

Bringing service to life

# serco

Annual report and accounts 2011



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## Serco in brief



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Look for page references or flags for additional content throughout the text to help with cross referencing. Links are illustrated with the following markers:



Cross reference to a page with more information



Further information available online

## Who we are

Serco delivers essential services that matter to millions of people around the world.

Our work for national and local governments involves us in the most important areas of services to the public, including providing safe transport, delivering efficient and reliable IT and business process outsourcing (BPO) services, finding sustainable jobs for the long-term unemployed, helping patients recover more quickly, improving and protecting the local environment, rehabilitating offenders, protecting borders and supporting the armed forces.

Our private sector customers are industry-leading organisations in a wide variety of markets. We support them through effective facilities management, technology and BPO services.

Serco has more than 50 years' experience of helping our customers to achieve their goals. Many want us to improve their productivity and service quality. Others need us to support their rapid growth. Government customers face crucial issues such as economic development, congestion, security and climate change, as well as ever-increasing demands for quality and efficiency from the citizens they serve. They value the innovation and passion we bring to these challenges, and the collaborative, flexible and imaginative way we work.

Serco is a values-led company and our culture and ethos are at the heart of everything we do. We give our people responsibility, so they can put their ideas into practice and make a real difference for our customers and the public. Our approach has made us one of the world's leading service companies and our vision is to be the world's greatest.

Our service ethos means that our customers come back to us again and again. These long-term relationships help us to meet their changing needs and to do what we do best...

...bringing service  
to life.



# Serco in brief

## What we offer

Serco operates in a broad and growing range of markets. We can do this because we can apply our experience of people-led service delivery and change management to so many customers. We transform service quality by:

- designing effective organisations
- finding innovative ways to meet their challenges
- applying the specialist skills their sector demands, and
- delivering excellent service.

Transferring our skills from one market to another allows us to help customers around the world. Our international scale means our customers can benefit from the knowledge and best practice we develop in the world's most sophisticated markets.

As well as operating frontline services, we also support customers through our leading skills and capabilities in business process outsourcing, helping them to improve their middle and back office functions. This enables them to reduce costs, increase efficiency and enhance the service they offer their own customers.

Building long-term customer relationships is fundamental to us. We devolve responsibility to our contract directors, allowing them to anticipate and respond to customers' needs. The Serco Management System, the framework which governs how we operate and behave, enables consistent service delivery and quality.



For more on what we offer and how we work, see page 12



More information about the Serco Management System is available on our website [www.serco.com](http://www.serco.com)

## Our vision and strategy

Our vision is to be the world's greatest service company. Everyone in Serco discovers their own interpretation of 'greatest', which supports what they do every day. However, it is not about revenue, profit or growth. It means being the best at what we do and how we do it – bringing service to life.

Our strategy for achieving this vision has four elements:

**1 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.

**2 Delivering excellent service:** This means meeting – and often exceeding – customer expectations. We do this by having the responsible behaviours enshrined in our values at the heart of everything we do. This enables us to build long-term customer relationships, to expand the scope and scale of contracts during their life, retain contracts at rebid and win new contracts.



**3 Making strategic acquisitions:** While we are primarily focused on organic growth, we make acquisitions to gain skills which will be important for future growth and to enable us to enter markets where we see strong opportunities.

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



For more on our strategy, see page 14



**Our track record of success**

Implementing our strategy and bringing service to life for our customers contributes directly to our financial performance. Our focus on service underpins our win rates of one in two for new bids and 90% of rebids and extensions, which in turn drive our revenue.

Serco has a long track record of financial success. Since we listed in 1988, we have consistently grown our revenue, primarily organically. Securing higher margin contracts and managing our cost base has increased our profitability. At the same time, we have delivered robust free cash flow, enabling investment in our future. Our operational success is recognised by others in the many awards we win for service excellence.



For more on our recent performance, see the Operating Review on pages 40 to 53 and the Finance Review on pages 54 to 61

**The future**

Customers around the world are looking for help in transforming the quality of their services, from frontline delivery to back office efficiency. This creates opportunities for Serco in new and existing markets.

Our prospects are supported by the high revenue visibility provided by our order book, our pipeline of opportunities and the growth potential we see across our markets.



For more on our markets and opportunities, see pages 28 to 31

# How we performed – 2011 highlights

Solid operational performance delivers strong financial result; global markets support confidence in future growth.

## Solid operational performance and contract awards across the portfolio

- Robust service delivery metrics and customer relationships
- New business models and service lines developed, including middle and back office support
- Continue to win 90% of rebids and extensions and one in two new bids
- £5.1bn of awards in 2011; £4.7bn signed contracts and £0.4bn preferred bidder appointments
- Order book of £17.9bn at 31 December 2011 (£16.6bn at 31 December 2010)
- 92% revenue visibility for 2012, 80% for 2013 and 70% for 2014

## Strong financial result for 2011

- Strong total revenue growth of 7.4%; good organic growth of 3.5%
- Exceptional growth in AMEAA of 37% organic
- Highest ever international mix, with 44% of total Group revenue now generated outside the UK
- Adjusted operating profit growth of 12.1%, representing a margin increase to 6.2%
- Group free cash flow of £168.3m, representing the return to a more usual conversion rate of profits
- Total dividend up 14.3% to 8.40p, reflecting growth in adjusted earnings

## Market developments and identified opportunities provide an extensive pipeline

- Ongoing demand for efficient, high-quality and innovative service provision from public and private sector customers
- UK markets showing some signs of improvement; US federal outsourcing industry still faces uncertainties and short-term pressure; strongest growth opportunities in fast-developing AMEAA region and global BPO market
- £30bn pipeline of identified opportunities across the Group

## Successful entry into global BPO market and organisational changes

- Creation of significant global capability in the fast-growing, higher margin, Business Process Outsourcing (BPO) market via Intelenet, smaller acquisitions and recent contract wins
- Organisational changes to reflect customers seeking more integrated and end-to-end services, to increase efficiency and deliver better services
- Proactive contract and portfolio management to position the Group for the best future opportunities

## Outlook supports continued resilience and encouraging future growth prospects

- Breadth of portfolio provides resilience and enhances overall growth potential
- For 2012, expect another year of strong total revenue growth, including further good organic growth, together with an Adjusted operating margin increase similar to 2011
- In the medium term, anticipate improvements in the rate of organic revenue growth, supporting the continued delivery of strong financial performance

Notes:

Adjusted operating profit, Adjusted profit before tax and Adjusted earnings per share are before amortisation of acquired intangibles and acquisition-related costs, as shown on the face of the Group's Consolidated Income Statement and the accompanying notes.

Group free cash flow is free cash flow from subsidiaries and dividends received from joint ventures, and is reconciled to movements in cash and cash equivalents in Section 3 of the Finance Review.

Performance at constant currency has been calculated by translating non-Sterling revenue and earnings for the year to 31 December 2011 into Sterling at the average exchange rates for 2010. The order book is the value of future revenues based on all existing signed contracts. It excludes contracts at the preferred bidder stage and excludes Indefinite Delivery, Indefinite Quantity (IDIQ) contract vehicles where we are one of a number of companies able to bid for specific task orders within the IDIQ.

The pipeline is the estimated value of all future potential opportunities that are clearly defined and identifiable.

## A year in the life of Serco – selected news



Merseyrail achieves the highest punctuality and customer satisfaction in the UK



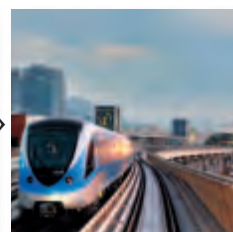
Serco receives the Carbon Trust Standard, reflecting our work to reduce emissions



Acacia Prison's performance is praised by the Western Australian Office of the Inspector of Custodial Services



Serco wins 24 safety awards from the Royal Society for the Prevention of Accidents



Dubai Metro wins the Best Rail Operator Award in the Middle East



**Revenue****£4,646.4m****+7.4%**

2010: £4,326.7m

**Adjusted operating profit****£290.1m****+12.1%**

2010: £258.7m

**Operating profit****£266.2m****+10.3%**

2010: £241.3m

**Adjusted profit before tax****£262.2m****+13.4%**

2010: £231.3m

**Profit before tax****£238.3m****+11.4%**

2010: £213.9m

**Adjusted earnings per share****39.59p****+14.1%**

2010: 34.69p

**Earnings per share****35.70p****+12.0%**

2010: 31.88p

**Dividend per share****8.40p****+14.3%**

2010: 7.35p

**Group free cash flow****£168.3m****(£17.5m)**

2010: £185.8m

“I am pleased with our solid operational performance and the number of contract wins which have underpinned our strong financial result for 2011. Whilst challenges remain in the US and some UK markets, the breadth of our portfolio around the world and in the AMEAA region in particular, continues to present many new prospects. Our order book has grown, our pipeline of opportunities is large and we are now preparing for the next stage of growth which includes our entry into the global BPO market. This gives us confidence for the future.”

**Christopher Hyman, Chief Executive**



Boeing recognises Serco as its supplier of the year in the technology category



Northern Rail wins Train Operator of the Year at the Rail Business Awards



Serco gains sixth Gold award in Business in the Community's Corporate Responsibility Index



UK Prisoner Escort and Custody Services contract granted Investors in People champion status

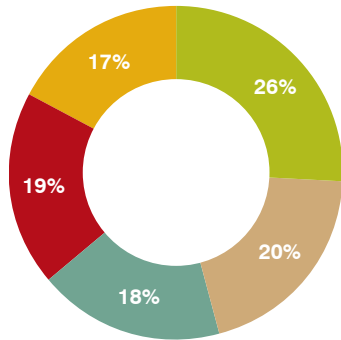


National Physical Laboratory's atomic clock proves to be the world's most accurate

# Our business

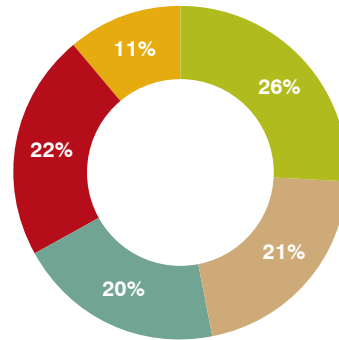
The following pages describe our operations around the world. This discussion is set out using the divisional structure that applied during 2011. In January 2012, we announced the creation of a Global Services division and the amalgamation of our UK and European operations into a single division. More information about our new structure can be found on pages 25 to 26.

Revenue by division 2011



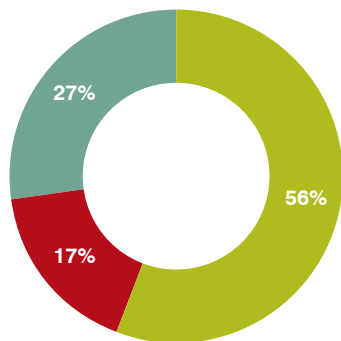
- Civil Government
- Defence, Science and Nuclear
- Local Government and Commercial
- Americas
- AMEAA

Revenue by division 2010



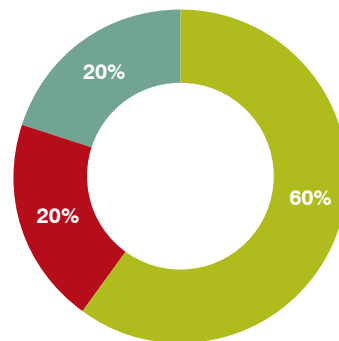
- Civil Government
- Defence, Science and Nuclear
- Local Government and Commercial
- Americas
- AMEAA

Revenue by geography 2011



- United Kingdom
- United States
- Other countries

Revenue by geography 2010



- United Kingdom
- United States
- Other countries

 More on the services provided by each of our divisions is included in the Operating Review, which begins on page 40



## Civil Government



### 2011 revenue

£1,199m

+6%

2010: £1,127m

Civil Government includes our UK and European operations in transport, home affairs, welfare to work and clinical healthcare.



For more information on our Civil Government division, see pages 40 to 43

We are a key provider of transport services in the UK. With our partner Abellio, we run both Northern Rail, the UK's largest train franchise, and Merseyrail, the UK's most punctual train operator. In London, we operate the Docklands Light Railway, the Barclays Cycle Hire scheme and the East London Traffic Control System. We also deliver national motorway traffic infrastructure services and install and maintain road safety cameras.

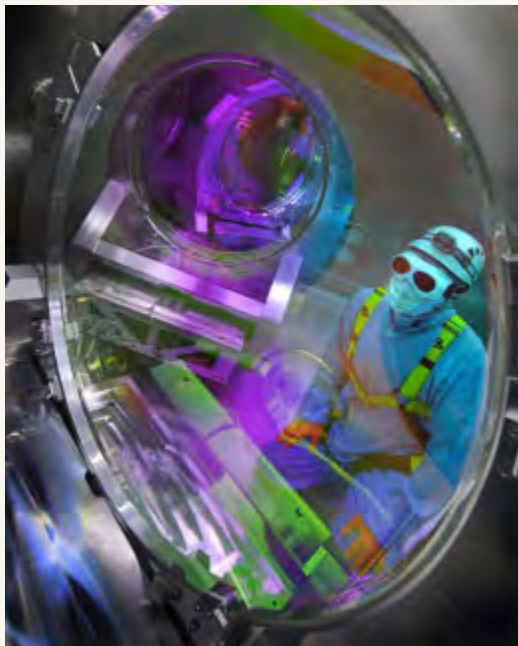
In home affairs, we are a leading private provider of custodial accommodation in the UK, operating four prisons, with a fifth becoming operational in 2012. We also run a young offender institution and a secure training centre. We provide prisoner escort and custody services, as well as electronically monitoring offenders within the community. We run two immigration removal centres and provide border control and security, and technology services.

In health, we have a groundbreaking pathology joint venture with Guy's and St Thomas' and King's College Hospital NHS Foundation Trusts. We are one of the UK's leading providers of occupational health services, supporting over 450,000 of our customers' employees nationwide. We are also the leading independent provider of custodial health services, providing for thousands of people in custody across the UK. We deliver GP out-of-hours services in Cornwall and the Isles of Scilly, providing medical assistance to residents and tourists across the region. At Braintree Community Hospital, we offer a comprehensive range of clinical services including general and plastic surgery, orthopaedics, ophthalmology, diagnosis of ear, nose and throat disorders, outpatient and diagnostic services.

In welfare to work, we have two contracts supporting the UK Government's Work Programme, under which we help long-term unemployed people into work in South Yorkshire and the West Midlands. We also have contracts with the UK Ministry of Justice, co-funded by the European Social Fund and National Offender Management Service, to help offenders into work in the South-East and East of England.

# Our business

## Defence, Science and Nuclear



### 2011 revenue

£939m

+3%

2010: £911m

Defence, Science and Nuclear brings together our businesses supporting the armed forces in the UK and Europe, our science-based businesses, our energy market operations and our nuclear safety and assurance business.



For more information on our Defence, Science and Nuclear division, see pages 44 to 45

In the UK, we provide training, engineering and operational support to the Royal Air Force and the aviation arms of the British Army and Royal Navy. We also support the Royal Navy's three main UK bases and operate and maintain strategic assets such as secure satellite communications, the Defence Academy of the United Kingdom, the Emergency Planning College and the UK's ballistic missile early warning system. We provide systems engineering, safety assurance and risk management services, and support the essential research carried out at the Defence Science and Technology Laboratory.

Serco has supported the German armed forces for more than 40 years, delivering training, logistics and operational support services. We also provide facilities management, prison and IT services to commercial companies and the German Government.

In the science market, we manage the UK's National Physical Laboratory, one of the world's major scientific establishments. With our partners Battelle and the University of Manchester, we also manage the National Nuclear Laboratory, one of the UK's leading technology service providers and a centre of excellence in nuclear non-proliferation.

We have an integral role in the UK nuclear defence industry. Our joint venture with Lockheed Martin and Jacobs Engineering manages the Atomic Weapons Establishment, which provides the warheads for the UK's nuclear deterrent. In addition we have provided nuclear safety advice to the Royal Navy's submarine fleet for nearly half a century.

We also offer specialist technical support to the UK's civil nuclear industry and the wider energy market, providing safety, environmental, risk and asset management advice and operational solutions. We support the operation of more than 20 nuclear reactors.

## Local Government and Commercial



### 2011 revenue

£860m

+1%

2010: £854m

Local Government and Commercial (LG&C) is made up of our UK and European IT-enabled BPO services, integrated and environmental services, education, leisure, consulting and commercial businesses.



For more information on our Local Government and Commercial division, see pages 46 to 47

Our work in IT-enabled BPO services includes joint ventures and strategic partnerships with local authorities. We provide frontline capability with middle and back office operations ranging from property services to finance and human resources. Our acquisition of The Listening Company adds significant contact centre scale and expertise, strengthening our ability to deliver high-volume call handling and frontline customer services. We are also a leading provider of services to European institutions, including the European Commission, the European Central Bank and CERN.

In integrated and environmental services, we provide a full range of waste management services, including refuse collection, recycling, street cleansing and grounds maintenance, to local authorities throughout the UK. We are a major provider of support services to hospitals, including the newly opened Forth Valley Royal Hospital in Scotland. We offer a full range of enabling services, allowing hospital staff to focus on patient care. Our facilities management customers also include many major companies, who look to us for services ranging from help desks to buildings maintenance.

Serco is one of the leading private sector partners in the education and children's services sectors. We partner with councils and individual schools to provide school improvement and related services. Our other services include inspections on behalf of the Office for Standards in Education, Children's Services and Skills (Ofsted), delivering training packages on behalf of the National College for School Leadership and providing management information systems for schools.

Our leisure business provides a comprehensive range of health, leisure, fitness, well-being and community focused services, managing 68 facilities on behalf of community leisure trusts, local authorities and universities.

Serco Consulting provides advisory, design and delivery expertise in the areas of operations strategy, transformation, programme delivery, outsourcing, people performance and selection, change management and research. It helps clients improve their business by giving them a competitive edge – growing revenue, reducing costs, becoming more efficient and improving customer service. It advises and helps deliver these benefits to both private sector companies as well as governments, in the UK and internationally.

# Our business

## Americas



2011 revenue

**£868m**

**-9%**

2010: £954m

Our Americas business provides professional, technology and management services that are focused primarily on the US Federal Government, including every branch of the military, key civilian agencies and the intelligence community.



For more information on our Americas division, see pages 48 to 49

We apply our award-winning enterprise architecture to define, design and satisfy defense agencies' Command, Control, Communications, Computer and Intelligence requirements. We provide communication system installations for the US Navy's fleet and have a 15-year track record as one of the largest systems engineering and technical assistance contractors for the US Air Force Space Command, supporting a wide range of military satellite systems. We have installed detection systems in over 100 locations in 30 countries, to help prevent a nuclear threat from entering the US.

We help soldiers' transition to civilian life and have provided personnel and family services to more than two million military personnel and their families. We support military veterans with career counselling, employment workshops and job fairs to help them continue their career as a civilian within the Federal Government. We have designed software and now provide systems, data centres and call centres to support four million government employees with their retirement plans. We have issued more than 1.5 million identification cards to defense personnel at over 65 military ID card offices around the world.

We processed 36 million visa transactions in 2011 for the Department of State and managed more than 62 million active records and related immigrant applications for the Department of Homeland Security US Citizenship and Immigration Services. Our work includes performing the pre-classification of all US patents. We also provide web-based support for USA.gov and other e-government initiatives.

Our transportation business includes the management of 63 Federal Aviation Administration control towers and approximately 192,000 square miles of airspace in five countries. In Canada, Serco's Driver Examination Services administer two million tests per year, including vision, knowledge and road tests for Ontario drivers.



## AMEAA



### 2011 revenue

£780m

+62%

2010: £481m

AMEAA consists of Africa, the Middle East, Asia and Australasia, where we provide a range of services including transport, home affairs, health, defence, BPO and facilities management.



For more information on our AMEAA division, see pages 50 to 53

In Australia, our two defence joint ventures make us a key provider of support services to the Australia Defence Force. Our two Australian prisons have received numerous awards and positive independent inspections, and we provide court security and custodial services to the Western Australian Department of Corrective Services. We work with the Australian Department of Immigration and Citizenship to transform its immigration services, and have entered the Australian health market through a significant contract at Fiona Stanley Hospital. In transport, we own and operate Great Southern Rail.

Serco has the only contract in New Zealand for a privately operated prison, at Mount Eden Corrections Facility in Auckland. In Hong Kong, we are the largest operator of road tunnels.

The Middle East is home to some of Serco's oldest contracts in aviation, which continue to expand as the region's air traffic grows. We are the largest international player in surface transport in the region. Most notably, we operate the Dubai Metro, the world's longest and most-advanced driverless light rail system. Our technology business serves the telecommunications, marine and biomedical sectors. We also provide integrated facilities management services to the education and commercial sectors. We concluded the acquisition of JBI Properties Services Company LLC from Mubadala in December 2011, which provides a stronger platform for our integrated facilities management services in the region.

India is the second-fastest growing economy in the world and presents significant opportunities for Serco. The acquisition of Intelenet in 2011 significantly added to the scale and depth of our capabilities, making Serco a leading provider of BPO services to the private sector around the world and number one in the domestic Indian market. Our BPO-related operations now provide transactional, process and voice support, finance and accounting services, and business transformation consulting, making us strongly placed to offer our customers around the world a broad range of end-to-end business services. India also presents opportunities beyond BPO. Our global frontline service capabilities offer entry into promising sectors such as rail, traffic management and aviation, as well as healthcare and education, with major infrastructure investment being made in each.

## What we offer our customers

Serco operates in a broad and growing range of markets. We can do this because our experience of people-led service delivery and change management can be applied to so many public and private sector organisations.

### **People-led service delivery and change management**

Our customers want more reliable, efficient and productive services. Increasingly, they are looking for end-to-end solutions that combine frontline capability with middle and back office operations, helping them to drive efficiency and better quality services.

We start by analysing their problems and producing a bespoke solution, with improved people management at its heart.

This means that we design organisations to:

- remove bureaucracy
- enhance processes
- instil our values, and
- free people to deliver their best.

In particular, we:

- use technology to increase efficiency
- invest throughout the contract's life, so our services keep pace with developments
- make the best use of our customers' assets, so we are as cost-effective as possible, and
- share best practice and compare performance across contracts, to help us constantly improve.

### **Specialist and transferable skills**

We combine our service and change management capability with the specialist skills our markets need, whether that means the knowledge of how to reduce reoffending, to deliver excellent clinical services, to design and operate innovative transport systems or to provide mission-critical services to the military.

We transfer our specialist skills between markets, so that customers gain from expertise we have honed in some of the world's most sophisticated markets, and bring together unique combinations of skills from across Serco, to create innovative solutions to customers' problems.

Increasingly we work in partnership with our customers, other companies or third-sector organisations. This allows us to draw on skills that together meet the contract's precise requirements.

### **Focus on excellent service**

Whatever service we provide, our focus is always on delivering excellence for our customers. We devolve responsibility to our contract directors, so they can act quickly and decisively to meet our customers' needs.

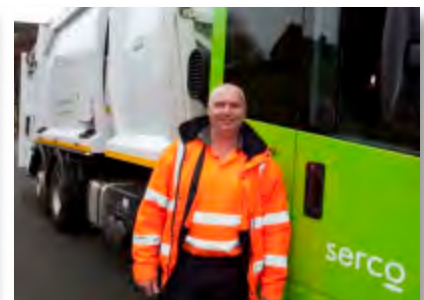
How we work is as important to us as what we do. The Serco Management System sets out our approach to everything, from health and safety to our business ethics. And our Governing Principles (see pages 18 and 19) underpin the thousands of decisions our people make each day, ensuring that we always act responsibly. Our culture and way of working frees our people to put their service ethos into action.

### **Building long-term relationships**

Our focus on excellent service comes with a desire to continuously improve. We are always looking to do better, to be more productive and to find new ways to help our customers.

We aim to build long-term and mutually beneficial relationships with our customers. The closer we are, the better we understand their goals. When our contracts come up for rebid or extension, we retain at least 90% of them, reflecting the value that we deliver for customers.

Our customers also frequently expand our contracts, as they see the benefits of our work at first hand.



# Our business drivers

## **Demand for high-quality and efficient services**

The differing economic environments around the world present opportunities for Serco. These stem from governments' need to:

- deliver efficient and lower cost public services
- invest to improve or create new services, and
- tackle structural challenges including economic development, ageing and growing populations, unemployment, migration, security, congestion and climate change.

Governments continue to recognise the benefits of opening new areas of public service to competition, to reduce cost and stimulate innovation.

Our private sector customers are seeking help to improve their service quality and productivity. Our expanded BPO platform opens up a significant growth area for Serco as we seek to offer a wider range of services to both our public and private sector customers.

## **Good potential for market growth**

Our markets are large but still have appreciable scope for growth. With only 10-15% of total spend typically opened up to competition in our major government markets, we have confidence in our medium- and long-term opportunities. Strong growth in the private sector BPO market is also expected.

The number of markets we can address also expands as we broaden our skills, either by combining skills from around our business, through acquisitions or by partnering with other companies, the voluntary sector or our customers. Our varied portfolio demonstrates this.

The scale of our markets means that we can be selective about the opportunities we bid for. It also means that our share of any one market does not affect our ability to grow.

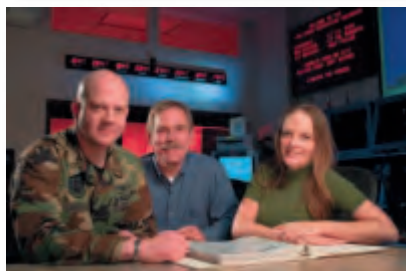
## **Our competitive environment**

Competition is necessary for our markets to operate, as it:

- encourages customers to put services out to tender
- provides a benchmark to ensure they are getting best value, and
- drives innovation.

Our business breadth means we have a large number of competitors for both public and private sector contracts. These competitors are primarily companies but for government contracts they can include public sector and voluntary bodies. As we enter new markets, we meet competitors who specialise in those areas. While we see effective competitors in every market, no organisation competes with us in all of them and only a few operate in more than one.

 For more on our prospects in our individual markets, see pages 28 to 31



# Our strategy

Each element of our strategy contributes to reducing our exposure to market fluctuations, strengthening our position in our markets and developing new skills and capabilities for the future.

Strategy	Description	Key achievements in 2011
<b>Building a balanced portfolio</b>	We aim to reduce risk and increase opportunities by building a balanced contract portfolio, 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.	Our performance in 2011 shows the benefit of a balanced portfolio, with the strongest growth coming from the AMEAA region and 44% of our revenue now generated in markets outside the UK.  We also continued to strengthen our portfolio, with £4.7bn of contracts signed and a further £0.4bn of preferred bidder appointments.  The formation of our Global Services division in 2012 will further develop our balance, with its emphasis on middle and back office service provision for which there are significant opportunities in the private sector.
<b>Delivering excellent service</b>	Delivering excellent service means meeting – and often exceeding – customer expectations. We do this by having the responsible behaviours enshrined in our values at the heart of everything we do.  This enables us to build long-term customer relationships, to expand the scope and scale of contracts during their life, retain contracts at rebid and win new contracts.	The quality of our service is reflected in our high contract win rates. We continued to win 90% of rebids and extensions, and one in two new bids.  We also frequently receive external recognition for our work. Some examples of our awards and commendations in 2011 can be found under 'A year in the life of Serco' on pages 4 to 5.
<b>Making strategic acquisitions</b>	While we are primarily focused on organic growth, we make acquisitions to gain skills which will be important for future growth and to enter markets where we see strong opportunities.	The acquisitions of Intelenet, a leading provider of international BPO, The Listening Company in the UK and Excelior in Australia significantly increased our ability to offer related services to companies and the public sector globally.  Other small acquisitions of specialist skills include: clinical and community healthcare skills through Braintree Clinical Services Limited; public sector debt management through Philips Collection Services Limited; and integrated facilities management expertise in the Middle East through JBI Properties Services Company LLC.
<b>Developing new models</b>	We respond to emerging opportunities by finding new ways to deliver services. This may mean innovative approaches to assessing and rewarding our performance, collaboration between our divisions, bringing together skills and experience which few other companies can replicate, or partnering with our customer or the voluntary sector. Our ability to lead change keeps us at the forefront of our markets.	We have successfully introduced payment by results into the prison market, through our new contract to operate HMP & YOI Doncaster. We expect this to be featured in the development of this market. ACCESS, our joint venture with Glasgow City Council, has seen further organic growth in the year and supported the wins of new strategic partnerships, such as that for Peterborough City Council.

## Developing our business strategy

Our strategy is the means for delivering our vision. To ensure our strategy remains on course, we have a planning process that follows a four-stage annual cycle: strategy (June), business planning (October), financial commitments (November) and people (March). Each stage informs the next, is clearly defined in terms of outcomes and expectations and is managed as a discrete programme of work. Group, divisions and business units all have specific roles in strategy development and the process is run in an inclusive, integrated manner.

The Serco Group plc Board sets our vision and corporate strategy: what and where we want to be and how we are going to get there. The Executive Committee is individually and collectively responsible for supporting our vision and delivering against the corporate strategy.

Divisions are responsible for creating five-year strategic plans on a rolling annual basis that cover, amongst other things:

- detailed market and capability analysis
- sources of competitive advantage
- growth plans, both organic and through acquisition, and
- the associated talent, resource and systems plans.

These plans are aligned to the vision and corporate strategy, and executed through business plans which translate the rolling five-year strategies into deliverables, revenue and costs. Divisions then implement processes that enable them to meet the requirements and timescales of the strategic planning cycle.

Corporate functions are responsible for the overall corporate strategic plan, with each developing specific objectives and targets for their areas of responsibility.



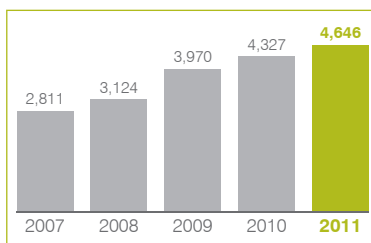
# Key performance indicators (KPIs)

We use the following KPIs to monitor our performance over time. They are split between financial and non-financial measures.

## Financial

### Revenue (£m)

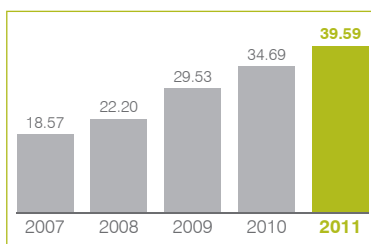
Revenue represents the amounts due for the services we provided during the year, and includes our share of revenue from joint ventures.



The 7.4% growth in the year represents a good performance against our strategic objectives, given the challenging environment.

### Adjusted earnings per share (EPS) (p)

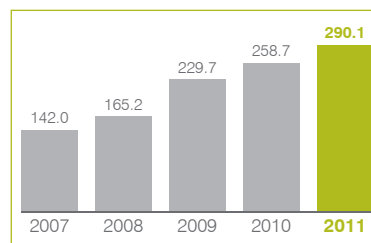
Adjusted EPS is our profit for the financial year (excluding the post-tax charge for the amortisation of intangibles arising on acquisition and acquisition-related costs) divided by the weighted average number of shares in issue during the year. Adjusted EPS provides a measure of shareholder return that is comparable over time. The details of the calculation are shown in note 12 to the financial statements.



The 14.1% growth demonstrates the delivery of a strong financial result for 2011.

### Adjusted operating profit (£m)

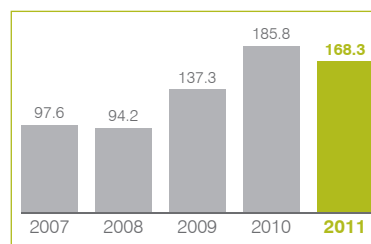
Adjusted operating profit is our operating profit before the amortisation of acquired intangibles and acquisition-related costs. We believe it is the most appropriate measure for assessing the profitability of our business.



The growth of 12.1% represents an increase in margin of 26 basis points to 6.2%.

### Group free cash flow (£m)

Group free cash flow is the free cash flow from subsidiaries and dividends received from joint ventures. It represents the cash flow to which the Group has access. The calculation is shown in the Finance Review on page 56.

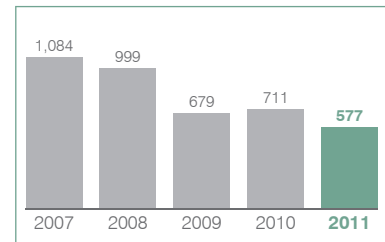


The reduction of £17.5m in Group free cash flow includes the anticipated £30m increase in net capital expenditure.

## Non-financial

### Reportable incident rate (per 100,000 employees)

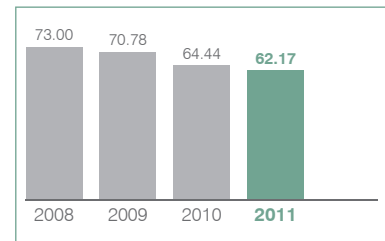
Reportable incidents include work-related fatalities, major injuries, injuries resulting in absences from work of more than three days, work-related diseases and near-miss incidents. The rate measures our success in providing a safe and secure working environment.



Our reportable incident rate was 577 per 100,000 employees, a reduction of 18.8% from 2010 and 42.2% below our 2008 baseline.

### Carbon dioxide emissions (tonnes of CO<sub>2</sub>/£m revenue)

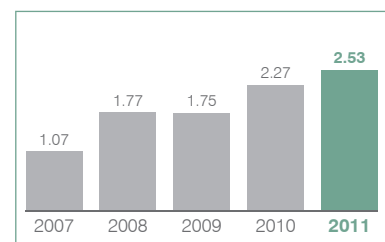
Reducing our carbon dioxide emissions is one of our key corporate responsibility objectives. We measure our emissions in relation to our revenue, to take account of our business growth.



The data here refers to our UK business, which generates around 80% of our CO<sub>2</sub> emissions. We reduced our emissions relative to revenue by a further 3.5% in the UK, giving us a cumulative reduction against our 2008 baseline of 14.8%.

### Investment into society (£m)

Each year, we aim to invest 1% of our pre-tax profits into society. We do this through cash donations, gifts in kind, employee volunteering and management time.



In 2011, we invested £2.53m, representing 1.06% of our pre-tax profit.

# Our business model

Our business model draws on our competitive advantages, which enable us to create value for our stakeholders. In particular, we have:

- a broad business with significant scope and scale, which allows us to pick the best opportunities in whichever market or country they occur
- the ability to transfer our skills around the world, helping us to open up new markets
- the experience to bring fresh perspectives to customers' problems, for example by creating new contracting or partnership models or bringing together unique combinations of skills from across the Group
- a devolved structure and a strong management system, which empower our people by pushing responsibility for service delivery to the contract level. This structure also makes our business scalable, enabling us to manage a growing contract portfolio
- a strong track record of delivery and a reputation for high-quality service, which helps us to retain contracts and to win new ones
- long-term customer relationships, some of which span several decades, which allow us to fully understand our customers' needs, increase the scope of the work we do for them and enhance our chances of retaining the contract at rebid.

Our competitive advantages underpin our Business Lifecycle Governance Process, which formalises Serco's approach to value creation and managing the associated risks.

### The Business Lifecycle Governance Process

The Business Lifecycle Governance Process is part of the Serco Management System (SMS). We use it to:

- determine the markets we want to be in
- bid successfully for contracts that add most value
- transition these contracts to deliver this value, and
- retain and grow them.

### Summary of the Business Lifecycle Governance Process



## 1 Selecting markets

We look for markets that:

- are politically and economically stable
- offer multiple contracts and good growth
- provide appropriate margins and cash flow, and
- allow us to differentiate ourselves from the competition.

We also analyse many other factors, including:

- the market's drivers
- our understanding of the customers and the way they procure
- any ethical or human rights issues, and
- whether we can provide an attractive working environment for our people.

In new markets, we also consider our entry strategy and whether we need an innovative contracting model.

## 2 Identifying opportunities

Once we know the market is attractive, we identify opportunities to pursue. We then test the quality of each opportunity, including:

- our understanding of the customer's business and vision
- their funding for the project, and
- how likely they are to procure.

We also compare opportunities against each other, to determine the best use of our resources.

## 3 Bidding selectively

Bidding can be expensive and take many months, so we only bid for opportunities that meet our criteria and where we have a strong chance of winning.

The bidding stage has numerous steps, from our initial submission, to being shortlisted, to our final bid. During the process, we develop a detailed solution for the customer and test it thoroughly. At every step we review the opportunity and confirm that we want to proceed.

Once the customer selects us, the final step is to negotiate and sign the contract.

## 4 Transitioning effectively

Effectively transitioning a new contract is vital. We ensure that we have the right planning and controls in place to start work seamlessly on day one, as we implement the solution we developed during bidding. We also transfer knowledge from the bid team to the contract management, and continue to strengthen our customer and stakeholder relationships.

## 5 Delivering operational excellence

We aim to deliver operational excellence and continual improvement.

Devolving responsibility to our contract directors allows them to innovate and respond to our customers' needs. The SMS sets out our control framework, ensuring we work safely and responsibly, and safeguard the needs of our stakeholders, people and Serco. Every decision we make must be in line with our Governing Principles (see pages 18 to 19).

Working in the right way helps us to build long-term relationships. This often leads to the customer expanding our contract during its life, which is important for our growth. It also positions us to win the contract at rebid.

## 6 Deciding to rebid

As we near the end of a contract, we decide whether or not to rebid it.

We will choose to rebid a contract because:

- the market continues to grow and can support our margin requirements, and
- the opportunity represents a good return on our investment.

## 7 Rebidding

Our long-term relationships and service quality help us retain around 90% of our contracts at rebid and extension.

We approach the rebid as if it were a new contract, designing ways to deliver even greater quality and productivity. Often the customer requests more services over a longer term, so a rebid can be considerably larger than the original contract.

Once we have secured the rebid, we return to the transition phase, bedding-in our innovations and any new services we have taken on.

## 8 Exit

When we finish a contract, we do so in the right way.

Where appropriate, we work closely with the incoming contractor to protect the interests of both the customer and any people who will transfer from us when our contract ends. This is also important because we may have other contracts with the customer or want to work with them in the future.

# A values-led and responsible business

## A values-led business

Serco could not succeed without the skill and dedication of our people around the world. They embody our culture and our values, which underpin the way we run the Company.

Our values, which are encapsulated in our Governing Principles, inform every decision we make. They ensure that we deliver the excellent service on which our success depends.

The Governing Principles are integral to the Serco Management System (SMS), which is our mandatory management framework within which all parts of Serco must operate. Each policy area in the SMS reflects one or more of our Governing Principles, which means that working within the SMS ensures we are living our values.



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## Our Governing Principles

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### 1 We foster an entrepreneurial culture

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We are passionate about building innovative and successful Serco businesses. We succeed by encouraging and generating new ideas. We trust our people to deliver. We embrace change and, by taking measured risks, encourage creative thinking.

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### 2 We enable our people to excel

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Our success comes from our commitment and energy to go the extra mile. We are responsible to each other and can expect support when we need it most. We expect our people to achieve more by recognising and harnessing the power of individuals. We value people for their knowledge, ideas and potential to contribute.

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### A responsible business

Our Governing Principles emphasise the importance of corporate responsibility (CR). We want to be good corporate citizens but acting responsibly is also essential to our strategy. Only by working in the right way can we deliver excellent service, continue to build our balanced contract portfolio and attract the partners with whom we create new contracting models.

We divide CR into four pillars – health and safety, people, community and the environment. The work we do for our customers encompasses all four pillars, but there are many things we do which go beyond our contractual or legal requirements. Our approach to CR also shapes the way we do business with our suppliers and partners.



For more on our approach to CR and our performance during the year, see pages 66 to 69 and our separate CR Report for 2011, which is available on [www.serco.com/cr2011](http://www.serco.com/cr2011)



### 3 We deliver our promises



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

### 4 We build trust and respect



We build respect by operating in a safe, socially responsible, consistent and honest manner. We never compromise on safety and we always operate in an ethical and responsible manner. We listen. In doing so, we treat others as we would wish to be treated ourselves and challenge when we see something is wrong. We integrate with our communities.

## Chairman's Statement



Last year, as I spoke of my assessment of Serco's principal strengths in my first statement as Chairman, I identified the breadth of Serco across both geography and sector; our ability to bring people together from across different parts of our business to share experience, skills and ideas; and our application of innovative thinking to derive better service outcomes.

That we have been able to achieve the quality of results of which Chris Hyman writes in detail in his Chief Executive's Statement is testament to these strengths against the backdrop of challenging conditions in our largest markets. To have achieved good organic revenue growth, further improvement in operating margins, and contract awards totalling over £5bn when we have seen pressures in certain areas of UK Government spending, in particular in local government, and delays and cancellations of previously anticipated work in the US, is a great credit to our management and our people, to whom I give my thanks on behalf of the Board for all their hard work and commitment.

Our strategic drive to broaden the base of our business in order to increase our resilience and our capability to pursue new commercial opportunities was exemplified by our acquisition of Intelenet, a leading provider of Business Process Outsourcing (BPO) services to the private sector around the world and in the domestic Indian market. Serco has historically been predominantly a provider of frontline services on behalf of the public sector. We have now added the ability to service a broad range of middle and back office requirements and a high-quality private sector customer base that provides excellent referenceability. These will enable us both to expand our BPO activity in existing and new markets and offer full service solutions – front, middle and back – to our extensive public sector customer base. The acquisition of Intelenet was complemented by smaller acquisitions of The Listening Company in the UK and Excelior in Australia, both leading providers of outsourced contact centre services in their domestic BPO markets. In his statement Chris sets out the enormous potential to be derived from bringing together all of our BPO related skills and capabilities as a new Serco Global Services division.

What these new capabilities make possible is amply evidenced by Serco achieving single bidder status to operate the Anglia Support Partnership, our first shared services proposition in the emerging market for middle and back office support to the UK health sector. Not only does this demonstrate the strength of our BPO credentials but also our growing presence in health operations. This is a sector where expertise demonstrated in one geography has enabled us to build a presence in another, which is a key feature of the Serco business model. Our being selected to provide non-clinical support services at the new Fiona Stanley hospital near Perth in Western Australia – a ten-year contract with a total value of A\$1.3bn – drew on our proven hospital support services operations in the UK, such as at the NHS Forth Valley Royal Hospital in Scotland. In the same way as Forth Valley demonstrated Serco's innovation including pioneering the use of robots within the service infrastructure, so at Fiona Stanley Serco will demonstrate its innovation through the integration of non-clinical services applying state-of-the-art technology to ensure the smooth running of the whole hospital. We see strong prospects for our healthcare services to grow further in both developed and emerging economies.

The design of innovative solutions to public sector service provision is central to Serco's ability to grow profitably, particularly when governments are so focused on delivering more for less. As a for instance, when we successfully rebid the contract to operate Doncaster Prison, this was based on a new payment by results pilot – a first for the UK prison sector – under which 10% of Serco's annual revenue is contractually dependent upon prisoners not reoffending in the year after their release.

Again, our justice sector is an excellent example of our application of capabilities and track record developed in one market to build strong positions in other geographies. During the year our contract for Acacia Prison in Western Australia was renewed for a further five years, and we signed and commenced a six-year contract at Mount Eden Corrections Facility in New Zealand to provide rehabilitation and reintegration programmes for prisoners, as well as logistics and infrastructure management. Pursuing this theme further, in the UK we have provided prisoner escort and custody services in London and the south-east since 2004 whilst in July we started a new contract to provide such services in Western Australia.

In the same way as the balance of our business is changing between UK and overseas and between public and private sector, so too should, and is, the make-up of the Board. During the year we welcomed Paul Brooks, Angie Risley and Ralph D. Crosby Jr as new Non-Executive Directors. Paul, Group CFO of Experian, and Angie, Group HR Director of Lloyds Banking Group, brought significant private sector experience. Ralph has just retired as Chairman and CEO of EADS in North America and, therefore, brings us an in-depth understanding of the US, in particular the defence sector that represents a major part of Serco's US business.

Over the ten years Paul had held the role at Experian he had played a central part in the growth of a global business and we were deeply saddened by his recent untimely death. Although he had only been with us a short time he had already firmly established himself as a much respected and well-liked colleague whose contribution to boardroom debate was always relevant, clear and concise, drawing on both his wide commercial experience and his technical financial competence. He will be much missed. Whilst we are currently seeking someone to take Paul's place, David Richardson has kindly agreed to defer his retirement as Chair of our Audit Committee and Senior Independent Director until the 2013 AGM, being the AGM following the ninth anniversary of his joining the Board.

With Serco now employing over 100,000 people across 30 countries, the attraction, retention and development of appropriate talent is high on the Board's agenda and it is of great benefit to have someone of Angie's experience around the table. She will succeed Leonard V. Broese van Groenou as Chair of our Remuneration Committee when Leonard completes his current term in May 2012. Leonard joined the Board of Serco in April 2006 and I should like to thank him, on behalf of my colleagues and the Company, for his commitment and contribution to Serco's success over this period.

Whilst Serco has a 'can do' mentality, it is one built on the foundations of a strong management system that ensures rigorous analysis of potential opportunities and their inherent risks, followed by meticulous implementation. Integral to such a strong management system is an effective Board exercising appropriate governance over the business, in particular the selection of our strategic objectives; the understanding and mitigation of the risks that may prejudice the achievement of those objectives;

the deliverability of managements' plans to implement the agreed strategy through the right combination of people, processes, and systems; and the measurement of progress in that implementation.

We have spent considerable time this year thinking about how our business needs to change over the next few years to apply our existing proven competencies and experience in new markets, delineated both by geography and sector, and to structure ourselves most effectively to meet the challenges of tighter economics in our core markets whilst taking advantage of the opportunities presented by rapid growth in other parts of the world. In his statement Chris outlines our plans to achieve these strategic objectives. Five years ago Serco derived revenues of £2.5bn at an operating margin of 4.8% of which 74% originated from the UK, generating Group profit before tax of £107m. Now close to half of our revenue is derived from outside the UK whilst we achieve an operating margin of over 6%, and are looking forward to total revenues of approximately double the 2006 level in 2012. These key metrics will all continue to develop as we implement our strategy.

Central to good governance is rigorous evaluation, and 2011 marked the triennial independent review of our Board's effectiveness. It was very encouraging, against the backdrop of a Board that was generally perceived to be performing well, to see directors, established and new to the Board, executive and non-executive, focusing on common areas, such as the importance of developing management talent for a growing complex business; the identification of relevant key performance indicators across our diverse activities; and the provision of regular feedback to directors as to their contribution and training needs. Equally important is effective management of the risks to which our Group is exposed, and these are set out in detail, alongside the way in which the risks are managed, later in this report.

Businesses do not operate in isolation: they have a material impact within the communities in which they operate, none more so than a business such as Serco that delivers essential services that matter to millions of people around the world. This is why building trust and respect is one of our four governing principles: we aim to build respect by operating in a safe, socially responsible, consistent and honest manner, and to integrate with our communities. A summary of our approach to corporate responsibility, and examples of the contributions we make, can be found in our Corporate Responsibility Report on our website.

Finally, may I thank our shareholders for their continued support and reiterate our desire to maintain with them an active dialogue as to our progress so that they may understand our objectives and both the challenges to, and our continued confidence in, their achievement.

**Alastair Lyons CBE**  
Chairman

## Chief Executive's Statement



### Overview

2011 has been another successful year for Serco. We have seen a solid operational performance and contract awards across our portfolio. This has delivered a strong financial result despite some challenging conditions. Our markets continue to develop and we have an extensive pipeline of opportunities to capitalise on global demand. We have successfully entered the global BPO market, and are positioning the Group for the best opportunities and future needs of our customers. We are therefore confident in the outlook for strong future growth of the Group, achieved through the commitment of our employees to deliver efficient, high-quality and innovative services that matter to millions of people around the world.

### Solid operational performance and contract awards across the global portfolio

Serco has seen another year of robust service delivery and customer relationships. We have specific performance metrics in our contracts and the results of our continuous measurement against these have been very positive during 2011. Many of our operations, from custodial services through to transport operations, undergo formal inspections and independent reports, with these again showing pleasing outcomes. Further industry recognitions and awards have also acknowledged the delivery of excellence around the Group.

The year has seen the development of new service lines and business models. From 2012 our new Global Services division will bring many of these together – such as Intelenet as a leader in international BPO, The Listening Company with its UK contact centre expertise, and Excelior covering the Australian market. Wins, such as Peterborough City Council and being selected to operate the Anglia Support Partnership NHS shared services, reinforce our confidence in this new area of development. Growth in AMEAA has included new sectors such as health and new countries of operation in the Middle East. The success of new business models, such as joint ventures with customers including ACCESS in Glasgow, or introducing payment by results at Doncaster, have also been highlights of our continuous development.

Our focus on service excellence, building long-term mutually beneficial customer relationships and ongoing innovation during a contract underpins our 90% win rate for rebids and extensions. Our one in two win rate for new bids has also been maintained, with both of these measures driving our revenue growth.

In 2011, contract awards across our wide portfolio of markets and geographies totalled £5.1bn, with signed contracts valued at £4.7bn and preferred bidder appointments for a further £0.4bn. Our wins included smaller and medium-sized awards which are fundamental to our growth, as well as significant rebids, extensions, expansions and new contracts. The value of these wins does not include the Indefinite Delivery, Indefinite Quantity (IDIQ) contracts in the US we won in 2011 as a prime contractor, which have a combined ceiling value of approximately US\$2bn among awardees. These new IDIQs enable us to compete for specific task orders issued under the IDIQ, with the value of the task orders recognised when won and then included within our order book.

Among the notable rebids, extensions and new contract awards during the year were:

- Prisoner Escort and Custody Services for London and the East of England, with a potential value to Serco of £420m over ten years;
- HM Prison and Young Offenders Institution Doncaster, valued at around £250m over 15 years;
- Barclays Cycle Hire scheme expansion, valued at approximately £50m over four years;
- The Helios programme of capital projects and associated support equipment for the Defence Science and Technology Laboratory (Dstl), valued at around £80m over five years;



- UK Ministry of Defence prime contract for further deployment of innovative radar technology, with a contract value of £27m over two years;
- Peterborough City Council strategic partnership for shared services, with an initial value of £100m over ten years;
- A 15-year partnership for support services at two of Sport England's National Sport Centres, valued at over £100m to Serco;
- IT support services to a major European banking organisation, with a rebid valued at €20m over four years and a new win valued at €50m over eight years;
- US Army task orders valued at US\$169m under various HRsolutions IDIQs;
- US Air Force Space Command task orders valued at US\$115m under the C4I2TSR IDIQ;
- US Navy task orders valued at US\$33m under the C4ISR IDIQs;
- Fiona Stanley Hospital near Perth, non-clinical integrated services with a total value to Serco of A\$1.3bn over ten years;
- Acacia Prison in Western Australia extended and expanded contract, valued at A\$310m over five years;
- Court Security and Custodial Services in Western Australia, valued at A\$210m over five years; and
- Anglia Support Partnership, chosen as single remaining bidder to provide middle and back office shared services to the NHS, with an estimated initial value of £120m over four years.

There has also been an encouraging level of contract awards following the end of the financial year.

More details of the above and other contract awards can be found in the Operating Review. We also signed numerous other smaller and medium-sized contracts during the year, some of which are described in the contract news updates available on our website, [www.serco.com](http://www.serco.com).

