Serco Group plc annual review and accounts 2004

highlights

Continued strong sales, profit and cash growth

- Underlying turnover (excluding disposals and contracts exited) up 14.0%
- Underlying profit before tax, amortisation and 2003 exceptionals up 16.4%
- Recommended final dividend of 1.82p, giving a total of 2.63p for the year, up 12.4%
- Group EBITDA to cash conversion of 94.9% (2003 – 80.7%)
- Free cash flow of £55.8m (2003 – £47.0m)

Strong organic growth

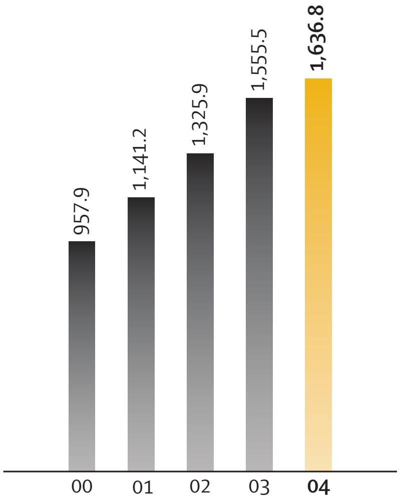
- 82% of increase in underlying turnover came from growth in existing contracts and new wins
- Continued win rates of over 90% on rebids and over 50% on new bids
- Contracts won valued at £4.1bn, including £2bn share of Northern Rail franchise, Electronic Monitoring and FAA Air Traffic Control Towers

Acquisitions strengthen our capabilities where we see strong organic growth opportunities

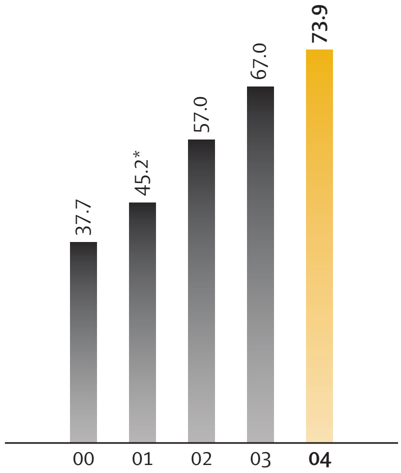
- ITNET plc – one of the UK's leading suppliers of IT and business process outsourcing services to local authorities, with expected 2004 sales of £209m
- Resource Consultants Inc (RCI) – supplier to US federal government of business process management and IT services, with expected 2004 sales of US$293m
- ITNET acquisition completed in February 2005. RCI expected to complete in March 2005

High visibility of future earnings

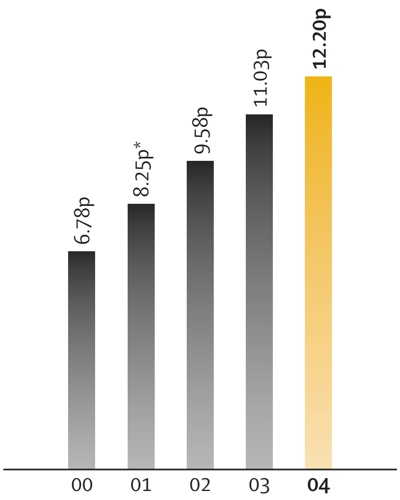
- Record forward order book of £12.7bn at year end
- 91% of 2005 planned turnover secured, 76% for 2006, 64% for 2007
- Bids worth £4.7bn submitted and under evaluation
- Strong start to 2005 with new wins of £0.4bn and contracts at preferred bidder valued at £0.9bn
- Over £16bn of further potential opportunities identified



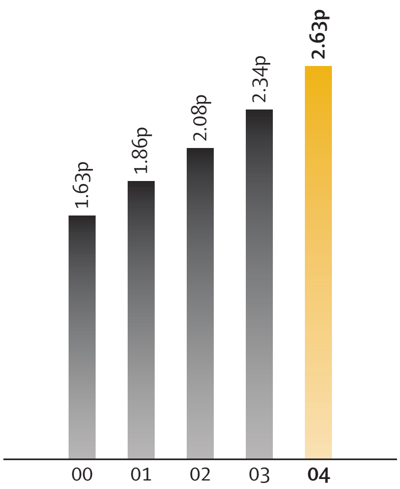
Turnover £m
including joint ventures



Profit £m
before intangible amortisation



Basic earnings per share
before intangible amortisation



Dividend per share

	2004	2003	
Turnover	**£1,637m**	£1,556m	up 5.2%
Profit before tax pre-amortisation	**£73.9m**	£67.0m	up 10.3%
Earnings per share pre-amortisation	**12.20p**	11.03p	up 10.6%
Profit before tax	**£57.4m**	£52.9m	up 8.6%
Earnings per share	**8.37p**	7.75p	up 8.1%
Dividend per share	**2.63p**	2.34p	up 12.4%

*Restated after the adoption of UITF 34 in 2002

2004 operating highlights

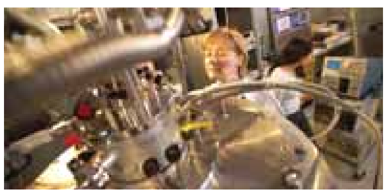
In 2004 we continued to grow in size and capability. Organic growth, built on a reputation for service and value for money, remains our foundation. It has enabled us to deliver consistent expansion from our existing contracts and customer relationships. In addition, we continued to add to the contract base with new business wins, including our largest-ever new contract, Northern Rail, and we announced two acquisitions to broaden our capabilities and market reach.

Strong relationships

We build relationships for the long term. We've been providing air traffic services in the Middle East for over 50 years. In 2004 we renewed our long-standing contract in Abu Dhabi for a further five-year period. Forty years ago we won our first contract to maintain the Ballistic Missile Early Warning System at RAF Fylingdales; in 2004 we renewed it for the tenth successive time. Strong customer relationships enabled us to maintain our contract renewal rate at over 90% – as we've done for many years.

Growing relationships

As clients (and their customers) discover the quality and value we can deliver for them, they want us to do more. Last year, examples of the growing scale and scope of our relationships included a £500m 10-year contract extending our role as managers of the National Physical Laboratory, where we successfully put forward a bold new vision for enlarging the science programme. We doubled our role in providing prisoner escorting and custody services in England and Wales. And we renewed multi-activity contracts with the Naval Air Command and RAF Northolt and Uxbridge with a significantly broader remit in each case.



Winning new contracts

Our record of delivery helps us win more than 50% of our bids for new business. In 2004 we won our largest-ever contract, the Northern Rail franchise, with our partner NedRailways. Valued at around £2bn to Serco over eight years and nine months, this service makes us a significant player in UK heavy rail operations, complementing our Merseyrail contract and our light rail strengths. In the US we expanded our services to the US federal government, winning our first contract with the Department of Agriculture. In Germany we became the first company to provide private non-custodial prison services. In Oman we're preferred supplier for the Middle East's first PFI project. The traffic management system we're creating to manage the link between Hong Kong and mainland China is our first in that country. Each contract marks the start of a new relationship with the potential to grow.

Bringing service to life

Our partnerships with customers grow because we deliver on and exceed our promises. In 2004 the UK's Office for Standards in Education gave us a glowing report for 'transforming' Walsall's 130 schools. The Chief Inspector of Prisons commended our management of Lowdham Grange prison and rapid turnaround of Ashfield Young Offenders Institution. We won ministerial praise for delivering Colnbrook Immigration Removal Centre on budget to a tight schedule. In Canada the Public Private Partnerships Council's Gold Award recognised the rapid success of our innovative Ontario Driver Examination Services concession. And in Hong Kong the Council of Social Service gave us its Caring Company award for the third time running. Docklands Light Railway won a major National Rail Award for the fifth successive year in partnership with Transport for London.

Extending our capabilities

The two acquisitions announced in December 2004 will broaden and strengthen our offering in the key UK local government and US federal markets. ITNET brings strategic skills in IT services, business process management and transformation with a complementary client base in local government and the private sector. These skills will help us develop propositions to integrate a wider range of services for all our customers using technology to deliver better service. RCI brings a strong base in the US federal government market, expertise in business process management and strong technical skills. These relationships and skills will heighten our capability in the world's largest service contracting market.

our business

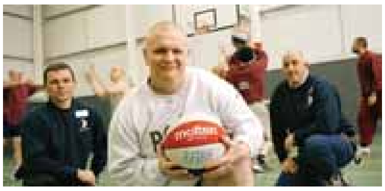
As one of the world's leading service companies, Serco is dedicated to bringing service to life. Around the world, we provide quality services that make a difference to people's lives. More than 90% of our activities support the public sector, and our people demonstrate a strong public service ethos. Both governments and commercial organisations continue to seek new and innovative ways of improving service delivery. This drive to improve service quality and value offers our employees, customers and shareholders excellent opportunities for continued growth.

Civil government

• Home affairs • Education • Health
• Regional and local government services

Income:	£547m
% of Group turnover:	33%
No. of employees (excluding JVs):	7,617

We have over 25 years' experience in delivering public services, across activities that now span home affairs, education, health and local government. We are at the forefront of the global trend towards improving the provision of public service through ever more sophisticated service oriented contracts. For many years we provided services predominantly in the UK and Asia Pacific. More recently we've won a growing number of contracts in mainland Europe – notably Germany and Italy – and North America, where the outsourcing of public services represents a vast potential market. With consulting groups operating in health, education, home affairs, defence, transport and central government, we are helping shape the future of public service delivery.



Transport

• Rail • Road • Air

Income:	£362m
% of Group turnover:	22%
No. of employees (excluding JVs):	4,600

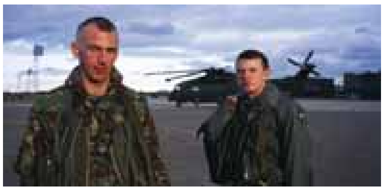
We have strong positions in the rail, road and air markets. In light rail we operate the Manchester Metrolink, the Copenhagen Metro and the award-winning Docklands Light Railway. Our heavy rail portfolio in the UK includes Merseyrail plus the Northern Rail franchise which we've operated since December 2004, and in Australia we run the recently extended Great Southern Railway. In road, we are a UK market leader in traffic management systems and operate the Highways Agency's new National Traffic Control Centre for England. We are the leading provider of air traffic control (ATC) and airport technical services in the Middle East, are a leading provider of ATC services in the US, and have a very successful airport services business in South Africa. Our acquisition of RCI will strengthen our capability in air traffic control and engineering.

Defence

• Land • Sea • Air

Income:	£487m
% of Group turnover:	30%
No. of employees (excluding JVs):	9,958

Since winning our first defence contract in the 1960s we've developed a broadly based business of more than 120 contracts in the UK, ranging from supporting secure military communications systems to managing, with our partners, the Atomic Weapons Establishment. We are a leading supplier of services to the armed forces in Australia, and provide more than 33% of Australia's garrison support services. In recent years we have developed a growing portfolio of defence contracts in Germany. The acquisition of RCI, when completed, will give us a substantial portfolio of business with the US Department of Defense in the fields of human resource solutions, technology and supply chain management.



Science

Income:	£116m
% of Group turnover:	7%
No. of employees (excluding JVs):	2,676

Our science business began in the 1970s with our work for the European Space Agency – which is still a major client – and we have built a leading position in the sector. We run the UK's National Physical Laboratory, which has a wide-ranging programme of world-class science projects, and have just signed our first contract to run a regional technology and innovation centre. We provide safety advice to nuclear power generators and the Royal Navy's nuclear submarine fleet, and work with the Geneva-based European Particle Physics Laboratory, CERN.

Private sector

Income:	£125m
% of Group turnover:	8%
No. of employees (excluding JVs):	2,755

Our work with the private sector consists mainly of multi-service facilities management for blue-chip clients. We operate a shared services centre for Microsoft's European subsidiaries for example, and we have a growing business in the US, providing maintenance and management of vehicles and infrastructure for utility companies. The acquisition of ITNET considerably broadens our role in the private sector, bringing a range of consultancy, business process management and IT services work with medium to large organisations.

chairman's statement

Kevin Beeston Executive Chairman

"These results demonstrate once again how Serco's focus on customer service and relationships is building a strong business around the world. Underlying Group turnover and profit have grown by 14% and 16% – principally through high levels of organic growth. The drive for better value for money public services around the globe puts Serco in an excellent position to continue its strong growth, further enhanced by our recently completed acquisition of ITNET in the UK and the planned acquisition of RCI in the US."

2004 was another very good year for Serco, and 2005 has started in excellent fashion too.

Our ability to achieve continued strong growth is rooted in a number of factors that are fundamental to Serco. These include our broad range of markets and services, our good reputation and the commitment and professionalism of our staff. We work in partnership with clients and stakeholders to deliver value for money and real service improvements.

As in the past, more than half our sales growth was achieved by expanding the scale and scope of existing contracts. This organic growth remains the primary focus for our business. We can only deliver it through high levels of customer satisfaction and a proactive and thoughtful approach to deepening our customer relationships and services.

We continued to strengthen our cash position and maintained our outstanding earnings visibility. By the end of 2004 we had achieved preferred bidder status on £0.9bn of contracts and had secured 91% of our planned revenues for 2005, 76% for 2006 and 64% for 2007. Over the year our forward order book rose from £10.3bn to £12.7bn, substantially boosted by our largest-ever contract win – the Northern Rail franchise, valued at some £2bn to Serco. Other wins included a £300m seven-year contract to provide court escort and custody services. Successful rebids included our air traffic control contract with the US Federal Aviation Administration (FAA) and multi-activity contracts with the UK's Royal Air Force and Naval Air Command. In fact, our defence business had its best year ever, with a good combination of organic growth and new business wins. And we further strengthened our position in the growing justice and national security markets.

To continue building our capabilities in areas where we see strong organic growth opportunities, in December we announced two significant acquisitions that will bring additional skills and capabilities in the UK and US, currently the world's largest public service outsourcing markets.

ITNET plc is a leading supplier of IT services, business process management and consulting to UK local authorities and private sector companies.

Resource Consultants Inc (RCI) supplies business process management, IT services, supply chain management, systems engineering, human resource management, and strategic consulting to the US federal government, primarily in defence. We expect this acquisition to complete during March 2005.

We expect both acquisitions to be earnings enhancing in 2005 and to further increase our ability to develop in current and emerging markets.

People

Ultimately, Serco's continued success stems from the achievements of dedicated, passionate people. Through the annual Chairman's Recognition Awards we acknowledge those individuals and teams who make exceptional contributions. Their stories emphasise how – day in, day out – the people of Serco are bringing service to life.

Leaders of the UK's major companies have recognised our employees' efforts by rating Serco as the UK's most admired support services company, and the sixth most admired company in the UK, in the *Management Today* 2004 annual survey. This recognition from peers and analysts is a tribute to the effort and commitment of everyone in the company. We congratulate and thank them all.

Financial performance

Sales and profit

Turnover grew 5.2% to £1,636.8m. After adjusting for the effect of disposals and contracts exited, underlying turnover growth was 14.0%.

Pre-tax profit rose 10.3% to £73.9m before intangible amortisation, and 8.6% to £57.4m after intangible amortisation. The previous year's profit figure benefited from exceptional items with a net profit of £3.6m; excluding these, the underlying profit growth before intangible amortisation was 16.4%.

Earnings per share rose 10.6% to 12.20p before intangible amortisation, and 8.1% to 8.37p after intangible amortisation.

Cash performance

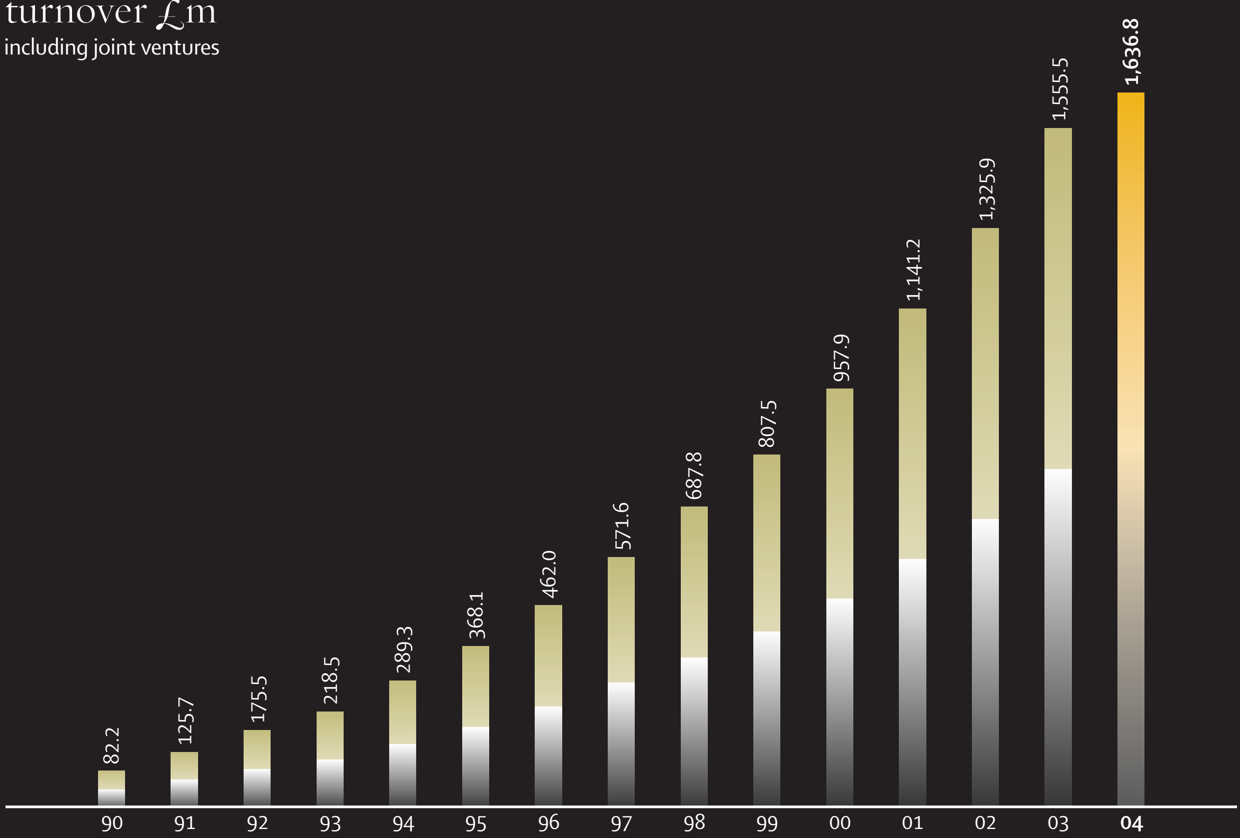
Our cash performance continues to strengthen. Free cash generation increased to £55.8m, compared with £47.0m in 2003. Conversion of Group EBITDA (earnings before interest, tax, depreciation and intangible amortisation) into cash was 95%, ahead of the previous year's 81%. This is a significant achievement in a rapidly growing business.

Dividend

The recommended final dividend of 1.82p per share gives a total for the year of 2.63p – an increase of 12.4% over 2003. It will be paid on 11 May to shareholders on the register on 11 March 2005.

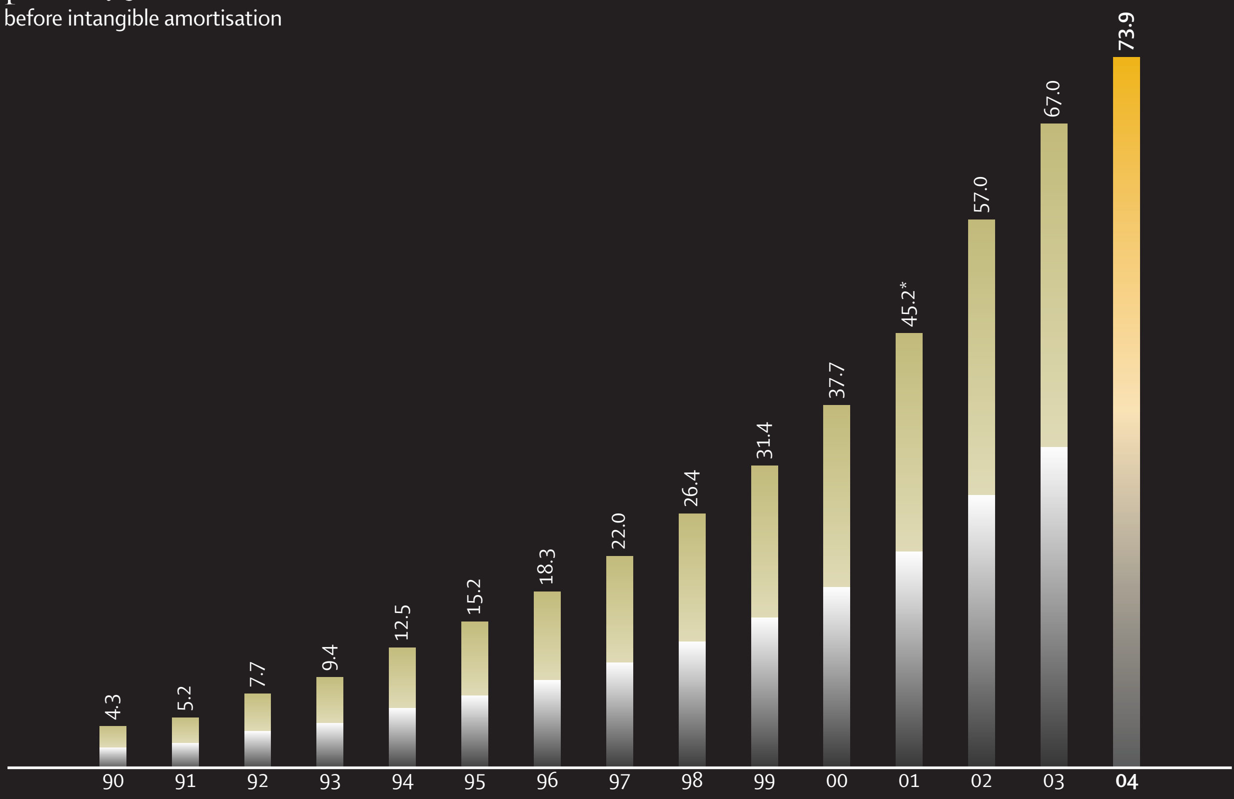
Turnover rose to £1,636.8m, an underlying increase of 14.0%, maintaining our long running track record of growth.

turnover £m
including joint ventures



Profit before tax and amortisation rose 10.3% to £73.9m, and underlying profit before tax, amortisation and 2003 exceptionals, increased by 16.4%.

profit £m
before intangible amortisation



*Restated after the adoption of UITF 34 in 2002

Strategy

Organic growth
Organic growth is Serco's primary strategic aim – and it delivered 82% of our underlying turnover increase in 2004. The majority (61%) came from extending the duration or scope of existing contracts and a further 21% came from new business wins. We aim to leverage the value of every new contract win. By working in partnership with clients and stakeholders to deliver value for money and real service improvements, we create opportunities to broaden and deepen our relationships.

In 2004, for example, we were awarded an extended court escort contract valued at £300m over seven years: double the size of the original contract. We also maintained our 90% success rate in rebids, including our contract to manage the UK's National Physical Laboratory, valued at over £500m, our US$118m air traffic control contract in the US and the £55m contract at RAF Northolt and Uxbridge.

Our strategy is to remain focused on areas with the right scope for growth through service delivery. In line with this strategy, we disposed of a number of smaller asset management contracts in Australia and New Zealand. In the UK, as agreed with Network Rail, we ended our rail maintenance contract for the East Midlands zone in January 2004.

Acquisitions
In tandem with our strong organic growth, we make acquisitions to gain capabilities or market access as a foundation for future organic development.

In the UK, the business transformation and local government outsourcing markets are set to grow by 50% by 2007 and we have sought to increase our present capabilities. The ITNET acquisition strengthens our offering to local government and brings expertise in business process management, an important element in the broader outsourcing contracts that we are increasingly pursuing. ITNET's consulting expertise, through French Thornton, complements our own growing consultancy business, which is helping to stimulate favourable change in our key markets. We also see opportunities to strengthen our service offering to markets such as health, justice, transport and defence, both in the UK and overseas.

