow increased to £47m (2002 – £9.7m)
  - 81% of group EBITDA converted into operating cash (2002 – 45%)
  - £9.9m cash from Great Southern Railway sale and leaseback and Norfolk and Norwich University Hospital refinancing

- **Continued high visibility of earnings**
  - Forward order book stands at £10.3bn
  - 93% of 2004, 77% of 2005 and 70% of 2006 planned turnover already secured

- **Succession of sales records broken**
  - Total contracts awarded in 2003 – £4.6bn
  - Largest new contract – 25-year Merseyrail Electrics contract – Serco share valued at £1.8bn
  - Significant rebids and extensions awarded – new 10-year National Physical Laboratory contract valued at £500m, 11-year contract at Goose Bay, Canada, valued at over C$440m and 15-year extension to the Atomic Weapons Establishment contract valued at over £1bn
  - Largest North American contract – 10-year Ontario driver examination services contract valued at C$600m
  - Largest Middle East contract and first PFI in the region – in February 2004 awarded preferred bidder for 30-year Oman Joint Technical College valued at approximately US$1.4bn – Serco's share of the consortium is 50%

- **Substantial range of future opportunities**
  - Bids worth £5bn submitted and under evaluation
  - Over £14bn of further opportunities identified

Note: Free cash flow is reconciled in part four of the Finance review. EBITDA is defined in the Chairman's statement.

Serco Group – vision:

"to be the leading
service company in
our chosen markets"

"In another excellent year for Serco we have maintained our consistent record of strong growth in sales and profits. Total turnover was up 17% to £1.6bn. Profit before tax and goodwill amortisation was up 17% to £67m. Free cash flow increased significantly to £47m. Contracts awarded in the year totalled a record £4.6bn and we enter 2004 with our largest-ever forward order book of £10.3bn.

The opportunities in our markets continue to grow, driven by unremitting pressure on governments to deliver value for taxpayers' money. Our proven track record of delivering both value and quality improvement in public services makes us confident that we can sustain continuing strong earnings growth."

Kevin Beeston Executive Chairman

The successful £500m rebid of our contract to run the UK's National Physical Laboratory completed an excellent year for Serco. We maintained our unbroken record of double-digit growth in sales and profits before goodwill, strengthened our free cash flow and balance sheet, and entered 2004 with our largest-ever forward order book of £10.3bn.

During the year we were awarded contracts valued at a record total of £4.6bn.

The key to Serco's sustained success is a high rate of organic growth from extending the scope and scale of existing contracts. Over 50% of the year's incremental sales were achieved in this way. We maintained our above 90% success rate on rebids and won a large number of extensions including our largest ever.

We were awarded a record £2.4bn of new contracts – including our biggest ever – as we continued to win over half our bids. There is ample scope for further growth: we currently have bids with a potential value of £5bn under evaluation and are addressing further opportunities valued at over £14bn.

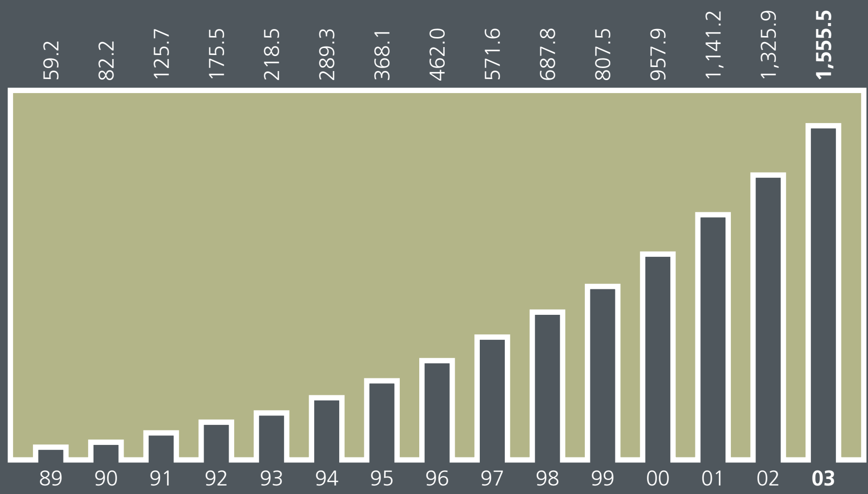
Financial performance

Double-digit sales and profit growth
Turnover grew 17% to £1,556m. Pre-tax profit was up 17% to £67m before goodwill amortisation and 8% to £52.9m after goodwill amortisation. Gross margin was maintained at 13.7% of sales.

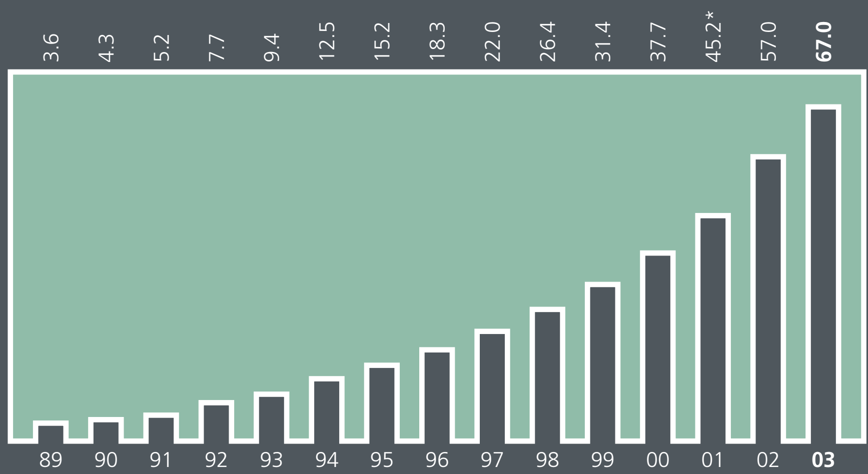
Earnings per share rose 15% to 11.03p before goodwill and 1% to 7.75p after goodwill.

Pre-tax profit before goodwill amortisation and exceptional items was up 11% to £63.4m. The exceptional items consisted of gains totalling £8.1m from the sale and leaseback of Great Southern Railway (GSR) rolling stock and the refinancing of Norfolk and Norwich University Hospital, partially offset by reorganisation costs of £4.5m.

Strong cash performance
Free cash flow increased to £47m, compared with £9.7m in 2002. Operating cash generation continued to strengthen: we converted 81% of group EBITDA (earnings before interest, tax, depreciation and goodwill amortisation) into cash, compared with 45% in 2002. This is a significant achievement as our



Turnover £m including joint ventures



Profit £m before amortisation of goodwill

*Restated after the adoption of UITF 34 in 2002 strong growth brings an accompanying demand for working capital – typically equivalent to a month's incremental turnover each year.

As part of our continuing focus on cash management we released significant cash value from capital assets. The sale and leaseback of the remaining GSR rolling stock in Australia generated £5.8m of cash and £4m of profit. This followed a similar arrangement completed in June 2001.

A further £4.1m cash and profit came from the refinancing of the Norfolk and Norwich University Hospital. This was possible because of the success of the project's construction phase, which delivered a major teaching hospital within budget and 20 weeks ahead of schedule.

Reorganisation
As our businesses grow, we need to back them with efficient and consistent support processes. As part of a continuing review of our organisational model, we announced in our interim report that we had restructured our UK support operations, bringing them together on a single business campus in Hampshire. This new arrangement is working well: although redundancy and relocation costs resulted in an exceptional charge of £4.5m in 2003, it will generate ongoing savings of some £1.5m a year.

Dividend
Continuing strong profit growth has enabled us to maintain double-digit dividend growth. The recommended final dividend of 1.62p per share gives a total for the year of 2.34p – an increase of 12.5% over 2002. It will be paid on 12 May 2004 to shareholders on the register on 12 March 2004.

Balance sheet
Maintaining a strong balance sheet is a priority for us, because of the continuing growth of the business and the scale of opportunities ahead. In August, we took advantage of historically low interest rates by issuing £117m of 8-12 year loan notes. This provides assured funding for the future and allows a mixed portfolio of debt. It has also enabled us to repay the short term facilities we used to acquire the remaining 50% of Premier Custodial Group (Premier). Following this restructuring of debt we now have a very strong balance sheet with increased long term debt capacity.

During the year we acquired full control of two PFI projects by buying-out joint venture partners' interests, together with a further five PFI projects through the acquisition of Premier. This has put us in a better position to manage the long term operating contracts and develop the potential for future organic growth.

It is also the principal reason why the non-recourse project debt shown on the group balance sheet rose over the year from £29.7m to £357m. Although shown as a liability on the balance sheet, non-recourse debt is ringfenced and secured on assets and income streams of individual projects with future revenues of over £3bn. They do not affect the group's credit agreement covenants, our risk profile or our ability to fund the group going forward.

Pensions
As previously announced, in February 2003 we merged our two UK defined benefit pension schemes to achieve cost and investment efficiencies.

The merged scheme continues to show a net deficit, now reduced to £70m. As announced in last year's report, we have raised our long term contribution rates to reduce the deficit. An additional payment of £9m was made in 2003.

Our underlying growth in pre-tax profit before goodwill, exceptional items and this incremental pension charge was 27% in 2003.

Growing the business

Contract wins

Sales grew by £230m compared with 2002. As usual, the majority of this increase (57%) came from extending the duration or scope of existing contracts. A further 26% came from our record level of new business wins, and 17% from acquisitions.

It was a good year for rebids and extensions. These are a crucial test of customer confidence because we can be judged on the performance and value that we have actually delivered. Our largest-ever contract extension, valued at £1bn, added 15 years to the 10-year contract under which we and our partners are managing the Atomic Weapons Establishment. It extends the contract until 2025.

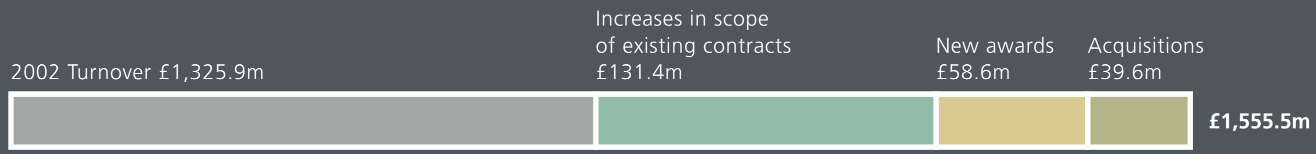
We were awarded preferred bidder status in our rebid for a further 10-year contract to run the UK's National Physical Laboratory, valued at £500m. This is a vote of confidence in our ability to run the most managerially and technically demanding contracts.

We successfully rebid and broadened our contract with the Canadian Department of National Defence to provide site support services at Goose Bay. The new 11-year contract is valued at over C$440m.

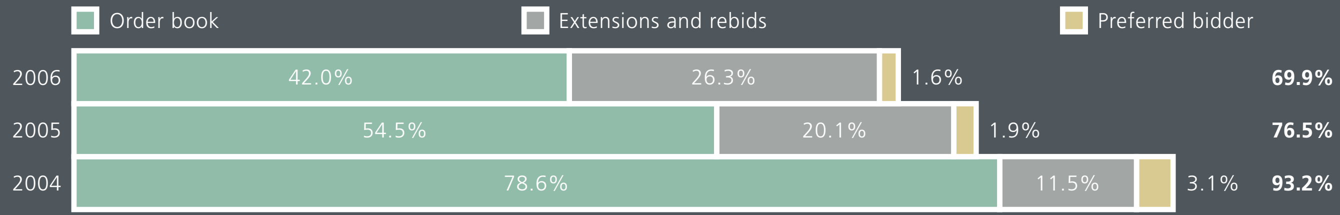
Our largest-ever new contract, to run Merseyrail Electrics in partnership with the Dutch rail operator Ned Railways, began in July. Serco's share of the £3.6bn contract is valued at £1.8bn over 25 years. Merseyrail Electrics is a self-contained network in and around Liverpool, with 66 stations and over 1,000 staff. When we took it over, it was already achieving Britain's best PPM – the Public Performance Measure by which train services are judged; in the first six months we raised its score even higher, to hit a record level in December.

Another strategically significant win was the public private partnership under which we are providing driver examination services to 12m residents throughout Ontario, Canada. This is the first contract of its kind in the North American market: the model can readily be applied to other activities where governments collect a fee for service, and other provinces are watching our progress with interest. We secured the 10-year franchise for C$114m, funded mainly with non-recourse debt raised in the Canadian market, and expect to generate revenues totalling some C$600m.

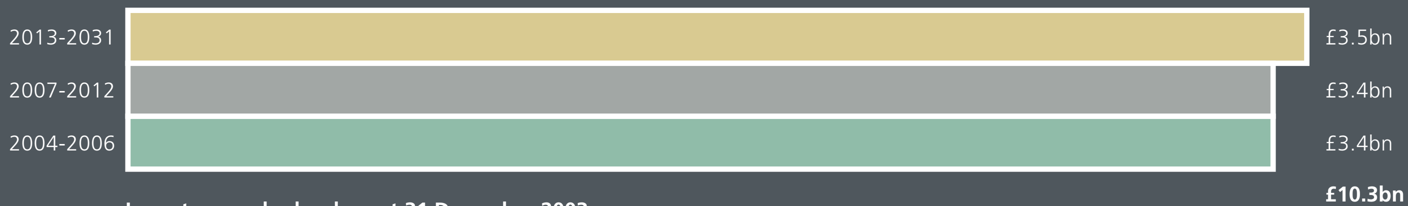
In continental Europe, we have taken over operational management of the Gefechtsübungszentrum (GÜZ), Germany's flagship army combat training centre. Valued at €50m, this is our most important German contract win to date and greatly strengthens our position in the country's developing defence outsourcing market.



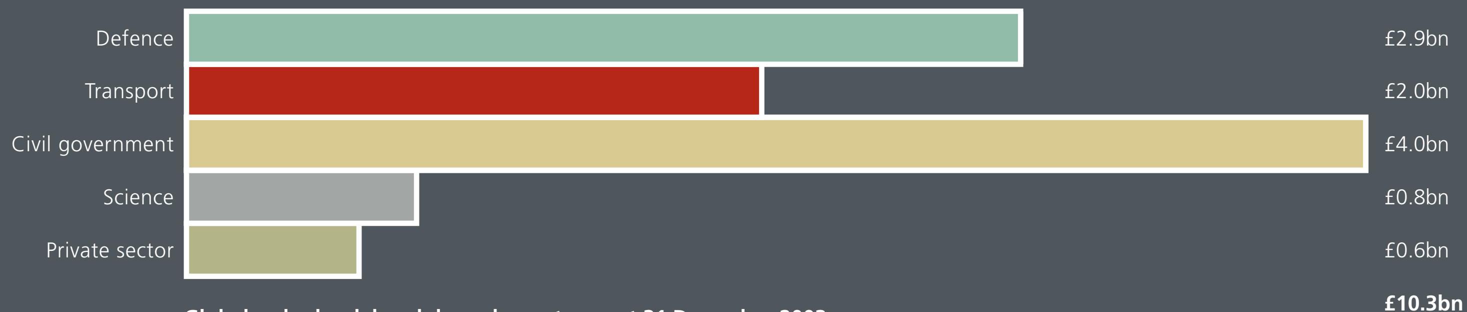
2003 Turnover growth including joint ventures



Near term confirmed order book as at 31 December 2003 percentage of planned revenue



Long term order book as at 31 December 2003



Global order book breakdown by sector as at 31 December 2003

While remaining very satisfied with our success rate of over 50% in new contract awards, we were disappointed that our consortium did not win the very large Future Strategic Tanker Aircraft PFI contract announced in January.

Market development

We are passionate about improving the quality and productivity of public services. In the UK, we have played a leading role in establishing and supporting the CBI's Public Services Strategy Board. The board works with the government and other stakeholders to stimulate debate, publish research and promote public private partnerships as a means of delivering better value for the taxpaying public. We also promote these ideas internationally through direct contact with governments and opinion leader audiences. During the year, Serco executives addressed public services conferences in Australia, Hong Kong, Italy, Japan and the US.

The Serco Institute will continue to keep Serco businesses and public sector stakeholders alert to market developments and thought leadership, and help us to position Serco appropriately. We have redefined the aims of the Institute to put greater emphasis on understanding private sector delivery of public services around the world and promoting best practice to governments, unions and other stakeholders. In 2003, Institute staff initiated a major research project on contractual performance regimes, using a number of Serco's contracts as the information base.

During the year we recruited management consultants from market leading firms to create Serco Government Consulting. This team is helping to shape the way our markets evolve by demonstrating the benefits of competition within public private partnerships and advising senior civil servants on ways to improve public service delivery through innovative public private partnerships and appropriate procurement strategies. Its strength as a consultancy is that it can deliver practice as well as principles – bringing in people from our operating companies to advise on practical issues and implement solutions.

International strategy

We have a well diversified risk profile. Our business spread – across a range of sectors and countries – enables us to take advantage of areas of opportunity as they arise and offset periods of slower growth in other regions.

We allocate resources in favour of the areas of greatest opportunity at any time. In the past year, the UK has contributed a growing percentage of our business because of a series of exceptionally large contract wins – not least the Merseyrail contract which began in July. But our commitment to international growth and diversity is undiminished: we remain convinced that this strategy is in the best long term interests of our shareholders.

Portfolio management

We regularly review our portfolio of contracts and make adjustments to focus the business on areas with greatest potential and reduce underperforming activities. During the year we disposed of several facilities management, leisure and IT contracts in the Swedish market and reached agreement with Network Rail in the UK to terminate our maintenance contract for the East Midlands zone in January 2004.

In July we acquired our partner's share of Premier, our custodial support services business. This £48.6m deal followed the acquisition of our partner's parent by a competitor. The move has strengthened our position in a market with high growth potential in the UK and overseas. It secures greater synergy with the rest of our justice business and enables us to react to the market more flexibly.

During the year we also bought-out our partners in the Metro Service joint venture, which runs the Copenhagen Metro, and the joint ventures set up to deliver the National Physical Laboratory and Manchester Metrolink PFIs. This has increased our control and ability to deliver change where capital assets have been constructed and projects have moved into the operating phase.

As in the past we will continue to review our portfolio on an ongoing basis.

Private Finance Initiatives
We are enthusiastic but selective participants in PFIs. Our PFI portfolio consists of 12 projects: we have operating contracts in all 12 and equity stakes in all but one. Together, these contracts account for some 9% of our turnover and are now delivering positive cash returns on both equity investment and operating contracts.

PFIs deliver proven benefits to governments and taxpayers. Recent analyses by HM Treasury and the National Audit Office have compared PFIs very favourably with conventional public sector procurement. The Treasury found that 89% of PFIs deliver on time or early, with no construction cost overruns borne by the taxpayer. It contrasted these figures with previous research into conventionally procured projects, which found only 30% delivered on time and 27% within budget.

PFIs are extremely good business for Serco. Our interest in them is primarily for the long term operating contracts that follow the construction or asset procurement phase: we have built a forward order book of operating contracts worth some £3bn. To the end of 2003 we have made capital investments of £15.3m, from which we have already realised cash inflows of £22.6m.

The emergence of a secondary market in PFI equity and debt confirms that the value of PFI stakes is now well-recognised and realisable. However, our strategy is generally to retain our stakes as we expect to generate further long term value from the operating contracts.

Corporate social responsibility
Social responsibility has always been part of our culture; now it is an increasingly formalised part. We have a structured approach which delegates accountability for corporate social responsibility performance to every contract manager. This ensures that the majority of initiatives are managed at a local level, where they have most impact. Social responsibility is integrated into the Serco Management System.

The first Business in the Community Corporate Responsibility Index, announced in March 2003, indicates that this approach is delivering encouraging results: Serco was ranked in the second quintile, and our overall score of 79% fell just short of the top quintile.

This year for the first time we are publishing a separate Corporate Responsibility Report, which covers our policies, processes and performance. We have also greatly enlarged the corporate responsibility area of our website, www.serco.com, which was recently relaunched.

In 2003 we launched the Serco Foundation to provide additional financial support to community projects.

Board

We reviewed the composition and balance of the board and appointed two new non-executive directors during 2003. In 2004 we see the retirement from the board of one executive and one non-executive director. Mindful of the new Combined Code on Corporate Governance published in July 2003, we believe these changes leave the board appropriately composed and balanced for the future.

In June we appointed David Richardson to the board as a non-executive director. David is finance director of Whitbread PLC, the FTSE 100 leisure group. His previous roles there have included eight years as strategy director.

In October we appointed Margaret Ford as a non-executive director. A successful entrepreneur and specialist in public sector management, she chairs English Partnerships, the national urban regeneration agency, and is a non-executive director of Thus plc.

In March 2004 Iestyn Williams retires as an executive director and in April Rhidian Jones retires as a non-executive director. Both became directors of Serco in 1987 after the buyout of RCA's UK business, where Iestyn had been director of personnel. Each has played a vital role in making Serco what it is today, and we thank them for their commitment, enthusiasm and guidance since Serco's establishment as a plc. Iestyn will remain involved with the company as non-executive chairman of our education business, Serco Learning.

On Rhidian's retirement, DeAnne Julius becomes senior non-executive director and David Richardson takes over as chairman of the Audit Committee.

People

Our continued growth is made possible by the individual commitment of everyone in Serco. We thank them all for their contribution, and this year we will be able to acknowledge exceptional achievements through the new Chairman's Recognition Awards. These cover individual and team contributions to environmental, safety and community initiatives – and other exceptional contributions to Serco's business success. The award winners are listed in our separate Corporate Responsibility Report.

To ensure that our management capabilities keep pace with our growth we continue to enhance leadership training and management development. We supplemented our very successful Institute of Directors and Chartered Management Institute accredited courses with a new Directing our Business programme for almost 240 directors and senior managers. To accelerate the development of managers with high potential we launched the Serco Leadership Programme, which provides fast-track training in a range of skills. Senior managers globally are now beginning to go through a profiling process to generate focused personal development plans.

Outlook

We have made an encouraging start to the new year – notably with our first PFI in the Middle East: to build, manage and deliver education at a new joint technical college in Oman. Our consortium, of which we have a 50% share, has been named as preferred bidder for the 30-year contract, which has an estimated value of US$1.4bn. In February we were nominated as preferred supplier to deliver prison escort and custody services for London and South East England. It is pleasing to announce preferred bidder status for our longest-standing contract, now over 40 years old – the solid state phased array radar support contract at RAF Fylingdales – and also the broadening of our multi-activity support role with the Naval Air Command under a new contract valued at about £39m.

At the start of 2004 our forward order book stood at £10.3bn, equivalent to about seven times last year's turnover, with contracts running until 2031. Our consistent success in winning rebids and extensions provides a solid platform for growth. Assuming a continuing 90% renewal rate on rebids, we already have contracts in place to provide 93% of planned revenue this year, 77% in 2005 and 70% in 2006.

The opportunities in our markets continue to grow, driven by unremitting pressure on governments to deliver value for taxpayers' money. Our proven track record of delivering both value and quality improvement in public services makes us confident that we can sustain continuing strong earnings growth.

"We deliberately set out to make ourselves an extension of Merseytravel, to blend our activities so that you'd have a job to see the join."

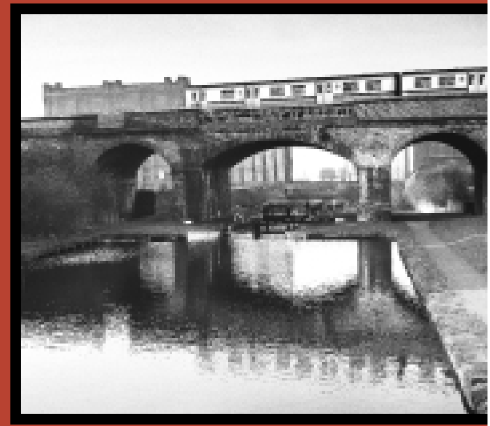
Challenged to make one of Britain's best-performing railways even better, our partnership with Ned Railways is building a sound track record on Merseyside...

partnership

dream ticket

Few companies work across such a wide range of sectors and challenges as we do. The key to success is to do what you're best at, and work with partners who bring the extra capabilities you need. As we take on ever larger and more complex contracts, it's important to be able to find the right partners, attract them on board – and quickly forge smooth-running relationships with them. This is a key skill for us.

Our core strength is planning and managing change to make organisations work better: we have the experience, the skills and the processes. When we decided to bid for the Merseyrail Electrics franchise, we also knew enough about railways to know we'd need a partner with a track record that complemented our own. Our joint bid with Ned Railways, the Dutch rail operator, won us the contract to improve Britain's best-performing railway. Together, we've achieved a successful technical and cultural fit that's meeting the challenge.



dream ticket

When we took it over in July last year, Merseyrail Electrics was already achieving Britain's best PPM – the Public Performance Measure by which train services are judged. But that didn't mean Merseytravel, the local passenger transport authority, was satisfied. "I want to see big improvements," Neil Scales, Merseytravel chief executive, announced when we signed the contract. "Merseyside can now look forward to 25 years of investment and improvement."

It's getting them. In the first six months we raised the average PPM from 93% to 93.5%. The December figure was a best-ever 94.6%. We're beginning to accumulate higher scores on performance indicators across the board, from security to train cleanliness. And further improvements are on the way. This year we're stepping-up the cleaning of trains and stations, refurbishing trains and improving customer services, passenger information and security.

Merseyrail Electrics is a self-contained network with 66 stations, 59 trains and over 1,000 staff. It's about twice the size of the Docklands Light Railway (DLR) that we operate in London.

The DLR has won us four national rail awards in four years: Best London Suburban Operator, Best Light Rail, and Rail Operator of the Year twice running. So why bring in another company? We have substantial experience in rail passenger services, track and signalling – but in the UK and continental Europe it's focused on light rail networks. To carry more weight on this and future

heavy rail bids, we sought out a partner with a strong record of delivering punctual and reliable services on high density urban heavy railways.

“Ned Railways are an excellent fit,” says Brian Burdsall, who heads our heavy rail operations and chairs the Merseyrail Electrics partnership. “They run one of Europe’s best railways. They have an excellent engineering department. They’re well known to our Strategic Rail Authority. And their culture and values are close to ours.”

The client was pleasantly surprised at how well we worked together to deliver a trouble-free phase-in to an express timetable. The contract was signed in May, and just eight weeks later we were running the network. Profitably too: we’ve already triggered bonus payments to Merseytravel under a profit-sharing agreement. And we’ve done it without shedding staff.

The staff response has been good. They’re proud of their railway and welcome our thorough approach. For example, there wasn’t an engineering director before, so we brought one in from Ned Railways: she’s an aerospace engineer with a whole range of ideas for improving reliability.

