

Improving service, **increasing value**

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Our customers – primarily national and local governments – face profound challenges. They must improve vital services, despite intense budget pressures. They must adapt to citizens' rising expectations and make services flexible and responsive. They must meet sustainability targets and address the imperatives of security and safety.

In order to meet these challenges, governments are turning to private sector partners who can help them transform services and reduce costs.

Major private companies also face issues of cost, efficiency and quality, meaning they too can benefit from our work.

This creates strong and growing demand for Serco's expertise, and we are ideally placed to respond. For more than 40 years, we have built up unrivalled capabilities and broadened our business and addressable markets into sectors ranging from air traffic control to running scientific establishments.



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What Serco offers

We can operate in a broad range of sectors because our core product is people-led change management.

We analyse a customer's problems and produce a bespoke solution, with the improved management of people at its heart.

We redesign organisations to remove bureaucracy, improve processes and liberate people to deliver their best. We introduce technology and continue to invest during the life of the contract. And – crucially – we instil our culture and values. Our governing principles and public-service ethos focus us on delivering the best for our customers, our people and the wider community.

Building long-term customer relationships is fundamental to Serco. This means meeting – and often exceeding – our customers' expectations. We invest in relationships by providing innovation and continuous improvement. We devolve responsibility, giving contract directors the freedom to anticipate and respond to customers' changing requirements. The Serco Management System, which controls how we operate, ensures that these actions are also in the best interests of Serco and its shareholders.

Serco's vision and strategy

Our vision is to be the leading service company in our chosen markets.

'Leading' means that we want to be the best partner to work with, the company people aspire to work for, and the company which delivers superior returns to shareholders. Our 'chosen markets' are those which promise strong revenue growth, attractive margins and the ability to offer good working conditions for our people.

Our strategy for achieving this vision has four elements:

Building a balanced portfolio: We aim to reduce risk and increase opportunity by building a balanced contract portfolio, spread across markets. This reduces our exposure to market fluctuations, enables us to select the best opportunities whichever market they are in, and allows us to transfer expertise from one market to another.

Maintaining high rebid and new win rates: Our service excellence results in a rebid win rate above 90%. We also win one in two new contracts, reflecting our ability to select only those opportunities where we can differentiate ourselves.

Making strategic acquisitions: While we are primarily focused on organic growth, we make acquisitions to acquire new skills and to enter new markets where we see strong opportunities.

Developing new models: We respond to emerging opportunities by finding new ways to deliver services. This may mean collaboration between our divisions, bringing together skills and experience which few other companies can replicate. Or it may mean partnering with our customer or the voluntary sector. Our ability to lead change keeps us at the forefront of our markets.



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Serco's track record of success

Our emphasis on bringing service to life for customers leads directly to our financial success, and we have grown quickly in recent years.

Since we listed in 1988, we have consistently delivered double-digit revenue growth. We have been able to leverage this scale and manage our contract portfolio, driving our margins higher. At the same time, we have delivered consistent improvements in our free cash flow.

Our success is also recognised by others. We are frequently voted the UK's leading support services company in Management Today's Most Admired Company Awards.

The future

We are optimistic about our future. Our markets continue to grow strongly and offer substantial opportunities, both in the UK and increasingly overseas. We also have stronger capabilities across more sectors to meet our customers' needs than ever before.

Serco's substantial order book contributes to excellent visibility of future revenues and our pipeline of identified opportunities reinforces our confidence.

The success we have achieved to date underpins our confidence of delivering double-digit revenue growth for the foreseeable future. The quality of our opportunities – and our ongoing portfolio management and efficiency improvement – will also allow us to further increase our margins.

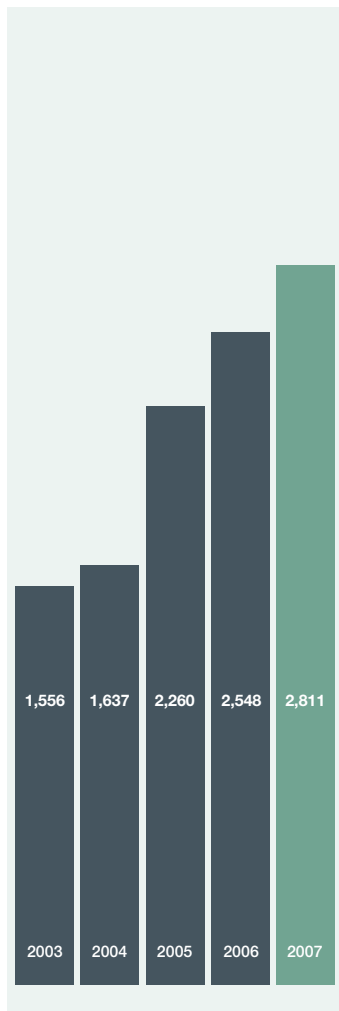
- 1 Support services at Norfolk and Norwich University Hospital
- 2 The Ghan transcontinental service in Australia
- 3 Court escort service in London
- 4 Multi-activity contract at RNAS Yeovilton
- 5 Maintenance at the Atomic Weapons Establishment
- 6 Running education services in Walsall

Highlights

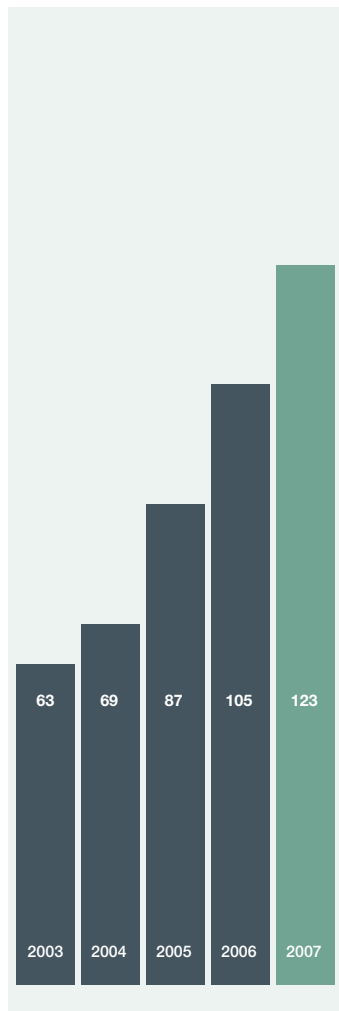
Revenue
(2006: £2,548m)

£2,811m
+10.3%

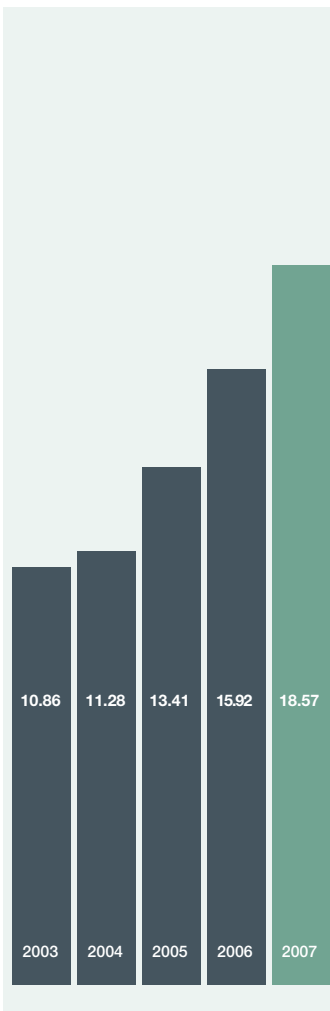
Revenue
(£m)



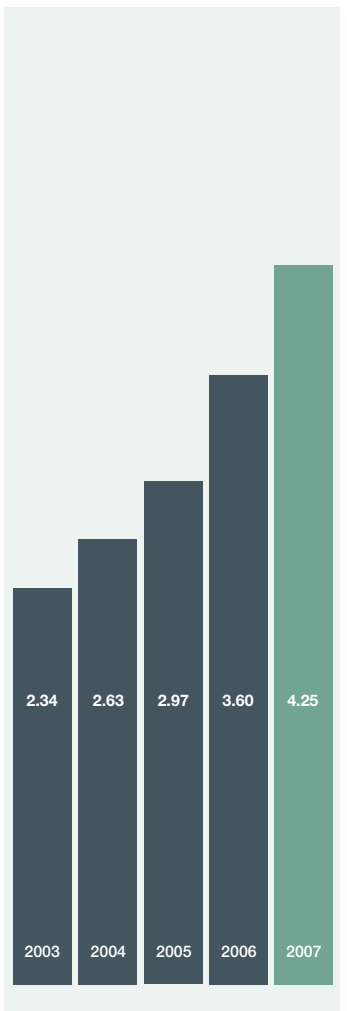
Adjusted profit before tax
(£m)



Adjusted earnings per share
(pence)



Dividend per share
(pence)



2003 Adjusted profit before tax and Adjusted earnings per share are estimated under IFRS

Adjusted profit before tax
(2006: £105.0m)

£123.2m
+17.3%

Adjusted earnings per share
(2006: 15.92p)

18.57p
+16.6%

Dividend per share
(2006: 3.60p)

4.25p
+18.1%

Profit before tax
(2006: £107.4m)

£114.6m
+6.7%

Earnings per share
(2006: 16.62p)

16.98p
+2.2%

Group free cash flow
(2006: £85.4m)

£97.6m
+14.3%

International success builds on UK strengths

Success across our markets

- Signed £3.6bn of contracts and appointed preferred bidder for a further £1.0bn
- Record level of international awards including Dubai Metro (over £400m), US Postal Service (\$260m), LOGCAP IV (\$225m) and Borallon Correctional Centre (Aus\$100m)
- Significant progress in other new markets, including Glasgow City Council strategic partnership (£265m) in local authority market and e-Borders (£200m) in homeland security
- Excellent progress in existing markets, including Marine Services (£750m) in UK defence, Forth Valley (£450m) in UK integrated facilities management and Yarl's Wood (£85m) in UK home affairs
- Maintained rebid win rate at more than 90% and continued to win one in two new bids

Strong margin and cash performance

- Adjusted PBT margin up from 4.1% to 4.4%
- Group free cash flow increased by 14.3% to £97.6m
- Strong balance sheet with Group recourse net debt reduced to £137.9m

Broad pipeline supports excellent visibility

- Order book at new record of £14.7bn at 31 December 2007
- Contracts valued at an additional £1.0bn at preferred bidder stage
- Visibility of 91% of planned revenue for 2008, 76% for 2009 and 63% for 2010
- £27bn of further opportunities identified

Growing markets and higher margins underpin positive outlook

- UK and international markets continue to generate increasing opportunities
- Confident of double-digit revenue growth for the foreseeable future
- Guidance for Adjusted PBT margin of 30 basis point increase for both 2008 and 2009

Note: Adjusted profit before tax (Adjusted PBT) and Adjusted earnings per share are before amortisation of acquired intangibles and the £11.4m gain on sale of PFI investments in 2006 as shown on the face of the Group's income statement. Group free cash flow is from subsidiaries and joint venture dividends and is reconciled in Section 3 of the Finance review.

Our business

We organise our business around dedicated market expertise in a variety of sectors: Civil Government, Defence, Transport and Science



Civil Government

Serco's work in civil government encompasses home affairs, information and communications technology (ICT), business process outsourcing, education and children's services, health, integrated facilities management and consulting.

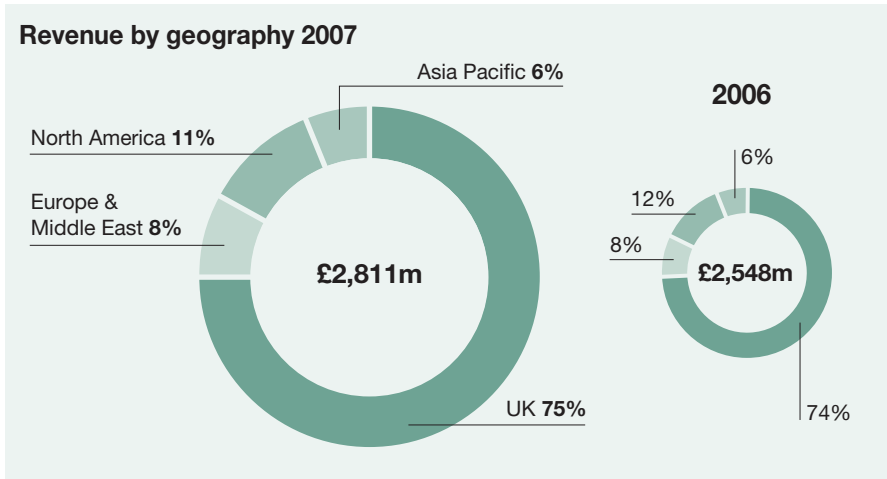
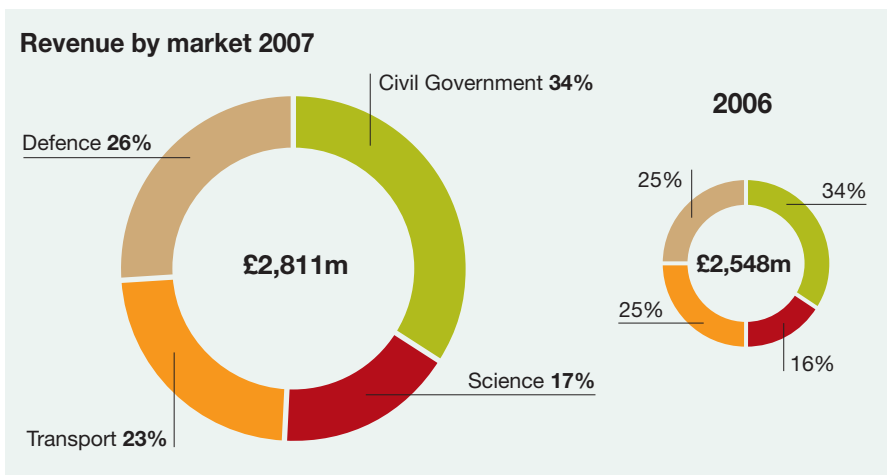
Our home affairs work includes managing prisons in the UK, Australia and Germany, electronically monitoring offenders, developing systems for law enforcement agencies, controlling immigration and improving civil resilience.

We run all education services in two local authority areas and all children's services in one area, providing services for over 500 schools and around 20,000 children.

Our expanding health business provides clinical services to over two million people in a range of primary and community settings.

We use our ICT skills and business process knowledge to deliver better, faster and cheaper ICT solutions to local government, schools and blue chip private sector customers. Our integrated facilities management business provides environmental, streetscene and other direct services to councils, and also works with hospitals and private customers.

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



Revenue

£952m
+8.8%



Defence

Serco is a major provider of support services to the armed forces of the UK, US, Germany and Australia.

In the UK, we provide training, engineering and operational support to the Royal Air Force and the flight arms of the British Army and Royal Navy. We put the Royal Navy to sea at its three main UK bases, operate and maintain strategic defence assets such as secure satellite communications and the Defence Academy of the United Kingdom, and provide systems engineering, safety assurance and risk management services.

In North America we are gaining critical mass with strength in providing enterprise management, engineering, logistics, economic cost analysis and human resources services to the military, in particular the US Army and US Navy.

We provide training, logistics and operational support services to the Australian Department of Defence, with a presence on every defence base in Australia, and to the German Bundeswehr, including our work at one of Europe's most advanced combat training centres.



Transport

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 Great Southern Rail, including The Ghan and Indian Pacific trans-continental services.

We have substantial experience of operating light rail systems, including the award-winning Docklands Light Railway in London. In March 2008, we will be signing the contract to operate and maintain the Dubai metro system which is planned to be the largest driverless metro system in the world. This breakthrough contract substantially increases Serco's transport sector presence in the Middle East.

Serco is also a UK market leader in traffic management systems, including the National Traffic Control Centre for England, which helps motorists to plan their journeys and make best use of the road network.

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 US.



Science

Serco is a world leader in managing both science-based organisations and the process of developing, transferring and applying knowledge.

We manage the National Physical Laboratory (NPL), which is one of the world's major scientific establishments. It is our responsibility to maximise the positive impact of NPL's mission in measurement standards and science, for business and government.

We have an integral role in the UK defence and civil nuclear industries. Since 2000, Serco has been entrusted with the management of the UK Atomic Weapons Establishment which is responsible for providing the warheads for the UK's nuclear deterrent. We do this as part of AWE Management Limited, a 25-year joint venture with Lockheed Martin UK and British Nuclear Group (BNG). In addition we have provided independent specialist nuclear safety advice to the Royal Navy in support of its nuclear submarine fleet for nearly half a century.

We also offer specialist technical support to the UK's civil nuclear industry, providing safety, environmental, risk and asset management advice and operational solutions across the UK's civil nuclear sites.

Revenue

£721m

+11.8%

Revenue

£655m

+4.7%

Revenue

£483m

+19.9%

Chairman's statement



Kevin Beeston, Chairman

I am delighted to report on another year of strong growth. The success we have achieved in 2007 underpins our confidence in delivering double-digit growth for the foreseeable future.

Financial results

I am delighted to report on another year of strong growth. Revenue grew by 10.3% to £2,811m, Adjusted profit before tax (Adjusted PBT) rose by 17.3% to £123.2m and Adjusted earnings per share grew 16.6% to 18.57p. The Adjusted PBT margin increased from 4.1% to 4.4%, benefiting from our management of the contract portfolio and continued efficiency improvements. Profit before tax rose by 6.7% to £114.6m and earnings per share were 2.2% higher at 16.98p. Profit before tax and earnings per share in 2006 included the benefit of the one-off gain on sale of our PFI investments.

Our cash performance continued to be strong, with Group free cash flow increasing 14.3% to £97.6m. This contributed to a reduction in Group recourse net debt of more than £34m to £137.9m. The strength of our balance sheet was further enhanced by the decline in our net pension liabilities.

Dividend

Serco's 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 3.02p per share, representing an increase on the 2006 final dividend of 18.4% and bringing the total dividend for the year to 4.25p, growth of 18.1%. The final dividend will be paid on 21 May 2008 to shareholders on the register on 7 March 2008.

Board

There were a number of changes to the composition of the Board during the year. As announced on 31 August 2006, I moved from Executive Chairman to Non-Executive Chairman on 1 September 2007. Grant Rumbles, our Chief Operating Officer, was appointed an Executive Director on 3 July 2007.

DeAnne Julius retired on 29 October 2007 as a Non-Executive Director and from her post as Senior Independent Director. I would like to thank her for her considerable contribution to our development and wish her well. Baroness Ford of Cunninghame was appointed the new Senior Independent Director from the same date.

Thomas Corcoran joined Serco as a Non-Executive Director on 3 December 2007. Thomas is a member of the Remuneration, Audit, Nomination and Training and Development committees.

Managing our growth

One of Serco's great strengths is its long-term customer relationships. We nurture these by devolving responsibility to the contract level, giving our people the freedom to anticipate and respond to customers' changing requirements. This delivers excellent organic growth but it also creates a need to make sure that these actions are applied consistently and in the best interests of Serco and its shareholders.

Over many years, we have developed a robust system of governance and internal controls, which we call the Serco Management System. It covers all areas of our operations, from finance through to bidding for new contracts, and we continue to evolve it to ensure it keeps pace with Serco's rapid development. This allows us to operate in a devolved manner while ensuring consistency and an upward line of accountability and control to the Board. The quality of these processes is evident in our operational and financial performance. The right balance between flexibility and control is essential and maintaining this balance will ensure a successful future for Serco.

Growing markets and higher margins underpin positive outlook

Our markets continue to generate a broad range of high-quality opportunities for Serco, both in the UK and internationally. The success we have achieved in 2007 underpins our confidence in delivering double-digit growth for the foreseeable future. At the same time, our focus on managing our contract portfolio, enhancing our efficiency and bidding selectively for higher-value work will allow us to further increase our margins and we expect a 30 basis point improvement in our Adjusted PBT margin in each of 2008 and 2009.

I look forward to reporting to shareholders on our progress in 2008.

Chief Executive's statement



Christopher Hyman, Chief

In 2007 we reaped the benefits of our strategy of increasing value: we won important contracts in existing markets, continued to build our position in new markets and were awarded record levels of international business.

In 2007 we reaped the benefits of our strategy of increasing value: we won important contracts in existing markets, continued to build our position in new markets and were awarded record levels of international business.

We delivered another year of double-digit revenue growth, enhanced our margins, further increased our free cash flow and strengthened our balance sheet.

I am pleased to say that we maintained our win rates at more than 90% for rebids and one in two for new bids. We signed £3.6bn of contracts and were appointed preferred bidder for further contracts valued at around £1bn.

Highlights of our success in existing markets included the substantial increase in value of our Royal Navy marine services contract to around £750m over 15 years, and the signing of the £450m, 30-year contract to provide services to the new NHS Forth Valley Acute Hospital.

The capabilities we acquired in 2005 with ITNET and RCI enabled us to enter exciting new markets. Two good examples were homeland security, where as a key member of the Trusted Borders consortium we were awarded a ten-year Home Office contract to develop and implement the 'e-Borders' project, and the local government strategic partnership market, where we won a contract with Glasgow City Council worth £265m to provide property, information and communication technology services.

A record level of international awards was also a key feature. Our performance in the US was particularly strong, with wins including a renewed and significantly increased contract with the US Postal Service worth \$260m, a cost analysis,

logistics planning and supply chain consulting contract for the US Army worth \$225m, and two contracts for the Space and Naval Warfare Systems Center to assist with anti-terrorism systems, with a total potential value of around \$180m.

Elsewhere, we also made significant progress. We were appointed preferred bidder for a £400m contract to operate and maintain the Dubai Metro, a contract we will be signing in March 2008, and in Australia, we won the contract to run Borallon Correctional Centre, worth around Aus\$100m over five years, as well as a four-year safety camera contract in Victoria valued at Aus\$90m.

Such successes demonstrate the growing international demand for the services we have developed within the UK market.

Appropriately, the theme for this report is 'increasing value'. In delivering essential services we touch many people and our challenge is to deliver increasing value to them all – customers, employees, investors and the communities in which we operate. This focus has been consistent throughout our history and as with so much in Serco, the starting point is our customers and by extension the citizens they serve. Given that the expectations of citizens rise every day, increasing value means a continuous improvement in quality.

At the same time, our customers expect significant savings. As noted elsewhere in this report, a study by the Serco Institute shows that introducing competition into public services delivers average cost reductions of 20% and sometimes much more.



But there is more to increasing value than just improving quality and cost. Our customers are also asking us to manage more and more complexity for them as well as to support them with their broader social objectives.

Being a thriving, values-led company creates value for employees. Our public service ethos makes Serco a rewarding place to work, helping us to attract and retain the best people. Our growth enables our people to take their careers in new directions.

The quality of our people is reflected in the awards we receive. Amongst these, for the fourth year in a row, Serco was voted the UK’s most admired support services company and this year was ranked as the country’s fourth most admired company overall. These awards, conducted by Management Today, have become a benchmark for excellence.

