
serco

Annual Report
and Accounts
2018

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Serco Group plc is a leading provider of public services. Our purpose is to be a trusted partner of governments, delivering superb services that transform outcomes and make a positive difference to our fellow citizens.

We gain scale, expertise and diversification by operating internationally across five sectors and four geographies: Defence, Justice & Immigration, Transport, Health and Citizen Services, delivered in the UK, Europe, North America, Asia Pacific and the Middle East.

20+
COUNTRIES

500+
CONTRACTS

50,000+
EMPLOYEES



For more and the latest information please visit our website at: www.serco.com

Strategic Report

Highlights

Revenue

£2,837m

2017: £2,951m

Underlying Trading Profit

£93.1m

2017: £69.3m

Underlying EPS, diluted

5.21p

2017: 3.36p

Free Cash Flow

£25.0m

2017: (£6.7m)

Order Book

£12.0bn

2017: £10.7bn

Reported Operating Profit

£80.5m

2017: £21.1m

Reported EPS, diluted

5.99p

2017: (0.76p)

Employee Engagement

67 points

2017: 56%

(see KPIs on page 11 for change of definition)



At a glance

What we do

Serco delivers services to governments and other institutions who serve the public or protect vital national interests.

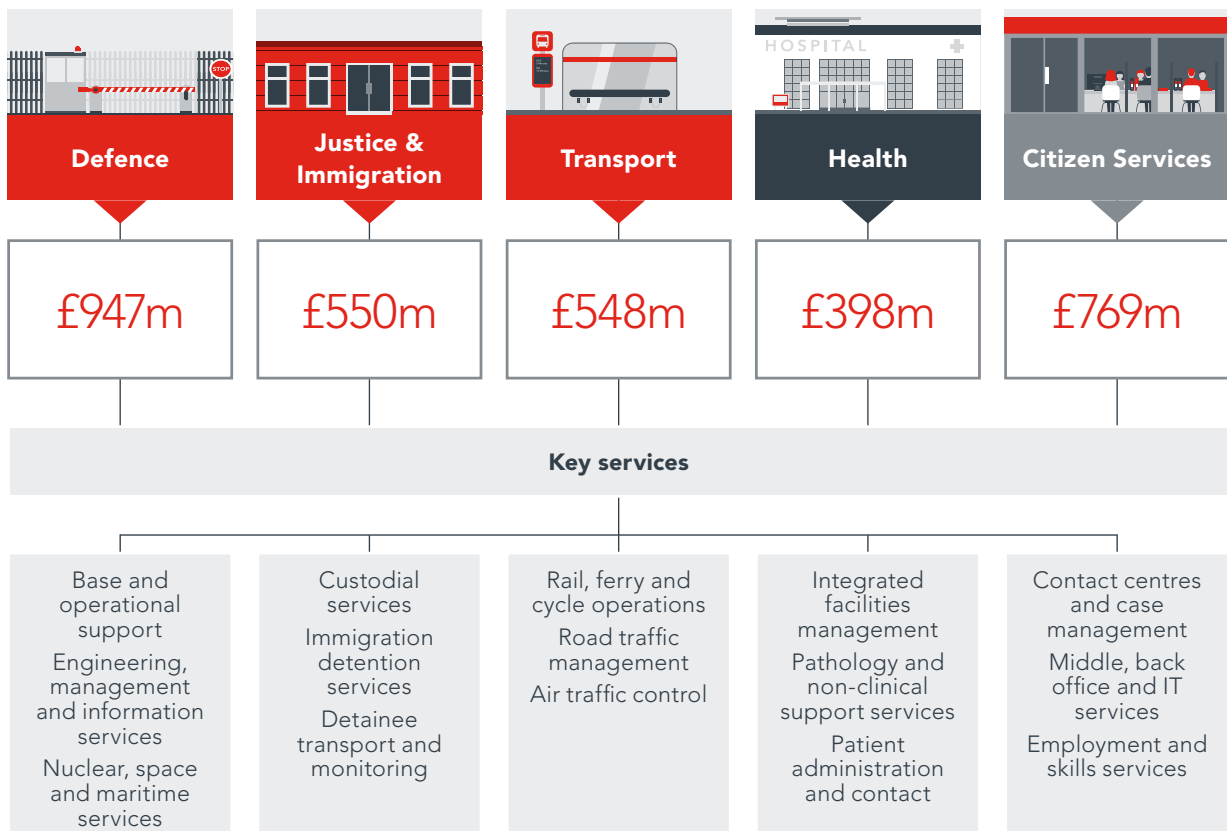
Serco's roots go back to 1929, and in 1988 the Group was listed on the London Stock Exchange. Now, Serco is a FTSE 250 company managing over 500 contracts worldwide and employing over 50,000 people across our operations.

We deliver services through people, supported by effective processes, technology and skilled management. Our customers define what outcomes or services they need to deliver, and we develop new and more effective ways to deliver them. We provide innovative solutions to some of the most complex challenges facing governments, bringing our experience, capability and

scale to deliver the service standards, cost efficiencies and policy outcomes governments want. In this way we make a positive difference to the lives of millions of people around the world, often looking after some of the most vulnerable and disadvantaged in society and helping to keep nations safe.

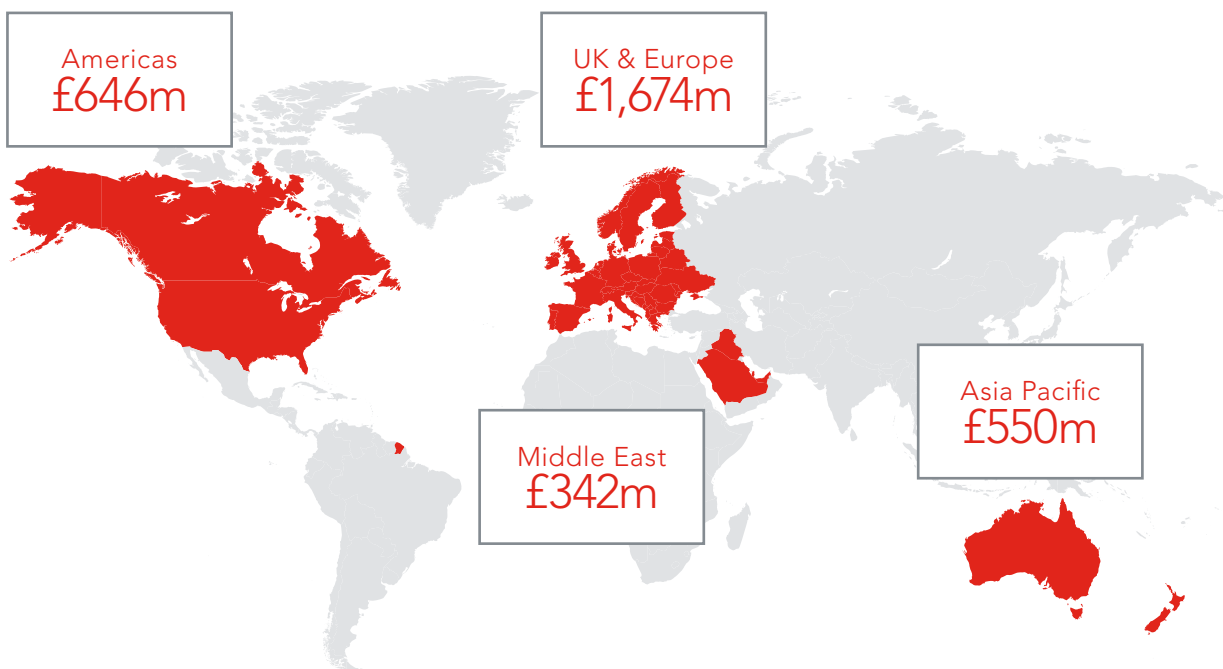
Our core sectors

Our business is focused across five core sectors, with revenue in 2018 of £2,837m or, including our share of joint ventures and associates to reflect our total scale in each sector, of £3,212m.



Where we operate

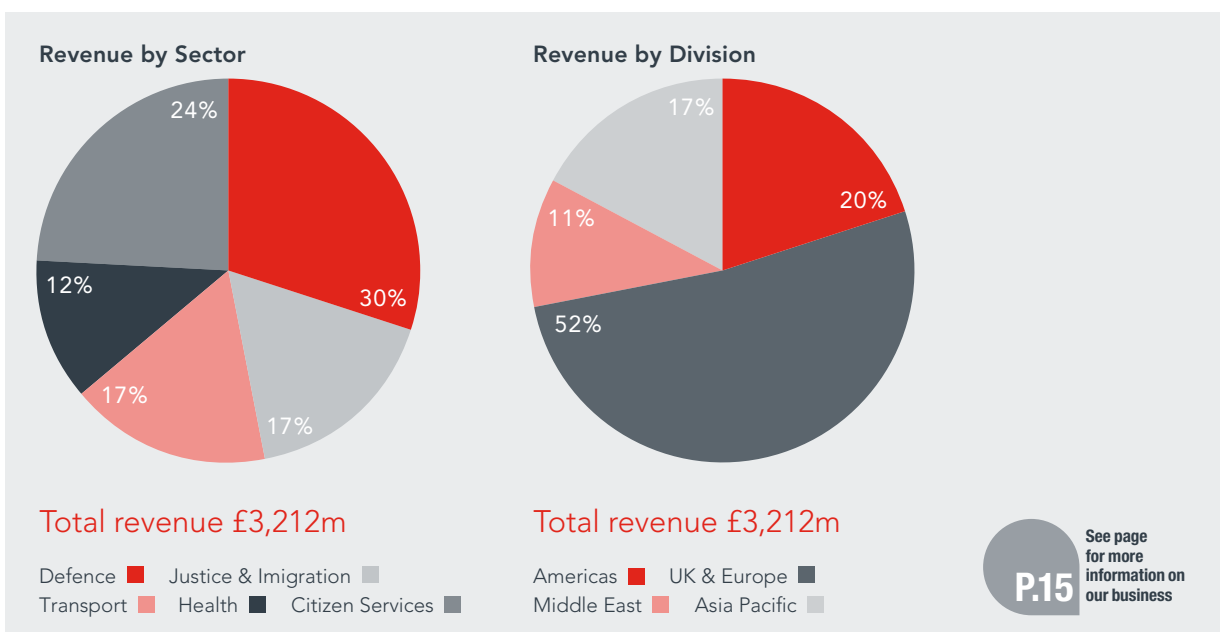
Serco's operations are across four geographic regions:



Revenue in 2018 (including share of joint ventures and associates).

Our business mix

Serco's revenue by sector and geographic division:



Revenue in 2018 (including share of joint ventures and associates).

Chairman's Statement



Sir Roy Gardner
Chairman

2018 has been a defining year of progress in delivering Serco's turnaround, and marks an inflection point for our business. We are moving through the 'Transform' stage to the 'Grow' stage as planned, whilst also taking the opportunity to shape markets and make acquisitions.

We have stabilised revenue, and, after several years of decline, in 2018 we substantially increased profits, generated positive free cash flow and maintained a strong balance sheet. Improving service delivery for our customers and operational performance has also been pleasing, including driving further cost efficiencies and excellent progress in expanding the value of our contract order book. Effective risk management and governance also remains at the heart of securing our future success.

2018 Highlights

- Underlying Trading Profit of £93m, an increase of 34%.
- Order intake of £2.9bn, a book-to-bill ratio of over 100%.
- Two acquisitions completed and integrated during the year.
- Strong balance sheet, with reduced leverage and refinancing completed.
- Positive engagement in the public debate regarding public services provision.
- Further development of the Board, governance and effectiveness.
- After a defining year of progress in 2018, positive outlook for 2019 and beyond.

Serco's purpose is to be a trusted partner of governments, providing superb public services that transform outcomes and make a positive difference for our fellow citizens, whilst delivering attractive returns to our shareholders and rewarding careers to our employees. Our approach to achieving this is through aspiring to be the best-managed company in our sector, and concentrating on doing four things really well: winning good business; executing brilliantly; being a place people are proud to work; and being profitable and sustainable. We have done well in 2018 against these objectives. I am proud of the work we do and of the progress being made.

Delivering our plan

In 2015, following an operating loss of £1.3bn in 2014 and major issues with our largest customer, new management set out a three-stage plan for Serco: Stabilise, Transform, Grow. Stabilisation was largely completed in 2015 with the recruitment of a new management team, recapitalisation of the business and delivery of a corporate renewal programme. Transformation then started in earnest, and will continue through 2019 while also ensuring it is embedded as 'business as usual'. 2018 has marked the start of delivering the third phase – Growth – with Underlying Trading Profit increasing for the first time in five years.

I am pleased to report that in 2018 we made progress on a number of fronts. First, we had another year of very strong order intake, at £2.9bn. This represents a book-to-bill ratio – the intake value of contracts we add to the order book compared to how much revenue we are billing our customers – of over 100%, repeating a similar achievement in 2017. Our closing order book now stands at £12.0bn – the highest level since 2013. The strong order intake underlines the progress we have made developing our customer propositions and business development skills. It also reflects the benefit of the balance of our business internationally and proof of our geographic reach, with around 80% of our intake in 2018 coming from customers outside the UK, the second successive year our order intake has been very largely from markets outside the UK.

Secondly, we have delivered significant growth in Underlying Trading Profit which increased by 34% from £69.3m to £93.1m, an outcome considerably better than our initial guidance of around £80m. Revenue reduced 4% to £2,837m, but was broadly flat on an organic constant currency basis in the second half of the year. The profit improvement includes a strong operating performance together with good progress on transformation savings and other cost efficiencies, notably from merging the UK operations into a single entity, as well as further reducing our other central support costs.

Thirdly, Serco executed two acquisitions during the year, buying a small US business specialising in the repair and maintenance of complex naval radio and radar systems, and buying from the liquidator of Carillion plc six contracts to provide facilities management services to the NHS; the acquisition of these contracts added £700m to our order book. The fact that we were able to execute these two acquisitions underlines the progress we have made over the last few years.

Fourthly, net debt at the end of the year was £188m, also better than our guidance at the start of the year. There is a much-reduced need for debt in the business, and to that end we successfully refinanced our Revolving Credit Facility during the year and with the terms and conditions substantially unchanged.