The US is the world's largest service contracting market and the announced acquisition of RCI deepens our access to federal government, where demand for outsourced services is accelerating. RCI has strong customer relationships in defence, which accounts for more than 75% of federal spending on services and is an area where we have much to offer. In the North American market, RCI's federal focus complements our existing customer base, which is largely civil agencies, state and local governments. And RCI's significant business process management and IT service capabilities complement our existing change management and service delivery resources.

International strategy

Our international strategy remains clear. As markets develop, we leverage our skills from one geographic market into another. In turn, increased diversity across borders and markets helps reduce risk. In 2004 we continued to transfer skills and capabilities around the globe, notably in defence, aerospace, prison services and road traffic management.

Consistent values

To deliver the service, relationships and growth we aspire to, it is essential to develop and nurture consistent values and principles. Our four governing principles – to foster an entrepreneurial culture, enable our people to excel, deliver our promises, and build trust and respect – are embedded in all our policies and processes.

Operational highlights

Bringing service to life

Around the world, people are experiencing a quality of service from Serco that makes a genuine difference to their lives.

Our rail businesses had a particularly good year in 2004. Merseyrail continued to set new performance standards and the Docklands Light Railway carried record numbers of passengers. In Australia, our iconic train The Ghan also carried record passenger numbers and ran its longest-ever trains on the world's first North-South transcontinental service. In England, with our partner NedRailways, we successfully phased-in the combination of two previously separate operations to launch the new Northern Rail franchise, which is already improving punctuality and modernising ticketing systems.

In other UK markets, pupils in Walsall are receiving significantly improved education thanks to the partnership between Serco's Education Walsall and the borough's council. An official inspection described the improvements as 'spectacular'. The young people in our care at Ashfield Young Offenders Institution near Bristol are receiving significantly improved education and support to reduce reoffending, thanks to a dramatic 15-month turnaround programme praised by the Chief Inspector of Prisons.

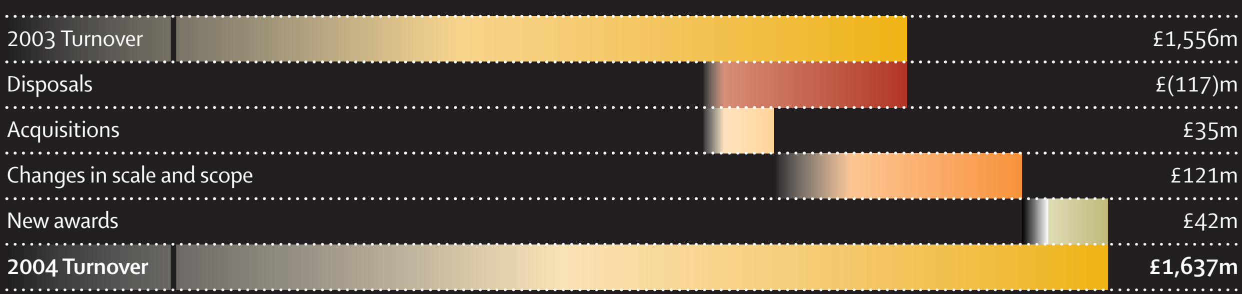
An MoD customer survey rated Serco among the best of its 'key suppliers'.

In the US, our focus on safety and service to pilots was recognised with a second award from the FAA, for which we now operate 54 air traffic control towers.

Organic growth is our primary strategic aim – and it delivered 82% of our underlying turnover increase in 2004. The majority of the increase came from extending the scale and scope of existing contracts.

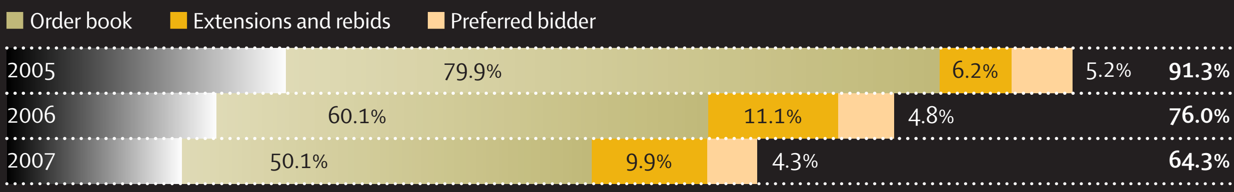
2004 turnover growth

including joint ventures

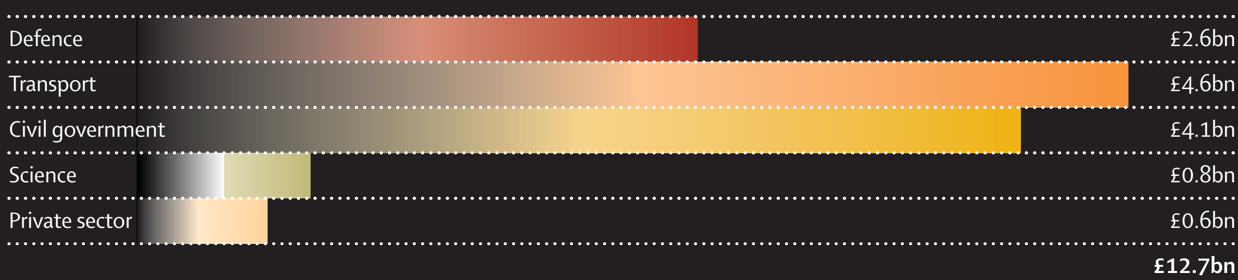


We have maintained our outstanding visibility of earnings. At the year end our forward order book stood at £12.7bn, and we had secured 91% of 2005 planned turnover and 76% for 2006.

percentage of planned revenue secured as at 31 December 2004



global order book breakdown by sector as at 31 December 2004



In Asia Pacific, the first of 12 new patrol boats being supplied by our joint venture was launched. We are also currently installing a traffic information and management system which will benefit commuters on the Shenzhen corridor, linking Hong Kong with mainland China.

Strong start to 2005

While still focused on growing the scope and scale of our existing services, we continue to win a broad range of new work.

In the UK we have signed the £400m Defence Academy Campus Integrator contract, which runs for nearly 24 years, to join the MoD's three existing postgraduate education colleges into an international academic centre of excellence for senior military and civilian personnel. We already manage one of the three colleges on the Defence Academy campus – the Joint Services Command and Staff College.

In the United Arab Emirates (UAE) we have entered into an agreement to form a joint venture to provide facilities management services to the UAE University's new campus in Al Ain for a minimum period of 10 years.

Market development

Our vision to be the leading service company in our chosen markets requires us to be a thought leader, proactively helping to shape the way our markets develop. Serco Government Consulting is bringing our expertise to the leading edge of public policy and service development by contributing strategic and operational expertise across a range of UK government departments. In the past year it has worked with the BBC, Department for Constitutional Affairs, Department for Environment, Food and Rural Affairs, Department of Health, Office of the Deputy Prime Minister and a number of local authorities.

In addition, the Serco Institute researches trends in competition and contracting and is stimulating debate worldwide on how governments can provide better public services.

Corporate responsibility

We are responsible for providing services that are essential to everyday life. For those working at the heart of society, corporate responsibility has to be second nature. At Serco it is. It underpins the culture and values that help distinguish us in our markets and is an explicit part of the Serco Management System that shapes the way we run our business. Our Corporate Assurance Group, which oversees our approach to corporate responsibility, reports directly to the Group Board and takes an integrated view of all aspects of our corporate governance, risk management, health and safety, and social responsibility.

In 2004 our investment in community initiatives totalled £0.8m in cash and in kind, representing 1.4% of pre-tax profit.

Our staff have begun a coordinated effort in 2005 to support the victims of the tsunami that devastated so many lives. In an effort that has united people across the Company in fundraising and volunteering, by mid-February employees had already raised over £70,000 to match Serco's £100,000 donation to the Disasters Emergency Committee. We look forward to reporting progress in this area during the year.

Our second corporate responsibility report has now been published. It explains more about our values and objectives, and details many of our initiatives. It is available both in printed form and on our website at www.serco.com/corporate_responsibility.

Corporate governance
Our commitment to effective governance embraces the whole organisation through the Serco Management System. Group Board members have continued to engage with employees, customers and investors to develop a deep and consistent understanding of our operational and strategic performance and to see at first hand how we are perceived by stakeholders.

In 2004, each Group Board meeting was held at a different Serco location to help Board members maintain their understanding of this rapidly expanding business. In addition, our Senior Independent Director attended meetings with institutional investors and all Board members attended the AGM. For the third successive year, all Directors participated in a formal Board appraisal process and the results and actions were discussed by the full Board. Full details of Serco's governance arrangements are described in the corporate governance report within the Annual Review and Accounts.

Board developments
In March 2004 Iestyn Williams retired as an Executive Director, and in April 2004 Rhidian Jones retired as a Non-Executive Director. Both became Directors of the newly-created Serco in 1987 after the buyout of RCA's UK business. We thank them for their significant contribution, commitment and guidance over the years. In addition to their other Board responsibilities, in April, DeAnne Julius took over the role of Senior Independent Director and David Richardson became Chairman of the Audit Committee. In February 2005 Joanne Roberts was appointed as Company Secretary – succeeding Julia Cavanagh, who has become Finance Director of our Government Services division. We thank Julia for her contribution over six years as Company Secretary.

Executive team developments
In light of our two acquisitions we have reorganised and expanded our executive team, which reports to the Group Board for Serco's direction, organisation, performance and governance.

Two members of our executive team have taken on additional responsibilities. Strategic Projects Director, Ian Downie, has become Chief Executive of the ITNET business. And Chief Development Officer, Steve Cuthill, has relocated to the US to become Chairman of Serco North America and take responsibility for integrating the RCI acquisition once it has been completed.

In addition, we have strengthened the executive team with Grant Rumbles, formerly Chief Executive of Serco Continental Europe & Middle East, as Group Operations Director; Clive Barton, formerly Chief Operating Officer of Serco Solutions, as Group Marketing Director; and Bridget Blow, formerly ITNET Chief Executive, as Group Technology Director.

Outlook
Across the world, governments and commercial organisations are increasingly seeking to deliver better services and gain greater value for money.

In the past year we have taken important steps towards our vision: to be the leading service company in our chosen markets. Our service delivery record and customer relationships help maintain and grow our business base. The acquisitions of ITNET and RCI strengthen our position in key markets and our major contract wins provide further scope for development. With our management further strengthened we believe that we have a better platform than ever for delivering continued strong growth.

business review

Christopher Hyman Chief Executive

"The year's excellent performance was founded on the passion, commitment and drive that we share throughout the business. The passion for quality and value in service delivery, the commitment to partnership with our customers in achieving constant improvement, and the drive to make it happen. Put those together and you get satisfied customers who want you to do more for them – that's how we keep generating strong organic growth, year after year."

Civil government

Market developments

The expanding civil government sector has become our largest market, accounting for 33% of sales during the year.

The UK government's choice and e-government agendas are fuelling growth and the Gershon Efficiency Review has increased the pressure on central and local government to reduce costs while improving public services.

Elsewhere in Europe, the German federal government is setting the pace in public private partnership and has let a growing number of defence outsourcing contracts. At a regional level private sector opportunities are emerging in German prisons and schools, and we anticipate the first PFIs will be announced this year.

In North America, the world's largest service contracting market, we see both federal and state governments working to reform public services in the face of substantial budget deficits. The US government aims to increase competitive sourcing at the federal level – where we have already won an early contract with the US Department of Agriculture – and increase focus on human capital management in all federal agencies.

Overall, major opportunities are emerging in home affairs, education and health, where the use of private sector support is relatively new.

Home affairs: organic growth supported by strong service delivery

Our work in this sector ranges from managing prisons and court escort services to operating electronic monitoring services, developing intelligence systems for the police and criminal intelligence agencies, and providing road safety equipment.

We achieved strong organic growth in this rapidly developing sector, where the UK Home Office's search for increasingly integrated solutions is creating attractive opportunities. Our Premier Custodial Group (PCG) business has now merged with the Serco Justice division to form a new Serco Home Affairs division, which will be better placed to extend our capabilities in the UK market and address the opportunities that are emerging overseas.

Since we took full ownership in 2003, PCG has expanded strongly. It is the only organisation providing services to all five UK Home Office markets: electronic monitoring, prisons, immigration, secure training centres, and prison escort and custody services.

In May PCG won a seven-year, £300m contract that increases our escort and custody services responsibilities to cover 25% of the England and Wales market. PCG also successfully renewed a contract to provide electronic monitoring of offenders, effectively maintaining its share of the market with a contract covering two of the five England and Wales regions. This is a volume related contract with significant growth potential.

In August PCG opened the 326-bed Colnbrook Immigration Removal Centre and Short Term Holding Facility near Heathrow Airport as planned and on budget. The scope of our business at the centre has already broadened and this year we expect to provide custody services to HM Customs & Excise (HMC&E). This will be the first time the private sector has provided HMC&E with such operational services. We also expanded the capacity of our Dungavel Immigration Removal Centre in Scotland.

Some 70% of prisoners reoffend within three years. A key aim is to educate, train and equip prisoners to lead normal lives and so reduce reoffending. At Doncaster prison we have opened a new community resettlement suite which helps the people in our care look for work, housing and training before release.

The Chief Inspector of Prisons commended our turnaround of Ashfield Young Offenders Institution (YOI) – now under our sole management – since a critical assessment in 2002. Ashfield was originally intended for both juveniles and young offenders. In 2004 we began reconfiguring it for juveniles only: we introduced more classrooms and educators and are now adding a resource centre and drug awareness facilities.

Chief Inspector Anne Owers praised the Ashfield team for the 'concentrated and hard work… needed to pull the establishment up so far and so fast' and looking 'beyond the fine print of the contract'. She also praised our management of Lowdham Grange prison after an unannounced inspection in March 2004. And she commended Dovegate prison's Therapeutic Community, the only privately run unit of its kind, for its 'significant achievement' in dealing with troubled and dangerous prisoners.

PCG won three Butler Trust Awards in 2004. The Special Educational Needs team at Ashfield YOI won the Pilgrim Trust Award for work with young offenders. HMP Dovegate's Islamic Minister, Sheik Mohammed Hanif Khan, received an award for his work both inside the prison and with the local community. And Stephen Sanderson won an award for his commitment to prisoners with mobility problems. Our five prison contracts were successfully audited by the British Safety Council (BSC), with four receiving a Five Star rating and two the British Sword of Honour, the highest recognition available in this field. Ashfield Young Offenders Institution and Lowdham Grange prison also received BSC National Safety Awards.

In June 2004 we began work on a new secure communications and information infrastructure for the UK's Immigration and Nationality Directorate, under the Mycroft programme. By the end of March 2005 we will have trained almost 700 users. The number of users will rise to 2,000 during the five-year, £40m contract. The core technology is adapted from a system we developed for the National Crime Squad. We anticipate further opportunities in this market.

Overall the UK government is investing heavily in national security, fighting crime and reducing reoffending. We expect the market available to us to double over the next five years.

We are also broadening our home affairs activities internationally. Germany is seeking to improve its prison services with the support of private suppliers. Serco won the country's first major prison contract, at Hünfeld in Hessen. Valued at £3.5m a year for six years, it covers all non-custodial services including psychological, medical and educational care, rehabilitation, catering and facilities management. The 502-capacity prison opens at the end of 2005.

In Italy we began a nine-year contract to supply electronic monitoring equipment and support services for up to 40% of the country, after running a successful pilot. We are also supplying equipment and support to the West Australian Department of Corrections at its Wooroloo Prison Farm to securely monitor up to 250 prisoners. We expect further international tagging opportunities this year and are trialling next-generation equipment which uses satellite positioning.

Education: improving results

Serco provides a range of integrated services to improve children's education. Teachers' professional development, head teachers' management systems and pupils' learning are all supported through a range of change management and technology-driven services.

The UK government's Building Schools for the Future (BSF) programme will deliver some £60bn of capital investment over the next 15 years to rebuild or refurbish 3,500 schools. We believe we are well placed to support educationalists and children through this programme with our schools software, educational management experience and broader IT and facilities management offers. The BSF pathfinder programme has begun and we are bidding on early opportunities.

The major achievement of 2004 was a glowing report from the Office for Standards in Education (Ofsted) on our performance in Walsall. Serco took over management of all aspects of educational services to Walsall's 130 schools at the end of 2002 after an inspection report had condemned overall performance as 'very poor'. Less than two years on, Ofsted found performance had been 'transformed'. The report declared education services in Walsall to be 'highly satisfactory' and praised the Education Walsall team for delivering 'good progress in a short time'.

Credit for the fastest educational turnaround on record is due to the passionate commitment of our team, and a highly effective partnership with Walsall Council's Chief Executive, her strategic board and the councillors. Over the past school year all school inspections have been successful.

In defence, as in more and more of our markets, the trend is towards larger contracts integrating multiple activities. This gives us major opportunities for organic growth.

Our new Naval Air Command multi-activity contract, for example, is substantially broader than the one it replaces. As well as operating Heron Flight for senior officers and VIPs, we're now responsible for the Fleet Requirements Air Direction Unit. Operating Hawk aircraft, we provide realistic threat simulations to enhance training for Royal Navy ships and aircraft.

In Australia, we have an innovative contract to supply 12 defence patrol boats for the Royal Australian Navy. We're managing design and construction of the vessels, adapting a high-speed civil design. And we'll provide through-life support, including crew training, for 15 years. The first vessel, *HMAS Armadale,* was launched in January 2005.

Our education contract in Bradford is also making progress. Attendance and attainment are improving at well above national average rates. Overall attendance in Bradford schools is the best ever and truancy rates are significantly lower. Fewer children are being permanently excluded from school.

We are committed to making further improvements to education in both Bradford and Walsall. With support from our local authority clients, head teachers and the Department of Education, we will be able to sustain progress.

In Germany we began our first schools facilities management contract, with the state of Nordrhein Westphalia. The 25-year contract, valued at €35m, covers a group of schools in Monheim. We are now bidding for more contracts in this field.

Health
Health is an emerging market for Serco. We already provide wide-ranging non-clinical support services to health customers in Europe and Asia Pacific, and our strategic healthcare consultancy develops ways of modernising the care process. In all our markets we make innovative use of IT and technology to help improve services.

In the UK we currently operate hospital services contracts at Wishaw in Scotland, Leicester Royal Infirmary and Norfolk & Norwich University Hospital.

Our strategic health and social care consultancy has won major new contracts, notably to evaluate the effectiveness of a Department of Health initiative to reduce patient waiting times. This year it has moved into new areas, such as supporting NHS Trusts and consortia implementing the National Programme for IT. It has continued to enhance its reputation in healthcare planning, and is working on several major capital schemes to redevelop acute and community hospitals.

Regional and local government services: deepening relationships
Our local government services business helps improve the essential services we all use. As a result, millions of people are enjoying a quality of service that makes a difference to their daily lives.

In 2004 we successfully delivered two major phases in Wiltshire County Council's business process re-engineering programme, which will improve customer service and reduce cost. In addition, our support to the council contributed to its recently improved Comprehensive Performance Assessment score, published by the government to help residents compare their council with others.

We also strengthened a decade of partnership with Canterbury City Council, with a new seven-year housing maintenance contract valued at £20m.

In November we signed a new environmental services contract with Breckland District Council in Norfolk. Valued at £30m over 10 years, it includes an innovative operating model that integrates streetscene and environmental services teams.

Over the year we won three of the four leisure centre management contracts offered by UK local councils, bringing the number of UK centres under Serco management to 63.

In Canada, our Ontario Driver Examination Services concession has already delivered the promised improvements in customer satisfaction and service availability, and our customer has broadened the scope of the service we provide. The rapid success of the operation has earned Serco a high profile in Canada, where we are seen as a leader and innovator in public services. The Ontario Ministry of Transportation and Serco have jointly been presented with the Canadian Public Private Partnerships Council's Gold Award for service delivery in the large business category. Also in Ontario, the Serco-managed Ray Friel Recreation Centre was voted employer of the year in the local business awards.

Other government services: growth in US and Middle East
New US federal government guidelines are encouraging competitive sourcing of public services. In 2004 the Department of Agriculture Forest Service awarded us a five-year contract valued at US$30m to maintain over 4,500 vehicles in 18 national forests throughout California. This gives us valuable experience for future opportunities at federal government level. When completed, our acquisition of RCI will provide an enhanced platform from which to leverage Serco's global capabilities in defence, integrated transport and homeland security.

Our Middle East profile is rising considerably and we have opened a new office in Dubai. Our Serco Gulf joint venture with local partners Istithmar won a facilities management consultancy contract to help design the services for Palm Island. This is a strategically important role in a venture with worldwide visibility. Serco Gulf is now also providing facilities management services on the large Gardens residential complex.

The United Arab Emirates University is planning to develop (through a PPP structure) a new 19,000-student university complex in Al Ain in 2010. Serco Middle East has entered into an agreement to form a joint venture to provide facilities management and operational services for the project for a minimum period of 10 years. Our JV partner for this project is Mubadala Development Company owned by the Abu Dhabi government.

Government consultancy: shaping future services
Serco Government Consulting (SGC), our management consulting business, has grown rapidly and profitably since its formation in 2003. In 2004, it achieved revenues of £4.5m and grew to 40 consultants. Its successful consulting assignments for central government departments are helping build Serco's reputation with senior decision makers across government.

Our strength in light rail is well established through the Docklands Light Railway, Manchester Metrolink and Copenhagen Metro. Now we're building an equally strong reputation in heavy rail.

Our new Northern Rail franchise brings together two previous operations. Together, they make a 475-station rural and inter-urban network serving passengers across the north of England. With our partner NedRailways we've already improved services on Merseyrail, our first heavy rail franchise. We aim to bring similar benefits to Northern's passengers, with the help of its 4,600 employees.

It's been a record-breaking year for our Great Southern Railway business in Australia. Record passenger numbers, record bookings, record profits. Australia's longest-ever train. And the world's first North-South transcontinental rail service. All thanks to the new Alice Springs-Darwin link, which extended The Ghan service to run coast to coast. Once a loss-making state-run business, the railway is now a booming worldwide tourist attraction – and a source of pride for Australians.

SGC is developing a reputation for addressing complex client issues by combining the skills of experienced consultants with the lessons learnt from Serco's operations. Its assignments range from operational performance improvement to the delivery of complex programmes such as New Dimension, which is strengthening the resilience of the UK emergency services to terrorist and other threats.

Transport

Market overview

A track record of improved service to road and rail users has supported strong growth over recent years in the transport sector, which now accounts for 22% of turnover.

We are a UK leader in the light rail market and are exploring further opportunities in the UK and internationally. We expect to see more growth as new schemes are approved. In the heavy rail market we have moved out of infrastructure management and maintenance to focus on passenger service operations. We have won two franchises since early 2003 and will pursue further franchises that fit with our risk profile.

From our position as UK leader in traffic management systems we are successfully applying our technology in the US, Sweden, Hong Kong and Australia. We are also pursuing opportunities in road pricing, which is forecast to develop into a major worldwide market in the next 10 years.

We have a strong position in aeronautical services, including air traffic control and airport services, in the Middle East – where we are market leader – the US and South Africa. We aim to continue building on this base.

Rail: reliability rewarded with record contract

In 2004 our heavy rail business took a major step forward with the signing of the Northern Rail franchise, with our partner NedRailways. This is our largest-ever contract, valued at around £2bn to us over eight years and nine months.

Northern provides passengers across the north of England with inter-urban commuter and rural services via 475 stations and a large fleet of diesel and electric multiple trains. Operations involving 4,600 employees began in December. The contract will be earnings and cash positive from this year.

Our success in winning this contract was undoubtedly helped by our proven performance on Merseyrail, Manchester Metrolink and London's Docklands Light Railway.

Merseyrail's train passengers are enjoying even more reliable and punctual trains. The employees and management have achieved record reliability and punctuality levels –

measured at 95%, compared to 91.5% in 2002/03 before we took over. The national average is 83.5%.

Docklands Light Railway continues to be the UK benchmark for light rail operations. In 2004 it set records for passenger numbers and won its fifth consecutive National Rail Award. Passenger numbers and revenue will increase further this year with the opening of the extension to London City Airport – soon to be followed by the extension to Woolwich. We are currently rebidding the contract, which expires in March 2006.

In Australia, our Great Southern Railway business continues to break booking and profit records on its iconic transcontinental services.