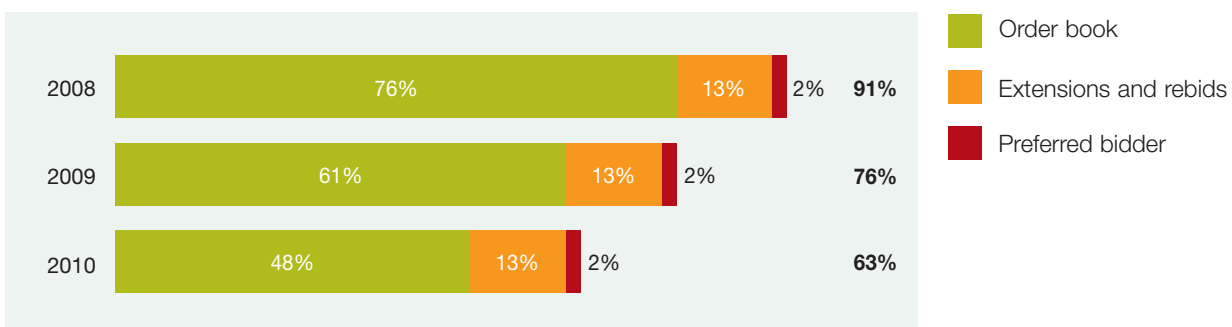
Increasing value for our customers and other stakeholders also increases value for investors. Delivering high-quality services helps us to renew and expand existing contracts and win work with new customers. Our ability to address the broader needs of our customers helps us to establish a leadership position that also drives our growth.

Our success in 2007 keeps us optimistic about the future. At the end of the year, our order book stood at a record £14.7bn and we were preferred bidder on contracts valued at £1bn, giving us excellent visibility of our revenue for the next few years.

Opening new markets in the UK and overseas has also significantly increased the breadth and depth of our pipeline of opportunities, which now stands at £27bn. The breadth gives us confidence of achieving double-digit growth for the foreseeable future, while the depth allows us to select higher margin work, enabling us to deliver further margin improvement.

This optimism is not limited to our financial performance. The strength of our business, our commercial know-how and the deep public services ethos which our people bring to life every day mean that we will continue to increase value for all of our stakeholders.

Visibility of planned revenue at 31 December 2007



Serco's Governing Principles

All Serco employees are expected to adhere to the highest standards in dealing 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.

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.

Serco's strategy has four key elements, which bring benefits to our customers and hence to our shareholders. The four elements are to:

1 Build a balanced portfolio of market facing businesses

This allows us to select the best opportunities for growth, to reduce our risk by avoiding concentration of revenue in a small number of contracts, and to share good practice and experience across the Group.

2 Maintain high rebid and new win rates

We maintain high win rates through building long-term customer relationships and by meeting – and often exceeding – customer expectations. This, along with our reputation with existing customers, helps us to expand the scope and scale of contracts during their life, retain contracts at rebid, and win new contracts.

3 Make strategic acquisitions to obtain new skills or enter markets

Organic growth has been the principal driver of Serco's success. However, we also make acquisitions to bring in new skills which will be important for future growth or to enter new markets where we see strong prospects.

4 Develop new models in existing and emerging markets

We are constantly looking at new ways to deliver services in response to our customers' changing needs. Examples of how we do this include: thorough collaboration between our divisions; partnering with third parties including the public, private and voluntary sectors; and the development of new frameworks such as payment on outcomes.

We have grown strongly and consistently in the 20 years since we listed.

By following our strategy we believe we will continue to grow strongly, since each of the four elements of our strategy contributes to one or more of the following outcomes:

- Reducing our exposure to market fluctuations

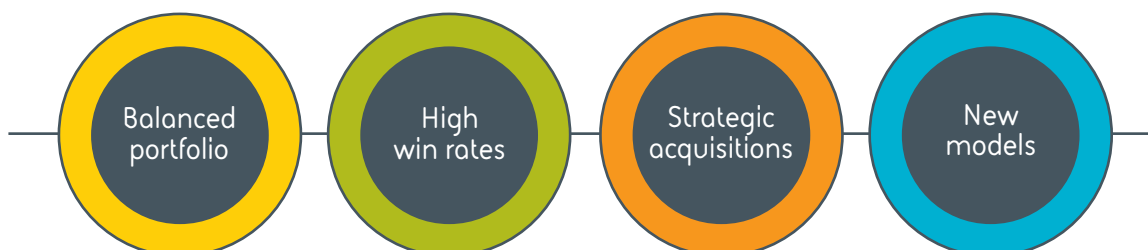
Our balanced portfolio and our high rebid and new contract win rates give high visibility of future revenue and protect against fluctuations in any one of our markets. Innovation allows us to enter new markets and find new ways of delivering services to customers.

- Strengthening our position in our chosen markets

We focus our resources on those markets where we see the best prospects, and innovate to satisfy our customers' needs. We supplement our organic growth with carefully selected acquisitions to expand our footprint.

- Developing new skills and capabilities for the future

We constantly invest in our skills and capabilities to strengthen our market position. We acquire to enhance our capabilities and to allow us to enter new markets which helps us secure opportunities for growth in the future.



Civil Government

Civil Government is our largest segment and includes home affairs, information technology and business process outsourcing, integrated facilities management, health, education and children's services, consulting and much of our work in the private sector.

2007 saw an increasing requirement for technological content in these markets, as customers looked to procure more sophisticated services. Segmental revenue increased by 8.8% to £952m, representing 34% of Group revenue (2006: 34%).

Home Affairs

We had two notable successes with the UK Home Office. Trusted Borders, a consortium of which Serco is a key member, signed a contract to develop and implement the nation's e-Borders project, an advanced border control and management programme. Serco is responsible for infrastructure and service management. The contract is valued at around £200m to Serco over ten years. We also won a contract to manage and operate Yarl's Wood Immigration Removal Centre. The contract began in April 2007 for an initial three years, with optional extensions for up to eight years. Over the full eight years, the contract is valued at around £85m.

We continued to build our presence in the Australian home affairs market, winning contracts to manage and operate Borallon Correctional Centre and to provide safety camera services. Borallon, near Brisbane, accommodates 500 male prisoners. This contract with the Queensland Department of Corrective Services is valued at around Aus\$100m over five years, with the potential for a further five-year extension. The safety camera contract is with the Victoria Department of Justice. The four-year contract is valued at Aus\$90m, with the potential for a three-year extension.

IT and BPO Services

In UK local government, Glasgow City Council approved the creation of a partnership with Serco, to transform the council's land, property and information and communications technology (ICT) services. The partnership will be worth £265m to Serco over ten years and will also position us to support the Council on transformational projects, to improve the Council's efficiency and service delivery. The partnership is the first of its kind in Scotland and is expected to save the Council more than £70m.

We also secured a £30m, ten-year partnership with Ealing Council, to provide ICT support, and Southwark Council selected Serco to provide and support its ICT infrastructure, in a five-year deal valued at £26m. West Sussex County Council appointed us for an IT partnership to manage desktop services more effectively and offer access to our wider IT and business process capabilities. The contract is valued at around £14m over seven years. West Sussex is a new customer for Serco.

We successfully rebid our contract with Regione Lombardia, one of the largest local authorities in Europe, to provide outsourced services for its IT infrastructure. The initial contract is valued at around £14m over six years, with additional services identified expected to expand this.

Revenue

£952m
+8.8%

Some of the things we do

- **Border protection**
- **Prisons management**
- **Education and children's services**
- **Environmental services**
- **Government portal management**
- **Health management and hospital support**
- **IT and IT-enabled services**
- **Management consultancy**



Providing resources to help businesses bloom

BusinessLink.gov brings together business information from more than 600 governmental and agency experts in one easy-to-access website. By providing the tools and resources which businesses really need, such as grant forms and annual leave calculators, BusinessLink has become one of the key gateways between Government and the business community.

Serco won the contract to deliver the already successful Business.gov programme in 2005. We have worked to increase awareness of the programme, improving communication, aligning with other major business initiatives across Government and co-ordinating channels to promote continuity of information to businesses.

We are personalising services to the needs of individual businesses, eliminating duplication of information and promoting efficiency. At the same time we are making it easier for businesses to transact with Government. Our enhancements to delivery will reduce costs by more than £25m over the life of the contract.

A key development has been to put in place systems to ensure that the BusinessLink website is delivering tangible value to business. A survey in 2007 showed a marked increase in the value delivered from c£2bn to £4bn. This translates into a saving of £100 for UK businesses for every £1 invested by the programme. The National Audit Office recognises the programme as an example of best practice.



Severn Trent – one of the world's largest private water companies – awarded Serco a five-year IT infrastructure framework contract valued at around £40m. We will provide programme and project management, consulting, technical delivery, IT engineering and technology refresh services.

We continued to enhance our position as the leader in the UK business support market, winning a contract with the South West Regional Development Agency to provide the BusinessLink service for Cornwall, Devon and Somerset. The contract is for 28 months and is valued at around £15m.

The US Postal Service Engineering Organization appointed Serco to provide engineering, technical, project management and IT services. The two-year contract has four two-year options and over the full ten years has a potential value of \$260m, a sizeable increase over our previous contract. The latest contract broadens our role to include management services focused on enhancing efficiencies, quality assurance services and testing of mail processing equipment.

The US Office of Personnel Management awarded Serco two indefinite-delivery/indefinite-quantity (IDIQ) contracts under the Training Management Assistance program. These programs assist government agencies in developing workforce planning and management strategies, e-learning and other training solutions. The contracts give Serco the opportunity to compete for a share of \$500m of work over the next five years.

Integrated Facilities Management

Our integrated facilities management business had several notable successes. We signed a £450m, 30-year contract to provide support to the new NHS Forth Valley Acute Hospital, drawing on our healthcare experience to influence the hospital's design and thereby enhance infection control. Innovations include segregation of patient, visitor and goods traffic as well as the introduction of proven robotic technology to support the movement of goods around the hospital site. The contract will begin in 2010.

We signed contracts to provide operational management to the United Arab Emirates University in Al Ain (£70m over ten years), and to deliver property management and support services to State Street Bank (£50m over five years). We were also awarded contracts to provide support services to Coca Cola at its London headquarters (£10m over five years) and to Volkswagen's UK headquarters, under a two-year rolling contract valued at £3.5m per annum.

Mid Suffolk and Babergh District Councils awarded us a contract in a groundbreaking shared services partnership for waste and recycling services. The contract is for up to 21 years and is valued at around £80m. Mid Sussex District Council also appointed us to provide refuse, recycling and street cleaning services. The contract is for up to 21 years and is valued at around £74m.



Education and Children's Services

Stoke-on-Trent City Council awarded us a contract to transform their children's services. The contract is valued at £5m over three years, with the potential for substantial growth. The contract is to lead and manage all the council's services for education and children's social care.

Consulting

Over the past year we have been building our consulting business with a focus on supporting our clients in the transformation of their businesses. Serco has many years of experience in the delivery of public services across a broad range of sectors and we are now applying this experience through three key parts of our transformation proposition – policy and strategy advice on transformation, the design and implementation of solutions, and ensuring that change is sustainable and realises benefits through the effective management of human capital.

Against this backdrop we developed the business with the acquisition of Cornwell Management Consultants plc, adding new capabilities in information and knowledge management, while increasing our capacity in project and programme management and enterprise architecture. We also acquired ER Consultants Limited (ER) as part of our building of capability in the area of sustainable change. ER brings experience and skills in leadership development and organisation design and development. These are key issues for many organisations and the acquisition enhances our ability to help our current customers and also to target new blue chip customers in the commercial sector.



Our consulting expertise resulted in our selection for a number of important frameworks in 2007. We were one of ten firms chosen to provide consultancy to UK government departments looking to undertake transformational projects as part of the four-year, £1.5bn Catalyst framework. Serco was one of only two suppliers included in all five categories of the Metropolitan Police's four-year, £200m Development Services framework. We were one of ten suppliers selected for the Ministry of Defence's (MoD) four-year, £100m Catalogue framework, the main route for the MoD to acquire consultancy services. We also qualified as one of only four providers of project and programme management resources to the Department for Environment, Food and Rural Affairs. The potential value of the framework to the qualified suppliers is £80m over four years.

Defence

Revenue in Defence increased by 11.8% to £721m, representing 26% of Group revenue (2006: 25%). 2007 was a year of strong organic growth in defence, supplemented by demand for our value-added services.

United Kingdom

We had a highly successful year in winning new business in the UK defence market, primarily in support of the Royal Navy and Royal Air Force.

The key win in the UK was a contract with the MoD to deliver marine services to the Royal Navy. The MoD selected our joint venture with Denholm Shipping and Infrastructure Investors (I²) for a 15-year private finance initiative (PFI) contract valued at around £1bn, of which Serco's operating contract represents £750m. This is a sizeable increase on our previous operating contract, under which we have provided marine services to the Royal Navy since 1996.

Serco will manage, operate and maintain a fleet of around 110 vessels, providing services that enable the Royal Navy to put to sea. The joint venture will also bring over 30 new vessels into service during the early years of the contract, enhancing service flexibility and responsiveness and helping to meet the Royal Navy's demanding operational requirements. Serco chose I² in 2006 to become its strategic partner for financing and investment in PFIs. In this project, I² will provide all the subordinated debt and the largest proportion of the equity (49%). Serco retains 41% of the equity as well as day-to-day management of the joint venture, so as to implement the successful transition of the project over the first 18 months.

The MoD awarded us a contract to manage the maintenance, repair and operation of the UK Armed Forces' estate facilities in Gibraltar. The contract is valued at around £50m over five years, with a further two option years and the potential for additional work. We will also provide military logistics, workshops and marine services support to the naval base and other MoD operations.

The Naval Air Command appointed Serco preferred bidder for a partnering contract valued at around £7m per annum. We will provide aviation, engineering and aircraft support at two Royal Naval Air Stations, Yeovilton and Culdrose, improving the availability of aircraft and trained aircrew to the Fleet Air Arm at a time of considerable operational pressure. The work will build on the operational support we already provide to the Royal Navy's aircraft.

We were also awarded a contract to provide a range of services at RAF Lyneham, home to the UK's tactical Air Transport force of Hercules aircraft and one of the largest and busiest operational stations in the RAF. In addition to providing base support, facilities management and logistics services, Serco will support the No 1 Air Mobility Wing, Tactical Medical Wing and No 4 Force Protection Wing. This win will further strengthen Serco's relationships with Air Command and key equipment manufacturers such as Rolls Royce. The contract is for four years with three option years and is valued at around £34m over the full seven years.

Revenue

£721m
+11.8%

Some of the things we do

- **Command/control systems**
- **Defence establishments management**
- **Economic cost analysis**
- **Logistics consulting**
- **Marine services**
- **Port security**
- **Risk and safety management**
- **Secure IT support**
- **Through-life capability management**
- **Training and personnel services**



Enhancing the Royal Navy's operational capacity

The UK armed forces are faced with unprecedented challenges, playing their part in protecting national and international security against a background of budgetary restraint. Increasing the effectiveness of assets and equipment makes an important contribution to their operational capacity.

Serco Denholm, a joint venture led by Serco, has been providing essential operational support to the Royal Navy for more than a decade. Over that period, we have built a highly effective working relationship.

In December 2007, Serco Denholm Marine Services signed a new 15-year contract with the Ministry of Defence to deliver a wide range of marine services to the Royal Navy. The contract is worth £750m to Serco, a significant increase on the previous contract, reflecting the strength of our relationship with the Royal Navy.

We are also managing more complexity for the customer. Around 240 staff and the services of the Royal Maritime Auxiliary Service transfer to Serco from April 2008 and Serco Denholm will also bring an additional 30 vessels into service under a PFI arrangement, to add to the 110 existing vessels. These new vessels are being procured by Serco Denholm to meet the Navy's future fleet requirements and to enhance support to trials and worldwide training.



We were awarded the Apache helicopter Interim Support Arrangement contract by AgustaWestland, the prime contractor for Apache 'depth' maintenance at Wattisham in the UK. Depth maintenance involves stripping the aircraft down and reassembling with repaired or new parts as necessary. The contract is valued at around £15m to Serco over three years.

Serco was also awarded a multi-activity support services contract for British Forces on the South Atlantic bases of Ascension Island and the Falkland Islands. The contract is valued at around £20m over five years.

United States

Our North American defence business won a record level of new contracts against a continued backdrop of pressure on non-combat operations. The US Army awarded us a contract to provide cost analysis, logistics planning and supply chain consulting services, under the Logistics Civil Augmentation Program IV (LOGCAP IV). This IDIQ contract has a one-year base period with four annual options, for a five-year total period and a potential value of \$225m.

The Space and Naval Warfare Systems Center (SPAWAR) awarded us two contracts to assist the Navy and other government agencies with anti-terrorism systems. Under the first contract we will evaluate, integrate and install advanced anti-terrorism systems at Navy ports around the world. This IDIQ contract has a total potential value of \$64m over five years. The second contract extends that relationship with SPAWAR to other government agencies. The contract is valued at around \$62m over three years, and could reach \$115m if all five of the six-month award options are exercised.

The US Navy selected us for the major portion of the Sea Enterprise contract. This IDIQ contract is to provide engineering and installation services for command, control, communication, computers, intelligence and reconnaissance systems at ship, shore and submarine locations on the West Coast of the United States. It has a one-year base period with four annual options, for a maximum term of five years and a potential value of around \$156m. A key objective is to reduce the costs of installations by improving productivity and achieving long-term efficiencies.

Transport

Transport revenues grew by 4.7% to £655m, representing 23% of Group revenue (2006: 25%). A key feature of the year was the use of our UK skills to secure international opportunities.

Light Rail

The Dubai Government Roads and Transport Authority (RTA) selected Serco as preferred bidder to operate and maintain the initial two lines of the new Dubai Metro, the first such system in the region and an important development for the city. We will be signing the contract in March 2008. The contract includes pre-launch consultancy and planning, with operations and maintenance running for five years from autumn 2009 and the potential for a further five-year extension. The contract is valued at more than £400m over this 12.5 year period.

Serco will run the operations control centre, maintain rolling stock, track and station facilities and provide train attendants and all station staff. The lines will cover 76 kilometres of track and are predicted to carry 200m passengers per year. Ultimately, the RTA intends to extend the Dubai Metro to more than 300 kilometres, making it the world's largest driverless metro system.

During the year, we finished our contracts to operate the Manchester Metrolink and the Copenhagen Metro. We did not renew the contracts at rebid, as we continue to actively manage our contract portfolio.

Traffic Management

In the UK, we successfully rebid our contract with Transport for London to maintain traffic signal control equipment and provide related services. The contract is for five years with the potential for a further two-year extension, and is valued at around £60m over seven years. Serco will provide cover for all traffic control equipment including traffic signals, crossings, automatic number plate recognition cameras and traffic information signs. The services cover central London and the City, including important transport link points for the 2012 Olympics.

Serco operates the National Traffic Control Centre (NTCC) on behalf of the Highways Agency. We were pleased that the NTCC achieved final completion in May 2007, recognising the delivery of quality services and continuing innovation at this world-first facility. We have successfully rolled out the travel time variable messaging system, providing valuable real-time information for drivers.

In the US, the Georgia Department of Transportation appointed us to run the state's Traffic Management Center. This is Serco's first traffic management contract in North America. The contract is for up to four years and is valued at \$12m.

Serco also won two parking-related contracts with the City of Chicago, valued at more than \$10m over the next five years. We will provide managed operations, mechanical maintenance identification, parking enforcement and revenue reporting.

Revenue

£655m
+4.7%

Some of the things we do

- Air traffic services
- Heavy rail operations and maintenance
- Light rail operations and maintenance
- Traffic control and transport systems
- Transport consultancy



Heavy Rail

Northern Rail, which we operate in a joint venture with NedRailways, carried nearly 79m passengers in 2007 and achieved a strong operational performance despite the severe floods in the summer. Northern Rail's success has led to it winning two prestigious national awards: Public Transport Operator of the Year at the National Transport Awards 2007 and the Example of Excellence in the Rural Action category at the 2007 Business in the Community awards. Our other joint venture with NedRailways – Merseyrail – was the best performing railway in the country in terms of reliability and punctuality, surpassing its previous best performance in 2005.

Great Southern Rail, our Australian rail operation, performed well in 2007, with good growth on both The Ghan and Indian Pacific services. The Overland service between Melbourne and Adelaide was re-launched in May 2007, since when its patronage has increased by more than 50%.

Network Rail awarded Serco two contracts during the year. We extended our contract for infrastructure monitoring and rail grinding services. The extension is valued at approximately £45m over two years. Network Rail also appointed us to operate locomotives on the test routes of the European Rail Traffic Management System (ERTMS) piloting scheme. ERTMS is a new signalling methodology that will ultimately be rolled out across Europe. The contract is valued at around £5m over three years.



Air Traffic Control

We successfully rebid our contract to provide air traffic control, airside operations, engineering and meteorological services in support of the Department of Civil Aviation at Dubai International Airport. The contract has a value of £17.5m over two years.

We also renewed our contract at Bahrain International Airport, to provide air traffic control, electronic engineering and maintenance, project planning and consultancy and administrative support. The contract is valued at around £13m over three years.



TO J10 (FOR A3)
8 MILES
11 MINS

Reducing congestion through enhancing driver information

The growing number of road journeys puts enormous pressure upon infrastructure and capacity, resulting in frustration, lost time and consequent cost to the economy. Road building is not a sustainable option; one solution is to allow drivers to make better use of the existing network.

Serco was selected by the Highways Agency in March 2001 to deliver and operate its National Traffic Control Centre (NTCC). The NTCC collects traffic data from thousands of roadside sensors, combined with information from hundreds of operational partners including the police, Highways Agency traffic officers, ports and airports and local highway authorities.

NTCC analyses this data and delivers real time traffic information via the Traffic England website (www.trafficengland.com) and phone service (08700 660115) and through broadcast partners, giving motorists the information they need to plan their journeys and avoid delays, making the best use of road capacity, reducing driver stress and improving road safety.

Serco continues to increase the value of the service by exploring new ways of reaching drivers and giving them the information they need, when and where they need it most.

In 2007 we introduced new road-side signs on motorways to give drivers predicted travel times between junctions based upon real-time information. Following a successful pilot this service has been rolled out across the network, publishing over a million messages every month.

Science

Science revenues grew by 19.9% to £483m, representing 17% of Group revenue (2006: 16%). Technology and innovation are at the heart of our offering in this market.

Our joint venture with British Nuclear Group (BNG) and Lockheed Martin to operate the UK's Atomic Weapons Establishment (AWE) continued to perform strongly. The infrastructure upgrade programme is progressing well, with the facility to house the Orion research project due to open on schedule in March 2008. This facility will cover both weapons research and civil science studies such as evolving stars and super-dense matter. The construction of energy-efficient offices for up to 1,400 staff is also on time and on budget. As previously reported, BNG is in the process of disposing of its shareholding in AWE and we hope this will be completed later this year.

Serco Technical and Assurance Services (Serco TAS) won several contracts in the nuclear market during the year. A consortium led by Serco TAS was awarded a £15m contract to provide specialist technical and engineering support to Magnox reactor sites over the next five years. A range of specialist nuclear technical services will be provided, including safety case management, systems engineering, analysis of safety-critical structures and systems and technical advice on waste management.

Serco TAS, in partnership with Golder Associates, was also awarded a £10m two-year contract to examine and develop plans to clean up contaminated land at Sellafield. The work will include assessment of the condition of the land and groundwater, mathematical modelling, development of a strategy for dealing with the contamination and identifying the technologies and actions needed for clean up.

The Nuclear Decommissioning Authority (NDA) appointed a consortium led by the the Washington Division of the US company, URS, as preferred bidder to manage the UK's low-level radioactive waste repository at Drigg in West Cumbria. Serco TAS is an integrated sub-contractor and will provide regulatory, safety and environmental technical support to the consortium. The ten-year contract can be extended to up to 17 years.

Revenue

£483m
+19.9%

Some of the things we do

- **Materials science**
- **Measurement science**
- **Nuclear assurance**
- **Research establishments management**
- **Technical training**



Ensuring the highest safety and training standards

The Atomic Weapons Establishment (AWE), which is responsible for the design, build, maintenance and decommissioning of the warheads for the United Kingdom's nuclear deterrent, has been central to the country's defence for more than 50 years. AWE is managed and operated for the Ministry of Defence by AWE Management Limited, a joint venture between Serco Group plc, Lockheed Martin Corporation and British Nuclear Group, under a contract that runs until 2025.

