

Bringing service to life

serco

A man with a mustache, wearing a dark pinstriped suit, white shirt, and blue patterned tie, is shown from the chest up. He is looking upwards and to the right with a thoughtful expression. Above his head is a large, hand-drawn black thought bubble containing the text "What does success mean to you?". Below the large bubble are two smaller, hand-drawn black circles, suggesting a trail of thought.

What does success  
mean to you?

Annual Review and Accounts 2006

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Serco is a service company that helps governments and companies manage change in a changing world and brings service to life for millions of people.

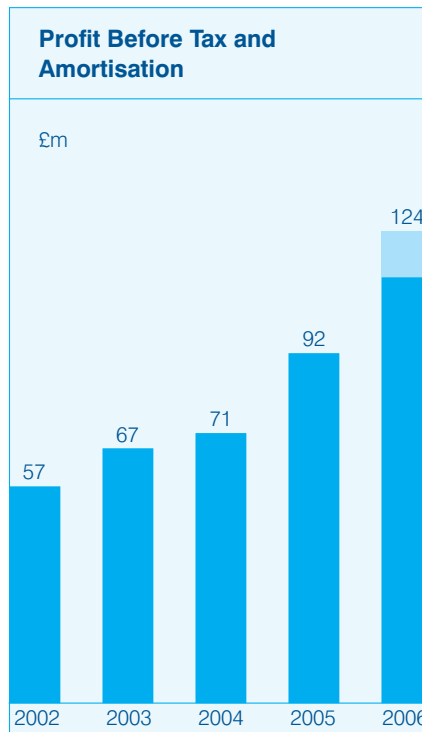
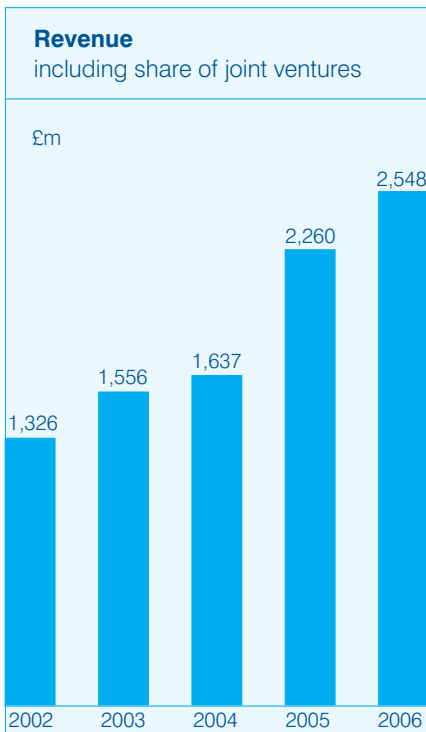
We began delivering public services in 1964 when the Ministry of Defence awarded us one of the UK Government's first outsourced contracts, at RAF Fylingdales – a contract we still hold today.

Since then, we have built a large and balanced portfolio, spread across markets and internationally, based on a foundation of excellent service, strong relationships and our ability to evolve as new opportunities emerge.

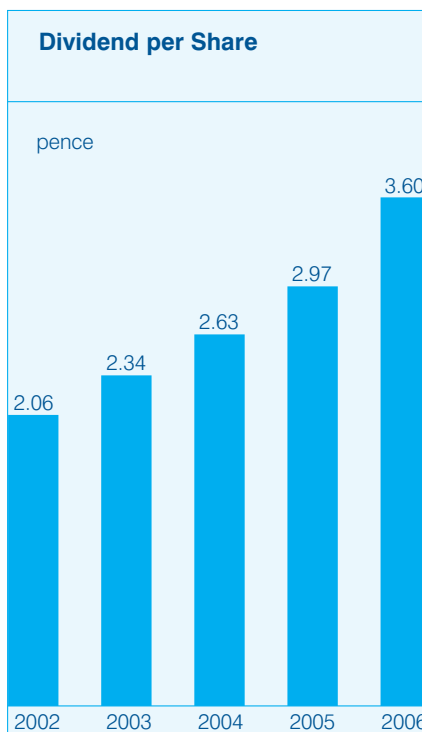
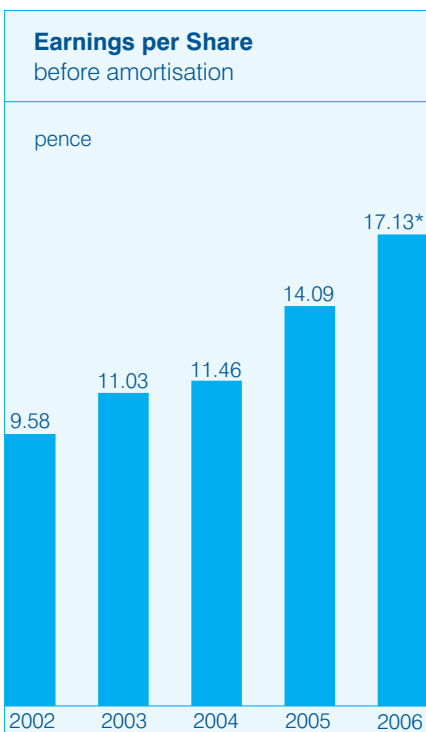
As governments and companies around the world increasingly find themselves facing the same challenges, that foundation will enable us to propel the business forward.

We report our business in four segments – Civil Government, Transport, Defence and Science. Our private sector business is split between these segments and provides IT services, fleet maintenance, facilities management and other services to major companies.

# Highlights



2006 includes £11.4m gain on sale



\*2006 excludes gain on sale

Note: 2002 to 2003 under UK GAAP, 2004 restated under IFRS



## Highlights

	2006	2005	
<b>Revenue</b>	<b>£2,548.2m</b>	£2,260.3m	<b>up 12.7%</b>
<b>Profit before tax</b>	<b>£107.4m</b>	£77.9m	<b>up 37.9%</b>
<b>Earnings per share (EPS)</b>	<b>16.62p</b>	11.66p	<b>up 42.5%</b>
<b>Profit before tax, amortisation and gain on sale</b>	<b>£112.2m</b>	£91.5m	<b>up 22.6%</b>
<b>EPS before amortisation and gain on sale</b>	<b>17.13p</b>	14.09p	<b>up 21.6%</b>
<b>Dividend per share</b>	<b>3.60p</b>	2.97p	<b>up 21.2%</b>
<b>Group free cash flow</b>	<b>£85.4m</b>	£73.8m	<b>up 15.7%</b>

### Excellent Performance

- £3bn of contracts signed including Docklands Light Railway (£400m), Defence Science and Technology Laboratories (£500m), London Development Agency (£69m) and Acacia Prison (AUS\$155m)
- Appointed preferred bidder on £1.9bn of contracts, including Future Provision of Marine Services (£1bn) and Forth Valley Hospital (£450m)
- Continued to win one in two new bids and maintained rebid win rate at more than 90%
- Created strategic Private Finance Initiative (PFI) investment partnership. Sold six PFI investments for £76.5m with £11.4m gain on sale and retained associated operating contracts
- PBTA margin before gain on sale of PFIs of 4.4%, up from 4.0% in 2005
- Group EBITDA to cash conversion of 98% resulting in 15.7% increase in group free cash flow

### Significant Visibility of Future Growth

- Forward order book of £13.9bn at 31 December 2006
- Contracts valued at an additional £3.5bn at preferred bidder stage
- Visibility of 91% of planned revenue for 2007, 77% for 2008 and 64% for 2009
- £23bn of further opportunities identified

### Continuing Positive Outlook

- Unprecedented market opportunities driven by social demands for better public services and reduced tax burden, aligned with the impact of global challenges of security, migration and the environment
- Increasing capacity to grow through deep relationships and capabilities allows us to be confident of double-digit growth
- Continued focus on portfolio management, selective bidding and efficiency will contribute to rising margins

Note: PBTA is profit before tax and amortisation. Group EBITDA is earnings from subsidiaries (excluding joint ventures) before interest, tax, depreciation, amortisation and other non cash items. Cash conversion is the ratio of Group operating cash flow to Group EBITDA. Group free cash flow is from subsidiaries and joint venture dividends and is reconciled in Section 4 of the Finance Review.

# Our Business



## Civil Government

Serco's work in civil government encompasses home affairs, education, health, local government and consulting – and some of the most pressing challenges faced by governments around the world.

Security, the threat of terrorism and the increasing cost of crime are key drivers in our home affairs market. In education, clients are focused on increasing the life chances of our children. Ageing populations and the rising cost of care are driving more opportunities in the health market and in both our local government and consulting markets we are responding to clients who need to transform services and structures in the face of rising consumer demand and relentless technological developments.

Our home affairs work includes managing prisons, electronically monitoring offenders, developing systems for law enforcement agencies, controlling immigration and improving civil resilience.

We run two local education authorities and are a growing supplier of school management software. Our rapidly expanding health business supports hospitals and provides out-of-hours doctor services to more than one million people.

In local government, we are a leading supplier of information technology (IT) and IT-enabled services. We also deliver environmental, streetscene and other direct services to councils.

And our consulting capability raises awareness of Serco and enhances our reputation with potential and existing customers, by providing high-value advisory services.



## Transport

Congestion and falling transport costs are forcing governments and travellers to radically reconsider how to get from A to B quickly, safely and affordably with the least environmental impact. As a result we are experiencing the smarter use of traffic data, greater use of congestion charging and increasing focus on integrating public transport systems.

Serco is a major provider of transport services. With our partner, NedRailways, we run Merseyrail – one of the UK's best performing franchises – and Northern Rail, which is the UK's largest network. In Australia, Serco owns and operates the Great Southern Railway, including its two trans-continental services, The Ghan and Indian Pacific.

Our urban transportation business operates the award-winning Docklands Light Railway and is a UK market leader in traffic management systems, including the National Traffic Control Centre for England.

In air, we are one of the world's largest private sector providers of air traffic control services, with operations in the UK, Middle East and the United States.



## Defence

As the nature of threats to national and international security change, so the requirements increase for armed forces to operate in more integrated and efficient ways.

Serco is a top two provider of support services to the UK Ministry of Defence (MoD), with more than 100 contracts ranging from supporting secure military communications to managing training colleges and providing marine services to the Royal Navy. We are committed to the partnering values in the MoD's Defence Industrial Strategy and work with equipment manufacturers to deliver through-life service to the MoD.

We are gaining critical mass in the key North American market, with particular strength in providing IT, engineering, logistics and human resources services to the military.

In Australia, we are a leading service supplier to the armed forces, with a growing portfolio of contracts, and we also have an established position in the German defence market.



## Science

The ability to enable innovation, increase skills and manage enormous environmental challenges is leading governments to renew their focus and investment in science. The pursuit of better solutions to nuclear decommissioning, improving the competitiveness of business and identifying how future energy demands can be met are some of the challenges that face us all.

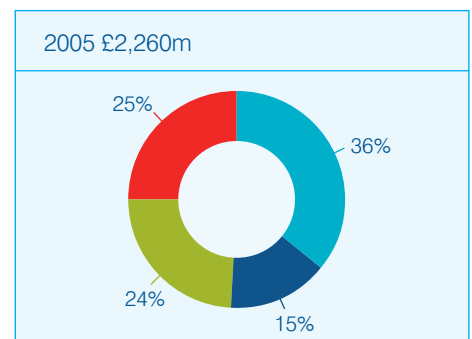
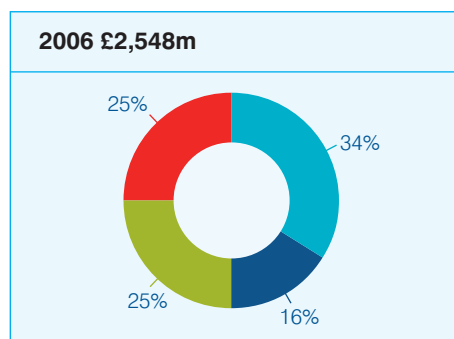
Serco has built a sector leading position in the science market. We run the National Physical Laboratory, which is the UK's national standards laboratory and one of the world's major scientific establishments.

With our partners, we operate the Atomic Weapons Establishment, responsible for the stewardship of the UK's nuclear deterrent. We also have a significant position in the civil nuclear market, providing independent safety, risk management and engineering services.

We are also a major provider of support services to the European Space Agency and CERN, the world's largest particle physics laboratory.

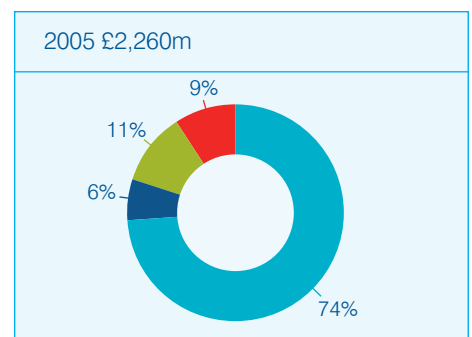
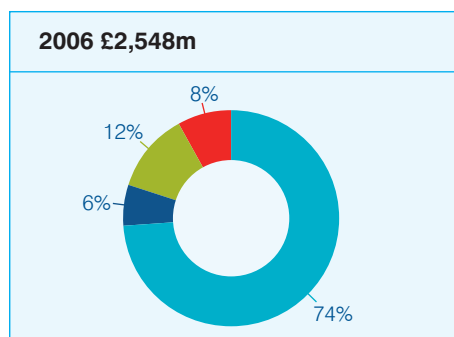
### Revenue by Market

- Civil Government
- Science
- Transport
- Defence



### Revenue by Geography

- UK
- Asia Pacific
- North America
- Europe and Middle East





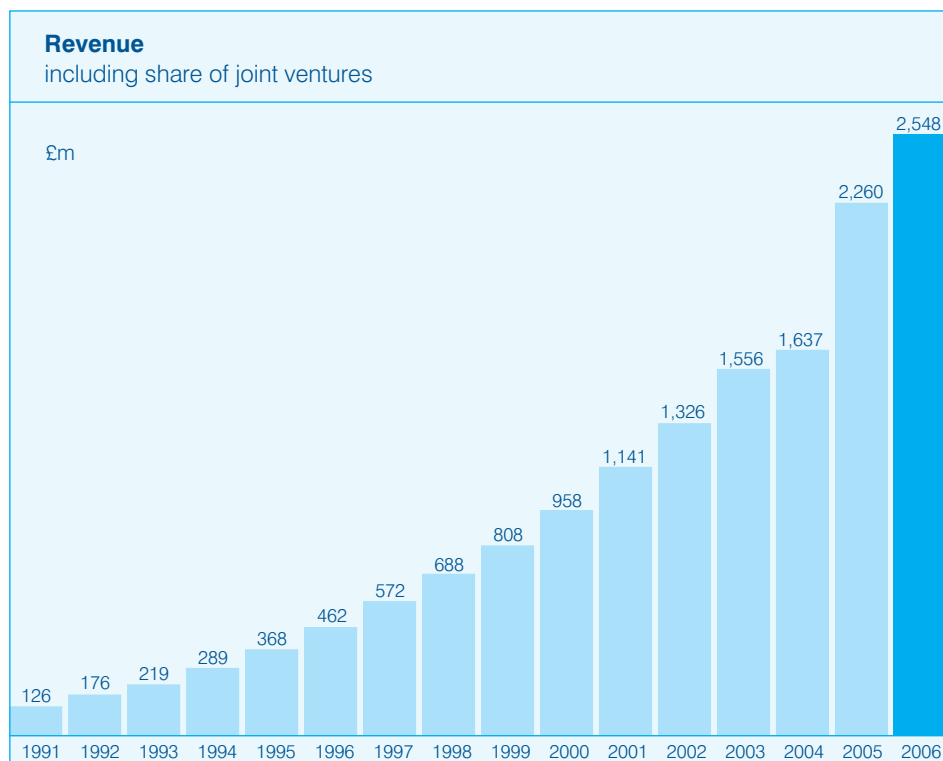
# Chairman's Statement



**Kevin Beeston** Executive Chairman

"I am delighted with the Group's performance in 2006. The strength of Serco's reputation, our expertise and ability to deliver high-quality service have seen us deliver tremendous outcomes for customers and excellent results for investors. I am encouraged by our performance and by the range of opportunities available to us, which position us for strong growth. We remain confident of maintaining double-digit growth and increasing margins."





### Excellent Year, Compelling Future

I am delighted to report that, building on very strong growth in 2005, Serco has again delivered an excellent performance in 2006 and the Group's prospects are equally compelling.

Revenue grew by 12.7% to £2,548.2m. Profit before tax increased 37.9% to £107.4m and earnings per share grew 42.5% to 16.62p.

Profit before tax, amortisation and the gain on sale of PFI investments rose by 22.6% to £112.2m and earnings per share on the same basis grew 21.6% to 17.13p. The corresponding margin increased from 4.0% to 4.4%, benefiting from our portfolio management, higher value services and efficiency improvements.

Our focus on cash generation delivered excellent results once again, with Group EBITDA to cash conversion of 98% (2005: 90%). Group free cash flow increased 15.7% to £85.4m.

The strength of Serco's reputation and our ability to deliver high-quality service were reflected in maintained win rates of more than 90% on rebids and one in two on new bids.

During the year, we signed £3bn of contracts and were appointed preferred bidder for contracts valued at around £1.9bn. We rebid two of our larger contracts; firstly, the renewed franchise with Transport for London to operate, maintain and support the Docklands Light Railway. The contract is valued at £400m over nine years and started in May 2006. In addition, a Serco-led joint venture was selected as preferred bidder for the UK Ministry of Defence's (MoD) Future Provision of Marine Services contract, valued at £1bn over 15 years. The joint venture will deliver marine support at major UK naval bases in Portsmouth, Devonport and the Clyde.

We also signed the £500m contract with the MoD's Defence Science and Technology Laboratories for the design and build of new facilities and the provision of support services.

The London Development Agency selected Serco to provide a new Business Link service to London's 600,000 small and medium sized enterprises from April 2007. The agreement is valued at £69m over three years, plus an option to renew for two additional years, and draws on skills from across the Group.

The strength of Serco's reputation and our ability to deliver high-quality service were reflected in maintained win rates of more than 90% on rebids and one in two on new bids

In Australia we signed a five-year contract to manage and operate Acacia prison for the Government of Western Australia's Department of Corrective Services. The client has the option to extend the AUS\$155m contract by up to ten years.

The Operational Performance section of the Business Review provides further information on contract wins, on pages 16 to 33.

We created a strategic PFI investment partnership with Infrastructure Investors Limited Partnership (I<sup>2</sup>) and sold equity and subordinated debt in six PFI projects to an I<sup>2</sup> subsidiary. We received a cash consideration of £76.5m, resulting in a profit on disposal of £11.4m. Under the partnership, I<sup>2</sup> will be able to provide equity investment for Serco's future PFI projects, giving us access to a large and competitively priced source of capital and enhancing our ability to compete in this market. Serco has retained the associated long-term operating contracts.

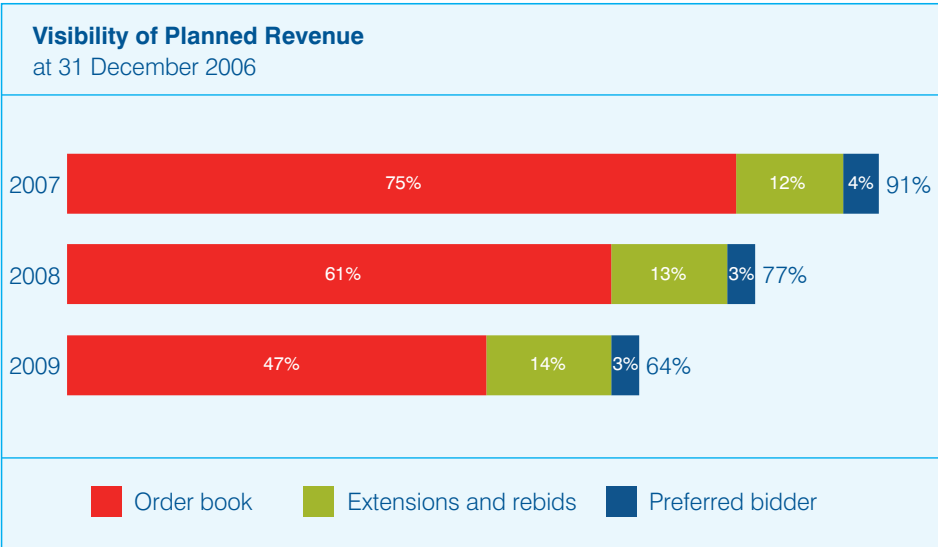
We are continuously working to deliver higher-value services to clients, reflecting the increasing skills and capabilities available across the Group. We also rigorously analyse contracts and markets to ensure that conditions exist for strong organic growth and appropriate returns. In addition, we continue to improve our internal structures and systems by, where appropriate, providing standardised systems and streamlining management structures. As a consequence, margins have improved and will improve further.

We regularly review the funding profile of our main Group defined benefit pension scheme. As previously announced, £70m has been injected into the scheme representing approximately half the deficit, with £19m added at the end of 2006 and £51m in early 2007. We also increased employer and employee contribution rates from January 2007. The sale of our investments in six PFI projects, the corresponding removal of non recourse debt and the cash injected into the pension scheme have resulted in a significant reduction in debt and simplification of the balance sheet.

At the year end, our order book stood at a record £13.9bn and we were preferred bidder on contracts valued at £3.5bn. We also had bids valued at £4.5bn for which we had been shortlisted to the final two or three bidders. In addition, we have identified a pipeline of further opportunities across our markets estimated at more than £23bn.

The visibility of our future revenue remains significant. At 31 December 2006, we had identified 91% of our planned revenue for 2007, 77% for 2008 and 64% for 2009.

At the year end, our order book stood at a record £13.9bn and we were preferred bidder on contracts valued at £3.5bn



### Strong Start to 2007

Serco has also enjoyed a strong start to 2007. The US Army selected our North American business to provide cost analysis, logistics planning and supply chain consulting services worldwide. The indefinite-delivery/indefinite-quantity contract has a one-year base period with four annual options and has a potential value of \$225m over the five years.

Other wins include a contract to manage and operate Yarl's Wood Immigration Removal Centre on behalf of the UK Home Office. The three-year contract starts in April 2007, with optional extensions for a further five years. Over the full eight years, the contract is valued at around £85m. The MoD also selected us as preferred bidder for a five-year Gibraltar-based support services contract valued at around £50m, with a further option for two years and the potential for additional work.

### Dividend

Our policy is to increase the total dividend each year broadly in line with the increase in underlying earnings. The Board has proposed a final dividend of 2.55p per share, representing an increase on the 2005 final dividend of 23.8%. The total dividend for the year is 3.60p, an increase of 21.2%. The final dividend will be paid on 16 May to shareholders on the register on 9 March.

### Board

There were two notable events during the year. On 31 August 2006 I announced my intention to move to the role of Non-Executive Chairman from 1 September 2007.

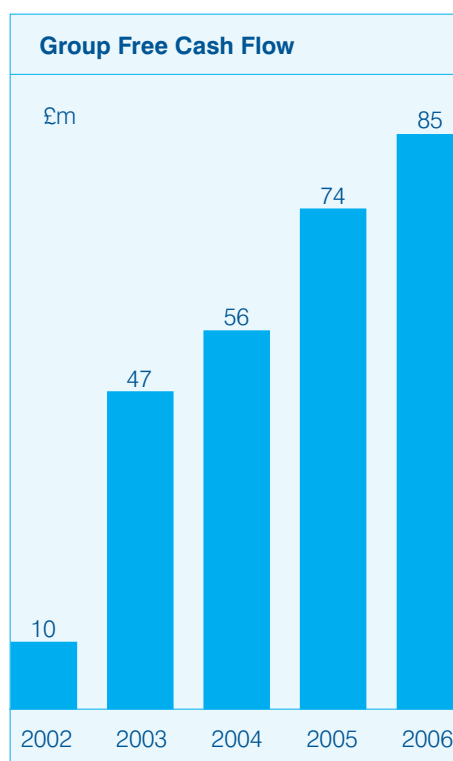
It has been a great honour to be an integral part of Serco's remarkable journey from a small technical support company to a leading multi-national service company valued at over £2bn and to have served shareholders in many roles over the past 22 years, including Finance Director, Chief Executive and Executive Chairman. As I now seek to diversify my business interests, I look forward as Non-Executive Chairman to continuing to chair the Board and overseeing the Group's development on behalf of shareholders.

In April 2006, Leonard V. Broese van Groenou joined the Board as a Non-Executive Director. Leonard is a member of the Remuneration, Audit, Nomination and Training and Development Committees. He was previously Vice-President Human Resources and member of the corporate executive committee of Air Products.

### Continuing Positive Outlook

Governments increasingly face the same issues, driven by social demands for better public services and a reduced tax burden, along with the impact of the global challenges of security, migration and the environment. Our breadth and depth of skills and relationships allows us to address new markets and opportunities. Our identified pipeline of opportunities is in excess of £23bn and this, together with our high visibility of revenues, enables us to be confident of continuing to deliver double-digit growth. At the same time, our continued focus on proactively managing our contract portfolio, bidding selectively and driving internal efficiency will allow us to further improve margins.

We are confident of delivering double-digit growth and further improving margins



What does success  
mean to you?

Changing people's lives  
by delivering great service – giving a  
child the education they deserve, helping  
an offender back into society or improving  
a patient's health. Taking another step on  
our journey towards our vision. And never  
forgetting to enjoy life – at work and in  
those precious hours at home.

**Christopher Hyman** Chief Executive



# Chief Executive's Statement

## What Does Success Mean to You?

For more than 40 years, we have built Serco by understanding the many different answers to this question. We ask it of those who use the services we run. We ask it of our customers. And we ask it of our employees, shareholders, partners, suppliers and the communities in which we operate.

Our expertise lies in taking the varied ambitions of our stakeholders and developing innovative, people-led solutions. We then implement those solutions efficiently, so that these ambitions are met and often exceeded.

Because of this approach, Serco has become a very successful business. We retain more than 90% of our contracts at rebid, win more than one in two of our new bids and have grown at double-digit rates every year since we listed. But we do not measure success purely by financial returns, crucial though they are.

Our vision is to be the leading service company in our chosen markets. We aim to be the best partner to work with, the company people aspire to work for and the company that delivers superior returns to its shareholders.

We will not achieve that vision unless everyone with a stake in Serco believes we help them achieve their ambitions, by bringing service to life. We still have a long way to go but I am heartened by our progress towards our vision and by the difference our people make every day.

And our success is being recognised. For the third year running Serco was voted the Most Admired Support Services Company in the Management Today survey and we won the UK growth category in the European Business Awards.

More significantly, colleagues such as Mick Walker MBE achieved personal recognition in the Queen's New Year's Honours List for the tremendous contribution they make. You can read about Mick's view of success on page 20.

My role as Chief Executive is to put in place the conditions that will allow us to achieve our vision – the right strategy, people and culture. Our approach to these, and their importance, is explained on the next few pages, along with an overview of our markets.

## Our Strategy

Serco's strategy is to build a balanced contract portfolio, spread across different sectors and geographic markets. We do this through organic growth, which results from delivering excellent service and building long-term relationships with our customers.

### **A Balanced Contract Portfolio**

Having a balanced portfolio brings three benefits: broader exposure to growth opportunities, better diversification of risk and the opportunity to share good practice honed by wide experience.

Exposure to many markets and geographies, through more than 600 contracts, ensures strong growth opportunities are always to be found. Even if one market slows down, our other markets will still deliver more than enough new opportunities.

The breadth of our business also allows us to select the best opportunities – those which meet our requirements for building long-term relationships, growth during the contract life, return on capital and margins. This selectiveness underpins our confidence that we can continue to increase the Group's margins in the medium term.

Risk is diversified because we are not reliant on any one contract for a substantial proportion of our revenue, with the largest – Northern Rail – providing around 10% of revenue in 2006.

Our vision is to be the leading service company in our chosen markets. Our strategy is to build a balanced contract portfolio, spread across different sectors and geographic markets



Serco Group Executive Team, left to right: **Grant Rumbles** Chief Operating Officer, **Andrew White** Marketing Director, **Kevin Beeston** Executive Chairman, **Andrew Jenner** Finance Director, **Christopher Hyman** Chief Executive and **Clive Barton** Corporate Development Director

The third benefit is our ability to share best practice across Serco. We can transfer our skills and capabilities from one sector to another and to other countries as their markets develop, helping to grow our business and deliver the service quality our customers deserve.

**Organic Growth**

Organic growth is fundamental to Serco. It comes from winning new work and by expanding the scale and scope of existing contracts. Serco's devolved structure enables this. Our divisions focus on individual markets or regions, making them expert in the needs of local customers and allowing them to identify new growth opportunities.

Within our divisions, we devolve responsibility as far as we can. We run each contract as an individual business, making Serco more responsive, customer-focused and entrepreneurial.

As Serco's organic growth prospects are strong, we only make acquisitions in two circumstances – to bring new skills into the Group or to open up new markets, either geographically or in new business areas. In either case, acquisitions must enhance Serco's prospects for organic growth.

**Delivering Excellent Service and Building Long-Term Relationships**

Our customers employ us to improve the quality of their services. By consistently meeting – and often exceeding – the service levels they demand, we attract new customers and encourage our existing ones to expand the scale and scope of our contracts with them. We aim to work in partnership with our customers to continually improve our services, to their benefit and ours. And by building these long-term relationships, we retain more than 90% of our contracts when they come up for renewal.

Organic growth is fundamental to Serco. It comes from winning new work and by expanding the scale and scope of existing contracts

## Our People

To succeed, Serco must attract and retain the right people. The skills and aptitudes they bring are important but not the only factor. To succeed, our people must believe in Serco's vision and live by our Governing Principles. The talented people we recruit directly or who join us as we win new contracts, bring with them a public service ethos that is central to the way we work.

Once we have the right people, we must harness their talents effectively. We provide training and personal development on the job, on internal programmes and with outside training organisations. These ensure continuous improvement at both personal and company levels.

People development is core to how we manage our business. Each contract is required to have succession plans that bring through the next generation of managers. This allows our longer-serving contract managers to continue their own development and take on different roles, often running new contracts we bring into the Group.

The breadth of Serco's business also benefits our people, offering them career paths that are unavailable in more narrowly-focused organisations. This helps us to motivate and retain people. Serco also gains, since bringing together people from different backgrounds promotes original thinking and fresh approaches to the work we do.

More information on our employment policies and training programmes is included on page 32.

## Our Culture and Governing Principles

Serco is one company made up of many businesses. Although the cultures vary, they are based on a single, fundamental set of values. We are proud to combine commercial know-how with a deep public service ethos and we work hard to protect that spirit by living our Governing Principles.

As their name suggests, our Governing Principles are not voluntary. They are the behaviours we expect to see throughout Serco. They embody Serco's determination to act in the best interests of our customers, our people and – by delivering strong growth – our shareholders. Our Governing Principles align our people to common standards, essential in an organisation as devolved as Serco.

You can find our Governing Principles and what they mean on page 15.

## Market Development

The world in which we operate is changing faster than ever. Governments, communities and individuals are increasingly experiencing the same challenges: dealing with climate change, declining energy reserves, rising migration, ageing populations and increasing health needs, the threat of terrorism and the challenge of congestion. These transformational issues are further influenced by new technology, globalisation, increasing demands for better services, increasing costs of service provision and citizens' unwillingness to accept higher tax burdens.

Serco is ideally placed to help governments resolve their challenges. Our teams efficiently deliver service transformations that improve a wide variety of public services around the world. We have grown strongly for the last 20 years, as successive UK governments have led the way in reforming public services and enabling new models of service delivery. This has delivered a very strong and highly visible forward order book and bid pipeline.

As governments around the world are dealing with the same issues and increasing the rate of reform of their public services, we are increasingly seeing opportunities to transfer our experience to international markets. What we were delivering for one government a few years ago, we are now delivering for several.

We are proud to combine commercial know-how with a deep public service ethos and we work hard to protect that spirit by living our Governing Principles



The nature of Serco's broad portfolio of skills, relationships, contracts, markets and geographies, combined with our inherent ability to deliver through change, means that we are very well placed to continue to grow. Ten years ago, Serco's annual revenue was less than £500m and our businesses in home affairs, transport and business process outsourcing were just developing. These have become substantial businesses in the UK and are also driving growth internationally.

Our home affairs business is helping governments to address common issues including reducing re-offending and the cost of crime, managing increasing migration and tackling the threat of terrorism. Serco is the only company competing in each of the market sub-sectors of civil resilience/homeland security, migration control, offender management and law enforcement. We expect more growth both in the UK home affairs market - already approaching £3bn per annum - and overseas, particularly in Australia and the US.

In the UK local government market, the priority for councils is building better and safer communities, with particular focus on children and young people, health, economic development and independent living. To meet the needs of local markets, we work in partnership with the emergency, health and education services, utility companies and private and voluntary organisations. Serco operates across the whole community to make citizens' lives better, whether through running a local education authority, piloting telecare projects to enable independent living, working to reduce re-offending levels or helping small businesses to grow. The skills, services and support we provide align with the Gershon-related drive to improve efficiency through joined-up government, and enable more to be spent on front line services by increasing back office efficiency.

Within health, expansion of the UK publicly-funded market is driven by the demand for better outcomes from finite resources. Our growing presence in primary care and occupational health is complemented by an established offering in hospital support services, all of which means we can address a substantial part of this market.

In our education business, improving outcomes is driving new ways of organising service delivery. The Children's Services Act requires those working in social services, health and education to work together for the benefit of children. Local authorities throughout England and Wales are using our organisational design and IT transformation capabilities to manage this change programme.

In transport, better utilisation of existing road and rail infrastructure is proving an environmentally and economically attractive proposition. Issues of congestion, carbon emissions, safety and journey reliability are being addressed through innovative technology and improved transport integration. Serco is at the forefront of using technology and operational delivery to better manage the movement of vehicles, such as through the UK's Active Traffic Management scheme and England's National Traffic Control Centre.