In addition to our partnership with Ned Railways, our teamwork with Merseytravel is also going, well, like a train. It’s an open-book relationship, based on transparency and collaboration.

“We deliberately set out to make ourselves an extension of Merseytravel, to blend our activities so that you’d have a job to see the join,” says Brian Burdsall. We’ve purposely kept our own profile low: the trains now run in Merseyrail Electrics livery, with no visible Serco or Ned Railways branding.

It’s a three-way partnership that’s working well so far for Merseyrail Electrics – and for its customers, the people of Merseyside. For Serco and Ned Railways, the aim now is to keep building credibility that will stand us in good stead for further heavy rail bids in the UK and elsewhere.

"In 2003 we maintained our record of strong growth in sales and profits, while further improving our cash flow. To achieve this while still investing substantially in future growth was particularly pleasing – and we have further strengthened our balance sheet so that we can take full advantage of the growth opportunities ahead. Communicating our performance clearly is important to us and our stakeholders, so we have again increased levels of disclosure and visibility in our reporting."

Andrew Jenner Finance Director

1. Financial performance

2003 has been a year of strong performance. The group has continued to deliver strong growth in both revenue and profit, combined with an improved free cash flow. Further analysis is provided in figure 1 on page 21.

1.1 Turnover

Total turnover for the year to 31 December 2003 increased by 17.3% to £1,555.5m.

Gross margin on group turnover, representing the average contract margin across the portfolio, was maintained at 13.7% for 2003.

Joint venture turnover increased by 1.1% to £231.2m. Joint venture turnover and profit in the second half of the year was reduced by the acquisition of the remaining 50% share in Premier Custodial Group (Premier) in July 2003, which was fully consolidated from that date.

1.2 Administration expenses

Administration expenses for the year increased by 22.8% to £138.5m. This includes a £9m increase in contribution to our UK defined benefit pension scheme (see 3. Pensions). Excluding this, underlying administration expenses increased by 14.8%.

1.3 Exceptional items

There were three exceptional items during 2003 resulting in a net profit of £3.6m. These items are explained in figure 2 on page 21.

1.3.1 Reorganisation costs

As the group grows, to ensure we have efficient and consistent support processes we have restructured our UK support operations, bringing them together on a single campus site in Hook, Hampshire. In addition, we have rationalised our Australian support offices to a single centre in Sydney. The resulting redundancy and relocation cost resulted in an exceptional charge of £4.5m in the first half year of 2003, and will generate savings of approximately £1.5m a year going forward.

1.3.2 GSR sale and leaseback

As part of the focus on cash generation we arranged the sale and leaseback of the remaining rolling stock belonging to our Great Southern Railway (GSR) business in Australia. This generated cash of £5.8m and profit of £4.0m, and followed a similar arrangement completed in June 2001.

1.3.3 Norfolk and Norwich University Hospital refinancing

The refinancing of the Norfolk and Norwich University Hospital, in which we are a 5% investor, was completed in December 2003. The refinancing released cash from a PFI asset whilst simultaneously providing additional funding to the NHS in Norfolk. This generated cash and profit of £4.1m (see 5. PFIs).

1.4 Profit before tax

Profit before tax and goodwill amortisation increased 17.4% to £67.0m, representing a net margin on turnover of 4.3% (2002 – 4.3%). Profit before tax, goodwill amortisation and exceptional items increased by 11.2%.

Profit before tax and after goodwill amortisation increased by 8.0%.

1.5 Goodwill

Amortisation of goodwill was £14.1m (2002 – £8.1m). The increase results largely from the acquisitions of the Ontario Driver Examination Services (DES) franchise and the remainder of Premier.

1.6 Tax

The tax charge of £19.1m (2002 – £16.6m) represents an effective rate of 36.1% (2002 – 34.0%). The increase in tax rate is largely due to the increased non-deductible goodwill charge discussed above.

1.7 Earnings per share

As a result of the above, earnings per share before goodwill amortisation grew by 15.1% to 11.03p. Earnings per share post goodwill amortisation grew by 1.2% to 7.75p.

2. Dividends

The proposed final dividend of 1.62p per share gives a cumulative dividend for 2003 of 2.34p, a 12.5% increase on 2002.

3. Pensions

The total 2003 pension charge for Serco was £36.8m (2002 – £29.1m), of which the UK defined benefit scheme had a charge of £20.0m (2002 – £12.5m).

In February 2003 we merged our two UK defined benefit pension schemes for cost and investment efficiency reasons. A one-off £15.5m cash contribution was made in 2002 to align the funding levels of the two schemes to facilitate the merger.

For 2003 we have continued to apply the transitional rules and disclosures for the implementation of FRS 17 *Retirement Benefits.* This requires the market values of the assets and liabilities for defined benefit schemes to be calculated and disclosed in a note, discussed in more detail in note 33 to the annual review and accounts.

FIGURE 1 PROFIT AND LOSS ACCOUNT

Year to 31 December	2003 £m	2002 £m	Increase %
Total turnover	**1,555.5**	1,325.9	17.3%
Group turnover	**1,324.3**	1,097.3	20.7%
Joint venture turnover	**231.2**	228.6	1.1%
Gross profit	**180.8**	150.0	20.6%
Administration expenses	**(138.5)**	(112.8)	
Exceptional items (net)	**3.6**	–	
Joint venture profit	**24.0**	23.9	
Net group interest	**(2.9)**	(4.1)	
Profit before goodwill and tax	**67.0**	57.0	17.4%
Goodwill amortisation	**(14.1)**	(8.1)	
Profit before tax	**52.9**	48.9	8.0%
Tax	**(19.1)**	(16.6)	
Profit after tax	**33.8**	32.3	
Effective tax rate	**36.1%**	34.0%	
Average number of shares	**429.9m**	421.8m	
Earnings per share before goodwill	**11.03p**	9.58p	15.1%
Earnings per share after goodwill	**7.75p**	7.66p	1.2%
Dividend per share	**2.34p**	2.08p	12.5%

FIGURE 2 EXCEPTIONAL ITEMS

	2003 £m
Reorganisation costs	**(4.5)**
GSR sale and leaseback	**4.0**
Norfolk and Norwich refinancing	**4.1**
Net exceptional profit	**3.6**

FIGURE 3 CASH FLOW

Year to 31 December	2003 £m	2002 £m
Operating profit before exceptional item	**28.2**	29.1
Exceptional item: reorganisation costs	**(4.5)**	–
Operating profit	**23.7**	29.1
Non-cash items	**33.8**	24.4
Group EBITDA	**57.5**	53.5
Pension fund equalisation payment	**–**	(15.5)
Working capital movement	**(11.1)**	(13.9)
Operating cash flow	**46.4**	24.1
Dividends from joint ventures	**12.6**	11.1
Interest and taxation	**(7.8)**	(11.9)
Exceptional item: GSR sale and leaseback	**5.8**	–
Capital expenditure	**(21.8)**	(23.6)
Disposal of assets	**8.9**	8.1
Other items	**2.9**	1.9
Free cash flow	**47.0**	9.7
Exceptional item: Norfolk and Norwich refinancing	**4.1**	–
Acquisitions/disposals	**(96.6)**	(10.3)
Financing		
– Long term loans	**117.5**	–
– Net increase in non-recourse debt	**47.0**	–
– Share issues/other financing	**(8.0)**	114.1
Dividends paid	**(9.5)**	(8.3)
Net cash flow	**101.5**	105.2

3. Pensions (continued)

In summary, at 31 December 2003 there was a net deficit in relation to the defined benefit scheme of £69.7m (2002 – £73.6m), and an asset base of approximately £350.4m (2002 – £294.5m). Long term employer contributions into the scheme were increased by £9m in 2003 to address the level of deficit on the scheme.

4. Cash flow

Free cash flow for 2003 was £47m (2002 – £9.7m). At 31 December 2003 net recourse debt was £22.3m (2002 – £6.3m cash). Further analysis is shown in figure 3 on page 22 and figure 4 on page 24.

4.1 Operating cash flow

There was an operating cash inflow for the year of £46.4m (2002 – £24.1m), an increase of 93%. This represents a conversion of 196% of operating profit into cash (2002 – 83%).

As operating profit is calculated after deduction of goodwill amortisation and depreciation, we believe that a more appropriate measure for operating cash flow is the conversion of group EBITDA into operating cash flow. For 2003 this was 81% (2002 – 45%).

The improvement in conversion rates is particularly notable given that our strong level of organic growth brings an accompanying demand for working capital, typically equivalent to a month's incremental turnover each year.

4.2 Joint venture dividends

Dividends received from joint ventures during 2003 of £12.6m (2002 – £11.1m) represent a 78% (2002 – 67%) conversion of profit after tax into cash.

4.3 Capital expenditure

Capital expenditure, excluding investment in PFI Special Purpose Companies (SPCs), for the year was £21.8m (2002 – £23.6m). This expenditure represented 1.6% of group turnover, and is broadly similar to prior years.

4.4 Acquisitions/disposals

There were two principal acquisitions during 2003: in February 2003, we acquired the franchise for the operation of DES, a Canadian contract for C$114m, funded by C$99m of non-recourse debt and C$15m of equity and subordinated debt. We acquired our joint venture partner's share of Premier, our custodial support services business, for £48.6m in July 2003.

Also during 2003, we bought out our partners in three businesses, to increase our direct control over the long term operating contracts. These were Laser (the National Physical Laboratory PFI SPC), Altram (the Manchester Metrolink PFI SPC) and Metro Service (the Copenhagen Metro joint venture).

As part of the review to focus the business on areas of greatest potential and to reduce underperforming activities, in October 2003 we disposed of a number of our Swedish contracts for £5.6m.

FIGURE 4 NET DEBT

As at 31 December	2003 £m	2002 £m
Closing cash	170.9	69.4
Long term loans	(165.3)	(47.4)
Other loans and finance leases	(27.9)	(15.7)
Recourse net (debt)/cash	(22.3)	6.3
Non-recourse debt (figure 5)	(357.0)	(29.7)
Total net debt	(379.3)	(23.4)

FIGURE 5 NON-RECOURSE DEBT

As at 31 December	2003 £m	2002 £m
Traffic Control Centre (TIS)	54.3	29.7
National Physical Laboratory (Laser)	82.4	–
Premier Custodial Group	170.6	–
Ontario Driver Examination Services	49.7	–
Non-recourse debt in consolidated balance sheet	357.0	29.7

4.5 Financing

The movement in long term loans arises as a result of the private placement (see 6. Treasury) taken out in August 2003.

The net increase in non-recourse loans of £47m primarily represents the loan taken out to fund the acquisition of the DES franchise.

4.6 Net debt

Non-recourse debt (see 5. PFIs) represents long term loans secured on the contracts of PFI and other concessions, and not any other assets of the group. The loans are excluded from all of our credit agreement and other covenants calculations, therefore having no impact on the group's ability to borrow. Further analysis is shown in figures 4 and 5 on page 24.

5. PFIs

5.1 Profile

At the end of 2003 the group had 12 PFI projects, with 11 equity investments and 12 operating contracts. These contracts contribute £3.0bn to the group's order book of £10.3bn. During 2003 PFIs contributed £133.4m to turnover and £11.9m to gross profit for the year.

At the end of 2003 we had invested £15.3m of equity and subordinated debt into our SPCs. As a result of refinancings and one sale, we have received back £22.6m cash from these investments, representing a net inflow to the group of £7.3m.

5.2 Disclosure

The 100% ownership of eight of our PFI SPCs at the end of 2003 has raised the transparency and visibility of their assets and liabilities on the group's balance sheet. We continue to expand our disclosure of PFIs in this year's annual review and accounts.

5.3 SPC funding

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

At the start of 2003, the Traffic Control Centre (TIS) was the only fully owned PFI, with full balance sheet consolidation of non-recourse debt and offsetting PFI asset. All remaining PFIs in which we had an interest were owned 50% or less, and so non-recourse debt and PFI assets were included in the share of gross assets and share of gross liabilities of joint ventures, which offset within the fixed asset area of the consolidated balance sheet.

During 2003 as described, we acquired all remaining share capital in Premier, Laser and Altram, and bought the franchise for the operation of DES. The impact of these changes is to consolidate on our balance sheet a non-recourse debt of £357m as at the end of 2003, as shown in figure 5 on page 24.

In addition to the above, non-recourse debt of £55.2m (2002 – £205.2m) is included in joint venture gross liabilities.

5.4 SPC refinancing
We are a 5% investor in the Norfolk and Norwich University Hospital. The refinancing of this SPC was completed in December 2003. This generated cash and profit of £4.1m. This is consistent with our philosophy of holding equity stakes in SPCs to increase our direct control over the operating contracts, whilst accelerating our future cash flows on those equity stakes through refinancing.

6. Treasury

6.1 Treasury management
The group's treasury function is responsible for managing the group's exposure to treasury risk, and operates within a defined set of policies and procedures approved and reviewed by the board.

6.2 Liquidity management
The group is funded by a £140m revolving credit facility, and two private placements.

Revolving credit facility
The credit facility of £140m is provided by a syndicate of seven banks and expires in 2007. The facility is floating rate, has unsecured obligations with covenants and obligations typical of these types of arrangement.

Private placements
The group has taken out two private placements. The first private placement of £43.2m was taken out in the US in 1997 and matures in 2007. During 2003 a new private placement was raised to extend the maturity profile of the group's debt and to take advantage of historically low interest rates. This second private placement raised £117m and has a maturity profile of 8-12 years, with an average fixed coupon of 5.8%.

6.3 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 largely 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 assets value of the group.

An element of the private placements was issued in US dollars and was swapped into sterling consistent with the risk profile set out above.

6.4 Interest rate risk
The group's exposure to interest rate fluctuations on its borrowing and deposits is selectively managed, using interest rate swaps. All short term debt is maintained at floating rates of interest.

7. UITF 38 – accounting for ESOP shares

Urgent Issues Task Force Abstract 38 (UITF 38) *Accounting for ESOP Trusts* was issued in December 2003 for accounting periods ending on or after 22 June 2004; early adoption is, however, encouraged. UITF Abstract 38 requires any investment in own shares to be deducted from shareholder funds as opposed to being held as an asset on the balance sheet. This also requires a restatement of the cash flow statement to include the movement on the ESOP shares balance in the non-cash movement section.

We have adopted UITF 38 for 2003 and have restated the 2002 balance sheet and cash flow statement accordingly.

8. International Financial Reporting Standards (IFRS)

The group is in the process of preparing to convert to IFRS in time for application to the 2005 accounts. It is a complex task to assess the differences between current accounting policies and IFRS, not least since many of the IFRS are themselves in the course of revision. A project team, which is working in conjunction with Deloitte & Touche LLP, has been working for more than a year to identify the major areas of impact with respect to known and anticipated changes to financial statements.

"We're impressed by Serco's professionalism and are already seeing tangible improvements in customer service – it's an excellent showcase for the outsourcing model."

Ontario's model for innovation in driver testing is attracting attention from as far afield as China...

innovation

licensed to license

Why involve the private sector in delivering public services? For one thing, the status quo gets challenged. There's a chance to reappraise factors such as risk, pace and scale of investment, quality, value, flexibility and customer responsiveness.

In short, there's real pressure to innovate. Or there should be. In the early days, contracts tended to be based on narrowly specified inputs: provide X personnel for Y days. Not much scope for innovation there. But the trend is towards more sophisticated models that specify a required output. For example, in Ottawa we were recently selected as the preferred bidder to provide a set amount of 'ice time' for ice hockey teams each year. How we do it is up to us.

Innovation in designing the contract provides a spur to innovation in delivering the service. We're all for it. So when the Government of Ontario had the idea of outsourcing its driver examination services, we were keen to bid…

Ontario has been one of the pioneers of public private partnerships in Canada. It is eager to innovate, and the model it designed for outsourcing its Driver Examination Services (DES) was attractively simple to administer. The Ministry of Transportation would sell the contractor a franchise to operate DES for a lump sum. The contractor would cover its costs and earn a return on its outlay from the examination fees. The contractor would pay for independent audit and compliance functions, to ensure that contractual standards were being met. And the Ministry of Transportation would simply need to oversee the audit and regulate the fees and policies.

It was simple to administer – but tough to bid for. Some potential bidders dropped out, deterred by the large number of unknowns that had to be addressed, and the rigour of the selection process. Our long experience of assessing bid risks and our highly developed bid processes gave us a valuable edge. We also included on the team a specialist in change management and designing new organisations – a crucial advantage during both the bid process and the phase-in.

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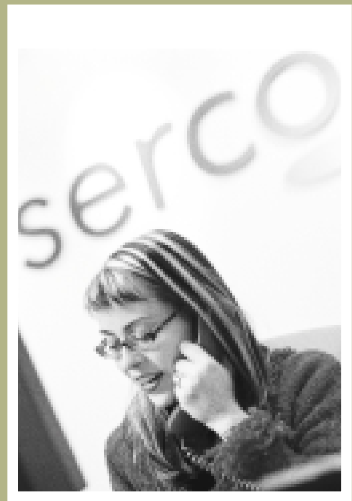
One challenge was the sheer scale of the operation. Ontario is big – five times bigger than the UK. DES conducts vision, knowledge and road tests at 55 centres around the province, and periodically at 37 other locations in far-flung communities. Peter Williams, who heads the Serco DES operation, visited eight of the most remote centres in the far north earlier this year. The trip took five days.

Another challenge was the volume of work required for the handover process. For example, new premises had to be found and equipped for 25 of the examination centres, and extra qualified staff were needed to clear the three-month waiting list for tests.

Above all, the client wanted to see change: a faster, better quality service that would bring credit to the politically controversial idea of public private partnerships.



We began operations in September 2003. Within three months, the waiting lists were down from three months to as little as a week. That has reduced calls to the call centre by 25%, so the phone service now works better too. Customers can book their tests online. And the traditional examiners' clipboards will be replaced by handheld computers as part of a wider drive to reduce paperwork.

The fresh thinking also extends to staff relations. “We’ve made the organisation more meritocratic and introduced an open-door management policy,” says Peter Williams. “We also introduced a staff association representing the driver examination centres around the province, which meets every six to eight weeks. After some initial trepidation, which is understandable, staff relations are now excellent.”

Ontario is pleased with progress so far. “It’s working like a real partnership should,” says Blake Forrest, Director, Business Services Branch Ministry of Transportation. “We’re impressed by Serco’s professionalism and are already seeing tangible improvements in customer service – it’s an excellent showcase for the outsourcing model. What we’re doing here has attracted a lot of interest from other governments in North America and elsewhere: we’ve had delegations visiting from as near as Quebec and as far away as China.”

"This has been a landmark year for us. The passionate, determined spirit of our people has produced record-breaking results. We have achieved targeted international growth and won significant new business with increased technical and integration content while at the same time increasing our operational efficiency and cash flow.

This excellent performance takes us one step closer towards our vision 'to be the leading service company in our chosen markets'. "

Christopher Hyman Chief Executive

Civil government

Market overview

In 2003, civil government contracts (excluding the transport and science sectors, which are reported as separate segments) accounted for 32% of turnover. This is one of our most rapidly-evolving markets, with attractive opportunities emerging in sectors such as justice, education and healthcare. We are addressing these sectors vigorously and leveraging our expertise in each market to stimulate others. For example, in the US – where we are developing relationships in a number of states to bring outsourcing solutions to budget-constrained governments – there is growing interest in outsourcing whole agencies along similar lines to our successful driver examination contract in Ontario, Canada.

In continental Europe, civil government outsourcing continues to gain momentum and we were pleased to win one of Germany's first public private partnership contracts, for schools maintenance and management, last year. Recent changes in the way European governments account for public private partnerships have further increased our confidence in the European market's potential.

The formation of Serco Government Consulting (SGC) has augmented our strength in this market, and its relationships and insights are helping our operating divisions to bid for a wider variety of contracts. SGC has already completed successful strategic work for a number of UK national and local government departments, US state governments, local authorities and the police.

The UK outsourced justice market is forecast to grow by more than 70% to £2.3bn over the next five years. We aim to be the pre-eminent service provider in this market. We see opportunities to provide integrated services that improve performance in areas that are growing significantly faster than the overall market – such as police support, immigration services, prison PFIs and custody services, probation, youth justice and tagging and tracking services. Our strategic consulting team is actively engaged in shaping some of these integrated services. On the Continent, both the French and German governments are examining the use of PFIs for their custodial requirements.

Education is a core issue for the UK government, which has increased funding and the pace of reform. While the market for involvement in Local Education Authorities (LEAs) has presently stalled, we are the market leader by size. This gives us both expertise and exposure to key government initiatives, strengthening our position as a potential participant in the emerging Building Schools for the Future programme. This is expected to attract over £2bn a year of additional government funding to rebuild or refurbish 3,500 schools. It includes a through-life service element, providing opportunities to target contracts in a total market worth over £35bn, primarily by providing our educational IT products and desktop support.

Delivering an improved National Health Service is another UK political imperative. The government has budgeted to increase revenue spending from £68bn in 2002/03 to £109bn in 2007/08. There is a committed pipeline of hospital building projects and Serco is established as a high quality supplier of services to PFI hospitals with the highest possible quality ratings. We also have a specialist health management consultancy, SDC Consulting, which has grown by some 20% in the last year.

Justice

In July we acquired our partner's 50% share of Premier Custodial Group (Premier). Under the terms of the original joint venture agreement we paid £48.6m, 90% of the independently assessed fair value.

Premier continues to grow strongly. In March 2003 it won a contract to design, build and operate a second immigration detention centre. The 326-bed Colnbrook Immigration Removal Centre and Short Term Holding Facility near Heathrow, London will bring our share of total capacity in the immigration centre market to almost a quarter. After managing the construction of the new facility, Premier will have an eight-year operating contract. The centre opens summer 2004.

In February 2004 Premier was named as preferred supplier for the prison escort and custody services contract in London and South East England. The seven-year contract involves the secure and safe transportation of prisoners from prison and police cells to court. Premier already provides these services in two of the eight existing contract areas in England and Wales, and satisfactory completion of negotiations will give us a 25% share of this market.

One of the benefits of taking full control of Premier is that we now have full responsibility for management performance. In 2002 the Premier-operated Ashfield Prison and Young Offenders Institution was criticised for some aspects of its management regime and processes. The action we took, leading to the restoration of acceptable standards, has been acknowledged in subsequent reports from the Prisons and Probation Ombudsman and HM Chief Inspector of Prisons. The latter report praised the 'concentrated and hard work that has been needed to pull the establishment up so far and so fast', noting that Ashfield now 'bore comparison with some of the best-performing young offender institutions'.

The National Crime Squad (NCS) formally accepted the ChildBase biometric identification and database system, completing a successful partnership development programme. ChildBase is used to track and investigate internet crime, specifically online child abuse, and won the 2003 International Law Enforcement Cybercrime Award from the Society for the Policing of Cyberspace, based in Canada. In partnership with the NCS, Serco is uniquely placed to resell this technology, which has a very broad range of potential uses.

Serco Government Consulting has also been working with the NCS on development of its corporate strategy, a new approach to business planning and construction of its budget. Our strong relationship with the NCS will stand us in good stead when the NCS joins forces with the National Criminal Intelligence services, parts of HM Customs and Excise and the Immigration and Nationality Directorate to form a new and more powerful organisation, the Serious Organised Crime Agency, in April 2006.

We have built a strong reputation for reliable IT support to UK police operations. During the year we won five-year contracts with two national operations. We have been engaged to provide software development and support services to key parts of the national policing infrastructure of the UK in addition to the hardware support and training services we already supplied to this body. We were also appointed to provide a managed IT service and helpdesk to the Asset Recovery Agency, which works closely with the National Crime Squad, Police Task Forces and HM Customs and Excise.

As part of a government road safety initiative, most parts of the UK have introduced Road Safety Camera Partnerships. During 2003 Serco, the leader in this market, was chosen as the approved equipment supplier for Transport for London, Essex, West Mercia, West Midlands, Lancashire, West Yorkshire, Edinburgh, Strathclyde, Swansea, Hertfordshire and Staffordshire.

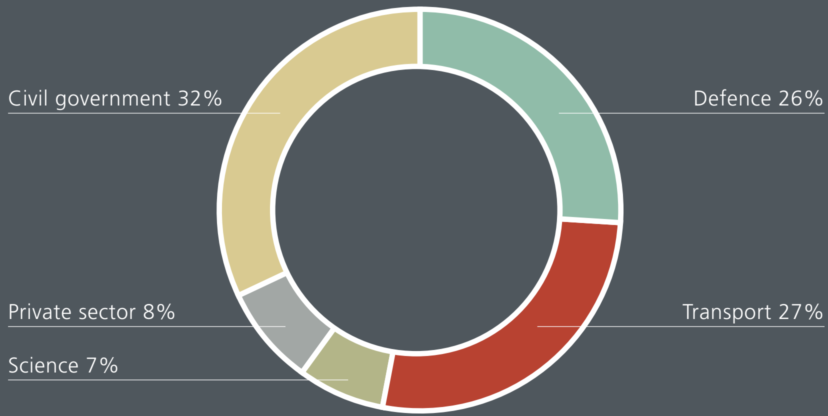
We are currently pursuing opportunities in the US at federal, state and local levels and establishing how best to leverage our security and technology experience into the Department of Homeland Security.

Education

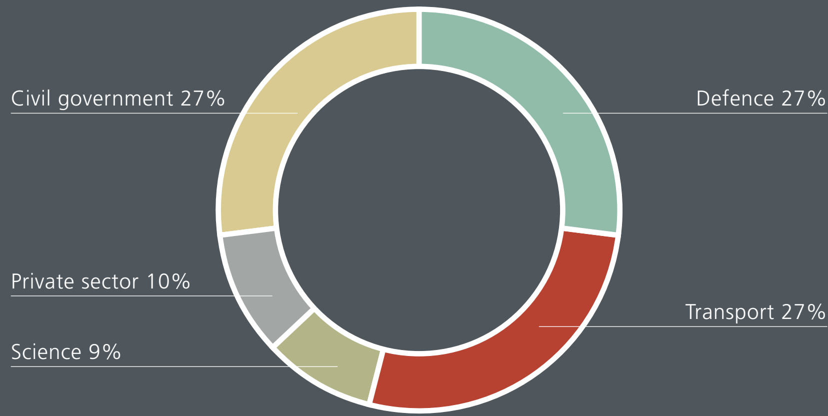
Our UK education business has two principal contracts, to provide the services that were previously the responsibility of the LEAs in Bradford and Walsall. Both have been controversial, arousing strong opinions and some misinformation in media, political and other arenas. What is now clear is that educational standards and achievement are rising in both these challenging inner city areas.