Visibility of earnings remains high due to the signed contracts that make up our order book, contracts we expect to extend and rebid, and contracts at the preferred bidder stage which we expect to sign. At 31 December 2011, our order book stood at £17.9bn, compared with £16.6bn at 31 December 2010. This leads to revenue visibility of 92% for 2012, 80% for 2013 and 70% for 2014.



*Left:* We continued to win logistical support task orders from the US Navy.

*Below:* We renewed our contract to run Doncaster Prison for a further 15 years.

*Bottom:* The Barclays Cycle Hire Scheme expanded into new areas of London.



For more details of these and other contract awards, see the Operating Review on pages 40 to 43



For details of some of the many smaller and medium-sized contract wins, see our contract news updates at [www.serco.com](http://www.serco.com)

# Chief Executive's Statement

## **Strong financial result for 2011**

Serco has delivered growth in revenues including good organic growth, increased the operating margin, and maintained a strong cash generation profile and financing position.

Total revenue growth was 7.4% to £4,646.4m. Growth at constant currency was also 7.4%, with the adverse movement on the US Dollar offset by the favourable movement on the Australian Dollar. Organic growth excluding acquisitions and currency effects was 3.5%.

This growth demonstrated the resilience of our portfolio and our ability to develop capabilities in new sectors and geographies. This has been achieved at the same time as headwinds have been felt in some UK and US markets. Revenue growth was exceptionally strong in AMEAA, reflecting growth from both existing contracts and those recently won. In the UK, performance was varied: Civil Government grew, benefiting from previous contract wins and expanded operations; Defence, Science and Nuclear saw modest growth; while Local Government and Commercial saw strong growth in its strategic markets offset by sharper headwinds from specific austerity measures. The Americas saw constant currency growth achieved in the first half of the year move into a decline for the year overall as the very challenging conditions for US federal contractors took hold. Our divisional performance is described fully in the Operating Review.

Adjusted operating profit rose by £31.4m or 12.1% to £290.1m, with a 26 basis point increase in the Adjusted operating profit margin to 6.2%. Adjusted profit before tax grew by £30.9m or 13.4% to £262.2m and Adjusted earnings per share increased by 14.1% to 39.59p.

Group free cash flow was £168.3m compared with £185.8m in 2010, representing the return to a more usual conversion rate of profits. Net capital expenditure increased by £30m, reflecting a return towards a more normal underlying level of capital investment, together with the anticipated investment in SAP systems in 2011.

Our policy is to increase the total dividend each year broadly in line with the increase in underlying earnings. Accordingly, the Board has proposed a final dividend of 5.90p per share, bringing the total dividend for the year to 8.40p, up 14.3% compared with the previous year. The final dividend will be paid, subject to shareholder approval, on 22 May 2012 to shareholders on the register on 9 March 2012.

Our earnings, cash flow, financing and related matters are described fully in the Finance Review.

*Below: We run Prisoner Escort and Custody Services in partnership with Wincanton.*



## **Market developments and identified opportunities provide an extensive pipeline**

Our pipeline of identified opportunities around the world has a total estimated value of some £30bn. We therefore see good prospects to continue driving future growth across the Group.

Ongoing demand is expected for efficient, high-quality and innovative service provision from public and private sector customers around the world. Demand is driven by the need to achieve efficiencies and cost savings in services, investment to improve or create new services, and structural challenges including economic development, ageing and growing populations, unemployment, migration, security, congestion and climate change.

Public service reform continues to increase the potential for our markets. With only 10-15% of total spend typically currently opened up to competition in our major government markets around the world, we remain confident in the medium- and long-term market opportunities and drivers of growth for Serco. Recognition is widely held of the benefits such as reducing cost and stimulating innovation when public service markets are competed. Of note was the UK Government's 2011 Parliamentary White Paper on Open Public Services, which we expect to deliver upon its stated aim of commissioning more services rather than the state continuing to provide these themselves.



*Below left: Providing community health services in Braintree, Essex.*

*Left: We operate New Zealand's only private prison.*

*Below: We will deliver nearly 30 non-clinical services at the new Fiona Stanley Hospital near Perth, Australia.*



In the UK, markets appear to have stabilised and are starting to show some signs of improvement; our financial performance was stronger in the second half of the year and the amount of potential tender opportunities appears to be increasing, together with further signs of markets opening up to support growth in future years. Some risk, however, still remains that further austerity measures may bring additional short-term pressures.

In the US, Congress's challenges in reaching agreement on a budget for 2011 created uncertainty for federal government agencies and the inability to fund new programmes. Economic and political challenges relating to the US debt ceiling and deficit reduction plan will likely result in continued short-term pressure for the US federal outsourcing market, with further delays and the risk of cancellations of bids and awards possible in 2012. Looking beyond, the opportunities in the federal government and wider US contracting industry remain substantial, with strong growth prospects in certain specific sectors.

The AMEAA region continues to exhibit the strongest growth opportunities. Whilst not without some potential risk, in general these areas of economic and population expansion are leading to growth in various infrastructure management markets, as are government programmes specifically targeted to improve social infrastructure. We have demonstrated our ability to internationalise our skills and capabilities into this region, and across multiple markets such as the transportation, home affairs, health and defence sectors.

The global BPO market is also fast-developing and presents substantial opportunities for the Group.

### **Successful entry into global BPO market and organisational changes**

2011 has seen Serco add significant global capability in the fast-growing, higher margin, business process outsourcing (BPO) market. The Intelenet acquisition is strategically important for Serco's development in this area. Firstly, it provides access to attractive markets: the international and domestic Indian BPO markets are large, forecast to grow around 15% per annum in the medium term, and have margins reflective of high-value services. Secondly, it broadens our customer and geographic reach: in line with our strategy of building a balanced portfolio, Intelenet's diverse and international private sector customer base will further increase our spread across markets. Thirdly, it adds to our scale and depth of capabilities: together with our existing BPO-related operations we will have around 40,000 employees providing transactional, process and voice support, finance and accounting services, and business transformation consulting, making us strongly placed to provide our customers with a broad range of end-to-end business services. Other in-fill acquisitions, such as The Listening Company in the UK and Excelior in Australia, have added additional specific customer contact capabilities and geographic reach.

Serco's existing strength in these areas includes our IT-enabled BPO service delivery for local authorities. Recent contract wins here have added both experience and capability. Of particular note is Serco being chosen as the single remaining bidder for the Anglia Support Partnership (ASP), which would add a further strategic partnership – in this instance with the UK's National Health Service – to our growing health support services and BPO operations. This bid was an opportunity to use the Group's combined capabilities for an integrated offering to transform public services in this area.

# Chief Executive's Statement



*Above left and left:* The acquisition of Intelenet gives us access to attractive markets around the world.

*Above:* The Listening Company extends our customer contact capabilities.

To reflect developments in market needs and opportunities such as ASP, we are progressing with organisational changes that have already begun in 2012. A part of this is the creation of a new global BPO division, our first global business, bringing together all of Serco's middle and back office skills and capabilities. The new Serco Global Services division will both improve the services we provide to customers and enable us to better target opportunities around the world in both the public and private sectors.

Serco's customers around the world are increasingly looking for more end-to-end services that combine frontline capability with middle and back office operations, helping them to drive more efficiency and better quality services. Our Global Services division will therefore work alongside the regional divisions in order to deliver fully integrated services for their customers.

As Serco continues to grow we regularly review our opportunities, our structure, the way Serco delivers services for customers and how we target future growth. We are therefore creating a single UK and Europe division, to increase efficiency and support the delivery of better services. As part of achieving this, the Global Services division will operate a wider-reaching shared service centre for the Group itself. These changes are likely to lead to reductions in headcount of around 500 people in management and in our own back office support functions out of our 100,000 employees around the world, including 35,000 in the UK.

These changes will help us achieve greater economies of scope through closer working relationships, position us better for more integrated and larger service delivery, as well as achieve greater efficiencies and scale economies for our customers.

We also continue to proactively manage our portfolio of contracts, assessing our operations for appropriate levels of performance, returns and strategic fit. Our stated strategy is to reduce risk and increase opportunities by building a balanced business, spread across markets. Where appropriate, this includes disposals and acquisitions. This helps to manage 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.

While we are primarily focused on organic growth, we will continue to acquire new skills and capabilities where they support expansion into new markets and sectors. In the BPO market, there may be opportunities for in-fill acquisitions of specific areas of expertise or geographic strength. While facing short-term challenges, the US market remains fundamentally attractive and may present opportunities in higher growth specialised areas. Strengthening our presence in vertical markets such as health, or entering new emerging economies such as South America may also yield acquisitions from which to further develop our operations organically.





*Left:* We provide personnel and family support services to the US Army.

*Below:* The Dubai Metro continued to achieve high levels of availability and punctuality.



### **Outlook supports continued resilience and encouraging future growth prospects**

The breadth of our portfolio across different markets and economies continues to provide resilience while at the same time enhancing our growth potential.

For 2012, we are forecasting another year of strong total revenue growth; this includes the contribution from acquisitions completed to date, together with further good organic growth. At this early stage of the financial year, our forecasts reflect the balance of risks and opportunities; we expect challenging conditions to remain in the US, but anticipate some further improvement in UK markets and another strong performance in AMEAA. We are forecasting a further increase in our full-year Adjusted operating margin, similar to that achieved in 2011. Net finance costs are expected to increase to around £45m, driven principally by the incremental cost of funding the acquisitions made during 2011.

The phasing during 2012 is likely to see organic growth weighted to the second half and the contribution from completed acquisitions weighted to the first half. Organisational changes are expected to have a broadly neutral impact on the full-year margin, but due to the timing of the implementation costs are likely to more than offset the underlying improvement in the first half.

Improving market conditions around the world, should they continue, would allow the Group to anticipate a modest improvement in the rate of organic revenue growth in 2013 and further improvement into the medium term. This would support the continued delivery of strong financial performance by Serco.

### **People**

We have a clear strategy for managing and developing our people, which, in turn supports our vision – to be the world’s greatest service company, we have to be the best at managing people.

I am pleased that we have made good progress against each part of our people strategy in 2011. More information on how we achieved this can be found on pages 62 to 65.

Serco has grown during 2011 and we now have more than 100,000 people delivering services around the world. Our success comes from their hard work and commitment to our values. I thank them for their contribution to Serco and our customers.

**Christopher Hyman CBE**  
Chief Executive

## Market opportunities and drivers

This section on market opportunities and drivers reflects our new organisational structure:

- UK and Europe
- Americas
- AMEAA (Africa, Middle East, Asia, and Australasia)
- Global Services.



*Right: The UK custodial sector continues to open up and modernise.*

### UK & Europe

The UK represents our most developed market, accounts for the vast majority of our operations in Europe as a whole, and continues to show future growth potential with markets such as justice and healthcare already becoming increasingly active. As well as an increasing focus on economic growth, there remains a clear fiscal imperative for the UK's coalition government to reduce the country's budget deficit within its originally prescribed timeline. This deficit reduction plan has led to spending cuts in public sector markets. However, competitive outsourcing remains a solution to funding pressures as well as a means of improving the standard of services, with numerous markets already presenting new opportunities or being under active review.

Demonstrating continued political will in this direction, The Open Public Services White Paper represents ambitious plans to introduce greater competition and reform into more areas of public services. There is a particular emphasis on the promotion of more complex contract and delivery vehicles, greater involvement of the third sector and SMEs, partnering models and payment by outcomes. Serco is highly experienced in these areas and has a proven track record of efficient, high-quality and innovative service provision. We therefore expect to continue making progress in our core market.

### Home Affairs

Following an initial market testing of existing public sector prisons in early 2011, a further nine prisons (eight in the public sector and one being run by a private sector operator) are currently being competed with the outcome expected in late 2012. This forms part of the UK Ministry of Justice programme of opening up and modernising the custodial sector, set out in its 'Competition Strategy for Offender Services' published in July 2011.

In the area of non-custodial sentencing, other opportunities include Community Payback schemes, the first of which to come to market is the London region, with Serco bidding in partnership with the London Probation Trust. We are also on a national framework to bid for further regions. In the growing market for court fines enforcement, Serco acquired in October 2011 Philips Collection Services Limited, the UK's largest independent revenue recovery company.

Serco was recently selected by the UK Border Agency as preferred bidder to deliver the COMPASS project in two regions, providing accommodation, associated services and transport for asylum applicants. Expected to commence in late 2012, this contract would draw upon our skills in a number of related services, reinforces an already strong customer relationship and positions Serco for further similar opportunities in other markets.

The demand for police operational support is expected to grow as forces, such as West Midlands and Surrey, seek to concentrate on frontline delivery of service to the public and look for private sector partners to manage their middle and back office functions.

### Health

In health we are seeing the emergence of a global market for enabling services that combine facilities management, support services and patient administration to improve service quality and productivity. These services are enabled by high-quality technology solutions and an engaged workforce. Our successes in the UK and recently in Western Australia position us well in this market.

In clinical services we continue to develop opportunities to operate both hospital and community-based services, either on our own or in partnership with some of the world's best clinical operators.



*Above left:* We are developing opportunities to operate hospital and community-based clinical services.

*Above:* A global market is emerging for health support services.

*Left:* The UK's armed forces are seeking new ways of delivering and supporting frontline services.

In the UK, the market is driven by the impact of fiscal pressure and the proposed structural reforms, whilst in global markets we anticipate that investment in establishing healthcare systems will underpin both enabling and clinical service opportunities.

#### *Transport, Welfare and Local Government*

In transportation, our recent contract to expand the Barclays Cycle Hire scheme and the operation of the Docklands Light Railway through the Olympic period will support short-term growth. Serco now has excellent credentials in urban transport systems which position us well for future growth in the UK and elsewhere around the world. Our other UK rail franchises in Northern Rail and Merseyrail continue to deliver growth in passenger numbers and achieve strong operational metrics.

As a leading welfare to work provider, we continue to assess the market potential in what is a significant area of government expenditure both in the UK and internationally. Our two Work Programme contracts have started well and build upon our experience and success in the previous Flexible New Deal contracts. Our place on the Department for Work and Pensions' 'Framework for the Provision of Employment Related Services' enables us to bid for tenders in seven UK regions, including opportunities that attract European Social Fund support.

In local government frontline services, reductions in funding and increased service demands from citizens are driving more interest in strategic partnering, service sharing and personalisation of services. This is expected to support growth in environmental services and other opportunities in integrated facilities management.

#### *Defence and Science*

After recent reviews into the structure and management of the MOD and the UK's armed forces, new ways of working and more radical approaches are being sought for the delivery and support of frontline services. Serco is well placed to provide support for innovative models for change management, transition and the provision of other complex integrated services.

Additional opportunities are expected to emerge in the defence market for such services as infrastructure management and asset management, business process and whole enterprise outsourcing, and technical and engineering services. In the energy field there is an emerging market for delivering energy management services to industry to help businesses reduce their energy bills and thereby reduce their carbon footprint and become more efficient.

Our involvement in managing and operating critical assets such as the Atomic Weapons Establishment and leading Public Sector Research Establishments such as the National Nuclear Laboratory and National Physical Laboratory, also present a number of related opportunities. This includes further whole enterprise outsourcing as well as delivering growth through existing customer relationships as we add additional responsibilities to drive further efficiencies.

#### *Americas*

The US federal government services industry faced dramatic challenges in 2011 given the federal budget pressures, growing national debt and uncertainty created by the inability of the government to reach agreement on budget priorities. This uncertainty resulted in delays in contract awards, cancellations to previously anticipated work and the reduction in scope of existing task orders. The bidding environment in many segments has

## Market opportunities and drivers



become increasingly competitive, reinforced by the government's greater emphasis on price. For the government fiscal year to September 2012, all federal budgets have been approved with relatively flat spending levels compared to the previous year. However, the industry is likely to face continued short-term attrition due to the ongoing uncertainty regarding budget levels beyond this. Given the upcoming Presidential election and gridlock in Congress on how to deal with the national debt, we do not expect much clarity or improvement in contracting conditions until 2013.

Despite these challenges, Serco continues to see attractive medium- and longer-term growth opportunities in the Americas division. The US Federal government services market remains the largest in the world, with over \$300bn spent annually on contracted services, out of which \$125bn is addressable by Serco. Within this market, Serco focuses on six key areas, with an established track record in each: Communication & Information Systems; Logistics & Program Management; National Intelligence; Human Capital Management; Business Process Outsourcing; and Transportation & Asset Management.

As the federal government seeks to adjust to a tightening budget environment, we expect to see a broad range of opportunities to grow our business by helping customers to achieve more with limited resources. We are focusing our portfolio towards long-term higher growth markets that are less susceptible to margin pressures, so as to respond to the new fiscal realities and competitive landscape.

Within information technology-related services, Command, Control, Communications, Computer, Intelligence, Surveillance and Reconnaissance support continues to be in strong demand, reflected by further task orders from the US Navy and US Air Force. Related opportunities with the federal civilian agencies are expected from government-mandated migration of data and applications to the cloud, enabling the government to eliminate redundant data centres and infrastructure, and lower operating costs. The Department of Defense is expected to increase its focus on areas such as Intelligence, Surveillance and Reconnaissance, unmanned assets, space and cybersecurity. Specifically for our navy customers, we expect growth through modernisation work to extend the service life of the existing fleet.

Demand for human capital management services will be supported by future changes to the size and shape of the armed forces, as the military transitions returning combatants to domestic stations and civilian status, and looks to provide increased health and social services. Defence and federal civilian agencies are adopting new tools and technologies for recruiting and training, as well as other specialised human capital services to manage transformation programmes.

In BPO, modernising legacy systems and delivering more cost-effective solutions are expected to result in considerable opportunities in areas such as records and application management. In another area, Serco has been providing economic



cost analysis to help the military and other government agencies to achieve procurement cost savings. Incorporating these skills into our programme management support services can provide additional opportunities with the Intelligence community and across the defense sector.

The transportation and infrastructure asset management markets are also expected to see good growth opportunities. The growth of global air travel and the move to space-based air traffic control sees Serco well placed as one of the world's largest private sector Air Navigation Services Providers. In surface transportation, our growing reputation in traffic management systems, operations and back office processing may open up further prospects in state and local markets in the US and Canada.

While general market conditions are likely to remain challenging in 2012, the Company continues to pursue a strong pipeline of opportunities across the federal government including the US Army, US Navy, US Air Force, Department of Homeland Security, Federal Aviation Administration, Veterans Affairs, the intelligence community, Department of State, and various Canadian government bodies.

### AMEAA

The AMEAA region is experiencing the fastest growth of our portfolio and still presents some of our strongest market opportunities and drivers for future growth. Having grown to represent around 17% of Group revenue, the region accounted for over a quarter of the Group's pipeline as at 31 December 2011. Our existing operations in Australasia, the Middle East and India each present strong prospects, with other territories in the Middle East and South East Asia offering possible further potential.



*Opposite page, top: We continue to see attractive medium- and longer-term opportunities in the Americas division.*

*Opposite page, bottom: The AMEAA region presents some of our strongest market opportunities.*

*Right: We expect the BPO market to continue to show attractive growth.*



In Australia, while volume-related activity in contracts such as our work with Australia's immigration services may reduce, there remains a growing range of opportunities. In the justice sector we see a number of new-build and existing prisons being put to the market as governments deal with capacity and efficiency challenges. Serco is strongly placed through its excellent track record and recent wins in the custodial markets in Australia and New Zealand. Following recent contract awards there are related opportunities in the youth justice and court escorting markets, as well as other areas of justice support. Our defence strategy in Australia has a firm base of garrison support and navy support contracts to build from, with further potential from systems integration and back office function support as performed in some of our other geographic markets.

We continue to pursue the emerging health markets in Australia, Hong Kong and the Middle East, as governments encourage the private and voluntary sectors to develop models for the build, finance and operation of hospitals. The Fiona Stanley Hospital contract represents a significant development, building upon substantial experience and expertise from our operations within UK hospitals and our other healthcare services in Australia.

The Middle East continues to show strength and resilience to the economic downturn as governments progress with their social infrastructure improvement programmes while seeking value for money and whole-life asset management. Growth in the region will be supported from expansion both in terms of new sectors and new territories. Significant opportunities are emerging in the healthcare market and other integrated facilities management areas including in the education and commercial sectors; in support of this, we made a small acquisition of JBI Properties Services Company LLC, which specialises in integrated facilities management in the region.

Building on our leadership in air traffic control and metro systems we continue to see a strong pipeline in aviation, urban transportation and related services. Countries such as Saudi Arabia, Qatar and Kuwait have taken significant steps to improve transparency and adopt international best practices for their procurement processes, and are starting to present new longer-term prospects for the Group.

In India, our frontline service capabilities offer opportunities in sectors such as transport (including rail, traffic management and aviation), as well as healthcare and education, with major infrastructure investment being made in each. For example, a number of light/metro rail and urban traffic projects are being developed. Our presence in the Indian domestic BPO market has been significantly enhanced to a leading position by the acquisition of Intelenet.

### Global Services

As referenced in the Chief Executive's Statement section on pages 25 to 26, Serco is forming a new Global Services division. This new division will bring together a number of related operations and capabilities currently reported and managed in different Serco divisions. It will enhance our market position and bring together the common market opportunities and drivers in the provision of middle and back office services.

As companies and public sector organisations seek out new ways to improve their service and reduce costs, we expect the BPO market to continue to show attractive growth and opportunities. Our acquisition of Intelenet has significantly enhanced Serco's positioning in this market, bringing highly valued capabilities and a strong customer base, which together with economies of scale, and a presence across four continents mean we can access new opportunities and strengthen our existing propositions. Intelenet has a significant pipeline of opportunities across its five vertical markets of: Banking, Financial Services & Insurance; Travel, Hospitality & Transportation; Healthcare, Utility, Retail & Manufacturing; Telecom, Technology & Online Services; and Media, Education & Government. With the selection for the Anglia Support Partnership, the first revenue synergies arising from having Intelenet within Serco are already being developed. With new capabilities in middle and back office services, our integrated offering will present further such opportunities to transform public services.

Our work with local authorities to help them transform their services show a strong pipeline of opportunities. Serco's existing IT-enabled BPO service delivery and credentials are strong, as represented by existing operations at Hertfordshire County Council and Glasgow City Council, both of which have been expanding, and recent wins such as Peterborough City Council. There are numerous similar strategic partnerships in our pipeline, with local authorities increasingly looking for a customer-centric approach and private sector expertise.

The smaller acquisitions of The Listening Company in the UK and Excelior in Australia are also key components of our future proposition as their significant onshore contact centre capabilities allow us to promote easier access to frontline services as well as encouraging the migration to the use of more effective and efficient customer contact channels. We expect this to enhance our capability to deliver both public sector transformation programmes and improve our market position to support the private sector.

## Our strategy in action

Serco has a clear strategy for achieving our vision. The case studies on the following pages show some of the ways that we put this strategy into action during 2011. We have grouped the case studies into key themes for our business – **partnership, new ideas, developing new markets** and **transferring skills** around the world.

The contracts and businesses in these case studies typically illustrate more than one aspect of our strategy. Working in

partnership, for example, can help us to build a balanced portfolio and ensure that we deliver high-quality service. New ideas can include developing new models or finding ways to enhance our service. Developing new markets through strategic acquisitions will, in turn, give us a platform for organic growth that broadens our contract portfolio.



More information on our strategy and our achievements during the year can be found on page 14



# Partnership

Working in partnership is fundamental to our business. It can mean forming a relationship with other companies or the third sector, working hand in hand with our customers or acting alongside public and community bodies.



*Above:* Our partnership with Catch22 and Turning Point at Doncaster Prison aims to reduce reoffending.

*Left:* Working with Wincanton will help us deliver further savings and innovation for our customer.

*Top right:* Part of our work with the Defense Ammunition Center is to ensure military personnel have the latest explosive safety information.

*Right:* Joining with local partners has helped us create jobs in Rhyl, Wales.



Serco has provided prisoner escort and custody services to the UK Ministry of Justice since the mid-1990s. When the contract came up for renewal, we wanted a partner who could help us deliver further savings and innovation.

Our partnership with Wincanton combines Serco's custodial and people care expertise with Wincanton's knowledge of logistics and vehicles. For our 1,240 employees, managing 184 vehicles, covering 131 police stations, 73 courts and 25 prisons in London and the East of England, Wincanton has helped introduce new routing and scheduling technology which is vital to our operation with some 650 daily prisoner transfers and movements. Together, we have developed more adaptable vehicles, allowing us to cater for differing prisoner needs, such as for pregnant women and young people. We have optimised our bases, using two existing Serco and five new Wincanton sites. The outcome is lower cost, greater visibility of our vehicle availability and deployment, reduced waiting times for prisoners and a more flexible service.

At HMP & YOI Doncaster, our partnership with charity Catch22 and social enterprise Turning Point aims to reduce reoffending. It draws on our work inside the prison and our partners' volunteer networks, which support young people and those with substance abuse problems. Prisoners are allocated a Catch22 case manager on arrival, who assesses their needs and works with them during their time in custody and, crucially, in the community following their release from prison when they are most at risk of reoffending. Doncaster is now the world's first prison to have fully scaled payment by results built into its contract. This means that 10% of our revenue depends on achieving a five percentage point reduction in reconviction rates. We believe our shared values and alliance with specialist organisations will allow us to succeed.

The Defense Ammunition Center (DAC) is the US military's 'one-stop shop' for explosive safety. Our contract started in 2004, with four Serco people supporting DAC's purchase of a learning management system to provide tools and training to support the storage and handling of explosive materials, both at home and in overseas theatres of war. Since then, through our successful partnership with DAC, this project has grown to include 20 full-time Serco people providing training, academic services, knowledge management and support to DAC's programme management office. Our close relationship also helps us to innovate and meet DAC's evolving needs. For example, Serco has developed two iPhone applications to give military personnel access to the latest learning materials and explosive safety information.

Our welfare-to-work contracts use partnerships with the third sector to help long-term unemployed people into work. But we've also created another partnership – with the Welsh Assembly, Denbighshire County Council, Rhyl City Strategy and Jobcentre Plus – to catalyse the regeneration of Edward Henry Street in Rhyl, part of one of the most deprived communities in Wales. By locating a business processing centre there, we have created local jobs for local people. Several of our employees from Rhyl have already gone on to other roles within Serco, a real achievement in an area where many thought they would never work again. The local authority and the Welsh Assembly have since bought houses in the street with the aim of building on our initiative and turning the street into an in-town business park.



## Our strategy in action



# New ideas

Our customers often need to achieve more with tight budgets, so they value fresh thinking and new perspectives. This might mean using technology, creating systems that improve efficiency or developing new contracting models.





*Left:* We use the latest technology to provide excellent patient nutrition to support patient care.

*Below:* Our unique project tracking system saved our customer money when we fitted a new computer system on the USS Nimitz.

*Opposite page:* We developed a collaborative model to finance alternative radar technology.



At the Forth Valley Royal Hospital in Scotland, we use the latest technology to support patient care. Uniquely, we were able to contribute to the hospital's design, ensuring it was simple to clean and maintain and that it could accommodate robotic systems. These systems take care of logistical tasks such as moving waste, linen and catering around the hospital. This allows our people to concentrate on making a difference to the patient experience.

Nutrition is vital to patient welfare, for example, so we introduced an electronic food ordering system. A ward housekeeper comes to the patient's bedside and enters their meal choice into a PDA, sending it to chefs who cook the meals on-site. Food is delivered to the wards using robots, keeping it fresh and allowing our staff to plate it at the bedside. They can then adjust portions to the patient's appetite, making the meal more appealing and cutting waste to less than 5%. In a recent NHS Scotland survey, Forth Valley scored 99% for standards of patient nutrition and we have also received numerous awards for innovation and cleanliness.

In the US, a Serco-developed system has enhanced our project management and saved money for customers. When we installed a new computer system on the USS Nimitz, we needed an accurate way of tracking our progress. The USS Nimitz is one of the world's largest warships, so the job was vast, involving 40 racks of equipment and more than 100 miles of cable.

Traditionally progress could only be estimated, so projects were often heavily staffed to ensure that deadlines were hit. Our solution was a unique tracking system that showed objectively what we had achieved. The system, known as Serco's Program Integrated Reporting and Installation Tracker (SPIRIT), combines quality

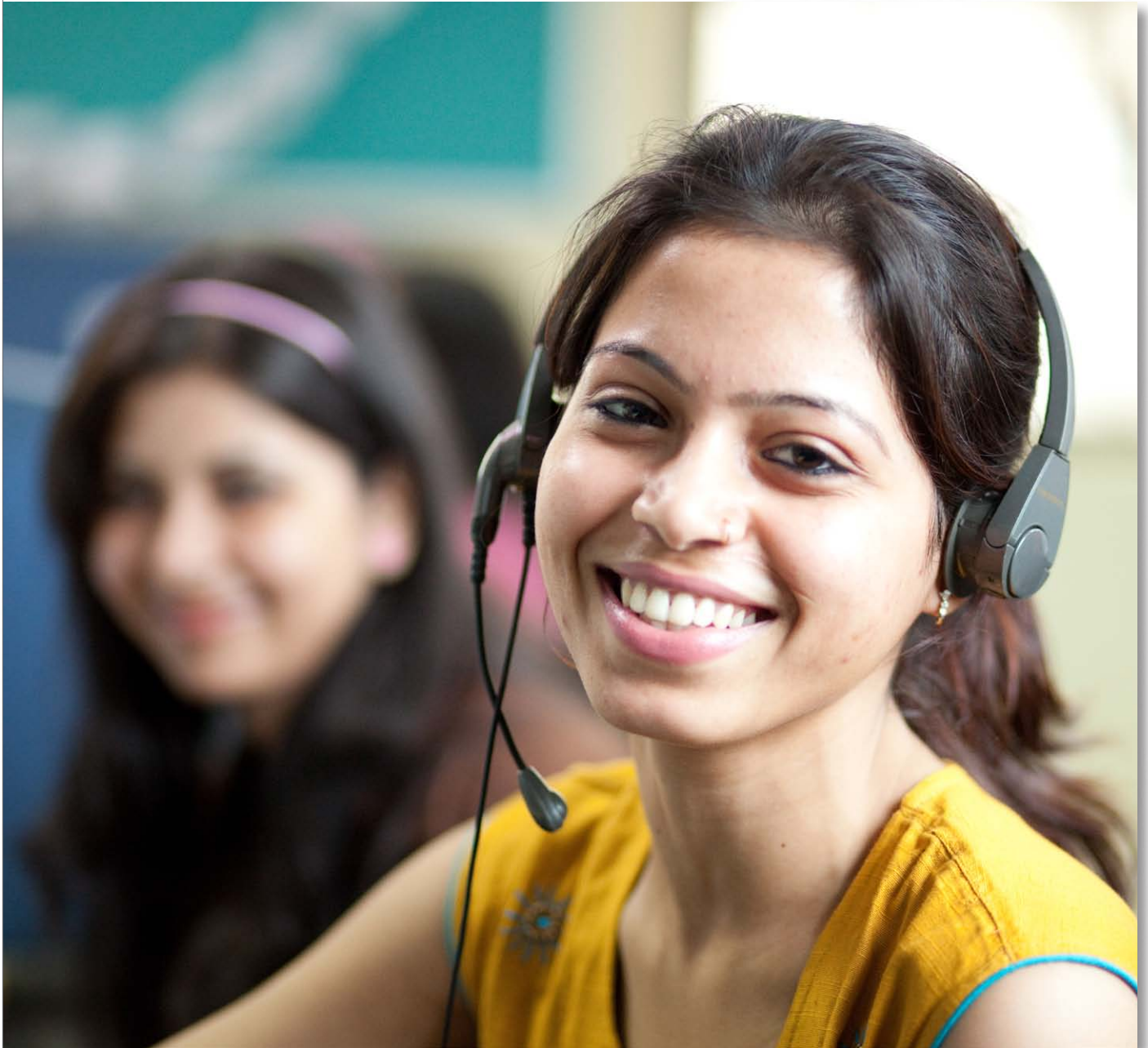
assurance and earned value management. Every day, our people submitted reports, which were fed into the system and weighted according to the project stage. We audited the installation as we went along, testing the tracker's accuracy and giving our customer comfort. This allowed us to adjust our staffing levels, saving the customer US\$0.5m from a US\$10m budget. We have since rolled the system out across our Engineering business unit in North America.

In the UK, we have developed a model that combines the introduction of technology with new funding. This is enabling major windfarm projects, which will help the Department of Energy and Climate Change to meet its commitments to reduce greenhouse gas emissions.

Windfarms interfere with radar systems that form a vital part of UK security. Serco has gained a detailed knowledge of radar performance through a long-standing maintenance contract. We knew that introducing an alternative radar technology would solve the problem and allow the government's defence and renewable energy commitments to co-exist.

With the government facing budget constraints, we instigated a collaborative model, under which the energy companies that are building the windfarms pool their budgets, raising enough money to finance an area radar solution and safeguarding the companies' substantial investments. We have installed one device, with a second scheduled for 2012 and a third for 2013, which will ensure that all the stakeholders' interests are met.

## Our strategy in action



# Developing new markets

Broadening our contract portfolio provides an additional platform for organic growth. Making strategic acquisitions often assists this. They allow us to gain new skills and to enter markets where we see attractive opportunities.

In 2011, we built a significant capability in business process outsourcing, a fast-growing and higher margin segment of the services market.

As part of this, we acquired The Listening Company, a UK-based business employing over 4,000 people providing multichannel customer management services to organisations in the public and private sectors.

Faced with the challenge to reduce costs while still attracting, retaining and developing customer relationships, organisations are increasingly turning to lower cost web self service channels to expand the capabilities of the traditional contact centre. The Listening Company has used web chat to successfully drive incremental online sales for BT since 2007.

Visitors to BT's consumer and business websites can browse for information on BT's products and services. If they appear to be having difficulty, they can be presented with a personalised invitation to chat directly with a specialist at The Listening Company, who will seamlessly guide them through what they want to achieve. Through The Listening Company, BT is able to proactively reach more customers, to sell more products and services, and feed information directly into their marketing teams, strengthening the consistency of brand messages and improving the quality of their website.



Innovative customer management capability like this opens new opportunities for Serco to provide truly transformational solutions for organisations in both the public and private sectors.

Health is another growth market for Serco and in 2011 we bought the company which manages Braintree Community Hospital in the UK, which delivers NHS care on behalf of Mid-Essex Primary Care Trust. This gives us direct experience of clinical delivery, to add to our long-standing capabilities in non-clinical services. The hospital provides a range of clinical services, including day surgery, outpatients, imaging, physiotherapy, endoscopy, a rapid assessment unit and a 24-bed inpatient ward.

Serco has effectively transformed the hospital, developing improved policies, procedures and processes, and enhancing its systems. A critical innovation was building a partnership with the Mid-Essex Hospital Services NHS Trust, creating a unique arrangement under which Mid-Essex provides consultants to Braintree. It also includes an agreement for the types of cases Braintree should handle, with more complex cases referred directly on to Mid-Essex. The result has been a transformation in service quality, with many of Braintree's key performance indicators such as waiting times turned from 'red' to 'green'. We have also maintained a 0% infection rate since taking over the hospital.

Braintree now gives us a valuable reference point for future bids. The hospital straddles both community and acute care, which will help us to bid for community health services and potentially for other failing hospitals. Our experience is also giving us pointers for enhancing our non-clinical services and we will be using this knowledge as we design the services we will be providing at the Fiona Stanley Hospital in Australia.



*Opposite page and top:* Acquisitions such as Intelenet and The Listening Company give us significant global BPO capability.

*Left:* Our work at Braintree Community Hospital gives us a valuable reference point for future bids.



## Our strategy in action



# Transferring skills

Our ability to transfer skills around the world and adapt them to local needs opens up new and exciting opportunities for us.



In 2011, we signed a major new contract with the Western Australian Department of Health to provide non-clinical support services at the new Fiona Stanley Hospital near Perth. The winning bid was the result of a partnership between our AMEAA and UK divisions, drawing on experience of UK hospital services and AMEAA's deep understanding of the customer, local government procurement and the health system.

Serco will be responsible for providing nearly 30 different non-clinical services, ranging from procurement to IT to human resources. When the hospital opens in 2014 we will use state-of-the-art technology to integrate our work with the clinical services and staff, creating a seamless environment. The contract team benefits from our experience at our UK hospitals, including Forth Valley Royal Hospital in Scotland, where we provide many similar services in a high-technology environment, but the breadth of our role at Fiona Stanley is even greater and will in turn develop new and valuable skills for us.

We have an outstanding reputation for air traffic control (ATC) services. Nowhere is this reputation stronger than in the Middle East, where we have successfully operated in the ATC market for some 60 years. This stood us in good stead as Iraq emerged from a post-conflict era. It recognised the importance of rejoining the aviation community and needed a partner that could help it develop ATC services to international standards. We were able to leverage our global ATC knowledge to win the contract.

In a team effort, experienced Serco staff from the Middle East helped to manage the mobilisation and transition of the contract. Our people on the ground, meanwhile, also had to adapt to Iraq's unique and challenging conditions. During 2011, the US military handed vast tracts of airspace back to the Iraqi civilian authorities, with substantial assistance from Serco. These processes can take years but we achieved it all in less than ten months. In addition, we introduced internationally recognised ATC procedures, to increase the capacity for aircraft flying through the airspace – generating more revenue for Iraq – and have begun training local people to develop Iraq's ATC expertise. The outcome has been significant month-on-month growth in air traffic, outstripping global and regional growth by some margin. Serco's efforts have resulted in an approximate 30% increase in overflying traffic since the contract started on 1 January 2011.



The Mount Eden Corrections Facility in New Zealand is the first in the country to be transferred from the public to the private sector. In February 2011, we signed the contract to run Mount Eden, using an operational model based on the one we developed at HMP & YOI Doncaster in the UK. For example, one of the key concepts in our bid was to introduce performance measurement around reducing reoffending, drawing on the work we have done at Doncaster. We are also building strong links to the local community.

The transition process was complex: we took over an existing prison, closed an old one and opened a new site within three months, while implementing the first-ever national ban on smoking in prison. We achieved this without disrupting services to the courts or suffering a major incident. We also worked hard with manawhenua groups to incorporate Maori values alongside our own value system, as we introduced an ethos of decency and respect for prisoners. This has already delivered important changes at Mount Eden. Our strong brand of prisoner engagement helped reduce violent incidents by around 15% and virtually eliminated self-harm incidents at the new site.



*Above:* Our operational model at Mount Eden Corrections Facility in New Zealand is based on one we developed in the UK.

*Left:* The contract team at Fiona Stanley Hospital near Perth benefits from our experience at our UK hospitals where we provide similar services.

*Opposite page:* We are leveraging our global air traffic control experience in Iraq.

# Operating Review | Civil Government

The Operating Review is presented according to the five divisions into which we were organised in 2011:

- Civil Government
- Defence, Science and Nuclear
- Local Government and Commercial
- Americas
- AMEAA (Africa, Middle East, Asia and Australasia).

The section outlines contract wins which are significant because of their value or their strategic contribution to our business. We have also won numerous other smaller and medium-sized contracts, details of some of which can be found on our website at [www.serco.com](http://www.serco.com).

**Civil Government includes our UK and European operations in transport, home affairs (custodial, immigration and field services, and border security and control), welfare to work and clinical healthcare.**

Revenue on a reported basis grew 6% to £1,199m (2010: £1,127m) and represented 26% of Group revenue. Revenue on an organic basis also increased 6%. Adjusted operating profit, before corporate expenses, increased by 20%, with the margin increasing from 5.9% to 6.6%.

Revenue growth was supported by previous large contract awards that became operational or saw revenues build through the course of 2010 and 2011. These included the timing of revenues earned under the previous Flexible New Deal welfare to work contracts and passenger growth on the Docklands Light Railway. The expansion of the GSTS Pathology joint venture to include King's College Hospital NHS Foundation increased revenues but challenged the achievement of efficiency improvements. The overall margin improvement reflected the higher than average bid costs in 2010 and the strong performance in 2011.



## Transport

Northern Rail continues to perform well, with 2011 punctuality metrics of 91.7%, just ahead of the industry average and maintaining the significant improvement achieved over our operation of the franchise. Northern Rail was named Public Transport Operator of the Year (Rail) at the 2011 National Transport Awards, awarded the top transport title from the Royal Society for the Prevention of Accidents for the third year running, as well as the 'Sustainable Business of the Year' for 2011 in the Environment and Energy Awards, supported by Sustainable Business. In May 2010, Northern Rail was awarded an extension to its franchise through to September 2013. We expect a further short extension through to April 2014, which would see the rebid process begin next year.

Merseyrail has also had a strong operational performance in the year, with the majority of its business indicators showing a stable and healthy performance, including punctuality at 95.1%, well above the industry average. This comes on top of being the UK's most punctual rail operation as well as the most highly rated in terms of customer satisfaction during 2010. Merseyrail has also achieved the Investors in Excellence Standard, an internationally recognised mark of quality, for achieving continuous improvement as well as ongoing success and sustainability.

Docklands Light Railway saw customer satisfaction improve to 96.7% in December 2011, the best result for four years. Service reliability has also increased to an average throughout the year of 97.7% of trains running to schedule and passenger growth has continued following the previous year's increase in capacity with

*Opposite page, top:* The Barclays Cycle Hire Scheme continued to grow its customer numbers.

*Below:* Our Prisoner Escort and Custody Services contract handles 650 prisoner movements each day.



*Top left:* Merseyrail's punctuality is well above the industry average.

*Top:* Northern Rail was Public Transport Operator of the Year.

*Above:* Docklands Light Railway is a key part of the London 2012 Olympic transport network.

the full roll-out of the three-carriage service. Docklands Light Railway was highly commended twice in the annual Light Rail Awards for the quality of its customer communication and community engagement. In August 2011, the Stratford International extension opened, a key part of the London 2012 Olympic and Paralympic transport network; it includes four new stations and connects five Games venues.

Serco's partnership of the Barclays Cycle Hire scheme continued to see growth in customer numbers which brought some operational challenges; Serco has implemented a number of changes to deliver improved service standards on this innovative scheme. Since the launch in August 2010, more than ten million journeys have been made. The success of the scheme has seen Serco awarded an expanded contract by Transport for London to support growth to East London, adding new docking stations in West London and an increase in the number available in the existing area. The expansion will add over 200 new docking stations, approximately 4,500 new docking points and 2,300 new bikes into the scheme. On average 25,000 customers use Barclays Cycle Hire each day and the scheme now has over 140,000 registered customers. The contract expansion is in total valued at approximately £50m and will run until 2015, in line with the existing £140m six-year contract awarded to Serco in August 2009. Recognition for the scheme has included an 'Infrastructure Award' at the Institution of Civil Engineers Awards, 'Innovative Transport Project' at the London Transport Awards and a 'Design of the Year' award at the Brit Insurance Design Awards for innovation from around the world.

### Home Affairs

The UK Government's Ministry of Justice awarded Serco a contract to provide Prisoner Escort and Custody Services within the new National Offender Management Service (NOMS) region of London and the East of England, with a potential value to Serco of £420m over ten years. This new contract replaces Serco's previous agreement to provide prisoner escorting services to the NOMS regions of London and the South-East, which had reached the end of its seven-year term. Serco is working in partnership with Wincanton plc to provide the safe, timely and secure transportation of prisoners between police stations, courts and HM Prisons. Whilst at court, Serco staff manage custody suites and accompany prisoners in courtroom docks. The contract solution brings together experience and expertise to deliver an innovative approach, high-quality services and considerable savings for the taxpayer.

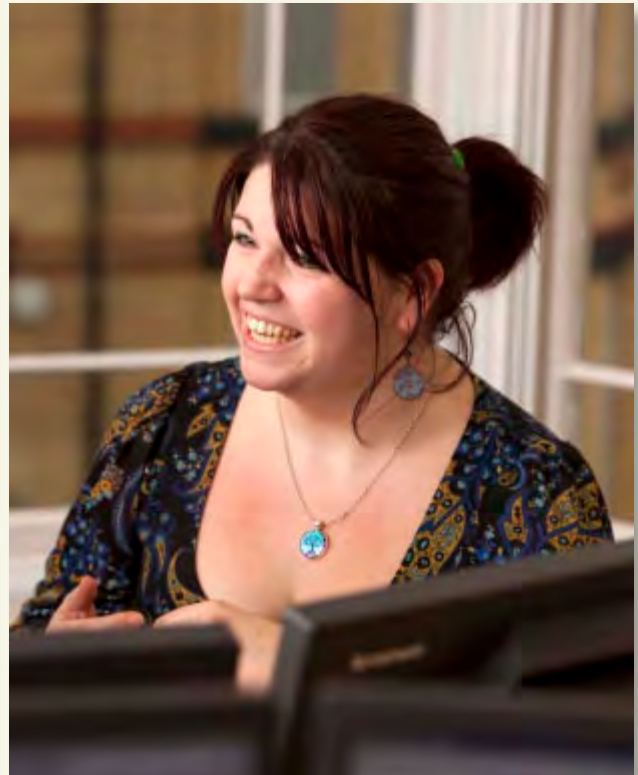
Serco was awarded the contract to continue operating HM Prison and Young Offender Institution Doncaster in the UK. The new contract commenced in October 2011 and is valued at around £250m over 15 years. As part of the contract, management and staff are working in partnership with social enterprise Turning Point and the leading charity Catch22 to pilot a rehabilitation programme, on a payment by results basis, to reduce reoffending. This is the first such pilot in the UK, and the Secretary of State for Justice has described its success as central to the Government's rehabilitation reform strategy.



# Operating Review | Civil Government

*Far right and below right:* Serco is working with a strong network of organisations to help long-term unemployed people into employment.

*Right:* We are piloting an offender rehabilitation programme on a payment by results basis at HMP & YOI Doncaster.



The new prison at Belmarsh West in London, to be known as HMP Thameside, will become operational from 30 March 2012. The contract has a value to Serco of approximately £415m over 26½ years. Serco-operated HMP Lowdham Grange received the highest possible performance rating in NOMS' annual survey and was described by the HM Chief Inspector of Prisons' recent report as 'among the most impressive category B training prisons in the system'. HMP & YOI Ashfield was also described as 'impressive' by the Chief Inspector, and HMP Dovegate, working with Staffordshire University, has helped to professionalise prison staff by developing the first Foundation Degree in Offender Management.

Our contract to manage Yarl's Wood Immigration Removal Centre has been extended by two years. The contract has also been expanded to include provision for male residents, increasing the total value of the extension to approximately £25m.

Serco signed a new contract as prime contractor with the UK Border Agency to provide service management for the e-Borders system, valued at £29m over two years. Having successfully agreed the cessation of the previous arrangements as a subcontractor, the new contract means Serco continues to operate the e-Borders service and the National Border Targeting Centre, which is the central hub of the multi-agency border security system. Together with our ongoing support to the UK Border Agency's CYCLAMEN programme, which provides radiological and nuclear scanning at ports, this means that Serco is making a significant contribution to national security and public safety.

## Welfare to Work

On 30 June 2011, Serco began operating two new contracts to deliver the Work Programme in the West Midlands and South Yorkshire for the UK Department for Work and Pensions. Serco is working with a strong network of some 33 organisations, around half of which are from the voluntary sector, so jobseekers can benefit from a rich mix of experience and expertise. For the same start-up period, our Work Programme performance is ahead of that under the previous Flexible New Deal contracts. In initial performance data released by the Department for Work and Pensions, our contracts are ranked top out of all 40, thereby ranking Serco the top provider out of all 18.

Revenues received under our previous Flexible New Deal contracts were greater than the previous year. This reflected the anticipated build-up of activity in the first half of the year and the successful cessation of the contracts in July 2011. These contracts have supported the entry of over 25,000 people into sustainable employment since October 2009.

Serco has been awarded two new contracts by the UK Ministry of Justice to help ex-offenders into work in the South-East and East of England. The four-year contracts, valued in total at £15m, are the second phase of an initiative called 'Job Deal' which aims to support ex-offenders into work by improving their employment prospects and tackling barriers to employment. Serco already delivers the first phase of Job Deal in these two regions via a network of subcontractors from the charitable, voluntary and private sectors. The contracts are co-financed by the European Social Fund and NOMS.



*Far right and centre:* Our GSTS Pathology joint venture added King's College Hospital as a partner.

*Below and right:* Braintree Community Hospital provides a comprehensive range of services to day surgery patients.



### Health

To expand our clinical capabilities, Serco has acquired for £1.6m Braintree Clinical Services Limited, which manages and operates the Braintree Community Hospital in the UK on behalf of the Mid-Essex Primary Care Trust. The recently built hospital provides a comprehensive range of services to day surgery patients under one roof. These include general surgery, plastic surgery, orthopaedics, ophthalmology and the diagnosis of ear, nose and throat disorders. It also provides outpatients, diagnostic services and has 24 community in-patient beds. Serco's aim is to make the best use of the state-of-the-art facilities to improve local healthcare.

Serco has consolidated its position as one of the UK's leading providers of primary healthcare support with the signing of a renewed contract with NHS Cornwall and Isles of Scilly for GP out-of-hours care. Serco has provided this service to more than half a million people since April 2006, working closely with local acute healthcare providers and community services to manage unscheduled care in its entirety. The five-year contract has a total value of approximately £32m.

Our GSTS Pathology joint venture has now obtained substantial scale having added King's College Hospital as a further partner. This increased 2011 revenues compared to the previous year. There remains significant management focus on delivering greater efficiency improvements in 2012.

*Above:* We are a leading provider of custodial health services.

## Operating Review | Defence, Science and Nuclear

Defence, Science and Nuclear brings together our businesses providing support to the armed forces in the UK and European defence markets, science-based businesses such as our contracts at the Atomic Weapons Establishment (AWE), the National Physical Laboratory and the National Nuclear Laboratory, our energy market operations and our nuclear safety and assurance business.

Revenue on a reported basis grew 3% to £939m (2010: £911m) and represented 20% of Group revenue. Revenue on an organic basis also increased 3%. Adjusted operating profit, before corporate expenses, increased by 3%, with the margin held at 8.5%.

Revenue progress in 2011 has reflected a number of short-term project awards, and was achieved in the face of strong competitive pressures and some delays to decision making and major contract awards as a result of customer budgetary reviews. Progress in other areas, including an exceptionally strong performance at AWE and a greater number of smaller value contract awards, has offset particular challenges in the level of higher margin discretionary project work and the timing of efficiency improvements in our marine services business.

In the UK defence market, Serco provides a range of operational support, engineering and training services, known as Multi-Activity Contracts (MAC), at various bases for the UK's armed forces, with these relationships continuing to strengthen. Our maintenance and support services at the Depth Maintenance Facility for the Royal Navy's Merlin helicopter fleet at Royal Naval Air Station Culdrose in Cornwall had its contract renewed with AgustaWestland, valued at £33m to Serco over five years, with our engineers also awarded a Commander-in-Chief Fleets Commendation for outstanding support to flying training. A new MAC was won for RAF Valley, supporting their crucial role in training fast jet pilots for both the RAF and the Royal Navy, valued at £20m over five years. After the year-end, there were further MACs successfully rebid, with a combined total potential value to Serco of over £100m.



As strategic partner appointed by the Defence Science and Technology Laboratory (Dstl) in 2006, Serco has now been awarded additional work to oversee and deliver part of Dstl's Helios programme, which was granted Ministerial approval to proceed in June 2011. The Helios Programme will see the relocation of all of Dstl's activities from its Fort Halstead site to, and the provision of new facilities at, its Head Office at Porton Down. The programme will enable Dstl to achieve its future strategic goals, to protect technical capability and to provide additional cost benefits. With the new buildings and facilities to be provided by 2016, the capital projects and associated support equipment has a total value to Serco of around £80m, and follows the successful completion of Project INSPIRE, which delivered award-winning, state-of-the-art science facilities at Dstl Porton Down.