In 2004 the Alice Springs-Darwin link was opened, enabling The Ghan to run Australia's first coast to coast North-South service. The 48-carriage inaugural train measured over 1.1km in length. Forward bookings are strong and we continue to increase capacity to meet demand.

Road: growing from Birmingham to China
Drivers on motorways in England are now receiving better traffic information thanks to the team at the National Traffic Control Centre, located on the M5 near Birmingham. The centre uses CCTV cameras, automatic number plate recognition cameras and induction loops to monitor traffic. Information on congestion and incidents is then communicated through roadside message signs, an interactive website and telephone service, as well as being supplied to the broadcast media and other data providers. Services began in November 2003. Real-time traffic information is now available online at www.trafficengland.com.

We have started another contract with the Highways Agency to design, supply and operate the Electronic Service Delivery for Abnormal Loads portal (ESDAL). This will provide a seamless link between hauliers, police, owners of structures such as bridges, and the Highways Agency for the request, planning and notification of abnormal load movements by road throughout the UK.

The Highways Agency is simplifying its purchasing of road maintenance services by engaging single contractors to oversee the management and maintenance of motorways and trunk roads in a given area. We are a strategic partner of InterRoute, a joint venture between RCS, part of Balfour Beatty, and Mott MacDonald, to provide the maintenance of all the traffic control and information technology. InterRoute was awarded the South West contract in December 2004. The five-year contract, valued at around £7.5m to Serco, begins in July 2005.

In Hong Kong we are applying technology proven in Scotland, Sweden and Australia to provide the traffic control and surveillance system for a massive new road and bridge

Traffic management technology travels well. Today we're taking skills we've honed in Scotland, Stockholm and Sydney and applying them across England and to Hong Kong's new link with mainland China.

Want to know about traffic conditions on England's motorways and trunk roads? Go to the Traffic England website at www.trafficengland.com or the interactive telephone service available soon on 0870 066 0115. You'll find live traffic information and forecasts, updates on roadworks – and you can even read any roadside message display on the network. It's all part of the service to drivers from the National Traffic Control Centre we're creating for the Highways Agency.

We're bringing world-class technology to a massive new road and bridge project linking Hong Kong with mainland China. With its 5km bridge, the Hong Kong-Shenzhen Western Corridor, Deep Bay Link and Yuen Long Highway will be a powerful symbol of Hong Kong's relationship with the mainland. Our job will be to keep the traffic moving, with a state of the art traffic control and surveillance system.

project. The Hong Kong-Shenzhen Western Corridor, Deep Bay Link and Yuen Long Highway will form a strategic route linking Hong Kong and mainland China, including a 5km bridge. This is the first major project that takes us onto the Chinese mainland and has involved significant collaboration between local Serco staff, who know the language and culture, and our UK-based technical specialists.

Air: safe services land more renewals
Our reputation for providing safe and reliable aeronautical and aviation services supported several successful rebids worldwide.

The US Federal Aviation Administration (FAA) reappointed Serco to run air traffic control (ATC) towers across the Western United States and Alaska. This is our third successful bid for this five year, US$118m contract. Serco-run towers have won the FAA's prestigious Willie F. Card Contract Service Award, which recognises excellence in safety and customer service, in both years since its launch. Four facilities received the 'None in a Million' award for handling a million aircraft operations without a single error.

Our contracts at Abu Dhabi and Al Ain airports have been renewed, ensuring we remain the Middle East's leading provider of ATC and other airport technical services. Abu Dhabi airport is planning extensive developments over the life of the contract, including an additional terminal and runway.

In mainland Europe we successfully rebid our contract to manage the flight information display systems at Brussels Airport for up to a further five years.

Defence

Market overview
Our defence business enjoyed its best-ever year in 2004, with overall growth of some 20% driven largely by expansion of existing contracts and rebids that broadened the scale and scope of contracts. The defence sector accounted for 30% of 2004 sales.

In the UK we are a leading supplier to the Ministry of Defence (MoD). We have a well-balanced portfolio of over 120 large, medium and small contracts across 110 locations, giving us an 8.5% market share. Despite tight budgetary pressures, we estimate the accessible MoD market will more than double by 2010.

Overseas, we are witnessing increased use of private service companies to support defence activities. We have a growing relationship with the German Ministry of Defence, for example. Completion of the RCI acquisition will give us a strong position with the US Department of Defense, which accounts for some 75% of US government spending on outsourced services.

Our strategy is to retain and expand our existing business, leveraging our capabilities into new but related areas and selected major bid opportunities, both in the UK and internationally. We will continue to target four main areas: equipment support, facilities and infrastructure management, training, and communications information systems – where Serco's IT expertise gives us considerable credibility.

An MoD customer survey rated Serco among the best of its 'key suppliers'.

UK: service and value win strong organic growth
Our RAF Northolt and Uxbridge contracts are good examples of our approach to organic growth – building broader and deeper customer relationships by delivering service and value. These contracts have been renewed and combined into a £55m multi-activity contract (MAC) running for nearly six years. RAF Northolt includes responsibility for maintaining and supporting No 32 (The Royal) Squadron whose tasks include Royal, VVIP and VIP flying. It complements the £39m Naval Air Command MAC successfully phased-in during 2004, which includes operating Heron Flight for senior officer and VIP flying.

July saw the passing-out ceremony for the first pilots trained under our MAC at RAF Cranwell, the RAF's premier officer training station. Under the £60m contract we provided seven King Air B200 training aircraft through an innovative arrangement that enabled us to introduce a new, modern aircraft for pilot training in a few months rather than years.

In a year when we presented our first 40-year staff long-service award at RAF Fylingdales, we were pleased to become the site's only contractor to win 10 successive rebids. In fact, we won two contracts. The first, valued at £31m over eight years, involves the operation, maintenance and repair of the Solid State Phased Array Radar and associated hardware including programme design and maintenance. The second, valued at £14m over two and a half years, provides support services for the UK Air Surveillance and Control System which ensures the integrity of UK airspace.

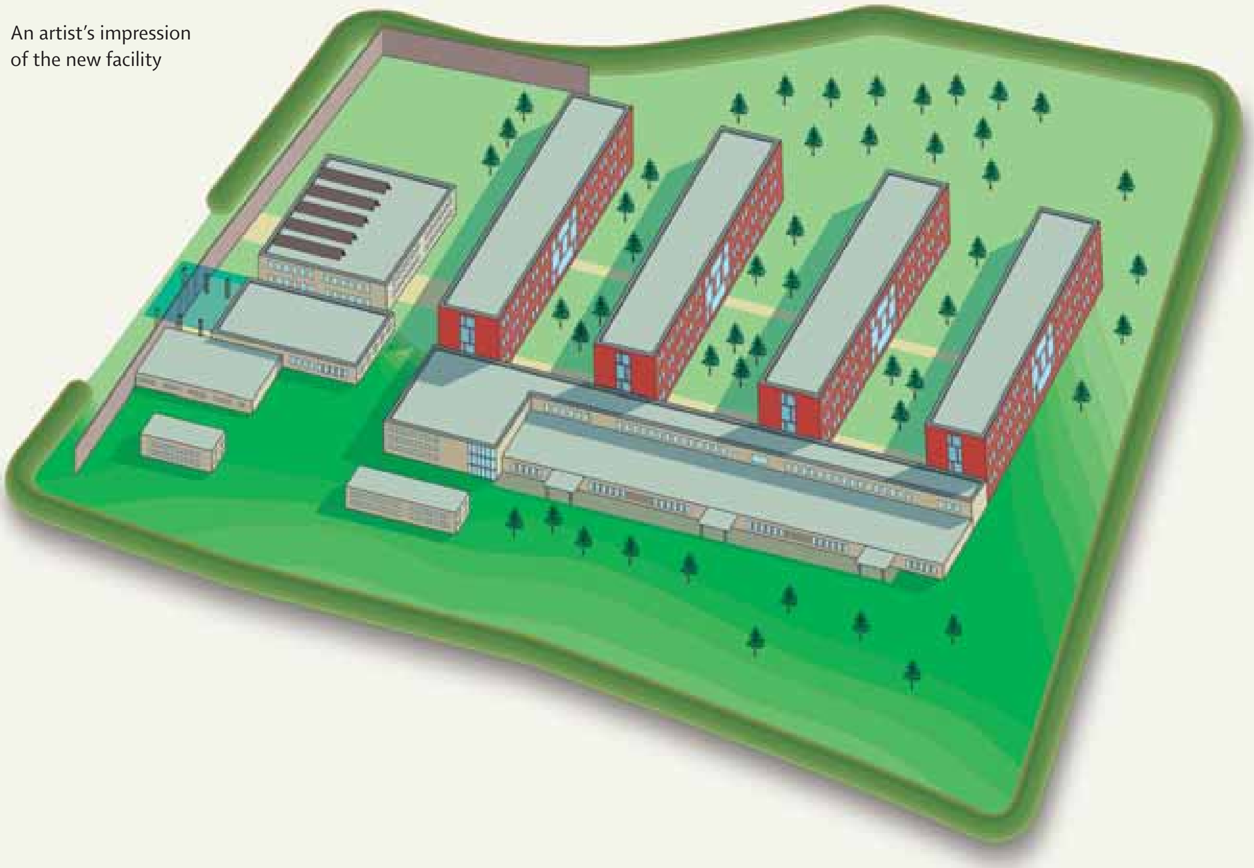
The Defence Logistics Organisation is changing the way it procures whole-life capability support, requiring manufacturers to become prime contractors for integrated operational support for the equipment they supply. This is proving advantageous for Serco. We have formed an alliance with AgustaWestland to provide integrated operational support for helicopters – achieving organic growth that complements the contracts we hold directly with the Navy and Army. We have signed a similar deal with Rolls-Royce to support aero engines and see such alliances with manufacturers as a source of future growth.

We won and delivered a contract to supply a Action Speed Tactical Trainer for the Royal Navy as part of the Warspite Project launched by Commander-in-Chief Fleet – in effect a complete naval warfare simulation package. This includes simulators for 10 ships and a fleet control room, with a command and control system for the war game controllers.

It's a tough business – and also a politically sensitive one. The rapid growth of our custodial service reflects the care and responsibility we bring to it.

In August 2004 we opened the 326-bed Colnbrook Immigration Removal Centre and Short Term Holding Facility near Heathrow Airport as planned and on budget. The scope of our business at the centre has already broadened and this year we expect to provide custody services to HM Customs & Excise (HMC&E). This will be the first time the private sector has provided HMC&E with such operational services. We also expanded the capacity of our Dungavaal Immigration Removal Centre in Scotland.

An artist's impression of the new facility



Last year we won Germany's first major outsourced prison services contract. German law prohibits private companies from providing prison warders. But we're delivering all the non-custodial services at the new 502-capacity Hünfeld Prison, which opens in late 2005. As well as catering and facilities management, these include psychological, medical and educational care, and rehabilitation.

Additionally, the Second Sea Lord opened the Waterfront Training and Education Centre for which we supplied the systems and operational support for the Royal Navy at Devonport. This demonstrated technology for reconfigurable 'smart' classrooms that can be used for a range of maritime warfare operator skills training and simulation at the quayside in any port area.

Early in 2005 we secured one of our largest-ever defence wins. The £400m Defence Academy Campus Integrator contract runs for almost 24 years. We have begun working with the MoD to integrate its three existing postgraduate colleges to create an international academic centre of excellence for senior military and civilian personnel. We already manage the Joint Services Command and Staff College, one of the three colleges on the Defence Academy site.

In the UK the services market continues to expand and we see more opportunities than we can deal with, so we will continue to be selective in our investment and bidding.

International: growing through technology and innovation
In January 2004 we began our contract at the German Army's Combat Training Centre (GÜZ) to provide technical support services for simulated battle training. This is one of the German Defence Authority's first total service outsourcing contracts and feedback to date from the German Ministry of Defence is very positive. The German armed forces are increasing their outsourcing of non-core support services and we are building on our existing good relationships.

In Australia our Defence Marine Services (DMS) joint venture with P&O has launched the first of the 12 defence patrol boats that it is building for the Royal Australian Navy. The innovative 15-year, A$500m contract uses a 56-metre commercial vessel design adapted for military use and encompasses through-life support including crew training. Following the launch, in January 2005, DMS was named as preferred bidder to supply eight patrol boats for Australian Customs.

In February 2004 we were appointed preferred bidder – with our local partner, the Bahwan Group – to build and operate a joint technical training college for the Oman Ministry of Defence. The college will train 2,000 students a year. The 30-year contract is the Middle East's first PFI and we expect to sign it in 2005.

Science

Market overview
Serco aims to be recognised as the leading private sector partner for the management of scientific organisations, programmes and consulting. We are already a UK market leader in the management of government scientific establishments and have a long-

standing relationship with the European Space Agency. Science contracts accounted for 7% of our 2004 sales.

In the UK alone we expect the accessible market to double by 2008. UK Regional Development Agencies have a growing role in developing innovation and technology centres and the UK's Nuclear Decommissioning Authority is being established to supervise the dismantling of redundant nuclear installations. Serco has excellent credentials for opportunities in these areas.

Business highlights: improving the quality of life

The year's most important development was the successful rebid of our contract to manage the UK's world-class National Physical Laboratory (NPL). The new contract, finalised in March 2004, is valued at a minimum of £500m over 10 years.

We are now implementing the new strategy we put forward for NPL, focused on applying scientific excellence to achieve positive economic and social benefits. We are supporting the Department of Trade and Industry's innovation strategy with a range of new science programmes – particularly in emerging technologies such as biotechnology and nanotechnology – and knowledge transfer to encourage commercial application.

The laboratory's world-leading new facilities are enabling us to carry out work that was previously impossible. For example, we are working on ever more precise atomic clocks, which could enhance systems ranging from electricity grids to global positioning satellites and the internet. We are also improving the accuracy of brachytherapy radiation treatment for a wide range of cancers including prostate, breast and lung cancer. Such projects promise improvements in the quality of life as well as benefits for the UK economy.

The laboratory is strengthening its international position and has been selected to lead a £3m European Commission project to promote co-operation in measurement science across Europe.

The new facilities at Teddington were being designed and built by John Laing Construction under a contract from a Laing/Serco PFI joint venture. After the construction company experienced financial difficulties, we acquired Laing's investment in the project and have been working with the Department of Trade and Industry (DTI) to complete the new facility. We have now agreed to end the PFI and transfer the completed building to the DTI, allowing it to complete the fit-out of certain laboratories. This mutually satisfactory arrangement does not affect our science management contract.

In 2004 Serco Assurance successfully rebid a contract to provide independent nuclear safety assessment and advice to the Royal Navy. This £50m, five-year contract includes responsibility for advising the MoD on the nuclear safety of each submarine in the UK fleet.

Our experience in air traffic control goes back half a century. But this is one job where what matters is your performance right now – every minute of every day.

A British company directing aircraft in US airspace? It's been daily routine in the western US for a decade. The Federal Aviation Administration now entrusts 54 air traffic control towers to our care. With good reason – we've held its national Contract Service Award, for safety and service, since its inception two years ago. Four of our facilities have received the 'None in a Million' award for handling a million aircraft operations without a single error. And in 2004 the FAA renewed our contract for a further five years.

Our relationship with Abu Dhabi airport was established long before the present international airport opened in 1982 – and our operation there has grown with it. Now the airport is planning further extensive developments including an additional terminal and runway. As the Middle East's leading provider of ATC and airport technical services, we're very much part of its plans. It's just awarded us a five-year contract in place of the previous three-year terms – and for the first time we'll be able to employ our local staff directly rather than through the government.

We are part of the successful SDC Alliance, which has won a major contract to provide one-stop engineering services to BNFL at Sellafield. This contract has potential to generate sales for Serco of more than £2m a year.

As part of its diversification strategy, Serco Assurance is playing a growing role in national security, working together with Serco Government Consulting on the UK's New Dimension project. It has also recently completed the assessment phase of the MoD's Integrated Sensor Management System. This is an intelligent network of sensors that can be placed around a field installation to detect chemical, biological or radiological attack. We have successfully applied innovative technology which is easily transferable to the civil sector and should secure a market leading position.

We continue to manage communications for the UK government's Envirowise programme, which promotes environmentally sound practice to businesses. The government has committed additional funding for this and other environmental projects from 2005.

In continental Europe we won extensions to two of our contracts with the European Space Agency. In Germany we won a six-year extension to our Eumetsat spacecraft operations contract and in Italy we were awarded an 18-month extension to our IT support services contract.

We have a growing presence at the Geneva-based CERN particle accelerator laboratory. In 2004 we won a new IT contract to provide desktop support services for 4,400 users. We now have some 160 IT and engineering staff at CERN, contributing to its ambitious goal to build the world's largest scientific instrument and its computing infrastructure.

Private sector

Market overview
We address new business opportunities in the private sector selectively and opportunistically. In 2004 the private sector accounted for 8% of sales – this is set to increase with the addition of ITNET's commercial business.

Business highlights: multi-tasking for Microsoft
In France we renewed our facilities management contract covering Oracle's Paris headquarters and seven other sites. We have provided this service since 1998.

In Ireland we have broadened our role with Microsoft. As well as providing facilities management we now operate a Shared Services Centre for Microsoft subsidiaries in 11 European countries. The initial one-year contract has an option to extend for three years. We also added a further contract to provide document administration for licensing agreements in Europe, the Middle East and Africa – a critical service previously run from the US.

We also successfully rebid our contract to maintain 79 properties for The Boots Company across Ireland for a further three years.

In the US we further strengthened our position in the utilities market. PECO Energy, a natural gas and electricity utility in Pennsylvania, awarded us a fleet management contract to support over 10 sites involving some 1,500 vehicles.

Acquisitions

Gaining skills and capabilities for expanding markets
Our people are experts at growing their business organically. By delivering high quality services they strengthen client relationships, expand existing contracts and win new ones. More than 80% of our 2004 underlying turnover growth came from renewing or extending existing contracts and winning new business.

We therefore make acquisitions to gain capabilities or market access as a foundation for organic growth.

The UK's business transformation and local government outsourcing markets are set to increase by 50% by 2007. Serco provides a range of these services under several of our contracts, but we needed to increase our capabilities. The acquisition of ITNET, completed in February 2005, significantly enhances our ability to compete for larger and higher value contracts.

ITNET has a strong reputation among local authorities for IT services and business process outsourcing, and its consulting expertise complements our own growing consultancy business. Half of ITNET's business is with local government and around 60% of 2003 sales came from the public sector.

ITNET will immediately enhance our technology and business process offering to the UK market. And our established presence in defence, transport and the justice markets will expand ITNET's addressable market.

The US is the world's largest service contracting market and the announced acquisition of RCI, with its enhanced technology capabilities and strong customer relationships, will increase our competitive position in this market.

Completion of the transaction in March will enhance our position in the US defence market – and beyond. By joining RCI's systems integration capabilities with Serco's partnering and service delivery experience, we will be well positioned to take advantage of emerging opportunities throughout North America.

Turning around a failing education authority is a huge responsibility. All those pupils can't wait for you to get results – it's their future that's on the line.

We took over management of Walsall's 130 schools after the regulator, Ofsted, had found the local education authority to be 'failing'. Less than two years later, Ofsted has found performance 'transformed' to 'highly satisfactory'.

It's a good demonstration of Serco's ability to get the best out of people – but we couldn't have done it on our own. The passionate commitment of our team was matched by a highly effective partnership with Walsall Council, elected members, the Chief Executive and her executive management team – and a tremendous response from dedicated teachers and head teachers. With their support, there's still plenty more we can achieve for the children of Walsall.

RCI's primary market is the Department of Defense. Half of the company's business is with the US Navy and a third is with the Army – two sectors where we have complementary experience around the world. We see scope for applying our air force support experience to open up opportunities for RCI with the US Air Force. We also expect, over time, to be able to apply RCI's capabilities in human resources management, systems engineering, IT, supply chain management and strategic consulting to customers in state and local government, the utilities industry and even outside North America.

Like Serco, ITNET and RCI have a record of contract renewal and achieving growth through long term customer relationships.

People

Training and development
Commitment to lifelong learning is a central part of our culture. Our groundbreaking training scheme with the Institute of Directors is now well established. So far nearly 80 directors and senior managers have achieved the IoD Serco Certificate in Company Direction and over 30 have achieved the Diploma. During the year we introduced a Europe-based module to broaden the programme's reach across the Group and 11 non-UK based managers passed either the Certificate or Diploma.

Our broader leadership development programme aims to fast-track development leadership and management skills in key people. By the end of 2004, 43 had joined or completed the programme and a further 15 are expected to join in 2005. Over 70 people are completing a programme focused on programme and project management skills and a further 180 will follow them this year.

We aim for continuous improvement in the courses themselves, and have reviewed and refreshed all open programme workshops managed by the Serco Best Practice Centre. In addition to these Group initiatives, training and development requirements are managed locally and each contract manager is required to develop and implement a training plan.

We see employee volunteering on community initiatives as a valuable tool, helping to develop people both professionally and personally. In September 2004 we launched Enabling People to Excel, a Group-wide initiative to encourage employee volunteering.

In the UK, we also launched Skills for You, a drive to provide basic skills training – in English, literacy and numeracy – to everyone in Serco who needs it. We believe there are perhaps as many as 4,000 people in the Company who would benefit. The scheme, which has strong union backing, offers assessments for all staff and provides basic skills and essential IT courses, with the opportunity to progress to National Vocational Qualifications.

finance review

Andrew Jenner Finance Director

"2004 was another strong year for Serco. We delivered good growth in underlying turnover, and profit was also well ahead of 2003. The increase in free cash flow was particularly pleasing, building on the improvement in the previous year, and reflects our continued focus on this important measure."

1. Financial performance

Analysis of the Group's financial performance in 2004 is shown in Figure 1.

1.1 Turnover

Total turnover for the year to 31 December 2004 increased by 5.2% to £1,636.8m. After adjusting for the effect of disposals and contracts exited (see 6.1 Disposals), turnover grew by 14.0%.

Turnover for 2004 includes an incremental contribution of £35m from Premier Custodial Group (PCG) following the acquisition of the remaining 50% in July 2003. From this date the results of PCG have been included in Group turnover.

Gross margin on Group turnover, representing the average contract margin across the portfolio, has increased to 13.8% (2003 – 13.7%).

1.2 Exceptional items

There were no exceptional items in 2004. During 2003 there were three exceptional items resulting in a net profit of £3.6m.

1.3 Profit before tax

Profit before tax and intangible amortisation increased by 10.3% to £73.9m, representing a net margin on turnover of 4.5% (2003 – 4.3%). Profit before tax, intangible amortisation and the contribution from exceptional items in 2003 grew by 16.4%.

Profit before tax and after intangible amortisation increased by 8.6% to £57.4m.

1.4 Intangible amortisation

Intangible amortisation, arising primarily from goodwill, was £16.5m in 2004 (2003 – £14.1m). The increase results largely from the acquisitions of the remaining 50% of PCG in July 2003 and the Ontario Driver Examination Services (DES) franchise which commenced operation in September 2003.

1.5 Tax

The tax charge of £20.4m (2003 – £19.1m) represents an effective rate of 35.5% (2003 – 36.1%). The small decrease in the rate is primarily due to changes in the geographical mix of profits.

1.6 Earnings per share

As a result of the above, earnings per share before intangible amortisation increased by 10.6% to 12.20p. Earnings per share after intangible amortisation grew by 8.1% to 8.37p.

2. Dividends

The proposed final dividend of 1.82 p per share gives a total dividend for 2004 of 2.63p, a 12.4% increase on 2003.

3. Cash flow

Free cash flow for 2004 was £55.8m (2003 – £47.0m). Further analysis is shown in Figure 2.

3. Cash flow (continued)

3.1 Operating cash flow
There was an operating cash inflow for the year of £68.0m (2003 – £46.4m), an increase of 47%. This represents a conversion of 196% (2003 – 196%) of operating profit and 95% (2003 – 81%) of Group EBITDA into cash.

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.

3.2 Dividends from joint ventures
Dividends received from joint ventures during 2004 of £14.2m (2003 – £12.6m) represent an 85% (2003 – 78%) conversion of profit after tax of joint ventures into cash.

3.3 Interest and taxation
The 2004 outflow of £5.2m (2003 – £7.8m) benefited from the Group being able to utilise tax losses of subsidiaries that were previously joint venture companies.