Finally, following the collapse of Carillion in January 2018 and the well-publicised difficulties of other suppliers in the sector, we engaged energetically in the public debate around the provision of public services by private companies. In last year's Annual Report, we proposed "Four Principles" for the governance of public sector outsourcing. Shortly after, the UK Government established a process to review the way it interacts with private service providers. This has been a very constructive process, run by the Cabinet Office and involving the supply side as well. Our Four Principles have provided, we believe, an important contribution to the development of policy, as well as playing a part in moderating the tone of public debate and establishing Serco as a thoughtful contributor to the debate including appearing multiple times in front of Parliamentary Committees. I am also delighted to mark the re-launch of the Serco Institute as a platform on which those interested in the delivery of public services can put forward their ideas.

You can read more about all of these points in the Chief Executive's Review on pages 20 to 27.

Looking ahead

As we look ahead to 2019, we expect Underlying Trading Profit to grow further to be approximately £105m, on revenues increasing to £2.9-3.0bn. Since the second half of 2016, we have been making progress on increasing our profit margin – a key deliverable of successfully implementing our strategy – and in 2019 we expect that further margin and profit progress will be driven largely by transformation savings, together with the start of revenue growth from new and expanding contracts.

Looking beyond 2019, the rate of margin improvement and profit growth will increasingly depend on our ability to grow revenues, and the recent increase in our order book and some very large contract wins since the start of 2019 give us confidence that we can do so. The Strategy Review announced in March 2015 set out a long-term ambition that the business could grow in line with a market which had historically grown at 5-7% a year and had enabled peers to achieve margins of 5-6%. Our plan for increasing margin – which at its lowest was 2.3% in 2017 when Underlying Trading Profit was £69.3m – was predicated on three factors: first, reducing costs as a percentage of sales; second, containing losses on onerous contracts and converting a number of them into profitable contracts on rebid; and, thirdly, increasing margins by growing profitable revenues whilst keeping overheads constant or reducing them further.

We remain on track with our plan to reduce costs. With regard to reducing the losses on OCP contracts, the recent award of the asylum seeker accommodation contracts will give a major boost as we move from significant losses under the old programme to new contracts that are expected to be profitable. However, demand in the UK, which is our largest market, is growing more slowly than its former trend rate, if at all, which we believe is largely as a result of Brexit being a distraction to Government having the normal amount of parliamentary time to progress other agendas such as public service development. Recent research we have done indicates that across all our segments and geographies, the current blended rate of growth is around 2-3%, largely as a result of the slowdown in the UK market. Given the fact that just under half our sales are in the UK, we see little likelihood that blended rates of growth across our markets will increase much beyond this in the immediate future, unless Brexit itself stimulates significant additional demand. Longer term, we see no reason why market growth rates should not revert to the historic levels of growth we foresaw in our 2015 Strategy Review, particularly given the enduring pressures on governments to relentlessly improve value for money and the quality of service provision, which we believe are also attractive structural growth drivers for increased use of private sector delivery through outsourcing.

Notwithstanding a weaker outlook for market growth, we still believe in the longer term that we will be able to achieve our margin target of 5% and hopefully beyond. Even quite small levels of revenue growth will have a noticeable effect on margins if we can keep overheads flat or reducing. Unless unforeseen headwinds or contract losses occur, we expect Serco's revenue growth to shift to being ahead of the market given the improvement in our order intake. The recent wins of the AASC asylum seekers contract – at £1.9bn the largest contract we have ever been awarded – and National Garrison Health Services in Australia support our confidence of achieving 3-4% revenue growth in 2019. The benefit of these two contracts into the following year, along with other previous wins that become operational that year such as Clarence Correctional Centre (formerly known as Grafton) and the Australian icebreaker vessel, lead us to expect revenue growth to improve to around 5% in 2020.

Chairman's Statement continued

Our Board

Serco's Board has seen considerable change since I became Chairman in July 2015. In considering new members of the Board, we have been determined to have a mix of backgrounds and experience to ensure that we have a balanced, dynamic and effective Board.

In November, Mike Clasper, Senior Independent Non-Executive Director, notified the Board of his intention to stand down with effect from 31 December 2018. John Rishton, who was appointed as a Non-Executive Director in 2016, assumed the role of Senior Independent Director and joined the Nomination Committee from 1 January 2019. Kirsty Bashforth, who was appointed as a Non-Executive Director of Serco in 2017, has replaced Mike as Chair of the Corporate Responsibility Committee. I would like to thank Mike for his support as the Senior Independent Director and, on behalf of the Board, for the extensive contribution he has made to the Company since joining in early 2014, a period during which the Board of Serco has had to deal with significant challenges. I would also like to welcome John to the role of Senior Independent Director, a position for which his immense experience makes him well qualified.

I was delighted to welcome Eric Born, who joined the Board as a Non-Executive Director and a member of the Audit and Corporate Responsibility Committees on 1 January 2019. Eric has considerable international, strategic and operational experience and will add to the strength and breadth of the Board. The background and experience of each Director are detailed in the Directors' Report on pages 84 to 85 and details of the selection process to the appointments are set out in the Nomination Committee Report on page 100.

We have continued in 2018 to further develop the effectiveness of our governance, operational resilience and organisational change processes. Your Board has also been actively involved in evaluating individual bids and contracts based on their size or risk profile, as well as meeting regularly with senior management responsible for the delivery of the Company's key operations and for the development of new business. Board members often visit contracts and meet with members of the wider management team, and Non-Executives participate in our Oxford University Serco Management training course, which is attended by around 30 managers and runs four times a year.

I am pleased to report that we have fully complied with the provisions of the UK Corporate Governance Code during 2018. This has included conducting an externally-led Board evaluation, which was deferred in 2017 given that three new Non-Executive Directors had joined that year, and so was carried out later in 2018.

The Board believes that strong governance is a vital component in the long-term success of the Company; further detail on our structures and processes, including recommendations from the Board evaluation, are set out in our Corporate Governance Report on pages 83 to 138, as well as the Committee reports.

Dividends

The Board is not recommending the payment of a dividend in respect of the 2018 financial year. The Board's appraisal of the appropriateness of dividend payments takes into account the Group's underlying earnings, cash flows and financial leverage, together with the requirement to maintain an appropriate level of dividend cover and the prevailing market outlook. Although the Board is committed to resuming dividend payments as soon as it judges it prudent to do so, in assessing whether we should resume dividend payments in respect of 2018, we are mindful of the fact that 2019 is the last year of significant outflows of cash related to OCPs and operating exceptional costs, which together will mean that net debt is likely to increase again 2019, albeit modestly. The Board will continue to keep the dividend policy under careful and regular consideration as we progress with completing the transformation stage and driving forward with the growth stage of our strategy.

Securing our future success

Your Board is absolutely focused on long-term, sustainable shareholder value creation, and doing so by promoting the best interests of shareholders alongside those of our employees, customers, and the societies and communities in which we work. Serco has a clear strategy to complete and embed the transformation of the business and position it for long-term success in its markets, and is on track to achieve this through a highly effective executive management team and a committed workforce that cares passionately about public service delivery.

We have made excellent progress in recent years turning the business around from its nadir in 2014, and I am delighted to report that in 2018 Serco is now growing its profits, has vastly improved its operational delivery, has a growing order book, a strong balance sheet, and has re-established its reputation with its customers.

I would like to thank all colleagues in the business for their efforts in achieving a very successful 2018, and for their continued support in helping Serco to be a superb provider of public services that we can all be proud of.



Sir Roy Gardner

Chairman
20 February 2019

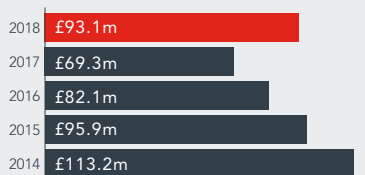
Key Performance Indicators

We use Key Performance Indicators (KPIs) to monitor our performance, ensuring we have a balance and an appropriate emphasis to both financial and non-financial aspects. In recent years, we have also evolved and improved our Management Information, including the contract performance monitoring process which tracks KPIs specific to each customer operation, our monthly management accounts and our Divisional Performance Review (DPR) processes.

For each KPI we explain the definition, relevance to our strategy and the performance in 2018. Aside from adding an additional KPI (order book), we have made no changes in 2018 to the KPIs presented and therefore there is comparability and consistency with our focus in the business and the guidance that we issue. The Finance Review provides further detailed definitions and reconciliations of our use of Alternative Performance Measures (APMs). Information on

our carbon emissions that was presented in this section in previous years can be found within our Corporate Responsibility Report on pages 66 to 82. A large number of other corporate responsibility measures can also be found on those pages, as well as in our more detailed corporate responsibility report for the year which is available on our website www.serco.com.

1. Underlying Trading Profit (UTP)



Definition

Trading Profit is defined as IFRS Operating Profit excluding amortisation of intangibles arising on acquisition as well as exceptional items. Consistent with IFRS, it includes Serco's share of profit after interest and tax of its joint ventures and associates. Underlying Trading Profit additionally excludes Contract & Balance Sheet Review adjustments (principally Onerous Contract Provision (OCP) releases or charges), and other material one-time items as set out in the Finance Review on pages 34 to 51.

Relevance to strategy

The level of absolute UTP and the relationship of UTP with revenue – i.e. the margin we earn on what our customers pay us – is at the heart of our 'profitable and sustainable' business objective, as well as being an output of 'winning good business' and 'executing brilliantly'. We describe on page 15 that the delivery of strategic success, after the

completion of further transformation, has potential in the longer term to deliver revenue growth of 5%+ and trading margins of 5%+.

Performance

The outcome was a significant improvement over the £80m we expected at the start of the year. The increase on 2017 was driven by a strong operating performance, good progress on transformation savings and the benefit of some non-recurring trading items. The underlying margin rose from 2.3% to 3.3%.

2. Underlying Earnings Per Share (EPS), diluted



Definition

Underlying EPS reflects the Underlying Trading Profit measure after deducting pre-exceptional net finance costs and related tax effects. It takes into account any non-controlling interests share of the result for the period, and divides the remaining result that is attributable to the equity owners of the Company by the weighted average number of ordinary shares outstanding, including the potential dilutive effect of share options, in accordance with IFRS.

Relevance to strategy

EPS builds on the relevance of UTP, and further reflects the achievement of being 'profitable and sustainable' by taking into account not just our ability to grow revenue and margin but also the strength and costs of our financial funding and tax arrangements. EPS is therefore a measure of financial return for our shareholders.

Performance

The increase reflects the strong UTP performance as described, together with the benefit of a lower underlying effective tax rate driven by the improvement in and mix of the Group's profitability.

Key Performance Indicators continued

3. Free Cash Flow (FCF)



Definition

Free Cash Flow is the net cash flow from operating activities before exceptional items as shown on the face of the Group's Consolidated Cash Flow Statement, adding dividends we receive from joint ventures and associates, and deducting net interest paid and net capital expenditure on tangible and intangible asset purchases.

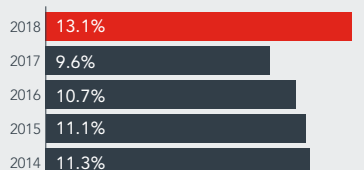
Relevance to strategy

FCF is a further reflection on how 'sustainable' our profits are, as well as the sustainability of the overall business, by showing a measure of how much of our effort turns into cash to reinvest back into the business or to deploy in other ways. Furthermore, 'winning good business' should reflect that which generates appropriate cash returns, and 'executing brilliantly' should include appropriate management of our working capital cash flow cycles.

Performance

The improvement includes that from increased UTP together with reduced outflows related to loss-making contracts subject to OCPs as reflected in the lower rate of provision utilisation. The working capital outflow at £22m was similar to the prior year, and the Group has not utilised any factoring or other working capital facilities during 2018.

4. Underlying Return on Invested Capital (ROIC)



Definition

ROIC is calculated as UTP for the period divided by the invested capital balance. Invested capital represents the assets and liabilities considered to be deployed in delivering the trading performance of the business. Invested capital assets are: goodwill and other intangible assets; property, plant and equipment; interests in joint ventures and associates; contract assets, trade and other receivables; and inventories. Invested capital liabilities are contract liabilities, trade and other payables. For 2014, invested capital is calculated using the closing balance sheet position, given the impact of the Contract & Balance Sheet Review during that year; for all other years it is calculated as a two-point average of the opening and closing balance sheet positions.

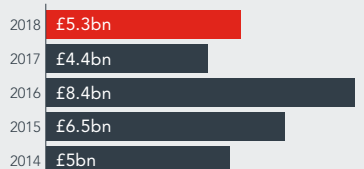
Relevance to strategy

ROIC measures how efficiently the Group uses its capital to generate returns from its assets. To be a sufficiently 'profitable and sustainable' business, a return must be achieved that is appropriately above a cost of capital hurdle reflective of the typical returns required by our weighting of the use of equity and debt capital.

Performance

The improvement in ROIC reflects both the increase UTP as described, as well as slightly lower invested capital largely resulting from the normalisation of average working capital balances. We expect further growth in ROIC to be driven by additional improvement in profit margin from successfully completing and embedding the 'Transform' stage and making continued progress with the 'Grow' phase of our strategy.

5. Pipeline of larger new bid opportunities



Definition

The estimated aggregate value at the end of the reporting period of new bid opportunities with Annual Contract Value (ACV) of at least £10m and which we expect to bid and to be adjudicated within a rolling 24-month timeframe. It does not include re-bids or extensions of existing business, and the Total Contract Value (TCV) of individual opportunities is capped at £1bn; also excluded is the potential value of framework agreements, prevalent in the US in particular where there are numerous arrangements classed as 'IDIQ' – Indefinite Delivery/Indefinite Quantity.

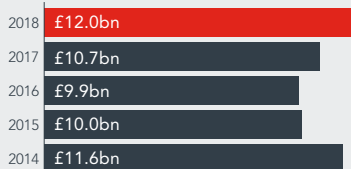
Relevance to strategy

The pipeline provides a key area of potential for 'winning good business' and therefore is a major input to being 'profitable and sustainable'. The size of the pipeline and our win-rate conversion of the bids within it will also ultimately be at the heart of successfully achieving progress in the third and final stage of our strategy implementation – the 'Grow' stage.

Performance

The pipeline at 31 December 2018 had increased by a net £0.9bn on the position a year earlier, reflecting a greater value of opportunities entering the pipeline versus those coming out. In January and February 2019, Serco has already won the two largest opportunities that were in the pipeline – AASC in the UK and NGHS in Australia. Removing these opportunities from the £5.3bn pipeline as at 31 December 2018 would reduce it down to around £3.6bn. As we have previously stated, a lower pipeline is not a matter of undue concern, particularly when this is driven by a strong order intake, together with the ability for us to also improve profitability through rebid opportunities or where we can add to our order book through acquisitions as evidenced with the Carillion health facilities management contracts.