Serco has been awarded a five-year extension to its contract to provide air traffic control, air traffic engineering, flight briefing and operations support services at Cranfield Airport, Bedfordshire in the UK. Serco has provided similar services at Cranfield Airport, which is owned and operated by Cranfield University, continuously since the 1950s. We have also secured an extension for the Woolwich Ferry, valued at approximately £14m.



*Opposite page and below left:* We have Multi-Activity Contracts at several bases for the UK's armed forces.

*Left:* The National Physical Laboratory continues to deliver world class research.

*Below:* Our joint venture at AWE continues to achieve excellent results.



Our joint venture with Lockheed Martin and Jacobs Engineering, which manages and operates AWE, continues to achieve excellent results. The contract incentivises us to save money against the future programme and our results reflect the benefit of providing substantial savings whilst achieving excellent performance in the quality and timeliness of our delivery. Following the building of the largest plasma physics research facility in the UK in recent years, the technical schedule continues apace. In addition, an AWE-led consortium was selected as preferred bidder to deliver elements of the Strategic Weapons Systems support at Royal Naval Armament Depot Coulport.

Operations of the National Physical Laboratory continue to develop. We achieved a record number of peer-reviewed publications (240) and received international recognition for the world's most accurate atomic clock (precise to one second in 138 million years). We have tripled third-party income since 2004 to represent around one third of overall income. The Shareholder Executive has extended our contract with Battelle and University of Manchester to manage the National Nuclear Laboratory (NNL). In 2011, NNL won work from the European Space Agency that will utilise NNL's world-leading expertise and state-of-the-art facilities to evaluate powering future European space missions.

In support of the UK Ministry of Defence's nuclear propulsion programme, Serco has been awarded a new three-year framework contract by Rolls-Royce Marine for the provision of research and technology services, with a total value of £15m. In addition, Serco was also awarded a new contract by the MoD to build a series of five test rigs that will be used to study environmentally-assisted corrosion of materials. Other smaller wins in technical services include those for the Nuclear Decommissioning Authority Radioactive Waste Management Directorate.

In our European defence operations, we have seen significant growth in our German revenue. Key contract wins have included our multi-activity contract for MBDA, a world leader in missiles and missile systems, which was successfully rebid. Mainly comprising facilities management services at Schrobenhausen in Germany, the contract is worth €14m over two years. Serco is also providing installation and support of a new radar system for Germany's Ministry of Defence.



# Operating Review | Local Government and Commercial

*Right:* The Listening Company opened its ninth major UK contact centre.

*Below right:* We are a major provider of support services to hospitals.

*Below:* We made good progress in our first year operating our largest environmental contract at Sandwell, in the UK.



## Local Government and Commercial comprises our UK and European IT-enabled BPO services, integrated and environmental services, leisure, education, consulting and commercial businesses.

Revenue on a reported basis grew 1% to £860m (2010: £854m) and represented 18% of Group revenue. Excluding the revenue contribution from the acquisition of The Listening Company, revenue on an organic basis declined by 7%. Adjusted operating profit, before corporate expenses, reduced by 6%, with the margin reducing from 6.5% to 6.1%.

The organic revenue decline was driven by the impact of government spending reductions in a number of areas and the return of education services to Bradford Council following our successful ten-year intervention contract. The majority of our regional Business Link services have closed and our businesslink.gov.uk contract significantly scaled back as a result of the funding cuts borne by Regional Development Agencies and central government departments. Following the 2010 Comprehensive Spending Review, we have continued to see some customers delay decisions on discretionary project work, which has also impacted margin. Strong performances in our strategic growth markets, including our citizen-centric partnership contracts with local authorities, have not been sufficient to offset the impact of these other areas of funding cuts. Although we expect some further impact of the current economic climate, this does not alter our belief in the significant market opportunities and the drivers of future growth in this sector.

### IT-Enabled BPO Services

Serco won a significant new local authority strategic partnership with Peterborough City Council. Providing frontline and back office support services, the contract has an initial value of £100m over ten years. The Council's in-house shared service centre

has transferred to Serco, along with delivery of support services including customer services, procurement, revenues and benefits collection and payment, and property services. The partnership with Peterborough is expected to grow, with further services being brought into scope as part of Serco's involvement in the Council's transformation.

Supplementary work has been added to our other local authority relationships. Our ground-breaking strategic partnership with Hertfordshire County Council commenced in April 2011, providing front and back office operations including information and communication technology (ICT) services, business processes such as finance, payroll and HR, and support services such as facilities management, customer contact centres and occupational health. The initial 350 staff increased to over 450 in 2011 with the addition of Hertfordshire's customer services centre. Since the start of full operations, we have been awarded an extension to the scope of our core contract to transform the customer experience and deliver a much wider scope of services, including adult social care and highways, which will take staff numbers to over 600 by April 2012. Serco's property and IT joint venture with Glasgow City Council, known as ACCESS, has been extended to include ICT support for the authority's secondary schools. Since the joint venture begun in 2008, our contract value has grown by over 40%.

In March 2011, Serco acquired The Listening Company, a UK-based provider of outsourced customer contact services to both private and public sector organisations. It specialises in bespoke solutions for managing customer interaction ranging from customer acquisition to retention, renewal and growth, and it operates across



*Right: We continue to grow our IT-enabled BPO work with local authorities.*

*Below right: Serco is one of the leading private sector partners in education and children's services.*



multiple communication channels. The business therefore adds significant contact centre scale and expertise which strengthens our capability to deliver high-volume call handling and frontline customer services. Wins at The Listening Company included becoming the new provider of West Sussex County Council's UK contact centre. During the year The Listening Company opened its ninth major UK contact centre. This will manage sales and customer service activity for a range of UK-based organisations, including Shop Direct Group, the UK's largest online and home shopping retailer.

Serco has continued to strengthen its position as a leading provider of services to European institutions. A contract was successfully rebid to provide a wide range of IT operational and support services to a major European banking organisation, valued at €20m over four years. This was followed by a new win at the same organisation to provide IT development, security engineering and maintenance activities across the organisation's IT infrastructure and application services, worth an estimated €50m over eight years. A contract was renewed to provide specialist technical engineering support services at the European Organization for Nuclear Research (CERN), valued at €42m over seven years. Other smaller contracts were won at the European Organisation for the Exploitation of Meteorological Satellites, the European Space Operations Centre and the Italian Space Agency.

Reflecting the delivery of synergies with The Listening Company, Serco expanded its existing IT support services to a major European institution by winning a contract to provide a voice-based contact centre. This multilingual contact centre will maintain a base capability of at least nine languages but will also support all 25 EU languages whenever required.

### **Integrated and Environmental Services**

Serco signed a 15-year partnership with Sport England to provide support services at two of Sport England's National Sports Centres, Bisham Abbey and Lilleshall. Under the contract, valued at over £100m, Serco will provide a number of services to these centres as well as playing a major part in the development of new accommodation and sporting facilities at both sites, and upgrading existing facilities and conference venues. This contract will focus upon delivering the best customer experience at each site. Supporting the National Governing Bodies of Sport and UK Sport based at these facilities, emphasis will be placed on youth development, community engagement and ensuring the facilities are managed to give home-grown athletes a competitive advantage as they prepare for the London 2012 Olympic and Paralympic Games.

Under challenges to meet government recycling targets and reduce costs such as landfill taxes, Serco has won a new contract for refuse and recycling services for Wandsworth Borough Council valued at £44m over eight years. Good progress has also been made in the first year of operating Serco's largest environmental

contract, the Sandwell 25-year Waste Improvement Plan, valued at around £650m. The new waste transfer station is under development, an improved recycling service has been introduced, with strong links forged with the local community through a series of successful community engagement initiatives to improve the local environment.

### **Education**

Reflecting changes to UK government policy within the Education Bill 2011, Serco is partnering with councils where schools buy back for the provision of school improvement and related services, with wins in the second half including North East Lincolnshire Council, Warrington Borough Council and Halton Borough Council. The combined total value of these and other recent education-related contracts is estimated at approximately £50m over the next three to five years.

As previously announced, our ten-year contract with Bradford Council came to an end in September 2011 and we transferred the responsibility for all education services back to the Council. We are delighted with the significant improvements that have been made over the duration of the contract. In 2001, SATS Key Stage 2 pupils achieving Level 4 or higher was 66% for English and 59% for Maths, with this improving to 71% in each subject in 2011. In 2001, GCSE pupils achieving five A\*-Cs was 34.3%, improving to 79% in 2011. Our contract in Walsall has been delivering similar successes, and its schools were confirmed as the eighth most improved at five A\*-C GCSEs in 2011. The contract will end in 2013, reflecting the shift to direct funding to purchase services previously provided through government grants to local education authorities.

## Operating Review | Americas

**Our Americas segment provides professional, technology and management services focused primarily on the US Federal government, including every branch of the military, a broad range of civilian agencies and the National Intelligence community. We also provide services to the Canadian government, selected US state governments and municipal governments.**

Revenue on a constant currency as well as on an organic basis declined by 6%. Revenue on a reported basis, given the weakening of the US Dollar, fell by 9% to £868m (2010: £954m) and represented 19% of Group revenue. Adjusted operating profit, before corporate expenses, reduced by 6% on a reported currency basis, with the margin slightly increasing to 8.4%, reflecting efficient cost management.

The funding of the US Federal government functioned under a series of continuing resolutions for most of 2011 due to partisan gridlock and rising concerns about federal deficits. Having still grown constant currency revenues by 3% in the first half of the year, the impact was felt greatest in the second half of the year given a particularly strong performance in the equivalent period in 2010. The challenges facing the 2011 budget process included government agencies postponing contract award announcements, delaying work under existing contracts and cancelling or reducing the scope of many contracts and task orders. Within this context, Serco has been focusing on markets that we expect will continue to receive funding support and on assisting government customers to achieve greater efficiencies and higher productivity with constrained resources.

US government agencies are increasingly using multi-award contract vehicles to issue task orders on a rapid-cycle, competitive basis. Qualifying for and winning business under such Indefinite Delivery, Indefinite Quantity (IDIQ) contract vehicles is a key contributor to Serco's growth.

Above: Serco provides mission-critical services to the US Air Force Space Command.



During 2011, Serco was one of four awardees that won an important IDIQ vehicle, the US Navy's Space and Naval Warfare Systems Command (SPAWAR) Sea Enterprise Global contract with a ceiling value of US\$1.4bn over five years. Under this contract we support Command, Control, Communications, Computers, Intelligence, Surveillance and Reconnaissance (C4ISR) systems on US Navy surface ships and shore stations, and in 2011 we won task orders under this new contract valued at US\$13m. Further task orders valued at US\$18m had been won earlier in 2011 under the predecessor Sea Enterprise I IDIQ contract. A further IDIQ contract win to provide engineering, testing, and support services to SPAWAR has a ceiling value of US\$34m to Serco over five years.

Serco provides similar services to the US Air Force Space Command, with the customer electing to exercise an additional two-year option period on the Command, Control, Computer, Communications, Intelligence and Reconnaissance (C4IT2SR) IDIQ contract. Serco is the sole prime contractor under this US\$800m contract, under which we provide a range of mission-critical engineering and IT services, and we were awarded new task orders during 2011 with a total value of US\$115m. These services include engineering, systems integration, hardware procurement, software development, technical support, installation testing, operations and maintenance.

Under our HRsolutions IDIQ with the US Army we won a recompeted US\$33m task order to support the US Army's OneSource initiative, which was established to provide comprehensive community support and service delivery for soldiers and their families regardless of geographic location. Also under HRsolutions, we renewed a US\$52m, three-year contract to provide

*Below right:* Our logistics team in Williamsburg, Virginia, works with the US Navy Expeditionary Medical Support Command.

*Below:* We provide air traffic control services at 63 towers for the Federal Aviation Administration.

*Far right:* We support the US Navy's procurement, handling and disposal of hazardous materials.

*Right:* We provide driver examination services in Ontario, Canada.



transition and employment assistance to soldiers and family members transitioning out of the military under the Army's Career and Alumni Program. Serco has provided career counselling support to over 2.2 million service members, army civilians and their families over the past two decades under this programme. Additionally, Serco won a new US\$10m, three-year task order to provide civilian workforce transition services and a new US\$9 million three-year task order to provide financial management services to the Army Defense Military Pay Office locations. During 2011, Serco won task orders with a total value of US\$169m under our three HRsolutions IDIQs.

We were one of seven large contractors to win an IDIQ contract to provide training services to the US Army's Maneuver Center of Excellence at Fort Benning, Georgia, with a ceiling value of US\$458m over five years. We also won an IDIQ contract to provide Manpower, Personnel, Training and Education (MPTE) planning support, policy and programme analysis, financial programme management and training solutions for the US Navy, with a ceiling value of US\$47m over three years.

During 2011, Serco was awarded a one-year extension and expansion to the VA for Vets contract with the Department of Veterans Affairs. Under this contract we are providing: programme management; a knowledge management-based web portal with job hiring tools, e-Learning elements and simulations, videos and chat rooms; mobile web technologies; a call centre and career coaching. Serco also manages the MyArmyBenefits website, providing site architecture, IT development, programming, content management, benefits help desk and retirement and survivor planning. This contract was renewed with a three-year total value of US\$10m.

Other defense-related contracts included: a renewed five-year, US\$12m contract with the US Navy for Training and Operational Readiness Information Services (TORIS) to provide web-based training support and capture readiness data for all US Navy surface ships; a renewed three-year, US\$13.5m contract with the US Air Force Special Operations Forces for engineering, financial and logistics management; and a US\$15m contract extension for personnel management support services at the Walter Reed National Military Medical Center.

Growth in the intelligence arena came from an expansion of programme management work and from success in growing our footprint with a new intelligence customer. Serco also re-competed and was awarded a contract with an intelligence agency. The contract is valued at US\$15m over five years to provide pre-employment processing for potential employees for the agency.

Other contract awards included a US\$25m, five-year rebid contract to provide fleet management and maintenance services to Louisville Gas & Electric, a utility company based in Kentucky.

Serco was selected by the Boeing Company as its 'Supplier of the Year' in the technology category. This is a tremendous honour, especially when considering that Boeing gave awards to only 16 out of its more than 17,500 suppliers worldwide. This award recognises Serco for its enterprise architecture work. This is the second time Serco's enterprise architecture team has received Boeing's Supplier of the Year award. *Vetpreneur* Magazine cited Serco as one of the '10 Best Corporations for Veteran-Owned Businesses to work with in 2011'. This achievement emphasises Serco's continued dedication to working with the veteran community.



## Operating Review | AMEAA



**Our AMEAA segment consists of Africa, the Middle East, Asia and Australasia, in which we provide a range of services including transport, justice, immigration, health, defence, BPO and facilities management.**

Revenue on a reported basis grew 62% to £780m (2010: £481m) and represented 17% of Group revenue, up from 11% in 2010. Revenue on a constant currency basis, which excludes the impact of the strong Australian Dollar, grew by 56%. Excluding the revenue contribution from acquisitions, principally Intelenet, revenue on an organic basis grew 37%. Adjusted operating profit, before corporate expenses, increased by 70% on a reported basis, with the margin increasing from 6.8% to 7.1% which includes the contribution of the higher margin Intelenet operations which more than offset higher than average bid and related costs for major contracts won in the year.

The exceptionally high organic revenue growth reflects new contracts that became operational in late 2010 and during 2011 as well as the expansion of existing contracts.

Our home affairs business in Australia works with the Australian Department of Immigration and Citizenship (DIAC) to transform its immigration services. Serco is committed to continuous improvement in the delivery of a dignified service for the people in our care. The average number of people in immigration detention in 2011 was higher than 2010. The increases in the contract values, since the contracts were originally signed, reflects the significant expansion of the detention network; as a result of this volume-related growth, the operations are currently now one of the largest of the Group. Over the life of the contract, Serco has been recognised by our customer for the transformation we have achieved, our humane approach and success in dealing with the challenges of substantially higher volumes than originally anticipated. The number of people in immigration detention reduced throughout the second half of 2011, reflecting government policy initiatives and improvements in visa processing times. We are working closely with DIAC to respond effectively to their changing needs.

*Top and right: Serco successfully completed a complex transition at Mount Eden Corrections Facility, taking over an existing prison, closing an old one and opening a new site within three months.*

*Above: We work with the Australian Department of Immigration and Citizenship to transform its immigration services.*

Serco signed a new contract with the Western Australian Department of Corrective Services to provide Court Security and Custodial Services including key services such as inter-prison transfers, court security services, and the operation of court custody centres. The contract, which commenced on 31 July 2011, has a value to Serco of around A\$210m (approximately £140m) over five years, with two options to extend to a maximum ten-year term. This contract builds on our achievements and record at Acacia Prison in Western Australia, as well as our expertise in providing this vital part of the criminal justice system in the UK.

Our contract for Acacia Prison in Western Australia was renewed in May 2011. The previous five-year contract awarded to Serco in 2006 had a total value of A\$155m, while the new five-year contract is valued at approximately A\$310m and has the potential for extension. Under the new operating contract, Serco will deliver all prison services working alongside the Department of Corrective Services which is managing the development of new living units and supporting infrastructure to accommodate a further 387 prisoners, bringing the total capacity to 1,387. Revenues will increase through the lifespan of the contract as the prison capacity increases.

Serco's commendable performance at Acacia Prison was validated by the independent report by the Western Australian Office of the Inspector of Custodial Services, released in May. This stated that Acacia is 'without doubt one of the best performing prisons in Western Australia, if not the best and it is also providing a financial saving to the State.'





For the same customer, Serco is preferred bidder to operate and maintain a new young adults facility in Western Australia. The facility is the first of its kind in Western Australia and marks Serco's entry into the youth justice sector in this region. The contract is valued at around A\$50m for five years with two extension options of five years. The contract is expected to commence shortly with the facility accommodating up to 80 male offenders aged 18-24 years. Serco will provide: rehabilitation and reintegration services; care and well-being services; custody and containment services; and facilities management. Our bid emphasised the importance of seamless case management, coupled with a through-care approach, specifically focused on individual rehabilitation and reintegration into the community.

A new five-year contract has been signed with Queensland Corrective Services to manage and operate the new 300-bed high-security South Queensland Correctional Centre in Gatton, transferring operations from Borallon Correctional Centre near Brisbane. The contract, which commenced on 1 January 2012, is valued at around A\$100m over five years, with an option to extend to ten years. This replaced and extended a similarly valued five-year contract, due to end in January 2013, to manage the Borallon Correctional Centre which is one of the oldest facilities in Queensland and is being temporarily decommissioned as part of a wider reorganisation of the state's prisons.

Serco signed and commenced its contract at Mount Eden Corrections Facility in Auckland for the New Zealand Department of Corrections. The six-year contract, to provide rehabilitation and reintegration programmes for prisoners as well as logistics and

infrastructure management, has an option for extension for a further four years, and is valued at around NZ\$300m over the full ten years. Responsibility for managing the prison facility began in May, with the transition completed in August 2011.

In defence, DMS Maritime (our 50:50 joint venture with P&O Maritime Services) which provides harbour and offshore services to the Royal Australian Navy, had its contract renewed in 2010. In 2011, a new contract was signed for the support of patrol boats under the Australian Department of Defence Pacific Patrol Boats Programme. This provides participating Pacific Island countries with patrol boats to police their Exclusive Economic Zones. DMS will provide technical, engineering and logistic support services for the 19 patrol boats in 11 countries and refits for eight of those vessels, for a period of five years, with options to extend for a further 12 years. The contract is worth around A\$50m to Serco over the entire contract life of 17 years.

Serco signed a new contract with the Australian Defence Force (ADF) to provide logistics and base support services in the Middle East. The two-year contract is valued at around A\$50m and has two one-year extension options. Under the contract, Serco will deliver fully integrated support services in the Middle East, ensuring the provision of high-quality services in areas such as healthcare, maintenance, ground refuelling, accommodation and catering services. Drawing on our 15-year experience of working with the Australian military as a trusted provider of complex, integrated services, together with our well-established capabilities in the Middle East, we are ideally placed to provide these vital services for the ADF.

## Operating Review | AMEAA

*Right:* The Dubai Metro has more than tripled ridership and won the Best Rail Operator Award in the Middle East.



In 2010 we expanded into a new market with the appointment by the Western Australian Department of Health as preferred bidder to provide vital non-clinical support services at the new Fiona Stanley Hospital near Perth. The ten-year contract was signed in July 2011 at a total value to Serco of A\$1.3bn (approximately £850m) and also has two five-year extension options. During the current pre-operational phase annual revenues will be approximately A\$30-50m. From the opening of the hospital in 2014, annual revenues will be approximately A\$160m.

The 783-bed hospital will be one of the leading hospitals in Australia and the major tertiary hospital serving communities south of Perth and across Western Australia. Under the Facilities Management Services contract, Serco will integrate non-clinical services through state-of-the-art technology to ensure the smooth running of the whole hospital. We will be responsible for 30 service lines, including: procurement for the fit-out of the hospital; management and maintenance of hospital assets including medical equipment; information and communication technology (ICT) services; estate and property management; recruitment and HR processes for all clinical staff; safety and incident management; design and provision of integrated bedside information and patient entertainment systems; the management of patient electronic medical records and a wide range of other support services.

Great Southern Rail's revenue has been broadly stable in 2011 despite the adverse market conditions from the strong Australian Dollar and weak consumer spending impacting the Australian tourism market. For the second year running, The Ghan was awarded 'best luxury rail journey' in *Luxury Travel* magazine's esteemed Gold List Awards, winning over competition from various famous international rail journeys. A new marketing campaign, new travel schedules, the expansion of the Platinum Service on the Indian Pacific and a second successful season of our newest train, *Southern Spirit*, have contributed to this result.

In the Middle East, the Dubai Metro has sustained its high level of service, with availability and punctuality continuing to exceed 99%. Ridership has more than tripled from 60,000 per weekday on opening in September 2009 to 206,000 per weekday in January 2012. In November 2011, the total number of customer journeys reached 100 million. The Dubai Metro won the Best Rail Operator Award in the Middle East in 2011 for outstanding performance, while the Palm Jumeirah Monorail which we also operate was shortlisted among other finalists. The Green Line of the Dubai Metro commenced service in September 2011, adding a further 24 kilometres of track, 18 additional stations, 17 more trains and a third depot.



*Left:* The Ghan was awarded 'best luxury rail journey' for the second year running.

*Below left:* We have a 60-year history of providing air traffic control services in the Middle East, experience which is helping us in Iraq.

*Below:* Intelenet has opened new delivery centres in India and Dubai to support new contract wins.



In the Kingdom of Saudi Arabia, the contract to deliver operations and maintenance consultancy services to the Al Mashaaer Al Mugaddassah Metro Southern Line in Makkah has been extended by one year, with an annual value of around £5.2m. This extension strengthens Serco's position as a leader in the global light rail market.

Serco has successfully secured an extension for air traffic control and aeronautical engineering services to the General Civil Aviation Authority of the UAE, valued at approximately £30m over three years. This complements the successful rebid earlier in 2011 of air navigation services at Abu Dhabi International Airport, Al Ain International Airport and Al Bateen International Airport valued at £22m over two years, and reaffirms Serco's position as a leading aviation services provider in the Middle East region. During 2011, Serco has also completed the full transfer of air traffic control services for lower airspace in Iraq.

In July 2011, Serco acquired Intelenet, a leading provider of BPO services to the private sector around the world and in the domestic Indian market, for up to £386m. The revenues and Adjusted operating profit consolidated by Serco since July were £84m and £10.7m respectively, reflecting the delivery of organic growth and maintained margins during this period. The integration of Intelenet into Serco is largely complete and Serco's existing India BPO operations have been incorporated into Intelenet to the full satisfaction of customers and with all operational performance measures maintained or improved.

Intelenet's order book is now approximately £600m. Since acquisition, contracts with a combined total value of over £50m have been awarded, including good traction with existing clients in both the international BPO and the Indian domestic markets. The opening of new delivery centres has also supported this and future growth, with openings in Lucknow in India and in Dubai to support new contract wins in the Middle East. Also of significance is Intelenet's involvement in the selection as single remaining bidder to operate the Anglia Support Partnership (ASP), Serco's first shared services proposition in the emerging market for middle and back office support to the UK health sector. ASP was not included in the value of 2011 awards. Further revenue synergies such as this, where the Group's combined capabilities and breadth of integrated offering are able to transform public services, are expected to continue to emerge in the future.

# Finance Review



## Overview

Our business delivered a strong financial performance in 2011, with revenue growing 7.4% and Adjusted operating profit increasing by 12.1% to £290.1m. Excluding currency effects, revenue growth was 7.4% (3.5% organic) and Adjusted operating profit growth was 12.4%. Our Adjusted operating margin increased by 26 basis points. Adjusted profit before tax grew by 13.4%. Group free cash flow decreased by £17.5m to £168.3m, principally as a result of an increase in net capital expenditure.

## 1. Income statement

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

Figure 1: Income statement

Year ended 31 December	2011 £m	2010 £m	Increase
Revenue	<b>4,646.4</b>	4,326.7	7.4%
Gross profit	<b>700.4</b>	644.3	8.7%
Administrative expenses	<b>(410.3)</b>	(385.6)	6.4%
Adjusted operating profit	<b>290.1</b>	258.7	12.1%
Investment revenue and finance costs	<b>(27.9)</b>	(27.4)	
Adjusted profit before tax	<b>262.2</b>	231.3	13.4%
Amortisation of acquired intangibles	<b>(20.0)</b>	(17.4)	14.9%
Acquisition-related costs	<b>(3.9)</b>	–	
Profit before tax	<b>238.3</b>	213.9	11.4%
Tax	<b>(63.1)</b>	(57.1)	10.5%
Profit for the year	<b>175.2</b>	156.8	11.7%
Effective tax rate	<b>26.5%</b>	26.7%	
Adjusted earnings per share	<b>39.59p</b>	34.69p	14.1%
Earnings per share	<b>35.70p</b>	31.88p	12.0%
Dividend per share	<b>8.40p</b>	7.35p	14.3%



### 1.1 Revenue

Revenue grew by 7.4% to £4,646.4m (7.4% excluding currency effects). Organic revenue growth, excluding currency effects and acquisitions, was 3.5%, reflecting the growth of existing contracts and the contribution of new contracts started in 2010 and 2011.

### 1.2 Adjusted operating profit

Following the significant acquisitions announced in the period, the calculations of Adjusted operating profit, Adjusted profit before tax and Adjusted EPS are now shown before acquisition-related costs as well as amortisation of acquired intangibles. There is no impact on the comparative results. Adjusted operating profit increased by 12.1% to £290.1m, representing an Adjusted operating profit margin of 6.2%. Adjusted operating profit margin increased by 26 basis points (28 basis points excluding currency effects).

### 1.3 Investment revenue and finance costs

Investment revenue and finance costs totalled a net cost of £27.9m (2010: £27.4m), an increase of £0.5m. The increase excluding currency effects was £0.9m. The principal reason for this increase was due to additional loans raised to finance acquisition activity, offset by greater interest receivable on retirement benefit obligations compared to the previous period.

### 1.4 Adjusted profit before tax

Adjusted profit before tax was £262.2m, an increase of 13.4%.

### 1.5 Acquisition-related costs

These represent incremental costs arising from acquisition activity during the year. £3.1m of the costs incurred related to the acquisition of Intelenet.

### 1.6 Tax

The tax charge of £63.1m (2010: £57.1m) represents an effective rate of 26.5% (2010: 26.7%).

### 1.7 Earnings per share (EPS)

Adjusted EPS rose by 14.1% to 39.59p. EPS grew by 12.0% to 35.70p. EPS and Adjusted EPS are calculated on an average share base of 490.5m during the year (2010: 491.5m). The decrease in the average share base resulted principally from the full weighting in 2011 of own shares purchased in 2010 to satisfy options granted under the Group's employee share option schemes.

## 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 5.90p per share, representing an increase on the 2010 final dividend of 14.6%, and bringing the total dividend for the year to 8.40p, a growth of 14.3%. The final dividend will be paid, subject to shareholder approval, on 22 May 2012 to shareholders on the register as at 9 March 2012.

# Finance Review

## 3. Cash flow

The Group generated a free cash inflow of £168.3m (2010: £185.8m), with the reduction arising principally as a result of an increase in net capital expenditure.

Figure 2 analyses the cash flow. As in previous years, we have designed the analysis to show the underlying 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 [112], 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	2011 £m	2010 £m
Adjusted operating profit excluding joint ventures	208.5	194.1
Non cash items	64.2	61.8
Adjusted EBITDA excluding joint ventures	272.7	255.9
Working capital movement	(32.3)	(30.6)
Operating cash flow excluding joint ventures	240.4	225.3
Interest	(32.7)	(25.2)
Tax	(32.2)	(24.0)
Net expenditure on tangible and intangible assets	(71.5)	(41.8)
Dividends from joint ventures	64.3	51.5
<b>Group free cash flow</b>	<b>168.3</b>	<b>185.8</b>
Acquisition of subsidiaries	(325.3)	(2.3)
Acquisition-related costs	(3.7)	–
Purchase of own shares and issue proceeds of share capital	(6.7)	(14.7)
Financing	236.0	(173.4)
Special pension contribution	(40.0)	(20.0)
Dividends paid	(37.3)	(32.3)
Group net decrease in cash and cash equivalents	(8.7)	(56.9)
Adjustment to include joint venture cash impacts	(15.1)	8.7
<b>Net decrease in cash and cash equivalents before exchange (losses)/gains</b>	<b>(23.8)</b>	<b>(48.2)</b>
Exchange (loss)/gain	(0.7)	8.1
<b>Net decrease in cash and cash equivalents</b>	<b>(24.5)</b>	<b>(40.1)</b>

Note: Adjusted EBITDA excluding joint ventures is earnings from subsidiaries before interest, tax, depreciation, intangible amortisation and other non cash items. Group free cash flow also excludes the cash impact of acquisition-related costs.

### 3.1 Operating cash flow excluding joint ventures

Operating cash flow excluding joint ventures of £240.4m (2010: £225.3m) reflects a conversion of Adjusted EBITDA into cash of 88% (2010: 88%). The working capital movement of £32.3m (2010: £30.6m) reflects the requirements of a growing business.

### 3.2 Interest

Net interest paid increased to £32.7m (2010: £25.2m), principally reflecting higher Group recourse net debt following acquisitions in the period.

### 3.3 Tax

Tax paid was £32.2m (2010: £24.0m). The increase in cash tax is principally as a result of higher overseas taxable profits arising in the period. Cash tax remains below the equivalent charge in the income statement, principally as a result of the availability of accelerated capital allowances and other timing differences.

### 3.4 Net expenditure on tangible and intangible assets

Net expenditure on tangible and intangible assets increased significantly to £71.5m (2010: £41.8m). This resulted from the planned additional investment in SAP systems in 2011 and a return to a more normal underlying level of contract capital investment compared to last year. This represents 1.9% of Group revenue excluding joint ventures (2010: 1.2%).

### 3.5 Dividends from joint ventures

Dividends received from joint ventures totalled £64.3m (2010: £51.5m), reflecting a higher than normal conversion rate of joint ventures' profit after tax into dividends of 100%.

### 3.6 Purchase of own shares and issue proceeds of share capital

This represents a £24.0m (2010: £23.0m) purchase of own shares for the Employee Share Ownership Trust in order to satisfy options granted under the Group's share option schemes net of cash inflows of £17.3m (2010: £8.3m) relating to proceeds from the issue of share capital and exercise of share options.

### 3.7 Financing

The movement in financing is primarily due to acquisition funding.

### 3.8 Special pension contribution

This £40.0m represents the second instalment of a special pension contribution into the Group's main defined benefit pension scheme which was agreed following the triennial actuarial valuation in 2009. The first payment of £20.0m was made in December 2010.

## Finance Review

### 4. Acquisitions

On 14 March 2011, the Group acquired The Listening Company Limited, a leading UK provider of outsourced contact centre services. The initial cash cost of the acquisition was £40.9m, comprising cash to the existing shareholders of £25.0m, plus the repayments of £15.9m of debt immediately after acquisition. In addition, deferred consideration with a fair value of £12.5m is payable, contingent on the financial performance in the two-year period from 1 March 2011 to the end of February 2013. The acquisition gave rise to goodwill of £39.4m. Intangible assets arising on the acquisition have been recognised at £6.6m and will be amortised on a straight-line basis over their expected lives.

On 7 July 2011, the Group acquired 87% of the share capital of SKR BPO Services Private Limited and its subsidiary companies (together Intelenet) for an initial cash consideration of £249.3m. A further £35.7m was paid on 19 October 2011 for the remaining 13% of share capital. Net debt acquired was £51.1m, comprising £55.5m of acquired loans and £4.4m of acquired cash balances. There are contingent deferred consideration cash payments of up to £49.8m through to December 2013. The contingent cash payments are dependent principally on the delivery of revenue targets. The fair value of this contingent deferred consideration is £23.7m. Intangible assets arising on the acquisition have been recognised at £44.2m and will be amortised on a straight-line basis over their expected lives. The acquisition gave rise to £289.2m of goodwill. Intelenet is a leading provider of business process outsourcing (BPO) services to the private sector around the world and in the domestic Indian market. It operates from 34 global delivery centres across seven countries, providing a broad range of middle and back office services and has a strong customer base of international organisations, predominantly across the financial services, travel, healthcare and telecom sectors.

During the year, the Group also made a number of smaller acquisitions. Between March 2011 and December 2011, the Group acquired Braintree Clinical Services Limited, a UK-based company providing clinical and hospital services to Strategic Health Authorities; Philips Collection Services Limited, a UK-based company engaged in the provision of debt collection and fine management services; Excelior Pty Limited, an Australian registered company providing contact centre services; and JBI Properties Services Company LLC, a UAE-based company engaged in the provision of facilities management services. The total consideration for these acquisitions amounted to £31.5m, of which £7.8m is deferred. These acquisitions in aggregate gave rise to goodwill of £29.2m.

£3.9m of acquisition-related costs incurred on the above acquisitions have been expensed to the income statement. The cash flow impact of these acquisition-related costs included in the cash flow statement was £3.7m.



## 5. Net debt

Figure 3: Net debt

At 31 December	2011 £m	2010 £m
Group – cash and cash equivalents	194.6	204.0
Group – loans	(819.4)	(482.6)
Group – obligations under finance leases	(45.0)	(25.0)
<b>Group recourse net debt</b>	<b>(669.8)</b>	<b>(303.6)</b>
Joint venture – cash and cash equivalents	60.2	75.3
Joint venture – loans	(7.9)	(7.8)
Joint venture – obligations under finance leases	(0.9)	(1.4)
<b>Total recourse net debt</b>	<b>(618.4)</b>	<b>(237.5)</b>
Group non recourse debt	(15.5)	(23.7)
<b>Total net debt</b>	<b>(633.9)</b>	<b>(261.2)</b>

### 5.1 Group recourse net debt

Group recourse net debt increased by £366.2m to £669.8m. The increase was principally a result of acquisition activity. Sources of funding are described in section 7 below.

Cash and cash equivalents includes encumbered cash of £5.5m (2010: £10.9m). This is cash relating to customer advance payments.

### 5.2 Group non recourse debt

The Group's debt is non recourse if no Group company other than the relevant borrower 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 £8.2m to £15.5m, as a result of £7.9m payments made in line with the debt repayment schedule on debt relating to our Driver Examination Services contract in Canada and £0.3m decrease in non recourse debt due to exchange movements.

## 6. Pensions

The Group is a sponsor of a number of defined benefit schemes and defined contribution schemes. At 31 December 2011, the net retirement benefit asset included in the balance sheet arising from our defined benefit pension scheme obligations was £16.8m (2010: net liability £83.0m), on a pension scheme asset base of £1.7bn.

Figure 4: Defined benefit pension schemes

At 31 December	2011 £m	2010 £m
Group schemes – non contract specific	58.8	(76.1)
Contract specific schemes:		
– reimbursable	(188.7)	(123.4)
– not certain to be reimbursable	(26.5)	(26.7)
Net retirement benefit liabilities	(156.4)	(226.2)
Intangible assets arising from rights to operate franchises and contracts	6.3	8.9
Reimbursable rights debtor	188.7	123.4
Deferred tax (liabilities)/assets	(21.8)	10.9
Net balance sheet assets/(liabilities)	16.8	(83.0)

# Finance Review

The total pension charge included in operating profit for the year ended 31 December 2011, including the proportionate share of joint ventures, increased to £112.3m (2010: £106.5m). Within this charge, the Group's contributions to UK and other defined contribution pension schemes increased to £80.4m (2010: £76.0m). The service charge relating to the Group's defined benefit schemes increased to £31.9m (2010: £30.5m), principally as a result of changes to the discount rate and inflation assumptions as at the end of 2010 and increases in payroll costs.

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 year to the consolidated statement of comprehensive income (the SOCI);
- 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; and
- 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 year to the SOCI, 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 either to the right of cost reimbursement or because the deficit will, in general, 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 2011, SPLAS had a surplus of £122.3m (2010: deficit of £16.4m). This is calculated under IAS 19 using market-derived rates at 31 December 2011. It therefore reflects the effect of the market conditions on investment returns in the year and the net impact of a decrease in inflation assumptions offset by a decrease in the applicable discount rate.

The estimated actuarial deficit of SPLAS as at 31 December 2011 was approximately £27.3m. The value calculated in the latest triennial review was a deficit of £141m at 6 April 2009. Following the 2009 review, the Group agreed with the Trustees to make a cash contribution of £60m to the scheme, of which £20m was paid in December 2010 and £40m in January 2011. We continue to review the level of benefits and contributions under the scheme in the light of our business needs and changes to pension legislation.

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

	Assumption	Change in assumption	Change in liability
Discount rate	4.70%	+0.5% (0.5)%	(9)% +10%
Price inflation	2.90% (RPI) and 2.10% (CPI)	+0.5% (0.5)%	+9% (8)%
Salary	3.30%	+0.5% (0.5)%	+2% (2)%
Longevity	20.9–24.6*	Increase by one year	+3%

\* Post retirement mortality range for male and female, current and future pensioners.

## 7. Treasury

The Group's committed bank credit facilities total £726.7m (2010: £698.9m). As at 31 December 2011, £241.3m had been drawn down on these combined bank facilities (2010: £329.8m). The facilities comprised:

- a £400.0m syndicated revolving credit facility, maturing in September 2013;
- a syndicated amortising term loan of £75.0m repayable over three years to June 2014;
- a syndicated amortising term loan for US Dollar 258.4m (£166.3m) repayable in September 2012 and September 2013. The next scheduled repayment of US Dollar 138.0m is due in September 2012; and
- bilateral credit facilities for £85.4m, of which £75.0m matures in September 2013 and Euro 12.5m (£10.4m) matures in April 2012.

In addition to the bank credit facilities, Serco has US private placements totalling £502.8m which will be repaid between 2012 and 2023. This includes £408.6m of US private placement notes issued in 2011. All of the Group's credit facilities detailed above are unsecured.

## 8. Going concern

The Directors have acknowledged the guidance 'Going Concern and Liquidity Risk: Guidance for Directors of UK Companies 2009', and 'An update for Directors of Listed Companies: Responding to increased country and currency risk in financial reports', published by the Financial Reporting Council in October 2009 and January 2012 respectively. Whilst the current economic environment remains uncertain, the broad base of our contract portfolio and with over 90% of our customers being government bodies, the Group is well placed to manage its business risks successfully (as discussed in the section 'Principal Risks and Uncertainties') and has adequate resources to continue in operational existence for the foreseeable future.

The Group's revenues are largely derived from long-term contracts with governments. Historically, these contracts have been relatively resilient to changes in the general economy. The contract portfolio is diverse and a downturn in any particular market, sector or geography has a more limited effect on the Group as a whole. In addition, with an order book of £17.9bn and high visibility of future revenue streams (92% in 2012; 80% in 2013 and 70% in 2014), the Group is well placed to manage its business risks despite the current uncertain economic climate.

As at 31 December 2011, the Group's principal financing is through revolving credit facilities, term facilities and US private placements. The Group has approximately £1,230m of committed credit facilities. The headroom on the facilities was approximately £485m as at 31 December 2011. Scheduled repayments in 2012 in respect of amortising term loans are for £25m in June against the £75m term loan and US Dollar 138m (£89m) in September against the US Dollar 258m term loan. The Group fully expects to meet these repayments through operational cash flows. Based on the information set out above, the Directors believe that it is appropriate to prepare the financial statements on a going concern basis.

# People

Serco's growth means that the number of people we employ is continually increasing. This year we welcomed 40,000 people into the Serco family.

This means we need a clear framework for managing and developing our people, so we can help them to be as good as they can be and to enable us to deliver great service to our customers.



Our people strategy therefore has three components. We want to:

- develop leaders who are fit for the future and who will thrive as Serco grows
- employ people who bring service to life, who are fully integrated and engaged with Serco and who we can develop to achieve their full potential, and
- make it easier to manage our people by continually enhancing our systems and processes.

### Developing our leaders

As a devolved and fast-growing organisation, Serco needs capable and motivated leaders who have the potential to grow with us. They are responsible for managing operations, securing our growth and creating the environment in which our people can do what they do best: serve customers with passion and skill. The way they lead is as important as what they deliver.

Our leadership model is known as H<sup>3</sup> – Heart, Head and Hands. These components describe how great leaders in Serco behave, with an emphasis on our Governing Principles and our customers.

The components of the model are summarised as:

**Heart.** This covers our leaders' motives and demonstration of our Governing Principles. We want them to create our culture through personal example and to have the courage to stand by their convictions.

**Head.** This relates to intellectual and personal capacity. We want leaders who can solve complex problems, take a long-term view, inspire and influence others, focus on outcomes, innovate, be resilient and be adaptable to a situation's needs.

**Hands.** This covers skills, knowledge and experience. We want our leaders to be skilled at shaping and delivering the plans and capabilities that will drive our performance and growth.

Behind each of these components is a further set of criteria, which explain in detail the desired behaviours and the standards against which we appraise our leaders' performance.

### Leadership talent reviews and succession planning

In 2011, we once again undertook leadership talent reviews across Serco. The reviews were led by our Chief Executive, Group Human Resources Director and the respective Divisional CEOs or Corporate Functional Directors. The key areas of focus were:

- understanding our current leadership capability
- future requirements to support our growth agenda
- the depth of our talent pipeline, and
- the depth of succession cover for the Global Management Team (GMT). The GMT is made up of around 80 of our most senior leaders.





We also launched a global talent management database, to improve access to and analysis of the leadership information and talent metrics captured in the talent reviews.

Serco has several programmes to further strengthen our talent pipeline:

- the 'Emerging Leaders Programme' provides training and development to employees who apply or who are identified as future leaders. The programme began in the UK and is being rolled out internationally, with a first cohort selected in the Middle East this year
- the 'Future Leaders Group' identifies a small number of emerging leaders that are considered to have the greatest potential. Over the course of a year, they have regular contact with the Executive Committee and are able to get involved in the business
- the 'Fast Tracker' programme identifies candidates (including external individuals) who have between two and five years' work experience and want to accelerate their careers by taking on work placements

#### *Leadership Academy – GMT development curriculum*

The GMT development curriculum has been created as part of our Leadership Academy. The curriculum is organised around the needs of three distinct groups: newly recruited GMT members; established GMT members; and GMT members who have advanced or specialist requirements. The aim is that all GMT members will have a minimum of 35 hours of development each year, captured in a continuous professional development scheme.

#### *Global Management Team mentor programme*

This programme allows GMT members to request mentoring from either the Executive Committee or Serco Alumni Masters, who are retired Serco Directors who act as consultants for bids and the Group generally. Around one third of GMT members have taken advantage of this so far, with mentoring lasting for three to six months.

#### *Integrating, engaging and developing our people*

We are dependent on the skill and enthusiasm of our people. They enable us to deliver great service to our customers and contribute considerably to the strength of our reputation and ability to grow.

We therefore need to integrate new joiners, effectively engage with all our people and help them achieve their potential. We recognise their outstanding achievements through our global Pulse Awards.

#### *Integrating new people*

Serco's growth means that thousands of people can join us every year. The increase in 2011 was unprecedented, with our employee numbers rising by 40,000 to more than 100,000, driven in particular by the acquisitions we made, as well as new contracts won that became operational during the year.

The Welcome Experience helps new joiners become part of Serco. This is a range of materials and events which ensure that joining Serco is welcoming and engaging, and is in addition to any induction at a local level. The materials include:

# People



- Discover Serco Passports, which help guide and direct new people
- the People Pack, which helps new leaders understand the importance of their role and the tools available to enable them to be a great leader
- Discover Serco e-learning, which is available for any new employee through the Serco Business Academy, and
- Discover Serco contract visits.

We want to ensure that everyone in Serco understands and lives our values. The best way of demonstrating our values is for our people to see them in action. Our leaders have a key role to play, by making decisions in accordance with our values. We also prioritise communication with our people, particularly in the transition phase after we have won a contract, so that they understand Serco and the way we work.

Our approach – and the outcome – is the same around the world. While there are always cultural differences between countries, our values are universal and our people embrace them wherever they are based.

### Integrating acquisitions

We made several acquisitions in 2011, including Intelenet, The Listening Company and Excelior. From a people perspective, the integration activities we undertook included reorganising management, mapping leadership roles onto Serco's levels of leadership, reviewing key capabilities and communicating with employees, including briefing them about Serco.

### Engaging with our people

We once again undertook our annual global employee survey, called Viewpoint. This gives us important insights into how we can improve the working experience at Serco, resulting in greater engagement with our people and enhanced service for customers.

Results from the survey show trends and areas on which to focus. An online tool gives materials to cascade and enables managers to prepare action plans to drive improvement.

We are developing case studies that highlight engagement best practice and which will help our managers put the associated ideas into practice. We are also studying the links between employee engagement and vital aspects of our business performance, such as customer advocacy and our financial results.

Serco continues to support the UK government's Engagement Taskforce. We have seconded a Serco leader to the taskforce to contribute to this initiative and to coordinate one of the taskforce groups, building best practice in employee engagement.

### Developing our people

Developing our people is critical if we are to enable them to excel, which is one of our Governing Principles. Development ranges from informal on-the-job training through to specialist and technical training. We use a 'blended learning' approach, with a balance of face-to-face and web-based learning.

### Management Foundations programme

The Management Foundations programme, aimed at developing values-led management, continues to be very successful. The programme was developed in the UK and is being expanded

internationally, with our Middle East operations now offering it. A further five training modules are in the process of being written.

In addition, we are creating a Leadership Foundations programme. This will be a two-day programme, aimed at a level above Management Foundations.

### Recognising achievement

Our 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 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 in areas such as safety and ethics. Forty-eight individuals and teams will receive an award for their work in 2011.

### Managing our people

We continually look to improve our efficiency, including the ways we manage our people. Our aim is to have intuitive, easy-to-use tools, processes and systems which make it easier to manage our growing workforce and deliver even higher levels of productivity and service as a result.

A change programme called Empower is transforming how we manage people across our business. By introducing new systems, tools and ways of working, Empower will help us to support our business and our customers with the right people, with the right

skills, at the right time. Empower will ultimately give our people greater visibility of career opportunities within Serco and provide better access to their personal information.

Empower includes what we call the 'HR Backbone', a standard global application that will hold core people data from all of our operations and give us a comprehensive view of our employee population. During the second half of 2011, the HR Backbone went live in the UK, Europe, Australia, Hong Kong, Singapore and part of our Indian operations.

We are now developing the next Empower application, Common Core People Management, which will incorporate a greater range of information and tools, including 'My HR' self-service functions that employees can use to maintain their personal information and book annual leave online. The self-service tool will give managers better visibility and control of their team information, the ability to carry out people management activities online, and access to reports to support planning and decision-making. We have also created a new People Management Operating Model, which will ensure that we deliver expert HR services consistently across Serco. These activities will allow us to implement shared service delivery and to develop capabilities that came to Serco through the acquisition of Intelenet.

The full Empower functionality is now live in Australia and will be introduced across the UK, North America and the Middle East in the second quarter of 2012.

## Objectives and performance

2011 Objective	Result	Comment
To make it easier to manage people. The focus will be to develop and implement the programme called 'Empower – Transforming People Management'.	Ongoing	The Empower programme represents a significant investment by Serco in improving the effectiveness of its workforce by developing and embedding a common best practice in people management globally. The programme will deliver standard global processes for managing people, supported by common IT systems and new shared services. At the heart of these systems is a single global database of our workforce, providing us with one source of truth about our people. This was successfully rolled out, on time, across the UK, Europe and Hong Kong in the first half of the year and then in Australia in November. Additional software to support staff scheduling and self-service has been deployed first in Australia, and full roll-out of Empower to all countries will be completed in the first half of 2012.
To develop leaders who are fit for the future. We will be looking to further embed the talent review and succession planning process across a wider proportion of our management population.	Ongoing	During 2011, we extended our talent review and development process throughout the pipeline of developing and existing leaders. Development programmes have been introduced that take leaders from their early days with Serco and support their progress throughout their career. This end-to-end curriculum now includes The Fast Tracker Programme, the Emerging Leaders Programme (called Aspire), The Management Foundations programme, The Future Leaders Group, the Leadership Academy for the Global Management Team and the emergence of functional programmes such as the Finance Global Curriculum. The Executive Committee set the example this year by undertaking its own development programme with Professor Bill George of the Harvard Business School.
To engage and motivate employees to bring service to life. We will continue to research and analyse the link between engagement and performance.	Ongoing	The 2011 employee engagement survey, Viewpoint, tells us much about maintaining employee engagement as we manage tougher trading conditions in some of our businesses and continue to grow in others. The Viewpoint process has given us a strong platform to further improve the way we run our business through creating meaningful dialogue across the Company. Our surveys are followed up by action plans across the business that are developed and owned by local managers and aimed at addressing the key issues raised by their employees.

### 2012 objectives

- To make it easier to manage people by implementing a single HR programme and common core processes
- To motivate and engage employees to bring service to life by linking engagement to performance
- To develop leaders who are fit for the future by embedding the talent review and succession planning process across a wider proportion of our management population

# Corporate responsibility

Achieving our vision to be the world's greatest service company requires us to work in the right way and to meet our responsibilities to customers, the public, our employees, partners and suppliers. As a result, corporate responsibility (CR) is part of who we are and how we behave.



Further information available online  
[www.serco.com](http://www.serco.com)

We divide our approach into four pillars – people, health and safety, community and the environment. Our work for customers encompasses all of these areas, but there are many things we do which go beyond our contractual or legal requirements.

Our approach to managing our responsibilities is summarised below. We also publish a Corporate Responsibility Report each year, which gives more detail of our activities and the way we embed CR in our business. The full report is available at [www.serco.com/CR2011](http://www.serco.com/CR2011)

### Managing corporate responsibility

Serco is a devolved organisation, which operates in multiple markets around the world. Our Group CR model provides overall guidance but our business units have the flexibility to implement regional and local strategies that meet the needs of their stakeholders.

Responsibility for shaping and delivering our overall CR strategy rests at the very top of our organisation. The Health, Safety and Environment Oversight Group reports to the plc Board through the Group Risk Management Committee. The Human Resources Directors' forum ensures the best governance of our people, while community activities are overseen by the Community Investment Forum, which also reports through the Executive Committee to the plc Board.