3.4 Capital expenditure
Capital expenditure for the year, excluding investment in PFI Special Purpose Companies (SPCs), was £19.3m (2003 – £21.8m). This expenditure represented 1.4% of Group turnover, and is broadly similar to prior years.

3.5 Acquisitions/disposals
The 2004 net outflow of £9.0m primarily relates to the acquisition of shares in ITNET plc prior to 31 December 2004 for £13.7m and the disposal of businesses in Australia and New Zealand for £3.2m. Further details are in section 6.

3.6 Non-recourse debt financed assets
The £25.2m outflow relates to the net movement on expenditure on PFI assets under construction, non-recourse loans and other PFI balance movements. Further analysis is provided in Figure 3.

The movements on the PFI balances are the result of timing differences between loan repayment/draw-down and asset spend/recovery. Over the lifetime of each PFI contract, we expect these movements to offset each other. Included within the change in PFI balances is £8.7m of equity and subordinated debt invested into the Traffic Information Services (TIS) PFI SPC in January 2004.

4. Net debt
At 31 December 2004 net recourse debt was £14.8m (2003 – £22.3m). Further analysis is provided in Figure 4.

Non-recourse debt (see 7. 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.

Non-recourse debt, utilised to fund PFI assets and the acquisition of the DES franchise, reduced during the year to £256.4m (2003 – £357.0m), largely due to Laser (see 7. PFIs) and the scheduled part repayment of other debt.

FIGURE 1: PROFIT AND LOSS ACCOUNT

Year to 31 December	2004 £m	2003 £m	Increase
Total turnover	**1,636.8**	1,555.5	5.2%
Group turnover	**1,381.4**	1,324.3	
Joint venture turnover	**255.4**	231.2	
Gross profit	**190.9**	180.8	5.5%
Administration expenses	**(139.7)**	(138.5)	
Exceptional items (net)	**–**	3.6	
Joint venture profit	**24.8**	24.0	
Net Group interest	**(2.1)**	(2.9)	
Profit before intangible amortisation and tax	**73.9**	67.0	10.3%
Intangible amortisation	**(16.5)**	(14.1)	
Profit before tax	**57.4**	52.9	8.6%
Tax	**(20.4)**	(19.1)	
Profit after tax	**37.0**	33.8	
Minority interest	**(1.0)**	(0.5)	
Profit for the financial year	**36.0**	33.3	
Effective tax rate	**35.5%**	36.1%	
Average number of shares	**430.1m**	429.9m	
Earnings per share before intangible amortisation	**12.20p**	11.03p	10.6%
Earnings per share after intangible amortisation	**8.37p**	7.75p	8.1%
Dividend per share	**2.63p**	2.34p	12.4%

FIGURE 2: CASH FLOW

Year to 31 December	2004 £m	2003 £m
Operating profit before exceptional item	**34.7**	28.2
Exceptional item: reorganisation costs	**–**	(4.5)
Operating profit	**34.7**	23.7
Non-cash items	**36.9**	33.8
Group EBITDA	**71.6**	57.5
Working capital movement	**(3.6)**	(11.1)
Operating cash flow	**68.0**	46.4
Dividends from joint ventures	**14.2**	12.6
Interest and taxation	**(5.2)**	(7.8)
Exceptional item: GSR sale and leaseback	**–**	5.8
Capital expenditure	**(19.3)**	(21.8)
Disposal of assets	**–**	8.9
Other items	**(1.9)**	2.9
Free cash flow	**55.8**	47.0
Exceptional item: Norfolk and Norwich refinancing	**–**	4.1
Acquisitions/disposals	**(9.0)**	(96.6)
Other financing	**(7.8)**	109.5
Dividends paid	**(10.4)**	(9.5)
Non-recourse debt financed assets	**(25.2)**	47.0
Net cash flow	**3.4**	101.5

FIGURE 3: NON-RECOURSE DEBT FINANCED ASSETS

Year to 31 December	2004 £m	2003 £m
Change in PFI balances		
PFI debtor	**6.9**	3.7
Assets in the course of construction	**(16.3)**	(33.0)
Non-recourse debt	**(12.8)**	26.6
	(22.2)	(2.7)
Change in other balances		
Non-recourse debt: Ontario Driver Examination Services	**(3.0)**	49.7
Non-recourse debt financed assets	**(25.2)**	47.0

FIGURE 4: NET DEBT

As at 31 December	2004 £m	2003 £m
Closing cash	**173.9**	170.9
Long term loans	**(167.4)**	(165.3)
Other loans and finance leases	**(21.3)**	(27.9)
Recourse net debt	**(14.8)**	(22.3)
Non-recourse debt	**(256.4)**	(357.0)
Total net debt	**(271.2)**	(379.3)

4. **Net debt (continued)**

In addition to Figure 4, non-recourse debt of £51.4m (2003 – £55.2m) is included in joint venture gross liabilities.

5. **Pensions**

For 2004 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 32 to the Annual Review and Accounts.

In summary, at 31 December 2004, there was a net deficit on an FRS 17 basis in relation to the defined benefit scheme of £75.6m (2003 – £69.7m), and an asset base of £380.8m (2003 – £350.4m). Long term employer and employee contributions were increased in 2003 and have remained at the same level to address the level of deficit in the scheme.

6. **Acquisitions/disposals**

6.1 **Disposals**

In line with our intention to focus the business on areas with the greatest potential for growth and profitability we announced in April 2004 the disposal of a number of small and medium sized contracts in Australia and New Zealand. The annual turnover of these contracts was approximately £38m. The disposals were completed by August 2004.

The above disposals, together with 2003's disposal of a number of our Swedish contracts and the exiting of our rail maintenance contract with Network Rail in January 2004, have reduced annualised turnover by £140m.

6.2 **Acquisitions**

Also during December 2004, we invested £13.7m in the shares of ITNET plc, a company in which we acquired a controlling interest during February 2005. (See 10. Post balance sheet events).

7. **PFIs**

At the end of 2004 the Group was involved in 11 PFI projects, with 10 equity investments and 11 operating contracts. These contracts contribute £3.2bn to the Group's order book of £12.7bn. During 2004 PFIs contributed £194m (2003 – £133.4m) to turnover and £14.6m (2003 – £11.9m) to gross profit.

At the end of 2004 we had invested £23.9m of equity and subordinated debt into our SPCs. Cumulatively, as at 31 December 2004, we had generated £26.9m of cash from these investments, representing a net inflow to the Group of £3.0m.

During October 2004, we stopped accounting for Laser (the National Physical Laboratory PFI SPC) as a subsidiary due to the discussions surrounding the transfer of control of the PFI asset to the DTI. This has removed the non-recourse debt and corresponding PFI debtor from the balance sheet.

8. Treasury

8.1 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 reviewed and approved by the Board.

8.2 Credit facilities and liquidity management

The Group's liquidity during 2004 was principally provided by a £140m revolving credit facility, which was undrawn at year-end, and two private debt placements.

The £140m facility was replaced in January 2005 by a five-year £450m term loan and revolving credit facility. The £450m facility is to fund the acquisitions of ITNET plc and RCI Holding Corporation and is also available to fund the Group's day-to-day liquidity requirements.

The £450m facility is unsecured, with covenants and obligations typical of these types of arrangement, which are consistent with our previous facilities.

The Group continues to service two private placements which include sterling and US dollar tranches. The first, for £43.2m, was taken out in 1997 and matures in 2007. The second, for £117m, was taken out in 2003 and amortises from 2011 to 2015.

8.3 Foreign exchange risk

The Group does not currently hedge the sterling equivalent of the net assets of its overseas operations as the net asset value of these businesses does not represent a significant proportion of the market value of the Group. Foreign exchange gains and losses therefore do not represent a material risk to the consolidated net asset value of the Group.

The foreign exchange exposure on the US dollar tranches of the private placements has been fully hedged into sterling in accordance with the risk profile set out above.

The nature of the Group's business in general does not involve a significant amount of cross-border trade. Consequently the Group is not exposed to substantial foreign currency transaction risk as sales and costs are approximately matched within overseas operations. Material transactional exposures of individual business units are hedged by forward foreign exchange contracts.

Central funding of individual business units gives rise to monetary assets and liabilities centrally and in the business units. Where the asset or liability is denominated in a currency that is not the operating currency of the business unit involved, and a foreign exchange risk would otherwise result, the foreign currency exposure arising is hedged by forward foreign exchange contracts.

8.4 Interest rate risk

The Group's exposure to interest rate fluctuations on its borrowing and deposits is selectively managed, using interest rate swaps.

8.5 Credit risk

The Group monitors the credit quality of counterparties and limits credit exposures accordingly.

9. International Financial Reporting Standards (IFRS)

Serco Group plc will adopt IFRS for accounting periods beginning on 1 January 2005. The Group's interim financial statements for the six months ending 30 June 2005 will be the first under IFRS.

The Group is well positioned to ensure compliance within the required timescale. Reporting systems and procedures have been enhanced to support the new reporting requirements and the Group's IFRS accounting policies are being developed. In addition, IFRS training programmes have been provided to ensure that IFRS knowledge is embedded throughout the organisation.

A number of areas of difference between IFRS and UK GAAP, which may impact the Group's reported results and financial position, have been identified. These include goodwill and intangible assets, financial instruments, share based payment, employee benefits including pensions, joint ventures and taxation. Areas that may require additional disclosure include segment reporting, service concessions and joint ventures.

The key points arising from the adoption of IFRS are:

- The Group's underlying performance, cash flow and ability to pay dividends will be unaffected
- The impact on year-on-year earnings growth after transition is likely to be minimal
- The fair value concept may introduce volatility into the balance sheet, largely due to the inclusion of financial instruments and actuarial gains and losses on defined benefit pension schemes
- On transition, the Group's profit before tax will be principally affected by non-amortisation of goodwill, partially offset by a charge for share based payment
- On transition, net assets will reduce principally through recognition of actuarial losses on defined benefit pension schemes.

The Group's analysis of the effect of IFRS is ongoing. In addition, the interpretation of standards is evolving so further changes may arise, notably in accounting for pension schemes and service concessions, including PFIs.

10. Post balance sheet events

During December 2004, Serco made a recommended offer to acquire all of the issued and to be issued share capital of ITNET plc, a UK listed company. The acquisition of ITNET was declared unconditional in all respects on 3 February 2005. On 17 February 2005, Serco announced that it had acquired, or contracted to acquire, more than nine tenths in value of ITNET's shares and that Serco intended to compulsorily acquire the outstanding ITNET shares.

Also during December 2004, Serco made an offer to purchase RCI Holding Corporation, an American private company. The process of obtaining US government approvals is continuing, and we expect to reach completion during March 2005.

how we run our business

Serco is a distinctive organisation. We are one company, made up of many diverse businesses all focused on bringing service to life. Our consistent values, empowering business model and service-driven management support our vision: to be the leading service company in our chosen markets.

What is Serco about?

Serco is passionate about service.

Everyone wants the services they pay for to be efficient and effective. Consumers, governments and commercial organisations all know that services can often be improved.

All over the world Serco is making it happen. How? By knowing how to bring out the best in people, we meet customer expectations – and often surpass them – because we're dedicated to bringing service to life and making a difference to people's lives.

We transform the quality and efficiency of services by working with customers and staff to introduce improvements, reduce bureaucracy and speed up decision-making. Wherever we operate, we are always looking to improve what we do.

Serco wants to be a company that is a great place to work, a good neighbour and a great partner. And by delivering great service and value to customers, we want to give good returns for investors.

Growing markets driven by a search for value

The market for private sector support in delivering public services is growing fast. It's driven by mounting pressure on national, regional and local governments to deliver value to taxpayers by improving the quality of services while reducing costs.

We focus on countries and market sectors where strong growth in demand is accompanied by a trend towards integrating a number of elements into larger scale contracts. We focus on the opportunities where we can add the greatest value and so achieve a fair return.

Clear strategy

Organic growth: We work hard to deliver great service and exceed the demands of our customers so we can broaden and extend our relationships with them. We only use acquisitions to extend our capabilities or market access, rather than to acquire size.

Resilience through diversity: Serco is different from its many competitors because we seek out opportunities across a wide range of government activities and countries. This brings three key benefits: broader exposure to growth opportunities, better diversification of risk and the opportunity to share good practice honed by wide experience. We have more than 600 contracts, but not one accounts for more than 7% of Group revenue.

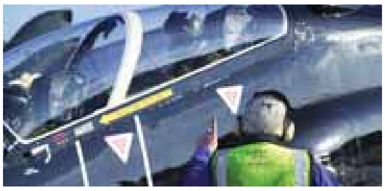
Devolved management approach

We have developed a different kind of organisation so we can be more responsive, customer focused and entrepreneurial. Our flat structure devolves responsibility as far as practicable. Each contract is run like a business in its own right and this keeps decisions close to clients, customers and local communities.

We encourage an entrepreneurial spirit. Each team works with clients and customers to create opportunities to broaden its contribution. We also actively shape the way our markets develop, promoting closer private sector involvement as the key to better quality and value in public services.

Effective risk management

The Serco Management System underpins our devolved structure and determines the way we run our businesses. It defines how we manage and how we make things happen. It provides unobtrusive monitoring and controls. Business risk management is an intrinsic element. We have robust processes for identifying, analysing and managing risks and our Corporate Assurance Group takes an integrated view of our governance, risk management, health and safety, environmental and social responsibility performance.



Distinct values

We value working with our customers in a collaborative, flexible and imaginative way. We understand the principles and passions that motivate public sector managers and we share their ethos and standards of conduct. We encourage social responsibility and try to treat people in the way we would wish to be treated. Our most powerful tool in improving performance is to instill a more stimulating culture where people feel they can personally make a difference. We've honed this tool into four Governing Principles that shape our individual behaviours and hence the way the company behaves.

Our Governing Principles are that we:

Foster an entrepreneurial culture

We are passionate about building innovative and successful Serco businesses.

We succeed by encouraging and generating new ideas. We trust our people to deliver. We embrace change and by taking measured risks encourage creative thinking.

Enable our people to excel

Our success comes from our commitment and energy to go the extra mile.

We are responsible to each other and can expect support when we need it most. We expect our people to achieve more by recognising and harnessing the power of individuals. We value people for their knowledge, ideas and potential to contribute.

Deliver our promises

We do what we say we will do to meet expectations.

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

Build trust and respect

We build respect by operating in a safe, socially responsible, consistent and honest manner.

We never compromise on safety and we always operate in an ethical and responsible manner. We listen. In doing so we treat others as we would wish to be treated ourselves and challenge when we see something is wrong. We integrate with our communities.

Directors, secretary and advisers

CHAIRMAN	Kevin Beeston
DIRECTORS	Margaret Ford* Ralph Hodge CBE* Christopher Hyman Andrew Jenner DeAnne Julius CBE*† David Richardson*
SECRETARY	Joanne Roberts
REGISTERED OFFICE	Serco House 16 Bartley Wood Business Park Bartley Way, Hook Hampshire RG27 9UY
AUDITORS	Deloitte & Touche LLP Hill House 1 Little New Street London EC4A 3TR
INVESTMENT BANKERS	Lazard Brothers & Co. Ltd 50 Stratton Street London W1J 8LL
	Morgan Stanley & Co. Ltd 20 Cabot Square Canary Wharf London E14 4QW
STOCKBROKERS	Cazenove & Co. Ltd 20 Moorgate London EC2R 6DA
	Merrill Lynch International Merrill Lynch Financial Centre 2 King Edward Street London EC1A 1HQ
PRINCIPAL BANKERS	Barclays Bank plc 5 The North Colonnade London E14 4BB
	The Royal Bank of Scotland plc 135 Bishopsgate London EC2M 3UR
SOLICITORS	Allen & Overy LLP One New Change London EC4M 9QQ
REGISTRARS	Computershare The Pavilions PO Box 82 Bridgwater Road Bristol BS99 7NH

* Non-Executive Director
† Senior Independent Director

Corporate governance report

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"). The Company has achieved full compliance with the code provisions set out in section 1 of the July 2003 FRC Combined Code on corporate governance during 2004.

THE BOARD AND ITS DIRECTORS

The Board currently comprises seven Directors, Kevin Beeston, Margaret Ford, Ralph Hodge, Christopher Hyman, Andrew Jenner, DeAnne Julius and David Richardson. Excluding the Executive Chairman, the Board comprises four Non-Executive Directors and two other Executive Directors.

Since the Group has been listed it has been run with a structure consisting of both an Executive Chairman and a Chief Executive with distinct and complementary roles. The Group has also maintained a position of Senior Independent Director throughout this time. During 2004, following Rhidian Jones' retirement, DeAnne Julius was appointed as the Group's Senior Independent Director.

The Board 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 business stakeholders. This role is distinct from that of the Chief Executive who focuses on the formation and implementation of the Group strategy, chairing and managing the Global Management Board and delivery of all aspects of the business. Job specifications are in place for both the Executive Chairman and the Chief Executive defining their roles and responsibilities. The Board have reviewed and re-approved the individual roles and responsibilities of both the Chairman and the Chief Executive during the year. The Directors' profiles are set out on pages 69 and 70.

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, finance and economics. The Senior Independent Director is DeAnne Julius, who took over from Rhidian Jones in April 2004 following Rhidian's retirement from the Board. David Richardson replaced Rhidian Jones as Chairman of the Audit Committee in April 2004. 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 Combined Code. The Non-Executive Directors have met 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, which may be extended for a further period of three years.

During the year the Board met 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. In addition, three other meetings took place during the year to discuss the proposed acquisitions of ITNET and RCI. Apologies were received from Christopher Hyman who could not attend the May 2004 Board meeting, due to his attendance at a key customer meeting.

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 each of the Board Committees were reviewed and revised by the Board in November 2003 following publication of the revised Combined Code. Terms of reference of the Committees are available on the Company's website www.serco.com. Membership of the Committees was revised following the changes to the Board in May 2004.

Board evaluation – During the year each Director has participated in a comprehensive Board and Committee evaluation process, comprising 1:1 meetings with the Chairman, completion of a detailed Board Evaluation Questionnaire, and discussion of a summary of the findings with the Board. As part of this review the effectiveness and independence of both the internal and external auditors was assessed. Following discussions had with other Board members, the Senior Independent Director met with the Chairman to discuss the evaluation of his performance.

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 the 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, a Director must retire at the Annual General Meeting (but is eligible for re-appointment) if he or she has held office for more than 30 months (as at the date of the notice convening the meeting) since he or she was appointed or last re-appointed.

THE BOARD AND ITS DIRECTORS (continued)

Other Directorships – The Board believes that it is in the customer's best interests for Executive Directors to gain additional experience through limited, but carefully selected, Non-Executive appointments. During the year Christopher Hyman was appointed Non-Executive Director of United Business Media plc for which he received £17,051 in remuneration and 815 shares during the year, and also Non-Executive Director of the Prince of Wales' charity In Kind Direct which is a non-fee earning role. Kevin Beeston is a Non-Executive Director of Ipswich Town Football Club plc and a member of the Board of Companions of the Chartered Management Institute. Both roles are non-fee earning. The Board is fully supportive of the external roles undertaken by Kevin and Christopher and consider that the time commitment required will not significantly impact their positions in the Company.

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 changes to the 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 and matters reserved for the Board are displayed on the Company's website www.serco.com.

THE AUDIT COMMITTEE

The Audit Committee is chaired by David Richardson, who was appointed in April 2004 following the retirement of Rhidian Jones. Margaret Ford and DeAnne Julius, Non-Executive Directors, are also members of the Committee. Apologies were received from Margaret Ford and DeAnne Julius who could not attend the meeting held in February 2004. 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. The Committee has also received a presentation and update reports on the impact of the International Financial Reporting Standards on the Company and the Group. During the year the Company has complied with the policy set by the Committee in respect of the provision of audit and non-audit services by Deloitte & Touche LLP ("Deloitte"). The Committee reviewed adherence to the policy during the year. Where appropriate non audit services have been provided by companies other than Deloitte. The Committee considered and recommended approval of the annual audit fee for Deloitte, which was subsequently approved by the Board.

The independence, objectivity and effectiveness of the external auditors has been examined by the Committee and discussions were 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 Combined Code, the Committee approved a formal "whistle-blowing" policy and procedure for implementation throughout the Group. This has been fully implemented during 2004 and responsibility for the operation of this policy has been delegated to the Company Secretary.

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 comprises the Executive Chairman, who chairs the Committee, and the four independent Non-Executive Directors. The Committee met twice during the year and all Committee members attended both meetings. Matters considered included succession planning and crisis management planning for the Board and the change of the Company Secretary.

THE REMUNERATION COMMITTEE

The Remuneration Committee is chaired by Ralph Hodge, with the other three Non-Executive Directors being the remainder of the Committee. The Committee met four times during the year to deal with matters relating to remuneration policy and individual remuneration for Executive Directors. All meetings were attended by each of the Committee members. The Remuneration Report is set out on pages 72 to 80. The Committee also considered the policy and framework of remuneration for senior executives within the Group. The individual remuneration of these executives is considered and approved by the Remuneration Committee of the Global Management Board (GMB), which comprises the Executive Team of the Global Management Board and is advised by the Human Resources (HR) Director.

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

THE APPROVALS AND ALLOTMENT COMMITTEE

This Committee meets on an as required basis and comprises the Executive Directors and the Company Secretary. Forty meetings were held during the year. The business of the Committee is varied and ranges from bid and contract approval to the releasing of share options. The 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 on a day-to-day basis. The level of authority delegated to this Committee is reviewed on an annual basis.

THE GLOBAL MANAGEMENT BOARD (GMB)

The Board has delegated responsibility for the day-to-day management of the business to the GMB. The GMB comprises a number of senior managers within the business and includes all three of the Executive Directors. The GMB meets formally three times a year to review Company activities and discuss operational issues. Other meetings are scheduled where required. Representatives from across the Serco businesses are often invited to the meetings to discuss aspects of their business or give presentations on specific topics. By bringing together senior managers from across the Group, the GMB is able to take a broad view of the business. 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.

THE TRAINING AND DEVELOPMENT COMMITTEE

The Training and Development Committee comprises Margaret Ford, Christopher Hyman, Ralph Hodge and is chaired by Kevin Beeston. The Committee met twice during the year to consider the training needs of all Directors and the Company Secretary, ensuring the appropriateness of the induction process for new Directors in providing a comprehensive familiarisation programme including the role of the Board and its Committees, the corporate governance framework and latest financial statements, together with site visits and meetings with senior management around the Group. In addition the Committee reviewed the leadership development programme being implemented across the Group. This programme of activities has been shaped to focus on the leadership attributes that will underpin delivery of the Group's strategic aspirations and, as well as addressing development of the existing leadership population, also targets those who have the greatest potential to undertake leadership roles in the future.

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.

THE COMPANY AND ITS SHAREHOLDERS (continued)

Formal presentations are made to institutional investors and brokers' analysts after the release of the interim and preliminary results. As part of her induction programme as Senior Independent Director, and in accordance with best practice, DeAnne Julius attended meetings with a number of shareholders following the interim results. She also attended three introductory meetings with the heads of corporate governance at leading institutions. Further requests for individual meetings are always welcomed by the Company.

An Investor Relations report is presented to the Board on a quarterly basis, which covers the dynamics of the market during the period including share price movements, market valuation, share register movements, key investor related activities of the Company, and analyst recommendations thereby ensuring that the Directors have a clear understanding of the Company's performance in the Investor Relations arena.

During the year the Company continued its online communication with a webcast of the interim and preliminary results presentations, an online radio broadcast for staff and a number of conference calls were held during the year. In addition to the interim and preliminary results announcements, the Company made two further regular trading updates during the year, together with a number of announcements covering key business events.

The principal methods of communication with private investors remain 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 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 2004 Annual General Meeting and the Extraordinary General Meeting held on 12 January 2005. It also has a link directly to our Registrars to enable shareholders to view their shareholding online. This online facility has also been extended to allow shareholders to vote on the notice of the 2005 Annual General Meeting.

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 Review and Accounts. These processes are reviewed regularly by the Board and conform to the requirements of the Combined Code. 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.

The Serco Management System (SMS), provides the framework within which the business divisions, operating companies and contracts have implemented processes and procedures in ways that are appropriate to the type of business being undertaken. Divisional Chief Executives and business unit managers have the responsibility and authority to implement the system and monitor its operation within their businesses. The SMS defines the Group's vision and strategy, the core values that define the context within which the business operates, a set of business principles that define the corporate behaviour of the organisation, the operating structure and roles and responsibilities of the principal elements of the organisation and the core processes of the business.