6. Order book



Definition

The order book reflects the estimated value of future revenue based on all existing signed contracts, excluding Serco's share of joint ventures and associates. It excludes contracts at the preferred bidder stage and excludes the award of new Multiple Award Contracts (MACs) or IDIQ contract or framework vehicles, where Serco cannot estimate with sufficient certainty its expected future value of specific task orders that may be issued under the IDIQ or MAC; in these situations the value of any task order is recognised within the order book when subsequently won. In 2018, the definition was aligned with IFRS15 disclosures of the future revenue expected to be recognised from the remaining performance obligations on existing contractual arrangements. This excludes unsigned extension periods, but the £12.0bn would be £13.0bn if option periods in our US business were included.

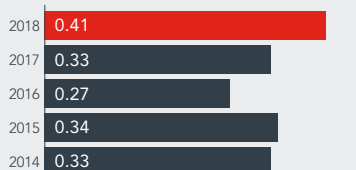
Relevance to strategy

The order book reflects progress with 'winning good business' including retaining existing work through extensions or rebids, and as a store of future value it is a key measure to ensure the Group is 'profitable and sustainable'. The value of how much is added to the order book compared to how much revenue we are billing our customers – the book-to-bill ratio – is key to achieving long term growth.

Performance

With an order intake of £2.9bn there has been growth in the order book through another year of a book-to-bill ratio of over 100%. This was further enhanced by adding £0.7bn to the order book with the acquisition of the Carillion health facilities management contracts. The AASC and NGHS wins in early 2019 will add a further £2.5bn to the order book.

7. Major incident frequency rate, per 1m hours worked



Definition

Major incidents are classed as fatalities, fractures, amputations, dislocations, loss of sight, chemical and hot metal burns, electrical burns, unconsciousness caused by asphyxia or exposure to a harmful substance, and acute illness resulting from substance inhalation or ingestion.

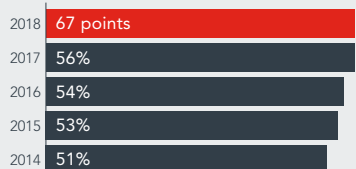
Relevance to strategy

Delivering excellent service to our customers, and therefore 'executing brilliantly', requires us to operate in the safest way possible. Safety also has a direct bearing on the commitment and engagement of our people, which is central to achieving 'a place people are proud to work'.

Performance

Across some 90 million hours worked in 2018 there were 37 major incidents reported. This resulted in a frequency rate of 0.41 per 1 million hours worked which is 24% up on 2017 and exceeds our target which was set at maintaining the 2017 baseline. This indicator has been impacted by increasing numbers of physical assaults and particularly serious physical assaults within our Justice & Immigration business. The importance of a safety culture is a key area of focus for the Group and hence why tough targets are set. This and the range of initiatives being implemented to address the situation are covered in the Corporate Responsibility Report.

8. Employee engagement



Definition

We use a specialist third party provider to run Viewpoint, our global employee engagement survey. The survey covers all employees, excluding our joint ventures, and measures engagement in two key areas: how happy employees are working at Serco, and their intention to recommend Serco to others. Our engagement score incorporates all employees' perceptions and shows the overall average view of these two areas when we survey. In 2018, our methodology for calculating employee engagement changed, aligned to our new provider. Pre-2018, engagement results represent the proportion of engaged employees expressed as a percentage. As of 2018, engagement scores represent the average response, with a maximum potential score of 100. It is not possible to adjust all our historic data to restate to the new methodology.

Relevance to strategy

Employee engagement reflects 'a place people are proud to work', which is crucial to delivering outstanding customer service and achieving our strategic aims.

Under the new scoring methodology, a score of 70 points or above is our target for 2020, which aligns with the global cross-sector benchmark provided by the specialist third party provider of our survey.

Performance

The 2018 Viewpoint survey was based on some 28,000 employees responding, representing a response rate of over 70% which is considered very strong versus the benchmark from the specialist third party provider of the survey. While the scoring methodology has changed as described above, analysis performed by the provider indicates that the engagement level was broadly stable on the previous year's score which was already the highest since we started measuring engagement in 2011. The Viewpoint results are cascaded throughout the organisation and detailed plans of activity put in place to focus on areas highlighted by the detailed scoring analysis and the comments raised. In addition to completing the survey questions, some 29,052 individual comments were submitted, which is considered to be very positive reflection of the culture of openness and care of our employees.

Our Market

We believe that fundamental drivers will continue to increase demand for our services.

Serco delivers services to governments and other institutions who serve the public or protect vital national interests. We focus on five sectors: Defence, Justice & Immigration, Transport, Health and Citizen Services, and deliver them in the UK, Continental Europe, North America, Asia Pacific and the Middle East.

Government as a purchaser of public services

Governments have two basic responsibilities: to develop policies, and to ensure that those policies are delivered. Some policies can be delivered simply by enacting legislation, relying on individuals and corporations to deliver the policy themselves by acting in accordance with the law, with the police and judiciary acting as enforcers of behaviour. An example of this would be a policy that required a speed limit of 20 mph near schools, which can be enforced by the police in the normal course of law enforcement. Other policies require substantial specialist workforces to be employed to deliver them. One example would be a policy that pending the adjudication of their applications, asylum seekers should be housed in the community, rather than in detention: such a policy requires the government to employ – directly or indirectly – the people required to manage housing and welfare services. Another example of a policy that requires a dedicated workforce to deliver it would be air traffic control, which requires highly qualified staff to be deployed, often to remote locations.

Public services require people

The delivery of many areas of government policy is labour intensive, and the number of people involved in the delivery of government services vastly outnumber those involved in developing policy; in some countries, government is the largest employer. For example, according to the United States Bureau of Labor Statistics, nearly twice as many people (22 million) are employed by local, state and federal government as are in manufacturing (12 million).

The labour-intensive nature of government service delivery demands strong management of the processes to recruit, organise and oversee the hundreds or even thousands of people required to deliver a public service. Many public servants are talented managers, but all governments find it hard to attract and retain in the numbers required to deliver services in the face of private sector competition for these skills. Serco helps governments by being a bridge between the drive, energy and innovation of the private sector, and the very specific requirements of public services.

The private sector as a supplier of public services

Governments have used private contractors to deliver public policy, often in very sensitive areas, for centuries. In medieval times, fighting wars and tax collection were often outsourced, in whole or part, to private enterprise. The transportation of prisoners from the UK to Australia, which started in 1788 and continued until 1868, was carried

out entirely by private contractors. Today, in the UK, frontline medical services by the National Health Service, which is widely perceived as a nationalised service, is largely provided by privately-owned businesses called General Practitioner Practices, the vast majority of whom are employed by private partnerships and companies rather than by the state. Some of the most sensitive and secret defence work, such as developing and supporting strategic nuclear weapons, is carried out by private companies.

Some services which governments need in order to deliver public policy are similar or identical to those required in the private sector, and suppliers can happily operate in both markets. Running payroll, providing telecoms networks and IT centres is not vastly different in the public and private sectors. But some government services – such as running prisons or providing air traffic control – are unique to government and have no private sector equivalent. Many government services are bought only by government, and providing them is a specialist business, quite different from anything found in the private sector. However, many of them can be run efficiently on behalf of government by private companies using techniques, management, technology and processes developed in the private sector.

Unique demands of public service delivery, and some history

Providing government services to citizens, funded by taxpayers, is different, and in many ways more demanding, than providing services to the private sector or consumers. Politics, transparency and accountability to multiple stakeholders are sometimes seen only dimly in the private sector, but are writ large in the public sector, and need careful management. Serco has deep expertise in providing this bridge: overlaid on our private sector techniques, drive and energy is a public service ethos that means that we can help deliver government services efficiently, but in a way that recognises the need for public accountability and trust, and the fact that we are often looking after some of the most vulnerable and disadvantaged in society.

Having government as your customer also means that you are exposed to the ever-changing political weather. In essence, this is no different from any other market where fashion, technology and economic conditions impact demand, but governments can change their policies and priorities with lightning speed. For nearly thirty years between 1980 and 2010, Serco grew rapidly as the market for outsourcing public services developed around the world. Inspired by Thatcherism and the policies of President Reagan, privatisation and outsourcing became popular in many countries and drove rapid growth of an industry that had barely existed before. Suppliers became highly profitable and skilled at extracting value from government contacts.

As the global financial crisis of 2008 took hold, governments began to urgently seek ways of reducing costs, and the private sector, now representing a significant proportion of government expenditure, became the object of close

“The challenge facing governments worldwide can, like our strategy, be simply expressed: to deliver more, and better, for less.”

government attention. Following the ending of the war in Afghanistan, military expenditure was sharply reduced, particularly in the US. 2010 saw in the UK the election of the Conservative-Liberal Democrat Coalition, with an avowed intent of reducing the deficit, and as a statement of intent demanded rebates of hundreds of millions of pounds from contractors; more importantly, the UK Government strengthened its commercial teams and procurement practices and set about transferring as much risk as it could to the private sector. It appeared to be a conclusion of UK Government that if risk transfer was a benefit to them of outsourcing, surely the more risk you could force suppliers to take, the better. In the US, “Lowest Price, Technically Acceptable” was increasingly used instead of an approach of overall “Best Value” as a tender evaluation methodology. Whilst these sorts of shifts in demand and in the relative power of customers and suppliers are common to all markets, the difference in dealing with government is the fact that government is a monopoly purchaser; only governments buy prisons, or weaponry, or care of asylum seekers, so when they change their direction it can have very profound impacts on their supply chain.

The story of the last five years in the UK has been one of acute difficulty for the outsourcing industry. Over-supply, highly-aggressive behaviour by both government and suppliers, and the ill-advised transfer of risks that often private companies had no way to mitigate or manage has led to the near-destruction of a once thriving industry, as multiple companies have suffered huge losses on government contracts. As a consequence, the UK Government is now faced by a much more wary, and less vibrant, supply chain. Having discovered to its joy that it could attract new international competition into the market because barriers to entry seemed low, it has subsequently discovered to its potential dismay that the barriers to exit were low as well.

Having swung too far in favour of contractors, the balance of power in the public services market in the UK swung too far back to government after 2010; it is, we believe, now beginning to work its way back towards a more balanced and sustainable position. Such is the way of all markets as they mature, and we believe that if governments and their suppliers recognise the consequences of their past excesses and work co-operatively it should become possible to anchor the balance of power between customer and supplier in a place which delivers value for money for taxpayers, high quality and reliable services to users, innovation and improving efficiency, as well as the fair returns to suppliers which will in turn ensure that government has choice from a vibrant supply chain containing companies both large and small.

Drivers of demand

Notwithstanding the difficulties in the UK market, the business of providing services to government is attractive in the long term for a number of reasons. First, in many areas of public service provision, private companies, properly managed, can deliver services of higher quality and lower cost than governments can themselves. Secondly, governments will continue to face relentless pressure to deliver more and better public services, at lower cost, and that this will lead them to focus relentlessly on value for

money and the quality of service provision. This pressure comes from what we call the ‘Four Forces’ comprising:

- the unavoidable increase, at rates above GDP growth, of demand for public services across important areas of government. Examples are the pressures on health and social care driven by ageing populations, and growing prison populations;
- the need to reduce public debt and expenditure deficits;
- rising expectations of service quality amongst public service users; and
- the unwillingness of voters and corporate taxpayers to countenance tax increases.

The third reason why the market for government services is attractive is because of its enduring nature compared to other markets. All around us, we see markets being disrupted and long-established business models being obliterated. Publishing, transport, retailing, energy, entertainment, computing, agriculture – it is hard to find industries which are not being fundamentally challenged by technology. We live in a world where it has become possible for the largest retailer to own no shops, the fastest-growing taxi service to own no vehicles, the largest social network to own no content, and the largest provider of overnight accommodation to own no property.

Whilst many areas of government will benefit from the ability to manage massive data and will find new ways to interact with citizens, we believe that there will be a continuing and enduring need for the kind of frontline services we provide. We are confident that in thirty years’ time, sick people will still go to hospitals, and when there they will have their rooms cleaned and food served predominantly by humans. That when people break the law they will be sent to prison where custody officers will look after them; and that complex defence infrastructure such as near-space radar will still be maintained predominantly by human beings, who will need to be security cleared, again by other human beings. The bank teller or lorry driver or shop assistant may be rightly fearful that technology will disintermediate their role, but a prison custody officer or hospital porter can sleep soundly in the knowledge that his or her skills will be required for years to come.

Finally, although in their own country a government can wield the power of a monopoly purchaser, every country has a government, and with an international footprint together with a range of service offerings, agile suppliers can move to where the demand is and where they can get a fair return for the risk they take on. In a market with low barriers to both entry and exit, suppliers can move, but governments cannot.

We believe that the long-term pressures to deliver value-for-money, increasing demand for public services, and the need to improve service delivery will ensure that the role of the private sector in the delivery of public services will remain robust. The challenge facing governments worldwide can, like our strategy, be simply expressed: to deliver more, and better, for less, and they cannot do this without the support of the private sector. Technology will have a profound impact on the delivery of government services, but many frontline services will still need the social and emotional skills that only

Our Market continued

humans provide, and we believe the principal method of delivery of many government services will remain people for years to come. And the employment of people in the reliable delivery of public services is what we do, and we do it very well.

Benefits of sector breadth and geographic reach

We focus our activities in five areas of government service: Defence, Justice & Immigration, Transport, Health and Citizen Services. Between them, these sectors account for a very large proportion of government expenditure and employ significant numbers of people in service delivery.

As well as providing a bridge between the private and public sector, Serco also provides the international and inter-departmental sharing of ideas and best practice which governments often find hard to achieve. New approaches for running prisons and reducing youth re-offending in the UK come from Australia; hospitals we manage in the Middle East use processes developed in the UK; likewise, our Defence business in the Middle East serves Australian armed forces. We transfer our insights, skills and processes from one sector or region to another, so we can anticipate and meet new challenges for customers. In our markets we are a rarity: a company that offers services covering front, middle, and back office requirements across multiple areas of government policy delivery, internationally.