AWE is a complex environment where safety is the number one priority. The Royal Society for the Prevention of Accidents recognises AWE's commitment to ensuring the highest standards of safety throughout its operations and has awarded it their prestigious Gold Medal, for achieving five consecutive Gold Awards for occupational health and safety. In addition, AWE has been awarded the Sir George Earle trophy for the most outstanding performance in health and safety by a company or organisation, as well as the Astor Trophy for the best managed occupational health programme.

Essential to its continued success is the development and retention of skills across a broad spectrum. A notable achievement in 2007 was the successful establishment of the AWE Programme Management Academy. Along with representatives from our AWE Management Limited partners, a team of Serco consultants undertook the planning and implementation of a comprehensive suite of training programmes. These have the goal of ensuring that there are sufficient people in the future who are qualified to successfully lead the multiple and highly-complex AWE programmes and projects. The Programme Management Academy will train around 1,000 staff in its first year of operation.

Market development

Serco's markets continue to expand rapidly, as local and national governments face budget deficits and ever-increasing pressure from citizens to improve public services.



Governments increasingly recognise the benefits of opening up public service monopolies to competition and innovation. A review by the Serco Institute of 200 government and academic studies spanning 30 years, 12 countries and five sectors found that competition resulted in typical cost savings of 20%, with savings as high as 30-40% in some cases. Value for money in public services is driven by innovation and smarter ways of working. In the UK, the Government has launched a major study to help it understand the contribution of the public service industry and how the Government can support it, including the potential to export the UK's expertise in this area.

Turning to individual markets, we expect to see continued strong growth in home affairs. In the UK we are well established across all areas and we are expanding our footprint in Australia. Key drivers include the threat of global terrorism, concern about immigration, perceptions of rising crime and the continued rise in prisoner numbers. These will increase governments' use of the private sector to provide capacity and to develop new capabilities to meet new threats.

Health and 'welfare to work' offer major future growth areas for Serco. The UK's National Health Service needs to deliver efficiency savings and meet stretching targets and Serco can play a critical supporting role. We plan to offer better value for money clinical services to the primary sector and to provide fully-managed healthcare solutions that deliver the information and support needed by clinicians and patients. The UK Government is also increasingly looking to the private sector to help the jobless move back into employment. We are well positioned to play a role in this important new market.

UK local authorities face major challenges, creating opportunities for Serco. The Government's 2007 Comprehensive Spending Review requires councils to deliver 3% annual efficiency savings, a degree of financial pressure new to many council leaders and chief executives. They will look to service providers for innovative and cost-effective solutions. In addition, local government reorganisation is creating a number of unitary authorities with greater responsibilities. This inevitably involves back-office consolidation, in particular in IT-based services. Serco is well placed to help. Finally, local authorities are being given a greater remit to shape their area and deliver local priorities, notably through agencies such as the police, health and highways. Serco's track record in reducing crime and in improving the environment, school performance and transport gives us a pivotal role, with our broad understanding of the local agenda placing us in a unique position in the market.

In defence, the public debate in the UK about the level of funding to equip and support the armed forces has intensified throughout the year. Our core business lies in helping government achieve greater value for money, and it is on that basis that we have continued to work with the MoD as it refreshes its Defence Industrial Strategy.



Our track record in the provision of operational support services to the front line commands and our independence from equipment manufacturers, position us well to deliver significant growth. This will be achieved by using our role as an integrator of people, infrastructure, training and technology to help the MoD deliver through-life capability management, and by leveraging our extensive capabilities in operational support and training into new overseas markets.

We have a significant position in the US defence market, and have broadened our offerings, which should serve us well as that sector continues to evolve to an imminent post-Iraq era. In particular, there is a continuing demand for our services to military personnel and their families, where we have a solid track record. We are well-positioned to provide logistics services as the military and other government agencies face greater pressures to reduce costs, and for advanced port security and other anti-terrorism/force protection applications, an area where we see continued emphasis in the near future.

In transport, we continue to monitor opportunities to address congestion and improve traffic efficiency. We have built strong links with customers in the UK and around the world to further this. In the United Arab Emirates there are substantial opportunities to grow our presence in the transport market with the development of the Dubai Metro. This system will be expanded over time and we anticipate a growing pipeline of opportunities with the rapid expansion of Dubai and further transport innovation across the Emirates, in particular Abu Dhabi. Our reputation for service delivery and working closely with clients is bringing a substantial range of opportunities across both light rail and traffic control systems that fit within our strategy.



We have engaged with the UK Government on future options for its trading funds and agencies. These options include the Government-Owned, Contractor-Operated (GOCO) model, of which our successful operations at AWE and the National Physical Laboratory are examples. GOCO is an attractive operating model where it is strategically important to retain a public stake in an organisation, and we will continue to work with Government to examine its full potential while exploring other contractual mechanisms.

In the UK NDA market, our primary focus is on producing a competitive bid for Sellafield. SBB Nuclear, the consortium of Serco, Bechtel and The Babcock & Wilcox Company, is one of four invited by the NDA to submit final tenders. Tender responses are scheduled to be returned to the NDA in the spring of 2008, with the announcement of the winning bidder planned for the summer of 2008. SBB Nuclear is a unique and highly effective team, with a proven track record of safely and securely delivering high performance at AWE and at nuclear sites in the US, through partnership with employees and local communities. Together our consortium has experience of successful transition at 26 major sites in the UK and US. We look forward to continuing to work with the NDA and the stakeholders at Sellafield through the concluding stages of the competition process. There are also a number of other opportunities, including the decommissioning of the Magnox reactors, Dounreay and other smaller sites. We will continue to review the attractiveness of these opportunities as the market develops.



We continue to study the potential for our service-led model to be introduced into a number of new markets. While many of these markets are at an early stage, China, India and South Africa look likely to present opportunities in the medium term.

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 of goods and services. 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.

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 transport, for example, our partnership with NedRailways began work at Merseyrail in 2003 and Northern Rail in 2004. Together we have become one of the UK's major train operating companies. Our partnership with Lockheed Martin and BNG at the Atomic Weapons Establishment has been highly successful and together we have consistently exceeded service targets.

We continue to create new partnerships. SSB Nuclear, our consortium with Bechtel and Babcock & Wilcox, was formed to support the UK Nuclear Decommissioning Authority's clean-up programme.

We also expect that strategic partnerships and joint ventures with customers will be important to our business in future.

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.

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 employees, wherever they are in the world.

The key employment policies are made available through line managers, human resources teams and our intranet. They 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 Group, 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 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. Our business managers' programme leads to a Diploma in Management from the Chartered Management Institute, helping our managers develop their business insight and people skills. We also have a groundbreaking relationship with the Institute of Directors, which underpins the strategic role of contract and divisional board membership.

Our Skills for You programme was developed in partnership with UK Government departments, trade unions and training providers. It offers Serco staff

the chance to brush up their literacy, numeracy and language skills while continuing with their workplace learning. At the end of 2007, more than 3,000 of our people had been assessed with nearly 500 achieving a qualification.

The Pulse Awards are designed to celebrate the very best qualities and achievements of Serco people, our customers and partners. The awards are closely linked to our four governing principles. They recognise people who excel at innovation, inspire through their leadership, demonstrate outstanding commitment and make an exceptional impact on communities, the environment or issues such as safety and ethics. In addition, the special heart award celebrates the most heroic acts of bravery and courage, where people save lives or overcome formidable obstacles to achieve their goals.

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.

Customers and potential customers tell us that corporate reputation is one of their key criteria in the selection and retention of private-sector partners. As a result, we are taking steps to measure customer advocacy and corporate reputation consistently on a group-wide basis.

We continue to build our reputation amongst business stakeholders through a communication programme which includes the publication of thought-leading research and attendance at seminars and conferences. However, we recognise that delivering value to customers and citizens by improving services' efficacy and efficiency is the most significant shaper of our reputation.

Finance review



Andrew Jenner, Finance Director

Serco continued to grow strongly in 2007 with another double-digit increase in revenue. At the same time, we successfully increased our margins and free cash flow and further strengthened our balance sheet.

I. Financial performance

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

As announced in our 2007 interim results, we have adopted a new pro forma profit measure, profit before tax and amortisation of acquired intangibles (Adjusted profit before tax). Figure 1 also shows Adjusted earnings per share, which is calculated before the amortisation of acquired intangibles. For 2006, the adjusted measures also exclude the gain on sale of our PFI investments of £11.4m.

Figure 1: Income statement

Year ended 31 December	2007 £m	2006 £m	Increase
Revenue	2,810.7	2,548.2	10.3%
Gross profit	406.2	365.7	11.1%
Administrative expenses	(264.2)	(242.9)	
Adjusted operating profit	142.0	122.8	15.6%
Investment revenue and finance costs	(18.8)	(17.8)	
Adjusted profit before tax	123.2	105.0	17.3%
Amortisation of acquired intangibles	(8.6)	(9.0)	
Gain on sale of PFI investments	-	11.4	
Profit before tax	114.6	107.4	6.7%
Tax	(32.2)	(27.9)	
Profit for the year	82.4	79.5	3.6%
Effective tax rate	28.1%	26.0%	
Adjusted earnings per share	18.57p	15.92p	16.6%
Earnings per share	16.98p	16.62p	2.2%
Dividend per share	4.25p	3.60p	18.1%

I.1 Revenue

Revenue grew by 10.3% to £2,810.7m, benefiting from the growth of existing contracts and the contribution of new wins.

I.2 Gross margin

Gross margin – the average contract margin across our portfolio – was 14.5%, a small increase on 2006.

I.3 Investment revenue and finance costs

Investment revenue and finance costs totalled a net cost of £18.8m (2006: £17.8m). In December 2006, we sold a number of our PFI investments to Infrastructure Investors Limited. The loss of net interest income from these investments was largely offset by the increase in net interest income from our retirement benefit obligations.

I.4 Adjusted profit before tax

Adjusted profit before tax was £123.2m, an increase of 17.3%. This represented a margin of 4.4%, up from 4.1% last year.

1.5 Gain on sale of PFI investments

2006 included an £11.4m one-off gain on the sale of PFI investments. The sale was part of our creation of a strategic PFI investment partnership with I². There was no corresponding gain in 2007.

1.6 Profit before tax

Profit before tax increased by 6.7% to £114.6m. Profit before tax excluding the gain on sale in 2006 was up by 19.4%.

1.7 Tax

The tax charge of £32.2m (2006: £27.9m) represents an effective rate of 28.1%, compared with 26.0% in 2006. The underlying rate in 2006 was 29.1% before the gain on sale of the PFI investments. The decrease in the underlying rate is primarily due to the mix of taxable profits.

1.8 Earnings per share (EPS)

Adjusted EPS rose by 16.6% to 18.57p. EPS grew by 2.2% to 16.98p.

EPS and Adjusted EPS are calculated on an average share base of 482.4m during the period (2006: 471.2m). The increase in the average share base resulted from the exercise of employees' share options.

2. Dividend

Serco's 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 3.02p per share, representing an increase on the 2006 final dividend of 18.4% and bringing the total dividend for the year to 4.25p, growth of 18.1%. The final dividend will be paid on 21 May to shareholders on the register on 7 March.

3. Cash flow

The Group generated a free cash inflow of £97.6m (2006: £85.4m), an increase of 14.3%. Figure 2 analyses the cash flow. As in previous years, 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 75, 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	2007 £m	2006 £m
Operating profit excluding joint ventures	92.2	87.9
Non cash items	52.1	35.0
Group EBITDA	144.3	122.9
Working capital movement	(4.7)	(2.1)
Group operating cash flow	139.6	120.8
Interest	(25.6)	(10.6)
Tax	(5.4)	(6.7)
Expenditure on tangible and intangible assets	(47.9)	(47.7)
Dividends from joint ventures	36.9	29.6
Group free cash flow	97.6	85.4
Disposal of joint ventures	3.3	–
Acquisition of subsidiaries	(7.4)	–
Cash received on sale of PFI investments	–	76.5
Cash disposed of and transaction costs on sale of PFIs	–	(58.3)
Other financing	(71.0)	(98.6)
Special pension contribution	(51.0)	(19.0)
Dividends paid	(17.9)	(14.5)
Group net decrease in cash and cash equivalents	(46.4)	(28.5)
Adjustment to include joint venture cash impacts	6.7	10.3
Net decrease in cash and cash equivalents	(39.7)	(18.2)

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

3.1 Group operating cash flow

Group operating cash flow of £139.6m (2006: £120.8m) reflects a conversion of Group EBITDA into cash of 97% (2006: 98%). This was a strong cash performance, given the level of organic growth in the business.

3.2 Interest

Net interest paid was £25.6m, compared to £10.6m in 2006. The increase is mainly due to lower cash interest receipts after the disposal of PFI investments in December 2006.

3.3 Tax

Tax paid was £5.4m (2006: £6.7m). Cash tax is below the equivalent tax charge in the income statement. This reflects timing differences and the availability of tax relief on the special pension contributions of £19m in December 2006 and £51m in January 2007.

3.4 Expenditure on tangible and intangible assets

Expenditure on tangible and intangible assets in the year was £47.9m (2006: £47.7m). This represents 2.2% of revenue excluding joint ventures (2006: 2.5%). Expenditure in 2007 included the completion of the roll-out of our SAP system in the UK.

3.5 Dividends from joint ventures

Dividends received from joint ventures totalled £36.9m (2006: £29.6m), a conversion rate of 100% (2006: 87%) of joint ventures' profit after tax and minority interest, excluding costs allocated by Group. Going forward, we expect conversion in the range of 80-90%.

3.6 Other financing

The movement in other financing resulted from repayments of our loans and the maturing of one of our private placements in December 2007 for £43.2m.

4. Net debt

Figure 3 analyses Serco's net debt.

Figure 3: Net debt

At 31 December	2007 £m	2006 £m
Group – cash and cash equivalents	138.1	177.8
Group – loans	(263.3)	(334.4)
Group – obligations under finance leases	(12.7)	(15.3)
Group recourse net debt	(137.9)	(171.9)
Joint venture recourse net cash	34.9	28.2
Total recourse net debt	(103.0)	(143.7)
Group non recourse debt	(59.3)	(62.2)
Total net debt	(162.3)	(205.9)

4.1 Group recourse net debt

Group recourse net debt decreased from £171.9m to £137.9m, due to the cash flows generated by the business.

Included within Group recourse net debt is £11.9m (2006: £10.6m) of encumbered cash. This is cash of PFI and other project companies securing credit obligations and customer advance payments.

4.2 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 £2.9m to £59.3m during the year, due to scheduled repayments. The non recourse debt relates to the Kilmarnock prison contract and our Driver Examination Services contract in Canada.

5. Pensions

At 31 December 2007, the net liability included in the balance sheet arising from our defined benefit pension scheme obligations was £52.2m (2006: £120.0m). Figure 4 provides further analysis.

Figure 4: Defined benefit pension schemes

At 31 December	2007 £m	2006 £m
Group schemes – non contract specific	(67.9)	(157.8)
Contract specific schemes		
– reimbursable	(60.7)	(67.6)
– not certain to be reimbursable	(14.0)	(23.9)
Net retirement benefit liabilities	(142.6)	(249.3)
Intangible assets arising from rights to operate franchises and contracts	17.4	20.6
Reimbursable rights debtor	60.7	67.6
Deferred tax assets	12.3	41.1
Net balance sheet liabilities	(52.2)	(120.0)

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

- Non contract specific – schemes which do not relate to specific contracts or franchises. For these schemes, we charge the actuarial gain or loss for the period to the consolidated statement of recognised income and expense (the SORIE)
- Reimbursable – 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
- Not certain to be reimbursable – schemes relating to specific contracts or franchises, where the deficit will pass back to the customer or on to the next contractor at the end of the contract. 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 at the start of the contract or franchise and amortise the intangible asset to the income statement over the contract or franchise life.

Serco has limited commercial risk in relation to the contract specific schemes, due to either the right of cost reimbursement or because the deficit will pass back to the customer or on to the next contractor at the end of the contract. Among our non contract specific schemes, the largest is the Serco Pension and Life Assurance Scheme (SPLAS). At 31 December 2007, SPLAS had a deficit of £28.7m (31 December 2006: £117.0m). The reduction in the deficit reflects the movement in bond yields and the action we have taken to ensure appropriate funding for the scheme, including the special pension contribution of £51m in 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%

6. 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 2007 we had £141m (31 December 2006: £163m) outstanding on the term loans and the revolving facility was undrawn. Interest is charged at a rate of 45 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, matured in December 2007 and was fully repaid. The second, for £117.0m, amortises evenly from 2011 to 2015.

Principal risks and uncertainties

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 the Group as a whole 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 at all levels of the business and is used to create the risk, opportunity, assumption and issue registers that support the decision-making processes.

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 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- to medium-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. 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.

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.

Reputational and emerging risks are kept under active review and the Board informed of changes. Emerging risks cover longer-term risks that could represent a threat to the Group's activities but which are not yet sufficiently defined to be included as active risks. Examples of these risks include financial market instability, influenza pandemic, climate change and changes in key markets.

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
- An Investment Committee meets on a monthly basis to consider new or developing projects against a defined set of criteria
- 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
- An Ethics Committee, comprising the Executive team, has been established with responsibility for the review of ethical issues that may arise from the Group's activities
- The Company Secretary manages 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 for 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 Board, providing analyses of performance against targets and advises the Board on policy and future activities to enhance best practice. In 2007, 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 2008 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

- An Aviation Safety Oversight Group, chaired by the Aviation Safety Director and comprising the aviation safety representatives from across the Group, which met once 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 Integrated Transport Non-Executive Director with Special Interest in Safety and comprising the rail safety representatives from across the Group, oversees the safety management systems within Serco's rail businesses in the United Kingdom, Middle East and Australia
- A Corporate Responsibility Steering Group, chaired by the Chief Operating Officer, provides direction on projects that address the social and environmental issues affecting our staff and the communities within which we work.

Internal audit

During 2007, 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. Where 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.

- 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 2007 and targets and objectives for 2008 are included in the 2007 Corporate Responsibility Report and at www.serco.com.

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 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

Directors, Secretary and Advisors

Chairman	Kevin Beeston	Stockbrokers	JP Morgan Cazenove Limited 20 Moorgate London EC2R 6DA
Directors	Leonard V. Broese van Groenou* Thomas A Corcoran* Baroness Ford of Cuninghame*^ Christopher Hyman Andrew Jenner David Richardson* Grant Rumbles		Merrill Lynch International Merrill Lynch Financial Centre 2 King Edward Street London EC1A 1HQ
Secretary	Joanne Roberts		
Registered Office	Serco House 16 Bartley Wood Business Park Bartley Way Hook Hampshire RG27 9UY	Principal Bankers	HSBC Bank PLC 8 Canada Square London E14 5HQ
Auditors	Deloitte & Touche LLP Hill House 1 Little New Street London EC4A 3TR	Solicitors	Linklaters LLP One Silk Street London EC2Y 8HQ
Investment Bankers	UBS Limited 1 Finsbury Avenue London EC2M 2PP	Registrars	Computershare Investor Services PLC The Pavilions PO Box 82 Bridgwater Road Bristol BS99 7NH

*Non-Executive Director

^Senior Independent Director

Corporate governance report

Introduction

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 processes is the Ethics and Business Conduct Policy Standard that the Company and Group have adopted to support the highest standards of corporate governance.

In 2007 Serco Group plc fully complied with the provisions of the Code of Best Practice as issued by the Financial Reporting Council in 2003 (and as superseded by the Combined Code on Corporate Governance issued by the Financial Reporting Council in June 2006 (the Code)). The Company is required to explain how it has applied the principles set out in the Code.

The paragraphs below together with the Business Review on pages 10 to 42 and the Remuneration Report on pages 57 to 70 provide details of how the Company has applied the principles and complies with the provisions of the Code.

The Board of Directors

Board composition:

Currently the Board has eight members: the Non-Executive Chairman, three Executive Directors and four Non-Executive Directors. No individual or group of individuals dominates the Board's decision-making. With the exception of the Chairman who is presumed under the Code not to be independent, the Board considers all of the Non-Executive Directors to be independent. In coming to this conclusion the Board has determined that each Director is independent in character and judgement and there are no relationships or circumstances which are likely to affect, or could appear to affect, the Directors' judgements.

Each Director brings a valuable range of experience and expertise to the Board. The profiles of all Directors can be found on pages 54 and 55.

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 to the Board, the Corporate Assurance Group (CAG) is tasked by the Group 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 42 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 2007, is available online at www.serco.com and 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
- Satisfying itself as to the integrity of financial information
- Dividend policy
- Ensuring adequate succession planning for the Board and senior management and appointing and removing Directors, the Company Secretary and Committee members
- Treasury policy
- Review of the effectiveness of the Group's system of internal control and risk management process.

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 48 to 50.

Information flow:

Senior executives below Board level attend certain Board meetings at which they 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 meeting and each Committee meeting, as appropriate.

Board meetings are routinely held four times a year over two days at a time and are structured to allow open discussion of the strategy, trading and financial performance and risk management of the Group.

Board and Committee 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 in which they were eligible to attend is shown in the table on page 47.

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:

On 1 September 2007, after 22 years with Serco and as communicated to shareholders in 2006, Kevin Beeston moved from Executive Chairman to Non-Executive Chairman. As Chairman, Kevin Beeston is responsible for:

- Ensuring the effective running of the Board, its agenda and processes
- Promoting the highest standards of corporate governance and ensuring appropriate communication with shareholders on these standards and the Group's overall performance
- Ensuring appropriate Director development and succession planning for the Board.

The Chief Executive, Christopher Hyman, is responsible for:

- The formation and implementation of the Group's global strategy
- Delivery of the Group's business plan
- Providing motivation and leadership to the operating 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 leadership and representation of the Group with major customers and industry organisations.

Senior Independent Director:

Baroness Ford of Cunninghame, Margaret Ford, was appointed Senior Independent Director on 29 October 2007 in place of DeAnne Julius who retired as a Director on the same date. As part of her role, Margaret is available to shareholders if they have any issues or wish to discuss any aspects of the Company's business without the Executive Directors or Chairman present.

External directorships for Executive Directors:

The Board considers that Executive Directors can gain valuable experience and knowledge through appropriate and limited 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 any appointments being taken up. Details of the fees received by Executive Directors for external appointments can be found in the Remuneration Report on page 61.

Significant other commitments of the Chairman:

Kevin Beeston is Non-Executive Chairman of Partnerships in Care, Infinitas Learning and Domestic and General Ltd, and holds Non-Executive Director positions on the boards of IMI plc and Ipswich Town Football Club plc. Kevin is also a member of the CBI President's Committee and Chairman of the CBI's Public Services Strategy Board, and is Commissioner for the TUC's Commission on Vulnerable Employment. The Board continues to believe that Kevin holds a well-balanced portfolio of positions which allow him to appropriately perform his duties as Chairman.

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 Annual General 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 2008 Annual General Meeting are set out in the Notice of 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 are to remain on the Board for more than nine years. The terms and conditions of the appointment of the Directors are summarised in the Directors' Remuneration Report on page 61 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. This meeting is chaired by the Senior Independent Director.

Board meetings and attendance

The Board holds its meetings on a quarterly basis with ad hoc meetings in between if required. Board meetings are scheduled over two days and are held at varying Group operating locations usually including one overseas meeting per annum. This allows a thorough exposure to the Group's activities, customers and management. The frequency and content of Board meetings are reviewed by the Board annually.

