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Our strategy in action can be found on:

p28-29

Transforming the back office for the Ministry of Defence



p32-33

Transporting the public to the London Olympics



p38

Protecting the eyesight of vulnerable people



p36-37

Improving lifeline ferry services in Scotland



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 makes a difference to the lives of millions of people around the world.

Our customers are national and local governments and leading companies. We have more than 50 years' experience of helping them to achieve their goals.

By focusing on the needs of the people they serve, we enable our customers to deliver better outcomes. Our frontline delivery involves us in vital areas of public life, including providing safe transport, finding sustainable jobs for the long-term unemployed, helping patients recover more quickly, improving the local environment, rehabilitating offenders, protecting borders and supporting the armed forces.

We also manage crucial business processes for both public and private sector organisations. This frees them to focus on their core operations, while delivering tangible benefits to their customers – from faster mortgage approvals to better online shopping.

The long-term drivers of our markets include public service reform, developing economies' investment in services and infrastructure, and our customers' need to deliver the best end-user experience. They want a partner who gives them confidence through consistent delivery, who can anticipate and adapt to change, and who can understand what they want to achieve across their organisation. They value our fresh thinking and the collaborative and imaginative way we work. We also look for opportunities to leverage our scale to our customers' advantage.

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. 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 improves the quality, reliability and efficiency of services that matter to millions of people around the world, by managing people, processes, technology and assets. We help our customers focus their precious resources on what they do best, confident that they can rely on us to do what we do best in the moments that matter.

For the public sector, we deliver essential frontline services to defence, transport, justice and health customers in national, state and local governments. For the private sector, we handle customer contact and business activities for financial, retail, travel and telecoms companies.

Our vision and strategy

Our vision is to be the world's greatest service company. This is a company that:

- customers see as a hallmark of quality, so they want to be associated with us, tell others about us, and talk proudly about what we do for them
- attracts the best talent in the world, where people can be challenged, rewarded and achieve their full potential, in a great culture that is respected by our peers
- communities welcome as a partner, because they know that we care and can use our talents and reach to solve the toughest problems they face, and
- investors see as a great share to own, because they trust us to deliver growth, excellent earnings visibility and stable cash flows.

Our strategy for achieving this vision has three elements:

1. Building a balanced portfolio: we aim to have a contract portfolio that is strong and diverse, and that is appropriately balanced between public and private sector customers, frontline and middle/back office business process outsourcing (BPO), and developed and developing economies. This allows us to select the most attractive growth opportunities, including making acquisitions that support our organic growth. We also actively manage our portfolio, to ensure it continues to fit our strategy and has appropriate levels of performance and returns.

2. Driving improved service and margin: as Serco grows, we will increasingly have opportunities to transfer our capabilities around the world, so that more of our capabilities are available to more of our customers and best practice is fully shared. With this increasing scale comes the chance to drive economies, in particular through the efficiency of shared services and common processes.

3. Enhancing our people and enabling strategies: our people strategy is designed to ensure we have the right people, in the right place, at the right time. We also look to have the right systems to support our business, and to actively manage our brand and reputation.

Corporate responsibility (CR) is a fundamental part of the way we work, influencing everything from the markets we choose to the way we manage and develop our people.



For more on our strategy, see pages 14 to 15. More on our approach to CR, including our people strategy and performance, can be found on pages 66 to 77

Our track record of success

Serco has a long track record of success. This flows directly from delivering the best possible service for our customers, which is recognised by others in the many awards we win for service excellence. Since we listed in 1988, we have consistently grown our revenue and broadened our portfolio, positioning us in faster growth and more profitable markets, while limiting the impact, if any, of our markets become challenging. At the same time, we have continually looked to enhance our efficiency and to invest for the future.



For more on our recent performance, see the Operating Review on pages 40 to 57 and the Finance Review on pages 58 to 65

The future

Customers around the world are looking for efficient, high quality and innovative service provision, 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 the Operating Review on pages 40 to 57



Docklands Light Railway, London, UK



Transperth passenger information and support services, Perth, Australia

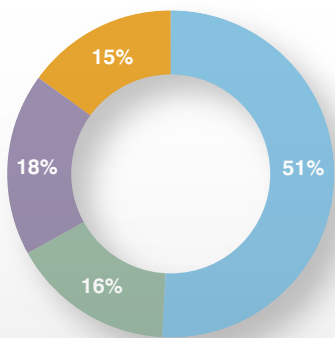


NorthLink Ferries, Scotland

Our business

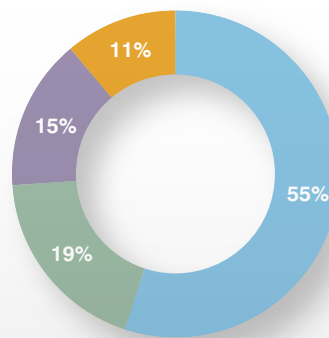
The following pages describe our operations around the world. In January 2012, we announced a new divisional structure, which created our Global Services division and amalgamated our UK and European operations into a single division. More information on the reorganisation can be found on pages 23 and 24.

Revenue by division **2012** – ongoing activities



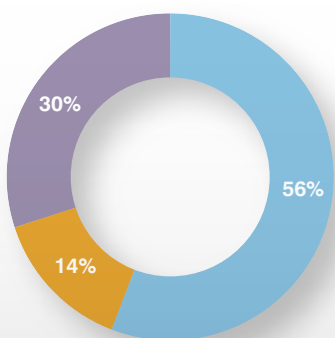
- UK & Europe
- Americas
- AMEAA
- Global Services

Revenue by division **2011** – ongoing activities



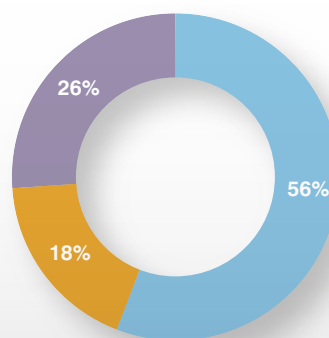
- UK & Europe
- Americas
- AMEAA
- Global Services

Revenue by geography **2012** – ongoing activities



- United Kingdom
- United States
- Other countries

Revenue by geography **2011** – ongoing activities



- United Kingdom
- United States
- Other countries



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

UK & Europe

2012 revenue – ongoing activities

£2,494m

+2%

2011: £2,434m

UK & Europe provides frontline services in Home Affairs, Health, Transport & Local Direct Services, and Defence and Science.

Home Affairs

Serco is a leading custodial accommodation provider, operating five adult prisons in England and Scotland. These include HMP & YOI Doncaster, which is piloting Payment by Results, a key component of the Government's strategy to reduce re-offending, and HMP Thameside, one of the world's most technologically advanced prisons. We also run a young offender institution and a secure training centre.

We provide prisoner escort and custody services, and electronically monitor defendants and offenders subject to home curfew. In partnership with the London Probation Trust, we deliver Community Payback, which requires offenders to do unpaid work for the community. On behalf of the Home Office we run two immigration removal centres and provide technology services for border control and security. We also provide accommodation and transport services for asylum applicants in the North West of England, Scotland and Northern Ireland.

On the Work Programme, Serco and its partners are placing thousands of jobseekers into sustainable employment. A Serco-led consortium operates the National Citizen Service, enabling 16 and 17-year-olds to develop skills through projects that contribute to society.

Health

Serco delivers GP out-of-hours services in Cornwall, and provides a comprehensive range of clinical services at Braintree Community Hospital and in the community in Suffolk. We are one of the UK's leading suppliers of occupational health services and the largest independent provider of custodial health services. We are also a major supplier of support services to a number of UK hospitals. Our GSTS Pathology joint venture is the UK's leading independent pathology services provider.

Transport & Local Direct Services

We are a key provider of transport services in the UK. With our partner Abellio, we operate both Northern Rail, the UK's largest train franchise, and Merseyrail, the UK's most punctual train operator. In London, we run the Docklands Light Railway, the Barclays Cycle Hire scheme and traffic management operations, supporting growth in regular journeys as well as major events such as the London Marathon, the Diamond Jubilee and the 2012 Olympic Games. We also provide lifeline freight and passenger ferry services to the Northern Isles in Scotland.

Serco provides environmental services and manages leisure facilities for local councils, community leisure trusts and universities across Britain. Our environmental services include refuse collection, recycling, street cleansing and grounds maintenance. Our leisure business provides a comprehensive range of health, leisure, fitness, well-being and community focused services.

Defence & Science

Serco provides training, engineering and operational support to the Royal Air Force, the Army Air Corps and the Royal Navy's Fleet Air Arm. 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 (Dstl). Our joint venture with Lockheed Martin and Jacobs Engineering manages the Atomic Weapons Establishment, which provides the warheads for the UK's nuclear deterrent.



For more information on our UK & Europe division, see pages 40 to 45



Americas

2012 revenue

£753m

-13%

2011: £868m

Our Americas business provides professional, technology and management services 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 46 to 49

We have a 16-year track record as the largest Network and Information Technology (IT) design, engineering and installation contractor and 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, missile defence systems, command and control systems, and mission essential networks and IT systems worldwide. We install and test communications and data networking systems for shore, ship and submarine installations for the US Navy and provide logistics support for the Navy's anti-submarine and undersea warfare capabilities. Through advanced economic cost analysis, we are helping the Navy to reduce procurement costs. We assist a major intelligence agency to acquire next generation IT systems. We are managing base closures for US forces in Afghanistan and upgrading communications systems for the Mine Resistant Ambush Protected vehicles, which protect soldiers from improvised explosive devices. We designed and installed nuclear materials detection systems at over 70 locations in 18 countries as part of the United States' "second line of defence".

Serco has helped more than two million Veterans to start or advance their civilian careers through career counselling, employment workshops and job fairs. We provided personnel and family support services to over two million military personnel and their families, and designed the software and operate the systems, data centres and call centres used by over four million federal employees to manage their retirement savings plans.

In 2012, Serco processed 32 million visa transactions for the Department of State and managed more than eight million application case files for the Department of Homeland Security. We have helped speed the review of patent applications by automating the pre-classification of nearly two million US patents over the past six years.

Serco manages air traffic control services at 64 towers across the US, ensuring the safe transport of nearly nine million commercial aircraft passengers a year, and in 2012 received an award for reducing aircraft delays by 98%. In Canada, we provide driver examination services at approximately 100 locations across Ontario, and deliver facilities management services at the Canadian Armed Forces Base in Goose Bay.



AMEAA


2012 revenue

£883m

+31%

2011: £672m

AMEAA consists of Australasia, the Middle East, Asia and Africa, where we provide services including transport, justice, immigration, health, defence and other direct services such as facilities management.

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

In Australia, Serco is an intelligent integrator of people, processes, equipment and technology for the Australian Defence Force. We recently strengthened our offering by acquiring the remaining 50% of DMS Maritime, one of the largest marine services providers in Australia. Our work in justice and corrections, focused on reducing reoffending, has been recognised by numerous industry and government awards. In health, we draw on Serco's global and regional expertise in providing quality clinical and non-clinical services. We are responsible for integrating facilities management and support services for Western Australia's flagship Fiona Stanley Hospital, which will open in 2014. We work with the Australian Department of Immigration and Citizenship to run its national network of immigration centres and have helped to transform its services. In transport, we offer every facet, from operating customer services and processing information to developing and maintaining infrastructure. Serco also owns Great Southern Rail, which operates Australia's iconic trains, the Indian Pacific and the Ghan.

In New Zealand, we manage Mt Eden Corrections Facility, which is currently the country's only privately operated prison, and are part of the consortium chosen to build and operate a new prison at Wiri, South Auckland, under a public-private partnership.

In Hong Kong, we are a market leader in managing, operating and maintaining road tunnels and related tollways infrastructure. The Hong Kong Institute of Facility Management gave us an award for excellence for our operation of EcoPark, Hong Kong's first recycling industrial park.

The Middle East is home to some of Serco's longest standing aviation contracts. We are also the region's largest international player in surface transport. 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, and we provide integrated facilities management to the education and commercial sectors.

In India, Serco has signed its first frontline service contract to operate and maintain the new Bus Rapid Transit System, in the city of Indore in the state of Madhya Pradesh.





Serco Global Services

2012 revenue – ongoing activities

£702m

+41%

2011: £497m

Serco Global Services brings together our customer contact, middle and back office skills, allowing us to provide broad end-to-end business process outsourcing (BPO) services to public and private sector customers. We are among the world's leading global BPO businesses, and the combination of our BPO expertise and frontline services sets us apart from other providers.

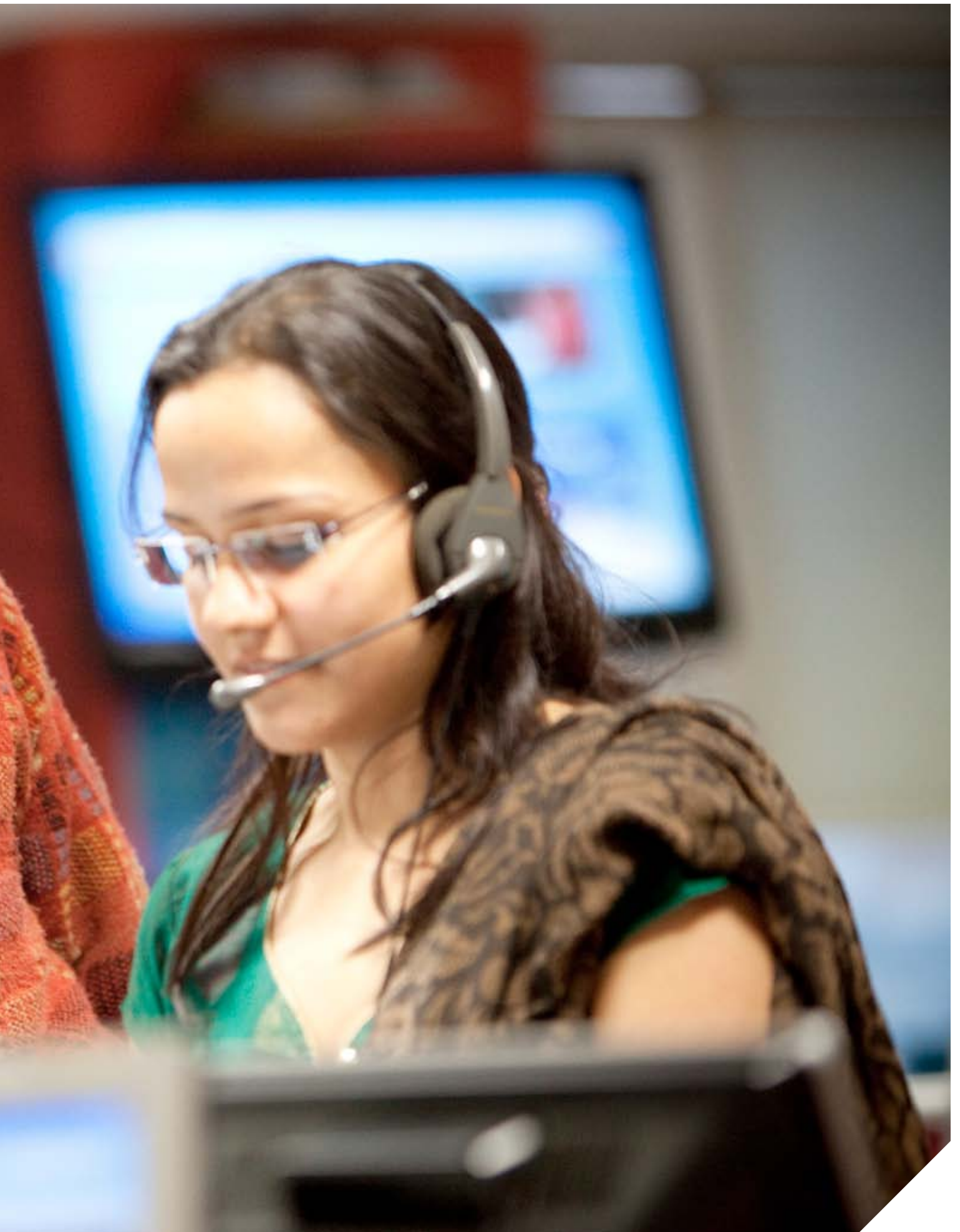
Serco Global Services operates in more than 100 locations across 13 countries, and employs 60,000 people. We conduct more than 90 million multi-channel interactions in 20 languages around the globe every year, as well as 600 million calls and 60 million back office transactions. Our widespread presence allows our customers to choose the onshore, nearshore or offshore delivery location that best matches their skill and cost requirements.

We offer three lines of service – BPO, consulting and technology services. Our specialist teams address customers' needs across functions including HR, finance and accounting, procurement, customer services and consulting. We provide advisory, design and delivery expertise in the areas of operations strategy, transformation, programme delivery, outsourcing, people performance and selection, change management and research. We are also experts in handling large workforce transfers and managing confidential data.

Our solutions are industry-specific, for customers in Banking & Financial Services, Insurance, Retail, Travel, Telecoms, Utilities, Healthcare and the public sector. We build customised solutions assisted by industry experts, whether our customer is a bank looking to improve the quality of its mortgage portfolio, a city council with a need to transform its local services or an airline wanting to reduce its costs.



For more information on our Global Services division, see pages 54 to 57



How we performed – 2012 highlights

Well placed for future growth following excellent achievements in 2012.

Record level of contract wins and excellent operational performance

- £5.8bn of awards (2011: £5.1bn); increase in order book to £19.1bn (2011: £17.9bn)
- High revenue visibility (92% for 2013, 79% for 2014 and 70% for 2015)
- Excellent service delivery across existing operations and major new contracts progressing well

Strong financial result for the year

- Total revenue growth of 5.7% to £4.9bn; growth of 6.2% at constant currency
- Organic growth of 3.3%, with excellent performances in AMEAA (up 22%) and Global Services (up 12%)
- Adjusted operating profit growth of 9.9% at constant currency; margin increase from 6.2% to 6.4%
- Adjusted earnings per share growth of 7.5% to 42.55p; growth of 8.7% at constant currency
- Group free cash flow of £181.2m, with an exceptionally strong conversion rate of profits in the second half
- Proposed 2012 total dividend of 10.10p, up 20%; increase reflects new policy to accelerate dividend growth on the path to a higher payout ratio

Greater exposure to international growth markets and sectors

- Growth prospects further underpinned by entry into new countries, services and private sector industries
- 31% total revenue growth in AMEAA increases region's exposure to 18% of the Group's portfolio
- 40% total revenue growth in our global Business Process Outsourcing (BPO) business increases non-frontline services to 15% of the Group's portfolio
- These achievements, together with a return to organic growth in the UK, more than offset US challenges

Strategic position further improved through ongoing proactive portfolio management

- Additional capabilities and market access from infill acquisitions such as Vertex and DMS Maritime
- Exits from non-core operations reflect our ongoing focus on strategic fit, performance and returns
- Leading BPO position after full integration of operations and successful launch of Global Services division

Extensive pipeline demonstrates attractive growth opportunities

- Estimated £31bn pipeline reflects growing demand for efficient, high quality and innovative services
- Positive developments opening up more frontline services markets; exciting new opportunities in AMEAA
- Good longer term opportunities in Americas, beyond the current tough US federal contracting environment
- Excellent growth prospects in the global BPO market with both private and public sector customers

Confident of further growth and continued resilience of the Group

- Strength of portfolio provides resilience and enhances growth potential
- Group well positioned following excellent strategic and organisational progress in 2012
- For 2013, expect a modest improvement in organic growth and operating margin to be broadly maintained
- Beyond 2013, planning for continued delivery of strong financial performance
- Confidence in outlook and strength of financial position underpin plans for higher dividend payout ratio

Notes:

Ongoing activities excludes the financial results of subsidiaries and operations disposed of during the year, being nuclear consulting services, defence-related German operations, education software and UK data hosting operations.

Adjusted operating profit is before amortisation of intangibles arising on acquisitions, acquisition-related costs and exceptional items (being profits or losses on disposals of subsidiaries and operations, and the one-off payment to establish the charitable foundation), as shown on the face of the Group's consolidated income statement and the accompanying notes. Adjusted profit before tax is also before the exceptional gain arising from the step acquisition accounting for the DMS joint venture in Australia.

Adjusted earnings per share is calculated on the basis of earnings before amortisation of intangibles arising on acquisitions, acquisition-related costs and exceptional items as noted above, together with the tax effect of these adjusting items.

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 2012 into Sterling at the average exchange rates for 2011.

The order book reflects the value of future revenues based on all existing signed contracts. It excludes contracts at the preferred bidder stage and excludes the award of new Indefinite Delivery, Indefinite Quantity (IDIQ) contract vehicles and Multiple Award Contracts (MACs) where Serco is one of a number of companies able to bid for specific task orders issued under the IDIQ or MAC. The value of any task order is recognised within the order book when subsequently won.

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

Revenue

£4,913.0m
+5.7%

2011: £4,646.4m

Adjusted operating profit

£314.8m
+8.5%

2011: £290.1m

Operating profit

£287.6m
+8.0%

2011: £266.2m

Adjusted profit before tax

£278.1m
+6.1%

2011: £262.2m

Profit before tax

£302.0m*
+26.7%

2011: £238.3m

* Includes the impact of exceptional items, principally the £51.1m non-cash gain arising from the step acquisition accounting for the DMS joint venture in Australia.

Adjusted earnings per share

42.55p
+7.5%

2011: 39.59p

Earnings per share

49.94p
+39.9%

2011: 35.70p

Dividend per share

10.10p
+20%

2011: 8.40p

Group free cash flow

£181.2m
+£12.9m

2011: £168.3m

"Serco improves the quality and efficiency of services that matter to millions of people around the world, helping our customers to focus their precious resources on what they do best. To continue developing our business we are providing more support to our existing customers, offering more to emerging markets and improving our ability to provide more complex services. This has resulted in a strong year for us in 2012 despite some very real challenges; we won more work than ever, we entered new markets, we built more capabilities and we established a global BPO business. Our unique breadth and depth leaves us strongly positioned to meet the growing demand from around the world for our skills and services. This confidence in our business prospects underpins our new dividend policy and commitment to a higher payout ratio over the coming years.

I am also enormously proud of the achievements of our 120,000 people around the world and with their support, in celebration of our 25th anniversary, we have launched the Serco Foundation to help charities and other organisations make an even bigger impact on some of the world's most critical issues."

Christopher Hyman, Chief Executive

Our business model

At the heart of our business model is a set of key strengths, which enable us to compete effectively and create value for our shareholders and other stakeholders. These competitive advantages derive from our broad contract portfolio, our devolved structure and robust management system, our people and values, and our focus on delivering the best for our customers.

Our strategy (see page 14) builds on and reinforces these strengths, enabling us to deliver growth and value creation into the future.

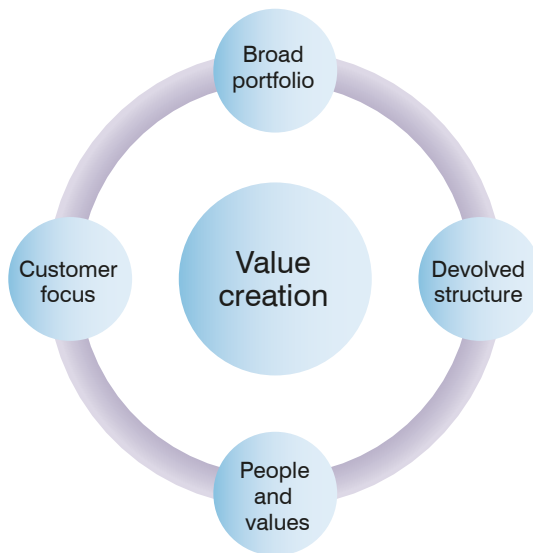
Broad portfolio

Our uniquely broad portfolio is diversified by market and geography. This allows us to pick the best opportunities, in whichever market or country they occur.

Our breadth also allows us to transfer skills honed in one market to other markets around the world, opening up new opportunities. And we can bring together unique combinations of skills from across the Group, for example by joining our frontline services with our BPO capabilities.

Customer focus

Delivering excellent service for our customers and the public is at the heart of our approach. It enables us to build long-term relationships, which help us to grow our contracts and retain them at rebid. It also contributes to our reputation, helping us to win new work and enter new markets. We use our 50 years' experience to bring fresh perspectives to customers' problems, for example by creating new contracting or partnership models.



Devolved structure

By devolving responsibility and decision making to the contract level, we empower our people to deliver excellent service. The Serco Management System provides a robust system of control, to ensure these decisions are also in Serco's best interests.

Devolving responsibility also makes our business scalable, allowing us to successfully manage our growing contract portfolio.

People and values

Serco is a people-based business, so we employ and develop excellent people with a strong service ethos.

We also have a deeply ingrained set of values, which are encapsulated in our Governing Principles and our approach to CR. Our people embody those values, ensuring they are reflected in every decision we take. These values help us to act in the right way, so we protect the interests of our stakeholders and Serco.

Our competitive environment

Our business model makes us a strong competitor in our chosen markets.

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.

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 Group. 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.

Our Governing Principles



1 We foster an entrepreneurial culture

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



2 We enable our people to excel

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



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.

Our strategy

Setting our strategic direction

We regularly review our strategy to ensure it remains appropriate and reflects the opportunities we see ahead of us. This led us to refresh our strategy in 2012, resulting in a strategic approach that remains centred on organic growth while also emphasising the factors that will support that growth – service quality, efficiency, people development and our systems and infrastructure.

The starting point for setting our strategy is our corporate plan, which defines the Group's medium-term direction and outlines the opportunities and challenges we face in getting there. Our divisions then create strategies that enable us to achieve this plan, by taking the actions necessary to succeed in their markets. The divisional strategies are then aggregated to produce the strategy for the Group as a whole.

Our Group strategy

Serco's Group strategy has three parts:

Strategy

Description

Building a balanced portfolio

We aim to have a strong and diverse contract portfolio that is appropriately balanced between public and private sector customers, frontline and BPO services, and developed and developing economies. This reduces our exposure to market fluctuations, enables us to select the best opportunities wherever they arise, and allows us to transfer expertise from one market to another.

We focus on services and markets where we can develop deep expertise, underpinning our growth and allowing us to offer the same services to customers around the world. This approach will increasingly enable us to apply common processes and drive economies of scale.

To support our organic growth, we make acquisitions that enhance our existing business or enable us to enter new markets or geographies. Our proactive portfolio management also involves ongoing assessment of our contracts for their strategic fit, together with their expected performance and returns.

Driving improved service and margin

As Serco grows, we look for opportunities to transfer our capabilities around the world, so that all of our capabilities are available to all of our customers. With this increasing scale comes the chance to drive economies, through shared services and common processes. We therefore look to share global best practices and maximise the efficiency of our operations.

Enhancing our people and enabling strategies

To support our growth, it is essential that we have the right people, in the right place, at the right time. Our people strategy aims to develop the leadership we will need, to have integrated and engaged people who bring service to life, and to make it easier to manage our people by continually enhancing our systems and processes.

We also look to have the right information technology to support our business, and to actively manage our brand and reputation, which is increasingly important as we enter new markets.

A responsible business

Serco is a values-led organisation and corporate responsibility is a consistent theme running through our strategy. Acting responsibly enables us to be a better, more efficient business and a good corporate citizen that benefits society in numerous ways.

Our approach to responsible business influences everything from the markets we choose to the way we manage and develop our people. It helps us to deliver excellent service by ensuring we keep our people safe and secure, and improves our efficiency by encouraging us to

reduce our energy and resource use, which at the same time mitigates our environmental impact. We also look to engage with our communities, which helps our customers achieve their aims and makes us a welcome partner in tackling community problems. This directly contributes to our ability to win and retain contracts, while striving to contribute positively to the communities in which we work.



For more information on our approach to corporate responsibility and our performance, see pages 66 to 77

Key achievements in 2012

Delivered revenue growth of 6%

Nearly half of Group revenue now generated outside the UK and 15% from BPO

Continued to win a wide range of contracts in new and existing markets, including entering new countries in the Middle East, frontline services in India, and new service lines such as community healthcare

Concluded a reorganisation that created our first global business, Serco Global Services, and a single UK & Europe division

Acquired Vertex's UK public sector BPO operations and the outstanding 50% of DMS Maritime in Australia

Disposed of a number of businesses that were non-core to the Group's development. These were our UK nuclear technical consulting services, education software and UK data hosting operations, and the majority of our mainly defence-related operations in Germany

Continued to deliver high quality services to customers. Of particular note was the performance of our contracts supporting the London Olympic Games and major new contracts which started during the year

Achieved an Adjusted operating profit margin of 6.4%, up from 6.2% in 2011

Completed a reorganisation which is delivering efficiencies, such as our internal shared service centre now operated by Serco Global Services

Evaluated our leaders to ensure the composition of our top 500 leaders now properly reflects the international nature of our business

Worked to better understand the link between customer advocacy and employee engagement

Undertook our annual global employee survey, giving us important insights into how we can improve the working experience at Serco

Completed Serco's first ever global software implementation, providing a range of self-service HR tools for both managers and employees

Key performance indicators (KPIs)

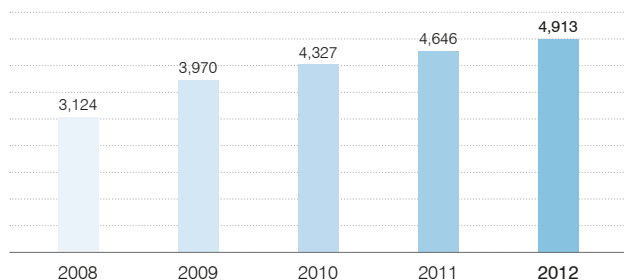
We use the following KPIs to monitor our performance over time. They are split between financial and non-financial measures.

Financial

Revenue (£m)

Definition

Revenue represents the amounts due for goods and services we provided during the year, and includes our share of revenue from joint ventures, net of discounts, VAT and other sales-related taxes.



Relevance to strategy

Our revenue growth flows directly from successful implementation of all three aspects of our strategy – a balanced portfolio of growth opportunities, delivering improved service for customers and ensuring we have the right people, systems and processes.

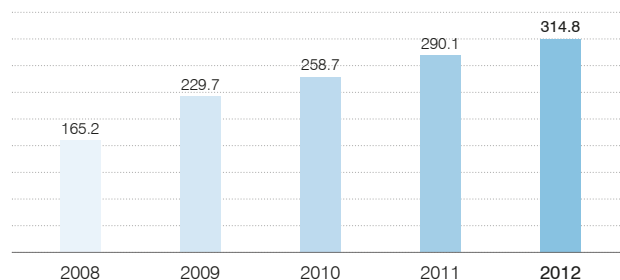
Performance

The 5.7% growth in the year represents a good performance against our strategic objectives, particularly given the challenging conditions we faced in certain markets, most notably the US federal contracting industry.

Adjusted operating profit (£m)

Definition

Adjusted operating profit is before amortisation of intangibles arising on acquisitions, acquisition-related costs and exceptional items (being profits or losses on disposals of subsidiaries and operations, and the one-off payment to establish the charitable Foundation).



Relevance to strategy

Our Adjusted operating profit reflects our ability to win and retain contracts with appropriate margins, our success at driving an improved margin through efficient operations, and our proactive portfolio management to ensure appropriate performance and returns.

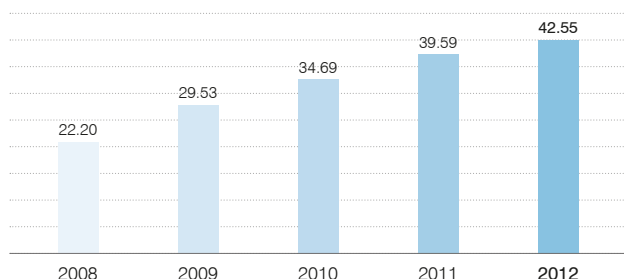
Performance

The growth of 8.5% represents an increase in margin from 6.2% to 6.4%.

Adjusted earnings per share (EPS) (p)

Definition

Adjusted earnings per share is calculated on the basis of earnings before amortisation of intangibles arising on acquisitions, acquisition-related costs and exceptional items as noted above, together with the tax effect of these adjusting items.



Relevance to strategy

Adjusted EPS reflects our ability to deliver a financial performance that grows both our revenue and our Adjusted operating profit margin, together with the strength of funding and overall financial position.

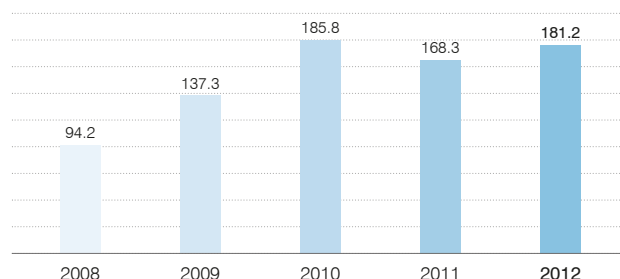
Performance

The 7.5% growth demonstrates the delivery of a strong financial result for 2012.

Group free cash flow (£m)

Definition

Group free cash flow is the free cash flow from subsidiaries and dividends received from joint ventures.



Relevance to strategy

Group free cash flow reflects our ability to drive a financial performance that generates the funds to invest in our future growth and strategic development.

Performance

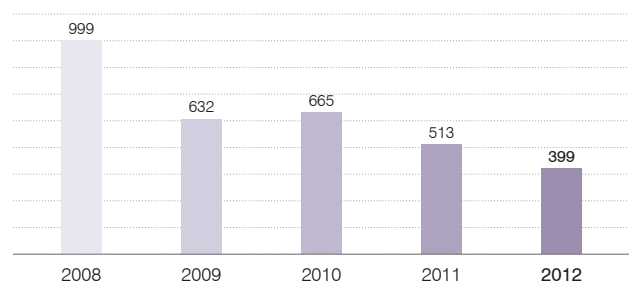
The Group free cash flow for the year represents a continued strong conversion of profits into funds to invest in our future.

Non-financial

Reportable incident rate (per 100,000 employees)

Definition

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 (excluding joint ventures).



Relevance to strategy

Delivering excellent service requires us to operate in the safest way possible. Safety also has a direct bearing on the commitment and engagement of our people.

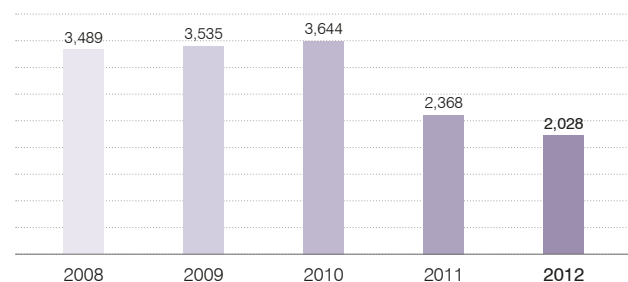
Performance

The 2012 RI rate is a 22% improvement on 2011 at 399, and a 60% improvement against 2008. This improvement has been partly driven by the evolving risk profile of the Group, with a significant increase in staff numbers in very low safety risk environments. The RI rate of our higher risk operations was largely flat compared with 2011 at 742, but was below the UK HSE Labour Force Survey All Industries benchmark of 750.

Carbon Emissions Headcount Intensity (tCO₂e/1000)

Definition

Serco has started to capture and report environmental data for its global operations. As the profile of our business changes, normalising by headcount is a more relevant way of setting targets and reporting performance. Moving forward we will therefore monitor Carbon Emissions Headcount Intensity (tCO₂e/1000).



Relevance to strategy

Our carbon dioxide emissions are directly related to our energy use, and hence to the efficiency of our operations.

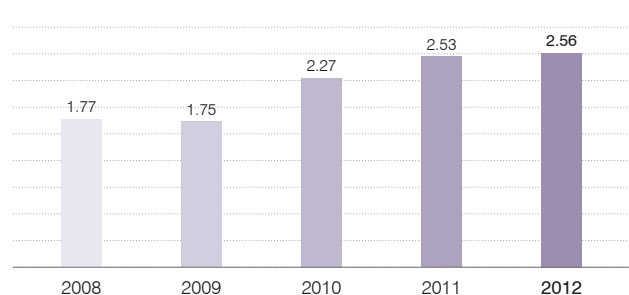
Performance

While our overall emissions have increased, the headcount intensity has shown an improvement of 14.4%, reflecting business growth and particularly increases in staff numbers in office-based environments.

Investment in 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.



Relevance to strategy

Strong community engagement helps us to win and retain contracts, as well as directly benefiting the lives of the people we assist.

Performance

We invested £2,560,084 through donations of money, assets and time to community projects and charities, representing 1% of our pre-tax profit. In addition, to mark Serco's 25th year as a publicly traded company dedicated to service excellence, we have established the Serco Foundation as an independent charitable foundation. An exceptional one-off payment of £5.0m has been made in the year to establish the charitable foundation.

Chairman's Statement



It was, I suggest, impossible to experience the atmosphere in the Olympic stadium on 11 August 2012, up on one's feet applauding Mo Farah's amazing 5,000 metre gold medal, and not be proud to be British. It was equally impossible not to be proud to be Chairman of Serco given the flawless performance of our Docklands Light Railway and Barclays Cycle Hire contracts during the period of the Olympic Games. All across the Group – in our Board, executive, management and operations – we felt the weight of the responsibility for not only transporting a significant proportion of the spectators to Britain's most important sporting showcase, but for ensuring our other London-based contracts, such as Court Escorting, continued to work as expected during this most unusual period. That everything functioned exactly as planned is testament to the foresight, capability, commitment and ingenuity of all those involved.

In all parts of Serco, when I visit our contracts I meet people who have the same commitment to service, to making a difference through helping those with whom they work while at the same time delivering against our promises. I have witnessed this ability to reconcile efficiency and humanity in such diverse areas as the way our electronic monitoring teams deal with new offenders; the way our staff supporting the US Veterans Agency interact with returning war-fighters; and the way our teams in Australia handle those seeking immigrant entry to the country. This ethos is deeply ingrained in Serco and is enshrined in our Governing Principles, which set out clearly and succinctly the behaviours by which we live.

Our desire to look beyond the confines of the contract and to put something back into the communities in which we work, is amply evidenced by the amount raised each year by our people for a wide variety of charitable causes. In recognition, the Board has decided that the most appropriate way to mark Serco's 25th year as a publicly traded company is to establish, with an endowment of £5m, an independent charitable foundation with the mission of helping charities be even more effective through the application of Serco's people, skills and capabilities.

Another of Serco's four Governing Principles is to foster an entrepreneurial culture, in particular, to embrace change and, by taking measured risks, encourage fresh thinking. The management team has successfully implemented significant change during the past year, restructuring the

business into a shape to be able to better support our customers and deliver our strategy over the next five or so years. Serco now has three distinct areas of regional focus: UK & Europe; Americas; and AMEAA; and one area of sector specialism – our Global Services BPO division. This reorganisation equips Serco to increase our exposure to international growth markets; builds a significant private, alongside our majority public sector customer base; creates an ability to bring together expertise across back and middle office, and our historic strength in frontline services; and slims us down to a much tighter concentration of functions at the centre.

Accompanying this restructuring is the proactive management of our portfolio by assessing the strategic fit of particular operations, together with their expected future levels of performance and returns. As a consequence we disposed of four operations during the year. At the same time we took advantage of opportunities to add further scale and depth of capability to Global Services through the acquisition of the UK public sector BPO operations of Vertex; and strengthened our position as a leading defence services provider, as well as increasing our exposure to the growing marine services market in Australia, by acquiring the remaining 50% of DMS Maritime.

The benefit of this portfolio shift is already starting to evidence itself. Over the last two years the proportion of our turnover derived from outside the UK has increased to 44%, while the value of our BPO



Fiona Stanley Hospital, Perth, Australia



Global Services supporting retail customers, UK



Docklands Light Railway, London, UK

contracts has risen to 15%. These changes in turn reflect the continued excellent revenue growth in AMEAA and the successful launch of Global Services, in part offset by the very difficult US environment.

With a large and high growth addressable market, Global Services has established itself very strongly with major new wins, for example, in retail customer contact, life and pensions transaction processing, and NHS shared service centre operations. Through the successful integration of related operations over the course of 2012, we have established Serco as a leading provider of BPO services, with extensive opportunities in the private sector and uniquely positioned to offer integrated services through joint bids with our frontline regional divisions.

We see the potential for sustained strong growth in the AMEAA region, with real GDP growth alongside a drive by governments to invest in social infrastructure, in particular in justice, health and transport. A small but significant step was achieved by winning our first frontline services contract in India, to operate a dedicated bus corridor in the city of Indore. Not only does this provide Serco with a foothold in the rapidly developing public transportation sector in India, but it also demonstrates how our achievements elsewhere in the world can support our entry into new markets. In this case, our management of complex transport systems such as the DLR, the Dubai Metro and the Barclays Cycle Hire scheme, were particularly relevant. Similarly, earlier in the year Serco was awarded the contract to provide and operate the innovative Wiri prison in New Zealand, building on our experience in custodial services across New Zealand, Australia and the UK.

The UK continues to account for more than half our turnover and, whilst we encountered some headwinds in 2012 from contract attrition, we continue to view the market outlook as positive. This is supported by the underlying economic pressures on government to deliver more services for less, and the approach to introducing more competition, choice and innovation, as set out in the Public Services White Paper.

The Americas have presented us with the toughest trading conditions, with new contract awards being constrained by the inability to agree federal government funding. Although this underlying uncertainty remains unresolved, the US is still the world's largest outsourcing and BPO market. We are, therefore, confident that having a significant established presence will reap dividends for the Group in the future.