International commitments have stretched defence budgets in the US and the UK. Private sector provision of back office support releases uniformed troops for front line service, and can deliver significant cost efficiencies and innovation. In the UK, the MoD's spend on services is expected to increase, driven by integration across the armed forces of equipment procurement and maintenance. This is evident in the merger of the Defence Logistics Organisation with the Defence Procurement Organisation, and the Defence Training Review, which is integrating training, where appropriate, across the armed forces. In the US, pressures on defence spending have delayed contracting of some support services. However, significant opportunities remain in the US and more opportunities are emerging in Australia.

An important new market has developed in the UK for the decommissioning of the country's civil nuclear liabilities. This market is valued at around £70bn in total, equating to more than £2bn per annum. Serco has created a world-class consortium to address this opportunity.

The world in which we operate is changing faster than ever. Serco is ideally placed to help governments resolve their challenges

## Future Success

I believe we have put the foundations in place for future success.

For as long as I have worked in Serco, we have talked of the Group being like a family. As we grow, we will put that family feel to the test but we are, and always will be, a people-focused organisation.

We deliver people-led change in a world that faces an increasingly shared set of challenges. These challenges are making us all rethink how we live and provide new opportunities for us to grow as a company.

Serco has an outstanding record of developing new businesses, by taking our skills and capabilities into new market sectors and new countries. Our ability to do this will make our future as compelling as our past.

These challenges also mean that the ambitions of our stakeholders are constantly evolving. For Serco to continue to succeed and achieve its vision, we must never stop asking: "What does success mean to you?"

## Serco's Governing Principles

### **We foster an entrepreneurial culture**

We are passionate about building innovative and successful businesses.

This means 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.

### **We enable our people to excel**

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

This means 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.

### **We deliver our promises**

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

This means 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.

### **We build trust and respect**

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

This means we never compromise on safety. We listen. We treat others as we would wish to be treated and challenge when we see something is wrong.

All Serco employees are expected to adhere to the highest standards in dealings with colleagues, customers, suppliers or shareholders. By setting these standards and by supporting each other, we aim to get the best out of our people and subsequently the best service for our customers. This is vital to our ongoing business.

What does success mean to you?

Having the capability to meet the everyday challenges and objectives that come with doing my job. On a more personal level, success means being part of an organisation that is willing to invest in my development, help me to work outside my comfort zone and broaden my abilities.



**Brian Anderson** Director, HMP & YOI Doncaster



# Civil Government

Civil Government is our largest segment and includes home affairs, IT services and business process outsourcing (BPO), local government, education, health, consulting, and much of our work in the private sector.

Segmental revenue increased by 9% to £875m, representing 34% of Group revenue (2005: 36%).

## Home Affairs

Home affairs encompasses our work in offender management, law enforcement, civil resilience and immigration control. Our teams have succeeded in significantly growing existing services, extending into important new markets and delivering quality services in complex environments.

We began our contract to provide electronic monitoring (EM) of offenders in Scotland. Volumes in both this contract and our contracts in England and Wales have increased as the benefits of EM have been rolled out.

The capacity constraints in the UK prison estate have also led the Home Office to order extensions to existing prisons and centres managed by us, valued at more than £79m.

The National Offender Management Service is the UK Government's new body for protecting the public and rehabilitating offenders in new ways, in particular having prison and probation services working closer than ever before and by using the best that the private and third sectors have to offer.

In the first award of its kind, Serco and third sector bodies Turning Point and Rainer were chosen to provide employment and rehabilitation support to offenders returning to the community. The contract, with the East of England Regional Offender Management Pathfinder Project, is valued at around £1.4m to Serco over two years.

Additionally, in 2006 we created a strong foothold in the changing Australian offender management market. We were selected by the Government of Western Australia's Department of Corrective Services to manage and operate the medium security Acacia Prison. The contract is valued at AUS\$155m over five years, with the potential to extend by up to ten years. Serco's proven success in prisoner rehabilitation and re-integration programmes and our specific Indigenous Strategy were crucial elements to the successful securing of the contract.

Further home affairs opportunities have been identified in Australia, including prison management, electronic monitoring, transport and migration management.

Our successful operation of Colnbrook Immigration Removal Centre, near Heathrow, was instrumental in securing the contract to run Yarl's Wood Immigration Removal Centre. The contract starts in April 2007 for an initial period of three years, with potential to extend for a further five years. Over the full eight years, the contract is valued at around £85m.

Together with our partners, Raytheon, Accenture and Detica, we are part of the Trusted Borders consortium, one of two consortia selected for the final stage of the e-Borders procurement, a UK Home Office initiative to provide electronic screening and tracking of travellers arriving and departing from the UK.

Our teams have succeeded in significantly growing existing services, expanding into important new markets and delivering quality services in complex environments

The law enforcement market is developing in the UK with proposals to merge police forces being dropped in favour of greater collaboration between forces and even the sharing of services in order to improve efficiency and service.

### IT Services and BPO

We are benefiting from the skills and capabilities that Serco Solutions has brought to the Group.

Building on the contract win in 2005 to run the UK Government's Businesslink.gov web portal, the London Development Agency selected us to run the Business Link service in London. The £69m, three-year agreement is focused on helping the capital's 600,000 small and medium-sized enterprises to increase their competitiveness, including regeneration opportunities created by the 2012 Olympics.

Serco was also successful in rebidding the Envirowise contract for the Department for Environment, Food and Rural Affairs. This contract, in conjunction with our partner Momenta, advises and supports UK businesses in minimising waste and reducing environmental impact.

Additional business has been contracted over the year, with customers including the London boroughs of Southwark and Enfield, and Coventry and Cambridge city councils.

Amongst private sector clients, MAN B&W extended its SAP FM support contract with Serco until the end of 2008 and awarded a separate contract to provide SAP application support for the same period. Red Bee Media selected us for an IT-enabled change programme valued at £7.1m over five years.

We continue to invest in the capacity and capability of the business and we have implemented a planned restructuring to enhance Serco Solutions' ability to grow. We look forward to strong growth in this sector.

### Local Government

In other aspects of our local government business, we signed and started two new streetscene services partnerships, with Welwyn Hatfield Council and Restormel Borough Council, valued at approximately £50m and £45m respectively. Our services

are key to helping councils meet climate change related targets and freeing up savings for reinvestment in a full range of local improvements.

### Education

At Education Bradford and Education Walsall, pupils have achieved significantly improved GCSE and A level results, exceeding the GCSE targets set by our customers.

The Department for Education and Skills has awarded a two-year contract to the Together for Children partnership, which is led by Serco. The contract, valued at around £10m to Serco, supports the development of 3,500 children's centres across England.

### Health

Serco was appointed preferred bidder to provide support services for the new NHS Forth Valley Acute Hospital, valued at around £450m over 30 years. We have drawn on our healthcare experience to influence the design of the new hospital, including the innovative use of robotics.

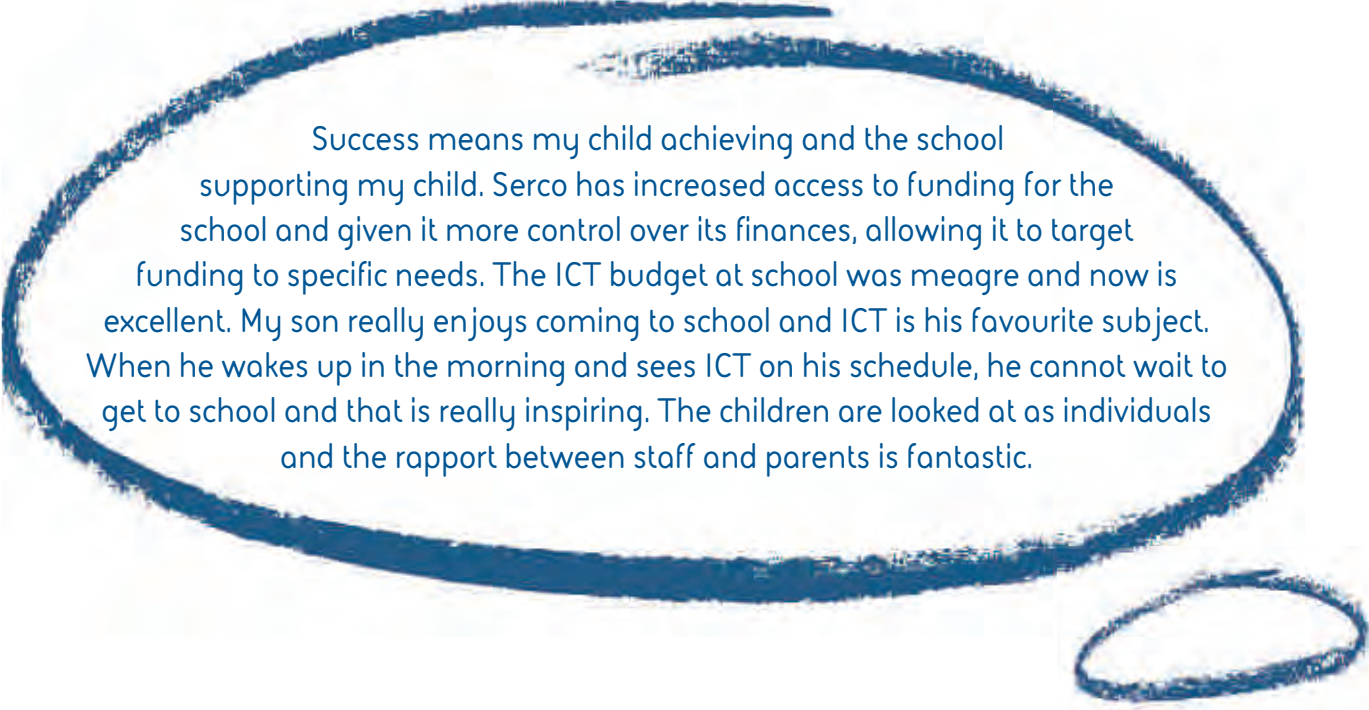
In addition to providing health services to Serco-run prisons, our healthcare business is now providing services to prisons run by the Home Office. We have been awarded three-year contracts at Cardiff, Bullingdon and Leicester prisons.

### Consulting

New awards for our successful consulting business included work with the BBC, the Home Office, HM Revenue & Customs, the Department for Environment, Food and Rural Affairs, Carlisle City Council and Cheshire Constabulary. Projects under way include helping a consortium comprising the Cabinet Office, Department for Education and Skills and the Department of Health to manage the provision of electronic government services through an external contractor.

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## What does success mean to you?



Success means my child achieving and the school supporting my child. Serco has increased access to funding for the school and given it more control over its finances, allowing it to target funding to specific needs. The ICT budget at school was meagre and now is excellent. My son really enjoys coming to school and ICT is his favourite subject. When he wakes up in the morning and sees ICT on his schedule, he cannot wait to get to school and that is really inspiring. The children are looked at as individuals and the rapport between staff and parents is fantastic.



**Clare Sly**  
Mother of a pupil at a Walsall school



What does success mean to you?

Success to me is one thing – job satisfaction. I love my job. I get up in the morning excited to go to work. You only get one chance at life so make the most of it, and that's what we do. At RAF Spadeadam, we train aircrew to be ready for battle situations and if we save one pilot's life as a result, then we've done our bit.



**Mick Walker MBE** Operations Manager, RAF Spadeadam



# Defence

Revenue in Defence increased by 14% to £645m, representing 25% of Group revenue (2005: 25%). Growth in the period benefited from the inclusion of the former RCI business for the full 12 months. It was first consolidated from 21 March 2005.

Our defence customers operate in an increasingly pressurised environment characterised by stringent budgetary constraints, operational complexity, demanding performance measures and intense public scrutiny. We enable them to succeed in this tough environment by designing, integrating and applying the best possible combination of people, processes, resources and technology to enhance their operations.

The MoD's Defence Industrial Strategy emphasises a shift from new platform design and development to the upgrade and maintenance of equipment. The aim is to enhance capability and availability of equipment through its lifespan. To succeed, this requires a new way of working between suppliers, and between Government and industry.

This is reflected in a number of our contract wins in 2006. For example, we signed a £125m 25-year manpower services contract with AgustaWestland under the Integrated Merlin Operational Support (IMOS) programme. IMOS is transforming logistics support for the MoD's EH101 Merlin helicopter fleet while improving availability and reducing through-life support costs for the platform.

In June, Rolls-Royce won a contract to ensure engine availability for the Hercules C-130 and engaged Serco to provide engineers for servicing work on the fleet at RAF Lyneham. Serco and Rolls-Royce's relationship was further strengthened through a Memorandum of Understanding signed to provide a joint service offering in the defence sector.

We were selected as preferred bidder for the MoD's Future Provision of Marine Services contract, which will enhance the operational capability of the Royal Navy at Portsmouth, Devonport and the Clyde. The contract is valued at around £1bn over 15 years, a substantial increase from the previous contract, and will be delivered by Serco Denholm, a 90:10 joint venture between Serco and J&J Denholm.

In July, we signed a strategic partnership with the UK Defence Science and Technology Laboratories (Dstl), for which we were appointed preferred bidder in 2005. Under the £500m, 15-year contract, we are managing the design and build of new facilities and providing integrated services across the Dstl estate.

Our support for the Government's drive to transform through-life capability management will continue in the coming year. We are developing the technology that will enable the MoD to predict and plan for the cost of equipment throughout its operational life. The whole life costing and optimisation model has the potential to deliver significant savings to the MoD, at the same time as enhancing the through-life availability of equipment to the front line.

In addition, our defence experts are working in close collaboration with technical and security specialists in our science and home affairs businesses to explore the potential of the Government's Defence Technology Strategy (DTS). The DTS describes the technologies that the MoD regards as critical to maintaining the UK's defence and security capabilities, playing to Serco's strengths in defence technology, chemical, biological, radiological and nuclear technology and homeland security.

We were selected as preferred bidder for the MoD's Future Provision of Marine Services contract, which will enhance the operational capability of the Royal Navy at Portsmouth, Devonport and the Clyde

Our contract to provide secure communications to the armed forces through the Skynet 5 satellite programme was extended by the Defence Communications Services Agency and the prime contractor, Paradigm Secure Communications. This takes the contract to 2020, with an additional value of approximately £58m.

In North America, our solid reputation for providing key services to the military meant that we won contracts, including several for larger, longer and more complex services, against a backdrop of reduced spending for non-combat operations. In particular, the existing family support and personnel services provided a platform to expand the reach of those services into other branches of the military. We won a Military Family Support services contract for the Navy valued at \$28m over two years. This is the first such service we have provided outside the Army.

Our extensive experience in providing administration support to the Army and Navy enabled us to win a two-year, \$6.5m contract with another new customer - the Air National Guard - to provide administrative support services. We were also selected by the Chief of the Naval Reserve Command for a \$12m contract to assist with their recruiting. Other examples of expansion of our military services included a five-year contract valued at a potential \$34m for the US Army Military Personnel Division (MPD) in Korea and a similar \$12.8 million contract with the MPD for the Army Reserve at Fort Dix.

Our San Diego-based engineering unit was included in a \$56.6m multiple award to provide systems development, engineering support, evaluation and logistics for the submarine command in the US Navy Space and Naval Warfare Systems Center. This win is strategically important for us since it moves us into an area of more complex and integrated services that allow us to showcase our capabilities in a broader range of C4I services.

In Australia, we have significantly expanded our presence. Our Serco Sodexho Defence Services (SSDS) 50:50 joint venture now has a presence on every operational and training base in Australia after being appointed to the Australian Defence Forces National Clothing Stores contract. The contract is valued at up to AUS\$60m to SSDS over six years and presents considerable opportunities for organic growth.

SSDS has also been selected for two other major garrison support services contracts on the east coast of Australia. These nine-year contracts are valued at more than AUS\$400m.

What does success mean to you?

Rolling up our sleeves, getting it right the first time and doing what we say we're going to do. That's what our customer is looking for and it's what we're delivering. It builds confidence and creates a platform from which other opportunities grow. It's refreshing to see how well ingrained Serco's values are. They are decent and honest values, and that's exactly how our customer and employees want us to be.

**David Morris** Alliance Manager, Serco Illawarra, Australia





## What does success mean to you?

To have success we must have a good support group. I've been fortunate enough to have a very smart and understanding wife for the last 20 years, some great mentors in my career and a great staff at the Portsmouth contract. I measure success by the respect that I have earned. The greatest feeling is when my family tell me they love me or when a business associate says thanks. What more could you ask for from life?

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# Transport

Transport revenues grew by 14% to £626m, representing 25% of Group revenue (2005: 24%).

## Rail

Northern Rail and Merseyrail – our two joint ventures with NedRailways – have grown passenger numbers on the back of rising levels of customer satisfaction. At Northern Rail, train punctuality and reliability have been consistently above target. Merseyrail continues to deliver the levels of service which have made it one of the UK's best performing franchises.

Both Northern Rail and Merseyrail continue to deliver excellent safety performance, with Northern Rail winning the prestigious Sir Robert Horton Award for Safety at the 2006 National Rail Awards.

With NedRailways, we are bidding to run the West Midlands rail franchise from November 2007.

In Australia, our new timetable for The Ghan commenced, with two weekly services now undertaking the 2,000 mile continental crossing between Adelaide and Darwin. We have also committed to a fleet expansion programme, currently in the design phase, which will provide additional capacity and potential for revenue growth from late 2007.

## Urban Transportation

Key developments in the year included signing the new franchise agreement to continue to operate, maintain and support the highly successful Docklands Light Railway in London. The seven-year contract may be extended for a further two years and is valued at around £400m over this extended period. The new franchise further improves services through more frequent trains, enhanced security and higher targets for punctuality, customer satisfaction and availability of ticket machines, escalators and information displays. We are also one of the three companies bidding for the Dubai Metro project, which will be the world's largest driverless urban transport system.

We were disappointed not to renew the Manchester Metrolink contract at rebid.

We have been operating Metrolink for ten years, overseeing significant extensions and improvements to the service; this contract will end in 2007. Our contract to operate the Copenhagen Metro is also coming to an end this year.

## Transportation Technologies

Serco operates the National Traffic Control Centre (NTCC) on behalf of the Highways Agency. NTCC is a world-first facility, giving a real-time analysis of what is happening across England's motorway and trunk road network and helping drivers to better plan their journeys. While full implementation has taken longer than expected, we were delighted that Transport Secretary Alistair Darling officially opened the NTCC on 30 March 2006. We continue to work closely with the Highways Agency to achieve formal completion.

Other developments in the traffic management sector include new pilot schemes to increase the capacity of motorways in England and motorway technology services. The Highways Agency has selected Serco to develop and maintain a new control system for the Active Traffic Management pilot scheme on the M42 to better manage the roadspace and utilise the hard shoulder during periods of congestion. This contract applies to a 17km section of the motorway and is valued at £4.5m up to 2010.

Our traffic management experience is attracting interest from outside the UK and we have been selected to run systems in Sweden, Hong Kong and China.

## Air

In the United Arab Emirates, we successfully renewed our contract to provide air traffic control and engineering services at the Emirates Area Control Centre, based in Abu Dhabi. The new contract is valued at £11.5m over three years, a substantial increase from the previous contract.

Both Northern Rail and Merseyrail continue to deliver excellent safety performance, with Northern Rail winning the prestigious Sir Robert Horton Award for Safety at the 2006 National Rail Awards

# Science

Science revenues grew by 18% to £403m, representing 16% of Group revenue (2005: 15%).

Serco enhanced its position in 2006 as a leading partner in the practice and management of science and has continued to grow its business in the UK civil and defence nuclear markets.

The National Physical Laboratory (NPL) had a vital impact on industry and society in 2006. In addition to NPL's focus on leading edge research in biotechnology, nanotechnology and advanced materials, the laboratory has established a national framework for training in measurement skills, in partnership with Rolls-Royce. NPL increased its commercial income by 18%, including a £1.2m contract to run a knowledge transfer network for Government and work worth £1.9m to provide equipment and expertise to the new micro and nano manufacturing centre of excellence.

NPL played a key role in addressing the global challenge of climate change. Its measurement work monitoring emissions from power stations, airports and industrial locations has enabled carbon pricing to be based on robust, scientifically sound and internationally accepted measurements.

Our strong position in the civil and defence nuclear markets was further enhanced during the year through our work at the Atomic Weapons Establishment (AWE) and our technical assurance business.

2006 was another successful year for our work at the AWE, a facility we manage and operate through a joint venture with Lockheed Martin and BNFL. This was the first full year of the programme to upgrade skills and facilities. Within this challenging programme, all major projects are on track and the key performance indicators are showing record levels of performance in almost all areas of activity.

Our assurance business increased its presence in the civil nuclear market, with contract awards from BNG to help with the clean up of the Sellafield site and from

British Energy and Magnox Electric in support of generating stations. In addition, we are assisting the MoD in a multi-million pound study looking at future nuclear propulsion reactor designs.

Serco's expertise in the civil and defence nuclear fields is being brought to bear on a developing UK market for the decommissioning of the country's civil nuclear liabilities.

In 2006, Serco created a world-class consortium to address the Sellafield decommissioning and operations opportunity. The consortium, called SBB Nuclear, brings together three leading international companies - Serco, Bechtel and BWXT - all with proven track records of service delivery, nuclear site management and clean-up capability. SBB Nuclear is committed to the Nuclear Decommissioning Authority's process of selecting a Parent Body Organisation for the Sellafield Site Licence Company and to the safe, secure and environmentally sensitive management of the site and to supporting the economic regeneration of the surrounding community in West Cumbria.

Our science business also combines the technical, financial and management expertise to deliver some of the UK Government's most ambitious science-based programmes.

We have unrivalled experience in managing flagship government-owned, contractor-operated facilities at NPL and AWE. Combined with our safety and technical assurance expertise and track record in delivering big, complex programmes on time and on budget, this puts Serco in a good position to help the Government achieve its National Nuclear Laboratory programme, and potentially other science management programmes which are currently emerging in the marketplace.

Serco enhanced its position in 2006 as a leading partner in the practice and management of science



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What does success mean to you?

Success for me is to provide a secure home for my family and to instil in them values which will help them to live their lives.



**Steve Jacques** Senior Engineer, Serco Assurance


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Serco Assurance



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## What does success mean to you?



Success for me is being part of a good project team that has designed and delivered the Community Matron role in partnership with Newham Primary Care Trust. That's enabled us to enhance patient care with closer monitoring of their conditions and bridge the communication gap between patients and GPs.



**Yvonne Fenn**  
Community Matron  
Serco Civil Government



What does success mean to you?

Success is the satisfaction of our customers and our contribution to the community.



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## What does success mean to you?

Success means delivering improved customer service at lower cost. Southwark is now achieving this. We have enterprise-wide infrastructure that is second to none and are now well-placed to deliver the next stage of our modernisation programme. We were thoroughly impressed by Serco's commitment to supporting our ambitions.

**Bill Murphy** Strategic Director of Customer and Corporate Services, London Borough of Southwark



# Contractual Relationships

## Suppliers

Alongside the hundreds of services Serco manages through contracts on behalf of customers, the Group also has its own extensive supplier relationships. We take the same approach to suppliers as we do to customers. We look for long-term relationships in which there is opportunity for continuous improvement and value creation based on innovation.

In order to continually improve quality and manage costs, the Group has steadily standardised the centralisation of buying for the £500m of goods and services that we purchase each year. The number of preferred suppliers for such goods and services, ranging from commodity computer peripherals to agency employees, has reduced and the terms and conditions enhanced.

Procurement policies and processes are clearly communicated internally and facilitated through online purchasing systems which reduce administration costs, reduce wastage, improve cash flow and give contract managers more time to focus on client needs.

In 2006, Serco established key relationships with global software and IT services companies Patni, Tata and Genpact to support continual improvement in our administration processes and to access their leading software and IT-development capabilities. This demonstrates our ability to transcend traditional contractual relationships and develop true partnerships that benefit both parties and extend service relationships into relationships that more closely resemble joint ventures.

## Joint Ventures and Strategic Partnerships

Serco has a number of joint ventures and strategic partnerships around the world that manage service contracts, particularly in the transport, defence and science sectors.

Strong relationships, mutual trust and respect and clarity of role are all essential ingredients if a service is to be successfully delivered through a joint venture.

Our track record for successful partnerships speaks volumes. In the transport arena, our partnership with NedRailways began work at Merseyrail in 2003 and together we have become one of the UK's major train operating companies, having been selected for the eight-year Northern Rail franchise.

Our partnership with Lockheed Martin and BNFL at the Atomic Weapons Establishment has been highly successful and together we have consistently exceeded service targets.

Relationships with joint venture partners are the responsibility of the relevant divisional management teams, supported by members of the Group Executive Team and Board as appropriate. Regular strategy and review meetings ensure the joint venture partners remain firmly committed to working together to deliver services to clients.

In 2006, Serco created further strategic partnerships. For example, we brought together Serco, Bechtel and BWXT into a consortium to support the UK Nuclear Decommissioning Authority's clean-up programme and we created a strategic partnership with Infrastructure Investors Limited Partnership in order to enhance our competitiveness within the attractive PFI market.

# Resources

## Our People

We know that our people are the key to our continuing success and so we have developed a comprehensive suite of employment policies to support our 47,000 employees, wherever they are in the world.

The key employment policies are made available through line managers, human resources teams and our intranet and include policies covering diversity and equality, for employees having children, resolving issues, health and safety, confidentiality, security and ethics and time off work.

As an international company, we experience differing employment legislation, customs and practice in different parts of the world. Our approach is always to respect local differences but not to fall short of minimum standards.

Our performance against our policies, and the implications of changing legislation and new best practice, is monitored by our human resources function. Where we need to change an approach, then appropriate communications and training are implemented.

Serco has developed bespoke programmes to assist people working in management and front line roles. In January 2006 we introduced a business managers' programme, leading to a Diploma in Management from the Chartered Management Institute, which helps our managers develop their business insight and people skills. So far, 26 people have participated.

We have a groundbreaking relationship with the Institute of Directors (IoD), which underpins the strategic role of contract and divisional board membership. To date, 116 people have been awarded the IoD Serco certificate, with 70 awarded a diploma and seven achieving chartered director status.

We were delighted when our Skills for You programme received a Business in the Community Big Tick award for business excellence. Skills for You is geared to the UK Government's Skills for Life strategy, for boosting adults' basic skills. 2,753 of our people have been assessed, with 380 in training.

## Our Reputation

Our reputation for delivering excellent service and our ability to build long-term relationships is behind the consistent success Serco has enjoyed to date.

As we move deeper into markets and extend into new ones, we need our reputation to precede us. The Serco name is becoming better known among commercial and political audiences and we continue to strengthen our brand through the services we provide, our contribution to policy debates and the provision of tangible and topical examples of service improvement.



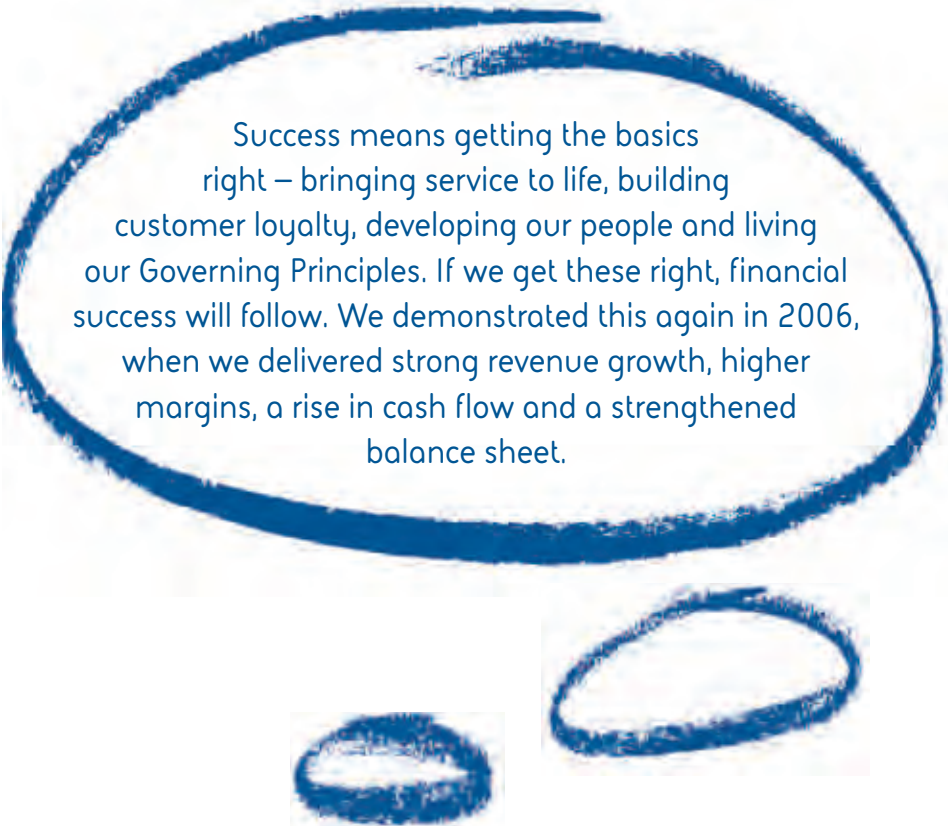
## What does success mean to you?

Success stories are often written using an output vocabulary - "did we achieve our key performance indicators?" - and on the DLR we are proud of our daily performance. But lasting success is built on a genuine commitment to find sustainable solutions between client and provider together - without this, success will be all too fleeting.


**Jonathan Fox** Director, Docklands Light Railway, Transport for London

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## What does success mean to you?



Success means getting the basics right – bringing service to life, building customer loyalty, developing our people and living our Governing Principles. If we get these right, financial success will follow. We demonstrated this again in 2006, when we delivered strong revenue growth, higher margins, a rise in cash flow and a strengthened balance sheet.



**Andrew Jenner** Finance Director



# Finance Review

## 1. Financial performance

Serco's financial results for 2006 demonstrate the strong growth in the business, a significant increase in margins and a good cash performance, together with a simplified balance sheet.

Serco's income statement for 2006 is summarised in Figure 1. This includes the results of joint ventures, which are proportionately consolidated.

Figure 1: Income statement

Year ended 31 December	2006 £m	2005 £m	Increase
Revenue	<b>2,548.2</b>	2,260.3	12.7%
Gross profit	<b>365.7</b>	325.0	12.5%
Administrative expenses	<b>(235.7)</b>	(214.3)	
Investment revenue and finance costs	<b>(17.8)</b>	(19.2)	
Profit before tax, amortisation and gain on sale	<b>112.2</b>	91.5	22.6%
Gain on sale of PFI investments	<b>11.4</b>	–	
Profit before tax and amortisation	<b>123.6</b>	91.5	35.1%
Amortisation	<b>(16.2)</b>	(13.6)	
Profit before tax	<b>107.4</b>	77.9	37.9%
Tax	<b>(27.9)</b>	(23.5)	
Profit for the year	<b>79.5</b>	54.4	46.1%
Effective tax rate	<b>26.0%</b>	30.2%	
Earnings per share	<b>16.62p</b>	11.66p	42.5%
Earnings per share before amortisation and gain on sale of PFI investments	<b>17.13p</b>	14.09p	21.6%
Dividend per share	<b>3.60p</b>	2.97p	21.2%

### 2.1 Revenue

Revenue grew by 12.7% to £2,548.2m. Excluding revenue from Serco Solutions and RCI, revenue growth was 11.4%.

Joint venture revenue increased by 20.0% to £643.3m. This increase was primarily due to growth in our contract to operate the Atomic Weapons Establishment.

During 2006, Serco Solutions contributed revenue of £216.2m (2005: £190.6m). RCI contributed revenue of £185.8m (2005: £143.3m). These businesses were acquired in February 2005 and March 2005 respectively.

### 2.2 Gross margin

Gross margin – the average contract margin across our portfolio – was 14.4% in 2006, consistent with the margin in 2005.

### 2.3 Investment revenue and finance costs

Investment revenue and finance costs totalled a net cost of £17.8m (2005: £19.2m). The decrease was due to lower net finance cost on the assets and liabilities of our defined benefit pension schemes.

## 2.4 Profit before tax and amortisation (PBTA)

PBTA before the gain on sale of PFI investments was £112.2m in 2006, which was an increase of 22.6% from 2005. This represented a margin of 4.4% in 2006, up from 4.0% in 2005.

Serco Solutions contributed PBTA of £16.8m (2005: £14.3m), representing a PBTA margin of 7.8% (2005: 7.5%), while RCI added £12.4m to PBTA (2005: £9.3m), at a PBTA margin of 6.7% (2005: 6.5%).

Excluding the profits generated by Serco Solutions and RCI, their associated funding costs and the gain on sale, growth in PBTA was 22.0%.

## 2.5 Intangible amortisation

The charge for intangible amortisation in the period was £16.2m (2005: £13.6m). The increase resulted from a full year of the amortisation of intangible assets arising on the acquisition of Serco Solutions and RCI and increased amortisation of software and development expenditure.

## 2.6 Profit before tax

Profit before tax increased by 37.9% to £107.4m (2005: £77.9m).

## 2.7 Tax

The tax charge of £27.9m (2005: £23.5m) represents an effective rate of 26.0%, compared with 30.2% in 2005. This decrease is principally due to the gain on the sale of the PFI investments not being taxable.

## 2.8 Earnings per share (EPS)

EPS grew by 42.5% to 16.62p. EPS before amortisation and the gain on sale of PFI investments rose by 21.6% to 17.13p.

EPS is calculated on an average share base of 471.2m during the period (2005: 458.1m). The increase resulted from a combination of share options issued in the year and the full year effect of shares issued during the first half of 2005, in part consideration for the acquisition of Serco Solutions.

## 3. Dividends

Serco's policy is to increase the total dividend per share each year broadly in line with the underlying increase in earnings. The proposed final dividend for 2.55p per share represents a 23.8% increase on the final dividend for 2005. The total dividend for 2006 is 3.60p per share, an increase of 21.2%. The final dividend will be paid on 16 May 2007 to shareholders on the register at the close of business on 9 March 2007.

## 4. Cash flow

The Group generated a free cash inflow of £85.4m, an increase of 15.7% compared with 2005.