Our contract with Bradford Council is in its third year. When it began, there had been no school inspections during the school reorganisation. It was not until the start of 2003 that a full analysis of all the schools had been undertaken and realistic benchmarks and targets for judging our performance could be established. This has enabled the council to revise some targets that had previously been set. In the first two years, overall school standards have risen faster than the national average improvement rate. GCSE 5 A* to C grades improved at twice the national average rate. In 2003 our Education Bradford team received Investors in People accreditation. The assessor reported that he was ‘humbled by the dedication and commitment’ of everyone he interviewed.

Our contract to manage the Walsall LEA is also successfully raising performance standards. In under two years we have hit 14 of the 16 contract targets. In July we won specialist status for five schools, qualifying them for additional government funding totalling £2.8m a year from April 2005. This will further improve opportunities for pupils. Three-quarters of Walsall’s secondary schools now have specialist status – the highest proportion in the West Midlands and one of the highest in the country.

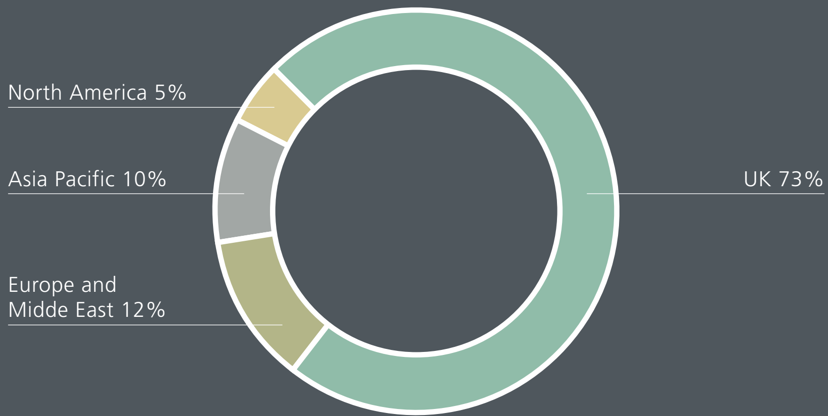


2003 Total turnover £1,555.5m
including joint ventures



2002 Total turnover £1,325.9m
including joint ventures

Sector segmental analysis – total group



2003 Total turnover £1,555.5m
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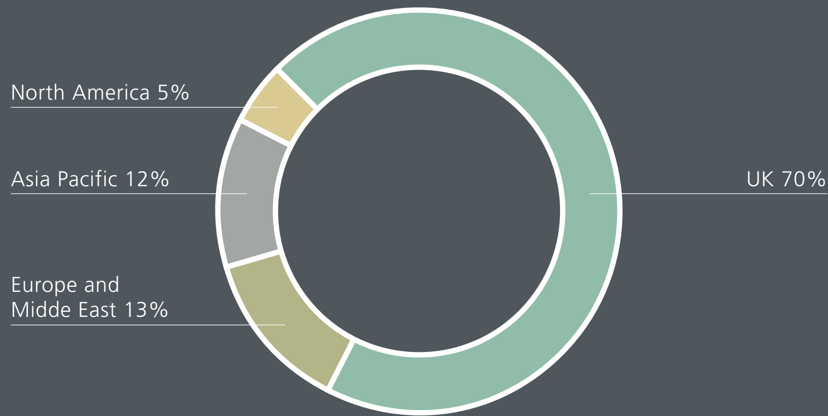


2002 Total turnover £1,325.9m
including joint ventures

Geographic segmental analysis – total group

Elsewhere in the UK we successfully rebid our one-year school inspections contract with Ofsted, the school inspection and regulatory body, increasing the contract size from £3m to £5m. We also successfully re-tendered to provide the National College for School Leadership's head teacher induction programme for England. This three-year contract maintains our prominence in leadership training to schools and LEAs as well as increasing our access to schools.

In its first year under Serco ownership, CCM Software Services – which provides management information systems and other solutions to schools – increased sales ahead of forecast. In December we acquired Teknical, a leading UK supplier of e-learning solutions to education, government and industry. The £350,000 acquisition enhances our joined-up approach to school performance management: we have integrated Teknical's Virtual Learning Environment with our school performance management products to create the first managed learning environment for UK schools.

In continental Europe a local authority in the state of North-Rhine/ Westphalia awarded us one of Germany's first public private partnership contracts. We have taken responsibility for building maintenance and management in a group of schools in Monheim under a 25-year contract valued at over €35m.

In Asia Pacific we added to our three existing education contracts with a sourcing, procurement and support service for Hong Kong's newly commissioned Po Leung Kuk Ngan Po Ling College.

Health

Our SDC Consulting business was part of two consortia that won hospital PFIs: Consort Healthcare at University Hospital Birmingham and the Equion group at North Staffordshire NHS Trust. It is currently involved with three PFI consortia – Skanska, Taylor Woodrow and Equion – on some of the country's largest hospital PFI bids.

Norfolk and Norwich University Hospital, built under a PFI contract in which Serco is a shareholder, was formally opened by HM The Queen on 5 February 2004. It was handed over to the NHS Trust in 2001, almost 20 weeks early. Successful completion of the construction and handover phase (where the risk is greatest) enabled Serco to generate a profit of £4.1m. Our primary interest in the PFI remains the continuing support services contract, which has now been extended from 30 to 35 years.

Our partnership with Summit Healthcare and Lanarkshire Acute Hospital NHS Trust won the Partners in PPP/PFI Award at the annual Premises & Facilities Management Partnership Awards. This acknowledges the quality of our services at Wishaw General Hospital in Lanarkshire, widely seen as a PFI flagship.

Regional and local government services

Our contract to provide driver examination services to 12m residents in Ontario is now fully operational, with over 500 new employees transferred from Ontario's Ministry of Transportation. This is our North American operation's largest contract win to date – with expected revenues of C$600m over 10 years – and its first public private partnership requiring financial structuring skills and a significant investment of capital. The client was impressed by our breadth of experience in government outsourcing, our commitment to work closely with the government to improve road user safety, and our approach to improving customer service – notably the reduction of road test appointment waiting times and the introduction of leading edge technology.

In a smaller but similarly innovative contract, we have undertaken to sell the City of Ottawa 2,400 hours of 'ice time' a year for hockey clubs. The demand for ice time significantly exceeds existing capacity in Ottawa, and we are the preferred contractor to build two new ice rinks at an existing leisure centre. We will design, build and operate the new facility in a combined contract with the leisure centre for 20 years.

In the UK we began an innovative partnership to combine Woking's ground maintenance and street cleaning services into unique area-based multifunctional service teams. The commercial framework is flexible, giving both parties opportunities to extend the initial contract term and add further services. Our level of financial return is related to public satisfaction surveys and the contract features a shared risk and reward mechanism to stimulate investment in service enhancements and future projects. Valued at some £25-30m over 10-20 years, it provides a potentially attractive model for other councils.

We were appointed preferred bidder in our rebid for a contract worth at least £21m to provide housing repairs and maintenance services to Canterbury City Council. This partnership contract should consolidate our position as a provider of local government housing maintenance services, helping to open up similar partnership opportunities over the coming year. Starting in April 2004, it extends our existing service to the council, broadening the range of activities and adding new measures such as pre-emptive maintenance to avoid repairs and reduce operating costs. Payments will be linked to tenants' satisfaction with the service.

Other government services
The Canada Mortgage and Housing Corporation awarded us a C$17.7m five-year extension to the contract under which we provide document services, project management, customer services, call centre operations and general contract support.

Serco Government Consulting (SGC), formed in early 2003, has already won and successfully delivered strategic consultancy work for a wide range of central and local government agencies in the UK and overseas. Its UK clients have included the Department of Health, Department for Constitutional Affairs, Foreign & Commonwealth Office, National Crime Squad, Office of the Deputy Prime Minister, London Borough of Newham and Wiltshire County Council.

A combined team from SGC and Serco North America recently completed a study of outsourcing for a US state government. As well as analysing activity to date, it identified scope for improvement and opportunities for further outsourcing using innovative business models.

Defence

Market overview
Defence, our longest-established market, accounted for 26% of turnover in 2003. We currently hold over £2.9bn worth of defence contracts and see no shortage of future opportunities.

Defence is a fast developing marketplace with good growth potential. We have a strong position and track record to build on and aim to become a benchmark organisation for the delivery of integrated service solutions in defence markets worldwide. Our strategy is to retain and expand our existing business, leveraging our core capabilities into new but related areas and selected major bid opportunities.

Serco is a major provider of services to the UK Ministry of Defence (MOD). We estimate that the MOD market accessible to the support services industry will grow from £3.5bn a year currently to £8bn by 2010. In 2003 we had an 8% share of this market.

We are also a leading provider of defence services in Australia – where we hold 55% of the garrison support market – and New Zealand. In Australia we recently began the rebid process for our support services business, in a total market valued at more than A$500m a year.

In Europe, the German Armed Forces are increasing their outsourcing of non-core support services. We are building on, and enhancing our good relationships with these customers. As a result we have once again been successful in winning new projects.

During the year, SGC recruited client-side procurement specialists to augment the capability of our defence business development teams. These senior consultants have been intimately involved in shaping new opportunities.

Major business wins
Our defence business had a very successful year, winning several very large bids and many smaller contracts.

Our largest win was the extension to our management contract at the UK's Atomic Weapons Establishment (AWE), which will now run until 2025 – adding £1bn to the forward order book. Through this contract the MOD now has access to private finance as required for major capital projects that provide environmental and operational improvements and increase efficiency.

As part of the £2.5bn Skynet 5 PFI with the MOD, we won a £220m support services contract extending to 2018. Serco is a partner in the Paradigm Secure Communications consortium, which is providing a new generation global military satellite communications system for Britain's armed forces. Our role will be to manage the network and facilities – providing spacecraft and network operations, network maintenance, training, supply management and through-life buildings and facilities maintenance. In preparation for Skynet 5 we are already managing the existing Skynet 4 network and facilities under an interim contract: this began in May 2003 after a seven-month handover from the RAF and was included in our order book figure for the end of 2002.

Another important win was the successful rebid of our site support services contract at the Canadian Forces Base, Goose Bay – one of the cornerstones of our Canadian operations. The new contract, valued at over C$440m, extends our original five-year contract by a further 11 years and broadens our responsibilities by transferring to us the base's vehicle fleet, including snow clearing vehicles and other emergency equipment.

UK

Among a series of contracts and rebids from the UK Ministry of Defence, we were particularly pleased to win the £60m support services multi-activity contract and multi-engine interim aircraft solution contract at RAF Cranwell, the RAF's premier officer training station. The contract, the first of its kind to deliver fixed wing aircraft to the RAF through a service solution, includes introducing a new training aircraft and associated simulation: we are leasing seven Beech King Air B200s to the station, which provides initial officer training, officer and aircrew training and all the RAF's multi-engine pilot training.

We were also pleased to be named as preferred bidder for the solid state phased array radar support contract at RAF Fylingdales, continuing a relationship of over 40 years.

The rebid of our infrastructure facilities maintenance contract at Plymouth Dockyard broadened the scope of our activities, raising the annual value from £3m to £8m for up to 10 years.

Another example of our ability to grow business organically was the contract awarded by Naval Air Command (NAC) for aircraft engineering and operational support at Culdrose, Yeovilton, Prestwick and Plymouth. This multi-activity contract, valued at approximately £39m, expands the range of support services that we have been providing to the NAC since 1995, and runs for up to three years.

We extended the duration of several other multi-activity contracts, including the support services contract with the RAF Personnel and Training Command covering RAF Brampton, Wyton and Henlow, valued at a total of £18m.

The MOD has extended all our current Works Service Management (WSM) estate management contracts to align them with the start of the Defence Estates new procurement model, rationalising all WSM services across the UK into five Regional Prime contracts. We are bidding for South East Regional Prime. We currently have 11 WSM contracts – all originally for three years, making a total of 33 years. Most have already been significantly extended, adding a total of 49 extra contract years.

International

A transportation and supply services contract with United States Air Force Europe (USAFE) took us into a new market area: this is the first time USAFE has outsourced such activities in the UK. The £5.5m contract includes ground passenger transportation, cargo transportation services, vehicle management, vehicle maintenance, personal property, supply support and supply training at five RAF sites over five years.

In Germany, we were delighted to win the contract to manage the Gefechtsübungszentrum (GÜZ) Army Combat Training Centre against very challenging opposition from the incumbent joint venture of German system companies. GÜZ, in the state of Sachsen-Anhalt, is the German army's flagship training centre and one of the world's best-equipped. We won the contract in partnership with Saab Training Systems. Valued at over €50m to Serco, it requires a complex combination of technical maintenance, operations support and systems management: using a combination of laser and computer engineering, 2,600 soldiers can exercise simultaneously in realistic conditions without live ammunition. GÜZ has the potential to become a hub for combat training personnel from a variety of European countries.

In the Middle East we have been selected with our Omani partner, the Bahwan Group, as preferred bidder for the first PFI in Oman. The contract is to design and build a joint technical college and operate it for 30 years. The college, which will be built on a greenfield site, will provide training for the Oman Ministry of Defence – leading to internationally accredited qualifications for army, navy and air force technicians. It will also provide both diploma and degree courses to civilians and will become a centre of education excellence within the region. The contract value is estimated at US$1.4bn over 30 years for the consortium, of which Serco has a 50% share. The project enhances our PFI and education portfolios and represents an important entry into a new region in the Arabian Gulf.

In Australia, our Defence Maritime Services (DMS) joint venture with P&O won a contract to design and build a new generation of patrol boats for the Royal Australian Navy. DMS will project manage the construction of 12 new 56-metre patrol craft between 2004 and 2007 and provide through-life support including crew training for a further 15 years at A$15.7m a year.

The patrol boat contract is the fruition of a successful relationship that has grown since DMS began a port and support craft services contract for the Navy in 1997. A Department of Finance review of this contract found that the Navy was obtaining 125% of value for 75% of the cost compared with the previous internal baseline.

Transport

Market overview

The transport sector has been a strong source of growth for us in recent years, primarily in the UK and Australia. In 2003 it accounted for 27% of turnover.

We have particular strength in light rail and traffic management systems and are the UK leader in both markets. In the UK, the traffic management market is expected to grow from £2.8bn a year to £4.3bn over the next five years, and light rail is expected to continue to grow to £205m as more new schemes are approved by government. The heavy rail market is growing more slowly but is already valued at over £5bn. We have exited rail infrastructure maintenance, where the risk/margin profile is no longer attractive, but continue to maintain rail property.

Our success in road traffic management is founded on our strength in systems design, development and integration. Following complex integration projects for the Dartford Crossing and Blackwall Tunnel in the 1980s we became UK market leader in the 1990s, ultimately winning the contract to create and operate the national Traffic Control Centre for the Highways Agency. This has involved developing a complex computer system and installing communications and monitoring equipment on England's strategic road network.

We aim to be the first choice for road and rail operations and infrastructure services, supporting the implementation of government transport policies in the UK and overseas. While growing our strong position in the UK, we are also seeking suitable opportunities in Europe and North America. Our focus in these markets will be to leverage our track record in integrated traffic management systems and efficient rail operations.

Road

In the UK we are completing the design, build and implementation stages of the national Traffic Control Centre in the West Midlands. The public launch is scheduled for June 2004, although the first operations began in November and the centre is now monitoring the motorway and major A-roads across England. It collects real-time information on network conditions from sources including CCTV cameras, automatic number plate recognition cameras and vehicle detection loops. Information on congestion and incidents is relayed directly to the public through an interactive telephone service, a real-time traffic information website and roadside variable message signs. We are also providing information to radio, TV and other commercial travel data providers.

In Scotland, we won a £4.7m contract to support Glasgow's Quality Bus Corridors scheme. We are installing automatic vehicle location, bus fleet management and real time passenger information systems over 18 months, and will maintain them for a further five years.

In the US, we added three contracts to our fleet maintenance portfolio – with the USDA Forest Service, the energy corporation Vectren and East Kentucky Power – and completed the installation of over 22,500 smart card parking meters for the city of San Francisco.

The Hong Kong government awarded us a contract to manage, operate and maintain all on-street parking for at least three years, in joint venture with Wilson Parking – a major parking operator in the Asia Pacific region.

Rail

In July we began our largest-ever contract, valued at £3.6bn, to run the Merseyrail Electrics contract for 25 years in partnership with the Dutch rail operator Ned Railways. Serco's share of the contract is valued at £1.8bn. Merseyrail Electrics is a self-contained railway network in and around Liverpool with 66 stations, 1,000 staff and two dedicated maintenance depots. We have already improved its performance ratings across the board, from security to train cleanliness; this year we are stepping-up the cleaning of trains and stations, refurbishing trains and further improving customer services, passenger information and security.

Our Great Southern Railway (GSR) business in Australia received worldwide media coverage in February 2004 when the Alice Springs-Darwin link opened. This enabled The Ghan service to make a full south-to-north run across the continent. Ticket sales for the route topped A$15m before the service began, and the first train was over a kilometre in length – the longest passenger train ever to run in Australia. The new route provides valuable additional revenue and some income smoothing because its peak demand profile differs from that of the other GSR services. It will further improve profitability by enhancing rolling stock utilisation.

During the first half we bought-out our partners in the Altram consortium which built Phase 2 of the Manchester Metrolink tramway system and operates and maintains Phases 1 and 2. Passenger revenues rose 6% in 2003, and the new revenue-sharing arrangement we agreed with the local transport authority during the year will provide further incentive to maintain growth.

In Denmark we bought-out our joint venture partner in the Copenhagen Metro, which opened in 2002. The second construction phase has now added six more stations and the new automated system is fully operational and approaching target performance levels. Passenger levels have doubled in the past year to 105,000 a day.

The Serco-operated Docklands Light Railway (DLR) won a UK National Rail Award for the fourth year running. It was named Best London Suburban Operator, adding to its Best Operator awards in 2001 and 2002 and Best Light Rail/Metro award in 2000. Canary Wharf DLR station won a national award from the Secure Stations scheme. And the railway was rated Level 7 in its annual regulatory safety audit, the highest rating ever achieved in the UK.

Our dedicated call centre in Cardiff has provided a substantial part of Britain's National Rail Enquiry Service for seven years, consistently achieving the highest quality ratings. The contract ends in March 2004 and we were disappointed to lose the rebid. However, we have agreed that 400 of our staff will transfer to the incoming operator with effect from 1 April, and we are working hard to ensure a smooth handover of the service.

We continue to bid for carefully selected rail contracts and our Merseyrail Electrics success has encouraged us in our bids for the Northern Rail franchise and the third phase of the Manchester Metrolink. In December we were one of two companies shortlisted for the Northern Rail franchise, which begins in October 2004.

Air

In the Middle East, we broadened our aeronautical services contract at Dubai International Airport. The new contract is valued at £10.2m over two years and continued growth in Dubai tourism has created a need for additional controllers in 2004. We are still the region's only private sector provider of air traffic services and are actively seeking other opportunities in the Gulf, where we are well established.

We continued to increase our aviation operations in the US as the Federal Aviation Administration (FAA) added two more towers to our air traffic control contract, bringing the total to 60. One of the additions, Vandenberg Air Force Base, is the first active duty military facility to outsource its air traffic control services. The FAA also added new facilities in Tallahassee, Florida and Corpus Christi, Texas to our weather observation contract, bringing the total to 11 facilities.

We are supporting the efforts of the United States Agency for International Development (USAID) to restore civil aviation in Iraq. Operating through a prime contractor, we started providing operational management services at Baghdad International Airport in July and Basra International Airport in September. Three more airports may follow. The £6m contract is for 18 months and two option years.

In the UK, we began a new £4.8m four-year contract to manage Newquay Airport in Cornwall. Also in the UK, the Civil Aviation Authority Safety Regulation Group approved our aviation safety management system – making us the first commercial provider to gain this approval.

Science

Market overview

Management of government scientific undertakings is a fast-emerging sector, in which Serco was an early entrant and has established a strong competitive position. Our science contracts now account for 7% of turnover, exclusive of AWE.

We aim to be recognised by governments as one of the best private-sector partners for the management of scientific organisations, programmes and consulting services. We are focusing on three market segments created by the demands of UK and international governments and agencies: management and operation of scientific and technical organisations (where we are UK market leader), strategic technical services, and management of individual science and innovation programmes. In the UK alone, markets accessible to Serco are expected to grow from £0.5bn a year in 2003 to £1bn in 2008.

Business highlights

Our contract to continue running the UK's National Physical Laboratory (NPL) for a further 10 years, valued at £500m, was a welcome recognition of what we have achieved there since 1995. During this time we have grown revenues and the number of young scientists working at NPL. We have strengthened the laboratory's global leadership in measurement science and it will continue to develop standards and measurement technologies that have a major impact on British competitiveness and quality of life. NPL is currently moving into a world-class new science facility, which we have been building under a PFI with Laing Investments. The construction phase is virtually complete and we have acquired Laing's 50% share in the joint venture for a nominal sum.

Serco Assurance has been appointed preferred bidder for two contracts for the Conditioned Waste Store Project at the Dounreay nuclear establishment. The new facility will provide a secure and modern environment for storing almost 10,000m^3 of nuclear waste from decommissioning and site restoration work over the next 50-60 years. Serco Assurance will act as building services and facilities management consultant, and provide vital safety and environmental protection solutions. It has also won a contract to provide regulatory advice, assessment and inspection support to the MOD's new Nuclear Weapon Regulator.

CERN, the European Organisation for Nuclear Research, awarded us a contract to provide electrical, mechanical and electronic support services at the world's largest particle physics laboratory in Switzerland and France. We are collaborating with two French companies and the value to Serco will be some €9m over five years.

At the European Space Operations Centre (ESOC) in Darmstadt, Germany, we successfully rebid a contract to provide teams of analysts and controllers to cover all European Space Agency (ESA) missions. We have participated in the majority of ESA missions over more than 20 years.

We successfully rebid the contract we have held for five years to maintain and run ESOC's operational computing and communications infrastructure: the new contract adds five more years plus a five-year renewal option. We also successfully rebid our support services contract with ESOC's Ground Systems Engineering Department in Darmstadt, Germany for three years, with a two-year renewal option. And we were awarded a two-year extension, valued at over €8m, to our earth observation ground segment engineering and operations contract at ESA's ESRIN Earth Observations Centre in Italy.

In the US, we are exploring opportunities within the Department of Energy, which is looking into increasing private sector involvement in the management and operation of its laboratory contracts.

Private sector

Market overview

The private sector accounted for 8% of turnover in 2003. Because of the scope available to us in the public sector, this market has not been a primary focus so far; but we do pursue selected opportunities where we can apply our core skills effectively.

Business highlights

In the UK, GlaxoSmithKline added a three-year extension to the facilities management contract that we have held at its Ware site since 1995. Building on this relationship, we were also awarded the catering services contract for the site, taking the total contract value to £2.6m a year.

In Germany, Audi awarded us a five-year contract to train dealer service engineers for its A8 and A3 models. We took just eight weeks to establish the training centre, train the trainers and set up the administration.

We won our first facilities management contract in Italy, covering the external areas of Rome's EUR business district. The client is a recently privatised public entity owned by the Treasury Ministry and the City of

Rome. The wide-ranging contract includes parks and gardens maintenance and a call centre operation; it has an initial annual value of €1.7m.

Broadband Maritime, a US-based telecommunications service provider, awarded us a contract to install and maintain the first widely affordable broadband satellite communications solution for ships at sea. Serco is exclusively contracted to install and maintain the system on commercial maritime vessels worldwide, and we expect to deliver over 2,000 installations in the next three years.

Telecom New Zealand broadened a long established relationship by appointing us as property manager for its corporate, mobile and network estates throughout New Zealand under a new three-year NZ$6.9m contract. We successfully rebid a NZ$5.2m facilities maintenance contract with New Zealand Steel. And we broadened our alliance partnership with BlueScope Steel (formerly BHP Steel) in Australia: we now provide comprehensive security and emergency response services, fire equipment inspection, maintenance and all personnel transport management at its operations in the Illawarra region of New South Wales.

People

Training and development

During the year, we launched personal development planning for all members of Serco divisional boards and the Global Management Board. Plans are based on comprehensive assessment against a defined leadership model, augmented by an online 360° feedback survey. Over 50 directors underwent assessment in 2003, and the rest will follow this year. The Serco Leadership Model specifies required knowledge in commercial, stakeholder and people management, together with personal leadership skills.

Our director development programme in partnership with the Institute of Directors (IoD) continues to be a great success. By the year end an additional 37 people had qualified for the IoD/Serco Certificate in Company Direction. They included a fast track group from our Continental Europe and Middle East region – many studying in English as a second language – who achieved a pass rate of 73%. A further 11 people moved onto the second level, achieving Diploma status, and several are now working for Chartered Director status, the highest qualification available. All pass rates were ahead of national averages. In addition, almost 240 members of Serco Divisional Boards worldwide attended a one-day Directing Our Business workshop designed in association with the IoD.

In partnership with the Chartered Management Institute (CMI), we are preparing to deliver training and assessment for accredited CMI qualifications for UK front line managers and supervisors. In 2004 we will deliver the CMI Diploma in Management, preparing candidates to become Chartered Managers. Meanwhile, eight people have qualified for a Diploma in Management in the pilot programme in 2003.

Over 600 people in the UK attended workshops to receive training in Serco's core business processes. Similar courses were held in the US, continental Europe, the Middle East and Australia. New courses from the Serco Best

Practice Centre included a workshop on strategic selling to help managers create new business opportunities with their customers.

During 2003 we launched the Serco Leadership Programme for high-potential individuals. The first 13 candidates are currently on a pilot programme covering core skills plus personal development planning based on the Serco Leadership Model. Early indications are very encouraging and the programme is being extended in 2004.

Because of our worldwide spread, distance learning is a valuable and increasingly important part of our training strategy. We are major users of e-learning programmes delivered through our intranet. During 2003 we released two new online learning products: an interactive exercise to simulate running an operational business and Leading Change, an interactive explanation of our change management methods with supporting tools and case studies.

"A lot of exciting projects are coming up in satellite communications and global positioning technology, in both the public and private sectors worldwide."

Eight industry leaders are creating the Skynet 5 system, on earth and in space. Serco is one of them.

complexity

the sky's not the limit

We began, 40 years ago, with a radar maintenance contract. Today we're involved in PFI projects so large and sophisticated that it takes teams of specialist companies to deliver them.

For Skynet 5, eight major companies joined forces to enable Paradigm Secure Communications (which is sponsored by EADS) to create the next-generation secure communications system for Britain's armed forces. EADS Astrim is the systems provider and Paradigm Services is the operator. And as subcontractor to Paradigm Services, Serco will manage the network and facilities to exacting performance standards.