At the forthcoming Annual General Meeting we say goodbye to David Richardson. David joined the Board of Serco in June 2003 and has served as Chairman of our Audit Committee for the past nine years and as Senior Independent Director since 1 January 2011. Turnover in 2003 was £1.6bn, compared with £4.9bn in the year just ended, such has been the extent of change over the period David has been a Director. I would like to extend to him the thanks of the Board for his wise counsel during this journey and our best wishes for the future. In David's place as Audit Chair I am delighted to welcome Malcolm Wyman, who joined the Board with effect from 1 January 2013. Malcolm has a long and distinguished career having retired in 2011 after ten years as Chief Financial Officer of SAB Miller, a period of substantial international expansion for the group. He is also a non-executive director of Imperial Tobacco and is SID and Audit Chair at the Nedbank Group.

Finally, may I once again thank our shareholders for their continued support and for the time they have devoted to maintaining an active dialogue with our management and our Board. Given the breadth and diversity of our business, we aim to ensure that our shareholders understand our objectives and the challenges to their achievement. Where relevant, such as on matters relating to remuneration, we seek to consult with them at an early stage and take their input into account as we develop our thinking. In turn I, and my colleagues on the Board, are always available should there be issues they would like to discuss in more detail.

Alastair Lyons CBE
Chairman

Chief Executive's Statement



Overview

2012 has been a year of significant progress operationally, financially and strategically. With a record level of contract wins driving £5.8bn of awards in total, our order book has grown to £19.1bn. Revenue and Adjusted operating profit were £4,913m and £314.8m, representing growth at constant currency of 6.2% and 9.9% respectively. The breadth of our portfolio has enabled our strength in the AMEAA region and the successful launch of our Global Services BPO division to offset challenges in the US federal contracting market. We have made further significant strategic progress in positioning our business to deliver strongly for the future. The pipeline of identified opportunities has been replenished to stand now at an estimated £31bn. We remain, therefore, confident of continued resilience in times of dynamic market conditions and of Serco's overall outlook and attractive future growth prospects.

Record level of contract wins and excellent operational performance

In 2012, across our wide portfolio of markets and geographies, we signed a record level of contracts valued at £5.6bn and were appointed preferred bidder for a further £0.2bn. The total £5.8bn of awards compares with £5.1bn in 2011. Our wins included smaller and medium-sized awards which are fundamental to our growth, as well as significant rebids, extensions, expansions and new contracts. Reflecting the substantial level of awards, our order book grew to £19.1bn at 31 December 2012 (£17.9bn at 31 December 2011).

Notable contract awards, along with approximate total value and contract length where appropriate, included:

- Ferry services to the Northern Isles in Scotland (£350m over six years)
- Environmental Services for Wycombe and Chiltern District Councils (£55m over seven years)
- UK asylum applicant accommodation and transport services (£175m over five years)
- Community Payback probation services in London (£38m over four years)
- Delivery of the UK's National Citizen Service (£70m over two years)
- NHS Suffolk community health services (£140m over three years)
- Next pricing period signed for Atomic Weapons Establishment (AWE) management and operation (£1.5bn over five years)
- Leadership for corporate services (DBS) for the UK Ministry of Defence (£36m over four years)
- US Army base closure support in Afghanistan (US\$57m over three years)
- US Navy Automated Digital Network Systems engineering (US\$68m over five years)
- San Francisco parking services (US\$43m over five years)
- US MRAP military vehicle equipment and system upgrades (US\$73m over 15 months)
- Wiri Prison 25-year operating contract in New Zealand (approximately £15m a year from 2015)
- Wandoo Reintegration Facility in Western Australia (A\$50m over five years)
- Bus operations in city of Indore, India (£13m over six years)

- Australian Tax Office contact centre services (£90m over five years)
- Major BPO contract with leading UK retailer Shop Direct Group (£430m over ten years)
- Contact and support services for AEGON UK (£170m over ten years), and
- Anglia Support Partnership shared services operation for UK health sector (£120m over four years).

More details of these and other contract awards can be found in the Operating Review, with further information and other smaller and medium-sized contract awards during the year described in the contract news updates and other announcements available on our website, www.serco.com.

Visibility of future earnings remains high due to the signed contracts that make up our order book, contracts that we expect to extend and rebid, and contracts at the preferred bidder stage which we expect to sign. At 31 December 2012, revenue visibility was 92% for 2013, 79% for 2014 and 70% for 2015.

Across the Group we have maintained excellent service delivery. We were particularly proud of our achievements through the 2012 Olympic Games, where a number of our contracts were heavily involved. We carried record passenger numbers while maintaining exceptional service metrics on our transport-related services, most notably the Docklands Light Railway, where volumes were substantially ahead of forecasts and there were half a million passengers on the busiest day. We have also been delighted with service standards through the mobilisation and transition phases for major new contracts that commenced across our home affairs, transport, health and BPO operations.

Strong financial result for the year

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

Reported Group revenues were £4,913.0m, representing total growth of 5.7%. Excluding operations disposed of during the year, revenues from ongoing activities were £4,832.2m, with growth at constant currency of 8.5%. Within this, organic growth was 3.3% and the contribution from acquisitions added 5.2%.



Chief Executive's Statement



Community health services, Suffolk, UK



Defence Business Services, UK



Environmental services, Sandwell, UK

Good organic growth, for the Group as a whole, demonstrated the resilience of the portfolio and our successful development in new markets and geographies. There was further very strong revenue growth in AMEAA – up 22% organically. Global Services, our newly created BPO division, saw organic growth of 12%, with underlying growth of over 30% after adjusting for the transfer back of the Bradford education contract and the government funding cuts to our previous work for the UK Regional Development Agencies. Our UK & Europe frontline services division, supported by new contract wins, saw a return to organic revenue growth of 2%. Growth in these three divisions more than offset the 14% decline in organic revenues for the Americas division that resulted from the challenging conditions of the US federal outsourcing market. Our divisional performance is described fully in the Operating Review.

Adjusted operating profit increased 8.5% to £314.8m. Excluding operations disposed of during the year, Adjusted operating profit from ongoing activities was £309.1m, representing growth at constant currency of 13.4% and an increase in the operating margin to 6.4%. Net finance costs were £8.8m higher, principally reflecting the incremental cost of funding acquisitions. Adjusted profit before tax of £278.1m and Adjusted earnings per share of 42.55p grew at constant currency by 7.3% and 8.7% respectively.

Following successful portfolio management activity, there was a £5.6m net exceptional profit on disposals of subsidiaries and operations in the year. This, together with the £5.0m one-off payment to establish the

charitable foundation, is excluded from Adjusted operating profit. There was also an exceptional gain of £51.1m arising from the step acquisition accounting for the DMS joint venture in Australia. This significantly enhances reported profit before tax and earnings per share, but has been excluded from our measures of adjusted financial performance in order to aid comparability.

Group free cash flow was £181.2m compared with £168.3m in 2011. There was an exceptionally strong conversion rate of profits in the second half of the year, and dividend distributions from joint ventures were £16.3m higher. After the effect of acquisitions and disposals, the payment of dividends and other financing movements, total net debt reduced by £53m to £581m as at 31 December 2012.

Our dividend policy in the past has been to increase the total dividend each year broadly in line with the increase in underlying earnings. Reflecting this, in 2011 we increased the total dividend by 14% to 8.40p, which based on 39.59p of Adjusted earnings per share represented a payout of 21% and dividend cover of 4.7 times.

The Board is confident in the future growth prospects for the Group and of the strong financial position that we have. We therefore intend progressively to increase the payout ratio and thereby reduce our dividend cover over the next three years. Beyond that point, we anticipate a policy of maintaining dividend cover of between 2.5 and 3 times and therefore reverting to increasing the total dividend each year broadly



in line with the increase in underlying earnings. The Board has proposed a final dividend for 2012 of 7.45p per share, bringing the total dividend for the year to 10.10p, up 20% compared with the previous year. This represents a payout of 24% based on 42.55p of Adjusted earnings per share, or dividend cover of 4.2 times. The final dividend will be paid, subject to shareholder approval, on 22 May 2013 to shareholders on the register on 15 March 2013.

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

Greater exposure to international growth markets and sectors

Governments and companies face an increasing need to improve the quality of services to their citizens or customers while contending with constrained or reducing budgets. Competition and outsourcing offers a solution to this need, where: deep operational expertise can assure delivery; a breadth of knowledge and experience can bring fresh thinking; and a mixture of front, middle and back office expertise can enable transformation. We are already a leading player in our core markets of defence, transport, justice and health in the public sectors, and financial services, retail, travel and telecoms in the private sector, benefitting from the growth in these markets. Our strategy is to widen our exposure to emerging markets, where superior growth and margins can be achieved, and to deepen our transformational expertise to access larger, more complex and higher margin growth opportunities across our core markets.

Our achievements in 2012 supported this strategy, driven in particular by excellent performances in our AMEAA and BPO operations. Our AMEAA region grew total revenue by 31%, increasing to 18% the region's share of the Group's portfolio. Meanwhile our Global Services BPO business saw 40% total revenue growth, driven by the combination of the contribution from acquisitions and a series of very strong contract wins. Both the AMEAA region and our BPO operations are expected to account for an increasing proportion of the Group's revenue mix.

The excellent performances in the AMEAA and Global Services divisions, together with a return to organic growth in the UK, more than offset the performance of our Americas division. This has been impacted by extremely tough conditions for the US federal contracting market, due to the political challenges of the annual budgeting process and reaching agreement on future government funding.

As described in our Operating Review, 2012 has seen greater exposure to growth markets following entry into new countries in the Middle East as well as new frontline services in India, the provision of new service lines such as community healthcare, and breaking into new private sector industries such as the UK Life and Pensions segment of the financial services market. We also set out for each of our divisions areas of future growth opportunity, which we expect to pursue in 2013 and beyond.

Strategic position further improved through ongoing proactive portfolio management

As part of widening our exposure to emerging markets and deepening our transformational expertise, the launch of our Global Services division in 2012 has been key, adding significant capability in the fast growing, higher margin BPO market. The acquisition of Intelenet in 2011 was strategically important for Serco's development, as were other smaller infill acquisitions such as The Listening Company in the UK and Excelior in Australia. These acquisitions added specific customer contact capabilities and geographic reach. During 2012 these have been fully integrated with Serco's own BPO operations, while the acquisition of Vertex's UK public sector BPO operations has provided additional expertise and strategic partnerships. The success of bringing together our BPO skills and scale in one global division has been reflected in contract awards in the year totalling over £1bn and with Serco being recognised in independent studies and awards as a new leading force in the BPO industry.

Another acquisition in the year was our purchase of the remaining 50% stake in DMS Maritime from our joint venture partner. This strengthens Serco's position as a leading defence services provider in Australia and in the growing marine services market. While remaining primarily focused on organic growth, Serco will continue to look at potential acquisitions that similarly bring new skills, capabilities or market access.

Our proactive portfolio management also involves an ongoing assessment of our existing operations for strategic fit, together with expected future levels of performance and returns. As part of this, Serco made four disposals of operations that were non-core to the future development of the Group. These were: our Technical Services business which provided consulting and project solutions to the UK civil and nuclear defence markets; the majority of our mainly defence-related operations in Germany; our education software business; and our UK data hosting operations. We will continue to serve the energy, defence,

Chief Executive's Statement



Supporting our BPO customers, Mumbai, India



Parking services, San Francisco, US



Marine Services, Portsmouth, UK

education and IT-enabled BPO markets in other ways, but will focus on our long-term contract model to develop the best opportunities and a balanced portfolio.

The successful Group reorganisation has also enhanced our strategic positioning. Creating the new BPO division as our first global business brought together all of Serco's middle and back office skills and capabilities, improving the services we provide to customers and enabling better targeting of opportunities around the world in both the private and public sectors. The reorganisation has also created a single UK & Europe division, supporting better customer relationship management and service development, as well as increased internal efficiencies. For example, since July 2012, the Global Services division has been operating an internal shared service centre for the Group. These organisational changes, which led to headcount reductions in management and our own back office support functions, have generated in-year savings to cover the associated costs.

Extensive pipeline demonstrates attractive growth opportunities

A significant number of opportunities were successfully converted to contract awards in 2012. Newly identified prospects across our portfolio have increased the pipeline value to an estimated £31bn. This increase reflects an ongoing demand for efficient, high quality and innovative service provision from public and private sector customers around the world.

There is a strong pipeline in AMEAA, with many exciting new opportunities such as those in the growing health markets in the region and in the justice sector. There also remain substantial prospects in: defence support, engineering and marine services; transportation markets including light rail, road networks and air traffic control; and integrated facilities management services to support major infrastructure projects in the region.

In the UK, markets continue to show stabilisation and increasing signs of improvement. There are further indications of new markets opening up, supported by the agenda for public service reform. New opportunities include those driven by the growth in commissioning of health services, defence organisation strategic partnerships and from competition being introduced to numerous areas of the home affairs market such as offender rehabilitation.

While the US is expected to remain very challenging in the short term, due to government budget and funding issues, we continue to develop our business and expect to secure new areas of work in defence technology and engineering, logistics and programme support and human capital management. Other civilian markets such as transport and health will be actively pursued. We therefore see good longer term opportunities in the US, as well as strong potential to develop our presence in the wider Americas region.



There are strong growth prospects in the global BPO market as well. Following significant recent wins in the private sector, further prospects are being pursued across a number of vertical markets including life and pensions, telecom, retail, travel and utilities. There are also opportunities in the UK public sector, including more strategic partnerships with local authorities to transform their services, and prospects for future central government shared service centres continue to develop.

Confident of further growth and continued resilience

Serco's portfolio breadth across different markets and economies continues to provide resilience while at the same time enhancing our growth potential. For example, while conditions remain very difficult and uncertain for the US federal outsourcing market, we anticipate further improvement in UK markets and strong performances from our AMEAA and Global Services BPO operations. The strategic and organisational activity in 2012 has also positioned the Group well for future growth.

For 2013, we are forecasting a modest improvement in the rate of organic revenue growth. The effect of acquisitions and disposals to date is likely to have a broadly neutral impact on total revenue growth. We are forecasting our Adjusted operating margin to be broadly maintained at the level achieved in 2012.

Net finance costs are anticipated to be approximately £45-50m, including the impact from the forthcoming revision to IAS 19. This would represent a slight increase on the equivalent 2012 restated net finance cost. Reflecting anticipated further incremental working capital investment supporting BPO growth, together with lower dividends from joint ventures, free cash flow in 2013 may be lower than the level achieved in 2012.

Beyond 2013, we are planning for continued delivery of strong financial performance at Serco. Our confidence in continued resilience, the overall outlook and future growth prospects for the Group have also been reflected in our plans to increase the proportion of our profits paid as dividends to our shareholders.

Serco Foundation established

To mark Serco's 25th year as a publicly traded company dedicated to service excellence, we have established the Serco Foundation as an independent charitable foundation with a one-off endowment of £5m. The foundation will build partnerships with large charities to make donations and also support them in the delivery of their programmes through the application of Serco's people, skills and capabilities.

People

We have a clear strategy for managing and developing our people, which in turn supports our vision. I am pleased that we made good progress against each part of this strategy in 2012. More information on how we achieved this can be found on pages 68 and 69.

Serco's continued growth in 2012 means that we now have more than 122,000 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



For more details of these and other contract awards, see the Operating Review on pages 40 to 57



For details of some of the many smaller and medium-sized contract wins, see our contract news updates at www.serco.com

Our strategy in action

We have a clear strategy for achieving our vision. The case studies on the following pages show just some of the ways that we put that strategy into action during 2012.

The case studies illustrate a number of the key themes for our business – new markets, new ideas, outcomes for citizens and integrating with our communities. Each of these is important for the continued development of our business.

Entering new markets helps us to build a balanced portfolio, with our unique breadth and depth positioning us to take advantage of attractive growth opportunities. Our customers increasingly want new ideas, which are rooted in our world-class expertise and can drive improvements in the quality and efficiency of their services.

Local and national governments face demands from citizens for more and better services within constrained budgets, or need to deliver new services to citizens in countries where the size and wealth of the population is growing. And the communities around our contracts play a vital role. Our people live and work in those communities and we often deliver services directly to local people. Helping our communities tackle their pressing issues is therefore part of the way we work. Many of the case studies here illustrate more than one of these themes.



New markets



New ideas



Outcomes for citizens



Integrating with our communities



More information on our strategy and our achievements during the year can be found on pages 14 and 15

Providing high-value BPO services to Orbitz

New markets



New ideas

Outcomes for citizens

Integrating with our communities

The acquisition of Intelenet took Serco into new markets around the world. In the US, we entered the travel, transportation and hospitality sector for the first time, serving major private-sector customers.

A key example is Orbitz. Orbitz Worldwide is a leading global online travel company that uses innovative technology to enable leisure and business travellers to research, plan and book a broad range of travel products. It has more than eight million unique visitors each month and has also become a major player in corporate travel.

We provide a range of sophisticated customer service and back-office functions, which have helped Orbitz improve productivity and sales performance since 2002. Our people help Orbitz's customers to make and manage their bookings. We also give consultative support, so they get the best deal on their transactions. Back-office work includes ticketing, processing exchanges and researching issues for travellers. We also provide Orbitz with exclusive support to its corporate travel programme, working with Fortune 500 organisations to deliver everything from general to executive travel.

Our at-home agent model allows us to recruit anywhere in the US, finding people with the specific skills and experience we need. The average agent for Orbitz has more than ten years in the industry, including former airline and travel agency employees. We also provide substantial training, typically running for eight weeks or more.

We now have the opportunity to apply these high-value services to other customers, within the travel sector and beyond. We do this by sharing best practices around our global business, working collaboratively to spread our capabilities and make them available to all of our customers.



Our strategy in action

Transforming the back office for the Ministry of Defence

New markets



New ideas



Outcomes for citizens

Integrating with our communities

In March 2012, Serco began to operate the Defence Business Services (DBS) contract for the UK Ministry of Defence (MoD). DBS plays a vital role in the MoD's administration, including paying the salaries of all of the MoD's 74,000 civil servants, settling four million invoices totalling £26bn each year, and carrying out all the vetting for the MoD and its contractors.

DBS is our first pure back-office contract in the UK public sector and has some particularly innovative features. In a traditional outsourcing arrangement, all the staff and assets transfer to us for the life of the contract. At DBS, we provide the leadership team while the staff and assets remain with the customer. Our team delivers management expertise to DBS through the roles of chief executive; chief operating, information and people officers; and transformation director.

This model, known as management insertion, allows for faster procurement and gives the customer a broader range of options when the initial contract comes to an end. In addition, our remuneration is based 100% on the results we achieve – a new approach for a UK government contract.

Since we began to operate the service, DBS has produced excellent results. We have met all of the performance measures in the contract, while delivering first-year savings of around 20% to the MoD and coping with a 35% reduction in workforce since DBS's formation. We see significant potential for further back-office work in the UK public sector, with DBS demonstrating the benefits customers can receive.



Our strategy in action

A new approach to community healthcare

New markets



New ideas



Outcomes for citizens



Integrating with our communities



Serco's contract with NHS Suffolk is our first to provide community health services. It covers community nursing, specialist nursing, community hospitals, speech and language therapy, community dentistry, community equipment and specialist children's services.

At the heart of our approach is our unique partnership with South Essex Partnership University NHS Foundation Trust, which is a leading provider of community and mental health services, and Community Dental Services CIC, a staff-owned social enterprise. This gives us a powerful combination of expertise from the private, public and not-for-profit sectors.

The contract serves over 700,000 Suffolk residents. To ensure we took account of their views, we undertook a substantial engagement exercise, involving nearly 80 meetings with key stakeholders including patients, the public and local doctors. Benefits of the service include extending times for routine appointments from 8 hours to 12 hours a day, a named care lead for each patient, new mobile technology for frontline clinical staff and a centralised administration centre – the first of its

kind in the NHS. The centre, which has just completed a pilot phase, is based in Ipswich and employs local people. It gives patients, carers and doctors a central point of contact for all enquiries, reducing the administrative burden on clinical staff.

In total, we aim to increase the time clinical staff can spend with patients by more than one quarter, giving patients the support they need to manage their conditions more effectively and live happily and independently in their own homes.



Our strategy in action

Transporting the public to the London Olympics

New markets

New ideas



Outcomes for citizens



Integrating with our communities

The Docklands Light Railway (DLR) is the UK's busiest light railway. Serco has operated and maintained it since 1997, on behalf of Transport for London (TfL).

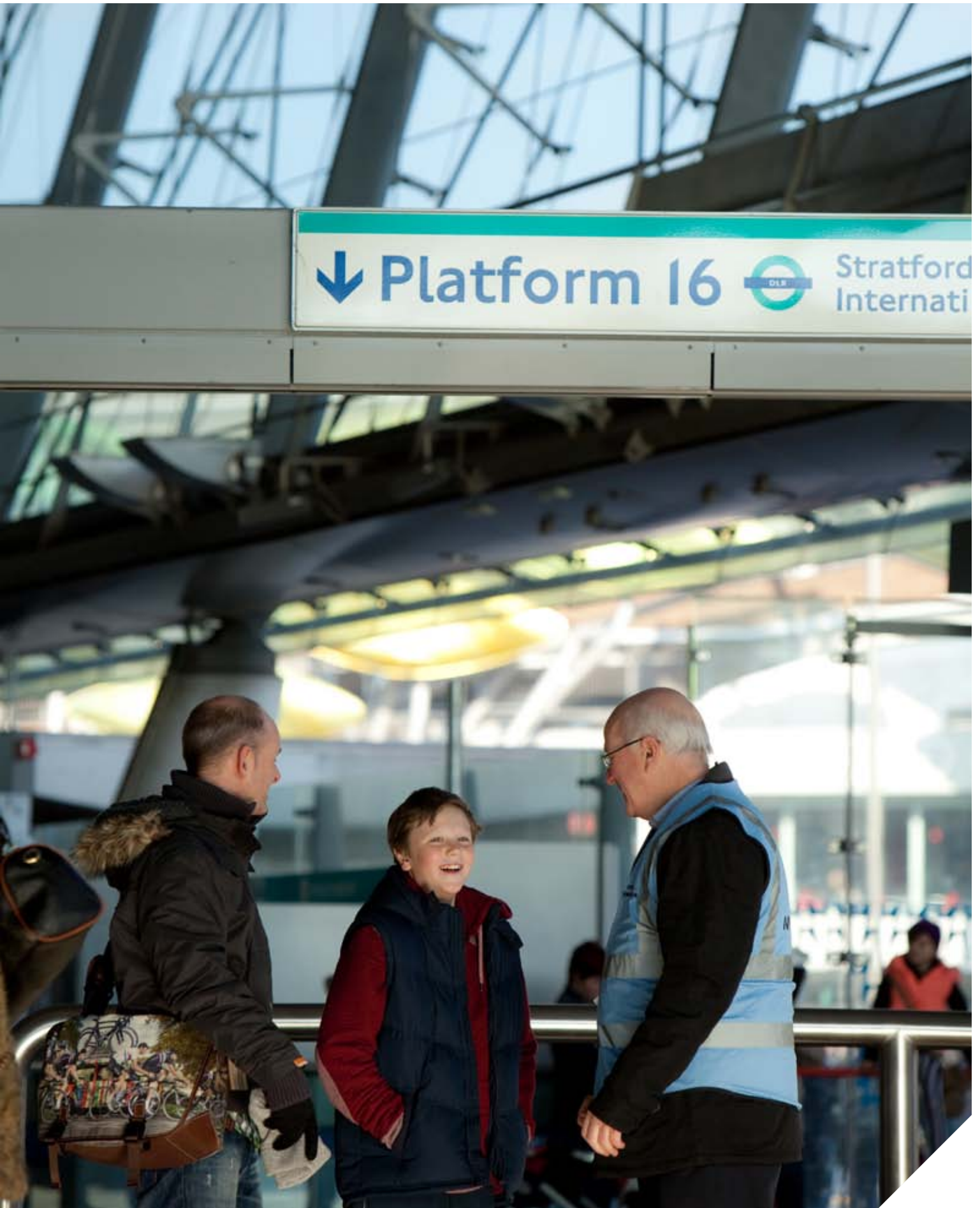
2012 saw the DLR face one of its biggest challenges, as a key transport link for the London Olympics – the largest ever peacetime event in the UK. We began our preparations in spring 2011, more than a year before the Games. Our programme plan included 11 workstreams with more than 3,500 activities.

We were at the centre of the Games, servicing the Olympic and Paralympic venues at the Olympic Park in Stratford, Greenwich Park and the Royal Artillery Barracks in Woolwich, as well as being the only direct transport provider to the ExCel Centre in Custom House.

In total, our support to the Olympics required temporary staffing arrangements consisting of over 900 extra temporary workers. Over 45,000 extra staff hours coverage were required through Olympic rosters for full time staff.

We created ten bespoke timetables to run during the Games, with three-car trains on all routes. Plans were developed to enable 25 stations to be manned around the clock, with staff welfare centres strategically located throughout the system. New passenger information systems were introduced and a 24/7 team set up to deal with any operational issues that arose.

The outcome was a great success. The DLR carried 7.2 million passengers during the Olympics – more than double the normal level – with trains running at an average of 99% for departures and reliability. The enhancements we delivered have since enabled us to improve our ongoing service to the DLR's regular users, and to sign an extended contract with TfL to operate and maintain DLR for another 18 months.



Our strategy in action

Building links in a remote community

New markets

New ideas

Outcomes for citizens



Integrating with our communities



Scherger Immigration Detention Centre (SIDC) is in a remote part of Queensland, Australia. When the centre opened, local residents were concerned that its employees would put pressure on health services and leave less room on flights to the region. In addition, negative media coverage of immigration raised fears about SIDC's clients.

As SIDC's operator, we recognised the need to build stronger community relationships. The centre is based on indigenous land and the area has a much higher proportion of indigenous people than the national average. Along with the Department of Aboriginal & Torres Strait Multicultural Affairs, we therefore created an action plan to demonstrate our commitment to supporting the needs of Aboriginal people.

Other initiatives included arranging for a team of SIDC's clients to compete in a local cricket tournament. The team was so popular that ABC News covered the final match. SIDC clients have since helped to renovate the clubhouse and worked on other community projects. We also renovated a local park,

providing somewhere for clients to go during excursions from the centre. In addition, we built relationships with Rio Tinto – the major local employer – through charity events and community projects.

The outcome has been a significant increase in SIDC's standing with local people, helping us to attract new employees and improving our ability to care for our clients by opening up local amenities to them.



Our strategy in action

Improving lifeline ferry services in Scotland

New markets

New ideas

Outcomes for citizens



Integrating with our communities



Serco operates NorthLink Ferries on behalf of Transport Scotland, carrying passengers and freight between the Shetland and Orkney archipelagos and the Scottish mainland. We took over the contract in July 2012 and by the end of the year, the ferries had carried over 160,000 passengers and more than 33,000 cars, as well as 130,000 sheep, 30,000 cattle and 60,000 tonnes of fish food.

The ferries play a vital part in everyday lives, so community engagement is key. During the bidding process, we talked to local residents and service users to learn what they needed and how we might shape an enhanced service. We continue to engage, by offering passengers the chance to give feedback to customer service teams on board, through Facebook and Twitter, and at the ferry terminals. We also attend ZetTrans, a forum and alliance of key stakeholders, which looks to ensure the transport network is sustainable.

Our engagement has informed the changes we have made. These include a £1m shipboard refurbishment programme, which increased the number of reclining seats and introduced premium services. We have initiated marketing campaigns on a new website that offers a wide range of news, timetables, special offers and opportunities for interaction and feedback,

and a visual identity with a local flavour that users can identify with. Islanders can also use a resident card to pre-book seats at no cost and receive a 20% discount on many onboard retail products.

Our approach also supports Transport Scotland's priorities. After a short handover, we moved quickly from transition to transformation and delivered refurbishment and restructuring seamlessly. We have introduced variable passenger capacity and made timetabling and staff rostering more efficient, all while achieving savings for our customer.



Our strategy in action

Protecting the eyesight of vulnerable people

New markets

New ideas

Outcomes for citizens



Integrating with our communities



Serco-run Acacia prison in Australia has a restorative justice strategy that enables prisoners to give back to society, while learning skills they can use on release. The programme has been running for several years and prisoners are now suggesting their own projects.

One of these was Clear Vision. With the support of the Optometrist Association and Vision West, it allows prisoners to refurbish spectacles, which are distributed to underprivileged people in Perth and developing countries. This can be life changing for the recipients, often helping them to see clearly for the first time in years.

Acacia found workshop space for the prisoners to use and the first delivery of spectacles to the prison contained 30,000 pairs – all of which were saved from landfill. As more prisoners have become involved, it has helped them to build confidence and boosted their communication and people skills.

Clear Vision now has the chance to make an even greater difference. It is collecting and restoring sunglasses, to distribute in countries where sun-related eye damage is an immense challenge. Large companies have also expressed an interest in collecting glasses and Acacia is looking to fund a full workshop. The prison has received approximately A\$25,000 worth of donated ophthalmic equipment for this project, along with the services of a professional optometrist to set up the workshop and train prisoners to use it.



Changing lives through welfare to work

New markets

New ideas
✓

Outcomes for citizens
✓

Integrating with our communities

Unemployment can ruin lives but our contracts – under the UK government’s Work Programme for long-term unemployed people and Job Deal for ex-offenders – help to turn lives around.

Our model for getting people back into work brings together a network of partners to deliver all frontline services, drawing on the best national providers from the private, public and voluntary sectors, and integrating them with smaller and community-based organisations.

In total, we have helped more than 41,000 people into work – a rate of over 1,000 each month. Some find employment, while others are supported with starting a business.

Anna is just one example. As a single mother, she found it hard to balance work and childcare and had been unemployed for two years. After she joined the Work Programme, she was referred to one of our partners, which provides professional and practical business support services to entrepreneurs.

Anna immediately embraced the opportunity. Her adviser helped her with the legalities of self employment and helped her to create cash-flow and profit forecasts, based on market research data. Anna was able to turn her artistic skills into a business by transforming old furniture into attractive one-offs. She now has a unit where she sells her work and her adviser provides ongoing support, helping Anna with any concerns.

Our contracts deliver successes each day but we are always looking for new ideas. For example, we are planning to work with the government to apply behavioural science to inform the behaviour of long-term unemployed people, to improve the number starting and sustaining employment.



Operating Review and Growth Opportunities

This section is presented according to the four divisions, based around our principal markets:

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

The section outlines contract awards which are significant because of their value or their strategic contribution to our business. Further details of these, as well as other medium and smaller-sized contracts, can be found on our website www.serco.com.

UK & Europe

The UK & Europe division includes our frontline services in: Home Affairs (encompassing justice-related operations, immigration and border security, and welfare); Health; Transport & Local Direct Services; and Defence & Science.



Defence Business Services, UK



Environmental services, Sandwell, UK



Prisoner Escort and Custody Services, London, UK

UK & Europe – operating review

Revenue from ongoing activities grew by 2% to £2,494m (2011: £2,434m), and represented 51% of Group ongoing revenue (2011: 55%). On an organic basis, revenue also grew by 2%. Adjusted operating profit from ongoing operations grew by 5% to £172.9m (2011: £165.0m), with the margin increasing to 6.9% (2011: 6.8%). Including the impact of disposals, reported revenue declined by 1% to £2,561m (2011: £2,595m) and Adjusted operating profit was broadly unchanged at £177.8m (2011: £177.6m).

The return to organic revenue growth, after a marginal decline in 2011, reflected the start of numerous new contracts that also reinforce our view of an improving outlook. This more than offset the impact of Serco operating fewer contracts in the welfare to work market and ongoing government austerity which places pressure on areas of discretionary spend with Serco. The margin performance reflected the delivery of operational improvements, largely offset by the effect of the start of new contracts particularly in the second half of the year. The creation of a single UK & Europe division has involved significant organisational change during 2012, both to increase our own efficiency and, crucially, to support the delivery of better services for our customers. In 2013, there will be further activity to drive operational improvements and efficiencies.

Home Affairs

Our operations across the Home Affairs market account for approximately 20% of UK & Europe revenues.

HMP Thameside, the new prison at Belmarsh West in London, became operational in 2012. As one of the most technologically advanced prisons in the world, it has, for example, advanced CCTV digital recording and monitoring, the latest drug and contraband intervention equipment, biometric key vending for staff, and in-cell IT for prisoner education and administration. Currently HMP Thameside is a local Category B establishment with an operational capacity of 900 convicted and remand male prisoners, and the Ministry of Justice has recently announced that it will be expanded with the building of a new houseblock.

In the probation services market, which is expected to see substantial future development with the introduction of competition to improve services and efficiencies, Serco has been awarded the first UK contract. In partnership with the London Probation Trust, Serco is operating Community Payback, which requires offenders to undertake unpaid work for the community. The partnership is providing an integrated service to manage the approximate 15,000 offenders who receive non-custodial sentences in London every year. The four-year contract is valued in total at £38m, with this delivering savings to the taxpayer of over 30%.

Our Payment by Results pilot at HMP & YOI Doncaster is also showing that it has real potential to reduce re-offending. Typical of the many innovative interventions in place are the Families First Programme, which supports prisoners' relationships with their partners and children, and Second Shot Productions, which teaches technical and creative skills in filming and graphic design. Both of these programmes won prestigious Butler Trust Awards in 2012.

For the UK Border Agency (UKBA), Serco commenced the delivery of the COMPASS project, providing accommodation, transport and associated services for asylum applicants in the northwest of England and in Scotland and Northern Ireland. Full Permit to Operate in both regions was awarded at the end of 2012 and Serco is now managing over 6,000 service users across 2,800 properties.

In the welfare to work market, our Work Programme performance continues to rank Serco as one of the leading performers in securing successful job outcomes from the referrals made to our services. Reflecting our approach and performance in this market, Serco's consortium was awarded a contract to deliver the National Citizen Service across six regions in the UK. Expanding our experience of working in partnership with the voluntary sector, Serco in association with the National Youth Agency, UK Youth, Catch 22 and vInspired, will offer 16- and 17-year olds from different backgrounds a six-week programme to develop life skills through community activities working with charitable

organisations and business leaders. The estimated combined total value of the contracts over the initial two-year period is approximately £70m.

Health

Our operations across Health account for approximately 10% of UK & Europe revenues.

A number of significant new health contracts began during 2012. For the NHS in Suffolk, Serco commenced operations in October to provide a wide range of community health services. These include community nursing, specialist nursing, management and operation of community hospitals, speech and language therapy, specialist children's services and community equipment services. Serco is working with a range of NHS and third sector partners to create a unique model of integrated service delivery. The three-year contract has a total value of approximately £140m.

In integrated facilities management (FM) services for the health market, Serco began a new contract for the East Kent Hospitals University NHS Foundation Trust, delivering services to three acute hospitals, two community hospitals and several small clinics in the area. The contract has a total value of approximately £140m over a maximum ten-year period. For equivalent services at Forth Valley hospital, where Serco has implemented a number of innovative technological solutions, we received the highest level of recognition in the 2012 Global FM Awards for Excellence in Facilities Management.



National Physical Laboratory, London, UK



The Work Programme, Rhyl, UK



Operating Review and Growth Opportunities

UK & Europe



GSTS Pathology, London, UK



Northern Rail, UK



Barclays Cycle Hire scheme, London, UK

Elsewhere, we continue to transform the services at Braintree Community Hospital, for which Serco became responsible in 2011, and our GSTS pathology joint venture is delivering the necessary efficiency improvements as it modernises services.

Transport & Local Direct Services

Our operations across Transport & Local Direct Services account for approximately 40% of UK & Europe revenues.

Our London transport contracts – comprising the Docklands Light Railway (DLR), the Barclays Cycle Hire scheme and traffic management operations – have all achieved excellent operational performance during the year. Serco continues to support growth in regular journeys as well as annual events such as the London marathon, and successfully executed the significant additional workload involved in the Diamond Jubilee and the 2012 Olympic Games. The DLR in particular was a key part of the London 2012 Games transport network, with the Stratford International Extension, opened last summer, adding four new stations and connecting five Games venues. According to Transport for London and the Olympic Delivery Authority, during the period of the Olympic Games, the DLR carried 7.2 million passengers – up by over 100% on normal levels. On the busiest day, the DLR carried a record-breaking 500,000 people. Serco was named 'Light Rail Operator of the Year' in 2012 and since the year-end our DLR contract has been extended to September 2014. In July, Barclays Cycle Hire rentals exceeded one million for the first time in any month.

Our other UK rail franchises, Northern Rail and Merseyrail, are also supporting growth in passenger numbers and continued strong operational metrics. At Northern Rail, our performance has led to a further extension of the contract through to 1 April 2014.

In July, Serco began operating a new contract for lifeline freight and passenger ferry services to the Northern Isles in Scotland, building on our experience of managing and transforming other critical local transport services such as Northern Rail and Scatsta Airport on the Shetland Islands. Serco also has extensive operations in the international marine market, including services for the Royal Navy through which it operates more ships under the UK flag than any other company. The new six-year contract has a total value of approximately £350m.

In direct services for local authorities, a number of contracts were awarded during the year. In April, Serco began providing refuse and recycling services for 127,000 households in the London Borough of Wandsworth, helping the council to meet Government recycling targets and reduce costs such as landfill taxes. The contract is valued at £44m over eight years. Serco has been appointed to operate a new joint environmental services contract for Wycombe and Chiltern District Councils. The integrated services include household waste, recycling collections and street cleansing, with the joint contract targeting operational efficiencies while increasing recycling rates across both districts. The initial seven-year contract is valued at approximately £55m. Serco has also successfully rebid its waste and recycling services

contract and its landscapes and grounds maintenance services contract for Canterbury City Council. In our provision of a comprehensive and high quality range of health, leisure, fitness, wellbeing and community-focused services, Serco secured new contracts with North Down Borough Council, Mansfield District Council and Shropshire Council.

Defence & Science

Our operations across Defence & Science account for approximately 30% of UK & Europe revenues.

Our management and operation of the Atomic Weapons Establishment, as part of a joint venture with Lockheed Martin and Jacobs Engineering, has been achieving excellent results. The contract is delivering value for money for the Ministry of Defence (MoD) whilst achieving excellent performance in the quality and timeliness of our programme delivery. In recognition of this, arrangements for the next pricing period through to 31 March 2018 were successfully concluded. The next five-year period will see Serco's share of revenue expected to remain on average at approximately £300m a year, although under the back-end weighted agreed incentivisation arrangements, the earnings and margin rate in the initial years will be similar to those achieved in the initial years of the current pricing period.

In April 2012 Serco began operating a new contract for the MoD to provide training and support to the British Army prior to deployment on operations overseas. Known as the Contemporary Operating Environment Force, and awarded by Army Headquarters, critical pre-deployment training includes language, cultural and operational environment skills, and the creation of realistic training conditions to prepare UK military forces for operations in Afghanistan and other theatres of operation around the world. The contract runs to December 2014, including an option year, and has a total value of approximately £55m.

Our defence multi-activity contracts at RAF Northolt and RAF Brize Norton were expanded in the year. Additional services include IT, vehicle maintenance, expanded aircraft handling and the maintenance of two aircraft operating out of the Middle East using Sponsored Reserves. We successfully rebid our multi-activity contract at RAF Cranwell, home to the Royal Air Force College, which selects and trains all new officers and aircrew and where we support 3,000 simulator hours and 5,500 flying hours per year. The combined total value of the expansions and rebid, which have two to three-year terms, is approximately £30m. A new contract for RAF Valley, supporting their crucial role in training fast jet pilots for both the RAF and the Royal Navy, also became operational in the year.



Waste and recycling services, UK



Multi-activity contract, RAF Brize Norton, UK

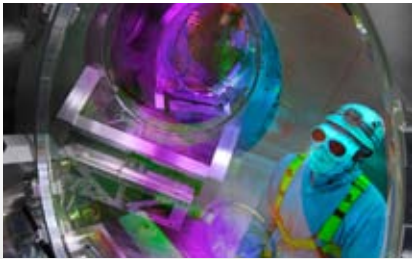


NorthLink Ferries, UK



Operating Review and Growth Opportunities

UK & Europe



Atomic Weapons Establishment, UK



HMP & YOI Doncaster, UK



Community health services, Suffolk, UK

For Defence Business Services (DBS), Serco was awarded a contract to provide an executive leadership team. DBS provides corporate services for the MoD such as civilian human resources, finance, information and security vetting. Serco is working with DBS staff to transform the organisation into a lean and effective shared services centre, building on private sector best practice. The contract is valued at around £36m over its initial four-year duration.

At the National Physical Laboratory (NPL), which has been managed and operated by Serco since 1995, the Centre for Carbon Measurement was launched, ensuring the UK is a leading force in climate modelling, global carbon markets and green technology. Business and government welcomed the project, highlighting its potential to reduce emissions and stimulate the economy. The government has, however, announced that our current ten-year contract (with an original value totalling approximately £500m) will not be extended beyond March 2014, as they will look instead at alternative structures for operation, investment and ownership of the facilities. Serco is proud of its record at NPL and its contribution to its development over the past 17 years.

Serco is overseeing and delivering the Defence Science & Technology Laboratory's (Dstl) Helios programme, which will see the relocation of all of Dstl's activities from Fort Halstead to Porton Down and Portsdown West. The programme will help to support Dstl's future strategic goals, protect their capabilities and provide additional cost benefits, building on an already strong total facilities management partnership between Serco and Dstl.

UK & Europe – growth opportunities

The UK, which accounts for the vast majority of the division's operations, shows signs of increasing activity and good growth potential. Competitive outsourcing supports the UK government's aim of achieving savings while improving services and social outcomes. The reform of public services provision is an ongoing process, but the Cabinet Office and spending departments appear increasingly focused on bringing new opportunities to market.

The 2012 reorganisation into a single division places Serco in a better position to target future growth opportunities across the wider public sector, including where customers are looking for more end-to-end services that combine frontline capability with middle and back office operations. In such instances, the UK & Europe division, as the relationship lead, will draw upon the skills and capabilities of the new Global Services division to deliver fully integrated services. We continue to strengthen our brand and account relationships at all levels, including central government, the devolved authorities in Scotland and London, in local government and in public service frontline organisations such as the police and NHS.