During 2011, we reviewed and relaunched the Serco Management System (SMS) globally, to ensure it was properly aligned to our business and strategy. The system provides accountability and effective controls and provides the framework within which we operate and behave. The Governing Principles are embedded



Above: Sally Hughes, one of our former apprentices, now teaches engineering and underwater safety at Royal Navy Air Station Yeovilton.

within the SMS, so each of the system's policy areas reinforces one or more aspects of our principles.

Our Code of Conduct helps to embed the SMS into our working culture by providing an overview of the behaviour we expect from our staff. Last year, we launched a training programme to give our people guidance on the ethical issues associated with our Code of Conduct and the UK Bribery Act.

### Our people

Pages 62 to 65 explain our people strategy, our 2011 initiatives to improve the ways in which we develop, engage, motivate and manage them, and our objectives for 2012.

### Health and safety

Our aspiration is to achieve zero harm. Nothing we do is so urgent or important that we cannot do it safely.

Wherever they work and whatever their role, our people must adhere to stringent health and safety procedures. These procedures are embedded in the SMS and are the minimum standards that must be applied. To maintain these standards, we audit ourselves against them, looking for best practices that we can apply more widely within our business. We address any inadequate performance and put in place new, better practices.

As part of the SMS refresh, we have reviewed and updated our health, safety and environment (HSE) policy. In brief, this means we now:

- define policy and procedures to protect the environment and the health and safety of those to whom we owe a duty of care



- meet and, where appropriate, exceed any legal and other requirements that apply
- identify and assess HSE hazards, impacts and risks from our activities and services
- set HSE objectives and targets that reflect legal requirements and any identified risks, and show that we are seeking to continuously improve
- consider the input of employees and others when making decisions on HSE matters, and understand local sustainability challenges
- develop and introduce plans to agreed objectives and manage identified risks
- identify, train and use necessary, competent resources within a defined structure and allocate HSE responsibilities to people who have the necessary skills
- investigate and report on incidents to identify areas where we need to make improvements and prevent further problems
- monitor, review and report on our performance at group, division and contract level, measured against set objectives and targets
- regularly review our systems' suitability and effectiveness, identify any procedural improvements needed, and share best practice.

A strong HSE performance ensures the safety of our staff and can help to distinguish us in the market and enhance our reputation. This demands consistent, co-ordinated and properly resourced initiatives, driven from within the business, with best practice shared across the Group.

We already have an effective HSE management system and processes but to drive consistency and efficiency, we are working to implement a single, company-wide HSE integrated management system.

Serco operates in a number of safety-critical areas that are heavily regulated, which places stringent requirements upon us. We have the systems in place to deliver these requirements and this is reflected in the regulatory approvals and licences we have to operate under. This also means that we have regular regulatory oversight. Together, these factors give us a strong controls framework with which to manage our HSE responsibilities.

In 2011, Serco businesses, contracts and joint ventures in the UK were awarded 24 accolades by the Royal Society for the Prevention of Accidents. Our contract at RAF Fylingdales was granted the Order of Distinction, an award that marks the contract's sixteenth successive Gold Award. President's Awards, given in recognition of high levels of safety maintained over a number of years, were bestowed upon other Serco services, including the joint venture at the Atomic Weapons Establishment and for marine services to the Royal Navy.

## Objectives and performance

2011 Objective	Result	Comment
To continue focusing on reducing our lost time incident rate (LTIR). We aim to be back on trajectory to reach our target of a 50% reduction in our LTIR (against the 2008 benchmark) by the end of 2012.	Target on plan	We achieved an LTIR of 1,000, a reduction of 15.9% against 2010 (1,189) and 37.2% lower than the 2008 baseline (1,593). The LTIR has received significant management attention. A number of initiatives, particularly focused around our higher-risk custodial and transportation businesses, improved our performance in 2011. This performance improvement was also helped by the acquisition of Intelenet, which added a large number of staff in low-risk roles. However, there has been a negative shift in the risk profile in some of our higher-risk business areas. For example, our immigration business has grown in scale as well as seeing an increase in detention periods, resulting in more assaults and injuries to our people. This is an important area of focus in 2012. The longer-term trend remains positive. Along with a reduction in incidents, the average number of days lost per incident reduced in 2011 by 30% against 2010.
To continue focusing on reducing reportable incidents (RI). Based on current performance, we have revised our target to 599 to reflect a 40% reduction in staff RI rate by the end of 2012 against the 2008 benchmark.	Target met	Our reportable incident rate was 577 per 100,000 employees, a reduction of 18.8% from 2010 (711) and 42.2% lower than our 2008 baseline (999). As with our improvement in lost time incidents, this has been helped by the addition through acquisition of a large number of staff in low-risk roles. Whilst we have achieved our target a year early, we will continue to drive further reductions, particularly in our transport and immigration businesses where some risk factors are increasing. Recognising this changing risk profile, we are keeping our target at a rate of 599 and aim to remain just under this level.
To develop systems and processes to manage and monitor near-miss events more effectively. Our target remains to establish a baseline for future improvements for 2012.	Ongoing	We continue to strengthen our data capture processes through ASSURE™, our intranet-based data capture system. During 2011, more than 33,000 events were entered on ASSURE™. With this improved data available, we will consider an appropriate baseline during 2012 and consider specific objectives.

### 2012 objectives

- To achieve an LTIR of 796, a 50% reduction against the 2008 baseline
- To achieve a 40% reduction in the staff reportable incident rate against the 2008 baseline
- To establish a baseline of near-miss events against which future performance can be tracked

# Corporate responsibility

*Right: Puppy training at Southern Queensland Correctional Centre, Australia, supports rehabilitation of prisoners and helps people with disabilities.*



## Community

Serco's devolved structure helps us to integrate into the communities in which we operate, and our aim is to have a positive and lasting impact on them. We do this by employing local people when we can, providing training opportunities and work experience, and by using local suppliers where possible.

Our commitment is reflected in our target to reinvest 1% of our pre-tax profits into wider society. Last year, we invested £2,532,175 through donations to community projects and charities, as well as the donation of assets and time.

Across Serco, our people engage in many different activities, as individuals or as part of the wider Serco community. These activities range from local community projects, such as volunteering to help homeless people, to raising money to help international disaster relief efforts, such as the floods in Thailand. We also support organisations whose work touches our own, such as the Military Child Education Coalition in the US, which helps children affected by their parents' relocation and deployment.

In the UK, the government's drive to reduce youth unemployment has seen the launch of a new work experience scheme aimed at 18–24 year olds. The scheme targets the creation of 100,000 work experience placements of two to eight weeks in length over the next two years. Serco has committed to offering 1,000 placements and 500 apprenticeships.

Serco is also taking part in an industry-led initiative, supported by the UK government, to develop an online careers platform for young people. This will provide a single starting point for young people to explore their work ambitions and to plan how to achieve them. The website will be launched in 2012.

Our results in the 2011 Business in the Community Corporate Responsibility Index, the UK's leading benchmark of corporate responsibility, reflect the difference we make. Serco was rated Gold for the sixth year running, while our community investment (benefits and impact) was rated 100% across all five areas that were measured.

## Objectives and performance

2011 Objective	Result	Comment
To continue to invest 1% of our pre-tax profits into society.	Target met	We invested £2,532,175, representing 1.06% of our pre-tax profits.
To continue to promote the theme of employability.	Ongoing	In the UK, we have continued to engage with the theme of employability through the promotion of work experience and apprenticeship opportunities within our business. Working with JobCentre Plus, we have identified and made available 1,000 work experience placements for young people and currently have 1,400 apprentices in training.
To continue to develop our relationships with charities, social enterprise and community organisations.	Ongoing	During 2011, a UK internal advisory group was formed whose members are experienced in working with third sector organisations. This forum meets as and when required to consider Serco's relationships with the third sector as partners and suppliers.
To promote employee volunteering.	Ongoing	The promotion of employee volunteering remains a high priority for our businesses and is embedded within the Business Ethics and Conduct section of the Serco Management System. CR strategies for our businesses in the Americas and Australia, for example, clearly articulate a need to develop employee volunteering. In the UK, our contracts continue to support on a case-by-case basis employees who request time off to volunteer.
To promote payroll giving.	Ongoing	During 2011, the UK developed a relationship with Payroll Giving in Action, to develop a communications campaign to encourage employee giving, to be implemented during 2012. Employee giving is also a high priority for our businesses in the US, Australia, New Zealand and India.

### 2012 objectives

- To continue to invest 1% of pre-tax profits back into wider society
- To continue to promote the theme of employability
- To continue to develop our relationships with third sector partners
- To promote employee volunteering
- To promote payroll giving

Right: We provide environmental services to UK local authorities that help improve their environmental performance.



### Environment

Serco's aspiration for zero harm applies as much to the environment as it does to health and safety.

Our environmental policy is driven by the desire to do what is right for the world we live in and because it makes good business sense to protect our reputation and reduce our energy consumption and environmental impact.

Although Serco's activities are typically managed at a local level, we are united in our strategy of measuring our impact and reducing our environmental footprint. This supports many initiatives in our operations around the world. These range from reducing water usage in Australia, to improving recycling levels at US contracts and reducing electricity use in UK prisons.

We also have contracts that help our customers to improve their environmental performance. For example, Serco provides environmental services to UK local authorities, which help our customers to reduce the volumes of waste sent to landfill sites.

Our environmental efforts are reflected in the recognition we receive. In the UK, we achieved Carbon Trust Standard certification at the beginning of 2011, as a result of our work to reduce carbon emissions. We also improved our position in the UK's Carbon Disclosure Project FTSE 350 report, which measures carbon disclosure and performance. Our score rose from 78% in 2010 to 88% and we were placed in the Carbon Disclosure Leadership Index. Serco was also one of only seven organisations to achieve band A (the highest) in the Carbon Performance Leadership Index.

### Objectives and performance

2011 Objective	Result	Comment
To achieve a 15% reduction in CO <sub>2</sub> tonnes/£m revenue against the 2008 benchmark by end of 2012.	Target met	Our UK business generates around 80% of our CO <sub>2</sub> emissions. We reduced our emissions relative to revenue by a further 3.5% in the UK, giving us a cumulative reduction against our 2008 baseline of 14.8%.
To retain the Carbon Trust Standard.	Target met	We retained the Carbon Trust Standard in 2011, reflecting our commitment to reducing our emissions.

#### 2012 objectives

- To achieve an 18% reduction in our UK business's CO<sub>2</sub> tonnes/£m revenue against the 2008 benchmark
- To retain the Carbon Trust Standard

# Resources

## Business relationships

### Customers

Developing long-term relationships with our customers is central to our business. Day-to-day responsibility for meeting our customers' needs lies with our contract directors. Our approach to working with our customers is set out in our Governing Principles (see pages 18 to 19), which aim to empower our contract directors and ensure that we deliver high-quality service.

We maintain relationships at all levels with our customers, so they are aware of how we can help them and we can anticipate their changing needs and identify opportunities at an early stage. These relationships lie with our divisional and Group leaders.

Our reputation with our existing customers is also vital in winning new work. Many factors influence our reputation, including:

- the quality of our service
- our values and service ethos
- our capacity to innovate, and
- our engagement with our employees and other stakeholders, such as local communities.

We believe that our high rebid and new bid win rates demonstrate the strength of our reputation with new and existing customers.

### Suppliers

Effective procurement contributes to achieving our vision and delivering high-quality service to our customers. We are professional in all our dealings with suppliers and aim to establish mutually beneficial relationships.

We have a Procurement and Supply Chain team, which is responsible for putting this approach into practice. Our businesses have many common purchasing needs which we strive to fulfil with preferred suppliers, enabling us to achieve better terms and conditions and make the most of our scale. In 2011, we put in place a number of commercial arrangements for services we buy globally, such as telecoms. Our teams also procure services locally when appropriate, drawing on the expertise of our divisional procurement specialists to manage the process effectively.

We continue to focus on developing our supplier relationships. During 2011, we introduced a supplier relationship management strategy, which will help us to further improve the way we work with our suppliers.



As part of this, we have enhanced the governance of our key supplier relationships. This includes defining the key points of contact between us, writing account plans which set out what we both intend to achieve and commitments to regular meetings.

In the UK, we held a conference attended by 50 of our largest suppliers, enabling us to brief them on our business, as well as ways we could work together more closely. In 2012 we will be organising informal regional events for our suppliers to meet key Serco people and to network with each other.

Serco works with thousands of small- and medium-sized (SME) suppliers and we continue to improve our interaction with them. This includes setting up a Small Business Advisory Body in the UK, with representatives of SMEs from across the business. The Body guides us on our communications with and support to SMEs.

In the US, we have a supplier mentor programme which provides guidance to small businesses on key matters such as growing their businesses and creating budgets. We received a Commendation of Excellence award from the Department of State for exceeding small business subcontracting goals, one of only three contractors to be recognised in this way.

Our other initiatives include developing a welcome pack, which we send to all new suppliers. This provides information such as how to register as a supplier and how our payment process works. We also moved to standard payment terms of 30 days in the UK, aligning us with the Government's guidelines on supplier payment.





#### Joint venture partners

Serco has many joint ventures with commercial partners and customers, examples of which are set out below.

In the UK, AWE Management Limited, our highly successful joint venture with Lockheed Martin and Jacobs Engineering Group Inc., manages the Atomic Weapons Establishment. We also have a joint venture with Wincanton to provide prisoner escort and custody services.

In Australia, DMS Maritime, our joint venture with P&O Maritime Services, is a key partner for the Australian Defence Force (ADF) and other agencies. In partnership with Sodexo, we deliver garrison support services to the ADF through Serco Sodexo Defence Services Pty Limited.

We also have successful joint ventures with customers. For example, GSTS Pathology is a joint venture with Guy's and St Thomas' NHS Foundation Trust and King's College Hospital NHS Foundation Trust. ACCESS is our joint venture with Glasgow City Council, designed to streamline and maximise the use of the Council's property and ICT assets.

Strong relationships, based on mutual trust and respect and clarity of roles, are essential ingredients if a joint venture is to deliver excellent customer service. Our divisional management teams are responsible for relationships with our joint venture partners, supported by members of the Group Executive Committee and Board as appropriate. This includes holding regular strategy and review meetings with our partners.

#### Strategic partners

We often deliver services as part of a consortium, either as prime contractor or as a subcontractor. This allows us to bring together companies with the skills to meet the precise requirements of a bid.

Our values and the open and honest way in which we work also make us an attractive partner for voluntary sector organisations, who often lack the scale and experience to access major government programmes. Examples include:

- our model for providing welfare to work services in the UK, which utilises a network of commercial and voluntary sector partners, and
- our partnership with Catch22 and Turning Point at HMP & YO1 Doncaster, UK, to reduce reoffending rates and help integrate ex-offenders back into society.

Responsibility for relationships with our strategic partners lies with the relevant contract and divisional management.

# Principal risks and uncertainties

Serco 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 our assets and reputation.

The Board has overall responsibility for our internal control system and for reviewing its effectiveness, and has delegated to management the implementation of policies on risk and control.

Risk management is fundamental to how we manage the business. We have developed robust systems and processes to identify and manage the key risks facing each of our businesses and the Group as a whole, and all parts of the business have appropriate risk and crisis management plans that meet defined policy standards.

Whilst divisional boards review quarterly the risks they face, the Group Risk Management Committee (GRMC), a formal committee of the Executive Committee, meets quarterly to provide governance and oversight of risk across the Group. The Board receives a quarterly report on the GRMC's assessment of the principal risks facing the Group and the action being taken by management to mitigate risks that are outside of the Group's risk appetite.

Our risk management policies, systems and processes conform to the requirements of the Combined Code and form part of the Serco Management System (SMS).

Such systems and processes, 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 report and accounts.

## **Our approach to risk within the Serco Management System**

The SMS sets out policy standards, systems and processes that identify, review and report risks at all levels of our business

and in the Group as a whole with the aim of safeguarding our shareholders' investments and our assets and reputation. At each level within our business, risk management processes reflect the nature of the activities being undertaken and the business and operational risks inherent in them, and therefore the level of control considered necessary to protect our interests and those of our stakeholders.

These controls and processes fall into four main areas: Identification, Assessment, Planning and Control, and Monitoring, so that we:

- identify business objectives that reflect the interests of all stakeholders, and the risks associated with the achievement of these objectives
- regularly assess our exposure to risk, including through the regular measurement of key risk indicators
- control and reduce risk as far as reasonably practicable or achievable through cost-effective risk treatment options
- identify new risks as they arise and remove those risks that are no longer relevant.

### *Risk identification*

In identifying the potential risks associated with the achievement of our business objectives, we consider both external factors arising from the environment within which we operate, and internal risks arising from the nature of our business, its controls and processes, and our management decisions.

Once identified, we document risks in risk registers, which are maintained at a contract, business unit, programme, divisional and Group level. These risk registers change as new risks emerge and existing risks diminish, so that the registers reflect the current key risks. We review risk registers at least quarterly and more frequently as required. The GRMC reviews the Group risk register quarterly ahead of formal review by the Board.

#### *Risk assessment*

We assess the potential effect of each identified risk on the achievement of our business objectives and wider stakeholder interests. To do so, we use a risk scoring system based on our assessment of the probability of a risk materialising and the effect it does. This is assessed from three perspectives:

- the risk's significance to the achievement of our business objectives
- the risk's significance to society, including its impact on public safety and the environment, and
- our ability to influence, control and mitigate the risk.

Analysis of our key risks allows us to assess the probability of disruption to our business objectives, and highlights critical areas that require management attention.

#### *Risk planning and control*

We assign each identified and assessed risk to a risk owner, who is responsible for controlling and managing it and developing a robust and effective plan to reduce or mitigate the risk. Risk owners are required to report to the GRMC or, as appropriate, the Board on specific risks. Either may ask for additional information or request an audit to provide additional assurance.

Risk reduction involves taking early management action to remove or reduce identified risks before they can affect the contract or project. We consider options to eliminate, reduce or control the risks as part of the risk identification and analysis process.

Risk mitigation involves us identifying appropriate measures, including contingency plans, to reduce the severity of the impact of the risks, should they occur. This includes developing crisis management plans in response to risks whose potential impact warrants a specific management process.

The SMS requires every contract to develop a risk management plan reflecting assessed risks and supported by appropriate measures and contingency plans to mitigate the impact of the risks.

#### *Risk monitoring*

Changes in our external environment, internal structures and management decisions may all affect the nature and extent of the risks to which the Group is exposed.

Our risk monitoring process therefore regularly monitors changes to our business and the external environment, to ensure that we respond appropriately to reduce the impact of emerging risks.

#### *Principal risks*

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

The Group's key stakeholders include, but are not limited to, shareholders, customers, suppliers, staff, trade unions, government, regulators, banks and insurers. The way we operate as a responsible company recognises the interests of the community in areas such as social, environmental and ethical impact, as described under Corporate Responsibility on pages 66 to 69.

The most significant risks relate to our reputation, and to operational and financial performance. A number of our risks reflect social, environmental and ethical issues, but these do not currently represent significant threats to achieving our strategic objectives.

Summarised on the following pages are the key risks we have identified that could have a material impact on our reputation, our operations or our financial performance.

We also have material investments in a number of joint ventures, where we have joint control over management practices. Our representatives within these companies ensure that their processes and procedures for identifying and managing risk are appropriate and that internal controls exist and are regularly monitored.

We keep reputational and emerging risks under active review and inform the Board of changes. Emerging risks cover longer-term risks that could represent a threat to our activities but which are not yet sufficiently defined to be included as active risks.

#### *Managing and mitigating risk*

Our risk management process enables us to understand our operational risk profile. While operational risk can never be eliminated, we endeavour to minimise the impact by the consistent implementation of the SMS, ensuring that appropriate infrastructure, controls, systems, staff and processes are in place.

Some of our key management and control techniques defined in the SMS are set out below:

- our operating processes fully reflect the principles of clear delegation of authority and segregation of duties
- our GRMC meets quarterly to ensure that risks, internal control and business assurance are effectively managed and reviewed
- comprehensive business review processes ensure we meet customer expectations, regulatory requirements, and performance criteria including operational effectiveness, investment returns, cash flow requirements and profitability

# Principal risks and uncertainties

- we monitor and regularly review key performance indicators. These include analysis of business performance and variances from plan, occupational health and safety incidents, and error and exception reporting
- selective recruitment, succession planning and other human resource policies and practices ensure that staff skills are aligned with Serco's current and future needs
- we maintain insurance policies against losses arising from circumstances such as damage or destruction of physical assets, theft, legal liability for third-party loss and professional advice. We review the adequacy of our insurance cover at regular intervals
- our Investment Committee meets regularly to ensure appropriate governance and the management of risk associated with larger or higher risk bids, acquisitions, disposals and areas of significant capital expenditure
- we apply robust project management and change implementation disciplines to all major projects including new contract transitions, acquisitions, new technology applications, change programmes and other major initiatives
- the Directors' Report describes our approach to health, safety and environmental protection. Qualified and experienced staff in each business unit provide advice and support on health, safety and environmental issues and undertake regular audits
- we have safety specialists in our aviation, rail, defence, nuclear and marine businesses who report to the Board and maintain and further develop the very high standards expected in these industries
- the Chief Information Officer is responsible for ensuring that systems and processes are in place to ensure the confidentiality, integrity and availability of sensitive information and the associated information systems that support our business activities
- our Ethics Committee has responsibility for the review of ethical issues that may arise from our current and future activities
- the Company Secretary manages a confidential reporting service, to which staff can report illegal, dangerous, dishonest or unethical activities. This process was enhanced and relaunched at the end of 2010
- we have crisis and business continuity plans in place to manage crisis events, both within divisions and the Group.

## Internal audit

An integral part of risk management is assurance that the controls identified to manage risks are operating and effective.

The Head of Internal Audit is responsible for delivery of the assurance strategy, ensuring our assurance programme remains aligned to test the key controls managing the Group's risks. Internal audit is delivered at three levels across the business:

- Group internal audit
- functional internal audit, and
- divisional internal audit.

The Head of Internal Audit leads the Group internal audit programme, which is independently delivered by KPMG LLP. Its findings are reported directly to the Group Audit Committee. In addition to the audits conducted by KPMG, the Head of Internal Audit supplements the programme by conducting periodic special reviews as requested by the Serco Group plc Board or Executive Committee.

The functional internal audit programme supplements the Group internal audit programme. It addresses finance processes and controls, through a centrally provided audit programme delivered by divisional management on a peer to peer basis, as well as audit programmes completed by Group functional specialists covering health, safety and environment, and IT systems and security policy compliance.

In addition to these programmes, each operating division maintains a divisional risk register, from which we develop a divisional internal audit programme. This programme selects a number of contracts for review based on certain key risks. These reviews are completed through a self-assessment programme focused on testing the controls which manage and mitigate these key risks. Divisional audit committees, which track and report on the progress of the divisional internal audit programme, meet three times a year.

The Head of Internal Audit oversees the internal audit process, as well as acting as the conduit for sharing best practice and flagging emerging risks to ensure each part of the business benefits from the wider scale of the Group's assurance activity.

In addition to internal audit, many parts of our business are subject to other reviews of their controls by third parties, including industry regulators, ISO Standards, customers and other external audits. This third-party scrutiny significantly increases the scope of auditing conducted across the Group each year.

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



## Market risks

### Risk *Significant change in Government policies, expenditure levels and budgetary constraints*

Description/Comment	Impact	Mitigation
<p>As a major proportion of Serco's customers are governments and governmental agencies, a substantial part of the business is dependent on government policies, budget priorities and regulatory or political constraints, in particular those regarding maintaining and improving public infrastructure, which could have a significant impact on the size, scope, timing and duration of contracts and orders under them and therefore on the level of business that we may win. As such, these businesses are susceptible to changes in government, government policy, budget allocations and the political environment, primarily in the UK and the US. Any reduction in such government expenditure and funding could result in a suspension, cancellation, termination or non-renewal of contracts. Revenues may also be adversely affected by changes to the UK Government's or US Government's policy in respect of outsourcing.</p>	<ul style="list-style-type: none"> <li>● Reduction in market opportunities</li> <li>● Changes to terms of existing or new contracts</li> <li>● Failure to meet growth or profit expectations</li> </ul>	<ul style="list-style-type: none"> <li>● Business strategy</li> <li>● Diverse business across geographies and markets</li> <li>● External Affairs monitor political landscape and government activities</li> <li>● Business significantly focused on developed markets with strong and established legal systems providing protection to changes in contract terms</li> </ul>

### Risk *Failure to win a strategic or significant bid or rebid*

Description/Comment	Impact	Mitigation
<p>Failure to win material bids or renew material contracts could restrict growth opportunities for the future or have an adverse impact on Serco's business, financial condition and results of operations. Further, a significant number of Serco's contracts with the UK Government, the US Government and other public sector customers, including renewals and extensions of previous contracts, are awarded through formal competitive bidding processes. Competitive bidding processes present a number of risks, including substantial cost and management time and effort to prepare bids and proposals for contracts that may not be won. In addition, there is often a long period between a successful competition tender offer and entering into definitive contractual documentation and financial close, and in some cases financial close may not occur.</p>	<ul style="list-style-type: none"> <li>● Failure to meet growth or profit expectations</li> <li>● Significant financial loss or cost overrun</li> <li>● Damage to reputation resulting in loss of existing or new business</li> <li>● Impact on strategic objectives</li> </ul>	<ul style="list-style-type: none"> <li>● Business Lifecycle Governance process embedded in SMS</li> <li>● Governance structure managed through Investment Committee, programme and project boards, divisional and contract boards</li> <li>● Business strategy and targets managed through internal boards</li> <li>● Regular review and monitoring of risk registers</li> <li>● Gate review and formal sign-off process</li> </ul>

# Principal risks and uncertainties

## Operational risks

### Risk *Any harm to the Company's reputation could adversely impact business*

Description/Comment	Impact	Mitigation
<p>The Company is dependent on maintaining its reputation in each jurisdiction in which it operates in order to maintain and grow its business. It is exposed to the risk that litigation, misconduct, operational failures and negative publicity could harm its reputation. In addition, the Company's reputation could also be adversely affected if its services, or the services performed by its subcontractors, do not perform as expected. Any harm to its reputation could have a material adverse effect on its business, financial condition and results of operations.</p>	<ul style="list-style-type: none"> <li>● Failure to meet growth or profit expectations</li> <li>● Significant financial loss or cost overrun</li> <li>● Loss of contract revenue related to operations and service charges</li> <li>● Inability to attract the human and financial capital necessary to grow or expand into new markets</li> <li>● Damage to reputation resulting in loss of existing or new business</li> <li>● Impact on strategic objectives</li> </ul>	<ul style="list-style-type: none"> <li>● Robust bidding and contract review process including financial, technical and commercial reviews</li> <li>● Governance structure managed through Investment Committee, programme and project boards and divisional boards</li> <li>● Business strategy and targets</li> <li>● Regular review and monitoring of risk registers and operational performance indicators</li> <li>● Customer engagement and employee engagement strategies</li> <li>● Relationship management and communication with external stakeholders</li> <li>● Gate review and formal sign-off process</li> <li>● Quality management systems</li> </ul>

### Risk *Failure of significant programmes, including operating within agreed fixed costs*

Description/Comment	Impact	Mitigation
<p>Serco has a number of complex programmes which it is contracted to deliver for the customer. These are often let on a fixed price basis irrespective of the actual costs incurred, and therefore if costs exceed the contract ceiling the Company may not be able to obtain full reimbursement. Further, some projects require delivery in accordance with specified milestones on agreed dates. Significant adverse financial consequences can be imposed where milestones are not met or a project is not delivered on time. The length and complexity of such projects mean that management estimates can be particularly difficult to make and could turn out to be inaccurate.</p>	<ul style="list-style-type: none"> <li>● Failure to meet growth or profit expectations</li> <li>● Significant financial loss or cost overrun</li> <li>● Loss of contract revenue related to operations and service charges</li> <li>● Damage to reputation resulting in loss of existing or new business</li> <li>● Impact on strategic objectives</li> </ul>	<ul style="list-style-type: none"> <li>● Robust bidding and contract review process including financial, technical and commercial reviews</li> <li>● Governance structure managed through Investment Committee, programme and project boards, divisional and contract boards</li> <li>● Robust cost accounting</li> <li>● Internal audit</li> <li>● Business strategy and targets</li> <li>● Regular review and monitoring of risk registers</li> <li>● Gate review and formal sign-off process</li> <li>● Quality management systems</li> </ul>

### Risk *Lack of preparedness for the 2012 London Olympics*

Description/Comment	Impact	Mitigation
<p>In summer 2012, London will be hosting the 2012 Olympics which will be Britain's 'largest peacetime logistical exercise'. In a relatively short time frame, it is anticipated that over 11 million game spectators and almost 300,000 athletes, officials, media and other 'Games Family' members and workforce will descend upon the city. The majority of spectators will take public transport, walk or cycle to the Games and activities. Although Serco are not providing specific support directly to the Olympics, at least 23 of our current contracts have potential moderate to very high impact. The top three contracts with very high potential impact are: DLR, London Cycle Hire and Traffic Streets.</p>	<ul style="list-style-type: none"> <li>● Damage to reputation resulting in loss of existing or new contracts</li> <li>● Failure to meet customer performance and service level requirements</li> <li>● Escalation of cost leading to profit erosion</li> <li>● Disruption to contract delivery in the event of a terrorist attack at the Games</li> </ul>	<ul style="list-style-type: none"> <li>● Steering Committee established several months ago to monitor/track/guide risks</li> <li>● Programme Office established to identify and work all risks across all contracts</li> <li>● Risks have been identified across each contract and are being vetted</li> <li>● Support is being provided for planning and implementation where gaps are identified</li> <li>● Planning and scenario testing schedules in place in directly impacted contracts</li> <li>● Development of mitigation strategies and contingency plans</li> </ul>

## Risk *Failure to deliver operational efficiency*

Description/Comment	Impact	Mitigation
<p>To deliver our commitments we must ensure that we have efficient operations. Our operational efficiency programme facilitates delivery of business transformation, operational change and sustainable margin improvement. Failure to deliver may impact our ability to deliver business commitments.</p>	<ul style="list-style-type: none"> <li>● Erosion of profit</li> <li>● Impact on competitiveness</li> <li>● Damage to reputation resulting in loss of existing or new business</li> <li>● Failure to meet customer expectations and business strategy</li> </ul>	<ul style="list-style-type: none"> <li>● Business strategy and supporting plans</li> <li>● Internal governance structure</li> <li>● Business review</li> <li>● Internal audit</li> <li>● LEAN/Continuous Improvement programme</li> <li>● Quarterly management reporting</li> </ul>

## Risk *Major information security breach*

Description/Comment	Impact	Mitigation
<p>Serco must comply with restrictions on the handling of sensitive information (including personal and customer) and provide for secure transmission of such information. This is a heightened risk, particularly with respect to government contracts, due to the sensitive and confidential nature of government data. Despite controls to ensure the confidentiality of such information, Serco may breach restrictions or be subject to attack from computer programs that attempt to penetrate its network security and misappropriate confidential information.</p>	<ul style="list-style-type: none"> <li>● Loss of service to our customers</li> <li>● Damage to reputation resulting in loss of existing or new business (disqualification from future tenders, contract termination, etc.)</li> <li>● Impact on strategic objectives</li> <li>● Costly to rectify and potential for dilution of shareholder returns</li> <li>● Criminal and civil action</li> <li>● Contract and business external accreditations withdrawn</li> <li>● Significant media attention and future scrutiny</li> </ul>	<ul style="list-style-type: none"> <li>● Security and information systems policies, systems and embedded governance structure</li> <li>● Think Privacy campaign to raise staff awareness, provide training, promote incident reporting and strengthen control processes</li> <li>● User and data management including data encryption, information classification, identity management, data cleansing and access controls (strong authentication, passwords etc.)</li> <li>● Regular risk reviews</li> <li>● ISO 27000 certification</li> <li>● Internal and external audit</li> </ul>

## Risk *Major IT failure or prolonged loss of critical IT systems*

Description/Comment	Impact	Mitigation
<p>The IT Strategy is focused on standardising common processes, establishing common business systems and enabling ways of working by providing and embedding tools that support what we do. Within this the Company has defined enterprise applications. These are key information technology-based business systems within Serco. They include SAP for Finance, Procurement and Human Resources; Payroll, Risk Management, Safety Assurance, email, intranet and Nimbus Control for Process Excellence systems. Failings in the systems have the potential to seriously impact the management of the business.</p>	<ul style="list-style-type: none"> <li>● Damage to reputation resulting in loss of existing or new business</li> <li>● Impact on strategic objectives</li> <li>● Inability to meet contract requirements or perform core business processes</li> <li>● Costly to rectify and potential for dilution of shareholder returns</li> <li>● Significant media attention and future scrutiny</li> </ul>	<ul style="list-style-type: none"> <li>● Information systems policy, systems and embedded governance structure</li> <li>● Data recovery capability designed into systems and periodically tested</li> <li>● Design out single points of failure</li> <li>● Server and system performance monitoring and reporting</li> <li>● Capacity management</li> <li>● Data back-up and business continuity plans in place</li> </ul>

# Principal risks and uncertainties

## Governance risks

### Risk Significant incident of bribery or corrupt practice

Description/Comment	Impact	Mitigation
<p>Serco operates in international markets, which brings with it inherent risks including bribery and corruption, particularly in certain developing nations. Serco operates in a number of countries which are recognised as having a higher bribery and corruption risk. Increasing legislation significantly increases the consequences of bribes and other corrupt practices. As we expand into new services and geographic markets that are considered a higher risk in the context of corrupt practices we must ensure our policies and procedures are fully and effectively applied.</p>	<ul style="list-style-type: none"> <li>● Legal action and fines against the Company</li> <li>● Debarment from tender lists</li> <li>● Damage to reputation resulting in loss of existing or new business</li> <li>● Significant media attention and future scrutiny</li> </ul>	<ul style="list-style-type: none"> <li>● Policies and systems embedded in SMS</li> <li>● Code of Conduct</li> <li>● Ethics Committee</li> <li>● Speak Up process</li> <li>● Ethics and compliance programme and training</li> <li>● Risk assessment</li> <li>● Third-party contracts</li> </ul>

### Risk Major accident or incident

Description/Comment	Impact	Mitigation
<p>It is possible that a major catastrophic event, such as a major train derailment or air traffic accident, could occur at one of the projects in relation to which Serco has provided professional design, construction, engineering or support services. Such a catastrophic event could result in the personal injury or death of one or more employees of the Company, employees of other subcontractors working on the project or members of the public, significant, actionable environmental harm, and/or extensive damage to third-party property. In the event that such a catastrophic event is found or perceived to be caused by the negligence of Serco, it could subject the Company to claims for personal injury, wrongful death, property damage by customers, subcontractors, governments, employees or members of the public, which could lead to the payment of extensive damages and result in significant adverse publicity and reputational harm. Such adverse publicity and reputational harm could lead to a loss of business.</p>	<ul style="list-style-type: none"> <li>● Deaths or serious injuries to employees or third parties</li> <li>● Major environmental damage</li> <li>● Severe financial impact (fine by regulators, suspension of operating licence, compensation, clean up, etc.)</li> <li>● Loss of business (disqualification from future tenders, contract termination, etc.)</li> <li>● Contract and business external accreditations withdrawn</li> <li>● Significant media attention and future scrutiny</li> <li>● Criminal and civil action against Company or individuals</li> </ul>	<ul style="list-style-type: none"> <li>● Robust management systems subject to external, regulatory and internal audit</li> <li>● System certification and regulatory approval</li> <li>● Formal oversight through GRMC, Health, Safety and Environment Oversight Group, divisional and internal boards</li> <li>● Crisis management and business continuity plans in place</li> <li>● Insurance</li> <li>● Strategy, objectives, targets and regular reporting</li> <li>● Formal assurance structure operating within defined competencies</li> <li>● Staff induction and training</li> </ul>



**Risk**    *Significant changes in energy and carbon costs and reporting requirements*

Description/Comment	Impact	Mitigation
<p>We must understand our environmental impacts, manage them and measure our performance to demonstrate improvement. Fuel poverty is impacting energy prices. We have seen increases in energy costs and expect these to rise further in the future. We need to make sure we are managing our consumption to minimise the cost and reduce our carbon emissions. We also need to recognise and respond to increasing legislation and reporting requirements.</p>	<ul style="list-style-type: none"> <li>● Legal action and fines against the Company</li> <li>● Significant financial loss</li> <li>● Debarment from tender lists</li> <li>● Damage to reputation resulting in loss of existing or new business</li> <li>● Significant media attention and future scrutiny</li> </ul>	<ul style="list-style-type: none"> <li>● Environmental policy and systems</li> <li>● Environment Oversight Group</li> <li>● Aspects and impacts assessment</li> <li>● ISO 14001</li> <li>● Carbon Trust Standard</li> <li>● Reporting methodology and systems</li> <li>● Environmental strategy objectives and targets</li> </ul>

**Risk**    *Compliance with complex laws and regulations*

Description/Comment	Impact	Mitigation
<p>Serco must comply with laws and regulations relating to the formation, administration and performance of government contracts that affect how it does business and may impose added costs. Further, it is required to obtain environmental and safety permits from various government authorities which require periodic renewal or review of their conditions. Failure to comply with any of these regulations could result in civil and criminal penalties and administrative sanctions, including termination of contracts, forfeiture of profits, harm to its reputation, suspension of payments, fines and suspension or debarment from doing business with governments.</p>	<ul style="list-style-type: none"> <li>● Substantial monetary damages and/or criminal violations</li> <li>● Damage to reputation resulting in loss of existing or new business</li> <li>● Debarment from tender lists</li> <li>● Significant media attention and future scrutiny</li> </ul>	<ul style="list-style-type: none"> <li>● Policies and systems embedded in SMS</li> <li>● Code of Conduct</li> <li>● Risk assessment</li> <li>● Third-party contracts</li> <li>● System certification and regulatory approval</li> <li>● Internal board and governance structure</li> <li>● Staff induction and training</li> <li>● Internal compliance programmes</li> </ul>

# Principal risks and uncertainties

## People risks

### Risk *Failure to attract and retain senior management and other key employees*

Description/Comment	Impact	Mitigation
<p>The success of the Company depends on the efforts, abilities, experience and expertise of the senior management teams and on recruiting, retaining, motivating, effectively communicating with and developing highly skilled and competent people at all levels of the organisation. There can be intense competition for personnel from other companies and organisations and there may at any time be shortages in the availability of appropriately skilled people at all levels within Serco. Further, the Company cannot guarantee the retention of such key executives and technical personnel. The failure of the Company to retain and/or recruit additional or substitute senior managers and/or other key employees could have a material adverse effect on its business.</p>	<ul style="list-style-type: none"> <li>● Increased cost in recruitment activity and time taken to fill roles</li> <li>● Instability and loss of business continuity</li> <li>● Dilution of brand and values</li> <li>● Reduced employee engagement through loss of compelling leadership</li> <li>● Strengthen competitors (loss of leaders to them)</li> <li>● Impact on business – risk of not achieving level of planned growth</li> </ul>	<ul style="list-style-type: none"> <li>● People policies and systems, strategy and targets supported by governance structure, including Remuneration Committee</li> <li>● Succession planning</li> <li>● Leadership model</li> <li>● Annual external (independent) remuneration review</li> <li>● Job structure and grading system</li> <li>● Talent database and leadership development programme</li> <li>● Employment engagement strategy, including annual staff survey</li> </ul>

### Risk *Failure to manage union/industrial relations*

Description/Comment	Impact	Mitigation
<p>A significant number of Serco's employees are members of trade unions in the UK and a number are members of trade unions in the US and other countries. These include operations where a failure to manage relationships may result in industrial action by Serco staff in high-profile business operations, i.e. where there will be significant reputational damage, client or media attention. Some sectors of the business are subject to union recognition agreements. The Company maintains a number of relationships with trade unions and staff through work councils and other bodies.</p>	<ul style="list-style-type: none"> <li>● Failure to deliver contractual requirements</li> <li>● Instability and loss of business continuity</li> <li>● Dilution of brand and values</li> <li>● Reduced employee engagement</li> <li>● Damage to reputation resulting in loss of existing or new business</li> <li>● Significant media attention and future scrutiny</li> </ul>	<ul style="list-style-type: none"> <li>● Policies and systems embedded in SMS</li> <li>● Industrial relations strategy</li> <li>● Industrial Relations Working Group</li> <li>● Stakeholder management of key relationships</li> <li>● Annual external (independent) remuneration review</li> <li>● Job structure and grading system</li> <li>● Employment engagement strategy</li> </ul>

## Finance risks

### Risk *The impairment of goodwill could adversely impact reported results*

Description/Comment	Impact	Mitigation
Goodwill accounts for just over one-third of Serco Group's recorded total assets as at 31 December 2011. Serco evaluates goodwill for impairment annually, or more frequently when evidence of potential impairment exists. Any decrease in expected cash flows or a deterioration in market conditions could require Serco to record impairment charges that could have a material impact on the financial position and results of operations.	<ul style="list-style-type: none"> <li>● Inability to meet profit expectations</li> <li>● Damage to reputation and shareholder confidence</li> <li>● Impact on strategic objectives</li> </ul>	<ul style="list-style-type: none"> <li>● Internal board and governance structure</li> <li>● Strategic plans</li> <li>● Business plans</li> <li>● Business Lifecycle Governance process</li> <li>● Financial review and reporting</li> </ul>

### Risk *Additional funding requirements for pension schemes*

Description/Comment	Impact	Mitigation
Serco operates defined benefit pension schemes for qualifying employees of its subsidiaries in the UK and other European countries. In addition, we have interests in joint ventures, which operate defined benefit schemes for qualifying employees. The nature of a defined benefit scheme means that the funding levels of the schemes are subject to factors outside Serco's control, including the introduction of new legislation, which could create or impact a deficit in the scheme at future actuarial valuations. If the deficit in the scheme increases at future actuarial valuations, the Group may be required to make additional cash contributions to the schemes in the future, preventing the use of cash for other purposes, which could have a material impact on the Group's business, financial condition and results of operations over the long term.	<ul style="list-style-type: none"> <li>● Inability to meet profit expectations</li> <li>● Reduction in cash availability</li> </ul>	<ul style="list-style-type: none"> <li>● Obtain actuarial assessment of scheme liabilities</li> <li>● Appropriate investment management and independent measurement of asset returns</li> <li>● Ensure robust monitoring via HR policy, systems and governance structure including review by the Audit and Remuneration Committees and Board of Pension Trustees</li> </ul>

### Risk *Fluctuations in foreign currency exchange rates that are not effectively hedged*

Description/Comment	Impact	Mitigation
The international nature of Serco's business means it is exposed to fluctuations in foreign currency exchange rates in relation to various currencies, primarily the US Dollar, the Australian Dollar and the Euro, arising from the translation of earnings. In addition, some of Serco's bank debt is denominated in currencies other than pound Sterling.	<ul style="list-style-type: none"> <li>● Material effect on the Group's future results of operations and financial position</li> </ul>	<ul style="list-style-type: none"> <li>● The Group hedges short-term transaction risks that are material in value</li> <li>● Management of translational risk by the part currency matching of borrowings with the net assets of overseas subsidiaries</li> </ul>

### Risk *Fluctuations in interest rates*

Description/Comment	Impact	Mitigation
Historically, Serco has financed its operations partly through draw down of funding facilities. Adverse movements in interest rates could therefore impact profitability and net assets.	<ul style="list-style-type: none"> <li>● Inability to meet profit expectations and associated impact on net assets</li> <li>● Impact on competitiveness</li> </ul>	<ul style="list-style-type: none"> <li>● Fixed rate debt instruments and interest rate derivatives that swap floating for fixed rates</li> </ul>

# 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 of its activities around the world. A fundamental part of the Group's corporate governance processes is the Business Conduct and Ethics Standard that the Company and Group have adopted.

Throughout 2011 Serco Group plc complied fully with the provisions of the UK Corporate Governance Code issued by the Financial Reporting Council (the Code). The paragraphs below, together with the 'Our performance' section on pages 20 to 81 and the Remuneration Report on pages 96 to 107, 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 seven members: the Chairman, two Executive Directors and four Non-Executive Directors. Following the retirements of Margaret Ford and Tom Corcoran at the end of 2010, three Non-Executive Directors, Paul Brooks, Angie Risley and Ralph D. Crosby Jr, were appointed in the year.

With the sad and untimely passing of Paul Brooks in January 2012, an externally led recruitment process is underway for his successor.

As announced on 20 March 2012, Leonard V. Broese van Groenou will be retiring from the Board at the end of the Company's Annual General Meeting, being held on 14 May 2012 and hence will not stand for re-election. Angie Risley will succeed Leonard as Chairman of the Remuneration Committee.

No individual or group of individuals dominates the Board's decision-making. 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 94 and 95.

### **Diversity**

With reference to the report by Lord Davies of Abersoch entitled 'Women on Boards', Serco strongly supports the principle of boardroom diversity, of which gender is one, but not the only, key aspect. Diversity of thought, experience and approach are all important and we will always seek to appoint on merit against objective criteria, including diversity.

The Board aims to achieve an appropriate diversity across all elements of Serco's management. As, over time, we recruit new members we would, therefore, expect to address the issue of diversity in general, and to increase the proportion (currently 14%) that women constitute of our plc Board.

### **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 Governance function 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 'Our Performance' section on pages 20 to 81 details the internal control and risk policies, procedures and management framework adopted by the Group. The Corporate Responsibility Report is available online at [www.serco.com](http://www.serco.com) and illustrates how Serco's approach to corporate assurance and responsibility translates from the Board into everyday working practices.

### **Conflicts of interest**

The Company's Articles of Association, as approved by shareholders at the Company's 2010 Annual General Meeting, include provisions reflecting recommended practice concerning conflicts of interest. The Board has in place procedures for Directors to report any potential or actual conflicts to the other members of the Board for their authorisation where appropriate. In deciding whether to authorise a conflict or potential conflict of interest only non-interested Directors (i.e. those that have no interest in the matter under consideration) will be able to take the relevant decision; in taking the decision the Directors must act in a way they consider, in good faith, will be most likely to promote the Company's success. In addition, the Directors may impose conditions or limitations when giving authorisation if they think this is appropriate.

The process of reviewing conflicts disclosed, and authorisations given, is repeated at least annually. Any conflicts or potential conflicts considered by the Board and any authorisations given are recorded in the Board minutes and in a register of Directors' conflicts which is maintained by the Company Secretary.



### **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 half-year 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
- Training and development of the Board and the Company Secretary.

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 86 to 88. Each Committee has an appropriate balance of skills, experience, independence and knowledge of the Company.

### **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 scheduled six times a year, four over two days at a time, and two meetings held for one day each. Board meetings are structured to allow open discussion of the strategy, trading and financial performance and risk management of the Group. One of the two-day meetings is dedicated to the review of the longer-term strategy of the Group. Board and Committee meetings are held at varying locations, including overseas units, 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 as required.

The attendance of individual Directors at Board meetings held during the year is shown in the table on page 85.

### **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, good information flows 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**

The roles of the Chairman and the Chief Executive are separately held and the division of their responsibilities is clearly established, set out in writing, and agreed by the Board.

As Chairman, Alastair Lyons is responsible for:

- Ensuring the effectiveness and successful operation 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 training and development takes place
- Board succession planning.

# Corporate Governance Report

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 Executive Committee 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, shareholders and industry organisations.

## *Senior Independent Director*

David Richardson was appointed to the role of Senior Independent Director in January 2011. As part of this role, David 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. Additionally, in accordance with the provisions of the Code, David is available to provide a sounding board for the Chairman and to act as an intermediary for Non-Executive Directors when necessary.

## *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 102.

## *Significant other commitments of the Chairman*

Alastair Lyons is non-executive Chairman of Admiral Group plc, Deputy Chairman and Senior Independent Director of Bovis Homes Group PLC, Senior Independent Director of Phoenix Group Holdings and Chairman of the Towergate Insurance Group.

The Board believes that Alastair holds a well-balanced portfolio of positions which allow him to perform his duties as Chairman appropriately.

## *Re-election of Directors*

The Company's Articles of Association stipulate that each Director shall retire (but be eligible for re-election) at the annual general meeting held in the third calendar year following the year in which he or she was elected or last re-elected by the Company. 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, excluding the Chairman, who have served for more than nine years will be subject to annual re-election.

Notwithstanding the above, in accordance with provisions contained within the Code all Directors retired and stood for re-election at the 2011 Annual General Meeting and will do so on an annual basis at each annual general meeting. Their names 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 Remuneration Report on page 102 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 (with input from Executive Directors as described below). This meeting is chaired by the Senior Independent Director.

### Board meetings and attendance

Board meetings were held on a bi-monthly basis with ad hoc meetings in between as required. During the year, three such ad hoc meetings were held to discuss matters relating to the Intelenet acquisition. The frequency and content of Board meetings are reviewed by the Board annually.

The attendance of the individual Directors at Board and Committee meetings of which they were members during 2011 was as follows:

	Board (9 meetings)	Audit (3 meetings)	Remuneration (6 meetings)	Nomination (3 meetings)
Alastair Lyons	9	n/a	4 (4)	3
Christopher Hyman	9	n/a	n/a	1 (1)
Andrew Jenner	9	n/a	n/a	n/a
Leonard V. Broese van Groenou	9	3	6	n/a
David Richardson	9	3	6	3
Paul Brooks	6 (7)	3	n/a	1 (1)
Angie Risley	5 (6)	n/a	4 (4)	0 (0)
Ralph D. Crosby Jr	4 (4)	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. Where a number is given in brackets against a Director's attendance, this is the number of meetings which took place during their tenure.

### Board effectiveness

#### Induction

On joining the Board, Directors are given background information describing the Company and its activities. They receive an induction pack which includes 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. Meetings are also arranged with a number of key people from across the Group on a structured basis to assist with a Director's induction. Visits are also made, where possible, to a number of contracts around the country. Paul Brooks, Angie Risley and Ralph D. Crosby Jr undertook a number of meetings and site visits on joining the Group, both in the UK and overseas, and Alastair Lyons has continued to further his knowledge of the Group with a comprehensive ongoing programme of contract visits, numbering in excess of 40 since joining the Board.

#### Continued professional development

During 2011 the Board members were all engaged in a range of training and professional development activities. Board members attended a workshop on the UK Bribery Act during the year. This included not only consideration of the legal implications but also the Company's wider approach to compliance and refresher training on the Company's procedures around anti-bribery and corruption as specified within the Serco Management System.

The Board considers the training needs of the Executive and Non-Executive Directors plus the Company Secretary. All Board members are encouraged to attend relevant training courses at the Company's expense. The development needs of the Directors and the Company Secretary fall within the remit of the Chairman who reviews and agrees these individually.

#### Performance evaluation

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.

In 2011, the Board commissioned an external review completed by an independent consultant, who, it is confirmed, is not connected with the Company in any way. The objectives of the review were:

- To provide an independent evaluation of the Board's structure and composition, processes and decision-making, performance and outcomes and alignment of the Board's priorities to Company strategy, in line with UK corporate governance standards;
- To review the effectiveness of the Audit Committee, Nominations Committee and the Remuneration Committee;
- To provide insight into areas of strength and areas that would further increase the effectiveness of the Board and its Committees.