Figure 2 analyses the cash flow. As in previous periods, we have designed the analysis to show the true cash performance of the Group – the cash flows generated by subsidiaries plus the dividends received from joint ventures. It therefore differs from the consolidated cash flow on page 76, which proportionately consolidates the cash flows of joint ventures. The adjustment line in Figure 2 reconciles the movement in Group cash to the consolidated cash flow.

Figure 2: Cash flow

Year ended 31 December	2006 £m	2005 £m
Operating profit excluding joint ventures	87.9	62.4
Non cash items	35.0	45.2
Group EBITDA	122.9	107.6
Working capital movement	(2.1)	(11.2)
Group operating cash flow	120.8	96.4
Interest	(10.6)	(15.7)
Tax	(6.7)	(1.0)
Expenditure on tangible and intangible assets	(47.7)	(31.6)
Dividends from joint ventures	29.6	25.7
<b>Group free cash flow</b>	<b>85.4</b>	<b>73.8</b>
Cash received on sale of PFI investments	76.5	–
Cash disposed of and transaction costs on sale of PFIs	(58.3)	–
Acquisitions	–	(281.7)
Other financing	(98.6)	253.8
Special pension contribution	(19.0)	–
Dividends paid	(14.5)	(12.5)
Group net (decrease)/increase in cash and cash equivalents	(28.5)	33.4
Adjustment to include joint venture cash impacts	10.3	4.1
Net (decrease)/increase in cash and cash equivalents	(18.2)	37.5

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

#### 4.1 Group operating cash flow

The Group operating cash inflow was £120.8m (2005: £96.4m), an increase of 25.3%. This represents a conversion of Group EBITDA into cash of 98% (2005: 90%). This EBITDA conversion and working capital performance is particularly notable given the strong level of organic growth.

#### 4.2 Interest

Net interest paid in 2006 was £10.6m, compared to £15.7m in 2005. The decrease was principally due to the timing of the sale of the PFI investments.

#### 4.3 Tax

Tax paid in 2006, excluding joint ventures, was £6.7m compared to £1.0m in 2005. This increase is primarily due to a tax refund received in 2005.

Cash tax is below the equivalent tax charge in the income statement. The difference reflects timing differences, including a continued residual level of accelerated capital allowances, and the availability of tax relief on the special pension contribution.

#### 4.4 Expenditure on tangible and intangible assets

Expenditure on tangible and intangible assets in the period was £47.7m (2005: £31.6m). This represents 2.5% of revenue excluding joint ventures (2005: 1.8%). The increase mainly resulted from expenditure on designing and building our new SAP accounting system and shared service centre. The total cost of the initial programme is estimated to be approximately £35m, of which £20m was incurred in 2006 and £7m in 2005.

#### 4.5 Dividends from joint ventures

Dividends received from joint ventures totalled £29.6m (2005: £25.7m), equivalent to 98% (2005: 101%) of joint ventures' profit after tax and minority interest. The high level of conversion in both years reflects dividend payments made by joint ventures from reserves retained in previous years.

## 4.6 Other financing

The movement in other financing is primarily as a result of repayments on our loan facility.

## 5. Net debt

Serco's net debt has reduced significantly during 2006. Group recourse net debt has decreased by £92.1m to £171.9m and total net debt has decreased by £389.3m to £205.9m. Figure 3 analyses Serco's net debt at 31 December 2006 and 31 December 2005.

Figure 3: Net debt

At 31 December	2006	2005
	£m	£m
Group – cash and cash equivalents	177.8	210.0
Group – loans	(334.4)	(453.1)
Group – obligations under finance leases	(15.3)	(20.9)
<b>Group recourse net debt</b>	<b>(171.9)</b>	<b>(264.0)</b>
Joint venture recourse net cash	28.2	18.0
<b>Total recourse net debt</b>	<b>(143.7)</b>	<b>(246.0)</b>
Group non recourse debt	(62.2)	(326.8)
Joint venture non recourse debt	–	(22.4)
<b>Total non recourse debt</b>	<b>(62.2)</b>	<b>(349.2)</b>
<b>Total net debt</b>	<b>(205.9)</b>	<b>(595.2)</b>

### 5.1 Group recourse net debt

Group recourse net debt reduced from £264.0m at 31 December 2005 to £171.9m at 31 December 2006.

Included within Group recourse net debt is £10.6m (2005: £22.7m) of encumbered cash, comprising cash of PFI and other project companies securing credit obligations and customer advance payments.

### 5.2 Group non recourse debt

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

Group non recourse debt reduced by £264.6m to £62.2m during the year, primarily as a result of the sale of the PFI investments (see section 7). At 31 December 2006, the remaining non recourse debt related to the Kilmarnock prison contract and our Driver Examination Services contract in Canada.

### 5.3 Joint venture non recourse debt

The joint venture non recourse debt recorded in 2005 resulted from debt taken on in the course of operating a contract where we have a right of full cost reimbursement. A debtor equal to the value of this non recourse debt was included in Serco's accounts to reflect this. During the first half of 2006, we renegotiated certain terms of this loan. This allows us to offset the debtor and non recourse debt in our accounts, thereby reflecting the economic reality of the contract.

## 6. Pensions

At 31 December 2006, the net liability included in the balance sheet arising from our defined benefit pension scheme obligations was £120.0m (2005: £149.9m). Figure 4 provides further analysis.

Figure 4: Defined benefit pension schemes

At 31 December	2006 £m	2005 £m
Group schemes – non contract specific	<b>(157.8)</b>	(200.4)
Contract specific schemes		
– reimbursable	<b>(67.6)</b>	(84.9)
– not certain to be reimbursable	<b>(23.9)</b>	(21.3)
Net retirement benefit liabilities	<b>(249.3)</b>	(306.6)
Intangible assets arising from rights to operate franchises and contracts	<b>20.6</b>	19.0
Reimbursable rights debtor	<b>67.6</b>	84.9
Deferred tax assets	<b>41.1</b>	52.8
Net balance sheet liabilities	<b>(120.0)</b>	(149.9)

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

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

At 31 December 2006, the principal non contract specific scheme was the Serco Pension and Life Assurance Scheme (SPLAS). This scheme was closed to new members in 2001. Prior to the special pension contributions at the end of the year, the scheme had a gross deficit of £136m. Following a detailed funding review in the second half of 2006, we have made a special cash contribution of £70m into the scheme. A payment of £19m was made in December 2006 and the remaining £51m was paid in January 2007. We have agreed an increase in employer and employee contributions from January 2007.

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

Figure 5: Pension assumption sensitivities

	Change in assumption	Change in liability
Discount rate	+0.5%	(9)%
	(0.5)%	+10%
Price inflation	+0.5%	+7%
	(0.5)%	+7%
Salary	+0.5%	+3%
	(0.5)%	(3)%
Longevity	Increase by one year	+2.75%



## 7. Private Finance Initiatives (PFIs)

### 7.1 Sale of PFI investments

On 2 December 2006, Serco sold its equity investments relating to six PFI projects to Infrastructure Investors Limited (I<sup>2</sup>). As part of this transaction, we retained the long-term operating contracts associated with the PFIs, and provide management services to I<sup>2</sup>, such as acting as the day-to-day interface with the customer.

The investments were sold for a total cash consideration of £76.5m, resulting in a gain on sale of £11.4m. Net assets of £46.8m were disposed of, including cash of £56.6m, PFI debtors of £329.8m and non recourse loans of £242.3m. The cash disposed of was held in the special purpose companies primarily to honour forthcoming debt repayments.

### 7.2 Remaining PFI portfolio

At 31 December 2006, Serco continued to hold a 100% equity investment in one PFI special purpose company and a minority shareholding in two others. Serco retains operating contracts in eleven PFI projects. We continue to recognise our remaining PFI debtors at amortised cost, as defined by IAS 39, maintaining an accounting treatment consistent with UK GAAP and existing IFRS. IFRIC 12 'Service Concession Arrangements' has been issued but is not mandatory until 1 January 2008. We will review the impact of the IFRIC during 2007.

## 8. Provisions

At 31 December 2006, the Group held provisions amounting to £22.3m (2005: £26.3m). Provisions include amounts relating to long-term service awards, terminal gratuities, property, contracts and restructuring. The decrease in provisions includes a reduction as a result of the completion of a planned restructuring in Serco Solutions.

## 9. Treasury

The Group's principal debt finance consists of a £400m bank credit facility comprising a term loan facility and a revolving credit facility. At 31 December 2006, we had £163m (2005: £279m) outstanding on the term loans and the revolving facility was undrawn. Interest is charged at a rate of 50 basis points over LIBOR on borrowings under the facility. The facility is unsecured and matures in December 2009.

Serco has also issued loan notes under two private placements. The first private placement, for £43.2m, matures in December 2007 and the second, for £117.0m, amortises evenly from 2011 to 2015.

At 31 December 2006, Serco also had £62.2m (2005: £349.2m) of non recourse debt that is used to fund remaining PFI and similar activities. In all cases, no entity other than the relevant borrower has an obligation, as a result of a guarantee or other arrangement, to repay non recourse debt.

# Principal Risks and Uncertainties

## Internal Control System

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. 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 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.

The Serco Management System (SMS) is the framework within which business divisions, operating companies and contracts implement processes and procedures that are appropriate to the business being undertaken. Divisional chief executives and business unit managers have the responsibility and authority to implement and monitor the system within their businesses. The SMS incorporates the Group's vision and strategy; the core values and 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 its core processes.

## Policy Statements and Standards

As part of the SMS, the Board has authorised a set of policy statements which are supported by standards, guidance and training material.

An ethical standard defines the following principles that apply to all our business activities:

- 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.

These broad principles are further interpreted in respect of individual and corporate behaviours.

A separate corporate responsibility standard defines the corporate responsibility programme that is implemented throughout the Group.

The Group's risk management standard defines the processes required in the organisation to manage and mitigate threats to our business objectives. The risk management process is described in a risk management manual and a set of guidance notes covering specific aspects appropriate to particular business activities. An internally developed and supported risk database tool supports the risk management process and is used to create risk, opportunity, assumption and issue registers.

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. Guidance on the risk appetite of the Group has been issued which defines the appetite/tolerance levels both for individual risks and for projects or business units where multiple risks are present.

## Principal Risks

The Group risk register identifies the principal risks facing the business, including those that are managed directly at a Group level. The process specifically

We will undertake our business activities in accordance with the highest standards of professionalism, integrity and honesty

identifies the business objectives and 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 at least quarterly, reviewed six monthly by the Risk Oversight Group and discussed at quarterly Board meetings; active risks are ranked by importance and grouped under the following six headings:

- Strategic – covering threats to the long-term deliverability of the Group's strategy. Principal risks include loss of competitive position and risks associated with acquisitions
- Financial/commercial – covering threats to the short-term performance. Principal risks include the loss of key contracts, 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. Principal risks include legal action resulting from compliance failures and unethical behaviour by Directors or members of staff
- Safety and security – covering threats to the safety of staff, sub-contractors, members of the public and the environment and the security of the Group's assets and staff. Risks include the responsibility for a major accident or incident where public safety is concerned, environmental pollution, assaults on staff in the course of their duties and crime, fraud and terrorism
- Operational – covering threats to the continuity of business operations after adverse events. Principal risks include the failure of information systems, loss of key infrastructure and the recruitment and retention of key staff
- Management – covering possible internal failures of managers or management systems. Principal risks include failures of internal controls and management systems.

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 Group's strategy at present. All risks and potential threats are kept under regular review and the Board informed of changes. Recent work has included the identification and tracking of emerging risks including pandemic influenza.

### Risk Mitigation

Each risk in the Group register 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 or request that an audit is undertaken to provide additional assurance. Risk management techniques used 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.

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

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

- 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 Global Management Board for consideration 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 employees. 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 maintain and further develop the very high standards 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 (whistleblowing), to which staff can report illegal, dangerous, dishonest or unethical activities
- A programme of internal audits confirms the extent to which key controls are applied across the Group. Audit priorities are established on the basis of risk assessments, regulatory requirements and business imperatives
- The operational risk framework tracks key 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.

### Corporate Assurance Group

The Corporate Assurance Group (CAG) oversees and reviews internal controls and risk policies, procedures and management frameworks and develops guidance, training material and management training to ensure the business needs are met. The Board recognises its responsibilities to shareholders and the wider community where social, environmental and ethical issues are very important. CAG is responsible for developing and overseeing the corporate responsibility activities within the Group.

Every quarter, CAG reports formally to the Executive Chairman and the Board, providing analyses of performance against targets and advises the Board on policy and future activities to enhance best practice. In 2006, CAG reviewed internal controls including risk management, health, safety and environmental management. As a result, a number of activities have been included in CAG's 2007 programme to strengthen performance in these areas.

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, which 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

The commitment and capability of staff is critical for the effective management of operational risk



- An Aviation Safety Oversight Group, chaired by the Aviation Safety Director and comprising the aviation safety representatives from across the Group, which 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 and comprising the rail safety representatives from across the Group oversees the 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.

### Internal Audit

During 2006, Grant Thornton 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.

### Joint Ventures

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 Group's joint ventures participate in the Assurance Network and the Risk Oversight and Rail Safety Oversight Groups.

### Review of Internal Controls

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

## Corporate Responsibility

Corporate responsibility is about living the values and principles that govern the way we operate and behave. Our approach reflects the importance corporate responsibility has to those we come into contact with. It is also good business practice, which we believe will ultimately help us deliver better returns to shareholders.

The responsibilities of CAG, which reports directly to the Board, include developing and overseeing our corporate responsibility activities. Our corporate responsibility model, which is described in detail in our separate Corporate Responsibility Report, encompasses four elements:

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

Details of our performance in 2006 and targets and objectives for 2007, are included in the 2006 Corporate Responsibility Report and at [www.serco.com](http://www.serco.com).

CAG reports formally to the Chief Executive and to the Board on a quarterly basis, providing analyses of performance against our assurance targets and also advises the Board regarding policy and future activities to enhance best practice around the organisation.

Our approach to corporate responsibility reflects the importance it has to those we come into contact with. It is also good business practice, which we believe will ultimately help us deliver better returns to shareholders

# Directors, Secretary and Advisors

<b>Chairman</b>	Kevin Beeston	<b>Stockbrokers</b>	JP Morgan Cazenove Limited 20 Moorgate London EC2R 6DA
<b>Directors</b>	Leonard V. Broese van Groenou* Margaret, Baroness Ford of Cuninghame* Christopher Hyman Andrew Jenner DeAnne Julius CBE* ^ David Richardson*		Merrill Lynch International Merrill Lynch Financial Centre 2 King Edward Street London EC1A 1HQ
<b>Secretary</b>	Joanne Roberts		
<b>Registered Office</b>	Serco House 16 Bartley Wood Business Park Bartley Way Hook Hampshire RG27 9UY	<b>Principal Bankers</b>	Barclays Bank plc 5 The North Colonnade London E14 4BB
<b>Auditors</b>	Deloitte & Touche LLP Hill House 1 Little New Street London EC4A 3TR		The Royal Bank of Scotland 135 Bishopsgate London EC2M 3UR
<b>Investment Bankers</b>	UBS Limited 1 Finsbury Avenue London EC2M 2PP	<b>Solicitors</b>	Linklaters One Silk Street London EC2Y 8HQ
		<b>Registrars</b>	Computershare Investor Services PLC The Pavilions PO Box 82 Bridgwater Road Bristol BS99 7NH

\*Non-Executive Director

^ Senior Independent Director

# Corporate Governance Report

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

In 2006, Serco Group plc complied fully with the provisions of the Code of Best Practice as issued by the Financial Reporting Council in 2003 (and superseded by the Combined Code on Corporate Governance issued in June 2006 (the Code)).

The paragraphs below together with the Business Review on pages 10 to 44 and the Remuneration Report on pages 59 to 71 provide details of how the Company has applied the principles and provisions of the Code.

## The Board of Directors

**Board composition:** Currently the Board has seven members: the Chairman, two Executive Directors and four Non-Executive Directors. No individual or group of individuals dominates the Board's decision-making. The Chairman is presumed under the Code not to be independent. The Board considers all the Non-Executive Directors to be independent. They bring a valuable range of experience and expertise to the Board. The profiles of all Directors can be found on page 57.

**The role of the Board:** The Board has responsibility for the overall management and performance of the Group, the approval of its long-term objectives and commercial strategy, and for ensuring that any necessary corrective action is taken promptly.

Reporting directly to the Board, the Corporate Assurance Group (CAG) is tasked to develop and oversee corporate processes for the identification and management of business risks and the appropriate application of the Serco Management System (SMS) and corporate responsibility activities throughout the Group. The Business Review on pages 10 to 44 details the internal control and risk policies, procedures and management framework adopted by the Group. The Corporate Responsibility Report, which covers the whole spectrum of corporate assurance processes and outcomes for 2006 is available online at [www.serco.com](http://www.serco.com). The Report illustrates how Serco's approach to corporate assurance and responsibility translates from the Board into everyday working practices.

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

- Group strategy
- Annual financial and operating plans
- Major capital expenditure, acquisitions or divestments
- Annual and interim financial results
- Dividend policy
- Treasury policy.

In addition, the Board satisfies itself as to the integrity of financial information, ensures adequate succession planning for the Board and senior management, together with the appointment and removal of Directors, the Company Secretary and committee members and reviews the effectiveness of the Group's system of internal control and risk management processes.



Other specific responsibilities are delegated to Board committees which operate within clearly defined terms of reference. Details of the responsibilities delegated to the committees are given on pages 49 to 50.

**Information flow:** Senior executives below Board level attend certain Board meetings and make presentations on the results and strategies of their divisional units and functional areas of the Group. Board members are given appropriate documents in advance of each Board and each committee meeting. Board meetings are routinely held four times a year over two days at a time. They are structured to allow open discussion and for all Directors to participate fully in discussing the strategy, trading and financial performance and risk management of the Group. Meetings are held at varying locations and the opportunity is used to combine the formal business of the Board with site visits and divisional presentations and discussions. Additional Board meetings are scheduled if required, usually to discuss major transactions, if any.

The attendance of individual directors at Board meetings held during the year, which they were eligible to attend, is shown in the table on page 48.

**Company Secretary and independent advice:** The Company Secretary is responsible for advising the Board on all corporate governance matters, ensuring that all Board procedures are followed, ensuring good information flow and facilitating induction programmes for Directors. All Directors have access to the advice and services of the Company Secretary. The Board has approved a procedure for Directors to take independent professional advice if necessary at the Company's expense.

**Chairman and Chief Executive:** Kevin Beeston is currently the Executive Chairman of the Group. On 31 August 2006, after 22 years with Serco, he announced his intention to move to Non-Executive Chairman from 1 September 2007. This move is supported by the Board and has been communicated to and discussed with major shareholders as appropriate.

As Chairman, Kevin Beeston is responsible for:

- Ensuring the effective running of the Board, its agenda and process
- Promoting the highest standards of corporate governance and ensuring appropriate communication with shareholders on these standards and the Group's overall performance
- Maintaining appropriate external relationships and promoting the Group and its business.

The Chairman's role is distinct from that of the Chief Executive, Christopher Hyman, who is responsible for:

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

**Senior Independent Director:**

DeAnne Julius is the Senior Independent Director and is available to shareholders if they have any issues or wish to discuss any aspects of the Group's business without the Executive Directors being present.

**External directorships for Executive Directors:**

The Board considers that Executive Directors can gain valuable experience and knowledge through appropriate Non-Executive appointments in other listed companies or independent sector organisations. The Board is careful to ensure that any such appointments do not compromise the effective management of the Group and that these are approved in advance of appointments being taken up. Details of the fees received by Executive Directors for external appointments can be found in the Remuneration Report on page 63.

**Re-election of directors:** 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. Any Directors appointed by the Board since the last Annual General Meeting must stand for re-election at the next Annual General Meeting. Any Non-Executive Directors who have served for more than nine years will be subject to annual re-election.

The names of the Directors retiring and standing for re-election at the 2007 Annual General Meeting are set out in the Notice of the Annual General Meeting.

### The Non-Executive Directors

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

**Term of appointment:** All Non-Executive Directors are appointed for an initial term of three years. Thereafter, subject to satisfactory performance, they may serve one or two additional three-year terms, with a thorough review of their continued independence and suitability to continue as Non-Executive Directors being undertaken if they remain on the Board for more than nine years. The terms and conditions of the appointment of the Directors are summarised in the Remuneration Report on page 63 and are available on request from the Company Secretary.

**Meetings of Non-Executive Directors:** Non-Executive Directors meet separately (without the Chairman or Executive Directors being present) at least once a year principally to appraise the Chairman's performance.

### Board Meetings and Attendance

The attendance of the individual Directors at Board and committee meetings during 2006 was as follows:

	Board (4 meetings) <sup>2</sup>	Audit (3 meetings)	Remuneration (5 meetings)	Training & Development (1 meeting)	Nomination (1 meeting)
Kevin Beeston	4	n/a	n/a	1	1
Christopher Hyman	4	n/a	n/a	n/a	n/a
Andrew Jenner	4	n/a	n/a	n/a	n/a
Leonard V. Broese van Groenou <sup>3</sup>	3	2	4	1	0
Margaret Ford	4	3	5	1	1
Ralph Hodge <sup>4</sup>	1	1	1	0	1
DeAnne Julius	4	3	5	1	1
David Richardson	4	3	5	1	1

Notes:

1. N/a means that the specified Director is not a member of that committee, although he or she may attend meetings at the invitation of the Chairman of the committee.
2. In addition to the four full Board Meetings, which are run over two days, there was one Board meeting, attended by the Executive Directors only, for the approval of the year end results which had been considered previously by the full Board, with authority delegated from the Board to the Executive Directors for final approval of the results.
3. Leonard V. Broese van Groenou was appointed to the Board as a Non-Executive Director on 3 April 2006.
4. Ralph Hodge retired as a Director on 5 May 2006.

### Board Effectiveness

**Induction:** On joining the Board, Directors are given background information describing the Group and its activities. Leonard V. Broese van Groenou, who was appointed as a Director on 3 April 2006, received an induction pack which included information on all the governance processes of the Group, the roles of the Board, committees and other management teams and a range of other appropriate information about the Group, its activities and its advisors. He also met with a range of key people from across the Group on a structured basis to assist his induction. Visits were also arranged to a number of contracts around the country.

### Continued professional development:

During 2006 the Board members were all engaged in a range of training and professional development activities. These activities are reported to the Training and Development Committee, which also considers the training needs of all Directors and the Company Secretary. All Board members are encouraged to attend relevant training courses at the Group's expense.

**Performance evaluation:** In October 2006, a rigorous evaluation of the Board and its committees was undertaken which included a formal evaluation questionnaire and one-to-one meetings for all Directors held with the Chairman plus an evaluation of the Chairman's performance led by the Senior Independent Director. The Group recognises the importance of a rigorous evaluation process for the Board and ensures that comments and recommendations are considered carefully and implemented where appropriate to ensure the continued development of the Board. The outcomes from the Board's appraisal were discussed fully at the November 2006 Board meeting. The principal finding from the evaluation was confirmation that the Board is effective and in many cases is considered to be leading in aspects of best practice. All Directors feel that the Board and Group is open and that appropriate information is provided to the Board in the furtherance of its responsibilities. Aspects for further development were largely procedural and covered such areas as the balance between formal reports and presentations

and the frequency of certain of the reports to the Board. All recommendations from the evaluation have been implemented.

### Board Committees

The Board has delegated authority to a number of permanent committees to deal with matters in accordance with written terms of reference. The terms of reference for all committees are reviewed on a regular basis by the Board to ensure they are still appropriate and reflect any changes in good practice and governance. Committees are authorised to obtain outside legal or other independent professional advice if they consider it necessary.

### The Audit Committee and Audit Committee Report

**Membership:** The Audit Committee is chaired by David Richardson and comprises Margaret Ford, DeAnne Julius and Leonard V. Broese van Groenou. The Committee consists solely of independent Non-Executive Directors. The Chairman of the Committee has recent and relevant experience for this role. The Audit Committee met three times during the year.

At the invitation of the Committee, the Finance Director, Director of Corporate Assurance, Grant Thornton (the Group's internal audit providers) and Deloitte & Touche LLP (the external auditors), attend meetings. The Committee meets with each of the internal auditors, external auditors and Corporate Assurance teams separately at least once a year. All Directors have access to the minutes of the Audit Committee meetings.

**Responsibilities:** The Audit Committee is responsible for exercising the full power and authority of the Board on accounting matters and financial reporting matters including the integrity of the financial statements of the Group, the accounting policies adopted, significant financial reporting judgements made and the role of the internal auditors. In accordance with the Combined Code, the Committee is responsible for a formal whistleblowing policy and procedure which applies throughout the Group. Responsibility for the operation of this policy has been delegated to the Company Secretary.



During 2006, the Audit Committee considered the following:

- Corporate Governance Report and Directors' Statement of Responsibilities for inclusion in the 2005 Annual Review and Accounts
- 2006 Interim Report
- 2006 external audit fees
- Review of the whistleblowing policy
- Assessment of the Committee and the external and internal auditors
- 2006 internal audit programme and proposed 2007 programme
- Work undertaken and fees incurred by the external auditors to ensure that the external auditors remain independent of the Group.

**Non-audit services:** During the year, the Group has complied with the policy set by the Audit Committee in respect of the provision of audit and non-audit services by Deloitte & Touche LLP, the Group's external auditors. Where appropriate, non-audit services have been provided by companies other than Deloitte & Touche LLP.

**Auditor independence:** 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 recommended to the Board that Deloitte & Touche LLP 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

**Membership:** The Nomination Committee is chaired by Kevin Beeston and comprises Margaret Ford, DeAnne Julius, David Richardson and Leonard V. Broese van Groenou. The Committee met once during 2006 in February.

**Responsibilities:** Matters considered included the appointment of Leonard V. Broese van Groenou as a Non-Executive Director (which took place when Ralph Hodge was still a Non-Executive Director and before the appointment of Leonard V. Broese van Groenou), the Board structure and composition going forward and the appointment of Margaret Ford as Chair of the Remuneration Committee.

### The Remuneration Committee

Details of the Remuneration Committee and its policies together with the Directors' remuneration, emoluments and interests in the Company's share capital are set out in the Remuneration Report on pages 59 to 71.

### The Training and Development Committee

**Membership:** The Training and Development Committee is chaired by Kevin Beeston and comprises Margaret Ford, DeAnne Julius, David Richardson and Leonard V. Broese van Groenou.

**Responsibilities:** The Committee met once during 2006 in November to consider the training needs of all Directors and the Company Secretary.

### Executive committees

The Board has delegated responsibility for the day-to-day management of the business to the Global Management Board (GMB). The GMB is chaired by the Chief Executive, Christopher Hyman and its membership currently comprises fifteen senior managers representing each of the Group's operating divisions and a number of functional heads. It also includes the Finance Director plus the Chairman by invitation. The GMB meets formally three times a year, over two days at a time to review the Group's activities and discuss management and operational issues.

Representatives from across the Serco business are invited to the meetings to discuss aspects of their business or give presentations on specific topics. The GMB is able to take a broad view of the business due to its membership being drawn from across the Group.

A senior group of the GMB, the Executive Team, which is chaired by the Chief Executive and comprises six members including the three Executive Directors, is responsible for the oversight of all aspects of the day-to-day operations and trading of the Group. The Executive Team met 12 times during the year.

### Relationships with Shareholders

The Group's relationships with shareholders are given a high priority. The Annual Review and Accounts is available to all shareholders and a shorter Annual Review and Summary Financial Statement is also available by election or on request. In addition, an Interim Report is produced. Regular trading updates are published ahead of closed periods and before the Annual General Meeting by press release. In addition, press releases and stock exchange announcements are made regarding significant contracts or transactions. All trading announcements are posted on the Group's website [www.serco.com](http://www.serco.com).

### Annual General Meeting

Individual shareholders have the opportunity at the Annual General Meeting to question the Chairman and, through him, the chairs of the various Board committees and other Directors.

Details of the meeting are set out in the Notice of Meeting, which is sent to shareholders and contains the text of the resolutions to be proposed with explanatory notes.

Shareholders attending will be advised of the number of proxy votes lodged for each resolution, in the categories "for" and "against" together with the number of "votes withheld". This information is also posted on the Group's website [www.serco.com](http://www.serco.com).

### Institutional investors

All three Executive Directors have regular dialogue with institutional investors. The Group's investor relations programme and day-to-day activities are managed by Richard Hollins, Head of Investor Relations. As part of her role as the Senior Independent Director, DeAnne Julius is available to shareholders and has participated in a number of routine meetings during 2006.

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

### Group website

The Group website [www.serco.com](http://www.serco.com) is a primary source of information on the Group. The site includes an area tailored for investors, including information such as an archive of reports, announcements, presentations and webcasts, share price tools, the terms of reference for all Board committees and information on voting at the Annual General Meeting. It also has a link directly to the Company's registrars, allowing shareholders to view their shareholding online and to vote on the resolutions set out in the Notice of Meeting for the 2007 Annual General Meeting.

### Business Conduct

The Group has published an Ethics and Business Conduct Policy that applies to all business divisions, operating companies and business units throughout the world.

The Policy outlines the Group's position on a wide range of ethical and legal issues including conflicts of interest, financial inducements, human rights and legal and regulatory compliance. The Policy applies to Directors and to all employees regardless of their position or location.

Serco has established a dedicated whistleblowing hotline so that employees can seek guidance or express any concerns on Group related issues. The Company Secretary investigates any issues raised independently and reports back to the Board. Reports can be made anonymously and without fear of retaliation.

The Group maintains a position of impartiality with respect to party politics. Accordingly, it does not contribute funds to any political party. It does however contribute to the public debate of policy issues that may affect the Group in the countries in which it operates.

### Internal Control and Risk Management

Further to the comments above regarding Corporate Assurance, details of the Group's internal control and risk management processes are contained in pages 41 to 43 of the Business Review. The Board confirms that the actions it considers necessary have been taken to remedy such failings and weaknesses, which it has determined to be significant from its review of the Group's internal controls.

### 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.

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



**Joanne Roberts**  
Secretary

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

28 February 2007



# 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 2006.

## Activities

Serco Group plc is a holding Company which operates via its subsidiaries and joint ventures to improve services by managing people, processes, technology and assets more effectively. Serco supports governments, agencies and companies by offering operational, management and consulting expertise in the aerospace, defence, education, health, home affairs, local government, science, technology, transport and commercial sectors.

The Chairman's statement on pages 6 to 9, and the Business Review on pages 10 to 44 report on the activities during the year, post balance sheet events and likely future developments. The information in these reports which is required to fulfil the requirements of the Business Review is incorporated in this Directors' Report by reference.

## Share Capital

The authorised and issued share capital of the Company, together with the details of shares issued during the year are shown in note 29 to the financial statements.

## Dividends

An interim dividend of 1.05p (2005 – 0.91p) per ordinary share was paid on 18 October 2006. The Directors recommend a final dividend of 2.55p (2005 – 2.06p) per ordinary share which, if approved by shareholders at the Annual General Meeting, will be paid on 16 May 2007 to those shareholders on the register at the close of business on 9 March 2007.

## Substantial Shareholdings

As at 28 February 2007, the Company had been notified, pursuant to the Companies Act 1985, of the following substantial interests representing over 3% of the issued share capital:

	No of shares (millions)	Percentage of issued share capital %
FMR Corp. and Fidelity International Limited	44.1	9.24
Aviva plc	26.1	5.47
HBOS plc	23.5	4.94
Resolution Investment Services Limited	20.1	4.22
AEGON UK plc Group of Companies	19.5	4.10
Legal & General Group plc	17.2	3.61

## Directors

The current members of the Board together with biographical details of each Director are set out on pages 56 to 57.

On 24 February 2006, the Board approved the appointment of Leonard V. Broese van Groenou as a Non-Executive Director and Ralph Hodge retired as a Non-Executive Director at the 2006 Annual General Meeting on 5 May 2006.

## Directors' Interests

With the exception of the Executive Directors' service contracts and the Non-Executive Directors' letters of appointment, there are no contracts in which any Director has an interest.

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 59 to 71.

## Annual General Meeting

The Annual General Meeting of the Company will be held at the Queen Elizabeth II Conference Centre, London on 4 May 2007 at 11.00 am.

The Notice of the Meeting together with explanatory notes is sent to shareholders with this Review.

## Employment Policies

The Board is committed to maintaining a working environment where staff are individually valued and recognised. Group companies and divisions operate within a framework of human resources policies, practices and regulations appropriate to their own market sector and country of operation.

The Group is committed to ensuring equal opportunity, honouring the rights of the individual and fostering partnership and trust in every working relationship. Policies and procedures for recruitment, training and career development promote equality of opportunity regardless of gender, sexual orientation, age, marital status, disability, race, religion or other beliefs and ethnic or national origin.

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

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

Participation by staff in the success of the Group is encouraged by the availability of sharesave schemes 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.

## Corporate Responsibility

The Group has implemented policies on environmental, health and safety matters and operates a Code of Corporate Responsibility and Business Ethics.

Further information on environmental and employee health and safety matters is contained in the Corporate Responsibility report which is also available online at [www.serco.com](http://www.serco.com).

### Creditor Payment Policies

The Group requires each of its business units to negotiate and agree terms and conditions for payment for the supply of capital and revenue items just as keenly as they negotiate prices and other commercial matters. Suppliers are made aware of the terms and the way in which disputes are to be settled. Payment is then made in accordance with those terms.

The Group's average creditor payment terms in 2006 were 26 days (2005: 26 days); Company 20 days (2005: 20 days).

### Donations

The Group continues to encourage all staff to participate in their local communities and has a process to capture community investment information on a worldwide basis. This measure is based upon the Business in The Community (BiTC) reporting format. The value of this investment at £942,340 (2005: £1,017,129) represents 1% of the Group's pre tax profit excluding the gain on sale of PFI investments, and represents a 7.4% decrease on investment made in 2005. However, whilst the total for 2006 is less than 2005, the 2005 figure included a corporate one-off donation for the Tsunami fund. When this is taken out, the like for like comparison shows a 2.3% increase in investment in 2006 over the previous year.