Home Affairs

As part of opening up to competition existing public sector prison operations, Serco was short-listed for two groups consisting of five prisons in total. This is in excess of the maximum of four prisons that can be won under the competition structure. Serco is therefore pleased to be proceeding to the next stage as the single remaining bidder for the South

Yorkshire group, comprising three HM Prisons (Moorland, Hatfield and Lindholme), and looks forward to further developing its bid to produce the compelling package of reforms for delivering cost reduction, improvements to regimes and a working prisons model in these prisons. Serco is also working with its customer to expand HMP Thameside, adding capacity under Serco's more modern and efficient design.

The Ministry of Justice is proposing to open up ancillary and 'through-the-gate' resettlement services across the whole public sector prison estate by spring 2015, rather than further prison-by-prison competitions. This includes recommendations to transform offender rehabilitation, opening up the approximate £600m per annum probation market to competition and rapidly expanding the payment by results approach to improve rehabilitation outcomes. This is expected to provide significant opportunities for Serco.

The growing use of court fines is also expected to generate opportunities for our collection services business, as well as a larger opportunity for the overarching management of compliance and enforcement that would draw upon skills and capabilities from within the Global Services division. Serco is currently in the process of rebidding its electronic monitoring contracts in England and Wales, with preferred bidder appointments expected later in 2013.

Health

The UK health market is being driven by the impact of fiscal pressure and the proposed structural reforms, which require increased introduction of competitive forces. In clinical services, we are developing opportunities to operate both hospital and community-based services. For example, our new innovation partnership with South Warwickshire Foundation Trust will seek to use the expertise and skills of both organisations to improve the care delivered to patients, while delivering best value. This partnership approach will enable the Trust to deliver benefits more quickly to patients, building on existing arrangements such as the Anglia Support Partnership. Initial discussions between the organisations started following a shared vision and interest in working with George Eliot NHS Hospital Trust on their plans for the future.

Our frontline health services business has already had success in working closely with the Anglia Support Partnership shared services operations, led by the Global Services division. This has seen growth by providing additional occupational health and counselling services and a separate clinical strategic procurement contract. Further growth through this strategic partnership framework is being pursued.

The Department of Health currently spends £12bn per annum on community-based services, and this is anticipated to grow given the changing nature of care and patient demographics. The Department's national 'Transforming Community Services' guidance stipulates that all primary care trusts will no longer directly provide community services and will instead commission them. Serco therefore anticipates building on its Suffolk contract award.

There is a growing market for enabling services – both in the UK and elsewhere around the world – that combine facilities management, support services and patient administration to improve service quality and productivity in hospitals and other health establishments.

At our GSTS pathology joint venture, the management team has been further strengthened in the year with the appointment of an independent Chairman. This role is integral in helping GSTS take forward its strategy for modernising NHS pathology and implementing its plans to deliver growth of the business. GSTS has recently been successful in bidding to provide pathology services to the NHS Midlands & East Strategic Health Authority cluster.

Transport & Local Direct Services

Serco's excellent credentials in transportation systems will support selected future growth opportunities in the UK and other countries. For example, Serco has signed a cooperation agreement with Strömma Tourism & Maritime to make a joint bid to manage and operate the ferry services in Stockholm's archipelago and harbour from 2014. As well as transferring skills and capabilities to new markets, we are pursuing further existing contract expansion, as has been demonstrated in our support of the growth of the Barclays Cycle Hire scheme in London. We will also be progressing with the rebid processes for our DLR contract, which runs to 14 September 2014, and our Northern Rail contract, which runs to 1 April 2014, while other potential opportunities may emerge as part of governments' future structuring of transport networks and services.

In local government frontline services, growth in environmental services and other areas of integrated facilities management such as leisure services are expected to emerge. Reductions in funding and increased service demands from citizens are driving more interest in strategic partnering, service sharing and personalisation of services.

Defence & Science

The defence market is expected to develop further opportunities for support in areas such as infrastructure management, business process and whole enterprise outsourcing, and technical and engineering services. Serco will also seek similar opportunities in the science market and emerging markets for energy management.

Developing from Serco's operation of Defence Business Services and supported by the skills and capabilities of the Global Services division, we will be pursuing opportunities for strategic partnerships such as the Defence Infrastructure Organisation (DIO). The DIO is responsible for managing and maintaining land and property for the MoD in the UK and abroad, with the potential for further efficiencies to be achieved across its operations. A similar opportunity is for the Defence Equipment & Support division, which is currently going through further review as to how a competitive process could be run.

Serco has formed a partnership with two other leading nuclear companies, CH2M HILL and AREVA, to participate in the Nuclear Decommissioning Authority's competition to oversee management of decommissioning activities at 12 UK nuclear sites. The CAS Restoration Partnership brings together the unparalleled UK and international expertise of its three partners across nuclear operations, site management, decommissioning and waste management.

Serco has successfully expanded the scope of existing contract relationships to broaden its services. For example, within the scope of the original Dstl contract, options can be exercised for additional Target Services and in 2012 Serco added the provision of an end-to-end procurement service for laboratory assets across Dstl's three core sites. Serco will pursue further contract expansions in the future, to continue driving additional value for our defence and science customers.

Operating Review and Growth Opportunities

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.



Electronic parking, San Francisco, US



Ship board installation for the US Navy



US Navy logistical support

Americas – operating review

Revenue on a constant currency as well as on an organic basis declined by 14%. Revenue on a reported currency basis, given the marginal strengthening of the US dollar, fell by 13% to £753m (2011: £868m) and represented 16% of Group ongoing revenue (2011: 19%). Adjusted operating profit reduced by 24% on a reported currency basis to £55.2m (2011: £73.0m), with the margin decreasing to 7.3% (2011: 8.4%).

The US federal contracting market has remained very difficult. The decline in revenues reflects challenges that have faced the US government's fiscal 2012 and 2013 annual federal budgeting processes, with a series of Continuing Resolutions again being necessary due to political difficulties in reaching agreement on budget funding. Both the Department of Defense and civilian agencies have been facing cuts, with the threat of these being on an automatic basis via a mechanism known as 'sequestration'. These factors have severely disrupted the industry, with government agencies further postponing contract award announcements, delaying work under existing contracts and cancelling or reducing the scope of many contracts and task orders. The Bureau of Economic Analysis reported that, with the threat of sequestration looming, in the final quarter of 2012 the Federal government's defence spending was down 22%, the biggest reduction for 40 years. Further pressures have included an increase in 'small business set asides' in Serco's served markets that restrict our ability to be prime contractor in some cases, and the Federal government shifting to awarding primarily on a methodology of 'Lowest Price Technically Acceptable' rather than 'Best Value'.

Significant cost reduction was undertaken in 2011, allowing margins to be held at the time. While cost actions have continued, the challenging market conditions have led inevitably to lower margins in 2012, with this likely to continue while the difficult and uncertain environment persists.

While revenues have reduced due to the market conditions, new task orders, contract awards and rebids continue to be secured in numerous areas that are less affected by the general budgetary challenges.

Serco's US Army Career and Alumni Program (ACAP) contract secured two expansions during the year. ACAP services include transition and employment assistance counselling for military personnel at 54 ACAP locations across the United States, Korea, Italy, Kuwait and Germany. Under the program, Serco has served more than 2.3 million active personnel, their families and members of the Guard and Reserves for over two decades, with this now expanding to extend support to Guard and Reserve members who are not able to visit an ACAP Center for services. Serco's second expansion includes the addition of financial planning counsellors at ACAP Centers around the world. The two expansions over the two remaining option years are valued in total at US\$54m.

In the area of mission critical logistical support services, Serco began a new contract valued in total at US\$57m over a maximum three years. This supports the United States Forces Afghanistan (USFOR-A) base closure and transition initiative through the coordination of logistics and deconstruction of bases throughout Afghanistan. Similar to the services

we provided in Iraq, Serco's Base Closure Assistance Teams (BCATs) are assisting military units with the key aspects of redeployment. Serco also provides logistics expertise to the US Army under the Logistics Civil Augmentation Program (LOGCAP), where we provide programme management, cost analysis, logistics planning and administrative services around the world in support of the United States and allied forces during operations. Additional task orders awarded in the year were valued in total at US\$12m.

Also for the US Army, we have been awarded a new contract for a full range of technical support services to assist in forecasts that reflect the changes in the political and military climate. The contract has a total value of US\$9m over a maximum of five years. Under an IDIQ vehicle with the US Navy, Serco has been awarded a US\$11m task order for similar work to provide forecasting models to support Navy personnel readiness. Under the same IDIQ, a further US\$4m task order has been awarded to provide counsellors in support of wounded Sailors and Coast Guardsmen.

Serco was awarded a new production and engineering services contract for the US Navy to support Automated Digital Network Systems (ADNS). Serco will perform hardware integration and testing to deliver the Navy's newest ADNS configuration on shore, ships and submarines. The contract has a total value of US\$68m over a maximum of five years.

Serco was awarded a new contract to upgrade Command, Control, Communications, Computers, Intelligence, Technology, Surveillance and Reconnaissance (C4ITSR) equipment and systems on Mine Resistant Ambush Protected (MRAP) vehicles for the US Air Force, US Army, US Marine Corp and US Navy. The installation is being carried out on-site in Afghanistan, Kuwait and Qatar, enabling immediate deployment with Serco also providing in-country maintenance support services. The 15-month contract, awarded under the Sea Enterprise IDIQ contract vehicle, has a nine-month base period and a six-month option period with a total value of US\$73m. Serco provided additional services under this IDIQ contract vehicle to the US Navy's Space and Naval Warfare Systems Command (SPAWAR), with task orders awarded in the year valued at US\$19m.

Serco provides a range of other mission-critical engineering and IT services to the Department of Defense under the C4ITSR contract vehicle. These services include engineering, systems integration, hardware procurement, software development, technical support, installation testing operations and maintenance. Additional task orders awarded in the year were valued in total at US\$59m. During the period Serco was also officially granted ISO/IEC 20000 certification, which measures our approach and capability in delivering world-class IT managed services.

Serco also secured important rebids and extensions for defence and security customers. Serco signed a one-year extension valued at approximately US\$100m for its contract with a US intelligence agency, where we provide IT architecture, systems and systems engineering, financial management and procurement support, risk management performance assessment and reporting. Our contract to support undersea surveillance for the US Navy was successfully rebid at a total value of US\$19m over a maximum of five years.

Beyond our defence and security work, Serco has also rebid and extended other important relationships. For the San Francisco Municipal Transportation Agency, under a five-year US\$43m contract Serco will continue to provide a range of parking related services, infrastructure and systems support including deploying GPS vehicle tracking technology. For Seminole County Florida, Serco has rebid its management and maintenance services contract for a 2,200 vehicle and equipment fleet, worth US\$20m over five years. For the Federal Retirement Thrift Investment Board, Serco will continue to support the US government retirement plan delivering records management and processing solutions in an extension valued at US\$26m over a maximum two years. For the US Patent and Trademark Office, where Serco will now classify approximately 1,500 patent applications a day, our contract has been extended and expanded, valued in total over three years at US\$43m. Serco's long-standing work with United States Citizenship and Immigration Services has been extended to manage and process an additional two million records as a result of an Executive Order issued by President Obama in support of Immigration Qualifications, Deferred Action for Childhood Arrival. This two-year extension is valued in total at US\$25m.



Operating Review and Growth Opportunities

Americas



Personnel and family support services to the US Army



Air traffic control services, US



Logistical services for the US Navy, Virginia, US

Americas – growth opportunities

The federal contracting market is likely to face continued attrition due to the ongoing budget uncertainty and the protracted challenges facing Congress in dealing with the growing national debt. The threat of sequestration, as originally included in 2011's debt ceiling deal, was due to take effect from 2 January 2013 unless some form of agreement was reached by the government on tax and spending issues, but received a short-term postponement. Current federal funding is also continuing to operate under short-term Continuing Resolutions, which often limit commitments to new programs. As a result, the outlook for spending on government services remains both unclear and severely challenged. Industry studies suggest the total budget addressable by government contractors could decline by approximately 10% or more annually in 2013 and potentially beyond until the cycle turns.

As is normal for our Americas division, there is a higher frequency of rebids than is typical for our operations elsewhere around the world. The development of our business will also be shaped by the successful outcome of rebids within a challenging market environment. Important short-term extensions have been secured as noted, while other significant rebids are due over the next 12 months such as Ontario Driver Examination Services, the National Visa Center, the Federal Retirement Thrift Investment Board and the Department of Veteran Affairs.

Serco continues to focus on markets that we expect will receive ongoing funding support, and on assisting government customers to achieve greater efficiencies and higher productivity with constrained resources. Our key areas are: Logistics & Program Management; Communication & Information Systems; National Intelligence; Human Capital Management; Business Process Outsourcing; and Transportation & Asset Management. US government agencies are increasingly using multi-award contract vehicles to issue task orders on a rapid-cycle, competitive basis. Continuing to qualify for and win business under such IDIQ contract vehicles will be a key contributor to Serco's growth.

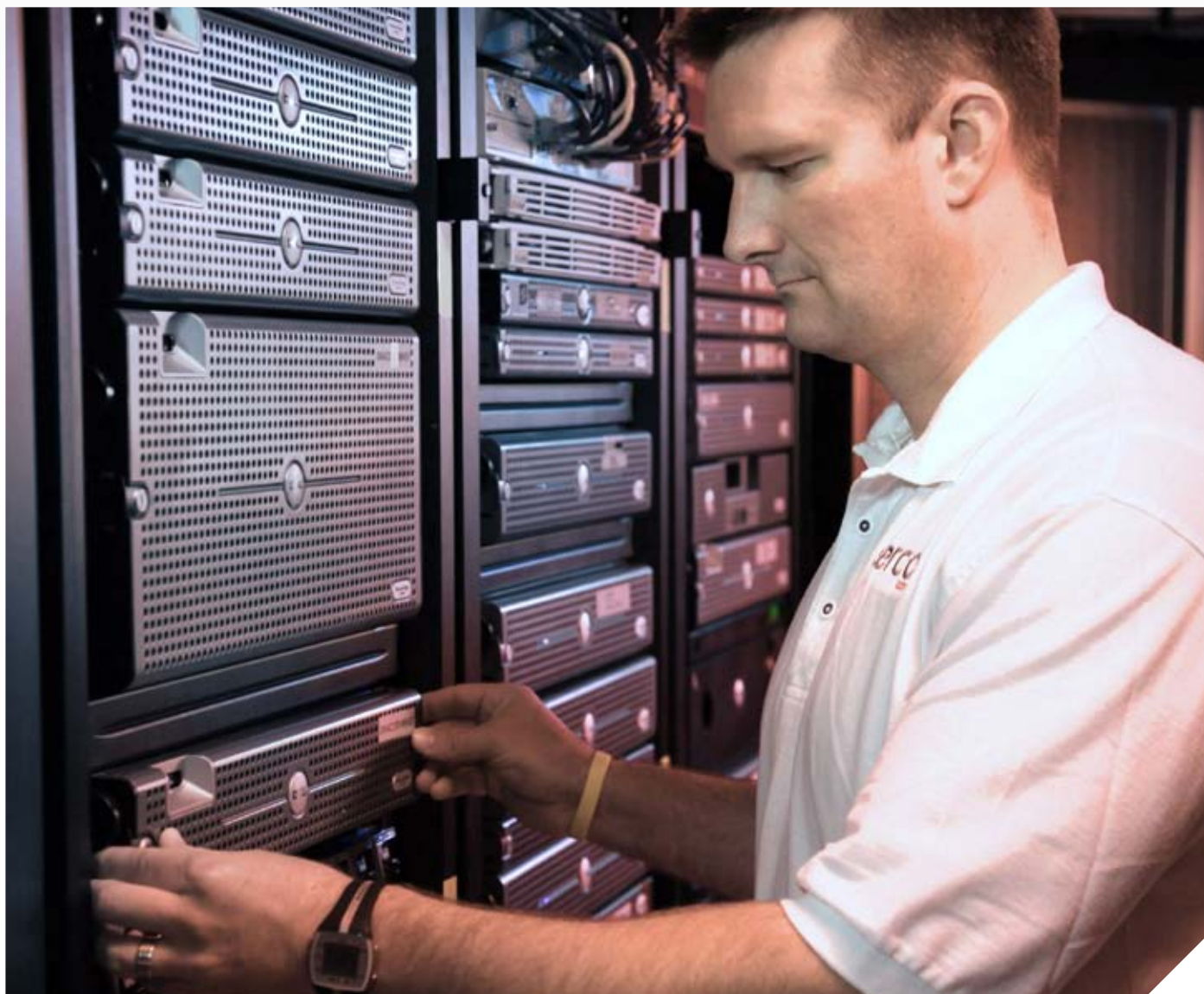
In IT services and solutions, Serco is one of 54 awardees on a government-wide acquisition contract (GWAC) with a ceiling value of US\$20bn over a ten-year period. Serco will bid on a range of task orders for all federal civilian and Department of Defense agencies that require services and solutions including biomedical IT systems, cloud computing, cybersecurity, mobility, telecommunications, and data centre consolidation. Serco is one of seven recent awards on a new SPAWAR Systems Center (SSC) Atlantic Pillar Multiple Award Contract (MAC) for Production, Installation and In-Service (PII) support. This MAC has a potential ceiling value of US\$900m over a maximum of five years, and enables Serco to bid on task orders to provide PII support, life-cycle logistics, training and large scale integration to deliver engineering, equipment and systems support.

Serco is also one of eight awards on a new MAC supporting SSC with integrated Command and Control (C2) engineering and technical support services for command centres. This MAC has a potential ceiling value of US\$145m over a maximum of three years.

Serco has been awarded a place on the new Consultant, Advisory, and Technical Services (CATS) contract vehicle that will provide support services to the US Air Force Medical Service (AFMS) at 69 Air Force Medical Treatment Facilities in the United States and its territories. Serco is among 13 award winners on the IDIQ contract, which is valued at US\$985m over a five-year period. Serco will compete for task orders for Advisory & Assistance Services (A&AS) that will help reduce critical workload demands being placed on the AFMS. Services will include support in the areas of healthcare administration, executive assistance, financial analysis, business process consulting, policy analysis, engineering and technical services.

Serco Americas' pipeline includes numerous further areas of longer term opportunity. For our Navy customers, we expect growth through modernisation work to extend the service life of the existing fleet. The Department of Defense is expected to increase its focus on areas such as Intelligence, Surveillance and Reconnaissance (ISR), unmanned flight, space and cybersecurity. Human capital management and transformation programmes are widening in scope to support future

changes to the size and shape of the armed forces. As a result of the US government's Affordable Care Act, we see opportunities to deliver solutions supporting patient satisfaction requirements and health insurance enrolment initiatives. BPO opportunities with federal and other customers will be pursued to deliver enhanced service and more cost-effective solutions. We plan to leverage our strong capabilities in economic cost analysis and programme management to support the Department of Defense's drive for cost savings. The transportation market is expected to provide opportunities for our air traffic control, traffic management systems and other transport infrastructure and operational management skills and capabilities. We will also continue to review markets in both North America and South America for potential to transfer more of Serco's skills and capabilities.



Operating Review and Growth Opportunities

AMEAA

Our AMEAA segment consists of Australasia, Middle East, Asia and Africa, in which we provide a range of frontline services including transport, justice, immigration, health, defence and other direct services such as facilities management.



Air traffic control services, Baghdad, Iraq



Dubai Metro, Dubai, UAE



Passenger information and support services, Perth, Australia

AMEAA – operating review

Revenue on a reported currency basis grew 31% to £883m (2011: £672m), and represented 18% of Group ongoing revenue, up from 15% in 2011. Revenue on a constant currency basis grew by 30%. Excluding the contribution from acquisitions, revenue on an organic basis grew by 22%. Adjusted operating profit grew by 25% on a reported currency basis to £64.3m (2011: £51.4m), with the margin decreasing to 7.3% (2011: 7.6%).

The very strong organic growth reflects revenue from new contracts begun in 2012 and those that had started but were not fully operational throughout 2011, as well as the expansion of existing contracts, particularly an increase in the amount of work undertaken for the Australian Department of Immigration and Citizenship (DIAC). The reduction in margin principally reflects the return to a more normal level of margin on the DIAC contract.

In Immigration Services in Australia, the level of irregular maritime arrivals has increased in 2012, leading to a growth in the number of people in our care. In response, we successfully managed the opening of new detention centres in the Northern Territory and Western Australia. The level of our future activity is still likely to fluctuate based on country conditions in the Middle East and Asia, where most people in our care originate, and the prevailing government policy, speed of visa processing and the application of the Australian government's recent off-shore processing legislation. Serco has a very strong customer relationship with DIAC,

with both parties working closely to maintain a safe and stable network of centres, responding with humanity and respect in the operation of this sensitive contract.

A number of other contract awards in Australia generated incremental revenues. Serco's operation of Court Security and Custodial Services for the Western Australian Department of Corrective Services was fully operational, achieving over 30,000 client movements in the year. A new contract valued at A\$50m over five years (with potential to extend to 15 years in total) for the new Wandoo Integration Facility in Western Australia became fully operational in November 2012. Serco also expanded the scope of its contracts at Acacia Prison in Western Australia and for the new South Queensland Correctional Centre, which replaced the previous facility at Borallon. In New Zealand, Serco's operation of the Mount Eden Corrections facility in Auckland successfully completed its first full year.

The pre-operational phase of the new-build Fiona Stanley Hospital in Perth has continued to see Serco's involvement grow. Plans are on track for the opening in 2014, at which point Serco's full facilities management and support services contract to ensure the smooth running of the whole hospital will begin. The first phase of recruiting over 1,000 non-clinical staff required to operate the hospital has already begun. In our transport operations, Great Southern Rail, in adverse conditions for the Australian tourism market, has continued to hold revenue broadly stable through additional operating investment. The business was presented with the

Service Excellence award at the 2012 Australian Business Awards, while The Ghan was voted 'best luxury rail journey' worldwide in Luxury Travel Magazine for the third year running.

DMS Maritime, our defence and marine services business, has continued to show good organic growth. As one of Australia's largest maritime service operators, it has facilities in every major port and a technical support network that extends a wide range of engineering and technical services across Asia Pacific. DMS Maritime manages, operates and maintains over 600 vessels in the region, with commercial, defence and government agency customers including the Royal Australian Navy and the Australian Customs & Border Protection Service. Towards the end of the year, Serco completed the purchase of the remaining 50% equity stake in the business from its joint venture partner, P&O Maritime Services.

In the Middle East, service on the Dubai Metro has continued to see world class operational standards, with 99.9% of all trains on time and the Roads and Transport Authority reporting a record number of Metro passengers in 2012, up by 58% on 2011. During the year, Serco also added engineering and maintenance responsibilities required to support network expansion. Our logistics and base support operations in the region for the Australian Defence Force successfully completed their first year of operations, whilst our integrated facilities management operations in the region have also delivered strong growth.



Operating Review and Growth Opportunities

AMEAA



Fiona Stanley Hospital, Perth, Australia



Immigration services, Australia



Dubai Metro, Dubai, UAE

AMEAA – growth opportunities

The AMEAA region has experienced the fastest growth of our portfolio for a number of years and we continue to see good opportunities for further strong growth. Our existing operations in Australasia, the Middle East and India each present prospects. In addition, there is further growth potential from expanding into new regions as emerging market governments take steps to adopt international best practice in procurement processes, to support their social infrastructure improvement programmes.

In the justice sector, we see further opportunities in the operation of new-build and existing prisons as governments deal with capacity and efficiency challenges. For example, Serco's consortium signed a contract during the year to provide and operate the new Wiri prison in Auckland. Under the design, construct, manage and finance contract, Serco will manage the new 960-place male prison for 25 years once it becomes operational in 2015. The contract will deliver revenues of approximately £15m a year. Related services such as court escorting also represent opportunities.

In transport, Serco is seeking to leverage its international expertise, particularly in urban transportation and metro systems. In India, Serco has been awarded its first frontline services contract to operate and maintain the new Bus Rapid Transit Services, a dedicated 11.3km bus corridor in the city of Indore in central India. Further expanding our services with the

Dubai Airports Company, Serco will be providing the operations and maintenance for the new Automated People Mover at the airport. Numerous bidding opportunities throughout the AMEAA region are expected to support other road and rail operation and maintenance contracts, as well as traffic management systems.

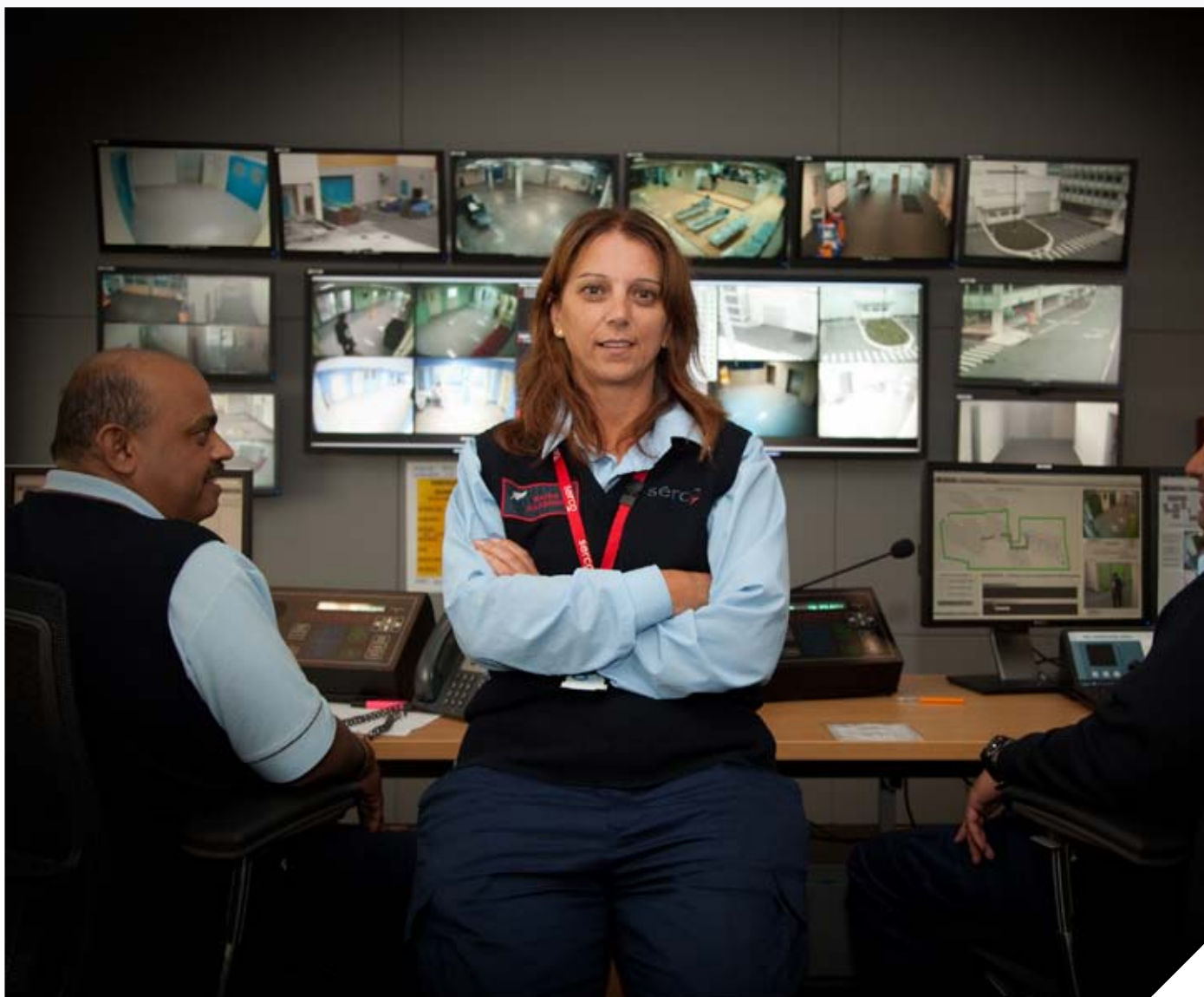
Serco is also a global leader in air navigation, and sees opportunities to expand services both within the region and into new geographies. For example, in 2012 Serco's management of Iraqi airspace at Baghdad International Airport was expanded to deliver air traffic control services at Erbil in Iraqi Kurdistan. Our ability to mobilise highly skilled aviation teams quickly is well established, and we are in discussions with a number of potential customers seeking a step change in air navigation safety, capacity and performance.

Integrated facilities management contracts in the commercial and other sectors are expected to grow, particularly given ongoing completion of major construction projects in the UAE. Last year's acquisition of a small regional specialist is delivering strong results. Serco has also capitalised on its new business development presence in the Kingdom of Saudi Arabia. Two new consultancy agreements will provide asset management strategies to implement operational efficiency processes for building maintenance and infrastructure.

Our defence business in Australia has a strong base from which to expand services, including garrison and maritime support, training, engineering and maintenance. In the growing marine services market, our presence has been strengthened by our full ownership of DMS Maritime. Serco will now be well placed to pursue more complex opportunities that may emerge from new capability requirements for the Australian Defence Force, to be detailed in its forthcoming White Paper 2013. It will allow Serco to fully leverage DMS Maritime's defence systems integration, supply chain management and through-life support capabilities across the maritime, land, systems and ultimately aerospace domains. DMS Maritime additionally provides Serco with a platform to further expand the breadth of our marine services to the commercial maritime market. This includes port infrastructure and related services to the resources sector, driven by the ongoing high demand for commodities and energy.

In the emerging and rapidly growing health markets in the region, governments are increasingly looking to involve private sector provision. Across the region, Serco will be pursuing potential opportunities for the operation of hospitals and related services, building on the strength of our UK operations and the Fiona Stanley Hospital in Australia. For example, Serco was also awarded a new support services contract for the Prince of Wales Hospital, one of the busiest in Hong Kong with over 1,000 beds and complex facilities.

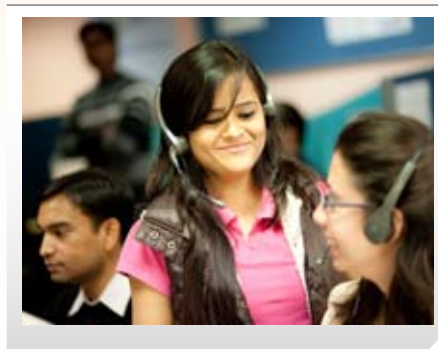
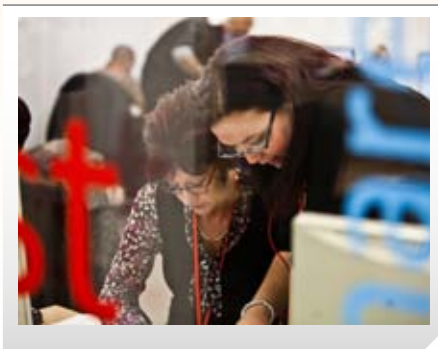
The AMEAA division will also be supported by the Global Services division in joint growth opportunities for its customers. Relationships, skills and capabilities will be pooled for opportunities such as providing shared services to government departments.



Operating Review and Growth Opportunities

Global Services

In 2012, Serco created a new global BPO division, bringing together all of Serco's middle and back office skills and capabilities across customer contact, transaction and financial processing, and related consulting and technology services.



Global Services – operating review

The new Global Services division improves the services we provide to customers and addresses a wider range of opportunities in both the private and public sectors. Customers around the world are increasingly looking for end-to-end services that combine frontline capability with middle and back office operations, helping them to drive more efficiency and better quality services. In addition to seeking specific BPO opportunities, the division will also work alongside the regional divisions to deliver fully integrated services for their customers. The establishment and growth of Serco Global Services, with global annual revenues in excess of \$1.1 billion, places Serco as a top tier international BPO organisation.

Revenue on a reported currency basis grew 40% to £716m (2011: £511m). This represented 15% of Group ongoing revenue, up from 11% in 2011. Revenue on a constant currency basis grew by 45%. Excluding the contribution from acquisitions, principally Intelenet and Vertex, revenue on an organic basis grew by 12%. In the previous year there were revenues from the Bradford education contract which transferred back to the Council in September 2011, and from our Business Link services, the majority of which have now closed due to the government funding cuts borne by the Regional Development Agencies. Excluding these two areas, underlying revenue growth for our new global BPO division has been over 30%.

Adjusted operating profit grew by 83% on a reported currency basis to £62.1m (2011: £34.0m), with the margin increasing to 8.7% (2011: 6.7%). The margin increase was driven principally by the contribution from the higher margin Intelenet operations and significant private sector wins.

Over the course of 2012, we concluded the significant programme of integrating the acquisitions made in 2011, combining them with Serco's existing strength in IT-enabled service delivery. Tools such as Workforce Management have been rolled out, as well as standardising and strengthening all management and compliance procedures. Significant investment has been made in IT integration, and this will continue to be a feature to place the business in the strongest position for future growth. In 2013 there will also be further additional investment costs for new delivery centres and business development initiatives around the world, supporting the strong pipeline of growth opportunities.

In its first full year of Serco ownership, the former Intelenet operations have met our expectations as set out at the time of acquisition. Intelenet has been a key part of the strong underlying revenue growth for the whole of Serco Global Services. As well as incremental revenues already achieved, numerous major strategic wins made part way through 2012 will also support expected strong revenue growth into 2013.

In July 2012, Serco began operating a new ten-year contract for Shop Direct Group, the UK's leading online and home shopping retailer, valued in total at approximately £430m. Serco has taken over responsibility for providing all customer contact services across Shop Direct's brands. The partnership will work together to significantly enhance service levels and efficiency through investment in the latest technology, such as web chat and mobile digital services, which are designed to seamlessly integrate online and mobile customer contact management. Our solution combines capabilities from the Intelenet and The Listening Company acquisitions, as well as the additional scale advantage from Serco's other BPO operations.

In November 2012, Serco began a new outsourcing partnership to provide customer contact and support services for AEGON, the leading life and pensions company, marking Serco's entry into this important segment of the financial services market. The initial ten-year contract is valued in total at around £170m. Delivering a wide range of services for AEGON's UK-based protection business, Serco is managing all aspects of the customer journey from initial underwriting through to claims processing, as well as servicing a small number of closed-book policies. Serco is responsible for the administration of approximately 500,000 current and closed-book policies in total.

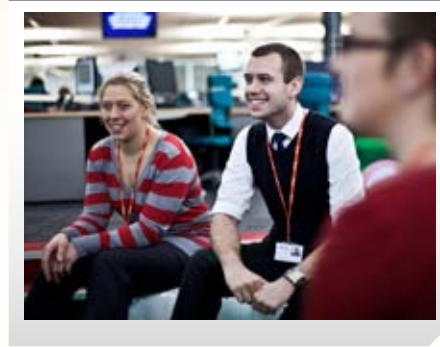
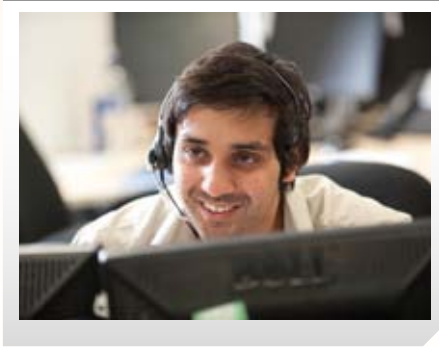
Many other new private sector BPO operations began during 2012. In retail, a £55m ten-year contract with Freemans Grattan Holdings sees Serco delivering all aspects of customer contact services, including customer enquiries, inbound and outbound sales, credit applications, payments, order processing, white mail and e-mail handling. Serco also secured new relationships with two of the UK's most prestigious retailers, to provide services including order line and customer management, while for a leading European media company Serco is providing frontline customer contact, back office and specialist support from an expanded service centre in Teltow, near Berlin, Germany. These three contracts, which have three to five-year terms, have a total combined value of approximately £50m.

Serco was awarded a new contract to provide multi-lingual customer contact services for leading European airline easyJet. Serco has responsibility for the operation, administration and management of easyJet's multi-channel customer contact, delivered through a blend of near-shore and off-shore provision from Poland and India. This initial three-year contract has a total value of approximately £18m. Serco also began a wide range of customer sales services for British Gas in the UK, delivering customer acquisition activities for energy, domestic appliance and drain care services in a new three-year contract, valued in total at approximately £16m.



Operating Review and Growth Opportunities

Global Services



Other new contract awards include: support to a UK general insurance provider to reduce their backlog of Financial Services Authority regulated complaints; providing 1,800 customer contact employees and multi-channel services for a large banking and financial services company in India; supporting the booking processes for travel and hospitality services for an award-winning loyalty program on behalf of a leading US-based global online travel company; and establishing off-shore delivery centres to provide back office services such as indexing, invoice processing, claims adjudication and policy maintenance for a leading UK-based healthcare insurance provider.

In the public sector, The Anglia Support Partnership (ASP), which has an initial value of £120m over four years, began operating in April 2012. This is Serco's first shared services proposition in the emerging market for middle and back office support to the UK health sector. Current support services include operational and specialist IT, finance operations, employment services, contracts management, procurement, primary care support services, occupational health, risk management, catering, and estates and property. The framework agreement also permits the call-off of additional services and allows other NHS organisations to access services.

The Peterborough City Council strategic partnership, which had an initial value of £100m over ten years, saw the transfer of the in-house shared service centre to Serco in late 2011. Serco is already successfully growing this contract, with further services such as procurement being brought into scope as part of the Council's transformation. The Hertfordshire County Council operations which commenced in April 2011 have also widened their scope, with staff numbers more than doubling and new operations such as the Adult Social Care Access Service now being provided. Additionally, Serco's property and IT joint venture with Glasgow City Council, known as ACCESS, has seen information, communications and technology (ICT) support for the authority's schools added to its responsibilities.

Other strategically important existing relationships were also developed in the period. Serco has extended and expanded its relationship with a leading telecom provider in India for a further three-year term. Providing contact services and transaction support, the contract which began in 2006 from three delivery centres has expanded to ten today and handles an average of 14 million calls and transactions per month. Our expertise in this relationship also supported the award of a new contract with another leading telecom provider, where five delivery centres will provide contact services under this new relationship. These three-year contracts on a combined basis have a total value of approximately £60m.

Serco successfully renewed its contract with the Australian Tax Office (ATO) to provide contact centre services to Australian taxpayers, businesses and tax professionals across a diverse range of taxation and superannuation-related issues. Serco, in partnership with the ATO and other suppliers, is responsible for providing advice and responding to enquiries relating to tax numbers, refunds, business activity statements, debt management, return submissions and tax information packs. The renewed contract has an initial five-year term with a total value of approximately £90m. Serco also successfully renewed its contract to provide a comprehensive range of customer services for the National Rail Enquiries service in the UK. The contract which has been operated by Serco and the former Intelenet business since 2004 includes Help Point support, customer care, enquiries and complaint handling across a range of channels including voice, email and web chat. Responding to changing patterns of consumer engagement, this innovative five-year contract is valued in total at approximately £10m.

Recognising the substantial amount of new business won during the year, Serco was identified as one of the top three global BPO service providers by the leading BPO industry analyst firm NelsonHall in its 2012 BPO Index. This index measures the performance of leading BPO service providers based on the total contract value of wins achieved in 2012. Recognising the overall scale of our operations, we were also named as one of the top 15 BPO providers within leading technology insights and advisory services firm ISG's TPI Index.

During 2012, our operations have continued to win various accolades in the crucial area of employee development. According to NASSCOM's ranking of IT-BPO employers in India, Serco Global Services is now the largest pure-play BPO business. Awards in 2012 include recognition within 'Asia's Best Employer Brand Awards' and 'India's Best Companies to Work For', the latter being for 'Best Company in Career Growth'.

Global Services – growth opportunities

Serco has built significant capability in the fast growing, higher margin BPO market, broadening Serco's customer and geographic reach. This has added scale and depth to provide private and public sector customers with a range of end-to-end, integrated business services as they seek to reduce costs and improve efficiencies by transforming their operations.

Serco's approach is increasingly recognised for leadership in transforming a customer's operations as opposed to simple 'lift and shift' solutions. Serco's bids benefit from our substantial scale and global reach, in particular from the ability to provide a blend of on-shore, near-shore and off-shore service provision. We are also a clear leader in areas such as multi-channel customer contact services. Significant contract wins in 2012 such as Shop Direct and AEGON have demonstrated these factors and provide excellent short-term growth into 2013 as these annualise, but importantly also provide strong referenceability for similar work in the future.

We are addressing a large number of private sector opportunities. The significant pipeline of prospects continues to be spread across large and diverse industry groups: Banking, Financial Services & Insurance; Travel, Hospitality & Transportation; Retail, Healthcare, Utilities & Manufacturing; and Telecom, Technology, Online Services & Media.

Our geographic reach both for customers and service centre locations has expanded to support future growth. This has included new operations in Germany, South Africa and Saudi Arabia. The latter, following our first centre launch in Dubai in 2011, supports further expansion in the largest economy in the Middle East. Global Services also expanded its India-based Agra facility, further strengthening its dominant position in the Indian domestic BPO market. The management team in the Americas region has also been strengthened to target significant growth opportunities.

In the public sector, the Global Services division is working alongside the regional divisions to bid and deliver fully integrated solutions for their customers. Significant revenue synergies have already been achieved where the Group's combined capabilities are able to transform public services, and we expect more to emerge in the future.

In June 2012, Serco acquired Vertex's UK public sector BPO operations, bringing additional expertise and strategic partnerships to support expansion into new areas of middle and back office support, and at the same time increase Serco's operational scale. This will help develop future opportunities in both the central and local government markets, with Vertex bringing significant customer referenceability and specific skills in HR and payroll, revenues and benefits, complex case management and administration services. Its 3,000 employees handle approximately 4.5 million citizen interactions a year.