As part of the SMS, a set of policy statements have been authorised by the Board and supporting standards, guidance and training material has also been produced.

An ethical standard defines the following principles that apply to all business activities undertaken by the Group:

- We will comply with the laws of the country in which business is being transacted
- We will respect the rights of the individual
- We will respect the traditions and culture of communities and protect the environment within which we operate
- We will undertake our business activities in accordance with the highest standards of professionalism, integrity and honesty.

INTERNAL CONTROL AND RISK MANAGEMENT (continued)

These broad principles are further interpreted in respect of individual and corporate behaviours. A separate standard defines the corporate responsibility programme that is implemented throughout the Group.

A risk management standard defines the processes that are required at each level in the organisation in order to manage and mitigate the threats to the achievement of our business objectives. Risk registers are maintained at a contract, business unit, 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 on the business and the actions being taken to reduce and mitigate the risks. Risks are prioritised using a consistent scoring system across the business. Guidance on the risk appetite of the Group has been issued to managers which defines the appetite/tolerance levels both for individual risks and for projects or business units where multiple risks may be present.

The Group risk register identifies the key principle risks facing the business including risks that are managed directly at a Group level. The risks identified in the Group risk register could arise as a result of internal or external events or decisions and could affect the Group's short or long term value, its reputation, the safety of its staff or third parties or compliance with statutory obligations. The risk management process specifically identifies the interests not only of shareholders but also of other stakeholders that are likely, directly or indirectly, to influence the performance of the business and its value. These include, but are not limited to, customers, suppliers, staff, trade unions, government, regulators, banks and insurers. The interests of the wider community in areas such as social, environmental and ethical impact are recognised in the Group's corporate responsibility programme.

The Group risk register is updated regularly, reviewed six monthly by the Risk Oversight Group and discussed at quarterly Board meetings; active risks are ranked into five categories of importance based on the risk score and grouped under the following six headings:

- Business strategy – covering threats to the long-term deliverability of the Group's strategy. Principle risks of the Group include loss of competitive position, and strategic risks associated with recent acquisitions
- Financial/commercial performance – covering threats to the short term performance of the Group's existing business. Principle risks of the Group include the loss of key contracts, the failure to meet financial business plans, pension fund liabilities and delays or cost over-runs in major transition programmes
- Compliance – covering compliance with all relevant legislation and regulations. Principle risks of the Group include legal action resulting from compliance failures, the introduction of the International Financial Reporting Standards (IFRS) and unethical behaviour by Directors or members of staff
- Safety – covering threats to the safety of staff, sub-contractors, members of the public and the environment. Risks of the Group include the responsibility of a major accident or incident where public safety is concerned, environmental pollution and assaults on staff in the course of their duties
- Business continuity – covering threats to the continuity of business operations in the event of adverse events. Principle risks of the Group include the failure of information systems, loss of key infrastructure and the recruitment and retention of key staff
- Hostile actions – covering threats posed by the deliberate actions of individuals and organisations against the interests of the Group. Principle risks of the Group include crime and fraud, pressure group action, terrorism and industrial action.

Additionally, risks relating to the reputation of the Group are assessed by Corporate Communications and the Board on an ongoing basis.

For the Group, the most significant risks relate to the strategy and safety areas; social, environmental and ethical issues, while recognised within a number of the Group's risks, do not represent significant threats to the achievement of the Group's strategy at present. All risks and potential threats are kept under regular review and the Board informed of changes as they occur.

Each risk is assigned an owner at Board or senior management level and specific risk reduction and risk mitigation actions are identified. The Board may ask for additional information in respect of risk reduction or mitigation actions from risk owners or request that a specific audit is undertaken to provide additional assurance in respect of the risk controls. Risk management techniques used by Serco include appropriate systems, staff, internal controls, public and media relations and business continuity planning. These techniques are designed with clarity of accountability and responsibility and with certain formal policies covering areas such as compliance, safety and environmental protection. Serco's business units build and maintain an understanding of their operational risk profiles and are expected to fully understand the likelihood and potential impact of any operational incidents, at the same time making appropriate and informed decisions that balance the risks against the potential returns and opportunities.

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 or developing projects against a defined set of criteria. Projects can then be submitted to the GMB for consideration as a Group key target and allocation of appropriate resources
- 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 Group'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
- The Group's approach to health, safety and environmental protection is described in the Directors' Report. Qualified and experienced staff in each business unit, provide advice and support on health, safety and environmental issues and undertake regular audits
- The Company Secretary is responsible for the review of ethical issues that may arise from the Group's activities and for managing the confidential reporting service (whistle-blowing), to which staff can report illegal, dangerous, dishonest or unethical activities.
- A programme of internal audits confirms the extent to which key controls are in place and are being applied 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 performance and variances from plan, 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.

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. The Board recognises not only its responsibilities to shareholders but also to the wider community where social, environmental and ethical issues are becoming increasingly important. CAG is responsible for developing and overseeing the corporate responsibility activities within the Group. The corporate responsibility model is described in the separate Corporate Responsibility Report and encompasses four elements:

- Safety – recognising the Group's legal responsibility for the safety of our staff and the general public for whom we have a duty of care
- People – addressing the Group's legal and moral responsibility for its employees
- Community – addressing the Group's social responsibility for the communities within which we operate
- Environment – recognising the Group's legal and moral responsibility to protect the environment from damage as a direct result of its operations and to promote activities to protect and sustain the wider environment.

The Corporate Responsibility Report includes performance measures against key objectives within these four areas.

CAG reports formally to the Executive Chairman and 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. CAG has undertaken a number of reviews of internal controls during 2004 including risk management, health, safety and environmental management. As a result of these reviews, a number of activities have been included in CAG's programme for 2005 to strengthen the Group's performance in these areas.

INTERNAL CONTROL AND RISK MANAGEMENT (continued)

CAG sponsors five 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 SMS that defines how the Group operates
- A Risk Oversight Group, chaired by the Risk Director, comprising assurance representatives 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
- A Corporate Responsibility Steering Group, chaired by the Executive Chairman, provides direction on projects that address the social and environmental issues affecting our staff and the communities within which we work.

During 2004, Grant Thornton has continued to provide an internal audit function within the Group, in addition to that provided by internal peer review and CAG. Their programme is complementary to the Group's broader programme and has been designed to address internal control and risk management processes and the recommendations of the Combined Code. Grant Thornton reported to the Audit Committee twice during the year. There were no material weaknesses identified as a result of the audits undertaken and corrective action has been taken where deficiencies were found.

In addition to contracts held in Serco's name, the Group has material investments in a number of joint ventures and associated companies. Where these investments are not wholly 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 Company's joint ventures participate in the Assurance network and the Risk Oversight and Rail Safety Oversight Groups.

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 2004

The Company has achieved full compliance with the code provisions set out in section 1 of the July 2003 FRC Combined Code on corporate governance during 2004.

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

JRoberts.

Joanne Roberts
Secretary

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

1 March 2005

Directors' report

ANNUAL REVIEW AND ACCOUNTS

The Directors have pleasure in presenting the Annual Review and Accounts of the Group for the year ended 31 December 2004.

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 2004 can be found in the Business Review on pages 20 to 45.

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 0.81p (2003 – 0.72p) per Ordinary Share was paid on 11 October 2004. The Directors recommend a final dividend of 1.82p (2003 – 1.62p) per Ordinary Share, which if approved by shareholders at the Annual General Meeting, will be paid on 11 May 2005, to those shareholders on the register at the close of business on 11 March 2005. After dividends, retained profits of £24,211,000 will be transferred to reserves.

SUBSTANTIAL SHAREHOLDINGS

At close of business on 1 March 2005 (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 share capital:

Fidelity International Limited	6.63%
HBOS plc	5.03%
Legal and General Group plc	3.41%
Morley Fund Management Limited	3.69%

CHANGES TO THE BOARD

The current Directors of the Company are listed on page 58 and their profiles on pages 69 and 70.

As detailed in the 2003 Annual Review and Accounts Iestyn Williams and Rhidian Jones retired from the Board in March and April 2004 respectively.

With effect from 2 February 2005, Joanne Roberts was appointed Company Secretary of the Group. Julia Cavanagh moved within the Group to become Finance Director of the Government Services division.

The Board wishes to place on record its thanks to Julia for her contribution as Company Secretary since her appointment in April 1999 and to wish her every success in her new role within the Group.

DIRECTORS' INTERESTS

With exception of the Executive Directors' service contracts and Non-Executive Directors' letters of appointment, there are 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 72 to 80.

ANNUAL GENERAL MEETING

The 18th Annual General Meeting of the Company will be held at the Queen Elizabeth II Conference Centre, London on 29 April 2005 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 e-recruitment facility has assisted in tracking the diversity of applicants, and the benchmarking of employment policies against the best in class, which is enabling 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 structure 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 offered in 2004 to all eligible staff a further sharesave scheme. This opportunity was taken up by over 5,000 staff worldwide.

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. Appropriate H,S&E risk assessment and management processes are applied across the Group and are subject to regular audit as part of wider assurance processes with key performance indicators 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 Company operates, for our staff, our customers, members of the public and any other third party. The Group recognises that it is everyone's responsibility to reduce 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 divisional support offices or in contracts, which provide advice and support on H,S&E issues. All employees share responsibility for continually 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 but also in the overall context of assurance within the Company.

Serco has been committed to addressing issues of work-related ill-health 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.

During the year the Company has undertaken a comprehensive review of spending patterns and is seeking to expand the level of preferred suppliers relationships, thereby improving supply chain management and value for money.

The Group's average creditor payment terms in 2004 were 24 days (2003 – 26 days); Company 21 days (2003 – 26 days).

DONATIONS

The Company continues to encourage all staff to participate in their local communities and has a process to capture investment on a worldwide basis. This measure is based upon the Business in The Community (BiTC) reporting format. The value of this investment at £795,000 represents 1.4% of the Group's pre tax profit, and an 8% increase on investment made in 2003.

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") required 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 April 2004.

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.

From left to right. Top row: Joanne Roberts (Company Secretary), Ralph Hodge
Bottom row: Andrew Jenner, David Richardson, Margaret Ford, Kevin Beeston, DeAnne Julius, Christopher Hyman

Directors' profiles

KEVIN STANLEY BEESTON FCMA (42)
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 Board member of the Chartered Management Institute and a Non-Executive Director of Ipswich Town Football Club plc and IMI plc.

MARGARET FORD MA MPhil (47)
Non-Executive Director
Margaret Ford 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) (70)
Non-Executive Director
Ralph joined Serco as a Non-Executive Director in April 2000 and chairs the Board's Remuneration Committee. He is 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) (41)

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. During 2004 Christopher was appointed a Non-Executive Director of United Business Media plc and also of the Prince of Wales' charity In Kind Direct.

ANDREW MARK JENNER ACA (36)

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.

DEANNE SHIRLEY JULIUS CBE PhD (Econ) (55)

Senior Independent Director

DeAnne joined Serco as a Non-Executive Director in October 2001. She is Chairman of The Royal Institute of International Affairs, was a founder member of the Bank of England Monetary Policy Committee 1997 – 2001 and also sat on the Court of the Bank of England until May 2004. 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.

DAVID RICHARDSON (FCA) (53)

Non-Executive Director

David joined Serco as a Non-Executive Director in June 2003 and chairs the Board's Audit Committee. He is currently Finance Director of Whitbread, 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. David was appointed a Non-Executive Director of Dairy Crest Plc during the year.

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

Joanne Roberts
Secretary

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

1 March 2005

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 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:

JRoberts.

Joanne Roberts
Secretary

Serco House
16 Bartley Wood Business Park
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Hampshire
RG27 9UY

1 March 2005

Remuneration report

INTRODUCTION

The following report details the remuneration policy, and the actual remuneration of the Directors of the Company for the year ended 31 December 2004, as determined by the Committee and adopted by the Board. In preparing this report, consideration has been given to the provisions set out in the Combined Code and the requirements for the disclosure of the Directors' Remuneration Regulations 2002.

During the year the Remuneration Committee (the "Committee") commissioned a review of Executive Directors' remuneration. The review was set in the context of the remuneration strategy established in 2003, a strategy that had been created through consultation with the Company's six largest institutional investors, representing approximately 35% of the shareholder base, and the ABI and a strategy that the Committee concluded was still relevant to and supportive of the Company's overall business strategy. A key new development during 2004 was the Committees' increasing focus on tax simplification legislation relating to pension provision. During the year the Committee commissioned and received several reports and updates from their pension advisors Mercer Human Resource Consulting ("Mercer") to assist in the development of a revised pensions strategy for the Executive Directors and for the wider Leadership Group.

The recommendations of the review, which are included in detail in the Remuneration Report below are based on a remuneration philosophy grounded in the following four principles:

- Total rewards should be market competitive
- Incentive plans should be used to reinforce a high performance culture
- The interests of Directors and shareholders should be aligned as far as reasonably possible
- The reward structure should be easily understood by all

COMPOSITION AND TERMS OF REFERENCE OF THE REMUNERATION COMMITTEE

The Committee currently comprises all 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) attend the Committee meetings by invitation.

ADVISERS TO THE REMUNERATION COMMITTEE

During the year, the Committee has been advised by Lucy Adams, HR Director and Mercer who were appointed by the Committee following a competitive tendering process. Advice has been sought from Mercer on matters surrounding remuneration policy and philosophy, benchmarking exercises for both individual Executive Directors and remuneration packages based on current market trends.

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 ("E&Y"). E&Y has also provided advice to the Company in the areas of company secretarial compliance and governance.

REMUNERATION POLICY AND PRACTICE

The members of the Committee met four 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.

Executive Directors' remuneration comprises a combination of short and long term rewards as explained below and then detailed on pages 75 to 78. The Committee recognises the importance of maintaining an appropriate balance between those elements of remuneration which are fixed and those which are variable by performance.

During the year, a remuneration review was carried out to ensure the continued adherence to the remuneration philosophy and strategy established by the Committee. To ensure consistency, the peer group of companies, chosen in 2003 for their business relevance and comparability in terms of scale were also chosen for this year's review. The Committee took a decision to review the composition of the peer group of companies during 2005.

SALARIES AND BENEFITS

1. Base Salary

The remuneration philosophy of the Committee is that base salary for the Executive Directors should be set at the market median. In the 2004 remuneration review, the Committee were advised by Mercer that the Executive Chairman and Chief Executive identical base salaries were positioned very slightly below the sector peer median. The Finance Director's base salary was just above peer lower quartile.

As a result of this review the Committee implemented a base salary increase for both the Executive Chairman and Chief Executive of 4% and a base salary increase of 9% for the Finance Director.

Following this increase, base salaries for Executive Directors are at approximately the market median, and will be reviewed again in 2005.

2. Bonus Schemes

In 2003 the Company introduced an annual bonus plan which included an ability to defer a portion of the bonus earned for full time Executive Directors, and this was approved by shareholders at the Annual General Meeting in May 2003. The maximum value of annual bonus is 40% of base salary and will be awarded on the basis of the Company's earnings per share growth before goodwill amortisation ("EPS") in comparison to RPI.

The Company will be reviewing the calculation of the EPS growth during 2005, to ensure it is consistent under IFRS.

The maximum award will be paid if EPS growth reaches RPI + 10%. No award is achieved if EPS growth is less than RPI + 5%. For EPS growth between RPI +10% and RPI + 5% the bonus will be reduced from 40% to 20% on a straight line basis.

As mentioned above, 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 are matched by the Company if stretching performance targets are met.

The performance condition for matching shares on bonuses deferred in 2004 is total shareholder return (TSR) relative to the FTSE 350 over the three year deferral period. The matching shares awarded are based on the following criteria:
- No matching shares will be awarded if the Company does not meet or exceed the median TSR of the FTSE 350
- A one for two match of shares deferred will be made if performance is at the median, or between median and upper quartial, and
- A one for one match of shares deferred will be made if performance is at or above the upper quartile of the FTSE 350.

The Committee were advised by Mercer that this level of short term incentive remuneration was consistent with the remuneration philosophy agreed by the Board in 2003 and therefore agreed that this should continue at the current level for 2004.

Bonuses for the Executive Directors who are members of the Serco Pension and Life Assurance Scheme have been, to date, pensionable. The Committee agreed during 2004 to remove bonuses from the definition of pensionable salary for pension accrued after 31 December 2005.

More detail on this is provided in the pension section.

3. 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 below. The Company complies with the ABI guidelines in relation to granting of no more than 10% of share capital for employee share schemes in any 10 year period.

The Company will be reviewing the calculation of the EPS growth during 2005, to ensure it is consistent under IFRS.

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.

Pre 1 January 2003 Awards: 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 the absolute growth in the Company's EPS over the performance period of three financial years.

The vesting of the awards is based on the following criteria:
- 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%
- Awards will vest on a straight line basis for each percentage increase in EPS growth above 35% over the three year period until full vesting is achieved.

SALARIES AND BENEFITS (continued)

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

Post 1 January 2003 Awards: For awards granted on or after 1 January 2003, achievement of the performance criteria is measured by reference to the Company's TSR performance. Performance is measured relative to the companies comprising the FTSE 350 index at the start of the performance period.

The vesting of the awards is based on the following schedule:
- No award vests if the Company's performance is below the median of comparator group over the three year performance period.
- 40% of the award vests if performance is at the median
- The award vests in full if performance reaches or exceeds the upper quartile
- For performance between the median and the upper quartile, a proportion of the award will vest.

The Committee has selected the FTSE 350 as an appropriate broad benchmark of performance, as Serco is a constituent of the FTSE 350. The performance comparator group will be reviewed in 2005.

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

For awards which have vested by 31 December 2004, EPS growth has been at least 35% over the three-year performance period. Awards made since 1 January 2003 have yet to complete their performance period.

Executive Option Plan ("EOP")

Options granted under the EOP may be exercised after the third anniversary of grant, dependant 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.

Pre 1 January 2003 Grants: 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 absolute growth in the Company's EPS over the three year performance period.

The vesting of the grants is based on the following schedule:
- If the annual compound growth in EPS is less than 10%, none of the options may be exercised
- If compound growth in EPS is more than 15%, all 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.

Post 1 January 2003 Grants: For awards granted on or after 1 January 2003, achievement of the performance criteria is measured by reference to the Company's EPS performance relative to RPI over the three year performance period.

The vesting of the grants is based on the following schedule:
- If the level of EPS growth is less than RPI + 5% per annum, none of the options may be exercised
- If the level of EPS growth is equal to RPI + 5% per annum, 40% of the award may be exercised
- If the level of EPS growth is equal to RPI + 10% per annum, all of the options may be exercised
- For an EPS growth of between RPI + 5% and RPI + 10% per annum, a proportion of the options may be exercised.

For awards which have vested by 31 December 2004, the annual compound growth in EPS has been at least 10%. Awards made since 1 January 2003 have yet to complete their performance period.

Pensions and Life Assurance

Serco operates both defined benefit and defined contribution pension schemes. The Executive Directors participate in the Serco Pension and Life Assurance Scheme. This is a funded, defined benefit scheme which provides for a pension of 2/3rds of pensionable salary following a full career. The normal retirement age is 60. Members contribute to the scheme at a rate of 8% of pensionable salary.

For the year ending 31 December 2004, bonuses have been included in pensionable salary as per the rules of the scheme. The Committee realised that by omission this disclosure was incomplete in 2003 and as part of their ongoing dialogue with ABI and NAPF have discussed this and confirmed the correct disclosure for 2004. As shareholders may be aware, bonuses are relatively new in Serco with 2003 being the first year they were paid and therefore were pensionable.

The Committee reviewed this during 2004 and decided that as a policy, bonuses should not be pensionable for any Serco employee. Therefore, the rules will be amended with effect from 31 December 2005 to define pensionable salary as base salary only for pension accrued after that date. No compensation will be paid to any Director or other staff member for the removal of bonuses from the definition of pensionable salary.

As a result of their joining the Company after 1989, Christopher Hyman and Andrew Jenner are subject to the Inland Revenue Earnings Cap on pensionable salary within the Serco pension plan. The Company provides defined contribution pension arrangements to supplement the Serco Pension and Life Assurance Scheme for Christopher Hyman and Andrew Jenner. These arrangements are currently under review.

SALARIES AND BENEFITS (continued)

Pensions and Life Assurance (continued)

The Committee have been advised by Mercer throughout the year on the implications of the forthcoming legislation on tax simplification for pensions. The Committee has considered its response to the legislation in 2006 and have concluded that it will take the following approach:

- It will ensure that its members are provided with the latest information as the legislation progresses
- The Committee will ensure it is provided with regular and current analysis of the approaches adopted by other companies within its comparator group and within the broader FTSE 250
- It will consider and produce a response to the new legislation which both complies with any ABI guidelines, and enables the Company to continue to recruit and retain talented individuals within its senior management.

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 all have a notice period of 12 months.

Under the service contracts for the 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, whether or not he is dismissed or he elects to leave on notice, he will be entitled to receive a payment equivalent of up to one year's remuneration. The service contracts do not provide for termination payments to be made in any other circumstances.

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

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

Name of Director	Date joined Group	Date of appointment to the Board	Date of contract/ Letter of appointment	Un-expired Term and Notice Period at 31 December 2004
Executive Directors:				
K S Beeston	29 April 1985	29 February 1996	21 July 2003	Rolling contract with 12 months notice period
C R Hyman	30 August 1994	1 April 1999	21 July 2003	Rolling contract with 12 months notice period
A M Jenner	4 November 1996	3 May 2002	21 July 2003	Rolling contract with 12 months notice period
I M Williams	16 October 1978	12 September 1986	1 April 1999	Retired 31 March 2004

Name of Director	Date of appointment to the Board	Date of contract/ Letter of appointment	Un-expired Term and Notice Period at 31 December 2004
Non-Executive Directors:			
M A Ford	8 October 2003	7 October 2003	21 Months
R N Hodge	5 April 2000	17 March 2004	3 Months
R H B Jones	17 June 1996		Retired on 30 April 2004
D S Julius*	29 October 2001	18 November 2004	35 Months
D H Richardson	2 June 2003	29 May 2003	17 Months

*Senior Independent Director

Note: Non-Executive Directors have a three month notice period and no compensation or other benefits are payable on early termination.

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 2004, 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. They are currently set at a rate of £35,000 per annum. The Board has also approved the payment of £5,000 per annum to the Chairmen of the Audit and Remuneration Committees with effect from 1 June 2003, and £5,000 per annum to the Senior Independent Director. 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:

	Note	Remuneration	Fees	Bonus	Total Estimated value of any other non-cash benefits	Total Remuneration excluding pensions 2004	Total remuneration excluding pensions 2003
K S Beeston	*3,4*	**420,533**	**–**	**122,404**	**23,817**	**566,754**	586,522
M A Ford	*1*	**–**	**34,166**	**–**	**–**	**34,166**	7,785
R N Hodge		**–**	**39,166**	**–**	**–**	**39,166**	35,500
C R Hyman	*3,4*	**420,533**	**–**	**122,404**	**26,081**	**569,018**	586,540
A M Jenner	*3,4*	**259,560**	**–**	**78,009**	**26,032**	**363,601**	364,500
R H B Jones	*2*	**–**	**12,666**	**–**	**–**	**12,666**	35,500
D S Julius		**–**	**37,500**	**–**	**–**	**37,500**	32,583
D H Richardson	*1*	**–**	**36,999**	**–**	**–**	**36,999**	19,250
I M Williams	*2*	**49,500**	**–**	**–**	**6,675**	**56,175**	216,966
Total		**1,150,126**	**160,497**	**322,817**	**82,605**	**1,716,045**	1,885,146

Notes:
1. D H Richardson and M A Ford were appointed on 2 June 2003 and 8 October 2003 respectively.
2. I M Williams and R H Jones retired from the Company on 31 March 2004 and 30 April 2004 respectively.
3. The bonuses shown include performance bonuses earned in the period under review, but not paid in the financial year.
4. The value of the non-cash benefits relates to the provision of a car allowance and private healthcare.