During the year neither the Company nor the Group made political donations and this policy will continue.

### Financial Statements

At the date of this report, as far as each Director is aware there is no relevant audit information of which the Group's auditors are unaware. Each Director has taken all the steps that he/she ought to have taken as a Director in order to make himself/herself aware of any relevant audit information and to establish that the Group's auditors are aware of that information.

### 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.

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



### Joanne Roberts

Secretary

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

28 February 2007



From left to right:

**Mark Duckworth** Acting Company Secretary 2006

**Christopher Hyman** Chief Executive

**DeAnne Julius, CBE** Senior Independent Director

**David Richardson** Non-Executive Director

**Andrew Jenner** Finance Director

**Leonard V. Broese van Groenou** Non-Executive Director

**Margaret, Baroness Ford of Cunninghame** Non-Executive Director

**Kevin Beeston** Executive Chairman



# Directors' Profiles

## Kevin Beeston FCMA (44)

### Executive Chairman

*Chair of the Nomination and Training and Development Committees* <sup>(3), (4)</sup>

Kevin was appointed Executive Chairman of Serco Group plc in May 2002, having previously served as the Group's Finance Director and Chief Executive. He has announced his intention to move to Non-Executive Chairman of Serco in September 2007. A qualified accountant, Kevin joined Serco in 1985. He is a member of the CBI President's Committee and Chairman of the CBI's Public Services Strategy Board, which promotes the role business has in transforming the UK's public services. In addition, he holds Non-Executive Director positions on the boards of IMI plc and Ipswich Town Football Club plc.

## Leonard V. Broese van Groenou (60)

### Non-Executive Director

<sup>(1), (2), (3), (4)</sup>

Leonard joined Serco as a Non-Executive Director in April 2006. Leonard was previously vice-president Human Resources and member of the corporate executive committee of Pennsylvania-based Air Products, a New York listed company serving customers in technology, energy, healthcare and industrial markets worldwide where he served for nearly 30 years. His career at Air Products spans numerous international roles including financial control, business planning, operational management and human resources.

## Margaret, Baroness Ford of Cuninghame MA MPhil (49)

### Non-Executive Director

*Chair of the Remuneration Committee* <sup>(1), (2), (3), (4)</sup>

Margaret joined Serco in October 2003 as a Non-Executive Director. She spent her early career in a variety of roles either in the public sector or as an advisor to Government and is a specialist in leadership development, culture change and public sector reform. From 1997 to 2000 she was the Chair of Lothian Health Board and from 2000 to 2003 was a Non-Executive Director of Ofgem. From 2000 to 2005, Margaret was a Director of Good Practice Limited, the publishing company that she founded. Margaret is the Chairman of English Partnerships, the national regeneration agency and in 2006 she was appointed the Non-Executive Chairman of Pinnacle Staffing Group plc and of Irvine Bay Regeneration Company. Margaret is also currently a Director of Scotland's Futures Forum Limited.

## Christopher Hyman CA (SA) (43)

### Chief Executive

Christopher was appointed Chief Executive of Serco Group plc in 2002. He is also Non-Executive Director of United Business Media plc, the Prince of Wales' charity In Kind Direct, Habitat for Humanity and the Borneo Tropical Rainforest Foundation. He is also a member of the UK Government's Honours Advisory Committee for Economy. Christopher graduated from Natal University in Durban, South Africa and qualified as a chartered accountant, serving with Arthur Andersen and Ernst & Young before joining Serco in 1994 as the European Finance Director. He was appointed Group Company Secretary in 1996, Corporate Finance Director in 1997 and Group Finance Director in April 1999. He is responsible for setting the vision and strategy of the Group.

## Andrew Jenner ACA (38)

### Finance Director

Andrew joined Serco in 1996 as Group Financial Controller, having previously worked for Unilever and Deloitte & Touche LLP. He became Corporate Finance Director with additional responsibility for Treasury activities in 1999 and Group Finance Director in May 2002. Andrew shares responsibility for our relationship with shareholders and the City with the other Executive Directors. He is also responsible for the Group's PFI investment business.

## DeAnne Julius CBE PhD (Econ) (57)

### Senior Independent Director

<sup>(1), (2), (3), (4)</sup>

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 BP PLC and Roche Holdings SA.

## David Richardson BSc FCA (55)

### Non-Executive Director

*Chair of the Audit Committee* <sup>(1), (2), (3), (4)</sup>

David joined Serco as a Non-Executive Director in June 2003. He has previously held the position of Finance Director of Whitbread, where his roles in a 20-year career have included eight years as Strategy Director. David was instrumental in transforming Whitbread from a brewing and pubs company into a market leader in hotels, restaurants and leisure clubs. David is currently a Non-Executive Director of Dairy Crest Plc, Forth Ports Plc, The Restaurant Group plc and Tomkins plc.

(1) Member of the Audit Committee

(2) Member of Remuneration Committee

(3) Member of the Nomination Committee

(4) Member of the Training and Development Committee

# Directors' Responsibilities

The Directors are responsible for preparing the Annual Review and Accounts.

The Directors are required to prepare financial statements for the Group in accordance with International Financial Reporting Standards (IFRS), the Companies Act 1985 and Article 4 of the IAS Regulation. They have elected to prepare financial statements for the Company in accordance with UK Generally Accepted Accounting Principles.

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

Directors are also required to:

- Properly select and apply accounting policies
- Present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information and
- Provide additional disclosures when compliance with the specific requirements of IFRS is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the Group's financial position and financial performance.

The Directors are responsible for keeping proper accounting records, which disclose with reasonable accuracy at any time the financial position of the Group, for safeguarding the assets, for taking reasonable steps for the prevention and detection of fraud and other irregularities and for the preparation of a Directors' Report and Directors' Remuneration Report which comply with the requirements of the Companies Act 1985.

The Directors are also responsible for the maintenance and integrity of the Group's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

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



**Joanne Roberts**  
Secretary

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

28 February 2007

# Remuneration Report

## Introduction

The following report details the remuneration policy and the actual remuneration of the Directors of the Group for the year ended 31 December 2006. In preparing this report, consideration has been given to the disclosure requirements of the 2006 Combined Code and Schedule 7A of the Companies Act 1985. A resolution to approve this report will be proposed at the Annual General Meeting on 4 May 2007.

## The Remuneration Committee

The Remuneration Committee (the Committee) comprises all the independent Non-Executive Directors: Margaret Ford (Chair), DeAnne Julius, David Richardson and Leonard V. Broese van Groenou. Margaret Ford succeeded Ralph Hodge as Chair of the Committee on 5 May 2006.

Kevin Beeston (Executive Chairman) and Christopher Hyman (Chief Executive) may attend meetings of the Committee at its discretion and as appropriate. Lucy Adams (Group Human Resources Director) also provides advice and guidance to the Committee. The Executive Directors are not in attendance when their own remuneration arrangements are discussed.

The Committee met five times during the year. The terms of reference of the Committee, a copy of which can be found on the Group's website, are reviewed annually to ensure that they meet best practice. Details of the Directors' attendance at the Committee meetings can be found in the Corporate Governance Report on pages 46 - 52.

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

## Advisors to the Remuneration Committee

During the year, the Committee has been advised by Mercer Human Resource Consulting (Mercer) who were appointed by the Committee in 2005 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 as a whole based on current market trends.

Mercer also provides benchmarking data to the Group from time to time and advice to the Trustees of the Serco Pension and Life Assurance Scheme (SPLAS).

The Committee does not consider there to be any conflict in relation to Mercer acting both for the Committee and the Pension Trustees and with them providing data to the Group.

## Remuneration Policy and Practice

During 2005, the Committee carried out its triennial comprehensive review of executive remuneration to ensure that the Group's arrangements continue to be aligned with the business strategy and current best practice.

As a result of the review, changes were made to the remuneration package and these were detailed in the 2005 Annual Review and Accounts. The following principles described below have been adopted to determine the remuneration package of the Executive Directors. The remuneration should:

- Support Serco's business strategy
- Align the financial interests of executives and shareholders
- Provide market competitive reward opportunities for performance in line with expectations, but have the potential to deliver significant financial rewards for sustained out-performance
- Reflect UK market norms
- Be supported by a clear rationale which participants, shareholders and other stakeholders are able to understand.

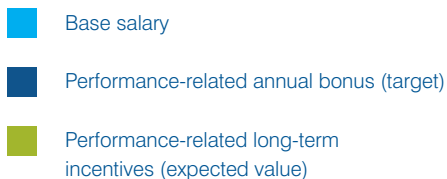
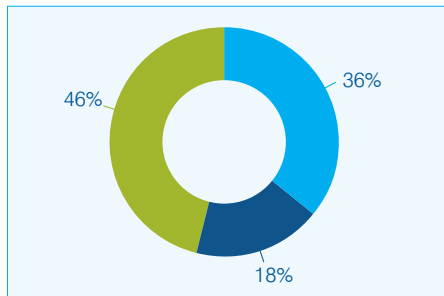
The Committee believes that the existing executive remuneration principles remain appropriate.

## Remuneration Package

### Composition

The current remuneration package for Executive Directors consists of base salary, annual bonus, long-term incentives, pensions and other benefits. The Group's policy is to ensure that a significant proportion of the package is performance related, even at target levels.

The relative proportions of performance and non-performance related remuneration for an Executive Director's "on-target" remuneration are shown below:



### Base Salary

The Committee's policy is to set the base salaries of the Executive Directors at the median of a comparator group of companies, which consists of 14 companies in the FTSE 250 Index of broadly similar size and business fit. Salaries are normally reviewed annually and the Committee takes note of relative pay and employment conditions within the comparator group in determining salary increases.

In 2006, the base salaries for Kevin Beeston, Christopher Hyman and Andrew Jenner were increased by 6%, 6% and 9% respectively. The base salary increases for Kevin Beeston and Christopher Hyman are in line with executive pay increases in the comparator group. Andrew Jenner received a 9% increase to reflect his progression in the role and the fact that the salary movement for finance directors is higher than that of other main board directors in the UK.

### Annual Bonuses

For 2006, the annual bonuses for Executive Directors are calculated as follows:

- The threshold payment at 20% of base salary
- The target payment at 50% of base salary
- The maximum payment at 100% of base salary.

The criteria for performance measurement comprise a mix of financial and corporate measures that account for 80% and 20% of the bonus allocation respectively. Financial measures are based on the Serco Group results and the corporate measures are team based. The financial measures for 2006 were based on turnover, profit before tax and amortisation (PBTa) and cash conversion. These measures reflect the growth and margin improvement strategies of the business and are extremely stretching at the maximum end. The 20% allocated to corporate measures was split between performance on a number of strategically important projects.

Based on the achievement of stretching turnover and PBTa growth of 12.7% and 22.6% respectively and achievement of the goals under the corporate objectives, a bonus equal to 95% of base salary will be paid for performance during 2006. The bonus award is made on the salary at the time of the award.

Annual bonuses are not pensionable.

### Deferred Bonus Scheme

For bonuses paid in respect to the 2003, 2004 and 2005 financial years, the annual bonus plan included the ability for the Executive Directors to defer a portion of the bonus earned. Participants could elect to defer, for three financial years, up to 100% of the bonus earned by purchasing shares in the Company pursuant to the terms of the Deferred Bonus Scheme. The shares purchased will be matched by the Company if stretching performance targets are met.

The performance conditions for matching shares on deferred bonuses is Total Shareholder Return (TSR) relative to companies comprising the FTSE 350 Index and measured over the three-year deferral period. The matching shares awarded are based on the following criteria:

- No matching shares will be awarded if the Group does not meet or exceed the median TSR of the comparator group



- A one for two match of shares deferred will be made if performance is at the median and
- A one for one match of shares deferred will be made if performance is at or above the upper quartile.

There is no further opportunity for the Executive Directors to defer bonuses paid in respect of the 2006 financial year and onwards.

### Share-based Incentives

Long-term share-based incentives are awarded to Executive Directors under the Serco Group plc 2006 Long Term Incentive Plan and the Serco Group plc 2005 Executive Option Plan. Previous long-term share incentives were granted under the Serco Group 2005 Long Term Incentive Scheme and 1998 Executive Share Option Scheme. The various scheme and plan rules have all been approved by shareholders at Annual General Meetings. All grants and awards are made pursuant to the rules of the applicable plans and in accordance with the Model Code and policies in relation to the treatment of the leavers have been adopted. The measurement of the performance targets is undertaken by Ernst & Young in relation to the Long Term Incentive Scheme and Executive Option Plan, while Mercer undertake the measurement for the 2006 Long Term Incentive Plan. The conditions relating to the schemes are detailed below.

#### 2006 Long Term Incentive Plan

Shareholders approved the Serco Group plc 2006 Long Term Incentive Plan (LTIP) at the Annual General Meeting held in May 2006. The LTIP awards granted to Executive Directors are calculated at 100% of salary at the time of grant. As the 2006 plan was approved at the AGM and no awards had been granted under the Long Term Incentive Scheme (LTIS) in 2005, an award of 100% of salary was made immediately and a further award of 100% of salary was made at the normal annual award time in November. In future years the annual award limit will normally be limited to 100% of salary.

The vesting of awards made during 2006 will depend on the Group's TSR measured relative to the top 250 companies in the FTSE 350 Index, as ranked by market capitalisation, excluding those in certain sectors which are not comparable with the Group. The proportion of awards that vest will be determined by the following schedule:

- No part of the awards will vest if the Group's TSR is below the median of the comparator group
- 30% of awards will vest for median performance
- 100% of awards will vest for upper quartile performance
- Between median and upper quartile performance a proportion between 30% and 100% of the awards will vest pro rata
- 200% of awards will vest for top decile performance
- Between upper quartile and top decile, a proportion between 100% and 200% will vest pro rata.

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

There is no re-testing under the LTIP.

#### Executive Option Plan

The Serco Group plc 2005 Executive Option Plan (EOP) was approved at the Annual General Meeting held in April 2005 as a replacement for the Serco Group 1998 Executive Option Plan. Since the approval of the 2005 Plan, no options have been granted under the 1998 Plan, which is now closed.

Options granted under the EOP may be exercised after the third anniversary of grant, depending upon the achievement of a financial performance target over three years. The options are granted at market value and awards made to Executive Directors under the 1998 EOP 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 Group's earnings per share (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 is measured by reference to the Group'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 options may be exercised
- If the level of EPS growth is equal to RPI + 10% per annum, all of the options may be exercised
- For an EPS growth of between RPI + 5% and RPI + 10% per annum, a proportion of the options between 40% and 100% may be exercised

For option grants which completed their performance period on 31 December 2006, the Group's EPS growth was 15.76% per annum over the three-year performance period which resulted in all options vesting. The level at which maximum vesting would occur was 13.37% per annum.

#### **Long Term Incentive Scheme**

Prior to the approval of 2006 Long Term Incentive Plan, awards were granted under the Long Term Incentive Scheme (LTIS). Awards granted under the LTIS may be exercised after the third anniversary of grant once confirmation has been received from the auditors regarding the achievement of the performance criteria.

*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 Group's EPS over the performance period of three financial years.

The vesting of the awards is based on the following criteria:

- 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
- Full vesting will only occur if the cumulative EPS growth over the three year performance period is at least 64%

*Post 1 January 2003 Awards:* For awards granted on or after 1 January 2003, achievement of the performance is measured by reference to the Group's TSR performance 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 Group's performance is below the median of the 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 between 40% and 100% will vest.

For awards which completed their performance period on 31 December 2006, the Group's TSR performance was in the upper quartile of the comparator group over the three-year performance period, resulting in the award vesting in full.

The Committee considers that TSR and EPS are the key performance indicators for Serco and are most relevant for measuring relative shareholder value created and the Group's underlying financial performance respectively.

### Sharesave Scheme

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

### External Appointments

The Board believes that the Group can benefit from its Executive Directors holding appropriate Non-Executive directorships of companies or independent bodies. Such appointments are subject to the approval of the Board. Fees may be retained by the Executive Director concerned.

Kevin Beeston is a Non-Executive Director of IMI plc for which the fees payable in the year were £45,000. Christopher Hyman is a Non-Executive Director of United Business Media plc for which the fees payable in the year were £45,000. Neither receives any other fees from Non-Executive Directorships held.

### Pensions and Life Assurance

Serco operates both defined benefit and defined contribution pension schemes. The Executive Directors participate in the SPLAS. This is a funded, defined benefit scheme, which provides for a pension of two-thirds of pensionable salary following a full career. The normal retirement age of Executive Directors is 60. Members contribute to the scheme at rates varying according to the section of the scheme. Christopher Hyman and Andrew Jenner contributed to the scheme at 8% of pensionable salary up to 31 December 2006 (subject to Revenue limits prior to 6 April 2006). This rate increased to 9.5% with effect from 1 January 2007. Until 6 April 2006, Kevin Beeston contributed 7% of pensionable salary to the scheme.

Kevin Beeston's pension benefits accrued prior to 6 April 2006 exceeded the new Lifetime Allowance, which came into force at that date, and he opted to cease paying contributions and accruing benefits in the pension scheme after 6 April 2006. Since that time, he has been in receipt of a cash allowance equal to 33% of his base salary in lieu of further pension provision.

Kevin Beeston remains entitled to lump sum and widow's pension benefits should he die before retirement and whilst still employed by Serco.

As a result of their joining the Group after 1989, Christopher Hyman and Andrew Jenner have been subject to the Earnings Cap on pensionable salary within the SPLAS. The Group has provided defined contribution pension arrangements to supplement the SPLAS for Christopher Hyman and Andrew Jenner. However these arrangements ceased during 2005 and were replaced by a cash alternative until 6 April 2006. Pensions earned in the SPLAS for service after 6 April 2006 are no longer subject to the Earnings Cap and accordingly the cash alternative ceased with effect from 6 April 2006.

### Non-Executive Directors

The Group's policy is that the fees of Non-Executive Directors, which are determined by the Board, are set at a level which will attract individuals with the necessary experience and ability to make a substantial contribution to the Group's affairs.

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

As at 31 December 2006, the Non-Executive Directors of the Group have no personal financial interest in the matters determined by the Board, there are no conflicts of interest arising from cross-directorships and no involvement in the day-to-day running of the Group. The Non-Executive Directors do not participate in the Group's incentive or pension schemes, or receive other benefits except as described.

The fees and terms of engagement of Non-Executive Directors are reviewed on a biennial basis and approved by the Board. In addition to the basic fee for each Non-Executive Director and the Senior Independent Director, supplements are paid to the Chairs of the Audit and

Remuneration Committees to reflect the extra responsibilities attached to those positions. The standard fees payable for Non-Executive Directors during the financial year under review and the proposed revised fees for the current year are shown in the table below.

	January 2006 to Date £	From 1 March 2007 £
Board membership	35,000	45,000
Committee Chair	10,000	10,000
Senior Independent Director	5,000	10,000

At the present time, the Board believes that payment of fees on a cash-only basis is appropriate, as opposed to the partial payment of fees in shares. Non-Executive Directors are encouraged to hold shares in the Company but are not subject to a shareholding requirement. Non-Executive Directors' fees are not performance-related.

### 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 the 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 Company	Date of Appointment to the Board	Date of Contract	Unexpired term and notice period at 31 December 2006
Executive Directors:				
Kevin Beeston	29 April 1985	29 February 1996	21 July 2003	Rolling contract with 12 months notice period
Christopher Hyman	30 August 1994	1 April 1999	21 July 2003	Rolling contract with 12 months notice period
Andrew Jenner	4 November 1996	3 May 2002	21 July 2003	Rolling contract with 12 months notice period

Name of Director	Date of Appointment to the Board	Date of Letter of Appointment	Unexpired term and notice period at 31 December 2006
Non-Executive Directors:			
Margaret Ford	8 October 2003	7 October 2003	33 months
Leonard V. Broese van Groenou	3 April 2006	20 February 2006	27 months
DeAnne Julius	29 October 2001	29 October 2001	11 months
David Richardson	2 June 2003	29 May 2003	29 Months



## Directors' Remuneration

This section has been audited by Deloitte & Touche LLP.

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

	Note	Remuneration £	Fees £	Bonus £	Total estimated value of any other non-cash cash benefits £	Allowance £	Total remuneration excluding pensions 2006 £	Total remuneration excluding pensions 2005 £
Kevin Beeston	1,2,3	510,000	–	503,500	63,419	125,969	1,202,888	704,814
Christopher Hyman	1,2	510,000	–	503,500	63,604	–	1,077,104	702,908
Andrew Jenner	1,2	309,000	–	310,650	63,697	–	683,347	501,713
Leonard V. Broese van Groenou	4	–	26,250	–	–	–	26,250	–
Margaret Ford	–	–	41,665	–	–	–	41,665	35,000
Ralph Hodge	5	–	15,865	–	–	–	15,865	42,917
DeAnne Julius	–	–	40,000	–	–	–	40,000	40,000
David Richardson	–	–	45,000	–	–	–	45,000	44,083
<b>Total</b>		<b>1,329,000</b>	<b>168,780</b>	<b>1,317,650</b>	<b>190,720</b>	<b>125,969</b>	<b>3,132,119</b>	<b>2,071,435</b>

Notes:

- The bonuses shown include performance bonuses earned in the period under review, but not paid in the financial year.
- The value of the non-cash benefits relates to the provision of a car allowance and private healthcare.
- The allowance comprises payments made to Kevin Beeston in lieu of pension, calculated as a percentage of base salary, from which he makes his own pension arrangements (further details as set out in the section on Directors' Pensions on page 70).
- Leonard V. Broese van Groenou was appointed to the Board on 3 April 2006.
- Ralph Hodge retired from the Board on 5 May 2006.
- Total remuneration has increased during 2006 following on from the 2005 triennial review, which led to an increase in total remuneration packages for Executive Directors as the review established where packages were below the market median. The strong financial performance of the Group during 2006 has led to bonuses paying out at close to the maximum level.

## Directors' Shareholdings

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

	Notes	Ordinary Shares of 2p each fully paid at 1 January 2006 or, if later, the date of appointment as Director	Ordinary Shares of 2p each fully paid at 31 December 2006
Kevin Beeston	1	182,638	159,413
Leonard V. Broese van Groenou	2	–	1,935
Margaret Ford		6,983	6,983
Christopher Hyman	1	116,598	134,885
Andrew Jenner	1	60,994	84,351
DeAnne Julius		15,000	15,000
David Richardson		10,000	10,000

Notes:

- 21,557 of Kevin Beeston's shares, 49,336 of Christopher Hyman's and 29,378 of Andrew Jenner's shares are all held in trust on their behalf under the terms of their participation in the Deferred Bonus Scheme. Provided such shares remain in trust for three years, they are also granted an award over additional shares dependent on the achievement of certain performance conditions as set out on pages 60 - 61.
- Leonard V. Broese van Groenou was appointed to the Board on 3 April 2006.

## Share-based Incentives

This section has been audited by Deloitte & Touche LLP.

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

### (i) Serco Group plc Deferred Bonus Scheme

Conditional rights to receive matching shares over Serco Group plc's ordinary shares under the Scheme held by Directors at 31 December 2006 are as follows:

	Awards held at 31 December 2006	Performance period	Vesting date
Kevin Beeston	21,557	1 Jan 2004-31 Dec 2006	2 March 2007
Christopher Hyman	21,557	1 Jan 2004-31 Dec 2006	2 March 2007
	10,030	1 Jan 2005-31 Dec 2007	9 March 2008
	17,749	1 Jan 2006-31 Dec 2008	22 March 2009
Andrew Jenner	12,711	1 Jan 2004-31 Dec 2006	2 March 2007
	6,018	1 Jan 2005-31 Dec 2007	9 March 2008
	10,649	1 Jan 2006-31 Dec 2008	22 March 2009

Notes:

1. The Scheme has now been closed and no further awards will be made under its terms.
2. The awards shown in the table are the maximum number of shares that can vest under the performance conditions.
3. The performance conditions attached to the awards are described on pages 60 - 61.
4. No shares vested, lapsed or were released during the year. On the 31 December 2006 the performance conditions attached to the awards made on the 2 March 2004 were satisfied, though the awards may not be exercised until 2 March 2007.

### (ii) Serco Group plc 2006 Long Term Incentive Plan

The conditional rights to Serco Group plc ordinary shares under the 2006 Long Term Incentive Plan held by Directors at 31 December 2006 were as follows:

	Awards made during the year	Market price on award (pence)	Awards held at 31 December 2006	Performance period	Earliest exercise date	Latest exercise date
Kevin Beeston	147,928	349.00	147,928	1 Jan 2006-31 Dec 2008	5 May 2009	5 May 2016
	145,205	372.50	145,205	1 Jan 2007-31 Dec 2009	29 Nov 2009	29 Nov 2016
Christopher Hyman	147,928	349.00	147,928	1 Jan 2006-31 Dec 2008	5 May 2009	5 May 2016
	145,205	372.50	145,205	1 Jan 2007-31 Dec 2009	29 Nov 2009	29 Nov 2016
Andrew Jenner	88,757	349.00	88,757	1 Jan 2006-31 Dec 2008	5 May 2009	5 May 2016
	89,589	372.50	89,589	1 Jan 2007-31 Dec 2009	29 Nov 2009	29 Nov 2016

Notes:

1. The performance conditions attached to the awards are described on page 61.
2. No shares vested, lapsed or were released during the year.
3. Awards take the form of nominal cost options.
4. Awards made are calculated at 100% of salary at the time of grant. During the 2006 financial year, two awards of 100% of salary were granted on an exceptional basis as no awards were granted under the Long Term Incentive Scheme in 2005.

## Share-based Incentives (continued)

## (iii) Serco Group plc Long Term Incentive Scheme (LTIS)

The LTIS has been superseded by the Serco Group plc 2006 Long Term Incentive Plan.

The last award to Executive Directors under the Scheme was made in June 2005.

Those shares which vested on 31 December 2006 had a market price of 382 pence.

	Awards held at 1 January 2006	Market price at grant (pence)	Lapsed during period	Vested during the period	Awards held at 31 December 2006	Performance period	Earliest vesting date	Date of expiry of awards
Kevin Beeston	38,736	426	–	–	38,736	1 Jan 2000 - 31 Dec 2002	31 Dec 2002	4 Apr 2010
	50,797*	490	–	–	50,797	1 Jan 2001 - 31 Dec 2003	31 Dec 2003	23 Nov 2010
	40,898*	465	–	–	40,898	1 Jan 2002 - 31 Dec 2004	31 Dec 2004	15 Nov 2011
	185,289*	153	81,822	103,467	103,467	1 Jan 2003 - 31 Dec 2005	31 Dec 2005	5 May 2013
	173,142*	175	–	173,142	173,142	1 Jan 2004 - 31 Dec 2006	31 Dec 2006	26 Nov 2013
	119,411	231	–	–	119,411	1 Jan 2005 - 31 Dec 2007	31 Dec 2007	21 Dec 2014
Christopher Hyman	32,868	426	–	–	32,868	1 Jan 2000 - 31 Dec 2002	31 Dec 2002	4 Apr 2010
	43,540*	490	–	–	43,540	1 Jan 2001 - 31 Dec 2003	31 Dec 2003	23 Nov 2010
	35,056*	465	–	–	35,056	1 Jan 2002 - 31 Dec 2004	31 Dec 2004	15 Nov 2011
	185,289*	153	81,822	103,467	103,467	1 Jan 2003 - 31 Dec 2005	31 Dec 2005	5 May 2013
	173,142*	175	–	173,142	173,142	1 Jan 2004 - 31 Dec 2006	31 Dec 2006	26 Nov 2013
	119,411	231	–	–	119,411	1 Jan 2005 - 31 Dec 2007	31 Dec 2007	21 Dec 2014
Andrew Jenner	111,174*	153	49,093	62,081	62,081	1 Jan 2003 - 31 Dec 2005	31 Dec 2005	5 May 2013
	105,138*	175	–	105,138	105,138	1 Jan 2004 - 31 Dec 2006	31 Dec 2006	26 Nov 2013
	76,101	231	–	–	76,101	1 Jan 2005 - 31 Dec 2007	31 Dec 2007	21 Dec 2014

## Notes:

- The awards shown in the table are the maximum amount of shares that can vest under the performance condition.  
The performance conditions attached to the awards are described on page 62.
- No awards were made or exercised during the year.
- For those awards marked with an (\*) approximately 14.67% (13.5% for prior year grants) of the options granted under the Plan represent supplementary awards, granted for the sole purpose of compensating participants for agreeing to bear the Company's liability to employers' National Insurance Contributions upon the exercise of the underlying Plan awards. These awards can only be exercised in conjunction with and to the extent of the underlying award.
- Awards take the form of nominal cost options.
- Awards made are calculated at 100% of salary at the time of grant.

## Share-based Incentives (continued)

### iv) Serco Group plc 1998 and 2005 Executive Option Plan

Options over Serco Group plc ordinary shares granted under the 1998 Executive Share Option Plan and the 2005 Executive Share Option Plan and held by Executive Directors at 1 January 2006 and 31 December 2006 were as follows:

	Awards held at 1 January 2006	Granted during period	Exercised during period	Balance at at 31 December 2006	Market price on exercise date (pence)	Exercise price (pence)	Date from which exercisable	Date of expiry of option
Kevin Beeston	82,710	–	–	82,710	–	218	21 May 2001	20 May 2008
	76,734	–	–	76,734	–	245	1 Apr 2002	31 Mar 2009
	58,764	–	–	58,764	–	426	5 Apr 2003	4 Apr 2010
	91,321*	–	–	91,321	–	435	28 Mar 2004	27 Mar 2011
	135,768*	–	–	135,768	–	264	3 May 2005	2 May 2012
	289,515*	–	–	289,515	–	153	6 May 2006	5 May 2013
	219,320	–	–	219,320	–	217	3 Mar 2007	2 Mar 2014
	183,404	–	–	183,404	–	235	29 Apr 2008	28 Apr 2015
–	147,492	–	147,492	–	339	5 May 2009	4 May 2016	
Christopher Hyman	39,078	–	–	39,078	–	218	21 May 2001	20 May 2008
	40,812	–	–	40,812	–	245	1 Apr 2002	31 Mar 2009
	49,830	–	–	49,830	–	426	5 Apr 2003	4 Apr 2010
	78,275*	–	–	78,275	–	435	28 Mar 2004	27 Mar 2011
	116,373*	–	–	116,373	–	264	3 May 2005	2 May 2012
	289,515*	–	–	289,515	–	153	6 May 2006	5 May 2013
	219,320	–	–	219,320	–	217	3 Mar 2007	2 Mar 2014
	183,404	–	–	183,404	–	235	29 Apr 2008	28 Apr 2015
–	147,492	–	147,492	–	339	5 May 2009	4 May 2016	
Andrew Jenner	4,134	–	4,134	–	318	218	21 May 2001	20 May 2008
	15,996	–	8,574	7,422	318	245	1 Apr 2002	31 Mar 2009
	12,336	–	–	12,336	–	426	5 Apr 2003	4 Apr 2010
	18,524*	–	–	18,524	–	435	28 Mar 2004	27 Mar 2011
	69,824*	–	–	69,824	–	264	3 May 2005	2 May 2012
	173,709*	–	–	173,709	–	153	6 May 2006	5 May 2013
	133,178	–	–	133,178	–	217	3 Mar 2007	2 Mar 2014
	116,885	–	–	116,885	–	235	29 Apr 2008	28 Apr 2015
–	88,495	–	88,495	–	339	5 May 2009	4 May 2016	

#### Notes:

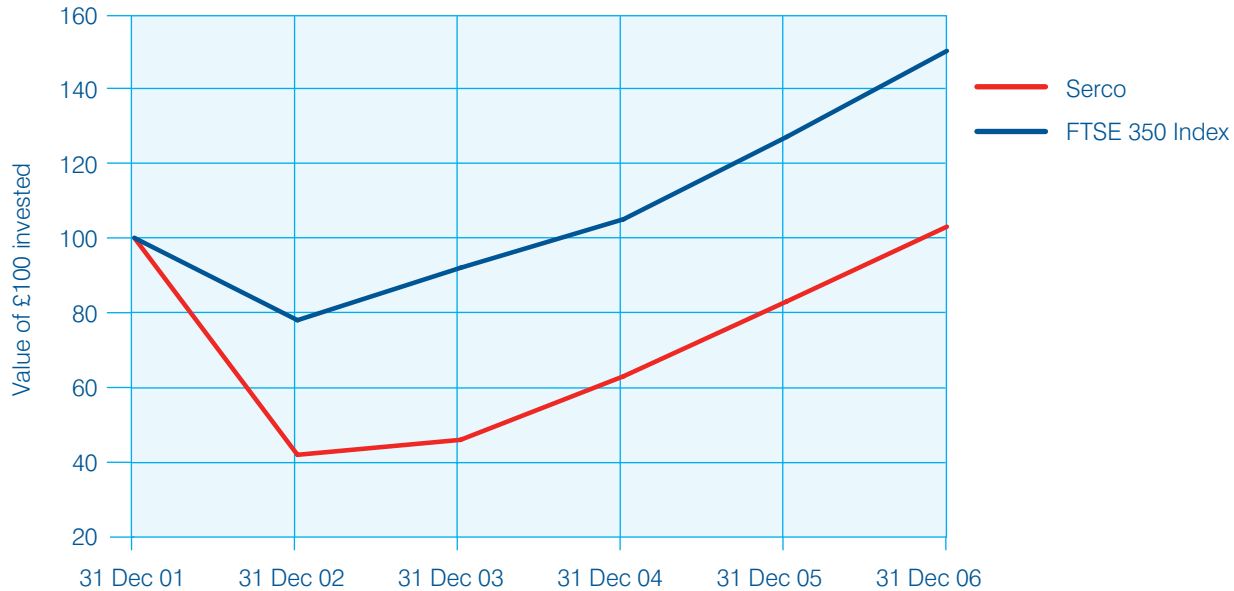
- The awards shown in the table are the maximum number of shares that can vest under the performance conditions.
- The performance conditions attached to the awards are described on pages 61 - 62.
- For those options marked with an (\*) approximately 14.67% (13.5% for prior year grants) of the options granted under the Plan represent supplementary options, granted for the sole purpose of compensating participants for agreeing to bear the Company's liability to employers' National Insurance Contributions upon the exercise of the underlying Plan awards. These options can only be exercised in conjunction with and to the extent of the underlying option.
- No options lapsed during the year.
- No payment was made for the grant of the awards.
- Grants of options under the 1998 Share Option Plan are calculated at 100% of salary at the time of grant.
- The market price of the Company's ordinary shares at the close of business on 29 December 2006 was 382p and the range during the year to 31 December 2006 was 296.25p to 384.75p respectively.