The attendance of the individual Directors at Board and Committee meetings during 2007 was as follows:

	Board (4 meetings) ⁽²⁾	Audit (3 meetings)	Remuneration (4 meetings)	Training & Development (1 meeting)	Nomination (2 meetings)
Kevin Beeston	4	n/a	n/a	1	2
Thomas A Corcoran ⁽³⁾	0	0	0	0	0
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	3	3	4	1	2
Margaret Ford	4	3	4	1	2
DeAnne Julius ⁽⁴⁾	3	2	3	1	1
David Richardson	4	3	4	1	2
Grant Rumbles ⁽⁵⁾	2	n/a	n/a	n/a	n/a

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.
3. Thomas A Corcoran was appointed to the Board as Non-Executive Director on 3 December 2007.
4. DeAnne Julius retired as a Director on 29 October 2007.
5. Grant Rumbles was appointed to the Board on 3 July 2007.

Board effectiveness induction

On joining the Board, Directors are given background information describing the Company and its activities.

Thomas A Corcoran, who was appointed on 3 December 2007, received an induction pack which included information on all the governance processes of the Group, the roles and responsibilities 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. Grant Rumbles was appointed to the Board on 3 July 2007, and received an induction pack which included appropriate information about the roles and responsibilities of the Board and its Committees, and information on all governance processes of the Board. He also attended relevant training on the duties of a plc Director.

Continued professional development:

During 2007 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 Company's expense.

Performance evaluation:

In October 2007 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 (taking into account the views of both the Non-Executive and Executive Directors).

The Group recognises the importance of a comprehensive evaluation process for the Board and ensures that comments and recommendations are considered carefully and implemented where appropriate to ensure its continued development. The outcomes from the Board's appraisal were discussed fully at the November 2007 Board meeting. The principal finding from the evaluation was confirmation that the Board remains effective and in some cases best in class. All Directors feel that the Board and Company is open, professional and enjoyable to be a part of 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 developments in reporting formats and the balance of business presentations and formal papers to the Board. All recommendations from the evaluation have been implemented. In carrying out the performance evaluation process, the Board considered appointing an independent evaluator but concluded that its own process was sufficiently rigorous.

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, Leonard V. Broese van Groenou and DeAnne Julius until her retirement in October 2007. Thomas A Corcoran joined the Committee on his appointment as Non-Executive Director to the Board on 3 December 2007.

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, the 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 main responsibilities of the Audit Committee are:

- To monitor the integrity of the financial statements of the Company, including interim management statements, and any formal announcements relating to the Company's financial performance, reviewing significant financial reporting judgements contained in them
- To review the internal audit programme and ensure that the internal audit function is adequately resourced and has appropriate standing with the Company
- To review management's and the internal auditors' reports on the effectiveness of systems for internal financial control, financial reporting and risk management
- To consider the appointment, re-appointment and removal of the external auditors and assess independence of the external auditors, ensuring that key partners are rotated at appropriate intervals

- To recommend the audit fee to the Board and pre-approve any fees in respect of non-audit services provided by the external auditors and to ensure that the provision of non-audit services does not impair the external auditors' independence or objectivity
- To discuss with the external auditors, before the audit commences, the nature and scope of the audit and to review the auditors' quality control procedures and steps taken by the auditors to respond to changes in regulatory and other requirements
- To oversee the process for selecting the external auditors and make appropriate recommendations through the Board to the shareholders to consider at the AGM.

Additionally, 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.

Members of the Audit Committee have received updates on accounting standards and generally accepted accounting principles on a quarterly basis as part of the Finance Director's report to the Board, and also on a half-yearly basis from the external auditors.

During 2007 the Audit Committee considered the following:

- Corporate Governance Report and Directors' Statement of Responsibilities for inclusion in the 2006 Annual Review and Accounts
- 2007 Interim Statement and Auditors' report thereon
- 2007 external audit fees
- Review of the whistleblowing policy
- Assessment of the Audit Committee and the external and internal auditors
- 2007 internal audit programme and the proposed 2008 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 to safeguard auditor objectivity and independence.

Auditors' independence: The independence, objectivity and effectiveness of the external auditors have 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 2008 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, David Richardson, Leonard V. Broese van Groenou and until her retirement, DeAnne Julius. Thomas A Corcoran joined the Committee on his appointment as Non-Executive Director to the Board on 3 December 2007. The Committee met twice during 2007.

Responsibilities: Matters considered during the year included the appointment of Grant Rumbles as Executive Director and Thomas A Corcoran as Non-Executive Director, Margaret Ford as Senior Independent Director and Leonard V. Broese van Groenou as Chair of the Remuneration Committee.

The Committee engaged external head hunters in the recruitment of Thomas A Corcoran, who applied rigorous selection procedures in proposing a number of candidates for the Committee's consideration. The Committee each individually met with Thomas before his recommended appointment to the Board.

In addition the Committee considered the Board structure and composition going forward, including succession and contingency plans for each of the Executive Directors, and the appointment of Margaret Ford as Senior Independent Director and of Leonard V. Broese van Groenou 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 57 to 70.

The Training and Development Committee

Membership: The Training and Development Committee is chaired by Kevin Beeston and comprises Margaret Ford, David Richardson, Leonard V. Broese van Groenou and until her retirement DeAnne Julius. Thomas A Corcoran joined the Committee on his appointment to the Board on 3 December 2007.

Responsibilities: The Committee met once during 2007 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 16 senior managers representing each of the Group's operating divisions and a number of functional heads. It also includes all three of the Executive Directors. 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 from across the Group.

A senior group of the GMB, the Executive Team, which is chaired by the Chief Executive and comprises five 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.

Relationship with shareholders

The Company's relationship with shareholders is 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 also posted on the Group's website 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 which contains the text of the resolutions to be proposed and 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 to the Group’s website www.serco.com.

Institutional investors

The Chief Executive and Finance Director have regular dialogue with institutional investors. The Chairman also meets with institutional investors from time to time and as required. The Company’s investor relations programme and day to day activities are managed by the Head of Investor Relations. As part of the role of Senior Independent Director, Margaret Ford is also available to meet shareholders should it be required.

The Board receives an investor relations report on a quarterly basis. This reviews share price movements and valuation, changes in the share register, the Company’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 Company’s investor relations performance.

Group website

The Group website 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 all reports, announcements, presentations and webcasts, share price tools, the terms of reference for all Board committees and information on voting at the 2008 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 for the 2008 Annual General Meeting.

Business conduct

Serco Group has published an Ethics and Business Conduct Policy Standard 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 it 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 38 to 42 of the Business Review. The Board confirms that the actions it considers necessary have been taken to remedy any failings and weaknesses which it has determined to be significant from its review of the Group’s internal controls and risk management processes.

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

27 February 2008

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 2007. Comparative figures used in this report are for the year ended 31 December 2006.

Activities

Serco Group plc is a holding company which operates via its subsidiaries and its 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 aviation, defence, education, health, home affairs, local government, nuclear, science, technology, transport and commercial sectors.

The Chairman's Statement on pages 8 to 9 and the Business Review on pages 10 to 42 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 is shown in note 30 to the financial statements.

The powers of the Directors to issue or buy back shares is restricted to that approved at the Company's Annual General Meeting.

Dividends

An interim dividend of 1.23p (2006 – 1.05p) per ordinary share was paid on 17 October 2007. The Directors recommend a final dividend of 3.02p (2006 – 2.55p) per ordinary share, which if approved by shareholders at the Annual General Meeting, will be paid on 21 May 2008, to those shareholders on the register at the close of business on 7 March 2008.

Substantial shareholdings

As at 25 February 2008 the Company had been notified under Rule 5 of the Disclosure and Transparency Rules of the Financial Services Authority of the following holdings of voting rights in its shares:

	No of shares (millions)	% held
FMR Corp. and Fidelity International Limited	48.0	9.90
HBOS plc	20.5	4.22
Resolution Investment Services Limited	20.1	4.15
AEGON UK plc Group of Companies	19.8	4.09
Legal & General Group plc	19.3	3.98

The Directors are unaware of any restrictions on transfer of securities in the Company or on voting rights. There are also no known agreements between holders of the company's securities which may result in such restrictions.

Directors

The current members of the Board together with biographical details of each Director are set out on pages 54 to 55.

Grant Rumbles was appointed to the Board as Chief Operating Officer on 3 July 2007. DeAnne Julius retired as a Non-Executive Director on 29 October 2007. Thomas A Corcoran was appointed a Non-Executive Director on 3 December 2007.

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.

Certain change of control conditions are included in the service contracts of Directors which provide compensation or reduction of notice periods in the event of a change of control of the Company.

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 57 to 70.

Annual general meeting

The Annual General Meeting of the Company will be held at the Queen Elizabeth II Conference Centre, London on 13 May 2008 at 11.00am.

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

Financial risk policies

A summary of the Group's treasury policies and objectives relating to financial risk management, including exposure to associated risks, is on pages 101 to 104.

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 Company has implemented across the Group policies on environmental, health and safety matters and operates an Ethics and Business Conduct Policy Standard.

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.

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 2007 were 24 days (2006: 26 days); Company 16 days (2006: 20 days).

Donations

The Group continues to encourage all staff to participate in their local communities and has a process to capture investment on a worldwide basis. This measure is based upon the Business in The Community (BITC) reporting format.

The value of this investment at £1,066,527 (2006: £942,340) represents 0.9% of the Group's pre-tax profit, and represents a 13.1% increase on investment made in 2006.

During the year neither the Company nor the Group made political donations and they intend to continue with this policy.


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

27 February 2008



From left to right:

Joanne Roberts Company Secretary

Leonard V. Broese van Groenou Non-Executive Director

Christopher Hyman Chief Executive

Andrew Jenner Finance Director

Kevin Beeston Chairman

David Richardson Non-Executive Director

Margaret, Baroness Ford of Cuninghame Non-Executive Director

Grant Rumbles Chief Operating Officer

Directors' profiles

Kevin Beeston FCMA (45) Chairman^{(1), (4)}

Chair of the Nomination and Training and Development Committees

Kevin Beeston became Non-Executive Chairman of Serco Group plc in September 2007, having previously served as the Group's Executive Chairman, Chief Executive and Finance Director.

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 and he is a Commissioner for the TUC's Commission on Vulnerable Employment.

In addition, he is the Non-Executive Chairman of Partnerships in Care, Infinitas Learning and Domestic and General Ltd, and holds Non-Executive Director positions on the boards of IMI plc and Ipswich Town Football Club plc.

Christopher Hyman CA (SA) (44)

Chief Executive

Christopher Hyman 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 (39)

Finance Director

Andrew Jenner joined Serco in 1996 having previously worked for Unilever and Deloitte & Touche LLP. He has held a number of positions at Serco including Group Financial Controller and Corporate Finance Director. Andrew became Group Finance Director and joined the Board in May 2002. As well as setting the Group's financial strategy, Andrew is responsible for its PFI investment business and the development of risk management across the Group. He shares responsibility for our relationship with shareholders and the City with the Chief Executive.

Thomas A Corcoran BA PhD (63)

Non-Executive Director ^{(1), (2), (3), (4)}

Thomas Corcoran joined Serco in December 2007 as a Non-Executive Director. He brings 40 years of global business experience, particularly in the US aerospace and defence contracting industry. He is currently Senior Advisor to private equity firm The Carlyle Group and President of Corcoran Enterprises, LLC, a management consulting firm.

Thomas has held senior positions in the aerospace, defence and electronics industries including Chairman and Chief Executive Officer of Allegheny Teledyne and President and Chief Operating Officer of Lockheed Martin's Electronic and Space Sectors. During his 26 years with General Electric, Thomas held senior management positions including Vice President and General Manager of GE's Aerospace operations.

He is also Non-Executive Director of Aer Lingus Ltd, L3 Communications Holdings Inc, Labarge Inc, REMEC Inc and ARINC Inc.

Leonard V. Broese van Groenou MSc (61)

Non-Executive Director ^{(1), (2), (3), (4)}

Chair of the Remuneration Committee

Leonard V. Broese van Groenou 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.

Baroness Ford of Cunninghame MA MPhil (50)

Senior Independent Director ^{(1), (2), (3), (4)}

Margaret Ford 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 Chairman 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.

In December 2007 Margaret retired from English Partnerships, the national regeneration agency, after six highly successful years. Margaret is Managing Director, Social Infrastructure and Development, Royal Bank of Canada Capital Markets and Chairman of Irvine Bay Urban Regeneration Company.

David Richardson BSc FCA (56)

Non-Executive Director ^{(1), (2), (3), (4)}

Chair of the Audit Committee

David Richardson 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 a Non-Executive Director of Dairy Crest Group Plc, Forth Ports Plc, Tomkins plc and The Restaurant Group plc.

Grant Rumbles (50)

Chief Operating Officer

Grant Rumbles is Chief Operating Officer of Serco Group plc.

Having joined Serco in 1982, Grant has led several Serco divisions including Continental Europe, Middle East and the Group's IT and BPO division.

In 2001 he was appointed to the Global Management Board and in 2004 he was promoted to Chief Operating Officer, responsible for the day-to-day operations of the Group. Grant is also responsible for leading the development of best practice, corporate responsibility and sustainable growth across the Group.

Grant is a member of the Executive Board of the Prince's Trust Construction and Business Services Leadership Group.

(1) Member of the Training and Development Committee
 (2) Member of the Audit Committee
 (3) Member of the Remuneration Committee
 (4) Member of the Nomination 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 (UK GAAP).

Company law requires the Directors to prepare such financial statements in accordance with IFRS, the Companies 1985 and Article 4 of the IAS Regulation.

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
- 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 Company 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

27 February 2008

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 2007. 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 13 May 2008.

The Remuneration Committee

The Remuneration Committee (the Committee) comprises all the independent Non-Executive Directors: Leonard V. Broese van Groenou (Chair), Margaret Ford, David Richardson and DeAnne Julius until her retirement in October 2007. Thomas A Corcoran joined the Committee on his appointment as Non-Executive Director to the Board on 3 December 2007. Leonard V. Broese van Groenou succeeded Margaret Ford as Chair of the Committee on 29 October 2007, on her appointment as Senior Independent Director.

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 four 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 page 47.

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 Limited (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. 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 2006 remuneration structure and packages which were detailed in the 2005 and subsequent Annual Review and Accounts and have been followed since. 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.

In setting remuneration of the Executive Directors, in particular the corporate objectives relating to the annual bonus scheme, the Remuneration Committee is able to consider corporate performance on environmental, social and corporate governance issues and retains discretion to reduce bonuses or share incentives should performance in these areas be unsatisfactory.

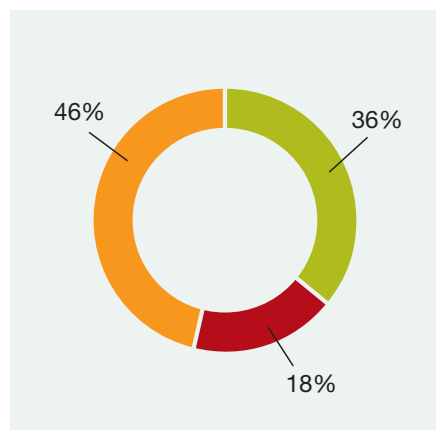
The Committee believes that the existing executive remuneration principles remain appropriate but will be carrying out a further triennial review during 2008 and any changes will be set out in detail in next year's report.

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 in the chart below.



- Base salary
- Performance-related long-term incentives (expected value)
- Performance-related annual bonus (target)

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 2007, the base salaries for Christopher Hyman, Andrew Jenner and Grant Rumbles were increased by 5.66%, 5.50% and 6.67% respectively. Base salary increases are in line with executive pay increases in the comparator group.

Annual bonuses

For 2007, the annual bonuses for Executive Directors were to be 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 2007 were based on turnover, Adjusted PBT 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 including leadership development, new business success, SAP implementation and investor relations.

Based on the achievement of stretching turnover and Adjusted PBT of £2,811m and £123m respectively and achievement of the goals under the personal objectives, a bonus equal to 88.9% of base salary will be paid for performance during 2007. The bonus is calculated on the salary at the time of the award.

Annual bonuses are not pensionable.

Deferred bonus scheme

For bonuses paid in respect of 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 Group pursuant to the terms of 2003 Deferred Bonus Scheme. The shares purchased will be matched by the Company if stretching performance targets are met.

The performance condition 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
- 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.

For the bonuses paid in respect of the 2004 financial year and deferred for the three financial years up to 31 December 2007, TSR performance relative to the comparator group was in the upper quartile (84th percentile). A one for one match of shares deferred will be made in March 2008.

Share-based incentives

Long-term share 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 Option Plan. 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.

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. An award of 100% of salary was made at the normal annual award time in November 2007 for evaluation between 1 January 2008 and 31 December 2010.

The vesting of awards made during 2007 will depend on the Group's TSR measured relative to the top 250 companies in the FTSE, 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 vests 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 are based on 100% of salary as at the 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 the Retail Price Index (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 2007, the Group's EPS growth was 18.56% per annum over the three-year performance period which resulted in all options vesting. The level at which maximum vesting would occur was 13.46% per annum.

Long Term Incentive Scheme

Prior to the approval of the 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:

- Full vesting will only occur if the cumulative EPS growth over the three-year performance period is at least 64%
- Awards will partially vest where the cumulative EPS growth is at least 35%
- Awards will vest on a straight line basis for each percentage increase in EPS growth above 35% over the three-year period until full vesting is achieved.

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 part of the awards will vest if the Group's performance is below the median of the comparator group over the three-year performance period
- 40% of the awards will vest if performance is at the median
- The awards vest in full if performance reaches or exceeds the upper quartile
- For performance between the median and the upper quartile, a proportion between 40% and 100% of the awards will vest pro rata.

For awards which completed their performance period on 31 December 2007, the Group's TSR performance was in the upper quartile (84th percentile) of the comparator group over the three-year performance period, resulting in the awards 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. The options granted under the Scheme in 2004 matured on 1 June 2007.

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.

Christopher Hyman is a Non-Executive Director of United Business Media plc for which the fees payable in the year were £45,000. He does not receive any other fees from Non-Executive directorships held.

No other fee-paying external positions were held by any of the Executive Directors.

Pensions and life assurance

Serco operates both defined benefit and defined contribution pension schemes. The Executive Directors participate in the Serco Pension and Life Assurance Scheme (SPLAS). This is a funded, defined benefit scheme, which provides for a pension of two-thirds of pensionable salary following a full career. 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 Inland Revenue limits prior to 6 April 2006). This rate increased to 9.5% with effect from 1 January 2007.

However, from this date Serco also introduced SMART whereby all members were given the option to have their pension contributions paid by salary sacrifice. Under this arrangement the member makes no normal pension contributions, Serco makes additional contributions to SPLAS equal to those that the member would otherwise have made and the member's contractual pay is reduced by the amount of these contributions. Both Christopher Hyman and Andrew Jenner opted to have their contributions paid by SMART.

Kevin Beeston's and Grant Rumbles' pension benefits accrued prior to 6 April 2006 exceeded the new Lifetime Allowance, which came into force at that date, and they opted to cease paying contributions and accruing benefits in the pension scheme after 6 April 2006. Since that time, and prior to his becoming Non-Executive Chairman, Kevin Beeston had been in receipt of a cash allowance equal to 33% of his base salary in lieu of further pension provision. This ceased on 1 September 2007.

Grant Rumbles is in receipt of a cash allowance of 22% of his base salary in lieu of further pension provision.

Kevin Beeston and Grant Rumbles remain entitled to lump sum and widow's pension benefits should they die before retirement and whilst still employed by or an officer of Serco.

Non-Executive Directors

On 1 September 2007, after 22 years with Serco and as communicated to shareholders in 2006, Kevin Beeston moved from Executive Chairman to Non-Executive Chairman. As from this date he is no longer eligible to participate in the Group's annual bonus and long-term incentive plans, save those grants made during his tenure as an Executive Director.

The Group's policy is that the fees of the 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 2007, 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.

Current Fee Structure

Non-Executive Directors' remuneration consists of cash fees paid monthly with increments for positions of additional responsibility. In addition, reasonable travel and related business expenses are paid. No bonuses are paid to Non-Executive Directors. The Board believe that payment of fees on a cash-only basis remains appropriate as opposed to the partial payment of fees in shares.

Non-Executive Directors are encouraged to hold shares in the Group but are not subject to a shareholding requirement. Non-Executive Directors' fees are not performance related.

The fees and terms of engagement of Non-Executive Directors are reviewed on an annual basis and approved by the Board.

The standard annual fees payable for Non-Executive Directors during the financial year under review are shown in the table below.

	From 1 September 2007 to date £	
Chairman ⁽¹⁾	200,000	
	1 January 2007 to 28 February 2007 £	From 1 March 2007 to date £
Board member	35,000	45,000
Committee Chairmanship	10,000	10,000
Senior Independent Director	5,000	10,000

⁽¹⁾ The Chairman has the use of a fully maintained office for company business, a company car plus private health and long-term disability insurance. Life insurance and personal accident and business travel insurance are also provided under the terms of the Company's policy.

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 of 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 at 31 December 2007
Non-Executive Chairman:				
Kevin Beeston	29 April 1985	29 February 1996	1 September 2007	30 months
Executive Directors:				
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
Grant Rumbles	3 July 1982	3 July 2007	3 July 2007	Rolling contract with 12 months notice period
		Date of Appointment to the Board	Date of Letter of Appointment	Unexpired term at 31 December 2007
Non-Executive Directors:				
Margaret Ford		8 October 2003	7 October 2003	21 months
Leonard V. Broese van Groenou		3 April 2006	20 February 2006	15 months
David Richardson		2 June 2003	29 May 2003	17 months
Thomas A Corcoran		3 December 2007	3 December 2007	35 months

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

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 benefits £	Allowance £	Total remuneration excluding pensions 2007 £	Total remuneration excluding pensions 2006 £
Kevin Beeston	1,2,3	353,332	66,668	314,113	55,699	115,639	905,451	1,202,888
Christopher Hyman	1,2,7	540,000	Nil	497,840	55,900	Nil	1,093,740	1,077,104
Andrew Jenner	1,2,7	334,500	Nil	306,705	55,797	Nil	697,002	683,347
Grant Rumbles	4	156,667	Nil	142,240	15,137	34,467	348,511	–
Leonard V. Broese van Groenou		Nil	45,000	Nil	Nil	Nil	45,000	26,250
Margaret Ford		Nil	53,333	Nil	Nil	Nil	53,333	41,665
DeAnne Julius	5	Nil	43,333	Nil	Nil	Nil	43,333	40,000
David Richardson		Nil	53,333	Nil	Nil	Nil	53,333	45,000
Thomas A Corcoran	6	Nil	3,750	Nil	Nil	Nil	3,750	Nil
Total		1,384,499	265,417	1,260,898	182,533	150,106	3,243,453	3,116,254

Notes:

1. The bonuses shown include performance bonuses earned in the period under review, but not paid in the financial year.
2. The value of the non cash benefits relates to the provision of a car allowance and private healthcare.
3. The allowance comprises payments made to Kevin Beeston, whilst he was Executive Chairman, and Grant Rumbles in lieu of pension, calculated as a percentage of base salary, from which they make their own pension arrangements (further details as set out in the section on Directors' Pensions on page 69).
4. Grant Rumbles was appointed to the Board on 3 July 2007. Remuneration is only disclosed for the period from his appointment.
5. DeAnne Julius retired from the Board on 29 October 2007.
6. Thomas A Corcoran was appointed to the Board on 3 December 2007.
7. Remuneration is shown gross of salary sacrificed under the SMART scheme. See page 61.

Directors' shareholdings

The Directors' interests in the shares of the Company are detailed in the following table. Each of the Executive Directors is encouraged to maintain a shareholding equal to one years' base salary, to be built up over three years where newly appointed to the Board.