# Corporate Governance Report

Each Board Member completed a detailed, structured questionnaire about the Board's effectiveness and was then interviewed to clarify views where necessary and discuss common themes emerging from the research. The consultant interviewed the Company Secretary, a number of members of the Executive Committee and selected Company advisers to understand their perspectives on the Board's effectiveness.

A presentation to the Board was given of the results of the evaluation on its conclusion.

The review concluded that the Board operates effectively under strong leadership from the Chairman. Members participate fully in open and constructive debate and appropriate focus is given to key areas of risk and strategy.

Recommendations have been made with respect to increasing Board contact with the key talent and rising stars from across the Group and reviewing the format of management information provided at and between Board meetings. Further, the Board recognised the value of previous detailed sessions held on City and Investor Relations and the evaluation has recommended including another such meeting in the next two years. These, along with more administrative recommendations, have been given due consideration by the Board and actions for each have been agreed accordingly.

In addition, 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) was carried out during the year. It is considered that the Chairman provides strong leadership of the Board, his time commitment to learning about the Group not only gives him a more informed view of the Group but enables him to provide a strong sounding board for the Executive Directors and there is a good level of trust between him and the Chief Executive. The value to Serco employees of the Chairman's commitment to contract and site visits was also acknowledged.

## **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; these are available online at [www.serco.com](http://www.serco.com).

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 consists solely of independent Non-Executive Directors. It is chaired by David Richardson and comprises Leonard V. Broese van Groenou and, from February 2011 until his passing in January 2012, Paul Brooks.

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 Head of Internal Audit, KPMG LLP (the Group's internal auditor), and Deloitte LLP (the external auditor) attend meetings. The Committee meets with each of the internal auditor, external auditor and the Head of Internal Audit 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 monitor and 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 auditor's reports on the effectiveness of systems for internal financial control, financial reporting and risk management
- To consider the appointment, reappointment and removal of the external auditor and assess independence and objectivity of the external auditor, ensuring that key partners are rotated at appropriate intervals and relevant UK professional and regulatory requirements are taken into account
- To recommend the audit fee to the Board and pre-approve any fees in respect of non-audit services provided by the external auditor and to ensure that the provision of non-audit services does not impair the external auditor's independence or objectivity
- To discuss with the external auditor, before the audit commences, the nature and scope of the audit and to review the auditor's quality control procedures and steps taken by the auditor to respond to changes in regulatory and other requirements
- To oversee the process for selecting the external auditor and make appropriate recommendations through the Board to the shareholders to consider at the annual general meeting
- Review the Company's procedures for detecting fraud and its systems and controls for the prevention of bribery and receive reports on non-compliance.



Additionally, in accordance with the Code, the Committee is responsible for a formal whistle-blowing 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 practice 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 auditor.

During 2011 the Audit Committee discharged fully its responsibilities listed above and, in doing so, considered the following:

- Corporate Governance Report and the Statement of Directors' Responsibilities for inclusion in the 2010 Annual report and accounts
- 2011 Half Year Report and Auditor's report thereon
- 2011 external audit fees
- Review of the whistle-blowing process and significant reports from that process
- Evaluation of the Audit Committee and the achievement of its Terms of Reference
- 2011 internal audit programme and the proposed 2012 programme
- The continuing independence of the external auditors.

Due to the nature and complexity of the business and its contracts, in considering the integrity of the financial statements of the Company the Committee paid particular attention, amongst other matters, to contract accounting, goodwill impairment, pensions accounting and taxation.

**Non-audit services:** The Committee has reconfirmed its policy on the provision of audit and non-audit services by Deloitte LLP. It determined three categories of services: Approved (e.g. audit and related assurance services), Permitted (e.g. tax compliance and due diligence) and Not Permitted (e.g. design/implementation of financial information systems and quasi management services). The Committee, the Company and Deloitte LLP all monitor compliance with the policy and review at each meeting the fees earned and the estimates for the year.

The Committee acknowledges that the Group's external audit firm will have a significant understanding of the Group's business and this knowledge and experience can be utilised to the Group's advantage in many areas thus ensuring efficiency in costs to the Group. They also operate to professional codes of conduct including the management of conflicts of interest. Accordingly, the external auditor may be engaged for the following non-audit services:

- a) assistance in tax compliance activities (including the preparation of tax returns);
- b) tax advisory services;
- c) accountants' reports for any Stock Exchange purposes;
- d) ad hoc reporting on historic financial information for any other purpose and ad hoc accounting advisory services;
- e) due diligence activities associated with potential acquisitions or disposals of businesses;
- f) other corporate finance advisory services required in support of potential transactions or bids including the review of financial models for internal consistency and compliance with Group financial accounting policies;
- g) any other services which are not prohibited and are authorised by the Finance Director or Group Company Secretary.

Where such services are considered to be recurring in nature approval of the Committee may be sought for the full financial year at the beginning of that year. Approval for other permitted non-audit services has to be sought on an ad hoc basis: where no Audit Committee meeting is scheduled within an appropriate time frame the approval is to be sought from the Chairman of the Committee (or his nominated alternate). The Committee may establish fee thresholds for pre-approved services and similar approvals are required for work awarded to accounting firms other than firms' auditors where fees are expected to exceed pre-approved limits. The Group Company Secretary is nominated by the Audit Committee as the point of review and approval for the engagement of non-audit services.

The Group has complied with the policy throughout the year. Where appropriate, non-audit services have been provided by companies other than Deloitte LLP to safeguard auditor objectivity and independence. The fees paid to Deloitte for audit, audit-related and non-audit services for 2011 can be found in note 6 to the Consolidated Financial Statements. The principal areas of engagement of Deloitte LLP for audit-related and non-audit services were commissioned in full compliance with the above policy and a formal tender exercise was undertaken where appropriate. The services principally related to taxation advice, IT security testing and due diligence and other corporate finance advisory services.

# Corporate Governance Report

**Auditor's independence:** The independence, objectivity and effectiveness of the external auditor have been examined by the Committee and discussions were held regarding their terms of engagement and remuneration. The Senior Statutory Auditor is Richard Knights who was appointed to the role at the beginning of 2011. There are no contractual obligations that restrict the Company's current choice of external auditor and consideration was given to the merits of appointing an alternative external audit firm. Following an assessment of the relative strengths and weaknesses of an alternative provider against the continued engagement of the incumbent provider, the Committee recommended to the Board that Deloitte LLP be proposed for reappointment at the forthcoming 2012 Annual General Meeting. This recommendation has been accepted and will be proposed to shareholders.

## ***The Nomination Committee***

**Membership:** The Nomination Committee is chaired by Alastair Lyons and comprises David Richardson, Angie Risley from 1 April 2011 and Christopher Hyman who was appointed to the Committee on 10 May 2011. Paul Brooks was also a member of the Committee from 1 February until 10 May 2011. The Committee met three times during 2011.

**Responsibilities:** Matters considered during the year included succession and contingency planning, Board structure and composition and the recruitment of Paul Brooks, Angie Risley and Ralph D. Crosby Jr.

The Committee has responsibility for the identification and nomination of candidates to fill Board vacancies as they arise, engaging external search consultants when necessary. Approval of appointment is a responsibility of the Board.

The Nomination Committee has engaged relevant external executive search consultants for the appointment of new Non-Executive Directors. In consultation with the chosen search consultants, specifications were drawn up for the roles and attributes were identified that were felt to be essential for their effective performance, including what would be considered acceptable in terms of time commitment.

## ***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 96 to 107.

## ***Executive Committees***

Throughout 2011, an Executive Committee has operated which is chaired by the Chief Executive and comprises 11 other members, including the Group Finance Director, Divisional Chief Executives and other selected Corporate function heads. The Committee has delegated responsibility from the Board to ensure the effective direction and control of the business and to deliver the Group's long-term strategy and goals. The Committee met 12 times during the year to review the Group's activities and discuss management and operational issues. Representatives from across the Serco business were invited to the meetings to discuss aspects of their business or give presentations on specific topics.

## ***Relationship with shareholders***

The Company's relationship with shareholders is given a high priority. The Annual report and accounts is available to all shareholders both in hard copy and online at [www.serco.com](http://www.serco.com).

We no longer produce a printed report of our half-year results. Instead, a letter summarising those results is issued to shareholders and a copy of the full stock exchange announcement is available on request.

Regular trading updates are published ahead of close 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](http://www.serco.com).

## ***Annual general meeting***

Individual shareholders have the opportunity at the annual general meeting (AGM) 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 the AGM are invited to vote by means of a poll. A poll reflects the number of voting rights exercisable by each member and is considered by the Board to be a more democratic method of voting. Shareholders are advised of the total number of votes lodged for each resolution, in the categories 'for' and 'against' together with the number of 'votes withheld'. This information is also posted on the Group's website [www.serco.com](http://www.serco.com).

### **Institutional investors**

The Chief Executive and Finance Director have regular dialogue with institutional investors. The Chairman also meets with significant institutional investors from time to time. 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, David Richardson is also available to meet shareholders, should it be required.

The Board receives an investor relations report at each meeting. 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 and enables them to develop an understanding of the views of major shareholders.

### **Group website**

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

### **Business conduct**

Serco Group operates within a Management System that defines the policies, standards and processes to be applied wherever we operate. Integral to this is our policy on Business Conduct and Ethics that applies to all business divisions, operating companies and business units throughout the world. This 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. It applies to Directors and to all employees regardless of their position or location. Recognising that ethical dilemmas may arise in a growing company the Group has an Ethics Consultation Process that is to be followed to determine the Group's position on particular issues. To support this process an Ethics Committee, comprising members of the Executive Team with a quorum of three and chaired by the Corporate Affairs Director, meets as required. As the leadership of the Company, the Executive Team will make any fine judgements about what it considers acceptable or otherwise.

Serco's outsourced Ethics Hotline operated throughout the year, which enables employees to report any concerns they may have, or report any wrongdoing, that they do not feel able to raise with their line manager, human resources colleagues or through other reporting channels. In addition to the Hotline, which is available toll-free worldwide in several languages, employees can also make reports via email or the internet. The Company Secretary investigates independently any issues raised and reports back to the Audit Committee and, as required, the Board. During the year new territories and languages have been efficiently integrated to encompass the extended coverage of the Group as a result of acquisitions.

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 Governance, details of the Group's internal control and risk management processes are contained in pages 72 to 81 of the 'Our Performance' section. 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 have acknowledged the guidance on 'Going Concern and Liquidity Risk: Guidance for the Directors of UK Companies 2009' and 'An Update for Directors of Listed Companies: Responding to increased country and currency risk in financial reports', published by the Financial Reporting Council in 2009 and January 2012 respectively. This is discussed in the Finance Review starting on page 54.

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



Joanne Roberts  
Secretary  
27 February 2012

# Directors' Report

## Annual report and accounts

The Directors have pleasure in presenting the Annual report and accounts of the Group for the year ended 31 December 2011. Comparative figures used in this report are for the year ended 31 December 2010. The Corporate Governance Report set out on pages 82 to 89 forms part of the statutory Directors' Report.

## 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 who seek a trusted partner with a solid track record of providing assured service excellence. Our people offer operational, management and consulting expertise in the aviation, BPO, defence, education, environmental services, facilities management, health, home affairs, information and communications technology, knowledge services, local government, science and nuclear, transport, welfare to work and the commercial sectors.

The Chairman's Statement and the remainder of the 'Our Performance' section on pages 20 to 81 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 issued share capital of the Company, together with the details of shares issued during the year, is shown in note 29 to the Consolidated Financial Statements.

The powers of the Directors to issue or buy back shares are restricted to that approved at the Company's annual general meeting.

The rules relating to the appointment and replacement of Directors are contained in the Company's Articles of Association. Changes to the Articles of Association must be approved by the shareholders in accordance with the legislation in force from time to time.

## Dividends

An interim dividend of 2.50p (2010: 2.20p) per ordinary share was paid on 14 October 2011. The Directors recommend a final dividend of 5.90p (2010: 5.15p) per ordinary share which, if approved by shareholders at the annual general meeting, will be paid on 22 May 2012 to those shareholders on the register at the close of business on 9 March 2012.

## Interests in voting rights

As at 27 February 2012 the Company had been notified under Rule 5 of the Disclosure Rules and Transparency Rules of the Financial Services Authority of the following holdings of voting rights in its shares (the percentage figure is at date of notification):

	Number of shares (millions)	% held
UBS Investment Bank	29.1	5.90
Morstan Nominees Limited	25.1	5.11
Capital Research and Management Company	25.0	5.08
AXA S.A.	24.4	4.95
Lloyds Banking Group plc	24.2	4.96
Fidelity International Limited	23.9	4.93
Baillie Gifford & Co	24.0	4.92
Newton Investment Management Limited	23.6	4.85
BlackRock Inc	21.8	4.42
HBOS plc	20.5	4.22
Legal & General Group plc	19.5	3.99
Ignis Investment Services Limited	15.5	3.15

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 94 and 95.

On 28 March 2011, the Company announced the appointment of Angie Risley as a Non-Executive Director of the Company with effect from 1 April 2011. Both Angie's and Paul Brooks' appointments were approved at the 2011 AGM. Additionally, on 30 June 2011, the Company announced the appointment of Ralph D. Crosby Jr as a Non-Executive Director of the Company with effect from that date. Ralph will stand for election at the Company's AGM on 14 May 2012.

As announced on 20 March 2012, at the conclusion of the Company's 2012 AGM Leonard V. Broese van Groenou will retire as a Non-Executive Director of the Company and, accordingly, will not be standing for re-election. Angie Risley will take over as Remuneration Committee Chairman on Leonard's retirement. All other Directors will stand for re-election at the AGM.

With the sad and untimely passing of Paul Brooks in January 2012, an externally led recruitment process is underway to address Board composition and succession planning.

## **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 in control conditions are included in the service contracts of Directors which provide compensation or reduction of notice periods in the event of a change in 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 96 to 107.

## **Annual general meeting**

The annual general meeting of the Company will be held at Linklaters LLP, One Silk Street, London EC2Y 8HQ on 14 May 2012 at 11.30am.

The Notice of Annual General Meeting together with explanatory notes is sent to shareholders with this Annual report.

## **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 142 to 148.

## **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, whilst subject to Group-wide principles.

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 arrangements are made wherever practicable 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 and a long-term incentive plan for senior management which effectively aligns their interests with those of shareholders by requiring that performance criteria are achieved prior to exercise.

## Directors' Report

### **Corporate responsibility**

The Group maintains a focus on corporate responsibility through a structured model that is applied across the business. Our corporate responsibility model focuses on our people, safety, the environment and the communities we serve. This model forms an integral part of our Management System and is supported by defined policies in all of the areas it covers. These are applied within the context of our policies on Business Conduct and Ethics. Activities are reported quarterly as part of our internal assurance reporting process.

Further information on our approach to corporate responsibility and how we have delivered our commitments is contained in the Corporate Responsibility Report which is available online at [www.serco.com](http://www.serco.com). This site also provides an overview of our approach to corporate responsibility, our management system and our policies.

### **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 2011 were 32 days (2010: 31 days).

### **Donations**

The Group continues to encourage all staff to participate in their local communities and has a process to assess both the value and type of investment on a worldwide basis. This measure is based upon the Business in The Community reporting format.

The value of this investment in 2011 at £2,532,175 (2010: £2,271,575) represents 1.06% of the Group's pre-tax profit.

During the year neither the Company nor the Group made political donations and they intend to continue with this policy. Within the US business there exists a Political Action Committee (PAC), which is funded entirely by employees and their spouses. The Serco PAC and its contributions are administered in strict accordance with regulatory requirements. Employee contributions are entirely voluntary and no pressure is placed on employees to participate. Under US law, an employee-funded PAC must bear the name of the employing company.

### **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 or she ought to have taken as a Director in order to make himself or herself aware of any relevant audit information and to establish that the Group's auditors are aware of that information.

### **Auditors**

Deloitte LLP have expressed their willingness to continue in office as auditors and a resolution to reappoint 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 2012

\*As at 5 March 2012, the Company had not been notified of any changes or additions to these interests.

# Directors' Responsibilities

The Directors are responsible for preparing the Annual Review, Directors' Report, Directors' Remuneration Report and the financial statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare financial statements for each financial year. Under that law the Directors are required by the IAS Regulation to prepare the Group financial statements under International Financial Reporting Standards (IFRS) as adopted by the European Union. The Group financial statements are also required by law to be properly prepared in accordance with the Companies Act 2006 and Article 4 of the IAS Regulation. Under company law the Directors must not approve the accounts unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period.

International Accounting Standard 1 requires that IFRS 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 definition 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 IFRSs.

This requires Directors 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 in IFRSs are insufficient to enable users to understand the impact of particular transactions, other events and conditions on the Group's financial position and financial performance; and
- make an assessment of the Company's ability to continue as a going concern.

The Directors have elected to prepare the parent Company financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (UK Accounting Standards and applicable law). The parent Company financial statements are required by law to give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period. In preparing these financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable UK accounting standards have been followed; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

The Directors are responsible for keeping proper accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the parent Company financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

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

## **Responsibility Statement**

We confirm to the best of our knowledge:

- the financial statements, prepared in accordance with the applicable set of accounting standards, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Company and the undertakings included in the consolidation taken as a whole; and
- the management report, which is incorporated into the Directors' Report, includes a fair review of the development and performance of the business and the position of the Company and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties they face.

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



Joanne Roberts  
Secretary  
27 February 2012

## Directors' profiles



**Alastair Lyons CBE (58)**

**Role:** Chairman

**Appointment:** Alastair was appointed a Non-Executive Director of Serco Group plc in March 2010, becoming Chairman at the conclusion of the Company's AGM in May 2010.

**Responsibilities:** Alastair is responsible for the effective operation of the Board and oversight of corporate governance. He is Chair of the Nomination Committee and a member of the Remuneration Committee.

**Experience:** In his executive career Alastair was Group Finance Director and subsequently Chief Executive of the National & Provincial Building Society. When the society was acquired in 1996 by Abbey National he joined the Abbey National main Board as Managing Director of its Insurance Division. In 1997 he became Chief Executive of the pensions specialist NPI where he led its demutualisation and acquisition by AMP, subsequent to which he joined NatWest in 1999 as Director of Corporate Projects.

A chartered accountant with an MA in economics from Trinity College Cambridge, Alastair has been a non-executive director of, successively, the Department for Work & Pensions and the Department for Transport.

**External appointments:** Alastair has been Chairman of Admiral Group plc, the direct motor insurer, since 2000. In 2008 he was appointed Deputy Chairman of Bovis Homes Group PLC, one of the UK's leading quoted housebuilders and in March 2010 Senior Independent Director and Audit Chair of Phoenix Group Holdings, the UK's largest closed life and pension fund consolidator. In February 2011 he was appointed Chairman of the Towergate Insurance Group.



**Christopher Rajendran Hyman CBE (48)**

**Role:** Chief Executive

**Appointment:** Chris was appointed Chief Executive of Serco Group plc in 2002.

**Responsibilities:** Chris is responsible for the formation and implementation of the Group's global strategy, as well as the day-to-day management of the business operations and our relationship with the City and key stakeholders. He provides leadership and representation of the Group with major customers, shareholders and industry organisations. Chris is a member of the Nomination Committee.

**Experience:** Chris 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.

**External appointments:** Chris is Chairman of HRH The Prince of Wales's charity In Kind Direct, is a Trustee Director of the Board for Business in the Community (BITC) and is Chairman of The Prince's Seeing is Believing BITC Programme. In the 2010 Queen's Birthday Honours List Chris was awarded a CBE for his services to business and charity.



**Andrew Mark Jenner (43)**

**Role:** Finance Director

**Appointment:** Andrew was appointed Group Finance Director in May 2002.

**Responsibilities:** Andrew is responsible for the Group's financial management, reporting and control, for operational efficiency and for our risk management and assurance framework. He shares responsibility with the Chief Executive for our relationship with shareholders and the City.

**Experience:** Andrew, a chartered accountant, joined Serco in 1996 as Group Financial Controller, having previously worked for Unilever and Deloitte & Touche LLP. He became Corporate Finance Director with additional responsibility for treasury activities in 1999 before joining the Board in 2002.

**External appointments:** Andrew is a non-executive Director of Galliford Try plc, one of the UK's leading construction and housebuilding groups and is Chairman of its Audit Committee.





**Angie Risley (53)**

**Role:** Non-Executive Director

**Appointment:** Angie joined Serco as a Non-Executive Director on 1 April 2011.

**Responsibilities:** Angie is a member of the Remuneration and Nomination Committees.

**Experience:** As Group Human Resources Director of Lloyds Banking Group plc, Angie is a member of the Lloyds Banking Group Executive Committee and has responsibility for developing group-wide people practices for over 100,000 employees and is also sponsor for the company's Diversity and Inclusion programme. Previously, she was an executive director of Whitbread PLC until May 2007, having joined the Whitbread Group in 1989. She has also been a member of the Low Pay Commission, and a non-executive director of Biffa plc and Arriva plc.

**External appointments:** Angie is Group Human Resources Director of Lloyds Banking Group plc.



**David Richardson (60)**

**Role:** Senior Independent Director

**Appointment:** David joined Serco as a Non-Executive Director in June 2003.

**Responsibilities:** David is Chair of the Audit Committee and a member of the Remuneration and Nomination Committees.

**Experience:** David, a chartered accountant, has previously held the position of Finance Director of Whitbread, where his roles in a 22-year career 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. Until June 2011 David also served as a Chairman of Forth Ports plc.

**External appointments:** David is a non-executive Director of Assura Group Limited and Chairman of BBGI (SICAV) SA and a Director of the Supervisory Board of World Hotels AG.



**Leonard V. Broese van Groenou (65)**

**Role:** Non-Executive Director

**Appointment:** Leonard joined Serco as a Non-Executive Director in April 2006.

**Responsibilities:** Leonard is Chair of the Remuneration Committee and a member of the Audit Committee.

**Experience:** 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.

**External appointments:** Leonard is the Chairman of the Netherlands Benevolent Society.



**Ralph D. Crosby Jr (64)**

**Role:** Non-Executive Director

**Appointment:** Ralph joined Serco as a Non-Executive Director on 30 June 2011.

**Experience:** Ralph was Chairman of EADS North America until his retirement from that position at the end of December 2011. He joined EADS in 2002 as Chairman and Chief Executive Officer of EADS North America and also served as a member of the EADS global Executive Committee until 2010. Previously, Ralph held numerous positions with Northrop Grumman Corporation, concluding over 20 years of service as President of their Integrated Systems Sector. Prior to his industry career, Ralph served as an Officer in the US Army. Ralph has an MA in Public Administration from Harvard, an MA in International Relations from the Graduate Institute of International Studies, Switzerland, and a BSc from the United States Military Academy at West Point, NY.

**External appointments:** Ralph is a non-executive Director of American Electric Power Co Inc. and Ducommun Inc. in the United States.

# Remuneration Report

## Dear Shareholder

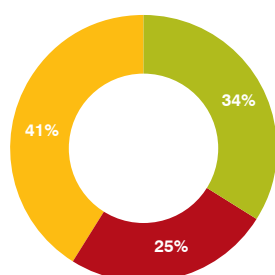
I am pleased to present the Directors' Remuneration Report for 2011.

As reported in the Operating Review (pages 40 to 53), Serco has delivered a strong financial and operational performance in 2011 with good organic growth plus increased operating margin and strong cash generation. Looking forward it is expected that the UK and US markets will continue to be challenging, with new sectors and geographies being important areas of strategic development.

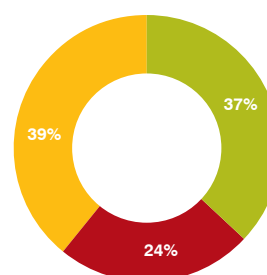
The Committee has devoted a great deal of time during the year to the triennial review of executive remuneration. As a result of the deliberations, the Committee has concluded that, for now, the overall structure and shape of remuneration should remain unchanged.

The current emphasis on performance-related pay will remain the same. For 'target' performance – variable pay accounts for well over half of total direct pay.

**Remuneration for Chief Executive**



**Remuneration for Finance Director**



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

Some changes have been made in the light of the development of Serco Group's business strategy. The Committee has consulted with major shareholders and the voting guidance services on two important adaptations to the pay arrangements of Executive Directors.

First, we have increased the emphasis on Earnings Per Share (EPS) growth but, at the same time, retained relative Total Shareholder Return (TSR) as a key measure. Growth in EPS is a key performance indicator both for Serco and for our major shareholders. Over the coming years we shall face a challenging operating environment in the UK and US coupled with an intention to grow the Group in what we perceive to be the more attractive geographies and sectors. This suggests to us that, to maximise the alignment of interest between Executive Directors and shareholders, we need also to enhance the emphasis on EPS growth. The Committee also believes that this increases the 'line of sight' for the executive linking longer-term pay and performance.

The definition of EPS will remain the same and exclude material acquisitions, disposals, currency movements and be before amortisation of acquired intangibles and acquisition-related costs. The Committee will continue to retain the discretion to vary the shares that vest to ensure that outcomes are fair in the light of Serco's underlying financial performance. This will allow the Remuneration Committee to take into account the quality of earnings and the general financial health of the Company.

Prior to 2012 the vesting of shares awarded to the Executive Directors under the Performance Share Plan (PSP) was determined by relative TSR performance for 70% of the shares and by reference to EPS growth for the remaining 30%. Under the Deferred Bonus Plan (DBP) the vesting levels for the award of matching shares was determined in equal measure by relative TSR performance and by EPS growth. From 2012, the vesting of shares awarded under the PSP will be weighted 50% based on EPS growth and 50% relative TSR. Any matching shares awarded under the DBP will vest on EPS growth targets. The performance ranges for 2012 awards will be discussed with shareholders before the awards are made.

These changes have also been made to the wider leadership team. Reinforcing the importance of increasing line of sight in the performance measures, the Company will also be introducing a minimum share ownership level for the members of the Executive Committee, who also participate in the DBP. At the end of the year the Chief Executive held 820,197 shares and the Finance Director 310,991 shares representing, by reference to the share price at that time (474p), share ownership levels as a percentage of salary of 534% and 345% respectively.

We have thought carefully about these changes and hope that our shareholders will support them.

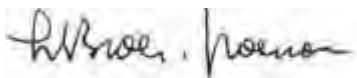
During the year the Committee conducted its regular annual review of base salaries of the Executive Directors, taking into account the current economic climate, the challenges facing the business, their performance and the competitiveness of their remuneration against the UK market. The Committee also had regard to the overall pay decisions for employees across the Group as a whole. Against this backdrop, salaries were adjusted in line with our remuneration principles to provide market competitive reward opportunities for performance where appropriate. In 2011 increases were awarded of 4% and 3.4% for the Chief Executive and Finance Director respectively.

On the basis of Serco's performance in 2011, annual bonus awards of 121% and 105% of salary have been determined for the Chief Executive and the Finance Director. The Executive Directors delivered a financial performance that met the target for revenue growth and exceeded the targets for PBT and Cash performance. Serco's financial performance for the year is described in more detail in the 'Our performance' section starting on page 20. The personal objectives set for each of the Directors covered areas such as Corporate reputation management, the securing of key strategic contracts to deliver long-term performance as well as specific activities around the ongoing development of the Group Strategy. In addition, the entry into the Global BPO market was an important objective for 2011.

Under the 2009 PSP, vesting of 30% of the shares are subject to our EPS performance, and under the DBP, 50% of the matching shares are subject to this measure. Our performance against the three-year EPS performance measure was compound growth of 20.9% per annum which resulted in 100% vesting for the 2009 PSP and the DBP.

It is disappointing that our TSR performance for the period ended 31 December 2011 relative to the comparator group was below median, therefore no shares vested under this element of either the PSP (70%) or the DBP (50%).

After six years I shall be sorry to leave the board at the 2012 Annual General Meeting. I am, however, delighted that Angie Risley, who is already a Director and a member of the Committee, will be replacing me as the Chairman of the Remuneration Committee.



Leonard V. Broese van Groenou  
Remuneration Committee Chairman  
27 February 2012

# Remuneration Report

## **Introduction**

The following report details the remuneration policy and the decisions on remuneration of the Directors of the Group for the year ended 31 December 2011. In preparing this report, consideration has been given to the disclosure requirements of the UK Corporate Governance Code, the Companies Act 2006 and the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008.

## **The Remuneration Committee**

In 2011, the Remuneration Committee (the Committee) comprised three independent Non-Executive Directors. These were Leonard V. Broese van Groenou (Chairman of the Committee), David Richardson, and Angie Risley from 1 April 2011. Alastair Lyons also became a member of the Committee on 10 May 2011. He is Chairman of the Board and was deemed independent on appointment to the Board.

The Executive Directors may attend meetings of the Committee at its discretion and as appropriate. They are not in attendance when their own remuneration arrangements are discussed.

The Committee met six 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 remain appropriate. Details of the Directors' attendance at the Committee meetings can be found in the Corporate Governance Report on page 85.

The Committee determines the overall remuneration policy for senior management and the individual remuneration of 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). The Committee also determines the remuneration of the Chairman.

During the year, in addition to the triennial review, the Committee meetings covered a number of topics including the annual base salary review, the determination of bonus payments, a review of service contracts and 2011 performance targets.

## **Advisors to the Remuneration Committee**

The Committee has been advised by Towers Watson, who were originally appointed by the Committee in May 2008. They have provided advice throughout the triennial review process on the overall remuneration policy and philosophy. Consulting services have also been provided to the Group by Towers Watson in relation to retirement benefits and pay data. In this regard, the Committee is satisfied that any potential conflicts are appropriately managed. Towers Watson is a member of the Remuneration Consultants' Group which oversees the voluntary code of conduct in relation to executive consulting in the UK. Fees paid to Towers Watson during the period totalled £434,000, the majority of which related to services provided for executive remuneration.

The Group Human Resources Director, Geoff Lloyd, also provides advice and guidance to the Committee.

## **Remuneration policy**

During 2011 the Committee carried out its triennial review of the executive remuneration and of the principles which form the basis of the Company's remuneration policy. The Committee concluded that it was not appropriate to change Serco's remuneration policy, which it considered supported the achievement of the Company's long-term strategic objectives. Serco's approach to executive remuneration should:

- Support Serco's long-term future growth, strategy and values;
- Align the financial interests of executives and shareholders;
- Provide market competitive reward opportunities for performance in line with expectations and deliver significant financial rewards for sustained outperformance;
- Enable Serco to recruit and retain the best in all our chosen markets;
- Be based on a clear rationale which participants, shareholders and other stakeholders are able to understand and support.

In setting the remuneration of the Executive Directors, in particular the non-financial objectives relating to the annual bonus scheme, the Remuneration Committee is able to consider corporate performance on safety, environmental, social and corporate governance matters. The Committee retains discretion to reduce bonuses or the vesting of awards under the share plans if performance in these areas is unsatisfactory.

## **The elements of remuneration**

### **Composition**

The remuneration package for Executive Directors consists of base salary, annual bonus, long-term share-based incentives, pension and other benefits. The Group's policy is to ensure that a significant proportion of the package is related to performance.

### **Base salary**

The Committee's policy is to set the base salaries of the Executive Directors so as to ensure that total target remuneration is competitive. Base salaries are normally reviewed annually. The Committee takes note of relative pay and employment conditions, both within the Company and the comparator group, when determining salaries.

The Committee is satisfied that the size profile of the companies in Towers Watson's database is representative of the companies in the FTSE 51 to 130. It also believes that it is important that the same sources of market data are used across the Company to ensure consistency.

To ensure that pay and conditions across the Group are taken into account when making decisions on Executive Directors' pay, the Committee was briefed about the overall decisions on base salaries and pay bill increases for Serco's Executive Committee and employees across the Group. The Committee is satisfied that the principles and considerations that were applied to Executive Directors are, as far as possible, applied to all employees. Pay levels are designed to be competitive, fair and to reflect the skills and performance of individual employees. Individual pay increases in excess of those granted to the Executive Directors were awarded to various employees for reasons including promotion and increased scope of role. The salary review date for the Executive Directors was moved to April in 2011 which brings them into line with the vast majority of Serco's employees.

The Committee considered carefully whether base salaries for Christopher Hyman and Andrew Jenner should be increased in 2011. With effect from 1 April 2011, their salaries were increased by 4% to £728,000 and by 3.4% to £427,000 respectively. In 2012 the salaries will be increased for both Directors by 3% to £750,000 and £440,000 respectively. These increases were very much in line with increases for higher performers across the Group. The impact of these increases on the market position of total remuneration (including pension) is to maintain the competitive position established at the time of the last triennial review.

A comprehensive explanation of the business performance during the year has been provided in the 'Our performance' section on pages 20 to 81.

### **Annual bonus**

Bonus is earned on the basis of achievement of a mix of financial and non-financial objectives which are weighted 80% and 20% respectively. Payment for target performance is at 75% of base salary for the Chief Executive and 65% of base salary for the Finance Director. The maximum annual bonus opportunity is 150% of base salary for the Chief Executive and 130% of base salary for the Finance Director. Annual bonuses are not pensionable.

Financial measures are based on Serco Group's Key Performance Indicators (KPIs) and the non-financial measures are individually set and are based on key strategic goals. The three financial measures for 2011 were based on revenue, profit before tax and cash conversion. These measures reflect the growth and margin improvement strategies of the business. The standards of performance set are designed to be stretching. The non-financial goals set for 2011 assessed performance against a number of strategically important objectives for each individual linked to key strategic areas such as – corporate reputation management, the securing of key strategic contracts to deliver long-term performance as well as specific activities related to the development and execution of the Group's Strategy. In addition, the entry into the global business process outsourcing (BPO) market was an important objective for 2011.

On the basis of Serco's performance in 2011, annual awards of 121% and 105% of salary have been determined for the Chief Executive and Finance Director respectively. The Executive Directors delivered a financial performance that met the quantitative targets and, in the case of PBT and Cash performance, exceeded those targets.

The bonus objectives for 2012 have been set on a similar basis.

### **Share-based remuneration**

Long-term share incentives are awarded usually on an annual basis to Executive Directors under the Serco Group plc Deferred Bonus Plan (DBP) and the Serco Group plc Performance Share Plan (PSP). All 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 leavers have been adopted. The measurement of the performance targets is undertaken by Mercer for the DBP and the PSP, and in relation to the Earnings Per Share (EPS) growth element of the targets, is audited by Deloitte LLP. The conditions relating to the plans are detailed below.

#### **Deferred Bonus Plan**

Under the DBP, Executive Directors can elect to defer, for three financial years, up to 50% of their annual bonus by purchasing investment shares. If stretching performance targets, measured over three years, are met each investment share which could have been purchased with the gross equivalent of the amount used to purchase investment shares will be matched by a maximum of two 'matching' shares.

For awards made in 2011 the performance measures, each determining the vesting of half of the matching shares, were:

- TSR compared to the companies in the FTSE 51 to 130 (excluding investment trusts); and
- Annual compound EPS growth.

The structure for vesting was the same for both measures and no matching shares vest where performance is below median (TSR) or threshold (EPS).

On a combined basis, for median level TSR performance and a threshold level of EPS performance, each invested share will be matched (on a gross investment basis) by half of a share. For upper quartile level of TSR performance and a maximum level of EPS performance, each invested share will be matched (on a gross investment basis) by two shares. For performance between median or threshold and upper quartile or maximum, the number of matching shares will be determined on a straight line basis.

For the award made under the DBP and the PSP in 2009, the structure for vesting for the first year of the performance period is annual growth in EPS of 13% at threshold to 19% at maximum. This takes into account the impact on earnings of the acquisition of SI at the end of 2008.



# Remuneration Report

The definition of EPS is basic EPS excluding material acquisitions, disposals, currency movements and before amortisation of acquired intangibles.

The Committee has discretion to vary the proportion of awards that vest under the DBP to ensure that the outcomes are fair and appropriately reflect the underlying financial performance of the Group.

In 2011 both the Chief Executive and the Finance Director elected to defer 50% of their earned bonus into the DBP.

For matching awards which completed their performance period on 31 December 2011, performance against the three-year EPS measure was compound growth of 20.9% per annum which resulted in 100% of the EPS element (50%) of the award vesting. For the TSR element of the matching award, the Group's TSR performance relative to its comparator group was below median and therefore no shares under TSR element (50%) of the matching award vested.

## Changes to the Deferred Bonus Plan

The Committee has consulted with a selection of the largest shareholders and the voting guidance services in a key change to the DBP. In a challenging environment, EPS growth through, for example, our increased penetration of high-growth sectors and geographies, is one of Serco's KPIs and will be a critical value driver over the next few years. To enhance the line of sight for Executive Directors between performance against this key objective and reward, EPS growth will become the sole measure to determine the vesting of matching shares. The Committee believes EPS growth can be directly influenced by executive decision-making whereas relative TSR reflects not only the achievements of our management but also that of other companies and the factors influencing the market as a whole, particularly for Serco for which there are no direct comparators. There is, therefore, a much weaker link between executive performance and reward as determined by relative TSR performance. This combined with the significant shareholdings of the Executive Directors will also drive alignment of interest with shareholders. The DBP also extends to Serco's Executive Committee on the same basis.

Some shareholders have asked why deferral of bonus is not mandatory and why the matching shares are necessary. The DBP is part of a carefully considered approach to Serco's executive remuneration policy. The Committee wants to encourage Executive Directors – who already have significant shareholdings – to invest further in the Company. As ever we shall keep emerging 'best practice' under review.

The EPS growth range will be determined in the next few weeks and discussed with major shareholders.

## Performance Share Plan

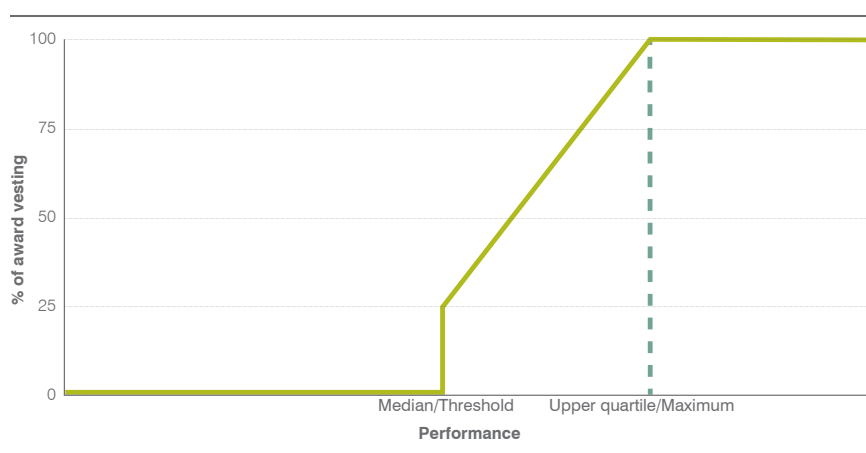
The PSP awards granted to the Executive Directors are calculated at a face value on grant of 200% of base salary for the Chief Executive and 175% of base salary for the Finance Director.

The shares will normally only vest at the end of a three-year period, if the Executive Directors are still in employment with Serco and two performance conditions have been met. The measures are EPS growth and TSR compared to the companies in the FTSE 51 to 130 (excluding investment trusts). The two measures are independent and each determines a fixed proportion of the award.

EPS growth is measured on a compound basis over a three-year performance period. 25% of the award will vest for threshold performance rising on a straight line basis to 100% for maximum performance.

Threshold vesting for the relative TSR condition is at 50% of the TSR achieved by the comparator group. Maximum vesting is achieved if the Company's relative TSR ranking is in the upper quartile. Relative TSR is measured with reference to the cumulative performance over the three-year period.

The graph below illustrates the mechanics of vesting, which is the same for both measures. Note that no awards vest for performance below Median/Threshold.



For awards made in 2011 Relative TSR performance determined the vesting of 70% of the shares and EPS growth the remainder.

### Summary of EPS performance to 31 December 2011

Compound EPS growth was 20.9% per annum. Accordingly, 100% of the June 2009 awards vest. The level at which maximum vesting would occur was 19% for year one and 14% per annum for the remaining two years of the performance period.

### Summary of TSR performance to 31 December 2011

The Group's TSR performance relative to the comparator group was below median and therefore the TSR element of the award lapses in full.

### Changes to the Performance Share Plan

From 2012 the vesting of shares awarded under the PSP will be weighted 50% based on EPS growth and 50% relative TSR. Going forward whilst relative TSR remains an appropriate measure the Committee has decided that greater emphasis should be placed on EPS growth for the reasons stated above in connection with the DBP.

Dividends are reinvested and distributed under both plans only in respect of shares that vest at the end of the performance period.

The Committee has discretion to vary the proportion of awards that vest under the Plans, to ensure that the outcomes are fair and appropriately reflect the underlying financial performance of the Group.

Prior to 2009 share-based incentive awards were made under the Serco Group plc 2006 Long Term Incentive Plan (LTIP) and the Serco Group plc 2005 Executive Option Plan (EOP); the conditions relating to these plans are detailed in the notes to the share-based incentive tables.

### 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.

### Share ownership policy

The share ownership requirement for the Chief Executive is two times base salary and one times base salary for the Finance Director. The Committee believes that share ownership is a meaningful way to align executives' interest with those of shareholders. Executive Directors are required to retain in shares 50% of the net value of any performance shares or options exercised until they satisfy the shareholding requirement. Going forward members of the Executive Committee are also going to be required to build over a period of five years, their shareholding in the Company to the level of one times base salary.

At the end of the year, by reference to the share price at that date, Executive Directors' share ownership levels were as follows:

	Ordinary shareholding at 31 December 2011 (474p)		Ordinary shareholding at 31 December 2010 (555.5p)	
	No. of shares	% of salary	No. of shares	% of salary
Chief Executive	820,197	534%	777,889	617%
Finance Director	310,991	345%	289,574	390%

### Pensions, life assurance and other benefits

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 target 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.

From 1 January 2007 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.

Christopher Hyman opted to cease accruing benefits in the pension scheme after 1 April 2010 and Andrew Jenner after 31 December 2010.

Since 1 April 2010 Christopher Hyman has been in receipt of a cash allowance equal to 33% of his base salary in lieu of further pension provision. From 1 January 2011 Andrew Jenner has also been in receipt of a cash allowance equal to 33% of his base salary in lieu of pension provision. The Executive Directors remain entitled to lump sum and widow's pension benefits should they die before retirement and while still employed by Serco.

The Executive Directors receive a range of other benefits which comprise 25 days' holiday per year, a car, private medical insurance, permanent health insurance, life cover, an annual allowance for independent financial advice, and voluntary health checks every two years.

# Remuneration Report

## Service contracts and compensation

Each Executive Director has a rolling service contract and these contracts will be available for inspection prior to the start of and after the Company's annual general meeting.

The service contracts have a notice period of 12 months. The Company reserves the right to make a payment in lieu of notice. In addition, where a Director leaves the Company following a change of control, whether or not he is dismissed or he elects to leave on notice, he will be entitled to receive a payment equivalent to up to one year's remuneration. The service contracts do not provide for termination payments to be made in any other circumstances.

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

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 2011
Christopher Hyman	30 August 1994	1 April 1999	10 June 2009	Rolling contract of 12 months' notice period
Andrew Jenner	4 November 1996	3 May 2002	10 June 2009	Rolling contract of 12 months' notice period

## 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 are retained by the Executive Director concerned.

Andrew Jenner served as a Non-Executive Director of Galliford Try plc during the year. Fees payable in the year were £40,000.

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

## The Chairman and Non-Executive Directors

The Group's policy is that the fees of the Chairman and 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.

During 2011 the Committee introduced an allowance for the Non-Executive Directors and Chairman of £5,000 per Board meeting where long-haul travel is required outside of the country of residence.

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. From 2011 Directors are also required to stand for re-election annually in accordance with the UK Corporate Governance Code.

As at 31 December 2011, the Non-Executive Directors of the Group had 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. Non-Executive Directors' fees are not performance related.

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

The fees and terms of engagement of Non-Executive Directors are reviewed on an annual basis, taking into consideration market practice and are approved by the Board. The standard annual fees payable for the Chairman and Non-Executive Directors during the financial year under review are shown in the table below.

1 January 2011 to 31 December 2011  
£

Chairman <sup>(1)</sup> <sup>(2)</sup>	250,000
Board member <sup>(2)</sup>	50,000
<b>Fees for additional duties</b>	
Senior Independent Director	10,000
Audit Committee Chairmanship	12,500
Remuneration Committee Chairmanship	10,000

(1) Alastair Lyons' remuneration consists of cash fees paid monthly. In addition, reasonable travel and related business expenses are paid. No bonuses are payable.

(2) £5,000 is payable for overseas Board meetings.

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

	Date of appointment to the Board	Date of letter of appointment
<b>Chairman:</b>		
Alastair Lyons	16 March 2010	15 March 2010
<b>Non-Executive Directors <sup>(1)</sup>:</b>		
Leonard V. Broese van Groenou	3 April 2006	20 February 2006
David Richardson	2 June 2003	29 May 2003
Paul Brooks	1 February 2011	12 January 2011
Angie Risley	1 April 2011	23 March 2011
Ralph D. Crosby Jr	30 June 2011	30 June 2011

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

(2) Non-Executive Directors are required to retire and stand for re-election in accordance with the Company's Articles of Association.

From 2011 Directors are also required to stand for re-election annually in accordance with the UK Corporate Governance Code.

(3) With effect from the conclusion of the AGM on 14 May 2012 Leonard V. Broese van Groenou will retire from the Board.

### Directors' remuneration

This section has been audited by Deloitte LLP.

The remuneration of the Directors for the year ended 31 December 2011 was as follows:

	Remuneration	Fees	Bonus	Total estimated value of any non-cash benefits	Allowance	Total remuneration excluding pensions 2011	Total remuneration excluding pensions 2010
Note	£	£	£	£	£	£	£
Alastair Lyons	1,6	Nil	250,000	Nil	5,000	<b>255,000</b>	199,038
Christopher Hyman	2,3,4,5	721,000	Nil	880,900	312,195	<b>1,916,843</b>	1,858,900
Andrew Jenner	2,3,4,5	423,375	Nil	448,400	214,485	<b>1,089,008</b>	948,295
Leonard V. Broese van Groenou	1,6	Nil	60,000	Nil	5,000	<b>65,000</b>	60,000
David Richardson	1,6	Nil	72,500	Nil	5,000	<b>77,500</b>	61,250
Paul Brooks	1,6	Nil	45,833	Nil	5,000	<b>50,833</b>	Nil
Angie Risley	1,6	Nil	37,500	Nil	5,000	<b>42,500</b>	Nil
Ralph D. Crosby Jr	1,6	Nil	25,189	Nil	20,000	<b>45,189</b>	Nil
<b>Total</b>		<b>1,144,375</b>	<b>491,022</b>	<b>1,329,300</b>	<b>5,496</b>	<b>3,541,873</b>	<b>3,127,483</b>

Notes:

1 In addition, reasonable travel and related business expenses are paid but are not subject to UK income tax.

2 The value of the non-cash benefits relates to private healthcare.

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

4 Remuneration is shown gross of salary sacrificed under the SMART scheme. See page 101.

5 The allowance comprises payments made in lieu of pension, calculated as a percentage of base salary, from which he makes his own pension arrangements see page 101 for further details, and the provision of a car allowance (fully inclusive of all scheme costs including insurance and maintenance, previously disclosed under non-cash benefits).

6 The allowance comprises payment for travel to overseas Board meetings.

# Remuneration Report

## Directors' shareholdings

The Directors' interests in the shares of the Company are detailed in the following table.

	Note	Ordinary shares of 2p each fully paid at 31 December 2011	Ordinary shares of 2p each fully paid at 1 January 2011 or if later the date of appointment as Director
Alastair Lyons		15,000	15,000
Leonard V. Broese van Groenou		5,375	5,375
Christopher Hyman	2,3	820,197	777,889
Andrew Jenner	2	310,991	289,574
David Richardson		15,000	15,000
Paul Brooks		10,000	–
Angie Risley		4,399	–
Ralph D. Crosby Jr		–	–

Notes:

- 1 Ordinary shares are beneficial holdings which include the Directors' personal holdings and those of their spouses and minor children.
- 2 122,990 of Christopher Hyman's and 65,386 of Andrew Jenner's shares are held in trust on their behalf under the terms of their participation in the Deferred Bonus Plan. Provided such shares remain in trust for three years and subject to certain performance conditions, they are also granted an award over matching shares equivalent to two times the gross bonus initially used for the share purchase.
- 3 Security has been granted to Christopher Hyman's bank over 85,564 ordinary shares held in his name.
- 4 As at 5 March 2012 there were no changes to the Directors' interests.

## Share-based incentives

This section has been audited by Deloitte 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 Deferred Bonus Plan (DBP)

Conditional rights to receive matching shares over Serco Group plc's ordinary shares under the DBP held by Directors at 31 December 2011 were as follows:

	Awards held at 1 January 2011	Date of award	Market price at award (pence)	Granted during the period	Awards held at 31 December 2011	Performance period	Vesting date
Christopher Hyman	130,754	12 Jun 2009	404	–	130,754	1 Jan 2009 – 31 Dec 2011	12 Jun 2012
	144,666	29 Mar 2010	602	–	144,666	1 Jan 2010 – 31 Dec 2012	29 Mar 2013
	–	4 Apr 2011	551	173,898	173,898	1 Jan 2011 – 31 Dec 2013	4 Apr 2014
Andrew Jenner	76,232	11 Jun 2009	408	–	76,232	1 Jan 2009 – 31 Dec 2011	11 Jun 2012
	73,865	29 Mar 2010	602	–	73,865	1 Jan 2010 – 31 Dec 2012	29 Mar 2013
	–	4 Apr 2011	551	88,033	88,033	1 Jan 2011 – 31 Dec 2013	4 Apr 2014

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 99 and 100.
- 3 No awards were exercised during the period.
- 4 For awards which completed their performance period on 31 December 2011, our performance against the three-year EPS performance measure was compound growth of 20.9% per annum which resulted in 100% of the EPS element (50%) of the award vesting. For the TSR element of the matching award, the Group's TSR performance relative to its comparator group was below median and therefore no shares under the TSR element (50%) of the matching award vested.

### (ii) Serco Group plc Performance Share Plan (PSP)

The conditional rights to Serco Group plc ordinary shares under the PSP held by Directors at 31 December 2011 were as follows:

	Awards held at 1 January 2011	Date of award	Market price at award (pence)	Granted during the period	Awards held at 31 December 2011	Performance period	Earliest vesting date	Latest exercise date
Christopher Hyman	315,789	22 Jun 2009	408	–	315,789	1 Jan 2009 – 31 Dec 2011	22 Jun 2012	21 Jun 2019
	213,750	6 Apr 2010	604	–	213,750	1 Jan 2010 – 31 Dec 2012	6 Apr 2013	5 Apr 2020
	–	31 Mar 2011	566	247,568	247,568	1 Jan 2011 – 31 Dec 2013	31 Mar 2014	30 Mar 2021
Andrew Jenner	162,790	22 Jun 2009	408	–	162,790	1 Jan 2009 – 31 Dec 2011	22 Jun 2012	21 Jun 2019
	110,190	6 Apr 2010	604	–	110,190	1 Jan 2010 – 31 Dec 2012	6 Apr 2013	5 Apr 2020
	–	31 Mar 2011	566	127,652	127,652	1 Jan 2011 – 31 Dec 2013	31 Mar 2014	30 Mar 2021

Notes:

- 1 Awards take the form of nominal cost options.
- 2 Awards made are calculated at a face value on grant of 200% and 175% of base salary for the Chief Executive and Finance Director respectively.
- 3 The performance conditions attached to the awards are described on pages 100 and 101.
- 4 On 31 December 2011 the performance conditions attached to the awards made on 22 June 2009 were satisfied. Our performance against the three-year EPS performance measure was compound growth of 20.9% per annum which resulted in 100% of the EPS element (30%) of the award vesting. For the TSR element of the matching award, the Group's TSR performance relative to its comparator group was below median and therefore no shares under the TSR element (70%) of the matching award vested.