2. DIRECTORS' SHAREHOLDINGS

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

	Ordinary Shares of 2p each fully paid 1 January 2004	Ordinary Shares of 2p each fully paid 31 December 2004
K S Beeston	161,081	**182,638***
M A Ford	–	**–**
R N Hodge	2,010	**2,010**
C R Hyman	84,330	**106,234***
A M Jenner	42,265	**54,976***
R H B Jones	65,000	**65,000†**
D S Julius	15,000	**15,000**
D H Richardson	10,000	**10,000**
I M Williams	1,387,323	**1,387,323†**

* 21,557 of K S Beeston's shares, 21,557 of C R Hyman's shares and 12,711 of A M Jenner's shares are all held in trust on their behalf under the terms of their participation in the Deferred Bonus Scheme, under which , provided that such shares remain in trust for three years, they are also granted an award over an equivalent number of shares.
†At date of retirement

3. SHARE-BASED INCENTIVES

i) Serco Group plc 2003 Executive Deferred Bonus Scheme

	Number of shares under award at 31 December 2004	Date of grant	Vesting date
K S Beeston	21,557	2-Mar-2004	2-Mar-2007
C R Hyman	21,557	2-Mar-2004	2-Mar-2007
A M Jenner	12,711	2-Mar-2004	2-Mar-2007

The above awards were granted for nil consideration.

3. SHARE-BASED INCENTIVES (continued)

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:

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

		Number of shares under option at 1-Jan-2004 (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-Dec-2004 (or, if earlier, cessation date as Director)	Exercise price £	Market price at grant £	Value realised on exercise £	Date exerciseable	Date of expiry of option
K S Beeston	3 yr award	38,736	–	–	–	38,736	Nil	4.26	–	31-Dec-2002	4-Apr-2010
	3 yr award	51,885*	–	–	–	51,885	Nil	4.90	–	31-Dec-2003	23-Nov-2010
	3 yr award	54,676*	–	–	–	54,676	Nil	4.65	–	31-Dec-2004	15-Nov-2011
	3 yr award	185,289*	–	–	–	185,289	Nil	1.53	–	31-Dec-2005	5-May-2013
	3 yr award	173,142*	–	–	–	173,142	Nil	1.75	–	31-Dec-2006	26-Nov-2013
	3 yr award	–	119,411	–	–	119,411	Nil	2.31	–	31-Dec-2007	22-Dec-2014
M A Ford	–	–	–	–	–	–	–	–	–	–	–
R N Hodge	–	–	–	–	–	–	–	–	–	–	–
C R Hyman	3 yr award	32,868	–	–	–	32,868	Nil	4.26	–	31-Dec-2002	4-Apr-2010
	3 yr award	44,474*	–	–	–	44,474	Nil	4.90	–	31-Dec-2003	23-Nov-2010
	3 yr award	46,865*	–	–	–	46,865	Nil	4.65	–	31-Dec-2004	15-Nov-2011
	3 yr award	185,289*	–	–	–	185,289	Nil	1.53	–	31-Dec-2005	5-May-2013
	3 yr award	173,142*	–	–	–	173,142	Nil	1.75	–	31-Dec-2006	26-Nov-2013
	3 yr award	–	119,411	–	–	119,411	Nil	2.31	–	31-Dec-2007	22-Dec-2014
A M Jenner	3 yr award	111,174*	–	–	–	111,174	Nil	1.53	–	31-Dec-2005	5-May-2013
	3 yr award	105,138*	–	–	–	105,138	Nil	1.75	–	31-Dec-2006	26-Nov-2013
	3 yr award	–	76,101	–	–	76,101	Nil	2.31	–	31-Dec-2007	22-Dec-2014
D S Julius	–	–	–	–	–	–	–	–	–	–	–
D H Richardson	–	–	–	–	–	–	–	–	–	–	–

*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 unapproved 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 73 and 74.

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 £2.40 and the highest and lowest market prices during the financial year were £2.42 and £1.69 respectively.

3. SHARE-BASED INCENTIVES (continued)

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

		Number of shares under option at 1-Jan-2004 (or, if later, the date of appointment as Director)	Granted during period	Exercised during period	Lapsed unexercised during period	Balance at 31 December 2004	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-May-2001	20-May-2008
	Unapproved	68,922	–	–	–	68,922	–	2.18	–	21-May-2001	20-May-2005
	Unapproved	76,734	–	–	–	76,734	–	2.45	–	1-Apr-2002	31-Mar-2006
	Unapproved	58,764	–	–	–	58,764	–	4.26	–	5-Apr-2003	4-Apr-2007
	Unapproved	91,321*	–	–	–	91,321	–	4.35	–	28-Mar-2004	27-Mar-2008
	Unapproved	152,035*	–	–	–	152,035	–	2.64	–	3-May-2005	2-May-2009
	Unapproved	289,515*	–	–	–	289,515	–	1.53	–	6-May-2006	5-May-2010
	Unapproved	–	219,320	–	–	219,320	–	2.17	–	3-Mar-2007	2-Mar-2011
M A Ford	–	–	–	–	–	–	–	–	–	–	–
R N Hodge	–	–	–	–	–	–	–	–	–	–	–
C R Hyman	Approved	13,788	–	–	–	13,788	–	2.18	–	21-May-2001	20-May-2008
	Unapproved	25,290	–	–	–	25,290	–	2.18	–	21-May-2001	20-May-2005
	Unapproved	40,812	–	–	–	40,812	–	2.45	–	1-Apr-2002	31-Mar-2005
	Unapproved	49,830	–	–	–	49,830	–	4.26	–	5-Apr-2003	4-Apr-2007
	Unapproved	78,275*	–	–	–	78,275	–	4.35	–	28-Mar-2004	27-Mar-2008
	Unapproved	130,316*	–	–	–	130,316	–	2.64	–	3-May-2005	2-May-2009
	Unapproved	289,515*	–	–	–	289,515	–	1.53	–	6-May-2006	5-May-2010
	Unapproved	–	219,320	–	–	219,320	–	2.17	–	3-Mar-2007	2-Mar-2011
A M Jenner	Approved	4,134	–	–	–	4,134	–	2.18	–	21-May-2001	20-May-2008
	Approved	8,574	–	–	–	8,574	–	2.45	–	1-Apr-2002	31-Mar-2009
	Unapproved	7,422	–	–	–	7,422	–	2.45	–	1-Apr-2002	31-Mar-2006
	Unapproved	12,336	–	–	–	12,336	–	4.26	–	5-Apr-2003	4-Apr-2007
	Unapproved	18,524*	–	–	–	18,524	–	4.35	–	28-Mar-2004	27-Mar-2008
	Unapproved	78,189*	–	–	–	78,189	–	2.64	–	3-May-2005	2-May-2009
	Unapproved	173,709*	–	–	–	173,709	–	1.53	–	6-May-2006	5-May-2009
	Unapproved	–	133,178	–	–	133,178	–	2.17	–	3-Mar-2007	2-Mar-2011
D S Julius	–	–	–	–	–	–	–	–	–	–	–
D H Richardson	–	–	–	–	–	–	–	–	–	–	–

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

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

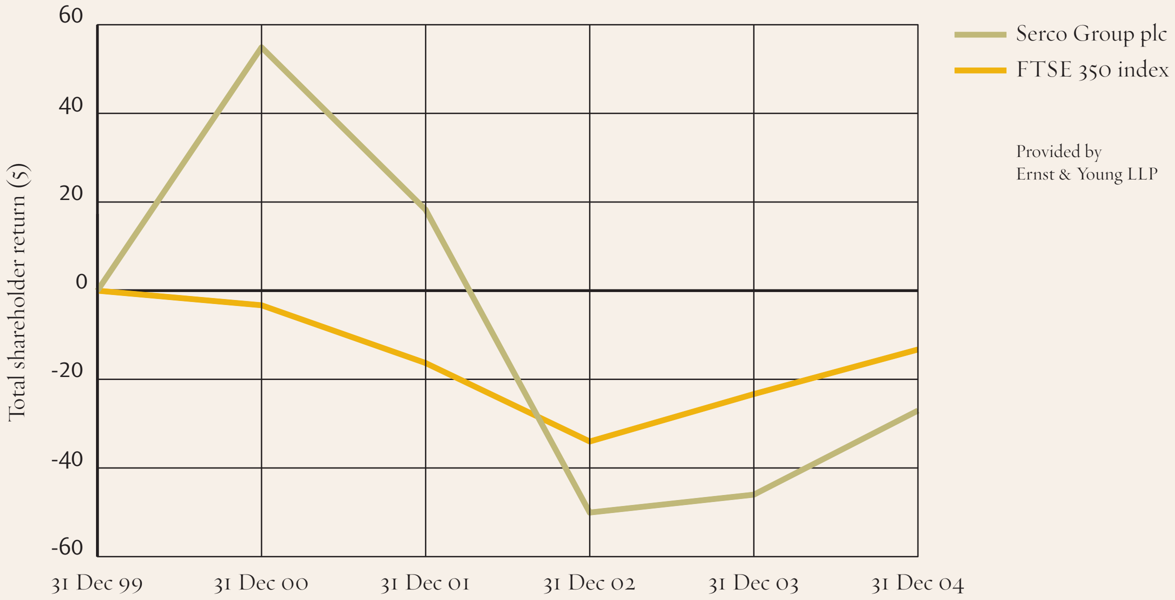
No payment was made for the grant of the awards, no awards have had terms varied during the period, and the Directors have exercised no awards since the end of the financial year.

The performance criteria to which the exercise of awards under the EOP is conditional are as set out on page 74.

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 £2.40 and the highest and lowest market prices during the financial year were £2.42 and £1.69 respectively.

Section three has been audited by Deloitte.

4. PERFORMANCE GRAPH – SERCO GROUP PLC FIVE-YEAR TSR VS FTSE 350 INDEX



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 AND LIFE ASSURANCE

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 32. 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 the Serco Pension and Life Assurance Scheme, which is a defined benefit scheme, are as follows:

	Transfer value of accrued benefits at 31 December 2004 (1) £	Transfer value of accrued benefits at 31 December 2003 (2) £	Director's contributions for the year (3) £	Increase in transfer value during the year (4) = (1)-(2)-(3) £	Gross increase in accrued pension during the year (5) £ p.a.	Increase in accrued pension during the year, net of inflation (6) £ p.a.	Value of net increase in accrual over the year (7) £	Total accrued pension at year end (8) £ p.a.
K S Beeston	1,153,549	804,571	40,757	308,221	35,429	30,950	196,692	179,918
C R Hyman	183,260	133,696	15,187	34,377	4,025	3,386	9,983	24,650
A M Jenner	54,965	29,142	15,187	10,636	3,575	3,396	4,776	9,350
I M Williams*	2,299,157	1,511,915	3,395	783,847	3,493	2,510	28,292	136,247

*retired 31 March 2004

5. PENSIONS AND LIFE ASSURANCE (continued)

Notes to pension benefits:

a) The total accrued pension shown is that which would be paid annually on retirement, based on service to the end of this year, or date of retirement in the case of I M Williams. The increase in accrued pension during the year is shown both as a gross increase and excluding any increase in respect of inflation.

b) The figures for KS Beeston allow for bonuses paid in 2003 and 2004. The transfer value as at 31 December 2003 has been restated to reflect the 2003 bonus. The Serco Pension & Life Assurance Scheme defines pensionable salary to include bonuses. This applies to all members of the scheme. In accordance with the new rules of the scheme, bonuses will become non-pensionable from 31 December 2005.

c) Transfer values have been calculated in accordance with version 8.1 of the Guidance Note GN11 issued by the actuarial profession. The difference between the transfer values at the beginning and end of the year, shown in (4), includes the effect of fluctuations in the transfer value due to factors beyond the control of the Company and the Directors, such as stockmarket movements. It is calculated after deducting Directors' contributions.

d) 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 increase in the accrued pension net of inflation after deducting the Director's contribution.

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

f) 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.

g) I M Williams retired on 31 March 2004 and elected to take a cash lump sum of £376,725 in lieu of part of his entitlement. The transfer value at the year end is the value of the current pension in payment after allowing for this cash sum.

h) C R Hyman also benefits 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 in 2004 under this arrangement amounted to £40,720.

   C R Hyman also received a special (non-pensionable) cash payment of £95,400 in September 2004, in recognition of the higher contribution due from his time of appointment as Chief Executive.

i) A M Jenner also benefits 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 in 2004 under this arrangement amounted to £22,376.

Section 5 has been audited by Deloitte.

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

J Roberts.

Joanne Roberts
Secretary

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

1 March 2005

Independent auditors' report to the members of Serco Group plc

for the year ended 31 December 2004

We have audited the financial statements of Serco Group plc for the year ended 31 December 2004 which comprise the profit and loss account, the balance sheets, the cash flow statement, the statement of total recognised gains and losses, the statement of accounting policies and the related notes 1 to 35. These financial statements have been prepared under the accounting policies set out therein. We have also audited the information in the part of the directors' remuneration report that is described as having been audited.

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

RESPECTIVE RESPONSIBILITIES OF DIRECTORS AND AUDITORS

As described in the statement of directors' responsibilities, the company's directors are responsible for the preparation of the financial statements in accordance with applicable United Kingdom law and accounting standards. They are also responsible for the preparation of the other information contained in the annual report including the directors' remuneration report. Our responsibility is to audit the financial statements and the part of the directors' remuneration report described as having been audited in accordance with relevant United Kingdom legal and regulatory requirements and auditing standards

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements and the part of the directors' remuneration report described as having been audited have been properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the directors' report is not consistent with the financial statements, if the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law 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 nine provisions of the July 2003 FRC 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 financial statements.

BASIS OF AUDIT OPINION

We conducted our audit in accordance with United Kingdom auditing standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements and the part of the directors' remuneration report described as having been audited. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements and of whether the accounting policies are appropriate to the circumstances of the company and the group, consistently applied and adequately disclosed.

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

OPINION

In our opinion:

- the financial statements give a true and fair view of the state of affairs of the company and the group as at 31 December 2004 and of the profit of the group for the year then ended; and
- the financial statements and 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

1 March 2005

Consolidated profit and loss account

for the year ended 31 December 2004

	Note	2004 Group £'000	2004 Joint Ventures £'000	2004 Total £'000	2003 Group £'000	2003 Joint Ventures £'000	2003 Total £'000
Turnover: Group and share of joint ventures – continuing operations	2	1,381,417	255,440	1,636,857	1,324,271	231,255	1,555,526
Less: Share of joint ventures	2	–	(255,440)	(255,440)	–	(231,255)	(231,255)
Group turnover	2	1,381,417	–	1,381,417	1,324,271	–	1,324,271
Cost of sales		(1,190,531)	–	(1,190,531)	(1,143,418)	–	(1,143,418)
Gross profit		190,886	–	190,886	180,853	–	180,853
Administrative expenses		(156,204)	–	(156,204)	(157,144)	–	(157,144)
Amortisation of intangible assets		(16,476)	–	(16,476)	(14,131)	–	(14,131)
Other administrative expenses		(139,728)	–	(139,728)	(138,516)	–	(138,516)
Exceptional item: reorganisation costs		–	–	–	(4,497)	–	(4,497)
Operating profit-continuing operations		34,682	–	34,682	23,709	–	23,709
Exceptional item: GSR sale and leaseback	4	–	–	–	3,977	–	3,977
Share of operating profit in joint ventures		–	25,437	25,437	–	22,700	22,700
Interest receivable and similar income	5	31,171	4,111	35,282	16,760	11,397	28,157
Group		31,171	–	31,171	12,691	–	12,691
Exceptional item: Norfolk and Norwich refinancing		–	–	–	4,069	–	4,069
Share of joint ventures		–	4,111	4,111	–	11,397	11,397
Interest payable and similar charges	6	(33,259)	(4,760)	(38,019)	(15,609)	(10,080)	(25,689)
Group		(33,259)	–	(33,259)	(15,609)	–	(15,609)
Share of joint ventures		–	(4,760)	(4,760)	–	(10,080)	(10,080)
Profit on ordinary activities before taxation	7	32,594	24,788	57,382	28,837	24,017	52,854
Taxation on profit on ordinary activities	8			(20,371)			(19,103)
Profit on ordinary activities after taxation				37,011			33,751
Share of joint venture minority interest				(577)			(198)
Minority interest				(413)			(255)
Profit for the financial year				36,021			33,298
Equity dividends	9			(11,810)			(10,050)
Retained profit for the financial year	25			24,211			23,248
Earnings per Ordinary Share (EPS)	10						
Basic EPS:							
After amortisation of intangible assets				8.37p			7.75p
Before amortisation of intangible assets				12.20p			11.03p
Diluted EPS:							
After amortisation of intangible assets				8.27p			7.74p
Before amortisation of intangible assets				12.06p			11.02p

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

Consolidated balance sheet

as at 31 December 2004

	Note	2004 £'000	2003 £'000
Fixed Assets			
Intangible assets	11	215,157	222,950
Tangible assets	12	79,537	77,398
Investments in joint ventures	13	27,196	24,886
Share of gross assets		195,475	151,460
Share of gross liabilities		(168,279)	(126,574)
Other investments	13	13,712	–
		335,602	325,234
Current assets			
Stocks	14	36,204	39,543
Debtors: Amounts due within one year	15	293,608	278,931
Debtors: Amounts due after more than one year	15	333,615	419,589
Cash at bank and in hand	18	173,886	170,888
		837,313	908,951
Creditors: Amounts falling due within one year			
Trade creditors		76,886	81,335
Other creditors including taxation and social security	16	114,179	90,892
Accruals and deferred income		192,032	177,866
Proposed dividend	9	8,330	6,958
		391,427	357,051
Net current assets		445,886	551,900
Total assets less current liabilities		781,488	877,134
Creditors: Amounts falling due after more than one year	17	415,088	539,798
Provisions for liabilities and charges	19	61,981	56,526
Net assets		304,419	280,810
Capital and reserves			
Called up share capital	22	8,707	8,697
Share premium account	23	191,510	190,791
Capital redemption reserve		143	143
ESOP reserve	24	(15,815)	(16,949)
Profit and loss account	25	119,874	98,128
Equity shareholders' funds	21	304,419	280,810

These Accounts and Notes were approved by the Board of Directors on 1 March 2005 and signed on behalf of the Board:

Kevin Beeston Executive Chairman

Andrew Jenner Finance Director

Company balance sheet

as at 31 December 2004

	Note	2004 £'000	2003 £'000
Fixed Assets			
Tangible assets	12	3,897	1,256
Investments in subsidiary undertakings	13	453,298	262,783
Other investments	13	13,712	–
		470,907	264,039
Current Assets			
Stock	14	46	41
Amounts owed by subsidiary companies due after more than one year		12,445	146,501
Debtors: Amounts due within one year	15	28,484	21,281
Debtors: Amounts due after more than one year	15	1,513	1,169
Cash at bank and in hand		84,681	39,165
		127,169	208,157
Creditors: Amounts falling due within one year			
Bank overdrafts		105,427	–
Trade creditors		925	881
Other creditors including taxation and social security	16	7,077	11,010
Accruals and deferred income		12,048	5,801
Proposed dividend	9	8,330	6,958
		133,807	24,650
Net current (liabilities)/assets		(6,638)	183,507
Total assets less current liabilities		464,269	447,546
Creditors: Amounts falling due after more than one year	17	160,583	161,456
Provisions for liabilities and charges	19	201	–
Net Assets		303,485	286,090
Capital and reserves			
Called up share capital	22	8,707	8,697
Share premium account	23	191,510	190,791
Capital redemption reserve		143	143
Profit and loss account	25	103,125	86,459
Equity shareholders' funds		303,485	286,090

These Accounts and Notes were approved by the Board of Directors on 1 March 2005 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 2004

	Note	2004 £'000	2003 £'000
Operating profit		34,682	23,709
Depreciation and amortisation of intangible assets		35,790	32,532
Movement in ESOP investment		1,134	1,258
Net increase in working capital		(3,642)	(11,111)
Net cash inflow from operating activities before PFI asset expenditure		67,964	46,388
Movement in PFI debtor *		6,902	3,680
Expenditure on PFI assets under construction *		(16,278)	(33,001)
Net cash inflow from operating activities after PFI asset expenditure	26	58,588	17,067
Dividends received from joint ventures		14,239	12,630
Returns on investments and servicing of finance			
Interest received		31,033	5,652
Interest paid		(34,767)	(6,054)
Exceptional item: Norfolk and Norwich refinancing		–	4,069
Net cash (outflow)/inflow from returns on investments and servicing of finance		(3,734)	3,667
Taxation			
Tax paid		(1,479)	(7,354)
Capital expenditure and financial investment			
Purchase of tangible fixed assets		(19,257)	(21,835)
Sale of tangible fixed assets		51	8,878
Exceptional item: GSR sale and leaseback		–	5,761
Net cashflows with joint ventures		(1,960)	2,969
Net cash outflow from capital expenditure and financial investment		(21,166)	(4,227)
Acquisitions and disposals			
Acquisitions †		(13,890)	(107,463)
Net cash acquired with acquisitions		–	12,843
Net overdraft/(cash) redeemed upon disposal		16	(3,141)
Subscription for shares in joint ventures		–	(3,354)
Proceeds from disposal of subsidiary and business undertakings		3,159	4,471
Proceeds from reduction in investment in joint ventures		1,763	–
Net cash outflow from acquisitions and disposals		(8,952)	(96,644)
Equity dividends paid			
Dividends paid		(10,438)	(9,529)
Net cash outflow from equity dividends paid		(10,438)	(9,529)
Net cash inflow/(outflow) before financing		27,058	(84,390)
Financing			
Issue of ordinary share capital		729	–
(Decrease)/increase in other loans		(782)	115,793
(Decrease)/increase in non-recourse debt financing		(15,798)	76,285
Capital element of finance lease repayments		(7,782)	(6,188)
Net cash (outflow)/inflow from financing		(23,633)	185,890
Increase in cash in the year		3,425	101,500
Balance at 1 January		170,888	69,388
Non-cash movements		(427)	–
Balance at 31 December		173,886	170,888

* PFI assets and debtor financed by non-recourse bank loans.
† Includes investment of £13,712,000 in respect of ITNET prior to the acquisition offer becoming unconditional.

Consolidated statement of total recognised gains and losses

for the year ended 31 December 2004

	2004 £'000	2003 £'000
Profit for the financial year	**36,021**	33,298
Currency translation differences on foreign currency net investments	**(2,714)**	6,654
Total recognised gains and losses for the year	**33,307**	39,952

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 throughout the year, and the preceeding year.

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 and controlled 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.

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.

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.

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.

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.

Intangible assets
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.

Development expenditure
Development expenditure relating to software is capitalised as an intangible asset where the Directors are satisfied as to the technical, commercial and financial viability of individual projects. It is amortised over the period in which the Group is expected to benefit. This period is between three to five years, or the length of the contract if longer. Provision is also made for impairment if required. All other research and development expenditure is written off as incurred.

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

1. ACCOUNTING POLICIES (continued)

Depreciation

Depreciation is provided on a straight-line basis at rates which, in the opinion of the Directors, reduce the assets to their residual value over their estimated useful lives.

The principal annual rates used are:

Freehold buildings	2.5%
Short leasehold building improvements	The higher of 10% or rate produced by lease term
Machinery	15% – 20%
Motor vehicles	18% – 50%
Furniture	10%
Office equipment	20% – 33%
Leased equipment	The higher of the rate produced by either lease term or useful life

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.

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.

Fixed asset investment

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

Stocks

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

Contract balances

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 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.

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 seven 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.

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 shares, 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.

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.

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. The expected cost to the company for providing defined benefit pensions is calculated in accordance with periodic valuations by consulting actuaries.

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 (FRS17) – Retirement Benefits. For further information see Note 32.