When the £2.5bn contract was awarded in October 2003, Skynet 5 was the biggest defence PFI ever. Even larger and more complex projects will mean more and more multi-partner teams being formed to tackle unprecedented challenges. Our primary interest in joining these consortia is to win the long term operating contracts that follow the construction phase. It's a role that requires real teamworking skills, as we need to form effective partnerships with all the other participants – and the customer.

Serco began as a provider of technical skills. Our first contract, in the mid-1960s, was to maintain the Ballistic Missile Early Warning System at RAF Fylingdales. We broadened our capability to cover complete management of all support services. This took us into early PFI joint ventures such as the Joint Services Command and Staff College contract, where a 'build' partner teamed up with Serco as the 'operate' partner. Now, as we embark on complex multi-partner PFIs, our technical skills are as important as ever – but it's our management and partnering skills that have come to the fore.

Skynet 5 will guarantee secure communications for Britain's armed forces whenever and wherever they're required. Our track record on many defence contracts – and also with the European Space Agency – helped us win the 15-year operating contract, valued at over £220m.

the sky's not the limit

Everything about Skynet is big and complex: the bid and negotiation process alone took four years. The phase-in began in November 2002, while negotiations continued, and since March 2003 we've been gaining invaluable experience in operating and maintaining the existing Skynet 4 system. This may be nearing the end of its service life, but the UK's involvement in crisis points such as Bosnia and Iraq means it's been fully stretched. "In October 2003 we saw the highest level usage of military satellite communications voice and data services ever recorded via the Skynet 4 system," says Richard Vella, our Network Director, who transferred to Serco with some 75% of the Skynet 4 ground station staff.

Modern military operations call for greater capacity than Skynet 4 can provide. Delivering it will require many skills. The Paradigm team, led by European spacecraft manufacturer EADS, includes Cable & Wireless, Cogent, General Dynamics, LogicaCMG and Stratos as well as Serco.

Paradigm has already started building new ground infrastructure including new transmitters. In 2006 and 2007 it will add two new satellites. Paradigm is also equipping the ground stations to use capacity on commercial satellites to bolster its ability to meet military and commercial user demands.

Serco's operational role includes network maintenance, training, supply management, through-life maintenance of the buildings and facilities, installation of communication systems in operational zones such as Bosnia – and spacecraft operations. Our spacecraft control teams work round the clock, manoeuvring the satellites to maintain their orbital position, orient them in the right direction and keep them in optimal condition. There are planned operations – such as regular station-keeping manoeuvres to return the spacecraft to their normal orbital position – and unplanned, in response to onboard failures or factors such as solar activity.

Maintaining business as usual while Skynet 5 takes shape requires effective teamwork with all the Paradigm partners. We're also helping them with system reviews and advice on developing new procedures.

As a newcomer to Serco, Richard Vella says he's been impressed by "the can-do approach, and the ability to interact so well with the other partners. By embedding ourselves in their organisations, we're helping to bind the whole project together."

For Serco, Skynet could provide a springboard to further opportunities. "A lot of exciting projects are coming up in satellite communications and global positioning technology, in both the public and private sectors worldwide," says Project Director Paul King. "Skynet 5 is a ground-breaking deal. It will be used as a basis for many other similar procurements worldwide. By showing our ability to work with our partners on Skynet 5, and our ability to deliver, we'll be well placed to address this exciting new market."

PFIs are generating good returns for Serco – and good value for taxpayers

Our portfolio of Private Finance Initiative (PFI) projects is delivering cash returns on our investment and a £3bn order book of service contracts. We now wholly own the great majority of the PFIs that we're involved in, which makes for better long term customer relations. And we're seeing good cash returns from our investments, with cash inflows exceeding our total investment.

PFIs continue to offer very good value for money to governments, in the UK and, increasingly, overseas. Their effectiveness has been confirmed by recent studies from HM Treasury and the UK's National Audit Office. They have been proven to deliver better results than traditional procurement methods through better project definition, reduced procurement time, focus on service delivery, better asset utilisation, effective competition and risk transfer. In the UK, PFIs will continue to play a partial but important part in public sector capital investment. Contracts signed to date have a combined capital value of over £35bn, and an equivalent value of contracts are currently out to tender or identified.

We are currently involved in 12 PFIs – with operating contracts in all 12 and equity stakes in 11. Last year PFIs contributed £133.4m to turnover and £11.9m to gross profit. By the year end, total cash inflows of £22.6m exceeded our investment to date by £7.3m.

PFIs provide multiple income streams. Our primary interest is the income that comes from the operating contracts, which are generally long term and significantly improve the visibility of our earnings and cash flows. Some £3bn of our current £10.3bn order book comes from PFI operating contracts. We can earn dividend income from our equity stake in each project and interest on any loans we make. And as the risk profile of a project declines – notably when the construction phase is complete – it may be possible to realise a further financial gain by refinancing the debt capital raised from third parties.

More than 90% of any PFI's funding comes from competitively sourced non-recourse debt. These non-recourse debts are secured on the relevant projects' assets and cash flows: creditors have no recourse to Serco and the debt has no impact on our banking covenants. More information on non-recourse debt is included on page 25 in the Finance review.

The size and maturity of our portfolio means we can manage the capital base actively and efficiently – for example through the Norfolk and Norwich University Hospital refinancing in 2003, which realised £4.1m of profit for Serco as well as releasing significant resources for the NHS.

During the year we bought out our partners in two PFI joint ventures where the construction phase is complete, and our partner in Premier Custodial Group, which has a number of PFIs. This has enabled us to manage the long term operating contracts better and develop the potential for future organic growth. It also means that we own 100% of the projects' assets and debts, which can therefore be shown more visibly on our balance sheet.

If PFIs are such good business for Serco, why don't we have more of them?

Because not all PFIs are the same, and we're highly selective. We look for projects with high service content where we can minimise our equity investment in relation to the operating contract value.

The PFI model continues to evolve. There is now a solid base of good practice to build on, and standardisation of contracts will reduce bidding costs and procurement times for many projects. The bundling of similar projects into a single package – as in the proposed Building Schools for the Future programme – will make the PFI model viable for smaller projects. And new approaches to public private partnership, such as our Ontario Driver Examination Services franchise, are still emerging. The creation of Serco Government Consulting will help us stay in the forefront of this process by helping national and local governments to devise appropriate models for procuring assets efficiently.

Supporting but not spoonfeeding **Lynne Morrison** Associate Director, Premier Custodial Group

"When I started, a colleague told me Serco supports its employees but doesn't spoonfeed them. They were right. Serco's good at recognising what people have to offer. It will give you opportunities. And if you want anyone's advice or experience you only have to ask – everyone's door is open. It's a company that's good at sharing what it knows."

1994: Wheelchair field services supervisor in North Wales

1997: Contracts administration manager, Serco Investments

1998: Commercial manager, Serco Investments, working on PFIs

2002: Associate director, Serco Investments

2004: Associate director, Premier Custodial Group

Ten years ago, Lynne Morrison was 'an unemployed mum who had been a secretary' and had started a distance learning law degree. She's learned a lot since then –- completing her degree and, with Serco's help, a Certificate in Management Studies and a Master's in Finance and Administration. She joined as a workshop supervisor. The management studies helped with the first job. The law degree took her into contracts administration. And the Master's, which involved a dissertation on refinancing PFIs, led to a stint as commercial manager on a succession of PFIs. Now she's moving to Premier Custodial Group to develop new areas of business in the justice sector.

"If you do a good job of, say, change management, you'll be drawn to somewhere else where that skill is needed. There are no barriers."

Careers in Serco don't tend to go in straight lines. We like people to move around – across sectors, functions and national frontiers.

development

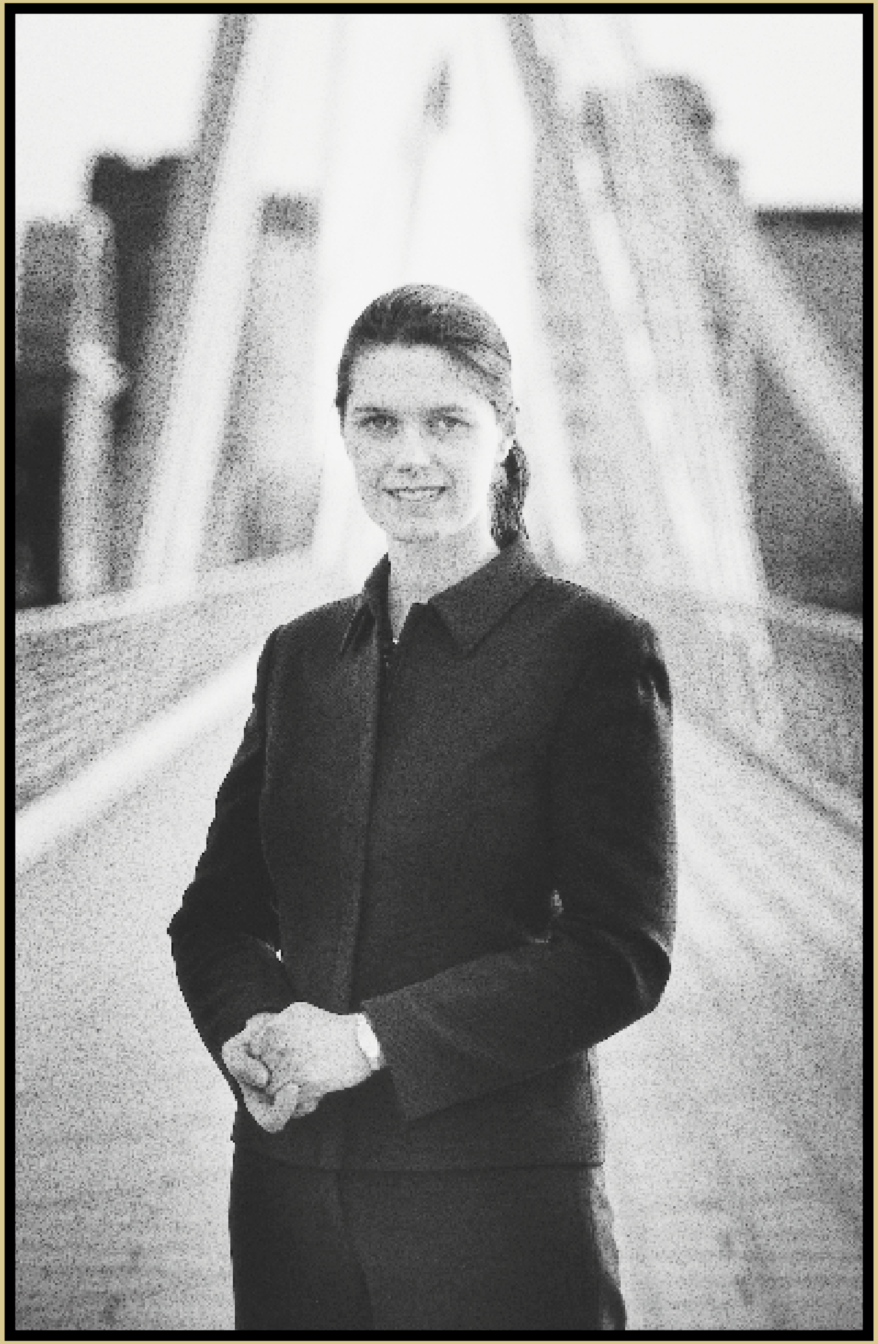
all the right moves

Customers don't bring us in to preserve the status quo. They want us to change things. That's why the people who do well in Serco are the ones who see things differently, who find better ways to get things done. It's also why we like to move people around. We offer them new challenges in unexpected areas, where their skills will open up fresh thinking. It's a great way to transfer skills and share knowledge. Often, unconventional career moves enable people to come up with unexpected solutions to tough problems. And as they move around, they enrich their experience and understanding even more.

It's exciting to see people rise to new challenges. But to be sure they succeed, you need to give them all the support they need. We're keen to give people training in skills they'll find useful. The Serco Leadership Model helps us identify and develop management capability. And, importantly, we have an open and collaborative culture where people are encouraged to share their experience, advice and ideas.

A constant upward pull

Dilys Foster Director, Serco Government Services



1989: Satellite ground stations engineer, European Space Operations Centre, Germany – and supporting a worldwide network including Belgium, Kenya, Canaries and French Guiana

1998 (after a career break): Leading Serco's Skynet 5 PFI team

2000: Contract support director, Serco Aerospace

2001: Serco Institute, seconded to government task force

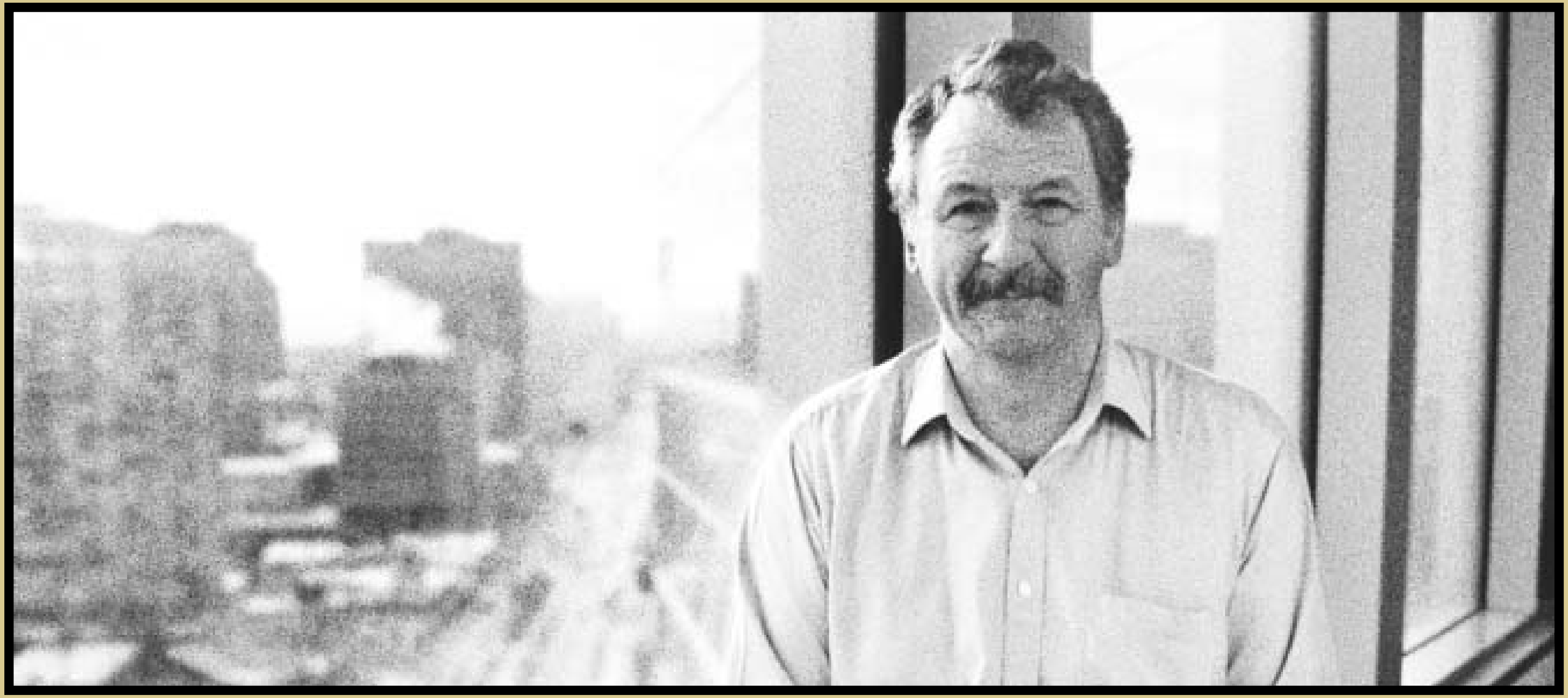
2002: Director of Serco Facilities Management

2003: Director of Serco Government Services, managing strategic selling initiative

"Serco is growing rapidly, so there is a constant pull up the organisation to fill new roles. There are always exciting opportunities available, and many will be outside your past experience." Dilys Foster should know. She joined Serco in 1989 as a satellite ground stations engineer. Today –– via aerospace, several PFIs and secondment to a government task force on strategic partnering –– she's taking on strategic marketing as a director of Serco Government Services. "If you do a good job of, say, change management, you'll be drawn to somewhere else where that skill is needed. There are no barriers – people move internationally because they are supported and encouraged to do so."

The opportunity to change things

Peter Williams Managing Director, Ontario Driver Examination Services, Serco North America



1994: Contract manager, Shoeburyness firing range

1995: Contract manager on facilities management contract at Abbey Wood office complex, housing 6,000 civil servants

1998: Facilities team leader on Atomic Weapons Establishment bid

1999: Project director, Joint Services Command and Staff College PFI

2003: Managing director, Ontario Driver Examination Services, Serco North America

Peter Williams likes making things happen. He joined us 10 years ago, after 29 years in the British Army. After managing support contracts at a weapons research range and one of Europe's largest office complexes, he helped lead our then largest-ever bid, to run the Atomic Weapons Establishment. When we won it, he took over the £130m Joint Services Command and Staff College PFI contract a year before construction finished. He got it open on time and ran it for three years. Now he's moved to Ontario to lead our Driver Examination Services franchise. "If you're willing to take on new challenges, Serco will help you all the way," he says. "The culture is: prove your worth and we'll let you get on with it. I like giving people the opportunity to change things for the better – and that's the key to Serco."

Looking outside as well as inside

Gordon Paterson Chief Executive, Serco Solutions

1984: Joined Serco as a young engineer in Guisborough, worked on a series of road and rail information systems

1993: Operations manager, Serco Guisborough

1998: Managing director, Serco Transport Systems

1999: Managing director, Serco Technology

2000: Managing director of newly created Serco Government Services

2002: Set up Serco Integrated Solutions to bid for large, complex contracts

2003: Chief executive of Serco Solutions, formed by integrating our investment management business and new consulting business

Gordon Paterson has spent 20 years with Serco. "Not intentionally," he says. "The challenges just came so thick and fast that I have never wanted to look elsewhere." Today he's on our Global Management Board. But he's not averse to looking outside for fresh ideas, even at the top.

"Outsourcing business models are changing very fast," he says. "In Serco Solutions we've put together the capability to design and implement contracts that are unprecedented in their scale and sophistication. We need to ensure top management has the skills to maintain our leadership position. Our new joint training courses with the Institute of Directors and Chartered Management Institute help bring in ideas from outside and keep our thinking fresh. So does external recruitment, like the influx of people we've recruited for our consulting business. We're here to take capabilities and ideas and turn them into competitive advantage – to reinvent the whole solution, even if we draw on familiar core principles. We need these external influences to shape our thinking."

03

Serco Group plc Accounts 2003

DIRECTORS, SECRETARY AND ADVISERS

Chairman
Kevin Beeston

Directors
Margaret Ford*
Ralph Hodge CBE*
Christopher Hyman
Andrew Jenner
Rhidian Jones*†
DeAnne Julius CBE*
David Richardson*
Iestyn Williams

Secretary
Julia Cavanagh

Investment Bankers
Lazard Brothers & Co Ltd
21 Moorfields
London
EC2P 2HT

Morgan Stanley & Co Ltd
25 Cabot Square
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E14 4QA

Principal Bankers
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EC3P 3AH

The Royal Bank of Scotland plc
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EC2M 3UR

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Auditors
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Chartered Accountants
London

Stockbrokers
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Merrill Lynch International
Merrill Lynch Financial Centre
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Solicitors
Allen & Overy
One New Change
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Registrars
Computershare
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* Non-Executive Director
† Senior Non-Executive Director

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”). In July 2003, The Financial Reporting Council published a revised Combined Code on Corporate Governance which includes certain recommendations from 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”).This Report sets out how the Company applies the 2003 Revised Combined Code, with which it has been largely in compliance, during the year. It is the Company’s intention to achieve full compliance with the 2003 Revised Combined Code, or justify any exceptions, during 2004.

The Board and its Directors

The Board currently comprises nine Directors: Kevin Beeston, Margaret Ford, Ralph Hodge, Christopher Hyman, Andrew Jenner, Rhidian Jones, DeAnne Julius, David Richardson and Iestyn Williams. Excluding the Chairman, the Board comprises five Non-Executive and three Executive Directors. This will be reduced to four and two respectively following the retirement of Iestyn Williams and Rhidian Jones on 31 March and 30 April 2004.

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. Job specifications are in place for both the Executive Chairman and the Chief Executive defining their roles and responsibilities. The Directors’ profiles are set out on pages 73 and 74.

The Board believes that all 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 judgment. They bring a wide range of experience to the Board including international business operations, strategy, human resources 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. As announced in the 2002 Annual Report, Rhidian Jones will be retiring in April 2004. It has been agreed by the Board that DeAnne Julius will be appointed Senior Non-Executive Director following Rhidian’s retirement. David Richardson will replace Rhidian as Chairman of the Audit Committee. As Finance Director of a FTSE 100 Company, the Board believes that David has the relevant financial experience to chair this Committee as recommended by the Higgs Review. The Non-Executive Directors meet on an informal basis during the year without the presence of the Executive Directors. The Non-Executive Directors are initially appointed for a three-year term.

During the year the Board met six times, on four occasions for two days at a time, at varying locations, and took the opportunity to combine the formal business of the Group with site visits and divisional presentations and discussions. During the year a strategy review was held, hosted by the Executive Chairman, and attended by the Board and key senior managers of the Group.

There is a formal schedule of matters reserved for the Board including the responsibility for leading and directing the affairs of the Group. This schedule together with the terms of reference for the Board Committees were reviewed and revised by the Board in November in light of the 2003 Revised Combined Code.

The Board and its Directors **(continued)**
During the year each Director completed an evaluation questionnaire, the results of which were discussed at the Board Meeting in November 2003. There were no material matters arising, although a small number of minor procedural improvements have been effected. The Chairman also held meetings with individual Directors to discuss the operation and performance of the Board. A further review will be undertaken during 2004. The Senior Non-Executive Director met with the Executive Chairman to evaluate his performance as Chairman of the Board.

During the year Kevin Beeston was appointed as a Non-Executive Director of Ipswich Town Football Club PLC. The Board are fully supportive of his role and consider that the time commitment required will not significantly impact his position in the Company. The role is non-fee earning. Iestyn Williams also holds a number of Non-Executive positions including Non-Executive Deputy Chairman of V Holdings Ltd. As Iestyn has a part time role with the Company, his Non-Executive roles are undertaken in his own time. He retains the fees earned from these positions.

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 and for advising on governance matters. 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 and responsible for operation of the Group’s whistle-blowing procedure. 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, timely and adequate and enables the Directors to discharge their duties. The information provided to the Board was assessed as part of the Board evaluation process.

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 stood for re-election. The Directors are proposing to adopt new Articles of Association at the Company’s Annual General Meeting in April 2004. One of the changes to the Articles will be to replace the requirement that the Directors retire by rotation, with a requirement that a Director must retire at an annual general meeting (but be eligible for re-appointment) if he has held office for more than 30 months (as at the date of the notice convening the meeting) since he was appointed or last re-appointed. This change is intended to align the Articles more closely with the requirements of the 2003 Revised Combined Code.

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 were reviewed and revised in November 2003 to take account of the 2003 Revised Combined Code. The Chairmen of the Board Committees attend the Annual General Meeting to answer questions from shareholders.

The Terms of Reference for the Board Committees are displayed on the Company’s website www.serco.com.

Board Committees (continued)

As required by the 2003 Revised Combined Code, detailed below are the members, meetings and attendance records for the Board and each of the following Committees: Audit, Nomination and Remuneration. Reports of the Audit and Remuneration Committees have also been provided.

Name	Board	Audit	Nomination	Remuneration
Kevin Beeston	C		C	
Margaret Ford	X	X	X	X
Ralph Hodge	X		X	C
Christopher Hyman	X			
Andrew Jenner	X			
Rhidian Jones	X	C	X	
DeAnne Julius	X	X	X	X
David Richardson	X	X	X	X
Iestyn Williams	X			
Number of Meetings	6	3	3	5
Apologies for Absence	0	0	0	0

C = Chairman X = Member

The Audit Committee

The Audit Committee is currently chaired by Rhidian Jones. David Richardson will chair this Committee following Rhidian's retirement. The terms of reference for the Audit Committee were updated during the year to take into account the recommended changes of the 2003 Revised Combined Code which incorporates certain of the recommendations of the Smith Report. In accordance with best practice the Committee has produced a report on its activities during the year, which can be found below;

Report of the Audit Committee

The Audit Committee met three times 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. During the year the Committee held discussions regarding the business risk auditing activities undertaken by the Company's internal audit providers, Grant Thornton. Members of the Committee have received 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. Early in the year the Committee considered and approved a policy in relation to the provision of audit and non audit services by Deloitte & Touche LLP ("Deloitte") and other financial advisers. Financial limits were set in relation to services provided and these have been monitored during the year by the Committee. Deloitte provide other services to the Group such as tax advice and technical advice in relation to accounting for new bids where appropriate. Non-audit work is subject to a tender process as required, and as a result work has been undertaken during the year by a number of other firms including Ernst & Young LLP and KPMG. The Committee also considered and approved the annual audit fee for Deloitte.

Report of the Audit Committee **(continued)**
The independence, objectivity and effectiveness of the external auditors has been examined by the Committee and discussions held regarding their terms of engagement, remuneration and proposal for partner rotation. The Committee has met with both the internal and external auditors without the presence of the Executive Directors.

In accordance with the 2003 Revised Combined Code, the Committee has considered and approved a formal whistleblowing policy and procedure for implementation around the Group. Updates will be provided to the Committee in relation to this matter.

The Committee recommended to the Board that Deloitte be proposed for re-appointment at the forthcoming Annual General Meeting. This recommendation has been accepted and will be proposed to Shareholders.

The Nomination Committee
The Nomination Committee is chaired by Kevin Beeston, and met three times during the year. Matters considered included the appointment of Non-Executive Directors, succession planning and crisis management for the Board. The recruitment process was undertaken using an external consultancy and formal terms of reference. The successful candidates were met by all members of the Board prior to appointment. Consideration was given to the skills, knowledge and experience desired by the Board and the need to ensure an effective and balanced Board. The existing commitments of the candidates were also discussed to ensure sufficient time was available to undertake their duties as a Director of the Company.