In the UK, the government has recently set out how it intends to achieve efficiencies in shared service centres and has also set out the transaction costs involved in providing services for citizens. The Global Services division would provide support in bidding for operations such as contact centre services, case management, identity verification, transaction processing, ICT, human resources and payroll, finance and accounting, and any other middle or back office support function that is required. For example, for the Ministry of Justice, Global Services is providing support to the UK & Europe division for court fines and compliance and enforcement, electronic monitoring and prison management. The future development of the Ministry of Defence's DIO opportunity, similar in nature to the DBS contract already led by the UK & Europe division, would also see Global Services support, as would tenders expected for the Home Office in areas such as visa services.

The ASP contract is expected to be a key enabler to growing Serco's combination of health support services and BPO operations. We are already seeing growth in areas such as procurement services, and expect the framework agreement to support significant further growth. Other opportunities in providing business services to NHS organisations are also being pursued.

We recently signed a new contract to provide multi-channel contact centre services to the Department of Health to cover a range of public health programmes. Other central government shared service centre opportunities are expected to be developed. For example, the Department for Work and Pensions is assessing the case for a shared services centre to process claims and payments. There is also the potential to expand the scope of support for existing customers such as Job Centre Plus and emerging BPO opportunities for other agencies and departments.

Our work with local authorities to transform their services continues to show a good pipeline of opportunities. Local authorities are further developing their strategies based on a smaller proportion of services that they deem to be core, thereby increasing the potential to outsource other non-core supporting operations. Existing Serco strategic partnerships at Hertfordshire, Glasgow and Peterborough have all demonstrated the potential for expansion, and the addition of the Thurrock and Westminster contracts previously operated by Vertex adds to our ability to increase the scope of services. Research by YouGov supports the view that local authorities are looking for further outsourcing, with this increasingly focused on transformational change.

Finance Review



Overview

Our business delivered a strong financial performance in 2012, with revenue growing 5.7% and Adjusted operating profit increasing by 8.5% to £314.8m. Excluding currency effects, revenue growth was 6.2% (3.3% organic) and Adjusted operating profit growth was 9.9%. Our Adjusted operating margin increased by 17 basis points (22 basis points excluding currency effects). Adjusted profit before tax grew by 6.1% (7.3% excluding currency effects). Group free cash flow increased by 7.7% to £181.2m, principally as a result of the increase in profits and an exceptionally high level of dividends received from joint ventures.

For 2013, we are forecasting a modest improvement in the rate of organic revenue growth. The impact of acquisitions and disposals to date is likely to have a broadly neutral impact on total revenue growth. We are forecasting our Adjusted operating margin to be broadly maintained at the level achieved in 2012.

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. The table shows separately the revenue and Adjusted operating profit of ongoing activities, which exclude the financial results of subsidiaries and operations disposed of during the year. Measures of Adjusted operating profit, Adjusted profit before tax and Adjusted earnings per share are presented, which are calculated before amortisation of intangibles arising on acquisitions, acquisition-related costs and exceptional items (being profit or losses on disposal of subsidiaries and operations, the donation to the Serco Foundation and the gain arising from step acquisition accounting on the DMS joint venture).

Figure 1: Income statement

Year ended 31 December	2012 Before exceptional items £m	2012 Exceptional items £m	2012 Total £m	2011 £m	
Revenue ongoing activities	4,832.2	–	4,832.2	4,471.8	8.1%
Revenue disposed activities	80.8	–	80.8	174.6	
Total revenue	4,913.0	–	4,913.0	4,646.4	5.7%
Gross profit	743.5	–	743.5	700.4	6.2%
Administrative expenses	(428.7)	–	(428.7)	(410.3)	4.5%
Adjusted operating profit ongoing activities	309.1	–	309.1	276.4	11.8%
Adjusted operating profit disposed activities	5.7	–	5.7	13.7	
Adjusted operating profit	314.8	–	314.8	290.1	8.5%
Amortisation of intangibles arising on acquisition	(24.1)	–	(24.1)	(20.0)	
Acquisition-related costs	(3.7)	–	(3.7)	(3.9)	
Exceptional net profit on disposal of subsidiaries and operations	–	5.6	5.6	–	
Exceptional donation to Serco Foundation	–	(5.0)	(5.0)	–	
Operating profit	287.0	0.6	287.6	266.2	8.0%
Exceptional other gain	–	51.1	51.1	–	
Investment revenue and finance costs	(36.7)	–	(36.7)	(27.9)	
Profit before tax	250.3	51.7	302.0	238.3	26.7%
Tax	(62.6)	6.5	(56.1)	(63.1)	
Profit for the year	187.7	58.2	245.9	175.2	40.4%
Effective tax rate	25.0%	–	18.6%	26.5%	
Adjusted operating margin	6.4%	–	6.4%	6.2%	
Adjusted profit before tax	£278.1m	–	£278.1m	£262.2m	6.1%
Adjusted earnings per share	42.55p	–	42.55p	39.59p	7.5%
Earnings per share	38.09p	11.85p	49.94p	35.70p	39.9%
Dividend per share	–	–	10.10p	8.40p	20.2%

1.1 Revenue

Revenue grew by 5.7% to £4,913.0m (6.2% excluding currency effects). Organic revenue growth, excluding currency effects and acquisitions, was 3.3% reflecting the growth of existing contracts and the contribution of new contracts started in 2011 and 2012.

1.2 Adjusted operating profit

Adjusted operating profit increased by 8.5% to £314.8m, representing an Adjusted operating profit margin of 6.4%. Adjusted operating profit margin increased by 17 basis points (22 basis points excluding currency effects).

Finance Review

1.3 Reportable segments and ongoing activities

The table below shows the segmental results split between ongoing activities, being the part of the business which will continue into 2013, and disposed activities, being the part of the business which contributed to the 2012 and 2011 results but was disposed of during the year.

Figure 2: Reportable segments

Year ended 31 December 2012	UK & Europe £m	Americas £m	AMEAA £m	Global Services £m	Total £m
Segment revenue					
Ongoing activities	2,494.0	753.4	883.0	701.8	4,832.2
Disposed activities	67.1	–	–	13.7	80.8
Revenue	2,561.1	753.4	883.0	715.5	4,913.0
Segment Adjusted operating profit					
Ongoing activities	172.9	55.2	64.3	61.3	353.7
Disposed activities	4.9	–	–	0.8	5.7
Segment Adjusted operating profit	177.8	55.2	64.3	62.1	359.4
Corporate expenses					(44.6)
Adjusted operating profit					314.8
Year ended 31 December 2011	UK & Europe £m	Americas £m	AMEAA £m	Global Services £m	Total £m
Segment revenue					
Ongoing activities	2,434.1	868.2	672.1	497.4	4,471.8
Disposed activities	161.1	–	–	13.5	174.6
Revenue	2,595.2	868.2	672.1	510.9	4,646.4
Segment Adjusted operating profit					
Ongoing activities	165.0	73.0	51.4	32.9	322.3
Disposed activities	12.6	–	–	1.1	13.7
Segment Adjusted operating profit	177.6	73.0	51.4	34.0	336.0
Corporate expenses					(45.9)
Adjusted operating profit					290.1

1.4 Acquisition-related costs

These represent incremental costs arising from acquisition activity during the year. The £3.7m of costs principally related to the acquisitions of Vertex Public Services Limited (Vertex) and the remaining 50% share of DMS Maritime Pty Limited (DMS) that are described in more detail in Section 4 below.

1.5 Exceptional net profit on disposal of subsidiaries and operations

The £5.6m exceptional item represents net profit on disposal of the four subsidiaries and operations during the year, which are described in more detail in Section 5 below.

1.6 Exceptional donation to Serco Foundation

To mark Serco's 25th year as a publicly traded company dedicated to service excellence, we have established the Serco Foundation as an independent charitable foundation. An exceptional one-off payment of £5.0m has been made in the year to establish the charitable foundation.

1.7 Operating profit

Operating profit after exceptional items was £287.6m, an increase of 8.0%.

1.8 Exceptional other gain

The exceptional other gain represents the gain arising from step acquisition accounting of the DMS joint venture. This requires that, before accounting for the purchase of the remaining 50%, the original 50% shareholding held at book value in Serco's accounts is restated to fair value. The revaluation of this original 50% is recognised in the consolidated income statement, which resulted in a £51.1m non-cash exceptional gain.

1.9 Investment revenue and finance costs

Investment revenue and finance costs totalled a net cost of £36.7m (2011: £27.9m), an increase of £8.8m. The increase excluding currency effects was £9.6m. The principal driver of the cost increase was the full year effect of additional loans raised in the prior year to finance acquisition activity.

For 2013, net finance costs are anticipated to be approximately £45-50m including the impact from the forthcoming revision to IAS 19; this would represent a slight increase on the equivalent 2012 restated net finance cost.

1.10 Tax

The tax charge of £56.1m (2011: £63.1m) represents an effective rate of 18.6% (2011: 26.5%). Excluding exceptional items the effective rate was 25.0% (2011: 26.5%). Excluding exceptional and other adjusting items, the effective rate was 24.6% (2011: 25.9%). The decrease in the effective tax rate is primarily due to changes in the mix of taxable profits and the impact of the reduction in the UK headline tax rate from 26% to 24% on 1 April 2012.

1.11 Earnings per share (EPS)

Adjusted EPS rose by 7.5% to 42.55p (8.7% excluding currency effects). EPS grew 39.9% to 49.94p while EPS excluding exceptional items grew by 6.7% to 38.09p. EPS and Adjusted EPS are calculated on an average share base of 491.2m during the year (2011: 490.5m).

1.12 Expected impact of changes to accounting standards

In 2013 there will be two significant changes to accounting under International Financial Reporting Standards ('IFRS') which will affect Serco's 2013 results and require the restatement of 2012 comparative figures. These relate to changes in the joint venture accounting rules (IFRS 11) and to the pension accounting rules (IAS 19 revised).

The change to joint venture accounting rules (IFRS 11) will remove the option for proportional consolidation of joint ventures and require equity accounting for joint ventures instead. The estimated effect on the 2012 results for this change would be to reduce statutory reported revenue by £852.9m and profit before tax by £15.1m. There is no impact on post tax profits, earnings per share, or net assets from this change. In addition to the statutory measures, the 2013 income statement will also disclose revenue and Adjusted operating profit including the proportional share of joint venture results, to provide consistency in the presentation of the results.

The change to the pension accounting rules (IAS 19 revised) will principally require pension interest return to be calculated using the value of scheme assets multiplied by the discount rate rather than the expected rate of asset return. After accounting for IFRS11, the additional estimated effect on the 2012 results for this change reduces Adjusted pre tax profits by £6.5m.

2. Dividend

The Board is confident in the future growth prospects for the Group and of the strong financial position that we have. We therefore intend progressively to increase the payout ratio and thereby reduce our dividend cover over the next three years. Beyond that point, we anticipate a policy of maintaining dividend cover of between 2.5 and 3 times and therefore reverting to increasing the total dividend each year broadly in line with the increase in underlying earnings. The Board has proposed a final dividend for 2012 of 7.45p per share, bringing the total dividend for the year to 10.10p, up 20% compared with the previous year. This represents a payout of 24% based on 42.55p of Adjusted earnings per share, or dividend cover of 4.2 times. The final dividend will be paid, subject to shareholder approval, on 22 May 2013 to shareholders on the register on 15 March 2013.

Finance Review

3. Cash flow

The Group generated a free cash inflow of £181.2m (2011: £168.3m), with the increase arising principally from the increase in profits and the exceptionally high level of dividends received from joint ventures.

For 2013, it is anticipated that there will be further incremental working capital investment to support growth in our BPO business and lower dividends from joint ventures, which may result in free cash flow being lower than the level achieved in 2012.

Figure 3 provides cash flow analysis. 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 119, which proportionately consolidates the cash flows of joint ventures. The adjustment line in Figure 3 reconciles the movement in Group cash to the consolidated cash flow.

Figure 3: Cash flow

Year ended 31 December	2012 £m	2011 £m
Adjusted operating profit excluding joint ventures	237.4	208.5
Non cash items	56.0	64.2
Adjusted EBITDA excluding joint ventures	293.4	272.7
Working capital movement	(47.6)	(32.3)
Operating cash flow excluding joint ventures	245.8	240.4
Interest	(44.7)	(32.7)
Tax	(33.6)	(32.2)
Net expenditure on tangible and intangible assets	(66.9)	(71.5)
Dividends from joint ventures	80.6	64.3
Group free cash flow	181.2	168.3
Acquisition of subsidiaries net of cash acquired	(141.8)	(325.3)
Disposal of subsidiaries and operations net of cash disposed	131.0	–
Acquisition-related costs	(3.9)	(3.7)
Purchase of own shares and issue proceeds of share capital	(10.3)	(6.7)
Financing	(152.0)	236.0
Exceptional donation to Serco Foundation	(5.0)	–
Special pension contribution	–	(40.0)
Dividends paid	(41.9)	(37.3)
Group net decrease in cash and cash equivalents	(42.7)	(8.7)
Adjustment to include joint venture cash impacts	(4.5)	(15.1)
Net decrease in cash and cash equivalents before exchange loss	(47.2)	(23.8)
Exchange loss	(9.0)	(0.7)
Net decrease in cash and cash equivalents	(56.2)	(24.5)

Notes:

Adjusted EBITDA excluding joint ventures is earnings before interest, tax, depreciation, intangible amortisation, profit on disposal of subsidiaries and operations, charitable donation, other exceptional gains and other non cash items.

Net expenditure on tangible and intangible assets excludes assets funded under finance lease arrangements. Financing is stated net of directly reimbursed capital expenditure.

3.1 Operating cash flow excluding joint ventures

Operating cash flow excluding joint ventures of £245.8m (2011: £240.4m) reflects a conversion of Adjusted EBITDA into cash of 83.8% (2011: 88.2%). The increase in working capital movement to £47.6m (2011: £32.3m) principally reflects the timing of transition and mobilisation of new contract awards and an increased level of investment in supporting growth of our BPO business.

3.2 Interest

Net interest paid increased to £44.7m (2011: £32.7m), principally reflecting higher average Group recourse net debt following acquisitions during the current and prior year.

3.3 Tax

Tax paid was £33.6m (2011: £32.2m). The increase in cash tax is principally as a result of higher overseas taxable profits arising in the year. 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 was £66.9m (2011: £71.5m). The spend principally comprises required contract capital investment. This expenditure represents 1.6% of Group revenue excluding joint ventures (2011: 1.9%). The expenditure in 2011 included additional investment in SAP systems.

3.5 Dividends from joint ventures

Dividends received from joint ventures totalled £80.6m (2011: £64.3m), reflecting a higher than normal conversion rate of joint ventures' profit after tax into dividends of 125%. We expect the conversion rate to return to a more normal rate of approximately 90% in 2013.

3.6 Purchase of own shares and issue proceeds of share capital

This represents £16.0m (2011: £24.0m) for the purchase of own shares for the Employee Share Ownership Trust (ESOT) in order to satisfy options granted under the Group's share option schemes, net of cash inflows of £5.7m (2011: £17.3m) relating to proceeds from the issue of share capital and exercise of share options.

4. Acquisitions

On 13 April 2012, Serco entered into an agreement to acquire the trade and assets of Anglia Support Partnership (ASP). ASP provides support services to the Cambridge and Peterborough NHS Foundation Trust, together with a further five partnering NHS organisations. The initial cash consideration in respect of the business combination was £5.2m and deferred consideration of £3.5m was paid in the year.

On 1 June 2012, Serco acquired 100% of the issued share capital of Priority Properties North West Limited (PPNW). PPNW is a property management company specialising in the provision of short and long term housing. The cash cost of the acquisition in the period was £2.7m. In addition, deferred consideration of up to £1.1m is payable contingent on financial performance in the period to 31 January 2013.

On 11 June 2012, Serco acquired 100% of the issued share capital of Vertex Public Services Limited (Vertex), a provider of high quality business process outsourcing services to UK local and central government. The cash cost of the acquisition was £55.5m. Vertex brings additional expertise and strategic partnerships to support expansion into new areas of middle and back office support. This acquisition considerably increases Serco's market presence and further improves Serco's position for large scale outsourcing opportunities.

On 16 November 2012, Serco acquired the remaining 50% stake in DMS Maritime Pty Limited from our joint venture partner P&O Maritime Services. The transaction strengthens Serco's position as a leading defence services provider in Australia and in the growing marine services market. The cash cost of the acquisition was £69.1m (A\$106.3m). DMS was formerly accounted for as a joint venture and following the acquisition of further shares it became a wholly owned subsidiary. In accordance with IFRS 3 (Revised 2008) – Business Combinations, which requires that before accounting for the purchase of the remaining 50%, the value of the previously held 50% shareholding was restated to fair value on the acquisition date. This resulted in a gain of £51.1m being recognised in the income statement.

£3.7m of acquisition-related costs incurred on the above acquisitions have been expensed to the income statement. The cash flow impact of these costs included in the cash flow statement was £3.9m, which includes £0.2m of acquisition-related costs from prior year acquisitions.

A deferred payment of £6.6m has also been made in relation to the prior year acquisition of Serco Listening Company Limited (formerly The Listening Company Limited).

5. Disposals

On 29 June 2012, the Group disposed of its Technical Services business which provides consulting and project solutions primarily to the UK civil and nuclear defence markets for net consideration of £135.3m. Net assets disposed amounted to £70.3m, giving a gain of £57.6m, after accounting for disposal costs of £7.4m.

On 29 June 2012, the Group disposed of its interest in Serco GmbH. The fair value of consideration receivable was £nil. The business provides support services for the German air defence radar systems, engineering and administrative support services for the defence sector, as well as training services, facilities management, field installation and maintenance services and IT consulting and related services. Net assets disposed amounted to £21.8m, giving a loss of £27.7m, after accounting for disposal costs of £5.9m.

On 21 December 2012, the Group agreed to dispose of its UK data hosting operations. There was £nil cash consideration and the net assets disposed amounted to £7.8m, giving a loss of £11.5m, after accounting for disposal costs of £3.7m.

On 31 December 2012, the Group disposed of its education software business. There was £6.3m of consideration received and the net assets disposed amounted to £17.7m, giving a loss of £12.8m, after accounting for disposal costs of £1.4m.

Finance Review

6. Net debt

Figure 4: Net debt

At 31 December	2012 £m	2011 £m
Group – cash and cash equivalents	142.8	194.6
Group – loans	(699.5)	(819.4)
Group – obligations under finance leases	(50.2)	(45.0)
Group recourse net debt	(606.9)	(669.8)
Joint venture – cash and cash equivalents	55.8	60.2
Joint venture – loans	(3.9)	(7.9)
Joint venture – obligations under finance leases	(0.6)	(0.9)
Total recourse net debt	(555.6)	(618.4)
Group non recourse debt	(25.1)	(15.5)
Total net debt	(580.7)	(633.9)

6.1 Group recourse net debt

Group recourse net debt reduced by £62.9m to £606.9m. Sources of funding are described in Section 8 below.

Cash and cash equivalents includes encumbered cash of £7.5m (2011: £5.5m). This is cash relating to customer advance payments.

6.2 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 increased by £9.6m to £25.1m. The increase is mainly due to additional asset financing on the National Physical Laboratory contract.

7. Pensions

The Group is a sponsor of a number of defined benefit schemes and defined contribution schemes. At 31 December 2012, the net retirement benefit asset included in the balance sheet arising from our defined benefit pension scheme obligations was £14.1m (2011: £16.8m), on a pension scheme asset base of £1.9bn.

Figure 5: Defined benefit pension schemes

At 31 December	2012 £m	2011 £m
Group schemes – non contract specific	45.6	58.8
Contract specific schemes:		
– reimbursable	(214.7)	(188.7)
– not certain to be reimbursable	(32.2)	(26.5)
Net retirement benefit liabilities	(201.3)	(156.4)
Intangible assets arising from rights to operate franchises and contracts	6.2	6.3
Reimbursable rights debtor	214.7	188.7
Deferred tax liabilities	(5.5)	(21.8)
Net balance sheet assets	14.1	16.8

The total pension charge included in operating profit for the year ended 31 December 2012, including the proportionate share of joint ventures, increased to £112.5m (2011: £112.3m). Within this charge, the Group's contributions to UK and other defined contribution pension schemes increased to £85.1m (2011: £80.4m). The service charge relating to the Group's defined benefit schemes decreased to £27.4m (2011: £31.9m) principally as a result of a £6.1m curtailment gain relating to the disposal of the Technical Services business. This curtailment gain resulted from active members of the Serco Pension and Life Assurance Scheme (SPLAS) becoming deferred members, creating a reduction in scheme liabilities. The gain is recognised in the income statement within the gain on disposal of the Technical Services business.

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

- 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 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 SPLAS. At 31 December 2012, SPLAS had a surplus of £69.7m (2011: surplus of £122.3m). This is calculated under IAS 19 using market-derived rates at 31 December 2012. It therefore reflects the effect of the market conditions through the actual investment returns in the year and the impact of an increase in inflation assumptions and a decrease in the applicable discount rate.

The estimated actuarial deficit of SPLAS as at 31 December 2012 was approximately £10.9m (2011: £27.3m). The value calculated in the latest triennial review was a deficit of £141m at 6 April 2009. 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.

Retirement benefit obligations reduced by £50.5m as a result of the disposal of Serco GmbH. The acquisition of Vertex Public Services Limited included the acquisition of £13.4m of net retirement benefit obligations as at 11 June 2012.

Figure 6 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 6: Pension assumption sensitivities

	Assumption	Change in assumption	Change in liability
Discount rate	4.3%	+0.5% (0.5)%	(9)% +10%
Price inflation	3.00% (RPI) and 2.20% (CPI)	+0.5% (0.5)%	+9% (8)%
Salary	3.40%	+0.5% (0.5)%	+1% (1)%
Longevity	21.0–24.6*	Increase by one year	+2%

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

8. Treasury

The Group's committed bank credit facilities total £730.0m (2011: £726.7m). As at 31 December 2012, £177.6m had been drawn down on bank facilities (2011: £241.3m). The bank facility is solely comprised of a £730.0m syndicated revolving credit facility, which matures in March 2017. It was signed in March 2012 and replaced all existing committed bank credit facilities.

In addition to the bank credit facility, Serco has US private placements totalling £460.8m which will be repaid between 2013 and 2023. All of the Group's credit facilities detailed above are unsecured.

9. 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 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 £19.1bn and high visibility of future revenue streams (92% in 2013; 79% in 2014 and 70% in 2015), the Group is well placed to manage its business risks despite the current uncertain economic climate.


As at 31 December 2012, the Group's principal financing is through a revolving credit facility and US private placements. The Group has approximately £1,191m of committed credit facilities. The headroom on the facilities was approximately £552m as at 31 December 2012. Scheduled repayments in 2013 in respect of US private placement maturities are £23.4m in August. The revolving credit facility matures in March 2017 whilst repayments of the US private placements occur between 2013 and 2023. 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.

Andrew Jenner
Finance Director

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.

Our approach to managing our responsibilities is summarised below. We also publish a CR report each year, which is available at www.serco.com/cr2012

 Further information available online www.serco.com



Managing corporate responsibility

Our approach to CR has five elements – our people, health and safety, the communities we serve, the environment and our marketplace, where we carefully manage our relationships with our customers, suppliers and other parties.

The Serco Group plc board has ultimate responsibility for our Group business strategy and therefore approves the elements that make up our Group CR strategy. The Chief Executive is the board sponsor for all elements of CR and the board receives formal progress reports at every board meeting.

The Executive Committee is responsible for delivering our Group CR objectives. Each element of our CR approach has its own strategy, which is developed as follows:

- the Group HR Director sponsors our people strategy, which is developed through the HR Directors Forum. The forum is made up of divisional HR directors and other senior corporate function members, and meets regularly under the Group HR Director’s chairmanship.
- the Group Director of Risk and Acquisitions sponsors our health, safety and environment (HSE) strategy. This is based on the four divisional strategies plus a group perspective, which considers emerging HSE risks and the Group’s evolving HSE risk profile. The HSE Oversight Group, which is made up of senior corporate function members and HSE leads from the four divisions, agrees the HSE strategy before it is submitted to the Group Risk Management and Safety Committee (GRMSC). The GRMSC reviews the HSE strategy and monitors our performance at its quarterly meetings. The chair of the GRMSC reports and presents the HSE strategy to the Executive Committee.
- our Chief of Staff is the Executive Committee sponsor for our community strategy. This strategy is developed through a CR Oversight Group. The community strategy is then reviewed and monitored by the Executive Committee.
- our approach to the marketplace falls within our overall business strategy, for which the Chief of Staff is responsible. The business strategy consolidates the divisions’ business strategies into an overall Group strategy, as described on pages 14 and 15.



Each division has a CR strategy, which describes the core themes and appropriate targets. This strategy is monitored by the divisional board and owned by the division's CEO. Contracts are responsible for developing CR initiatives that are in line with their divisional strategies and appropriate to their business and the communities in which they operate. The contract director is responsible for delivering these initiatives. Our CR activities also reflect the passionate involvement of our people in local causes, which often involve them volunteering significant amounts of their own time to raise money or provide direct help to causes that matter to them.

Corporate responsibility

People

The number of people we employ is continually increasing, so we need a clear framework for managing and developing them.

Our people strategy 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 leaders who are fit for the future

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 best serve our customers.

During the year, we undertook a detailed evaluation of the leaders who joined us through the 2011 acquisition of Intelenet. This used our leadership evaluation tool, which considers the size of a leader's role and its complexity. The output from this exercise allows us to position people appropriately in our leadership structure, so we can:

- include them in succession planning
- ensure their base and variable pay properly reflects the market, and
- where appropriate, include them in the Global Management Team, which comprises Serco's top 180 leaders.

As a result of the evaluation work, the composition of our top 500 leaders now properly reflects the international nature of our business.

Serco's leadership model is known as H³ – Heart, Head and Hands. These components describe how great leaders in Serco behave, with an emphasis on our Governing Principles and our customers:

- **Heart** covers our leaders' motives and demonstration of our Governing Principles
- **Head** relates to intellectual and personal capacity
- **Hands** covers skills, knowledge and experience

We have used assessment tools based on H³ to create development plans for hundreds of leaders across the Group. In 2012, we also used those tools, along with our leadership evaluation tool, to ensure we had the right leaders in place as we reorganised our UK and European

businesses from three divisions into one. This was a rigorous process, which we ran with the assistance of external consultants.

Our leadership evaluation tool is also important as we enter new geographical markets. It gives us a tried and tested method for analysing leadership roles in that market and ensuring we can create reward packages that will attract and retain the right people for those roles.

Transferring knowledge and skills from one market to another is a key part of our business model (see page 12). We therefore need to effectively support our leaders as they move around the world. During 2012, we employed Ernst & Young to help us improve our global mobility processes, enabling us to offer first-class support to our people when they relocate.

In 2012, we remained committed to developing our Executive and have built relationships with a number of leading business schools.

Employing people who bring service to life

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

Employee engagement was a major focus for Serco in 2012, recognising that engagement is fundamental to employee wellbeing, the quality of our services and our ability to deliver organic growth.

During the year, we worked with Aon Hewitt to better understand the link between customer advocacy and employee engagement. This showed a strong correlation, with more engaged employees leading directly to higher customer satisfaction, which in turn links to contract retention and organic growth. We have since produced a set of case studies setting out key lessons from contracts with the highest levels of engagement, helping us to spread best practices around the business.

We also 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.

In addition, we continued to support the UK government's Engage for Success taskforce. This is an independent and voluntary group of leaders, managers, trade unionists, engagement practitioners and experts, who all want to highlight the importance of employee engagement. In November 2012, the taskforce launched evidence that showed the UK was missing out on £26bn of GDP because workers were not actively engaged. The group also launched a free-to-use website (www.engageforsuccess.org) which contains case studies, tools and techniques for engaging employees.



Our global 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. More than 40 individuals and teams will receive an award for their work in 2012.

Making it easier to manage our people

Our aim is to have easy-to-use tools, processes and systems that make it easier to manage our growing workforce and deliver even higher levels of productivity and service.

We have therefore developed a target operating model for HR, which will support our growth. The model gives us common HR processes around the world and allows us to centralise important aspects of our HR support, while decentralising the tools that our managers need to effectively run their teams.

As part of this, we have created a shared service centre in Birmingham, UK. This includes a centralised recruitment service, which is already delivering savings. One particular achievement has been our use of LinkedIn to identify candidates. By building Serco's presence on the site, we now have access to around one million people.

We have also created a transaction management centre in Delhi, India. Our team there ensures that our HR transactions are processed smoothly, for example by ensuring that new joiners have access to our systems, the right computers or other equipment, and an identity card. The Delhi centre consistently achieves high accuracy rates, making an important contribution to our HR efficiency.

During 2012, we also completed Serco's first ever global software implementation. MyHR is now live across the business and provides a range of self-service tools for both managers and employees. MyHR gives 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. The system also makes HR processes easier for employees, for example by allowing them to maintain their personal information or book annual leave online.

Over the next few years, we will be able to build on the work we have done in 2012 to further enhance our HR tools. This could include adding learning management systems and performance management, as well as allowing individual employees to monitor their compensation and how it has changed over time.

Objectives and performance

2012 objective	Result	Comment
To make it easier to manage people by implementing a single HR programme and common core processes	Achieved	We successfully introduced our target operating model and completed the first phase of implementing MyHR.
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	Achieved	We incorporated the leaders who joined us as a result of the acquisition of Intelenet. In early 2012, we undertook a thorough review of our leadership talent, which included applying rigorous leadership selection processes. As a result, we are prioritising the strengthening of our pipeline of leadership talent through the promotion, mobility and acquisition of individuals with skills and experiences required to deliver our goals.
To motivate and engage employees to bring service to life by linking engagement to performance	Ongoing	We have begun to analyse the link between employee engagement and customer advocacy and to communicate the best practices identified to further drive engagement.

2013 objectives

- To continue to implement MyHR – the single HR programme and common core processes – throughout the business
- To continue to develop leaders who are fit for the future by embedding the talent review and success planning process across a wider proportion of our management population
- To improve our overall engagement levels by focusing on the top four engagement drivers for each division or function

Corporate responsibility

Health and safety

Our aspiration is zero harm. Nothing we do is so urgent or important that we cannot do it safely. A strong HSE performance ensures the safety of our staff, helps to distinguish us in the market and enhances our reputation.

This means that wherever they work and whatever their role, our people must adhere to stringent health and safety procedures. These procedures are embedded in the Serco Management System 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.

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

A key development during the year was the creation of the new UK & Europe division, which required us to review the way we manage HSE in the region. As a result, we created a Safety, Risk and Compliance (SRC) department for the UK & Europe, under the control of a Director of SRC.

This new department has adopted a regional service model, with three teams of SRC professionals supported by subject matter experts covering our main safety-critical areas. This follows a proven model deployed by one of our former UK divisions and aligns with the UK Health & Safety Executive's new model. The model will help to ensure consistent application of best practice across the UK & Europe.

In addition to the reorganisation, we undertook a wide range of initiatives during the year to drive continuous improvement and better manage our HSE risks. Among the many examples were:

- detailed audits of businesses and contracts around the world
- working with regulators in the UK, the United States, the Middle East and Australia to develop deeper relationships
- IOSH training programmes for managers in the Middle East
- improvements to incident reporting, injury management and return-to-work processes in Australia
- safety meetings, training and an update to the Engineering Business Unit safety management system in the Americas.



Objectives and performance

2012 objective	Result	Comment
To achieve a lost time incident rate (LTIR) of 796 per 100,000 employees, a 50% reduction against the 2008 baseline	Achieved	<p>The LTIR continued to improve in 2012, to 603. This was a reduction of 33% compared with 2011 and 24% ahead of our target. This performance was helped by the growth in Serco Global Services, which operates in a low risk environment.</p> <p>Our performance also reflects our focus on continuous improvement and the maturity of our health and safety systems, particularly in our higher risk custodial, immigration and transportation business. This is reflected in our LTIR excluding Global Services, which improved by 11% in 2012.</p>
To achieve a 40% reduction in the staff reportable incident rate (RIR) per 100,000 employees against the 2008 baseline	Achieved	The RIR was 399, a reduction of 22% compared with 2011 and a 60% reduction since 2008, compared with our target of 40%. As with the LTIR, this benefited from the performance of Serco Global Services. Excluding Global Services, the RIR was flat year on year. We have a number of ongoing initiatives aimed at improving performance.
To establish a baseline of near-miss events against which performance can be tracked	Ongoing	Given the scale and diversity of our business, capturing near-miss events is challenging. All divisions have continued to try to establish consistent reporting through ASSURE, our system for capturing and analysing HSE performance data.

In 2012, the Royal Society for the Prevention of Accidents (RoSPA) presented Serco with 26 awards for contracts in the UK & Europe. Of particular note was our contract at RAF Fylingdales, which won an Order of Distinction for receiving 17 consecutive Gold awards from RoSPA. Our Air Surveillance and Control Systems contract and Serco Energy received President's Awards for 11 consecutive Golds, while our contract at Norfolk & Norwich University Hospital obtained a Gold Medal Award, to recognise six consecutive Golds. The National Physical Laboratory won the Research and Development sector award. In addition, the British Safety Council presented International Safety Awards to our HMP & YOI Doncaster and Prisoner Escort & Custody Services contracts.

We were particularly saddened by the deaths of four of our colleagues during the year. A colleague at our environmental services contract in the London Borough of Hammersmith and Fulham was fatally injured when he tried to prevent a burglary. In Pondicherry, India, two colleagues were fatally injured in a road traffic accident when travelling home at the end of their shift. In Australia, a colleague also died in a car accident when returning from a regional meeting.

Although Serco could not have prevented these incidents, we have taken action to try to avoid a recurrence. This includes conflict resolution training, the recognition of risk in induction training and special guidance on driving and fatigue.

2013 objectives

Our previous HSE strategy established our objectives for the period 2008 to 2012. We have therefore set a new HSE strategy and objectives through to 2016. As part of this, we will publish annual targets. Our objectives for 2013 are as follows:

- A Lost Time Incident Rate of 573 per 100,000 employees, representing a 5% reduction against the 2012 baseline
- A Major Reportable Incident Rate per 100,000 employees of 57, representing a 15% reduction against the 2012 baseline
- A Physical Assault Rate of 528 per 100,000 employees, representing a 15% reduction against the 2012 baseline

Corporate responsibility

Community

Engaging with our communities is fundamental to achieving our vision to be the world's greatest service company (see page 2). Our communities are primarily the people who live and work around our contracts but our definition extends to include the third-sector organisations we partner with, to deliver a number of our contracts.

Our commitment is reflected in our target to reinvest 1% of our pre-tax profits into society. Last year, we invested £2,560,084 through donations of money, assets and time to community projects and charities, representing 1% of our pre-tax profit.

Working with communities contributes directly to our business success. It helps to enhance our reputation and build trust with our customers and the public, by demonstrating that Serco is a values-led organisation. Engaging also gives us a better understanding of communities' needs, which can help us to win bids and to operate existing contracts successfully, particularly where we are delivering services directly to the public.

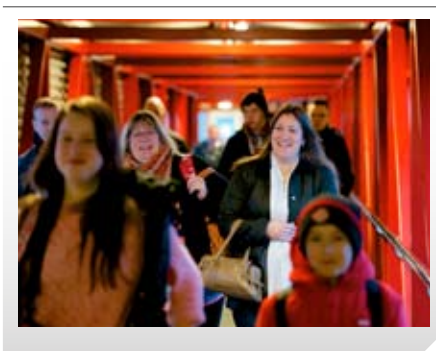
At the same time, we aim to have a positive and lasting impact on our communities, and to be welcomed by them as a partner who can help to solve the problems they face. Serco's devolved structure helps us to achieve this. Across the Group, our people engage in many different activities, as individuals or as teams. These activities allow them to get involved in activities they are passionate about, ranging from local community projects to raising money to help international disaster relief efforts.

Serco celebrates its 25th anniversary as a listed company in 2013. To mark this occasion we have set up the Serco Foundation, an independent charity.

The Serco Foundation will work with charities and NGOs, within the regions where Serco operates, to capitalise on the passion of our people to do good and to make donations that will significantly benefit the campaigns of the charities it chooses to work with. It will also seek to work with large foundations and NGOs to help them consider how to improve the delivery outcomes they seek to achieve.

The Foundation will be independent of Serco and will operate on a not-for-profit basis. To ensure that the Foundation will have a long-term future it will be established with a one-off endowment of £5m from Serco. In addition we are planning to make small regular donations to the Foundation, comprising cash donations and secondments.

Employability has been an important theme in our community work. We were proud to second a senior member of our Group HR team to work for the UK government as the CEO and founding partner of Plotr, a new, industry-led not-for-profit venture, aimed at inspiring young people about their future career and preparing them to be more competitive in the labour market. A Serco team also helped the UK government to advance its National Citizenship Service programme, by developing a well-received online tool to engage with 16 year olds and encourage them to improve their skills by taking part in local community projects.



Examples include the AMEAA division's Walkabout Week. The event, which was held across the Asia Pacific region, raised money for Red Dust, a charity that supports the health of indigenous communities. Staff raised A\$47,830 and Serco donated an additional A\$40,000. The total amount raised exceeded the target by A\$17,830. Serco Americas supported the American Diabetes Association's Tour de Cure bike ride, with 38 riders raising over \$20,000, making them the second highest grossing corporate team. Among the many activities undertaken by Serco Global Services' employees were partnering with Swiss Emmaus Leprosy Relief Work (India) to create awareness and raise funds for people affected by leprosy, and visiting orphanages in Mumbai to donate food, clothes and toys.

We also support organisations whose work touches our own, such as the Military Child Education Coalition (MCEC) in the US, which helps children affected by their parents' relocation and deployment. As well as making donations, we have seconded a senior employee from our Americas division, who provides invaluable support to MCEC.

Working with third-sector partners is an important part of our approach in a number of markets, including the Work Programme in the UK and in our prison contracts. This allows our customers to benefit from the expertise of these organisations in their particular fields, while enabling the organisations to become involved in government programmes that they lack the scale to compete for on their own. Our approach includes agreeing a payment mechanism with our third-sector partners, which smooths their cash flows and helps to keep them on a stable footing.

Recognising the importance of the third sector, we are represented in the working group for a UK government review into leadership and skills in the sector, led by Dame Mary Marsh. The review will consider how businesses and professionals can share their expertise with charities and social enterprises, and recommend ways in which the sector can upgrade and maintain its skills to meet the challenges of the future.

Serco's commitment to its communities and corporate responsibility was recognised once again by Business in the Community, which awarded us Gold status in its 2012 Corporate Responsibility Index. This is the seventh year running that Serco has achieved a Gold award. Equally pleasing was the increase in our score, from 90% to 93%.

Objectives and performance

2012 objective	Result	Comment
To continue to invest 1% of pre-tax profits back into wider society	Achieved	We invested £2,560,084 into society, through donations of money, assets and time. This represented 1% of our pre-tax profits. In addition, we contributed £5m to the Serco Foundation.
To continue to promote the theme of employability	Ongoing	<p>Employability has been a key theme for Serco for the past ten years. We focus on our own employees, long-term unemployed people and youth employment.</p> <p>In the UK, we are committed to making available 1,000 work placements and to working closely with the Prince's Trust to help young unemployed people gain work experience. We recently reached a milestone at Norfolk & Norwich University Hospital, where the 100th young person from the Prince's Trust programmes gained work experience through Serco.</p> <p>In the US, the Serco Scholars programme has continued to help families of employees. In 2012, ten scholarships of \$5,000 were awarded.</p> <p>In the Middle East, our technical apprenticeship programme on the Dubai Metro is designed to address skill shortages within railway engineering in the region and to attract apprentices who are interested in railway engineering as a long term career.</p>
To continue to develop our relationships with third-sector partners	Ongoing	<p>We continue to commission work from a range of third-sector providers, including the national charities Catch22 and Turning Point in our prison contracts. Third-sector organisations also deliver 35% of Serco's Work Programme contracts and 43% of our Job Deal contracts.</p> <p>In addition, the Serco-led NCS Network consortium has successfully bid to deliver the National Citizen Service programme in 2013.</p> <p>We are also represented in the working group for a UK government review into leadership and skills in the third sector.</p>
To promote employee volunteering	Ongoing	We encourage volunteering within local communities and organisations. In Australia, we have implemented an employee volunteering policy, giving employees up to two days a year paid time to volunteer.
To promote payroll giving	Ongoing	Employee giving continues to be a high priority for our businesses across the globe.

2013 objectives

- To continue to invest 1% of pre-tax profits into wider society
- To promote and support the Serco Foundation
- To use the Serco25 campaign to encourage our people to raise money for charities

Corporate responsibility



Environment

Serco's aspiration for zero harm applies as much to the environment as it does to health and safety. It makes good business sense to protect our reputation and reduce our energy consumption and environmental impact. Our environmental policy is also driven by the desire to do what is right for the world we live in.

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. 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.

As with our health and safety efforts, our businesses around the world undertook a wide range of initiatives to improve their environmental performance. The following are just some of the examples:

- reducing electricity use in our UK prisons by installing LED lighting in cells
- cutting water use in our UK leisure contracts, for example by using swimming pool backwashes to irrigate golf courses

- developing a formal environmental training package and improved environmental data capture in Australia
- assisting Americas contracts with a range of projects including fuel storage, Spill Prevention Control and Countermeasure regulations, hazardous materials/waste handling, disposal advisory development and air quality regulation compliance.

Our environmental efforts are reflected in the recognition we receive. In the UK, we were ranked fifth in the Carbon Disclosure Project's FTSE 350 report, with a score of 92%, placing us in the Carbon Disclosure Leadership Index. We also achieved a rating of B in the Carbon Performance Leadership Index. These indices highlight good practices in reporting, governance, risk management, verification and emissions reduction activities that drive climate change adaptation and mitigation.