**(iii) Serco Group plc 2006 Long Term Incentive Plan (LTIP)**

The LTIP has been replaced by the PSP. The last award under the LTIP was made in November 2007. The conditional rights to Serco Group plc ordinary shares under the LTIP held by Directors at 31 December 2011 were as follows:

	Awards held at 1 January 2011	Date of award	Market price on grant (pence)	Vested during the period	Market price on vesting (pence)	Awards held at 31 December 2011	Performance period	Earliest vesting date	Latest exercise date
Christopher Hyman	122,874	12 Nov 2007	456	84,500	556	<b>84,500</b>	1 Jan 2008 – 31 Dec 2010	31 Dec 2010	11 Nov 2017
Andrew Jenner	75,699	12 Nov 2007	456	52,058	556	<b>52,058</b>	1 Jan 2008 – 31 Dec 2010	31 Dec 2010	11 Nov 2017

Notes:

- 1 Awards take the form of nominal cost options.
- 2 Awards made are calculated at 100% of salary at the time of grant.
- 3 The TSR performance condition is 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.
- 4 No awards were granted, exercised or lapsed during the period.
- 5 The performance conditions attached to the awards which vested on 31 December 2010 achieved performance between median and upper quartile, resulting in 68.77% of the award vesting.

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

Options over Serco Group plc ordinary shares granted under the EOP and held by Directors at 31 December 2011 were as follows:

	Awards held at 1 January 2011	Exercised during period	Awards held at 31 December 2011	Market price on exercise date (pence)	Exercise price (pence)	Date from which exercisable	Date of expiry of options
Christopher Hyman	78,275*	78,275	–	583	435	28 Mar 2004	27 Mar 2011
	116,373*	–	<b>116,373</b>	–	264	3 May 2005	2 May 2012
	289,515*	–	<b>289,515</b>	–	153	6 May 2006	5 May 2013
	219,320*	–	<b>219,320</b>	–	217	3 Mar 2007	2 Mar 2014
	183,404	–	<b>183,404</b>	–	235	29 Apr 2008	28 Apr 2015
	147,492	–	<b>147,492</b>	–	339	5 May 2009	4 May 2016
	120,798	–	<b>120,798</b>	–	439	19 Mar 2010	18 Mar 2017
	123,076	–	<b>123,076</b>	–	455	27 Feb 2011	26 Feb 2018
Andrew Jenner	69,824*	–	<b>69,824</b>	–	264	3 May 2005	2 May 2012
	173,709*	–	<b>173,709</b>	–	153	6 May 2006	5 May 2013
	133,178*	–	<b>133,178</b>	–	217	3 Mar 2007	2 Mar 2014
	116,885	–	<b>116,885</b>	–	235	29 Apr 2008	28 Apr 2015
	88,495	–	<b>88,495</b>	–	339	5 May 2009	4 May 2016
	74,530	–	<b>74,530</b>	–	439	19 Mar 2010	18 Mar 2017
	75,824	–	<b>75,824</b>	–	455	27 Feb 2011	26 Feb 2018

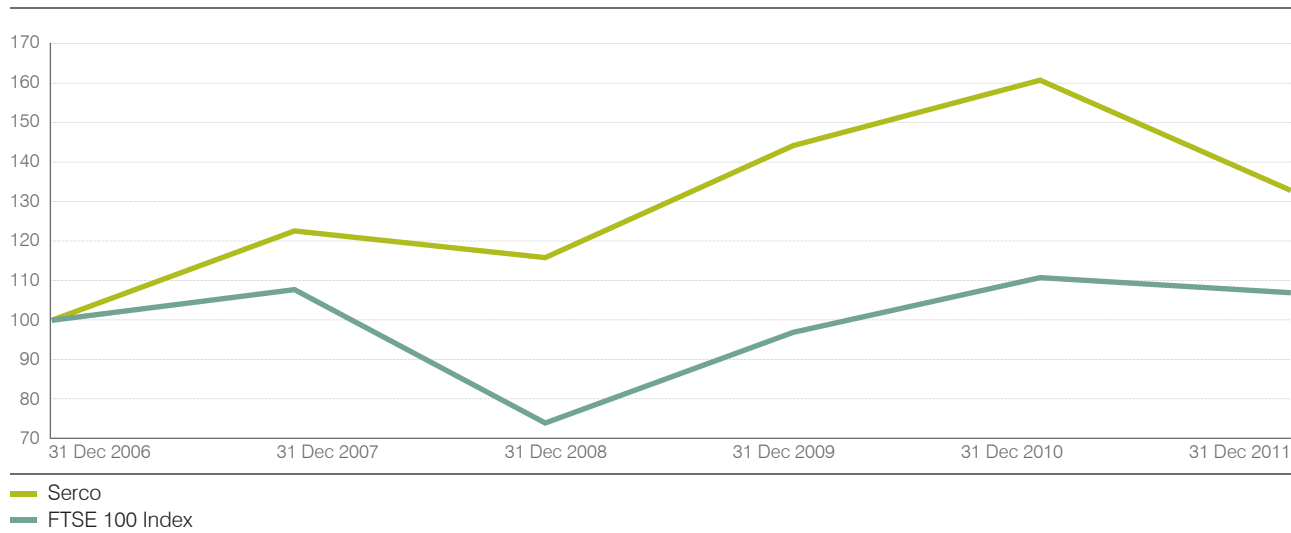
Notes:

- 1 The final award to Executive Directors under this Plan was made in February 2008.
- 2 The awards shown in the table are the maximum number of shares that can vest under the performance conditions.
- 3 The extent to which an award will vest is measured by reference to the Group's Earnings Per Share (EPS) performance relative to the Retail Price Index (RPI) over the three-year performance period. Full details of the vesting schedule for these awards can be found in previous reports.
- 4 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.
- 5 No payment was made for the grant of the awards.
- 6 Grants of options under the EOP 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 2011 was 474p and the range during the year to 31 December 2011 was 458p to 618.5p.
- 8 No grants were made during the year.
- 9 For the final option grant under this plan which became exercisable on 27 February 2011, the performance period ended on 31 December 2010, the Group's EPS growth was 22.73% per annum over the three-year performance period which resulted in all options vesting. The level at which maximum vesting would occur was 12.69% per annum.
- 10 The aggregate of the total theoretical gains on options exercised by Directors during 2011 amounted to £0.1 million. This is calculated by reference to the difference between the closing mid-market price of the shares on the date of exercise and the exercise price of the options, disregarding whether such shares were sold or retained on exercise, and is stated before tax. The 78,275 options exercised, were all sold.

# Remuneration Report

## Comparison of total shareholder returns

Serco Group plc total shareholder return (TSR) vs FTSE 100 Total Return Index  
Value of investment of £100 on 31 December 2006



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 100 Index, which is a broad equity market index of 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 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 the note on pages 149 to 154. In the event of death in service, the Serco Supplementary Death Benefit Scheme provides for a lump sum payment.

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 at 31 December 2011 (1) £	Transfer value at 31 December 2010 (2) £	Director's contributions for the year (3) £	Change in transfer value during the year (4) = (1)-(2)-(3) £	Increase in accrued pension during the year (5) £ p.a.	Increase in accrued pension during the year, net of inflation (6) £ p.a.	Transfer value of increase in accrual over the year (7) £	Accrued pension at year end (8) £ p.a.
Christopher Hyman	2,180,757	1,744,001	–	436,756	5,122	(407)	(7,022)	126,390
Andrew Jenner	1,184,608	929,133	–	255,475	2,989	(212)	(3,231)	77,719

Notes:

- Christopher Hyman ceased pension accrual on 1 April 2010 and Andrew Jenner on 31 December 2010, opting to receive a cash alternative equal to 33% of base pay (excluding bonuses) in lieu of any further pension provision. Executives remain entitled to lump sum and widow's pension benefits should they die before retirement and whilst employed by Serco.
- The accrued pension shown is that which would be paid annually on retirement, based on pensionable service to the date of ceasing accrual.
- The increase in the accrued pension over the year is shown both as a gross increase and net of statutory inflation (see further notes below).
- Transfer values have been calculated in accordance with the Occupational Pension Schemes (Transfer Value) Regulations 1996. The assumptions used for calculating transfer values have been reviewed by the Trustees during the year and updated to reflect future pension increases and revaluations linked to the Consumer Prices Index (CPI) measure of inflation, rather than Retail Prices Index (RPI).
- CPI increased by 5.2% over the year September 2010 to September 2011, the period used for statutory increases. Statutory indexation restricts pre-retirement increases to 5% p.a. for pension earned prior to 5 April 2009 and to 2.5% p.a. for pension earned after that date, and we have used this measure of inflation for calculating the increase in accrued pension net of inflation in (6).
- The increase in the accrued pension for both Directors allows for an increase in line with RPI to a maximum of 4% p.a. over the period from date of ceasing accrual to the year end, as agreed when they ceased accrual. Since the increase in pension over the year has been less than the statutory increase in inflation that would have applied on leaving service, the increase allowing for inflation in (6) is negative.
- The impact of allowing for CPI in the transfer value assumptions on its own would result in lower transfer values than would have applied with the previous assumptions. However, market movements over the year have acted to increase transfer values. The difference between the transfer values at the beginning and end of the year, shown in (4), includes the effect of both changes in the transfer value assumptions and 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 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.

## Share dilution

Awards granted under the Serco Group plc share plans are met either by the issue of new shares or by shares held in trust when awards vest. The Committee monitors the number of shares issued under its various share plans and their impact on dilution limits. The relevant dilution limits established by the Association of British Insurers in respect of all share plans (10% in any rolling ten-year period) and discretionary share plans (5% in any rolling ten-year period) were, based on the Company's issued share capital at 31 December 2011, 6.48% and 4.35% respectively.

The Group has an employee share ownership trust which is administered by an independent trustee and which holds ordinary shares in the Company to meet various obligations under the share plans. In April 2011 a loan of £24 million was made to the Employee Share Ownership Trust in order to finance the purchase of shares to satisfy the ongoing liabilities under the Company's employee share plans.

The Trust held 4,710,201 and 8,267,992 ordinary shares at 1 January 2011 and 31 December 2011 respectively.

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



Joanne Roberts  
Secretary  
27 February 2012

# Independent Auditor's Report

## **Independent Auditor's 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 2011 which comprise the Consolidated Income Statement, the Consolidated Statement of Comprehensive Income, the Consolidated Statement of Changes in Equity, the Consolidated Balance Sheet, the Consolidated Cash Flow Statement and the related notes 1 to 37. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. 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 auditor's 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 Auditor**

As explained more fully in the Directors' Responsibilities Statement, the Directors are responsible for the preparation of the Group Financial Statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the Group Financial Statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

## **Scope of the audit of the financial statements**

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Group's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the annual report to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

## **Opinion on the Group Financial Statements**

In our opinion the Group Financial Statements:

- give a true and fair view of the state of the Group's affairs as at 31 December 2011 and of its profit for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006 and Article 4 of the IAS Regulation.

## **Opinion on other matter prescribed by the Companies Act 2006**

In our opinion the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the Group Financial Statements.

## **Matters on which we are required to report by exception**

We have nothing to report in respect of the following:

Under the Companies Act 2006 we are required to report to you if, in our opinion:

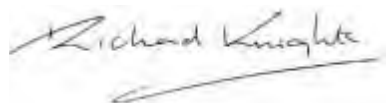
- certain disclosures of Directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

Under the Listing Rules we are required to review:

- the Directors' statement contained within the Corporate Governance Report in relation to going concern; and
- the part of the Corporate Governance Statement relating to the Company's compliance with the nine provisions of the UK Corporate Governance Code specified for our review; and
- certain elements of the report to shareholders by the Board on Directors' remuneration.

## **Other matter**

We have reported separately on the parent Company Financial Statements of Serco Group plc for the year ended 31 December 2011 and on the information in the Directors' Remuneration Report that is described as having been audited.



**Richard Knights (Senior Statutory Auditor)**  
for and on behalf of Deloitte LLP  
Chartered Accountants and Statutory Auditor  
London, United Kingdom  
27 February 2012

# Consolidated Income Statement

For the year ended 31 December

	Note	2011 £m	2010 £m
<b>Continuing operations</b>			
Revenue	4,5	4,646.4	4,326.7
Cost of sales		(3,946.0)	(3,682.4)
<b>Gross profit</b>			
Administrative expenses		(410.3)	(385.6)
<b>Adjusted operating profit</b> – before amortisation of intangibles arising on acquisition and acquisition-related costs			
Other expenses – amortisation of intangibles arising on acquisition	14	(20.0)	(17.4)
Acquisition-related costs		(3.9)	–
<b>Operating profit</b>			
Investment revenue	5,6	266.2	241.3
Finance costs	8	12.2	3.9
	9	(40.1)	(31.3)
<b>Profit before tax</b>			
Tax	10	(63.1)	(57.1)
<b>Profit for the year</b>			
		175.2	156.8
Attributable to:			
Equity holders of the parent		175.1	156.7
Non-controlling interest		0.1	0.1
<b>Earnings per share (EPS)</b>			
Basic EPS	12	35.70p	31.88p
Diluted EPS	12	35.08p	31.35p

# Consolidated Statement of Comprehensive Income

For the year ended 31 December

	Note	2011 £m	2010 £m
<b>Profit for the year</b>			
		175.2	156.8
<b>Other comprehensive income for the year:</b>			
Net actuarial (loss)/gain on defined benefit pension schemes <sup>1</sup>	27	(51.0)	49.9
Actuarial gain/(loss) on reimbursable rights <sup>1</sup>	27	116.5	(38.4)
Net exchange (loss)/gain on translation of foreign operations <sup>2</sup>		(2.2)	19.0
Fair value (loss)/gain on cash flow hedges during the year <sup>2</sup>		(35.7)	1.7
Tax relating to components of other comprehensive income <sup>3</sup>	10	(5.9)	(4.9)
Recycling of cumulative net hedging reserve <sup>2</sup>		0.3	0.3
<b>Total comprehensive income for the year</b>			
		197.2	184.4
Attributable to:			
Equity holders of the parent		197.1	184.3
Non-controlling interest		0.1	0.1

1 Recorded in retirement benefit obligations reserve in the consolidated statement of changes in equity.

2 Recorded in hedging and translation reserve in the consolidated statement of changes in equity.

3 Of the tax charge, a debit of £14.7m (2010: debit of £4.3m) was recorded in the retirement benefit obligations reserve and a credit of £8.8m (2010: debit of £0.6m) was recorded in the hedging and translation reserve.



# Consolidated Statement of Changes in Equity

For the year ended 31 December

	Share capital £m	Share premium account £m	Capital redemption reserve £m	Retained earnings £m	Retirement benefit obligations reserve £m	Share-based payment reserve £m	Own shares reserve £m	Hedging and translation reserve £m	Total equity £m	Non-controlling interest £m
At 1 January 2010	9.8	304.1	0.1	444.1	(150.0)	49.6	(13.0)	47.3	692.0	0.1
Total comprehensive income for the year	–	–	–	156.7	7.2	–	–	20.4	184.3	0.1
Shares transferred to option holders on exercise of share options	0.1	2.6	–	–	–	(2.9)	8.5	–	8.3	–
Dividends paid	–	–	–	(32.3)	–	–	–	–	(32.3)	(0.2)
Expense in relation to share-based payment	–	–	–	–	–	8.8	–	–	8.8	–
Tax credit in relation to share-based payments	–	–	–	–	–	3.2	–	–	3.2	–
Purchase of own shares for Employee Share Ownership Trust (ESOT)	–	–	–	–	–	–	(23.0)	–	(23.0)	–
<b>At 1 January 2011</b>	<b>9.9</b>	<b>306.7</b>	<b>0.1</b>	<b>568.5</b>	<b>(142.8)</b>	<b>58.7</b>	<b>(27.5)</b>	<b>67.7</b>	<b>841.3</b>	<b>–</b>
Total comprehensive income for the year	–	–	–	175.1	50.8	–	–	(28.8)	197.1	0.1
Shares transferred to option holders on exercise of share options	–	16.0	–	–	–	(2.0)	3.3	–	17.3	–
Dividends paid	–	–	–	(37.3)	–	–	–	–	(37.3)	(0.1)
Expense in relation to share-based payment	–	–	–	–	–	11.2	–	–	11.2	–
Tax charge in relation to share-based payments	–	–	–	–	–	(1.8)	–	–	(1.8)	–
Purchase of own shares for Employee Share Ownership Trust (ESOT)	–	–	–	–	–	–	(24.0)	–	(24.0)	–
<b>At 31 December 2011</b>	<b>9.9</b>	<b>322.7</b>	<b>0.1</b>	<b>706.3</b>	<b>(92.0)</b>	<b>66.1</b>	<b>(48.2)</b>	<b>38.9</b>	<b>1,003.8</b>	<b>–</b>

# Consolidated Balance Sheet

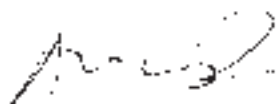
At 31 December

	Note	2011 £m	2010 £m
<b>Non-current assets</b>			
Goodwill	13	1,259.0	899.5
Other intangible assets	14	184.9	145.0
Property, plant and equipment	16	194.8	135.4
Trade and other receivables	19	261.9	156.7
Retirement benefit assets	27	122.3	–
Deferred tax assets	23	28.2	38.1
Derivative financial instruments	26	2.0	3.5
		<b>2,053.1</b>	<b>1,378.2</b>
<b>Current assets</b>			
Inventories	18	58.8	65.4
Trade and other receivables	19	798.6	786.2
Current tax assets		9.2	4.0
Cash and cash equivalents	21	254.8	279.3
Derivative financial instruments	26	7.6	3.9
		<b>1,129.0</b>	<b>1,138.8</b>
<b>Total assets</b>		<b>3,182.1</b>	<b>2,517.0</b>
<b>Current liabilities</b>			
Trade and other payables	25	(804.2)	(805.5)
Current tax liabilities		(17.8)	(19.5)
Obligations under finance leases	24	(10.3)	(7.1)
Provisions	28	(10.4)	–
Loans	22	(206.6)	(159.5)
Derivative financial instruments	26	(12.3)	(2.4)
		<b>(1,061.6)</b>	<b>(994.0)</b>
<b>Non-current liabilities</b>			
Trade and other payables	25	(61.4)	(22.2)
Obligations under finance leases	24	(35.6)	(19.3)
Loans	22	(636.2)	(354.6)
Derivative financial instruments	26	(26.3)	(5.2)
Retirement benefit obligations	27	(278.7)	(226.2)
Provisions	28	(56.2)	(39.6)
Deferred tax liabilities	23	(22.3)	(14.6)
		<b>(1,116.7)</b>	<b>(681.7)</b>
<b>Total liabilities</b>		<b>(2,178.3)</b>	<b>(1,675.7)</b>
<b>Net assets</b>		<b>1,003.8</b>	<b>841.3</b>
<b>Equity</b>			
Share capital	29	9.9	9.9
Share premium account	30	322.7	306.7
Capital redemption reserve		0.1	0.1
Retained earnings		706.3	568.5
Retirement benefit obligations reserve	31	(92.0)	(142.8)
Share-based payment reserve	31	66.1	58.7
Own shares reserve	31	(48.2)	(27.5)
Hedging and translation reserve	31	38.9	67.7
<b>Equity attributable to equity holders of the parent</b>		<b>1,003.8</b>	<b>841.3</b>
<b>Non-controlling interest</b>		<b>–</b>	<b>–</b>
<b>Total equity</b>		<b>1,003.8</b>	<b>841.3</b>

The financial statements were approved by the Board of Directors on 27 February 2012 and signed on its behalf by:



Christopher Hyman  
Chief Executive



Andrew Jenner  
Finance Director

# Consolidated Cash Flow Statement

For the year ended 31 December

	Note	2011 £m	2010 £m
<b>Net cash inflow from operating activities before special pension contribution</b>		<b>257.0</b>	261.0
Special contribution to defined benefit pension schemes		(40.0)	(20.0)
<b>Net cash inflow from operating activities</b>	32	<b>217.0</b>	241.0
<b>Investing activities</b>			
Interest received		3.4	3.3
Increase in security deposits		(8.2)	–
Proceeds from disposal of property, plant and equipment		9.2	6.1
Proceeds from disposal of intangible assets		–	7.3
Acquisition of subsidiaries, net of cash acquired (excluding acquisition-related costs)	15	(325.3)	(2.1)
Purchase of other intangible assets		(35.2)	(20.9)
Purchase of property, plant and equipment		(49.7)	(35.4)
<b>Net cash outflow from investing activities</b>		<b>(405.8)</b>	(41.7)
<b>Financing activities</b>			
Interest paid		(35.8)	(27.9)
Dividends paid	11	(37.3)	(32.3)
Non-controlling interest dividends paid		(0.1)	(0.2)
Cash inflow from matured derivative financial instruments		4.9	1.6
Repayment of loans		(559.8)	(167.8)
Repayment of non recourse loans		(7.9)	(7.6)
New loan advances		818.4	10.1
Capital element of finance lease repayments		(10.7)	(8.7)
Purchase of own shares for Employee Share Ownership Trust (ESOT)		(24.0)	(23.0)
Proceeds from issue of share capital and exercise of share options		17.3	8.3
<b>Net cash inflow/(outflow) from financing activities</b>		<b>165.0</b>	(247.5)
<b>Net decrease in cash and cash equivalents</b>		<b>(23.8)</b>	(48.2)
<b>Cash and cash equivalents at beginning of year</b>		<b>279.3</b>	319.4
Net exchange (loss)/gain		(0.7)	8.1
<b>Cash and cash equivalents at end of year</b>	21	<b>254.8</b>	279.3

# Notes to the Consolidated Financial Statements

## 1. General information

Serco Group plc (the Group) is a company incorporated in the United Kingdom under the Companies Act 2006. 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 109 to 164 have been prepared in accordance with International Financial Reporting Standards (IFRSs) adopted for use in the European Union (EU) 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 following principal accounting policies adopted have been applied consistently in the current and preceding financial year except as stated below.

As discussed in more detail in the Finance Review, these financial statements have been prepared on the going concern basis.

### **Adoption of new and revised standards**

The following new and revised standards and interpretations have been adopted in the current year. Their adoption has not had any significant impact on the amounts reported in these financial statements but may impact the accounting for future transactions and arrangements.

#### **Amendments to IFRS 1 Limited Exemption from Comparative IFRS 7 Disclosures for First-Time Adopters**

The amendment relieves first-time adopters of IFRSs from providing the additional disclosures introduced in March 2009 by Improving Disclosures about Financial Instruments (Amendments to IFRS 7).

#### **IAS 24 (2009) Related Party Disclosures**

The amendments to IAS 24 have updated the definition of a related party and of a related party transaction to clarify the intended meaning and remove inconsistencies. In addition, the revised standard provides an exemption from the disclosure requirements for transactions between entities controlled, jointly controlled or significantly influenced by the same state.

#### **IAS 32 Financial Instruments: Presentation: Classification of Rights Issues**

Rights issues offered for a fixed amount of foreign currency practice appeared to require such issues to be accounted for as derivative liabilities. The amendment states that if such rights are issued pro rata to an entity's all existing shareholders in the same class for a fixed amount of currency, they should be classified as equity regardless of the currency in which the exercise price is denominated.

#### **Amendment to IFRIC 14 Prepayments of a Minimum Funding Requirement**

The amendments now enable recognition of an asset in the form of prepaid minimum funding contributions.

#### **IFRIC 19 Extinguishing Financial Liabilities with Equity Instruments**

IFRIC 19 provides guidance on how an entity should account for transactions where a creditor agrees to accept an entity's shares or other equity instruments to settle a financial liability fully or partially in accordance with IAS 39 Financial Instruments: Recognition and Measurement and IAS 32 Financial Instruments: Presentation.

#### **Improvements to IFRSs 2010**

Aside from those items already identified above, the amendments made to standards under the 2010 improvements of IFRSs have had no impact on the Group.

# Notes to the Consolidated Financial Statements

## 2. Significant accounting policies (continued)

### **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.

Non-controlling 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.

The information previously presented in the consolidated statement of comprehensive income (SOCl) and the consolidated statement of changes in equity (SOCIE) for the year ended 31 December 2010 has been re-presented. The tax credit on the expense in relation to share-based payments previously reported within the SOCl has now been separately disclosed within the SOCIE.

### **Business combinations**

Acquisitions of subsidiaries and businesses are accounted for using the acquisition method. The consideration for each 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. Acquisition-related costs are recognised in profit or loss as incurred.

Where applicable, the consideration for the acquisition includes any asset or liability resulting from a contingent consideration arrangement, measured at its acquisition date fair value. Subsequent changes in fair values are adjusted against the cost of acquisition where they qualify as measurement period adjustments (which is subject to a maximum of one year). All other subsequent changes in the fair value of contingent consideration classified as an asset or liability are accounted for in accordance with the relevant accounting standards. Changes in the fair value of contingent consideration classified as equity are not recognised.

The acquiree's identifiable assets, liabilities and contingent liabilities that meet the conditions for recognition under IFRS 3 (2008) Business Combinations are recognised at their fair value at the acquisition date, except where a different treatment is mandated by another standard.

Goodwill arising on acquisition is recognised as an asset at the date that control is acquired. Goodwill is measured as the excess of the sum of the consideration transferred, the amount of any non-controlling interest and the fair value of any previously held equity interest in the acquired entity, over the net of the acquisition date amounts of the identifiable assets and liabilities acquired.

If, after reassessment, the Group's interest in the net fair value of the acquiree's identifiable net assets exceeds the sum of the consideration transferred, the amount of any non-controlling interest and the fair value of any previously held equity interest in the acquired entity, the excess is recognised immediately in the income statement.

Any adjustments to contingent consideration in respect of acquisitions made prior to 1 January 2010 will continue to be reflected in goodwill in accordance with IFRS 3 (2004).

### **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 assets and liabilities of a subsidiary, associate or jointly controlled entity, at the date of acquisition. Goodwill is initially recognised as an asset at cost and is subsequently measured at cost less any accumulated impairment losses. Goodwill, which is recognised as an asset, is reviewed for impairment at least annually. Any impairment is recognised immediately in profit or loss and is not subsequently reversed.

For the purpose of impairment testing, goodwill is allocated to each of the Group's cash-generating units (CGUs) expected to benefit from the synergies of the combination. CGUs to which goodwill has been allocated are tested for impairment annually, or more frequently when there is an indication that the unit may be impaired. If the recoverable amount of the CGU is less than the carrying amount of the unit, the impairment loss is allocated first to reduce the carrying amount of any goodwill allocated to the unit and then to the other assets of the unit pro rata on the basis of the carrying amount of each asset in the unit. An impairment loss recognised for goodwill is not reversed in a subsequent period.

On disposal of a subsidiary, associate 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 retained at the previous United Kingdom Generally Accepted Accounting Practice (UK GAAP) amounts subject to being tested for impairment at that date. Goodwill written off to reserves under UK GAAP prior to 1998 has not been reinstated and is not included in determining any subsequent profit or loss on disposal.



## 2. Significant accounting policies (continued)

### **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.

### **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 designed 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 income statement.

Assets are grouped into classes of similar nature and use and separately disclosed except where this is not material.

### **Other intangible assets**

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

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

- an asset is created that can be separately identified, and which the Group intends to use or sell;
- the finalisation of the asset is technically feasible and the Group has adequate resources to complete its development for use or sale;
- it is probable that the asset created will generate future economic benefits; and
- the development cost of the asset can be measured reliably.

Purchased software and 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 life of the contract.

Assets are grouped into classes of similar nature and use and separately disclosed except where this is not material.

# Notes to the Consolidated Financial Statements

## 2. Significant accounting policies (continued)

### **Impairment of tangible and intangible assets**

Annually, the Group reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Where the asset does not generate cash flows that are independent from other assets, the Group estimates the recoverable amount of the CGU to which the asset belongs. A CGU is the smallest group of assets that generates cash inflows from continuing use that are largely independent of the cash flows of other assets or groups of assets. For the purpose of impairment testing, the goodwill acquired in a business combination is allocated to the CGUs that are expected to benefit from the synergies of the combination.

Recoverable amount is defined as 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. Impairment losses recognised in respect of CGUs are allocated first to reduce the carrying amount of any goodwill allocated to the units and then to reduce the carrying amount of the other assets in the unit (group of units) on a pro rata basis.

An impairment loss in respect of goodwill is not reversed. In respect of other assets, impairment losses recognised in prior periods are assessed at each reporting date for indications that the loss has decreased or no longer exists. 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, net of depreciation or amortisation, 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 administrative expenses within the consolidated income statement.

### **Revenue recognition**

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

Revenue is deferred when the Group has received consideration under the terms of a contract in advance of performing the related service or delivering the associated goods. Deferred revenue is recognised as revenue in the income statement when the Group has fulfilled the relevant contractual commitment.

### **Revenue recognition: repeat service-based contracts**

Revenue on repeat service-based contracts is recognised as services are provided.

### **Revenue recognition: 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 and IAS 11 Construction Contracts. This is measured by the proportion of contract costs incurred for work performed to date compared to the estimated total contract costs.

Variations in contract work, claims and incentive payments are included to the extent that they have been agreed with the customer or are virtually certain of being received.

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 are probable to 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.

### **Revenue recognition: other**

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

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.

## 2. Significant accounting policies (continued)

### **Bid costs and phase-in costs**

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. Bid costs are only capitalised to the extent that it is expected that the related contract will generate sufficient future economic benefits to at least offset the amortisation charge.

Phase-in costs directly related to phase-in programmes of contracts are treated as an integral part of contract costs and are recognised on a straight-line basis over the life of the contract except where they are specifically reimbursed as part of the terms of the contract when they are recognised as revenue.

### **Segmental information**

Segmental information is based on internal reports about components of the Group that are regularly reviewed by the Group's Chief Operating Decision Maker in order to allocate resources to the segments and to assess their performance.

Segmental revenue is analysed on an external basis. Inter-segment revenue is not presented as it is not significant in the context of revenue as a whole. Net finance costs are not presented for each operating segment as they are reviewed on a consolidated basis by the Group's Chief Operating Decision Maker.

Items excluded from segmental results comprise corporate expenses. Specific corporate expenses are allocated to the corresponding segments. Segment assets comprise goodwill, other intangible assets, property, plant and equipment, inventories, trade and other receivables (excluding corporation tax recoverable), and any retirement benefit asset. Segment liabilities comprise trade and other payables and retirement benefit obligations.

### **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).

Total 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 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 rate prevailing on 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 consolidated statement of comprehensive income (SOCI).

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.

# Notes to the Consolidated Financial Statements

## 2. Significant accounting policies (continued)

### **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 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 actuarial cost 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 SOCI.

The current service cost represents the increase in the present value of the scheme 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 vests. 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 scheme.

The economic benefit from refunds is only recognised to the extent that the Group has an unconditional right to receive a refund.

To the extent that an economic benefit is available as a reduction in contributions and there is a minimum funding requirement, the economic benefit available as a reduction in contributions is calculated at the present value of:

- a) the estimated future service cost in each year; less
- b) the estimated minimum funding contributions required in respect of the future accrual and benefits in that year.

### **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 SOCI.

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 scheme 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 SOCI. The change in fair value of the reimbursable rights that is not presented in the income statement is reported in the SOCI.

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

Multi-employer pension schemes are classified as either 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.

## 2. Significant accounting policies (continued)

### Tax

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 profits will be available against which these items can be utilised.

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

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

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

Deferred tax is measured at the tax rates that are expected to apply in the period when the liability is settled or the asset is realised, based upon tax rates and legislation that have been enacted or substantively enacted by 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 legally 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.

### 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).

### Share-based payment

The Group makes equity-settled share-based payments to certain employees and operates an HMRC approved Save As You Earn (SAYE) 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. SAYE options are treated as cancelled when employees cease to contribute to the scheme, resulting in an acceleration of the remainder of the related expense.

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

### Trade receivables

Trade receivables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest rate 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 recoverable amount. The carrying amount of the asset is reduced through the use of an allowance for doubtful debts 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 allowance for doubtful debts. Subsequent recoveries of amounts previously written off are credited against administrative expenses.



# Notes to the Consolidated Financial Statements

## 2. Significant accounting policies (continued)

### 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 from the date of acquisition. 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 declared, appropriately authorised and no longer at the discretion of the Company.

### 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 using the effective interest rate method. Accrued interest is recorded separately from the associated borrowings within current liabilities.

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

### Derivative financial instruments and hedging activities

The Group enters into a variety of derivative financial instruments to manage the exposure to interest rate foreign exchange risk and price risk, including currency swaps, foreign exchange forward contracts, interest rate swaps and commodity future contracts. Further details of derivative financial instruments are given in note 26.

Derivatives are initially recognised at fair value at the date a derivative contract is entered into and are subsequently remeasured to their fair value at each balance sheet date. A derivative with a positive fair value is recognised as a financial asset whereas a derivative with a negative fair value is recognised as a financial liability. The resulting gain or loss is recognised in profit or loss immediately unless the derivative is designated and effective as a hedging instrument, in which event the timing of the recognition in profit or loss depends on the nature of the hedge relationship. The Group designates certain derivatives as either hedges of the fair value of recognised assets or liabilities or firm commitments (fair value hedges), hedges of highly probable forecast transactions or hedges of foreign currency risk of firm commitments (cash flow hedges), or hedges of net investments in foreign operations.

A derivative is presented as a non-current asset or a non-current liability if the remaining maturity of the instrument is more than 12 months and it is not expected to be realised or settled within 12 months. Other derivatives are presented as current assets or current liabilities.

### Embedded derivatives

Derivatives embedded in other financial instruments or other host contracts are treated as separate derivatives when their risks and characteristics are not closely related to those of the host contracts and the host contracts are not measured at fair value through profit or loss.

### Hedge accounting

The Group designates certain hedging instruments, which include derivatives, embedded derivatives and non-derivatives in respect of foreign exchange risk, as either fair value hedges, cash flow hedges, or hedges of net investments in foreign operations. Hedges of foreign exchange risk on highly probable forecast transactions and firm commitments are accounted for as cash flow hedges.

At the inception of the hedge relationship, the entity documents the relationship between the hedging instrument and the hedged item, along with its risk management objectives and its strategy for undertaking various hedge transactions. Furthermore, at the inception of the hedge and on an ongoing basis, the Group documents whether the hedging instrument that is used in a hedging relationship is highly effective in offsetting changes in fair values or cash flows of the hedged item.

Details of the fair values of the derivative instruments used for hedging purposes and movements in the hedging and translation reserve in equity are detailed in the SOCI and described in note 26.

### Fair value hedges

Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in profit or loss immediately, together with any changes in the fair value of the hedged item that is attributable to the hedged risk. The change in the fair value of the hedging instrument and the change in the hedged item attributable to the hedged risk are recognised in the line of the income statement relating to the hedged item.

Hedge accounting is discontinued when the Group revokes the hedging relationship, the hedging instrument expires or is sold, terminated, exercised or no longer qualifies for hedge accounting. The adjustment to the carrying amount of the hedged item arising from the hedged risk is amortised to profit or loss from that date.

## 2. Significant accounting policies (continued)

### Cash flow hedges

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges are deferred in equity. The gain or loss relating to the ineffective portion is recognised immediately in profit or loss.

Amounts deferred in equity are recycled to profit or loss in the periods when the hedged item affects profit or loss, in the same line of the income statement as the recognised hedged item. However, when the forecast transaction that is hedged results in the recognition of a non-financial asset or a non-financial liability, the gains and losses previously deferred in equity are transferred from equity and included in the initial measurement of the cost of the non-financial asset or non-financial liability.

Hedge accounting is discontinued when the Group revokes the hedging relationship, the hedging instrument expires or is sold, terminated, exercised or no longer qualifies for hedge accounting. Any cumulative gain or loss deferred in equity at that time remains in equity and is recognised when the forecast transaction is ultimately recognised in profit or loss. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was deferred in equity is recognised immediately in profit or loss.

### Hedges of net investments in foreign operations

Hedges of net investments in foreign operations are accounted for similarly to cash flow hedges. Any gain or loss on the hedging instrument relating to the effective portion of the hedge is recognised in equity and accumulated in the hedging and translation reserve. The gain or loss relating to the ineffective portion is recognised immediately in profit or loss and is included in the 'net exchange gain/loss on translation of foreign operations' line item.

Gains and losses on the hedging instrument relating to the effective portion of the hedge accumulated in the foreign currency translation reserve are reclassified to profit or loss in the same way as exchange differences relating to the foreign operations.

### Net investments in foreign operations

Exchange differences arising on monetary items that form part of the Group's net investment in foreign operations are initially recognised in equity and accumulated in the hedging and translation reserve and reclassified from equity to profit or loss on disposal of the net investment.

### 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

At the date of authorisation of these financial statements, the following standards and interpretations which have not been applied in these financial statements were in issue but not yet effective (and in some cases had not yet been adopted by the EU):

- IFRS 1 (amended) Severe Hyperinflation and Removal of Fixed Dates for First-time Adopters
- IFRS 7 (amended) Disclosures – Transfers of Financial Assets
- IFRS 9 Financial Instruments
- IFRS 10 Consolidated Financial Statements
- IFRS 11 Joint Arrangements
- IFRS 12 Disclosure of Interests in Other Entities
- IFRS 13 Fair Value Measurement
- IAS 1 (amended) Presentation of Items in Other Comprehensive Income
- IAS 12 (amended) Deferred Tax: Recovery of Underlying Assets
- IAS 19 (revised) Employee Benefits
- IAS 27 (revised) Separate Financial Statements
- IAS 28 (revised) Investments in Associates and Joint Ventures
- IFRIC 20 Stripping Costs in the Production Phase of a Surface Mine

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 except as follows:

- IFRS 9 will impact both the measurement and disclosures of financial instruments;
- IFRS 11 will require the Group to change from proportionate consolidation of joint arrangements and adopt equity accounting;
- IFRS 12 will impact the disclosure of interest Serco Group plc has in other entities;
- IFRS 13 will impact the measurement of fair value for certain assets and liabilities as well as the associated disclosures; and
- IAS 19 (revised) will impact the measurement of the various components representing movements in the defined benefit obligation and associated disclosures, but not the Group's total obligation. It is likely that following the replacement of expected returns on scheme assets with a net finance cost in the income statement, the profit for the period will be reduced and accordingly other comprehensive income increased.

Beyond the information above, it is not practicable to provide a reasonable estimate of the effect of these standards and interpretations until a detailed review has been completed.

# Notes to the Consolidated Financial Statements

## 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.

### 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 (CGUs) to which goodwill has been allocated. The value in use calculation involves an estimation of the future cash flows of CGUs and also the selection of appropriate discount rates, which involves judgement, to calculate present values (see note 13). The carrying value of goodwill is £1,259.0m (2010: £899.5m) at the balance sheet date.

### Retirement benefit obligations

The calculation of retirement benefit obligations is dependent on material key assumptions including discount rates, future returns on assets and future contribution rates (see note 27). The value of net retirement benefit obligations at the balance sheet date is £156.4m (2010: £226.2m). Details of the impact of changes in assumptions relating to retirement benefit obligations are disclosed in the Finance Review (page 54).

### Business combinations

The calculation of fair values associated with business combinations requires the use of judgement in determining the future economic inflows and outflows associated with the acquired assets and liabilities. This includes the estimation of contingent deferred consideration and intangibles arising on acquisition. As permitted by IFRS 3 (2008), provisional amounts are recognised for acquired net assets during the measurement period where complete information about the facts and circumstances that existed at the acquisition date is not available at the reporting date.

## 4. Revenue

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

	2011 £m	2010 £m
Rendering of services	4,481.3	4,103.5
Revenue from long-term project-based contracts	165.1	223.2
Revenue as disclosed in the consolidated income statement	4,646.4	4,326.7
Investment revenue (note 8)	12.2	3.9
Operating lease income	0.7	–
<b>Total revenue as defined in IAS 18</b>	<b>4,659.3</b>	<b>4,330.6</b>

## 5. Segmental information

Information reported to the Chief Operating Decision Maker for the purposes of resource allocation and assessment of segment performance focuses on the categories of customer identified using their respective markets. Details of the different products and services provided by each operating segment are included in the Our business and Our performance sections of this report. The Group's reportable operating segments under IFRS 8 Operating Segments are:

Reportable segments	Operating segments
Civil Government	UK and Europe civil government and transport;
Defence, Science and Nuclear	UK and Europe defence and science-based businesses;
Local Government and Commercial Americas	UK and Europe IT and BPO, integrated services, education and commercial businesses; US defence, intelligence and federal civil government agencies operations, and Canadian operations; and
AMEAA	Africa, Middle East, Asia (including Hong Kong and India) and Australasia.

The accounting policies of the reportable segments are the same as the Group's accounting policies described in note 2.

## 5. Segmental information (continued)

The following is an analysis of the Group's revenue and results by reportable segment in the year ended 31 December 2011.

### Reportable segments

Year ended 31 December	Civil Government 2011 £m	Defence, Science and Nuclear 2011 £m	Local Government and Commercial 2011 £m	Americas 2011 £m	AMEAA 2011 £m	Total 2011 £m
<b>Revenue</b>	<b>1,199.1</b>	<b>939.1</b>	<b>859.8</b>	<b>868.2</b>	<b>780.2</b>	<b>4,646.4</b>
<b>Result</b>						
Segment Adjusted operating profit	79.7	79.9	52.4	73.0	55.4	340.4
Amortisation of intangibles arising on acquisition	(0.2)	–	(3.0)	(13.6)	(3.2)	(20.0)
Acquisition-related costs	(0.2)	–	(0.6)	–	(3.1)	(3.9)
Segment result	79.3	79.9	48.8	59.4	49.1	316.5
Corporate expenses						(50.3)
<b>Operating profit</b>						<b>266.2</b>
Investment revenue						12.2
Finance costs						(40.1)
<b>Profit before tax</b>						<b>238.3</b>
Tax						(63.1)
<b>Profit for the year</b>						<b>175.2</b>
<b>Goodwill and capital expenditure*</b>						
Goodwill	13.0	–	39.4	–	305.4	357.8
Property, plant and equipment: segments	8.6	6.9	20.4	0.6	49.2	85.7
Property, plant and equipment: corporate						3.1
<b>Total</b>						<b>88.8</b>
Intangible assets: segments	1.3	0.9	9.4	1.6	49.5	62.7
Intangible assets: corporate						23.8
<b>Total</b>						<b>86.5</b>
<b>Depreciation and amortisation</b>						
Depreciation: segments	6.6	4.0	16.4	3.4	15.6	46.0
Depreciation: corporate						–
<b>Total</b>						<b>46.0</b>
Amortisation of intangibles arising on acquisition: segments	0.2	–	3.0	13.6	3.2	20.0
Amortisation – other: segments	2.8	1.9	1.8	1.0	2.1	9.6
Amortisation – other: corporate						9.9
<b>Total</b>						<b>39.5</b>
<b>Segment assets</b>						
Reportable segment assets	268.6	450.1	611.5	660.7	707.3	2,698.2
Corporate assets						182.1
Total segment assets						2,880.3
Unallocated assets						301.8
<b>Consolidated total assets</b>						<b>3,182.1</b>
<b>Segment liabilities</b>						
Reportable segment liabilities	(225.8)	(361.8)	(177.8)	(103.9)	(190.2)	(1,059.5)
Corporate liabilities						(84.8)
Total segment liabilities						(1,144.3)
Unallocated liabilities						(1,034.0)
<b>Consolidated total liabilities</b>						<b>(2,178.3)</b>

\* Capital expenditure is stated on a cash basis: including acquisitions but excluding finance leases.

Group Adjusted operating profit is £290.1m and comprises segment Adjusted operating profit of £340.4m less Corporate expenses of £50.3m.

## Notes to the Consolidated Financial Statements

## 5. Segmental information (continued)

## Reportable segments

Year ended 31 December	Civil Government 2010 £m	Defence, Science and Nuclear 2010 £m	Local Government and Commercial 2010 £m	Americas 2010 £m	AMEEA 2010 £m	Total 2010 £m
<b>Revenue</b>	1,126.9	910.8	853.9	953.9	481.2	4,326.7
<b>Result</b>						
Segment Adjusted operating profit	66.6	77.3	55.8	77.9	32.6	310.2
Amortisation of intangibles arising on acquisition	(0.2)	–	(2.7)	(13.9)	(0.6)	(17.4)
Segment result	66.4	77.3	53.1	64.0	32.0	292.8
Corporate expenses						(51.5)
<b>Operating profit</b>						241.3
Investment revenue						3.9
Finance costs						(31.3)
<b>Profit before tax</b>						213.9
Tax						(57.1)
<b>Profit for the year</b>						156.8
<b>Goodwill and capital expenditure*</b>						
Goodwill	–	–	1.9	–	1.2	3.1
Property, plant and equipment: segments	3.7	8.4	11.3	1.4	10.4	35.2
Property, plant and equipment: corporate						0.2
<b>Total</b>						35.4
Intangible assets: segments	0.2	1.3	1.8	4.9	3.5	11.7
Intangible assets: corporate						9.2
<b>Total</b>						20.9
<b>Depreciation and amortisation</b>						
Depreciation: segments	7.2	2.6	15.1	4.8	9.1	38.8
Depreciation: corporate						0.6
<b>Total</b>						39.4
Amortisation of intangibles arising on acquisition: segments	0.2	–	2.7	13.9	0.6	17.4
Amortisation – other: segments	3.6	1.7	5.3	1.3	1.2	13.1
Amortisation – other: corporate						13.1
<b>Total</b>						43.6
<b>Segment assets</b>						
Reportable segment assets	292.2	408.0	533.5	694.5	251.0	2,179.2
Corporate assets						9.0
Total segment assets						2,188.2
Unallocated assets						328.8
<b>Consolidated total assets</b>						2,517.0
<b>Segment liabilities</b>						
Reportable segment liabilities	(243.0)	(313.3)	(176.0)	(133.5)	(85.8)	(951.6)
Corporate liabilities						(102.3)
Total segment liabilities						(1,053.9)
Unallocated liabilities						(621.8)
<b>Consolidated total liabilities</b>						(1,675.7)

\* Capital expenditure is stated on a cash basis: including acquisitions but excluding finance leases.

Group Adjusted operating profit is £258.7m and comprises segment Adjusted operating profit of £310.2m less Corporate expenses of £51.5m.



## 5. Segmental information (continued)

	2011 £m	2010 £m
<b>Segment assets comprise:</b>		
Goodwill	1,259.0	899.5
Other intangible assets	184.9	145.0
Property, plant and equipment	194.8	135.4
Trade and other receivables – non-current	261.9	156.7
Retirement benefit assets	122.3	–
Inventories	58.8	65.4
Trade and other receivables – current	798.6	786.2
<b>Total segment assets</b>	<b>2,880.3</b>	2,188.2
Unallocated assets	301.8	328.8
<b>Consolidated total assets</b>	<b>3,182.1</b>	2,517.0
	2011 £m	2010 £m
<b>Segment liabilities comprise:</b>		
Trade and other payables – current	(804.2)	(805.5)
Trade and other payables – non-current	(61.4)	(22.2)
Retirement benefit obligations	(278.7)	(226.2)
<b>Total segment liabilities</b>	<b>(1,144.3)</b>	(1,053.9)
Unallocated liabilities	(1,034.0)	(621.8)
<b>Consolidated total liabilities</b>	<b>(2,178.3)</b>	(1,675.7)

### Geographic information

	Revenue 2011 £m	Non-current assets* 2011 £m	Revenue 2010 £m	Non-current assets* 2010 £m
United Kingdom	2,587.3	1,008.8	2,586.4	707.9
United States	802.1	460.8	880.3	463.2
Other countries	1,257.0	553.3	860.0	165.5
<b>Total</b>	<b>4,646.4</b>	<b>2,022.9</b>	4,326.7	1,336.6

\* Non-current assets exclude financial instruments and deferred tax assets.

Revenues from external customers are attributed to individual countries on the basis of the location of the customer.

### Information about major customers

The Group has two major governmental customers which each represent more than 10% of Group revenues. The customers' revenues were respectively £2,470.2m (2010: £2,418.3m) across all reported segments other than Americas and AMEAA and £740.2m (2010: £850.5m) within the Americas segment.

## Notes to the Consolidated Financial Statements

## 6. Operating profit

Operating profit is stated after charging/(crediting):

	2011 £m	2010 £m
Net foreign exchange losses	7.7	1.8
Research and development costs	57.6	62.3
Loss on disposal of property, plant and equipment	0.5	0.8
Depreciation and impairment of property, plant and equipment (note 16)	46.0	39.4
Amortisation of intangible assets – arising on acquisition (note 14)	20.0	17.4
Amortisation and impairment of intangible assets – other (note 14)	19.5	26.2
Impairment of goodwill (note 13)	–	4.2
Staff costs (note 7)	2,010.9	1,837.3
Allowance for doubtful debts charged to income statement (note 19)	7.2	2.2
Fair value adjustment on financial instruments		
– recycling of amounts on discontinued cash flow hedges (note 26(d))	0.3	0.3
– forward foreign exchange contracts: non-designated hedges (note 26(a))	(6.9)	(1.4)
Operating lease payments	130.0	128.6
Operating lease income (note 4)	(0.7)	–

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

	2011 £m	2010 £m
Fees payable to the Company's Auditor for the audit of the Company's annual accounts	0.8	0.9
Fees payable to the Company's Auditor and their associates for other services to the Group:		
– audit of the Company's subsidiaries	0.6	0.7
<b>Total audit fees</b>	<b>1.4</b>	<b>1.6</b>
– Audit-related assurance services	0.2	–
– Taxation compliance services	0.2	0.1
– Other taxation advisory services	0.4	0.2
– Other assurance services	–	0.1
– Other services	0.4	0.2
<b>Total non-audit fees</b>	<b>1.2</b>	<b>0.6</b>

Fees payable to Deloitte LLP and their associates for non-audit services to the Company are not required to be disclosed separately because the consolidated financial statements are required to disclose such fees on a consolidated basis.

Details of the Company's policy on the use of auditors for non-audit services and how the auditor's independence and objectivity was safeguarded are set out in the Corporate Governance Report on page 87. No services were provided pursuant to contingent fee arrangements.

## 7. Staff costs

The average monthly number of employees (including Executive Directors) was:

	2011 Number	2010 Number
Civil Government	12,300	11,313
Defence, Science and Nuclear	8,386	8,516
Local Government and Commercial	13,768	11,477
Americas	9,260	10,192
AMEAA	32,615	17,014
Unallocated	341	287
<b>Total</b>	<b>76,670</b>	<b>58,799</b>

Average monthly numbers of employees for joint ventures are included on a proportionately consolidated basis in the table above.