The Remuneration Committee
The Remuneration Committee is chaired by Ralph Hodge. The Committee met five times during the year to deal with matters relating to remuneration for Executive Directors. The Remuneration Report is set out on pages 77 to 87. The Committee also considered the policy and framework of remuneration for senior executives within the Group. The remuneration of these executives is considered and approved by the Remuneration Committee of the Global Management Board (“GMB”), which comprises the Executive Chairman, Chief Executive and Chief Operating Officer and is advised by the Human Resources (“HR”) Director. The quorum of the Committee being any two of the members.

There are three further committees of the Board, details of which are provided below:

The Approvals and Allotment Committee
This Committee meets on an as required basis and comprises the Executive Directors with any two forming a quorum, except in relation to the exercise of share options when the Company Secretary and any one Director can constitute a quorum. The business of the Committee is varied and ranges from bid approval to approval to the releasing of share options. This Committee also considers matters requiring formal approval following discussion by the GMB. The Committee forms a key part of the Group’s internal controls and acts to facilitate and authorise the operations of the business at a certain level on a day-to-day basis. The level of authority delegated to this Committee is reviewed on an annual basis.

The Global Management Board
The Board has delegated responsibility for the day-to-day management of the business to the GMB. The GMB meets formally on a quarterly basis and more frequently if required. The GMB is made up of a number of senior managers within the business and includes three of the Executive Directors. Matters discussed by the GMB which require formal approval are submitted to the Board or the Approvals and Allotment Committee, details of which are provided above. Further details relating to the ongoing management of the business can be found in the Annual Review section of the Accounts.

The Training and Development Committee
The Training and Development Committee comprises Margaret Ford, Christopher Hyman, Ralph Hodge, Rhidian Jones, DeAnne Julius and is chaired by Iestyn Williams. Following Iestyn's retirement, Kevin Beeston will take over as Chairman of this Committee. The Committee met once during the 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 Group's corporate governance framework and latest financial statements, together with site visits and meetings with senior management around the Group. New Non-Executive Directors have attended full induction programmes as determined by the Committee. All Board members are encouraged to attend training courses at the Company's expense.

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 Group.

Formal presentations are made to institutional investors and brokers' analysts after the release of the interim and final results. Further requests for individual meetings are considered on a case-by-case basis. Two Non-Executive Directors attended a site visit and strategy visit respectively with institutional investors and analysts during year. An Investor Relations Report is presented to the Board on a quarterly basis, which ensures the Directors have a clear understanding of the views of investors and brokers.

During the year the Company continued its on-line communication with a webcast of the interim results presentation and an online radio broadcast for staff. An open conference call for investors was also provided. In addition to the Interim and Preliminary Results announcements, the Company has introduced two further trading updates during the year.

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.

The Company's website, www.serco.com was substantially improved and updated during 2003. The new site includes an area specifically tailored for investors including information such as the Terms of Reference for all the Board committees and information on voting at the last Annual General Meeting. It also has a link directly to our Registrars to enable Shareholders to view their shareholding on line.

Internal Control and Risk Management
The Group 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 Group's assets and reputation. Whilst the Board has overall responsibility for the Group'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 requirements of the 2003 Revised Combined Code on Corporate Governance. 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 misstatement or loss.

Internal Control and Risk Management (continued)

The Corporate Assurance Group ("CAG") has the responsibility to oversee and review the internal control and risk policies, procedures and management framework within the Group and to develop guidance, training material and management training to ensure the current and future needs of the business are met. CAG reports to the Board on a quarterly basis providing analyses of performance against previously established assurance targets, and also advises the Board regarding policy and future activities to enhance best practice around the organisation.

The CAG sponsors four specialist Groups:

- An Assurance Network Group, chaired by the Assurance Director, and comprising senior assurance representatives from across the Group. During the year, this group met four times to review policy and procedures, and the development, integration and dissemination of the Serco Management System that defines how the Group operates.

- A Risk Oversight Group, chaired by the Risk Director, comprising members from across the Group, met twice during the year to review 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 Safety 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 between Serco's aviation operating companies.

- A Rail Safety Oversight Group, chaired by the Rail Technical Director of the Integrated Transport division, and comprising the rail safety representatives from across the Group was established in 2003 to oversee safety management systems within Serco's rail businesses in the United Kingdom, Denmark and Australia.

The Serco Management System provides the framework within which the business divisions and their operating companies have implemented processes and procedures 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 the Serco Management System, a set of policies have been authorised by the Board and supporting standards, guidance and training material have also been produced. A risk management standard defines the processes that are required at each level in the organisation in order to manage the threats to the achievement of our business objectives. Risk registers are maintained at a contract, company, divisional and Group level and are reviewed at least quarterly and more frequently as required. The risk registers 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 consistent scoring system across the business. 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.

Internal Control and Risk Management (continued)

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

- The principles of clear delegation of authority and segregation of duties are fully reflected in the Group's operating processes;

- Comprehensive business review processes ensure that our services and products meet customer expectations, performance criteria, operational effectiveness, regulatory requirements, investment returns and profitability;

- An Investment Committee meets on a monthly basis to consider new projects against a defined set of investment criteria. Projects can then be submitted to the GMB for consideration as a group key target and allocation of appropriate resource from across the Group;

- There is a formal review and approval process for all proposals and business acquisitions including delegated authority for sign-off based on the financial value and capital requirement of the transaction and the assessed risk of the project;

- 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 improves 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 and safety and environmental protection are addressed by qualified and experienced staff in each business unit. The Group also outsources support in the area of occupational health to a professional consultancy;

- A programme of internal audits confirms that key controls are in place across the Group's business activities. Audit priorities are established on the basis of risk assessments, regulatory requirements and business imperatives;

- The operational risk framework tracks key risk indicators. These include analysis of business planning and variances, customer satisfaction and retention data, staff turnover and satisfaction levels, occupational health and safety incidents, and error and exception reporting;

- The Group 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.

Internal Control and Risk Management **(continued)**
During 2003, Grant Thornton has continued to provide an internal audit function within the Group. Their programme has been designed to address internal control and risk management processes and the recommendations of the Combined Code. This year Grant Thornton undertook a review of the Group's risk management framework and the quarterly assurance reporting process managed by CAG. Grant Thornton reported to the Audit Committee twice during the year.

In addition to contracts held in Serco's name, the Group has material investments in a number of joint ventures. Where these investments are not wholly owned 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 Group's joint ventures are invited to participate in the Assurance Network and the Risk Oversight Group.

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 2003
With the exception of the contractual notice periods for the Executive Directors which were reduced to twelve months following the Annual General Meeting, the Company has fully complied throughout the year with the provisions stated in Section 1 of the Combined Code and believes that it is largely compliant with the proposed Combined Code.

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

Julia Cavanagh
Secretary

Serco House
16 Bartley Wood Business Park
Bartley Way, Hook
Hampshire RG27 9UY
United Kingdom

2 March 2004

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 2003.

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 2003 can be found in the Business review on pages 33 to 47.

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 22 of the Accounts.

Dividends and Transfers to Reserves

An interim dividend of 0.72p (2002 – 0.64p) per Ordinary Share was paid on 10 October 2003. The Directors recommend a final dividend of 1.62p (2002 – 1.44p) per Ordinary Share, which if approved by shareholders at the Annual General Meeting, will be paid on 12 May 2004, to those shareholders on the register at the close of business on 12 March 2004. After dividends, retained profits of £23,248,000 will be transferred to reserves.

Substantial Shareholdings

At close of business on 1 March 2004 (being the latest practical date prior to the printing of the Directors' Report), the Company had received notifications of the following substantial interests representing over 3% of the issued capital:

HBOS plc – 3.01%
Legal & General Group plc – 3.96%
Morley Fund Management Limited – 4.92%

Following a reduction in the shareholding of Merrill Lynch Investment Managers Limited the Company has received no further notification regarding new material interests representing 10% or more of the issued share capital.

Changes to the Board

The current Directors of the Company are listed on page 60 and their profiles are provided on pages 73 and 74.

As detailed in the 2002 Annual Review and Accounts and the 2003 Interim Report, Iestyn Williams will be retiring as an Executive Director and Rhidian Jones as an Non-Executive Director in March and April 2004 respectively. David Richardson and Margaret Ford have been appointed during 2003 as Non-Executive Directors, and in accordance with the Company's Articles of Association 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 82 to 84.

Annual General Meeting

The seventeenth Annual General Meeting of the Company will be held at the Queen Elizabeth II Conference Centre, London on 30 April 2004 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 is also committed to the creation of diverse teams, placing diversity at the heart of business performance. The launch of an e-recruitment facility will assist in tracking the diversity of applicants, and the benchmarking of employment policies against the best in class will enable the Group to drive forward best practice in this area.

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 Company 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.

The Group gives full consideration to applications for employment, career development and promotion, received from the disabled and offers employment when suitable opportunities arise. If employees become disabled during their service with the Group, 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 sharesave schemes, and a share option scheme for senior management which effectively aligns their interests with those of shareholders by requiring that performance criteria are achieved prior to exercise. Following the success of two previous sharesave schemes, the Company is offering all eligible staff the opportunity to participate in a further sharesave scheme in March 2004.

Health, Safety and Environmental Policies
The Group recognises and accepts its responsibility for health, safety and the environment ("H,S&E"). A full time Director of Health, Safety and Environment, 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. This report consolidates divisional assurance reports that have been reviewed and approved by the respective divisional boards.

The Group is committed to maintaining a safe and healthy working environment in all places that the Group operates, for our staff, our customers, members of the public and any other third party. During the year the UK Health and Safety Executive approached the Company to participate in a collaborative study into the way that it engages with major support services contractors. As part of the study it provided an independent review of our health and safety commitment, systems and processes. The report provided confirmation of the Group's commitment to the principles of effective health and safety management. A number of recommendations were made which are being actioned and form part of our safety strategy for 2004. 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.

CAG is supported by dedicated H,S&E teams in Serco Business Services, divisional support offices and in contracts, which provide advice and support on H,S&E issues. All employees share responsibility for continuously improving the Group's performance in relation to H,S&E management.

Regular H,S&E meetings are held and representatives from the operating divisions attend quarterly Assurance Network meetings.

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 and also in the overall context of assurance within the Group.

Serco has been committed to addressing issues of work related ill-health over many years and has established occupational support across the business. Our aim is to provide a working environment where the health of our employees is not affected by the work that they undertake. Our occupational health providers support management in their efforts to identify and prevent work related illness and provide support and guidance about health problems at work. They also provide health surveillance where appropriate and assist in issues such as absence from work and supporting the Group's programme of encouraging individuals back to work where possible.

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 2003 were 26 days (2002 – 29 days); Company 26 days (2002 – 29 days).

Donations
Charitable donations totalling £159,395 (2002 – £94,859) were made during the year. During the year the Group introduced a process to capture investment in local communities on a worldwide basis. This measure takes into account cash support, gifts in kind, staff time and management costs, and is based upon the Business in the Community ("BiTC") established reporting format. The value of this investment has been calculated as £648,566. This figure equates to 1.2% of the Group's pre-tax profit.

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

The Political Parties and Referendums Act 2000 (the "Act") 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 the forthcoming Annual General Meeting, a similar resolution was passed unanimously by Shareholders in May 2003.

Auditors
Deloitte & Touche LLP 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.

Kevin Stanley Beeston FCMA (41) *Executive Chairman*
Since joining Serco in 1985, Kevin has worked in both financial and commercial roles. He was Group Finance Director 1996-1999 and Chief Executive 1999-2002, becoming Executive Chairman in May 2002. He is a member of the CBI's President's Committee, Deputy Chairman of the CBI's Public Services Strategy Board, a council member of Business in the Community, and a non-executive director of Ipswich Town Football Club.

Margaret Anne Ford MA MPhil (46) *Non-Executive Director*
Margaret joined Serco as a Non-Executive Director in October 2003. Margaret is the Chairman of English Partnerships, the national regeneration agency, a non-executive director of Thus plc and of Good Practice Ltd, the publishing company that she founded. She spent her early career in a variety of roles either in the public sector or as an adviser to government and is a specialist in leadership development, culture change and public sector reform. From 1997-2000 she was Chairman of Lothian Health Board and from 2000-2003 was a non-executive director of Ofgem.

Ralph Noel Hodge CBE BEng (Hons) (69) *Non-Executive Director*
Ralph joined Serco as a Non-Executive Director in April 1999 and chairs the Board's Remuneration Committee. He is Chairman of the Water Research Council and a non-executive director of British Ceramic Tiles and ORC (Inc). He was previously non executive Chairman of Enron Europe, Chief Executive of ICI Chemicals and Polymers and a non-executive director of the Halifax Building Society.

Christopher Rajendran Hyman CA (SA) (40) *Chief Executive*
Christopher joined Serco in 1994 as Finance Director for Serco Europe. He was appointed Group Company Secretary with additional responsibility for corporate finance in 1996, and Group Finance Director in April 1999. In 2000 he took additional responsibility as Chief Executive of a new division, Serco Global Projects, and he has been instrumental in developing new processes and capabilities at the leading edge of our activities. He became Chief Executive in May 2002.

Andrew Mark Jenner ACA (35) *Finance Director*
Andrew joined Serco in 1996 as Group Financial Controller, having previously worked for Unilever. He became Corporate Finance Director with additional responsibility for Treasury activities in 1999 and Group Finance Director in May 2002. Andrew shares with the Executive Chairman responsibility for our relationship with Shareholders and the City.

Rhidian Huw Brynmor Jones MA FCIS FCMI (60) *Senior Non-Executive Director*
Rhidian became a Serco Non-Executive Director in 1996, having previously served on the Board 1987-1994. He is Chairman of the Board's Audit Committee. He is an experienced corporate finance lawyer and was Head of the Corporate Department of solicitors Nabarro Nathanson until retiring from that firm in May 2002. 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 is a policy adviser on company law to ICSA and was formerly non-executive Deputy Chairman of Britannia, the UK's second largest building society. Rhidian will be retiring from the Board on 30 April 2004.

DeAnne Shirley Julius CBE PhD (Econ) (54) *Non-Executive Director*
DeAnne joined Serco as a Non-Executive Director in October 2001. She is Chairman of the Royal Institute of International Affairs and sits on the Court of the Bank of England, having been a founder member of its Monetary Policy Committee 1997-2001. She has held senior strategy positions with British Airways and Royal Dutch Shell, and spent seven years with the World Bank developing infrastructure projects in Asia and Africa. She is a non-executive director of Lloyds TSB, BP and Roche. DeAnne will be taking over as Senior Non-Executive Director from May 2004.

David Hedley Richardson BSc FCA (52) *Non-Executive Director*
David joined Serco as a Non-Executive Director in June 2003 and will chair the Board's Audit Committee from May 2004. He is currently Finance Director of Whitbread PLC, where his previous roles in a 20-year career have included eight years as Strategy Director: he was instrumental in transforming Whitbread from a brewing and pubs company into a market leader in hotels, restaurants and leisure clubs.

Iestyn Milton Williams BA (52) *Executive Director*
Iestyn joined RCA in 1978, becoming Serco's Personnel Director after the management buyout in 1987. 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 been developing new business activities, first in Continental Europe and latterly in the education sector. Iestyn is non-executive chairman of Senad Group Ltd, non-executive deputy chairman of V Holdings Ltd and non-executive director of Law at Work. He is also a Governor of a local school. Iestyn has announced that he will be retiring from the Board of Serco Group plc at the end of March 2004.

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

Julia Cavanagh
Secretary

Serco House
16 Bartley Wood Business Park
Bartley Way
Hook
Hampshire
RG27 9UY

2 March 2004

With thanks to Merseyrail Electrics

Julia Cavanagh
(Company Secretary)

David Richardson

Iestyn Williams

Ralph Hodge

Margaret Ford

Kevin Beeston

Andrew Jenner

DeAnne Julius

Christopher Hyman

Rhidian Jones

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 ensuring proper accounting records are kept 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

Serco House
16 Bartley Wood Business Park
Bartley Way
Hook
Hampshire
RG27 9UY

2 March 2004

Introduction
The following report details the remuneration policy, and the actual remuneration of the Directors of the Company for the year ended 31 December 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 requirements for the disclosure of Directors' remuneration under the Directors' Remuneration Report Regulations 2002. Reference has also been made to the 2003 Revised Combined Code, which incorporates certain recommendations from the Higgs Review where it is deemed appropriate.

Following extensive review of Executive Directors' remuneration during 2002 and as detailed in last year's Remuneration Report, resolutions relating to the introduction of a deferred bonus scheme for Directors and changes to the performance criteria for the Long Term Incentive Scheme and Executive Option Plan were presented to Shareholders at the Company's Annual General Meeting on 6 May 2003. These resolutions were all passed and the changes effected during the year.

Composition and Terms of Reference of the Remuneration Committee
The Committee is currently comprised of four independent Non-Executive Directors; Margaret Ford, DeAnne Julius, David Richardson and Ralph Hodge (Chairman). It operates in accordance with written terms of reference, which are determined by the Board and take into account best practice and the requirements of the Combined Code. The Executive Chairman and the Group Human Resources Director ("HR Director") may attend the Committee meetings by invitation.

During the year the terms of reference for the Committee were reviewed and revised in light of the changes to the Combined Code and approved by the Board in November 2003.

Advisers to the Remuneration Committee
During the year, the Committee has been advised by the HR Director and Mercer Human Resource Consulting ("Mercer"). As part of the annual remuneration review process, Mercer undertook a benchmarking exercise on behalf of the Committee, of remuneration packages for individual Executive Directors based on current market trends. Mercer also provides advice to the Trustees of the Serco Pension and Life Assurance Scheme.

Advice in respect of employee share plans has been provided to the Committee by Ernst & Young LLP. Ernst & Young has also provided advice to the Company in the areas of company secretarial compliance, governance, bid modelling and treasury matters.

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. As detailed in the 2002 Remuneration Report, notice periods for Executive Directors have been reduced to 12 months during the year.

Executive Directors' remuneration comprises a combination of short and long term rewards as explained below and then detailed on pages 82 to 87. The Committee recognises the importance of maintaining an appropriate balance between those elements of remuneration which are fixed versus variable, and incentives which are short term versus longer term. The split of remuneration between salary and bonus and long term incentives for Executive Directors is currently estimated to be 60:40.

1 Salaries and Benefits

Base Salary
Base salary levels for full time Executive Directors were reviewed in September 2003 following an external benchmarking exercise undertaken by Mercer against a peer group of 12 companies.

Bonus Schemes
As explained in the Remuneration Report last year, the Committee recommended to the Board that the Company introduce a deferred bonus scheme for full time Executive Directors, this was approved by Shareholders at the Annual General Meeting in May 2003 and implemented for the year ended 31 December 2003.The maximum value of this bonus is 40% of base salary and will be awarded on the basis of the Company's earnings per share growth before FRS 10 ("EPS") in comparison to RPI. 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. Details of the relevant performance conditions are provided in the Performance Criteria section below.

As described in 2002, the Remuneration Committee approved an interim cash only bonus plan for the financial year 2002 for full time Executive Directors. This bonus was paid during 2003 and 50% of the net proceeds were used by each of the relevant Directors to acquire further shares in the Company.

2 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 the schemes are detailed in the Performance Criteria section below. The Company complies with the ABI guidelines in relation to the granting of no more than 10% of share capital for employee share schemes in any 10-year period.

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 once confirmation has been received from the auditors regarding the achievement of the performance criteria. 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. For awards granted after 1 January 2003 achievement of the performance criteria is measured by reference to the Company's total shareholder return performance. Details relating to both measures are detailed in the Performance Criteria section below.

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

2 Share Based Incentives (continued)

Executive Option Plan ("EOP")
Options granted under the EOP may be exercised after the third anniversary of grant, dependent upon the achievement of a financial performance target over three years. The options are granted at market value and awards made to 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.

For awards granted after 1 January 2003, achievement of the performance criteria is measured by reference to the Company's EPS performance relative to RPI. Details relating to both measures are detailed in the Performance Criteria section below.

Performance Criteria
Prior to Shareholder approval at the Annual General Meeting in 2003, the Company's share based incentives were based on EPS growth targets, this being regarded as best practice at the time of implementation. Following the extensive review of remuneration undertaken in 2002, resolutions were put to Shareholders to introduce varied performance targets for bonus schemes and share plans: the details of these changes are provided below. Whilst it is recognised that no single target provides an acceptable performance measure for all investors, the Company believes that the portfolio of targets measuring achievement against both earnings per share and total shareholder return provides a balanced approach for investors returns and is appropriate for the business.

i) Earnings per Share ("EPS")
As detailed above, prior to 2003 the performance criteria for both the LTIS and EOP were measured against absolute EPS growth. For LTIS grants made in relation to performance periods commencing prior to 1 January 2003, full vesting will only occur if the cumulative EPS growth over the three year performance period 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. For LTIS grants made in relation to periods commencing from 1 January 2003, the performance target is measured against total shareholder return, as detailed below.

For EOP grants made in relation to performance periods commencing prior to 1 January 2003, if compound growth in EPS is more than 15% all of the options may be exercised; if the annual compound growth in EPS is less than 10%, none of the options may be exercised. For a compound growth in EPS of between 10% and 15% a proportion of the options may be exercised. As detailed below the performance criteria for EOP remains growth in EPS, however the measurement is now against RPI rather than an absolute growth requirement. With effect from 2003, the Deferred Bonus Scheme and EOP measure the achievement of the Company's EPS growth against the Retail Price Index ("RPI"). For the bonus scheme EPS growth is measured over the financial year, whilst for the EOP the measurement is compound growth over the performance period of three financial years.

For both schemes the maximum award is achieved when EPS growth reaches RPI + 10%. No award is achieved if EPS growth is less than RPI + 5%. For an EPS growth between RPI + 10% and RPI + 5% the bonus will reduced from 40% to 20% on a straight line basis. The equivalent EPS performance under the EOP will reduce the level of vesting from 100% to 40% on a straight line basis. The use of EPS growth versus RPI, provides a measure of the real growth in the Company's EPS.

2 Share Based Incentives (continued)

ii) Total Shareholder Return ("TSR") and the FTSE 350

The LTIS and deferral element of the Deferred Bonus Scheme measure the achievement of the Company's TSR against that of the constituent companies of the FTSE 350 immediately prior to the start of the performance period. TSR is defined as the return shareholders would receive if they hold a notional number of shares, and receive dividends on those shares over a three year performance period. It measures the percentage growth in the Company's share price together with the value of any dividends paid, assuming the dividends are re-invested into the Company's shares.

For both schemes the maximum award is achieved when the Company's TSR performance is in the top quartile with no award vesting for below median performance. For top quartile performance 100% of the LTIS vests and a maximum one for one share matching occurs under the Deferred Bonus Scheme; for median performance 40% of the LTIS vests and a one for two share matching occurs. Between median and upper quartile performance, LTIS vesting increases from 40% to 100% and share matching increases from one for two, to one for one, both on a straight line basis.

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. The Company also remains in the middle of the FTSE 350. The relevance of measuring performance against this group of companies was reviewed during the year and the Committee continues to believe this is correct for the business.

3 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 33 to the accounts. In the event of death in service, each scheme provides for a lump sum payment as well as a dependant's pension.

4 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. The service contracts were amended during 2003 to reflect a reduction in notice period from 24 months to 12 months, thereby bringing all Executive Directors' notice periods into line.

Under the new service contracts for Executive Directors 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 be entitled to receive a payment equivalent to up to one year's remuneration. The service contracts do not provide for termination payments to be made in any other circumstances.

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

4 Service Contracts and Compensation (continued)

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

Name of Director	Date of appointment to the Board	Date of contract/ letter of appointment	Un-expired term and notice period at 31 December 2003
Executive Directors:			
K S Beeston	29 February 1996	21 July 2003	Rolling contract with 12 months notice period
C R Hyman	1 April 1999	21 July 2003	Rolling contract with 12 months notice period
A M Jenner	3 May 2002	21 July 2003	Rolling contract with 12 months notice period
I M Williams	12 September 1986	1 April 1999	Will be retiring on 31 March 2004
Non-Executive Directors:			
M A Ford	8 October 2003	8 October 2003	34 months
R N Hodge	5 April 1999	15 January 2003	15 months
R H B Jones	17 June 1996	1 September 2002	Will be retiring on 30 April 2004
D S Julius	29 October 2001	29 October 2001	10 months
D H Richardson	2 June 2003	2 June 2003	29 months

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

As at 31 December 2003, the Non-Executive Directors of the Company have no personal financial interest in the matters determined by the Committee, there are no 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 approved the payment of £5,000 per annum to the Chairmen of the Audit and Remuneration Committees with effect from 1 June 2003. 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 Directors' Remuneration

The Remuneration of the Directors for the year was as follows:

Names	Note	Total basic salary £	Fees £	Bonuses £	Total estimated value of any other non-cash benefits £	Total remuneration excluding pensions 2003 £	Total remuneration excluding pensions 2002 £
K S Beeston	*4,5*	**395,000**	**–**	**166,000**	**25,522**	**586,522**	555,453
M A Ford	*1*	**–**	**7,785**	**–**	**–**	**7,785**	–
R N Hodge		**–**	**35,500**	**–**	**–**	**35,500**	37,125
C R Hyman	*4,5*	**395,000**	**–**	**166,000**	**25,540**	**586,540**	588,261
A M Jenner	*2,4,5*	**238,000**	**–**	**100,800**	**25,700**	**364,500**	252,880
R H B Jones		**–**	**35,500**	**–**	**–**	**35,500**	30,125
D S Julius		**–**	**32,583**	**–**	**–**	**32,583**	30,125
D H Richardson	*1*	**–**	**19,250**	**–**	**–**	**19,250**	–
I M Williams	*3,5*	**190,500**	**–**	**–**	**26,466**	**216,966**	211,286
Total		**1,218,500**	**130,618**	**432,800**	**103,228**	**1,885,146**	1,705,255

Notes:

1 D H Richardson and M A Ford were appointed on 2 June 2003 and 8 October 2003 respectively.

2 A M Jenner was appointed as Finance Director on 3 May 2002.

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

4 The bonuses shown include performance bonuses earned in the period under review, but not paid in the financial year.

5 The value of the non-cash benefits relates to the provision of a car allowance and private healthcare.

This section has been audited by Deloitte.