**Comparison of total shareholder returns**

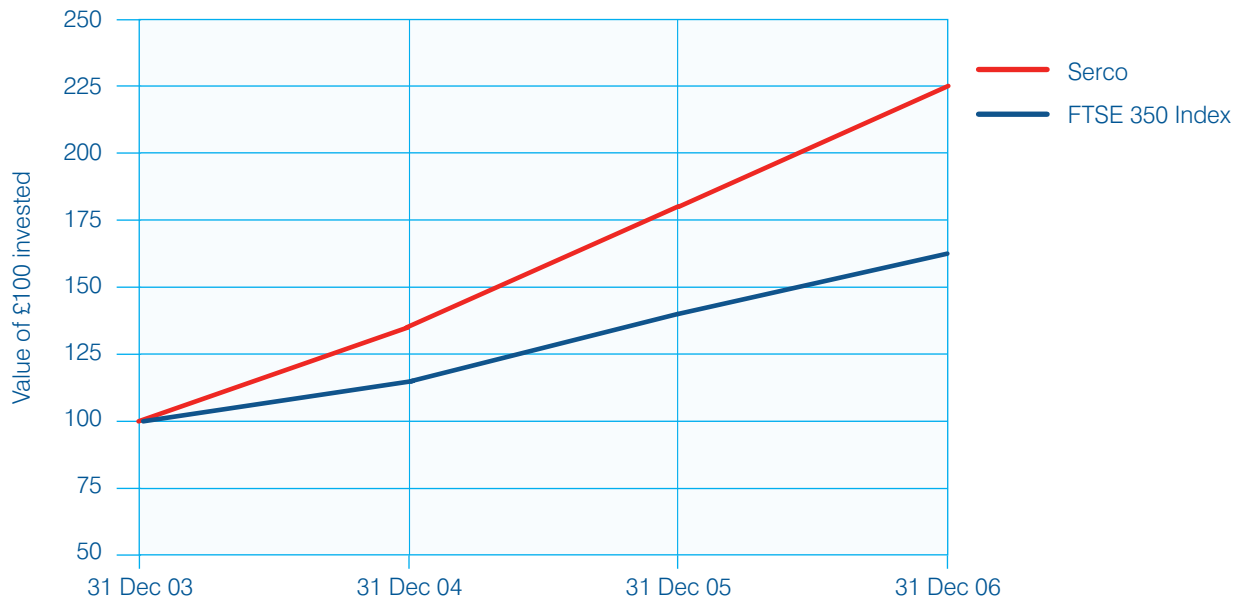
**Serco Group plc TSR vs FTSE 350 Total Return Index over five years**

Value of investment of £100 on 31 December 2001



**Serco Group plc TSR vs FTSE 350 Total Return Index over three years**

Value of investment of £100 on 31 December 2003



In drawing these graphs, it has been assumed that all dividends paid have been reinvested. The TSR level shown at 31 December each year is the average of the closing daily TSR levels for the 30-day period up to and including that date. The Company's TSR is compared to that of the FTSE 350 Index, which is a broad equity market index in which it is a constituent.

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

## Pensions and life assurance

This section has been audited by Deloitte & Touche LLP.

The Directors receive pension and life assurance benefits consistent with those provided by other leading companies.

The details of the defined benefit schemes operated by the Group are set out in note 27. In the event of death in service, each scheme provides for a lump sum payment as well as a dependant's pension.

The accrued pension benefits of all Directors under the SPLAS, which is a defined benefit scheme, are as follows:

	Transfer value of accrued benefits at 31 December 2006	Transfer value of accrued benefits at 31 December 2005	Directors' contributions for the year	Increase in transfer value during the year	Gross increase in accrued pension during the year	Increase in accrued pension during the year, net of inflation	Value of increase in accrual over the year	Total accrued pension at year end
	(1)	(2)	(3)	(4) = (1)-(2)-(3)	(5)	(6)	(7)	(8)
	£	£	£	£	£	£	£	£
Kevin Beeston	1,966,075	1,706,038	8,675	251,361	37,129	29,152	257,038	258,714
Christopher Hyman	370,763	259,286	30,518	80,959	12,828	11,782	73,821	41,868
Andrew Jenner	151,823	95,513	18,458	37,852	8,109	7,634	35,931	21,309

Notes:

- (a) The total accrued pension shown is that which would be paid annually on retirement, based on pensionable service to the end of this year, or in Kevin Beeston's case, to 5 April 2006 when he opted out of the scheme. 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 accrual of pension for Christopher Hyman and Andrew Jenner increased with effect from 6 April 2006 when the Earnings Cap ceased to apply to pensionable salary. Pension accrued before that date is unaffected.
- (c) Transfer values have been calculated in accordance with version 9.2 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 stock market 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, or 5 April 2006 in Kevin Beeston's case. It is based on the increase in the accrued pension net of inflation after deducting the Director's contribution.
- (e) Transfer values disclosed do not represent the sum paid or payable to the individual Director. Instead, they represent a potential liability of the pension scheme.
- (f) Christopher Hyman also benefits from a defined contribution arrangement to which the Group contributed prior to April 2005. The Company's contributions to this arrangement were 15 per cent of remuneration in excess of the Permitted Maximum under the approved Scheme. There were no contributions to this arrangement in 2006. Christopher Hyman received non-pensionable cash payments totalling £32,538 between 1 January 2006 and 6 April 2006 in place of contributions to the defined contribution arrangement. These cash payments ceased at 6 April 2006 when pensionable salary in the approved scheme ceased to be subject to the Earnings Cap.
- (g) Andrew Jenner also benefits from a defined contribution arrangement to which the Group contributed prior to June 2005. The Group's contributions to this arrangement were 15 per cent of remuneration in excess of the Permitted Maximum under the approved Scheme. There were no contributions to this arrangement in 2006. Andrew Jenner received non-pensionable cash payments totalling £16,038 between 1 January 2006 and 6 April 2006 in place of contributions to the defined contribution arrangement. These cash payments ceased at 6 April 2006 when pensionable salary in the approved scheme ceased to be subject to the Earnings Cap.

### Share Dilution

New shares are issued in order to satisfy options granted under the 1998 Executive Share Option Scheme, Sharesave Scheme and Long Term Incentive Scheme. In the ten-year period to 31 December 2006, awards made under the Group's share schemes represented 3.07% (2005: 1.68%) of the Company's issued share capital, leaving an available dilution headroom of 6.93% (2005: 8.32%). Shares are purchased in the market in order to satisfy options granted under the Long Term Incentive Plan.

### Employee Benefit Trust

The Group has an employee benefit trust which is administered by an independent trustee and which holds ordinary shares in the Company to meet the various obligations under the Group's 1998 Executive Share Option scheme, Long Term Incentive Scheme and Deferred Bonus Scheme. The Trust held 5,250,152 ordinary shares at 31 December 2006 and 1 January 2006.

Kevin Beeston, Christopher Hyman and Andrew Jenner together with all employees, are potential beneficiaries of the Trust and are deemed to be interested in all the shares held in the Trust.

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



**Joanne Roberts**  
Secretary

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

28 February 2007

# Independent Auditors' Report

## Independent Auditors' Report to the members of Serco Group plc

We have audited the group financial statements of Serco Group plc for the year ended 31 December 2006 which comprise the consolidated income statement, the consolidated statement of recognised income and expense, the consolidated balance sheet, the consolidated cash flow statement and the related notes 1 to 37. These group financial statements have been prepared under the accounting policies set out therein. We have also audited the information in the Directors' Remuneration Report that is described as having been audited.

We have reported separately on the parent company financial statements of Serco Group plc for the year ended 31 December 2006.

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

The directors' responsibilities for preparing the Annual Review and Accounts, the Directors' Remuneration Report and the group financial statements in accordance with applicable law and International Financial Reporting Standards (IFRS) as adopted by the European Union are set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the group financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the group financial statements give a true and fair view, whether the group financial statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation and whether the part of the Directors' Remuneration Report described as having been audited has been properly prepared in accordance with the Companies Act 1985. We also report to you whether in our opinion the information given in the Directors' Report is consistent with the group financial statements.

In addition we report to you if, in our opinion, we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

We review whether the Corporate Governance Report reflects the Company's compliance with the nine provisions of the 2003 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 other information contained in the Annual Review and Accounts as described in the contents section and consider whether it is consistent with the audited group financial statements. The other information comprises only the Directors' Report, the Chairman's Statement, the unaudited part of the Directors' Remuneration Report, the Business Review and the Corporate Governance Report. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the group financial statements. Our responsibilities do not extend to any further information outside the Annual Review and Accounts.

### Basis of Audit Opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the group financial statements and the part of the Directors' Remuneration Report to be audited. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the group financial statements, and of whether the accounting policies are appropriate to the Group's circumstances, 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 group financial statements and the part of the Directors' Remuneration Report to be 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 group financial statements and the part of the Directors' Remuneration Report to be audited.

### Opinion

#### In our opinion:

- the group financial statements give a true and fair view, in accordance with IFRS as adopted by the European Union, of the state of the Group's affairs as at 31 December 2006 and of its profit for the year then ended;
- the group financial statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation;
- the part of the Directors' Remuneration Report described as having been audited has been properly prepared in accordance with the Companies Act 1985; and
- the information given in the Directors' Report is consistent with the group financial statements.

*Deloitte & Touche LLP*

#### Deloitte & Touche LLP

Chartered Accountants and  
Registered Auditors  
London

28 February 2007

## Consolidated Income Statement

For the year ended 31 December 2006

	Note	2006 £m	2005 £m
<b>Continuing operations</b>			
Revenue	4,5	2,548.2	2,260.3
Cost of sales		(2,182.5)	(1,935.3)
<b>Gross profit</b>		<b>365.7</b>	<b>325.0</b>
Administrative expenses		(235.7)	(214.3)
Other expenses – amortisation of intangibles		(16.2)	(13.6)
Total administrative expenses		(251.9)	(227.9)
Gain on sale of PFI investments	15	11.4	–
<b>Operating profit</b>	5,6	<b>125.2</b>	<b>97.1</b>
Investment revenue	8	31.7	33.6
Finance costs	9	(49.5)	(52.8)
<b>Profit before tax</b>		<b>107.4</b>	<b>77.9</b>
Tax	10	(27.9)	(23.5)
<b>Profit for the year</b>		<b>79.5</b>	<b>54.4</b>
Attributable to:			
Equity holders of the parent		78.3	53.4
Minority interest		1.2	1.0
<b>Earnings per share (EPS)</b>			
Basic EPS	12	16.62p	11.66p
Diluted EPS	12	16.43p	11.46p

## Consolidated Statement of Recognised Income and Expense

For the year ended 31 December 2006

	Note	2006 £m	2005 £m
Net actuarial gain/(loss) on defined benefit pension schemes	27, 31	78.9	(58.4)
Actuarial (loss)/gain on reimbursable rights	27, 31	(53.4)	35.6
Net exchange (loss)/gain on translation of foreign operations	31	(12.3)	6.9
Fair value gain on cash flow hedges during the year	31	2.2	6.1
Tax (charge)/credit on items taken directly to equity	31	(7.0)	2.0
<b>Net income/(expense) recognised directly in equity</b>		<b>8.4</b>	<b>(7.8)</b>
<b>Profit for the year</b>		<b>79.5</b>	<b>54.4</b>
<b>Total recognised income and expense for the year</b>		<b>87.9</b>	<b>46.6</b>
Attributable to:			
Equity holders of the parent		87.1	45.6
Minority interest		0.8	1.0

# Consolidated Balance Sheet

At 31 December 2006

Financial Statements

	Note	2006 £m	2005 £m
<b>Non-current assets</b>			
Goodwill	13	528.5	544.5
Other intangible assets	14	126.1	107.8
Property, plant and equipment	16	93.6	103.0
Trade and other receivables	19	110.5	459.8
Deferred tax assets	22	73.7	91.2
		<b>932.4</b>	<b>1,306.3</b>
<b>Current assets</b>			
Inventories	18	51.7	36.4
Trade and other receivables	19	463.3	528.8
Cash and cash equivalents	20	217.9	240.7
		<b>732.9</b>	<b>805.9</b>
<b>Total assets</b>		<b>1,665.3</b>	<b>2,112.2</b>
<b>Current liabilities</b>			
Trade and other payables	24	(541.9)	(531.1)
Current tax liabilities		(13.0)	(19.5)
Obligations under finance leases	23	(8.3)	(8.2)
Loans	21	(57.9)	(64.8)
Financial instruments	26	(10.6)	(4.9)
		<b>(631.7)</b>	<b>(628.5)</b>
<b>Non-current liabilities</b>			
Trade and other payables	24	(10.4)	(5.0)
Obligations under finance leases	23	(11.5)	(18.2)
Loans	21	(346.1)	(744.7)
Financial instruments	26	(14.2)	(30.8)
Retirement benefit obligations	27	(249.3)	(306.6)
Provisions	28	(22.3)	(26.3)
Deferred tax liabilities	22	(19.9)	(92.1)
		<b>(673.7)</b>	<b>(1,223.7)</b>
<b>Total liabilities</b>		<b>(1,305.4)</b>	<b>(1,852.2)</b>
<b>Net assets</b>		<b>359.9</b>	<b>260.0</b>
<b>Equity</b>			
Share capital	29	9.5	9.4
Share premium account	30	283.5	269.5
Capital redemption reserve		0.1	0.1
Retained earnings	31	196.6	132.8
Retirement benefit obligations reserve	31	(119.5)	(139.0)
Share-based payment reserve	31	25.5	16.6
Own shares reserve	31	(16.4)	(16.4)
Hedging and translation reserve	31	(21.3)	(15.1)
<b>Equity attributable to equity holders of the parent</b>		<b>358.0</b>	<b>257.9</b>
<b>Minority interest</b>		<b>1.9</b>	<b>2.1</b>
<b>Total equity</b>		<b>359.9</b>	<b>260.0</b>

The financial statements were approved by the Board of Directors on 28 February 2007 and signed on its behalf by:



**Kevin Beeston**  
Executive Chairman



**Andrew Jenner**  
Finance Director

# Consolidated Cash Flow Statement

For the year ended 31 December 2006

	Note	2006 £m	2005 £m
<b>Net cash inflow from operating activities</b>	32	<b>159.5</b>	140.8
<b>Investing activities</b>			
Interest received		32.4	32.8
Disposal of subsidiary and business undertakings	15	18.2	–
Proceeds from disposal of property, plant and equipment		1.4	0.4
Acquisition of subsidiaries, net of cash acquired		–	(281.7)
Purchase of other intangible assets		(30.4)	(13.1)
Purchase of property, plant and equipment		(27.8)	(22.3)
<b>Net cash outflow from investing activities</b>		<b>(6.2)</b>	(283.9)
<b>Financing activities</b>			
Interest paid		(42.2)	(47.6)
Dividends paid	11	(14.5)	(12.5)
Dividend paid to minority interest		(1.0)	–
Repayment of borrowings		(103.4)	(5.8)
New loan advances		9.4	272.0
Capital element of finance lease repayments		(8.6)	(8.4)
Proceeds from issue of share capital		14.1	4.4
Decrease in non recourse loans		(25.3)	(21.5)
<b>Net cash (outflow)/inflow from financing activities</b>		<b>(171.5)</b>	180.6
<b>Net (decrease)/increase in cash and cash equivalents</b>		<b>(18.2)</b>	37.5
<b>Cash and cash equivalents at beginning of year</b>		<b>240.7</b>	200.5
Net exchange (loss)/gain		(4.6)	2.7
<b>Cash and cash equivalents at end of year</b>	20	<b>217.9</b>	240.7



## 1. General information

Serco Group plc (the Group) is a Company incorporated in the United Kingdom under the Companies Act 1985. The address of the registered office is Serco House, 16 Bartley Wood Business Park, Bartley Way, Hook, Hampshire, RG27 9UJ.

These consolidated financial statements (the financial statements) are presented in pounds sterling because this is the currency of the primary economic environment in which the Group operates. Foreign operations are included in accordance with the policies set out in note 2.

## 2. Significant accounting policies

### Basis of accounting

These financial statements on pages 74 to 119 have been prepared in accordance with International Financial Reporting Standards (IFRS) adopted for use in the European Union and therefore the group financial statements comply with Article 4 of the EU IAS regulation.

The financial statements have been prepared on the historical cost basis. The principal accounting policies adopted are set out below.

### Presentation of financial information

The primary statements within the financial information contained in this document have been presented in accordance with IAS 1 'Presentation of Financial Statements'.

Interest paid within the cash flow statement has been re-presented and is shown within financing activities in accordance with latest guidance (interest paid was previously shown within investing activities).

### Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Company, entities controlled by the Company (its subsidiaries) and entities jointly controlled by the Company (its joint ventures) made up to 31 December each year. Control is achieved where the Company has the power to govern the financial and operating policies of an investee entity so as to obtain benefits from its activities.

The results of subsidiaries and joint ventures acquired or disposed of during the year are included in the consolidated income statement from the effective date of acquisition or up to the effective date of disposal as appropriate.

Where necessary, adjustments are made to the financial statements of subsidiaries and joint ventures to bring accounting policies used into line with those used by the Group.

All intra-Group transactions, balances, income and expenses are eliminated on consolidation.

Minority interests represent the portion of profit or loss and net assets in subsidiaries that is not held by the Group and is presented within equity in the consolidated balance sheet, separately from parent shareholders' equity.

### Business combinations

The acquisition of subsidiaries is accounted for using the purchase method. The cost of the acquisition is measured at the aggregate of the fair values, at the date of exchange, of assets given, liabilities incurred or assumed, and equity instruments issued by the Group in exchange for control of the acquiree, plus any costs directly attributable to the business combination. The acquiree's identifiable assets, liabilities and contingent liabilities that meet the conditions for recognition under IFRS 3 'Business Combinations' are recognised at their fair value at the acquisition date.

Goodwill arising on acquisition is recognised as an asset and initially measured at cost, being the excess of the cost of the business combination over the Group's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities recognised. If, after reassessment, the Group's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities exceeds the cost of the business combination, the excess is recognised immediately in the income statement.

## 2. Significant accounting policies (continued)

The interest of minority shareholders in the acquiree is initially measured at the minority's proportion of the net fair value of the assets, liabilities and contingent liabilities recognised.

### Goodwill

Goodwill arising on consolidation represents the excess of the cost of acquisition over the Group's interest in the fair value of the identifiable net assets and liabilities of a subsidiary, or jointly-controlled entity at the date of acquisition.

Goodwill is recognised as an intangible asset. Goodwill is not amortised and is reviewed for impairment at least annually. Any impairment is recognised immediately in the income statement and is not subsequently reversed.

On disposal of a subsidiary or jointly-controlled entity, the attributable amount of goodwill is included in the determination of the profit or loss on disposal.

Goodwill arising on acquisitions before the date of transition to IFRS has been carried forward as the unadjusted UK GAAP amounts. Goodwill written off to reserves under UK GAAP prior to 1998 has not been reinstated.

### Investments in joint ventures

The Group's investments in joint ventures are reported in the financial statements using the proportionate consolidation method, whereby the Group's share of each of the assets, liabilities, income and expenses of its joint ventures is combined line by line with similar items in the Group's financial statements or reported as separate line items within the Group's financial statements.

### Revenue recognition

Revenue is measured at the fair value of the consideration received or receivable and represents amounts receivable for goods and services provided in the normal course of business, net of discounts, VAT and other sales-related taxes.

Sales of goods are recognised when goods are delivered and title has passed.

Revenue from long-term project-based contracts is recognised in accordance with the Group's accounting policy below.

Interest income is accrued on a time basis, by reference to the principal outstanding and at the effective interest rate applicable, which is the rate that exactly discounts estimated future cash receipts through the expected life of the financial asset to that asset's net carrying amount.

Dividend income from investments is recognised when the shareholders' rights to receive payment have been established.

### Segmental information

Segmental information is based on two segment formats: the primary format reflects the Group's management structure, whereas the secondary format is geographically-orientated.

Unallocated items comprise mainly corporate expenses. Specific corporate expenses are allocated to the corresponding segments. Segment assets comprise goodwill, other intangible assets, property, plant and equipment, inventories and trade and other receivables (excluding corporation tax recoverable). Liabilities comprise trade and other payables, retirement benefit obligations, and other creditors.

### Long-term project-based contracts

The Group has a number of long-term contracts for the provision of complex, project-based services. Where the outcome of such long-term project-based contracts can be measured reliably, revenue and costs are recognised by reference to the stage of completion of the contract activity at the balance sheet date in accordance with IAS 18 'Revenue'. This is measured by the proportion that contract costs incurred for work performed to date bear to the estimated total contract costs, except where this would not be representative of the stage of completion. Variations in contract work, claims and incentive payments are included to the extent that they have been agreed with the customer.

Where the outcome of a long-term project-based contract cannot be estimated reliably, contract revenue is recognised to the extent of contract costs that it is probable will be recovered. Contract costs are recognised as expenses in the period in which they are incurred.

## 2. Significant accounting policies (continued)

When it is probable that the total contract costs will exceed total contract revenue, the expected loss is recognised as an expense immediately.

All bid costs are expensed through the income statement up to the point where contract award (or full recovery of costs) is virtually certain. Bid costs incurred after this point are then capitalised within trade and other receivables. On contract award these bid costs are amortised through the income statement over the contract period by reference to the stage of completion of the contract activity at the balance sheet date. Phase-in costs directly related to phase-in programmes of contracts are treated as an integral part of contract costs and are recognised in accordance with the stage of completion as described above.

### Inventories

Inventories are stated at the lower of cost and net realisable value and comprise service spares, parts awaiting installation and long-term project-based contract balances. Cost comprises direct materials and, where applicable, direct labour costs that have been incurred in bringing the inventories to their present location and condition.

### Leases

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

Assets held under finance leases are recognised as assets of the Group at fair value or, if lower, at the present value of minimum lease payments determined at the inception of the lease. The corresponding liability to the lessor is included in the balance sheet as a finance lease obligation. Lease payments are apportioned between finance charges and reduction of the lease obligation so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are charged directly against income, unless they are directly attributable to a qualifying asset, in which case they are capitalised in accordance with the Group's general policy on borrowing costs (see below).

Rentals payable under operating leases are charged to income on a straight-line basis over the term of the relevant lease.

### Foreign currencies

Transactions in currencies other than pounds sterling are recorded at the rates of exchange on the dates of the transactions. At each balance sheet date, monetary assets and liabilities that are denominated in foreign currencies are retranslated at the rates prevailing on the balance sheet date. Non-monetary assets and liabilities carried at fair value that are denominated in foreign currencies are translated at the date when the fair value was determined. Gains and losses arising on retranslation are included in the net profit or loss for the period, except for exchange differences arising on non-monetary assets and liabilities where the changes in fair value are recognised directly in equity in the statement of recognised income and expense (the SORIE).

On consolidation, the assets and liabilities of the Group's overseas operations are translated at exchange rates prevailing on the balance sheet date. Income and expense items are translated at the average exchange rates for the period. Exchange differences arising, if any, are recognised directly within equity in the Group's hedging and translation reserve. Such translation differences are recognised as income or expenses in the period in which the operation is disposed of.

Goodwill and fair value adjustments arising on the acquisition of a foreign entity are treated as assets and liabilities of the foreign entity and translated at the closing rate.

### Borrowing costs

Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, which are assets that necessarily take a substantial period of time to get ready for their intended use or sale, are added to the cost of those assets, until such time as the assets are substantially ready for their intended use or sale.

All other borrowing costs are recognised as an income or expense in the period in which they are incurred.

## 2. Significant accounting policies (continued)

### **Retirement benefit costs**

Payments to defined contribution pension schemes are charged as an expense as they fall due.

For defined benefit pension schemes, the cost of providing benefits is determined using the projected unit credit method, with actuarial valuations being carried out at each balance sheet date. Actuarial gains and losses are recognised in full in the period in which they occur. They are recognised outside the income statement and are presented in the SORIE.

The current service cost represents the increase in the present value of the plan liabilities expected to arise from employee service in the current period.

Past service cost is recognised immediately to the extent that the benefits are already vested, and is amortised on a straight-line basis over the average period until the benefit becomes vested. Gains and losses on curtailments or settlements are recognised in the period in which the curtailment or settlement occurs.

The retirement benefit obligation recognised in the balance sheet represents the present value of the defined benefit obligation as adjusted for unrecognised past service costs, and as reduced by the fair value of scheme assets. Any asset resulting from this calculation is limited to past service cost, plus the present value of available refunds and reductions in future contributions to the plan.

### ***Defined benefit obligations arising from contractual obligations***

Where the Group takes on a contract and assumes the obligation to contribute variable amounts to the defined benefit pension scheme throughout the period of the contract and it is not virtually certain that the contributions will be recovered from the customer, the Group's share of the defined benefit obligation less its share of the pension scheme assets that it will fund over the period of the contract is recognised as a liability at the start of the contract with a corresponding amount being recognised as an intangible asset. The intangible asset, which reflects the Group's right to manage and operate the contract, is amortised over the contract period. The Group's share of the scheme assets and liabilities is calculated by reducing the scheme assets and liabilities by a franchise adjustment. The franchise adjustment represents the amount of scheme deficits that will be funded outside the contract period. Subsequent actuarial gains and losses in relation to the Group's share of pension obligations are recognised outside the income statement and are presented in the SORIE.

Where the Group takes on a contract and assumes the obligation to contribute variable amounts to the defined benefit pension scheme throughout the period of the contract and it is virtually certain that the contributions will be recovered from the customer, the Group's share of the defined benefit obligation less its share of the pension scheme assets are recognised as a liability at the start of the contract with a corresponding amount being recognised as a financial asset at fair value, being the fair value of the reimburseable rights. In the consolidated income statement, the expense relating to the defined benefit plan is presented net of the amount recognised for reimbursement. Subsequent actuarial gains and losses in relation to the Group's share of pension obligations are recognised outside the income statement and are presented in the SORIE. The change in fair value of the reimburseable right that is not presented in the income statement is reported in the SORIE.

### ***Multi-employer pension schemes***

Multi-employer pension schemes are classified as a defined contribution pension scheme or a defined benefit scheme under the terms of the scheme.

When sufficient information is not available to use defined benefit accounting for a multi-employer defined benefit pension scheme, the Group accounts for the scheme as if it were a defined contribution scheme.

### **Taxation**

The tax expense represents the sum of current tax expense and deferred tax expense.

Current tax expense is based on taxable profit for the year. Taxable profit differs from net profit as reported in the income statement because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The Group's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the balance sheet date.



## 2. Significant accounting policies (continued)

Deferred tax is provided, using the liability method, on temporary differences at the balance sheet date between the tax bases of assets and liabilities and their carrying amounts for accounting purposes.

Deferred tax liabilities are generally recognised for all taxable temporary differences. Deferred tax assets are generally recognised for all deductible temporary differences, carry forward of unused tax credits and unused tax losses, to the extent that it is probable that taxable profit will be available against which these items can be utilised.

Deferred tax assets and liabilities are not recognised if the temporary difference arises from goodwill or from the initial recognition of an asset and liability in a transaction other than a business combination and, at the time of the transaction, affects neither the tax profit nor the accounting profit.

Deferred tax liabilities are recognised for taxable temporary differences arising on investments in subsidiaries and joint ventures, except where the Group is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be utilised.

Deferred tax is measured at the tax rates that are expected to apply in the period when the liability is settled or the asset is realised, based upon tax rates and legislation that have been enacted or substantively enacted at the balance sheet date. Deferred tax is charged or credited in the income statement, except where it relates to items charged or credited directly to equity, in which case the deferred tax is also recognised in equity.

Deferred tax assets and liabilities are offset when there is a legal enforceable right to set off current tax assets against current tax liabilities and when they relate to income taxes levied by the same tax authority where the Group intends to settle its current tax assets and liabilities on a net basis.

### Property, plant and equipment

Assets held for use in the rendering of services, or for administrative purposes, are stated in the balance sheet at cost, net of accumulated depreciation and any provision for impairment.

Depreciation is provided on a straight-line basis at rates to reduce the assets to their residual value over their estimated useful lives.

The principal annual rates used are:

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

The gain or loss arising on the disposal or retirement of an asset is determined as the difference between the sales proceeds and the carrying amount of the asset and is recognised in the consolidated income statement.

### Research and development costs

Expenditure on research is recognised as an expense in the period in which it is incurred. Development costs are expensed in the period in which the costs are incurred unless the criteria for capitalisation is met (see Other intangible assets policy).

## 2. Significant accounting policies (continued)

### Other intangible assets

Customer relationships represent the value of contracts acquired on the acquisition of subsidiaries and are amortised over the average length of the contracts which is eight years.

Development expenditure relating to software is capitalised as an intangible asset only if all of the following conditions are met:

- an asset is created that can be identified;
- it is probable that the asset created will generate future economic benefits; and
- the development cost of the asset can be measured reliably

Development expenditure is amortised over the period in which the Group is expected to benefit. This period is between three to eight years, or the length of the contract if longer. Provision is also made for any impairment. All other development expenditure is written off as incurred. Assets under the course of construction are not depreciated.

Licences comprise premiums paid for the acquisition of licences, which are amortised on a straight-line basis over the life of the licence.

Franchises represent costs incurred in obtaining franchise rights and franchise goodwill arising on the acquisition of franchises. These are amortised on a straight-line basis over the life of the franchise.

Pension related intangibles represent assets arising in relation to the Group's right to manage and operate contracts where there is a defined benefit pension scheme and it is not virtually certain that contributions will be recovered from the customer but where the Group's obligation to contribute to the scheme ends when the contract ends. The intangible assets represent the Group's share of scheme net liabilities on the date that contracts commence and are amortised on a straight-line basis over the contract life.

### Impairment of tangible and intangible assets excluding goodwill

Annually, the Group reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Where the asset does not generate cash flows that are independent from other assets, the Group estimates the recoverable amount of the cash-generating unit (CGU) to which the asset belongs.

Recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have not been adjusted.

If the recoverable amount of an asset (or CGU) is estimated to be less than its carrying amount, the carrying amount of the asset (or CGU) is reduced to its recoverable amount. An impairment loss is recognised as an expense immediately.

Where an impairment loss subsequently reverses, the carrying amount of the asset (or CGU) is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset (or CGU) in prior years. A reversal of an impairment loss is recognised as income immediately.

Impairment losses and reversals are included within other expenses within the consolidated income statement.

### Share-based payment

The Group has applied the requirements of IFRS 2 'Share-based payment'. In accordance with the transitional provisions, IFRS 2 has been applied to all grants of equity instruments after 7 November 2002 that were not fully vested as of 1 January 2005.

The Group issues equity-settled share-based payments to certain employees and operates an Inland Revenue approved Save As You Earn share option scheme open to eligible employees which allows the purchase of shares at a discount. These are measured at fair value at the date of grant. The fair value is expensed on a straight-line basis over the vesting period, based on the Group's estimate of shares that will eventually vest.

## 2. Significant accounting policies (continued)

Fair value is measured by use of the Black Scholes, Binomial lattice or Monte Carlo Simulation models depending on the type of scheme, as set out in note 34. The expected life used in the models has been adjusted, based on management's best estimate, for the effects of non-transferability, exercise restrictions, and behavioural considerations. Where relevant, the value of the option has also been adjusted to take account of market conditions applicable to the option.

### 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 contractors, during the period of initial asset construction, costs incurred as a direct consequence of financing, designing and constructing the asset are shown as PFI assets in the course of construction within non-current trade and other receivables. On completion of the asset construction phase, the asset is transferred within trade and other receivables to 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 as notional interest receivable within investment revenue.

The Group has one (2005 – seven) fully owned Special Purpose Company (SPC) which is used for the purpose of running the PFI business.

### Cash and cash equivalents

Cash and cash equivalents comprise cash in hand and balances with banks and similar institutions, which are readily convertible to known amounts of cash and which are subject to insignificant changes in value and have a maturity of three months or less. This definition is also used for the consolidated cash flow statement.

### Dividends

Dividends are recorded in the Group's consolidated financial statements in the period in which they are approved by the Group's shareholders.

### Loans

Loans are initially stated at the amount of the net proceeds after deduction of issue costs. The carrying amount of loans hedged by derivatives is increased by the finance cost in respect of the accounting period and reduced by payments made in the period. Loans which are unhedged are stated at amortised cost with accrued interest recorded separately from the associated borrowings within current liabilities.

Loans of certain SPCs and joint ventures are described as non recourse loans and classified as such only if no Group company other than the relevant borrower has an obligation under a guarantee or other arrangement, to repay the debt.

### Derivative financial instruments and hedging activities

The Group has adopted IAS 32 'Financial Instruments: Disclosure and Presentation' and IAS 39 'Financial Instruments: Recognition and Measurement' with effect from 1 January 2005. Derivatives are initially accounted for and measured at fair value on the date a derivative contract is entered into and subsequently measured at fair value. The gain or loss on re-measurement is taken to the income statement except where the derivative is a designated cash flow hedging instrument. The accounting treatment of derivatives classified as hedges depends on their designation, which occurs on the date that the derivative contract is committed to. The Group designates derivatives as:

- a hedge of the fair value of an asset or liability (fair value hedge)
- a hedge of the income/cost of a highly probable forecast transaction or commitment (cash flow hedge)
- a hedge of net investment in a foreign entity

Gains and losses on fair value hedges are recorded in the income statement with the gain or loss on the hedged item attributable to the hedged risk.