	Note 1	Ordinary shares of 2p each fully paid at 1 January 2007 or if later the date of appointment as Director	Ordinary shares of 2p each fully paid at 31 December 2007
Kevin Beeston		159,413	138,218
Leonard V. Broese van Groenou		1,935	3,375
Margaret Ford		7,392	11,686
Christopher Hyman	2	134,885	156,457
Andrew Jenner	2	84,351	97,062
David Richardson		10,000	10,000
Grant Rumbles	3	Nil	Nil
Thomas A Corcoran	4	Nil	Nil

Notes:

1. Ordinary shares are beneficial holdings which include the Directors' personal holdings and those of their spouses and minor children.
2. 27,779 of Christopher Hyman's and 16,667 of Andrew Jenner's shares are 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 and subject to certain performance conditions, they are also granted an award over an equivalent number of shares.
3. Grant Rumbles was appointed to the Board on 3 July 2007.
4. Thomas A Corcoran was appointed to the Board on 3 December 2007.

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 were as follows:

(i) Serco Group plc 2003 Deferred Bonus Scheme (DBS)

Conditional rights to receive matching shares over Serco Group plc's ordinary shares under the DBS held by Directors at 31 December 2007 were as follows:

	Awards held at 1 January 2007	Market price at grant (pence)	Vested during the period	Market price on vesting (pence)	Awards held at 31 December 2007	Performance period	Earliest vesting date
Kevin Beeston	21,557	217	21,557	418	–	1 Jan 2004 – 31 Dec 2006	2 Mar 2007
Christopher Hyman	21,557	217	21,557	418	–	1 Jan 2004 – 31 Dec 2006	2 Mar 2007
	10,030	242	–	–	10,030	1 Jan 2005 – 31 Dec 2007	9 Mar 2008
	17,749	334	–	–	17,749	1 Jan 2006 – 31 Dec 2008	22 Mar 2009
Andrew Jenner	12,711	217	12,711	418	–	1 Jan 2004 – 31 Dec 2006	2 Mar 2007
	6,018	242	–	–	6,018	1 Jan 2005 – 31 Dec 2007	9 Mar 2008
	10,649	334	–	–	10,649	1 Jan 2006 – 31 Dec 2008	22 Mar 2009

Notes:

1. The DBS 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 page 59.
4. On 31 December 2007 the performance conditions attached to the awards made on 9 March 2005 were satisfied though the awards may not be exercised until 9 March 2008 as described on page 59.

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

The conditional rights to Serco Group plc ordinary shares under the LTIP held by Directors at 31 December 2007 were as follows:

	Awards held at 1 January 2007	Market price on grant (pence)	Granted during the period	Awards held at 31 December 2007	Performance period	Earliest vesting date	Latest exercise date
Kevin Beeston	147,928	349	–	147,928	1 Jan 2006 - 31 Dec 2008	4 May 2009	4 May 2016
	145,205	373	–	145,205	1 Jan 2007 - 31 Dec 2009	31 Dec 2009	28 Nov 2016
Christopher Hyman	147,928	349	–	147,928	1 Jan 2006 - 31 Dec 2008	4 May 2009	4 May 2016
	145,205	373	–	145,205	1 Jan 2007 - 31 Dec 2009	31 Dec 2009	28 Nov 2016
	–	456	122,874	122,874	1 Jan 2008 - 31 Dec 2010	31 Dec 2010	11 Nov 2017
Andrew Jenner	88,757	349	–	88,757	1 Jan 2006 - 31 Dec 2008	4 May 2009	4 May 2016
	89,589	373	–	89,589	1 Jan 2007 - 31 Dec 2009	31 Dec 2009	28 Nov 2016
	–	456	75,699	75,699	1 Jan 2008 - 31 Dec 2010	31 Dec 2010	11 Nov 2017
Grant Rumbles ⁽⁶⁾	43,550	349	–	43,550	1 Jan 2006 - 31 Dec 2008	4 May 2009	4 May 2016
	–	510	33,892	33,892	1 Jan 2007 - 31 Dec 2009	7 May 2010	7 May 2017
	–	456	70,213	70,213	1 Jan 2008 - 31 Dec 2010	31 Dec 2010	11 Nov 2017

Notes:

1. The performance conditions attached to the awards are described on page 59.
2. Awards take the form of nominal cost options.
3. Awards made are calculated at 100% of salary at the time of grant.
4. No awards vested, lapsed or were exercised during the period.
5. Awards during the year were made on 12 November 2007.
6. All awards held by Grant Rumbles, with the exception of that made on 12 November 2007, were granted prior to him being appointed Executive Director. An award made on 8 May 2007 relates to the three year performance period commencing 1 January 2007.

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

The LTIS has been superseded by the LTIP. The last award to Executive Directors under the LTIS was made in June 2005.

	Awards held at 1 January 2007	Market price at grant (pence)	Vested during the period	Market price on vesting (pence)	Awards held at 31 December 2007	Performance period	Earliest vesting date	Date of expiry of awards
Kevin Beeston	38,736	426	–	153	38,736	1 Jan 2000 – 31 Dec 2002	31 Dec 2002	4 Apr 2010
	50,797*	490	–	172	50,797	1 Jan 2001 – 31 Dec 2003	31 Dec 2003	23 Nov 2010
	40,898*	465	–	240	40,898	1 Jan 2002 – 31 Dec 2004	31 Dec 2004	15 Nov 2011
	103,467*	153	–	314	103,467	1 Jan 2003 – 31 Dec 2005	31 Dec 2005	5 May 2013
	173,142*	175	–	382	173,142	1 Jan 2004 – 31 Dec 2006	31 Dec 2006	26 Nov 2013
	119,411	231	119,411	462	119,411	1 Jan 2005 – 31 Dec 2007	31 Dec 2007	21 Dec 2014
Christopher Hyman	32,868	426	–	153	32,868	1 Jan 2000 – 31 Dec 2002	31 Dec 2002	4 Apr 2010
	43,540*	490	–	172	43,540	1 Jan 2001 – 31 Dec 2003	31 Dec 2003	23 Nov 2010
	35,056*	465	–	240	35,056	1 Jan 2002 – 31 Dec 2004	31 Dec 2004	15 Nov 2011
	103,467*	153	–	314	103,467	1 Jan 2003 – 31 Dec 2005	31 Dec 2005	5 May 2013
	173,142*	175	–	382	173,142	1 Jan 2004 – 31 Dec 2006	31 Dec 2006	26 Nov 2013
	119,411	231	119,411	462	119,411	1 Jan 2005 – 31 Dec 2007	31 Dec 2007	21 Dec 2014
Andrew Jenner	62,081*	153	–	314	62,081	1 Jan 2003 – 31 Dec 2005	31 Dec 2005	5 May 2013
	105,138*	175	–	382	105,138	1 Jan 2004 – 31 Dec 2006	31 Dec 2006	26 Nov 2013
	76,101	231	76,101	462	76,101	1 Jan 2005 – 31 Dec 2007	31 Dec 2007	21 Dec 2014
Grant Rumbles [®]	45,454	231	45,454	462	45,454	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 conditions. The performance conditions attached to the awards are described on page 60.
- No awards were exercised, awarded or lapsed during the year.
- For those awards marked with an (*) approximately 14.67% (13.50% for prior year grants) of the options granted under the LTIS 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 LTIS 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.
- All awards held by Grant Rumbles were granted prior to him being appointed Executive Director.

(iv) Serco Group plc 1998 and 2005 Executive Option Plan (EOP)

Options over Serco Group plc ordinary shares granted under the 1998 Executive Option Plan and the 2005 Executive Option Plan and held by Executive Directors at 1 January 2007 and 31 December 2007 were as follows:

	Awards held at 1 January 2007	Granted during period	Exercised during period	Awards held at 31 December 2007	Market price on exercise date (pence)	Exercise price (pence)	Date from which exercisable	Date of expiry of options
Kevin Beeston	82,710	–	13,788	68,922	434	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
–	120,798	–	120,798	–	439	19 Mar 2010	18 Mar 2017	
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
–	120,798	–	120,798	–	439	19 Mar 2010	18 Mar 2017	
Andrew Jenner	7,422	–	–	7,422	–	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
	–	74,530	–	74,530	–	439	19 Mar 2010	18 Mar 2017

(iv) Serco Group plc 1998 and 2005 Executive Option Plan (EOP) (continued)

	Awards held at 1 January 2007	Granted during period	Exercised during period	Awards held at 31 December 2007	Market price on exercise date (pence)	Exercise price (pence)	Date from which exercisable	Date of expiry of options
Grant Rumbles ⁽⁹⁾	4,002	–	–	4,002	–	218	21 May 2001	20 May 2008
	12,336	–	–	12,336	–	245	1 Apr 2002	31 Mar 2009
	9,954	–	–	9,954	–	426	5 Apr 2003	4 Apr 2010
	13,113	–	–	13,113	–	408	20 Mar 2004	19 Mar 2011
	26,099*	–	–	26,099	–	264	3 May 2005	2 May 2012
	12,453*	–	–	12,453	–	165	6 Sept 2005	5 Sept 2012
	52,639*	–	–	52,639	–	153	6 May 2006	5 May 2013
	58,387	–	–	58,387	–	214	30 Apr 2007	29 Apr 2014
	89,361	–	–	89,361	–	235	29 Apr 2008	28 Apr 2015
	67,846	–	–	67,846	–	339	5 May 2009	4 May 2016
	–	61,538	–	61,538	–	439	19 Mar 2010	18 Mar 2017

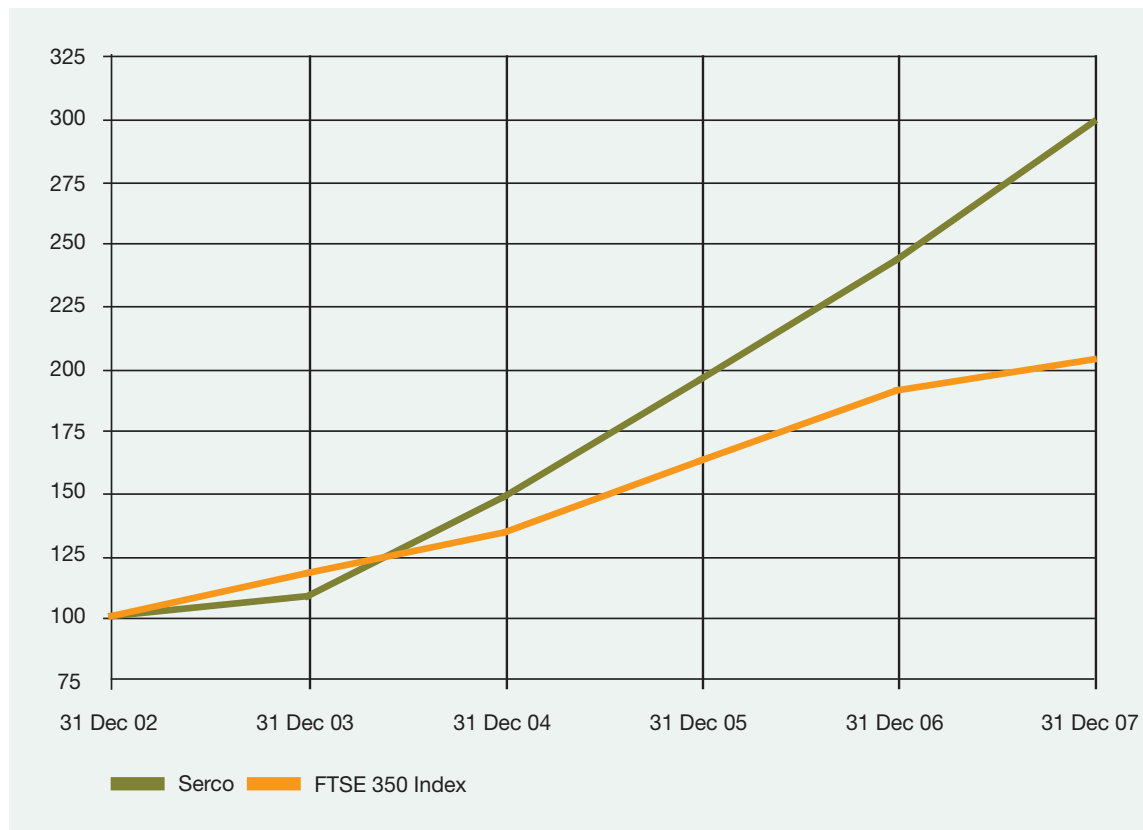
Notes:

1. The awards shown in the table are the maximum number of shares that can vest under the performance conditions.
2. The performance conditions attached to the awards are described on pages 59 to 60.
3. For those options marked with an (*) approximately 14.67% (13.50% 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.
4. No options lapsed during the year.
5. No payment was made for the grant of the awards.
6. Grants of options under the 1998 Executive Option Plan are calculated at 100% of salary at the time of grant.
7. The market price of the Company's ordinary shares at the close of business on 31 December 2007 was 462.25p and the range during the year to 31 December 2007 was 379.00p to 514.25p.
8. Awards during the year were made on 19 March 2007.
9. All awards held by Grant Rumbles were granted prior to him being appointed Executive Director.

Comparison of total shareholder returns

Serco Group plc total shareholder return (TSR) vs FTSE 350 Total Return Index

Value of investment of £100 on 31 December 2002



In drawing this graph, it has been assumed that all dividends paid have been reinvested. The TSR level shown at 31 December each year is the average of the closing daily TSR levels for the 30-day period up to and including that date. 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 28. 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 Serco Pension and Life Assurance Scheme, which is a defined benefit scheme, are as follows:

	Transfer value of accrued benefits at 31 December 2007	Transfer value of accrued benefits at 31 December 2006	Directors' contributions for the year	Increase in transfer value during the year (4) = (1)-(2)-(3)	Gross increase in accrued pension during the year (5)	Increase in accrued pension during the year, net of inflation (6)	Value of increase in accrual over the year (7)	Total accrued pension at year end (8)
	(1) £	(2) £	(3) £	(4) £	(5) £	(6) £	(7) £	(8) £
Kevin Beeston	2,921,990	1,966,075	–	955,915	13,392	3,302	35,455	272,106
Christopher Hyman	776,483	370,763	–	405,720	18,677	17,044	218,589	60,544
Andrew Jenner	363,309	151,823	–	211,486	11,131	10,300	113,354	32,440
Grant Rumbles	2,164,769	1,400,899	–	763,870	20,553	15,899	246,046	139,884

Notes:

- 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 for Kevin Beeston and Grant Rumbles, to 5 April 2006 when they 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.
- Grant Rumbles became a Director with effect from 3 July 2007. The pension note above covers accrual over the whole year and also shows the transfer value of his accrued benefits at the end of the previous year.
- The pensions which Kevin Beeston and Grant Rumbles had accrued up to 5 April 2006, when they opted out of the Scheme, are increased in line with their pensionable remuneration (averaged over three years) since 5 April 2006. The increase in Kevin Beeston's accrued pension over the year to 31 December 2007 is largely due to inflation, as shown by columns (5) and (6). The increase in Grant Rumbles' accrued pension is a result of a significant increase in his basic remuneration over the past year.
The increase in the accrued pensions of Christopher Hyman and Andrew Jenner allow for both the increase in their pensionable salaries over the year and for the accrual of a further year of pensionable service as a result of a further year's active membership of the Scheme.
- Transfer values have been calculated in accordance with version 9.2 of the Guidance Note GN11 issued by the actuarial profession. The assumptions used for calculating transfer values were reviewed during the year and updated to reflect improvements in mortality expectations and the investment strategy of the scheme. This has resulted in higher transfer values than would have applied using the previous assumptions. The difference between the transfer values at the beginning and end of the year, shown in (4), includes not only the effect of the changes in the assumptions, but also 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.
- The value of the increase in accrual shown in (7) is the value of the net increase in pension shown in (6) and 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 the case of Kevin Beeston and Grant Rumbles. It is based on the increase in the accrued pension net of inflation.
- With effect from 1 January 2007 Christopher Hyman and Andrew Jenner opted to have their contributions paid by the Company under SMART (salary sacrifice) and hence no contributions were paid by the Directors during the year.
- 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.
- Christopher Hyman also benefits from a defined contribution arrangement to which the Company contributed prior to April 2005. The Company's contributions to this arrangement were 15% of remuneration in excess of the Permitted Maximum under the approved Scheme. There were no contributions to this arrangement in 2007.
- Andrew Jenner also benefits from a defined contribution arrangement to which the Company contributed prior to June 2005. The Company's contributions to this arrangement were 15% of remuneration in excess of the Permitted Maximum under the approved Scheme. There were no contributions to this arrangement in 2007.

Share dilution

New shares are issued in order to satisfy options granted under the 1998 and 2005 Executive Option Plans, Sharesave Scheme, Long Term Incentive Scheme and 2006 Long Term Incentive Plan. In the ten year period to 31 December 2007, awards made under the Group's share schemes represented 4.82% (2006: 3.07%) of the Company's issued share capital, leaving available dilution headroom of 5.18% (2006: 6.93%).

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 and 2005 Executive Option Plans, Long Term Incentive Scheme, 2006 Long Term Incentive Plan and Deferred Bonus Scheme. The Trust held 5,250,152 and 4,849,759 ordinary shares at 1 January 2007 and 31 December 2007 respectively.

Kevin Beeston, Christopher Hyman, Andrew Jenner and Grant Rumbles, 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

27 February 2008

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 2007 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 38. 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 2007.

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. The information given in the directors' report includes that specific information presented in the chairman's statement and the business review that is cross referred from the directors' report.

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 director's remuneration and other transactions is not disclosed.

We review whether the corporate governance statement reflects the company's compliance with the nine provisions of the 2006 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 statement. 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 judgments 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 2007 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

27 February 2008

Consolidated income statement

For the year ended 31 December 2007

	Note	2007 £m	2006 £m
Continuing operations			
Revenue	4,5	2,810.7	2,548.2
Cost of sales		(2,404.5)	(2,182.5)
Gross profit		406.2	365.7
Administrative expenses		(264.2)	(242.9)
Other expenses – amortisation of intangibles arising on acquisition	14	(8.6)	(9.0)
Total administrative expenses		(272.8)	(251.9)
Gain on sale of PFI investments		–	11.4
Operating profit	5,6	133.4	125.2
Investment revenue	8	12.2	31.7
Finance costs	9	(31.0)	(49.5)
Profit before tax		114.6	107.4
Tax	10	(32.2)	(27.9)
Profit for the year		82.4	79.5
Attributable to:			
Equity holders of the parent		81.9	78.3
Minority interest		0.5	1.2
Earnings per share (EPS)			
Basic EPS	12	16.98p	16.62p
Diluted EPS	12	16.74p	16.43p

Consolidated statement of recognised income and expense

For the year ended 31 December 2007

	Note	2007 £m	2006 £m
Net actuarial gain on defined benefit pension schemes	28, 32	62.2	78.9
Actuarial loss on reimbursable rights	28, 32	(19.4)	(53.4)
Net exchange gain/(loss) on translation of foreign operations	32	12.8	(12.3)
Fair value gain on cash flow hedges during the year	32	9.0	2.2
Tax charge on items taken directly to equity	32	(11.5)	(7.0)
Net income recognised directly in equity		53.1	8.4
Profit for the year		82.4	79.5
Total recognised income and expense for the year		135.5	87.9
Attributable to:			
Equity holders of the parent		134.9	87.1
Minority interest		0.6	0.8

Consolidated balance sheet

At 31 December 2007

	Note	2007 £m	2006 £m
Non-current assets			
Goodwill	13	542.1	528.5
Other intangible assets	14	139.4	126.1
Property, plant and equipment	17	95.1	93.6
Trade and other receivables	20	104.6	110.5
Deferred tax assets	23	51.6	73.7
Derivative financial instruments	27	1.2	–
		934.0	932.4
Current assets			
Inventories	19	46.3	51.7
Trade and other receivables	20	573.6	463.3
Cash and cash equivalents	21	185.0	217.9
Derivative financial instruments	27	1.5	–
		806.4	732.9
Total assets		1,740.4	1,665.3
Current liabilities			
Trade and other payables	25	(670.0)	(541.9)
Current tax liabilities		(14.8)	(13.0)
Obligations under finance leases	24	(7.7)	(8.3)
Loans	22	(13.5)	(57.9)
Derivative financial instruments	27	(2.1)	(10.6)
		(708.1)	(631.7)
Non-current liabilities			
Trade and other payables	25	(13.3)	(10.4)
Obligations under finance leases	24	(8.7)	(11.5)
Loans	22	(317.4)	(346.1)
Derivative financial instruments	27	(11.2)	(14.2)
Retirement benefit obligations	28	(142.6)	(249.3)
Provisions	29	(18.6)	(22.3)
Deferred tax liabilities	23	(22.0)	(19.9)
		(533.8)	(673.7)
Total liabilities		(1,241.9)	(1,305.4)
Net assets		498.5	359.9
Equity			
Share capital	30	9.7	9.5
Share premium account	31	299.3	283.5
Capital redemption reserve		0.1	0.1
Retained earnings	32	260.6	196.6
Retirement benefit obligations reserve	32	(90.2)	(119.5)
Share-based payment reserve	32	34.6	25.5
Own shares reserve	32	(15.1)	(16.4)
Hedging and translation reserve	32	(1.8)	(21.3)
Equity attributable to equity holders of the parent		497.2	358.0
Minority interest		1.3	1.9
Total equity		498.5	359.9

The financial statements were approved by the Board of Directors on 27 February 2008 and signed on its behalf by:



Christopher Hyman
Chief Executive



Andrew Jenner
Finance Director

Consolidated cash flow statement

For the year ended 31 December 2007

	Note	2007 £m	2006 £m
Net cash inflow from operating activities	33	134.1	159.5
Investing activities			
Interest received		10.3	32.4
Disposal of joint ventures	16	2.5	18.2
Proceeds from disposal of intangible assets		1.7	–
Proceeds from disposal of property, plant and equipment		2.9	1.4
Acquisition of subsidiaries, net of cash acquired	15	(9.1)	–
Purchase of other intangible assets		(30.6)	(30.4)
Purchase of property, plant and equipment		(26.2)	(27.8)
Net cash outflow from investing activities		(48.5)	(6.2)
Financing activities			
Interest paid		(34.2)	(42.2)
Dividends paid	11	(17.9)	(14.5)
Dividend paid to minority interest		(1.2)	(1.0)
Repayment of borrowings		(74.6)	(103.4)
New loan advances		2.2	9.4
Capital element of finance lease repayments		(8.4)	(8.6)
Proceeds from issue of share capital and exercise of share options		17.1	14.1
Decrease in non recourse loans		(8.3)	(25.3)
Net cash outflow from financing activities		(125.3)	(171.5)
Net decrease in cash and cash equivalents		(39.7)	(18.2)
Cash and cash equivalents at beginning of year		217.9	240.7
Net exchange gain/(loss)		6.8	(4.6)
Cash and cash equivalents at end of year	21	185.0	217.9

Notes to the financial statements

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 9UY.

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 73 to 121 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.

The Group adopted IFRS 7 'Financial instruments: Disclosures' and the complementary amendment to IAS 1 'Presentation of Financial Statements – Capital Disclosures' from 1 January 2007. IFRS 7 introduces new disclosures relating to financial instruments. This standard does not have any impact on the classification or valuation of the Group's financial instruments and covers disclosures only.

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'.

Previously, amortisation of intangibles was shown separately within administrative expenses in the income statement and was excluded from the adjusted earnings per share calculation. Only amortisation of intangibles arising on acquisition is now shown separately in the income statement and excluded from the adjusted earnings per share calculation. The 2006 comparatives have been re-presented. There is no change to operating profit or administrative costs in total as a result of this change in presentation.