Risk management is central to our thinking at both a strategic and an operational level. In terms of strategy, although being a focused and specialist B2G business, we think it beneficial, and a competitive advantage, to diversify our exposure to individual governments and sectors. Governments can be capricious; decision-making processes regularly come to a halt around elections; the attitude to using private companies can be volatile; political priorities can change in the blink of an eye, switching discretionary resources from defence to immigration to healthcare and back again. In this environment, being diversified both by sector and geography reduces risk and volatility. Most companies operating in our market are heavily focused in either a particular sector, or within a geography; in our market, Serco is a rare beast, operating amongst five sectors and four regions.

But management of risk is only one reason we favour a strategy of operating across a number of jurisdictions and sectors. Governments across the world face similar challenges, and we believe that we can gain competitive advantage and deliver value to customers by operating internationally. At a detailed operational level, providing cleaning and catering services in a hospital is very similar in Western Australia and in Abu Dhabi. In terms of capability, many of our contracts employ hundreds, and some, thousands, of people; so recruitment, training, staff rostering and time management are key capabilities applicable across all our sectors and geographies. The same is true of project and case management; we are also able to adopt consistent approaches to key operational tools such as Continuous Improvement.

A large and growing market

People ask: how large is the market for the private sector provision of public services? This is hard to determine with precision, as the boundaries of the market are fiendishly hard to define. Does the maintenance contract for a mainframe computer operated by the government fall within the definition of the market? How should we treat services provided by government-owned agencies operating on an arm's-length basis? Within Defence, do we count supply and support of, say, missile systems, or just the types of services we currently (as opposed to could) supply? And how do we disentangle the very different definitions of, and accounting for, expenditure used by the various governments with whom we deal?

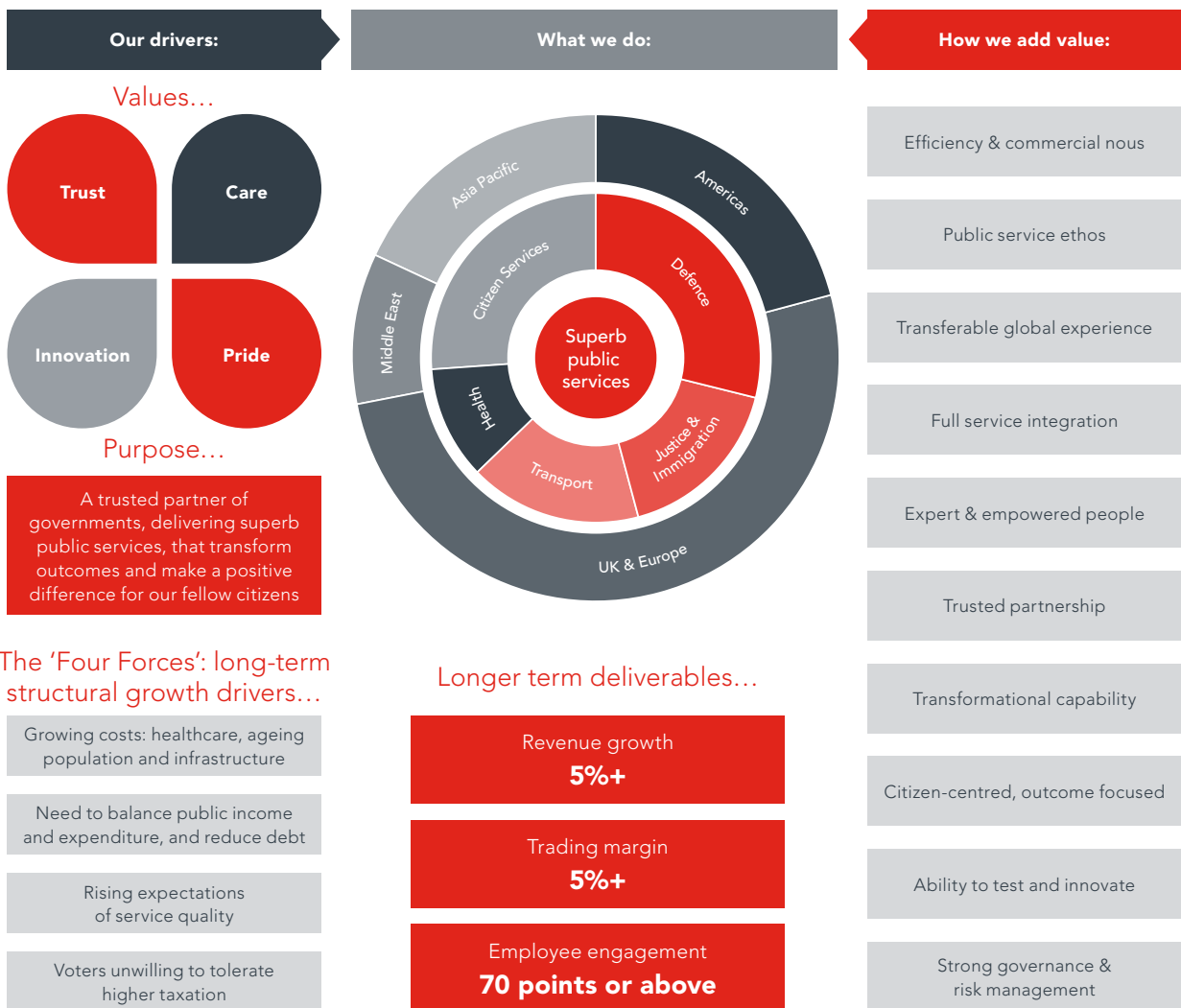
In 2014, and again in 2016, we did a lot of work to try and size the market in the sectors and geographies we currently operate in, which are clearly a subset of the global market. Our best guess is that the total annual value of government services in our target segments and geographies which could be provided by the private sector is around £300bn, of which around £100bn is delivered by private companies. Rather than concentrate on the absolute number, some key conclusions from our work are:

- the market for private sector delivery of government services is very large;
- the supply-side is fragmented; as a leading international supplier, our market share within our existing footprint, at around 3%, is small, although it is larger in some specific segments within certain sectors; and
- there is significant opportunity for growth, given that around two-thirds of the services that could be provided by the private sector are currently self-delivered by government.

In terms of market growth, in 2018 we carried out further work to assess the rate of growth in our specific sectors and geographies. When we last did this, in 2014, we concluded that the blended rate of growth of our mix of businesses had been running at 5-7%. Largely as a function of the weighting of our revenues to the UK – some 40% of the total Group – and the well-publicised travails of our home market, caused both by Brexit and the issues in government supplier relations described above, we now think that market growth is likely to be running at around 2-3% as a weighted average across our markets. We see little likelihood that blended rates of growth across our markets will increase much beyond this in the immediate future, with much dependent on the nature of the UK Government post-Brexit, though Brexit itself may stimulate additional demand. We see no reason to believe, however, that in the longer term that the rate of market growth might not revert to the previous levels of 5%+.

Our Business Model

We combine people, processes and technology in order to achieve our purpose of delivering superb public services. Serco is not a consultancy or a technology business; we use process and technology as enabling tools, not as products to sell. Furthermore, since processes and technology depend on people, it can be simply said that the success of our strategy will depend upon how well we manage, organise, motivate, develop and select people. So the answer to 'how?' is: 'by being the best-managed business in our sector'.

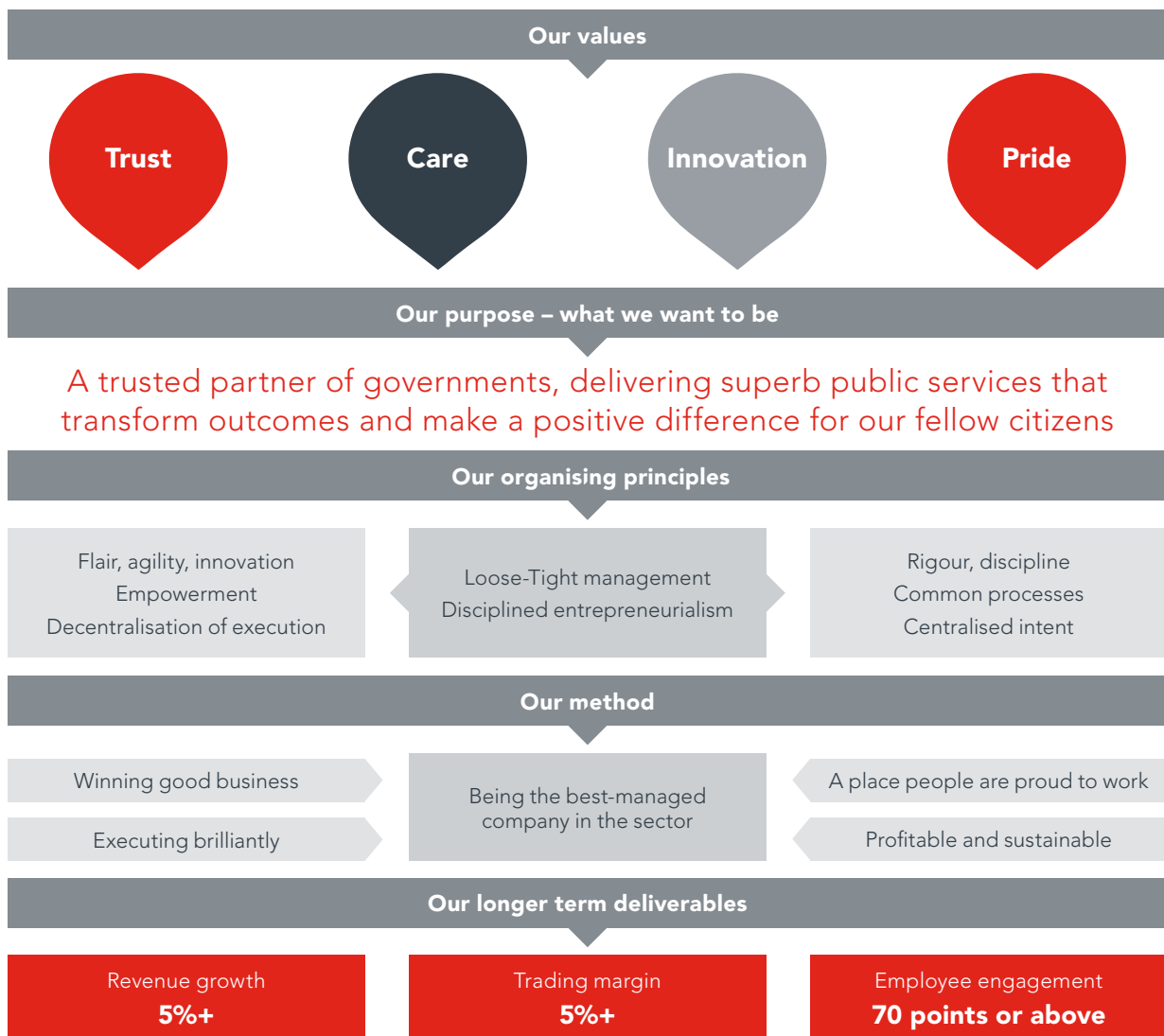


Having such an ambition may sound trite, but we believe that it is a worthy and value-creating aspiration, and one that we can use to inspire our management teams and customers. In any given circumstances, and whatever the slings and arrows of fortune, well-managed businesses do better than poorly-managed businesses, and the best managed businesses do best of all.

As managers, our job is to ensure Serco delivers value to the people and institutions who have an interest in our success: to our customers and service-users, by providing high-quality, resilient and innovative public services; to our shareholders, by providing sustainable and growing returns on capital; to our lenders, by providing them with a solid and secure credit; and to our colleagues, by enabling them to have interesting and rewarding careers.

Our performance framework and strategic priorities

We are great believers in succinctness and simplicity. Accordingly, we have managed to fit our performance framework and strategic priorities – of what might be considered a complex and diverse business – into a single graphic that we use throughout the Serco.



The purpose of the performance framework is to provide a structure which will deliver value to our customers, shareholders, and to the people who work in the business. Like the Business Model, therefore, it ends with our deliverables and starts with our Values.

Our values

Whilst we use technology and processes, the core of our business is people – many thousands of them – delivering public services. It is of central importance to our success that our colleagues, many of whom are former public servants, and our customers, know that we have values appropriate to a company delivering services funded by taxpayers to often vulnerable and disadvantaged citizens. "Working at the leading edge of technology" may be inspiring to people working for IT businesses, but they are not reasons why a

prison officer makes a cup of tea for a suicidal prisoner at two o'clock in the morning; why a housing officer leaves the comfort of an office to guide a nervous asylum seeker's child to school on their first day; why an engineer crawls into that impossibly small space in the foetid bowels of an aircraft-carrier to make sure the cable-ties are secured just right so they will stay in place in storm or battle. It is because they care about their work, they recognise the importance of what they do, and they take immense pride in it.

Before our customers will give us sensitive work, they have to trust us. And to win business we have to come up with innovative solutions which will enable governments to deliver more, and better, for less. This is why our Values of Trust, Care, Innovation and Pride are so important. We don't pretend to be saints, or to be holier-than-thou; we are not so naïve as to believe that in a workforce of over 50,000 people there will not be some uncaring bad eggs. But the overwhelming majority of our colleagues are decent, hard-working, committed, and want to make a positive difference to those they serve. In this, we reflect the values of our customers, which they call a "public service ethos", and we call our Values.

Our organising principles

Our organising principles have to reflect the fact that many of the things our customers want are mutually exclusive: they want excellent and resilient services, delivered by highly motivated staff, but they want them to be low cost; they want local accountability and flexibility, but they also want strong governance and risk management. As a management team, we believe in the principle of subsidiarity: that decisions should be taken by managers who are as close to the customer as possible. But we are also conscious of the fact that many of our contracts carry with them risks that need careful management and supervision. So we describe our organising principles with two concepts: 'loose-tight', and 'disciplined entrepreneurialism'. Neither of these is our own invention; they are based on the work of, respectively, Tom Peters and Jim Collins. They describe in subtly different ways an approach to management which recognises the need for both local management autonomy and strong governance. Two quotations from their works give a taste of the type of organisation we are trying to achieve:

"Loose-Tight... is the coexistence of central direction and maximum individual autonomy. ... Organisations that live by the loose-tight principle, are on the one hand rigidly controlled, yet at the same time allow (indeed insist on), autonomy, entrepreneurship, and innovation from their people."