2. SEGMENTAL REPORT

Classes of Business 2004	Group £'000	Joint Ventures £'000	Total £'000
Turnover			
Civil government	540,634	6,498	547,132
Defence	320,598	165,907	486,505
Transport	279,049	83,035	362,084
Science	115,972	–	115,972
Private sector	125,164	–	125,164
Total	**1,381,417**	**255,440**	**1,636,857**
Profit before taxation and other costs			
Civil government	24,374	656	25,030
Defence	23,389	17,620	41,009
Transport	16,125	7,161	23,286
Science	10,439	–	10,439
Private sector	3,081	–	3,081
Total	**77,408**	**25,437**	**102,845**
Other costs			
Common costs			(26,250)
Amortisation of intangible assets			(16,476)
Net interest – group			(2,088)
Net interest – joint ventures			(649)
Profit on ordinary activities before taxation			**57,382**
Net assets			
Civil Government			66,228
Defence			67,378
Transport			58,108
Science			60,399
Private sector			31,131
Total			**283,244**
Unallocated assets			21,175
Total			**304,419**

2. SEGMENTAL REPORT (continued)

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)

Geographical segments 2004	Group £'000	Joint Ventures £'000	Total £'000
Turnover			
United Kingdom	1,006,310	196,030	1,202,340
Europe and Middle East	180,612	6,051	186,663
Asia Pacific	105,556	47,747	153,303
North America	88,939	5,612	94,551
Total	**1,381,417**	**255,440**	**1,636,857**
Profit before taxation and other costs			
United Kingdom	51,986	21,989	73,975
Europe and Middle East	13,200	496	13,696
Asia Pacific	3,386	2,630	6,016
North America	8,836	322	9,158
Total	**77,408**	**25,437**	**102,845**
Other costs			
Common costs			(26,250)
Amortisation of intangible assets			(16,476)
Net interest – group			(2,088)
Net interest – joint ventures			(649)
Profit on ordinary activities before taxation			**57,382**
Net assets			
United Kingdom			172,650
Europe and Middle East			42,352
Asia Pacific			41,252
North America			26,990
Total			**283,244**
Unallocated assets			21,175
Total			**304,419**

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

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**

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

3. INFORMATION REGARDING DIRECTORS AND EMPLOYEES

	2004 £'000	2003 £'000
a) Directors' remuneration:		
Fees as Directors	160	131
Other emoluments	1,556	1,754
Total remuneration excluding pensions	1,716	1,885

	2004 £'000	2003 £'000
b) Employee costs including Directors*:		
Wages and salaries	584,589	551,117
Social security costs	53,259	50,320
Other pension costs (Note 32)	34,765	36,755
Long Term Incentive Scheme costs (Note 24)	1,134	1,258
	673,747	639,450

	2004	2003
c) The average number of persons employed by Serco Group plc and its subsidiaries in the provision of services was*:		
Civil Government	7,617	8,135
Defence	9,958	7,920
Transport	4,600	5,577
Science	2,676	1,630
Private sector	2,755	2,941
Non-specific	467	249
	28,073	26,452

*Excludes joint ventures

4. NON-OPERATING EXCEPTIONAL ITEM

	2004 £'000	2003 £'000
Profit on GSR sale & leaseback	–	3,977
Effect of tax charged to the profit and loss account	–	1,193

In 2003 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

	2004 £'000	2003 £'000
Interest on loans to joint ventures	278	831
Other	30,893	11,860
	31,171	12,691
Exceptional Item: Norfolk and Norwich refinancing	–	4,069
Total Group	31,171	16,760
Share of interest earned by joint venture companies	4,111	11,397
	35,282	28,157

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

6. INTEREST PAYABLE AND SIMILAR CHARGES

	2004 £'000	2003 £'000
Interest on loans and overdrafts	32,533	15,075
Interest relating to finance leases and hire purchase contracts	726	534
	33,259	15,609
Share of interest payable by joint venture companies	4,760	10,080
	38,019	25,689

7. PROFIT ON ORDINARY ACTIVITIES BEFORE TAXATION

	2004 £'000	2003 £'000
Profit on ordinary activities before taxation is stated after charging:		
Rentals under operating leases:		
Land and buildings	16,105	13,884
Plant and machinery	24,112	19,067
Depreciation on tangible assets:		
Owned	14,810	13,742
Held under finance leases	4,753	4,659
Amortisation of intangible assets	16,227	14,131
Goodwill previously written off to reserves, released on sale of subsidiary	249	–
Auditors' remuneration for audit services:		
Deloitte & Touche LLP	883	772
Other auditors	189	116
Other fees paid to Deloitte & Touche LLP:		
Bid support	261	186
Tax	804	889
Other	318	1,223
Other fees paid to other accountancy firms:		
Internal audit	165	165
Other	120	98

In addition to the above there are other fees included in the balance sheet in respect of acquisition advice which are payable to Deloitte & Touche LLP of £750,000 and for other accountancy firms of £600,000.

8. TAXATION ON PROFIT ON ORDINARY ACTIVITIES

	2004 £'000	2003 £'000
The taxation charge is made up as follows:		
United Kingdom corporation tax	6,139	–
Overseas taxation	3,598	5,074
Adjustment in respect of prior years:		
United Kingdom corporation tax	(8,706)	898
Overseas taxation	(582)	(122)
Current tax	449	5,850
Deferred taxation		
Current year movement	5,362	5,292
Adjustments in respect of prior years	7,085	182
Share of joint ventures' taxation charge	7,475	7,779
	20,371	19,103

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

	2004 £'000	2003 £'000
Profit on ordinary activities before taxation	57,382	52,854
Less: Share of profit before tax of joint ventures	(24,788)	(24,017)
	32,594	28,837
Profit on ordinary activities before taxation multiplied by the UK corporation tax rate of 30%	9,778	8,651
Effect on the reported tax charge of:		
Amortisation of goodwill, intangible assets and investment in own shares not deductible for tax	2,370	2,220
Differences between tax and accounting basis of assets disposed	1,575	–
Other expenses not deductible for tax	3,931	2,935
Tax allowances in excess of depreciation	(3,489)	(4,729)
Other short term timing differences	(1,870)	(2,245)
Unrelieved tax losses and different tax rates on overseas earnings	679	352
Untaxed income and the effect of the use of unrecognised tax losses	(851)	(159)
Tax incentives	(2,386)	(1,951)
Adjustments in respect of prior years	(9,288)	776
Current tax	449	5,850
Deferred tax	12,447	5,474
Share of joint ventures' tax charge	7,475	7,779
Taxation on profit on ordinary activities	20,371	19,103

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

	2004 £'000	2003 £'000
Interim dividend of 0.81p per share on 429,629,630 Ordinary Shares (2003 – 0.72p on 429,466,207 Ordinary Shares) of 2p each fully paid – paid on 11 October 2004.	3,480	3,092
Proposed final dividend of 1.82p per share on 457,724,795 Ordinary Shares (2003 – 1.62p on 429,529,098 Ordinary Shares) of 2p each fully paid – proposed payment on 11 May 2005.	8,330	6,958
	11,810	10,050

A dividend waiver is effective for those shares held on behalf of the Company by its Employee Share Ownership Trust (Note 24).

10. EARNINGS PER ORDINARY SHARE

Basic and diluted earnings per Ordinary Share have been calculated in accordance with Financial Reporting Standard 14 (FRS 14) – Earnings Per Share. Earnings per share is shown both before and after amortisation of intangible assets to assist in the understanding of the impact of FRS10 on the Group Accounts.

	2004	2003
Weighted number of shares in issue	430,127,262	429,878,711
Weighted average number of dilutive share options	5,276,198	412,330
Total number of shares for calculating diluted earnings per share	435,403,460	430,291,041

	2004 Earnings £'000	2004 Per share amount pence	2003 Earnings £'000	2003 Per share amount pence
Basic earnings	36,021	8.37	33,298	7.75
Amortisation of intangible assets	16,476	3.83	14,131	3.28
Earnings before amortisation of intangible assets	52,497	12.20	47,429	11.03
Diluted earnings	36,021	8.27	33,298	7.74
Diluted earnings before amortisation of intangible assets	52,497	12.06	47,429	11.02

11. INTANGIBLE ASSETS

Group	Goodwill £'000	Development expenditure £'000	Other £'000	Total £'000
Cost:				
At 1 January 2004	253,221	–	1,775	254,996
Additions during the year	–	4,158	–	4,158
Transfers	–	2,326	–	2,326
Deconsolidation (Note 13i)	2,119	–	–	2,119
At 31 December 2004	**255,340**	**6,484**	**1,775**	**263,599**
Accumulated amortisation:				
At 1 January 2004	31,345	–	701	32,046
Charge for the year	15,638	209	380	16,227
Deconsolidation	169	–	–	169
At 31 December 2004	**47,152**	**209**	**1,081**	**48,442**
Net book value:				
At 31 December 2004	**208,188**	**6,275**	**694**	**215,157**
At 31 December 2003	221,876	–	1,074	222,950

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

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 2004	10,144	18,530	140,205	168,879
Subsidiaries sold	(757)	(556)	(9,063)	(10,376)
Additions during the year	610	2,977	20,896	24,483
Transfers	–	–	2,650	2,650
Disposals	(102)	(722)	(10,742)	(11,566)
Foreign exchange translation differences	118	(126)	(194)	(202)
At 31 December 2004	**10,013**	**20,103**	**143,752**	**173,868**
Accumulated depreciation:				
At 1 January 2004	2,885	6,612	81,984	91,481
Subsidiaries sold	(66)	(382)	(5,557)	(6,005)
Provided during the year	334	1,772	17,457	19,563
Disposals	(36)	(687)	(9,990)	(10,713)
Foreign exchange translation differences	25	78	(98)	5
At 31 December 2004	**3,142**	**7,393**	**83,796**	**94,331**
Net book value:				
At 31 December 2004	**6,871**	**12,710**	**59,956**	**79,537**
At 31 December 2003	7,259	11,918	58,221	77,398

12. TANGIBLE ASSETS (continued)

The cost of assets held by the Group under finance leases at 31 December 2004 was £40,517,000 (2003 – £38,008,000). The accumulated depreciation provided for those assets at 31 December 2004 was £16,163,000 (2003 – £13,472,000).

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 £5,226,000 (2003 – £13,824,000).

Company	Short leasehold building improvements £'000	Machinery, motor vehicles, furniture and equipment £'000	Total £'000
Cost:			
At 1 January 2004	271	3,344	3,615
Additions during the year	715	2,144	2,859
At 31 December 2004	**986**	**5,488**	**6,474**
Accumulated depreciation:			
At 1 January 2004	175	2,184	2,359
Provided during the year	13	205	218
At 31 December 2004	**188**	**2,389**	**2,577**
Net book value:			
At 31 December 2004	**798**	**3,099**	**3,897**
At 31 December 2003	96	1,160	1,256

The cost of assets held by the Company under finance leases at 31 December 2004 was £750,000 (2003 – £750,000). The accumulated depreciation provided for those assets at 31 December 2004 was £138,000 (2003 – £63,000).

13. INVESTMENTS HELD AS FIXED ASSETS

	Company £'000
a) Shares in subsidiary undertakings at cost:	
At 1 January 2004	262,783
Increase in investments in subsidiary undertakings	190,515
At 31 December 2004	**453,298**

	Group £'000
b) Group investments in joint ventures:	
At 1 January 2004	24,886
Acquisitions	154
Reduction in investment	(1,284)
Foreign exchange translation differences	330
Share of profits after tax	16,736
Dividends receivable	(13,626)
At 31 December 2004	**27,196**

13. INVESTMENTS HELD AS FIXED ASSETS (continued)

c) Joint ventures:

The Group's share of its joint venture profit and assets are summarised as follows:

	2004 AWE* £'000	2004 Other £'000	2004 Total £'000	2003 AWE* £'000	2003 Other £'000	2003 Total £'000
Turnover	111,892	143,548	255,440	101,493	129,762	231,255
Profit before tax	10,305	14,483	24,788	8,984	15,033	24,017
Tax	(2,323)	(5,152)	(7,475)	(1,584)	(6,195)	(7,779)
Minority Interest	–	(577)	(577)	–	(198)	(198)
Profit after tax	7,982	8,754	16,736	7,400	8,640	16,040
Fixed assets	–	29,397	29,397	–	19,236	19,236
Current assets	42,197	123,881	166,078	28,875	103,349	132,224
	42,197	153,278	195,475	28,875	122,585	151,460
Liabilities due within one year	35,171	41,847	77,018	17,207	32,740	49,947
Liabilities due after more than one year	1,514	89,747	91,261	7,356	69,271	76,627
	36,685	131,594	168,279	24,563	102,011	126,574
Share of net assets	5,512	21,684	27,196	4,312	20,574	24,886

*Atomic Weapons Establishment Management Limited

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

d) Other investments represent listed UK equity investments of 4,254,542 ordinary shares of 10 pence each in ITNET plc, which had a market value at 31 December 2004 of £13,933,625.

e) A list of the principal undertakings of Serco Group plc is shown in Note 34. With the exception of Laser (Teddington II) Limited (Laser) (see Note 13i), all the subsidiaries of the Group have been consolidated.

f) At 31 December 2004, Group companies had branches in UAE, Bahrain, Chile, Korea, Saudi Arabia and Switzerland.

g) 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.

h) Disposals:

In 2004 the Group sold its 100% interest in the ordinary share capital of Serco Group NZ Limited, together with five facilities maintenance contracts in Australia. The net proceeds from the sales amounted to £3,159,000. Net assets at the date of disposal amounted to £3,673,000, resulting in a loss on disposal of £763,000 after charging £249,000 of goodwill previously written off to reserves.

13. INVESTMENTS HELD AS FIXED ASSETS (continued)

i) Deconsolidation of Laser

Laser was a PFI special purpose company which had a contract to build the new science building for the National Physical Laboratory in Teddington. The contract was financed by non-recourse debt. After lengthy negotiations between the management of Laser, the Department of Trade and Industry (DTI) and the banks, the DTI announced their intention to end the contract in October 2004.

It is considered that, since October 2004, severe long-term restrictions have existed which have substantially hindered the exercise of the Group's rights over the assets and management of Laser. It has, therefore, been deconsolidated in accordance with FRS 2 – Subsidiary Undertakings, and has been treated as an unlisted investment in the Group balance sheet.

The fair value of the Group's investment in Laser was £nil at 31 December 2004, after a provision of £96,129 was made in the year against the investment. Amounts owed to other Group companies arising from a facilities management contract at 31 December 2004 amounted to £2,225,376, after a provision of £215,000 was made in the year against these debts.

14. STOCKS

	Group 2004 £'000	Group 2003 £'000	Company 2004 £'000	Company 2003 £'000
Service spares	**14,216**	15,954	**–**	–
Long term contract balances	**21,988**	23,589	**46**	41
	36,204	39,543	**46**	41

15. DEBTORS

	Group 2004 £'000	Group 2003 £'000	Company 2004 £'000	Company 2003 £'000
a) Amounts due within one year:				
Amounts recoverable on contracts	**194,261**	198,687	**73**	189
Other debtors	**39,399**	32,572	**13,354**	8,129
Corporation tax recoverable	**1,784**	1,670	**15,057**	12,125
Prepayments and accrued income	**46,696**	35,924	**–**	613
Amounts owed by joint ventures	**6,078**	2,600	**–**	225
PFI debtor *	**5,390**	7,478	**–**	–
	293,608	278,931	**28,484**	21,281

15. DEBTORS (continued)

	Group 2004 £'000	Group 2003 £'000	Company 2004 £'000	Company 2003 £'000
b) Amounts due after more than one year:				
Amounts recoverable on contracts	27,972	22,043	–	–
Other debtors	16,064	21,780	1,513	1,169
Pensions prepayment (Note 32)	34,580	30,580	–	–
Amounts owed by joint ventures	2,934	8,869	–	–
PFI debtor *	181,816	260,780	–	–
PFI assets in the course of construction*	70,249	75,537	–	–
	333,615	419,589	1,513	1,169
Total debtors	627,223	698,520	29,997	22,450

*The PFI assets analysed above are funded by non-recourse bank loans of £208,905,000 (2003 – £307,229,000).
*Movements in PFI balances during the year include a reduction of £94,634,540 in respect of the deconsolidation of Laser (See Note 13i).

16. OTHER CREDITORS INCLUDING TAXATION AND SOCIAL SECURITY

	Group 2004 £'000	Group 2003 £'000	Company 2004 £'000	Company 2003 £'000
Obligations under finance leases	6,542	5,898	146	131
Other loans	23,496	4,473	–	–
	30,038	10,371	146	131
Other taxes and social security costs	22,917	9,022	–	–
Other creditors	49,289	55,214	218	679
Amounts owed to joint ventures	11,935	16,285	6,713	10,200
	114,179	90,892	7,077	11,010

17. CREDITORS: AMOUNTS FALLING DUE AFTER MORE THAN ONE YEAR

	Group 2004 £'000	Group 2003 £'000	Company 2004 £'000	Company 2003 £'000
Non-recourse bank loans (relating to PFI assets)	208,905	307,229	–	–
Other non-recourse loans	47,538	49,750	–	–
Obligations under finance leases	20,144	23,461	532	671
Other loans	168,539	169,729	160,197	160,916
	445,126	550,169	160,729	161,587
Less: amounts included in creditors falling due within one year	30,038	10,371	146	131
Amounts falling due after more than one year	415,088	539,798	160,583	161,456

17. CREDITORS: AMOUNTS FALLING DUE AFTER MORE THAN ONE YEAR (continued)

	Group 2004 £'000	Group 2003 £'000	Company 2004 £'000	Company 2003 £'000
Analysis of loan repayments due:				
Non-recourse bank loans (relating to PFI assets):				
Within one year or on demand	**17,662**	–	**–**	–
Between one and two years	**18,486**	29,445	**–**	–
Between two and five years	**59,491**	63,337	**–**	–
After five years	**113,266**	214,447	**–**	–
Other non-recourse loans:				
Within one year or on demand	**4,671**	–	**–**	–
Between one and two years	**5,352**	10,020	**–**	–
Between two and five years	**15,661**	15,970	**–**	–
After five years	**21,854**	23,760	**–**	–
Obligations under finance leases:				
Within one year or on demand	**6,542**	5,898	**146**	131
Between one and two years	**8,146**	7,214	**386**	146
Between two and five years	**5,025**	9,289	**–**	394
After five years	**431**	1,060	**–**	–
Other loans:				
Within one year or on demand	**1,163**	4,473	**–**	–
Between one and two years	**3,996**	763	**–**	–
Between two and five years	**46,183**	46,561	**43,000**	43,171
After five years	**117,197**	117,932	**117,197**	117,745
	445,126	550,169	**160,729**	161,587

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

18. DERIVATIVES AND OTHER FINANCIAL INSTRUMENTS

Page 52 of the Finance Review provides an explanation of the role that financial instruments have had during the year in managing the risks the Group faces in its activities. The explanation summarises the policies for holding or issuing financial instruments that have been followed during the year.

The numerical disclosures in this note deal with financial assets and financial liabilities as defined in Financial Reporting Standard 13 (FRS 13), Derivatives and other Financial Instruments: Disclosures. As permitted by FRS 13, short-term debtors and creditors have been excluded from the note, other than the currency exposures (note c).

a) Interest rate profile
After taking into account interest rate swaps and forward foreign currency contracts entered into by the Group, the interest rate profile of the Group's financial assets and liabilities was as follows:

i) Financial assets

31 December 2004	Sterling £'000	Euro £'000	Australian Dollar £'000	US Dollar £'000	Other currencies £'000	Total £'000
Cash and short term deposits	116,985	18,614	21,446	12,230	4,611	173,886
Long term interest-bearing loans to joint ventures	2,934	–	–	–	–	2,934
Other long term debtors	321,621	242	488	8,330	–	330,681
Total long term assets	**324,555**	**242**	**488**	**8,330**	**–**	**333,615**

18. DERIVATIVES AND OTHER FINANCIAL INSTRUMENTS (continued)

a) Interest rate profile (continued)

i) Financial assets (continued)

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

Cash and short-term deposits includes £21,623,000 (2003 – £21,851,000) which is not currently available to be distributed or lent to other Group companies. £13,726,000 (2003 – £11,868,000) of this represents a debt service reserve in favour of the lenders of non-recourse debt.

Long term debtors includes £252,065,000 (2003 – £336,317,000) recognised by companies that are funded by non-recourse debt.

Fixed rate loans included in the above comprise Sterling loans of £8,217,000 carrying a weighted average interest rate of 12.74%. (2003 – Sterling fixed rate 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%).

ii) Financial liabilities

					Fixed rate liabilities	
31 December 2004	Total liabilities £'000	Floating rate liabilities £'000	Fixed rate liabilities £'000	Interest free liabilities £'000	Weighted average interest rate %	Weighted average time for which rate is fixed Years
Sterling	376,064	26,339	349,725	–	6.77	7
Australian Dollar	–	–	–	–	–	–
US Dollar	–	–	–	–	–	–
Canadian Dollar	47,538	–	47,538	–	5.27	5
Other	1,380	–	–	1,380	–	–
Total	**424,982**	**26,339**	**397,263**	**1,380**		

					Fixed rate liabilities	
31 December 2003	Total liabilities £'000	Floating rate liabilities £'000	Fixed rate liabilities £'000	Interest free liabilities £'000	Weighted average interest rate %	Weighted average time for which rate is fixed Years
Sterling	469,594	21,545	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	526,708	28,908	497,800	–		

18. DERIVATIVES AND OTHER FINANCIAL INSTRUMENTS (continued)

a) Interest rate profile (continued)

ii) Financial liabilities (continued)

Included within liabilities recognised above is £256,443,000 of non-recourse debt (2003 – £356,979,000).

Excluded from the above analysis is £20,144,000 of amounts payable under finance leases, which are subject to fixed rates of interest (2003 – £23,461,000).

The interest rate on floating rate financial liabilities is linked to three-month or six-month LIBOR.

Details of the Group's credit facilities are included in section 8.2 of the Finance Review.

b) Maturity of financial liabilities

The maturity of the Group's financial liabilities at 31 December 2004 and 31 December 2003 were:

	2004 £'000	2003 £'000
In one year or less	**30,038**	10,371
In more than one year but not more than two years	**35,980**	47,442
In more than two years but not more than five years	**126,360**	135,157
In more than five years	**252,748**	357,199
	445,126	550,169

c) Currency exposures

The analysis below shows the Group's net monetary assets and liabilities that are not denominated in the functional currency of the relevant business unit, and therefore potentially give rise to exchange gains and losses in the profit and loss account. The amounts shown in the table take into account the effect of hedging instruments used to manage these exposures.