2 Directors' Shareholdings

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

	Ordinary Shares of 2p each fully paid 1 January 2003	Ordinary Shares of 2p each fully paid 31 December 2003
K S Beeston	106,520	**161,081**
M A Ford	0*	**0**
R N Hodge	2,010	**2,010**
C R Hyman	29,394	**84,330**
A M Jenner	9,529	**42,265**
R H B Jones	55,000	**65,000**
D S Julius	5,000	**15,000**
D H Richardson	0*	**10,000**
I M Williams	2,387,323	**1,387,323**

* 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")

		Number of shares under option at 1 January 2003 (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 2003 (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
	3 yr award	–	185,289*	–	–	185,289	Nil	1.53	–	31.12.05	05.05.13
	3 yr award	–	173,142*	–	–	173,142	–	1.75	–	31.12.06	26.11.13
M A Ford	–	–	–	–	–	–	–	–	–	–	–
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
	3 yr award	–	185,289*	–	–	185,289	Nil	1.53	–	31.12.05	05.05.13
	3 yr award	–	173,142*	–	–	173,142	Nil	1.75	–	31.12.06	26.11.13
A M Jenner	3 yr award	–	111,174*	–	–	111,174	Nil	1.53	–	31.12.05	05.05.13
	3 yr award	–	105,138*	–	–	105,138	Nil	1.75	–	31.12.06	26.11.13
R H B Jones	–	–	–	–	–	–	–	–	–	–	–
D S Julius	–	–	–	–	–	–	–	–	–	–	–
D H Richardson	–	–	–	–	–	–	–	–	–	–	–
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
	3 yr award	–	86,628*	–	–	86,628	Nil	1.53	–	31.12.05	05.05.13

*Approximately 14.67% (13.5% for prior year grants) 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. These options can only be exercised in conjunction with and to the extent of the underlying award.

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 78 to 80.

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 £1.72 and the highest and lowest market prices during the financial year were £1.92 and £1.055 respectively.

3 Share-based incentives (continued)

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

		Number of shares under option at 1 January 2003 (or, if later, the date of appointment as Director)	Granted during period	Exercised during period	Lapsed unexercised during period	Balance at 31 December 2003	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
	Unapproved	–	289,515*	–	–	289,515	–	1.53	–	06.05.06	05.05.10
M A Ford	–	–	–	–	–	–	–	–	–	–	–
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
	Unapproved	–	289,515*	–	–	289,515	–	1.53	–	06.05.06	05.05.10
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
	Unapproved	–	173,709*	–	–	173,709	–	1.53	–	06.05.06	05.05.10
R H B Jones	–	–	–	–	–	–	–	–	–	–	–
D S Julius	–	–	–	–	–	–	–	–	–	–	–
D H Richardson	–	–	–	–	–	–	–	–	–	–	–
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
	Unapproved	–	135,357*	–	–	135,357	–	1.53	–	06.05.06	05.05.10

Approximately 14.67% (13.5% for prior year grants) 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. These options can only be exercised in conjunction with and to the extent of the underlying option.

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.

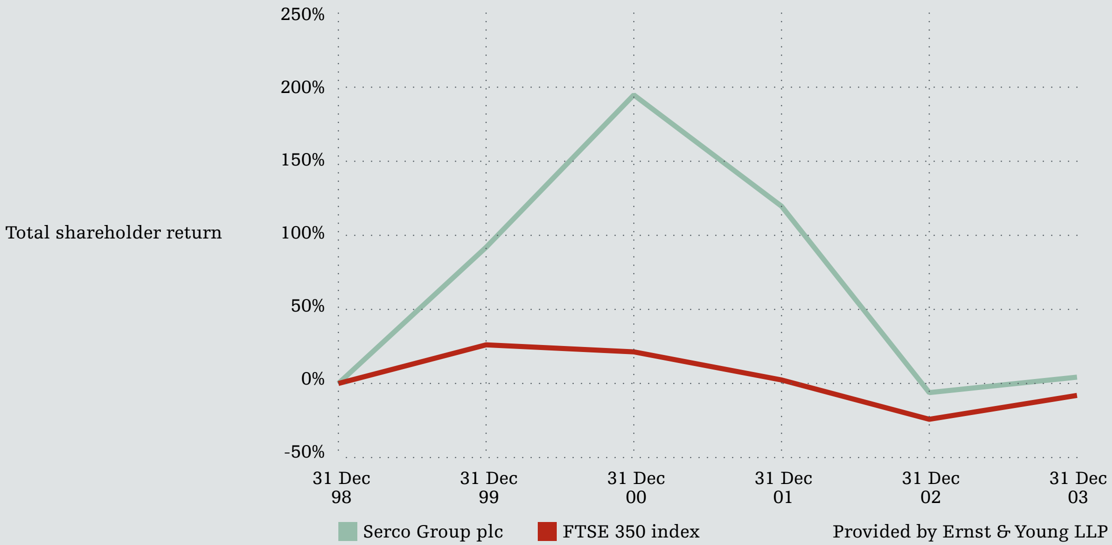
The performance criteria to which the exercise of awards under the EOP is conditional are as set out on page 79.

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 £1.72 and the highest and lowest market price during the financial year were £1.92 and £1.055 respectively.

This section has been audited by Deloitte.

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

Serco Group plc TSR vs FTSE 350 index TSR



In drawing this graph it has been assumed that all dividends paid have been reinvested. The TSR level shown at 31 December each year is the average of the closing daily TSR levels for the 30-day period up to and including that date.

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

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 33. 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 2003 £	Transfer value of accrued benefits as at 31 December 2002 £	Increase in transfer value during the year £	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	685,469	539,342	126,576	18,027	15,085	81,574	123,100
C R Hyman	133,696	100,212	18,701	3,615	3,139	5,557	20,625
A M Jenner	29,142	11,025	4,076	3,345	3,277	2,495	5,775
I M Williams	1,511,915	1,141,718	360,871	31,618	27,913	308,581	163,940

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. The increase in accrued pension during the year is shown both as a gross increase and excluding any increase in inflation. Part of the increase in the accrued pension of I M Williams is the result of receiving confirmation from the Inland Revenue during the year regarding his pension calculation as a part time Director.

b) Transfer values have been calculated in accordance with version 9.0 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.

5 Pensions **(continued)**

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) CR Hyman and AM Jenner also benefit from defined contribution arrangements 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 are as follows: CR Hyman £52,072 and AM Jenner £27,607.

Section 5 has been audited by Deloitte.

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

Julia Cavanagh
Secretary

Serco House
16 Bartley Wood Business Park
Bartley Way, Hook
Hampshire RG27 9UY
United Kingdom

2 March 2004

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF SERCO GROUP PLC

For the year ended 31 December 2003

We have audited the accounts of Serco Group plc for the year ended 31 December 2003 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 35. These accounts 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 accounts 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 accounts 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 accounts give a true and fair view and whether the accounts 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 Directors' Report is not consistent with the accounts, 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 Directors' Report and the other information contained in the Annual Report for the above year as described in the contents section including the unaudited part of the Directors' Remuneration Report and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the accounts.

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 accounts 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 accounts 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 accounts 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 accounts and the part of the Directors' Remuneration Report described as having been audited.

Opinion
In our opinion:

- the accounts give a true and fair view of the state of affairs of the Company and the Group as at 31 December 2003 and of the profit of the Group for the year then ended; and

- the accounts 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 LLP.

Deloitte & Touche LLP
Chartered Accountants and Registered Auditors
London

2 March 2004

CONSOLIDATED PROFIT AND LOSS ACCOUNT

For the year ended 31 December 2003

	Note	2003 Group £'000	2003 Joint Ventures £'000	2003 Total £'000	2002 Group £'000	2002 Joint Ventures £'000	2002 Total £'000
Turnover: Group and share of joint ventures – continuing operations	2	1,324,271	231,255	1,555,526	1,097,278	228,670	1,325,948
Less: Share of joint ventures	2	–	(231,255)	(231,255)	–	(228,670)	(228,670)
Group turnover	2	1,324,271	–	1,324,271	1,097,278	–	1,097,278
Cost of sales		(1,143,418)	–	(1,143,418)	(947,313)	–	(947,313)
Gross profit		180,853	–	180,853	149,965	–	149,965
Administrative expenses		(157,144)	–	(157,144)	(120,862)	–	(120,862)
Amortisation of intangible assets		(14,131)	–	(14,131)	(8,098)	–	(8,098)
Other administrative expenses		(138,516)	–	(138,516)	(112,764)	–	(112,764)
Exceptional item: reorganisation costs		(4,497)	–	(4,497)	–	–	–
Operating profit-continuing operations		23,709	–	23,709	29,103	–	29,103
Exceptional item: GSR sale and leaseback	4	3,977	–	3,977	–	–	–
Share of operating profit in joint ventures		–	22,700	22,700	–	21,883	21,883
Interest receivable and similar income	5	16,760	11,397	28,157	1,422	16,894	18,316
Group		12,691	–	12,691	1,422	–	1,422
Exceptional item: Norfolk and Norwich refinancing		4,069	–	4,069	–	–	–
Share of joint ventures		–	11,397	11,397	–	16,894	16,894
Interest payable and similar charges	6	(15,609)	(10,080)	(25,689)	(5,486)	(14,875)	(20,361)
Group		(15,609)	–	(15,609)	(5,486)	–	(5,486)
Share of joint ventures		–	(10,080)	(10,080)	–	(14,875)	(14,875)
Profit on ordinary activities before taxation	7	28,837	24,017	52,854	25,039	23,902	48,941
Taxation on profit on ordinary activities	8			(19,103)			(16,639)
Profit on ordinary activities after taxation				33,751			32,302
Share of joint venture minority interest				(198)			–
Minority interest				(255)			–
Profit for the financial year				33,298			32,302
Equity dividends	9			(10,050)			(9,441)
Retained profit for the financial year	25			23,248			22,861
Earnings per Share (EPS) per ordinary share of 2p each	10						
Basic EPS, after amortisation of goodwill				7.75p			7.66p
Basic EPS, before amortisation of goodwill				11.03p			9.58p
Diluted EPS, after amortisation of goodwill				7.74p			7.63p
Diluted EPS, before amortisation of goodwill				11.02p			9.54p

The basis of preparation of this statement is set out in Note 1.

CONSOLIDATED BALANCE SHEET

At 31 December 2003

	Note	2003 £'000	Restated 2002 £'000
Fixed assets			
Intangible assets	*11*	**222,950**	147,473
Tangible assets	*12*	**77,398**	62,479
Investments in joint ventures	*13*	**24,886**	35,883
Share of gross assets		**151,460**	317,831
Share of gross liabilities		**(126,574)**	(281,948)
		325,234	245,835
Current assets			
Stocks	*14*	**39,543**	38,744
Debtors: amounts due within one year	*15*	**278,931**	220,042
Debtors: amounts due after more than one year	*15*	**419,589**	108,932
Cash at bank and in hand	*18*	**170,888**	71,774
		908,951	439,492
Creditors: amounts falling due within one year			
Bank loans and overdrafts	*17*	**–**	2,386
Trade creditors		**81,335**	74,377
Other creditors including taxation and social security	*16*	**90,892**	93,843
Accruals and deferred income		**177,866**	136,766
Proposed dividend	*9*	**6,958**	6,184
		357,051	313,556
Net current assets		**551,900**	125,936
Total assets less current liabilities		**877,134**	371,771
Creditors: amounts falling due after more than one year	*17*	**539,798**	87,588
Provisions for liabilities and charges	*19*	**56,526**	34,533
Net assets		**280,810**	249,650
Capital and reserves			
Called up share capital	*22*	**8,697**	8,697
Share premium account	*23*	**190,791**	190,791
Capital redemption reserve		**143**	143
ESOP reserve	*24*	**(16,949)**	(18,207)
Profit and loss account	*25*	**98,128**	68,226
Equity shareholders' funds	*21*	**280,810**	249,650

These Accounts and Notes were approved by the Board of Directors on 2 March 2004 and signed on behalf of the Board:

Kevin Beeston Executive Chairman **Andrew Jenner** Finance Director

COMPANY BALANCE SHEET

As at 31 December 2003

	Note	2003 £'000	2002 £'000
Fixed assets			
Tangible assets	*12*	**1,256**	2,309
Investments in subsidiaries	*13*	**262,783**	141,418
		264,039	143,727
Current assets			
Stock	*14*	**41**	–
Amounts owed by subsidiary companies due after more than one year		**146,501**	111,426
Debtors: amounts due within one year	*15*	**21,281**	21,669
Debtors: amounts due after more than one year	*15*	**1,169**	1,297
Cash at bank and in hand		**39,165**	17,753
		208,157	152,145
Creditors: amounts falling due within one year			
Bank loans and overdrafts	*17*	**–**	–
Trade creditors		**881**	1,066
Other creditors including taxation and social security	*16*	**11,010**	688
Accruals and deferred income		**5,801**	6,395
Proposed dividend	*9*	**6,958**	6,184
		24,650	14,333
Net current assets		**183,507**	137,812
Total assets less current liabilities		**447,546**	281,539
Creditors: amounts falling due after more than one year	*17*	**161,456**	43,784
Provisions for liabilities and charges	*19*	**–**	335
Net assets		**286,090**	237,420
Capital and reserves			
Called up share capital	*22*	**8,697**	8,697
Share premium account	*23*	**190,791**	190,791
Capital redemption reserve		**143**	143
Profit and loss account	*25*	**86,459**	37,789
Equity shareholders' funds		**286,090**	237,420

These Accounts and Notes were approved by the Board of Directors on 2 March 2004 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 2003

	Note	2003 £'000	Restated 2002 £'000
Operating profit before exceptional item		**28,206**	29,103
Exceptional item: reorganisation costs		**(4,497)**	–
Operating profit		**23,709**	29,103
Depreciation and amortisation of goodwill		**32,532**	23,632
Movement in ESOP investment		**1,258**	776
Net increase in working capital		**(11,111)**	(13,900)
One-off pension fund contribution		**–**	(15,500)
Net cash inflow from operating activities before PFI asset expenditure		**46,388**	24,111
Movement in PFI debtor*		**3,680**	–
Expenditure on PFI assets under construction*		**(33,001)**	(14,950)
Net cash inflow from operating activities after PFI asset expenditure	*26*	**17,067**	9,161
Dividends received from joint ventures		**12,630**	11,095
Returns on investments and servicing of finance			
Interest received		**5,652**	1,223
Interest paid		**(6,054)**	(7,362)
Exceptional item: Norfolk and Norwich refinancing		**4,069**	–
Net cash inflow/(outflow) from returns on investments and servicing of finance		**3,667**	(6,139)
Taxation			
Tax paid		**(7,354)**	(5,738)
Capital expenditure and financial investment			
Purchase of tangible and intangible fixed assets		**(21,835)**	(23,596)
Sale of tangible fixed assets		**8,878**	8,125
Exceptional item: GSR sale and leaseback		**5,761**	–
Net cashflows with joint ventures		**2,969**	1,235
Net cash outflow from capital expenditure and financial investment		**(4,227)**	(14,236)
Acquisitions and disposals			
Acquisitions†		**(107,463)**	(11,353)
Net cash acquired with acquisitions		**12,843**	397
Net cash redeemed upon disposal		**(3,141)**	–
Subscription for shares in joint ventures		**(3,354)**	(370)
Proceeds on disposal of subsidiary undertakings		**4,471**	–
Proceeds on disposal of joint ventures		**–**	1,030
Net cash outflow from acquisitions and disposals		**(96,644)**	(10,296)
Equity dividends paid			
Dividends paid		**(9,529)**	(8,283)
Net cash outflow from equity dividends paid		**(9,529)**	(8,283)
Net cash outflow before financing		**(84,390)**	(24,436)
Financing			
Issue of ordinary share capital		**–**	117,929
Debt due within one year: (decrease) in other loans		**(1,709)**	(300)
Debt due beyond one year: increase in:		**193,787**	15,624
Other loans		**117,502**	24
Non-recourse debt financing – DES†		**49,774**	–
Non-recourse debt financing PFI assets*		**26,511**	15,600
Capital element of finance lease repayments		**(6,188)**	(3,594)
Net cash inflow from financing		**185,890**	129,659
Increase in cash in the year		**101,500**	105,223
Balance at 1 January		**69,388**	(35,835)
Balance at 31 December		**170,888**	69,388

* PFI assets and debtor financed by non-recourse loans

CONSOLIDATED STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES

For the year ended 31 December 2003

	2003 £'000	2002 £'000
Profit for the financial year	**33,298**	32,302
Currency translation differences on foreign currency net investments	**6,654**	(1,911)
Total recognised gains and losses for the year	**39,952**	30,391
Prior year adjustment	**–**	(806)
Total gains and losses recognised since last annual report and accounts	**39,952**	29,585

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 investment in own shares 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, 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. The results of subsidiaries acquired or sold are consolidated for the periods from or to the date on which control passed. Acquisitions are accounted for under the acquisition method.

Restatement
The 2002 Accounts have been restated to reflect the early adoption of the Urgent Issues Task Force Abstract 38 (UITF 38) – Accounting for ESOP trusts. Investment in own shares which was previously disclosed in Fixed Assets is now classified as an ESOP reserve and is shown as a reduction in the shareholders' funds.

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, during the period of initial asset construction costs incurred as a direct consequence of financing, designing and constructing the asset are shown as 'assets in the course of construction' within current assets. On completion of the asset construction phase the asset is transferred to debtors as a PFI debtor.

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.

The Group has eight fully owned Special Purpose Companies (SPC) which are used for the purpose of running the PFI business. All other SPCs are 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 33.

Turnover
Turnover represents net sales of goods and services to third parties. To the extent that the Group acts as an agent under the definitions of Financial Reporting Standard (FRS 5) – Reporting the Substance of Transactions, Application Note G, amounts invoiced in respect of items procured on behalf of customers are not recognised within turnover.

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 the economic useful life of the asset or a period of 20 years, whichever is shorter.

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

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 include certain PFIs is included under the heading 'investments in joint ventures'. The share of net assets is split between gross assets and gross liabilities.

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.

Finance costs
Finance costs of debt are recognised in the profit and loss account over the term of such instruments at a constant rate on the carrying amount.

Finance costs which are directly attributable to the construction of tangible fixed assets are capitalised as part of the cost of those assets. The commencement of capitalisation begins when both finance costs and expenditures for the asset are being incurred and activities that are necessary to get the asset ready for use are in progress. Capitalisation ceases when substantially all the activities that are necessary to get the asset ready for use are complete.

1 Accounting policies (continued)

Debt
Debt is initially stated at the amount of the net proceeds after deduction of issue costs. The carrying amount is increased by the finance cost in respect of the accounting period and reduced by payments made in the period.

Debt of certain Special Purpose Companies is described as non-recourse debt. Debt is described as non-recourse debt only if the security granted to the relevant lenders is limited to the assets and cash flows of the borrowing company.

Derivative financial instruments
The Group uses derivative financial instruments to reduce exposure to foreign exchange risk and interest rate movements. The Group does not hold or issue derivative financial instruments for speculative purposes.

For a forward foreign exchange contract to be treated as a hedge the instrument must be related to actual foreign currency assets or liabilities or to a probable commitment. It must involve the same currency or similar currencies as the hedged item and must also reduce the risk of foreign currency exchange movements on the Group's operations. Gains and losses arising on these contracts are deferred and recognised in the profit and loss account, or as adjustments to the carrying amount of fixed assets, only when the hedged transaction has itself been reflected in the Group's accounts.

For an interest rate swap to be treated as a hedge the instrument must be related to actual assets or liabilities or a probable commitment and must change the nature of the interest obligation by converting a fixed rate to a variable rate or vice versa. Interest differentials under these swaps are recognised by adjusting net interest payable over the periods of the contracts.

Tangible fixed assets
Tangible fixed assets are stated at cost or valuation, net of depreciation and any provision for impairment.

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.

1 Accounting policies (continued)

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 stage of completion of the work carried out to date and provision for anticipated future losses on contracts. 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.

Amounts recoverable on long term contracts, which are included in debtors, are stated at the net sales value of the work done less amounts received as progress payments on account.

Pre-contract costs
All bid costs are expensed through the profit and loss account up to the point where contract award (or full recovery of costs) is virtually certain in accordance with Urgent Issues Task Force Abstract 34 'Pre-contract costs'. 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.

ESOP reserve
The ESOP reserve represents shares in Serco Group plc held by the Serco Group plc 1998 Employee Share Ownership Trust (the Trust).

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. In accordance with UITF 38, the difference between the market value of the shares at the date of award and any consideration to be paid for the shares in respect of these schemes is charged to the profit and loss account over the performance period during which the benefits are earned by employees.

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 2003	Group £'000	Joint Ventures £'000	Total £'000
Turnover			
Civil government	444,875	42,897	487,772
Defence	252,469	151,496	403,965
Transport	385,793	36,862	422,655
Science	111,004	–	111,004
Private sector	130,130	–	130,130
Total	**1,324,271**	**231,255**	**1,555,526**
Profit before taxation and other costs/income			
Civil government	17,025	4,195	21,220
Defence	17,878	15,968	33,846
Transport	18,976	2,537	21,513
Science	11,619	–	11,619
Private sector	8,697	–	8,697
Total	**74,195**	**22,700**	**96,895**
Other (costs)/income			
Common costs			(31,858)
Exceptional items – reorganisation costs and GSR sale and leaseback			(520)
Amortisation of intangible assets			(14,131)
Net interest – group			(2,918)
Exceptional item – Norfolk and Norwich refinancing			4,069
Net interest – joint ventures			1,317
Profit on ordinary activities before taxation			**52,854**
Net assets			
Civil Government			43,749
Defence			53,127
Transport			59,173
Science			64,508
Private sector			32,436
Total			**252,993**
Unallocated assets			27,817
Total			**280,810**

2 Segmental report (continued)

Classes of business 2002	Group £'000	Joint Ventures £'000	Total £'000
Turnover			
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
Total	**1,097,278**	**228,670**	**1,325,948**
Profit before taxation and other costs/income			
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
Total	**62,935**	**21,883**	**84,818**
Other (costs)/income			
Common costs			(25,734)
Amortisation of intangible assets			(8,098)
Net interest – group			(4,064)
Net interest – joint ventures			2,019
Profit on ordinary activities before taxation			**48,941**

	Restated
Net assets	
Civil Government	43,269
Defence	53,400
Transport	45,716
Science	69,771
Private sector	31,679
Total	**243,835**
Unallocated assets	5,815
Total	**249,650**

2 Segmental report (continued)

Geographical segments 2003	Group £'000	Joint Ventures £'000	Total £'000
Turnover			
United Kingdom	950,098	174,723	1,124,821
Europe and Middle East	185,936	8,355	194,291
Asia Pacific	109,627	43,251	152,878
North America	78,610	4,926	83,536
Total	**1,324,271**	**231,255**	**1,555,526**
Profit before taxation and other costs/income			
United Kingdom	43,017	19,274	62,291
Europe and Middle East	14,414	227	14,641
Asia Pacific	6,982	2,831	9,813
North America	9,782	368	10,150
Total	**74,195**	**22,700**	**96,895**
Other (costs)/income			
Common costs			(31,858)
Exceptional items – reorganisation costs and GSR sale and leaseback			(520)
Amortisation of intangible assets			(14,131)
Net interest – group			(2,918)
Exceptional item – Norfolk and Norwich refinancing			4,069
Net interest – joint ventures			1,317
Profit on ordinary activities before taxation			**52,854**
Net assets			
United Kingdom			142,166
Europe and Middle East			41,670
Asia Pacific			42,553
North America			26,604
Total			**252,993**
Unallocated assets			27,817
Total			**280,810**

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

2 Segmental report (continued)

Geographical segments

2002	Group £'000	Joint Ventures £'000	Total £'000
Turnover			
United Kingdom	752,247	178,207	930,454
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
Total	**1,097,278**	**228,670**	**1,325,948**
Profit before taxation and other costs/income			
United Kingdom	35,065	19,029	54,094
Europe and Middle East	12,895	625	13,520
Asia Pacific	9,503	1,750	11,253
North America	5,472	479	5,951
Total	**62,935**	**21,883**	**84,818**
Other (costs)/income			
Common costs			(25,734)
Amortisation of intangible assets			(8,098)
Net interest – group			(4,064)
Net interest – joint ventures			2,019
Profit on ordinary activities before taxation			**48,941**

	Restated
Net assets	
United Kingdom	142,821
Europe and Middle East	43,951
Asia Pacific	40,057
North America	17,006
Total	**243,835**
Unallocated assets	5,815
Total	**249,650**

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

3 Information regarding directors and employees

	2003 £'000	2002 £'000
a) Directors' remuneration:		
Fees as directors	**131**	97
Other emoluments	**1,754**	1,730
Total remuneration excluding pensions	**1,885**	1,827

	2003 £'000	2002 £'000
b) Employee costs including directors:		
Wages and salaries	**551,117**	444,693
Social security costs	**50,320**	36,713
Other pension costs (Note 33)	**36,755**	29,096
Long Term Incentive Scheme costs (Note 24)	**1,258**	776
	639,450	511,278

	2003	2002
c) The average number of persons employed by Serco Group plc and its subsidiaries in the provision of services was:		
Civil government	**8,135**	7,138
Defence	**7,920**	6,251
Transport	**5,577**	4,442
Science	**1,630**	1,665
Private sector	**2,941**	2,999
Non-specific	**249**	202
	26,452	22,697

4 Non-operating exceptional item

The effect of the exceptional item reported after operating profit on the amount of taxation charged to the profit and loss account was:

	2003 £'000	2002 £'000
Profit on GSR sale and leaseback	**3,977**	–
Effect of tax charged to the profit and loss account	**1,193**	–

The sale and leaseback of the remaining rolling stock belonging to the Group's Great Southern Railway (GSR) business in Australia generated cash of £5,761,000 and profit of £3,977,000.

5 Interest receivable and similar income

	2003 £'000	2002 £'000
Loans to joint ventures	**831**	604
Other	**11,860**	818
	12,691	1,422
Exceptional Item: Norfolk and Norwich refinancing	**4,069**	–
Total group	**16,760**	1,422
Share of joint venture interest	**11,397**	16,894
	28,157	18,316

The refinancing of the Norfolk and Norwich University Hospital, in which the Group is a 5% investor, was completed in December 2003. This generated cash and investment income of £4,069,000.