Objectives and performance

2012 objective	Result	Comment
To achieve an 18% reduction in our UK business's CO ₂ tonnes/£m revenue against the 2008 benchmark	Revised	Historically we have normalised our environmental data by revenue for comparative purposes. We do not believe that this continues to be meaningful, given the changing risk profile of the business and growth in employee numbers, particularly within our BPO business. We have therefore revised this KPI and extended it to cover our global footprint so that we normalise on a per head basis. Based on this we have shown a 42% improvement in Carbon Emissions Headcount Intensity rate (tCO ₂ e per 1,000 employees) since 2008 (2008 = 3,489, 2012 = 2,028).
To retain the Carbon Trust Standard	Achieved	We have retained our Carbon Trust Standard

2013 objectives

As part of our updated HSE strategy, we have set the following environmental objectives for 2013:

- Carbon Emissions Headcount Intensity rate of 1,967 tonnes of CO₂ equivalent per 1,000 employees, which represents a 3% reduction
- Zero environmental prosecutions, fines and enforcement notices from our activities



Corporate responsibility



Marketplace

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 and 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.

Suppliers

Effective procurement helps us to achieve our vision and deliver high-quality service to customers. We aim to be professional in all our dealings with suppliers and to establish mutually beneficial relationships.

We have a Procurement and Supply Chain function, which is responsible for putting this approach into practice. During 2012, we realigned the procurement team to reflect the new structure of the business. Each division now has its own dedicated procurement business partner embedded within the divisional management team.

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. We have also bolstered our category teams and refocused on specific areas where we can deliver significant benefit to our frontline customer service delivery.

Serco works with thousands of small- and medium-sized (SME) suppliers and we continue to improve our interaction with them. Our Small Business Advisory Body in the UK is made up of 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 further enhanced our systems in 2012, to upgrade the procurement functionality of SAP. This makes the process more efficient for us and our suppliers. In particular, it enables suppliers to upload electronic catalogues, which can then be accessed through a single portal for our people to buy from. These upgraded systems allow us to streamline our processes, improve compliance and enable our suppliers to work with us in a simple and consistent way.

In the UK, we also signed up to the Prompt Payment Code. Code signatories undertake to pay suppliers on time, to give them clear guidance (for example on payment procedures and how to make complaints) and promote good practice by requesting leading suppliers to encourage adoption in their own supply chains.

Joint venture partners

Serco has many joint ventures with commercial partners and customers. 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. 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, our assets and our 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; it informs decision making and aligns to the organisation's strategic objectives. 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 and Safety Committee (GRMSC), 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 GRMSC'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, that impact upon strategic objectives, with the aim of safeguarding our shareholders' investments, our assets and our 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, and
- 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, programme, Business Unit, Divisional and Group level. These Risk Registers change as new risks emerge and existing risks diminish, so that the registers reflect the current threats to the relevant strategic objectives. We review the Group and Divisional Risk Registers at least quarterly and more frequently as required. The GRMSC 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 impact if 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 impact of disruption to our business objectives, the probability of this occurring and highlight 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, managing, and developing a robust and effective plan to reduce or mitigate the risk. Risk owners are required to report to the GRMSC 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 bid, programme, project or contract. 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 have sight of and respond appropriately to reduce the impact of emerging risks.

Managing and mitigating risk

Our risk management process enables us to understand our operational risk profile. Operational risk can never be eliminated; risks are necessary to achieve targeted benefits (risk management informs decisions). However, while risk is necessary, we minimise the probability and impact of threats through 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 GRMSC 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
- 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 and Ethics 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 that 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 Investment and 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 re-launched at the end of 2010
- We have crisis and business continuity plans in place to manage crisis events, both within Divisions and the Group
- All Divisional CEOs are required to self certify their Division's compliance to the SMS at half and end of year points, and
- As mandated by the SMS, throughout the business lifecycle of all our bids and contracts independent reviews (such as Black Hats and Gate Reviews) are required to provide a minimum standard of assurance and governance across the business.

Independent risk function

While line managers are responsible for identifying and managing all risks within their risk appetite and tolerance limits, in line with the policies and standards set within the SMS, the Group Risk and Programmes team (reporting to the Group Director, Risk and Acquisitions) is responsible for the development and implementation of risk management policy, strategy and governance. In addition to this the team manages the Group risk profile and provides risk management oversight, assurance and challenge to the business.

Internal audit

An integral part of risk management is assurance that the controls identified to manage risks are operating and effective. Internal audit is responsible for reviewing the design and operation of risk management processes and controls operated across the Group, providing objective assurance around the effectiveness of the Group's system of internal controls.

The Group Head of Internal Audit is responsible for delivery of the internal audit programme, ensuring that it is risk based and aligned with the overall strategy of the Group. Internal audit is delivered at Group and Divisional levels, using a mix of outsourced and in-house resources, with each Division holding an Audit and Risk Committee which reviews the results of relevant internal audits three times a year. The findings of the overall internal audit programme are reported directly to the Group Audit Committee.

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 independent assurance 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.

Principal risks and uncertainties

Principal risks

The Group Risk Register identifies the principal risks facing the business as a whole, 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 77.

The most significant risks relate to our reputation, and to operational and financial performance, which are all direct threats to the achievement of 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. A number of our other risks reflect social and ethical issues.

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.

Group risks and mitigating actions overview

Market risks

Risk | Significant change in political environment (e.g. government policies, expenditure levels and budgetary constraints)

Description

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, Australia 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, US government's or Australian government's policy in respect of outsourcing.

Impact

- Reduction in market opportunities
- Changes to terms of existing or new contracts
- Failure to meet growth or profit expectations

Mitigation

- Business strategy
- Diverse business across geographies and markets
- Dedicated teams regularly monitor the political landscape and government activities, reporting on government policy changes and the political environments where we are operating. We continue to develop expertise and capability in new markets and geographies

Risk | Failure to win a strategic or significant bid or rebid

Description

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.

Impact

- Failure to meet growth or profit expectations
- Significant financial loss or cost overrun
- Negative reputational impact, potentially resulting in loss of existing or new business
- Impact on strategic objectives

Mitigation

- Business Lifecycle governance process embedded in SMS
- Governance structure managed through Investment and Ethics Committee, Programme and Project Boards, Divisional and Contract Boards
- Business strategy and targets managed through internal boards
- Regular review and monitoring of Risk Registers
- Gate reviews of bids and formal sign-off process
- Robust bidding and contract review process including financial, technical and commercial reviews

Operational risks

Risk | Any harm to the Group's reputation could adversely impact business

Description	Impact	Mitigation
<p>The Group 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 Group'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"> ● Failure to meet growth or profit expectations ● Significant financial loss or cost overrun ● Loss of contract revenue related to operations and service charges ● Could impact share price ● Inability to attract the human and financial capital necessary to grow or expand into new markets ● Damage to reputation resulting in loss of existing or new business ● Impact on strategic objectives 	<ul style="list-style-type: none"> ● Governance structure managed through Investment and Ethics Committee, Programme and Project Boards, and Divisional and Contract Boards ● An effective risk, issues and controls structure identifies potential reputational impacts allowing effective management and oversight ● Customer engagement and employee engagement strategies ● Relationship management and communication with external stakeholders

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

Description	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 Group may not be able to obtain full reimbursement. Further, some programmes require delivery in accordance with specified milestones on agreed dates. Significant adverse financial consequences can be imposed where milestones are not met or a programme is not delivered on time. The length and complexity of such programmes mean that management estimates can be particularly difficult to make and could turn out to be inaccurate.</p>	<ul style="list-style-type: none"> ● Failure to meet growth or profit expectations ● Significant financial loss or cost overrun ● Loss of contract revenue related to operations and service charges ● Damage to client relations and wider reputation resulting in loss of existing or new business ● Impact on strategic objectives 	<ul style="list-style-type: none"> ● Robust bidding and contract review process including financial, technical and commercial reviews ● Governance structure managed through Investment and Ethics Committee, Programme and Project Boards, and Divisional and Contract Boards ● Robust cost accounting ● Business strategy and targets ● Regular review and monitoring of Risk Registers ● Gate reviews and formal sign-off process ● Quality management systems

Principal risks and uncertainties

Operational risks continued

Risk | Major accident or incident

Description

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 Group, 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 Group to claims for personal injury, wrongful death, or 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.

Impact

- Deaths or serious injuries to employees or third parties
- Major environmental damage
- Severe financial impact (fine by regulators, suspension of operating licence, compensation, clean up, etc.)
- Loss of business (disqualification from future tenders, contract termination, etc.)
- Contract and business external accreditations withdrawn
- Significant media attention and future scrutiny
- Criminal and civil action against the Group or individuals

Mitigation

- Robust management systems subject to external and regulatory scrutiny and oversight
- System certification and regulatory approval
- Formal oversight through GRMSC, Health, Safety and Environment Oversight Group, Divisional and internal boards
- Crisis management and business continuity plans in place
- Insurance
- A clear and comprehensive HSSE Strategy including annual and long term objectives, regularly reported and governed, drives a proactive safety management culture across the business
- Formal assurance structure operating within defined competencies
- Staff induction and training
- Effective Quality Management Systems embedded within the business

Risk | Major information security loss or breach

Description

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 cyber attacks (e.g. from computer programs or hacktivist groups) that may attempt to penetrate its network security and misappropriate confidential information.

Impact

- Loss of service to our customers
- Damage to reputation resulting in loss of existing or new business (disqualification from future tenders, contract termination, etc.)
- Impact on strategic objectives
- Costly to rectify and potential for dilution of shareholder returns
- Criminal and civil action
- Contract and business external accreditations withdrawn
- Significant media attention and future scrutiny

Mitigation

- Security and information systems policies, systems and embedded governance structure
- Think Privacy campaign to raise staff awareness, provide training, promote incident reporting and strengthen control processes
- Cyber Security Contract Risk Assessments
- Cyber Resilience of Enterprise Applications
- User Management, Multifactor Authentication, User Awareness
- Regular risk reviews
- ISO 27000 certification

Operational risks continued

Risk | Major IT failure or prolonged loss of critical IT systems

Description	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 Group 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. Therefore failings in the systems have the potential to seriously impact the management of the business.</p>	<ul style="list-style-type: none"> • Damage to reputation resulting in loss of existing or new business • Impact on strategic objectives • Inability to meet contract requirements or perform core business processes • Cost incurred to rectify and potential for dilution of shareholder returns • Significant media attention and future scrutiny 	<ul style="list-style-type: none"> • Information systems policy, systems and embedded governance structure • Data recovery capability designed into systems and periodically tested • Design out single points of failure • Server and system performance monitoring and reporting • Capacity management • Data back-up and business continuity plans in place

Governance risks

Risk | Significant incident of bribery or corrupt practice

Description	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.</p>	<ul style="list-style-type: none"> • Legal action and fines against the Group • Debarment from tender lists • Damage to reputation resulting in loss of existing or new business • Significant media attention and future scrutiny 	<ul style="list-style-type: none"> • Policies and systems embedded in SMS • Code of Conduct • Ethics Committee • Speak Up process • Ethics and compliance programme and training • Risk assessment • Third-party contracts

People risks

Risk | Failure to build depth & capability of leaders 'Fit for Future'

Description	Impact	Mitigation
<p>The success of the Group 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 Group cannot guarantee the retention of such key executives and technical personnel. The failure of the Group 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"> • Risk of not achieving level of planned growth • Increased cost in recruitment activity and time taken to fill roles • Instability and loss of business continuity • Dilution of brand and values • Reduced employee engagement through loss of compelling leadership • Strengthen competitors (loss of leaders to them) 	<ul style="list-style-type: none"> • People policies and systems, strategy and targets supported by governance structure, including Remuneration Committee • Succession planning • Leadership model • Annual external (independent) remuneration review • Job structure and grading system • Talent database and leadership development programme • Employment engagement strategy, including annual staff survey

Principal risks and uncertainties

Finance risks

Risk | The impairment of goodwill could adversely impact reported results

Description

Goodwill accounts for just over one-third of Serco Group's recorded total assets as at 31 December 2012. Serco evaluates goodwill for impairment annually or more frequently when evidence of potential impairment exists. Any decrease in expected cash flows or 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.

Impact

- Inability to meet profit expectations
- Breach of financial covenants
- Damage to reputation and shareholder confidence
- Impact on strategic objectives

Mitigation

- Internal board and governance structure
- Strategic plans
- Business plans
- Business Lifecycle Governance process
- Financial review and reporting

Risk | Negative fluctuations in foreign currency exchange rates that are not effectively hedged

Description

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.

Impact

- Material effect on the Group's future results of operations and financial position

Mitigation

- The Group hedges short-term transaction risks that are material in value
- Management of translational risk by the part currency matching of borrowings with the net assets of overseas subsidiaries

Risk | Negative fluctuations in interest rates

Description

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.

Impact

- Inability to meet profit expectations and associated impact on net assets
- Impact on competitiveness

Mitigation

- Fixed rate debt instruments and interest rate derivatives that swap floating for fixed rates

Corporate Governance Report

Introduction

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

Throughout 2012 Serco Group plc complied fully with the provisions of the UK Corporate Governance Code issued by the Financial Reporting Council (the Code) with the exception of membership of the Audit Committee as explained on page 88 below. The paragraphs below, together with the 'Our performance' section on pages 18 to 84 and the Remuneration Report on pages 98 to 114, provide details as to 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. Malcolm Wyman was appointed to the Board on 1 January 2013. Leonard V. Broese van Groenou served on the Board during 2012 until his retirement on 14 May 2012.

David Richardson will be retiring from the Board at the end of the Company's Annual General Meeting, being held on 15 May 2013 and hence will not stand for re-election. As announced on 6 December 2012, Malcolm Wyman will succeed David as Chairman of the Audit Committee. Malcolm will also succeed David as Senior Independent Director.

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 96 and 97.

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 18 to 84 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/cr2012 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 such a 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.

Corporate Governance Report

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 88 to 90. Each Committee has an appropriate balance of skills, experience, independence and knowledge of the Group.

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. Board and Committee meetings are held at varying locations and the opportunity is used to combine the formal business of the Board with site visits and divisional presentations and discussions. Additional Board meetings are scheduled as required.

The attendance of individual Directors at Board meetings held during the year is shown in the table on page 87.

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 and there are good information flows, together with facilitating induction programmes for newly appointed 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 effective operation of the Board, its agenda and processes
- Promoting the highest standards of corporate governance and ensuring appropriate communication with shareholders on the Group's overall performance
- Ensuring appropriate Director training and development takes place
- Board succession planning.

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. Following David's retirement from the Board at the end of the Company's 2013 Annual General Meeting, Malcolm Wyman will succeed David as Senior Independent Director with the same role and responsibilities.

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 103.

Significant other commitments of the Chairman

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

The Board believes that Alastair holds a 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 2012 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. The terms and conditions of the appointment of the Directors are summarised in the Remuneration Report on pages 98 and 106 and are available on request from the Company Secretary.

Meetings of Non-Executive Directors

Non-Executive Directors meet separately (without the Chairman or Executive Directors being present) at least once a year principally to appraise the Chairman's performance. This meeting is chaired by the Senior Independent Director.

Board meetings and attendance

Board meetings were held on a bi-monthly basis with ad hoc meetings in between as required. 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 2012 was as follows:

Executive Director	Board (8 meetings)	Audit (3 meetings)	Remuneration (8 meetings)	Nomination (3 meetings)
Alastair Lyons	8	n/a	8	3
Christopher Hyman	8	n/a	n/a	3
Andrew Jenner	8	n/a	n/a	n/a
Leonard V. Broese van Groenou	3(3)	1(1)	5(5)	n/a
David Richardson	8	3	8	3
Angie Risley	8	2(2)	8	3
Ralph D. Crosby Jr	8	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.

Corporate Governance Report

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 range of relevant senior managers from across the Group on a structured basis to assist with a Director's induction. Visits are also arranged, where possible, to a number of contracts. An induction programme for Malcolm Wyman, who joined the Board on 1 January 2013, is already underway and includes site visits and meetings with senior executives of, and advisers to, the Group. The Chairman continues to undertake an extensive programme of contract visits.

Continued professional development

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 the Chairman 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. The Board intends to comply with the requirements of the UK Corporate Governance Code and carry out such an external evaluation at least once every three years. In 2012, an internal evaluation of the Board and Committees was undertaken, which consisted of each Director completing a detailed questionnaire, followed by an interview with the Chairman.

A presentation to the Board was given of the results of the evaluation.

The evaluation concluded that the Board operates effectively under strong leadership from the Chairman and makes good use of the individual competencies of the Board's membership. The Board is felt to have a strong understanding of the views of major investors and stakeholders and a good understanding of the markets in which the business operates. Changes to some of the reports presented to the Board in response to previous evaluation feedback had been very well received and there is felt to be a good and transparent relationship between Non-Executive Directors and senior management. The Board was felt to be effective at managing risk and to have an appropriately conservative attitude to risk whilst equally being prepared to take well considered and appropriately evaluated material risk judgements. The Committee structure and effectiveness were also highly rated.

It was acknowledged that the profile of the Board would be enhanced through greater diversity, both of expertise in areas such as brand and marketing as well as experience of new geographical markets under consideration by the Group. Whilst the Board recognised the importance of well developed succession plans, it acknowledged that there should be continued focus on emerging talent as succession to key senior management roles. 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 continues to provide strong leadership of the Board, and there is a good level of trust between him and the Chief Executive. The Chairman's commitment to contract and site visits and the value derived from these by the business was also acknowledged. His very well informed view of the Group's operations also enables him to provide a strong sounding board for the Executive Directors.

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.

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 comprised of David Richardson, who Chairs the Committee, and Angie Risley, who replaced Leonard V. Broese van Groenou when he retired from the Board and Committees on 14 May 2012. Following the sad and untimely passing of Paul Brooks in January 2012, membership of the Committee was reduced below the level required by the Code. The Board considered it appropriate to pend increasing membership of the Committee until a new non-executive director, with the right balance of skills, is appointed to the Board. The Company Chairman, who is himself a qualified accountant and a listed Audit Committee Chairman, attended all meetings in the year and the Board considers that appropriate representation was maintained as a consequence. Malcolm Wyman, who joined the Committee on his appointment to the Board on 1 January 2013, will take over as Chairman of the Committee on the retirement of David Richardson at the close of the Company's 2013 Annual General Meeting.

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 Group Head of Internal Audit, KPMG LLP (the Group's internal audit providers), and Deloitte LLP (the external auditors) attend meetings. The Committee meets with each of the internal audit providers, external auditors and the Group 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 auditors' reports on the effectiveness of systems for internal financial control, financial reporting and risk management
- To consider the appointment, re-appointment and removal of the external auditors and assess independence and objectivity of the external auditors, 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 auditors and to ensure that the provision of non-audit services does not impair the external auditors' independence or objectivity
- To discuss with the external auditors, before the audit commences, the nature and scope of the audit and to review the auditors' quality control procedures and steps taken by the auditors to respond to changes in regulatory and other requirements
- To oversee the process for selecting the external auditors and make appropriate recommendations through the Board to the shareholders to consider at the annual general meeting
- To 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 auditors.

During 2012 the Audit Committee discharged fully its responsibilities listed above and, in doing so, considered the following:

- Corporate Governance Report and statement of Directors' Responsibilities for inclusion in the 2011 Annual Report and Accounts
- 2012 Half Year Report and Auditors' report thereon
- 2012 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
- 2012 internal audit programme and the proposed 2013 programme
- The continuing independence of the external auditors.

In considering the Financial Statements for the year ending 31 December 2012, the Committee discussed with the auditors and management all areas of risk it identified during both the audit planning process and year end audit. In the Committee's judgement these areas are usual for a company of Serco's size and business model.

A small, but significant, number of Serco's contracts are Long Term Contracts for accounting purposes and calculations around Revenue and Profit recognition require management judgement. We have considered carefully the judgements made and their impact on all aspects of the financial statements. We have had detailed input from management on the forecasts and validity of the estimates made historically and have discussed and reviewed these with the auditors at our meetings.

Profit Before Tax (PBT) in 2012 includes an exceptional gain which arises on the step purchase of a former Joint Venture. We have confirmed that the accounting for this acquisition is in accordance with the accounting standards.

Goodwill is a significant asset for the Group. It is supported for accounting purposes by management's cash flow forecasts at agreed cash generating unit level. We carefully considered the reasonableness of these forecasts.

Finally, cash accounting, pension provisions, charges for taxation, and accounting for acquisitions and disposals are all major items which we consider in detail in order to satisfy ourselves that the financial statements are reasonable. We satisfied ourselves, as required, that Serco is a Going Concern.

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, it considers that the external auditors 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

Corporate Governance Report

- 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, and
- 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 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 the Company's 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 LLP for audit, audit-related and non-audit services for 2012 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 advisory work and due diligence and other corporate finance advisory services.

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 2013 Annual General Meeting. This recommendation has been accepted and will be proposed to shareholders. The Committee further noted the requirement within the FRC's September 2012 "Guidance on Audit Committees", applying to the Company's next reporting period, requiring FTSE350 companies to put their external audit services out to tender at least once in every ten years.

The Nomination Committee

Membership: The Nomination Committee is chaired by Alastair Lyons and throughout 2012 comprised David Richardson, Angie Risley and Christopher Hyman. The Committee met three times during 2012. Malcolm Wyman joined the Committee in his appointment to the Board on 1 January 2013.

Responsibilities: Matters considered during the year included succession and contingency planning, Board structure and composition and the recruitment of a successor to David Richardson as Chair of Audit.

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

The Nomination Committee has engaged the Zygos Partnership, an independent external executive search consultancy, for the appointment of new Non-Executive Directors. The Board confirms the Zygos Partnership is not connected with the Company in any way. In consultation with the chosen search consultants, specifications are drawn up for the roles and attributes that are felt to be essential for the effective performance of any new Non-Executive Director, 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 98 to 114.

Executive Committees

Throughout 2012, an Executive Committee has operated which is chaired by the Chief Executive and comprises eight other members, including the Group Finance Director, Regional 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 nine 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, as appropriate, 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.

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.

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 AGM 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.

Institutional investors

The Chief Executive and Finance Director have regular dialogue with institutional investors. The Chairman also each year offers to meet with the Company's largest institutional investors. 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 on a quarterly basis. This reviews share price movements and valuation, changes in the share register, the Company's recent and planned investor relations activities, communication with shareholders, analyst recommendations and significant news from the market and specifically the support services sector. The report ensures that the Board has a clear understanding of the Company's investor relations performance and enables all directors to develop an understanding of the views of major shareholders.

Group website

The Group website www.serco.com is a primary source of information on the Group. The site includes an area tailored for investors, including information such as an archive of all reports, announcements, presentations and webcasts, share price tools, the terms of reference for all Board Committees, 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 Investment and Ethics Committee, comprising members of the Executive Team with a quorum of three and chaired by the Chief of Staff, meets as required. As the leadership of the Company, the Executive Team will make judgements about what it considers acceptable.

Serco's outsourced Ethics Hotline operated throughout the year, which enabled employees to report any concerns, or report any wrongdoing, that they did 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.

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 78 to 84 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 '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. This is discussed in the Finance Review starting on page 58.

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



John Hickey
Secretary
4 March 2013

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 2012. Comparative figures used in this report are for the year ended 31 December 2011. The Corporate Governance Report set out on pages 85 to 91 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 commercial sectors.

The Chairman's Statement and the remainder of the 'Our performance' section on pages 18 to 84 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 32 to the Consolidated Financial Statements.

The powers of the Directors to issue or buy back shares are restricted to those 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 2.65p (2011: 2.50p) per ordinary share was paid on 19 October 2012. The Directors recommend a final dividend of 7.45p (2011: 5.90p) per ordinary share which, if approved by shareholders at the Annual General Meeting, will be paid on 22 May 2013 to those shareholders on the register at the close of business on 15 March 2013.

Interests in voting rights

As at 4 March 2013* 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:

	Number of shares	
	(millions)	% held
Invesco Limited	60.1	12.05
Capital Research and Management Company	30.3	6.07
UBS Investment Bank	29.1	5.90
Morstan Nominees Limited	25.1	5.11
AXA S.A.	24.4	4.95
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

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 96 and 97.

On 6 December 2012, the Company announced the appointment of Malcolm Wyman as a Non-Executive Director of the Company with effect from 1 January 2013. Malcolm will stand for election at the Company's AGM on 15 May 2013.

At the conclusion of the Company's 2013 AGM David Richardson will retire as a Non-Executive Director of the Company and, accordingly, will not be standing for re-election. Malcolm Wyman will take over as Audit Committee Chairman and Senior Independent Director on David's retirement. All other Directors will stand for re-election at the AGM.

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 98 to 114.

Annual general meeting

The Annual General Meeting of the Company will be held at the offices of Linklaters LLP, One Silk Street, London EC2Y 8HQ on 15 May 2013 at 11.00am.

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 153 to 158.

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 is 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 in 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, a share option scheme, and long term incentive arrangements for senior management, which effectively align 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 model that is applied across the business focusing 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 against our commitments is contained in the Corporate Responsibility Report which is available online at www.serco.com/cr2012. 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 2012 were 26 days (2011: 32 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 (BiTC) reporting format.

The value of this investment in 2012 at £2,560,084 (2011: £2,532,175) represents 1.02% of the Group's pre-tax profit before exceptional items.

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.

As announced on 20 December 2012, Serco has set out plans to establish the Serco Foundation as an independent charitable foundation to mark 2013 as Serco's 25th year as a publicly traded company dedicated to service excellence. Serco has made a one-off endowment of £5m to the Foundation and will provide ongoing support for its mission to help charities through the application of Serco's people, skills and capabilities. The Foundation will be independent of Serco and will operate on a not-for-profit basis.

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:



John Hickey
Secretary
4 March 2013

* As at 25 March 2013 the Company had not been notified of any changes or additions to these interests.

Directors' Responsibilities

The Directors are responsible for preparing the Annual 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 to prepare the group financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union and Article 4 of the IAS Regulation and have elected to prepare the parent company financial statements in accordance with Financial Reporting Standard 101 Reduced Disclosure Framework. 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.

In preparing the parent company financial statements, the Directors are required to:

- Select suitable accounting policies and then apply them consistently;
- Make judgments and accounting estimates that are reasonable and prudent;
- State whether Financial Reporting Standard 101 Reduced Disclosure Framework has been followed, subject to any material departures disclosed and explained in the financial statements; and
- Prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

In preparing the Group financial statements, International Accounting Standard 1 requires that Directors:

- 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 entity's financial position and financial performance; and
- Make an assessment of the company's ability to continue as a going concern.

The Directors are responsible for keeping adequate 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 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 that to the best of our knowledge:

- The financial statements, prepared in accordance with the relevant financial reporting framework, 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 that they face.

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



John Hickey
Secretary
4 March 2013

Directors' profiles



Alastair Lyons CBE (59)

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 house-builders and in March 2010 he was appointed 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. He was awarded the CBE in the 2001 Queen's Birthday Honours for services to social security.



Christopher Rajendran Hyman CBE (49)

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' charity In Kind Direct, and a Trustee of the Africa Foundation. Chris is a Trustee Director of the Board for Business in the Community and is Chairman of The Prince's Seeing is Believing Programme. In the 2010 Queen's Birthday Honours Chris was awarded the CBE for services to business and charity.



Andrew Mark Jenner (44)

Role: Finance Director

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

Responsibilities: Andrew is responsible for the Group's financial strategy and management including treasury, tax, reporting and control. He also has responsibility 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 house-building groups and is Chairman of its Audit Committee.



Ralph D. Crosby Jr (65)

Role: Non-Executive Director

Appointment: Ralph joined Serco as a Non-Executive Director in 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 has 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.



David Richardson (61)

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 have included eight years as Strategy Director. David was instrumental in transforming Whitbread from a brewing and pub company into a market leader in hotels, restaurants and leisure clubs. David has been Chairman of De Vere Group plc, Forth Ports plc and a non-executive director of Tomkins plc, Dairy Crest Group plc and The Restaurant Group plc.

External Appointments: David is Chairman of BBGI (sicav) SA and Four Pillars Hotels Ltd. He is also a director of Assura Group Ltd and a member of the Supervisory Board of World Hotels AG.



Angie Risley (54)

Role: Non-Executive Director

Appointment: Angie joined Serco as a Non-Executive Director in April 2011.

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

Experience: As Group Human Resources Director of J Sainsbury plc, Angie serves on Sainsbury's Operating Board and has responsibility for corporate, retail and logistics HR for 150,000 colleagues.

Previously, Angie was Group Human Resources Director of Lloyds Banking Group plc, serving as a member of the Lloyds Banking Group Executive Committee with responsibility for developing group-wide people practices. Until May 2007, she was an executive director of Whitbread PLC, 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 J Sainsbury plc.



Malcolm Wyman (66)

Role: Non-Executive Director

Appointment: Malcolm joined Serco as a Non-Executive Director in January 2013.

Responsibilities: Malcolm is a member of the Audit, Remuneration and Nomination Committees.

Experience: Malcolm was previously an executive director and the Chief Financial Officer of SABMiller plc, until his retirement in July 2011. Malcolm joined SAB in 1986 and joined the board as Group Corporate Finance Director in 1990. He was appointed to the board of SABMiller upon its listing on the London Stock Exchange in 1999. He was Chief Financial Officer from 2001 until his retirement in July 2011.

External appointments: Malcolm, a chartered accountant, is a non-executive director and Audit Committee Chairman of Imperial Tobacco Group PLC, and a non-executive director of Tsogo Sun Holdings Limited and Senior Independent Director and Audit Committee Chairman of Nedbank Group Limited in South Africa.

Remuneration Report

Dear Shareholder

On behalf of your Board, I am pleased to introduce the Directors' Remuneration Report for the year ended 31 December 2012.

In presenting my first report to shareholders, I would like to thank my predecessor, Leonard V. Broese van Groenou, for his very valued contribution to the Remuneration Committee over his six year tenure.

The Remuneration Committee recognises the importance of the BIS consultation on Executive Remuneration and the need to ensure that companies' remuneration reports include clear information about the link between pay and performance. This year's report includes additional disclosures on our reward and on our remuneration decisions in line with the proposals put forward in the BIS consultation.

This Report is in two parts:

1. **Remuneration policy report** setting out all elements of a company's remuneration policy and key factors that were taken into account in setting that policy, and
2. **Implementation report showing how the policy was implemented**, setting out actual payments to directors and details on the link between company performance and pay for the financial year covered by the accounts.

As reported in the Operating Review (pages 40 to 57), 2012 has been a year of significant progress operationally, financially and strategically for Serco. In addition to a record level of contract wins, the breadth of our portfolio has enabled our strength in the AMEAA region and the successful launch of our Global Services BPO division to offset challenges in the US federal contracting market. We have made further significant strategic progress in positioning our business to deliver strongly for the future.

During the year, the Committee reviewed the existing remuneration arrangements and determined that the overall structure and shape of remuneration should be retained for 2013 and no changes have therefore been made for the coming year. As part of that process the Committee engaged with our larger Shareholders and two key shareholder bodies and we found the process extremely helpful. I would like to personally thank the Shareholders for their time, and for their open and transparent dialogue.

The Committee conducted its regular annual review of 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 has 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. With effect from 1 April 2012, their salaries increased by 3% to £750,000 for the Chief Executive and £440,000 for the Finance Director.

On the basis of Serco's performance in 2012, annual bonus awards of 108.3% and 93.9% have been determined for the Chief Executive and the Finance Director. These outcomes reflect the performance achieved in the year against the financial and non-financial targets set. Serco's financial performance for the year is described in more detail in the 'Our performance' section starting on page 18. The personal objectives set for each of the Directors covered areas such as active portfolio management (with capability driven acquisitions and non-core disposals), widening our exposure to emerging markets and the securing of key strategic contracts to deliver long-term performance as well as specific activities around the ongoing development and execution of the Group's strategy.

Awards made in 2010 were subject to two performance measures, EPS growth and relative TSR. Under the 2010 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. We are pleased that our EPS performance against the three-year measure was compound growth of 12.6% per annum which resulted in 79.5% vesting for the EPS element of the 2010 PSP and DBP. It is however, disappointing that our TSR performance for the period ended 31 December 2012 relative to the comparator group was below median, therefore no shares vested under this element of either the PSP (70%) or the DBP (50%).

The voting outcome at the 14 May 2012 AGM in respect of the Directors' Remuneration Report for the year ended 31 December 2011 is set out on page 110 and reflected very strong Shareholder support of the Company's remuneration policy, which remains unchanged for 2013.

The Committee continues to be mindful of the views of Shareholders and other stakeholders, and welcomes Shareholder feedback on any aspects of Executive remuneration.



Angie Risley
Remuneration Committee Chairman
4 March 2013

Remuneration Policy Report

The following report details the remuneration policy and the decisions on remuneration of the Directors of the Group for the year ended 31 December 2012. In preparing this report, consideration has been given to the disclosure requirements of the UK Corporate Governance Code, the Companies Act 2006, Schedule 8 of the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 and the draft regulations from BIS on the proposed content of the new style Directors' Remuneration Report that is anticipated to apply to accounting periods ending on or after September 2013.

The remuneration policy report is effective for the financial year ending 31 December 2013.

Remuneration policy

Serco's remuneration policy supports the achievement of the Company's long-term strategic objectives. Serco's approach to executive remuneration is designed to:

- 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 out-performance
- Enable Serco to recruit and retain the best with the required skills and experience in all our chosen markets
- Be based on a clear rationale which participants, shareholders and other stakeholders are able to understand and support.

Key elements of remuneration table

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.

Each element of reward and how it will support Serco's remuneration policy and the Group's short- and long-term strategic objectives is summarised below. Whilst the table is focused on Executive Directors, the following section provides further information of how pay policies are set for the broader employee population.

Element and purpose	Approach and performance measurement	Level	Change for 2013
Base salary <ul style="list-style-type: none"> ● Help recruit and retain executives. ● Recognise individual's experience, responsibility and performance. 	<ul style="list-style-type: none"> ● Pay levels are designed to be competitive and fair and reflect the skills and performance of individuals. ● Base salaries are benchmarked annually and are set to ensure that total target remuneration is competitive. ● Normally reviewed by the Committee annually and fixed for 12 months commencing 1 April. ● The relative pay and employment conditions both within the Company and the comparator group are considered when determining salaries. 	CEO: £779,000 FD: £457,000	Increase: 3.86% Increases reflect performance achieved in the year and are in-line with our performance related approach to salaries across the Group.
Benefits <ul style="list-style-type: none"> ● To provide a competitive level of benefits. 	<ul style="list-style-type: none"> ● Benefits are reviewed annually against market practice and are designed to be competitive 	25 days' holiday per year, car, private medical insurance, permanent health insurance, life cover, annual allowance for independent financial advice, and voluntary health checks every two years.	No change
Pension	<ul style="list-style-type: none"> ● The Executive Directors participated in the Serco Pension and Life Assurance Scheme (SPLAS) – defined benefits scheme. ● Christopher Hyman opted to cease accruing benefits in the pension scheme after 1 April 2010 and Andrew Jenner after 31 December 2010. ● Since ceasing to accrue benefits both Executive Directors have been in receipt of a cash allowance equal to 33% of base salary in lieu of further 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. 		No change

Remuneration Report

Element and purpose	Approach and performance measurement	Level	Change for 2013
<p>Annual Bonus</p> <ul style="list-style-type: none"> ● Incentivise executives to achieve specific, predetermined goals during a one-year period. ● Reward ongoing stewardship and contribution to core values. 	<ul style="list-style-type: none"> ● Bonus is earned on the basis of achievement of a mix of financial and non-financial objectives which are weighted 80% and 20% respectively. ● 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 objectives. ● Bonus result is determined by the Committee after year end, based on performance against targets. 	<ul style="list-style-type: none"> ● Maximum bonus opportunity: 150% of base salary for the Chief Executive and 130% for the Finance Director. ● On-target bonus: 75% of base salary for the Chief Executive and 65% for the Finance Director. 	No change
<p>Deferred Bonus Plan ("DBP")</p> <p>Incentivise executive to achieve superior returns for shareholders.</p>	<ul style="list-style-type: none"> ● Executive Directors can elect to defer, for three financial years, up to 50% of their annual bonus by purchasing invested shares. ● If stretching performance targets, measured over three years, are met each invested share which could have been purchased with the gross equivalent of the amount used to purchase invested shares will be matched by a maximum of two 'matching' shares. ● EPS growth is the sole measure to determine the vesting of matching shares. ● Dividends are reinvested and distributed 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, to ensure that the outcomes are fair and appropriate and reflect the underlying financial performance of the Group. 	Each individual investment share is matched with two shares for maximum performance.	No change
<p>Performance Share Plan ("PSP")</p> <p>Drive achievement of longer term objectives aligned closely to shareholders' interests.</p>	<ul style="list-style-type: none"> ● Awards of nominal cost options/conditional shares made annually, with vesting dependent on EPS growth and relative TSR (compared to the companies in the FTSE 51 to 130 (excluding investment trusts)) measured over three-year performance period. ● The two performance measures are independent, measured over a three-year performance period and each determines 50% of the award. ● No awards vest for performance below Median/Threshold. <p>EPS growth:</p> <ul style="list-style-type: none"> ● EPS growth is measured on a compound basis. 25% of the award will vest for threshold performance rising on a straight line basis to 100% for maximum performance. <p>Relative TSR:</p> <ul style="list-style-type: none"> ● 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. ● Dividends are reinvested and distributed 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, to ensure that the outcomes are fair and appropriate reflect the underlying financial performance of the Group. 	Face value on grant of 200% of base salary for the Chief Executive and 175% for the Finance Director.	No change

Element and purpose	Approach and performance measurement	Level	Change for 2013
<p>Fees for non-executive directors</p> <p>Reflect the time commitment and responsibilities of the roles.</p>	<ul style="list-style-type: none"> 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. The Chairman receives no fees in addition to the Chairman's fee. Each committee chairmanship and SID fee are all additional to the NEDs' basic fee. Fees are reviewed on an annual basis, taking into consideration market practice and are approved by the Board. An allowance is payable for attendance at international meetings. No bonuses are paid to Non-Executive Directors. NEDs are encouraged to hold shares in the Group but are not subject to a shareholding requirement. NED fees are not performance related. 	<p>Base fee: Chairman: £270,000</p> <p>NED base fee: £50,000</p> <p>Additional fees: SID fee: £10,000</p> <p>Chairman of audit committee: £12,500</p> <p>Chairman of remuneration committee: £10,000</p> <p>Allowance: £5,000 for attendance at each international meeting.</p>	<p>Chairman's base fee increased by 3.8% with effect from 1 April 2013.</p> <p>The Chairman's fee increase reflects positioning against market and the contribution made in his role.</p> <p>No change to NED's base or additional fees</p>

Remuneration policy for other employees

The remuneration policy described in the previous table applies specifically to executives of the group. The remuneration committee believes that the structure of management reward at Serco is also linked to Serco's strategy and performance. The table below explains how the remuneration policy has been cascaded below Executive Directors to achieve alignment of policy across the organisation.

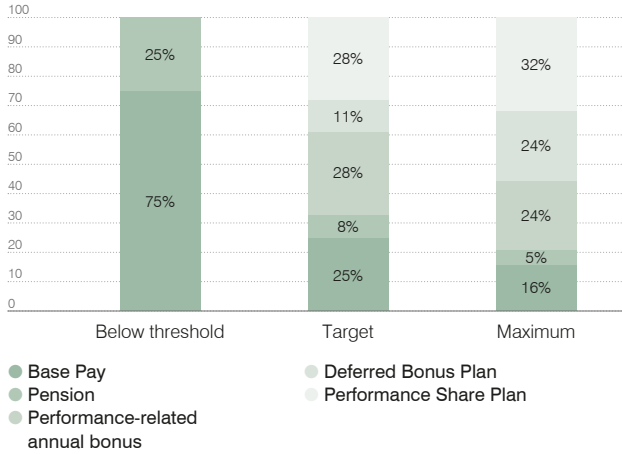
Element	Difference in remuneration policy for other employees
Base salary	<ul style="list-style-type: none"> The same principles and considerations that are applied to Executive Directors are, as far as possible, applied to all employees.
Benefits	<ul style="list-style-type: none"> Serco also has provisions for market aligned benefits for all employees.
Pension	<ul style="list-style-type: none"> The Group operates a number of defined benefit schemes and defined contribution schemes.
Annual bonus	<ul style="list-style-type: none"> Approximately 500 members of the Global Leadership Team are eligible for a bonus award under The Leadership Team Bonus Scheme.
Deferred Bonus Plan ("DBP")	<ul style="list-style-type: none"> Members of the Executive Committee are invited to participate in the DBP on the same terms as the Executive Directors.
Performance Share Plan ("PSP")	<ul style="list-style-type: none"> The PSP is awarded to approximately 500 employees in the Global Leadership Team.
Sharesave	<ul style="list-style-type: none"> An all-employee scheme. Options are normally granted at a discount of 10% to the market value and have no performance conditions. The Executive Directors do not participate in Sharesave.

Remuneration Report

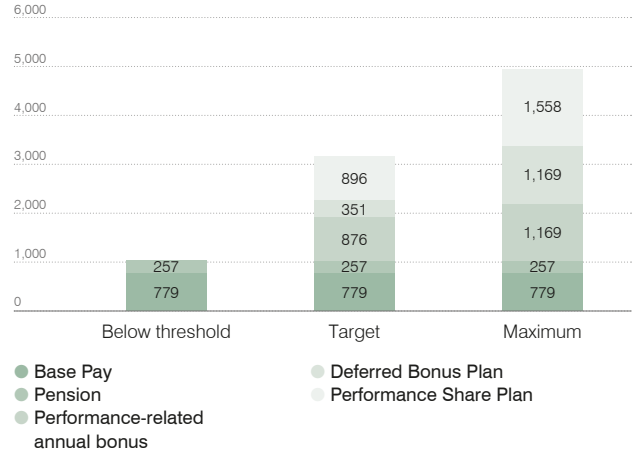
Remuneration scenarios

The charts illustrate the composition and value of the different elements of remuneration that the Executive Directors will receive for below threshold, target and maximum corporate performance. The chart indicates that a significant proportion of both target and stretch pay is performance-related. For 'target' performance – variable pay accounts for two thirds of total pay.