Tom Peters: *In Search of Excellence*

"Avoid bureaucracy and hierarchy and instead create a culture of discipline. When you put two complementary forces together – a culture of discipline with an ethic of entrepreneurship – you get a magical alchemy of superior performance and sustained results."

Jim Collins: *Good to Great*

Organisationally we structure ourselves with three types of function: Divisions, Group and Shared Services. All operational delivery is executed through four geographic Divisions: UK & Europe, the Americas, Asia Pacific and the Middle East. Within their domains, Divisions are responsible for everything involved in winning and delivering contracts; 98% of our employees work in these Divisions. A lean Group function provides governance, strategy, asset allocation, policy-setting and oversight, as well as certain specialist consolidation and functional roles in Finance, Legal Risk and HR; the Group also manages Centres of Excellence (CoEs) which provide focused expertise and support to the Divisions, and enable sharing of best practice and the development of

common propositions in areas such as Justice & Immigration and Health. Shared Services provide common functional and processing support in areas such as IT, HR and finance to the Divisions.

Our method – the strategic priorities to achieve our aspiration

The method we use to deliver our aspiration – to be the best-managed business in our sector – and to deliver our strategy is to concentrate on doing four things really well. These are the four strategic priorities we want Serco to be famous for:

- Winning good business
- Executing brilliantly
- Being a place people are proud to work
- Being profitable and sustainable

We try to make sure that everything we do improves our performance against one or more of these objectives, and start from a position where we know we can do better.

We can improve the way we bid and manage contracts; develop innovative propositions; measure performance; reduce the cost and improve the quality of our administrative systems and processes. None of these comes easily or quickly, and we need to steer a tricky course between the need to reduce our costs relative to revenues in the short term and investing in systems and processes that will produce sustainable benefits in the long term.

Our longer term deliverables

The tangible evidence of our success or otherwise will be a return to former industry rates of growth and margins. In recent years our revenues have been shrinking and our underlying trading margins are far too low at around 2-3%. Our challenge, and our opportunity, is to get back to long-term industry rates of revenue growth, which in the past were around 5-7%, and Trading Profit margins across Serco's mix of business in the range of 5-6%.

Largely as a function of the weighting of our revenues to the UK – some 40% of the total Group – and the well-publicised travails of our home market, caused both by Brexit and the issues in government supplier relations described above, we now think that market growth is likely to be running at around 2-3% as a weighted average across our markets. We see little likelihood that blended rates of growth across our markets will increase much beyond this in the immediate future, with much dependent on the nature of the UK Government post-Brexit, though Brexit itself may stimulate significant additional demand. We see no reason to believe, however, that in the longer term this might not revert to the previous levels of 5%+.

Strategy implementation

In 2014 we identified three distinct phases in the implementation of our strategy:



The first phase – Stabilisation – recognised the urgent need to recapitalise the business and restore customer confidence and employee morale following the very significant write-downs upon the realisation that Serco had a number of very heavily loss-making contracts. This phase was largely completed in 2014, although the fundraising and essential stabilisation of our balance sheet did not take place until 2015 after which further rebuilding of customer confidence and trust could then follow. The Transformation phase gathered pace in 2016 and 2017, and in practice will continue through into 2019, and is an essential underpin as we progressively move into the Growth stage. When we launched the plan, it was conceived that Growth would refer to both revenues and profit.

However, more recently, we believe that market rates of growth have been lower and certainly for the next few years the market may well only be more likely to grow at a low single-digit percentage rate, but our margins can still increase as we transition from our Transformation phase and see more growth coming from cost reduction and increased efficiency. Nature does not draw lines – she smudges them, and the same applies to our strategy implementation, where the phases of Stabilisation, Transformation and Growth necessarily overlap.

Transform: progress to date

Key achievements during our Transformation phase have been:

- We have successfully strengthened our balance sheet, following the Rights Issue completed in April 2015 and the disposal of our private sector BPO business; together these raised over £700m, and our underlying leverage measure of Net Debt:EBITDA now stands at 1.2x, with period-end net debt reduced from £745m at the end of 2013 to £188m at the end of 2018.
- We have made further excellent progress rebuilding confidence and trust with our major customers, in large part due to greatly improved operational performance.
- Portfolio rationalisation carried out, including the disposal of the majority of our private sector BPO business at the end of 2015.
- We continue to mitigate the impact of loss-making contracts; we have always regarded our Onerous Contract Provisions as a portfolio, knowing that the actual out-turn on individual contracts would almost certainly be different from the original estimates made at the end of 2014. Up to the end of 2018, actual expenditure against the £447m of Onerous Contract Provisions has been very close to the original estimate.
- We continue to strengthen our sector propositions, most particularly through the work carried out by our CoEs such as those covering Health and Justice & Immigration, which have been heavily involved in developing propositions to support major bids such as Barts Health NHS Trust (won in 2016) and Clarence Correctional Centre (previously known as Grafton prison) in Australia (won in 2017).
- Our order intake has grown very substantially, such that in 2017 and 2018 it was ahead of revenue, the first time since 2012 that book-to-bill had been greater than 100%; at the end of 2018, our order book stood at £12.0bn.

Grow: progress to date

We are now making significant progress in growing the business again, with key achievements being:

- After four years of decline, in the second half of 2018 the Group achieved broadly flat organic revenue, with a return to growth anticipated for 2019. Improving our win rates and retention of work in our focused sectors and geographies has been paramount to achieving this.
- Profits and margin grew significantly in 2018, and further progress is expected in 2019. In particular this reflects the success to date in reducing the businesses' operating costs; in 2018 they were more than £1bn lower than in 2014. The majority of this reduction relates to costs removed from contracts which have ended and businesses disposed of, but it is certainly an achievement to have reduced costs broadly in line with revenues. Importantly, our cost reduction also includes more than £20m in 2018 in addition to the over £100m removed over the prior three years of the Transformation stage, through our programmes to deliver savings by reducing the number of management layers, implementing better procurement and driving greater efficiency in the operation of shared services.

- After three years of outflows, positive Free Cash Flow was achieved in 2018. The outflows related to onerous contracts have more than halved between 2015 and 2018, while working capital and cash flow management has also normalised.

Summary

We believe we have the right strategy for our business, and every year since 2015 we have delivered results which have been in line or ahead of our plan, which is no mean achievement. So far, so good, and with Underlying Trading Profit growing by 34% in 2018, and our strong order intake, 2018 feels like something of an inflection point for our business. But the long-term test of the strategy will be our ability to deliver further margin increases, together with profitable revenue growth. The market is currently growing at rates below historic trend, and we expect that in 2019 profit growth will continue to come more from further cost efficiency and operational progress than from any significant increase in revenues. However, looking to 2020 and beyond, the strong order intake in recent years which includes some contracts such as Clarence Correctional Centre and the Australian icebreaker vessel which will only start to contribute operational revenues in 2020, as well as the award of some £2.5bn of orders in January and February 2019, give us confidence that we will be able to start to deliver increased revenue growth in 2020, and that this should result in further improvements in our margin towards our target level.

In summary, our plan seems to be working.

Chief Executive's Review



Rupert Soames
Chief Executive

"2018 marked an inflection point for Serco. After several years of declining revenues and profits, Underlying Trading Profit at constant currency rose 40%, Reported Operating Profit grew fourfold and Revenue started to grow again in the second half.

Underlying Earnings per Share (EPS) grew by 63%, Reported EPS was positive for the first time since 2013, and Free Cash Flow also turned positive for the first time since 2014. Our balance sheet remains strong, with Net Debt : EBITDA for covenant purposes at 1.1x, down from 1.4x in 2017; our pension schemes are well funded; there was no use of working capital finance facilities; we pay our suppliers on average in 30 days and our customers pay us on average in 29 days; and we have recently successfully completed the refinancing of a £250m banking facility committed to December 2023, on terms similar to previous arrangements.

Strong order intake gave us a book-to-bill ratio of over 100% for the second year in a row, and in addition the acquisition of the Carillion health contracts contributed to our order book growing to £12.0bn at the end of 2018, an increase of around 20% since 2016. Also for the second year in a row, and reflecting the Group's broad international footprint, 80% of our order intake in 2018 came from outside the UK. Our confidence has been further bolstered by the signing in the first six weeks of 2019 of two very large contracts: AASC – asylum accommodation and support services in the UK valued at £1.9bn, and NGHS – defence healthcare provision in Australia valued at £0.6bn.

We expect to deliver further progress in 2019, with Revenue and Underlying Trading Profit both expected to grow. Beyond 2019, and consistent with our strategy announced in 2015, we believe we will be able to continue to improve our margins, with a target of achieving 5% or above in the longer term. In terms of demand, we now believe that the weighted growth rate across all our geographies and sectors has slowed from the 5-7% seen in 2010-2014 to around 2-3% now; whilst demand in some markets – for example US defence – remains robust, conditions in the UK, which represents about 40% of our revenues, are weak and this is acting as a drag to aggregate market growth. Despite this, our recent strong order intake means that we believe we should be able to outperform a weaker market in the next few years, absent unforeseen headwinds or major rebid losses. We expect Serco to achieve revenue growth of 3-4% in 2019, accelerating to around 5% in 2020 as contracts such as Grafton, Icebreaker, AASC and NGHS become fully operational."

2018 Highlights

- Revenue⁽¹⁾ at constant currency declined 5.6% in the first half, but grew 2.5% in the second half, resulting in a decline for the full year of 1.7%, comprising a 3.1% organic decline from net contract attrition, partially offset by a 1.4% net contribution from acquisitions. The adverse impact of currency in the full year was £65m, or 2.2%, resulting in a 3.9% decline in revenue at reported currency.
- Underlying Trading Profit⁽²⁾ at constant currency increased by 40% as a result of a strong operating performance, further good progress on transformation savings and other cost efficiencies, as well as £10m of non-recurring trading items such as end-of-contract settlements. There was an adverse currency impact of £4.0m or 6%, resulting in a 34% increase at reported currency. Margin increased by a percentage point to 3.3% (2017: 2.3%). The improvement in performance was widely spread, with all regional divisions delivering double-digit percentage growth in UTP and increases in margin.
- Reported Operating Profit increased nearly fourfold, and includes a £23.6m net credit from Contract & Balance Sheet Review items (2017: net charge of £24.2m) offset by a net charge for exceptional items of £31.9m (2017: net charge of £19.6m), neither of which are included in Underlying Trading Profit. Onerous Contract Provisions (OCPs) are ahead of our 2014 plan and the residual liability now stands at £82m, down from £447m in 2014 and £147m at the start of the year.
- Underlying EPS increased by 55%, reflecting the growth in Underlying Trading Profit, together with the benefit of the tax rate reducing from 35% to 26%. Reported EPS, which includes the after-tax impact of non-underlying items as well as net exceptional costs, stood at 5.99p (2017: loss per share of 0.76p).
- After three years of outflows, Free Cash Flow⁽⁴⁾ turned positive at £25m.
- Net debt increased by £47m (2017: £32m), as the positive Free Cash Flow was offset by £19m of exceptional items, net acquisition consideration of £31m and a £22m negative net foreign exchange impact largely related to our US\$ denominated debt. However, the growth in EBITDA resulted in underlying leverage of 1.23x and of 1.06x for covenant purposes, comfortably around the bottom of our normal target range of 1-2x. During the year we successfully refinanced our banking facility on terms similar to those previously in place, with a £250m Revolving Credit Facility now committed until December 2023.
- Acquisitions: BTP Systems, acquired for £13m in February 2018 with the intention of deepening our satellite and radar capabilities, is now fully integrated within our US defence business. Six Carillion health facilities management contracts in the UK, acquired for £17m, have now been successfully transitioned to our ownership and management.
- Order intake of £2.9bn, book-to-bill ratio over 100%; 80% of order intake was from customers of our Americas, Middle East, AsPac and continental European operations, with the remaining 20% from the UK. 66% of the order intake comprised existing work being rebid or extended, and 34% was new business. The largest award was the rebid of our US health insurance eligibility contract valued at around £700m, with over 40 other awards worth more than £10m.
- Order book increased to £12.0bn, up from £10.7bn a year earlier; the increase includes the strong order intake together with £0.7bn added via the acquisition of the Carillion health facilities management contracts and an adjustment to the definition to align with IFRS15 future contractual revenue.
- Pipeline of larger new bid opportunities increased by £0.9bn to £5.3bn at 31 December 2018; the £2.5bn of contract awards in January and February 2019 for AASC and NGHS have the effect of reducing the pipeline by £1.7bn.
- Revenue guidance for 2019 is increased from a range of £2.8-£2.9bn to a range of £2.9-£3.0bn, reflecting recent contract wins. Following an encouraging start to the year, Underlying Trading Profit is now expected to be approximately £105m under IFRS16; this represents the top end of the £95-100m guidance range given at the Closed Period Update issued on 13 December 2018, together with a £5m increase as a result of the adoption of IFRS16 (with an offsetting £5m increase to Net Finance Costs). Net debt at the end of 2019, excluding lease obligations newly recognised under IFRS16, is expected to be approximately £200m, equivalent to covenant leverage of approximately 1.3x.