6 Interest payable and similar charges

	2003 £'000	2002 £'000
Share of joint venture interest	**10,080**	14,875
Other	**15,609**	5,486
	25,689	20,361

7 Profit on ordinary activities before taxation

	2003 £'000	2002 £'000
Profit on ordinary activities before taxation is stated after charging:		
Rentals under operating leases:		
Land and buildings	**13,884**	12,599
Plant and machinery	**19,067**	20,686
Depreciation on tangible assets:		
Owned	**13,742**	12,307
Held under finance leases	**4,659**	3,227
Finance lease interest on operational assets	**1,067**	721
Amortisation of goodwill and intangible assets	**14,131**	8,098
Auditors' remuneration for audit services:		
Deloitte & Touche LLP	**772**	514
Other auditors	**116**	175
Other fees paid to Deloitte & Touche LLP:		
Bid support	**186**	1,237
Tax	**889**	560
Other	**1,223**	458
Other fees paid to other accountancy firms:		
Internal audit	**165**	152
Other	**98**	555

8 Taxation on profit on ordinary activities

	2003 £'000	2002 £'000
The taxation charge is made up as follows:		
United Kingdom corporation tax	**–**	1,654
Overseas taxation	**5,074**	1,950
Adjustment in respect of prior years:		
United Kingdom corporation tax	**898**	(750)
Overseas taxation	**(122)**	(37)
Current tax	**5,850**	2,817
Deferred taxation		
Current year movement	**5,292**	4,120
Adjustments in respect of prior years	**182**	2,375
Share of joint ventures' taxation charge	**7,779**	7,327
	19,103	16,639

8 Taxation on profit on ordinary activities (continued)

The current tax is different to the United Kingdom corporation tax rate of 30%. The reasons for this are set out below:

	2003 £'000	2002 £'000
Profit on ordinary activities before taxation	**52,854**	48,941
Less: Share of profit before tax of joint ventures	**(24,017)**	(23,902)
	28,837	25,039
Profit on ordinary activities before taxation multiplied by the UK corporation tax rate of 30%	**8,651**	7,512
Effect on the reported tax charge of:		
Amortisation of goodwill and investment in own shares not deductible for tax	**2,220**	1,437
Other expenses not deductible for tax	**2,935**	1,869
Tax allowances in excess of depreciation	**(4,729)**	(1,828)
Other short term timing differences	**(2,245)**	(1,953)
Unrelieved tax losses and different tax rates on overseas earnings	**352**	255
Tax exempt income and the effect of the use of unrecognised tax losses	**(159)**	(634)
Tax incentives	**(1,951)**	(3,054)
Adjustments in respect of prior years	**776**	(787)
Current tax	**5,850**	2,817
Deferred tax	**5,474**	6,495
Share of joint ventures' tax charge	**7,779**	7,327
Taxation on profit on ordinary activities	**19,103**	16,639

Factors affecting future tax charge

The tax charge of the Group in future periods is expected to be affected most significantly by the non-deductible amortisation of goodwill, the higher effective rate of tax borne by certain PFI projects, the incurrence of non-deductible expenditure and the utilisation of unrecognised deferred tax assets.

9 Dividends

	2003 £'000	2002 £'000
Interim dividend of 0.72p per share on 429,466,207 Ordinary Shares (2002 – 0.64p on 429,260,960 Ordinary Shares) of 2p each fully paid – paid 10 October 2003	**3,092**	2,747
Proposed final dividend of 1.62p per share on 429,529,098 Ordinary Shares (2002 – 1.44p on 429,448,207 Ordinary Shares) of 2p each fully paid – proposed payment on 12 May 2004	**6,958**	6,184
	10,050	8,931
2001 final dividend of 1.29p on 39,547,465 shares issued between 31 December 2001 and 13 March 2002 (ex dividend date)	–	510
	10,050	9,441

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

10 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 £33,298,000 for the year ended 31 December 2003 (2002 – £32,302,000) and the weighted average number of 429,878,711 (2002 – 421,813,107) 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 £47,429,000 (adjusted for the effect of goodwill amortisation of £14,131,000) for the year ended 31 December 2003 (2002 – £40,400,000 adjusted for the effect of goodwill amortisation of £8,098,000) and the weighted average number of 429,878,711 (2002 – 421,813,107) 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 £33,298,000 for the year ended 31 December 2003 (2002 – £32,302,000) and the weighted average number of 430,291,041 (2002 – 423,288,423) 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 £47,429,000 (adjusted for the effect of goodwill amortisation of £14,131,000) for the year ended 31 December 2003 (2002 – £40,400,000 adjusted for the effect of goodwill amortisation of £8,098,000) and the weighted average number of 430,291,041 (2002 – 423,288,423) Ordinary Shares of 2p each assuming that the options are all exercised.

11 Intangible assets

	Goodwill £'000	Other £'000	Group Total £'000
Cost:			
At 1 January 2003	165,515	1,775	167,290
Additions during the year	89,608	–	89,608
Disposals	(1,902)	–	(1,902)
At 31 December 2003	**253,221**	**1,775**	**254,996**
Accumulated amortisation:			
At 1 January 2003	19,496	321	19,817
Charge for the year	13,751	380	14,131
Disposals	(1,902)	–	(1,902)
At 31 December 2003	**31,345**	**701**	**32,046**
Net book value:			
At 31 December 2003	**221,876**	**1,074**	**222,950**
At 31 December 2002	146,019	1,454	147,473

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

Additions are further explained in Note 13.

12 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 2003	8,032	13,736	120,420	142,188
Subsidiaries acquired	–	1,471	2,370	3,841
Additions	1,844	3,427	30,847	36,118
Disposals	(93)	(355)	(18,192)	(18,640)
Foreign exchange differences	361	251	4,760	5,372
At 31 December 2003	**10,144**	**18,530**	**140,205**	**168,879**
Accumulated depreciation:				
At 1 January 2003	2,558	5,069	72,082	79,709
Provided during the year	210	1,653	16,538	18,401
Disposals	(59)	(222)	(9,490)	(9,771)
Foreign exchange differences	176	112	2,854	3,142
At 31 December 2003	**2,885**	**6,612**	**81,984**	**91,481**
Net book value:				
At 31 December 2003	**7,259**	**11,918**	**58,221**	**77,398**
At 31 December 2002	5,474	8,667	48,338	62,479

The cost of assets held by the Group under finance leases at 31 December 2003 was £38,008,000 (2002 – £24,977,000). The accumulated depreciation provided for those assets at 31 December 2003 was £13,472,000 (2002 – £9,168,000).

12 Tangible assets (continued)

Company	Short leasehold building improvements £'000	Machinery, motor vehicles, furniture and equipment £'000	Total £'000
Cost:			
At 1 January 2003	1,265	4,083	5,348
Transfers to subsidiary undertakings	(1,090)	(1,639)	(2,729)
Additions	96	900	996
At 31 December 2003	**271**	**3,344**	**3,615**
Accumulated depreciation:			
At 1 January 2003	548	2,491	3,039
Transfers to subsidiary undertakings	(407)	(556)	(963)
Provided during the year	34	249	283
At 31 December 2003	**175**	**2,184**	**2,359**
Net book value:			
At 31 December 2003	**96**	**1,160**	**1,256**
At 31 December 2002	717	1,592	2,309

The cost of assets held by the Company under finance leases at 31 December 2003 was £750,000 (2002 – £872,000). The accumulated depreciation provided for those assets at 31 December 2003 was £63,000 (2002 – £71,307).

13 Investments held as fixed assets

	Company £'000
a) Shares in subsidiary companies at cost:	
At 1 January 2003	141,418
Increase in investments in Group companies	121,365
At 31 December 2003	**262,783**

	Group £'000
b) Group investments in joint ventures:	
At 1 January 2003	35,883
Acquisitions	4,077
Disposals	(19,460)
Foreign exchange translation difference	976
Share of profits after tax	16,040
Dividends received	(12,630)
At 31 December 2003	**24,886**

Disposals are further explained in g) i) and ii).

13 Investments held as fixed assets (continued)

c) Joint ventures:

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

	2003 AWE* £'000	2003 Other £'000	**2003 Total £'000**	2002 AWE* £'000	2002 PCG £'000	2002 Other £'000	2002 Total £'000
Turnover	101,493	129,762	**231,255**	91,386	52,504	84,780	228,670
Profit before tax	8,984	15,033	**24,017**	7,801	4,993	11,108	23,902
Tax	(1,584)	(6,195)	**(7,779)**	(1,832)	(2,070)	(3,425)	(7,327)
Minority interest	–	(198)	**(198)**	–	–	–	–
Profit after tax	7,400	8,640	**16,040**	5,969	2,923	7,683	16,575
Fixed assets	–	19,236	**19,236**	–	2,288	31,278	33,566
Current assets	28,875	103,349	**132,224**	21,861	124,266	138,138	284,265
	28,875	122,585	**151,460**	21,861	126,554	169,416	317,831
Liabilities due within one year	17,207	32,740	**49,947**	17,660	17,518	27,313	62,491
Liabilities due after more than one year	7,356	69,271	**76,627**	1,066	94,446	123,945	219,457
	24,563	102,011	**126,574**	18,726	111,964	151,258	281,948
Share of net assets	4,312	20,574	**24,886**	3,135	14,590	18,158	35,883

* Atomic Weapons Establishment Management Limited

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

d) A list of the principal undertakings of Serco Group plc is shown in Note 34. All the subsidiaries of the Group have been consolidated.

e) At 31 December 2003, Group companies had branches in UAE, Bahrain, Chile, Korea, Saudi Arabia, Switzerland and South Africa.

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

13 Investments held as fixed assets (continued)

g) 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 the economic useful life of the asset or a period of 20 years, whichever is shorter.

i) Premier Custodial Group Limited

In July 2003 the Group acquired the remaining 50% of the issued share capital of Premier Custodial Group Limited (Premier) for a total cash consideration of £48,600,000. Acquisition costs of £3,481,000 were incurred.

The provisional fair value of the net assets acquired was £16,671,000 representing 50% of the book values of the assets and liabilities. The following table sets out the book values of the identifiable assets and liabilities acquired and their provisional fair value to the Group:

	Provisional fair value to group £'000
Tangible fixed assets	3,266
Current assets	
PFI debtor	194,878
Stocks	1,994
Debtors	37,751
Cash	15,878
Total assets	**253,767**
Liabilities	
Trade creditors	17,583
Senior debt financing	169,965
Subordinated debt financing	16,817
Accruals and deferred income	9,149
Provisions	6,911
Total liabilities	220,425
Net assets	**33,342**
Net assets acquired (50 per cent)	16,671
Goodwill	35,410
Cash consideration	**52,081**

13 Investments held as fixed assets (continued)

i) Premier Custodial Group Limited (continued)

The following table sets out the summary profit and loss account for Premier for the period 1 January 2003 to 3 July 2003:

	Six months to 3 July 2003 £'000
Turnover	60,660
Operating profit	520
Profit before taxation	3,924
Taxation on profit on ordinary activities	(2,062)
Profit for the period	**1,862**

The corresponding profit after tax for the full year to 31 December 2002 was £5,846,000.

ii) Buy-out of other investment partners

During the year the Group bought out its partners in the following businesses, two of which are PFI projects. In March 2003 the Group acquired the remaining 50% of Laser (Teddington II) Limited, a joint venture with Laing Investments Limited formed to build the new science building for the National Physical Laboratory in Teddington. Also in March 2003 the Group acquired the remaining 74% of the Altram consortium company, which had built Phase 2 of the Metrolink system in Manchester and operates and maintains Phases 1 and 2. In June 2003 the Group acquired the remaining 33% of Metro Service AS.

The total cash consideration amounted to £2,389,000. The fair value of the net liabilities acquired was £51,000. The total adjustment, required to the book values of the assets and liabilities of the companies acquired in order to present the net assets of those companies at fair values in accordance with Group accounting policies, was £2,300,000.

The aggregate goodwill arising on consolidation is £140,000.

iii) Other acquisitions

In February 2003, the Group acquired a renewable 10-year franchise (renewable to a maximum 20-year term) from the province of Ontario, Canada, relating to Ontario Driving Examination Services (DES).

Consideration of £47,707,000 was incurred along with £5,248,000 of related acquisition costs. The fair value of the net assets acquired are considered to be the same as their book value and amounted to £1,952,000.

Goodwill arising is £51,003,000.

Prior to acquisition the financial results of the DES business were not separately reported by the Ministry of Transportation, Ontario, and as such, it has not been possible to provide a summarised profit and loss account for the pre-acquisition period in accordance with FRS 6.

The acquisition of Teknical in December 2003 gave rise to goodwill of £746,000.

13 Investments held as fixed assets (continued)

h) Disposals:

In October 2003 the Group sold its 100% interest in the ordinary share capital of Serco Sverige AB. The total sales proceeds of £5,601,000 comprised cash of £4,471,000 and a loan note of SKr 15,200,000 (£1,130,000) payable in two equal annual instalments commencing 31 December 2004. The loan carries interest at 150bp over 3-month LIBOR which is payable semi-annually in arrears commencing 31 December 2003. The net assets disposed of were £4,753,000 and disposal costs amounted to £581,000, resulting in a profit on disposal of £267,000. The profit of Serco Sverige AB up to the date of disposal was £749,000, and for its last financial year was £897,000.

14 Stocks

	Group 2003 £'000	Group 2002 £'000	**Company 2003 £'000**	Company 2002 £'000
Service spares	**15,954**	10,065	**–**	–
Long term contract balances	**23,589**	28,679	**41**	–
	39,543	38,744	**41**	–

15 Debtors

	Group 2003 £'000	Group 2002 £'000	**Company 2003 £'000**	Company 2002 £'000
a) Amounts due within one year:				
Amounts recoverable on contracts	**198,687**	168,820	**189**	–
Other debtors	**32,572**	18,425	**8,129**	6,623
Corporation tax recoverable	**1,670**	–	**12,125**	14,466
Prepayments and accrued income	**35,924**	30,131	**613**	580
Amounts owed by joint ventures	**2,600**	2,666	**225**	–
PFI debtor*	**7,478**	–	**–**	–
	278,931	220,042	**21,281**	21,669

15 Debtors (continued)

	Group 2003 £'000	Group 2002 £'000	Company 2003 £'000	Company 2002 £'000
b) Amounts due after more than one year:				
Amounts recoverable on contracts	**22,043**	18,412	**–**	–
Other debtors	**21,780**	16,297	**1,169**	1,297
Pensions prepayment (Note 33)	**30,580**	28,350	**–**	–
Amounts owed by joint ventures	**8,869**	12,033	**–**	–
PFI debtor*	**260,780**	–	**–**	–
PFI assets in the course of construction*	**75,537**	33,840	**–**	–
	419,589	108,932	**1,169**	1,297
Total debtors	**698,520**	328,974	**22,450**	22,966

Included in amounts recoverable on contracts is £12,448,000 (2002 – £7,978,000) in respect of items procured on behalf of customers. This is offset by an amount of £9,933,000 (2002 – £8,792,000) in trade creditors and an amount of £7,659,000 (2002 – £945,000) in accruals.

*PFI contract balances in debtors

The impact of the PFI contract balances in debtors on the Group accounts in relation to the Traffic Control Centre, Laser and Premier contracts is summarised as follows:

	Balance at 1 January 2003 £'000	Acquired during the year £'000	Movement during the year £'000	Balance at 31 December 2003 £'000
Balances in relation to PFI contracts:				
PFI assets excluding capitalised interest	32,088	275,498	27,777	**335,363**
Interest included in PFI debtor	1,752	5,136	1,544	**8,432**
Total PFI debtor and assets in the course of construction	33,840	280,634	29,321	**343,795**

The PFI assets analysed above are funded by non-recourse loans of £307,205,000 (2002 – £29,700,000).

16 Other creditors including taxation and social security

	Group 2003 £'000	Group 2002 £'000	Company 2003 £'000	Company 2002 £'000
Obligations under finance leases	5,898	4,836	131	267
Corporation tax	–	2,195	–	–
Other taxes and social security costs	9,022	31,432	–	304
Other creditors	55,214	38,034	679	117
Amounts owed to joint ventures	16,285	16,974	10,200	–
Other loans	4,473	372	–	–
	90,892	93,843	11,010	688

17 Creditors: amounts falling due after more than one year

	Group 2003 £'000	Group 2002 £'000	Company 2003 £'000	Company 2002 £'000
a) Bank loans and overdrafts	–	2,386	–	–
Obligations under finance leases	23,461	15,291	671	792
Other loans	526,708	77,505	160,916	43,259
Total loans	550,169	95,182	161,587	44,051
Less: amounts included in creditors falling due within one year	10,371	7,594	131	267
Amounts falling due after more than one year	539,798	87,588	161,456	43,784

17 Creditors: amounts falling due after more than one year (continued)

	Group 2003 £'000	Group 2002 £'000	Company 2003 £'000	Company 2002 £'000
b) Analysis of loan repayments due:				
Bank loans and overdrafts:				
Within one year or on demand	–	2,386	–	–
Obligations under finance leases:				
Within one year or on demand	5,898	4,836	131	267
Between one and two years	7,214	4,667	146	525
Between two and five years	9,289	4,291	394	–
After five years	1,060	1,497	–	–
Other loans:				
Within one year or on demand	4,473	372	–	–
Between one and two years	80,111	1,687	–	–
Non-recourse debt	79,348	–	–	–
Other	763	1,687	–	–
Between two and five years	110,402	70,735	43,171	43,259
Non-recourse debt	63,841	25,200	–	–
Other	46,561	45,535	43,171	43,259
After five years	331,722	4,711	117,745	–
Non-recourse debt	213,790	4,500	–	–
Other	117,932	211	117,745	–
	550,169	95,182	161,587	44,051

Included above in other loans payable after five years is a private placement for £117m sourced from a number of institutions and completed by the Group in August 2003. This private placement is designed to lengthen the maturity profile of the Group's debt, with a final maturity of 12 years and an average term of 10 years. The debt was issued in Sterling and US Dollars at a fixed average coupon of 5.7%. The debt issued in US Dollars has been swapped into Sterling.

The non-recourse debt has a term to maturity of between 10 and 23 years. The interest rates payable on this debt range from 5.5% to 8.7%.

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

18 Financial assets and liabilities

A description of the Group's treasury and risk management policies is set out in the Finance review on page 26.

As permitted by Financial Reporting Standard 13 (FRS 13) – 'Derivatives and other Financial Instruments' 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.

i) Assets

31 December 2003	Sterling £'000	Euro £'000	Australian Dollar £'000	US Dollar £'000	Other currencies £'000	**Total £'000**
Cash and short term deposits	121,257	20,112	6,556	3,261	19,702	**170,888**
Long term interest-bearing loans to joint ventures	3,436	–	5,433	–	–	**8,869**
Other long term debtors	398,963	479	1,265	–	10,013	**410,720**
Total long term assets	**402,399**	**479**	**6,698**	**–**	**10,013**	**419,589**

31 December 2002	Sterling £'000	Euro £'000	Australian Dollar £'000	US Dollar £'000	Other currencies £'000	Total £'000
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
Total long term assets	95,927	7,285	5,720	–	–	108,932

Included within the assets recognised above is cash of £21,851,000 (2002 – £270,000) and debtors of £336,317,000 (2002 – £33,840,000) held by companies that are funded by non-recourse debt. The cash is not currently freely distributable as it represents a debt service reserve for the lenders of the non-recourse debt.

Fixed rate loans included in the above comprise Sterling loans of £2,217,000 carrying a weighted average interest rate of 9.3%, and an Australian Dollar loan of £1,033,000 carrying an interest rate of 15%.

67% of short-term trade debtors are Sterling denominated (2002 – 79%).

18 Financial assets and liabilities (continued)

ii) Liabilities

31 December 2003	Total liabilities £'000	Floating rate liabilities £'000	Fixed rate liabilities £'000	Fixed rate liabilities: Weighted average interest rate %	Fixed rate liabilities: Weighted average time for which rate is fixed Years
Sterling	493,055	45,006	448,049	6.83	9
Australian Dollar	955	955	–	–	–
US Dollar	223	223	–	–	–
Canadian Dollar	53,215	3,464	49,751	5.27	5
Other	2,721	2,721	–	–	–
Total	**550,169**	**52,369**	**497,800**		

31 December 2002	Total liabilities £'000	Floating rate liabilities £'000	Fixed rate liabilities £'000	Fixed rate liabilities: Weighted average interest rate %	Fixed rate liabilities: Weighted average time for which rate is fixed Years
Sterling	87,757	24,354	63,403	6.45	4
Australian Dollar	3,075	3,075	–	–	–
US Dollar	3,714	3,714	–	–	–
Euro	636	636	–	–	–
Total	95,182	31,779	63,403		

Included within the liabilities recognised above is non-recourse debt of £356,979,000 (2002 – £29,700,000).

75% of short-term trade creditors are Sterling denominated (2002 – 80%).

The maturity of the Group's financial liabilities at 31 December 2003 and 31 December 2002 were:

31 December 2003	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	5,933	36,563	117,964	332,595	**493,055**
Australian Dollar	495	230	230	–	**955**
US Dollar	83	140	–	–	**223**
Canadian Dollar	8,268	4,844	15,687	24,416	**53,215**
Other	909	348	1,276	188	**2,721**
Total	**15,688**	**42,125**	**135,157**	**357,199**	**550,169**

18 Financial assets and liabilities (continued)

ii) Liabilities (continued)

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	73,848	5,920	87,757
Australian Dollar	768	1,255	829	223	3,075
US Dollar	2,085	1,215	349	65	3,714
Euro	636	–	–	–	636
Total	7,594	6,354	75,026	6,208	95,182

iii) Fair values

The book value and fair value of the Group's financial assets and liabilities at 31 December 2003 and 31 December 2002 were:

	2003 Book value £'000	**2003 Fair value £'000**	2002 Book value £'000	2002 Fair value £'000
Long term debt	**(525,724)**	**(529,884)**	(88,047)	(91,879)
Cross currency swaps	**(8,757)**	**(3,233)**	459	4,138
Short term debt	**(15,688)**	**(15,688)**	(7,594)	(7,594)
Interest rate swaps	**–**	**(27,230)**	–	–
Forward exchange contracts	**–**	**(5,726)**	–	(2,422)
Cash and short term deposits	**170,888**	**170,888**	71,774	71,774
Long term loans to joint ventures	**8,869**	**8,869**	12,033	12,033
Other long term debtors	**410,720**	**410,720**	96,899	96,899
Total	**40,308**	**8,716**	85,524	82,949

Foreign currency assets and liabilities 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 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 in the accounts until the hedged position matures. There was an unrecognised loss of £36,189,000 (2002 – gain of £1,716,000) on derivatives held to manage currency and interest rate risk as at 31 December 2003. The unrecognised loss of £36,189,000 includes the fair value of interest rate swaps in Premier Custodial Group and Laser (Teddington II) Limited. The equivalent values for these swaps are not included in the prior year comparative number of £1,716,000 because Premier Custodial Group and Laser (Teddington II) Limited were joint ventures on 31 December 2002.

18 Financial assets and liabilities (continued)

iii) Fair values (continued)

The expected movements in the fair value of hedges, are as follows:

	Interest rate hedges £'000	Cross currency swaps £'000	Forward exchange contracts £'000	**Total £'000**
Losses on hedges unrecognised at 31 December 2003	(27,230)	(3,233)	(5,726)	**(36,189)**
Expected to be recognised in the following year	(6,678)	(453)	(1,281)	**(8,412)**
Expected to be recognised thereafter	(20,552)	(2,780)	(4,445)	**(27,777)**

19 Provisions for liabilities and charges

Group	Balance 1 January 2003 £'000	Subsidiaries acquired £'000	Utilised £'000	Charged to the profit and loss account £'000	Foreign exchange differences £'000	**Balance 31 December 2003 £'000**
Pensions provision	25,808	–	(839)	1,663	2,008	**28,640**
Deferred taxation	8,725	11,958	–	7,195	8	**27,886**
	34,533	11,958	(839)	8,858	2,016	**56,526**

Company	Balance 1 January 2003 £'000	Subsidiaries acquired £'000	Utilised £'000	Charged to the profit and loss account £'000	Foreign exchange differences £'000	**Balance 31 December 2003 £'000**
Deferred tax	335	–	–	(531)	–	**(196)**

The deferred tax asset in the Company balance sheet at 31 December 2003 has been included within 'other debtors'.

20 Deferred taxation

	Group 2003 £'000	Group 2002 £'000	Company 2003 £'000	Company 2002 £'000
The amounts of deferred taxation provided in the accounts are:				
Deferred tax liabilities:				
Tax allowances in excess of depreciation	16,166	2,650	(203)	(77)
Overseas timing differences	28	1,967	–	–
Other timing differences	11,692	4,108	7	412
	27,886	8,725	(196)	335
Deferred tax assets (included within 'other debtors'):				
Overseas timing differences	(1,721)	–	–	–
	26,165	8,725	(196)	335
Movement in deferred taxation				
Balance 1 January 2003	8,725			
Acquisitions in the year	11,958			
Tax charge for the year	7,195			
Tax credit for the year	(1,721)			
Foreign exchange	8			
Balance 31 December 2003	26,165			
Potential amounts of deferred taxation for which no credit has been taken:				
Overseas timing differences	(6,100)	(2,767)	–	–
	(6,100)	(2,767)	–	–

21 Reconciliation of movements in shareholders' funds

	2003 £'000	Restated 2002 £'000
Profit on ordinary activities after taxation	**33,751**	32,302
Share of joint venture minority interest	**(198)**	–
Minority interest	**(255)**	–
Dividends	**(10,050)**	(9,441)
	23,248	22,861
Currency translation differences on foreign currency net investments	**6,654**	(1,911)
New capital subscribed	–	117,929
Exercise of share scheme options	–	(93)
Change in ESOP reserve	**1,258**	–
Net increase in shareholders' funds	**31,160**	138,786
Opening shareholders' funds as previously stated	**249,650**	129,071
Restatement	–	(18,207)
Opening shareholders' funds as restated	**249,650**	110,864
Closing shareholders' funds as restated	**280,810**	249,650

22 Called up share capital

	2003 £'000	2002 £'000
a) Authorised 550,000,000 (2002 – 550,000,000) Ordinary Shares of 2p each	**11,000**	11,000

	2003 £'000	2002 £'000
b) Called up, allotted and fully paid:		
434,880,837 (2002 – 434,862,837) Ordinary Shares of 2p each	**8,697**	8,697

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

During the year 80,891 Ordinary Shares of 2p each were allotted to the holders of options or their personal representatives.

Of these, 18,000 were allotted using newly issued shares, 18,000 were allotted at £nil value.

Of the remaining 59,438 were allotted at £nil value and 3,453 at a price of £1.645 using shares purchased in the market and held in trust.