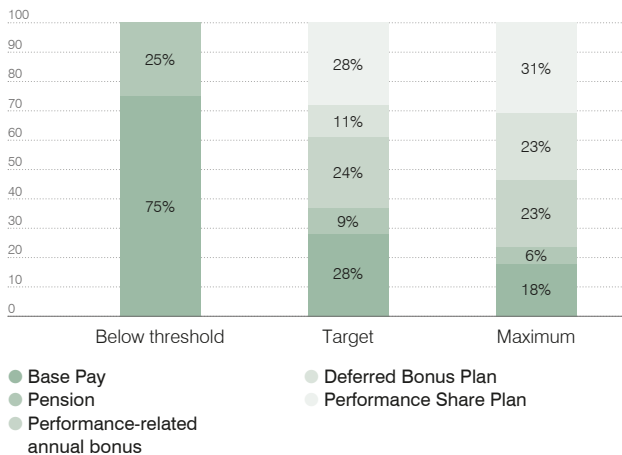
Proportion of remuneration package value delivered through fixed and performance-related pay for the CEO (%)



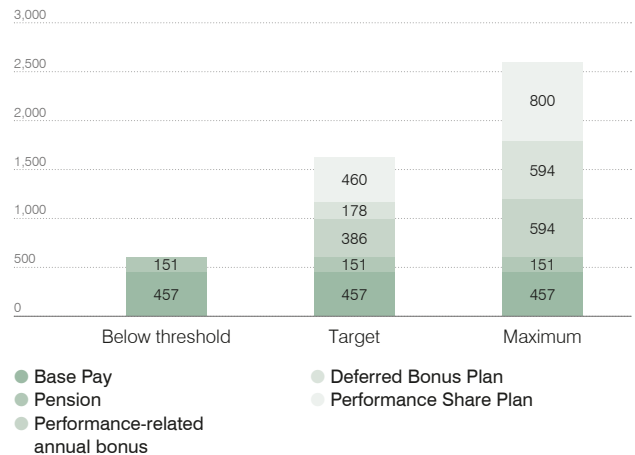
Potential value of the CEO's 2013 remuneration package (£000)



Proportion of remuneration package value delivered through fixed and performance-related pay for the FD (%)



Potential value of the FD's 2013 remuneration package (£000)



Notes:

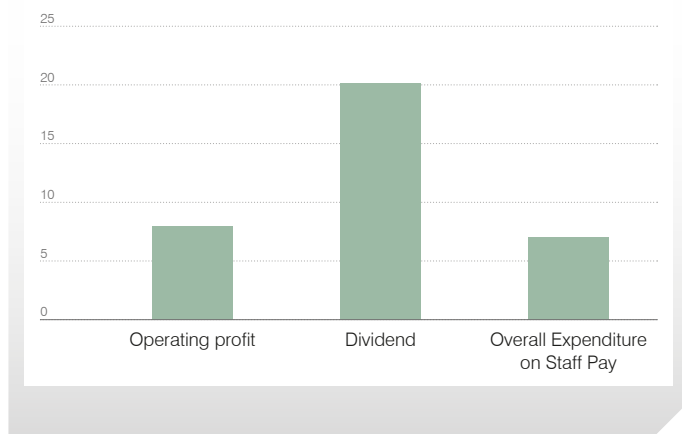
- Base salary corresponds to 2013 salary for CEO and FD.
- Pension represents 33% salary allowance for CEO and FD.
- Below threshold no incentives vest (bonus and LTI).
- Bonus pays out 75% and 65% of salary for on target performance for the CEO and FD respectively and 150% and 130% of salary for maximum performance for the CEO and FD respectively.
- Deferred bonus provides a match of 1:2 for target performance and 2 matching shares for maximum performance.
- The LTI values reflect target and maximum vesting of the proposed 2013 award. Share price movement has not been incorporated into the above figures.

Changes in key metrics

The chart below details the percentage change in profit, dividends and overall expenditure on pay compared with the previous financial year.

Serco considers overall expenditure on staff pay in the context of the general finances of the company; this includes the determination of the annual salary increase budget, the annual grant of shares and annual bonus funding for the business.

Change in profit, dividends and overall expenditure on pay
2012 v 2011 (%)



'Operating Profit' excludes exceptional items, 'Dividend', and 'Overall Expenditures on Staff Pay' shall have the same meaning as used in the preparation of the accounts of the Company

Considerations of conditions elsewhere in the group

When making decisions on executive remuneration, the Remuneration Committee considers the wider economic environment and conditions within the Company. In particular the Committee considers pay across the company when reviewing base salaries for Executive Directors.

Individual pay increases that range from zero to amounts in excess of those granted to the Executive Directors were awarded to various employees for reasons including performance, promotion, increased scope of role and market position.

Service contracts

Executive Director	Date joined the Company	Date of appointment to the Board	Date of contract
Christopher Hyman	30 August 1994	1 April 1999	10 June 2009
Andrew Jenner	4 November 1996	3 May 2002	10 June 2009

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. The Executive Directors are also entitled to a range of benefits which comprise 25 days holiday per year, a car, private medical insurance, health cover, annual allowance for independent financial advice and voluntary health checks every two years.

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

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.

Remuneration Report

Implementation Report – Summary of 2012 remuneration outcomes

The Remuneration Committee

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.

Terms of reference

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 87.

Remuneration Committee members and attendees (the Committee met eight times during 2012)

Remuneration Committee members	Position	Comments
Angie Risley	Chairman of the Remuneration Committee (from 14 May 2012)	Independent
Alastair Lyons	Member from 10 May 2011	Independent
David Richardson	Member from 2 June 2003	Independent
Leonard V. Broese van Groenou	Chairman of the Committee until 14 May 2012	Retired from the Board at the conclusion of the Company's 2012 annual general meeting on 14 May 2012

Remuneration Committee attendees during the year	Position	Comments
Christopher Hyman	Chief Executive	Attends by invitation
Andrew Jenner	Finance Director	Attends by invitation
Geoff Lloyd	Group HR Director	Attends as an executive responsible for advising on the remuneration policy
Cathy Aldwinckle/Richard Hortop	Group Head of Reward	Attends as an executive responsible for advising on the remuneration policy
John Hickey	Company Secretary	Attends as the secretary to the Committee

No person is present during any discussion relating to their own remuneration arrangements.

Advisors to the Remuneration Committee

During the year the Committee has been advised by Towers Watson who were originally appointed by the Committee in May 2008 and PricewaterhouseCoopers LLP ("PwC") who were appointed as independent advisers following a competitive tendering process by the Committee in August 2012. Consulting services have also been provided to the Group by the advisors in relation to retirement benefits and pay data, accounting and taxation services.

Towers Watson and PwC provided advice throughout the year mainly around the following key executive reward areas:

- Advice on reviewing the existing PSP
- Support in shareholder consultation process
- Benchmarking the Chairman and Non-Executive Director fees
- Benchmarking Board and Executive Committee total remuneration
- Support in reviewing the DRR
- Responding to general and technical reward queries

Both Towers Watson and PwC are members 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 as advisers to the Committee during the year totalled £88,017 and fees paid to PwC as advisers to the Committee totalled £212,880.

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.

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. No compensation or other benefits are payable on early termination. The renewal of appointments is not automatic, Non-Executive Directors are required to retire and stand for re-election in accordance with the UK Corporate Governance Code and 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 2012, 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.

Remuneration Report

Remuneration of Non-Executive Directors

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.

Fees

	Alastair Lyons Chairman; Member of Nomination and Remuneration Committees	David Richardson Chairman of Audit Committee; SID; Member of Nomination and Remuneration Committees	Angie Risley Chairman of Remuneration Committee; Member of Audit and Nomination Committees	Ralph D. Crosby Jr	Malcolm Wyman Member of Audit, Nomination and Remuneration Committees
Date of appointment to the Board	16 March 2010	2 June 2003	1 April 2011	30 June 2011	1 January 2013
Date of letter of appointment	15 March 2010	29 May 2003	23 March 2011	30 June 2011	26 November 2012
Base	£270,000 ^{1,2}	£50,000	£50,000	£50,000	£50,000
SID		£10,000			£10,000
Audit Committee Chairmanship		£12,500			£12,500
Remuneration Committee Chairmanship			£10,000		
Total fee	£270,000	£72,500	£60,000	£50,000	£72,500
Comments		Will retire from the Board at the conclusion of the Company's 2013 annual general meeting on 15 May 2013	Assumed role of Chair of Remuneration Committee with effect from 14 May 2012		Will assume the role of Chair of the Audit Committee and SID on retirement of David Richardson

Notes:

1. Fees for the Chairman have increased from £260,000 to £270,000 with effect from 1 April 2013

2. Alastair Lyons' remuneration consists of cash fees paid monthly. In addition, reasonable travel and related business expenses are paid. No bonuses are payable.

3. £5,000 is payable for travel to international meetings.

Directors' remuneration

This section has been audited by Deloitte LLP.

Directors' remuneration for the financial year ended 31 December 2012

	Note	Remuneration £	Fees £	Bonus £	Total estimated value of non cash benefits £	Allowance £	Sub-total remuneration excluding pensions 2012 £	Sub-total remuneration excluding pensions 2011 £	LTIP value vesting in 2012 £	Total estimated 'Single figure' remuneration in 2012 year £
Alastair Lyons	1,6	Nil	257,500	Nil	Nil	5,000	262,500	255,000	Nil	Nil
Christopher Hyman	2,3,4,5,8	744,500	Nil	812,250	2,989	319,950	1,879,689	1,916,843	632,620	2,512,309
Andrew Jenner	2,3,4,5,8	436,750	Nil	412,984	2,989	218,894	1,071,617	1,089,008	324,462	1,396,079
Leonard V. Broese van Groenou	1,6,7	Nil	30,000	Nil	Nil	Nil	30,000	65,000	Nil	Nil
David Richardson	1,6	Nil	72,500	Nil	Nil	5,000	77,500	77,500	Nil	Nil
Angie Risley	1,6	Nil	56,666	Nil	Nil	5,000	61,666	42,500	Nil	Nil
Ralph D. Crosby Jr	1,6	Nil	50,000	Nil	Nil	25,000	75,000	45,189	Nil	Nil
Total		1,181,250	466,666	1,225,234	5,978	578,844	3,457,972	3,491,040	957,082	3,908,388

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 99.
5. The allowances include payments made in lieu of pension, calculated as a percentage of base salary, from which he makes his own pension arrangements and does not include the value of accrued pension under the DB scheme – see page 99 for further details, and the provision of a car allowance (fully inclusive of all scheme costs including insurance and maintenance).
6. The allowance comprises payment for travel to international meetings.
7. Leonard V. Broese van Groenou retired from the Board at the conclusion of the Company's 2012 annual general meeting on 14 May 2012.
8. The value of shares vested in the year based on an average market value over the last quarter of the financial year.
9. Prior to the sad and untimely passing of Paul Brooks in January 2012 he received £4,167 in fees.

Variable pay outcomes

Performance-related annual bonus

For 2012, bonus was earned on the basis of achieving a mix of financial and non-financial objectives which were weighted 80% and 20% respectively. Payment for target was set at 75% of Chief Executive's base salary and at 65% of the Finance Director's base salary. The maximum annual bonus opportunity was set 150% of the Chief Executive's base salary and at 130% of the Finance Director's base salary. Annual bonuses are not pensionable.

Financial measures were based on Serco Group's Key Performance Indicators (KPIs) and the non-financial measures were individually set and are based on key strategic goals. The three financial measures for 2012 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 2012 assessed performance against a number of strategically important objectives for each individual linked to key strategic areas such as active portfolio management (with capability driven acquisitions and non-core disposals), widening our exposure to emerging markets and the securing of key strategic contracts to deliver long-term performance as well as specific activities around the ongoing development and execution of the Group's strategy.

On the basis of Serco's performance in 2012, annual awards of 108.3% and 93.9% of salary have been determined for the Chief Executive and Finance Director respectively.

Remuneration Report

Performance-related long term incentives

Deferred Bonus Plan (DBP)

Executive Directors can elect to defer, for three financial years, up to 50% of their annual bonus by purchasing invested shares. Under the 2010 DBP, 50% of the matching shares were subject to EPS growth and 50% subject to relative TSR. In 2012 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 2012, achievement against the measure is shown in the table below:

2010 DBP deferral	Performance condition	Weight	Achievement	Resulting vesting
CEO – 50%	EPS growth. The range was 9% (threshold) – 14% (maximum). For threshold performance each invested share is matched by half a share rising to a match of two shares at maximum performance.	50%	Compound growth 12.6%	79.5%
FD – 50%		50%	Below median	No shares vest
	Relative TSR. For median performance each invested share is matched by half a share rising to a match of two shares for upper quartile performance.			

For performance between median or threshold and upper quartile or maximum, the number of matching shares will be determined on a straight line basis.

Performance Share Plan (PSP)

For the awards of nominal cost options that were made in April 2010, vesting was dependent on EPS growth and relative TSR measured over a three-year performance period. Face value awards on grant were 200% of base salary for the Chief Executive and 175% for the Finance Director.

For the PSP awards which completed their performance period on 31 December 2012, achievement against the measure is shown in the table below:

2010 PSP awards (% of salary)	Performance condition	Weight	Achievement	Resulting vesting
CEO – 200%	EPS growth. The range was 9% (threshold) – 14% (maximum). For threshold performance 25% of the award vests rising on a straight line basis to 100% at maximum performance.	30%	Compound growth 12.6%	79.5%
FD – 175%		70%	Below median	No shares vest
	Relative TSR. For median performance 25% of the award vests rising on a straight line basis to 100% for upper quartile performance.			

Variable pay awarded during the financial year

Deferred Bonus Plan (DBP)

In 2012 both the Chief Executive and the Finance Director elected to defer 50% of their earned bonus into the DBP.

For matching share awards made in 2012, EPS growth was the sole performance measure. The range for the three-year performance period was set at annual compound EPS growth of 5.5% at threshold to 10.5% at maximum. No matching shares will vest where performance is below threshold. For threshold performance, each invested share will be matched by one matching share. For maximum level performance each invested share will be matched (on a gross investment basis) by two shares. For performance between threshold and maximum, the number of matching shares will be determined on a straight line basis.

The definition of EPS is Adjusted EPS calculated in accordance with IAS 33 "Earnings per Share" and is before amortisation on acquired intangibles, acquisition related costs and exceptional items. EPS is also adjusted for any material acquisitions, disposals and currency movements.

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.

Performance Share Plan (PSP)

In 2012 the executive directors received awards equivalent to 200% of salary for the Chief Executive and 175% for the Finance Director.

The shares will normally only vest at the end of a three-year performance period, if the Executive Directors are still in employment with Serco and the two performance measures have been met. The measures are EPS growth and relative TSR compared to the companies in the FTSE 51 to 130 (excluding investment trusts). The two measures are independent and each determines the vesting of half of the award

The structure for vesting is the same for both measures and no shares vest where performance is either below threshold (EPS) or below median (TSR).

For threshold/median performance 25% of the award will vest rising on a straight line basis to 100% for maximum/upper quartile performance. The EPS growth range was set at 5.5%-10.5%.

Total pension entitlement 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 159 to 166. 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 2012 (1) £	Transfer value at 31 December 2011 (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 net of inflation (7) £	Accrued pension at year end (8) £ p.a.
Christopher Hyman	2,158,373	2,180,757	–	(22,384)	1,245	351	5,933	127,635
Andrew Jenner	1,132,366	1,184,608	–	(52,242)	2,100	–	–	79,819

Notes:

- Christopher Hyman ceased pension accrual on 1 April 2010 and Andrew Jenner on 31 December 2010, both 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 he die before retirement and whilst employed by Serco.
- The accrued pension shown is that which would be paid annually on retirement, were 31 December 2012 the director's Normal Retirement Date, 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 changes in expectation of inflation and life expectancy.
- CPI increased by 2.2% over the year September 2011 to September 2012, the period used for statutory increases, and by 5.2% for the prior year. Statutory indexation restricts pre retirement increases to 5% p.a. over the period of measurement 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 accrued pension for Andrew Jenner receives statutory increases and hence the increase net of inflation is zero. The increase in the accrued pension for Christopher Hyman allows for an increase in line with RPI to a maximum of 4% p.a. over the period from date of ceasing accrual to April 2012, as agreed when he ceased accrual. Statutory increases will be received from April 2013, as agreed following recent changes in legislation.
- The impact of allowing for changes in expectations of inflation and improvement in life expectancy in the transfer value assumptions on their own would result in higher transfer values at the beginning and end of the year, shown in (4), includes the effect of both changes in the transfer values 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.

Remuneration Report

Shareholder context

The Annual General Meeting of Serco Group plc was held on 14 May 2012. In line with recommended practice, a poll was conducted on each resolution at the meeting. The results of the poll to approve the Directors' Remuneration Report for the year ended 31 December 2011 are set out below.

	For ¹		Against		Withheld ²
	Votes	%	Votes	%	Votes
	351,474,463	93.72	235,472,217	6.28	8,299,355

1. Includes those votes giving the Chairman discretion.
2. A "Vote Withheld" is not a vote in law and is not counted in the calculation of the proportion of votes "For" or "Against" a Resolution.
3. At the meeting date there were 498,248,152 ordinary shares in issue.

Directors' shareholding

The Committee believes that employee share ownership is an important means to support long-term commitment to the Company and the alignment of employee interests with those of shareholders. The ownership requirement for the Executive Directors is two times base salary for the Chief Executive and one times base salary for the Finance Director. As shown in the table below both Directors exceed their share ownership requirements.

Executives are required to retain in shares 50% of the net value of any performance shares vesting or options exercised until they satisfy the shareholding requirement.

As at 31 December 2012, the Executive Directors' share ownership against the guidelines were:

	Ordinary shareholding at 31 December 2012 (535p)		Ordinary shareholding at 31 December 2011 (474p)	
	No. of shares	% of salary	No. of shares	% of salary
Christopher Hyman	917,024	654%	820,197	534%
Andrew Jenner	364,831	444%	310,991	345%

The table below shows the shareholdings for the Executive Directors and the Non-Executive Directors at the end of 2012.

	Note	Ordinary shares of 2p each fully paid at 31 December 2012 or date of cessation if earlier	Ordinary shares of 2p each fully paid at 1 January 2012
Alastair Lyons	1	15,000	15,000
Leonard V. Broese van Groenou	2	5,375	5,375
Christopher Hyman	3,4	917,024	820,197
Andrew Jenner	3	364,831	310,991
David Richardson		15,000	15,000
Angie Risley		4,399	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. Leonard V. Broese van Groenou retired from the Board of Serco Group plc at the conclusion of the Company's 2012 annual general meeting on 14 May 2012.
3. 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.
4. Security has been granted to Christopher Hyman's bank over 85,564 ordinary shares held in his name.
5. As at 25 March 2013 there were no changes to the Director's interests.

Other Shareholding information

The following pages detail other share movements and share information for 2012.

The information in these tables has been audited by Deloitte LLP.

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 2012 were as follows:

	Awards held at 1 January 2012	Date of award	Market price at award (p)	Granted during the period	Awards held at 31 December 2012	Performance period	Vesting date
Christopher Hyman	130,754	12 Jun 2009	404	–	–	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
	173,898	4 Apr 2011	551	–	173,898	1 Jan 2011– 31 Dec 2013	4 Apr 2014
	–	21 May 2012	518	170,935	170,935	1 Jan 2012– 31 Dec 2014	21 May 2015
Andrew Jenner	76,232	12 Jun 2009	404	–	–	1 Jan 2009– 31 Dec 2011	12 Jun 2012
	73,865	29 Mar 2010	602	–	73,865	1 Jan 2010– 31 Dec 2012	29 Mar 2013
	88,033	4 Apr 2011	551	–	88,033	1 Jan 2011– 31 Dec 2013	4 Apr 2014
	–	21 May 2012	518	87,010	87,010	1 Jan 2012– 31 Dec 2014	21 May 2015

Notes:

- The awards shown in the table are the maximum number of shares that can vest under the performance conditions.
- The performance conditions attached to the awards are described on page 100.
- The performance conditions attached to the awards that vested on 12 June 2012 achieved maximum against the EPS element (50%) of the award resulting in 100% vesting and below threshold against the TSR element (50%) resulting in zero vesting.
- For awards which completed their performance period on 31 December 2012, our performance against the three-year EPS performance measure was compound growth of 12.6% per annum which resulted in 79.5% 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.
- The aggregate of the total theoretical gains on the awards exercised by the Directors during 2012 amounted to £0.6 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 award price, disregarding whether such shares were sold or retained on exercise, and is stated before tax. Of the 107,281 awards exercised, 51,298 shares were retained.

Remuneration Report

Serco Group plc Performance Share Plan (PSP)

Conditional rights to Serco Group plc ordinary shares under the PSP held by Directors at 31 December 2012 were as follows:

	Awards held at 1 January 2012	Date of award	Market price at award (p)	Granted during the period	Awards held at 31 December 2012	Performance period	Earliest vesting date	Latest exercise date
Christopher Hyman	315,789	22 Jun 2009	408	–	98,206	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
	247,568	31 Mar 2011	566	–	247,568	1 Jan 2011– 31 Dec 2013	31 Mar 2014	30 Mar 2021
	–	8 Jun 2012	535	272,149	272,149	1 Jan 2012– 31 Dec 2014	8 Jun 2015	7 Jun 2022
Andrew Jenner	162,790	22 Jun 2009	408	–	50,624	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
	127,652	31 Mar 2011	566	–	127,652	1 Jan 2011– 31 Dec 2013	31 Mar 2014	30 Mar 2021
	–	8 Jun 2012	535	139,672	139,672	1 Jan 2012– 31 Dec 2014	8 Jun 2015	7 Jun 2022

Notes:

- Awards take the form of nominal cost options.
- 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.
- The performance conditions attached to the awards are described in the Policy Report on page 100.
- The performance conditions attached to the awards that vested on 22 June 2012 achieved maximum against the EPS element (30%) of the award resulting in 100% vesting and below threshold against the TSR element (70%) resulting in zero vesting.
- On 31 December 2012 the performance conditions attached to the awards made on 6 April 2010 were satisfied. Our performance against the three-year EPS performance measure was compound growth of 12.6% per annum which resulted in 79.5% 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 TSR element (70%) of the matching award vested.

Serco Group plc 2006 Long Term Incentive Plan (LTIP)

The LTIP has been replaced by the PSP. The conditional rights to Serco Group plc ordinary shares under the LTIP held by Directors at 31 December 2012 were as follows:

	Awards held at 1 January 2012	Date of award	Market price at grant (p)	Vested during the period	Market price on vesting (p)	Awards held at 31 December 2012	Performance period	Earliest vesting date	Latest exercise date
Christopher Hyman	84,500	12 Nov 2007	456	–	556	84,500	1 Jan 2008– 31 Dec 2010	31 Dec 2010	11 Nov 2017
Andrew Jenner	52,058	12 Nov 2007	456	–	556	52,058	1 Jan 2008– 31 Dec 2010	31 Dec 2010	11 Nov 2017

Notes:

- Awards take the form of nominal cost options.
- Awards made are calculated at 100% of salary at the time of grant.
- 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.
- No awards were granted, exercised or lapsed during the period.
- The last award under the LTIP was made in November 2007.

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 2012 were as follows:

	Awards held at 1 January 2012	Exercised during the period	Awards held at 31 December 2012	Market price on exercise date (p)	Exercise price (p)	Date from which exercisable	Date of expiry of options
Christopher Hyman	116,373*	116,373	–	520	264	3 May 2005	2 May 2012
	289,515*	–	289,515	–	153	6 May 2006	5 May 2013
	219,320*	–	219,320	–	217	3 Mar 2007	2 Mar 2014
	183,404	–	183,404	–	235	29 Apr 2008	28 Apr 2015
	147,492	–	147,492	–	339	5 May 2009	4 May 2016
	120,798	–	120,798	–	439	19 Mar 2010	18 Mar 2017
	123,076	–	123,076	–	455	27 Feb 2011	26 Feb 2018
Andrew Jenner	69,824*	69,824	–	520	264	3 May 2005	2 May 2012
	173,709*	–	173,709	–	153	6 May 2006	5 May 2013
	133,178*	–	133,178	–	217	3 Mar 2007	2 Mar 2014
	116,885	–	116,885	–	235	29 Apr 2008	28 Apr 2015
	88,495	–	88,495	–	339	5 May 2009	4 May 2016
	74,530	–	74,530	–	439	19 Mar 2010	18 Mar 2017
	75,824	–	75,824	–	455	27 Feb 2011	26 Feb 2018

Notes:

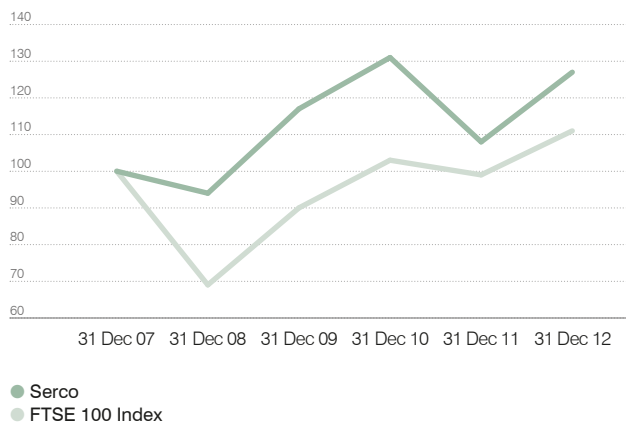
- The final award to Executive Directors under this plan was made in February 2008.
- The awards shown in the table are the maximum number of shares that can vest under the performance conditions.
- The extent to which an award will vest is measured by reference to the Group's Earnings Per Share (EPS) 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.
- For those options marked with an (*) approximately 14.67% of the options granted under the Plan represent supplementary options, granted for the sole purpose of compensating participants for agreeing to bear the Company's liability to employers' National Insurance Contributions upon the exercise of the underlying Plan awards. These options can only be exercised in conjunction with and to the extent of the underlying option.
- No payment was made for the grant of the awards.
- Grants of options under the EOP are calculated at 100% of salary at the time of grant.
- The market price of the Company's ordinary shares at the close of business on 31 December 2012 was 535p and the range during the year to 31 December 2012 was 483.2p to 602p.
- No grants were made during the year.
- The aggregate of the total theoretical gains on options exercised by Directors during 2012 amounted to £0.5 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. Of the 186,197 options exercised, 148,303 were sold and 37,894 were retained.

Remuneration Report

Five-year total shareholder returns

The chart shows the value, as at 31 December 2012, of a £100 investment in Serco share on 31 December 2007, compared with £100 invested in the FTSE 100 on the same date. 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.

Total shareholder returns (£)



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 is 10% in any rolling ten year period and in respect of discretionary share plans is 5% in any rolling ten-year period. Based on the Company's issued share capital at 31 December 2012, our dilution level was 6.67% against all share plans and 4.38% against discretionary share plans.

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 July 2012 a loan of £16 million was made to the Employee Trust in order to finance the purchase of shares to satisfy the ongoing liabilities under the Company's employee share plans.

The Trust held 8,267,992 and 10,174,594 ordinary shares at 1 January 2012 and 31 December 2012 respectively.

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

John Hickey
Secretary
4 March 2013

Independent Auditor's Report

We have audited the Group Financial Statements of Serco Group plc for the year ended 31 December 2012 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 40. 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 2012 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:

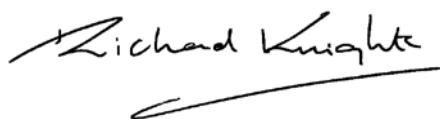
- certain disclosures of Directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

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 2012 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
4 March 2013

Consolidated Income Statement

For the year ended 31 December

	Note	2012			2011 £m
		Before exceptional items £m	Exceptional items £m	Total £m	
Continuing operations					
Revenue	4	4,913.0	–	4,913.0	4,646.4
Cost of sales		(4,169.5)	–	(4,169.5)	(3,946.0)
Gross profit		743.5	–	743.5	700.4
Administrative expenses		(428.7)	–	(428.7)	(410.3)
Adjusted operating profit		314.8	–	314.8	290.1
Other expenses – amortisation of intangibles arising on acquisition		(24.1)	–	(24.1)	(20.0)
Other expenses – acquisition-related costs		(3.7)	–	(3.7)	(3.9)
Exceptional net profit on disposal of subsidiaries and operations	18	–	5.6	5.6	–
Exceptional donation to Serco Foundation	8	–	(5.0)	(5.0)	–
Operating profit		287.0	0.6	287.6	266.2
Investment revenue	9	12.4	–	12.4	12.2
Exceptional other gain	10	–	51.1	51.1	–
Finance costs	11	(49.1)	–	(49.1)	(40.1)
Profit before tax		250.3	51.7	302.0	238.3
Tax	12	(62.6)	6.5	(56.1)	(63.1)
Profit for the year		187.7	58.2	245.9	175.2
Attributable to:					
Equity owners of the Company		187.1	58.2	245.3	175.1
Non-controlling interest		0.6	–	0.6	0.1
Earnings per share (EPS)					
Basic EPS	14	38.09p	11.85p	49.94p	35.70p
Diluted EPS	14	37.21p	11.57p	48.78p	35.08p

Adjusted operating profit is stated before net profit on disposals of subsidiaries and operations, the exceptional donation to the Serco Foundation, amortisation of intangibles arising on acquisitions and acquisition-related costs.

Consolidated Statement of Comprehensive Income

For the year ended 31 December

	Note	2012 £m	2011 £m
Profit for the year		245.9	175.2
Other comprehensive income for the year:			
Net actuarial loss on defined benefit pension schemes ¹	30	(201.2)	(51.0)
Actuarial gain on reimbursable rights ¹	30	110.2	116.5
Net exchange loss on translation of foreign operations ²		(17.9)	(2.2)
Fair value loss on cash flow hedges during the year ²		(5.5)	(35.7)
Tax relating to components of other comprehensive income ³	12	29.9	(5.9)
Recycling of cumulative hedging and translation reserve ²		–	0.3
Total comprehensive income for the year		161.4	197.2
Attributable to:			
Equity owners of the Company		160.8	197.1
Non-controlling interest		0.6	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 credit of £25.4m (2011: debit of £14.7m) was recorded in the retirement benefit obligations reserve and a credit of £4.5m (2011: £8.8m) 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 2011	9.9	306.7	0.1	568.5	(142.8)	58.7	(27.5)	67.7	841.3	–
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 payments	–	–	–	–	–	11.2	–	–	11.2	–
Tax credit in relation to share-based payments	–	–	–	–	–	(1.8)	–	–	(1.8)	–
Purchase of own shares for Employee Share Ownership Trust (ESOT)	–	–	–	–	–	–	(24.0)	–	(24.0)	–
At 1 January 2012	9.9	322.7	0.1	706.3	(92.0)	66.1	(48.2)	38.9	1,003.8	–
Total comprehensive income for the year	–	–	–	245.3	(65.6)	–	–	(18.9)	160.8	0.6
Shares transferred to option holders on exercise of share options	0.1	3.8	–	–	–	(3.6)	5.4	–	5.7	–
Dividends paid	–	–	–	(41.9)	–	–	–	–	(41.9)	(0.4)
Expense in relation to share-based payments	–	–	–	–	–	12.1	–	–	12.1	–
Tax charge in relation to share-based payments	–	–	–	–	–	3.1	–	–	3.1	–
Purchase of own shares for Employee Share Ownership Trust (ESOT)	–	–	–	–	–	–	(16.0)	–	(16.0)	–
Change in non-controlling interest	–	–	–	–	–	–	–	–	–	1.1
At 31 December 2012	10.0	326.5	0.1	909.7	(157.6)	77.7	(58.8)	20.0	1,127.6	1.3

Consolidated Balance Sheet

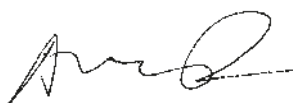
At 31 December

	Note	2012 £m	2011 £m
Non-current assets			
Goodwill	15	1,312.3	1,259.0
Other intangible assets	16	226.9	184.9
Property, plant and equipment	19	190.6	194.8
Trade and other receivables	22	260.5	261.9
Retirement benefit assets	30	69.7	122.3
Deferred tax assets	26	43.3	28.2
Derivative financial instruments	29	0.1	2.0
		2,103.4	2,053.1
Current assets			
Inventories	21	64.4	58.8
Trade and other receivables	22	856.1	798.6
Current tax assets		21.0	9.2
Cash and cash equivalents	24	198.6	254.8
Derivative financial instruments	29	3.6	7.6
		1,143.7	1,129.0
Total assets		3,247.1	3,182.1
Current liabilities			
Trade and other payables	28	(883.1)	(804.2)
Current tax liabilities		(14.0)	(17.8)
Obligations under finance leases	27	(10.8)	(10.3)
Provisions	31	(11.5)	(10.4)
Loans	25	(64.6)	(206.6)
Derivative financial instruments	29	(13.8)	(12.3)
		(997.8)	(1,061.6)
Non-current liabilities			
Trade and other payables	28	(42.5)	(61.4)
Obligations under finance leases	27	(40.0)	(35.6)
Loans	25	(665.1)	(636.2)
Derivative financial instruments	29	(24.5)	(26.3)
Retirement benefit obligations	30	(271.0)	(278.7)
Provisions	31	(46.2)	(56.2)
Deferred tax liabilities	26	(31.1)	(22.3)
		(1,120.4)	(1,116.7)
Total liabilities		(2,118.2)	(2,178.3)
Net assets		1,128.9	1,003.8
Equity			
Share capital	32	10.0	9.9
Share premium account	33	326.5	322.7
Capital redemption reserve		0.1	0.1
Retained earnings		909.7	706.3
Retirement benefit obligations reserve	34	(157.6)	(92.0)
Share-based payment reserve	34	77.7	66.1
Own shares reserve	34	(58.8)	(48.2)
Hedging and translation reserve	34	20.0	38.9
Equity attributable to owners of the Company		1,127.6	1,003.8
Non-controlling interest		1.3	–
Total equity		1,128.9	1,003.8

The financial statements were approved by the Board of Directors on 4 March 2013 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	2012 £m	2011 £m
Net cash inflow from operating activities before special pension contribution		303.4	257.0
Special contribution to defined benefit pension schemes		–	(40.0)
Net cash inflow from operating activities	35	303.4	217.0
Investing activities			
Interest received		3.1	3.4
Increase in security deposits		–	(8.2)
Proceeds from disposal of property, plant and equipment		21.0	9.2
Proceeds from disposal of intangible assets		0.1	–
Proceeds on disposal of subsidiaries and operations	18	131.0	–
Acquisition of subsidiaries, net of cash acquired (excluding acquisition-related costs)	17	(141.8)	(325.3)
Purchase of other intangible assets		(49.9)	(35.2)
Purchase of property, plant and equipment		(52.7)	(49.7)
Net cash outflow from investing activities		(89.2)	(405.8)
Financing activities			
Interest paid		(47.4)	(35.8)
Dividends paid	13	(41.9)	(37.3)
Non-controlling interest dividends paid		(0.4)	(0.1)
Cash inflow from matured derivative financial instruments		–	4.9
Repayment of loans		(366.6)	(559.8)
Repayment of non recourse loans		(8.7)	(7.9)
New loan advances		216.8	818.4
Capital element of finance lease repayments		(2.9)	(10.7)
Purchase of own shares for Employee Share Ownership Trust (ESOT)		(16.0)	(24.0)
Proceeds from issue of share capital and exercise of share options		5.7	17.3
Net cash (outflow)/inflow from financing activities		(261.4)	165.0
Net decrease in cash and cash equivalents		(47.2)	(23.8)
Cash and cash equivalents at beginning of year		254.8	279.3
Net exchange loss		(9.0)	(0.7)
Cash and cash equivalents at end of year	24	198.6	254.8

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 116 to 176 have been prepared in accordance with International Financial Reporting Standards (IFRSs) adopted for use in the European Union and therefore the Group financial statements comply with Article 4 of the EU IAS regulation.

The financial statements have been prepared on the historical cost basis, except for the revaluation of financial instruments. 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.

IFRS 1 (amended) Severe Hyperinflation and Removal of Fixed Dates for First-time Adopters

The amendments provide guidance for entities preparing financial statements in accordance with IFRS after a period when their functional currency was subject to severe hyperinflation. They also remove references to a fixed transition date to eliminate the need for companies adopting IFRSs for the first time after 1 January 2004 to restate derecognition transactions that occurred before the date of transition to IFRSs.

IFRS 7 (amended) Disclosures – Transfers of Financial Assets

These amendments are intended to provide greater transparency around risk exposures of transactions where a financial asset is transferred but the transferor retains some level of continuing exposure (referred to as 'continuing involvement') in the asset.

IAS 12 (amended) Deferred Tax: Recovery of Underlying Assets

The amendment provides a practical solution to the problem by introducing a presumption that recovery of the carrying amount will normally be through sale.

IAS 1 (amended) Presentation of Items in Other Comprehensive Income

This amendment increases the required level of disclosure within the statement of comprehensive income.

Improvements to IFRSs 2011

Aside from those items already identified above, the amendments made to standards under the 2011 improvements of IFRS have had no impact on the Group.

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) 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 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.

2. Significant accounting policies (continued)

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.

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 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.

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.

Notes to the Consolidated Financial Statements

2. Significant accounting policies (continued)

Property, plant and equipment

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

Depreciation is provided on a straight-line basis at rates 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.

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 cash-generating units 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, VAT 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.

Notes to the Consolidated Financial Statements

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 assets. 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 (SOI).

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

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

Borrowing costs

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

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

2. Significant accounting policies (continued)

Retirement benefit costs

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

For defined benefit pension schemes, the cost of providing benefits is determined using the projected unit credit 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.

Notes to the Consolidated Financial Statements

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 at the balance sheet date. Deferred tax is charged or credited in the income statement, except where it relates to items charged or credited directly to equity, in which case the deferred tax is also recognised in equity.

Deferred tax assets and liabilities are offset when there is a 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 37. 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 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 uncollectible, it is written off against the allowance for doubtful debts. Subsequent recoveries of amounts previously written off are credited against administrative expenses.

Cash and cash equivalents

Cash and cash equivalents comprise cash in hand and balances with banks and similar institutions, which are readily convertible to known amounts of cash and which are subject to insignificant changes in value and have a maturity of three months or less 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.

2. Significant accounting policies (continued)

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 29.

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 these 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 29.

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.

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 reclassified 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.

Notes to the Consolidated Financial Statements

2. Significant accounting policies (continued)

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) Government loans
- IFRS 7 (amended) Disclosures – Offsetting Financial Assets and Financial Liabilities
- 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 19 (revised) Employee Benefits
- IAS 27 (revised) Separate Financial Statements
- IAS 28 (revised) Investments in Associates and Joint Ventures
- IAS 32 (amended) Offsetting Financial Assets and Financial Liabilities
- Mandatory Effective Date and Transition Disclosures (Amendments to IFRS 9 and IFRS 7)
- Annual Improvements 2009–2011.

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. A restatement of the 2012 results for these changes reduces statutory reported revenue by £852.9m and profit before tax by £15.1m. There is no impact on post tax profits, earnings per share, or net assets from this change;
- 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 plan 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.

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 to which goodwill has been allocated. The value in use calculation involves an estimation of the future cash flows of cash-generating units and also the selection of appropriate discount rates, which involves judgement, to calculate present values (see note 15). The carrying value of goodwill is £1,312.3m (2011: £1,259.0m) 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 30). The value of net retirement benefit obligations at the balance sheet date is £201.3m (2011: £156.4m). Details of the impact of changes in assumptions relating to retirement benefit obligations are disclosed in the Finance Review (page 58).

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 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:

	2012 £m	2011 £m
Rendering of services	4,823.0	4,481.3
Revenue from long-term project-based contracts	90.0	165.1
Revenue as disclosed in the consolidated income statement	4,913.0	4,646.4
Investment revenue (note 9)	12.4	12.2
Operating lease income	0.9	0.7
Total revenue as defined in IAS 18	4,926.3	4,659.3

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. From 1 April 2012, the Group has reapportioned its business into four segments resulting in a restatement of the 2011 segmental information. The Group's reportable operating segments under IFRS 8 Operating Segments are:

Reportable Segments	Operating Segments
UK & Europe	UK and Europe frontline services in areas including home affairs, defence, health, transportation and local government direct services;
Americas	US defence, intelligence and federal civilian agencies operations, and Canadian operations;
AMEAA	Frontline contracts in Australasia, Middle East, Asia (including Hong Kong and India) and Africa; and
Global Services	Global BPO middle and back office services

The accounting policies of the reportable segments are the same as the Group's accounting policies described in note 2.

Notes to the Consolidated Financial Statements

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 2012.