Chief Executive's Review continued

How we performed

Year ended 31 December	2018	2017 ⁽⁵⁾	Change at reported currency	Change at constant currency
Revenue ⁽¹⁾	£2,836.8m	£2,950.9m	(4%)	(2%)
Underlying Trading Profit (UTP) ⁽²⁾	£93.1m	£69.3m	+34%	+40%
Reported Operating Profit (ie after exceptional items) ⁽²⁾	£80.5m	£21.1m	+282%	+300%
Underlying Earnings Per Share (EPS), diluted ⁽³⁾	5.21p	3.36p	+55%	+63%
Reported EPS (ie after exceptional items), diluted	5.99p	(0.76p)		
Free Cash Flow ⁽⁴⁾	£25.0m	(£6.7m)		
Net Debt	£188.0m	£141.1m		

Notes to summary table of financial results:

- Revenue is as defined under IFRS, which excludes Serco's share of revenue of its joint ventures and associates. Organic revenue growth is the change at constant currency after adjusting to exclude the impact of relevant acquisitions or disposals. Change at constant currency is calculated by translating non-Sterling values for the year ended 31 December 2018 into Sterling at the average exchange rates for the prior year.
- Trading Profit is defined as IFRS Operating Profit excluding amortisation of intangibles arising on acquisition as well as exceptional items. Consistent with IFRS, it includes Serco's share of profit after interest and tax of its joint ventures and associates. Underlying Trading Profit additionally excludes Contract & Balance Sheet Review adjustments (principally Onerous Contract Provision (OCP) releases or charges) and other material one-time items. A reconciliation of Underlying Trading Profit to Trading Profit and Reported Operating Profit is as follows:

Year ended 31 December	2018 £m	2017 £m
Underlying Trading Profit	93.1	69.3
Include: non-underlying items		
Contract & Balance Sheet Review adjustments	23.6	(24.2)
Trading Profit	116.7	45.1
Amortisation of intangibles arising on acquisition	(4.3)	(4.4)
Operating Profit Before Exceptional Items	112.4	40.7
Operating Exceptional Items	(31.9)	(19.6)
Reported Operating Profit (after exceptional items)	80.5	21.1

- Underlying EPS reflects the Underlying Trading Profit measure after deducting pre-exceptional net finance costs and related tax effects.
- Free Cash Flow is the net cash flow from operating activities before exceptional items as shown on the face of the Group's Condensed Consolidated Cash Flow Statement, adding dividends we receive from joint ventures and associates, and deducting net interest paid and net capital expenditure on tangible and intangible asset purchases.
- The results for the year ended 31 December 2017 have been restated for the adoption of IFRS15. The restatement to revenue is £2.7m from £2,953.6m to £2,950.9m, and to Underlying Trading Profit is £0.5m from £69.8m to £69.3m. All references to prior year performance referred to in the Chief Executive's Review and the Divisional Reviews have been restated accordingly. Further details regarding the impact of the adoption of IFRS15 are included in note 2 to the consolidated financial statements on pages 157 to 161.

Reconciliations and further detail of financial performance are included in the Finance Review on pages 34 to 51. This includes full definitions and explanations of the purpose and usefulness of each non-IFRS Alternative Performance Measure (APM) used by the Group. The consolidated financial statements and accompanying notes are on pages 139 to 227.

Summary of financial performance

Revenue and Trading Profit

Reported Revenue declined 3.9% to £2,837m (2017: £2,951m); this measure excludes Serco's share of revenue from joint ventures and associates of £375m (2017: £356m). Net currency movements reduced revenue by £65m or 2.2%, whilst the net revenue contribution from acquisitions added £43m or 1.4%. At constant currency, the organic revenue decline was therefore £92m or 3.1%; this decline was driven mainly by contracts which were exited or lost on re-compete in 2017, including Glasgow ACCESS in the UK, the Armidale Class Patrol Boats contract in Australia and the Western Australia Court Security and Custodial Services contract. The effect of these and other losses were offset partly by increased revenues from a number of new contracts in the UK, US and AsPac, and the impact of the BTP and Carillion healthcare acquisitions. Importantly, after a 5.6% organic decline in revenue in the first half of the year, revenues in the second half were broadly flat on an organic basis and grew 2.5% including the benefit of acquisitions.

Underlying Trading Profit increased by £23.8m or 34% to £93.1m (2017: £69.3m); excluding the £4.0m net currency impact, the increase was £27.8m or 40%. The improvement reflected a strong operating performance together with further good progress on transformation savings and other cost efficiencies; these more than offset the impact of contract attrition and the reduction in workload volumes on some contracts, as well as some new contracts which were mobilised and incurred start-up and transition costs. It is particularly pleasing to note that all our regional divisions delivered double-digit growth in UTP and improved their margins as set out on page 28. Transformation has continued to focus on driving efficiencies in central support functions and overheads, with our reported administrative expenses a net £20m lower than the prior year; this takes the total cumulative reduction in the cost of overheads and central support services since 2014 to over £120m. In addition, there were a number of non-recurring trading items such as end-of-contract settlements which contributed approximately £10m to UTP. Reflecting the strong increase in profits, the Underlying Trading Profit margin improved a whole percentage point to 3.3% (2017: 2.3%).

Trading Profit was £116.7m (2017: £45.1m), £23.6m higher than Underlying Trading Profit as a result of a net credit of Contract & Balance Sheet Review and other material one-time items, whereas in 2017 there was a £24.2m net charge. As with prior years, both Trading Profit and Underlying Trading Profit benefited from losses on previously-identified onerous contracts being neutralised by the utilisation of Onerous Contract Provisions (OCPs); the £52m utilised in 2018 was lower than our expectations at the start of the year and the £69m utilised in 2017. The closing balance of OCPs now stands at £82m, compared to £147m at the start of the year and the initial charge of £447m taken at the end of 2014.

Reported Operating Profit and Exceptional Costs

Reported Operating Profit of £80.5m (2017: £21.1m) was £36.2m lower than Trading Profit as a result of £4.3m (2017: £4.4m) of amortisation of intangibles arising on acquisition and operating exceptional costs of £31.9m (2017: £19.6m), mainly comprising restructuring programme costs of £32.3m (2017: £28.6m) related to the Transformation stage of our strategy, including redundancy charges, asset impairments and other incremental costs; they also included a £13.9m exceptional profit from a settlement related to the disposal of Serco GmbH in 2012, and a £9.6m exceptional charge related to equalising Guaranteed Minimum Pension (GMP) payments on pension schemes. Within reported net finance costs there was a £7.5m exceptional profit related to the early repayment of the vendor loan note issued on the disposal of the Intelenet business in 2015. Together with an exceptional tax credit of £2.1m (2017: charge of £5.0m), total net exceptional costs were therefore £22.3m (2017: £24.6m).

Financing and pensions

Pre-exceptional net finance costs were £13.9m (2017: £11.2m), with the increase driven principally by a lower credit related to pension schemes. Average net debt was £51m higher than the prior year, very similar to the £47m increase between the start and the end of the year, though the impact on our interest expense was largely offset by the effect of having repaid some of our US private placement notes during the year. Cash net interest paid was £18.1m (2017: £17.0m).

Serco's pension schemes are in a strong funding position, resulting in a balance sheet accounting surplus, before tax, of £71m (2017: £26m) on scheme gross assets and gross liabilities each of approximately £1.3bn. The net asset position leads to a small net credit within net finance costs of £0.8m (2017: £3.8m), which is lower than the prior year due to the purchase in June 2017 by the Trustees of the Serco Pension and Life Assurance Scheme (SPLAS) of a bulk annuity from an insurer, which, for around half of all scheme members, has the effect of fully removing longevity, investment and accounting risks; the gross liability remains recognised on our balance sheet, but there is an equal and opposite insurance asset reflecting the perfect hedge established by the annuity.

Tax

The underlying effective tax cost was £20.6m (2017: £20.2m), representing an underlying effective rate of 26% (2017: 35%) based upon £79.2m (2017: £58.1m) of Underlying Trading Profit less net finance costs. The rate is higher than the UK statutory rate of corporation tax as there was no deferred tax credit taken against UK losses incurred in the year, and because it reflects the tax charges at locally prevailing rates in the international divisions which tend to be higher than the UK's rate; these two factors are partially offset by the proportion of Serco's profit before tax generated by consolidating our share of joint venture and associate earnings which have already been taxed. The rate is lower than the prior year reflecting the improvement in and mix of the Group's profitability, together with the net effect of US tax reform; we expect the rate to continue to reduce over the longer term as a result of further improvements in the profitability of the UK business.

Chief Executive's Review continued

The tax on non-underlying items was a net credit of £11.8m (2017: £6.6m), which includes an additional £2.9m of deferred tax asset in relation to UK losses to reflect the improved forecast of UK taxable income. Total pre-exceptional tax costs were £8.8m (2017: £13.6m). Cash net tax paid was £10.6m (2017: £11.4m). Our reported effective tax rates are likely to be volatile until we are able to show sufficient profitability in our UK business to be able to recognise on our balance sheet all of the UK tax asset arising from losses in 2014 and 2015 principally as a result of the Contract & Balance Sheet Review.

Reported result for the year

The reported result for the year, as presented at the bottom of the Group's Consolidated Income Statement on page 151, was a profit of £67.4m (2017: loss of £8.0m). This reflects: Trading Profit of £116.7m (2017: £45.1m); amortisation of intangibles arising on acquisition of £4.3m (2017: £4.4m); pre-exceptional net finance costs of £13.9m (2017: £11.2m); a non-cash fair value gain in 2017 of £0.7m (2018: nil); pre-exceptional tax costs of £8.8m (2017: £13.6m); and total net exceptional costs of £22.3m (2017: £24.6m).

Earnings Per Share (EPS)

Underlying EPS, which reflects the Underlying Trading Profit measure after deducting pre-exceptional net finance costs and related tax effects, increased by 55% to 5.21p (2017: 3.36p). The improvement reflects the 34% increase in Underlying Trading Profit at reported currency, and the increase in net finance costs which was more than offset by the lower tax rate; the weighted average number of shares in issue, after the dilutive effect of share options, was broadly unchanged at 1,125.4m (2017: 1,120.6m). Reported EPS, which includes the impact of the other non-underlying items and exceptional costs, was a profit per share of 5.99p (2017: loss per share of 0.76p).

Cash Flow and Net Debt

Free Cash Flow was positive £25m (2017: negative £7m), the first year of positive Free Cash Flow since 2014. Cash generated from Underlying Trading Profit was partially offset by the outflows related to loss-making contracts subject to OCPs, principally the Caledonian Sleeper, COMPASS and PECS contracts. These cash outflows were lower than the prior year, as reflected in the lower rate of OCP utilisation of £52m (2017: £69m). There was a working capital outflow of £22m (2017: outflow of £14m); whilst the Company has a working capital financing facility, it has not been drawn since the first quarter of 2017. Average working capital days in the year were broadly unchanged: the average credit period taken by Serco's customers is 29 days (2017: 23 days) and the average credit period taken by Serco for our trade purchases is 30 days (2017: 33 days), with 85% of UK supplier invoices paid in under 30 days.

Closing net debt at 31 December 2018 increased to £188m (2017: £141m); the increase of £47m includes the Free Cash inflow of £25m, offset principally by three sources of outflow: a £19m (2017: £33m) cash outflow related to exceptional items; £31m net outflow for acquisitions (which includes £17m for the Carillion health contracts and £13m for the BTP Systems acquisitions); and a net adverse currency translation effect of £22m, predominantly reflecting the Group's US\$ Private Placement debt. The closing net debt compares to a daily average of £235m (2017: £184m) and a peak net debt of £307m (2017: £243m), with the peak reflecting the timing of acquisition outflows and the adverse currency impact.

At the closing balance sheet date, our leverage for debt covenant purposes was 1.06x EBITDA (2017: 1.36x), which compares with the covenant requirement to be less than 3.5x; removing the benefit of the £23.6m of non-underlying items within covenant EBITDA, underlying leverage is 1.23x and remains therefore comfortably around the bottom of our normal target range of 1-2x.

During the year we successfully refinanced our Bank facilities on terms similar to those previously in place, with a £250m Revolving Credit Facility now in place until December 2023.

Dividends

The Board is not recommending the payment of a dividend in respect of the 2018 financial year. The Board's appraisal of the appropriateness of dividend payments takes into account the Group's underlying earnings, cash flows and financial leverage, together with the requirement to maintain an appropriate level of dividend cover and the prevailing market outlook. Although the Board is committed to resuming dividend payments as soon as it judges it prudent to do so, in assessing whether we should resume dividend payments in respect of 2018, we are mindful of the fact that 2019 is the last year of significant outflows of cash related to OCPs and operating exceptional costs, which together will mean that net debt is likely to increase again 2019, albeit modestly. The Board will continue to keep the dividend policy under careful and regular consideration as we progress with completing the transformation stage and driving forward with the growth stage of our strategy.

The Revenue and Trading Profit performances are described further in the Divisional Reviews. More detailed analysis of earnings, cash flow, financing and related matters are described further in the Finance Review.

Contract awards, order book, rebids and pipeline

Contract awards

The Group's order intake totalled £2.9bn during 2018, representing a book-to-bill ratio of just over 100%; this is the second year in succession that the book-to-bill ratio has been positive. There were over 40 contract awards worth more than £10m each, by far the largest of which was the rebid of our health insurance eligibility support contract in the US for the Center for Medicare & Medicaid Services (CMS) which is estimated to be worth around £700m over the next five years. Rebids and extensions of existing work together represented 66% of the total value signed, with the balancing 34% represented by the value of new business won.

Other notable contract awards included, again in the US: a sole-source contract vehicle to support Naval Electronic Surveillance Systems (NESS); program management to the United States Air Forces Central Command (AFCENT); installation support for Close-In Weapons Systems (CIWS); US Army global acquisition and logistics operations support; and defence training support services. There was also a single-award Indefinite Delivery/Indefinite Quantity (ID/IQ) framework to support the Federal Emergency Management Agency (FEMA), though only a very small initial value is included within the awards value. In the UK, we received a 10-year extension supporting Peterborough County Council with a range of frontline and back office services, an 18-month extension for the NorthLink Ferries service, and a new award for environmental services with Hart and Basingstoke councils. In AsPac, awards were dominated by new contact centre services for Victoria Police, Australia's National Disability Insurance Scheme and the Department of Human Services, together with a new contract to manage road tunnels in Hong Kong. In the Middle East, we received a letter of intent to extend our Dubai Metro operations for a further two years, successfully rebid the MELABS defence base logistics and support services contract and facilities management support in Abu Dhabi, added new fire and rescue services at King Fahd International Airport in Dammam in Saudi Arabia, and extended our air traffic control services contract in Iraq. In aggregate, around 80% of order intake came from customers of our Americas, AsPac, Middle East and continental European operations, with the remaining 20% from the UK.

The largest losses of bids for new work were the Defence Fire & Risk Management Organisation (DFRMO) tender in the UK, and two bids in the US - maintenance and logistics support for Solid State Phased Array Radar Systems (SSPARS) and Navy C5ISR kitting and cabling work (CIKC). In regard to DFRMO, our legal challenge to the award is still in process. Of existing work, the largest loss was our support of air traffic control services in Bahrain, though the annual revenue was less than 0.5% of the Group overall.

Win rates by volume for the year were around 50% for new bids and 90% for rebids and extensions. Win rate by value was around 25% for new work and around 93% for securing existing work.

In the first six weeks of 2019 we signed two major contracts: in the UK we won our largest ever contract, being £1.9bn over 10 years for AASC (providing asylum accommodation and support services) and £0.6bn for NGHS (providing health services to the Australian Defence Force working as a sub-contractor to Bupa).