31 December 2004		Net foreign currency monetary assets/(liabilities)					
Functional currency of business unit	Sterling £'000	Euro £'000	Australian Dollar £'000	Canadian Dollar £'000	US Dollar £'000	Other currencies £'000	Total £'000
Sterling	–	2,041	–	80	652	(139)	2,634
Other currencies	2,054	–	–	–	–	–	2,054
Total	**2,054**	**2,041**	**–**	**80**	**652**	**(139)**	**4,688**

31 December 2003		Net foreign currency monetary assets/(liabilities)					
Functional currency of business unit	Sterling £'000	Euro £'000	Australian Dollar £'000	Canadian Dollar £'000	US Dollar £'000	Other currencies £'000	Total £'000
Sterling	–	751	1,063	–	206	450	2,470
Other currencies	2,260	–	–	–	–	–	2,260
Total	2,260	751	1,063	–	206	450	4,730

18. DERIVATIVES AND OTHER FINANCIAL INSTRUMENTS (continued)

d) Fair values

The book value and fair value of the Group's financial assets and liabilities at 31 December 2004 and 31 December 2003 were:

	2004 Book value £'000	2004 Fair value £'000	2003 Book value £'000	2003 Fair value £'000
Primary financial instruments held or used to finance the Group's operations:				
Short-term financial liabilities and current portion of long-term debt	**(30,038)**	**(30,038)**	(10,371)	(10,371)
Long-term debt	**(415,088)**	**(404,114)**	(531,041)	(535,201)
Cash & short-term deposits	**173,886**	**173,886**	170,888	170,888
Other long-term debtors	**330,681**	**330,681**	410,720	410,720
Long-term loans to joint ventures	**2,934**	**2,934**	8,869	8,869
Derivative financial instruments held to manage interest rate and exchange rate profile:				
Interest rate swaps	**–**	**(17,497)**	–	(27,230)
Cross currency swaps	**–**	**(9,419)**	(8,757)	(3,233)
Forward exchange contracts	**–**	**(8,577)**	–	(5,726)

The fair values of cross currency swaps, interest rate swaps, and forward foreign exchange contracts have been determined by reference to prices available from the markets on which the instruments involved are traded.

e) Gains and losses on hedges

Changes in the fair value of instruments used as hedges are not recognised in the financial statements until the hedged position matures. An analysis of these unrecognised gains and losses is as follows:

	2004 Gains £'000	2004 Losses £'000	2004 Net £'000	2003 Gains £'000	2003 Losses £'000	2003 Net £'000
Unrecognised gains and losses on hedges at 1 January	**–**	**(36,189)**	**(36,189)**	4,138	(2,422)	1,716
Arising in previous years that were recognised in the year	**–**	**7,130**	**7,130**	(4,138)	–	(4,138)
Deconsolidated in the year (Note 13i)	**–**	**6,100**	**6,100**	–	–	–
Arising before 1 January that were not recognised in the year	**–**	**(22,959)**	**(22,959)**	–	(2,422)	(2,422)
Arising in the year that were not recognised in the year	**9**	**(12,543)**	**(12,534)**	–	(33,767)	(33,767)
Unrecognised gains and losses on hedges at 31 December	**9**	**(35,502)**	**(35,493)**	–	(36,189)	(36,189)
Expected to be recognised in the following year	**9**	**(4,969)**	**(4,960)**	–	(8,412)	(8,412)
Expected to be recognised after the following year	**–**	**(30,533)**	**(30,533)**	–	(27,777)	(27,777)

19. PROVISIONS FOR LIABILITIES AND CHARGES

Group	Balance 1 January 2004 £'000	Deconsolidation £'000	Utilised £'000	Charged to the profit and loss account £'000	Foreign exchange differences £'000	Balance 31 December 2004 £'000
Pensions provision	28,640	–	(817)	1,718	215	**29,756**
Deferred taxation	27,886	(6,330)	–	10,726	(57)	**32,225**
	56,526	(6,330)	(817)	12,444	158	**61,981**

Company	Balance 1 January 2004 £'000	Utilised £'000	Charged to the profit and loss account £'000	Foreign exchange differences £'000	Balance 31 December 2004 £'000
Deferred taxation	(196)	–	397	–	**201**

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

20. DEFERRED TAXATION

	Group 2004 £'000	Group 2003 £'000	Company 2004 £'000	Company 2003 £'000
The amounts of deferred taxation provided in the accounts are:				
Deferred tax liabilities:				
Tax allowances in excess of depreciation	**22,397**	16,166	**(189)**	–
Overseas timing differences	**273**	28	**–**	–
Other timing differences	**9,555**	11,692	**390**	–
	32,225	27,886	**201**	–
Deferred tax assets (included within 'other debtors'):				
Tax allowances in excess of depreciation	**–**	–	**–**	(203)
Other timing differences	**–**	–	**–**	7
Overseas timing differences	**–**	(1,721)	**–**	–
	32,225	26,165	**201**	(196)

	Group 2004 £'000	Group 2003 £'000
Movement in deferred taxation		
Balance 1 January	**26,165**	8,725
(Deconsolidation)/acquisitions	**(6,330)**	11,958
Tax charge for the year	**10,726**	7,195
Reversal of deferred tax asset	**1,721**	–
Tax credit for the year	**–**	(1,721)
Foreign exchange	**(57)**	8
Balance 31 December	**32,225**	26,165

The Group has not provided deferred tax assets in respect of certain overseas timing differences. The amount of unprovided deferred tax assets as at 31 December 2004 is approximately £11.0 million (2003 – £6.1 million).

21. RECONCILIATION OF MOVEMENTS IN EQUITY SHAREHOLDERS' FUNDS

	2004 £'000	2003 £'000
Retained profit for the financial year	**24,211**	23,248
Goodwill previously written off released on sale of subsidiary	**249**	–
Currency translation differences on foreign currency net investments	**(2,714)**	6,654
New capital subscribed	**729**	–
Change in ESOP reserve	**1,134**	1,258
Net increase in equity shareholders' funds	**23,609**	31,160
Opening equity shareholders' funds	**280,810**	249,650
Closing equity shareholders' funds	**304,419**	280,810

22. CALLED UP SHARE CAPITAL

	2004 £'000	2003 £'000
a) Authorised 550,000,000 (2003 – 550,000,000) Ordinary Shares of 2p each	**11,000**	11,000

	2004 £'000	2003 £'000
b) Called up, allotted and fully paid: 435,352,903 (2003 – 434,880,837) Ordinary Shares of 2p each	**8,707**	8,697

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

During the year 682,900 Ordinary Shares of 2p each were allotted to the holders of options or their personal representatives. Of these, 472,066 were allotted using newly issued shares. Of the remaining 210,834 all were allotted at £nil value using shares purchased in the market and held in trust.

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 2004 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 2004 no options remain.

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 2004 there remained 201,661 options which are exercisable at a price of £2.175* each and 1,805 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 2004 there remained 285,654 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 2004 there remained 242,077 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 'Serco Group plc 1996 Long Term Incentive Scheme as amended by the Company on 5 April 2000'. At 31 December 2004 there remained 15,695 options which are exercisable at £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'. At 31 December 2004 there remained 21,893 options which are exercisable at a price of £5.825 and 8,878 options are exercisable at a price of £4.90 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)

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 'Serco Group plc 1996 Long Term Incentive Scheme as amended by the Company on 5 April 2000'. At 31 December 2004 there remained 126,008 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 plc 1998 Executive Option Plan'. At 31 December 2004 there remained 1,904,230 options which are exercisable at a price of £4.075 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 plc 1998 Executive Option Plan'. At 31 December 2004 there remained 326,062 options which are exercisable at a price of £4.35 each in accordance with the rules of the Scheme.

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 'Serco Group plc 1996 Long Term Incentive Scheme as amended by the Company on 5 April 2000'. At 31 December 2004 there remained 132,785 options which were 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 plc 1998 Executive Option Plan'. At 31 December 2004 there remained 5,603,524 options which are exercisable at a price of £2.64 each and 27,626 which are exercisable at a price of £2.89 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 'Serco Group plc 1996 Long Term Incentive Scheme as amended by the Company on 5 April 2000'. At December 2004 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 plc 1998 Executive Option Plan'. At 31 December 2004 there remained 4,916,585 options which are exercisable at a price of £1.645 each and 48,241 which are exercisable at a price of £1.69 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 'Serco Group plc 1996 Long Term Incentive Scheme as amended by the Company on 5 April 2000'. At 31 December 2004 there remained 700,730 options which 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 plc 1998 Executive Option Plan'. At 31 December 2004 there remained 10,346,033 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 plc 1998 Executive Option Plan'. At 31 December 2004 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 'Serco Group plc 1996 Long Term Incentive Scheme as amended by the Company on 5 April 2000'. At 31 December 2004 no options had been exercised or lapsed.

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 plc 1998 Executive Option Plan'. At 31 December 2004 there remained 35,178 options which are exercisable at a price of £1.70 each in accordance with the rules of the Scheme.

XX. On 3 March 2004, 824,432 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 2004 there remained 824,432 options which are exercisable at a price of £2.17 each in accordance with the rules of the Scheme.

XXI. On 30 April 2004, 903,148 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 2004 there remained 841,329 options which are exercisable at a price of £2.1375 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)

XXII. On 21 December 2004, 539,716 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 as amended by the Company on 05 April 2000'. At 31 December 2004 no options had been exercised or lapsed. These options have been granted in respect of a three-year performance period starting 1 January 2005 and are exercisable at a £nil value 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 2004 was £2.40. The market price of these shares ranged from £1.69 to £2.42 during the year.

23. SHARE PREMIUM ACCOUNT

Group and Company	£'000
Balance at 1 January 2004	190,791
Premium on shares issued	719
Balance at 31 December 2004	**191,510**

24. ESOP RESERVE

Group	£'000
At 1 January 2004	(16,949)
Amortisation	1,134
At 31 December 2004	**(15,815)**

The "ESOP" reserve represents 5,183,003 (2003 – 5,351,739) shares in Serco Group plc held by the Employee Share Ownership Trust (the Trust) equal to 1.19% of current allotted share capital (2003 – 1.23%). The market value of shares held by the Trust at 31 December 2004 was £12,439,207 (2003 – £9,204,991). 168,736 shares were allotted during the year at £nil value (2003 – 59,438 were allotted at £nil value and 3,453 at a price of £1.645).

25. PROFIT AND LOSS ACCOUNT

	Group £'000	Company £'000
Balance at 1 January 2004	98,128	86,459
Profit for the financial year	36,021	28,492
Equity dividends	(11,810)	(11,810)
Goodwill previously written off, released on sale of subsidiary	249	–
Currency translation differences on foreign currency net investments	(2,714)	(16)
Balance at 31 December 2004	**119,874**	**103,125**

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.

26. RECONCILIATION OF OPERATING PROFIT TO NET CASH INFLOW FROM OPERATING ACTIVITIES

	2004 £'000	2003 £'000
Operating profit	**34,682**	23,709
Depreciation	**19,563**	18,401
Amortisation of goodwill and intangible assets	**16,227**	14,131
Loss/(profit) on sale of tangible fixed assets	**803**	(1,965)
Loss/(profit) on sale of subsidiary undertaking and joint venture	**313**	(267)
Decrease in stocks	**1,658**	1,875
Increase in debtors	**(17,284)**	(4,401)
Increase/(decrease) in creditors	**14,125**	(19,263)
Increase in provisions	**901**	12,910
Decrease in ESOP investment	**1,134**	1,258
Increase in development expenditure	**(4,158)**	–
Net cash inflow from operating activities before PFI asset expenditure	**67,964**	46,388
Movement in PFI debtor	**6,902**	3,680
Expenditure on PFI assets in the course of construction	**(16,278)**	(33,001)
Net cash inflow from operating activities after PFI asset expenditure	**58,588**	17,067

27. ANALYSIS OF NET DEBT

	Balance 1 January 2004 £'000	Disposals £'000	Cash flow movement £'000	Exchange adjustments £'000	Non-cash changes £'000	Balance 31 December 2004 £'000
Cash at bank and in hand	170,888	–	3,425	(359)	(68)	**173,886**
Other loans due within one year	(4,473)	–	3,310	–	–	**(1,163)**
Other loans due after more than one year	(165,256)	397	(2,528)	11	–	**(167,376)**
Finance leases	(23,461)	1,369	7,782	(244)	(5,590)	**(20,144)**
Recourse net debt	(22,302)	1,766	11,989	(592)	(5,658)	**(14,797)**
Non-recourse debt	(356,979)	–	15,798	(740)	85,478	**(256,443)**
Net debt	(379,281)	1,766	27,787	(1,332)	79,820	**(271,240)**

Non-cash changes to non-recourse debt represents £85,478,000 in respect of the deconsolidation of Laser.

28. RECONCILIATION OF INCREASE IN CASH TO MOVEMENT IN NET DEBT

	2004 £'000	2003 £'000
Increase in cash	**3,425**	101,500
Cash outflow/(inflow) from non-recourse debt	**15,798**	(76,285)
Cash outflow/(inflow) from debt and lease financing	**8,564**	(109,605)
Change in net debt resulting from cash flows before:	**27,787**	(84,390)
Change in debt due to acquisitions	**–**	(250,994)
Change in net debt due to disposals	**1,766**	–
Non-cash changes from other debt and lease financing	**78,488**	(20,489)
Movement in net debt in the year	**108,041**	(355,873)
Net debt at 1 January	**(379,281)**	(23,408)
Net debt at 31 December	**(271,240)**	(379,281)

Non-cash changes from other debt and lease financing includes £85,478,000 in respect of the deconsolidation of Laser.

29. CONTINGENT LIABILITIES

The Company has provided guarantees and indemnities in respect of the loan, overdraft and bonding facilities of its subsidiaries amounting to £11,399,000, and its joint ventures amounting to £5,879,000.

At 31 December 2004, the value of loans and overdrafts drawn against the above was £7,057,000 in respect of subsidiaries and £1,279,000 in respect of joint ventures.

In addition, the Group has given performance guarantees, and indemnities relating to performance bonds and letters of credit issued by its banks on its behalf, in the ordinary course of business. These are not expected to result in any material financial loss.

30. CAPITAL AND OTHER COMMITMENTS

	Group 2004 £'000	Group 2003 £'000	Company 2004 £'000	Company 2003 £'000
Capital expenditure contracted but not provided	587	11,878	–	–

In addition to the above, the Company was contracted to acquire the balance of share capital of ITNET plc for a consideration of £229,000,000.

Annual financial commitments under operating leases were as follows:

	Land and buildings 2004 £'000	Land and buildings 2003 £'000	Other 2004 £'000	Other 2003 £'000
Leases which expire:				
Within one year	1,691	4,323	9,622	3,004
Between one and five years	3,709	8,139	11,801	19,596
After five years	7,801	4,308	4,572	1,023
	13,201	16,770	25,995	23,623

31. 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 2004:

	2004 £'000	2003 £'000
Net loans during the year	3,328	(7,821)
Net trading	12,577	1,561
Royalties and management fees receivable	1,579	1,098
Dividends receivable	13,626	12,630
	31,110	7,468

31. RELATED PARTIES (continued)

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

	2004 £'000	2003 £'000
Amounts due within one year:		
Loans	**1,607**	1,944
Trading balance	**144**	488
Royalties and management fees	**4,327**	168
	6,078	2,600
Amounts due after more than one year:		
Loans	**2,934**	3,619
Royalties and management fees	**–**	5,250
	2,934	8,869

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

	2004 £'000	2003 £'000
Amounts payable within one year:		
Loans	**11,935**	16,285
	11,935	16,285

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

32. PENSION SCHEMES

The Group has continued to account for pensions in accordance with SSAP 24. 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 2004 was £75.6 million (2003 – £69.7 million) on an asset base of £380.8 million (2003 – £350.4 million).

a) SSAP 24 Disclosure

The net pension charge in accordance with SSAP 24 for the year ended 31 December 2004 was £34,765,000 (2003 – £36,755,000). 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 2004 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 is 27%.

This is a pre-funded defined benefit scheme.

32. PENSION SCHEMES (continued)

a) SSAP 24 Disclosure (continued)

i) Serco Pension and Life Assurance Scheme (SPLAS) (continued)

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 are:

Investment yield	7.25% p.a.
Salary growth	4.0% p.a.
Price inflation	2.75% p.a.
Pension increases	2.75% 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 £18,852,000 (2003 – £22,250,000), of which £324,000 (2003 – £910,000) related to special contributions and augmentations. The £9,000,000 incremental contribution in 2003 was replaced in 2004 by increased employer contributions resulting in an average contribution rate of 27% (2003 – 19%).

At 31 December 2004 a prepayment of £34,580,000 (2003 – £30,580,000) in respect of the scheme was included in the balance sheet and £14,804,000 (2003 – £20,020,000) was charged to the profit and loss account in respect of the scheme.

ii) 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 completed review being carried out as at 5 April 2001 and updated to 31 December 2004 by a qualified independent actuary. 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 38% 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 2004 profit and loss account were £2,925,000 (2003 – £1,974,000).

32. PENSION SCHEMES (continued)

a) SSAP 24 Disclosure (continued)

iii) Serco GmbH 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 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 £1,718,000 (2003 – £1,663,000) and a provision of £29,756,000 (2003 – £28,640,000) has been included in the balance sheet as at 31 December 2004 of which £29,336,000 (2003 – £22,482,000) relates to the hybrid element of the scheme, and £420,000 (2003 – £6,158,000) to the defined benefit element of the scheme.

iv) 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 2003. The attained age method was used for the actuarial valuation of the scheme as at 31 December 2003. 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 valuation 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 £956,232 (A$2,341,909) at 31 December 2003 with a ratio of market value of assets to current funding level liabilities of 106%.

The actuarial value of assets of the defined benefit element of the scheme represented 106% of its ongoing liabilities at 31 December 2003. The pension cost calculated under the attained age method will be reassessed annually based on future working lives of the existing members of an average of 11 years.

Employer pension contributions charged to the profit and loss account relating to the defined benefit element of the scheme were £14,056 (2003 – £nil).

32. 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% for the scheme.

Employer pension contributions charged to the 2004 profit and loss account during the year were £221,000 (2003 – £783,000).

vi) Serco Metrolink Pension Scheme

This is a pre-funded defined benefit scheme. The Company accounts for this scheme as a defined contribution scheme as at 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 12.8%.

Employer pension contributions charged to the 2004 profit and loss account were £349,000 (2003 – £277,000).

32. 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. Serco 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 2004. 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	7.7%	p.a.
Salary growth	4.0%	p.a. (including promotional scale)
Price inflation	2.5%	p.a.
Pension increases	2.5%	p.a.

The actuarial value of assets represented 82% of the ongoing liabilities of the scheme. The current contribution rate is 20.9%.

Employer pension contributions charged to the 2004 profit and loss account were £1,956,000 (2003 – £1,521,000).

viii) Other defined contribution schemes

The Group paid employer contributions of £12,777,944 (2003 – £10,517,000) into UK and other defined contribution schemes, foreign state pension schemes and multi-employer schemes.

b) FRS 17 disclosure

The disclosures required under the transitional arrangements within FRS17 have been based on the most recent full actuarial valuation of the Serco Pension and Life Assurance Scheme as at 6 April 2002 and updated to 31 December 2004 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:

	2004 £'000	2003 £'000
Net assets excluding net pension assets	**280,213**	259,404
Net pension liability	**(75,606)**	(69,712)
Net assets including pension liabilities	**204,607**	189,692

	2004 £'000	2003 £'000
Profit and loss reserve	**119,874**	98,128
Reversal of SSAP 24 prepayments, net of deferred taxation	**(24,206)**	(21,406)
	95,668	76,722
Net pension liability	**(75,606)**	(69,712)
Profit and loss reserve adjusted	**20,062**	7,010

32. PENSION SCHEMES (continued)

b) FRS 17 Disclosure (continued)

The financial assumptions used were:

	2004 % p.a.	2003 % p.a.	2002 %p.a.
Rate of increase in salaries	**3.75**	3.80	3.85
Rate of increase in deferred pensions	**2.75**	2.70	2.25
Rate of increase in pensions in payment	**2.75**	2.70	2.25
Discount rate	**5.30**	5.40	5.47
Inflation assumption	**2.75**	2.80	2.35

The scheme's assets, liabilities and the expected rates of return as at 31 December 2004 were:

	2004 % p.a.	2004 £'000	2003 % p.a.	2003 £'000	2002 % p.a.	2002 £'000
Equities	**7.00**	**177,707**	7.30	192,684	7.00	183,802
Bonds	**5.30**	**68,092**	5.40	41,510	5.47	26,840
Gilts	**4.50**	**102,139**	4.80	75,627	4.50	47,434
Property	**6.15**	**9,295**	6.35	8,192	6.24	7,690
Cash and other	**4.75**	**3,284**	4.00	2,985	4.50	908
Annuity policies	**5.30**	**20,305**	5.40	29,418	5.47	27,798
Total market value of assets		**380,822**		350,416		294,472
Present value of scheme liabilities		**(488,830)**		(450,005)		(399,617)
Deficit in the scheme		**(108,008)**		(99,589)		(105,145)
Related deferred tax asset		**32,402**		29,877		31,544
Net pension liability		**(75,606)**		(69,712)		(73,601)

The amount chargeable to operating profit under FRS17 in 2004 would have been:

	2004 £'000	2003 £'000
Service cost	**11,862**	13,655
Past service cost	**838**	1,350
Total operating charge	**12,700**	15,005

Analysis of the net return on the pension scheme for the year ended 31 December 2004.

	2004 £'000	2003 £'000
Expected return on pension scheme assets	**22,388**	18,965
Interest on pension liabilities	**(24,333)**	(22,056)
Net interest cost	**(1,945)**	(3,091)

32. 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 2004.

	2004 £'000	2003 £'000
Actual return less expected return on assets	995	22,520
Experience gains and losses on liabilities	9,715	6,637
Changes in assumptions	(23,336)	(27,755)
Actuarial (loss)/gain recognisable in STRGL	(12,626)	1,402

Movement in deficit during the year:

	2004 £'000	2003 £'000
Deficit in scheme at 31 December	(99,589)	(105,145)
Movement in year:		
Current service cost	(11,862)	(13,655)
Contributions	18,852	22,250
Past service costs	(838)	(1,350)
Net interest costs	(1,945)	(3,091)
Actuarial (loss)/gain	(12,626)	1,402
Deficit in scheme at 31 December	(108,008)	(99,589)

History of experience gains and losses:

	2004 £'000	2003 £'000	2002 £'000
Difference between expected and actual return on scheme assets	995	22,520	(73,096)
Percentage of scheme assets	–	6%	(21%)
Experience gains and losses on scheme liabilities	9,715	6,637	(19,313)
Percentage of scheme liabilities	2%	1%	(5%)
Total amount recognised in STRGL	(12,626)	1,402	(100,699)
Percentage of scheme liabilities	(3%)	–	(25%)

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

33. POST BALANCE SHEET EVENT – ACQUISITION OF ITNET PLC (ITNET)

On 16 December 2004 the Board announced an offer for the entire ordinary share capital of ITNET and the offer went unconditional on 3 February 2005. The total consideration for the acquisition is estimated to be £250,000,000. The market capitalisation of ITNET on 3 February 2005 was £236,984,000.

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%
	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 GmbH	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%
Asia Pacific		
Australia	Serco Group Pty Limited	100%
	Serco Australia Pty Limited	100%
	Great Southern Railways 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%

The above excludes Laser (Teddington II) Limited which was deconsolidated in 2004 (see Note 13i).

34. LIST OF PRINCIPAL UNDERTAKINGS (continued)

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%
	Northern Rail 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%
Cyprus	Serco Kalisperas	50%
Singapore	Serco Guthrie Pte Ltd	50%
Turkey	Elektronik Sistemer Destek Sanavi ve Ticaret AS	51%
RSA	Equity Aviation Holdings (Pty) Limited	50%

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

Serco Group plc will adopt International Financial Reporting Standards (IFRS) for accounting periods beginning on 1 January 2005. The adoption of IFRS will be first reflected in the Group's interim financial statements for the six months ending 30 June 2005 and subsequent financial statements for the year ending 31 December 2005.

A project team has been working in conjunction with Deloitte & Touche LLP to achieve compliance in the required timescale. Reporting systems and procedures have been enhanced to support the new reporting requirements and the Group's IFRS accounting policies are being developed. In addition, IFRS training programmes have been provided to ensure that IFRS knowledge is embedded throughout the organisation.

A number of areas of difference between IFRS and UK GAAP, which may impact the Group's reported results and financial position, have been identified. These include goodwill and intangible assets, financial instruments, share-based payment, employee benefits including pensions, joint ventures and taxation. Areas that may require additional disclosure include segment reporting, service concessions and joint ventures.

The Group's analysis of the effect of IFRS is ongoing. In addition the interpretation of standards is continuing to evolve so further changes may arise notably in accounting for pension schemes and private finance initiatives.

Investor and shareholder information

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
Bridgwater 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 2004 there were 435,352,903 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.

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.

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.

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

calendar of events

05

9 March
Ex dividend date

11 March
Record date

18 March
Accounts published

19 April
Last day for DRIP election

29 April
Annual General Meeting

11 May
Proposed payment of final dividend

September
Proposed announcement
of interim results

October
Proposed payment
of interim dividend

We would like to thank all our staff who appeared in this report , especially:
Front cover: Mike Mabey
Inside front cover: Samantha Ruddock
Inside back cover: Dawn Wilby
Back cover: Kevin Jerry

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 their environmental management systems which include an active policy on sustainable forestry management.

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Serco Group plc
(Registered Office)
Serco House
16 Bartley Wood Business Park
Bartley Way
Hook
Hampshire
RG27 9UY
United Kingdom

T +44 (0)1256 745900
F +44 (0)1256 744111
E generalenquiries@serco.com

Serco Institute
22 Hand Court
London
WC1V 6JF
United Kingdom

T +44 (0)20 7421 6486
F +44 (0)20 7421 6471
E institute@serco.com

Serco Continental Europe and Middle East
PO Box 9197
Dubai
United Arab Emirates

T +971 (0)4 4033500
F +971 (0)4 4033501
E generalenquiries-ceme@serco.com

Serco Group, Inc.
20 E Clementon Road
Suite 102 South
Gibbsboro
New Jersey 08026
United States

T +1 856 346 8800
F +1 856 346 8463
E generalenquiries-na@serco.com

Serco Group Pty Limited
Level 10
90 Arthur Street
North Sydney
NSW 2060
Australia

T +61 (0)2 9964 9733
F +61 (0)2 9964 9924
E generalenquiries-aspac@serco.com

Serco Group plc is a company registered in England and Wales No. 2048608