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.

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.

2. Significant accounting policies (continued)

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.

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.

2. Significant accounting policies (continued)

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 (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.

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.

2. Significant accounting policies (continued)

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 reimbursable 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 reimbursable rights 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 pension 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.

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 taxable 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.

2. Significant accounting policies (continued)

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	10% – 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).

Other intangible assets

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

Development expenditure 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

The Group reviews the carrying amounts of its tangible and intangible assets annually 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.

2. Significant accounting policies (continued)

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.

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 35. 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 (2006 – one) fully owned Special Purpose Company (SPC) which is used for the purpose of running the PFI business.

Trade receivables

Trade receivables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method, less provision for impairment. A provision for impairment of trade receivables is established when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of the contract. Significant financial difficulties of the debtor, probability that the debtor will enter bankruptcy or financial reorganisation, and default or delinquency in payments are considered indicators that a trade receivable is impaired. The amount of the provision is based on management's best estimate of the likelihood of the recoverable amount. The carrying amount of the asset is reduced through the use of a bad debt provision account and the amount of the loss is recognised in the income statement within administrative expenses. When a trade receivable is uncollectable, it is written off against the bad debt provision account for trade receivables. Subsequent recoveries of amounts previously written off are credited against administrative expenses.

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.

2. Significant accounting policies (continued)

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 at the balance sheet date. 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

Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the income statement within finance costs, together with any changes in the fair value of the hedged asset or liability that are attributable to the hedged risk.

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges 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 recognised in 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 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 partially disposed of or sold.

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:

International Accounting Standards (IAS/IFRSs)		Effective date
IAS 23 (Amendment)	Borrowing Costs	1 January 2009
IFRS 8	Operating Segments	1 January 2009
International Financial Reporting Interpretations Committee (IFRIC)		
IFRIC 11	IFRS 2 – Group and treasury share transactions	1 January 2008
IFRIC 12	Service Concession Arrangements	1 January 2008
IFRIC 14	IAS 19 – The limit on a defined benefit asset, minimum funding requirements and their interaction	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.

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 and profit recognition of long-term project-based contracts

Revenue and profit 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 £542.1m (2006 – £528.5m) 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 28). The value of retirement benefit obligations at the balance sheet date is £142.6m (2006 – £249.3m). Details of the impact of changes in assumptions relating to retirement benefit obligations are disclosed in the Finance review (page 37).

4. Revenue

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

	2007 £m	2006 £m
Rendering of services	2,810.7	2,548.2
Revenue as disclosed in the consolidated income statement	2,810.7	2,548.2
Investment revenue (note 8)	12.2	31.7
Total revenue as defined in IAS 18	2,822.9	2,579.9

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 2007	Civil Government £m	Defence £m	Transport £m	Science £m	Total £m
Revenue	952.2	720.5	655.0	483.0	2,810.7
Result					
Segment result	46.8	49.8	26.7	45.7	169.0
Unallocated expenses					(35.6)
Operating profit					133.4
Investment revenue					12.2
Finance costs					(31.0)
Profit before tax					114.6
Tax					(32.2)
Profit for the year					82.4
Capital expenditure including acquisitions					
Property, plant and equipment	15.6	5.3	10.2	1.6	32.7
Goodwill	9.8	-	1.4	-	11.2
Intangible assets – segments	11.8	1.2	1.3	0.5	14.8
Intangible assets – unallocated					16.2
					31.0
Depreciation and amortisation					
Depreciation	17.7	6.2	4.6	1.7	30.2
Amortisation – segments	11.3	0.6	3.8	1.5	17.2
Amortisation – unallocated					6.0
					23.2
Segment assets					
Business segment assets	776.3	290.6	149.9	227.4	1,444.2
Unallocated assets					56.1
					1,500.3
Segment liabilities					
Business segment liabilities	(281.4)	(233.8)	(108.0)	(179.4)	(802.6)
Unallocated liabilities					(23.3)
					(825.9)

5. Segmental information (continued)

Market segments

Year ended 31 December 2006	Civil Government £m	Defence £m	Transport £m	Science £m	Total £m
Revenue	875.0	644.8	625.7	402.7	2,548.2
Result					
Segment result	42.0	41.2	26.7	36.9	146.8
Unallocated expenses					(33.0)
Gain on sale of PFI investments					11.4
Operating profit					125.2
Investment revenue					31.7
Finance costs					(49.5)
Profit before tax					107.4
Tax					(27.9)
Profit for the year					79.5
Capital expenditure including acquisitions					
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
Depreciation and amortisation					
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
Segment assets					
Business segment assets	715.3	249.5	150.9	208.3	1,324.0
Unallocated assets					49.7
					1,373.7
Segment liabilities					
Business segment liabilities	(237.0)	(284.3)	(116.9)	(150.8)	(789.0)
Unallocated liabilities					(12.6)
					(801.6)

Geographical segments

Year ended 31 December 2007	United Kingdom £m	North America £m	Europe and Middle East £m	Asia Pacific £m	Total £m
Revenue	2,125.6	300.9	222.1	162.1	2,810.7
Capital expenditure including acquisitions					
Property, plant and equipment	19.0	1.2	3.0	9.5	32.7
Goodwill	9.8	–	1.4	–	11.2
Intangible assets	29.3	1.1	0.5	0.1	31.0
Assets					
Geographical segment assets	1,115.8	207.8	117.5	59.2	1,500.3

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
Revenue	1,886.5	295.3	213.4	153.0	2,548.2
Capital expenditure including acquisitions					
Property, plant and equipment	19.8	1.9	4.3	4.4	30.4
Goodwill	–	–	–	–	–
Intangible assets	35.5	–	2.1	–	37.6
Assets					
Geographical segment assets	1,002.1	199.5	124.3	47.8	1,373.7
				2007 £m	2006 £m
Segment assets comprise:					
Goodwill				542.1	528.5
Other intangible assets				139.4	126.1
Property, plant and equipment				95.1	93.6
Trade and other receivables – non-current				104.6	110.5
Inventories				46.3	51.7
Trade and other receivables – current excluding tax recoverable				572.8	463.3
				1,500.3	1,373.7
				2007 £m	2006 £m
Segment liabilities comprise:					
Trade and other payables – current				(670.0)	(541.9)
Trade and other payables – non-current				(13.3)	(10.4)
Retirement benefit obligations				(142.6)	(249.3)
				(825.9)	(801.6)

6. Operating profit

Operating profit is stated after charging/(crediting):

	2007 £m	2006 £m
Net foreign exchange (gains)/losses	(1.1)	0.3
Research and development costs	44.9	44.2
Loss on disposal of property, plant and equipment	1.3	1.1
Depreciation of property, plant and equipment (note 17)	30.2	30.0
Amortisation of intangible assets – arising on acquisition (note 14)	8.6	9.0
Amortisation of intangible assets – other (note 14)	14.6	7.2
Staff costs (note 7)	1,183.6	1,115.5
Bad debt provision charged to income statement (note 20)	0.5	0.5
Fair value adjustment on financial instruments		
- recycling of amounts on discontinued cash flow hedge	0.3	–
- forward foreign exchange contracts: non-designated hedges	(1.1)	–
Operating lease payments	108.4	113.9
Operating lease income	(0.1)	(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.

	2007 £m	2006 £m
Fees payable to the Company's auditors for the audit of the Company's annual accounts	0.8	0.7
Fees payable to the Company's auditors and their associates for other services to the Group:		
- audit of the Company's subsidiaries pursuant to legislation	0.8	0.8
Total audit fees	1.6	1.5
Other services pursuant to legislation	0.2	0.1
Tax services	0.4	0.7
Other services	0.2	0.1
Total non-audit fees	0.8	0.9

7. Staff costs

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

	2007 Number	2006 Number
Civil Government	17,916	17,894
Defence	11,676	10,660
Transport	8,114	8,206
Science	3,525	3,062
Unallocated	214	264
Total	41,445	40,086

Their aggregate remuneration comprised:

	2007 £m	2006 £m
Wages and salaries	1,011.6	958.4
Social security costs	92.0	87.6
Other pension costs (note 28)	75.0	64.7
	1,178.6	1,110.7
Share-based payment expense (note 35)	5.0	4.8
Total	1,183.6	1,115.5

8. Investment revenue

	2007 £m	2006 £m
Net fair value adjustments on derivative financial instruments	0.3	–
Interest receivable by PFI companies	3.2	25.6
Interest receivable on other loans and deposits	5.5	6.1
Net interest receivable on retirement benefit obligations (note 28)	3.2	–
	12.2	31.7

9. Finance costs

	2007 £m	2006 £m
Net fair value adjustments on derivative financial instruments	–	0.5
Interest payable on non recourse loans	3.7	18.0
Interest payable on obligations under finance leases	1.0	0.6
Interest payable on other loans	26.3	28.5
Net interest payable on retirement benefit obligations (note 28)	–	1.9
	31.0	49.5

10. Tax

	2007 £m	2006 £m
Current tax		
UK corporation tax	12.2	17.4
Foreign tax	11.1	7.7
Adjustment in respect of prior years:		
UK corporation tax	(3.9)	(8.5)
Foreign tax	(0.1)	(0.3)
	19.3	16.3
Deferred tax		
Current year	16.5	5.1
Adjustment in respect of prior years	(3.6)	6.5
	12.9	11.6
	32.2	27.9

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

	2007 £m	2006 £m
Profit before tax	114.6	107.4
Tax calculated at a rate of 30% (2006 - 30%)	34.4	32.2
Expenses not deductible for tax purposes	6.5	5.6
Unrelieved tax losses and different tax rates on overseas earnings	3.2	1.2
Untaxed income and the effect of the use of unrecognised tax losses	(1.3)	(2.2)
Untaxed income on sale of PFI investments	-	(3.4)
Tax incentives	(3.0)	(3.2)
Adjustments in respect of prior years	(7.6)	(2.3)
Tax charge	32.2	27.9

11. Dividends

	2007 £m	2006 £m
Amounts recognised as distributions to equity holders in the year:		
Final dividend for the year ended 31 December 2006 of 2.55p per share on 471.1 million ordinary shares (2006 – Final dividend for the year ended 31 December 2005 – 2.06p on 463.0 million ordinary shares)	12.0	9.5
Interim dividend for the year ended 31 December 2007 of 1.23p per share on 478.9 million ordinary shares (2006 – Interim dividend for the year ended 31 December 2006 – 1.05p on 469.5 million ordinary shares)	5.9	5.0
	17.9	14.5
Proposed final dividend for the year ended 31 December 2007 of 3.02p per share on 480.2 million ordinary shares (2006 – 2.55p on 471.1 million ordinary shares)	14.5	12.0

The proposed final dividend for 2007 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 32).

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 arising on acquisition (see note 14) 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

	2007 Millions	2006 Millions
Weighted average number of ordinary shares for the purpose of basic EPS	482.4	471.2
Effect of dilutive potential ordinary shares: share options	6.8	5.5
Weighted average number of ordinary shares for the purpose of diluted EPS	489.2	476.7

Earnings

	2007		2006	
	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	81.9	16.98	78.3	16.62
Less:				
Gain on sale of PFI investments	–	–	(11.4)	(2.42)
Add back:				
Amortisation of intangible assets arising on acquisition, net of tax of £0.9m (2006 - £0.9m)	7.7	1.59	8.1	1.72
Adjusted earnings before amortisation of intangible assets and gain on sale of PFI investments	89.6	18.57	75.0	15.92
Earnings for the purpose of basic EPS	81.9	16.98	78.3	16.62
Effect of dilutive potential ordinary shares	–	(0.24)	–	(0.19)
Diluted EPS	81.9	16.74	78.3	16.43

At 31 December 2007, options over 27,000 (2006 – 3.3 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
At 1 January 2006	544.5
Additions	–
Exchange differences	(16.0)
At 1 January 2007	528.5
Additions	11.2
Exchange differences	2.4
At 31 December 2007	542.1

Goodwill has been allocated to cash-generating units (CGUs) in the following business segments:

Cost	2007 £m	2006 £m
Civil Government	325.5	318.6
Defence	97.0	98.5
Science	102.3	99.1
Transport	17.3	12.3
At 31 December	542.1	528.5

In 2006, goodwill relating to RCI and ITNET was reported separately. In 2007, these are shown within the Defence (£90.9m) and Civil Government (£260.9m) sectors respectively in line with how the Group monitors its goodwill internally.

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:

	2007 %	2006 %
Civil Government	11.8 – 13.5	11.8 – 13.5
Defence	11.3 – 12.3	11.3 – 12.3
Science	11.3	11.3
Transport	11.8	11.8

14. Other intangible assets

	Acquisition related		Software and development expenditure £m	Other		Total £m
	Customer relationships £m	Licences and franchises £m		Pension related intangibles £m		
Cost						
At 1 January 2007	22.0	54.8	61.7	26.7		165.2
Transfers	–	–	1.9	–		1.9
Arising on acquisition of a company	0.4	–	–	–		0.4
Additions	–	–	30.6	–		30.6
Disposals	–	(0.8)	(1.1)	–		(1.9)
Exchange differences	–	8.0	0.8	–		8.8
At 31 December 2007	22.4	62.0	93.9	26.7		205.0
Amortisation						
At 1 January 2007	5.5	19.1	8.4	6.1		39.1
Charge for the year	2.9	5.7	11.4	3.2		23.2
Disposals	–	(0.2)	–	–		(0.2)
Exchange differences	–	3.1	0.4	–		3.5
At 31 December 2007	8.4	27.7	20.2	9.3		65.6
Net book value						
At 31 December 2007	14.0	34.3	73.7	17.4		139.4

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

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

- Software and development expenditure – over their estimated useful lives
- Customer relationships – over average length of contracts acquired

Amortisation of intangibles arising on acquisition consists of amortisation in relation to Customer relationships and Licences and franchises and totals £8.6m (2006 – £9.0m).

15. Acquisitions

(a) During the first half of the year, Equity Aviation Holdings (Pty) Limited, a 50% joint venture company, acquired several small companies. Equity Aviation provides ground handling services to the aviation industry.

(b) On 16 May, 8 August and 31 December 2007, the Group acquired Cornwell Management Consultants plc, Alexander Hughes Interim Management Limited and ER Consultants Limited respectively. All of these companies are involved in the provision of consultancy services to the public and private sector.

(c) On 1 December 2007, the Group acquired all of the issued share capital of Business Link Devon and Cornwall Limited (BLDC). BLDC provides business link services to the South West of England.

The total consideration for all acquisitions was £14.4m.

All transactions have been accounted for in accordance with IFRS 3 'Business Combinations'.

Net assets acquired were:

	Book value £m	Fair value adjustments £m	Fair value £m
Intangible assets	–	0.4	0.4
Property, plant and equipment	1.1	(0.2)	0.9
Debtors	8.5	(0.3)	8.2
Cash and cash equivalents	1.8	–	1.8
Loans	(0.3)	–	(0.3)
Provisions	–	(0.4)	(0.4)
Creditors	(7.7)	0.3	(7.4)
Net assets acquired	3.4	(0.2)	3.2
Goodwill			11.2
Total consideration			14.4

Satisfied by:

	£m
Consideration paid in January 2008	2.9
Consideration paid in 2007	9.8
Purchase consideration	12.7
Directly attributable costs	1.7
Total consideration	14.4

Net cash outflow arising on acquisitions:

	£m
Purchase consideration paid in 2007	9.8
Directly attributable costs paid in 2007	1.1
Cash and cash equivalents acquired	(1.8)
	9.1

Acquisitions contributed £15.6m to revenue and £0.8m to the Group's profit before tax for the period between the date of acquisition and the balance sheet date. If the acquisitions had taken place at the start of the year, the Group's revenue and profit before tax would have been approximately £10m and £0.3m higher respectively.

16. Disposals

During the year ended 31 December 2007, Serco disposed of its investments in the following joint ventures:

	Date of disposal	Joint Venture % held
Serco Gulf LLC	31 May 2007	49%
Serco Guthrie PTE Ltd	22 June 2007	50%
Serco Project Engineering Ltd	23 July 2007	50%

The aggregated financial effect of the disposals on the consolidated accounts for the period is as follows:

Net assets disposed of were:

	£m
Property, plant and equipment	0.7
Inventories	1.4
Trade and other receivables	8.0
Cash and cash equivalents	3.2
Trade and other payables	(5.6)
Accruals and deferred income	(0.4)
Loans	(0.5)
Tax	(0.9)
	5.9

The gain on sale is calculated as follows:

	£m
Cash consideration received in 2007	6.3
Deferred consideration	0.3
Less:	
Net assets disposed of	(5.9)
Gain on sale of joint venture investments	0.7

The net cash inflow arising on disposal is as follows:

	£m
Cash consideration received in 2007	6.3
Less:	
Cash disposed of	(3.2)
Cash inflow in relation to 2007 disposals	3.1
Transaction costs paid during the year in relation to 2006 disposals	(0.6)
Net cash inflow	2.5

I 7. Property, plant and equipment

	Freehold land and buildings £m	Short leasehold building improvements £m	Machinery, motor vehicles, furniture and equipment £m	Total £m
Cost				
At 1 January 2007	8.4	24.2	183.2	215.8
Additions	–	4.8	27.0	31.8
Disposals	(1.0)	(1.2)	(11.6)	(13.8)
Reclassifications	(1.2)	1.2	–	–
Transfers	–	–	1.3	1.3
Arising on acquisition of subsidiaries	–	–	1.1	1.1
Elimination on disposals of joint ventures	(0.2)	(0.2)	(1.8)	(2.2)
Exchange differences	0.4	0.5	6.3	7.2
At 31 December 2007	6.4	29.3	205.5	241.2
Accumulated depreciation and impairment				
At 1 January 2007	2.5	11.2	108.5	122.2
Charge for the year	0.2	3.1	26.9	30.2
Eliminated on disposals	(0.2)	(0.5)	(8.9)	(9.6)
Arising on acquisition of subsidiaries	–	–	0.2	0.2
Elimination on disposals of joint ventures	(0.1)	(0.1)	(1.3)	(1.5)
Exchange differences	0.1	0.3	4.2	4.6
At 31 December 2007	2.5	14.0	129.6	146.1
Net book value				
At 31 December 2007	3.9	15.3	75.9	95.1

	Freehold land and buildings £m	Short leasehold building improvements £m	Machinery, motor vehicles, furniture and equipment £m	Total £m
Cost				
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	–	–	(8.2)	(8.2)
Exchange differences	(0.1)	(0.6)	(6.5)	(7.2)
At 31 December 2006	8.4	24.2	183.2	215.8
Accumulated depreciation and impairment				
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	–	–	(4.1)	(4.1)
Exchange differences	–	(0.3)	(3.7)	(4.0)
At 31 December 2006	2.5	11.2	108.5	122.2
Net book value				
At 31 December 2006	5.9	13.0	74.7	93.6

17. Property, plant and equipment (continued)

The carrying amount of the Group's machinery, motor vehicles, furniture and equipment includes an amount of £17.4m (2006 – £18.1m) in respect of assets held under finance leases.

The carrying amount of the Group's freehold land and buildings includes an amount of £nil (2006 – £0.2m) in respect of assets held under finance leases.

The carrying amount of the Group's short-leasehold building improvements includes an amount of £1.0m (2006 – £0.5m) in respect of assets held under finance leases.

18. 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

	2007 £m	2006 £m
Revenue	680.1	643.3
Expenses	(638.9)	(606.0)
Operating profit	41.2	37.3
Investment revenue	4.9	3.3
Finance costs	(0.9)	(1.3)
Profit before tax	45.2	39.3
Tax	(12.1)	(8.6)
Profit for the year	33.1	30.7
Minority interest	(0.3)	(0.6)
Share of post-tax results of joint ventures	32.8	30.1

Operating profit is after allocating £4.0m (2006 – £4.0m) of costs incurred by Group.

Balance sheet

	2007 £m	2006 £m
Non-current assets	102.6	104.0
Current assets	124.2	104.5
Current liabilities	(123.3)	(92.8)
Non-current liabilities	(75.5)	(90.4)
Net assets	28.0	25.3

19. Inventories

	2007 £m	2006 £m
Service spares	14.9	19.6
Parts awaiting installation	11.2	11.0
Long-term project-based contract balances	20.2	21.1
	46.3	51.7

20. Trade and other receivables

	2007 £m	2006 £m
Trade and other receivables: Non-current		
PFI debtor*	27.4	29.8
Amounts owed by joint ventures	0.6	2.3
Amounts recoverable on retirement benefit obligations (note 28)	60.7	67.6
Other debtors	15.9	10.8
	104.6	110.5
	2007 £m	2006 £m
Trade and other receivables: Current		
Trade receivables	418.1	340.1
Other amounts recoverable on contracts	50.3	45.3
PFI debtor*	2.4	1.5
Corporation tax recoverable	0.8	–
Prepayments and accrued income	51.3	39.8
Other debtors	50.7	36.6
	573.6	463.3

* The PFI debtor analysed above is funded by a non recourse loan of £22.5m (2006 – £24.8m).

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

As of 31 December 2007, trade receivables of £1.4m (2006 – £1.8m) were considered to be impaired. Impairments to trade receivables are based on specific estimated irrecoverable amounts and general provisions on outstanding balances greater than a year old unless there is firm evidence that the balance is recoverable. The amount of the provision was only £1.4m as of 31 December 2007 (2006 – £1.4m) primarily because our customers have a sovereign credit rating being either Government organisations or blue chip private sector companies.

The ageing of trade receivables is as follows:

	2007 £m	2006 £m
Neither impaired nor past due	334.6	275.1
Not impaired but overdue by less than 30 days	53.4	40.6
Not impaired but overdue by between 30 and 60 days	13.5	9.7
Not impaired but overdue by more than 60 days	16.6	14.3
Impaired	1.4	1.8
Bad debt provision	(1.4)	(1.4)
	418.1	340.1

Movements on the Group bad debt provision are as follows:

	2007 £m	2006 £m
At 1 January	1.4	1.3
Charged to income statement	0.5	0.5
Utilised	(0.5)	(0.4)
At 31 December	1.4	1.4

The maximum exposure to credit risk in relation to trade receivables at the reporting date is the fair value of trade receivables. The Group does not hold any collateral as security.

21. Cash and cash equivalents

	Sterling 2007 £m	Other currencies 2007 £m	Total 2007 £m	Sterling 2006 £m	Other currencies 2006 £m	Total 2006 £m
Cash of PFI and other project companies						
securing credit obligations	1.7	4.0	5.7	1.7	3.5	5.2
Customer advance payments	–	6.2	6.2	–	5.4	5.4
Other cash and short-term deposits	97.6	75.5	173.1	157.7	49.6	207.3
Total cash and cash equivalents	99.3	85.7	185.0	159.4	58.5	217.9

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.

22. Loans

	Non recourse loans (relating to PFI assets) 2007 £m	Other non recourse loans 2007 £m	Other loans 2007 £m	Total 2007 £m	Non recourse loans (relating to PFI assets) 2006 £m	Other non recourse loans 2006 £m	Other loans 2006 £m	Total 2006 £m
Loans are repayable as follows:								
On demand or within one year	2.8	5.9	4.8	13.5	3.3	5.6	49.0	57.9
Between one and two years	5.2	5.9	144.3	155.4	2.0	5.1	4.9	12.0
Between two and five years	7.6	18.8	51.9	78.3	6.8	15.9	193.0	215.7
After five years	6.9	6.2	70.6	83.7	12.7	10.8	94.9	118.4
	22.5	36.8	271.6	330.9	24.8	37.4	341.8	404.0
Less: Amount due for settlement within one year (shown within current liabilities)	(2.8)	(5.9)	(4.8)	(13.5)	(3.3)	(5.6)	(49.0)	(57.9)
Amount due for settlement after one year	19.7	30.9	266.8	317.4	21.5	31.8	292.8	346.1

The carrying amounts and fair values of the loans are as follows:

	Carrying amount		Fair value	
	2007 £m	2006 £m	2007 £m	2006 £m
Non recourse loans (relating to PFI assets)	22.5	24.8	21.0	22.8
Other non recourse loans	36.8	37.4	38.2	39.1
Other loans	271.6	341.8	274.6	343.2
	330.9	404.0	333.8	405.1

The fair values are based on cash flows discounted using a rate based on the borrowing rate associated with the loan. All loans, apart from a private placement repaid in December 2007, are valued at amortised cost.