## 2. Significant accounting policies (continued)

Gains or losses on cash flow hedges that are regarded as highly effective are recognised in equity. Where the forecast transaction results in a financial asset or liability, only gains or losses previously recognised in equity are reclassified to profit or loss in the same period as the asset or liability affects profit or loss. Where the forecast transaction or commitment results in a non-financial asset or liability, any gains or losses previously deferred in equity are included in the cost of the related asset or liability if the forecast transaction or commitment results in future income or expenditure. Gains and losses deferred in equity are transferred to the income statement in the same period as the underlying income or expenditure. The ineffective portion of the gain or loss on the hedging instrument is recognised in the consolidated income statement.

For the ineffective portion of hedges or transactions that are not designated for hedge accounting under IAS 39, any change in assets or liabilities is recognised immediately in the income statement. Where a hedge no longer meets the effectiveness criteria, any gains or losses deferred in equity are only transferred to the income statement when the committed or forecast transaction is recognised in the income statement. However, where cash flow hedge accounting has been applied for a forecast or committed transaction that is no longer expected to occur, then the cumulative gain or loss that has been recorded in equity at that time remains in equity and is recognised when the forecast transaction is ultimately recognised in the income statement.

Where the Group hedges net investments in foreign entities through currency borrowings, the gains or losses on the translation of the borrowings are recognised in equity. Gains and losses accumulated in equity are included in the income statement when the foreign operation is disposed of.

### Provisions

Provisions are recognised when the Group has a present obligation as a result of a past event, and it is probable that the Group will be required to settle that obligation. Provisions are measured at the Directors' best estimate of the expenditure required to settle the obligation at the balance sheet date.

### New standards and interpretations not applied

During the year, the IASB and IFRIC have issued the following standards and interpretations with an effective date after the date of these financial statements:

<b>International Accounting Standards (IAS/IFRSs)</b>		<b>Effective date</b>
IFRS 7	Financial Instruments: Disclosures, and the related amendment to IAS 9 on capital disclosures	1 January 2007
<b>International Financial Reporting Interpretations Committee (IFRIC)</b>		
IFRIC 7	Applying the Restatement Approach under IAS 29 Financial Reporting in Hyperinflationary Economies	1 January 2007
IFRIC 8	Scope of IFRS 2	1 January 2007
IFRIC 9	Reassessment of Embedded Derivatives	1 January 2007
IFRIC 10	Interim Financial Reporting and Impairment	1 January 2007
IFRIC 11	Group and Treasury Share Transactions	1 January 2007
IFRIC 12	Service Concession Arrangements	1 January 2008

The Directors do not anticipate that the adoption of these standards and interpretations will have a material impact on the Group's financial statements in the period of initial application.

Upon adoption of IFRS 7, the Group will have to disclose additional information about its financial instruments, their significance and the nature and extent of risks that they give rise to. More specifically, the Group will need to disclose the fair value of its financial instruments and its risk exposure in greater detail. There will be no effect on reported income or net assets.

### 3. Critical accounting judgements and key sources of estimation uncertainty

#### Critical judgements in applying the Group's accounting policies

In the process of applying the Group's accounting policies, which are described in note 2 above, management has made the following judgements that have the most significant effect on the amounts recognised in the financial statements (apart from those involving estimations which are dealt with below).

#### Revenue recognition

Revenue is recognised for certain long-term project-based contracts based on the stage of completion of the contract activity. This is measured by the proportion of costs incurred to estimated whole-life contract costs except where this would not be representative of the stage of completion.

#### Key sources of estimation uncertainty

The key assumptions concerning the future, and other key sources of estimation uncertainty at the balance sheet date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year, are discussed below.

#### Impairment of goodwill

Determining whether goodwill is impaired requires an estimation of the value in use of the cash-generating units to which goodwill has been allocated. The value in use calculation involves an estimation of the future cash flows of cash-generating units and also the selection of appropriate discount rates, which involves judgement, to use to calculate present values (see note 13). The carrying value of goodwill is £528.5m (2005 – £544.5m) at the balance sheet date.

#### Retirement benefit obligations

The calculation of retirement benefit obligations is dependent on material key assumptions including discount rates, future returns on assets and future contribution rates (see note 27). The value of retirement benefit obligations at the balance sheet date is £249.3m (2005 – £306.6m). Details of the impact of changes in assumptions relating to retirement benefit obligations are disclosed in the Finance Review (page 39).

### 4. Revenue

An analysis of the Group's revenue is as follows:

	2006 £m	2005 £m
Rendering of services	2,548.2	2,260.3
Revenue as disclosed in the consolidated income statement	2,548.2	2,260.3
Investment revenue (note 8)	31.7	33.6
<b>Total revenue as defined in IAS 18</b>	<b>2,579.9</b>	<b>2,293.9</b>



## 5. Segmental information

The Group manages its business on a market segment basis and these segments are the basis on which the Group reports its primary segment information.

### Market segments

Year ended 31 December 2006

	Civil Government £m	Defence £m	Transport £m	Science £m	Total
<b>Revenue</b>	875.0	644.8	625.7	402.7	2,548.2
<b>Result</b>					
Segment result	42.0	41.2	26.7	36.9	146.8
Unallocated expenses					(33.0)
Gain on sale of PFI investments (note 15)					11.4
<b>Operating profit</b>					125.2
Investment revenue					31.7
Finance costs					(49.5)
<b>Profit before tax</b>					107.4
Tax					(27.9)
<b>Profit for the year</b>					79.5
<b>Capital expenditure including acquisitions</b>					
Property, plant and equipment	13.9	4.7	10.4	1.4	30.4
Goodwill	–	–	–	–	–
Intangible assets – segments	3.6	0.3	7.5	0.4	11.8
Intangible assets – unallocated					25.8
					37.6
<b>Depreciation and amortisation</b>					
Depreciation	17.8	6.2	4.6	1.4	30.0
Amortisation – segments	10.5	0.1	2.9	1.4	14.9
Amortisation – unallocated					1.3
					16.2
<b>Segment assets</b>					
Business segment assets	715.3	249.5	150.9	208.3	1,324.0
Unallocated assets					49.7
					1,373.7
<b>Segment liabilities</b>					
Business segment liabilities	(237.0)	(284.3)	(116.9)	(150.8)	(789.0)
Unallocated liabilities					(12.6)
					(801.6)

## 5. Segmental information (continued)

## Market segments

Year ended 31 December 2005

	Civil Government £m	Defence £m	Transport £m	Science £m	Total £m
<b>Revenue</b>	803.6	565.6	548.7	342.4	2,260.3
<b>Result</b>					
Segment result	37.5	33.3	25.0	31.4	127.2
Unallocated expenses					(30.1)
<b>Operating profit</b>					97.1
Investment revenue					33.6
Finance costs					(52.8)
<b>Profit before tax</b>					77.9
Tax					(23.5)
<b>Profit for the year</b>					54.4
<b>Capital expenditure including acquisitions</b>					
Property, plant and equipment	23.3	5.3	6.7	1.0	36.3
Goodwill	262.1	93.7	–	–	355.8
Intangible assets – segments	24.8	2.4	0.6	0.4	28.2
Intangible assets – unallocated					12.4
					40.6
<b>Depreciation and amortisation</b>					
Depreciation	17.7	6.8	4.3	1.5	30.3
Amortisation – segments	9.4	0.5	1.7	1.5	13.1
Amortisation – unallocated					0.5
					13.6
<b>Segment assets</b>					
Business segment assets	818.1	403.6	248.9	271.8	1,742.4
Unallocated assets					36.4
					1,778.8
<b>Segment liabilities</b>					
Business segment liabilities	(324.8)	(149.5)	(146.8)	(172.1)	(793.2)
Unallocated liabilities					(49.5)
					(842.7)

## 5. Segmental information (continued)

### Geographical segments

Year ended 31 December 2006	United Kingdom £m	North America £m	Europe and Middle East £m	Asia Pacific £m	Total £m
<b>Revenue</b>	<b>1,886.5</b>	<b>295.3</b>	<b>213.4</b>	<b>153.0</b>	<b>2,548.2</b>
<b>Capital expenditure including acquisitions</b>					
Property, plant and equipment	19.8	1.9	4.3	4.4	30.4
Goodwill	–	–	–	–	–
Intangible assets	35.5	–	2.1	–	37.6
<b>Assets</b>					
Geographical segment assets	1,002.1	199.5	124.3	47.8	1,373.7

### Geographical segments

Year ended 31 December 2005	United Kingdom £m	North America £m	Europe and Middle East £m	Asia Pacific £m	Total £m
<b>Revenue</b>	<b>1,661.7</b>	<b>254.5</b>	<b>205.2</b>	<b>138.9</b>	<b>2,260.3</b>
<b>Capital expenditure including acquisitions</b>					
Property, plant and equipment	26.8	3.5	3.1	2.9	36.3
Goodwill	262.1	93.7	–	–	355.8
Intangible assets	37.4	2.4	0.8	–	40.6
<b>Assets</b>					
Geographical segment assets	1,343.3	249.6	118.4	67.5	1,778.8

	2006 £m	2005 £m
<b>Segment assets comprise:</b>		
Goodwill	528.5	544.5
Other intangible assets	126.1	107.8
Property, plant and equipment	93.6	103.0
Trade and other receivables – Non-current	110.5	459.8
Inventories	51.7	36.4
Trade and other receivables – Current excluding tax recoverable (note 19)	463.3	527.3
	<b>1,373.7</b>	<b>1,778.8</b>

	2006 £m	2005 £m
<b>Segment liabilities comprise:</b>		
Trade and other payables – Current	(541.9)	(531.1)
Trade and other payables – Non-current	(10.4)	(5.0)
Retirement benefit obligations	(249.3)	(306.6)
	<b>(801.6)</b>	<b>(842.7)</b>

## 6. Operating profit

Operating profit is stated after charging/(crediting):

	2006 £m	2005 £m
Net foreign exchange losses	0.3	0.1
Research and development costs	44.2	29.3
Loss on disposal of property, plant and equipment	1.1	0.4
Depreciation of property, plant and equipment	30.0	30.3
Amortisation of intangible assets included in other expenses	16.2	13.6
Staff costs (note 7)	1,115.5	1,018.2
Operating lease charges	113.9	88.5
Operating lease income	(0.2)	(0.2)

Amounts payable to Deloitte & Touche LLP and their associates by the Company and its subsidiary undertakings in respect of audit and non-audit services are shown below.

	2006 £m	2005 £m
Fees payable to the Company's auditors for the audit of the Company's annual accounts	0.7	0.7
Fees payable to the Company's auditors and their associates for other services to the Group:		
- The audit of the Company's subsidiaries pursuant to legislation	0.8	0.6
<b>Total audit fees</b>	<b>1.5</b>	<b>1.3</b>
- Other services pursuant to legislation	0.1	0.6
- Tax services	0.7	0.7
- Valuation and actuarial services	-	0.1
- Other services	0.1	0.3
<b>Total non-audit fees</b>	<b>0.9</b>	<b>1.7</b>

In addition to the above, there are other fees capitalised in the balance sheet in respect of acquisition advice from Deloitte & Touche LLP of £nil (2005 – £0.8m).

## 7. Staff costs

The average monthly number of employees (including executive directors) was:

	2006 Number	2005 Number
Civil Government	17,894	16,368
Defence	10,660	10,252
Transport	8,206	7,476
Science	3,062	2,851
Unallocated	264	306
<b>Total</b>	<b>40,086</b>	<b>37,253</b>

Their aggregate remuneration comprised:

	2006 £m	2005 £m
Wages and salaries	958.4	878.2
Social security costs	87.6	78.7
Other pension costs (note 27)	64.7	55.6
	1,110.7	1,012.5
Share-based payment expense (note 34)	4.8	5.7
<b>Total</b>	<b>1,115.5</b>	<b>1,018.2</b>

## 8. Investment revenue

	2006 £m	2005 £m
Interest receivable by PFI companies	25.6	26.7
Interest receivable on other loans and deposits	6.1	6.9
	<b>31.7</b>	<b>33.6</b>

## 9. Finance costs

	2006 £m	2005 £m
Interest payable on non recourse loans	18.0	19.9
Interest payable on obligations under finance leases	0.6	0.8
Fair value adjustment on fair value hedges and non IAS 39 designated hedges	0.5	(0.4)
Interest payable on other loans	28.5	27.8
Net interest payable on retirement benefit obligations (note 27)	1.9	4.7
	<b>49.5</b>	<b>52.8</b>

## 10. Tax

	2006 £m	2005 £m
<b>Current tax</b>		
UK corporation tax	17.4	16.1
Foreign tax	7.7	5.7
Adjustment in respect of prior years:		
UK corporation tax	(8.5)	3.1
Foreign tax	(0.3)	(0.3)
	<b>16.3</b>	<b>24.6</b>
<b>Deferred tax</b>		
Current year	5.1	1.3
Adjustment in respect of prior years	6.5	(2.4)
	<b>11.6</b>	<b>(1.1)</b>
	<b>27.9</b>	<b>23.5</b>

The charge for the year can be reconciled to the profit in the consolidated income statement as follows:

	2006 £m	2005 £m
<b>Profit before tax</b>	<b>107.4</b>	<b>77.9</b>
Tax calculated at a rate of 30% (2005 – 30%)	32.2	23.4
Expenses not deductible for tax purposes	5.6	3.6
Unrelieved tax losses and different tax rates on overseas earnings	1.2	0.4
Untaxed income and the effect of the use of unrecognised tax losses	(2.2)	(2.1)
Untaxed income on sale of PFI investments	(3.4)	–
Tax incentives	(3.2)	(2.2)
Adjustments in respect of prior years	(2.3)	0.4
<b>Tax charge</b>	<b>27.9</b>	<b>23.5</b>



## 11. Dividends

	2006 £m	2005 £m
<b>Amounts recognised as distributions to equity holders in the year:</b>		
Final dividend for the year ended 31 December 2005 of 2.06p per share on 463.0 million ordinary shares (2005 – Final dividend for the year ended 31 December 2004 – 1.82p on 457.7 million ordinary shares)	9.5	8.3
Interim dividend for the year ended 31 December 2006 of 1.05p per share on 469.5 million ordinary shares (2005 – Interim dividend for the year ended 31 December 2005 – 0.91p on 461.3 million ordinary shares)	5.0	4.2
	<b>14.5</b>	<b>12.5</b>
Proposed final dividend for the year ended 31 December 2006 of 2.55p per share on 471.1 million ordinary shares (2005 – 2.06p on 463.0 million ordinary shares)	12.0	9.5

The proposed final dividend for 2006 is subject to approval by shareholders at the Annual General Meeting and has not been included as a liability in these financial statements. A dividend waiver is effective for those shares held on behalf of the Company by its Employee Share Ownership Trust (note 31).

## 12. Earnings per share

Basic and diluted earnings per ordinary share (EPS) have been calculated in accordance with IAS 33 'Earnings Per Share'. EPS is shown both before and after amortisation of intangible assets and the gain on sale of PFI investments to assist in the understanding of the underlying performance of the business.

The calculation of the basic and diluted EPS is based on the following data:

### Number of shares

	2006 millions	2005 millions
Weighted average number of ordinary shares for the purpose of basic EPS	471.2	458.1
Effect of dilutive potential ordinary shares: share options	5.5	8.0
Weighted average number of ordinary shares for the purpose of diluted EPS	476.7	466.1

### Earnings

	2006		2005	
	Earnings £m	Per share amount Pence	Earnings £m	Per share amount Pence
Earnings for the purpose of basic EPS being net profit attributable to the equity holders of the parent	78.3	16.62	53.4	11.66
Less:				
Gain on sale of PFI investments	(11.4)	(2.42)	–	–
Add back:				
Amortisation of intangible assets, net of tax of £2.4m (2005 – £2.4m)	13.8	2.93	11.2	2.43
Basic earnings before amortisation of intangible assets and gain on sale of PFI investments	80.7	17.13	64.6	14.09
Earnings for the purpose of basic EPS	78.3	16.62	53.4	11.66
Effect of dilutive potential ordinary shares	–	(0.19)	–	(0.20)
Diluted EPS	78.3	16.43	53.4	11.46

At 31 December 2006, options over 3.3 million (2005 – 9.4 million) shares were excluded from the weighted average number of shares used for calculating diluted earnings per share because their exercise price was below the average share price for the year and they were, therefore, anti-dilutive.

### 13. Goodwill

Cost	£m
<b>At 1 January 2005</b>	177.4
Additions	355.8
Exchange differences	11.3
<b>At 1 January 2006</b>	<b>544.5</b>
Additions	–
Exchange differences	(16.0)
<b>At 31 December 2006</b>	<b>528.5</b>

Goodwill has been allocated to cash-generating units (CGUs) in the following business segments which is how the Group monitors its goodwill internally:

Cost	2006 £m	2005 £m
Civil Government	57.7	58.9
Defence	6.6	6.8
Science	99.1	99.9
Transport	12.3	13.2
Serco Solutions (formerly ITNET)	260.9	260.9
RCI	91.9	104.8
<b>At 31 December</b>	<b>528.5</b>	544.5

The Group tests goodwill annually for impairment, or more frequently if there are indications that goodwill might be impaired.

The recoverable amounts of the CGUs are determined from value in use calculations using cash flow projections based on financial plans approved by senior management covering a five year period. The key assumptions for the value in use calculations are those regarding the discount rates, growth rates and expected changes to revenue and direct costs during the period. Management estimates discount rates using pre-tax rates that reflect current market assessments of the time value of money and the risks specific to the CGUs. The growth rates are based on industry growth forecasts. Changes in revenue and direct costs are based on past practices, the Group's order book and expectations of future changes in the market.

The Group prepares cash flow forecasts derived from the most recent financial plans approved by management for the next five years including a terminal value based on an estimated growth rate of 2.25%. This rate does not exceed the average long-term growth rate for the UK.

The rates used to discount the forecast cash flows for the Group are as follows:

	2006 %	2005 %
Civil Government	11.8	11.8
Defence	11.3	11.3
Science	11.3	11.3
Transport	11.8	11.8
Serco Solutions (formerly ITNET)	13.5	13.5
RCI	12.3	12.3

## 14. Other intangible assets

	Customer relationships £m	Software and development expenditure £m	Licences and franchises £m	Pension related intangibles £m	Total £m
<b>Cost</b>					
At 1 January 2006	22.4	25.0	62.7	22.4	132.5
Additions	–	33.1	0.2	4.3	37.6
Disposals	(0.2)	–	–	–	(0.2)
Reclassifications	–	1.2	(1.2)	–	–
Transfers from property, plant and equipment	–	2.2	–	–	2.2
Exchange differences	(0.2)	0.2	(6.9)	–	(6.9)
<b>At 31 December 2006</b>	<b>22.0</b>	<b>61.7</b>	<b>54.8</b>	<b>26.7</b>	<b>165.2</b>
<b>Amortisation</b>					
At 1 January 2006	2.6	3.5	15.2	3.4	24.7
Charge for the year	3.0	4.5	6.0	2.7	16.2
Reclassifications	–	0.1	(0.1)	–	–
Exchange differences	(0.1)	0.3	(2.0)	–	(1.8)
<b>At 31 December 2006</b>	<b>5.5</b>	<b>8.4</b>	<b>19.1</b>	<b>6.1</b>	<b>39.1</b>
<b>Net book value</b>					
<b>At 31 December 2006</b>	<b>16.5</b>	<b>53.3</b>	<b>35.7</b>	<b>20.6</b>	<b>126.1</b>

	Customer relationships £m	Software and development expenditure £m	Licences and franchises £m	Pension related intangibles £m	Total £m
<b>Cost</b>					
At 1 January 2005	–	9.2	53.3	22.4	84.9
Additions	–	16.0	1.6	–	17.6
Disposals	–	(0.2)	–	–	(0.2)
Acquired on acquisition of subsidiaries	22.4	0.6	–	–	23.0
Reclassifications	–	(0.4)	0.4	–	–
Exchange differences	–	(0.2)	7.4	–	7.2
<b>At 31 December 2005</b>	<b>22.4</b>	<b>25.0</b>	<b>62.7</b>	<b>22.4</b>	<b>132.5</b>
<b>Amortisation</b>					
At 1 January 2005	–	1.0	7.7	1.2	9.9
Charge for the year	2.6	2.6	6.2	2.2	13.6
Eliminated on disposals	–	(0.1)	–	–	(0.1)
Exchange differences	–	–	1.3	–	1.3
<b>At 31 December 2005</b>	<b>2.6</b>	<b>3.5</b>	<b>15.2</b>	<b>3.4</b>	<b>24.7</b>
<b>Net book value</b>					
<b>At 31 December 2005</b>	<b>19.8</b>	<b>21.5</b>	<b>47.5</b>	<b>19.0</b>	<b>107.8</b>

The following amortisation rates have been determined for the intangible assets acquired during the year:

Software and development expenditure – over their estimated useful lives

Licences and franchises – life of licence or franchise

Pension related intangibles – period of related contract

## 15. Disposals

On 2 December 2006, the Group sold its investments in ten wholly-owned subsidiaries which carried out six Private Finance Initiative (PFI) projects. The subsidiaries were sold to Infrastructure Investors Limited (I<sup>2</sup>) for a cash consideration of £76.5m resulting in a gain on sale of £11.4m.

The subsidiaries disposed of were as follows:

Defence Management (Holdings) Limited  
Defence Management (Watchfield) Limited  
Traffic Information Services (TIS) Holdings Limited  
Traffic Information Services (TIS) Limited  
Premier Custodial Investments Limited  
Premier Custodial Finance Limited  
Pucklechurch Custodial Services Limited  
Lowdham Grange Prison Services Limited  
Medomsley Training Services Limited  
Moreton Prison Services Limited

Net assets disposed of were:

	£m
Intangible assets	0.2
PFI debtor	329.8
Other debtors	11.1
Cash	56.6
Creditors	(22.2)
Non recourse loans	(242.3)
Financial instruments	(16.5)
Tax	(69.9)
	<b>46.8</b>

The gain on sale is calculated as follows:

	£m
Cash consideration	76.5
Less:	
Net assets disposed of	(46.8)
Transaction and other costs	(7.0)
Amounts transferred from hedging and translation reserve in relation to financial instruments disposed of	(9.0)
Recognition of financial instrument on sale	(2.3)
<b>Gain on sale of PFI investments</b>	<b>11.4</b>

Transaction and other costs includes liabilities triggered by the disposal.

The net cash inflow arising on disposal is as follows:

	£m
Cash consideration received	76.5
Less:	
Cash disposed of	(56.6)
Transaction costs paid during the year	(1.7)
<b>Net cash inflow</b>	<b>18.2</b>

## 16. Property, plant and equipment

	Freehold land and buildings £m	Short- leasehold building improvements £m	Machinery, motor vehicles, furniture and equipment £m	Total £m
<b>Cost</b>				
At 1 January 2006	11.3	22.4	195.4	229.1
Additions	1.2	1.8	27.4	30.4
Disposals	(1.8)	(1.6)	(24.9)	(28.3)
Reclassifications	(2.2)	2.2	–	–
Transfers to inventories	–	–	(3.6)	(3.6)
Transfers to intangible assets	–	–	(3.7)	(3.7)
Transfers to trade and other receivables	–	–	(0.9)	(0.9)
Exchange differences	(0.1)	(0.6)	(6.5)	(7.2)
<b>At 31 December 2006</b>	<b>8.4</b>	<b>24.2</b>	<b>183.2</b>	<b>215.8</b>
<b>Accumulated depreciation and impairment</b>				
At 1 January 2006	3.7	9.5	112.9	126.1
Charge for the year	0.4	2.2	27.4	30.0
Eliminated on disposals	(0.3)	(1.5)	(24.0)	(25.8)
Reclassifications	(1.3)	1.3	–	–
Transfers to inventories	–	–	(2.2)	(2.2)
Transfers to intangible assets	–	–	(1.5)	(1.5)
Transfers to trade and other receivables	–	–	(0.4)	(0.4)
Exchange differences	–	(0.3)	(3.7)	(4.0)
<b>At 31 December 2006</b>	<b>2.5</b>	<b>11.2</b>	<b>108.5</b>	<b>122.2</b>
<b>Net book value At 31 December 2006</b>	<b>5.9</b>	<b>13.0</b>	<b>74.7</b>	<b>93.6</b>

	Freehold land and buildings £m	Short- leasehold building improvements £m	Machinery, motor vehicles, furniture and equipment £m	Total £m
<b>Cost</b>				
At 1 January 2005	10.0	20.4	171.2	201.6
Additions	1.1	1.8	23.4	26.3
Disposals	–	(0.7)	(11.3)	(12.0)
Acquired on acquisition of subsidiaries	–	0.3	9.7	10.0
Exchange differences	0.2	0.6	2.4	3.2
<b>At 31 December 2005</b>	<b>11.3</b>	<b>22.4</b>	<b>195.4</b>	<b>229.1</b>
<b>Accumulated depreciation and impairment</b>				
At 1 January 2005	3.2	7.6	94.6	105.4
Eliminated on disposals	–	(0.6)	(10.6)	(11.2)
Charge for the year	0.4	2.3	27.6	30.3
Exchange differences	0.1	0.2	1.3	1.6
<b>At 31 December 2005</b>	<b>3.7</b>	<b>9.5</b>	<b>112.9</b>	<b>126.1</b>
<b>Net book value At 31 December 2005</b>	<b>7.6</b>	<b>12.9</b>	<b>82.5</b>	<b>103.0</b>

The carrying amount of the Group's machinery, motor vehicles, furniture and equipment includes an amount of £18.1m (2005 – £27.5m) in respect of assets held under finance leases.

The carrying amount of the Group's freehold land and buildings includes an amount of £0.2m (2005 – £0.3m) in respect of assets held under finance leases.

The carrying amount of the Group's short-leasehold building improvements includes an amount of £0.5m (2005 – £0.5m) in respect of assets held under finance leases.



## I 7. Joint ventures

The Group's interests in joint ventures are reported in the consolidated financial statements using the proportionate consolidation method.

The effect of the Group's joint ventures on the consolidated income statement and balance sheet is as follows:

### Income statement

	2006 £m	2005 £m
Revenue	643.3	536.1
Expenses	(606.0)	(501.4)
Operating profit	37.3	34.7
Investment revenue	3.3	4.3
Finance costs	(1.3)	(2.6)
Profit before tax	39.3	36.4
Tax	(8.6)	(10.4)
Profit for the year	30.7	26.0
Minority interest	(0.6)	(0.5)
Share of post-tax results of joint ventures	30.1	25.5

Expenses includes £4.0m (2005 – £6.6m) of costs incurred by Group.

### Balance sheet

	2006 £m	2005 £m
Non-current assets	104.0	117.2
Current assets	104.5	111.3
Current liabilities	(92.8)	(106.3)
Non-current liabilities	(90.4)	(107.3)
Net assets	25.3	14.9

## I 8. Inventories

	2006 £m	2005 £m
Service spares	19.6	17.3
Parts awaiting installation	11.0	–
Long-term project-based contract balances	21.1	19.1
	51.7	36.4

## 19. Trade and other receivables

	2006 £m	2005 £m
<b>Trade and other receivables: Non-current</b>		
PFI debtor*	29.8	363.1
Amounts owed by joint ventures	2.3	0.9
Amounts recoverable on retirement benefit obligations (note 27)	67.6	84.9
Other debtors	10.8	10.9
	<b>110.5</b>	<b>459.8</b>
	2006 £m	2005 £m
<b>Trade and other receivables: Current</b>		
Amounts recoverable on contracts	385.4	370.2
PFI debtor*	1.5	15.4
Corporation tax recoverable	–	1.5
Prepayments and accrued income	39.8	62.2
Amounts owed by joint ventures	0.1	3.5
Financial instruments (note 26)	–	0.5
Other debtors	36.5	75.5
	<b>463.3</b>	<b>528.8</b>

\* The PFI debtors analysed above are funded by non recourse loans of £24.8m (2005 – £278.2m).

The Directors estimate that the carrying amount of trade debtors approximates to their fair value.

## 20. Cash and cash equivalents

	Sterling 2006 £m	Other currencies 2006 £m	Total 2006 £m	Sterling 2005 £m	Other currencies 2005 £m	Total 2005 £m
Cash of PFI and other project companies						
securing credit obligations	1.7	3.5	5.2	13.0	3.8	16.8
Customer advance payments	–	5.4	5.4	–	5.9	5.9
Other cash and short-term deposits	157.7	49.6	207.3	202.0	16.0	218.0
<b>Total cash and cash equivalents</b>	<b>159.4</b>	<b>58.5</b>	<b>217.9</b>	<b>215.0</b>	<b>25.7</b>	<b>240.7</b>

Cash and cash equivalents (which are presented as a single class of assets on the face of the balance sheet) comprise cash at bank and other short-term highly liquid investments with a maturity of three months or less.

## 21. Loans

	Non recourse loans (relating to PFI assets)	Other non recourse loans	Other loans	Total	Non recourse loans (relating to PFI assets)	Other non recourse loans	Other loans	Total
	2006	2006	2006	2006	2005	2005	2005	2005
	£m	£m	£m	£m	£m	£m	£m	£m
Loans are repayable as follows:								
On demand or within one year	3.3	5.6	49.0	57.9	26.9	28.6	9.3	64.8
Between one and two years	2.0	5.1	4.9	12.0	24.3	6.3	51.8	82.4
Between two and five years	6.8	15.9	193.0	215.7	77.0	17.7	281.3	376.0
After five years	12.7	10.8	94.9	118.4	150.0	18.4	117.9	286.3
	<b>24.8</b>	<b>37.4</b>	<b>341.8</b>	<b>404.0</b>	<b>278.2</b>	<b>71.0</b>	<b>460.3</b>	<b>809.5</b>
Less: Amount due for settlement within one year (shown within current liabilities)	(3.3)	(5.6)	(49.0)	(57.9)	(26.9)	(28.6)	(9.3)	(64.8)
Amount due for settlement after one year	<b>21.5</b>	<b>31.8</b>	<b>292.8</b>	<b>346.1</b>	<b>251.3</b>	<b>42.4</b>	<b>451.0</b>	<b>744.7</b>

## 22. Deferred tax

Deferred income taxes are calculated in full on temporary differences under the liability method using a principal tax rate of 30% (2005 – 30%).

The gross movement on the deferred income tax account is as follows:

	2006	2005
	£m	£m
At 1 January	0.9	(5.9)
Income statement charge/(credit) (note 10)	11.6	(1.1)
Acquisitions	–	9.8
Disposals	(68.3)	–
Items taken directly to equity	2.0	(2.0)
Exchange differences	–	0.1
<b>At 31 December</b>	<b>(53.8)</b>	<b>0.9</b>

The movement in deferred tax assets and liabilities during the year was as follows:

	Temporary differences on assets/intangibles	Share-based payment and employee benefits	Retirement benefit schemes	Derivative financial instruments	Other temporary differences	Total
	£m	£m	£m	£m	£m	£m
At 1 January 2006	85.6	(15.3)	(52.8)	(10.4)	(6.2)	0.9
(Credited)/charged to income statement	(1.1)	0.4	5.7	0.1	6.5	11.6
Disposals	(73.3)	–	–	5.0	–	(68.3)
Items taken directly to equity	–	(4.1)	6.0	0.1	–	2.0
<b>At 31 December 2006</b>	<b>11.2</b>	<b>(19.0)</b>	<b>(41.1)</b>	<b>(5.2)</b>	<b>0.3</b>	<b>(53.8)</b>

## 22. Deferred tax (continued)

The movement in deferred tax assets and liabilities during the previous year was as follows:

	Temporary differences on assets/intangibles £m	Share-based payment and employee benefits £m	Retirement benefit schemes £m	Derivative financial instruments £m	Other temporary differences £m	Total £m
At 1 January 2005	52.1	(6.7)	(41.0)	(10.8)	0.5	(5.9)
(Credited)/charged to income statement	(1.6)	(1.7)	–	–	2.2	(1.1)
Acquisitions	25.5	(2.2)	(3.6)	(1.0)	(8.9)	9.8
Items taken directly to equity	9.5	(4.7)	(8.2)	1.4	–	(2.0)
Exchange differences	0.1	–	–	–	–	0.1
At 31 December 2005	85.6	(15.3)	(52.8)	(10.4)	(6.2)	0.9

Deferred income tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities and when the deferred income taxes relate to the same fiscal authority. The following is the analysis of the deferred tax balances (after offset) for financial reporting purposes:

	2006 £m	2005 £m
Deferred tax liabilities	19.9	92.1
Deferred tax assets	(73.7)	(91.2)
	(53.8)	0.9

At the balance sheet date, the Group did not recognise deferred tax assets of £13.2m (2005 – £7.3m) in respect of the aggregate of deductible temporary differences, unused tax losses and unused tax credits.

## 23. Obligations under finance leases

	Minimum lease payments 2006 £m	Present value of minimum lease payments 2006 £m	Minimum lease payments 2005 £m	Present value of minimum lease payments 2005 £m
Amounts payable under finance leases:				
Within one year	9.5	8.3	9.9	8.2
Between two and five years	12.0	11.0	19.8	17.3
After five years	1.2	0.5	1.3	0.9
	22.7	19.8	31.0	26.4
Less: future finance charges	(2.9)	–	(4.6)	–
Present value of lease obligations	19.8	19.8	26.4	26.4
Less: Amount due for settlement within one year (shown within current liabilities)	(9.5)	(8.3)	(9.9)	(8.2)
Amount due for settlement after one year	10.3	11.5	16.5	18.2

Finance lease obligations are secured by the lessors' title to the leased assets.

The fair value of the Group's lease obligations approximates their carrying amount.

## 24. Trade and other payables

	2006 £m	2005 £m
<b>Trade and other payables: Current</b>		
Trade creditors	127.6	124.3
Other creditors	133.7	104.2
Accruals and deferred income	280.6	297.2
Amounts owed to joint ventures	–	5.4
	<b>541.9</b>	<b>531.1</b>
<b>Trade and other payables: Non-current</b>	<b>10.4</b>	<b>5.0</b>

The average credit period taken for trade purchases is 26 days (2005 – 26 days). The Directors estimate that the carrying amount of trade creditors approximates to their fair value.