Order book

The Group's order book is an estimated £12.0bn at the end of 2018, up by £1.3bn versus £10.7bn at the start of the year, and by £2.1bn from the level at the end of 2016. The increase includes the strong order intake and the £0.7bn added to the order book as a result of the transfers of the six UK health facilities management contracts from Carillion. It also includes the change in definition to align with the IFRS15 disclosures of the future revenue expected to be recognised from the remaining performance obligations on existing contractual arrangements. It is worth noting that this excludes unsigned extension periods; however, the £12.0bn would be £13.0bn if option periods in our US business were included; as option periods have always tended to be exercised in our US business, we do include these in our assessment of order intake, as was the case with the value of the CMS contract as noted in the above section on contract awards.

There is £2.4bn of revenue secured in the order book for 2019, equivalent to around 80% visibility of our £2.9-3.0bn revenue guidance.

Rebids

As we look ahead over the next three years through to the end of 2021, across the Group there are around 60 contracts in our order book with annual revenue of over £5m where an extension or rebid will be required, representing current annual revenue of approximately £1.2bn in aggregate or around 40% of the Group's 2019 revenue guidance. This proportion of revenue that requires securing at some point over the next three years is not unusual given our average contract length of around seven years (or approximately ten years on average on a revenue-weighted basis, as larger contracts typically have longer terms); at the start of 2018 the three-year forward rebid value was £1.4bn. Contracts that could potentially end at some point before the conclusion of 2019 have aggregate annual revenue of over £400m, the largest of which are the Australian immigration services and NorthLink Ferries operations. In 2020, the annual value of contracts due for extension or re-compete is currently less than £400m, with our work under a US Navy installation framework (GIC) and the Prisoner Escorting Services (PECS) in the UK being the largest contracts anticipated to become due in that year.

Chief Executive's Review continued

Pipeline

Our measure of Pipeline is probably more narrowly defined than is common in our industry; it was originally designed as an indicator of future growth and focuses on bids for new business only. As a consequence, on average over the last five years less than half of our achieved order intake has come from the Pipeline. It measures only opportunities for new business that have an estimated Annual Contract Value (ACV) of at least £10m, and which we expect to bid and to be awarded within a rolling 24-month timeframe; we cap the Total Contract Value (TCV) of individual opportunities at £1bn, to attenuate the impact of single large opportunities; the definition does not include rebids and extension opportunities; and in the case of framework, or call-off, contracts such as 'ID/IQ' (Indefinite Delivery / Indefinite Quantity contracts which are common in the US) we only take the individual task orders into account. It is thus a relatively small proportion of the total universe of opportunities, many of which either have annual revenues less than £10m, or are likely to be decided beyond the next 24 months, or are rebids and extensions.

On this definition our Pipeline stood at £4.4bn at the beginning of 2018. Around £3.7bn has come out of the Pipeline due to wins and losses, together with the net effect of a small number of removals due to opportunities no longer meeting our definition, and value changes. A number of new opportunities matured to the stage where they meet our Pipeline definition, adding in aggregate £4.6bn over the course of the year. As a result, the Pipeline increased to stand at £5.3bn at 31 December 2018, which consists of around 30 bids that have an ACV averaging approximately £30m and a contract length averaging around six years.

As we have noted before, in the services industry in which Serco operates, pipelines are often lumpy, as individual opportunities can be very large, and when they come in and out of the Pipeline they can have a material effect on reported values. In 2019 to date, Serco has already won the two largest opportunities in its Pipeline – AASC in the UK and NGHS in Australia, valued at £2.5bn in aggregate. Removing these opportunities from the £5.3bn Pipeline as at 31 December 2018 would reduce it by £1.7bn to around £3.6bn; the reason why the Pipeline will not drop by the full amount of orders won is that part of AASC was a rebid of an existing region.

Guidance for 2019

At our Closed Period Update on 13 December 2018, we provided 2019 guidance for revenue of £2.8-2.9bn and Underlying Trading Profit (UTP) of £95-100m. Reflecting recent contract wins, namely the AASC asylum support services contracts in the UK and the NGHS defence health contract in Australia, we now believe that 2019 revenues will be higher, and in the £2.9-3.0bn range. Those contract wins are expected to have a negligible effect on profitability in 2019 due to mobilisation and transition costs, but in 2020 and thereafter we expect those contracts to be materially positive to both profitability and cash flow.

As previously stated in our December 2018 update, 2019 will not benefit from the £10m of non-recurring trading items such as end-of-contract settlements that contributed to the very strong profit growth delivered in 2018. However, profit growth and margin progress are still anticipated in 2019, in line with current market consensus. Whilst there are declines in some contracts, most notably MELABS in the Middle East division, these are expected to be offset by strong growth in the profits delivered by our UK Healthcare business as a consequence of the full-year effect of our acquisition of six Carillion health contracts and other contracts coming out of transition, together with the benefit of further cost efficiencies.

Following an encouraging start to the year, and adjusting for the adoption of IFRS16, our guidance for UTP in 2019 is now approximately £105m. This represents the top end of the range provided with our December 2018 update, together with an additional increase of £5m to take account of the new IFRS16 accounting standard for leases which is effective for the Group from 1 January 2019. IFRS16 results in the previous operating lease expense which was fully charged to UTP being split into: a depreciation charge of a newly recognised 'right of use' lease asset, with the depreciation being charged to UTP over the life of the lease calculated on a 'straight-line' basis; and secondly an 'interest cost' element of a newly recognised lease liability which will be charged to Net Finance Costs (NFC), but with this being calculated on a 'reducing balance' basis. In 2019, the increases to UTP and NFC are estimated to each be around £5m and therefore broadly net out. For all new leases they will fully net out over the life of each lease, though the interest cost will be higher in the early years of a lease and lower in the later years; this will therefore have a noticeable effect on the accounting for the thousands of property leases on the AASC contract in 2020, which will be its first full year of operation.

Previous guidance for NFC was for these to increase in 2019, principally as a result of an approximate £3m net reduction in investment revenue following the early repayment in October 2018 of the vendor loan note issued on our disposal of Intelenet in 2015. Together with the impact of IFRS16 described above, our NFC guidance is updated to approximately £20m. The interest cost associated with lease liabilities that are newly recognised under IFRS16 may prove to be volatile, particularly given the effect of the length of property leases which may not be known in advance. Importantly, whilst the NFC impact may be volatile from year-to-year both at individual lease and at aggregate level across the whole book of lease commitments, cashflows will follow the terms of the underlying leases, and will generally be smooth over the life of a lease.

The Group's underlying effective tax rate is expected to reduce to below 25% in 2019 as a result of improving profitability in the UK business. Exceptional restructuring costs are expected to be approximately £20m as we implement the final steps of the Group's transformation stage of our strategic plan implementation. The weighted average number of shares for diluted EPS is expected to be approximately 1,145m. Further background to these areas is included in the Finance Review.

With regard to Free Cash Flow, having turned positive in 2018 after three years of outflows, it is expected to be broadly similar in 2019, with the lack of non-recurring credits within 2018's FCF being offset by improved profitability and lower OCP utilisation in 2019. After the cash cost of exceptional items and a smaller acquisition-related payment, the overall movement in Net Debt is expected to be a modest outflow, resulting in closing net debt before the effect of IFRS16 (and therefore comparable to the opening position of £188m) of approximately £200m. IFRS16 has no cash flow impact, with reclassifications between operating and financing cash flows fully netting out over the life of a lease, nor is there any covenant impact, as the Group's financing facilities will continue to be calculated under the prior standard, IAS17. Guiding to net debt excluding lease obligations newly recognised with IFRS16 is therefore considered both more insightful and consistent with the covenant measure for the Group's financing facilities. Underlying leverage is expected to be approximately 1.3x EBITDA at the end of 2019, compared with 1.2x at the end of 2018.

As we remind people every year, there remains a wide range of potential outcomes reflecting the sensitivity of our profits to even small changes in revenues and costs. A key sensitivity is the movement of currency rates during the year, with our guidance based upon recent currency rates prevailing throughout 2019, which, given opposite movements in the US dollar and Australian dollar against sterling, currently implies a broadly neutral impact when compared to the average rates for 2018.

Outlook beyond 2019

When we set out our strategy in early 2015, we noted that for our mix of geographies and market sectors, the market grew by about 5-7% in the four years to 2014, with competitors achieving margins of 5-6%. It was our stated ambition for Serco to match market growth and industry margins in the longer term. Since then, market conditions have become less favourable in the UK, our largest market, and this has acted as a drag on our updated estimate of the weighted average rate of market growth.

Despite this we still believe that the Four Forces (relentlessly increasing demand for public services; expectations of higher service quality; structural fiscal deficits; electoral resistance to tax increases) will continue to encourage governments to seek innovative ways to deliver more services, of higher quality, and at lower cost (what we call 'More and Better for Less'). So, in the longer term, average annual market growth of 5%+ seems to us achievable. However, at the moment, we believe that the current weighted average rate of growth across all our geographies and sectors is currently running lower than that at 2-3%, in large part because of the difficult conditions in the UK, which represents some 40% of our revenues. It is not possible to forecast with any certainty how demand in the UK market will evolve during and after Brexit; the possible outcomes range from a rapid increase in demand, through to a gradual decline and where they will actually fall is unknowable, but we are inclined to believe that the risk to our business is weighted slightly to the upside. There is more commentary on our views on the UK market on pages 29 to 30.

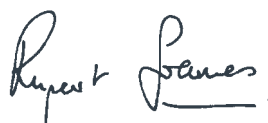
In this more uncertain outlook for market growth, a number of factors favour Serco and give us confidence that over the next few years, and absent unforeseen headwinds or losses on major rebids, we should be able to grow our revenues faster than the underlying market; we think that 2019 will see revenue growth of 3-4%, and that revenue growth will accelerate to around 5% in 2020 as contracts such as Grafton, Icebreaker, AASC and NGHS become fully operational.

The reasons we believe that we can grow faster than the market are, first, because although the UK Government's appetite for new projects has been reduced, frontline services of the type we provide tend to be non-discretionary and critical in nature; a government may decide whether it wants to invest in a major new outsourcing project, and can more or less speed up or slow down such projects at will. It cannot, however, suddenly decide it does not want to house 20,000 asylum seekers, or move its ships and submarines, or clean its hospitals. Our core competence in providing vital, frontline, people-enabled services, having been regarded as somewhat "below the salt", is now, we believe, an important asset. Second, our order intake in the last two years has been strong, and our order book – up around 20% since 2016 and about to be further blessed with £2.5bn of orders received in the first six weeks of 2019 – will underpin growth in our revenues over the next few years as those large new contracts become fully operational.

In terms of our ambition of achieving margins of at least 5% over the longer term, we believe that this is still achievable by a combination of contract and overhead cost efficiency, running off OCP contracts and the conversion of some of them into profitable contracts (of which AASC is a shining example), and revenue growth.

Summary

We have referenced in previous Annual Reports the maxim of the Prussian military strategist Helmuth von Moltke the Elder that "no strategy ever survives first contact with the enemy". A more contemporary version of this maxim comes from the boxer Mike Tyson who said: "Everyone's got a plan until they get punched in the mouth". As strategies age, the more punches events land upon them. Our own strategy, launched in 2015, is surviving well against the battering of events, including an unforeseen blow in the form of Brexit and its impact on the UK market. Notwithstanding this punch, we still think we can deliver on our objective of 5% revenue growth and margins working their way up to 5%, and hopefully beyond.



Rupert Soames

Group Chief Executive
20 February 2019

Serco – and proud of it.

Divisional Reviews

Serco's operations are reported as four regional divisions: UK & Europe (UK&E); the Americas; the Asia Pacific region (AsPac); and the Middle East. Reflecting statutory reporting requirements, Serco's share of revenue from its joint ventures and associates is not included in revenue, while Serco's share of joint ventures and associates' profit after interest and tax is included in Underlying Trading Profit. As previously disclosed and for consistency with guidance, Serco's Underlying Trading Profit measure excludes Contract & Balance Sheet Review adjustments (principally OCP releases or charges).

Year ended 31 December 2018	UK&E £m	Americas £m	AsPac £m	Middle East £m	Corporate costs £m	Total £m
Revenue	1,300.7	645.6	548.2	342.3	–	2,836.8
Change	(2%)	(6%)	(5%)	(3%)		(4%)
Change at constant currency	(2%)	(3%)	0%	+1%		(2%)
Organic change at constant currency	(4%)	(5%)	(1%)	+1%		(3%)
Underlying Trading Profit/(Loss)	39.2	45.7	26.8	21.5	(40.1)	93.1
Change	+12%	+26%	+20%	+24%	(4%)	+34%
Change at constant currency	+12%	+30%	+27%	+30%	(4%)	+40%
Margin	3.0%	7.1%	4.9%	6.3%	n/a	3.3%
Change	+40bps	+180bps	+100bps	+140bps		+100bps
Contract & Balance Sheet Review adjustments	12.4	(2.5)	13.7	–	–	23.6
Trading Profit/(Loss)	51.6	43.2	40.5	21.5	(40.1)	116.7
Amortisation of intangibles arising on acquisition	(0.5)	(3.2)	(0.6)	–	–	(4.3)
Operating profit/(loss) before exceptionals	51.1	40.0	39.9	21.5	(40.1)	112.4

Year ended 31 December 2017	UK&E £m	Americas £m	AsPac £m	Middle East £m	Corporate costs £m	Total £m
Revenue	1,331.5	689.3	577.5	352.6	–	2,950.9
Underlying Trading Profit/(Loss)	34.9	36.4	22.3	17.3	(41.6)	69.3
Margin	2.6%	5.3%	3.9%	4.9%	n/a	2.3%
Contract & Balance Sheet Review adjustments	(39.0)	3.4	11.4	–	–	(24.2)
Trading Profit/(Loss)	(4.1)	39.8	33.7	17.3	(41.6)	45.1
Amortisation of intangibles arising on acquisition	–	(3.0)	(1.4)	–	–	(4.4)
Operating profit/(loss) before exceptionals	(4.1)	36.8	32.3	17.3	(41.6)	40.7

The trading performance and outlook for each division are described on the following pages. Reconciliations and further detail of financial performance are included in the Finance Review on pages 34 to 51. This includes full definitions and explanations of the purpose of each non-IFRS Alternative Performance Measure (APM) used by the Group. The consolidated financial statements and accompanying notes are on pages 139 to 221.