Reportable segments

Year ended 31 December 2012	UK & Europe 2012 £m	Americas 2012 £m	AMEEA 2012 £m	Global Services 2012 £m	Total 2012 £m
Revenue	2,561.1	753.4	883.0	715.5	4,913.0
Result					
Segment Adjusted operating profit	177.8	55.2	64.3	62.1	359.4
Amortisation of intangibles arising on acquisition	(0.4)	(13.7)	(0.3)	(9.7)	(24.1)
Acquisition-related costs	(0.1)	–	(1.8)	(1.8)	(3.7)
Exceptional net profit on disposal of subsidiaries and operations	31.0	–	–	(25.4)	5.6
Segment result	208.3	41.5	62.2	25.2	337.2
Exceptional donation to Serco Foundation					(5.0)
Corporate expenses					(44.6)
Operating profit					287.6
Investment revenue					12.4
Exceptional other gain					51.1
Finance costs					(49.1)
Profit before tax					302.0
Tax					(56.1)
Profit for the year					245.9
Goodwill and capital expenditure*					
Goodwill additions	1.3	–	94.5	66.8	162.6
Property, plant and equipment: segments	19.8	0.8	20.9	19.7	61.2
Property, plant and equipment: corporate					1.9
Total					63.1
Intangible assets: segments	2.4	1.8	40.2	42.0	86.4
Intangible assets: corporate					9.3
Total					95.7
Depreciation and amortisation					
Depreciation: segments	23.2	2.9	7.6	17.7	51.4
Depreciation: corporate					–
Total					51.4
Amortisation of intangibles arising on acquisition: segments	0.4	13.7	0.3	9.7	24.1
Amortisation – other: segments	3.8	0.8	2.0	11.8	18.4
Amortisation – other: corporate					3.2
Total					45.7
Segment assets					
Reportable segment assets	980.1	604.3	476.3	844.9	2,905.6
Corporate assets					74.9
Total segment assets					2,980.5
Unallocated assets					266.6
Consolidated total assets					3,247.1
Segment liabilities					
Reportable segment liabilities	(656.6)	(93.7)	(160.7)	(256.3)	(1,167.3)
Corporate liabilities					(29.3)
Total segment liabilities					(1,196.6)
Unallocated liabilities					(921.6)
Consolidated total liabilities					(2,118.2)

*Capital expenditure is stated on a cash basis: including acquisitions but excluding finance leases.

Group Adjusted operating profit is £314.8m and comprises segment Adjusted operating profit of £359.4m less Corporate expenses of £44.6m.

5. Segmental information (continued)

Reportable segments

Year ended 31 December 2011 – restated	UK & Europe 2011 £m	Americas 2011 £m	AMEAA 2011 £m	Global Services 2011 £m	Total 2011 £m
Revenue	2,595.2	868.2	672.1	510.9	4,646.4
Result					
Segment Adjusted operating profit	177.6	73.0	51.4	34.0	336.0
Amortisation of intangibles arising on acquisition	(0.2)	(13.6)	–	(6.2)	(20.0)
Acquisition-related costs	(0.2)	–	–	(3.7)	(3.9)
Segment result	177.2	59.4	51.4	24.1	312.1
Corporate expenses					(45.9)
Operating profit					266.2
Investment revenue					12.2
Finance costs					(40.1)
Profit before tax					238.3
Tax					(63.1)
Profit for the year					175.2
Goodwill and capital expenditure*					
Goodwill additions	13.0	–	16.1	328.7	357.8
Property, plant and equipment: segments	23.4	0.6	14.2	47.5	85.7
Property, plant and equipment: corporate					3.1
					88.8
Intangible assets: segments	2.6	1.6	1.1	57.4	62.7
Intangible assets: corporate					23.8
Total					86.5
Depreciation and amortisation					
Depreciation: segments	19.8	3.4	7.7	15.1	46.0
Depreciation: corporate					–
Total					46.0
Amortisation of intangibles arising on acquisition: segments	0.2	13.6	–	6.2	20.0
Amortisation – other: segments	6.1	1.0	1.7	0.8	9.6
Amortisation – other: corporate					9.9
Total					39.5
Segment assets					
Reportable segment assets	1,126.6	660.7	298.0	652.5	2,737.8
Corporate assets					142.5
Total segment assets					2,880.3
Unallocated assets					301.8
Consolidated total assets					3,182.1
Segment liabilities					
Reportable segment liabilities	(658.8)	(103.9)	(128.1)	(199.5)	(1,090.3)
Corporate liabilities					(54.0)
Total segment liabilities					(1,144.3)
Unallocated liabilities					(1,034.0)
Consolidated total liabilities					(2,178.3)

*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 £336.0m less Corporate expenses of £45.9m.

Notes to the Consolidated Financial Statements

5. Segmental information (continued)

	2012 £m	2011 £m
Segment assets comprise:		
Goodwill	1,312.3	1,259.0
Other intangible assets	226.9	184.9
Property, plant and equipment	190.6	194.8
Trade and other receivables – non-current	260.5	261.9
Retirement benefit assets	69.7	122.3
Inventories	64.4	58.8
Trade and other receivables – current	856.1	798.6
Total segment assets	2,980.5	2,880.3
Unallocated assets	266.6	301.8
Consolidated total assets	3,247.1	3,182.1

	2012 £m	2011 £m
Segment liabilities comprise:		
Trade and other payables – current	(883.1)	(804.2)
Trade and other payables – non-current	(42.5)	(61.4)
Retirement benefit obligations	(271.0)	(278.7)
Total segment liabilities	(1,196.6)	(1,144.3)
Unallocated liabilities	(921.6)	(1,034.0)
Consolidated total liabilities	(2,118.2)	(2,178.3)

Geographic information

	Revenue 2012 £m	Non-current assets* 2012 £m	Restated	
			Revenue 2011 £m	Non-current assets* 2011 £m
United Kingdom	2,731.4	1,012.0	2,587.3	1,008.8
United States	694.4	437.4	802.1	460.8
Australia	824.8	189.4	660.4	61.5
Other countries	662.4	421.2	596.6	491.8
Total	4,913.0	2,060.0	4,646.4	2,022.9

*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 £2,589.1m (2011: £2,470.2m) across UK & Europe and Global Services and £649.7m (2011: £740.2m) within the Americas segment.

6. Operating profit

Operating profit is stated after charging/(crediting):

	2012 £m	2011 £m
Research and development costs	61.8	57.6
(Profit)/loss on disposal of property, plant and equipment	(0.9)	0.5
Depreciation and impairment of property, plant and equipment (note 19)	51.4	46.0
Amortisation of intangible assets – arising on acquisition (note 16)	24.1	20.0
Amortisation of intangible assets – other (note 16)	21.6	19.5
Staff costs (note 7)	2,125.5	2,010.9
Allowance for doubtful debts (credited)/charged to income statement (note 22)	(0.8)	7.2
Net foreign exchange (credit)/charge	(7.5)	7.7
Movement on non-designated hedges and reclassified cash flow hedges	7.1	(6.6)
Operating lease payments	137.0	130.0
Operating lease income (note 4)	(0.9)	(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.

	2012 £m	2011 £m
Fees payable to the Company's Auditor for the audit of the Company's annual accounts	0.9	0.8
Fees payable to the Company's Auditor and their associates for other services to the Group: – audit of the Company's subsidiaries pursuant to legislation	0.9	0.6
Total audit fees	1.8	1.4
– Audit-related assurance services	0.1	0.2
– Taxation compliance services	0.3	0.2
– Other taxation advisory services	0.3	0.4
– Other services	0.4	0.4
Total non-audit fees	1.1	1.2

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 pages 89 to 90. No services were provided pursuant to contingent fee arrangements.

Notes to the Consolidated Financial Statements

7. Staff costs

The average monthly number of employees (including Executive Directors) was:

	2012 Number	2011 Restated Number
UK & Europe	28,459	28,111
Americas	8,854	9,260
AMEAA	9,987	7,912
Global Services	48,672	31,046
Unallocated	141	341
Total	96,113	76,670

Average monthly numbers of employees for joint ventures are included on a proportionately consolidated basis in the table above.

Aggregate remuneration comprised:

	2012 £m	2011 £m
Wages and salaries	1,854.6	1,731.1
Social security costs	146.3	156.3
Other pension costs (note 30)	112.5	112.3
	2,113.4	1,999.7
Share-based payment expense (note 37)	12.1	11.2
Total	2,125.5	2,010.9

8. Exceptional donation to Serco Foundation

	2012 £m	2011 £m
Exceptional donation to Serco Foundation	5.0	–

To mark Serco's 25th year as a publicly traded company dedicated to service excellence, we have established the Serco Foundation as an independent charitable foundation. An exceptional payment of £5.0m has been made in the year to establish the charitable foundation.

9. Investment revenue

	2012 £m	2011 £m
Interest receivable on other loans and deposits	3.2	4.0
Net interest receivable on retirement benefit obligations (note 30)	9.2	8.2
Total	12.4	12.2

10. Exceptional other gain

	2012 £m	2011 £m
Gain on step acquisition accounting of joint venture (note 17b)	51.1	–

On 16 November 2012 Serco acquired the remaining 50% equity stake in DMS, taking its equity ownership to 100%. DMS was formerly accounted for as a joint venture and following the acquisition of further shares it became a wholly owned subsidiary. In accordance with IFRS 3 (Revised 2008) Business Combinations, before accounting for the purchase of the remaining equity stake, the value of the previously held 50% shareholding was restated to fair value on the acquisition date. This resulted in an exceptional gain of £51.1m being recognised in the income statement.

11. Finance costs

	2012 £m	2011 £m
Interest payable on non recourse loans	0.9	1.0
Interest payable on obligations under finance leases	2.9	2.1
Interest payable and amortisation of capitalised financing transaction costs on other loans	43.4	35.6
Movement in discount on provisions and deferred consideration	1.9	1.4
Total	49.1	40.1

12. Tax

12 (a) Income tax recognised in the income statement

	Before exceptional items 2012 £m	Exceptional items 2012 £m	Total 2012 £m	2011 £m
Current income tax				
Current income tax expense	56.4	(5.1)	51.3	67.0
Adjustments in respect of prior years	(7.8)	–	(7.8)	(5.5)
Deferred tax				
Current year	9.3	(1.4)	7.9	3.7
Adjustments in respect of prior years	4.7	–	4.7	(2.1)
	62.6	(6.5)	56.1	63.1

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

	Before exceptional items 2012 £m	Exceptional items 2012 £m	Total 2012 £m	2011 £m
Profit before tax	250.3	51.7	302.0	238.3
Tax calculated at a rate of 24.5% (2011: 26.5%)	61.3	12.7	74.0	63.1
Expenses not deductible for tax purposes	1.6	0.7	2.3	1.5
Unrelieved tax losses	3.6	–	3.6	3.1
Effect of the use of unrecognised tax losses	–	–	–	(2.6)
Unprovided deferred tax	1.1	–	1.1	2.5
Impact of changes in statutory tax rates	1.4	–	1.4	1.9
Overseas rate differences	3.2	–	3.2	5.1
Step acquisition accounting of joint venture	–	(12.5)	(12.5)	–
Disposal of Serco GmbH	–	6.8	6.8	–
Statutory tax benefits	(6.5)	(14.2)	(20.7)	(3.9)
Adjustments in respect of prior years	(3.1)	–	(3.1)	(7.6)
Tax charge	62.6	(6.5)	56.1	63.1

Notes to the Consolidated Financial Statements

12. Tax (continued)

12 (b) Income tax recognised in the SOCI

	2012 £m	2011 £m
Current tax		
Taken to retirement benefit obligations reserve	(7.0)	(18.0)
Deferred tax		
Relating to cash flow hedges	(4.5)	(8.8)
Taken to retirement benefit obligations reserve	(18.4)	32.7
	(29.9)	5.9

The income tax expense for the year is based on the blended UK statutory rate of corporation tax for the period of 24.5% (2011: 26.5%). The impact of changes in statutory tax rates relates principally to the reduction of the UK corporation tax rate from 26% to 24% from 1 April 2012, which was enacted on 26 March 2012. In addition, the UK corporation tax rate was reduced from 24% to 23% from 1 April 2013, which was enacted on 17 July 2012. 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 reduce the main tax rate down to 21% in 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.

12 (c) Tax on items taken directly to equity

	2012 £m	2011 £m
Current tax		
Recorded in share-based payment reserve	(0.6)	(0.8)
Deferred tax		
Recorded in share-based payment reserve	(2.5)	2.6
	(3.1)	1.8

13. Dividends

	2012 £m	2011 £m
Amounts recognised as distributions to equity holders in the year:		
Final dividend for the year ended 31 December 2011 of 5.9p per share on 490.2 million ordinary shares (2011: Final dividend for the year ended 31 December 2010 of 5.15p per share on 488.5 million ordinary shares)	28.9	25.2
Interim dividend for the year ended 31 December 2012 of 2.65p per share on 488.2 million ordinary shares (2011: Interim dividend for the year ended 31 December 2011 of 2.50p per share on 486.6 million ordinary shares)	13.0	12.1
	41.9	37.3
Proposed final dividend for the year ended 31 December 2012 of 7.45p per share on 488.3 million ordinary shares (2011: 5.90p on 489.1 million ordinary shares)	36.4	28.9

The proposed final dividend for 2012 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 34).

14. 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 16) 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

	2012	2011
	Millions	Millions
Weighted average number of ordinary shares for the purpose of basic EPS	491.2	490.5
Effect of dilutive potential ordinary shares: share options	11.7	8.6
Weighted average number of ordinary shares for the purpose of diluted EPS	502.9	499.1

Earnings per share

	Earnings	Per share	Earnings	Per share
	2012	amount	2011	amount
	£m	2012	£m	2011
		Pence		Pence
Earnings for the purpose of basic EPS being net profit attributable to the equity owners of the Company	245.3	49.94	175.1	35.70
Add back:				
Exceptional profit on disposal of subsidiaries, net of tax credit of £5.3m (2011: £nil)	(10.9)	(2.22)	–	–
Exceptional donation to Serco Foundation, net of tax of £1.2m (2011: £nil)	3.8	0.77	–	–
Exceptional gain on step acquisition, net of tax of £nil (2011: £nil)	(51.1)	(10.40)	–	–
Amortisation of intangible assets arising on acquisition, net of tax of £5.4m (2011: £4.3m)	18.7	3.81	15.7	3.20
Acquisition-related costs, net of tax of £0.5m (2011: £0.5m)	3.2	0.65	3.4	0.69
Adjusted earnings	209.0	42.55	194.2	39.59
Earnings for the purpose of basic EPS	245.3	49.94	175.1	35.70
Effect of dilutive potential ordinary shares	–	(1.16)	–	(0.62)
Diluted EPS	245.3	48.78	175.1	35.08

At 31 December 2012 options over nil (2011: nil) shares were excluded from the weighted average number of shares used for calculating diluted earnings per share because their exercise price was above the average share price for the year and they were, therefore, anti-dilutive.

Notes to the Consolidated Financial Statements

15. Goodwill

	£m
At 1 January 2011	899.5
Additions	357.8
Exchange differences	1.7
At 1 January 2012	1,259.0
Additions	162.6
Disposals	(86.8)
Exchange differences	(22.5)
At 31 December 2012	1,312.3

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 four acquisitions. More details of these acquisitions are presented in the Acquisitions note (note 17).

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:

	2012 £m	2011 Restated £m
UK & Europe	280.3	367.0
Americas	393.2	411.3
AMEAA	134.3	31.3
Global Services	504.5	449.4
At 31 December	1,312.3	1,259.0

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.

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.

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.

15. Goodwill (continued)

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:

	2012 %	2011 %
UK & Europe	2.5	2.5
Americas	2.7	3.0
AMEAA	2.5–3.5	2.5–3.5
Global Services	5.0	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:

	2012 %	2011 %
UK & Europe	8.0–8.4	8.8–9.1
Americas	9.0	9.9
AMEAA	9.5	10.4
Global Services	10.5	9.1–12.2

Sensitivity analysis

Sensitivity analysis has been performed for each key assumption and, except as noted below, 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.

Across the identified CGUs an increase in the discount rate of 1% would not cause the operating assets to exceed their recoverable amount in any CGU, with the exception of the Americas CGU where a 1% increase in the discount rate would result in an impairment of £30m. Across the identified CGUs a decrease in the terminal growth rate of 1% would not cause the operating assets to exceed their recoverable amount in any CGU, with the exception of the Americas CGU where a 1% decrease in the terminal growth rate would result in an impairment of £6m.

Notes to the Consolidated Financial Statements

16. 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	
Cost					
At 1 January 2012	116.5	74.2	170.9	26.2	387.8
Arising on acquisition	44.7	–	1.1	–	45.8
Eliminated on disposal	–	–	(14.9)	–	(14.9)
Additions	–	0.7	49.2	–	49.9
Disposals	(0.4)	–	(2.5)	–	(2.9)
Reclassification from property, plant and equipment	–	0.9	6.4	–	7.3
Pension scheme franchise adjustment	–	–	–	1.9	1.9
Exchange differences	(5.7)	(1.6)	(1.6)	–	(8.9)
At 31 December 2012	155.1	74.2	208.6	28.1	466.0
Amortisation					
At 1 January 2012	42.1	61.8	79.1	19.9	202.9
Arising on acquisition	–	–	0.3	–	0.3
Eliminated on disposal	–	–	(10.3)	–	(10.3)
Charge for the year	16.6	7.5	19.6	2.0	45.7
Disposals	(0.4)	–	(2.3)	–	(2.7)
Reclassification from property, plant and equipment	(0.3)	0.5	6.3	–	6.5
Exchange differences	(1.6)	(1.6)	(0.1)	–	(3.3)
At 31 December 2012	56.4	68.2	92.6	21.9	239.1
Net book value					
At 31 December 2012	98.7	6.0	116.0	6.2	226.9

	Acquisition related		Other		Total £m
	Customer relationships £m	Licences and franchises £m	Software, IT and other development expenditure £m	Pension related intangibles £m	
Cost					
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)
At 31 December 2011	116.5	74.2	170.9	26.2	387.8
Amortisation					
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)
At 31 December 2011	42.1	61.8	79.1	19.9	202.9
Net book value					
At 31 December 2011	74.4	12.4	91.8	6.3	184.9

Included in Software, IT and other development expenditure is an amount of £9.7m (2011: £nil) in respect of leased intangibles.

Customer relationships are amortised over the average length of contracts acquired.

16. Other intangible assets (continued)

Amortisation of intangibles arising on acquisition consists of amortisation in relation to Customer relationships and Licences and franchises and totals £24.1m (2011: £20.0m).

The Group is carrying £116.0m (2011: £91.8m) in relation to Software, IT and other development expenditure which includes assets relating to the Group's SAP finance-related systems of £59.4m (2011: £57.2m). The average amortisation period of these assets has three years (2011: four years) remaining.

The Group is carrying £98.7m (2011: £74.4m) in relation to Customer relationships of which the principal component is £35.8m arising from the acquisition of Intelenet in 2011. The remaining average life of the customer relationship intangible assets is approximately seven years (2011: seven years).

The value of internally generated intangible assets as at 31 December 2012 was approximately £71.9m (2011: £58.5m).

17. Acquisitions

During the year, the Group completed the following acquisitions which have been accounted for in accordance with IFRS 3 Business Combinations (2008).

17 (a) Vertex Public Services Limited

On 11 June 2012, Serco acquired 100% of the issued share capital of Vertex Public Services Limited (Vertex), a provider of high quality business process outsourcing services to UK local and central government. The cash cost of the acquisition was £55.5m.

	Book value £m	Fair value adjustments £m	Provisional fair value £m
Net assets acquired were:			
Goodwill	23.0	(23.0)	–
Intangible assets	3.7	3.7	7.4
Property, plant and equipment	1.2	(0.6)	0.6
Deferred tax asset	–	3.8	3.8
Trade and other receivables	28.5	(0.7)	27.8
Trade and other payables	(23.3)	–	(23.3)
Retirement benefit obligations	(13.4)	–	(13.4)
Provisions	–	(4.9)	(4.9)
Net liabilities acquired	19.7	(21.7)	(2.0)
Goodwill			57.5
Total consideration			55.5
Satisfied by:			
Cash			55.5
Total consideration			55.5
Net cash outflow arising on acquisition:			
Purchase consideration			55.5

The provisional fair value of the financial assets acquired includes trade receivables with a fair value of £24.3m and a gross contractual value of £24.4m.

The goodwill of £57.5m 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.

£1.0m of acquisition-related costs incurred on the Vertex acquisition have been expensed to the income statement.

Vertex Public Services Limited contributed £64.0m to revenue and £8.4m to the Group's Adjusted operating profit for the period between the date of acquisition and the balance sheet date. If the acquisition of Vertex Public Services Limited had been completed on the first day of the financial year, Group Revenue for the period would have been £5,041.0m and the Group's Adjusted operating profit would have been £331.6m.

Notes to the Consolidated Financial Statements

17. Acquisitions (continued)

17 (b) DMS Maritime Pty Limited

On 16 November 2012, Serco acquired the remaining 50% stake in DMS Maritime Pty Limited from our joint venture partner P&O Maritime Services. The transaction strengthens Serco's position as a leading defence services provider in Australia and in the growing marine services market. The cash cost of the acquisition was £69.1m (A\$106.3m). DMS was formerly accounted for as a joint venture and following the acquisition of further shares it became a wholly owned subsidiary. In accordance with IFRS 3 (Revised) the difference between the fair value of the equity owned prior to the acquisition of £55.3m and the book value of the joint venture of £4.2m was recognised in the consolidated income statement, with the gain of £51.1m reported in the exceptional other gain line.

	Book value £m	Fair value adjustments £m	Provisional fair value £m
Net assets acquired were:			
Intangible assets	–	32.7	32.7
Property, plant and equipment	4.8	–	4.8
Inventories	5.5	–	5.5
Trade and other receivables	10.0	–	10.0
Loans	(14.8)	–	(14.8)
Bank overdrafts	(0.4)	–	(0.4)
Deferred tax liability	(0.5)	(9.8)	(10.3)
Provisions	(0.4)	–	(0.4)
Net assets acquired	4.2	22.9	27.1
Gain on remeasurement to fair value			(51.1)
Goodwill			93.1
Total consideration			69.1
Satisfied by:			
Cash			69.1
Total consideration			69.1
Net cash outflow arising on acquisition:			
Purchase consideration			69.1

The provisional fair value of the financial assets acquired includes trade receivables with a fair value of £5.9m and a gross contractual value of £6.0m.

The goodwill of £93.1m arising from the acquisition represents future opportunities in the Australian marine services industry. None of the goodwill is expected to be deductible for corporate income tax purposes.

£1.8m of acquisition-related costs incurred on the above acquisitions have been expensed to the income statement.

The additional stake in DMS Maritime Pty Limited contributed £5.9m to revenue and £1.5m to the Group's Adjusted operating profit for the period between the date of acquisition and the balance sheet date. If the acquisition of DMS Maritime Pty Limited had been completed on the first day of the financial year, Group revenue for the period would have been £4,948.8m and the Group's Adjusted operating profit would have been £321.3m.

17. Acquisitions (continued)

17 (c) Other Acquisitions

Anglia Support Partnership

On 13 April 2012, Serco entered into an agreement to acquire the trade and assets of Anglia Support Partnership (ASP). ASP provides support services to the Cambridge and Peterborough NHS Foundation Trust, together with a further five partnering NHS organisations. The initial cash cost of the business combination was £5.2m. In addition, £3.5m of deferred consideration was paid on 30 September 2012. Up to a further £7.2m of deferred consideration is payable from 2013 to 2020, contingent on the financial performance of the acquired business. The fair value of this deferred contingent consideration is £3.3m. The provisional fair value of net assets acquired totalled £4.0m. £0.8m of acquisition-related costs incurred on this acquisition have been expensed to the income statement.

Due to the immaterial nature of this acquisition, full disclosures under IFRS 3 are not presented.

Priority Properties North West Limited

On 1 June 2012, Serco acquired 100% of the issued share capital of Priority Properties North West Limited (PPNW). PPNW is a property management company specialising in the provision of short and long term housing. The cash cost of the acquisition in the period was £2.7m. In addition, deferred consideration of up to £1.1m is payable contingent on financial performance in the period to 31 January 2013. The fair value of this deferred, contingent consideration is £0.5m. The provisional fair value of net assets acquired totalled £1.8m.

£0.1m of acquisition-related costs incurred on this acquisition have been expensed to the income statement.

Due to the immaterial nature of this acquisition, full disclosures under IFRS 3 are not presented.

Other acquisitions (in aggregate):

	Book value £m	Fair value adjustments £m	Provisional fair value £m
Net assets acquired were:			
Intangible assets	4.3	–	4.3
Property, plant and equipment	1.2	(0.6)	0.6
Trade and other receivables	2.1	–	2.1
Cash and cash equivalents	0.8	–	0.8
Trade and other payables	(1.2)	–	(1.2)
Tax liabilities	(0.1)	–	(0.1)
Provisions	–	(0.7)	(0.7)
Net assets acquired	7.1	(1.3)	5.8
Goodwill			9.4
Total consideration			15.2
Satisfied by:			
Cash			11.4
Contingent consideration arrangement			3.8
Total consideration			15.2
Net cash outflow arising on acquisitions:			
Purchase consideration			11.4
Cash and cash equivalents acquired			(0.8)
Net cash outflow arising on acquisitions			10.6

Serco Listening Company Limited (formerly The Listening Company Limited)

During the year, a cash payment of £6.6m was made in respect of deferred contingent consideration payable following the acquisition of The Listening Company Limited in 2011.

Notes to the Consolidated Financial Statements

18. Disposals

During the year, the Group generated the following net profit on disposal of subsidiaries and operations:

	2012 £m	2011 £m
Gain on disposal of Serco Technical Services	57.6	–
Loss on disposal of Serco GmbH	(27.7)	–
Loss on disposal of UK data hosting operations	(11.5)	–
Loss on disposal of education software business	(12.8)	–
Net profit on disposal of subsidiaries and operations	5.6	–

18 (a) Serco Technical Services

On 29 June 2012, the Group disposed of its Technical Services business which provides consulting and project solutions primarily to the UK civil and nuclear defence markets, for a consideration of £135.3m.

	£m
The net assets at the date of disposal were:	
Goodwill	64.4
Intangible assets	0.8
Property, plant and equipment	1.6
Trade and other receivables	13.2
Cash and cash equivalents	0.6
Trade and other payables	(5.1)
Deferred tax liabilities	(5.2)
Net assets disposed	70.3

	£m
The profit on disposal is calculated as follows:	
Cash consideration	135.3
Less:	
Net assets disposed	(70.3)
Disposal-related costs	(7.4)
Profit on disposal	57.6

	£m
The net cash inflow arising on disposal is as follows:	
Consideration received	135.3
Less:	
Cash and cash equivalents disposed	(0.6)
Disposal-related costs paid during the period	(4.9)
Net cash inflow on disposal	129.8

18 (b) Serco GmbH

On 29 June 2012, the Group disposed of its interest in Serco GmbH. The fair value of consideration receivable is £nil. The business provides support services for the German air defence radar systems, engineering and administrative support services for the defence sector as well as training services, facilities management, field installation and maintenance services, and IT consulting and related services.

	£m
The net assets at the date of disposal were:	
Goodwill	22.0
Intangible assets	1.2
Property, plant and equipment	6.0
Deferred tax asset	5.2
Trade and other receivables	21.4
Loans receivable	25.9
Cash and cash equivalents	0.6
Trade and other payables	(8.6)
Bank overdrafts	(1.3)
Retirement benefit obligations	(50.5)
Provisions	(0.1)
Net assets disposed	21.8

18. Disposals (continued)

18 (b) Serco GmbH (continued)

	£m
The loss on disposal is calculated as follows:	
Net assets disposed	(21.8)
Disposal-related costs	(5.9)
Loss on disposal	(27.7)

	£m
The net cash outflow arising on disposal is as follows:	
Cash and cash equivalents disposed	(0.6)
Disposal-related costs paid during the period	(2.9)
Net cash outflow on disposal	(3.5)

18 (c) Other disposals

On 21 December 2012, the Group agreed to dispose of its UK data hosting operations. There was £nil cash consideration and the net assets disposed amounted to £7.8m, giving a loss of £11.5m, after accounting for disposal costs of £3.7m.

On 31 December 2012, the Group disposed of its education software business. There was £6.3m of consideration received and the net assets disposed amounted to £17.7m, giving a loss of £12.8m, after accounting for disposal costs of £1.4m.

	£m
The net assets at the date of disposal were:	
Goodwill	0.4
Intangible assets	2.6
Property, plant and equipment	11.4
Trade and other receivables	19.1
Cash and cash equivalents	0.2
Trade and other payables	(1.9)
Finance lease obligations	(6.2)
Other loans	(0.1)
Net assets disposed	25.5

	£m
The loss on disposal is calculated as follows:	
Cash consideration	6.3
Less:	
Net assets disposed	(25.5)
Disposal-related costs	(5.1)
Loss on disposal	(24.3)

	£m
The net cash inflow arising on disposal is as follows:	
Consideration received	6.3
Less:	
Cash and cash equivalents disposed	(0.2)
Disposal-related costs paid during the period	(1.4)
Net cash inflow on disposal	4.7

Notes to the Consolidated Financial Statements

19. Property, plant and equipment

	Freehold land and buildings £m	Short-leasehold building improvements £m	Machinery, motor vehicles, furniture and equipment £m	Total £m
Cost				
At 1 January 2012	7.0	59.0	339.6	405.6
Additions	1.2	5.0	79.4	85.6
Reclassification from/(to) intangible assets	1.5	8.3	(17.1)	(7.3)
Disposals	(0.6)	(1.9)	(44.9)	(47.4)
Arising on acquisition	–	1.4	22.4	23.8
Eliminated on disposal	(4.2)	(8.2)	(42.2)	(54.6)
Exchange differences	(0.1)	(1.7)	(6.1)	(7.9)
At 31 December 2012	4.8	61.9	331.1	397.8
Accumulated depreciation and impairment				
At 1 January 2012	3.7	27.1	180.0	210.8
Charge for the year	0.3	8.8	42.3	51.4
Reclassification from/(to) intangible assets	0.2	3.4	(10.1)	(6.5)
Disposals	(0.1)	(1.1)	(26.1)	(27.3)
Arising on acquisition	–	1.3	16.5	17.8
Eliminated on disposal	(2.2)	(5.3)	(27.5)	(35.0)
Exchange differences	–	(0.8)	(3.2)	(4.0)
At 31 December 2012	1.9	33.4	171.9	207.2
Net book value				
At 31 December 2012	2.9	28.5	159.2	190.6

	Freehold land and buildings £m	Short-leasehold building improvements £m	Machinery, motor vehicles, furniture and equipment £m	Total £m
Cost				
At 1 January 2011	7.2	50.8	297.7	355.7
Additions	–	7.1	72.2	79.3
Reclassifications from intangible assets	–	–	0.2	0.2
Disposals	–	(5.4)	(59.6)	(65.0)
Arising on acquisition	–	7.2	32.9	40.1
Exchange differences	(0.2)	(0.7)	(3.8)	(4.7)
At 31 December 2011	7.0	59.0	339.6	405.6
Accumulated depreciation and impairment				
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)
At 31 December 2011	3.7	27.1	180.0	210.8
Net book value				
At 31 December 2011	3.3	31.9	159.6	194.8

The carrying amount of the Group's Machinery, motor vehicles, furniture and equipment includes an amount of £42.6m (2011: £45.6m) in respect of assets held under finance leases.

The carrying amount of the Group's Short-leasehold building improvements includes an amount of £0.5m (2011: £1.4m) in respect of assets held under finance leases.

20. 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

	2012 £m	2011 £m
Revenue	852.9	819.3
Expenses	(775.5)	(737.7)
Operating profit	77.4	81.6
Investment revenue	2.7	2.7
Finance costs	(0.5)	(0.7)
Profit before tax	79.6	83.6
Tax	(15.1)	(20.0)
Share of post-tax results of joint ventures	64.5	63.6

Operating profit is after allocating £nil (2011: £1.0m) of costs incurred by Group.

Balance sheet

	2012 £m	2011 £m
Non-current assets	237.9	218.4
Current assets	146.0	171.6
Current liabilities	(134.4)	(138.9)
Non-current liabilities	(238.9)	(212.5)
Net assets	10.6	38.6

21. Inventories

	2012 £m	2011 £m
Service spares	37.6	32.1
Parts awaiting installation	13.1	10.4
Long-term project-based contract balances	13.7	16.3
	64.4	58.8

Notes to the Consolidated Financial Statements

22. Trade and other receivables

	2012 £m	2011 £m
Trade and other receivables: non-current		
Amounts owed by joint venturers	6.6	5.9
Amounts recoverable on retirement benefit obligations (note 30a)	214.7	188.7
Loans receivable (note 25)	0.1	–
Security deposits	0.3	9.3
Other receivables	38.8	58.0
	260.5	261.9

	2012 £m	2011 £m
Trade and other receivables: current		
Trade receivables	628.8	609.0
Other amounts recoverable on contracts	69.9	62.0
Prepayments and accrued income	77.4	87.4
Loans receivable (note 25)	1.1	–
Security deposits	7.8	–
Other receivables	71.1	40.2
	856.1	798.6

As at 31 December 2012, trade receivables of £14.0m (2011: £2.9m) 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 £6.2m as of 31 December 2012 (2011: £7.2m) 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:

	2012 £m	2011 £m
Neither impaired nor past due	481.9	496.8
Not impaired but overdue by less than 30 days	85.5	83.7
Not impaired but overdue by between 30 and 60 days	30.9	15.5
Not impaired but overdue by more than 60 days	22.7	17.3
Impaired	14.0	2.9
Allowance for doubtful debts	(6.2)	(7.2)
	628.8	609.0

Movements on the Group allowance for doubtful debts are as follows:

	2012 £m	2011 £m
At 1 January	7.2	4.2
(Credited)/charged to income statement	(0.8)	7.2
Utilised	0.1	(4.2)
Exchange differences	(0.3)	–
At 31 December	6.2	7.2

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.

23. Long-term contracts

	2012 £m	2011 £m
Contracts in progress at the balance sheet date:		
Amounts due from long-term project-based contract customers included in trade and other receivables	24.0	39.4
Amounts due to long-term project-based contract customers included in trade and other payables	(0.9)	(0.5)
	23.1	38.9
Long-term project-based contract costs incurred plus recognised profits less recognised losses to date	685.2	872.2
Less: progress payments	(662.1)	(833.3)
	23.1	38.9

As at 31 December 2012, £nil (2011: £nil) of advances received from customers were included within long-term project-based contract balances. As at 31 December 2012, the Group had £1.3m (2011: £0.4m) of contract retentions held by customers.

24. Cash and cash equivalents

	Sterling 2012 £m	Other currencies 2012 £m	Total 2012 £m	Sterling 2011 £m	Other currencies 2011 £m	Total 2011 £m
Customer advance payments*	–	7.5	7.5	–	5.5	5.5
Other cash and short-term deposits	86.3	104.8	191.1	89.6	159.7	249.3
Total cash and cash equivalents	86.3	112.3	198.6	89.6	165.2	254.8

*Customer advance payments totalling £7.5m (2011: £5.5m) 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.

Notes to the Consolidated Financial Statements

25. Loans

	Non recourse loans 2012 £m	Other loans 2012 £m	Total 2012 £m	Non recourse loans 2011 £m	Other loans 2011 £m	Total 2011 £m
Loans are repayable as follows:						
On demand or within one year	10.0	53.5	63.5	7.8	198.8	206.6
Between one and two years	2.4	37.9	40.3	7.7	147.2	154.9
Between two and five years	7.3	212.2	219.5	–	104.5	104.5
After five years	5.4	399.8	405.2	–	376.8	376.8
	25.1	703.4	728.5	15.5	827.3	842.8
Less: amount due for settlement within one year (shown within current liabilities)	(10.0)	(54.6)	(64.6)	(7.8)	(198.8)	(206.6)
Less: Amounts shown in receivables (note 22)	–	1.2	1.2	–	–	–
Amount due for settlement after one year	15.1	650.0	665.1	7.7	628.5	636.2

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

	Carrying amount 2012 £m	Fair value 2012 £m	Carrying amount 2011 £m	Fair value 2011 £m
Non recourse loans	25.1	26.6	15.5	16.1
Other loans	703.4	723.5	827.3	848.9
	728.5	750.1	842.8	865.0

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.

26. 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:

	2012 £m	2011 £m
At 1 January – asset	(5.9)	(23.5)
Income statement charge (note 12)	12.6	1.6
Acquisitions/disposals	6.5	(10.8)
Items recognised in equity and in other comprehensive income (note 12)	(25.4)	26.5
Exchange differences	–	0.3
At 31 December – asset	(12.2)	(5.9)

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 2012	25.6	(23.8)	18.5	(9.1)	(17.1)	(5.9)
(Credited)/charged to income statement	(3.9)	4.6	0.7	–	11.2	12.6
Acquisitions/disposals	4.0	0.1	2.0	–	0.4	6.5
Items recognised in equity and in other comprehensive income	–	(2.5)	(18.4)	(4.5)	–	(25.4)
Exchange differences	(2.3)	0.2	0.1	–	2.0	–
At 31 December 2012	23.4	(21.4)	2.9	(13.6)	(3.5)	(12.2)

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 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/disposals	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
At 31 December 2011	25.6	(23.8)	18.5	(9.1)	(17.1)	(5.9)

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

	2012 £m	2011 £m
Deferred tax liabilities	31.1	22.3
Deferred tax assets	(43.3)	(28.2)
	(12.2)	(5.9)

At the balance sheet date, the Group did not recognise deferred tax assets of £16.5m (2011: £10.2m) which principally relate to unused tax losses of £48.4m (2011: £34.9m). Losses of £11.8m (2011: £4.5m) expire within five years, losses of £24.4m (2011: £17.2m) expire within six to ten years and losses of £12.2m (2011: £13.2m) 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 £nil (2011: £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.

Notes to the Consolidated Financial Statements

27. Obligations under finance leases

	Minimum lease payments 2012 £m	Present value of minimum lease payments 2012 £m	Minimum lease payments 2011 £m	Present value of minimum lease payments 2011 £m
Amounts payable under finance leases:				
Within one year	12.0	10.8	10.9	10.3
Between one and five years	39.8	36.8	32.9	30.5
After five years	3.3	3.2	5.2	5.1
	55.1	50.8	49.0	45.9
Less: future finance charges	(4.3)	–	(3.1)	–
Present value of lease obligations	50.8	50.8	45.9	45.9
Less: amount due for settlement within one year (shown under current liabilities)	(12.0)	(10.8)	(10.9)	(10.3)
Amount due for settlement after one year	38.8	40.0	35.0	35.6

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

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

28. Trade and other payables

	2012 £m	2011 £m
Trade and other payables: Current		
Trade payables	193.9	217.7
Other payables	167.5	140.3
Accruals and deferred income	520.3	446.2
Amounts owed to joint venturers	1.4	–
	883.1	804.2

The average credit period taken for trade purchases is 26 days (2011: 31 days).

	2012 £m	2011 £m
Trade and other payables: Non-current		
Other payables	42.5	61.4

29. Financial risk management

29 (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 2012, 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 2012 £m	Fair value hierarchy – Level 2 2012 £m		Amortised Cost 2011 £m	Fair value hierarchy – Level 2 2011 £m	
Loans and receivables:						
Trade receivables (note 22)	628.8		628.8	609.0		609.0
Loan receivables (note 22)	1.2		1.2	–		–
Derivative financial assets:						
Derivative financial instruments: non-current		0.1			2.0	
Derivative financial instruments: current		3.6			7.6	
Financial liabilities at amortised cost:						
Trade payables (note 28)	(193.9)		(193.9)	(217.7)		(217.7)
Loans (note 25)	(729.7)		(751.3)	(842.8)		(865.0)
Derivative financial liabilities:						
Derivative financial instruments: current		(13.8)			(12.3)	
Derivative financial instruments: non-current		(24.5)			(26.3)	

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 fuel prices.

Notes to the Consolidated Financial Statements

29. Financial risk management (continued)

29 (a) Fair value of financial instruments (continued)

(ii) Fair value of derivative financial instruments

The fair valuation of derivative financial instruments results in a net liability of £34.6m (2011: £29.0m), comprising non-current assets of £0.1m (2011: £2.0m), current assets of £3.6m (2011: £7.6m), current liabilities of £13.8m (2011: £12.3m) and non-current liabilities of £24.5m (2011: £26.3m).

	1 January 2012 £m	Movement in fair value of cash flow hedges £m	Movement in fair value of non-designated hedges £m	31 December 2012 £m
Currency swaps	0.8	(0.9)	(0.5)	(0.6)
Forward foreign exchange contracts	(31.6)	(0.4)	(2.9)	(34.9)
Interest rate swaps	(0.6)	0.6	(0.1)	(0.1)
Commodity futures contracts	2.4	(1.4)	–	1.0
	(29.0)	(2.1)	(3.5)	(34.6)

	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)

29 (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.

29 (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 2012 millions	Drawn 2012 £m	Undrawn 2012 £m	Total facility 2012 £m
Syndicated revolving credit facility	GBP	730.0	177.6	552.4	730.0
		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
			241.3	485.4	726.7

The £730.0m syndicated revolving credit facility was signed in March 2012 and matures in March 2017. It replaced all existing syndicated and bilateral credit facilities.

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 £460.8m of which £70.2m amortise between 2013 and 2015 and £390.6m are bullet repayments between 2016 and 2023.

29. Financial risk management (continued)

29 (c) Liquidity risk (continued)

(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 28)	193.9	–	–	–	193.9
Obligations under finance leases (note 27)	12.0	12.5	27.3	3.3	55.1
Loans (note 25)	64.6	40.4	219.5	405.2	729.7
Future loan interest	21.1	18.5	62.5	38.0	140.1
Derivative financial liabilities	14.6	9.9	19.0	–	43.5
At 31 December 2012	306.2	81.3	328.3	446.5	1,162.3

	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 28)	217.7	–	–	–	217.7
Obligations under finance leases (note 27)	10.9	10.6	22.3	5.2	49.0
Loans (note 25)	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
At 31 December 2011	476.9	201.3	203.6	453.0	1,334.8

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:

	Cross currency swaps £m	Forward foreign exchange contracts £m	Interest rate swaps £m	Total £m
On demand or within one year	–	(14.6)	–	(14.6)
Between one and two years	–	(9.8)	(0.1)	(9.9)
Between two and five years	(0.7)	(18.3)	–	(19.0)
At 31 December 2012	(0.7)	(42.7)	(0.1)	(43.5)

	Cross currency swaps £m	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)
At 31 December 2011	–	(44.8)	(0.6)	(45.4)

Notes to the Consolidated Financial Statements

29. Financial risk management (continued)

29 (d) Foreign exchange risk

(i) Transactional

It is the Group's policy to hedge material transactional exposures using forward foreign exchange contracts to fix the functional currency value of non-functional currency cash flows. At 31 December 2012, there were no material unhedged non-functional currency monetary assets or liabilities, firm commitments or probable forecast transactions.