Aggregate remuneration comprised:

	2011 £m	2010 £m
Wages and salaries	1,731.1	1,582.9
Social security costs	156.3	139.1
Other pension costs (note 27)	112.3	106.5
	<b>1,999.7</b>	<b>1,828.5</b>
Share-based payment expense (note 34)	11.2	8.8
<b>Total</b>	<b>2,010.9</b>	<b>1,837.3</b>

## 8. Investment revenue

	2011 £m	2010 £m
Interest receivable on other loans and deposits	4.0	3.9
Net interest receivable on retirement benefit obligations (note 27)	8.2	–
<b>Total</b>	<b>12.2</b>	<b>3.9</b>

## 9. Finance costs

	2011 £m	2010 £m
Interest payable on non recourse loans	1.0	1.4
Interest payable on obligations under finance leases	2.1	2.2
Interest payable and amortisation of capitalised financing transaction costs on other loans	35.6	23.7
Movement in discount on provisions and deferred consideration	1.4	1.2
Net interest payable on retirement benefit obligations (note 27)	–	2.8
<b>Total</b>	<b>40.1</b>	<b>31.3</b>

## Notes to the Consolidated Financial Statements

## 10. Tax

## 10 (a) Income tax recognised in the income statement

	2011 £m	2010 £m
<b>Current income tax</b>		
Current income tax expense	67.0	63.3
Adjustments in respect of prior years	(5.5)	(8.1)
<b>Deferred tax</b>		
Current year	3.7	2.5
Adjustments in respect of prior years	(2.1)	(0.6)
	<b>63.1</b>	57.1

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

	2011 £m	2010 £m
<b>Profit before tax</b>	<b>238.3</b>	213.9
Tax calculated at a rate of 26.5% (2010: 28.0%)	63.1	59.9
Expenses not deductible for tax purposes	4.0	3.6
Unrelieved tax losses	3.1	2.5
Effect of the use of unrecognised tax losses	(2.6)	–
Impact of changes in statutory tax rates	1.9	0.8
Overseas rate differences	5.1	3.2
Tax incentives	(3.9)	(4.2)
Adjustments in respect of prior years	(7.6)	(8.7)
<b>Tax charge</b>	<b>63.1</b>	57.1

## 10 (b) Income tax recognised in the SOCI

	2011 £m	2010 £m
<b>Current tax</b>		
Taken to retirement benefit obligations reserve	(18.0)	(9.7)
<b>Deferred tax</b>		
Relating to cash flow hedges	(8.8)	0.6
Taken to retirement benefit obligations reserve	32.7	14.0
	<b>5.9</b>	4.9

The income tax expense for the year is based on the blended UK statutory rate of corporation tax for the period of 26.5% (2010: 28.0%). The impact of changes in statutory tax rates relates principally to the reduction of the UK corporation tax rate from 27% to 26% from 1 April 2011, which was enacted on 29 March 2011. In addition, the UK corporation tax rate was reduced from 26% to 25% from 1 April 2012, which was enacted on 5 July 2011. These changes have resulted in a deferred tax charge arising from the reduction in the balance sheet carrying value of deferred tax assets to reflect the anticipated rate of tax at which those assets are expected to reverse. The UK Government has also indicated that it intends to enact future reductions in the main tax rate of 1% each year down to 23% by 1 April 2014. We estimate that the future rate changes would further reduce the UK deferred tax assets and liabilities recognised but the actual impact will be dependent on the deferred tax position at that time.

## 10 (c) Tax on items taken directly to equity

	2011 £m	2010 £m
<b>Current tax</b>		
Recorded in share-based payment reserve	(0.8)	(2.7)
<b>Deferred tax</b>		
Recorded in share-based payment reserve	2.6	(0.5)
	<b>1.8</b>	(3.2)

## 11. Dividends

	2011 £m	2010 £m
<b>Amounts recognised as distributions to equity holders in the year:</b>		
Final dividend for the year ended 31 December 2010 of 5.15p per share on 488.5 million ordinary shares (2010: Final dividend for the year ended 31 December 2009 of 4.40p per share on 490.5 million ordinary shares)	25.2	21.6
Interim dividend for the year ended 31 December 2011 of 2.50p per share on 486.6 million ordinary shares (2010: Interim dividend for the year ended 31 December 2010 of 2.20p per share on 488.2 million ordinary shares)	12.1	10.7
	<b>37.3</b>	<b>32.3</b>
Proposed final dividend for the year ended 31 December 2011 of 5.90p per share on 489.1 million ordinary shares (2010: 5.15p on 488.5 million ordinary shares)	28.9	25.2

The proposed final dividend for 2011 is subject to approval by shareholders at the Annual General Meeting and has not been included as a liability in these financial statements. A dividend waiver is effective for those shares held on behalf of the Company by its Employee Share Ownership Trust (note 31).

## 12. Earnings per share

Basic and diluted earnings per ordinary share (EPS) have been calculated in accordance with IAS 33 Earnings per Share. EPS is shown both before and after amortisation of intangible assets arising on acquisition (note 14) and acquisition-related costs 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

	2011 Millions	2010 Millions
Weighted average number of ordinary shares for the purpose of basic EPS	490.5	491.5
Effect of dilutive potential ordinary shares: share options	8.6	8.4
Weighted average number of ordinary shares for the purpose of diluted EPS	499.1	499.9

### Earnings per share

	Earnings 2011 £m	Per share amount 2011 Pence	Earnings 2010 £m	Per share amount 2010 Pence
Earnings for the purpose of basic EPS being net profit attributable to the equity holders of the parent	175.1	35.70	156.7	31.88
Add back:				
Amortisation of intangible assets arising on acquisition, net of tax of £4.3m (2010: £3.6m)	15.7	3.20	13.8	2.81
Acquisition-related costs, net of tax of £0.5m (2010: £nil)	3.4	0.69	–	–
Adjusted earnings before amortisation of intangible assets arising on acquisition	194.2	39.59	170.5	34.69
Earnings for the purpose of basic EPS	175.1	35.70	156.7	31.88
Effect of dilutive potential ordinary shares	–	(0.62)	–	(0.53)
Diluted EPS	175.1	35.08	156.7	31.35

At 31 December 2011 options over nil (2010: nil) shares were excluded from the weighted average number of shares used for calculating diluted EPS because their exercise price was above the average share price for the year and they were, therefore, antidilutive.



## Notes to the Consolidated Financial Statements

## 13. Goodwill

	£m
At 1 January 2010	898.4
Additions	3.1
Impairment	(4.2)
Reduction in deferred consideration payable	(13.7)
Exchange differences	15.9
At 1 January 2011	<b>899.5</b>
Additions	<b>357.8</b>
Exchange differences	<b>1.7</b>
<b>At 31 December 2011</b>	<b>1,259.0</b>

Goodwill is attributable to the excess of consideration over the fair value of net assets acquired and includes expected synergies, future growth prospects, staff knowledge, expertise and customer contacts.

Additions during the year relate to goodwill recognised on six acquisitions. More details of these acquisitions are presented in the Acquisitions note (note 15).

The goodwill acquired in business combinations is allocated, at acquisition, to the cash-generating units (CGUs) that are expected to benefit from that business combination. Goodwill has been allocated to CGUs in the following operating segments:

	2011 £m	2010 £m
Civil Government	<b>75.1</b>	62.1
Defence, Science and Nuclear	<b>104.6</b>	105.5
Local Government and Commercial	<b>334.7</b>	295.5
Americas	<b>411.3</b>	408.2
AMEAA	<b>333.3</b>	28.2
<b>At 31 December</b>	<b>1,259.0</b>	899.5

The Group tests goodwill annually for impairment or more frequently if there are indications that goodwill might be impaired. The recoverable amount of each CGU is based on value in use calculations.

### 13. Goodwill (continued)

#### Key assumptions

The value in use calculations use discounted cash flow projections based on financial plans approved by senior management covering a five-year period, and include a terminal value based on the projections for the final year of that plan, with a growth rate assumption applied.

The key assumptions affecting the CGUs within each operating segment are discussed below. The Directors have not identified any reasonably possible material changes relating to these key assumptions that would cause the carrying value of goodwill to exceed its recoverable amount.

#### Short-term growth rates

Short-term revenue growth rates used in each CGU five-year plan are based on internal data regarding the current pipeline of opportunities and published industry forecasts for the relevant market. Further discussion of the Group's order book and pipeline is provided in the Our business and Our performance sections.

#### Terminal growth rates

The cash flows subsequent to the five-year period are based upon management's estimate of the growth rates of the sectors in which the CGUs operate. Where possible these have been derived with reference to external sources. The range of terminal growth rates applied to the CGUs within each operating segment are set out below:

	2011 %	2010 %
Civil Government	2.5	2.5
Defence, Science and Nuclear	2.5	2.5
Local Government and Commercial	2.5	2.5
Americas	3.0	3.0
AMEAA	2.5 – 7.0	2.5 – 7.0

These rates do not exceed the average long-term growth rates forecast for the individual market sectors.

#### Discount rate

Pre-tax discount rates, derived from the Group's post-tax weighted average cost of capital have been used in discounting the projected cash flows. These rates are adjusted for risks specific to the market in which the CGU operates, including but not limited to: geographic and economic risks, contract length and customer type.

The range of pre-tax discount rates applied to the CGUs within each operating segment are disclosed below:

	2011 %	2010 %
Civil Government	9.1	9.2
Defence, Science and Nuclear	8.8 – 9.1	9.1 – 9.2
Local Government and Commercial	9.1	9.1
Americas	9.9	9.9
AMEAA	10.4 – 12.2	9.6 – 12.9

#### Sensitivity analysis

Sensitivity analysis has been performed for each key assumption and the Directors have not identified any reasonably possible material changes in the key assumptions that would cause the carrying value of net assets, including goodwill, to exceed the recoverable amount.

## Notes to the Consolidated Financial Statements

## 14. Other intangible assets

	Acquisition-related		Other		Total £m
	Customer relationships £m	Licences and franchises £m	Software, IT and other development expenditure £m	Pension-related intangibles £m	
<b>Cost</b>					
At 1 January 2011	73.4	78.3	134.5	26.6	312.8
Arising on acquisition	52.0	–	3.9	–	55.9
Additions	–	–	30.6	–	30.6
Disposals	(2.5)	–	(0.5)	–	(3.0)
Reclassification to property, plant and equipment	–	–	(0.2)	–	(0.2)
Pension scheme franchise adjustment	–	–	–	(0.4)	(0.4)
Exchange differences	(6.4)	(4.1)	2.6	–	(7.9)
<b>At 31 December 2011</b>	<b>116.5</b>	<b>74.2</b>	<b>170.9</b>	<b>26.2</b>	<b>387.8</b>
<b>Amortisation and impairment</b>					
At 1 January 2011	32.7	55.5	61.9	17.7	167.8
Charge for the year	12.7	7.3	17.3	2.2	39.5
Disposals	(2.5)	–	(0.5)	–	(3.0)
Exchange differences	(0.8)	(1.0)	0.4	–	(1.4)
<b>At 31 December 2011</b>	<b>42.1</b>	<b>61.8</b>	<b>79.1</b>	<b>19.9</b>	<b>202.9</b>
<b>Net book value</b>					
<b>At 31 December 2011</b>	<b>74.4</b>	<b>12.4</b>	<b>91.8</b>	<b>6.3</b>	<b>184.9</b>

	Acquisition-related		Other		Total £m
	Customer relationships £m	Licences and franchises £m	Software, IT and other development expenditure £m	Pension-related intangibles £m	
<b>Cost</b>					
At 1 January 2010	71.7	69.5	133.9	26.6	301.7
Additions	–	2.9	22.8	–	25.7
Disposals	–	–	(23.2)	–	(23.2)
Exchange differences	1.7	5.9	1.0	–	8.6
<b>At 31 December 2010</b>	<b>73.4</b>	<b>78.3</b>	<b>134.5</b>	<b>26.6</b>	<b>312.8</b>
<b>Amortisation and impairment</b>					
At 1 January 2010	22.5	44.1	55.5	15.2	137.3
Charge for the year	9.9	7.5	23.7	2.5	43.6
Disposals	–	–	(17.4)	–	(17.4)
Exchange differences	0.3	3.9	0.1	–	4.3
<b>At 31 December 2010</b>	<b>32.7</b>	<b>55.5</b>	<b>61.9</b>	<b>17.7</b>	<b>167.8</b>
<b>Net book value</b>					
<b>At 31 December 2010</b>	<b>40.7</b>	<b>22.8</b>	<b>72.6</b>	<b>8.9</b>	<b>145.0</b>

Customer relationships are amortised over the 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 £20.0m (2010: £17.4m).

The Group is carrying £91.8m (2010: £72.6m) in relation to Software, IT and other development expenditure, which includes assets relating to the Group's SAP finance-related systems, of £57.2m (2010: £42.7m). The average amortisation period of these assets has four years (2010: six years) remaining.

The Group is carrying £74.4m (2010: £40.7m) in relation to Customer relationships of which the principal component is £35.8m arising from acquisition of Intelenet. The remaining average life of the customer relationship intangible assets is approximately seven years (2010: five years).

The value of internally generated intangible assets as at 31 December 2011 was approximately £58.5m (2010: £44.8m).

## 15. Acquisitions

During the year, the Group completed the following acquisitions which have been accounted for in accordance with IFRS 3 Business Combinations (2008).

### 15 (a) The Listening Company Limited

On 14 March 2011, Serco acquired 100% of the issued share capital of The Listening Company Limited. The initial cash cost of the acquisition was £40.9m, comprising £25.0m in cash, plus the repayment of £15.9m of debt immediately after acquisition. Consideration under IFRS 3 for the acquisition is £37.5m, being the initial cash payment of £25.0m noted above, and £12.5m being the fair value of deferred consideration, payable conditional on the financial performance in the two-year period from 1 March 2011 to the end of February 2013. The Listening Company Limited is a leading UK provider of outsourced contact centre services.

	Book value £m	Fair value adjustments £m	Provisional fair value £m
<b>Net assets acquired were:</b>			
Goodwill	0.2	(0.2)	–
Intangible assets	–	6.6	6.6
Property, plant and equipment	7.8	(1.1)	6.7
Deferred tax asset	0.1	3.0	3.1
Trade and other receivables	19.8	0.2	20.0
Tax assets	–	0.1	0.1
Trade and other payables	(16.2)	1.1	(15.1)
Loans	(16.7)	–	(16.7)
Tax liabilities	(0.3)	0.3	–
Deferred tax liabilities	–	(1.8)	(1.8)
Obligations under finance leases	(0.2)	(0.6)	(0.8)
Provisions	–	(4.0)	(4.0)
Net liabilities acquired	(5.5)	3.6	(1.9)
Goodwill			39.4
Total consideration			37.5
Satisfied by:			
Cash			25.0
Contingent consideration arrangement			12.5
Total consideration			37.5
Net cash outflow arising on acquisition:			
Purchase consideration			25.0

The provisional fair value of the financial assets acquired includes trade receivables with a fair value of £14.0m and a gross contractual value of £14.5m.

The goodwill of £39.4m arising from the acquisition represents future opportunities in the UK outsourced contact centre services industry. None of the goodwill is expected to be deductible for corporate income tax purposes.

The potential undiscounted amount of all future payments that Serco Group plc could be required to make under the contingent consideration arrangement, which has been measured based upon current expectations of future performance, is between £nil and £13.5m and the fair value is £12.5m.

Acquisition-related costs, included in Operating profit, but excluded from Adjusted operating profit, amounted to £0.6m.

The Listening Company Limited contributed £69.0m revenue and £5.2m to the Group's Adjusted operating profit for the period between the date of acquisition and the balance sheet date. If the acquisition of The Listening Company Limited had been completed on the first day of the financial year, Group Revenue for the period would have been £4,663.3m and the Group's Adjusted operating profit would have been £291.1m.

## Notes to the Consolidated Financial Statements

## 15. Acquisitions (continued)

**15 (b) Intelenet Global Services Private Limited (Intelenet)**

On 7 July 2011, the Group acquired 87% of the share capital of SKR BPO Services Private Limited and its subsidiary companies, including Intelenet Global Services Private Limited (together Intelenet), for an initial cash consideration of £249.3m. On acquisition, the Group was unconditionally obligated to acquire the remaining 13% of share capital for which it paid a further £35.7m on 19 October 2011. As a result, the Group has accounted for Intelenet as a 100% subsidiary with no attributable non-controlling assets from the acquisition date.

Net debt acquired was £51.1m comprising £55.5m of acquired loans and £4.4m of acquired cash balances.

There are contingent deferred consideration cash payments of up to £49.8m through to December 2013. The contingent cash payments are dependent principally on the delivery of revenue targets. The fair value of this contingent deferred consideration is £23.7m.

Intelenet is a leading provider of business process outsourcing (BPO) services to the private sector around the world and in the domestic Indian market. It operates from 34 global delivery centres across seven countries, providing a broad range of middle and back office services and has a strong customer base of international organisations, predominantly across the financial services, travel, healthcare and telecom sectors.

	Book value £m	Fair value adjustments £m	Provisional fair value £m
<b>Net assets acquired were:</b>			
Goodwill	62.4	(62.4)	–
Intangible assets	3.6	44.2	47.8
Property, plant and equipment	47.9	(18.1)	29.8
Deferred tax asset	0.4	22.1	22.5
Derivative financial instruments (assets)	1.8	–	1.8
Trade and other receivables	46.6	–	46.6
Tax assets	14.4	(10.6)	3.8
Cash and cash equivalents	4.4	–	4.4
Trade and other payables	(19.0)	(12.0)	(31.0)
Loans	(55.5)	–	(55.5)
Derivative financial instruments (liabilities)	(0.2)	–	(0.2)
Tax liabilities	–	(4.5)	(4.5)
Deferred tax liabilities	–	(14.4)	(14.4)
Provisions	(1.8)	(29.8)	(31.6)
Net assets acquired	<b>105.0</b>	<b>(85.5)</b>	<b>19.5</b>
Goodwill			<b>289.2</b>
Total consideration			<b>308.7</b>
Satisfied by:			
Cash			<b>285.0</b>
Contingent consideration arrangement			<b>23.7</b>
Total consideration			<b>308.7</b>
Net cash outflow arising on acquisition:			
Purchase consideration			<b>285.0</b>
Less: cash and cash equivalent balances acquired			<b>(4.4)</b>
Net cash outflow arising on acquisition			<b>280.6</b>

The provisional fair value of the financial assets acquired includes trade receivables with a fair value of £30.2m and a gross contractual value of £31.1m, and other receivables with a fair value of £16.4m and a gross contractual value of £16.5m.

The acquisition gives rise to £289.2m of goodwill relating to future opportunities in BPO. None of the goodwill recognised is expected to be deductible for corporate income tax purposes.

The Group incurred £3.1m of acquisition-related expenses in the period to 31 December 2011 in relation to this acquisition.

Intelenet contributed £83.7m revenue and £10.7m to the Group's Adjusted operating profit for the period between the date of acquisition and the balance sheet date. If the acquisition of Intelenet had been completed on the first day of the financial year, Group Revenue for the period would have been £4,724.3m and the Group's Adjusted operating profit would have been £299.8m.



## 15. Acquisitions (continued)

### 15 (c) Other acquisitions

#### *Braintree Clinical Services Limited*

On 8 March 2011, the Group acquired 100% of the issued share capital of Braintree Clinical Services Limited. The net cash received was £1.1m, comprising cash balances acquired of £1.6m and initial cash consideration of £0.5m. In addition, deferred consideration of £1.1m is payable in 2012. The fair value of net liabilities acquired totalled £2.0m.

Braintree Clinical Services Limited is based in the United Kingdom and provides clinical and hospital services to Strategic Health Authorities in the UK.

The acquisition gives rise to £3.6m of goodwill relating to future opportunities in the provision of clinical and hospital services. None of the goodwill recognised is expected to be deductible for income tax purposes.

Acquisition-related costs, included in Operating profit, but excluded from Adjusted operating profit, amounted to £0.1m.

Due to the immaterial nature of this acquisition, full disclosures under IFRS 3 are not presented.

#### *Philips Collection Services Limited*

On 24 October 2011, the Group acquired 100% of the issued share capital of Philips Collection Services Limited and its subsidiary company Philips Bailiffs Limited. The initial cash cost of the acquisition was £6.8m. In addition, deferred consideration of up to £3.4m is payable, contingent on financial performance in the period to 31 December 2013. The fair value of this deferred, contingent consideration is £3.3m. The provisional fair value of assets acquired totalled £0.7m.

Philips Collection Services Limited and Philips Bailiffs Limited are based in the United Kingdom and are engaged in the delivery of debt collection and fine management services to local and central government agencies.

The acquisition gives rise to £9.4m of goodwill relating to future opportunities in the delivery of debt collection and fine management services. None of the goodwill recognised is expected to be deductible for income tax purposes.

Acquisition-related costs included in Operating profit, but excluded from Adjusted operating profit, amounted to £0.1m.

Due to the immaterial nature of this acquisition, full disclosures under IFRS 3 are not presented.

#### *Excelior Pty Limited*

On 31 October 2011, the Group acquired 100% of the issued share capital of Excelior Pty Limited. The initial cash cost of the acquisition was £6.0m. In addition, deferred consideration of up to £3.4m is payable, contingent on financial performance in the period to 31 December 2012. The fair value of this deferred, contingent consideration is £3.4m. The provisional fair value of assets acquired totalled £2.3m.

Excelior Pty Limited is based in Australia and is engaged in the provision of contact centre services and business processing.

The acquisition gives rise to £7.1m of goodwill relating to future opportunities in the provision of contact centre services and business processing. None of the goodwill recognised is expected to be deductible for income tax purposes.

Due to the immaterial nature of this acquisition, full disclosures under IFRS 3 are not presented.

#### *JBI Properties Services Company LLC*

On 29 December 2011, the Group acquired 100% of the issued share capital of JBI Properties Services Company LLC. The consideration for this acquisition was £10.4m. The provisional fair value of assets acquired totalled £1.3m.

JBI Properties Services Company LLC is based in the United Arab Emirates and is engaged in the provision of facilities management services.

The acquisition gives rise to £9.1m of goodwill relating to future opportunities in the provision of facilities management services. None of the goodwill recognised is expected to be deductible for income tax purposes.

Due to the immaterial nature of this acquisition, full disclosures under IFRS 3 are not presented.

## Notes to the Consolidated Financial Statements

## 15. Acquisitions (continued)

## 15 (c) Other acquisitions (continued)

## Other acquisitions (in aggregate):

	Book value £m	Fair value adjustments £m	Provisional fair value £m
<b>Net assets acquired were:</b>			
Intangible assets	0.3	1.2	1.5
Property, plant and equipment	3.7	(0.1)	3.6
Deferred tax assets	0.8	0.8	1.6
Inventories	2.9	(0.3)	2.6
Trade and other receivables	13.2	–	13.2
Cash and cash equivalents	4.0	–	4.0
Trade and other payables	(15.6)	(2.5)	(18.1)
Loans	(1.1)	–	(1.1)
Tax liabilities	(0.3)	–	(0.3)
Deferred tax liabilities	–	(0.2)	(0.2)
Provisions	(1.9)	(2.6)	(4.5)
Net assets acquired	6.0	(3.7)	2.3
Goodwill			29.2
Total consideration			31.5

## Satisfied by:

Cash	23.7
Contingent consideration arrangement	7.8
Total consideration	31.5

## Net cash outflow arising on acquisitions:

Purchase consideration	23.7
Less: cash and cash equivalent balances acquired	(4.0)
Net cash outflow arising on acquisitions	19.7

## 16. Property, plant and equipment

	Freehold land and buildings £m	Short- leasehold building improvements £m	Machinery, motor vehicles, furniture and equipment £m	Total £m
<b>Cost</b>				
At 1 January 2011	7.2	50.8	297.7	355.7
Arising on acquisition	–	7.2	32.9	40.1
Additions	–	7.1	72.2	79.3
Disposals	–	(5.4)	(59.6)	(65.0)
Reclassification from intangible assets	–	–	0.2	0.2
Exchange differences	(0.2)	(0.7)	(3.8)	(4.7)
<b>At 31 December 2011</b>	<b>7.0</b>	<b>59.0</b>	<b>339.6</b>	<b>405.6</b>
<b>Accumulated depreciation and impairment</b>				
At 1 January 2011	3.5	26.3	190.5	220.3
Charge for the year	0.3	6.2	39.5	46.0
Disposals	–	(5.3)	(50.0)	(55.3)
Exchange differences	(0.1)	(0.1)	–	(0.2)
<b>At 31 December 2011</b>	<b>3.7</b>	<b>27.1</b>	<b>180.0</b>	<b>210.8</b>
<b>Net book value</b>				
<b>At 31 December 2011</b>	<b>3.3</b>	<b>31.9</b>	<b>159.6</b>	<b>194.8</b>

## I 6. Property, plant and equipment (continued)

	Freehold land and buildings £m	Short- leasehold building improvements £m	Machinery, motor vehicles, furniture and equipment £m	Total £m
<b>Cost</b>				
At 1 January 2010	7.4	47.1	265.2	319.7
Additions	–	2.4	44.5	46.9
Disposals	–	(0.1)	(22.2)	(22.3)
Exchange differences	(0.2)	1.4	10.2	11.4
<b>At 31 December 2010</b>	<b>7.2</b>	<b>50.8</b>	<b>297.7</b>	<b>355.7</b>
<b>Accumulated depreciation and impairment</b>				
At 1 January 2010	3.3	20.2	167.0	190.5
Charge for the year	0.2	5.6	33.6	39.4
Disposals	–	–	(15.4)	(15.4)
Exchange differences	–	0.5	5.3	5.8
<b>At 31 December 2010</b>	<b>3.5</b>	<b>26.3</b>	<b>190.5</b>	<b>220.3</b>
<b>Net book value</b>				
<b>At 31 December 2010</b>	<b>3.7</b>	<b>24.5</b>	<b>107.2</b>	<b>135.4</b>

The carrying amount of the Group's Machinery, motor vehicles, furniture and equipment includes an amount of £45.6m (2010: £23.9m) in respect of assets held under finance leases.

The carrying amount of the Group's Short-leasehold building improvements includes an amount of £1.4m (2010: £2.3m) in respect of assets held under finance leases.

## I 7. Joint ventures

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

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

### Income statement

	2011 £m	2010 £m
Revenue	819.3	794.1
Expenses	(737.7)	(729.5)
Operating profit	81.6	64.6
Investment revenue	2.7	2.2
Finance costs	(0.7)	(0.5)
Profit before tax	83.6	66.3
Tax	(20.0)	(17.2)
Share of post-tax results of joint ventures	63.6	49.1

Operating profit is after allocating £1.0m (2010: £0.7m) of costs incurred by Group.

### Balance sheet

	2011 £m	2010 £m
Non-current assets	218.4	156.7
Current assets	171.6	173.4
Current liabilities	(138.9)	(146.0)
Non-current liabilities	(212.5)	(141.1)
Net assets	38.6	43.0

## Notes to the Consolidated Financial Statements

## 18. Inventories

	2011 £m	2010 £m
Service spares	32.1	29.8
Parts awaiting installation	10.4	7.4
Long-term project-based contract balances	16.3	28.2
	<b>58.8</b>	65.4

## 19. Trade and other receivables

	2011 £m	2010 £m
<b>Trade and other receivables: non-current</b>		
Amounts owed by joint venturers	5.9	4.7
Amounts recoverable on retirement benefit obligations (note 27)	188.7	123.4
Security deposits	9.3	1.1
Other receivables	58.0	27.5
	<b>261.9</b>	156.7
<b>Trade and other receivables: current</b>		
Trade receivables	609.0	579.4
Other amounts recoverable on contracts	62.0	64.9
Prepayments and accrued income	87.4	96.7
Other receivables	40.2	45.2
	<b>798.6</b>	786.2

As at 31 December 2011, trade receivables of £2.9m (2010: £4.2m) were considered to be impaired. Impairments to trade receivables are based on specific estimated irrecoverable amounts and 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 £7.2m as of 31 December 2011 (2010: £4.2m), primarily because our customers either have a sovereign credit rating being government organisations or are blue-chip private sector companies.

The ageing of trade receivables is as follows:

	2011 £m	2010 £m
Neither impaired nor past due	496.8	488.0
Not impaired but overdue by less than 30 days	83.7	56.9
Not impaired but overdue by between 30 and 60 days	15.5	14.0
Not impaired but overdue by more than 60 days	17.3	20.5
Impaired	2.9	4.2
Allowance for doubtful debts	(7.2)	(4.2)
	<b>609.0</b>	579.4

Movements on the Group allowance for doubtful debts are as follows:

	2011 £m	2010 £m
At 1 January	4.2	3.4
Charged to income statement	7.2	2.2
Utilised	(4.2)	(1.4)
<b>At 31 December</b>	<b>7.2</b>	4.2

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.

## 20. Long-term contracts

	2011 £m	2010 £m
<b>Contracts in progress at the balance sheet date:</b>		
Amounts due from long-term project-based contract customers included in trade and other receivables	39.4	51.0
Amounts due to long-term project-based contract customers included in trade and other payables	(0.5)	(3.4)
	<b>38.9</b>	47.6
Long-term project-based contract costs incurred plus recognised profits less recognised losses to date	<b>872.2</b>	857.3
Less: progress payments	<b>(833.3)</b>	(809.7)
	<b>38.9</b>	47.6

As at 31 December 2011, £nil (2010: £nil) of advances received from customers were included within long-term project-based contract balances. As at 31 December 2010, the Group had £0.4m (2010: £nil) of contract retentions held by customers.

## 21. Cash and cash equivalents

	Sterling 2011 £m	Other currencies 2011 £m	Total 2011 £m	Sterling 2010 £m	Other currencies 2010 £m	Total 2010 £m
Cash of project companies securing credit obligations*	–	–	–	–	7.3	7.3
Customer advance payments*	–	5.5	5.5	–	3.6	3.6
Other cash and short-term deposits	89.6	159.7	249.3	108.5	159.9	268.4
<b>Total cash and cash equivalents</b>	<b>89.6</b>	<b>165.2</b>	<b>254.8</b>	108.5	170.8	279.3

\* Cash of project companies and customer advance payments totalling £5.5m (2010: £10.9m) are encumbered cash balances.

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 2011 £m	Other loans 2011 £m	Total 2011 £m	Non recourse loans 2010 £m	Other loans 2010 £m	Total 2010 £m
Loans are repayable as follows:						
On demand or within one year	7.8	198.8	206.6	8.0	151.5	159.5
Between one and two years	7.7	147.2	154.9	7.9	114.3	122.2
Between two and five years	–	104.5	104.5	7.8	224.2	232.0
After five years	–	376.8	376.8	–	0.4	0.4
	<b>15.5</b>	<b>827.3</b>	<b>842.8</b>	23.7	490.4	514.1
Less: amount due for settlement within one year (shown within current liabilities)	(7.8)	(198.8)	(206.6)	(8.0)	(151.5)	(159.5)
<b>Amounts due for settlement after one year</b>	<b>7.7</b>	<b>628.5</b>	<b>636.2</b>	15.7	338.9	354.6

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

	Carrying amount 2011 £m	Fair value 2011 £m	Carrying amount 2010 £m	Fair value 2010 £m
Non recourse loans	15.5	16.1	23.7	25.3
Other loans	827.3	848.9	490.4	506.8
	<b>842.8</b>	<b>865.0</b>	514.1	532.1

The fair values are based on cash flows discounted using a rate based on the borrowing rate associated with the loan. All loans are held at amortised cost.



## Notes to the Consolidated Financial Statements

## 23. Deferred tax

Deferred income taxes are calculated in full on temporary differences under the liability method using local substantively enacted tax rates.

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

	2011 £m	2010 £m
At 1 January – asset	(23.5)	(39.0)
Income statement charge (note 10)	1.6	1.9
Acquisitions	(10.8)	–
Items recognised in equity and in other comprehensive income (note 10)	26.5	14.1
Exchange differences	0.3	(0.5)
<b>At 31 December – asset</b>	<b>(5.9)</b>	<b>(23.5)</b>

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

	Temporary differences on assets/intangibles £m	Share-based payment and employee benefits £m	Retirement benefit schemes £m	Derivative financial instruments £m	Other temporary differences £m	Total £m
At 1 January 2011	17.3	(27.1)	(13.5)	(0.3)	0.1	(23.5)
(Credited)/charged to income statement	(6.8)	2.2	(0.7)	–	6.9	1.6
Acquisitions	16.7	(1.4)	–	–	(26.1)	(10.8)
Items recognised in equity and in other comprehensive income	–	2.6	32.7	(8.8)	–	26.5
Exchange differences	(1.6)	(0.1)	–	–	2.0	0.3
<b>At 31 December 2011</b>	<b>25.6</b>	<b>(23.8)</b>	<b>18.5</b>	<b>(9.1)</b>	<b>(17.1)</b>	<b>(5.9)</b>

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

	Temporary differences on assets/intangibles £m	Share-based payment and employee benefits £m	Retirement benefit schemes £m	Derivative financial instruments £m	Other temporary differences £m	Total £m
At 1 January 2010	22.6	(17.8)	(25.4)	(1.0)	(17.4)	(39.0)
(Credited)/charged to income statement	(5.6)	(8.7)	(2.1)	0.1	18.2	1.9
Items recognised in equity and in other comprehensive income	–	(0.5)	14.0	0.6	–	14.1
Exchange differences	0.3	(0.1)	–	–	(0.7)	(0.5)
<b>At 31 December 2010</b>	<b>17.3</b>	<b>(27.1)</b>	<b>(13.5)</b>	<b>(0.3)</b>	<b>0.1</b>	<b>(23.5)</b>

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:

	2011 £m	2010 £m
Deferred tax liabilities	22.3	14.6
Deferred tax assets	(28.2)	(38.1)
	<b>(5.9)</b>	<b>(23.5)</b>

At the balance sheet date, the Group did not recognise deferred tax assets of £10.2m (2010: £9.7m) which principally relate to unused tax losses of £34.9m (2010: £31.8m). Losses of £4.5m (2010: £1.3m) expire within five years, losses of £17.2m (2010: £11.0m) expire within 6-10 years, losses of £nil (2010: £12.6m) expire within 15-20 years and losses of £13.2m (2010: £6.9m) may be carried forward indefinitely.

At the balance sheet date, the aggregate amount of temporary differences associated with undistributed earnings of subsidiaries for which deferred tax liabilities have not been recognised was £0.1m (2010: £0.1m). No liability has been recognised in respect of these differences because the Group is in a position to control the timing of the reversal of the temporary differences and it is probable that such differences will not reverse in the foreseeable future.

## 24. Obligations under finance leases

	Minimum lease payments 2011 £m	Present value of minimum lease payments 2011 £m	Minimum lease payments 2010 £m	Present value of minimum lease payments 2010 £m
Amounts payable under finance leases:				
Within one year	10.9	10.3	8.8	7.1
Between one and five years	32.9	30.5	20.5	18.2
After five years	5.2	5.1	1.3	1.1
	49.0	45.9	30.6	26.4
Less: future finance charges	(3.1)	–	(4.2)	–
Present value of lease obligations	45.9	45.9	26.4	26.4
Less: amount due for settlement within one year (shown under current liabilities)	(10.9)	(10.3)	(8.8)	(7.1)
<b>Amounts due for settlement after one year</b>	<b>35.0</b>	<b>35.6</b>	<b>17.6</b>	<b>19.3</b>

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 to their carrying amount.

## 25. Trade and other payables

	2011 £m	2010 £m
<b>Trade and other payables: current</b>		
Trade payables	217.7	203.8
Other payables	140.3	152.4
Accruals and deferred income	446.2	449.2
Amounts owed to joint venturers	–	0.1
	804.2	805.5
<b>Trade and other payables: non-current</b>		
Other payables	61.4	22.2

The average credit period taken for trade purchases is 31 days (2010: 31 days).

## Notes to the Consolidated Financial Statements

## 26. Financial risk management

## 26 (a) Fair value of financial instruments

## (i) Hierarchy of fair value

The classification of the fair value measurement falls into three levels, based on the degree to which the fair value is observable. The levels are as follows:

Level 1: derived from unadjusted quoted prices in active markets for identical assets or liabilities;

Level 2: derived from other observable market data for the assets or liabilities; and

Level 3: derived from valuation techniques using data that is not based on observable market data.

Based on the above, the derivative financial instruments held by the Group at 31 December 2011, are considered to fall into Level 2.

The Group held the following financial instruments which fall within the scope of IAS 39 Financial Instruments: Recognition and Measurement at 31 December:

	Carrying amount (measurement basis)		Comparison fair value	Carrying amount (measurement basis)		Comparison fair value
	Amortised cost 2011 £m	Fair value hierarchy – Level 2 2011 £m	2011 £m	Amortised cost 2010 £m	Fair value hierarchy – Level 2 2010 £m	2010 £m
<b>Loans and receivables:</b>						
Trade receivables (note 19)	609.0		609.0	579.4		579.4
<b>Derivative financial assets:</b>						
Derivative financial instruments: non-current		2.0			3.5	
Derivative financial instruments: current		7.6			3.9	
<b>Financial liabilities at amortised cost:</b>						
Trade payables (note 25)	(217.7)		(217.7)	(203.8)		(203.8)
Loans (note 22)	(842.8)		(865.0)	(514.1)		(532.1)
<b>Derivative financial liabilities:</b>						
Derivative financial instruments: current		(12.3)			(2.4)	
Derivative financial instruments: non-current		(26.3)			(5.2)	

The Directors estimate that the carrying amounts of trade receivables and trade payables approximate to their fair value.

The fair values of loans are based on cash flows discounted using a rate based on the borrowing rate associated with the loan. All loans are held at amortised cost.

The fair values of derivative financial instruments are calculated based on a discounted cash flow analysis using appropriate quoted interest rates for the duration of the instruments as noted below:

- Currency swaps and interest rate swaps are measured at the present value of estimated future cash flows. The present value of foreign currency balances are converted at the year end exchange rate;
- Forward foreign exchange contracts are measured using quoted forward exchange rates matching the maturities of the contracts; and
- Commodity contracts are measured at the present value of estimated cash flows with reference to quoted forward prices for Gas Oil.

## 26. Financial risk management (continued)

### 26 (a) Fair value of financial instruments (continued)

#### (ii) Fair value of derivative financial instruments

The fair valuation of derivative financial instruments resulted in a net liability of £29.0m (2010: £0.2m), comprising non-current assets of £2.0m (2010: £3.5m), current assets of £7.6m (2010: £3.9m), current liabilities of £12.3m (2010: £2.4m) and non-current liabilities of £26.3m (2010: £5.2m).

	1 January 2011 £m	Movement in fair value of cash flow hedges £m	Movement in fair value of non-designated hedges £m	31 December 2011 £m
Currency swaps	1.0	(0.2)	–	0.8
Forward foreign exchange contracts	(0.2)	(38.3)	6.9	(31.6)
Interest rate swaps	(3.6)	3.0	–	(0.6)
Commodity futures contracts	2.6	(0.2)	–	2.4
	(0.2)	(35.7)	6.9	(29.0)

	1 January 2010 £m	Movement in fair value of cash flow hedges £m	Movement in fair value of non-designated hedges £m	31 December 2010 £m
Currency swaps	(0.5)	1.5	–	1.0
Forward foreign exchange contracts	(2.3)	0.7	1.4	(0.2)
Interest rate swaps	(2.1)	(1.5)	–	(3.6)
Commodity futures contracts	1.6	1.0	–	2.6
	(3.3)	1.7	1.4	(0.2)

### 26 (b) Financial risk

The Board is ultimately responsible for ensuring that financial and non-financial risks are 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.

## Notes to the Consolidated Financial Statements

## 26. Financial risk management (continued)

**26 (c) Liquidity risk***(i) Credit facilities*

The Group maintains committed credit facilities to ensure that it has sufficient liquidity to maintain its ongoing operations. As at 31 December, the Group's committed bank credit facilities and corresponding borrowings were as follows:

	Currency	Amount 2011 Millions	Drawn 2011 £m	Undrawn 2011 £m	Total facility 2011 £m
Syndicated revolving credit facility	GBP	400.0	–	400.0	400.0
Syndicated term loan facility (amortising)	USD	258.4	166.3	–	166.3
Syndicated term loan facility (amortising)	GBP	75.0	75.0	–	75.0
Bilateral revolving credit facility	GBP	75.0	–	75.0	75.0
Bilateral revolving credit facility	EUR	12.5	–	10.4	10.4
			<b>241.3</b>	<b>485.4</b>	<b>726.7</b>

	Currency	Amount 2010 Millions	Drawn 2010 £m	Undrawn 2010 £m	Total facility 2010 £m
Syndicated revolving credit facility	GBP	400.0	76.6	323.4	400.0
Syndicated term loan facility (amortising)	USD	396.4	253.2	–	253.2
Bilateral revolving credit facility	GBP	35.0	–	35.0	35.0
Bilateral revolving credit facility	EUR	12.5	–	10.7	10.7
			<b>329.8</b>	<b>369.1</b>	<b>698.9</b>

The syndicated revolving credit facility matures in September 2013. The US Dollar syndicated term loan facility is repayable between September 2012 and September 2013. The Sterling syndicated term loan facility is repayable between June 2012 and June 2014. The bilateral revolving credit facilities mature between April 2012 and September 2013.

The banking facilities are unsecured and have financial and non-financial covenants and obligations typical of these arrangements.

In addition to the banking facilities, the Group has outstanding US private placements of £502.8m of which £94.2m amortise between 2012 and 2015 and £408.6m are bullet repayments between 2016 and 2023.

*(ii) Maturity of financial liabilities*

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
Trade payables (note 25)	217.7	–	–	–	217.7
Obligations under finance leases (note 24)	10.9	10.6	22.3	5.2	49.0
Loans (note 22)	206.6	154.9	104.5	376.8	842.8
Future loan interest	29.4	25.1	54.4	71.0	179.9
Derivative financial liabilities	12.3	10.7	22.4	–	45.4
<b>At 31 December 2011</b>	<b>476.9</b>	<b>201.3</b>	<b>203.6</b>	<b>453.0</b>	<b>1,334.8</b>

	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
Trade payables (note 25)	203.8	–	–	–	203.8
Obligations under finance leases (note 24)	8.8	6.1	14.4	1.3	30.6
Loans (note 22)	159.5	122.2	232.0	0.4	514.1
Future loan interest	16.0	11.4	11.2	0.3	38.9
Derivative financial liabilities	5.4	0.9	0.1	–	6.4
<b>At 31 December 2010</b>	<b>393.5</b>	<b>140.6</b>	<b>257.7</b>	<b>2.0</b>	<b>793.8</b>



## 26. Financial risk management (continued)

### 26 (c) Liquidity risk (continued)

The Group's derivative financial liabilities are settled on both a net and gross basis depending upon the terms of each derivative financial instrument. The maturity of the Group's undiscounted derivative financial liabilities is as follows:

	Forward foreign exchange contracts £m	Interest rate swaps £m	Total £m
On demand or within one year	(11.7)	(0.6)	(12.3)
Between one and two years	(10.7)	–	(10.7)
Between two and five years	(22.4)	–	(22.4)
<b>At 31 December 2011</b>	<b>(44.8)</b>	<b>(0.6)</b>	<b>(45.4)</b>

	Forward foreign exchange contracts £m	Interest rate swaps £m	Total £m
On demand or within one year	(2.4)	(3.0)	(5.4)
Between one and two years	(0.4)	(0.5)	(0.9)
Between two and five years	(0.1)	–	(0.1)
At 31 December 2010	(2.9)	(3.5)	(6.4)

### 26 (d) Foreign exchange risk

#### (i) Transactional

Other than within the AMEAA segment, the Group's business does not involve a significant amount of cross-border trade, and therefore the Group is not exposed to substantial foreign currency transaction risk as sales and costs are closely matched within each overseas operation. Any material transactional exposures that do arise are hedged by the Group treasury function using forward foreign exchange contracts.

Within the Group's AMEAA business there is a significant amount of cross-border trade on its sales contracts. Cash flow hedges are entered into by the local companies to hedge the majority of the highly probable revenue.

#### (ii) Translational

Central funding of individual businesses gives rise to monetary assets and liabilities. The currency of funding is selected to ensure that any foreign exchange risk resides with Group. This risk is then managed by the Group's treasury function, using forward foreign exchange contracts and any natural hedge positions that may exist.

#### (iii) 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 swap contracts in the management of its exchange rate exposures. These contracts are primarily denominated in the currencies of the Group's principal markets.

At 31 December 2011, the net total notional amount of outstanding forward foreign exchange and currency swap contracts to which the Group is committed to sell is £364.0m (2010: sell £59.6m). These arrangements are mainly designed to address the majority of foreign currency exposures over the next five years (2010: five years).

## Notes to the Consolidated Financial Statements

## 26. Financial risk management (continued)

## 26 (d) Foreign exchange risk (continued)

## (iv) Cash flow hedges

At 31 December 2011, the Group held two currency swaps designated as cash flow hedges against the 2003 US Dollar private placement. 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	Receivable USD interest rate	Payable GBP interest rate	Notional amount	Receivable USD interest rate	Payable GBP interest rate
	2011 USD m	2011 %	2011 %	2010 USD m	2010 %	2010 %
August 2015	32.0	5.7	5.7	35.0	5.7	5.7
August 2015	18.3	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 to sell of £213.2m (2010: buy £29.5m).

All currency derivatives designated as cash flow hedges are highly effective and the fair value loss of £35.7m (2010: £1.7m gain) has been deferred in equity. Amounts in the hedging reserve are recycled to the consolidated income statement as the hedged transactions affect the consolidated income statement. A loss of £0.3m (2010: £0.3m loss) has been included in the consolidated income statement and the remaining loss of £35.4m (2010: £2.0m gain) is expected to be recognised in the consolidated income statement in future periods.

## (v) Net investments in foreign operations

Where possible the Group will raise external funding to match the currency profile of its foreign operations and mitigate translation exposure. Currency derivatives are used to protect against movements in foreign exchange where match funding is not possible and there exists a liquid and economic market. At 31 December 2011 there is a net exchange loss on translation of foreign operations of £2.2m (2010: gain £19.0m).

## (vi) Currency sensitivity

The Group's currency exposures that result in net currency gains and losses in the income statement and equity arise principally from US Dollar financial instruments. At 31 December 2011, 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 £0.2m lower (2010: £0.1m lower), mainly as a result of movements on working capital.

## 26 (e) Interest rate risk

The Group's policy is to minimise the impact of interest rate volatility on earnings to provide an appropriate level of certainty to cost of funds. Exposure to interest rate risk arises principally on changes to US Dollar and Sterling interest rates.

## (i) Interest rate management

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

## Financial assets

	Floating rate	Fixed rate	Weighted average fixed interest rate	Floating rate	Fixed rate	Weighted average fixed interest rate
	2011 £m	2011 £m	2011 %	2010 £m	2010 £m	2010 %
Cash and cash equivalents	254.8	–		279.3	–	

## Financial liabilities

	Floating rate	Fixed rate	Weighted average fixed interest rate	Floating rate	Fixed rate	Weighted average fixed interest rate
	2011 £m	2011 £m	2011 %	2010 £m	2010 £m	2010 %
Non recourse Canadian Dollar loans	–	15.5	5.27	–	23.7	5.27
Sterling loans	105.4	94.2	5.93	19.2	118.6	5.83
US Dollar loans	191.6	408.6	3.66	106.3	223.5	2.53
Other loans	27.5	–		22.8	–	
	324.5	518.3		148.3	365.8	

Exposure to interest rate fluctuations is mitigated through the use of interest rate derivatives. Excluded from the above analysis is £45.9m (2010: £26.4m) of amounts payable under finance leases, which are subject to fixed rates of interest.

## 26. Financial risk management (continued)

### 26 (e) Interest rate risk (continued)

#### (ii) Interest rate swaps

During 2009 the Group entered into interest rate swaps to manage its exposure to interest rate risk on US Dollar 450m debt by swapping floating for fixed interest rates. The profile of the interest rate swaps is as follows:

Maturity	Notional value 2011 USD m	Payable USD weighted average interest rate 2011 %	Receivable USD interest rate 2011 %
March 2012	300	1.83	3 month USD LIBOR

Maturity	Notional value 2010 USD m	Payable USD weighted average interest rate 2010 %	Receivable USD interest rate 2010 %
March 2011	150	1.60	3 month USD LIBOR
March 2012	300	1.83	3 month USD LIBOR

The swaps were designated as cash flow hedges and are highly effective. The fair value gain of £2.9m has therefore been deferred within equity (2010: £1.5m loss).

#### (iii) Interest rate sensitivity

The sensitivity analysis below shows the exposure to interest rates for both derivative and non-derivative net financial liabilities at the balance sheet date. A 100 basis point increase in interest rates with all other variables held constant would have resulted in a gain on profit after tax for the year to 31 December 2011 of £0.5m (2010: £0.7m gain).

### 26 (f) Price risk

The Group is exposed to commodity price risk through its joint venture rail operations due to the volatility in the price of fuel.

The maturity profile of the commodity derivative used by the joint venture to reduce this risk is as follows:

Maturity	Notional value 2011 Million litres	Payable fixed rate 2011 p per litre
January 2012 – September 2013	64.6	44.81

Maturity	Notional value 2010 Million litres	Payable fixed rate 2010 p per litre
January 2011 – September 2011	18.5	28.95
January 2011 – September 2011	10.8	39.70
January 2011 – September 2013	74.2	42.96

The commodity derivative is designated as a cash flow hedge and is highly effective. During the year a loss of £0.3m (2010: £1.0m gain) has been deferred within equity.

#### (iv) Price risk sensitivity

An increase of US Dollar 0.2 per litre in the price of fuel at the balance sheet date would result in a gain of £4.2m in equity (2010: £7.1m gain). The sensitivity to changes in fuel prices resulting from changes in exchange rates is included within the currency sensitivity analysis (see note 26(d)).

# Notes to the Consolidated Financial Statements

## 26. Financial risk management (continued)

### 26 (g) Credit risk

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

Credit risk is the risk that a counterparty could default on its contractual obligations. In this regard, the Group's principal exposure is to cash and cash equivalents, derivative transactions and trade receivables.

The Group's trade receivables credit risk is relatively low given that a high proportion of our customer base are government bodies with strong sovereign, or sovereign-like, credit ratings. However, where the assessed creditworthiness of a customer, government or non government, falls below that considered acceptable, appropriate measures are taken to mitigate against the risk of contractual default using instruments such as credit guarantees.

The Group's Treasury function only transacts with counterparties that comply with Board policy. The credit risk is measured by way of a counterparty credit rating and as a minimum any counterparty must have a long-term public rating of 'Single A' from any two recognised rating agencies. Pre-approved limits are set based on a rating matrix and exposures monitored accordingly. The Group also employs the use of set-off rights in some agreements.

### 26 (h) Capital risk

The Group defines capital as equity, debt capital market issuance, loans and borrowings (note 22) and cash and cash equivalents (note 21). The Group does not have any externally imposed requirements for managing capital, other than those imposed by Company Law.

The Board's objective is to maintain a capital structure that supports the Group's strategic objectives, including but not limited to reshaping the portfolio through mergers, acquisitions and disposals. In doing so the Board seeks to manage funding and liquidity risk, optimise shareholder return and maintain an implied investment grade credit position. This strategy is unchanged from the prior year.