## 25. Financial risk management

### Financial risk

The Group's treasury function is responsible for managing the Group's exposure to financial risk, and operates within a defined set of policies and procedures reviewed and approved by the Board.

### Credit facilities and liquidity management

The Group maintains committed credit facilities that are designed to ensure that the Group has sufficient available funds for operations and planned expansions. The Group's main committed credit facility (the Bank Facility), expires in December 2009 and comprises term loans of £46.0m and £117.0m (USD 229.0m) and an undrawn £255.0m revolving credit facility.

The Bank Facility is unsecured with covenants and obligations typical of these types of arrangement.

The Group continues to service two private placements. The first, for £43.2m, was taken out in 1997 and matures in December 2007. The second, for £117.0m, was taken out in 2003 and amortises from 2011 to 2015.

### Foreign exchange risk

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.

The foreign exchange exposure on the US Dollar tranches of the private placements has been fully hedged into Sterling.

Central funding of individual business units gives rise to monetary assets and liabilities centrally and in the business units. The currency of resultant debt is selected to ensure that any foreign exchange risk is borne and managed by the Group's treasury function using forward foreign exchange contracts.

### Interest rate risk

The Group's exposure to interest rate fluctuations on its interest-bearing assets and liabilities is selectively managed using interest rate swaps.

Lenders of non recourse debt generally require that the debt is maintained on fixed rate terms or is swapped to fixed rate terms. Therefore, the Group hedges its interest rate risk by using interest rate swaps to exchange floating interest cash flows to fixed interest cash flows.



## 25. Financial risk management (continued)

### Credit risk

The Group's principal financial assets are cash and cash equivalents and trade and other receivables.

The Group's credit risk is relatively low because a high proportion of trade and other receivables have a sovereign or close to sovereign credit rating and the Group has a large number of counterparties and customers.

The credit risk on liquid funds and derivative financial instruments is limited because the counterparties are banks with high credit ratings assigned by international credit-rating agencies.

### 25 (a) Currency management

The Group's currency exposures that give rise to net currency gains and losses that are recognised in the income statement arise principally in companies with Sterling functional currency. Excluding monetary assets and liabilities denominated in overseas functional currency and borrowings designated as a hedge against overseas net assets, the Group's net foreign exchange transaction exposure is £1.2m (2005 – £5.8m).

### 25 (b) Interest rate management

An analysis of financial assets and liabilities exposed to interest rate risk is set out below:

#### (i) Financial assets

	2006			2005		
	Floating rate £m	Fixed rate £m	Weighted average fixed interest rate received %	Floating rate £m	Fixed rate £m	Weighted average fixed interest rate received %
Cash and cash equivalents	217.9	–	–	240.7	–	–
Other financial assets	1.3	1.8	6.12	2.1	2.0	8.50
	<b>219.2</b>	<b>1.8</b>		<b>242.8</b>	<b>2.0</b>	

#### (ii) Financial liabilities

	2006			2005		
	Floating rate £m	Fixed rate £m	Weighted average fixed interest rate paid %	Floating rate £m	Fixed rate £m	Weighted average fixed interest rate paid %
Non recourse Sterling loans (related to PFI assets)	–	24.8	6.50	–	278.2	6.50
Other non recourse Sterling loans	–	–	–	22.4	–	–
Non recourse Canadian Dollar loans	–	37.4	4.53	–	48.6	5.27
Sterling loans	65.0	141.9	5.99	178.5	140.9	5.98
US Dollar loans	120.7	–	–	139.5	–	–
Other loans	8.7	5.5	8.00	1.4	–	–
	<b>194.4</b>	<b>209.6</b>		<b>341.8</b>	<b>467.7</b>	

Excluded from the above analysis is £19.8m (2005 – £26.4m) of amounts payable under finance leases, which are subject to fixed rates of interest.

### 25 (c) Hedge of net investment in foreign entity

The Group has US Dollar denominated borrowings, some of which it has designated as a hedge of part of the net investment in its subsidiaries in the US. The carrying value of the designated borrowings was £25.0m (2005 – £28.5m). The foreign exchange gain of £3.5m (2005 – loss of £2.5m) on translation of the borrowings into Sterling has been recognised within the Group's hedging and translation reserve.

## 26. Financial instruments

	1 January 2006 £m	Movement in fair value of cash flow hedges £m	Movement in fair value of fair value hedges £m	Movement in fair value of non- designated hedges £m	Hedges disposed of £m	Hedges created £m	31 December 2006 £m
Currency swaps	(4.7)	(5.3)	(1.4)	–	–	–	(11.4)
Forward foreign exchange contracts	(5.8)	(2.1)	(1.0)	(0.2)	–	–	(9.1)
Interest rate swaps	(24.7)	7.6	–	0.8	16.5	(2.3)	(2.1)
Commodity futures contracts	–	(2.2)	–	–	–	–	(2.2)
	<b>(35.2)</b>	<b>(2.0)</b>	<b>(2.4)</b>	<b>0.6</b>	<b>16.5</b>	<b>(2.3)</b>	<b>(24.8)</b>

	1 January 2005 £m	Movement in fair value of cash flow hedges £m	Movement in fair value of fair value hedges £m	Movement in fair value of non- designated hedges £m	31 December 2005 £m
Currency swaps	(9.1)	3.6	0.8	–	(4.7)
Forward foreign exchange contracts	(8.6)	2.2	0.4	0.2	(5.8)
Interest rate swaps	(20.2)	(4.5)	–	–	(24.7)
	<b>(37.9)</b>	<b>1.3</b>	<b>1.2</b>	<b>0.2</b>	<b>(35.2)</b>

The maturity of derivative financial instruments is as follows:	Currency swaps 2006 £m	Forward foreign exchange contracts 2006 £m	Interest rate swaps 2006 £m	Commodity futures contracts 2006 £m	Total 2006 £m
On demand or within one year	(5.1)	(4.5)	(0.4)	(0.6)	(10.6)
Between one and two years	(0.3)	(1.1)	(0.3)	(0.4)	(2.1)
Between two and five years	(0.9)	(2.4)	(0.8)	(1.2)	(5.3)
After five years	(5.1)	(1.1)	(0.6)	–	(6.8)
	<b>(11.4)</b>	<b>(9.1)</b>	<b>(2.1)</b>	<b>(2.2)</b>	<b>(24.8)</b>

The maturity of derivative financial instruments is as follows:	Currency swaps 2005 £m	Forward foreign exchange contracts 2005 £m	Interest rate swaps 2005 £m	Total 2005 £m
On demand or within one year	(0.2)	0.2	(4.4)	(4.4)
Between one and two years	(2.8)	(0.5)	(3.9)	(7.2)
Between two and five years	(0.5)	(1.7)	(12.1)	(14.3)
After five years	(1.2)	(3.8)	(4.3)	(9.3)
	<b>(4.7)</b>	<b>(5.8)</b>	<b>(24.7)</b>	<b>(35.2)</b>

The net asset representing the fair value of the forward foreign exchange contracts repayable within one year comprises an asset of £nil (2005 – £0.5m) (see note 19) and a liability of £4.5m (2005 – £0.3m).

The fair value of the Group's derivative financial instruments are based on quoted market prices for equivalent instruments at the balance sheet date.

**26 (a) Currency risk management**

The Group utilises currency derivatives to hedge significant future transactions and cash flows. The Group is party to a variety of foreign currency forward contracts and swaps in the management of its exchange rate exposures. The instruments purchased are primarily denominated in the currencies of the Group's principal markets.

At the balance sheet date, the total notional amount of outstanding forward foreign exchange contracts to which the Group is committed is £77.3m (2005 – £72.6m).

These arrangements are mainly designed to address significant exchange exposures for the next eighteen months.

**Cash flow hedges**

At 31 December 2006, the Group held a number of currency swaps designated as cash flow hedges. Fixed interest cash flows denominated in US Dollars are exchanged for fixed interest cash flows denominated in Sterling. The profile of these currency swaps held by the Group was as follows:

**At 31 December 2006 and at 31 December 2005**

Maturity	Notional amount	Payable USD interest rate	Receivable GBP interest rate
	USDm	%	%
December 2007	39.0	7.6	6.8
August 2015	35.0	5.7	5.7
August 2015	20.0	5.7	5.7

The Group also held a number of forward foreign exchange contracts designated as cash flow hedges with a notional amount of £26.0m (2005 – £24.7m).

All currency derivatives designated as cash flow hedges are highly effective and the fair value thereof has been deferred in equity.

**Fair value hedges**

At 31 December 2006, the Group had currency swaps in place with a notional amount of USD 31m (2005 – USD 31m) whereby it receives a fixed interest rate of 6.81% (2005 – 6.81%) and pays a floating rate based on LIBOR on the notional amount. The swaps are being used to hedge the exposure to changes in the fair value of the Group's US Dollar denominated private placement loans. In addition, the Group held a forward foreign exchange contract with a notional amount of USD 15m (2005 – USD 15m) designated as a fair value hedge, hedging the foreign exchange exposure on the final repayment of the Group's US Dollar denominated private placement loans.

**26 (b) Interest rate risk management****Cash flow hedges**

The Group uses interest rate swaps to manage its exposure to interest rate risk on its non recourse loans by swapping these loans from floating to fixed rates. The profile of these interest rate swaps is as follows:

**At 31 December 2006**

Maturity	Notional amount	Payable GBP interest rate	Receivable GBP interest rate
	£m	%	%
June 2015	23.4	7.3	LIBOR
	23.4		

## 26 (b) Interest rate risk management (continued)

At 31 December 2005

Maturity	Notional amount £m	Payable GBP interest rate %	Receivable GBP interest rate %
June 2010	5.3	6.2	LIBOR
February 2011	45.8	5.5	LIBOR
June 2014	19.2	8.7	LIBOR
June 2015	23.4	7.3	LIBOR
December 2015	22.3	6.7	LIBOR
December 2017	59.8	6.8	LIBOR
February 2023	86.0	5.6	LIBOR
	261.8		

Apart from a small portion of one interest rate swap, all swaps are designated and highly effective as cash flow hedges and the fair value thereof has been deferred in equity. An amount of £3.8m (2005 – £4.0m) has been offset against hedged interest payments made in the period.

## 27. Retirement benefit schemes

The Group has accounted for pensions in accordance with IAS 19 'Employee Benefits'. The Group operates and is a member of a number of defined benefit schemes and defined contribution schemes. The pension charge for the year ended 31 December 2006, including the proportionate share of joint ventures, was £64.7m (2005 – £55.6m).

### 27 (a) Defined benefit schemes

The Group operates defined benefit schemes for qualifying employees of its subsidiaries in the UK, Asia Pacific region and Europe. In addition, the Group has interests in joint ventures, which operate defined benefit schemes for qualifying employees.

The assets of the funded plans are held independently of the Group's assets in separate trustee administered funds. The Group's major plans are valued by independent actuaries annually using the projected unit credit method. This reflects service rendered by employees to the dates of valuation and incorporates actuarial assumptions primarily regarding discount rates used in determining the present value of benefits, projected rates of salary growth, and long-term expected rates of return for plan assets. Discount rates are based on the market yields of high-quality corporate bonds in the country concerned. Long-term expected rates of return for plan assets are based on published brokers' forecasts for each category of scheme assets. Pension assets and liabilities in different defined benefit schemes are not offset unless the Group has a legally enforceable right to use the surplus in one plan to settle obligations in the other plan and intends to exercise this right.

The amounts recognised in the consolidated balance sheet are grouped together as follows:

#### **Contract specific – Virtually certain costs reimbursed**

The Group has an obligation to contribute to the pension scheme over the term of the contract. At rebid any deficit or surplus would transfer to the next contractor. Throughout the contract, it is virtually certain that the Group will be reimbursed the expenditure required to settle the defined benefit obligation. The Group's share of the defined benefit obligation less its share of the fair value of scheme assets that it will fund over the period of the contract has been recognised as a liability. The Group has recognised the right to reimbursement as a separate asset.

In the consolidated income statement, the expense relating to this defined benefit plan has been presented net of the amount recognised for the reimbursement, resulting in a nil charge to the income statement.

## 27 (a) Defined benefit schemes (continued)

### **Contract specific – Not certain costs reimbursed**

These are pre-funded defined benefit schemes. The Group has obligations to contribute variable amounts to the pension schemes over the terms of the related contracts. At rebid any deficit or surplus would transfer to the next contractor. The Group has recognised as a liability the defined benefit obligation less the fair value of scheme assets that it will fund over the period of the contracts with corresponding amounts recognised as intangible assets at the start of the contracts. Subsequent actuarial gains and losses in relation to the Group's share of the pension obligations have been recognised in the consolidated statement of recognised income and expense (the SORIE). The intangible assets are amortised over the term of the contracts.

### **Non contract specific**

These consist of a pre-funded defined benefit scheme which does not relate to any specific contract (the funding policy is to contribute such variable amounts, on the advice of the actuary, as will achieve 100% funding on a projected salary basis); an unfunded defined benefit scheme and an unfunded hybrid scheme all of which do not relate to any specific contract. Any liabilities arising are recognised in full.



## 27 (a) Defined benefit schemes (continued)

The assets and liabilities of the schemes at 31 December are:

Year ended 31 December 2006	Virtually certain costs reimbursed £m	Not certain costs reimbursed £m	Non contract specific £m	Total £m
<b>Scheme assets at fair value</b>				
Equities	164.0	240.3	307.7	712.0
Bonds	38.6	32.8	104.1	175.5
Gilts	–	10.5	167.6	178.1
Property	13.4	23.4	12.4	49.2
Cash and other	4.3	15.8	27.6	47.7
Annuity policies	–	0.4	23.9	24.3
Fair value of scheme assets	220.3	323.2	643.3	1,186.8
Present value of scheme liabilities	(287.9)	(375.0)	(802.2)	(1,465.1)
Net amount recognised	(67.6)	(51.8)	(158.9)	(278.3)
Members' share of deficit	–	4.8	1.1	5.9
Franchise adjustment	–	23.1	–	23.1
<b>Net pension liability</b>	<b>(67.6)</b>	<b>(23.9)</b>	<b>(157.8)</b>	<b>(249.3)</b>
<b>Related assets at 31 December 2006</b>				
Intangible assets (note 14)	–	20.6	–	20.6
Trade and other receivables (note 19)	67.6	–	–	67.6
	67.6	20.6	–	88.2
<b>Year ended 31 December 2005</b>				
	Virtually certain costs reimbursed £m	Not certain costs reimbursed £m	Non contract specific £m	Total £m
<b>Scheme assets at fair value</b>				
Equities	153.2	177.3	291.7	622.2
Bonds	37.9	28.7	95.7	162.3
Gilts	–	5.5	130.7	136.2
Property	–	20.2	11.9	32.1
Cash and other	4.3	8.2	8.6	21.1
Annuity policies	–	–	18.8	18.8
Fair value of scheme assets	195.4	239.9	557.4	992.7
Present value of scheme liabilities	(280.3)	(307.7)	(759.1)	(1,347.1)
Net amount recognised	(84.9)	(67.8)	(201.7)	(354.4)
Members' share of deficit	–	14.2	1.3	15.5
Franchise adjustment	–	32.3	–	32.3
<b>Net pension liability</b>	<b>(84.9)</b>	<b>(21.3)</b>	<b>(200.4)</b>	<b>(306.6)</b>
<b>Related assets at 31 December 2005</b>				
Intangible assets (note 14)	–	19.0	–	19.0
Trade and other receivables (note 19)	84.9	–	–	84.9
	84.9	19.0	–	103.9

Liabilities in relation to unfunded schemes included above amount to £36.2m (2005 – £37.6m).

**27 (a) Defined benefit schemes (continued)**

In some schemes, employee contributions vary over time to meet a specified proportion of the overall costs, including a proportion of any deficit. The liabilities recognised in the balance sheet for these schemes are net of the proportion attributed to employees. In addition, the amounts charged to the consolidated income statement for these schemes are net of the proportion attributed to employees. The amounts attributed to employees are shown separately in the reconciliation of changes in the fair value of scheme assets and liabilities.

The amounts recognised in the financial statements for the year are analysed as follows:

Year ended 31 December 2006	Virtually certain costs reimbursed £m	Not certain costs reimbursed £m	Non contract specific £m	Total £m
<b>Recognised in the consolidated income statement</b>				
Current service cost – employer	9.4	13.3	20.8	43.5
Past service cost	–	–	1.3	1.3
Reimbursed to employer	(9.4)	–	–	(9.4)
<b>Recognised in arriving at operating profit</b>	–	13.3	22.1	35.4
Expected return on scheme assets – employer	(12.8)	(11.9)	(31.9)	(56.6)
Interest on franchise adjustment	–	(1.9)	–	(1.9)
Interest cost on scheme liabilities – employer	13.6	11.8	35.8	61.2
Reimbursed to employer	(0.8)	–	–	(0.8)
<b>Finance costs</b>	–	(2.0)	3.9	1.9
<b>Included within the SORIE</b>				
Actual return on scheme assets	21.2	37.7	49.8	108.7
Less: expected return on scheme assets	(12.8)	(17.2)	(32.9)	(62.9)
	8.4	20.5	16.9	45.8
Other actuarial gains and losses	10.2	15.0	7.9	33.1
<b>Actuarial gains and losses recognised in the SORIE</b>	18.6	35.5	24.8	78.9
Change in franchise adjustment	–	(24.1)	–	(24.1)
Change in members' share	–	(10.4)	(0.3)	(10.7)
Reimbursed to employer	(18.6)	–	–	(18.6)
<b>Actuarial losses on reimbursable rights</b>	(18.6)	(34.5)	(0.3)	(53.4)
<b>Total pension cost recognised in the SORIE</b>	–	1.0	24.5	25.5

Year ended 31 December 2005	Virtually certain costs reimbursed £m	Not certain costs reimbursed £m	Non contract specific £m	Total £m
<b>Recognised in the consolidated income statement</b>				
Current service cost – employer	7.9	10.3	17.3	35.5
Past service cost	–	–	2.0	2.0
Reimbursed to employer	(7.9)	–	–	(7.9)
<b>Recognised in arriving at operating profit</b>	–	10.3	19.3	29.6
Expected return on scheme assets – employer	(10.7)	(8.8)	(27.4)	(46.9)
Interest on franchise adjustment	–	(1.3)	–	(1.3)
Interest cost on scheme liabilities – employer	11.6	9.3	32.9	53.8
Reimbursed to employer	(0.9)	–	–	(0.9)
<b>Finance costs</b>	–	(0.8)	5.5	4.7
<b>Included within the SORIE</b>				
Actual return on scheme assets	32.8	42.9	79.8	155.5
Less: expected return on scheme assets	(10.7)	(13.4)	(28.4)	(52.5)
	22.1	29.5	51.4	103.0
Other actuarial gains and losses	(48.5)	(38.3)	(74.6)	(161.4)
<b>Actuarial gains and losses recognised in the SORIE</b>	(26.4)	(8.8)	(23.2)	(58.4)
Change in franchise adjustment	–	8.4	–	8.4
Change in members' share	–	1.3	(0.5)	0.8
Reimbursed to employer	26.4	–	–	26.4
<b>Actuarial gains and losses on reimbursable rights</b>	26.4	9.7	(0.5)	35.6
<b>Total pension cost recognised in the SORIE</b>	–	0.9	(23.7)	(22.8)

Cumulative actuarial losses recognised in equity since 1 January 2004 are £13.7m (2005 – £39.2m).

## 27 (a) Defined benefit schemes (continued)

Changes in the fair value of plan liabilities are analysed as follows:

	Virtually certain costs reimbursed £m	Not certain costs reimbursed £m	Non contract specific £m	Total £m
<b>At 1 January 2005</b>	215.6	249.9	590.0	1,055.5
Arising on acquisition	–	–	57.8	57.8
Current service cost – employer	7.9	10.3	17.3	35.5
Current service cost – employee	–	4.7	0.5	5.2
Past service cost	–	–	2.0	2.0
Plan participants contributions	0.7	0.2	4.8	5.7
Interest cost – employer	11.6	9.3	32.9	53.8
Interest cost – employee	–	4.1	0.8	4.9
Benefits paid	(4.0)	(9.1)	(20.6)	(33.7)
Actuarial gains and losses	48.5	38.3	74.6	161.4
Foreign currency differences	–	–	(1.0)	(1.0)
<b>At 31 December 2005</b>	<b>280.3</b>	<b>307.7</b>	<b>759.1</b>	<b>1,347.1</b>
Arising on contract award	–	54.2	7.9	62.1
Current service cost – employer	9.4	13.3	20.8	43.5
Current service cost – employee	–	5.7	0.6	6.3
Past service cost	–	–	1.3	1.3
Plan participants contributions	0.8	0.6	5.0	6.4
Interest cost – employer	13.6	11.8	35.8	61.2
Interest cost – employee	–	4.6	0.9	5.5
Benefits paid	(6.0)	(7.9)	(20.6)	(34.5)
Actuarial gains and losses	(10.2)	(15.0)	(7.9)	(33.1)
Foreign currency differences	–	–	(0.7)	(0.7)
<b>At 31 December 2006</b>	<b>287.9</b>	<b>375.0</b>	<b>802.2</b>	<b>1,465.1</b>

Changes in the fair value of plan assets are analysed as follows:

	Virtually certain costs reimbursed £m	Not certain costs reimbursed £m	Non contract specific £m	Total £m
<b>At 1 January 2005</b>	159.6	193.3	423.6	776.5
Arising on acquisition	–	–	46.3	46.3
Expected return on plan assets – employer	10.7	8.8	27.4	46.9
Expected return on plan assets – employee	–	4.6	1.0	5.6
Employer contributions	6.3	9.6	22.4	38.3
Contributions by employees	0.7	3.2	5.0	8.9
Benefits paid	(4.0)	(9.1)	(19.7)	(32.8)
Actuarial gains and losses	22.1	29.5	51.4	103.0
<b>At 31 December 2005</b>	<b>195.4</b>	<b>239.9</b>	<b>557.4</b>	<b>992.7</b>
Arising on contract award	–	36.9	8.8	45.7
Expected return on plan assets – employer	12.8	11.9	31.9	56.6
Expected return on plan assets – employee	–	5.3	1.0	6.3
Employer contributions	8.9	12.0	41.3	62.2
Contributions by employees	0.8	4.6	5.5	10.9
Benefits paid	(6.0)	(7.9)	(19.5)	(33.4)
Actuarial gains and losses	8.4	20.5	16.9	45.8
<b>At 31 December 2006</b>	<b>220.3</b>	<b>323.2</b>	<b>643.3</b>	<b>1,186.8</b>

Employer contributions for non contract specific schemes in 2006 include £19.0m of special contribution paid in December 2006. A further £51.0m was paid in January 2007.

No assets are invested in the Group's own financial instruments, properties or other assets used by the Group.

**27 (a) Defined benefit schemes (continued)****History of experience gains and losses**

	2006	2005	2004
<b>Experience adjustments arising on scheme assets:</b>			
Amount (£m)	45.8	103.6	10.2
Percentage of scheme assets	4%	10%	1%
<b>Experience adjustments arising on scheme liabilities:</b>			
Amount (£m)	(13.1)	11.8	6.4
Percentage of the present value of the scheme liabilities	(1)%	1%	1%
Fair value of scheme assets (£m)	1,186.8	992.7	776.5
Present value of scheme liabilities (£m)	(1,465.1)	(1,347.1)	(1,055.5)
<b>Deficit (£m)</b>	<b>(278.3)</b>	<b>(354.4)</b>	<b>(279.0)</b>

The normal contributions expected to be paid during the financial year ended 31 December 2007 are £53.3m. In addition, a special contribution of £51.0m will be paid in January 2007 into the Group's main UK defined benefit scheme.

	2006	2005
	%	%
<b>Main assumptions:</b>		
Rate of salary increases	3.00 – 4.40	3.20 – 4.20
Rate of increase in pensions in payment	2.90	2.70
Rate of increase in deferred pensions	2.90	2.70
Inflation assumption	2.90	2.70
Discount rate	5.20	4.80
Expected rates of return on scheme assets:		
Equities	7.95	7.00
Bonds	5.20	4.80
Gilts	4.50	4.10
Property	5.75	5.35
Cash and other	5.00	4.50
Annuity policies	5.20	4.80
	2006	2005
	Years	Years
<b>Post-retirement mortality:</b>		
Current pensioners at 65 – male	20.2	18.7
Current pensioners at 65 – female	23.0	21.7
Future pensioners at 65 – male	21.5	21.3
Future pensioners at 65 – female	24.3	24.2

For some of the smaller schemes, allowance for expected future improvements in life expectancy has been made by reducing the discount rate by 0.2% per annum from the rate shown above.

**27 (b) Defined contribution schemes**

The Group paid employer contributions of £20.4m (2005 – £19.7m) into UK and other defined contribution schemes, foreign state pension schemes and multi-employer schemes, including those of joint ventures.

**Pre-funded defined benefit schemes treated as defined contribution**

Serco accounts for certain pre-funded defined benefit schemes relating to contracts as defined contribution schemes because the contributions are fixed until the end of the current concession and at rebid any surplus or deficit would transfer to the next contractor. Cash contributions are recognised as pension costs and no asset or liability is shown on the balance sheet.

## 28. Provisions

	Employee related £m	Other £m	Total 2006 £m	Employee related £m	Other £m	Total 2005 £m
<b>At 1 January</b>	<b>7.7</b>	<b>18.6</b>	<b>26.3</b>	6.0	–	6.0
Reclassification from creditors	0.7	–	0.7	1.1	0.1	1.2
Arising from acquisitions	–	–	–	–	23.8	23.8
Charged to income statement	2.6	4.7	7.3	1.1	2.1	3.2
Released to income statement	(2.0)	(1.8)	(3.8)	–	–	–
Utilised during the year	(1.5)	(6.5)	(8.0)	(0.5)	(7.4)	(7.9)
Exchange differences	(0.2)	–	(0.2)	–	–	–
<b>At 31 December</b>	<b>7.3</b>	<b>15.0</b>	<b>22.3</b>	7.7	18.6	26.3

Employee related provisions relate to long-term service awards and terminal gratuities liabilities which have been accrued and are based on contractual entitlement together with an estimate of the probabilities that employees will stay until retirement and receive all relevant amounts.

Other provisions include amounts relating to property, contracts and restructuring.

## 29. Share capital

	2006		2005	
	£m	Number millions	£m	Number millions
<b>Authorised:</b>				
550,000,000 (2005 – 550,000,000) ordinary shares of 2p each	11.0	550.0	11.0	550.0
<b>Issued and fully paid:</b>				
468,231,512 (2005 – 435,352,903) ordinary shares of 2p each at 1 January	9.4	468.2	8.7	435.4
Issued as consideration for acquisitions during the year	–	–	0.6	30.4
Issued on the exercise of share options	0.1	8.1	0.1	2.4
<b>476,295,589 (2005 – 468,231,512) ordinary shares of 2p each at 31 December</b>	<b>9.5</b>	<b>476.3</b>	9.4	468.2

The Company has one class of ordinary shares which carry no right to fixed income.

During the year 8,064,077 (2005 – 2,522,336) ordinary shares of 2p each were allotted to the holders of options or their personal representatives using newly listed shares.

## 30. Share premium account

	2006 £m	2005 £m
<b>At 1 January</b>	<b>269.5</b>	191.5
Premium on shares issued	14.0	78.0
<b>At 31 December</b>	<b>283.5</b>	269.5



### 31. Reserves

#### Retained earnings

	2006 £m	2005 £m
<b>At 1 January</b>	<b>132.8</b>	101.4
Dividends paid	(14.5)	(12.5)
Profit for the year attributable to equity holders of the parent	78.3	53.4
Tax charge on items taken directly to equity	–	*(9.5)
<b>At 31 December</b>	<b>196.6</b>	132.8

#### Other reserves

	Retirement benefit obligations reserve £m	Share-based payment reserve £m	Own shares reserve £m	Hedging and translation reserve £m	Total £m
<b>At 1 January 2005</b>	(124.4)	6.2	(16.4)	(26.7)	(161.3)
Net actuarial loss on defined benefit pension schemes	(58.4)	–	–	–	(58.4)
Actuarial gain on reimbursable rights	35.6	–	–	–	35.6
Credit in relation to share-based payment expense	–	5.7	–	–	5.7
Net exchange gain on translation of foreign operations	–	–	–	6.9	6.9
Fair value gain on cash flow hedges during the year	–	–	–	6.1	6.1
Tax charge on cash flow hedges	–	–	–	(1.4)	*(1.4)
Tax credit on items taken directly to equity	8.2	4.7	–	–	*12.9
<b>At 31 December 2005</b>	(139.0)	16.6	(16.4)	(15.1)	(153.9)
<b>At 1 January 2006</b>	(139.0)	16.6	(16.4)	(15.1)	(153.9)
Net actuarial gain on defined benefit pension schemes	78.9	–	–	–	78.9
Actuarial loss on reimbursable rights	(53.4)	–	–	–	(53.4)
Credit in relation to share-based payment expense	–	4.8	–	–	4.8
Net exchange loss on translation of foreign operations	–	–	–	(12.3)	(12.3)
Amounts transferred to income statement in relation to sale of PFI investments (note 15)	–	–	–	9.0	9.0
Fair value gain on cash flow hedges during the year	–	–	–	2.2	2.2
Tax charge on cash flow hedges	–	–	–	(5.0)	*(5.0)
Tax (charge)/credit on items taken directly to equity	(6.0)	4.1	–	(0.1)	*(2.0)
<b>At 31 December 2006</b>	(119.5)	25.5	(16.4)	(21.3)	(131.7)

\* In 2006 these amounts represent £7.0m of tax charge taken directly to equity in the SORIE (2005 – these amounts, including £(9.5)m in retained earnings, represent £2.0m of tax credit taken directly to equity in the SORIE).

The retirement benefit obligations reserve represents the actuarial gains and losses recognised in respect of annual actuarial valuations for defined benefit pension schemes, the fair value adjustments on reimbursable rights and the related movements in deferred tax balances.

The share-based payment reserve represents credits relating to equity-settled share-based payment transactions granted after 7 November 2002.

The own shares reserve represents the cost of shares in Serco Group plc purchased in the market and held by the Serco Group plc Employee Share Ownership Trust (ESOP) to satisfy options under the Group's share options schemes. At 31 December 2006, the ESOP held 5,250,152 (2005 – 5,250,152) shares equal to 1.1% of the current allotted share capital (2005 – 1.1%). The market value of shares held by the ESOP as at 31 December 2006 was £20,055,581 (2005 – £16,498,603).

The hedging and translation reserve represents foreign exchange differences arising on translation of the Group's overseas operations and movements relating to cash flow hedges.

## 32. Notes to the consolidated cash flow statement

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

	2006 £m	2005 £m
<b>Operating profit for the year</b>	<b>125.2</b>	97.1
Adjustments for:		
Share-based payment expense	4.8	5.7
Depreciation of property, plant and equipment	30.0	30.3
Amortisation of intangible assets	16.2	13.6
Loss on disposal of property, plant and equipment	1.1	0.4
Loss on disposal of intangible assets	–	0.1
Gain on sale of PFI investments	(11.4)	–
<b>Operating cash inflow before movements in working capital</b>	<b>165.9</b>	147.2
Increase in inventories	(13.9)	(1.9)
Decrease/(increase) in receivables	10.7	(47.2)
Increase in payables	21.8	51.0
Movement in provisions	(4.5)	(6.4)
Special contribution to defined benefit pension scheme (note 27)	(19.0)	–
<b>Cash generated by operations before PFI asset expenditure</b>	<b>161.0</b>	142.7
Movement on PFI debtor	17.4	15.3
Expenditure on PFI assets in the course of construction	–	(7.8)
<b>Cash generated by operations after PFI asset expenditure</b>	<b>178.4</b>	150.2
Tax paid	(18.9)	(9.4)
<b>Net cash inflow from operating activities</b>	<b>159.5</b>	140.8

Additions to fixtures and equipment during the year amounting to £2.3 million (2005 – £5.6 million) were financed by new finance leases.

### Analysis of net debt

	At 1		Disposals	Exchange differences	Non cash movements	At 31	
	January	Cash flow				December	December
	2006	£m	£m	£m	£m	2006	£m
Cash and cash equivalents	240.7	(36.4)	18.2	(4.6)	–	217.9	217.9
Non recourse loans (related to PFI assets)	(278.2)	19.7	242.3	–	(8.6)	(24.8)	(24.8)
Other non recourse loans	(71.0)	5.6	–	5.6	22.4	(37.4)	(37.4)
Other loans	(460.3)	94.0	–	18.1	6.4	(341.8)	(341.8)
Obligations under finance leases	(26.4)	8.6	–	0.3	(2.3)	(19.8)	(19.8)
	(595.2)	91.5	260.5	19.4	17.9	(205.9)	(205.9)

	At 1		Acquisitions/ Disposals	Exchange differences	Non cash movements	At 31	
	January	Cash flow				December	December
	2005	£m	£m	£m	£m	2005	£m
Cash and cash equivalents	200.5	32.5	5.0	2.7	–	240.7	240.7
Non recourse loans (related to PFI assets)	(256.0)	20.5	(43.1)	–	0.4	(278.2)	(278.2)
Other non recourse loans	(47.6)	1.0	–	(6.9)	(17.5)	(71.0)	(71.0)
Other loans	(194.1)	(266.2)	(4.0)	(12.2)	16.2	(460.3)	(460.3)
Obligations under finance leases	(26.3)	8.4	(5.8)	(0.2)	(2.5)	(26.4)	(26.4)
	(323.5)	(203.8)	(47.9)	(16.6)	(3.4)	(595.2)	(595.2)

Non cash movements in 2006 primarily relate to a joint venture non recourse debt. Certain terms of this debt were renegotiated in 2006 and this allows us to offset a related debtor and the non recourse debt in our accounts, thereby reflecting the economic reality of the contract.

Non cash movements in 2005 primarily relate to fixed assets acquired under finance leases.