(ii) Translational

Where possible the Group will raise external funding to match the currency profile of its foreign operations, and mitigate translation exposure. If match funding is not possible then currency derivatives are also used to protect against movements in foreign exchange.

(iii) Hedge accounting

For the purposes of hedge accounting, hedges are classified as either fair value hedges, cash flow hedges or hedges of net investments in foreign operations. Page 127 details the Group's accounting policies in relation to derivatives qualifying for hedge accounting under IAS 39. The hedge accounting relationships as at 31 December 2012 were as follows:

Cash flow hedges

At 31 December 2012, the Group held two cross 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 cross 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
	2012 USD m	2012 %	2012 %	2011 USD m	2011 %	2011 %
August 2015	21.0	5.7	5.7	32.0	5.7	5.7
August 2015	12.0	5.7	5.7	18.3	5.7	5.7

The Group also held a number of forward foreign exchange contracts designated as cash flow hedges. The net notional amounts are summarised by currency below:

	2012 £m	2011 £m
Sterling	(176.3)	(235.1)
US Dollar	(47.2)	(131.0)
Euro	9.5	(0.8)
Indian Rupee	190.7	337.0
Other	–	10.0

All currency derivatives designated as cash flow hedges are highly effective and as at 31 December 2012 a fair value loss of £33.8m (2011: £35.7m loss) has been deferred in the hedging reserve. The net fair value loss recognised on cash flow hedges during the year was £2.1m (2011: £35.7m loss), whilst net losses of £10.1m were reclassified to the consolidated income statement.

(iv) Currency sensitivity

The Group's currency exposures that result in net currency gains and losses in the income statement and equity arise principally from movement in US Dollar and Indian Rupee exchange rates. At 31 December 2012, if both had weakened by 10% against Sterling, with all other variables held constant, post-tax profit for the year would have been £0.6m higher (2011: £0.2m lower) and equity would have been £2.0m higher (2011: £1.4m higher).

29. Financial risk management (continued)

29 (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 2012 £m	Fixed rate 2012 £m	Weighted average fixed interest rate 2012 %	Floating rate 2011 £m	Fixed rate 2011 £m	Weighted average fixed interest rate 2011 %
Cash and cash equivalents	198.6	–		254.8	–	

Financial liabilities

	Floating rate 2012 £m	Fixed rate 2012 £m	Weighted average fixed interest rate 2012 %	Floating rate 2011 £m	Fixed rate 2011 £m	Weighted average fixed interest rate 2011 %
Non recourse Canadian Dollar loans	–	7.5	5.27	–	15.5	5.27
Non recourse Sterling loans	–	17.6	3.64	–	–	–
Sterling loans	100.2	50.6	5.90	105.4	94.2	5.93
US Dollar loans	26.5	410.9	4.34	191.6	408.6	3.66
AU Dollar loans	79.8	–		–	–	
Other loans	36.6	–		27.5	–	
	243.1	486.6		324.5	518.3	

Exposure to interest rate fluctuations is mitigated through the issuance of fixed rate debt and the use of interest rate derivatives. Excluded from the above analysis is £50.8m (2011: £45.9m) of amounts payable under finance leases, which are subject to fixed rates of interest.

(ii) Interest rate swaps

Interest rate swaps outstanding at 31 December 2012 relate to interest rate risk management on debt held locally within the Group.

Maturity

	Notional Value 2012 USD m	Payable USD interest rate 2012 %	Receivable USD interest rate 2012 %	Receivable JPY interest rate 2012 %
March 2014	2.1	6.89	–	3 month JPY Libor + 1.0
January 2015	3.8	6.30	3 month USD Libor + 2.0	–

Maturity

	Notional Value 2011 USD m	Payable USD interest rate 2011 %	Receivable USD interest rate 2011 %	Receivable JPY interest rate 2011 %
March 2012	300.0	1.83	3 month USD LIBOR	–
December 2012	9.1	4.65	6 month USD Libor + 1.6	–
December 2012	0.9	8.56	6 month USD Libor + 6.5	–
March 2014	3.7	6.89	–	3 month JPY Libor + 1.0
January 2015	5.0	6.30	3 month USD Libor + 2.0	–

The interest rate swaps were not designated as cash flow hedges. The fair value loss of £0.1m has therefore been recorded in the income statement (2011: £2.9m gain).

(iii) Interest rate sensitivity

A 100 basis point increase in interest rates on the net financial liability position at the balance sheet date, with all other variables held constant, would have resulted in a reduction in post-tax profit for the year to 31 December 2012 of £0.4m (2011: £0.5m).

Notes to the Consolidated Financial Statements

29. Financial risk management (continued)

29 (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 2012 Million litres	Payable fixed rate 2012 p per litre
January 2013 – September 2013	29.9	44.81
September 2013 – March 2014	22.3	48.70

Maturity	Notional value 2011 Million litres	Payable fixed rate 2011 p per litre
January 2012 – September 2013	64.6	44.81

The commodity derivative is designated as a cash flow hedge and is highly effective. As at 31 December 2012 a fair value gain of £1.0m (2011: £2.4m gain) has been deferred in the hedging reserve. This gain is expected to be recognised in the consolidated income statement in future periods.

Price risk sensitivity

An increase of US Dollar 0.2 (£0.13) per litre in the price of fuel at the balance sheet date would result in a gain of £3.3m in equity (2011: £4.2m gain). The sensitivity to changes in fuel prices resulting from changes in exchange rates is included within the currency sensitivity analysis (see note 29(d)).

29 (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 principle 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 credit worthiness 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.

29 (h) Capital risk

The Group defines capital as equity, debt capital market issuance, loans and borrowings and cash and cash equivalents. 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.

30. 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 2012, including the proportionate share of joint ventures, was £112.5m (2011: £112.3m).

30 (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.

(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 plan has been presented net of the amount recognised for the reimbursement, resulting in a nil charge to the income statement.

Contract specific – Not certain costs reimbursed

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

Notes to the Consolidated Financial Statements

30. Retirement benefit schemes (continued)

30 (a) Defined benefit schemes (continued)

(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 2012 £m	Not certain costs reimbursed 2012 £m	Non contract specific 2012 £m	Total 2012 £m
Scheme assets at fair value				
Equities	82.3	248.4	58.9	389.6
Bonds except LDI	44.1	91.9	11.9	147.9
Liability driven investments (LDI)	28.3	15.9	982.6	1,026.8
Gilts	-	27.7	20.9	48.6
Property	28.4	35.8	0.4	64.6
Cash and other	100.5	85.1	58.6	244.2
Annuity policies	-	-	22.5	22.5
Fair value of scheme assets	283.6	504.8	1,155.8	1,944.2
Present value of scheme liabilities	(498.3)	(755.2)	(1,115.3)	(2,368.8)
Net amount recognised	(214.7)	(250.4)	40.5	(424.6)
Members' share of deficit	-	67.2	4.2	71.4
Franchise adjustment	-	151.0	-	151.0
Effect of IFRIC 14	-	-	0.9	0.9
Net retirement benefit (obligation)/asset	(214.7)	(32.2)	45.6	(201.3)
Analysed as:				
Retirement benefit obligations	(214.7)	(32.2)	(24.1)	(271.0)
Retirement benefit assets	-	-	69.7	69.7
Related assets				
Intangible assets (note 16)	-	6.2	-	6.2
Trade and other receivables (note 22)	214.7	-	-	214.7
	214.7	6.2	-	220.9

30. Retirement benefit schemes (continued)

30 (a) Defined benefit schemes (continued)

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
Scheme assets at fair value				
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)
Net retirement benefit (obligation)/asset	(188.7)	(26.5)	58.8	(156.4)
Analysed as:				
Retirement benefit obligations	(188.7)	(26.5)	(63.5)	(278.7)
Retirement benefit assets	–	–	122.3	122.3
Related assets				
Intangible assets (note 16)	–	6.3	–	6.3
Trade and other receivables (note 22)	188.7	–	–	188.7
	188.7	6.3	–	195.0

Liabilities in relation to unfunded schemes included above amount to £0.2m (2011: £48.4m).

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% (2011: gilts +0.8%).

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.

Notes to the Consolidated Financial Statements

30. Retirement benefit schemes (continued)

30 (a) Defined benefit schemes (continued)

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

	Virtually certain costs reimbursed 2012 £m	Not certain costs reimbursed 2012 £m	Non contract specific 2012 £m	Total 2012 £m
Recognised in the income statement				
Current service cost – employer	10.7	19.4	12.9	43.0
Past service cost	–	0.1	1.1	1.2
Curtailment gain	–	–	(6.1)	(6.1)
Reimbursed to employer	(10.7)	–	–	(10.7)
Recognised in arriving at operating profit	–	19.5	7.9	27.4
Expected return on scheme assets – employer	(16.2)	(19.8)	(52.8)	(88.8)
Interest on franchise adjustment	–	(4.5)	–	(4.5)
Interest cost on scheme liabilities – employer	20.9	21.6	46.3	88.8
Reimbursed to employer	(4.7)	–	–	(4.7)
Finance income	–	(2.7)	(6.5)	(9.2)
Included within the SOCI				
Actual return on scheme assets	24.0	35.1	38.0	97.1
Less: expected return on scheme assets	(16.2)	(26.9)	(53.9)	(97.0)
	7.8	8.2	(15.9)	0.1
Other actuarial losses	(32.3)	(89.2)	(79.8)	(201.3)
Actuarial losses recognised in the SOCI	(24.5)	(81.0)	(95.7)	(201.2)
Change in IFRIC 14	–	–	8.3	8.3
Change in franchise adjustment	–	52.9	–	52.9
Change in members' share	–	22.4	2.1	24.5
Reimbursed to employer	24.5	–	–	24.5
Actuarial gains on reimbursable rights	24.5	75.3	10.4	110.2
Total pension cost recognised in the SOCI	–	(5.7)	(85.3)	(91.0)

30. Retirement benefit schemes (continued)

30 (a) Defined benefit schemes (continued)

	Virtually certain costs reimbursed 2011 £m	Not certain costs reimbursed 2011 £m	Non contract specific 2011 £m	Total 2011 £m
Recognised in the income statement				
Current service cost – employer	8.4	16.5	15.5	40.4
Past service cost	–	–	0.4	0.4
Curtailement gain	–	–	(0.3)	(0.3)
Settlement gain	–	–	(0.2)	(0.2)
Reimbursed to employer	(8.4)	–	–	(8.4)
Recognised in arriving at operating profit	–	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)
Finance income	–	(2.7)	(5.5)	(8.2)
Included within the SOCI				
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)
Actuarial (losses)/gains recognised in the SOCI	(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
Actuarial gains/(losses) on reimbursable rights	66.9	54.9	(5.3)	116.5
Total pension (cost)/income recognised in the SOCI	–	(11.4)	76.9	65.5

Notes to the Consolidated Financial Statements

30. Retirement benefit schemes (continued)

30 (a) Defined benefit schemes (continued)

Cumulative actuarial losses recognised since 1 January 2004 are £67.5m (2011: gains of £23.5m).

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 2011	378.2	510.4	951.5	1,840.1
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 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)
At 1 January 2012	441.3	594.9	1,001.3	2,037.5
Current service cost – employer	10.7	19.4	12.9	43.0
Current service cost – employee	–	7.4	0.2	7.6
Past service costs	–	0.1	1.1	1.2
Scheme participants' contributions	4.3	0.7	0.6	5.6
Interest cost – employer	20.9	21.6	46.3	88.8
Interest cost – employee	–	7.4	0.9	8.3
Benefits paid	(11.2)	(12.1)	(38.4)	(61.7)
Actuarial losses	32.3	89.2	79.8	201.3
Plan curtailments	–	–	(6.1)	(6.1)
Arising on acquisition of a subsidiary	–	26.6	69.9	96.5
Eliminated on disposal of a subsidiary	–	–	(51.6)	(51.6)
Exchange differences	–	–	(1.6)	(1.6)
At 31 December 2012	498.3	755.2	1,115.3	2,368.8

30. Retirement benefit schemes (continued)

30 (a) Defined benefit schemes (continued)

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 2011	254.8	403.3	875.1	1,533.2
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 (losses) and gains	(27.2)	(22.5)	107.8	58.1
Plan settlements	–	–	(4.1)	(4.1)
At 1 January 2012	252.6	429.3	1,065.3	1,747.2
Expected return on scheme assets – employer	16.2	19.8	52.8	88.8
Expected return on scheme assets – employee	–	7.1	1.1	8.2
Employer contributions	13.8	23.7	29.8	67.3
Contributions by employees	4.4	7.3	0.6	12.3
Benefits paid	(11.2)	(12.1)	(38.4)	(61.7)
Actuarial gains and (losses)	7.8	8.2	(15.9)	0.1
Arising on acquisition of a subsidiary	–	21.5	61.6	83.1
Eliminated on disposal of a subsidiary	–	–	(1.1)	(1.1)
At 31 December 2012	283.6	504.8	1,155.8	1,944.2

Employer contributions for non contract specific schemes in 2012 include a £nil (2011: £40.0m) special contribution.

History of experience gains and losses

	2012	2011	2010	2009	2008
Experience adjustments arising on scheme assets:					
Amount (£m)	0.2	58.1	52.2	73.2	(263.7)
Percentage of the fair value of scheme assets	0.0%	3.3%	3.4%	5.4%	(22.1)%
Experience adjustments arising on scheme liabilities:					
Amount (£m)	24.3	5.6	4.2	(58.2)	0.1
Percentage of the present value of scheme liabilities	1.0%	0.3%	0.2%	(3.3)%	0.0%
Fair value of scheme assets (£m)	1,944.2	1,747.2	1,533.2	1,356.9	1,194.1
Present value of scheme liabilities (£m)	(2,368.8)	(2,037.5)	(1,840.1)	(1,744.4)	(1,343.4)
Deficit (£m)	(424.6)	(290.3)	(306.9)	(387.5)	(149.3)

The normal contributions expected to be paid during the financial year ending 31 December 2013 are £61.8m (financial year ended 31 December 2012: £64.9m).

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 2012 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% (2011: 4.6%).

Notes to the Consolidated Financial Statements

30. Retirement benefit schemes (continued)

30 (a) Defined benefit schemes (continued)

The overall expected return on assets is calculated as the weighted average of the expected returns for the principal asset categories held by scheme.

	2012 %		2011 %
Main assumptions:			
Rate of salary increases	3.40		3.30
Rate of increase in pensions in payment	2.20 (CPI) and 3.00 (RPI)	2.10 (CPI) and 2.90 (RPI)	
Rate of increase in deferred pensions	2.20 (CPI) and 3.00 (RPI)	2.10 (CPI) and 2.90 (RPI)	
Inflation assumption	2.20 (CPI) and 3.00 (RPI)	2.10 (CPI) and 2.90 (RPI)	
Discount rate	4.30		4.70
Expected rates of return on scheme assets:			
Equities	7.70		7.70
Bonds except LDI	4.30		4.70
LDI	3.90		3.90
Gilts	3.10		3.10
Property	4.35		4.35
Cash and other	0.50		0.50
Annuity policies	4.30		4.70
	2012 Years		2011 Years
Post-retirement mortality:			
Current pensioners at 65 – male	21.0		20.9
Current pensioners at 65 – female	23.5		23.4
Future pensioners at 65 – male	22.5		22.5
Future pensioners at 65 – female	24.6		24.6

30 (b) Defined contribution schemes

The Group paid employer contributions of £71.3m (2011: £66.9m) 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.

31. Provisions

	Employee related £m	Property £m	Contract £m	Other £m	Total £m
At 1 January 2011	11.0	6.6	8.0	14.0	39.6
Arising from acquisitions	0.4	3.6	29.2	6.9	40.1
Charged to income statement	4.5	0.4	–	–	4.9
Released to income statement	–	(0.2)	(1.2)	(3.2)	(4.6)
Utilised during the year	(1.0)	(1.5)	(7.5)	(0.1)	(10.1)
Unwinding of discount	–	0.3	0.2	–	0.5
Exchange differences	0.1	(0.3)	(2.6)	(1.0)	(3.8)
At 1 January 2012	15.0	8.9	26.1	16.6	66.6
Arising from acquisitions	0.6	1.6	6.4	0.1	8.7
Derecognised on disposal of subsidiary	(0.1)	–	–	–	(0.1)
Charged to income statement*	1.4	–	–	9.0	10.4
Released to income statement	(0.8)	(0.7)	(5.7)	(0.1)	(7.3)
Utilised during the year	(0.7)	(1.7)	(11.3)	(4.7)	(18.4)
Unwinding of discount	–	0.2	0.3	–	0.5
Exchange differences	(0.6)	(0.4)	(0.9)	(0.8)	(2.7)
At 31 December 2012	14.8	7.9	14.9	20.1	57.7
Analysed as:					
Current	–	0.9	5.2	5.4	11.5
Non-current	14.8	7.0	9.7	14.7	46.2

*Included in amounts charged to income statement is an amount of £6.6m relating to businesses disposed in the year.

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 underutilised 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

32. Share capital

	2012 £m	Number 2012 Millions	2011 £m	Number 2011 Millions
Issued and fully paid:				
497,327,070 (2011: 493,220,805) ordinary shares of 2p each at 1 January	9.9	497.3	9.9	493.2
Issued on the exercise of share options	0.1	1.2	–	4.1
498,462,508 (2011: 497,327,070) ordinary shares of 2p each at 31 December	10.0	498.5	9.9	497.3

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

During the year 1,135,438 (2011: 4,106,265) ordinary shares of 2p each were allotted to the holders of share-based awards or their personal representatives using newly listed shares.

33. Share premium account

	2012 £m	2011 £m
At 1 January	322.7	306.7
Premium on shares issued	3.8	16.0
At 31 December	326.5	322.7

34. Reserves

34 (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.

34 (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.

34 (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 2012, the ESOT held 10,174,594 (2011: 8,267,992) shares equal to 2.0% of the current allotted share capital (2011: 1.7%). The market value of shares held by the ESOT as at 31 December 2012 was £54.4m (2011: £39.2m).

34 (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.

35. Notes to the consolidated cash flow statement

Reconciliation of operating profit to net cash inflow from operating activities

	2012 £m	2011 £m
Operating profit for the year	287.6	266.2
Adjustments for:		
Share-based payment expense	12.1	11.2
Depreciation of property, plant and equipment	51.4	46.0
Amortisation and impairment of intangible assets	45.7	39.5
Exceptional net profit on disposal of subsidiaries and operations	(5.6)	–
(Profit)/loss on disposal of property, plant and equipment	(0.9)	0.5
Movement in provisions	(19.8)	(9.8)
Other non cash movements	(2.8)	3.4
Operating cash inflow before movements in working capital	367.7	357.0
(Increase)/decrease in inventories	(1.5)	9.2
(Increase)/decrease in receivables	(48.7)	26.8
Increase/(decrease) in payables	38.6	(84.5)
Special contribution to defined benefit pension scheme (note 30a)	–	(40.0)
Cash generated by operations	356.1	268.5
Tax paid	(52.7)	(51.5)
Net cash inflow from operating activities	303.4	217.0

Additions to fixtures and equipment during the year amounting to £14.4m (2011: £29.6m) were financed by new finance leases.

Analysis of net debt

	At 1 January 2012 £m	Cash flow £m	Acquisitions* £m	Disposals £m	Exchange differences £m	Non cash movements £m	At 31 December 2012 £m
Cash and cash equivalents	254.8	(46.6)	0.8	(1.4)	(9.0)	–	198.6
Non recourse loans	(15.5)	(9.7)	–	–	0.1	–	(25.1)
Other loans	(827.3)	136.2	(15.2)	(24.4)	27.3	–	(703.4)
Obligations under finance leases	(45.9)	2.9	–	6.2	0.2	(14.2)	(50.8)
	(633.9)	82.8	(14.4)	(19.6)	18.6	(14.2)	(580.7)

	At 1 January 2011 £m	Cash flow £m	Acquisitions* £m	Disposals £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)

*Acquisitions represent the net cash/(debt) acquired on acquisition

Notes to the Consolidated Financial Statements

36. Capital and other commitments

	2012 £m	2011 £m
Capital expenditure contracted but not provided:		
– Property, plant and equipment	1.2	1.4
– Intangible assets	7.7	–

Included within the balances above is joint venture capital expenditure contracted but not provided in relation to property, plant and equipment of £0.1m (2011: £0.1m).

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:

	2012 £m	2011 £m
Within one year	110.5	137.0
Between one and five years	189.9	198.3
After five years	133.7	131.2
	434.1	466.5

Principal lease commitments are within the UK & Europe segment, with future minimum lease payments totalling £219.6m (2011 restated: £205.3m). 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.

37. Share-based payment expense

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

	2012 £m	2011 £m
Executive Option Plan	–	0.1
Long Term Incentive Scheme and Plan	0.8	0.9
Sharesave	0.2	0.7
Transformational Share Scheme	0.1	0.1
Performance Share Plan	9.9	8.5
Deferred Bonus Plan	1.1	0.9
	12.1	11.2

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 2012 Thousands	Weighted average exercise price 2012 £	Number of options 2011 Thousands	Weighted average exercise price 2011 £
Outstanding at 1 January	3,389	2.49	3,957	2.63
Granted during the year	–	–	–	–
Exercised during the year	(759)	2.29	(294)	3.37
Lapsed during the year	(158)	2.22	(274)	3.62
Outstanding at 31 December	2,472	2.56	3,389	2.49

Of these options 2,471,696 (2011: 3,300,690) were exercisable at the end of the year, with a weighted average exercise price of £2.56 (2011: £2.34).

The options outstanding at 31 December 2012 had a weighted average contractual life of 2.0 years (2011: 2.5 years).

37. Share-based payment expense (continued)

Executive Option Plan (EOP) (continued)

The exercise prices for options outstanding at 31 December 2012 ranged from £1.39 to £4.55 (2011: £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 £5.50 (2011: £5.34).

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 Executive Option Plans 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. 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 or service period conditions.

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 2012 Thousands	Weighted average exercise price 2012 £	Number of options 2011 Thousands	Weighted average exercise price 2011 £
Outstanding at 1 January	2,638	Nil	3,691	Nil
Granted during the year	218	Nil	23	Nil
Exercised during the year	(247)	Nil	(411)	Nil
Lapsed during the year	(1,692)	Nil	(665)	Nil
Outstanding at 31 December	917	Nil	2,638	Nil

Of these options 521,459 (2011: 2,169,500) were exercisable at the end of the year.

The options outstanding at 31 December 2012 had a weighted average contractual life of 3.9 years (2011: 5.8 years).

There were four grants of LTIP options during the year. 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 is £5.25.

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 2012 Thousands	Weighted average exercise price 2012 £	Number of options 2011 Thousands	Weighted average exercise price 2011 £
Outstanding at 1 January	86	Nil	119	Nil
Granted during the year	–	Nil	–	Nil
Exercised during the year	(53)	Nil	(33)	Nil
Lapsed during the year	–	Nil	–	Nil
Outstanding at 31 December	33	Nil	86	Nil

None of these options were exercisable at the end of the year (2011: none).

The options outstanding at 31 December 2012 had a weighted average contractual life of 0.2 years (2011: 0.6 years).

Notes to the Consolidated Financial Statements

37. Share-based payment expense (continued)

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 2012 Thousands	Weighted average exercise price 2012 £	Number of options 2011 Thousands	Weighted average exercise price 2011 £
Outstanding at 1 January	7,426	0.02	3,944	0.02
Granted during the year	4,104	0.02	3,987	0.02
Exercised during the year	(125)	0.02	(9)	0.02
Lapsed during the year	(1,321)	0.02	(496)	0.02
Outstanding at 31 December	10,084	0.02	7,426	0.02

148,830 of these options were exercisable at the end of the year (2011: none).

The options outstanding at 31 December 2012 had a weighted average contractual life of 8.5 years (2011: 8.7 years).

In the year, four grants were made with 50% of the options granted subject to TSR performance conditions and 50% 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:

	2012	2011
Weighted average share price	540p	558p
Weighted average exercise price	2p	2p
Expected volatility	22.7%	28.1%
Expected life	3 years	3 years
Risk free rate	0.3%	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.

The assumptions for options granted during the year with EPS growth performance conditions are:

	2012	2011
Weighted average share price	540p	558p
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 is £4.38.

37. Share-based payment expense (continued)

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 a specified 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 2012 Thousands	Weighted average exercise price 2012 £	Number of options 2011 Thousands	Weighted average exercise price 2011 £
Outstanding at 1 January	750	Nil	426	Nil
Granted during the year	519	Nil	324	Nil
Exercised during the year	(107)	Nil	–	Nil
Lapsed during the year	(104)	Nil	–	Nil
Outstanding at 31 December	1,058	Nil	750	Nil

None of these options were exercisable at the end of the year (2011: none).

The options outstanding at 31 December 2012 had a weighted average contractual life of 1.6 years (2011: 1.5 years).

In the year, one grant was made with 100% of the deferred bonus subject to EPS growth performance conditions.

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.

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.

The assumptions for options granted during the year with EPS growth performance conditions are:

	2012	2011
Weighted average share price	515p	548p
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 is £5.16.

Notes to the Consolidated Financial Statements

37. Share-based payment expense (continued)

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 2012 Thousands	Weighted average exercise price 2012 £	Number of options 2011 Thousands	Weighted average exercise price 2011 £
Outstanding at 1 January	1,108	4.0	5,479	4.0
Granted during the year	–	4.0	–	4.0
Exercised during the year	(807)	4.0	(3,981)	4.0
Lapsed during the year	(301)	4.0	(390)	4.0
Outstanding at 31 December	–	4.0	1,108	4.0

Of these options none (2011: 1,101,183) were exercisable at the end of the year.

The options outstanding at 31 December 2012 had a weighted average contractual life of nil (2011: 0.2 years). Given that options granted under the Sharesave scheme 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.

Sharesave 2012

The Sharesave 2012 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 2012 options are as follows:

	Number of options 2012 Thousands	Weighted average exercise price 2012 £	Number of options 2011 Thousands	Weighted average exercise price 2011 £
Outstanding at 1 January	–	–	–	–
Granted during the year	6,074	5.14	–	–
Exercised during the year	–	5.14	–	–
Lapsed during the year	(62)	5.14	–	–
Outstanding at 31 December	6,012	5.14	–	–

Of these options, none (2011: none) were exercisable at the end of the year.

The options outstanding at 31 December 2012 had a weighted average contractual life of 3.4 years (2011: nil). 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.

38. 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:

	2012 £m	2011 £m
Royalties and management fees receivable	2.3	1.5
Dividends receivable	80.6	64.3
	82.9	65.8

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

	2012 £m	2011 £m
Current:		
Loans	1.0	0.5
	2012 £m	2011 £m
Non-current:		
Loans	2.6	3.2

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:

	2012 £m	2011 £m
Short-term employee benefits	9.4	8.9
Post-employment benefits	0.4	0.6
Share-based payment expense	1.8	2.8
	11.6	12.3

The key management personnel comprise the Executive Directors, Non-Executive Directors and members of the Executive Committee (2012: 17 individuals, 2011: 18 individuals).

Notes to the Consolidated Financial Statements

39. 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		2012	2011
United Kingdom			
	Serco Limited	100%	100%
	NPL Management Limited	100%	100%
AMEEA			
Australia	Serco Australia Pty Limited	100%	100%
India	Intelenet Global Services Private Limited	100%	100%
North America			
USA	Serco Inc.	100%	100%
Joint venture undertakings		2012	2011
United Kingdom			
	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.

40. Contingent liabilities

The Company has guaranteed overdrafts, finance leases, and bonding facilities of its joint ventures up to a maximum value of £27.2m (2011: £8.2m). The actual commitment outstanding at 31 December 2012 was £23.2m (2011: £4.8m).

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.

Audit Report

on Parent Company Financial Statements prepared under FRS 101

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 2012 which comprise the Parent Company Balance Sheet and the related notes 1 to 16. The financial reporting framework that has been applied in their preparation is applicable law and Financial Reporting Standard 101 Reduced Disclosure Framework.

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 financial statements

In our opinion the parent company financial statements:

- give a true and fair view of the state of the company's affairs as at 31 December 2012;
- have been properly prepared in accordance with Financial Reporting Standard 101 Reduced Disclosure Framework; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matters prescribed by the Companies Act 2006

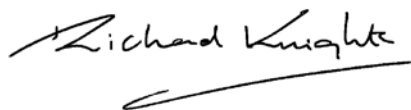
In our opinion:

- 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.



Richard Knights (Senior Statutory Auditor)
for and on behalf of Deloitte LLP
Chartered Accountants and Statutory Auditor
London, United Kingdom
4 March 2013

Company Balance Sheet

At 31 December

	Note	2012 £m	2011 Restated £m	2011 Originally reported £m
Fixed assets				
Investments in subsidiaries	2	811.8	816.6	816.6
		811.8	816.6	816.6
Current assets				
Debtors: amounts due within one year	3	6.0	4.7	4.7
Debtors: amounts due after more than one year	3	1,228.0	985.6	984.4
Derivative financial instruments due within one year	6	0.7	6.4	6.4
Derivative financial instruments due after more than one year	6	–	0.9	0.9
Cash at bank and in hand		5.6	–	–
		1,240.3	997.6	996.4
Total assets		2,052.1	1,814.2	1,813.0
Creditors: amounts falling due within one year				
Trade and other payables	4	(249.4)	(185.4)	(185.4)
Borrowings	5	(106.2)	(170.2)	(170.2)
Derivative financial instruments	6	(2.6)	(4.2)	(4.2)
		(358.2)	(359.8)	(359.8)
Net current assets		882.1	637.8	636.6
Amounts falling due after more than one year				
Borrowings	5	(615.0)	(606.7)	(606.7)
Amounts owed to subsidiary companies		(385.3)	(222.1)	(222.1)
Derivative financial instruments	6	(0.6)	(0.2)	(0.2)
		(1,000.9)	(829.0)	(829.0)
Provisions for liabilities		–	(1.0)	(1.0)
Total liabilities		(1,359.1)	(1,189.8)	(1,189.8)
Net Assets		693.0	624.4	623.2
Capital and reserves				
Called up share capital	8	10.0	9.9	9.9
Share premium account	9	326.5	322.7	322.7
Capital redemption reserve		0.1	0.1	0.1
Own shares reserve	10	(58.8)	(48.2)	(48.2)
Share-based payment reserve	11	57.7	49.1	48.0
Hedging and translation reserve	12	1.9	1.9	1.9
Profit and loss account	13	355.6	288.9	288.8
Total shareholders' funds		693.0	624.4	623.2

The financial statements (registered number 2048608) were approved by the Board of Directors on 4 March 2013 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 as restated.

Basis of accounting

The Company meets the definition of a qualifying entity under FRS 100 (Financial Reporting Standard 100) issued by the Financial Reporting Council. Accordingly, in the year ended 31 December 2012 the Company has undergone transition from reporting under UK GAAP to FRS 101 as issued by the Financial Reporting Council. The financial statements have therefore been prepared in accordance with FRS 101 (Financial Reporting Standard 101) 'Reduced Disclosure Framework' as issued by the Financial Reporting Council. This transition is not considered to have had a material effect on the financial statements.

As permitted by FRS 101, the Company has taken advantage of the disclosure exemptions available under that standard in relation to share-based payments, financial instruments, capital management, presentation of comparative information in respect of certain assets, presentation of a cash-flow statement, standards not yet effective, impairment of assets and related party transactions.

The financial statements have been prepared on the historical cost basis and on the going concern basis, except for the revaluation of certain financial instruments. Historical cost is generally based on the fair value of the consideration given in exchange for the assets.

Fixed asset investments

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

Share-based payment

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

The Company 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.

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 Company 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 fixed asset or a creditor: falling due after more than one year 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 creditors: amounts falling due within one year.

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 these are not measured at fair value through profit or loss.

Hedge accounting

The Company 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.

Movements in the hedging and translation reserve in equity are detailed in the SOCI and described in note 12.

Notes to the Company Financial Statements

1. Accounting policies (continued)

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 Company 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.

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 reclassified 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 Company 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 Company'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.

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. 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 Company is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

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

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

2. Investments held as fixed assets

	£m
Shares in subsidiary companies at cost:	
At 1 January 2012	816.6
Options over parent's shares awarded to employees of subsidiaries	7.2
Disposals	(12.0)
At 31 December 2012	811.8
	£m
Shares in subsidiary companies at cost:	
At 1 January 2011	812.1
Options over parent's shares awarded to employees of subsidiaries	7.1
Disposals	(2.6)
At 31 December 2011	816.6

Full details of the principal subsidiaries of Serco Group plc can be found in note 39 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

	2012 £m	2011 Restated £m	2011 Originally Reported £m
Amounts due within one year			
Amounts owed by subsidiary companies	–	0.1	0.1
Corporation tax recoverable	3.6	2.5	2.5
Other debtors	2.4	2.1	2.1
	6.0	4.7	4.7
Amounts due after more than one year			
Amounts owed by subsidiary companies	1,212.1	968.9	968.9
Amounts owed by joint ventures	4.1	3.3	3.3
Other debtors	5.9	8.5	8.5
Deferred tax asset (note 7)	5.9	4.9	3.7
	1,228.0	985.6	984.4
	1,234.0	990.3	989.1

4. Trade and other payables

	2012 £m	2011 £m
Amounts owed to subsidiary companies	231.5	171.4
Trade creditors	0.3	0.1
Accruals and deferred income	15.7	12.7
Other creditors including taxation and social security	1.9	1.2
	249.4	185.4

Notes to the Company Financial Statements

5. Borrowings

	2012 £m	2011 £m
Loans:	721.2	776.9
Less: amounts included in creditors falling due within one year – loans	(27.0)	(23.6)
Less: amounts included in creditors falling due within one year – bank loans & overdrafts	(79.2)	(146.6)
Amounts falling due after more than one year	615.0	606.7
Loans:		
Within one year or on demand	106.2	170.2
Between one and two years	23.4	126.0
Between two and five years	54.2	104.3
After five years	537.4	376.4
	721.2	776.9

6. Derivative financial instruments

	Assets 2012 £m	Liabilities 2012 £m	Assets 2011 £m	Liabilities 2011 £m
Currency swaps	–	(0.6)	0.9	–
Interest rate swaps	–	–	–	(0.6)
Forward foreign exchange contracts	0.7	(2.6)	6.4	(3.8)
	0.7	(3.2)	7.3	(4.4)
Analysed as:				
Non-current	–	(0.6)	0.9	(0.2)
Current	0.7	(2.6)	6.4	(4.2)
	0.7	(3.2)	7.3	(4.4)

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 29 of the Group's consolidated financial statements.

7. Deferred tax asset

	2012 £m	2011 Restated £m
Capital allowances in excess of depreciation	0.1	0.1
Short-term timing differences	5.8	4.8
	5.9	4.9

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

	2012 £m	2011 £m
At 1 January	4.9	2.8
Prior year adjustment	–	1.6
At 1 January restated	4.9	4.4
Charged to profit and loss account	0.8	1.8
Items taken directly to equity	0.2	(1.3)
At 31 December	5.9	4.9

8. Called up share capital

	2012 £m	Number 2012 Millions	2011 £m	Number 2011 Millions
Issued and fully paid:				
497,327,070 (2011: 493,220,805) ordinary shares of 2p each at 1 January	9.9	497.3	9.9	493.2
Issued on the exercise of share options	0.1	1.2	–	4.1
498,462,508 (2011: 497,327,070) ordinary shares of 2p each at 31 December	10.0	498.5	9.9	497.3

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

During the year 1,135,438 (2011: 4,106,265) 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

	2012 £m	2011 £m
At 1 January	322.7	306.7
Premium on shares issued	3.8	16.0
At 31 December	326.5	322.7

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 2012, the ESOT held 10,174,594 (2011: 8,267,992) shares equal to 2.0% of the current allotted share capital (2011: 1.7%). The market value of shares held by the ESOT as at 31 December 2012 was £54.4m (2011: £39.2m).

11. Share-based payment reserve

	2012 £m	2011 Restated £m	2011 Originally reported £m
At 1 January	49.1	38.7	38.7
Prior year adjustment	–	1.5	–
At 1 January restated	49.1	40.2	38.7
Options over parent's shares awarded to employees of subsidiaries	7.2	7.1	7.1
Share-based payment expense	4.8	4.2	4.2
Share options to holders on exercise	(3.6)	(2.0)	(2.0)
Tax charge on items taken directly to equity	0.2	(0.4)	–
At 31 December	57.7	49.1	48.0

Details of the share-based payment disclosures are set out in note 37 of the Group's consolidated financial statements.

Notes to the Company Financial Statements

12. Hedging and translation reserve

	2012 £m	2011 £m
At 1 January	1.9	(0.4)
Fair value (loss)/gain on cash flow hedges during the year	–	3.3
Tax credit/(charge) on items taken directly to equity	–	(0.9)
Net exchange loss on translation of foreign operations	–	(0.1)
At 31 December	1.9	1.9

13. Profit and loss account

	2012 £m	2011 Restated £m	2011 Originally Reported £m
At 1 January	288.9	226.1	226.1
Profit for the year	108.6	100.1	100.0
Equity dividends	(41.9)	(37.3)	(37.3)
At 31 December	355.6	288.9	288.8

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.

14. Reconciliation of shareholders' funds

	£m
At 31 December 2011: originally reported	623.2
Estimated profit due to transition to FRS101	0.1
Changes to share-based payment reserve due to transition to FRS101	1.1
At 31 December 2011: restated	624.4

15. 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 2012 was £151.0m (2011: £79.7m).

The Company has guaranteed overdrafts, finance leases and bonding facilities of its joint ventures up to a maximum value of £27.2m (2011: £8.2m). The actual commitment outstanding at 31 December 2012 was £23.2m (2011: £4.8m).

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.

16. 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 38 to the Group's consolidated financial statements.

Supplementary information

Five-year record

		2012	2011	2010	2009	2008
Revenue	£m	4,913	4,646	4,327	3,970	3,124
Adjusted operating profit	£m	314.8	290.1	258.7	229.7	165.2
Adjusted operating margin	%	6.41%	6.24%	5.98%	5.79%	5.29%
Profit before tax	£m	302.0	238.3	213.9	177.1	136.1
Group free cash flow	£m	181.2	168.3	185.8	137.3	94.2
Group recourse net debt	£m	(606.9)	(669.8)	(303.6)	(387.7)	(524.5)
Total net debt	£m	(580.7)	(633.9)	(261.2)	(358.5)	(514.1)
Adjusted earnings per share	p	42.55p	39.59p	34.69p	29.53p	22.20p
Dividend per share	p	10.10p	8.40p	7.35p	6.25p	5.00p

Directors, Secretary and Advisors

Chairman

Alastair Lyons CBE

Directors

Ralph D Crosby Jr*
Christopher Hyman CBE
Andrew Jenner
David Richardson* ^
Angie Risley*
Malcolm Wyman*

Secretary

John Hickey

* Non-Executive Director
^ Senior Independent Director

Registered Office

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

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

Auditors

Deloitte LLP
2 New Street Square
London
EC4A 3BZ

Investment Bankers

UBS Limited
1 Finsbury Avenue
London
EC2M 2PP

Stockbrokers

J.P. Morgan Cazenove
125 London Wall
London
EC2Y 5AJ

Bank of America Merrill Lynch
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 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 cost 8p per minute plus network extras.)

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 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 by choosing the Dividend Reinvestment Plan heading within the Share Dealing section under 'Products & Services'.

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 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.

Electronic communication

You can register for electronic communications by visiting 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 +44 (0)131 240 0414 between 8.00am and 4.30pm, Monday to Friday and quote Low Co 330. 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. 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 2012 is set out below:

Range of shareholdings	Number of shareholders	%	Number of shares	%
1 – 1,000	4,723	52.97	1,909,766	0.38
1,001 – 5,000	2,956	33.15	6,174,683	1.24
5,001 – 10,000	457	5.12	3,075,408	0.62
10,001 – 100,000	494	5.54	14,868,370	2.98
100,001 – 500,000	163	1.83	37,266,550	7.48
500,001 – 1,000,000	49	0.55	33,719,786	6.76
1,000,001 – 10,000,000	65	0.73	172,475,664	34.60
10,000,001 and above	10	0.11	228,972,281	45.94
Total	8,917	100	498,462,508	100

Financial calendar

2012 Full Year Results Announcement	5 March 2013
Ex-dividend date for 2012 final dividend	13 March 2013
Record date for 2012 final dividend	15 March 2013
Deadline for DRIP mandates	30 April 2013
AGM and Interim Management Statement	15 May 2013
Payment date for 2012 final dividend	*22 May 2013
Pre-close statement	*28 June 2013
2013 Half Year Results announcement	29 August 2013
Ex-dividend date for 2013 interim dividend	*4 September 2013
Record date for 2013 interim dividend	*6 September 2013
Deadline for DRIP mandates	*27 September 2013
Payment date for 2013 interim dividend	*18 October 2013
Interim Management Statement	*14 November 2013
Pre-close statement	*16 December 2013

* Provisional and/or subject to shareholder approval



Printed on Cocoon Silk 50 which is certified as an FSC® product manufactured with 50% recycled fibres and 50% virgin fibres.

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 Printed in England by Pureprint Group www.pureprint.com

Serco Group plc
Registered Office:
Serco House, 16 Bartley Wood Business Park
Bartley Way, Hook, Hampshire RG27 9UY

T: +44 (0)1256 745 900
E: generalenquiries@serco.com

www.serco.com