23. Deferred tax

Deferred income taxes are calculated in full on temporary differences under the liability method using a principal tax rate of 28% (2006 – 30%). From 1 April 2008, the UK corporation tax rate is 28%.

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

	2007 £m	2006 £m
At 1 January	(53.8)	0.9
Income statement charge (note 10)	12.9	11.6
Disposals	–	(68.3)
Items taken directly to equity	11.5	2.0
Exchange differences	(0.2)	–
At 31 December	(29.6)	(53.8)

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

	Temporary differences on assets/ intangibles £m	Share-based payment employee benefits £m	Retirement benefits schemes £m	Derivative financial instruments £m	Other temporary differences £m	Total £m
At 1 January 2007	11.2	(19.0)	(41.1)	(5.2)	0.3	(53.8)
(Credited)/charged to income statement	(3.0)	3.6	12.2	(0.1)	0.2	12.9
Exchange differences	(0.2)	–	–	–	–	(0.2)
Items taken directly to equity	–	(4.3)	13.5	2.3	–	11.5
At 31 December 2007	8.0	(19.7)	(15.4)	(3.0)	0.5	(29.6)

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

	Temporary differences on assets/ intangibles £m	Share-based payment employee benefits £m	Retirement benefits schemes £m	Derivative financial instruments £m	Other temporary differences £m	Total £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
At 31 December 2006	11.2	(19.0)	(41.1)	(5.2)	0.3	(53.8)

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:

	2007 £m	2006 £m
Deferred tax liabilities	22.0	19.9
Deferred tax assets	(51.6)	(73.7)
	(29.6)	(53.8)

At the balance sheet date, the Group did not recognise deferred tax assets of £7.7m (2006 – £13.2m) in respect of the aggregate of deductible temporary differences, unused tax losses and unused tax credits.

24. Obligations under finance leases

	Minimum lease payments 2007 £m	Present value of minimum lease payments 2007 £m	Minimum lease payments 2006 £m	Present value of minimum lease payments 2006 £m
Amounts payable under finance leases:				
Within one year	8.6	7.7	9.5	8.3
Between one and five years	9.1	7.5	12.0	11.0
After five years	1.4	1.2	1.2	0.5
	19.1	16.4	22.7	19.8
Less: future finance charges	(2.7)	–	(2.9)	–
Present value of lease obligations	16.4	16.4	19.8	19.8
Less: Amount due for settlement within one year (shown under current liabilities)	(8.6)	(7.7)	(9.5)	(8.3)
Amount due for settlement after one year	7.8	8.7	10.3	11.5

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

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

25. Trade and other payables

	2007 £m	2006 £m
Trade and other payables: Current		
Trade creditors	173.7	127.6
Other creditors	137.2	133.7
Accruals and deferred income	358.8	280.6
Amounts owed to joint ventures	0.3	–
	670.0	541.9
Trade and other payables: Non-current	13.3	10.4

The average credit period taken for trade purchases is 24 days (2006 – 26 days). The directors estimate that the fair value of trade creditors approximates to their carrying amount.

26. Financial risk management

The Group held the following financial instruments at 31 December:

	Carrying amount	
	2007 £m	2006 £m
Financial assets		
Derivative financial instruments at fair value (note 27)	2.7	–
Loans and receivables at amortised cost – Trade receivables (note 20)	418.1	340.1
– Other financial assets (note 26)	0.2	1.3
– Cash and cash equivalents (note 21)	185.0	217.9
	606.0	559.3
Financial liabilities		
Derivative financial instruments at fair value (note 27)	(13.3)	(24.8)
At fair value through profit and loss – Loans (note 22)	–	(39.2)
At amortised cost – Loans (note 22)	(330.9)	(364.8)
– Trade creditors (note 25)	(173.7)	(127.6)
– Obligations under finance leases (note 24)	(16.4)	(19.8)
	(534.3)	(576.2)
Net financial instruments	71.7	(16.9)

Financial risk

The Board is ultimately responsible for ensuring that financial and non-financial risk arising from financial instruments is monitored and managed within acceptable and known parameters. The Board delegates authority to the executive team to manage financial risks. The Group's treasury function acts as a service centre and operates within clearly defined guidelines and policies that are approved by the Board. The guidelines and policies define the financial risks to be managed; specify the objectives in managing these risks; delegate responsibilities to those managing the risks; and establish a control framework to regulate treasury activities to minimise operational risk.

Credit facilities and liquidity management

The Group maintains committed credit facilities to ensure that it has sufficient available funds to maintain its ongoing operations. The Group's main committed credit facility (the Bank Facility), expires in December 2009 and comprises term loans of £26m and US Dollar 229m, and an undrawn £255m revolving credit facility.

The Bank Facility is unsecured and has financial and non-financial covenants and obligations typical of this type of arrangement.

The Group has a private placement for £117m outstanding which amortises in equal annual instalments from 2011 to 2015.

The private placement comprises a tranche of £83m and a tranche of US Dollar 55m, which is hedged by two cross currency swaps (note 27a).

Foreign exchange risk

The Group's business does not involve a significant amount of cross-border trade and 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 that do arise are hedged by forward foreign exchange contracts.

The foreign exchange exposure on the US Dollar tranche of the private placement has been fully hedged into Sterling. The foreign exposure on the US Dollar Bank Facility is hedged against the net investment in the subsidiaries in the US and an internal loan receivable denominated in US Dollars.

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, the risk of which is mitigated by using forward foreign exchange contracts.

26. 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. External credit checks are completed for all new non Government customers before signing a contract above £100,000. For credit vetting for new Government body customers, there is an internal review of the client's ability to pay and timeliness of payment. The review includes a consideration of the expected contract budget as well as economic and industry factors and the budget holder's position within the Government body. At quarterly intervals, a management credit worthiness review for all ongoing customers with material outstanding balances is undertaken, including a review to determine if there has been any deterioration in the customer's payment history and a review of the total credit authorised to the customer throughout the Group.

The Group's treasury function transacts with counterparties that have a minimum long term and short term public rating of single A and A1/P1 only. It also ensures that no exposure to any one institution at any given time exceeds a pre-determined exposure limit.

Interest rate risk

The Group's interest rate risk arises on variable rate borrowings under the Bank Facility. The Group's policy is to hedge core borrowing requirements to protect against adverse interest rate movements.

Price risk

The Group is exposed to commodity price risk through its joint venture rail operations. The joint venture has used commodity derivatives to mitigate some of this risk (see note 27(c)).

26 (a) Currency management

The Group's currency exposures that give rise to net currency gains and losses on financial instruments that are recognised in the income statement and equity arise principally with respect to US Dollar with Sterling and US Dollar with Canadian Dollar financial instruments. The fluctuations in other exchange rates do not significantly alter the value of financial instruments. At 31 December 2007, if the US Dollar had weakened by 10% against Sterling, with all other variables held constant, post-tax profit for the year would have been £0.7m lower (2006 – £1.0m lower) mainly as a result of exchange losses on cash and derivative financial instruments. Equity would have been £0.6m lower (2006 – £0.8m lower) mainly due to exchange losses on commodity futures contracts denominated in US Dollars. At 31 December 2007, if the US Dollar had weakened by 10% against the Canadian Dollar, with all other variables held constant, post-tax profit for the year would have been £0.9m higher (2006 – £0.8m higher) mainly as a result of exchange gains on US Dollar denominated non-current intercompany borrowings. Equity would have been £0.4m higher (2006 – £0.4m higher) due to Canadian Dollar denominated non-current intercompany borrowings.

26 (b) Interest rate management

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

(i) Financial assets

	2007			2006		
	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	185.0	–	–	217.9	–	–
Other financial assets	0.2	1.2	6.00	1.3	1.8	6.12
	185.2	1.2		219.2	1.8	

(ii) Financial liabilities

	2007			2006		
	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)	–	22.5	7.35	–	24.8	7.35
Non recourse Canadian Dollar loans	–	36.8	4.53	–	37.4	4.53
Sterling loans	26.0	120.5	5.70	65.0	141.9	5.99
US Dollar loans	117.4	–	–	120.7	–	–
Other loans	2.9	4.8	8.00	8.7	5.5	8.00
	146.3	184.6		194.4	209.6	

Excluded from the above analysis is £16.4m of amounts payable under finance leases, which are subject to fixed rates of interest (2006 – £19.8m).

(iii) Interest rate sensitivity

The sensitivity analyses below have been determined on the exposure to interest rates for both derivatives and financial liabilities at the balance sheet date and on average balances of financial assets held throughout the past year. A 100 basis point movement in interest rates with all other variables held constant, would have an impact on post-tax profit for the year to 31 December 2007 of £0.6m (2006 – £0.6m). The variance is mainly due to interest exposure on floating rate borrowings. The resulting impact on equity due to a 100 basis point movement is £1.7m (2006 – £2.1m) mainly due to the movement in the fair value of derivative financial instruments held as cash flow hedges.

26 (c) Liquidity risk management

The Group's financial liabilities will be settled on a net basis based on the remaining period at the balance sheet to the contractual maturity date. The amounts disclosed below are the contractual undiscounted cash flows based on the earliest date on which the Group can be required to pay.

	On demand or within one year £m	Between one and two years £m	Between two and five years £m	After five years £m	Total £m
Loans	13.5	155.4	78.3	83.7	330.9
Loan interest	19.5	11.7	22.0	6.0	59.2
Finance leases	8.6	5.0	4.1	1.4	19.1
Derivative financial liabilities	1.9	1.8	5.0	1.2	9.9
Trade creditors	173.7	–	–	–	173.7
At 31 December 2007	217.2	173.9	109.4	92.3	592.8

	On demand or within one year £m	Between one and two years £m	Between two and five years £m	After five years £m	Total £m
Loans	57.9	12.0	215.7	118.4	404.0
Loan interest	23.7	19.7	31.5	21.8	96.7
Finance leases	9.5	6.6	5.4	1.2	22.7
Derivative financial liabilities	6.1	2.5	6.6	2.9	18.1
Trade creditors	127.6	–	–	–	127.6
At 31 December 2006	224.8	40.8	259.2	144.3	669.1

26 (d) Capital risk management

The Group manages capital to ensure that it has available resources and access to markets to ensure the continued growth of the Group and to meet immediate short-term borrowing requirements. The Group's objectives when managing capital are to safeguard its ability to continue as a going concern in order to provide returns for shareholders and benefits for other stakeholders and to maintain an appropriate capital structure that complies with loan covenants and other measures. Access to capital takes many forms and includes but is not exhaustive to equity markets, debt capital markets and bank markets.

During 2007, the Group maintained sufficient debt facilities which ensured its objectives were met.

26 (e) Price risk management

The Group is exposed to commodity price risk arising from the volatility in the price of fuel and manages this risk by holding commodity futures contracts. A US Dollar 0.2 per litre increase in the price of fuel as at the balance sheet date would result in a £5.0m increase (2006 – £6.3m increase) in equity. There is no impact in the income statement resulting from a change in fuel prices. The sensitivity to changes in fuel prices resulting from changes in exchange rates is included within the currency sensitivity analysis (see note 26(a)).

27. Derivative financial instruments

Derivative financial instruments total a net liability of £10.6m (2006 – £24.8m), comprising non-current assets of £1.2m (2006 – nil), current assets of £1.5m (2006 – nil), current liabilities of £2.1m (2006 – £10.6m) and non-current liabilities of £11.2m (2006 – £14.2m).

	1 January 2007 £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	Cash flow hedges disposed of £m	Cash flow hedges created £m	31 December 2007 £m
Currency swaps	(11.4)	3.7	1.4	–	–	–	(6.3)
Forward foreign exchange contracts	(9.1)	0.8	2.9	1.1	–	–	(4.3)
Interest rate swaps	(2.1)	0.1	–	–	–	–	(2.0)
Commodity futures contracts	(2.2)	4.2	–	–	–	–	2.0
	(24.8)	8.8	4.3	1.1	–	–	(10.6)

The movement in the fair value of fair value hedges relates to the maturing of currency swaps and a forward foreign exchange contract (see note 27(a)). The movement in the fair value of cash flow hedges includes an amount of £3.4m relating to the maturing of a currency swap (see note 27 (a)).

	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	Cash flow hedges disposed of £m	Cash flow 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)
	(35.2)	(2.0)	(2.4)	0.6	16.5	(2.3)	(24.8)

The maturity of derivative financial instruments is as follows:

	Currency swaps £m	Forward foreign exchange contracts £m	Interest rate swaps £m	Commodity futures contracts £m	Total £m
At 31 December 2007					
On demand or within one year	(0.4)	(0.6)	(0.4)	0.8	(0.6)
Between one and two years	(0.3)	(1.0)	(0.4)	0.6	(1.1)
Between two and five years	(0.9)	(2.7)	(0.9)	0.6	(3.9)
After five years	(4.7)	–	(0.3)	–	(5.0)
	(6.3)	(4.3)	(2.0)	2.0	(10.6)

Forward foreign exchange contracts comprise an asset of £0.8m, a current liability of £1.4m, and a non-current liability of £3.7m.

	Currency swaps £m	Forward foreign exchange contracts £m	Interest rate swaps £m	Commodity futures contracts £m	Total £m
At 31 December 2006					
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)
	(11.4)	(9.1)	(2.1)	(2.2)	(24.8)

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

27 (a) Forward foreign exchange contracts and currency swaps

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 £50.1m (2006 – £77.3m).

These arrangements are mainly designed to address significant exchange exposures for the next 18 months.

Cash flow hedges

At 31 December 2007, 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 is as follows:

Maturity	Notional amount USDm	2007		Notional amount USDm	2006	
		Receivable USD interest rate %	Payable GBP interest rate %		Receivable USD interest rate %	Payable GBP interest rate %
December 2007	–	–	–	39.0	6.8	7.6
August 2015	35.0	5.7	5.7	35.0	5.7	5.7
August 2015	20.0	5.7	5.7	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 £15.6m (2006 – £26.0m).

All currency derivatives designated as cash flow hedges are highly effective and the fair value movement of £4.5m has been deferred as a credit in equity. No amounts have been recognised in the income statement except for a discontinued cash flow hedge. A loss of £1.4m had been recognised in the hedging reserve and this is recycled to the income statement as the hedged transaction affects the income statement. A loss of £0.3m (2006 – loss of £0.5m) has been included in the income statement, and the remaining loss of £0.6m is expected to be recognised in the income statement in 2008.

Fair value hedges

During 2007, currency swaps and a forward foreign exchange contract, designated as fair value hedges, matured. The currency swaps had a notional amount of US Dollar 31m receiving a fixed interest rate of 6.81% and paying a floating rate based on LIBOR on the notional amount. The swaps were hedging the exposure to changes in the fair value of the Group's US Dollar denominated private placement loans. The forward foreign exchange contract with a notional amount of US Dollar 15m was hedging the foreign exchange exposure on the final repayment of the Group's US Dollar denominated private placement loans. A gain of £4.3m (2006 – £2.4m) has been recognised in the income statement in respect of the forward foreign exchange contract and currency swaps offset by a loss of £4.0m (2006 – £2.5m) arising on the maturity of the private placement loan.

27 (b) Interest rate swaps

Cash flow hedges

The Group uses an interest rate swap to manage its exposure to interest rate risk on its non recourse loan (related to PFI assets) by swapping this loan from floating to fixed rates. The profile of the interest rate swap is as follows:

At 31 December 2007 and 31 December 2006

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

Apart from a small portion, the swap is designated and highly effective as a cash flow hedge and the fair value movement of £0.1m has been deferred as a credit in equity; £26,000 (2006 – £0.1m) has been recognised as a gain in the income statement within investment income and finance cost. An amount of £0.1m (2006 – £3.8m) has been offset against hedged interest payments made in the period.

27 (c) Commodity futures contracts

The Group uses commodity futures contracts in its joint venture train operations in order to protect itself from volatility in the price of fuel. The Group has a contract expiring in 2011 whereby it pays a fixed rate of £0.2895 per litre and receives a floating rate for a variable quantity each month. The floating rate is calculated as the daily 0.2% NWE price in US Dollars per tonne converted into litres and then into Sterling at the daily spot rate. The commodity futures contracts are designated as cash flow hedges and are highly effective and the fair value movement of £4.2m has been deferred as a credit in equity. No amounts have been recognised in the income statement.

27 (d) 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 £24.6m (2006 – £25.0m). The foreign exchange gain of £0.4m (2006 – £3.5m) on translation of the borrowings into Sterling has been recognised within the Group's hedging and translation reserve. The hedge is highly effective so no amounts have been recognised in the income statement.

28. 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 2007, including the proportionate share of joint ventures, was £75.0m (2006 – £64.7m).

28 (a) Defined benefit schemes

The Group operates defined benefit schemes for qualifying employees of its subsidiaries in the UK 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.

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 a corresponding amount 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) and an unfunded defined benefit scheme, all of which do not relate to any specific contract. Any liabilities arising are recognised in full.

28 (a) Defined benefit schemes (continued)

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

	Virtually certain costs reimbursed £m	Not certain costs reimbursed £m	Non contract specific £m	Total £m
Year ended 31 December 2007				
Scheme assets at fair value				
Equities	163.1	247.6	213.7	624.4
Bonds except LDI	47.6	8.9	18.4	74.9
Liability driven investments (LDI)	–	–	438.0	438.0
Gilts	–	37.3	34.4	71.7
Property	18.7	25.0	11.9	55.6
Cash and other	6.5	42.5	2.2	51.2
Annuity policies	–	0.9	26.1	27.0
Fair value of scheme assets	235.9	362.2	744.7	1,342.8
Present value of scheme liabilities	(296.6)	(391.7)	(812.6)	(1,500.9)
Net amount recognised	(60.7)	(29.5)	(67.9)	(158.1)
Members' share of surplus	–	(2.1)	–	(2.1)
Franchise adjustment	–	17.6	–	17.6
Net pension liability	(60.7)	(14.0)	(67.9)	(142.6)
Related assets				
Intangible assets (note 14)	–	17.4	–	17.4
Trade and other receivables (note 20)	60.7	–	–	60.7
	60.7	17.4	–	78.1
Year ended 31 December 2006				
Scheme assets at fair value				
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
Net pension liability	(67.6)	(23.9)	(157.8)	(249.3)
Related assets				
Intangible assets (note 14)	–	20.6	–	20.6
Trade and other receivables (note 20)	67.6	–	–	67.6
	67.6	20.6	–	88.2

Liabilities in relation to unfunded schemes included above amount to £38.1m (2006 – £36.2m).

28 (a) Defined benefit schemes (continued)

During 2007, certain of the Group's non contract specific schemes introduced a Liability Driven Investment (LDI) strategy which aims to reduce volatility risk by better matching assets to liabilities. The main asset classes that make up the LDI investments are gilts and corporate bonds with inflation and interest swap overlays, and the assumed expected rate of return is taken to be gilts +0.2%.

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 2007	Virtually certain costs reimbursed £m	Not certain costs reimbursed £m	Non contract specific £m	Total £m
Recognised in the consolidated income statement				
Current service cost – employer	9.9	15.3	21.2	46.4
Past service cost	–	0.1	1.8	1.9
Reimbursed to employer	(9.9)	–	–	(9.9)
Recognised in arriving at operating profit	–	15.4	23.0	38.4
Expected return on scheme assets - employer	(16.2)	(16.8)	(40.1)	(73.1)
Interest on franchise adjustment	–	(1.2)	–	(1.2)
Interest cost on scheme liabilities - employer	15.1	14.5	40.4	70.0
Reimbursed to employer	1.1	–	–	1.1
Finance costs	–	(3.5)	0.3	(3.2)
Included within the SORIE				
Actual return on scheme assets	10.2	28.5	43.9	82.6
Less: expected return on scheme assets	(16.2)	(23.7)	(41.3)	(81.2)
	(6.0)	4.8	2.6	1.4
Other actuarial gains and losses	11.2	15.8	33.8	60.8
Actuarial gains and losses recognised in the SORIE	5.2	20.6	36.4	62.2
Change in franchise adjustment	–	(6.6)	–	(6.6)
Change in members' share	–	(6.4)	(1.2)	(7.6)
Reimbursed to employer	(5.2)	–	–	(5.2)
Actuarial losses on reimbursable rights	(5.2)	(13.0)	(1.2)	(19.4)
Total pension cost recognised in the SORIE	–	7.6	35.2	42.8

28 (a) Defined benefit schemes (continued)

Year ended 31 December 2006	Virtually certain costs reimbursed £m	Not certain costs reimbursed £m	Non contract specific £m	Total £m
Recognised in the consolidated income statement				
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)
Recognised in arriving at operating profit	–	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)
Finance costs	–	(2.0)	3.9	1.9
Included within the SORIE				
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
Actuarial gains and losses recognised in the SORIE	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)
Actuarial gains and losses on reimbursable rights	(18.6)	(34.5)	(0.3)	(53.4)
Total pension cost recognised in the SORIE	–	1.0	24.5	25.5

Cumulative actuarial gains recognised in equity since 1 January 2004 are £29.1m (2006 – losses £(13.7)m).

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
At 1 January 2006	280.3	307.7	759.1	1,347.1
Arising on acquisition	–	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)
At 31 December 2006	287.9	375.0	802.2	1,465.1
Arising on curtailment	–	–	(0.8)	(0.8)
Current service cost – employer	9.9	15.3	21.2	46.4
Current service cost – employee	–	5.9	0.7	6.6
Past service cost	–	0.1	1.8	1.9
Plan participants' contributions	0.9	0.8	1.5	3.2
Interest cost – employer	15.1	14.5	40.4	70.0
Interest cost – employee	–	5.3	1.1	6.4
Benefits paid	(6.0)	(9.4)	(24.8)	(40.2)
Actuarial gains and losses	(11.2)	(15.8)	(33.8)	(60.8)
Foreign currency differences	–	–	3.1	3.1
At 31 December 2007	296.6	391.7	812.6	1,500.9

28 (a) Defined benefit schemes (continued)

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
At 1 January 2006	195.4	239.9	557.4	992.7
Arising on acquisition	–	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
At 31 December 2006	220.3	323.2	643.3	1,186.8
Expected return on plan assets - employer	16.2	16.8	40.1	73.1
Expected return on plan assets - employee	–	6.9	1.2	8.1
Employer contributions	10.5	14.4	80.3	105.2
Contributions by employees	0.9	5.5	2.0	8.4
Benefits paid	(6.0)	(9.4)	(24.8)	(40.2)
Actuarial gains and losses	(6.0)	4.8	2.6	1.4
At 31 December 2007	235.9	362.2	744.7	1,342.8

Employer contributions for non contract specific schemes in 2007 include a £51m special contribution paid in January 2007. A special contribution of £19m was paid in December 2006.