### 33. Capital and other commitments

	2006 £m	2005 £m
Capital expenditure contracted but not provided	<b>1.6</b>	3.8

At the balance sheet date, the Group had outstanding commitments for future minimum lease payments under non-cancellable operating leases, which fall due as follows:

	2006 £m	2005 £m
Within one year	<b>90.3</b>	83.5
Between one and five years	<b>250.7</b>	251.9
After five years	<b>173.1</b>	211.9
	<b>514.1</b>	547.3

Future minimum rentals receivable under non-cancellable operating leases where the Group is the lessor are as follows:

	2006 £m	2005 £m
Within one year	<b>0.2</b>	0.2
Between one and five years	<b>0.6</b>	0.6
After five years	<b>0.3</b>	0.5
	<b>1.1</b>	1.3

A special contribution of £51.0m was paid in January 2007 into the Group's main UK defined benefit pension scheme (see note 27).

### 34. Share-based payment expense

The Group recognised the following expenses related to equity-settled share-based payment transactions:

	2006 £m	2005 £m
Executive Option Plan	1.7	2.7
Long Term Incentive Scheme and Plan	1.5	0.8
Sharesave 2004	1.6	2.2
	<b>4.8</b>	<b>5.7</b>

#### Executive Option Plan (the 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 eligible employees are based on between 50% and 100% of salary as at 31 December prior to grant. If the options remain unexercised after a period of 10 years from the date of grant, the options expire. Furthermore, options may be forfeited if the eligible employee leaves the group before the options vest. Details of the movement in all EOP options are as follows:

	2006		2005	
	Number of options '000	Weighted average exercise price £	Number of options '000	Weighted average exercise price £
<b>Outstanding at 1 January</b>	<b>24,695</b>	<b>2.22</b>	29,457	2.22
Granted during the year	565	3.39	927	2.35
Exercised during the year	(7,554)	1.83	(2,446)	1.78
Lapsed during the year	(1,176)	2.31	(3,243)	2.59
<b>Outstanding at 31 December</b>	<b>16,530</b>	<b>2.42</b>	24,695	2.22

13,577,169 (2005 – 12,561,936) of these options were exercisable at the end of the year.

The options outstanding at 31 December 2006 had a weighted average remaining vesting life of 0.92 years (2005 – 0.62 years) and a weighted average contractual life of 5.55 years (2005 – 6.47 years).

The fair value of options granted under the EOP is measured by use of the Binomial lattice model. The Binomial lattice model is considered to be most appropriate for valuing options granted under this scheme as it allows exercise over a longer period of time between the vesting date and the expiry date.

The inputs into the Binomial lattice model for options granted during the year are:

	2006	2005
Weighted average share price	304p	260p
Weighted average exercise price	339p	167p
Expected volatility	39.8%	45.5% to 46.6%
Expected life	5 years	5 years
Risk free rate	4.8%	4.0% to 4.9%
Expected dividends	0.8%	1.1% to 1.5%

Expected volatility was determined by calculating the historical volatility of the Group's share price over the previous five years. The expected life used in the model has been adjusted, based on management's best estimate, for the effects of non-transferability, exercise restrictions, and behavioural considerations.

**34. Share-based payment expense (continued)****Long Term Incentive Scheme (the LTIS) and Long Term Incentive Plan (the LTIP)**

Awards made to eligible employees under the above schemes are structured as options with a zero exercise price and may be exercised after the third anniversary of grant. The extent to which an award vests (and therefore becomes exercisable) is measured by reference to the growth in the Company's earnings per share or Total Shareholder Return over the performance period of three financial years.

If the options remain unexercised after a period of 10 years from the date of grant, the options expire. Furthermore, options may be forfeited if the eligible employee leaves the group before the options vest. Details of the movement in all LTIS and LTIP options are as follows:

	2006		2005	
	Number of options '000	Weighted average exercise price £	Number of options '000	Weighted average exercise price £
<b>Outstanding at 1 January</b>	<b>2,578</b>	<b>Nil</b>	2,386	Nil
Granted during the year	2,475	Nil	314	Nil
Exercised during the year	(335)	Nil	–	Nil
Lapsed during the year	(678)	Nil	(122)	Nil
<b>Outstanding at 31 December</b>	<b>4,040</b>	<b>Nil</b>	2,578	Nil

1,051,758 (2005 – 372,430) of these options were exercisable at the end of the year.

The options outstanding at 31 December 2006 had a weighted average contractual life of 8.35 years (2005 – 7.78 years).

The fair value of options granted under the LTIS and LTIP is measured by use of a Monte Carlo Simulation model. This model is considered to be most appropriate for valuing options granted under these schemes as it takes into account the changes in performance conditions by which the options are measured.

The inputs into the Monte Carlo Simulation model for options granted during the year are:

	2006	2005
Weighted average share price	314p	260p
Weighted average exercise price	Nil	Nil
Expected volatility	23.6% to 27.0%	41.8% to 51.0%
Expected life	3 years	3 years
Risk free rate	4.8% to 5.0%	3.8% to 4.8%
Expected dividends	0.8%	1.0% to 1.5%

Expected volatility was determined by calculating the historical volatility of the Group's share price over the previous three years. The expected life used in the model has been adjusted, based on management's best estimate, for the effects of non-transferability, exercise restrictions, and behavioural considerations.



### 34. Share-based payment expense (continued)

#### Sharesave 2004

The Sharesave 2004 scheme provides for a purchase price equal to the daily average market price on the date of grant less 20%. The options can be exercised for a period of six months following their vesting. Details of the movement in Sharesave 2004 options are as follows:

	2006		2005	
	Number of options '000	Weighted average exercise price £	Number of options '000	Weighted average exercise price £
<b>Outstanding at 1 January</b>	<b>7,057</b>	<b>1.72</b>	7,793	1.72
Exercised during the year	(175)	1.72	(76)	1.72
Lapsed during the year	(608)	1.72	(660)	1.72
<b>Outstanding at 31 December</b>	<b>6,274</b>	<b>1.72</b>	7,057	1.72

The options outstanding at 31 December 2006 had a weighted average contractual life of 0.80 years (2005 – 1.80 years). Options were valued using the Black Scholes model as this model reflects the fact that the options are exercisable only for a short period of six months following their vesting. An expected life of three years and three months is the mid point between the vesting and expiry dates. The model used the following assumptions when the options were granted in 2004:

Weighted average share price	<b>260p</b>
Weighted average exercise price	<b>172p</b>
Expected volatility	<b>47.6%</b>
Expected life	<b>3.25 years</b>
Risk free rate	<b>4.7%</b>
Expected dividends	<b>1.1%</b>

Expected volatility was determined by calculating the historical volatility of the Group's share price over the previous three years. The expected life used in the model has been adjusted, based on management's best estimate, for the effects of non-transferability, exercise restrictions, and behavioural considerations.

### 35. Related party transactions

Transactions between the Company and its wholly owned subsidiaries, which are related parties, have been eliminated on consolidation and are not disclosed in this note. Transactions between the Group and its joint venture undertakings are disclosed below, with the relevant proportion being eliminated on consolidation. Transactions between the Company and its subsidiaries and joint ventures are disclosed in the Company's separate financial statements.

#### Trading transactions

During the year, Group companies entered into the following material transactions with joint ventures:

	2006 £m	2005 £m
Sales of goods and services	0.9	2.2
Royalties and management fees receivable	1.0	1.0
Dividends receivable	29.5	25.7
	<b>31.4</b>	<b>28.9</b>

The following receivable balances relating to joint ventures were included in the consolidated balance sheet:

	2006 £m	2005 £m
<b>Current:</b>		
Loans	2.5	3.5
Royalties and management fees	–	2.1
	<b>2.5</b>	<b>5.6</b>

	2006 £m	2005 £m
<b>Non-current:</b>		
Loans	0.1	0.9
	<b>0.1</b>	<b>0.9</b>

The following payable balances relating to joint ventures were included in the consolidated balance sheet:

	2006 £m	2005 £m
<b>Current:</b>		
Loans	–	5.4
	<b>–</b>	<b>5.4</b>

The amounts outstanding are unsecured and will be settled in cash. No guarantees have been given or received. No provisions have been made for doubtful debts in respect of the amounts owed by related parties.

#### Remuneration of key management personnel

The Directors of Serco Group plc had no material transactions with the Group during the year other than service contracts and Directors' liability insurance.

The remuneration of the Executive Team (including Executive Directors), who are the key management personnel of the Group, is set out below in aggregate for each of the categories specified in IAS 24 'Related Party Disclosures':

	2006 £m	2005 £m
Short-term employee benefits	*3.9	3.0
Post-employment benefits	0.5	0.7
Share-based payment expense	1.7	1.5
	<b>6.1</b>	<b>5.2</b>

\* The short-term employee benefits include performance bonuses earned under the period under review, but not paid in the financial year.

### 36. List of principal undertakings

The companies listed below are, in the opinion of the Directors, the principal undertakings of Serco Group plc as at 31 December 2006. 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		2006	2005
<b>United Kingdom</b>			
	Serco Limited	100%	100%
	Serco-Denholm Limited	90%	90%
	Serco-IAL Limited	100%	100%
	Serco Railtest Limited	100%	100%
	NPL Management Limited	100%	100%
	Serco Leisure Operating Limited	100%	100%
	Healthcare Services 24 Limited	100%	100%
	Serco Regional Services Limited	100%	100%
	Serco Manchester Leisure Limited	100%	100%
	Serco Geografix Limited	100%	100%
	Premier Prison Services Limited	100%	100%
	Kilmarnock Prison Services Limited	100%	100%
<b>Europe and Middle East</b>			
Belgium	Serco Belgium SA	100%	100%
Denmark	Metro Service A/S	100%	100%
France	Serco France Sarl	100%	100%
	Serco France SAS	100%	100%
Germany	Serco GmbH	100%	100%
Ireland	Serco Services Ireland Limited	100%	100%
	CCM Software Services Limited	100%	100%
Italy	Serco SpA	100%	100%
Luxembourg	Serco Facilities Management SA	100%	100%
The Netherlands	Serco Facilities Management BV	100%	100%
Spain	Serco Gestion de Negocias SL	100%	100%
Switzerland	Serco Facilities Management SA	100%	100%
<b>Asia Pacific</b>			
Australia	Serco Australia Pty Limited	100%	100%
	Great Southern Railway Pty Limited	100%	100%
	Serco MAPS Pty Ltd	100%	100%
China	Serco Group Consultants (Shanghai) Limited	100%	100%
Hong Kong	Serco Group (Hong Kong) Limited	100%	100%
<b>North America</b>			
Canada	Serco Facilities Management Inc.	100%	100%
	Serco DES Inc.	100%	100%
USA	Serco Inc.	100%	100%
	Serco Management Services Inc. (Delaware)	100%	100%
	Serco Management Services Inc. (Tennessee)	100%	100%

**36. List of principal undertakings (continued)**

<b>Joint venture undertakings</b>		<b>2006</b>	<b>2005</b>
<b>United Kingdom</b>			
	Serco Gulf Engineering Limited	<b>50%</b>	50%
	AWE Management Limited	<b>33%</b>	33%
	Merseyrail Electrics 2002 Limited	<b>50%</b>	50%
	Northern Rail Limited	<b>50%</b>	50%
<b>Asia Pacific</b>			
<b>Australia</b>			
	Defence Maritime Services Pty Limited	<b>50%</b>	50%
	Serco Sodexho Defence Services Pty Limited	<b>50%</b>	50%
<b>UAE</b>			
<b>Dubai</b>			
	International Aeradio (Emirates) LLC	<b>49%</b>	49%
<b>Abu Dhabi</b>			
	International Aeradio (Emirates) LLC	<b>49%</b>	49%
<b>Other</b>			
<b>Bahrain</b>			
	Aeradio Technical Services WLL	<b>49%</b>	49%
<b>Singapore</b>			
	Serco Guthrie Pte Ltd	<b>50%</b>	50%
<b>South Africa</b>			
	Equity Aviation Services Limited	<b>50%</b>	50%

All joint ventures are accounted for using the proportionate consolidation method. All the subsidiaries of the Group have been consolidated. At 31 December 2006, Group companies had branches in UAE, Bahrain, Korea and Gibraltar.

All the principal subsidiaries of Serco Group plc and its joint venture undertakings are engaged in the provision of support services.

**37. Contingent liabilities**

The Company has guaranteed overdrafts, finance leases, and bonding facilities of its joint ventures up to a maximum value of £3.8m (2005 – £4.1m). The actual commitment outstanding at 31 December 2006 was £1.6m (2005 – £1.2m).

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

Further details of the contingent liabilities of Serco Group plc are contained in note 16 to the Serco Group plc company financial statements.

## Directors' Responsibilities – Company Financial Statements

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 as at the end of the financial year and of the profit and loss of the Company 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 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 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 by:



**Joanne Roberts**  
Secretary

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

28 February 2007



# Independent Auditors' Report – Company Financial Statements



## Independent Auditors' Report to the members of Serco Group plc

We have audited the parent company financial statements of Serco Group plc for the year ended 31 December 2006 which comprise the balance sheet and the related notes 1 to 17. These parent company financial statements have been prepared under the accounting policies set out therein.

We have reported separately on the group financial statements of Serco Group plc for the year ended 31 December 2006 and on the information in 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

The Directors' responsibilities for preparing the Annual Review and Accounts, the Directors' Remuneration Report and the parent company financial statements in accordance with applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice) are set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the parent company financial statements and the part of the Directors' Remuneration Report to be audited in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland). We report to you our opinion as to whether the parent company financial statements give a true and fair view and whether the parent company financial statements have been properly prepared in accordance with the Companies Act 1985. We also report to you whether in our opinion the Directors' Report is consistent with the parent company financial statements.

In addition we report to you if, in our opinion, 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 other transactions is not disclosed.

We read the other information contained in the Annual Review and Accounts as described in the contents section and consider whether it is consistent with the audited parent company financial statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the parent company financial statements. Our responsibilities do not extend to any further information outside the Annual Review and Accounts.

## Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the parent company financial statements. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the parent company financial statements, and of whether the accounting policies are appropriate to the company's circumstances, 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 parent company financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the parent company financial statements.

## Opinion

### In our opinion:

- the parent company financial statements give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the company's affairs as at 31 December 2006;
- the parent company financial statements have been properly prepared in accordance with the Companies Act 1985; and
- the information given in the Directors' Report is consistent with the parent company financial statements.

*Deloitte & Touche LLP*

### **Deloitte & Touche LLP**

Chartered Accountants and Registered Auditors  
London

28 February 2007

# Company Balance Sheet

At 31 December 2006



Company Financial  
Statements

	Note	2006 £m	2005 restated £m
<b>Fixed assets</b>			
Intangible assets	4	–	10.9
Tangible assets	5	–	4.5
Investments in subsidiary undertakings	6	596.2	758.2
		<b>596.2</b>	<b>773.6</b>
<b>Current assets</b>			
Amounts owed by subsidiary companies due after more than one year		185.1	16.0
Debtors: amounts due within one year	7	58.5	50.5
Debtors: amounts due after more than one year	7	9.6	4.4
Cash at bank and in hand		113.3	21.1
		<b>366.5</b>	<b>92.0</b>
<b>Creditors: amounts falling due within one year</b>			
Loans	9	(39.2)	–
Amounts owed to subsidiary companies		(2.7)	–
Trade creditors		(0.1)	(0.6)
Other creditors including taxation and social security	8	(2.0)	(6.2)
Financial instruments	10	(9.1)	(0.5)
Accruals and deferred income		(17.0)	(17.0)
		<b>(70.1)</b>	<b>(24.3)</b>
<b>Net current assets</b>		<b>296.4</b>	<b>67.7</b>
<b>Total assets less current liabilities</b>			
		<b>892.6</b>	<b>841.3</b>
Creditors: amounts falling due after more than one year	9	(280.8)	(440.3)
Amounts owed to subsidiary companies		(183.1)	–
Financial instruments	10	(10.9)	(10.5)
<b>Net assets</b>		<b>417.8</b>	<b>390.5</b>
<b>Capital and reserves</b>			
Called up share capital	11	9.5	9.4
Share premium account	12	283.5	269.5
Capital redemption reserve		0.1	0.1
Share-based payment reserve	13	16.8	12.5
Hedging and translation reserve	14	(9.5)	(6.0)
Profit and loss account	15	117.4	105.0
<b>Equity shareholders' funds</b>		<b>417.8</b>	<b>390.5</b>

The financial statements were approved by the Board of Directors on 28 February 2007 and signed on its behalf by:



**Kevin Beeston**  
Executive Chairman



**Andrew Jenner**  
Finance Director

# Notes to the Company Financial Statements

## I. Accounting policies

The principal accounting policies adopted are set out below and have been applied consistently throughout the current and preceding year, with the exception of FRS 20 as detailed in note 2.

### Basis of accounting

These financial statements have been prepared in accordance with UK GAAP and applicable UK law.

### Accounting convention

These accounts have been prepared under the historical cost convention.

### Changes to UK GAAP - impact on prior year comparatives

The Company has adopted the revisions to UK GAAP under FRS 20 'Share-based payment'. The impact of the revision to FRS 20 on the prior year comparatives is explained in note 2.

### Fixed asset investments

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

### Tangible fixed assets

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

Depreciation is provided on a straight-line basis at rates to reduce the assets to their residual value over their estimated useful lives.

The principal annual rates used are:

Short-leasehold building improvements	the higher of 10% or rate produced by the lease term
Machinery	15% – 20%
Furniture	10%
Office equipment	20% – 33%

### Share-based payment

The Company has applied the requirements of FRS 20 'Share-based payment'. In accordance with the transitional provisions, FRS 20 has been applied to all grants of equity instruments after 7 November 2002 that were not fully vested as of 1 January 2005.

The Company issues equity-settled share-based payments to certain employees and operates an Inland Revenue approved Save As You Earn share option scheme open to eligible employees which allows the purchase of shares at a discount. These are measured at fair value at the date of grant. The fair value is expensed on a straight-line basis over the vesting period, based on the Group's estimate of shares that will eventually vest, for employees of the Company. The fair value of options awarded to employees of subsidiaries is added to the cost of investment in the subsidiary on a straight-line basis over the vesting period.

Fair value is measured by use of the Black Scholes, Binomial lattice or Monte Carlo Simulation models depending on the type of scheme. The expected life used in the models has been adjusted, based on management's best estimate, for the effects of non-transferability, exercise restrictions, and behavioural considerations. Where relevant, the value of the option has also been adjusted to take account of market conditions applicable to the option.

### Derivative financial instruments and hedging activities

Derivatives are initially accounted for and measured at fair value on the date a derivative contract is entered into and subsequently measured at fair value. The gain or loss on re-measurement is taken to the profit and loss account except where the derivative is a designated cash flow hedging instrument. The accounting treatment of derivatives classified as hedges depends on their designation, which occurs on the date that the derivative contract is committed to. The Company designates derivatives as:

- a hedge of the fair value of an asset or liability (fair value hedge)
- a hedge of the income/cost of a highly probable forecast transaction or commitment (cash flow hedge)
- a hedge of net investment in a foreign entity

Gains and losses on fair value are recorded in the profit and loss account with the gain or loss on the hedged item attributable to the hedged risk.

### 1. Accounting policies (continued)

Gains or losses on cash flow hedges that are regarded as highly effective are recognised in equity. Where the forecast transaction results in a financial asset or liability, only gains or losses previously recognised in equity are reclassified to profit or loss in the same period as the asset or liability affects profit or loss. Where the forecast transaction or commitment results in a non-financial asset or liability, any gains or losses previously deferred in equity are included in the cost of the related asset or liability if the forecast transaction or commitment results in future income or expenditure. Gains and losses deferred in equity are transferred to the profit and loss account in the same period as the underlying income or expenditure. The ineffective portion of the gain or loss on the hedging instrument is recognised in the profit and loss account.

For the ineffective portion of hedges or transactions that are not designated for hedge accounting under FRS 26, any change in assets or liabilities is recognised immediately in the profit and loss account. Where a hedge no longer meets the effectiveness criteria, any gains or losses deferred in equity are only transferred to the profit and loss account when the committed or forecast transaction is recognised in the profit and loss account. However, where cash flow hedge accounting has been applied for a forecast or committed transaction that is no longer expected to occur, then the cumulative gain or loss that has been recorded in equity at that time remains in equity and is recognised when the forecast transaction is ultimately recognised in the profit and loss account.

Where the Company hedges net investments in foreign entities through currency borrowings, the gains or losses on the translation of the borrowings are recognised in equity. Gains and losses accumulated in equity are included in the profit and loss account when the foreign operation is disposed of.

#### Current tax

Current tax, including UK corporation tax, is provided at amounts expected to be paid (or recovered) using the tax rates and laws that have been enacted or substantially enacted at the balance sheet date.

#### Deferred tax

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

Deferred tax is recognised on a non-discounted basis using tax rates in force at the balance sheet date.

### 2. Prior year adjustment – change in accounting policy

The Company has adopted the revisions to FRS 20 'Share-based payment' from 1 January 2006. The revised standard requires that options over the Company's shares awarded to employees of the Company's subsidiaries are charged to the employing subsidiary and not, as previously, expensed to the profit and loss account of the parent. Charges booked to the profit and loss account in previous years for options awarded to employees of subsidiaries have been reversed and the carrying value of the investment held in the related subsidiary company has been increased by a corresponding amount.

The adoption of this revision has increased the reported profit for the year ended 31 December 2005 by £4.8m. In aggregate, the adoption of the revision has increased shareholders funds at 31 December 2005 by £7.0m (increase in cost of investment in subsidiaries £10.0m net of deferred tax £3.0m).

### 3. Auditors' remuneration

Auditors' remuneration of £10,000 (2005 - £10,000) and other charges from Deloitte & Touche LLP are borne by another group company.

#### 4. Intangible assets

	Software and development expenditure £m
<b>Cost</b>	
At 1 January 2006	10.9
Disposals	(10.9)
<b>At 31 December 2006</b>	–
<b>Amortisation</b>	
At 1 January and 31 December 2006	–
<b>Net book value</b>	
At 31 December 2006	–
At 31 December 2005	10.9

During the year, the Company sold its intangible assets at book value to a fellow group company.

#### 5. Tangible assets

	Short-leasehold building improvements £m	Machinery, furniture and equipment £m	Total £m
<b>Cost</b>			
At 1 January 2006	1.0	6.2	7.2
Additions	–	1.2	1.2
Disposals	(1.0)	(7.4)	(8.4)
<b>At 31 December 2006</b>	–	–	–
<b>Accumulated depreciation</b>			
At 1 January 2006	0.2	2.5	2.7
Charged for the year	0.1	0.8	0.9
Disposals	(0.3)	(3.3)	(3.6)
<b>At 31 December 2006</b>	–	–	–
<b>Net book value</b>			
At 31 December 2006	–	–	–
At 31 December 2005	0.8	3.7	4.5

During the year, the Company sold its tangible assets at book value to a fellow group company.

The cost of assets held by the Company under finance leases at 31 December 2006 was £nil (2005 – £0.8m). The accumulated depreciation provided for those assets at 31 December 2006 was £nil (2005 – £nil).



## 6. Investments held as fixed assets

	£m
<b>Shares in subsidiary companies at cost:</b>	
<b>At 1 January 2006 as previously reported</b>	748.2
Options over parent's shares awarded to employees of subsidiaries (note 2)	10.0
<b>At 1 January 2006 as restated</b>	758.2
Options over parent's shares awarded to employees of subsidiaries	3.6
Additions	85.9
Impairment of investments	(0.7)
Disposals	(250.8)
<b>At 31 December 2006</b>	596.2

During the year the Company disposed of its entire shareholdings in both ITNET Ltd and Serco Jersey Ltd to a fellow group company.

Full details of the principal subsidiaries of Serco Group plc can be found in note 36 to the Group's consolidated financial statements. The Company directly owns 100% of the ordinary share capital of the following entities except where stated:

Name	% ownership
Serco Holdings Limited	100%
Serco Investments Limited	100%
NPL Management Limited	100%
Serco Group (Hong Kong) Limited	50%

## 7. Debtors

	2006 £m	2005 restated £m
<b>Amounts due within one year:</b>		
Amounts recoverable on contracts	–	0.1
Amounts owed by subsidiary companies	21.3	13.5
Other debtors	–	10.1
Financial instruments (note 10)	–	0.5
Corporation tax recoverable	37.2	26.3
	<b>58.5</b>	<b>50.5</b>
<b>Amounts due after more than one year:</b>		
Other debtors	4.2	1.5
Deferred tax asset	5.4	2.9
	<b>9.6</b>	<b>4.4</b>
	<b>68.1</b>	<b>54.9</b>

The deferred tax asset at 31 December 2005 has been reduced from £5.9m to £2.9m following the revisions to FRS 20 'Share-based payment' – see note 2.

## 8. Other creditors including taxation and social security

	2006 £m	2005 £m
Obligations under finance leases	–	0.3
Other creditors	2.0	0.8
Amounts owed to joint ventures	–	5.1
	<b>2.0</b>	<b>6.2</b>

## 9. Creditors: amounts falling due after more than one year

	2006 £m	2005 £m
Obligations under finance leases	–	0.8
Loans	320.0	439.8
	320.0	440.6
Less: amounts included in creditors falling due within one year – loans	(39.2)	–
– obligations under finance leases	–	(0.3)
Amounts falling due after more than one year	280.8	440.3
<b>Analysis of loan and finance lease repayments:</b>		
<b>Obligations under finance leases:</b>		
Within one year or on demand	–	0.3
Between one and two years	–	0.5
<b>Loans:</b>		
Within one year or on demand	39.2	–
Between one and two years	–	42.7
Between two and five years	187.7	279.4
After five years	93.1	117.7
	320.0	440.6

## 10. Financial instruments

	2006		2005	
	Assets £m	Liabilities £m	Assets £m	Liabilities £m
Currency swaps	–	(11.4)	–	(4.7)
Forward foreign exchange contracts	–	(8.6)	0.5	(6.3)
	–	(20.0)	0.5	(11.0)
Analysed as:				
Non-current	–	(10.9)	–	(10.5)
Current	–	(9.1)	0.5	(0.5)

The Company holds derivative financial instruments in accordance with the Group's policy in relation to its financial risk management. Details of the disclosures are set out in note 26 of the Group's consolidated financial statements.

## 11. Called up share capital

	2006		2005	
	£m	Number millions	£m	Number millions
<b>Authorised:</b>				
550,000,000 (2005 – 550,000,000) ordinary shares of 2p each	11.0	550.0	11.0	550.0
<b>Issued and fully paid:</b>				
468,231,512 (2005 – 435,352,903) ordinary shares of 2p each at 1 January	9.4	468.2	8.7	435.4
Issued as consideration for acquisitions during the year	–	–	0.6	30.4
Issued on the exercise of share options	0.1	8.1	0.1	2.4
<b>476,295,589 (2005 – 468,231,512) ordinary shares of 2p each at 31 December</b>	<b>9.5</b>	<b>476.3</b>	<b>9.4</b>	<b>468.2</b>

The Company has one class of ordinary shares which carry no right to fixed income.

During the year 8,064,077 (2005 – 2,522,336) ordinary shares of 2p each were allotted to the holders of options or their personal representatives using newly listed shares.

## I 2. Share premium account

	2006 £m	2005 £m
<b>At 1 January</b>	<b>269.5</b>	191.5
Premium on shares issued	14.0	78.0
<b>At 31 December</b>	<b>283.5</b>	269.5

## I 3. Share-based payment reserve

	2006 £m	2005 restated £m
<b>At 1 January</b>	<b>12.5</b>	6.2
Options over parent's shares awarded to employees of subsidiaries (note 2)	3.6	4.8
Share-based payment expense	1.2	0.9
Tax (charge)/credit on items taken directly to equity	(0.5)	0.6
<b>At 31 December</b>	<b>16.8</b>	12.5

Details of the share-based payment disclosures are set out in note 34 of the Group's consolidated financial statements. The tax credit in 2005 has been reduced from £3.6m to £0.6m as a result of the adoption of FRS 20 'Share-based payment' (see note 2).

## I 4. Hedging and translation reserve

	2006 £m	2005 £m
<b>At 1 January</b>	<b>(6.0)</b>	(14.5)
Fair value (loss)/gain on cash flow hedges during the period	(5.0)	5.9
Tax credit on items taken directly to equity	1.5	2.6
<b>At 31 December</b>	<b>(9.5)</b>	(6.0)

## I 5. Profit and loss account

	2006 £m	2005 restated £m
<b>At 1 January</b>	<b>105.0</b>	103.5
Reversal of charge for options awarded to employees of subsidiaries (note 2)	–	5.2
Profit for the year	26.9	8.8
Equity dividends	(14.5)	(12.5)
<b>At 31 December</b>	<b>117.4</b>	105.0

As permitted by Section 230 of the Companies Act 1985, the profit and loss account of the Company is not presented as part of these accounts. The profit for the year in 2005 has increased from £4.0m to £8.8m as a result of the adoption of FRS 20 'Share-based payment' (see note 2).

## 16. Contingent liabilities

The Company has provided certain financial guarantees and indemnities in respect of the loans, overdraft and bonding facilities, and other financial commitments of its subsidiaries. The total commitment outstanding at 31 December 2006 was £17.4m (2005 – £20.6m).

The Company has also guaranteed overdrafts, finance leases, and bonding facilities of its joint ventures up to a maximum value of £3.8m (2005 – £4.1m). The actual commitment outstanding at 31 December 2006 was £1.6m (2005 – £1.2m).

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

## 17. Related party transactions

The Directors of Serco Group plc had no material transactions with the Company or its subsidiaries during the year other than service contracts and Directors' liability insurance. Details of the Directors' remuneration are disclosed in the remuneration report for the Group.

The Company is exempt under the terms of FRS 8 'Related party disclosure', from disclosing related party transactions with entities that are part of the Serco Group plc group. Full details of the transactions between Serco Group plc and its related parties can be found in note 35 to the Group's consolidated financial statements.

# Shareholder Information

## Group Website

Go to [www.serco.com](http://www.serco.com) to catch up on the current share price, latest news in the investors section and read the Annual Review and Accounts.

## Registrars

Administrative enquiries about the holding of Serco Group plc shares and enquiries in relation to the Serco Dividend Re-investment Plan (DRIP) should be directed to:

Computershare Investor Services PLC  
PO Box 82  
The Pavilions  
Bridgwater Road  
Bristol BS99 7NH  
Shareholder helpline: +44 (0)870 873 5839  
[www.computershare.com](http://www.computershare.com)

## Dividend Re-Investment Plan

You can elect to receive future dividends as shares rather than cash by participating in the DRIP. For further information or to register, please contact Computershare on the number provided above for a copy of the terms and conditions booklet and mandate form.

## Dividends paid direct to your bank account

- Avoids the risk of cheques being lost in the post
- No need to present cheques for payment
- Dividend credited to your account on payment date.

To set up a dividend mandate or change your existing mandated details, please register with the Investor Centre via the Computershare website or contact Computershare on the number provided above.

## Global Payment Services

For overseas shareholders in certain countries, Computershare offers a Global Payment Service. This service offers shareholders the ability to have their dividend converted into their local currency and sent electronically to their local bank account, for a fixed fee of £5 sterling. To sign up for this service, you need to register with Computershare's Investor Centre service at: [www.uk.computershare.com/investor](http://www.uk.computershare.com/investor).

## Electronic Communication

Serco is very proud to participate in eTree. eTree is a service through which you can register to receive communications about Serco electronically. By signing up via eTree for electronic communications, you will receive emails alerting you to communications as they become available. As part of the programme Serco will also donate a native sapling, per participating Shareholder, to the Woodland Trust. To participate in eTree you will need your shareholder reference number and register at [www.ETree.uk.com/serco](http://www.ETree.uk.com/serco).

## Share Dealing

We have arranged the following services that can be used to buy or sell Serco shares. Alternatively, if shareholders hold a share certificate they can also use any bank, building society or stockbroker offering share dealing facilities. Shareholders in any doubt about buying or selling their shares should seek professional financial advice.

- **For EU shareholders/share account members**

*Telephone/Internet:* Buy or sell shares over the telephone or internet through Computershare Investor Services. For telephone purchases or sales call 0870 873 5839 between 8.00 am and 4.30pm, Monday to Friday. For internet purchases or sales log on to: [www.computershare.com/dealing/uk](http://www.computershare.com/dealing/uk).

*Postal:* Cazenove & Co Limited provides a postal dealing service to buy and sell Serco shares. All transactions are undertaken on an "execution only" basis. For further information please contact Cazenove at: Sharedealing Service, 20 Moorgate, London EC2R 6DA, United Kingdom, Tel: +44 (0) 20 7155 5155

- **For Non EU shareholders**

Currently, non EU shareholders may only buy or sell shares through the Cazenove postal service (see above).

## Shareholder Profile

The range and size of ordinary shareholding at 31 December 2006 is set out below:

Range of shareholdings	No. of shareholders	%	No. of shares	%
1 – 1,000	3,222	43.25	1,481,149	0.31
1,001 – 5,000	2,652	35.60	6,140,662	1.29
5,001 – 10,000	586	7.88	4,194,573	0.88
10,001 – 100,000	660	8.86	19,929,931	4.19
100,001 – 500,000	191	2.57	46,780,251	9.82
500,001 – 1,000,000	54	0.72	37,594,466	7.90
1,000,001 – 10,000,000	75	1.00	223,541,234	46.93
10,000,001 and above	9	0.12	136,633,323	28.68
<b>Total</b>	<b>7,449</b>	<b>100</b>	<b>476,295,589</b>	<b>100</b>



# Financial Calendar

2007

7 March	Ex-dividend date
9 March	Record date
24 April	Last date for receipt/revocation of DRIP dividend mandates
4 May	Annual General Meeting
16 May	Final dividend pay date
30 August	Interim results announcement
October	Interim dividend pay date

## Serco Group plc

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E [generalenquiries@serco.com](mailto:generalenquiries@serco.com)

Serco Group plc is a company  
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No. 2048608

[www.serco.com](http://www.serco.com)