The Board reviews and approves at least annually a treasury policy document which covers, inter alia, funding and liquidity risk, capital structure and risk management. This policy details targets for committed funding headroom, diversification of committed funding and debt maturity profile.

The Articles of Association of Serco Group plc require that the net borrowings of Serco Group plc and its subsidiary undertakings shall not at any time without the previous sanction of an ordinary resolution exceed three and a half times adjusted capital and reserves.

The Group ensures that sufficient funds and distributable reserves are held to allow payments of projected dividends to shareholders and it intends to pursue a policy of dividend growth that broadly reflects the increase in underlying earnings of the business.

## 27. Retirement benefit schemes

The Group has accounted for pensions in accordance with IAS 19 Employee Benefits. The Group operates a number of defined benefit schemes and defined contribution schemes. The pension charge for the year ended 31 December 2011, including the proportionate share of joint ventures, was £112.3m (2010: £106.5m).

### 27 (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 schemes are held independently of the Group's assets in separate trustee administered funds. The Group's major schemes are valued by independent actuaries annually using the projected unit credit actuarial cost 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 scheme 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 scheme 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 scheme to settle obligations in the other scheme and intends to exercise this right.

## 27. Retirement benefit schemes (continued)

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

#### (i) Balance sheet values

The amounts recognised in the 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 income statement, the expense relating to this defined benefit scheme 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 SOCI. 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, both of which do not relate to any specific contract. Any liabilities arising are recognised in full.

#### (ii) Triennial funding valuation

Among our non contract specific schemes, the largest is the Serco Pension and Life Assurance Scheme (SPLAS). The most recent full actuarial valuation of this scheme was undertaken as at 6 April 2009 and resulted in an actuarially assessed deficit of £141m. Following this review, the Group agreed with the Trustees to make cash contributions of 30% of members' pensionable salaries until 2019, plus lump sum payments of £20m, which was paid in December 2010 and £40m, which was paid in January 2011. The Group continues to review the level of benefits and contributions under the scheme in light of our business needs and changes to pension legislation.

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

	Virtually certain costs reimbursed 2011 £m	Not certain costs reimbursed 2011 £m	Non contract specific 2011 £m	Total 2011 £m
<b>Scheme assets at fair value</b>				
Equities	84.2	234.9	39.1	358.2
Bonds except LDI	17.9	71.4	5.9	95.2
Liability driven investments (LDI)	24.0	16.0	918.6	958.6
Gilts	30.0	23.0	11.9	64.9
Property	24.2	28.4	3.0	55.6
Cash and other	72.3	55.6	60.8	188.7
Annuity policies	–	–	26.0	26.0
Fair value of scheme assets	252.6	429.3	1,065.3	1,747.2
Present value of scheme liabilities	(441.3)	(594.9)	(1,001.3)	(2,037.5)
Net amount recognised	(188.7)	(165.6)	64.0	(290.3)
Members' share of deficit	–	43.7	2.2	45.9
Franchise adjustment	–	95.4	–	95.4
Effect of IFRIC 14	–	–	(7.4)	(7.4)
<b>Net pension (liability)/asset</b>	<b>(188.7)</b>	<b>(26.5)</b>	<b>58.8</b>	<b>(156.4)</b>
<b>Analysed as:</b>				
Retirement benefit obligations	(188.7)	(26.5)	(63.5)	(278.7)
Retirement benefit assets	–	–	122.3	122.3
<b>Related assets</b>				
Intangible assets (note 14)	–	6.3	–	6.3
Trade and other receivables (note 19)	188.7	–	–	188.7
	188.7	6.3	–	195.0



## Notes to the Consolidated Financial Statements

## 27. Retirement benefit schemes (continued)

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

	Virtually certain costs reimbursed 2010 £m	Not certain costs reimbursed 2010 £m	Non contract specific 2010 £m	Total 2010 £m
<b>Scheme assets at fair value</b>				
Equities	132.2	255.2	36.6	424.0
Bonds except LDI	56.1	45.1	16.6	117.8
Liability driven investments (LDI)	–	9.3	651.3	660.6
Gilts	–	33.8	1.1	34.9
Property	17.8	26.5	9.5	53.8
Cash and other	48.7	32.4	134.9	216.0
Annuity policies	–	1.0	25.1	26.1
Fair value of scheme assets	254.8	403.3	875.1	1,533.2
Present value of scheme liabilities	(378.2)	(510.4)	(951.5)	(1,840.1)
Net amount recognised	(123.4)	(107.1)	(76.4)	(306.9)
Members' share of deficit	–	26.7	1.5	28.2
Franchise adjustment	–	53.7	–	53.7
Effect of IFRIC 14	–	–	(1.2)	(1.2)
<b>Net pension liability</b>	<b>(123.4)</b>	<b>(26.7)</b>	<b>(76.1)</b>	<b>(226.2)</b>
<b>Related assets</b>				
Intangible assets (note 14)	–	8.9	–	8.9
Trade and other receivables (note 19)	123.4	–	–	123.4
	123.4	8.9	–	132.3

Liabilities in relation to unfunded schemes included above amount to £48.4m (2010: £48.7m).

Certain of the Group's non contract specific schemes have 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. The assumed expected rate of return is taken to be gilts +0.8% (2010: gilts +0.7%).

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 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.

## 27. Retirement benefit schemes (continued)

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

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

Non contract	Virtually reimbursed 2011 £m	Not certain reimbursed 2011 £m	certain costs specific 2011 £m	costs Total 2011 £m
<b>Recognised in the income statement</b>				
Current service cost – employer	8.4	16.5	15.5	40.4
Past service cost	–	–	0.4	0.4
Curtailment gain	–	–	(0.3)	(0.3)
Settlement gain	–	–	(0.2)	(0.2)
Reimbursed to employer	(8.4)	–	–	(8.4)
<b>Recognised in arriving at operating profit</b>	–	16.5	15.4	31.9
Expected return on scheme assets – employer	(17.0)	(20.3)	(53.6)	(90.9)
Interest on franchise adjustment	–	(2.9)	–	(2.9)
Interest cost on scheme liabilities – employer	20.5	20.5	48.1	89.1
Reimbursed to employer	(3.5)	–	–	(3.5)
<b>Finance income</b>	–	(2.7)	(5.5)	(8.2)
<b>Included within the SOCI</b>				
Actual (loss)/return on scheme assets	(10.2)	5.3	162.8	157.9
Less: expected return on scheme assets	(17.0)	(27.8)	(55.0)	(99.8)
	(27.2)	(22.5)	107.8	58.1
Other actuarial losses	(39.7)	(43.8)	(25.6)	(109.1)
<b>Actuarial losses recognised in the SOCI</b>	(66.9)	(66.3)	82.2	(51.0)
Change in IFRIC 14	–	–	(6.2)	(6.2)
Change in franchise adjustment	–	38.4	–	38.4
Change in members' share	–	16.5	0.9	17.4
Reimbursed to employer	66.9	–	–	66.9
<b>Actuarial gains/(losses) on reimbursable rights</b>	66.9	54.9	(5.3)	116.5
<b>Total pension (cost)/income recognised in the SOCI</b>	–	(11.4)	76.9	65.5

## Notes to the Consolidated Financial Statements

## 27. Retirement benefit schemes (continued)

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

	Virtually certain costs reimbursed 2010 £m	Not certain costs reimbursed 2010 £m	Non contract specific 2010 £m	Total 2010 £m
<b>Recognised in the income statement</b>				
Current service cost – employer	9.7	15.5	14.7	39.9
Past service cost	–	–	0.3	0.3
Reimbursed to employer	(9.7)	–	–	(9.7)
<b>Recognised in arriving at operating profit</b>				
	–	15.5	15.0	30.5
Expected return on scheme assets – employer	(16.6)	(18.4)	(46.0)	(81.0)
Interest on franchise adjustment	–	(3.4)	–	(3.4)
Interest cost on scheme liabilities – employer	21.5	20.4	50.2	92.1
Reimbursed to employer	(4.9)	–	–	(4.9)
<b>Finance (income)/cost</b>	–	(1.4)	4.2	2.8
<b>Included within the SOCI</b>				
Actual return on scheme assets	24.1	35.7	81.7	141.5
Less: expected return on scheme assets	(16.6)	(25.3)	(47.4)	(89.3)
	7.5	10.4	34.3	52.2
Other actuarial gains/(losses)	13.8	3.7	(19.8)	(2.3)
<b>Actuarial gains recognised in the SOCI</b>	21.3	14.1	14.5	49.9
Change in IFRIC 14	–	–	0.3	0.3
Change in franchise adjustment	–	(7.7)	–	(7.7)
Change in members' share	–	(8.0)	(1.7)	(9.7)
Reimbursed to employer	(21.3)	–	–	(21.3)
<b>Actuarial losses on reimbursable rights</b>	(21.3)	(15.7)	(1.4)	(38.4)
<b>Total pension (cost)/income recognised in the SOCI</b>	–	(1.6)	13.1	11.5

## 27. Retirement benefit schemes (continued)

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

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

	Virtually certain costs reimbursed £m	Not certain costs reimbursed £m	Non contract specific £m	Total £m
At 1 January 2010	368.8	476.3	899.3	1,744.4
Current service cost – employer	9.7	15.5	14.7	39.9
Current service cost – employee	–	6.2	0.5	6.7
Past service costs	–	–	0.3	0.3
Scheme participants' contributions	3.1	0.6	0.9	4.6
Interest cost – employer	21.5	20.4	50.2	92.1
Interest cost – employee	–	7.6	1.3	8.9
Benefits paid	(11.1)	(12.5)	(33.7)	(57.3)
Actuarial gains and losses	(13.8)	(3.7)	19.8	2.3
Exchange differences	–	–	(1.8)	(1.8)
<b>At 1 January 2011</b>	<b>378.2</b>	<b>510.4</b>	<b>951.5</b>	<b>1,840.1</b>
Current service cost – employer	8.4	16.5	15.5	40.4
Current service cost – employee	–	6.6	0.3	6.9
Past service costs	–	–	0.4	0.4
Scheme participants' contributions	4.1	0.6	0.6	5.3
Interest cost – employer	20.5	20.5	48.1	89.1
Interest cost – employee	–	7.3	1.1	8.4
Benefits paid	(9.6)	(10.8)	(35.9)	(56.3)
Actuarial gains and losses	39.7	43.8	25.6	109.1
Plan curtailments	–	–	(0.3)	(0.3)
Plan settlements	–	–	(4.3)	(4.3)
Exchange differences	–	–	(1.3)	(1.3)
<b>At 31 December 2011</b>	<b>441.3</b>	<b>594.9</b>	<b>1,001.3</b>	<b>2,037.5</b>

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

	Virtually certain costs reimbursed £m	Not certain costs reimbursed £m	Non contract specific £m	Total £m
At 1 January 2010	224.5	354.9	777.5	1,356.9
Expected return on scheme assets – employer	16.6	18.4	46.0	81.0
Expected return on scheme assets – employee	–	6.9	1.4	8.3
Employer contributions	14.1	18.9	48.3	81.3
Contributions by employees	3.2	6.3	1.3	10.8
Benefits paid	(11.1)	(12.5)	(33.7)	(57.3)
Actuarial gains and losses	7.5	10.4	34.3	52.2
<b>At 1 January 2011</b>	<b>254.8</b>	<b>403.3</b>	<b>875.1</b>	<b>1,533.2</b>
Expected return on scheme assets – employer	17.0	20.3	53.6	90.9
Expected return on scheme assets – employee	–	7.5	1.4	8.9
Employer contributions	13.5	25.0	66.5	105.0
Contributions by employees	4.1	6.5	0.9	11.5
Benefits paid	(9.6)	(10.8)	(35.9)	(56.3)
Actuarial gains and losses	(27.2)	(22.5)	107.8	58.1
Plan settlements	–	–	(4.1)	(4.1)
<b>At 31 December 2011</b>	<b>252.6</b>	<b>429.3</b>	<b>1,065.3</b>	<b>1,747.2</b>

Employer contributions for non contract specific schemes in 2011 include a £40m (2010: £20m) special contribution paid in January 2011.

## Notes to the Consolidated Financial Statements

## 27. Retirement benefit schemes (continued)

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

## History of experience gains and losses

	2011	2010	2009	2008	2007
<b>Experience adjustments arising on scheme assets:</b>					
Amount (£m)	58.1	52.2	73.2	(263.7)	1.4
Percentage of the fair value of scheme assets	3.3%	3.4%	5.4%	(22.1)%	0.1%
<b>Experience adjustments arising on scheme liabilities:</b>					
Amount (£m)	5.6	4.2	(58.2)	0.1	(5.1)
Percentage of the present value of scheme liabilities	0.3%	0.2%	(3.3)%	0.0%	0.3%
Fair value of scheme assets (£m)	1,747.2	1,533.2	1,356.9	1,194.1	1,342.8
Present value of scheme liabilities (£m)	(2,037.5)	(1,840.1)	(1,744.4)	(1,343.4)	(1,500.9)
Deficit (£m)	(290.3)	(306.9)	(387.5)	(149.3)	(158.1)

The normal contributions expected to be paid during the financial year ending 31 December 2012 are £64.9m (financial year ended 31 December 2011: £59.6m).

Assumptions in respect of the expected return on scheme assets are based on market expectations of returns over the life of the related obligation. Due consideration has been given to current market conditions as at 31 December 2011 in respect to inflation, interest, bond yields and equity performance when selecting the expected return on assets assumptions.

The expected yield on bond investments with fixed interest rates is derived from their market value. The yield on equity investments contains an additional premium (an 'equity risk premium') to compensate investors for the additional anticipated risks of holding this type of investment, when compared to bond yields. Management have concluded that an appropriate equity risk premium is 4.6% (2010: 4.1%).

The overall expected return on assets is calculated as the weighted average of the expected returns for the principal asset categories held by scheme.

Cumulative actuarial gains recognised since 1 January 2004 are £23.5m (2010: losses of £42.0m).

	2011	2010
	%	%
<b>Main assumptions:</b>		
Rate of salary increases	3.30	3.50
Rate of increase in pensions in payment	2.10 (CPI) and 2.90 (RPI)	2.60 (CPI) and 3.10 (RPI)
Rate of increase in deferred pensions	2.10 (CPI) and 2.90 (RPI)	2.60 (CPI) and 3.10 (RPI)
Inflation assumption	2.10 (CPI) and 2.90 (RPI)	2.60 (CPI) and 3.10 (RPI)
Discount rate	4.70	5.40
Expected rates of return on scheme assets:		
Equities	7.70	8.30
Bonds except LDI	4.70	5.40
LDI	3.90	4.90
Gilts	3.10	4.20
Property	4.35	5.45
Cash and other	0.50	0.50
Annuity policies	4.70	5.40
	2011	2010
	Years	Years
<b>Post-retirement mortality:</b>		
Current pensioners at 65 – male	20.9	20.8
Current pensioners at 65 – female	23.4	23.3
Future pensioners at 65 – male	22.5	22.4
Future pensioners at 65 – female	24.6	24.5

## 27. Retirement benefit schemes (continued)

### 27 (b) Defined contribution schemes

The Group paid employer contributions of £66.9m (2010: £61.9m) into UK and other defined contribution schemes, foreign state pension schemes and multi-employer schemes, including those of joint ventures.

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

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

## 28. Provisions

	Employee related £m	Property £m	Contract £m	Other £m	Total £m
At 1 January 2010	7.7	8.0	10.4	16.2	42.3
Charged to income statement	3.5	0.1	0.2	2.3	6.1
Released to income statement	–	(0.9)	(0.9)	(2.7)	(4.5)
Utilised during the year	(0.6)	(1.2)	(2.2)	(2.7)	(6.7)
Unwinding of discount	–	0.3	0.3	–	0.6
Exchange differences	0.4	0.3	0.2	0.9	1.8
At 1 January 2011	<b>11.0</b>	<b>6.6</b>	<b>8.0</b>	<b>14.0</b>	<b>39.6</b>
Arising from acquisitions	<b>0.4</b>	<b>3.6</b>	<b>29.2</b>	<b>6.9</b>	<b>40.1</b>
Charged to income statement	<b>4.5</b>	<b>0.4</b>	–	–	<b>4.9</b>
Released to income statement	–	<b>(0.2)</b>	<b>(1.2)</b>	<b>(3.2)</b>	<b>(4.6)</b>
Utilised during the year	<b>(1.0)</b>	<b>(1.5)</b>	<b>(7.5)</b>	<b>(0.1)</b>	<b>(10.1)</b>
Unwinding of discount	–	<b>0.3</b>	<b>0.2</b>	–	<b>0.5</b>
Exchange differences	<b>0.1</b>	<b>(0.3)</b>	<b>(2.6)</b>	<b>(1.0)</b>	<b>(3.8)</b>
<b>At 31 December 2011</b>	<b>15.0</b>	<b>8.9</b>	<b>26.1</b>	<b>16.6</b>	<b>66.6</b>
Analysed as:					
Current					<b>10.4</b>
Non-current					<b>56.2</b>
					<b>66.6</b>

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.

Property provisions relate to leased properties which are either under utilised or vacant and where the unavoidable costs associated with the lease exceed the economic benefits expected to be required. Management has calculated the provision based on the discounted cash outflows required to settle the lease obligations as they fall due over the next ten years.

Contract provisions primarily relate to Intelenet where, as required under IAS 37, a provision has been taken for a loss-making onerous contract. Management has used the present value of the estimated future cash outflows required to settle the contract obligations as they fall due over the next seven years in determining the provision.

Other provisions are held for legal and other costs that the Group expects to incur over an extended period. These costs are based on past experience of similar items and other known factors and represent management's best estimate of the likely outcome.



## Notes to the Consolidated Financial Statements

## 29. Share capital

	2011 £m	Number 2011 Millions	2010 £m	Number 2010 Millions
<b>Issued and fully paid:</b>				
493,220,805 (2010: 490,912,075) ordinary shares of 2p each at 1 January	9.9	493.2	9.8	490.9
Issued on the exercise of share options	–	4.1	0.1	2.3
<b>497,327,070 (2010: 493,220,805) ordinary shares of 2p each at 31 December</b>	<b>9.9</b>	<b>497.3</b>	<b>9.9</b>	<b>493.2</b>

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

During the year 4,106,265 (2010: 2,308,730) ordinary shares of 2p each were allotted to the holders of share-based awards or their personal representatives using newly listed shares.

## 30. Share premium account

	2011 £m	2010 £m
At 1 January	306.7	304.1
Premium on shares issued	16.0	2.6
<b>At 31 December</b>	<b>322.7</b>	<b>306.7</b>

## 31. Reserves

**31 (a) Retirement benefit obligations reserve**

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.

**31 (b) Share-based payment reserve**

The share-based payment reserve represents credits relating to equity-settled share-based payment transactions and any gain or loss on the exercise of share options satisfied by own shares.

**31 (c) Own shares reserve**

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 (ESOT) to satisfy options under the Group's share options schemes. At 31 December 2011, the ESOT held 8,267,992 (2010: 4,710,201) shares equal to 1.7% of the current allotted share capital (2010: 1.0%). The market value of shares held by the ESOT as at 31 December 2011 was £39.2m (2010: £26.2m).

**31 (d) Hedging and translation reserve**

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

## 32. Notes to the Consolidated Cash Flow Statement

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

	2011 £m	2010 £m
<b>Operating profit for the year</b>	<b>266.2</b>	241.3
Adjustments for:		
Share-based payment expense	11.2	8.8
Depreciation and impairment of property, plant and equipment	46.0	39.4
Amortisation and impairment of intangible assets	39.5	43.6
Loss on disposal of property, plant and equipment	0.5	0.8
Profit on disposal of intangible assets	–	(1.5)
Impairment of goodwill	–	4.2
Movement in provisions	(9.8)	(5.1)
Other non cash movements	3.4	–
<b>Operating cash inflow before movements in working capital</b>	<b>357.0</b>	331.5
Decrease in inventories	9.2	3.5
Decrease/(increase) in receivables	26.8	(43.4)
(Decrease)/increase in payables	(84.5)	10.0
Special contribution to defined benefit pension scheme (note 27)	(40.0)	(20.0)
<b>Cash generated by operations</b>	<b>268.5</b>	281.6
Tax paid	(51.5)	(40.6)
<b>Net cash inflow from operating activities</b>	<b>217.0</b>	241.0

Additions to fixtures and equipment during the year amounting to £29.6m (2010: £10.0m) were financed by new finance leases.

### Analysis of net debt

	At 1 January 2011 £m	Cash flow £m	Acquisitions* £m	Exchange differences £m	Non cash movements £m	At 31 December 2011 £m
Cash and cash equivalents	279.3	(32.2)	8.4	(0.7)	–	254.8
Non recourse loans	(23.7)	7.9	–	0.3	–	(15.5)
Other loans	(490.4)	(258.6)	(73.3)	(5.0)	–	(827.3)
Obligations under finance leases	(26.4)	10.7	(0.8)	0.2	(29.6)	(45.9)
	(261.2)	(272.2)	(65.7)	(5.2)	(29.6)	(633.9)

	At 1 January 2010 £m	Cash flow £m	Acquisitions* £m	Exchange differences £m	Non cash movements £m	At 31 December 2010 £m
Cash and cash equivalents	319.4	(48.3)	0.1	8.1	–	279.3
Non recourse loans	(29.0)	7.6	–	(2.3)	–	(23.7)
Other loans	(624.9)	157.7	–	(21.8)	(1.4)	(490.4)
Obligations under finance leases	(24.0)	8.7	–	(1.1)	(10.0)	(26.4)
	(358.5)	125.7	0.1	(17.1)	(11.4)	(261.2)

\* Acquisitions represent the net cash/(debt) acquired on acquisition.

## Notes to the Consolidated Financial Statements

## 33. Capital and other commitments

	2011 £m	2010 £m
Capital expenditure contracted but not provided:		
– Property, plant and equipment	1.4	1.7

Included within the balances above is joint venture capital expenditure contracted but not provided in relation to property, plant and equipment of £0.1m (2010: £nil).

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:

	2011 £m	2010 £m
Within one year	137.0	112.0
Between one and five years	198.3	240.6
After five years	131.2	129.3
	<b>466.5</b>	<b>481.9</b>

Principal lease commitments are within the Civil Government segment, with future minimum lease payments totalling £215.9m (2010: £231.1m). These leases relate primarily to administrative and operational buildings, track and rolling stock within the train operating companies. The length of the leases is concurrent with the period of the franchises and the terms of the leases are fixed during this period.

## 34. Share-based payment expense

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

	2011 £m	2010 £m
Executive Option Plan	0.1	0.2
Long Term Incentive Scheme and Plan	0.9	2.5
Transformational Share Scheme	0.1	0.2
Performance Share Plan	8.5	4.4
Deferred Bonus Plan	0.9	0.5
Sharesave 2008	0.7	1.0
	<b>11.2</b>	<b>8.8</b>

**Executive Option Plan (EOP)**

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

	Number of options 2011 Thousands	Weighted average exercise price 2011 £	Number of options 2010 Thousands	Weighted average exercise price 2010 £
Outstanding at 1 January	3,957	2.63	6,857	2.72
Granted during the year	–	–	–	–
Exercised during the year	(294)	3.37	(2,620)	2.79
Lapsed during the year	(274)	3.62	(280)	3.47
<b>Outstanding at 31 December</b>	<b>3,389</b>	<b>2.49</b>	<b>3,957</b>	<b>2.63</b>

### 34. Share-based payment expense (continued)

#### Executive Option Plan (EOP) (continued)

Of these options 3,300,690 (2010: 3,534,982) were exercisable at the end of the year, with a weighted average exercise price of £2.34 (2010: £2.42).

The options outstanding at 31 December 2011 had a weighted average contractual life of 2.5 years (2010: 3.2 years).

The exercise prices for options outstanding at 31 December 2011 ranged from £1.39 to £4.55 (2010: £1.39 to £4.55).

The weighted average share price at the date of exercise approximates to the weighted average share price during the year, which was £5.34 (2010: £5.81).

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.

There were no new options granted under the EOP during the year.

#### 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 zero exercise price and may be exercised after the third anniversary of grant. The extent to which an award vests (and therefore becomes exercisable) is measured by reference to the growth in the Group's earnings per share (EPS) or total shareholder return (TSR) over the performance period of three financial years.

If the options remain unexercised after a period of ten 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:

	Number of options 2011 Thousands	Weighted average exercise price 2011 £	Number of options 2010 Thousands	Weighted average exercise price 2010 £
Outstanding at 1 January	3,691	Nil	5,623	Nil
Granted during the year	23	Nil	–	Nil
Exercised during the year	(411)	Nil	(1,786)	Nil
Lapsed during the year	(665)	Nil	(146)	Nil
<b>Outstanding at 31 December</b>	<b>2,638</b>	<b>Nil</b>	<b>3,691</b>	<b>Nil</b>

Of these options, 2,169,500 (2010: 1,544,054) were exercisable at the end of the year.

The options outstanding at 31 December 2011 had a weighted average contractual life of 5.75 years (2010: 6.8 years).

There was one grant of LTIP options during the year. There are no performance conditions attached.

The fair value is considered to be their face value less the present value of any dividend payments not paid over the vesting period.

The weighted average fair value of options granted under this scheme in the year was £5.36.

## Notes to the Consolidated Financial Statements

## 34. Share-based payment expense (continued)

**Transformational Share Scheme**

Awards made to eligible employees under the Transformational Share Scheme are structured as options with a £nil exercise price and are exercisable after the third anniversary of the grant.

The employee must exercise the options no later than 30 days after the vesting date. Furthermore, if the eligible employee leaves the Group before the options vest, the options may be forfeited.

	Number of options 2011 Thousands	Weighted average exercise price 2011 £	Number of options 2010 Thousands	Weighted average exercise price 2010 £
Outstanding at 1 January	119	Nil	86	Nil
Granted during the year	–	Nil	33	Nil
Exercised during the year	(33)	Nil	–	Nil
Lapsed during the year	–	Nil	–	Nil
<b>Outstanding at 31 December</b>	<b>86</b>	<b>Nil</b>	<b>119</b>	<b>Nil</b>

None of these options were exercisable at the end of the year (2010: none).

The options outstanding at 31 December 2011 had a weighted average contractual life of 0.6 years (2010: 0.8 years).

**Performance Share Plan (PSP)**

Under the PSP, eligible employees have been granted options with an exercise price of two pence. Awards vest after the performance period of three years and are subject to the achievement of two performance measures. The primary performance measure is TSR and the second performance measure is based on EPS growth.

	Number of options 2011 Thousands	Weighted average exercise price 2011 £	Number of options 2010 Thousands	Weighted average exercise price 2010 £
Outstanding at 1 January	3,944	0.02	479	Nil
Granted during the year	3,987	0.02	3,523	0.02
Exercised during the year	(9)	0.02	–	Nil
Lapsed during the year	(496)	0.02	(58)	Nil
<b>Outstanding at 31 December</b>	<b>7,426</b>	<b>0.02</b>	<b>3,944</b>	<b>0.02</b>

None of these options were exercisable at the end of the year (2010: none).

The options outstanding at 31 December 2011 had a weighted average contractual life of 8.7 years (2010: 9.2 years).

In the year, four grants were made with 70% of the options granted subject to TSR performance conditions and 30% subject to EPS growth performance conditions.

The options subject to TSR performance conditions were valued using the Monte Carlo Simulation model. The options subject to EPS growth performance conditions were deemed to have fair values equal to their face value less the present value of any dividend payments not received over the vesting period.

The Monte Carlo Simulation model is considered to be the most appropriate for valuing options granted under schemes where there are changes in performance conditions by which the options are measured, such as for the TSR-based awards.

The inputs into the Monte Carlo Simulation model for options granted during the year with TSR performance conditions are:

	2011	2010
Weighted average share price	558p	615p
Weighted average exercise price	2p	2p
Expected volatility	28.1%	28.9%
Expected life	3 years	3 years
Risk-free rate	1.8%	1.9%

Expected volatility was determined by calculating the historical volatility of the Group's share price over the previous three years. The expected life used in the model has been adjusted, based on management's best estimate, for the effects of non-transferability, exercise restrictions, and behavioural considerations.

### 34. Share-based payment expense (continued)

#### Performance Share Plan (PSP) (continued)

The assumptions for options granted during the year with EPS growth performance conditions are:

	2011	2010
Weighted average share price	558p	615p
Weighted average exercise price	2p	2p
Expected volatility	N/A	N/A
Expected life	3 years	3 years
Risk-free rate	N/A	N/A

The weighted average fair value of options granted under this scheme in the year was £3.92.

#### Deferred Bonus Plan (DBP)

Under the DBP, eligible employees are entitled to use up to 50% of their earned annual bonus to purchase shares in the Group at market price. Provided they remain in employment for the three-year performance period, the shares are retained for that period and the two performance measures (which are the same as the PSP scheme, being TSR and EPS growth) have been met, the Group will make a matching share award. For shares purchased by employees in 2011, the match was on a basis of two times the gross bonus deferred.

	Number of options 2011 Thousands	Weighted average exercise price 2011 £	Number of options 2010 Thousands	Weighted average exercise price 2010 £
Outstanding at 1 January	426	Nil	207	Nil
Granted during the year	324	Nil	219	Nil
Exercised during the year	–	Nil	–	Nil
Lapsed during the year	–	Nil	–	Nil
<b>Outstanding at 31 December</b>	<b>750</b>	<b>Nil</b>	<b>426</b>	<b>Nil</b>

None of these options were exercisable at the end of the year (2010: none).

The options outstanding at 31 December 2011 had a weighted average contractual life of 1.5 years (2010: 1.9 years).

In the year, one grant was made with 50% of the deferred bonus subject to TSR performance conditions and 50% subject to EPS growth performance conditions.

The portion subject to TSR performance conditions was valued using the Monte Carlo Simulation model. The portion subject to EPS growth performance conditions was deemed to have a fair value equal to their face value less the present value of any dividend payments not received over the vesting period.

The Monte Carlo Simulation model is considered to be the most appropriate for valuing options granted under schemes where there are changes in performance conditions by which the options are measured, such as for the TSR-based awards.

The inputs into the Monte Carlo Simulation model for options granted during the year with TSR performance conditions are:

	2011	2010
Weighted average share price	548p	602p
Weighted average exercise price	Nil	Nil
Expected volatility	28.1%	28.9%
Expected life	3 years	3 years
Risk-free rate	1.9%	1.8%

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.



## Notes to the Consolidated Financial Statements

## 34. Share-based payment expense (continued)

**Deferred Bonus Plan (DBP) (continued)**

The assumptions for options granted during the year with EPS growth performance conditions are:

	2011	2010
Weighted average share price	548p	602p
Weighted average exercise price	Nil	Nil
Expected volatility	N/A	N/A
Expected life	3 years	3 years
Risk-free rate	N/A	N/A

The weighted average fair value of options granted under this scheme in the year was £4.38.

**Sharesave 2008**

The Sharesave 2008 scheme provides for a purchase price equal to the daily average market price on the date of grant less 10%. The options can be exercised for a period of six months following their vesting. Details of the movement in Sharesave 2008 options are as follows:

	Number of options 2011 Thousands	Weighted average exercise price 2011 £	Number of options 2010 Thousands	Weighted average exercise price 2010 £
Outstanding at 1 January	5,479	4.0	6,106	4.0
Granted during the year	–	4.0	–	4.0
Exercised during the year	(3,981)	4.0	(248)	4.0
Lapsed during the year	(390)	4.0	(379)	4.0
<b>Outstanding at 31 December</b>	<b>1,108</b>	<b>4.0</b>	<b>5,479</b>	<b>4.0</b>

Of these options, 1,101,183 (2010: 16,278) were exercisable at the end of the year.

The options outstanding at 31 December 2011 had a weighted average contractual life of 0.2 years (2010: 1.2 years).

Given that options granted under the Sharesave plan can be exercised at any time after vesting, management consider the Binomial Lattice model to be appropriate to value the options granted under this scheme. The Binomial Lattice model allows exercise over a window in time, from vesting date to expiry date, and assumes option holders make economically rational exercise decisions.

### 35. Related party transactions

Transactions between the Company and its wholly owned subsidiaries, which are related parties, have been eliminated on consolidation and are not disclosed in this note. Transactions between the Group and its joint venture undertakings are disclosed below, with the relevant proportion being eliminated on consolidation.

#### Trading transactions

During the year, Group companies entered into the following material transactions with joint ventures:

	2011 £m	2010 £m
Royalties and management fees receivable	1.5	2.0
Dividends receivable	64.3	51.5
	<b>65.8</b>	<b>53.5</b>

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

	2011 £m	2010 £m
<b>Current:</b>		
Loans	0.5	0.1
	<b>2011 £m</b>	<b>2010 £m</b>
<b>Non-current:</b>		
Loans	3.2	3.5

Joint venture receivable and loan amounts outstanding have arisen from transactions undertaken during the general course of trading, are unsecured and will be settled in cash. Interest arising on loans is based on LIBOR, or its equivalent, with an appropriate margin. No guarantee has been given or received. No provisions are required for doubtful debts in respect of the amounts owed by the joint ventures.

#### 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 key management personnel of the Group is set out below in aggregate for each of the categories specified in IAS 24 Related Party Disclosures:

	2011 £m	2010 £m
Short-term employee benefits	8.9	7.5
Post-employment benefits	0.6	0.8
Share-based payment expense	2.8	2.8
	<b>12.3</b>	<b>11.1</b>

The key management personnel comprise the Executive Directors, Non-Executive Directors and members of the Executive Committee (2011: 18 individuals, 2010: 19 individuals).

# Notes to the Consolidated Financial Statements

## 36. List of principal undertakings

The Company has taken advantage of the exemption under Section 410(2) of the Companies Act 2006 by providing information only in relation to undertakings whose results or financial position, in the opinion of the Directors, principally affected the financial statements.

A complete list of subsidiary and associated undertakings will be attached to the next Serco Group plc annual return to Companies House.

The percentage of equity capital held directly or indirectly 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		2011	2010
<b>United Kingdom</b>	Serco Limited	100%	100%
	NPL Management Limited	100%	100%
<b>AMEAA</b>			
Australia	Serco Australia Pty Limited	100%	100%
India	Intelenet Global Services Private Limited	100%	–
<b>North America</b>			
USA	Serco Inc.	100%	100%
<b>Joint venture undertakings</b>		<b>2011</b>	<b>2010</b>
<b>United Kingdom</b>	AWE Management Limited	33%	33%
	Northern Rail Holdings Limited	50%	50%

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

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

## 37. Contingent liabilities

The Company has guaranteed overdrafts, finance leases, and bonding facilities of its joint ventures up to a maximum value of £8.2m (2010: £8.2m). The actual commitment outstanding at 31 December 2011 was £4.8m (2010: £5.6m).

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.

The Group is aware of claims and potential claims which involve or may involve legal proceedings against the Group. The Directors are of the opinion, having regard to legal advice received and the Group's insurance arrangements, that it is unlikely that these matters will, in aggregate, have a material effect on the Group's financial position.

# UK GAAP Audit Report – Parent Company

## **Independent Auditor's 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 2011 which comprise the Company Balance Sheet and the related notes 1 to 15. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. 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 auditor's 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 Auditor**

As explained more fully in the Directors' Responsibilities Statement, the Directors are responsible for the preparation of the parent Company Financial Statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the parent Company Financial Statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

## **Scope of the audit of the financial statements**

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the parent Company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the annual report to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

## **Opinion on the parent Company Financial Statements**

In our opinion the parent Company Financial Statements:

- give a true and fair view of the state of the parent Company's affairs as at 31 December 2011;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

## **Opinion on other matters prescribed by the Companies Act 2006**

In our opinion:

- the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006; and
- the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the parent Company Financial Statements.

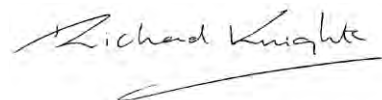
## **Matters on which we are required to report by exception**

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept by the parent Company, or returns adequate for our audit have not been received from branches not visited by us; or
- the parent Company Financial Statements and the part of the Directors' Remuneration Report to be audited are not in agreement with the accounting records and returns; or
- certain disclosures of Directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

## **Other matter**

We have reported separately on the Group Financial Statements of Serco Group plc for the year ended 31 December 2011.



Richard Knights (Senior Statutory Auditor)  
for and on behalf of Deloitte LLP  
Chartered Accountants and Statutory Auditor  
London, United Kingdom  
27 February 2012

# Company Balance Sheet

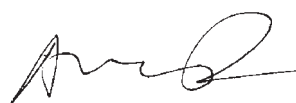
At 31 December

	Note	2011 £m	2010 £m
<b>Fixed assets</b>			
Investments in subsidiary undertakings	2	816.6	812.1
		<b>816.6</b>	812.1
<b>Current assets</b>			
Amounts owed by subsidiary companies due after more than one year		968.9	585.3
Debtors: amounts due within one year	3	4.7	5.6
Debtors: amounts due after more than one year	3	15.5	15.6
Derivative financial instruments: amounts due within one year	6	6.4	2.2
Derivative financial instruments: amounts due after more than one year	6	0.9	1.8
Cash at bank and in hand		–	–
		<b>996.4</b>	610.5
<b>Creditors: amounts falling due within one year</b>			
Bank loans and overdrafts	5	(146.6)	(200.6)
Loans	5	(23.6)	(23.6)
Amounts owed to subsidiary companies		(171.4)	(45.7)
Trade creditors		(0.1)	(0.7)
Other creditors including taxation and social security	4	(1.2)	(1.6)
Derivative financial instruments	6	(4.2)	(2.1)
Accruals and deferred income		(12.7)	(10.1)
		<b>(359.8)</b>	(284.4)
<b>Net current assets</b>		<b>636.6</b>	326.1
<b>Total assets less current liabilities</b>		<b>1,453.2</b>	1,138.2
Creditors: amounts falling due after more than one year	5	(606.7)	(335.8)
Amounts owed to subsidiary companies		(222.1)	(243.0)
Provisions		(1.0)	(1.0)
Derivative financial instruments	6	(0.2)	(4.8)
<b>Net assets</b>		<b>623.2</b>	553.6
<b>Capital and reserves</b>			
Called up share capital	8	9.9	9.9
Share premium account	9	322.7	306.7
Capital redemption reserve		0.1	0.1
Own shares reserve	10	(48.2)	(27.5)
Share-based payment reserve	11	48.0	38.7
Hedging and translation reserve	12	1.9	(0.4)
Profit and loss account	13	288.8	226.1
<b>Shareholders' funds</b>		<b>623.2</b>	553.6

The financial statements (registered number 2048608) were approved by the Board of Directors on 27 February 2012 and signed on its behalf by:



Christopher Hyman  
Chief Executive



Andrew Jenner  
Finance Director

# Notes to the Company Financial Statements

## 1. 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 United Kingdom Generally Accepted Accounting Practice (UK GAAP) and applicable UK law.

### **Accounting convention**

These accounts have been prepared under the historical cost convention and, as discussed in more detail in the Finance Review, on the going concern basis.

### **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 HMRC approved Save As You Earn (SAYE) 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. SAYE options are treated as cancelled when employees cease to contribute to the scheme, resulting in an acceleration of the remainder of the related expense.

Where the fair value of share options requires the use of a valuation model, fair value is measured by use of the 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.

### **Dividends**

Dividends are approved by the Board of Directors, and recorded in the Company's financial statements in the period in which they are declared, appropriately authorised and no longer at the discretion of the Company.

### **Derivative financial instruments and hedging activities**

Derivatives are initially recognised at fair value at the date a derivative contract is entered into and subsequently remeasured at fair value at each balance sheet date. The gain or loss is taken to the profit and loss account immediately unless the derivative is designated as a 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); and
- a hedge of a 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.



# Notes to the Company Financial Statements

## 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. Investments held as fixed assets

	£m
<b>Shares in subsidiary companies at cost:</b>	
At 1 January 2011	812.1
Options over parent's shares awarded to employees of subsidiaries	7.1
Disposals	(2.6)
<b>At 31 December 2011</b>	<b>816.6</b>

	£m
<b>Shares in subsidiary companies at cost:</b>	
At 1 January 2010	805.5
Options over parent's shares awarded to employees of subsidiaries	6.6
At 31 December 2010	812.1

Full details of the principal subsidiaries of Serco Group plc can be found in note 36 to the Group's consolidated financial statements. The Company directly owns 100% of the ordinary share capital of the following subsidiary.

Name	% ownership
Serco Holdings Limited	100%

### 3. Debtors

	2011 £m	2010 £m
<b>Amounts due within one year</b>		
Amounts owed by subsidiary companies	0.1	–
Corporation tax recoverable	2.5	3.0
Other debtors	2.1	2.6
	4.7	5.6
<b>Amounts due after more than one year</b>		
Amounts owed by joint ventures	3.3	3.4
Other debtors	8.5	9.4
Deferred tax asset (note 7)	3.7	2.8
	15.5	15.6
	20.2	21.2

### 4. Other creditors including taxation and social security

	2011 £m	2010 £m
Other creditors	1.2	1.6

### 5. Creditors: amounts falling due after more than one year

	2011 £m	2010 £m
Loans:	776.9	560.0
Less: amounts included in creditors falling due within one year – loans	(23.6)	(23.6)
Less: amounts included in creditors falling due within one year – bank loans and overdrafts	(146.6)	(200.6)
<b>Amounts falling due after more than one year</b>	606.7	335.8
Loans:		
Within one year or on demand	170.2	224.2
Between one and two years	126.0	111.8
Between two and five years	104.3	224.0
After five years	376.4	–
	776.9	560.0

## Notes to the Company Financial Statements

## 6. Derivative financial instruments

	Assets 2011 £m	Liabilities 2011 £m	Assets 2010 £m	Liabilities 2010 £m
Currency swaps	0.9	–	0.9	–
Interest rate swaps	–	(0.6)	–	(3.5)
Forward foreign exchange contracts	6.4	(3.8)	3.1	(3.4)
	<b>7.3</b>	<b>(4.4)</b>	4.0	(6.9)
Analysed as:				
Non-current	0.9	(0.2)	1.8	(4.8)
Current	6.4	(4.2)	2.2	(2.1)
	<b>7.3</b>	<b>(4.4)</b>	4.0	(6.9)

The Company holds derivative financial instruments in accordance with the Group's policy in relation to its financial risk management. Details of the disclosures are set out in note 26 of the Group's consolidated financial statements.

## 7. Deferred tax asset

	2011 £m	2010 £m
Capital allowances in excess of depreciation	0.1	0.2
Short-term timing differences	3.6	2.6
	<b>3.7</b>	2.8

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

	2011 £m	2010 £m
At 1 January	2.8	3.1
Charged to profit and loss account	1.8	(0.1)
Items taken directly to equity	(0.9)	(0.2)
<b>At 31 December</b>	<b>3.7</b>	2.8

## 8. Called up share capital

	2011 £m	Number 2011 Millions	2010 £m	Number 2010 Millions
<b>Issued and fully paid:</b>				
493,220,805 (2010: 490,912,075) ordinary shares of 2p each at 1 January	9.9	493.2	9.8	490.9
Issued on the exercise of share options	–	4.1	0.1	2.3
<b>497,327,070 (2010: 493,220,805) ordinary shares of 2p each at 31 December</b>	<b>9.9</b>	<b>497.3</b>	9.9	493.2

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

During the year 4,106,265 (2010: 2,308,730) ordinary shares of 2p each were allotted to the holders of share-based awards or their personal representatives using newly listed shares.

## 9. Share premium account

	2011 £m	2010 £m
At 1 January	306.7	304.1
Premium on shares issued	16.0	2.6
<b>At 31 December</b>	<b>322.7</b>	<b>306.7</b>

## 10. 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 (ESOT) to satisfy options under the Group's share options schemes. At 31 December 2011, the ESOT held 8,267,992 (2010: 4,710,201) shares equal to 1.7% of the current allotted share capital (2010: 1.0%). The market value of shares held by the ESOT as at 31 December 2011 was £39.2m (2010: £26.2m).

## 11. Share-based payment reserve

	2011 £m	2010 £m
At 1 January	38.7	32.8
Options over parent's shares awarded to employees of subsidiaries	7.1	6.6
Share-based payment expense	4.2	2.2
Share options to holders on exercise	(2.0)	(2.9)
<b>At 31 December</b>	<b>48.0</b>	<b>38.7</b>

Details of the share-based payment disclosures are set out in note 34 of the Group's consolidated financial statements.

## 12. Hedging and translation reserve

	2011 £m	2010 £m
At 1 January	(0.4)	(1.5)
Fair value gain on cash flow hedges during the period	3.3	0.5
Tax charge on items taken directly to equity	(0.9)	(0.2)
Net exchange (loss)/gain on translation of foreign operations	(0.1)	0.8
<b>At 31 December</b>	<b>1.9</b>	<b>(0.4)</b>

# Notes to the Company Financial Statements

## I 3. Profit and loss account

	2011 £m	2010 £m
At 1 January	226.1	173.2
Profit for the year	100.0	85.2
Equity dividends	(37.3)	(32.3)
<b>At 31 December</b>	<b>288.8</b>	<b>226.1</b>

As permitted by Section 408 of the Companies Act 2006, 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, overdraft and bonding facilities, and other financial commitments of its subsidiaries. The total commitment outstanding as at 31 December 2011 was £79.7m (2010: £126.0m).

The Company has also guaranteed overdrafts, finance leases, and bonding facilities of its joint ventures up to a maximum value of £8.2m (2010: £8.2m). The actual commitment outstanding at 31 December 2011 was £4.8m (2010: £5.6m).

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 Group. Full details of the transactions between Serco Group plc and its related parties can be found in note 35 to the Group's consolidated financial statements.

# Supplementary information

## Five-year record

		2011	2010	2009	2008	2007
Revenue	£m	<b>4,646</b>	4,327	3,970	3,124	2,811
Adjusted operating profit	£m	<b>290.1</b>	258.7	229.7	165.2	142.0
Adjusted operating margin	%	<b>6.24%</b>	5.98%	5.79%	5.29%	5.05%
Profit before tax	£m	<b>238.3</b>	213.9	177.1	136.1	114.6
Group free cash flow	£m	<b>168.3</b>	185.8	137.3	94.2	97.6
Group recourse net debt	£m	<b>(669.8)</b>	(303.6)	(387.7)	(524.5)	(137.9)
Total net debt	£m	<b>(633.9)</b>	(261.2)	(358.5)	(514.1)	(162.3)
Adjusted earnings per share	pence	<b>39.59p</b>	34.69p	29.53p	22.20p	18.57p
Dividend per share	pence	<b>8.40p</b>	7.35p	6.25p	5.00p	4.25p



## Directors, Secretary and Advisors

### **Chairman**

Alastair Lyons CBE

### **Directors**

Leonard V. Broese van Groenou\*

Ralph D. Crosby Jr\*

Christopher Hyman CBE

Andrew Jenner

David Richardson\* ^

Angie Risley\*

\* Non-Executive Director

^ Senior Independent Director

### **Secretary**

Joanne Roberts

### **Registered Office**

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Hampshire

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Serco Group plc is registered in  
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EC4A 3BZ

### **Investment Bankers**

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London

EC2M 2PP

### **Stockbrokers**

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125 London Wall

London

EC2Y 5AJ

Merrill Lynch International

2 King Edward Street

London

EC1A 1HQ

### **Principal Bankers**

HSBC Bank PLC

8 Canada Square

London

E14 5HQ

### **Solicitors**

Linklaters LLP

One Silk Street

London

EC2Y 8HQ

### **Registrars**

Equiniti

Aspect House

Spencer Road

Lancing

West Sussex

BN99 6DA

# Shareholder information

## Group website

Go to [www.serco.com](http://www.serco.com) to catch up on the current share price, latest news in the investors section and read the Annual report and accounts.

## Registrars

Administrative enquiries about the holding of Serco Group plc shares and enquiries in relation to the Serco Dividend Reinvestment Plan (DRIP) should be directed to:

Equiniti  
Aspect House  
Spencer Road  
Lancing  
West Sussex  
BN99 6DA

Tel: 0871 384 2932

There is a text phone available on 0871 384 2255 for shareholders with hearing difficulties.

(Calls to both of these numbers are charged at 8p per minute from a BT landline. Other telephony provider costs may vary.)

Callers from outside the UK should use +44 (0)121 415 7047.

Telephone lines are open 8.30am to 5.30pm Monday to Friday.

## Dividend reinvestment plan

You can elect to receive future dividends as shares rather than cash by participating in the DRIP. To register, request further information or to obtain a copy of the terms and conditions booklet and mandate form please contact Equiniti on 0871 384 2932. Alternatively, these can be downloaded from the website [www.shareview.co.uk](http://www.shareview.co.uk) by choosing the Dividend Reinvestment Plan heading within the Product Centre section.

## Dividends paid direct to your bank account

- Avoid 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 Shareholder Centre via the Shareview website or contact Equiniti on the number provided above.

## Global payment services

For overseas shareholders in certain countries, Equiniti offers an Overseas Payment Service by arrangement with Citibank Europe plc. This service offers shareholders the ability to have their dividend converted into their local currency and sent electronically to their local bank account. To sign up for this service, please contact Equiniti on 0871 384 2932 (+44 (0)121 415 7047 if calling from outside the UK). Alternatively, you can download an application form and terms and conditions from the website [www.shareview.co.uk](http://www.shareview.co.uk).

## Electronic communication

You can register for electronic communications by visiting [www.shareview.co.uk](http://www.shareview.co.uk); you will need your shareholder reference number to sign up. After you have registered you will receive emails alerting you to communications as they become available.

## Shareholder information

### Share dealing

Serco does not endorse any one service for the buying and selling of its shares. However, arrangements have been made with the following independent share-dealing provider to offer all shareholders competitive charges.

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.

### Stocktrade

We have arranged a telephone share dealing service with Stocktrade for purchases/sales of Serco Group plc shares. You should call 0845 601 0995 between 8.00am and 4.30pm, Monday to Friday and quote Low Co 330 (callers from outside the UK should call +44 (0)131 240 0508). Commission is charged at 0.5% on amounts to £10,000 and 0.2% on the excess thereafter, subject to a minimum charge of £17.50. Further details and other dealing options can be found at [www.stocktrade.co.uk/serco](http://www.stocktrade.co.uk/serco). This service is not available to US residents.

Please note that UK share purchases will be subject to 0.5% stamp duty.

### Shareholder profile

The range and size of ordinary shareholding as at 31 December 2011 is set out below:

Range of shareholdings	Number of shareholders	%	Number of shares	%
1–1,000	4,938	52.19	2,112,850	0.43
1,001–5,000	3,281	34.68	6,923,124	1.39
5,001–10,000	453	4.79	3,174,826	0.64
10,001–100,000	491	5.19	15,358,853	3.09
100,001–500,000	173	1.83	42,987,398	8.64
500,001–1,000,000	50	0.53	36,126,543	7.26
1,000,001–10,000,000	63	0.67	161,830,928	32.54
10,000,001 and above	11	0.12	228,812,548	46.01
<b>Total</b>	<b>9,460</b>	<b>100</b>	<b>497,327,070</b>	<b>100</b>

# Financial calendar

	2012
Preliminary results announcement	28 February
Ex-dividend date	7 March
Record date	9 March
Last date for receipt/revocation of DRIP dividend mandates	27 April
Interim Management Statement	14 May
Annual General Meeting	14 May
Final dividend pay date	22 May*
Half-year results announcement	29 August**
Financial year-end	31 December

\* Subject to shareholder approval

\*\* Provisional



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