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

History of experience gains and losses

	2007	2006	2005	2004
Experience adjustments arising on scheme assets:				
Amount (£m)	1.4	45.8	103.6	10.2
Percentage of scheme assets	0%	4%	10%	1%
Experience adjustments arising on scheme liabilities:				
Amount (£m)	(5.1)	(13.1)	11.8	6.4
Percentage of the present value of scheme liabilities	0%	(1)%	1%	1%
Fair value of scheme assets (£m)	1,342.8	1,186.8	992.7	776.5
Present value of scheme liabilities (£m)	(1,500.9)	(1,465.1)	(1,347.1)	(1,055.5)
Deficit (£m)	(158.1)	(278.3)	(354.4)	(279.0)

The normal contributions expected to be paid during the financial year ended 31 December 2008 are £54.3m.

28 (a) Defined benefit schemes (continued)

	2007 %	2006 %
Main assumptions:		
Rate of salary increases	3.00 – 4.70	3.00 – 4.40
Rate of increase in pensions in payment	3.20	2.90
Rate of increase in deferred pensions	3.20	2.90
Inflation assumption	3.20	2.90
Discount rate	5.70	5.20
Expected rates of return on scheme assets:		
Equities	7.95	7.95
Bonds except LDI	5.70	5.20
LDI	4.70	–
Gilts	4.50	4.50
Property	5.75	5.75
Cash and other	5.50	5.00
Annuity policies	5.70	5.20
	2007 Years	2006 Years
Post-retirement mortality:		
Current pensioners at 65 – male	20.3	20.2
Current pensioners at 65 – female	23.1	23.0
Future pensioners at 65 – male	21.6	21.5
Future pensioners at 65 – female	24.3	24.3

For some of the smaller schemes, allowance for expected future improvements in life expectancy has been made by reducing the discount rate by 0.25% (2006 – 0.20%) per annum from the rate shown above.

28 (b) Defined contribution schemes

The Group paid employer contributions of £26.1m (2006 – £20.4m) 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.

29. Provisions

	Employee related £m	Other £m	2007 Total £m	Employee related £m	Other £m	2006 Total £m
At 1 January	7.3	15.0	22.3	7.7	18.6	26.3
Reclassification from creditors	-	-	-	0.7	-	0.7
Arising from acquisitions	-	0.4	0.4	-	-	-
Charged to income statement	1.9	-	1.9	2.6	4.7	7.3
Released to income statement	-	(5.2)	(5.2)	(2.0)	(1.8)	(3.8)
Utilised during the year	(0.4)	(0.6)	(1.0)	(1.5)	(6.5)	(8.0)
Exchange differences	0.2	-	0.2	(0.2)	-	(0.2)
At 31 December	9.0	9.6	18.6	7.3	15.0	22.3

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.

30. Share capital

	2007		2006	
	£m	Number Millions	£m	Number Millions
Authorised				
550,000,000 (2006 – 550,000,000) ordinary shares of 2p each	11.0	550.0	11.0	550.0
Issued and fully paid				
476,295,589 (2006 – 468,231,512) ordinary shares of 2p each at 1 January	9.5	476.3	9.4	468.2
Issued on the exercise of share options	0.2	8.7	0.1	8.1
485,051,557 (2006 – 476,295,589) ordinary shares of 2p each at 31 December	9.7	485.0	9.5	476.3

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

During the year 8,755,968 (2006 – 8,064,077) ordinary shares of 2p each were allotted to the holders of options or their personal representatives using newly listed shares.

31. Share premium account

	2007 £m	2006 £m
At 1 January	283.5	269.5
Premium on shares issued	15.8	14.0
At 31 December	299.3	283.5

32. Reserves

Retained earnings

	2007 £m	2006 £m
At 1 January	196.6	132.8
Dividends paid (note 11)	(17.9)	(14.5)
Profit for the year attributable to equity holders of the parent	81.9	78.3
At 31 December	260.6	196.6

Other reserves

	Retirement benefit obligations reserve £m	Share-based payment reserve £m	Own shares reserve £m	Hedging and translation reserve £m	Total £m
At 1 January 2006	(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	–	–	–	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)
At 31 December 2006	(119.5)	25.5	(16.4)	(21.3)	(131.7)
At 1 January 2007	(119.5)	25.5	(16.4)	(21.3)	(131.7)
Net actuarial gain on defined benefit pension schemes	62.2	–	–	–	62.2
Actuarial loss on reimbursable rights	(19.4)	–	–	–	(19.4)
Credit in relation to share-based payment expense	–	5.0	–	–	5.0
Net exchange gain on translation of foreign operations	–	–	–	12.8	12.8
Fair value gain on cash flow hedges during the year	–	–	–	9.0	9.0
Exercise of share options	–	(0.2)	1.3	–	1.1
Tax charge on cash flow hedges	–	–	–	(2.3)	*(2.3)
Tax (charge)/credit on items taken directly to equity	(13.5)	4.3	–	–	*(9.2)
At 31 December 2007	(90.2)	34.6	(15.1)	(1.8)	(72.5)

* in 2007 these amounts represent £11.5m of tax charge taken directly to equity in the SORIE (2006 - £7.0m tax charge)

The retirement benefit obligations reserve represents the actuarial gains and losses recognised in respect of annual actuarial valuations for defined benefit retirement 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 but not fully vested as of 1 January 2005 and any gain or loss on the exercise of share options satisfied by own shares.

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 (the ESOP) to satisfy options under the Group's share options schemes. At 31 December 2007, the ESOP held 4,849,759 (2006 – 5,250,152) shares equal to 1.0% of the current allotted share capital (2006 – 1.1%). The market value of shares held by the ESOP as at 31 December 2007 was £22,211,896 (2006 – £20,055,581).

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.

33. Notes to the consolidated cash flow statement

Reconciliation of operating profit to net cash inflow from operating activities

	2007 £m	2006 £m
Operating profit for the year	133.4	125.2
Adjustments for:		
Share-based payment expense	5.0	4.8
Depreciation of property, plant and equipment	30.2	30.0
Amortisation of intangible assets	23.2	16.2
Loss on disposal of property, plant and equipment	1.3	1.1
Profit on disposal of joint ventures	(0.7)	–
Gain on derivatives	(1.1)	–
Gain on sale of PFI investments	–	(11.4)
Operating cash inflow before movements in working capital	191.3	165.9
Decrease/(increase) in inventories	5.9	(13.9)
(Increase)/decrease in receivables	(101.4)	10.7
Increase in payables	108.6	21.8
Movement in provisions	(4.3)	(4.5)
Special contribution to defined benefit pension scheme (note 28)	(51.0)	(19.0)
Cash generated by operations before PFI debtor movement	149.1	161.0
Movement on PFI debtor	1.5	17.4
Cash generated by operations after PFI debtor movement	150.6	178.4
Tax paid	(16.5)	(18.9)
Net cash inflow from operating activities	134.1	159.5

Additions to fixtures and equipment during the year amounting to £4.2m (2006 – £2.3m) were financed by new finance leases.

Analysis of net debt

	At 1 January 2007 £m	Cash flow £m	Acquisitions/ disposals £m	Exchange differences £m	Non cash movements £m	At 31 December 2007 £m
Cash and cash equivalents	217.9	(38.3)	(1.4)	6.8	–	185.0
Non recourse loans (related to PFI assets)	(24.8)	2.3	–	–	–	(22.5)
Other non recourse loans	(37.4)	6.0	–	(5.4)	–	(36.8)
Other loans	(341.8)	72.4	0.2	1.7	(4.1)	(271.6)
Obligations under finance leases	(19.8)	8.4	–	(0.4)	(4.6)	(16.4)
	(205.9)	50.8	(1.2)	2.7	(8.7)	(162.3)

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

Non cash movements in 2007 primarily relate to fixed assets acquired under finance leases, and the crystallisation of the fair value adjustment of £4.0m to the value of one of the private placement loans. The loan was hedged by forward foreign exchange contracts and cross currency swaps.

Non cash movements in 2006 primarily relate to a joint venture 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.

34. Capital and other commitments

	2007 £m	2006 £m
Capital expenditure contracted but not provided	2.0	1.6

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:

	2007 £m	2006 £m
Within one year	97.0	90.3
Between one and five years	258.1	250.7
After five years	138.7	173.1
	493.8	514.1

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

	2007 £m	2006 £m
Within one year	0.1	0.2
Between one and five years	0.6	0.6
After five years	0.2	0.3
	0.9	1.1

35. Share-based payment expense

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

	2007 £m	2006 £m
Executive Option Plan	0.9	1.7
Long Term Incentive Scheme and Plan	3.7	1.5
Sharesave 2004	0.4	1.6
	5.0	4.8

Executive Option Plan (EOP)

Options granted under the EOP may be exercised after the third anniversary of grant, dependant upon the achievement of a financial performance target over three years. The options are granted at market value and awards made to 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:

	2007		2006	
	Number of options '000	Weighted average exercise price £	Number of options '000	Weighted average exercise price £
Outstanding at 1 January	16,530	2.42	24,695	2.22
Granted during the year	443	4.39	565	3.39
Exercised during the year	(2,991)	2.20	(7,554)	1.83
Lapsed during the year	(258)	2.83	(1,176)	2.31
Outstanding at 31 December	13,724	2.53	16,530	2.42

11,939,768 (2006 – 13,577,169) of these options were exercisable at the end of the year.

The options outstanding at 31 December 2007 had a weighted average contractual life of 4.48 years (2006 – 5.55 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.

35. Share-based payment expense (continued)

The inputs into the Binomial lattice model for options granted during the year are:

	2007	2006
Weighted average share price	475p	304p
Weighted average exercise price	445p	339p
Expected volatility	33.7%	39.8%
Expected life	5 years	5 years
Risk free rate	5.1%	4.8%
Expected dividends	0.8%	0.8%

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.

Long Term Incentive Scheme (LTIS) and Long Term Incentive Plan (LTIP)

Awards made to eligible employees under the above schemes are structured as options with a nominal 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:

	2007		2006	
	Number of options '000	Weighted average exercise price £	Number of options '000	Weighted average exercise price £
Outstanding at 1 January	4,040	Nil	2,578	Nil
Granted during the year	3,055	Nil	2,475	Nil
Exercised during the year	(33)	Nil	(335)	Nil
Lapsed during the year	(22)	Nil	(678)	Nil
Outstanding at 31 December	7,040	Nil	4,040	Nil

1,529,440 (2006 – 1,051,758) of these options were exercisable at the end of the year.

The options outstanding at 31 December 2007 had a weighted average contractual life of 8.33 years (2006 – 8.35 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:

	2007	2006
Weighted average share price	425p	314p
Weighted average exercise price	Nil	Nil
Expected volatility	21.4% to 22.1%	23.6% to 27.0%
Expected life	3 years	3 years
Risk free rate	4.7% to 5.5%	4.8% to 5.0%
Expected dividends	0.8%	0.8%

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. 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:

	2007		2006	
	Number of options '000	Weighted average exercise price £	Number of options '000	Weighted average exercise price £
Outstanding at 1 January	6,274	1.72	7,057	1.72
Exercised during the year	(6,094)	1.72	(175)	1.72
Lapsed during the year	(110)	1.72	(608)	1.72
Outstanding at 31 December	70	1.72	6,274	1.72

The options outstanding at 31 December 2007 had a weighted average contractual life of nil years (2006 – 0.80 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	260p
Weighted average exercise price	172p
Expected volatility	47.6%
Expected life	3.25 years
Risk free rate	4.7%
Expected dividends	1.1%

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.

36. 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:

	2007 £m	2006 £m
Sales of goods and services	–	0.9
Royalties and management fees receivable	1.2	1.0
Dividends receivable	36.9	29.6
	38.1	31.5

The following receivable balances relating to joint ventures were included in the consolidated balance sheet:

	2007 £m	2006 £m
Current		
Loans	1.7	2.5
	2007 £m	2006 £m
Non-current		
Loans	0.6	0.1

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 Committee (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':

	2007 £m	2006 £m
Short-term employee benefits	3.8*	3.9*
Post-employment benefits	0.7	0.5
Share-based payment expense	1.9	1.7
	6.4	6.1

* the short-term employment benefits include performance bonuses earned under the period under review, but not paid in the financial year.

37. 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 2007. 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		2007	2006
United Kingdom			
	Serco Limited	100%	100%
	Serco-Denholm Limited	90%	90%
	Serco-IAL Limited	100%	100%
	NPL Management Limited	100%	100%
	Serco Leisure Operating Limited	100%	100%
	Serco Health Limited	100%	100%
	Serco Regional Services Limited	100%	100%
	Serco Manchester Leisure Limited	100%	100%
	Serco Geografix Limited	100%	100%
	Kilmarnock Prison Services Limited	100%	100%
Europe and Middle East			
Belgium	Serco Belgium SA	100%	100%
France	Serco SARL	100%	100%
	Serco SAS	100%	100%
Germany	Serco GmbH	100%	100%
Ireland	Serco Services Ireland 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%
Asia Pacific			
Australia	Serco Australia Pty Limited	100%	100%
	Great Southern Railway Pty Limited	100%	100%
	Serco MAPS Pty Limited	100%	100%
	Serco Traffic Camera Services Pty Limited	100%	–
China	Serco Group Consultants (Shanghai) Limited	100%	100%
Hong Kong	Serco Group (Hong Kong) Limited	100%	100%
North America			
Canada	Serco Facilities Management Inc.	100%	100%
	Serco DES Inc.	100%	100%
US	Serco Inc.	100%	100%
	Serco Management Services Inc. (Tennessee)	100%	100%

37. List of principal undertakings (continued)

Joint venture undertakings		2007	2006
United Kingdom			
	Serco Gulf Engineering Limited	50%	50%
	AWE Management Limited	33%	33%
	Merseyrail Electrics 2002 Limited	50%	50%
	Northern Rail Limited	50%	50%
Asia Pacific			
Australia			
	Defence Maritime Services Pty Limited	50%	50%
	Serco Sodexho Defence Services Pty Limited	50%	50%
UAE			
Dubai			
	Khadamat Facilities Management Company LLC	49%	–
	International Aeradio (Emirates) LLC	49%	49%
Abu Dhabi			
	International Aeradio (Emirates) LLC	49%	49%
Other			
Bahrain			
	Aeradio Technical Services WLL	49%	49%
South Africa			
	Equity Aviation Holdings (Pty) Limited	50%	50%

All joint ventures are accounted for using the proportionate consolidation method. All the subsidiaries of the Group have been consolidated.

At 31 December 2007, Group companies had branches in UAE, Bahrain, South Africa, Oman, Luxembourg and Gibraltar.

All the principal subsidiaries of the Serco Group plc and its joint venture undertakings are engaged in the provision of support services.

38. Contingent liabilities

The Company has guaranteed overdrafts, finance leases, and bonding facilities of its joint ventures up to a maximum value of £4.2m (2006 – £3.8m). The actual commitment outstanding at 31 December 2007 was £1.9m (2006 – £1.6m).

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 14 to the Serco Group plc Company financial statements.

UK GAAP directors' responsibilities – company


Directors' responsibilities

Company Law requires the directors to prepare accounts and notes for each financial year, which give a true and fair view of the state of affairs of the company 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
- 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

27 February 2008

UK GAAP audit report – parent company

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 2007 which comprise the balance sheet and the related notes 1 to 15. 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 2007 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 and the parent company financial statements in accordance with applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Principles) are set out in the statement of directors' responsibilities.

Our responsibility is to audit the parent company 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 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 judgments 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 2007;
- 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

27 February 2008

Company balance sheet

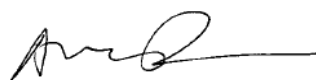
At 31 December 2007

	Note	2007 £m	2006 £m
Fixed assets			
Investments in subsidiary undertakings	3	792.6	596.2
		792.6	596.2
Current assets			
Amounts owed by subsidiary companies due after more than one year		132.8	185.1
Debtors: amounts due within one year	4	42.9	58.5
Debtors: amounts due after more than one year	4	8.6	9.6
Derivative financial instruments	7	0.7	–
Cash at bank and in hand		36.2	113.3
		221.2	366.5
Creditors: amounts falling due within one year			
Loans	6	–	(39.2)
Amounts owed to subsidiary companies		(133.0)	(2.7)
Trade creditors		(0.2)	(0.1)
Other creditors including taxation and social security	5	(2.4)	(2.0)
Derivative financial instruments	7	(1.6)	(9.1)
Accruals and deferred income		(10.5)	(17.0)
		(147.7)	(70.1)
Net current assets			
		73.5	296.4
Total assets less current liabilities			
		866.1	892.6
Creditors: amounts falling due after more than one year	6	(258.8)	(280.8)
Amounts owed to subsidiary companies		(146.5)	(183.1)
Derivative financial instruments	7	(9.7)	(10.9)
Net assets			
		451.1	417.8
Capital and reserves			
Called up share capital	9	9.7	9.5
Share premium account	10	299.3	283.5
Capital redemption reserve		0.1	0.1
Share-based payment reserve	11	21.7	16.8
Hedging and translation reserve	12	(6.2)	(9.5)
Profit and loss account	13	126.5	117.4
Equity shareholders' funds			
		451.1	417.8

The financial statements were approved by the Board of Directors on 27 February 2008 and signed on its behalf by:



Christopher Hyman
Chief Executive



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.

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.

Fixed asset investments

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

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 Company's estimate of shares that will eventually vest.

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.

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.

1. Accounting policies (continued)

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 date the timing differences are expected to reverse.

2. Auditors' remuneration

Auditors' remuneration of £10,000 (2006 – £10,000) has been borne by another group company.

3. Investments held as fixed assets

	£m
Shares in subsidiary companies at cost	
At 1 January 2006	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)
At 31 December 2006	596.2
At 1 January 2007	596.2
Options over parent's shares awarded to employees of subsidiaries	3.1
Additions:	
Cornwell Management Consultants plc	8.3
Serco Holdings Limited	185.0
At 31 December 2007	792.6

On 16 May 2007, the Company acquired 100% of Cornwell Management Consultants plc.

On 31 December 2007, the Company acquired four additional shares in Serco Holdings Limited for £185m, following the capitalisation of long term intercompany loans.

Full details of the principal subsidiaries of Serco Group plc can be found in note 37 to the Group's consolidated financial statements. The Company directly owns 100% of the ordinary share capital of the following subsidiaries except where stated.

Name	% ownership
Serco Holdings Limited	100%
Serco Investments Limited	100%
Cornwell Management Consultants plc	100%
Serco Group (HK) Limited	50%

4. Debtors

	2007 £m	2006 £m
Amounts due within one year		
Amounts owed by subsidiary companies	15.5	21.3
Corporation tax recoverable	24.9	37.2
Other debtors	2.5	–
	42.9	58.5
Amounts due after more than one year		
Other debtors	3.7	4.2
Deferred tax asset (note 8)	4.9	5.4
	8.6	9.6
	51.5	68.1

5. Other creditors including taxation and social security

	2007 £m	2006 £m
Other creditors	2.4	2.0

6. Creditors: amounts falling due after more than one year

	2007 £m	2006 £m
Loans	258.8	320.0
Less: amounts included in creditors falling due within one year - loans	–	(39.2)
Amounts falling due after more than one year	258.8	280.8
Loans:		
Within one year or on demand	–	39.2
Between one and two years	141.0	–
Between two and five years	47.1	187.7
After five years	70.7	93.1
	258.8	320.0

7. Derivative financial instruments

	2007		2006	
	Assets £m	Liabilities £m	Assets £m	Liabilities £m
Currency swaps	–	(6.3)	–	(11.4)
Forward foreign exchange contracts	0.7	(5.0)	–	(8.6)
	0.7	(11.3)	–	(20.0)
Analysed as:				
Non-current	0.7	(9.7)	–	(10.9)
Current	–	(1.6)	–	(9.1)

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 27 of the Group's consolidated financial statements.

8. Deferred tax asset

	2007 £m	2006 £m
Short-term timing difference	4.9	5.4

The movement in the deferred tax asset during the year was as follows:

	2007 £m	2006 £m
At 1 January	5.4	2.9
Credited to income statement	0.7	1.5
Items taken directly to equity	(1.2)	1.0
At 31 December	4.9	5.4

9. Called up share capital

	2007		2006	
	£m	Number Millions	£m	Number Millions
Authorised				
550,000,000 (2006 – 550,000,000) ordinary shares of 2p each	11.0	550.0	11.0	550.0
Issued and fully paid				
476,295,589 (2006 – 468,231,512) ordinary shares of 2p each at 1 January	9.5	476.3	9.4	468.2
Issued on the exercise of share options	0.2	8.7	0.1	8.1
485,051,557 (2006 – 476,295,589) ordinary shares of 2p each at 31 December	9.7	485.0	9.5	476.3

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

During the year 8,755,968 (2006 – 8,064,077) ordinary shares of 2p each were allotted to the holders of options or their personal representatives using newly listed shares.

10. Share premium account

	2007 £m	2006 £m
At 1 January	283.5	269.5
Premium on shares issued	15.8	14.0
At 31 December	299.3	283.5

11. Share-based payment reserve

	2007 £m	2006 £m
At 1 January	16.8	12.5
Options over parent's shares awarded to employees of subsidiaries	3.1	3.6
Share-based payment expense	1.8	1.2
Tax charge on items taken directly to equity	–	(0.5)
At 31 December	21.7	16.8

Details of the share-based payment disclosures are set out in note 35 of the Group's consolidated financial statements.

I 2. Hedging and translation reserve

	2007 £m	2006 £m
At 1 January	(9.5)	(6.0)
Fair value gain/(loss) on cash flow hedges during the period	4.5	(5.0)
Tax (charge)/credit on items taken directly to equity	(1.2)	1.5
At 31 December	(6.2)	(9.5)

I 3. Profit and loss account

	2007 £m	2006 £m
At 1 January	117.4	105.0
Profit for the year	27.0	26.9
Equity dividends	(17.9)	(14.5)
At 31 December	126.5	117.4

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.

I 4. Contingent liabilities

The Company has provided certain financial guarantees and indemnities in respect of the loans, overdrafts and bonding facilities, and other financial commitments of its subsidiaries. The total commitment outstanding as at 31 December 2007 was £16.6m (2006 – £17.4m).

The Company has also guaranteed overdrafts, finance leases, and bonding facilities of its joint ventures up to a maximum value of £4.2m (2006 – £3.8m). The actual commitment outstanding at 31 December 2007 was £1.9m (2006 – £1.6m).

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.

I 5. Related parties

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 36 to the Group's consolidated financial statements.

Shareholder information

Group website

Go to 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

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. To sign up for this service, you need to register with Computershare's Investor Centre service at 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.

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 8.00am and 4.30pm, Monday to Friday. For internet purchases or sales log on to: www.computershare.com/dealing/uk.

Postal: Cazenove & Co Limited provide 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 as at 31 December 2007 is set out below:

Range of shareholdings	No. of shareholders	%	No. of shares	%
1 - 1,000	4,120	44.50	1,890,947	0.39
1,001 – 5,000	3,553	38.38	8,042,396	1.66
5,001 – 10,000	591	6.38	4,189,022	0.86
10,001 – 100,000	641	6.92	20,453,459	4.22
100,001 – 500,000	205	2.21	49,397,220	10.18
500,001 – 1,000,000	49	0.53	35,394,769	7.30
1,000,001 – 10,000,000	89	0.96	208,598,028	43.01
10,000,001 and above	11	0.12	157,083,776	32.38
Total	9,259	100.00	485,049,617	100.00

Financial calendar

2008

27 February	Preliminary results announcement
5 March	Ex-dividend date
7 March	Record date
29 April	Last date for receipt/revocation of DRIP dividend mandates
13 May	Interim Management Statement
13 May	Annual General Meeting
21 May	Final dividend pay date
27 August	Interim results announcement
October	Interim dividend pay date
November	Interim Management Statement
31 December	Financial year end

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