22 Called up share capital (continued)

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 2003 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 2003 there remained 36,000 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 2003 there remained 1,416,413 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 2003 there remained 2,029,242 options which are exercisable at a price of £2.45* each in accordance with the rules of the Scheme.

v) 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 2003 there remained 1,710,792 options which are exercisable at a price of £4.2542* each in accordance with the rules of the Scheme.

vi) 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 2003 there remained 127,038 options which are exercisable at a nil value in accordance with the rules of the Scheme.

vii) 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 2003 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.

viii) 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 2003 there remained 170,481 options which are exercisable at nil value in accordance with the rules of the Scheme.

ix) On 20 March 2001, 2,851,962 options in respect of Ordinary Shares of 2p each were granted in accordance with the rules of the 'Serco Group 1998 Executive Option Plan'. As at 31 December 2003 there remained 2,626,535 options which are exercisable at a price of £4.07 each in accordance with the rules of the Scheme.

x) On 27 March 2001, 603,144 options in respect of Ordinary Shares of 2p each were granted in accordance with the rules of the 'Serco Group 1998 Executive Option Plan'. As at 31 December 2003 there remained 600,838 options which are exercisable at a price of £4.35 each in accordance with the rules of the Scheme.

22 Called up share capital (continued)

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

xi) 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 2003 there remained 179,650 options which are exercisable at nil value in accordance with the rules of the Scheme.

xii) 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 1998 Executive Option Plan'. As at 31 December 2003 there remained 5,753,308 options which are exercisable at a price of £2.64 each in accordance with the rules of the Scheme.

xiii) 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 2003 no options had been exercised or lapsed.

xiv) 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 1998 Executive Option Plan'. As at 31 December 2003 there remained 5,161,098 options which are exercisable at a price of £1.645 each in accordance with the rules of the Scheme.

xv) On 6 May 2003, 787,358 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 2003 no options had been exercised or lapsed. These options have been granted in respect of a three-year performance period starting 1 January 2003 and are exercisable at a nil value in accordance with the rules of the Scheme.

xvi) On 6 May 2003, 11,032,976 options in respect of Ordinary Shares of 2p each were granted in accordance with the rules of the 'Serco Group 1998 Executive Option Plan'. As at 31 December 2003 there remained 10,831,695 options which are exercisable at a price of £1.525 each in accordance with the rules of the Scheme.

xvii) On 6 May 2003, 60,675 options in respect of Ordinary Shares of 2p each were granted in accordance with the rules of the 'Serco Group 1998 Executive Option Plan'. As at 31 December 2003 there remained 60,675 options which are exercisable at a price of £1.39 each in accordance with the rules of the Scheme.

xviii) On 27 November 2003, 650,850 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 2003 no options had been exercised or lapsed. These options have been granted in respect of a three-year performance period starting 1 January 2004 and are exercisable at a nil value in accordance with the rules of the Scheme.

xix) On 17 December 2003, 35,178 options in respect of Ordinary Shares of 2p each were granted in accordance with the rules of the 'Serco Group 1998 Executive Option Plan'. As at 31 December 2003 there remained 35,178 options which are exercisable at a price of £1.70 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 2003 was £1.72. The market price of these shares ranged from £1.92 to £1.055 during the year.

23 Share premium account

Group and Company	£'000
Balance at 1 January 2003	190,791
Balance at 31 December 2003	**190,791**

24 ESOP reserve

Group	£'000
At 1 January 2003	(18,207)
Amortisation	1,258
At 31 December 2003	**(16,949)**

The ESOP reserve represents 5,351,739 (2002 – 5,414,630) shares in Serco Group plc held by the Employee Share Ownership Trust (the Trust) equal to 1.23% of current allotted share capital (2002 – 1.25%). The market value of shares held by the Trust at 31 December 2003 was £9,204,991 (2002 – £8,284,384). 62,891 shares were allotted during the year, 59,438 were allotted at nil value and 3,453 at a price of £1.645 (2002 – 142,403 all of which were at nil value).

25 Profit and loss account

Group	£'000
Balance at 1 January 2003	68,226
Retained profit transferred to reserves	23,248
Currency translation differences on foreign currency net investments	6,654
Balance at 31 December 2003	**98,128**

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 £59,510,000, which includes dividends of £72,080,000 received from subsidiary companies.

A final ordinary dividend of £6,958,000 is proposed, which together with the interim dividend of £3,092,000, leaves a profit of £49,460,000 which has been added to reserves brought forward of £37,789,000. This, along with a foreign exchange charge of £790,000, results in reserves carried forward of £86,459,000.

26 Reconciliation of operating profit to net cash inflow from operating activities

	2003 £'000	Restated 2002 £'000
Operating profit before exceptional item	**28,206**	29,103
Exceptional item: reorganisation cost	**(4,497)**	–
Operating profit	**23,709**	29,103
Depreciation	**18,401**	15,534
Amortisation of goodwill and intangible fixed assets	**14,131**	8,098
Profit on sale of tangible fixed assets	**(1,965)**	(1,948)
Profit on sale of subsidiary undertaking	**(267)**	–
Decrease/(increase) in stocks	**1,875**	(2,906)
Increase in debtors	**(4,401)**	(41,870)
(Decrease)/increase in creditors	**(19,263)**	30,019
Increase in provisions	**12,910**	2,805
Decrease ESOP investment	**1,258**	776
One-off pension fund contribution	**–**	(15,500)
Net cash inflow from operating activities before PFI asset expenditure	**46,388**	24,111
Movement in PFI debtor	**3,680**	–
Expenditure on PFI assets in the course of construction	**(33,001)**	(14,950)
Net cash inflow from operating activities after PFI asset expenditure	**17,067**	9,161

27 Analysis of net debt

	Balance 1 January 2003 £'000	Cash flow acquired during the year 2003 £'000	Cash flow movement during the year 2003 £'000	Other non-cash changes 2003 £'000	**Balance 31 December 2003 £'000**
Cash at bank and in hand	71,774	12,843	86,271	–	**170,888**
Overdrafts	(2,386)	–	2,386	–	**–**
Cash net of overdrafts	69,388	12,843	88,657	–	**170,888**
Other loans due after more than one year	(47,433)	–	(117,502)	(321)	**(165,256)**
Other loans due within one year	(372)	–	1,709	(5,810)	**(4,473)**
Finance leases	(15,291)	(234)	6,422	(14,358)	**(23,461)**
Recourse net cash/debt	6,292	12,609	(20,714)	(20,489)	**(22,302)**
Non-recourse debt	(29,700)	(250,994)	(76,285)	–	**(356,979)**
Net debt	(23,408)	(238,385)	(96,999)	(20,489)	**(379,281)**

28 Reconciliation of increase in cash to movement in net debt

	2003 £'000	2002 £'000
Increase in cash	**101,500**	105,223
Cash (inflow) from non-recourse debt	**(76,285)**	(15,600)
Cash (inflow)/outflow from debt and lease financing	**(109,605)**	3,870
Change in net debt resulting from cash flows before acquisitions	**(84,390)**	93,493
Change in debt due to acquisitions	**(250,994)**	–
Non cash changes from other debt and lease financing	**(20,489)**	(9,310)
Movement in net debt in the year	**(355,873)**	84,183
Net debt at 1 January	**(23,408)**	(107,591)
Net debt at 31 December	**(379,281)**	(23,408)

29 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 £13,824,000 (2002 – £7,611,000).

During the year £nil (2002 – £93,000) has been charged to the profit and loss reserve in respect of shares issued under employee share incentive schemes.

30 Contingent liabilities

The Group has given guarantees and indemnities in respect of loans amounting to £3,672,000. The total value of credit facilities and future lease payments guaranteed at 31 December 2003 was £15,081,000.

In addition, 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.

31 Capital and other commitments

	Group 2003 £'000	Group 2002 £'000	Company 2003 £'000	Company 2002 £'000
Capital expenditure contracted but not provided	**11,878**	8,595	**–**	–

During the year ending 31 December 2004 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	4,323	3,004
Between one and five years	8,139	19,596
After five years	4,308	1,023
	16,770	23,623

32 Related parties

Directors

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

Joint ventures

The following material transactions took place between the Group and its joint ventures during 2003:

	2003 £'000	2002 £'000
Net loans during the year	**(7,821)**	1,797
Net trading	**1,561**	1,800
Royalties and management fees receivable	**1,098**	2,302
Dividends receivable	**12,630**	11,095
	7,468	16,994

32 Related parties (continued)

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

	2003 £'000	2002 £'000
Amounts due within one year:		
Loans	**1,944**	2,140
Trading balance	**488**	287
Royalties and management fees	**168**	239
	2,600	2,666
Amounts due after more than one year:		
Loans	**3,619**	12,033
Royalties and management fees	**5,250**	–
	8,869	12,033

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

	2003 £'000	2002 £'000
Amounts payable within one year:		
Loans	**16,285**	16,974
	16,285	16,974

Details of Group investments in joint ventures and other principal undertakings are given in Note 34.

33 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 2003 was £69.7 million (2002 – £73.6 million) on an asset base of £350.4 million (2002 – £294.5 million). For 2003 the Group has increased its pension contribution by £9 million, which was accounted for evenly over the year.

33 Pension schemes (continued)

a) SSAP 24 disclosure

The net pension charge in accordance with SSAP 24 for the year ended 31 December 2003 was £36,755,000 (2002 – £29,096,000). The Group operates or is a member of a number of pension schemes as follows:

i) Serco Pension and Life Assurance Scheme (SPLAS)

The two principal defined benefit schemes, Serco Pension and Life Assurance Scheme (SPLAS), and the Serco-IAL Pension Scheme were merged in February 2003. During 2003 a bulk transfer was received from the Serco IAL Pension Scheme. A full actuarial valuation was carried out at 6 April 2002 and updated to 31 December 2003 by a qualified independent actuary.

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, excluding the increased pension contribution of £9 million, is 19%.

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 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.
Salary growth	3.7% 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 £216,085,000 at 6 April 2002. 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 86% 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 £22,250,000 (2002 – £14,425,000), of which £9,000,000 relates to the increased lump sum contributions, and of which £910,000 related to special contributions and augmentations (2002 – £1,100,000).

At 31 December 2003 a prepayment of £30,580,000 (2002 – £28,350,000) in respect of the scheme was included in the balance sheet. £20,020,000 was charged to the profit and loss account in respect of the scheme (2002 – £12,535,000).

33 Pension schemes (continued)

a) SSAP 24 disclosure (continued)

ii) 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 (2002 – £1,663,000) and a provision of £28,640,000 (2002 – £25,808,000) has been included in the Balance Sheet as at 31 December 2003 of which £22,482,000 (2002 – £20,271,000) relates to the hybrid element of the scheme, and £6,158,000 (2002 – £5,537,000) to the defined benefit element of the scheme.

iii) 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 salaries increases	5.5 % p.a.

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

33 Pension schemes (continued)

a) SSAP 24 disclosure (continued)

iii) Serco Superannuation Fund (continued)

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 in 2003 profit and loss account relating to the defined benefit element of the scheme were £nil (2002 – £257,000).

iv) 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 rebid any surplus or deficit would transfer to the next contractor. Cash contributions are recognised as pension costs and no asset or liability is shown on the balance sheet.

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 used 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 2003 profit and loss account were £1,974,000 (2002 – £1,903,000).

33 Pension schemes (continued)

a) SSAP 24 disclosure (continued)

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

This is a pre-funded defined benefit scheme. The Company accounts for this scheme as a defined contribution scheme since at rebid any surplus or deficit would transfer to the next contractor. Cash contributions are recognised as pension costs and no asset or liability is shown on the balance sheet.

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% of Section Pay.

Employer pension contributions charged to the 2003 profit and loss account during the year were £783,000 (2002 – £715,000).

vi) Serco Metrolink Pension Scheme

This is a pre-funded defined benefit scheme. The Group accounts for this scheme as a defined contribution scheme since at rebid any surplus or deficit would transfer to the next contractor. Cash contributions are recognised as pension costs and no asset or liability is shown on the balance sheet.

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 2003 profit and loss account were £277,000 (2002 – £244,000).

33 Pension schemes (continued)

a) SSAP 24 disclosure (continued)

vii) Docklands Light Railway Pension Scheme

This is a pre-funded defined benefit scheme with Docklands Light Railway Limited being the principal employer. The Group accounts for this scheme as a defined contribution scheme, since at rebid any surplus or deficit would transfer to the next contractor. Cash contributions are recognised as pension costs and no asset or liability is shown on the balance sheet.

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 2003 profit and loss account were £1,521,000 (2002 – £1,378,000).

viii) Other defined contribution schemes

The Group paid employer contributions of £10,517,000 (2002 – £10,401,000) into UK and other defined contribution schemes, foreign state pension schemes and multi-employer schemes.

33 Pension schemes (continued)

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 2002 and the Serco IAL Scheme as at 31 March 2001, updated to 31 December 2003 by independent qualified actuaries.

If the amounts had been recognised in the accounts the net assets and the profit and loss account would be as follows:

	2003 £'000	Restated 2002 £'000
Net assets excluding net pension assets	**259,404**	229,805
Net pension liability	**(69,712)**	(73,601)
Net assets including pension liabilities	**189,692**	156,204

	2003 £'000	2002 £'000
Profit and loss reserve	**98,128**	68,226
Reversal of SSAP 24 prepayments, net of deferred taxation	**(21,406)**	(19,845)
	76,722	48,381
Pension (deficit)	**(69,712)**	(73,601)
Profit and loss reserve adjusted	**7,010**	(25,220)

Serco Pension and Life Assurance Scheme (SPLAS)

The financial assumptions used were:

	2003 % p.a.	2002 % p.a.
Rate of increase in salaries	3.80	3.85
Rate of increase in deferred pensions	2.70	2.25
Rate of increase in pensions in payment	2.70	2.25
Discount rate	5.40	5.47
Inflation assumption	2.80	2.35

33 Pension schemes (continued)

b) FRS 17 disclosure (continued)

The Scheme's assets and the expected rates of return as at 31 December 2003 were:

	2003 % p.a.	2003 £'000	2002 % p.a.	2002 £'000
Equities	**7.30**	**192,684**	7.00	183,802
Bonds	**5.40**	**41,510**	5.47	26,840
Gilts	**4.80**	**75,627**	4.50	47,434
Property	**6.35**	**8,192**	6.24	7,690
Cash and other	**4.00**	**2,985**	4.50	908
Annuity policies	**5.40**	**29,418**	5.47	27,798
Total market value of assets		**350,416**		294,472
Present value of scheme liabilities		**(450,005)**		(399,617)
Deficit in the scheme		**(99,589)**		(105,145)
Related deferred tax asset		**29,877**		31,544
Net pension liability		**(69,712)**		(73,601)

The amount chargeable under FRS 17 in 2003 would have been:

	2003 £'000	2002 £'000
Service cost	**13,655**	13,691
Past service cost	**1,350**	1,100
Total operating charge	**15,005**	14,791

Analysis of the net return on the pension scheme for the year ended 31 December 2003.

	2003 £'000	2002 £'000
Expected return on pension scheme assets	**18,965**	20,772
Interest on pension liabilities	**(22,056)**	(19,664)
Net return on (interest cost)/assets	**(3,091)**	1,108

33 Pension schemes (continued)

b) FRS 17 disclosure (continued)

Analysis of amount recognisable in Statement of Total Recognised Gains and Losses (STRGL) for the year ended 31 December 2003:

	2003 £'000	2002 £'000
Actual return less expected return on assets	**22,520**	(73,096)
Experience gains and losses on liabilities	**6,637**	(19,313)
Changes in assumptions	**(27,755)**	(8,290)
Actuarial gain/(loss) recognisable in STRGL	**1,402**	(100,699)

Movement in deficit during the year:

	2003 £'000	2002 £'000
Deficit in scheme at 31 December 2002	**(105,145)**	(5,163)
Movement in year:		
(Current service cost)	**(13,655)**	(13,691)
Contributions	**22,250**	14,400
(Past service costs)	**(1,350)**	(1,100)
Net return on (interest cost)/assets	**(3,091)**	1,108
Actuarial gain/(loss)	**1,402**	(100,699)
Deficit in scheme at 31 December 2003	**(99,589)**	(105,145)

History of experience gains and losses:

	2003 £'000	2002 £'000
Difference between expected and actual return on scheme assets	**22,520**	(73,096)
Percentage of scheme assets	**6%**	–21%
Experience gains and losses on scheme liabilities	**6,637**	(19,313)
Percentage of scheme liabilities	**1%**	–5%
Total amount recognised in STRGL	**1,402**	(100,699)
Percentage of scheme liabilities	**0%**	–25%

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.

34 List of principal undertakings

The companies listed below are, in the opinion of the Directors, the principal undertakings of Serco Group plc. The percentage of equity capital directly or indirectly held by Serco Group plc is shown. The voting rights are the same as the percentage holding. The companies are incorporated and principally operate in the countries stated below.

Principal subsidiaries

United Kingdom	Serco Limited	100%
	Serco-Denholm Limited	90%
	Serco Europe Limited	100%
	Serco-IAL Limited	100%
	Serco Railtest Limited	100%
	Serco Systems Limited	100%
	NPL Management Limited	100%
	Serco Docklands Limited	100%
	Traffic Information Services (TIS) Limited	100%
	Premier Custodial Group Limited	100%
	Kilmarnock Prison Services Limited	100%
	Lowdham Grange Prison Services Limited	100%
	Medomsley Training Services Limited	100%
	Premier Prison Services Limited	100%
	Premier Monitoring Services Limited	100%
	Premier Geografix Limited	100%
	Pucklechurch Custodial Services Limited	100%
	Moreton Prison Services Limited	100%
	Laser (Teddington II) Limited	100%
	Altram (Manchester) Limited	100%
Rest of Europe		
Belgium	Serco Belgium SA	100%
Denmark	Metro Service A/S	100%
France	Serco France SAS	100%
Germany	Serco International GmbH	100%
	Serco GmbH & Co KG	100%
Ireland	Serco Services Ireland Limited	100%
	CCM Software Services Limited	100%
Italy	Serco SpA	100%
Guernsey	Serco Insurance Company Limited	100%
Luxembourg	Serco Facilities Management SA	100%
The Netherlands	Serco Facilities Management BV	100%
Spain	Serco Gestion de Negocias SL	100%
Switzerland	Serco Facilities Management S.A	100%

34 List of principal undertakings (continued)

Principal subsidiaries

Asia Pacific		
Australia	Serco Group Pty Limited	100%
	Serco Australia Pty Limited	100%
	Great Southern Railways Limited	100%
New Zealand	Serco Group NZ Limited	100%
Hong Kong	Serco Group (Hong Kong) Limited	100%
Other		
Canada	Serco Facilities Management Inc	100%
USA	Serco Group, Inc	100%
	Serco, Inc	100%
	Serco Management Services, Inc. (Delaware)	100%
	Barton ATC, Inc.	100%
	Serco Management Services, Inc. (Tennessee)	100%
	JL Associates, Inc.	100%

Joint venture undertakings

United Kingdom	Serco Gulf Engineering Limited	50%
	Defence Management Watchfield Limited	50%
	Serco-Denholm Shipping Company Limited	50%
	AWE Management Limited	33%
	Merseyrail Electrics 2002 Limited	50%
Asia Pacific		
Australia	Defence Maritime Services Pty Limited	50%
	Serco Sodexho Defence Services Pty Limited	50%
New Zealand	Serco Sodexho Defence Services Limited	50%
Other		
USA	Serco – SKE	50%
Bahrain	Aeradio Technical Services WLL	49%
Bermuda	BAS-Serco Limited	40%
Cyprus	Serco Kalisperas	50%
Singapore	Serco Guthrie Pte Ltd	50%
Turkey	Elektronik Sistemer 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.

35 International Financial Reporting Standards

The Council of the European Union announced in June 2002 that listed companies in Europe would adopt International Financial Reporting Standards (IFRS) for accounting periods beginning on or after 1 January 2005. The adoption of IFRS will be first reflected in the Group Accounts in the year ending 31 December 2005. In accordance with the Committee of European Securities Regulators (CESR) Guideline, set out below is a brief summary of how the Group is managing the convergence to IFRS.

The Group has established a global project team to manage the convergence to IFRS. The scope of this project necessarily includes:

- An initial assessment of the impact from the conversion to IFRS on the Group's reported financial results;

- A continued assessment of the impact from proposed future developments to IFRS;

- Identification of required changes to the Group's existing accounting systems and procedures;

- Targeted training and education of all employees within the businesses; and

- The timely communication to internal and external stakeholders, of areas subject to significant change.

Registrars
With effect from 2 February 2004 the Company's registrar changed to Computershare Investor Services. Computershare maintains our register of members and makes dividend payments to our Shareholders. Please direct any correspondence about your holding – including change of address and dividend mandate instructions – to Computershare at this address:

Computershare Investor Services PLC
PO Box 82
The Pavilions
Bridgewater Road
Bristol BS99 7NH

Computershare's shareholder website is at www.computershare.com. A dedicated shareholder services helpline is available on +44 (0)870 873 5839. The helpline is open during working hours (UK time) if you have any questions about your holding in the Company.

Shares in issue
At 31 December 2003 there were 434,880,837 Serco Group plc Ordinary 2p Shares in issue.

Dividend mandate
Dividends can be paid directly into your bank or building society account. To take advantage of this facility, please complete the dividend mandate form attached to your dividend cheque or contact Computershare by phone, fax or post.

The form is also available from the Computershare website.

Dividend Re-investment Plan
The Serco Dividend Re-investment Plan ("DRIP") gives Shareholders the chance to re-invest their dividends in Serco shares instead of receiving cash.

If you participate in the DRIP, your cash dividend will be paid directly to Computershare, who will calculate the number of shares to which you are entitled and buy them on the stock market. Because participants' share purchases are aggregated, the dealing costs are relatively low.

To register, simply complete a form and send it to the registrar. For further information about the DRIP please contact Computershare directly on the number provided above, or alternatively look under the home page section on the Computershare website.

Postal share dealing services
Serco has arranged with Cazenove & Co a simple, low-cost method of buying and selling its shares by post. Shares are bought and sold on the day Cazenove receives the instruction. For a dealing form, please contact the postal dealing department at Cazenove:

Cazenove & Co. Ltd
Share Dealing Service
20 Moorgate
London EC2R 6DA
United Kingdom

T +44 (0)20 7606 1768

The terms and conditions for this service are shown on the last page of the form.

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 website. This will include the Annual and Interim Reports and other Shareholder communications. You can then view the document(s) on our website at www.serco.com.

To receive documents electronically you will need to register online on the Computershare website. This is a secure, straightforward online service operated free of charge by Computershare.

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
United Kingdom

Change of registered office
On 7 May 2003 the registered office of Serco Group plc changed to :

Serco House
16 Bartley Wood Business Park
Bartley Way, Hook
Hampshire RG27 9UY
United Kingdom

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Calendar of events

10 March
Ex dividend date

12 March
Record date

26 March
Accounts published

20 April
Last day for DRIP election

30 April
Annual General Meeting

12 May
Proposed final dividend payment

September
Proposed announcement
of interim results

October
Proposed payment
of interim dividend

This report has been printed on paper which is recyclable. A great proportion of the raw material used is the by-product from other production processes ie saw mill waste and waste which results from forest thinning. The mill holds not only ISO 2002 but also the ISO 14001 accreditation for its environmental management systems which include an active policy on sustainable forestry management.

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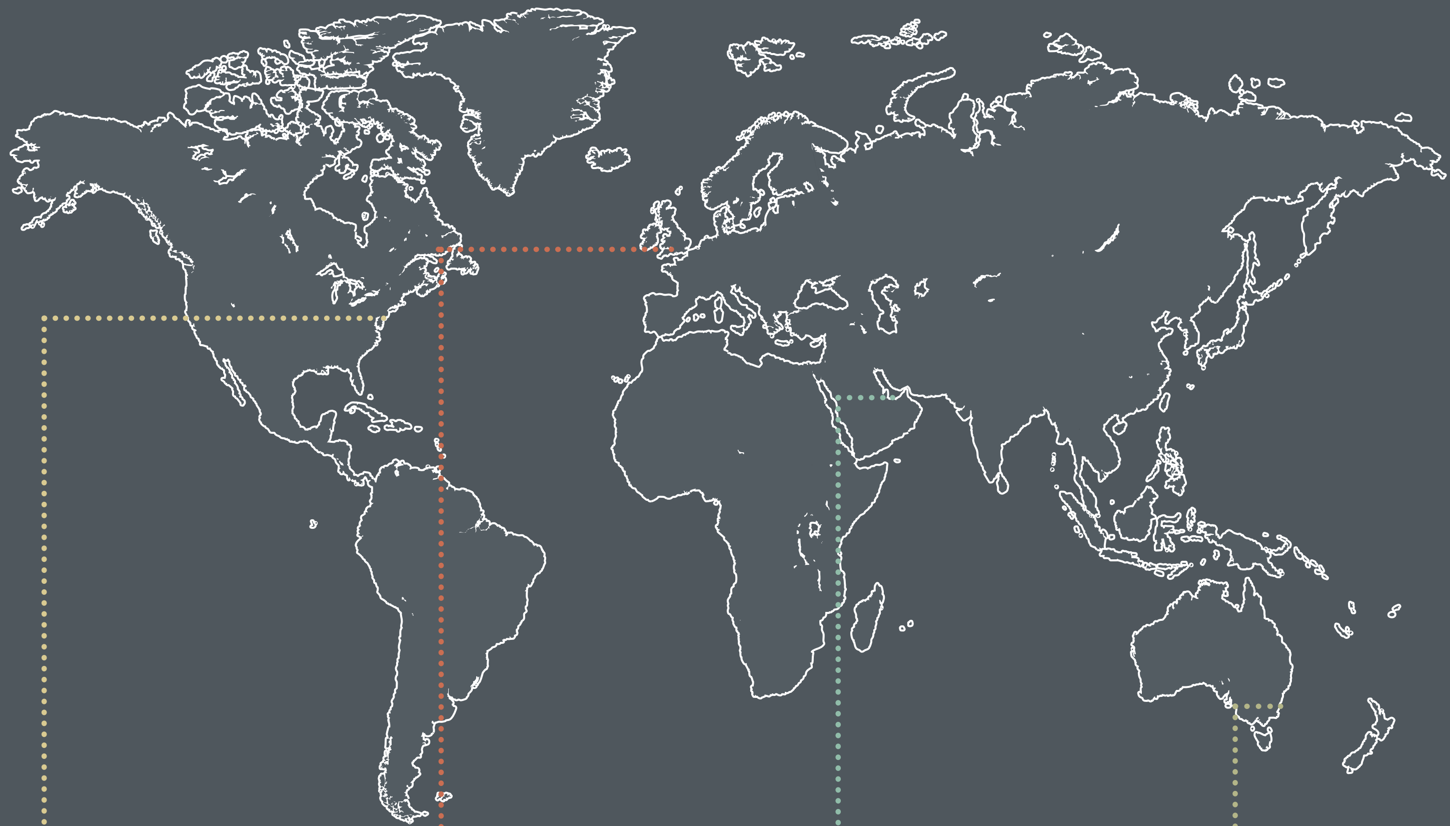

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