46% of Group revenue
£1,300.7m (2017: £1,331.5m)

UK & Europe

Serco's UK & Europe division supports public service delivery across all five of the Group's chosen sectors: our Justice & Immigration business provides a wide range of services to support the safeguarding of society and the reduction of reoffending, from prison management through to housing and welfare services for asylum seekers; in Defence, we are trusted to deliver critical support services and operate highly sensitive facilities of national strategic importance; we operate complex public Transport systems and services; our Health business provides primarily non-clinical support services to hospitals; and the Citizen Services business provides environmental and leisure services, as well as a wide range of other front, middle and back-office services to support public sector customers in the UK and European institutions. Serco's operations in the UK represent approximately 41% of the Group's reported revenue, and those across the rest of Europe approximately 5%.

Revenue for 2018 was £1,300.7m (2017: £1,331.5m), a decline of 2%. Reported Revenue excludes that from our joint venture and associate holdings which largely comprise the operations of AWE and Merseyrail. At constant currency, the decline in Revenue was also 2%, or £33m. The net contribution from acquisitions, driven by the transfer of the Carillion health facilities management contracts, was £23m or 2%, therefore the organic decline was £56m or 4%. The Glasgow ACCESS operations which transferred at the end of 2017 had a £57m impact and therefore accounted for virtually all of the organic decline; some other smaller contracts ending as well as some areas of reduced project work or volumes, such as the London Cycle Hire Scheme and the Child Maintenance Group, extended the level of revenue reduction. These were offset by new contract growth, in particular annualising 2017's start of hospital facility management services for Barts Health NHS Trust and University Hospital Southampton NHS Foundation Trust, as well as from the new Skills Support for the Workforce (SSW) contracts.

Underlying Trading Profit was £39.2m (2017: £34.9m), representing an implied margin of 3.0% (2017: 2.6%). Trading Profit includes the profit contribution (from which interest and tax have already been deducted) of joint ventures and associates; if the £374m (2017: £350m) proportional share of revenue from joint ventures and associates was also included and if the £5.7m (2017: £7.1m) share of interest and tax cost was excluded, the overall divisional margin would have been 2.7% (2017: 2.5%). The joint venture and associate profit contribution was modestly ahead at £28.1m (2017: £26.3m). The further improvement in Underlying Trading Profit included the benefit of transformation and cost efficiency programmes in the division as well as some improvement in the profitability of certain contracts moving out of their transition stages, with these more than offsetting the impact of other contract attrition and the investment required to mobilise and transition the Carillion contracts.

Within Underlying Trading Profit there was a reduced rate of OCP utilisation at £47m (2017: £55m), which served to offset the Division's loss-making operations, principally the Caledonian Sleeper, COMPASS asylum seeker support services, Prisoner Escort & Custody Services (PECS) and Lincolnshire Country Council contracts. Contract & Balance Sheet Review and other material one-time items resulted in a £12.4m net credit (2017: £39.0m net charge) to Trading Profit which increased sharply to £51.6m (2017: loss of £4.1m).

The UK & Europe division represented around £0.7bn or 25% of the Group's order intake. The two largest awards were a £105m ten-year contract extension for frontline and back office services to Peterborough City Council, and a £104m 18-month contract extension to continue managing and operating the NorthLink Ferries service for Transport Scotland. The largest new contract was an eight-year joint award for environmental services for Hart District Council and Basingstoke & Deane Borough Council. Other notable awards in the year included successfully rebidding with BAE Systems our repair and maintenance contract for Command Support Air Transport (CSAT) aircraft operated out of RAF Northolt by 32 (The Royal) Squadron, rebidding and adding new areas of support for the European Commission Directorate General for Informatics; expanding our contact centre services for the DWP, launching a new cycle hire scheme for Transport for Edinburgh, fire and rescue services for the construction phase of Hinkley Point C nuclear power station, and extending our support services for the European Organisation for Nuclear Research (CERN).

The signing of the Asylum Accommodation and Support Services Contracts (AASC) in January 2019 is very significant for the division, and indeed for the Group. AASC supersedes the current COMPASS contracts which have been incurring annual losses (offset in the P&L by the utilisation of the OCP) of around £15-20m for the last four years. Under the new AASC contracts, we did not retain the Scotland & Northern Ireland region, but gained the much larger Midlands region, whilst retaining our "home" region of the North West; as a consequence we will now be the largest provider of asylum seeker accommodation in the UK. Given our past experience, we also bid the regions at prices which we believe should allow us to make a fair return; we expect the new contract to deliver revenues of around £150m in the initial year, as against the current COMPASS run-rate of around £70m.

Of existing work where an extension or rebid will be required at some point before the end of 2021, there are over 20 contracts with annual revenue of over £5m within the UK & Europe division; in aggregate, these represent approximately 20% of the current level of annual revenue for the division. The largest of these are the NorthLink Ferries contract that was extended to 31 October 2019 and is now being rebid for the next six-year term; in 2020, the current PECS contract ends assuming a final extension option is not exercised by the customer; and in 2021, our strategic partnership contract supporting Hertfordshire County Council.

The rebid profile and the new bid pipeline have both reduced with the successful outcome of our bidding for AASC. Other opportunities in the new bid pipeline include several environmental services and health facilities management tenders, and a smaller number of other opportunities to support various defence, Citizen Services and Justice operations. We expect to add to our pipeline in 2019 those opportunities that will be competed for under the recently launched prison operator services framework.

Conditions in the UK market are highly uncertain as a result of Brexit, which is an overlay of immense complexity and distraction on top of what were already significant challenges to Departments as a result of Government efforts to reduce the structural deficit, whilst increasing spending on the NHS.

Divisional Reviews continued

UK & Europe continued

As we predicted eighteen months ago, the Government and the Civil Service have now come to be focused upon the challenges of negotiating and preparing for Brexit, and this has had the effect of reducing their appetite for new outsourcing and transformation projects. However, Government is still proceeding with procurements of non-discretionary services as existing arrangements come to an end. Examples of this include AASC and the upcoming PECS rebid.

In terms of the likely direct impact of Brexit upon our business – we are facing the same fog of uncertainty as every other business in the UK. It is certain that “taking back control” will require more people working for or on behalf of Government to do the taking back and the controlling; already 20,000 additional civil servants have been recruited into Central Government, and one would expect over time that the numerous additional regulatory functions will require some sort of support. We neither export nor import to any significant degree, therefore we are not exposed directly to the border issues that worry other businesses, although we are mindful that we will need to maintain continuity of supplies to the 5,000 prisoners we are responsible for, and indeed the 7 million patients cared for each year in the 18 NHS hospitals that Serco supports. In terms of the balance of risks, we think they are marginally balanced to the upside. In the short term there is a small possibility that there could be an upturn in demand if Government needs help quickly; on the downside, we think it unlikely that there will be any precipitous drop in demand as a result of Brexit. As far as our business in Europe is concerned, which accounts for about 5% of Group revenue, the vast majority of this is supplied via our wholly-owned EU-resident companies, and therefore should be largely unaffected. Finally, of our UK employees, only 6% are continental EU nationals, so whilst there might be an indirect effect of labour shortages, the direct effect should be limited.

As well as the challenges of Brexit, the Government has been wrestling with the fallout from the collapse of Carillion in early 2018, which has been accompanied by other major contractors becoming distressed and having to raise equity or refinance their debt. There has been a recognition by Government that it can neither abjure all responsibility for, nor ignore, its supply chain becoming so seriously distressed. Nor can it be blind to liquidity issues amongst outsourcers as banks become increasingly reluctant to support the sector.

In this difficult environment, Serco has worked hard to be a helpful and constructive partner of Government. We have publicly stated our admiration for the way they managed the liquidation of Carillion. We have published ideas to improve the working of the market in the form of Four Principles. These principles cover: greater **Transparency** in regard to the make-or-buy decision-making process for Government services, as well as publishing operational and financial key performance indicators so that taxpayers could see the quality of service they were receiving; **Security of Supply**, including the lodging of ‘Living Wills’; **Orderly Exit** provisions, for both the Government and suppliers; and **Fairness**, including codes of conduct for both Government and suppliers.

In the middle of 2018, the Cabinet Office set up a joint Government / Industry group to improve the working of the public services market; Serco has been deeply engaged in this

process which resulted in the publication in February 2019 of an ‘Outsourcing Playbook’ along with a comprehensive set of guidance notes. This sets out the ground rules for suppliers and Government departments for the outsourcing of public services. It also reiterates the value that Government sees in having private companies and third sector organisations being able to provide services. The Ministers responsible, David Lidington and Oliver Dowden, have been highly supportive of the role of the private sector, and forthright in stating their belief that the role of Government should be to procure services that deliver high quality, resilience and value for money for the taxpayer and service user, and be agnostic and even-handed as to whether this is achieved through the public or private sectors. This approach is all that a strong and healthy private sector should reasonably hope for; if we cannot deliver better innovation, value and quality than the public sector, then we don’t deserve the taxpayer’s shilling. We think that the publication of the Playbook, which reflects many of the ideas we put forward in our Four Principles, is an important and positive development.

Government has always been keen to emphasise that it wants to attract new suppliers, and that the barriers to entry into its supply chain are low; they are now seeing that, for both suppliers and their lenders, the barriers to exit are low as well. They are also seeing that a distressed supply base can be as much of a problem for customers as it is for suppliers. The effectiveness of the new Playbook in modifying some of the damaging behaviours of the past, by both Government and suppliers, should be decisive in maintaining a competitive, innovative and capable supply chain which Government can have at its behest to deliver high quality, resilient and cost-effective public services. The challenge will be ensuring Government departments comply with the good intentions of Ministers and the policy documents of the Cabinet Office. In order to ensure the Playbook works in practice, we hope that the principle of “comply or explain”, which has been so effective in promoting good practice in the world of public company governance, will be used to encourage compliance. We also hope that the Playbook will be incorporated into formal Treasury guidance on procurement, and that Cabinet Office and the National Audit Office will be given the resources they need to be able to act as guardians of its implementation.

Notwithstanding the fact that over 80% of our order intake in the last two years has been from governments outside the UK, the UK does still account for around 40% of our revenues, and it is therefore in Serco’s interest, and it is our responsibility, to support the work of the UK Government to ensure a vibrant and successful supply base, and to defend the consensus that the private sector has an important role to play in the delivery of public services. We are encouraged by the new Playbook, and are committed to being a leading player in the UK market for public service delivery. We believe that we are well placed to act in such a role given our credentials: deep capability and experience in many areas of public service delivery; a strong financial position; a track record of dealing fairly with suppliers, employees and customers; a strong public service ethos and commitment to social value; and a reputation for standing by our contractual commitments, but being resolute in not accepting risk that cannot either be mitigated or managed.

Americas

23% of Group revenue
£645.6m (2017: £689.3m)

Our Americas division accounts for approximately 23% of Serco's overall revenue, and provides professional, technology and management services focused on Defence, Transport, and Citizen Services. The US Federal Government, including the military, civilian agencies and the national intelligence community, are our largest customers. We also provide services to the Canadian Government and to some US state and municipal governments.

Revenue for 2018 was £645.6m (2017: £689.3m), a 6% reduction in reported currency. In US dollars, the main currency for operations of the division, revenue for the period was equivalent to approximately US\$860m (2017: US\$890m). The strengthening of Sterling reduced revenue by £23m or 3%; the acquisition of BTP added 2% to revenue; the organic change at constant currency was therefore a decline of 5%, or £33m. Lower volumes of work and the new contract structure of our CMS health insurance eligibility support contract drove a £54m decline, with further impact of fewer task orders in areas of ship modernisation work particularly in the first half of the year. There was partial offset from growth related to the new contract for supply chain management services for the Defense Logistics Agency (DLA), and for Anti-Terrorism/Force Protection (ATFP), Army base modernisation (IMCOM) and Naval Electronic Surveillance Systems (NESS) services. While there was the 5% organic decline for the year as a whole, there was organic growth of 3% in the second half.

Underlying Trading Profit was £45.7m (2017: £36.4m), representing a margin of 7.1% (2017: 5.3%). The benefit of profitable growth from new contracts, the new structure of the CMS contract and other cost efficiencies more than offset the effect of lower ship modernisation work in the first half of the year and the adverse currency movement of £1.6m. Within Underlying Trading Profit there was negligible OCP utilisation required to offset the loss-making Ontario Driver Examination Services (DES) contract in 2018 (2017: £5m). There was a £2.5m charge for Contract & Balance Sheet Review adjustments (2017: £3.4m credit), after which Trading Profit was therefore £43.2m (2017: £39.8m).

Americas represented around £1.3bn (\$1.8bn) or 45% of the Group's order intake. The largest award was the rebid of our health insurance eligibility support contract for the US Department of Health and Human Services, Center for Medicare & Medicaid Services (CMS), with an estimated total value to Serco, subject to workload volumes, of approximately \$900m if all options of the five-year contract are exercised. The second largest was a \$232m sole-source contract vehicle for Serco to continue supporting Naval Electronic Surveillance Systems (NESS). Along with numerous defence equipment modernisation task orders under our various ID/IQ frameworks, other notable awards included: programme management and technical support services to the United States Air Forces Central Command (AFCENT); installation support for Close-In Weapons Systems (CIWS) on US Navy, Army and Coast Guard vessels; supporting the US Army Sustainment Command (ASC) with global acquisition and logistics operations support; and training support services to the US Army Joint Munitions Command (JMC) and the Defense Ammunition Center (DAC).

A new single-award Indefinite Delivery/Indefinite Quantity (ID/IQ) contract to provide public technical assistance to the Federal Emergency Management Agency (FEMA) was awarded to Serco; while this has a potentially large ceiling value of \$600m over the next five years, only a very small initial value for programme management is recognised in our value of signed contracts and order book, as the workload will ultimately be dictated by task orders issued in response to declared major disasters and emergencies.

Of existing work where an extension or rebid will be required at some point before the end of 2021, there are 13 contracts with annual revenue of over £5m within the Americas division; in aggregate, these represent around 35% of the current level of annual revenue for the division, which is a significantly lower proportion versus a year earlier now that the CMS and NESS contracts were secured during 2018. There are few material contracts with potential end dates in 2019. Those coming up for rebid or extension in 2020 include the Global Installation Contract covering areas of our defence ship modernisation work, the Federal Aviation Administration's (FAA) Contract Tower (FCT) Program, and our operational support to Federal Retirement Thrift Investment Board.

Our pipeline of major new bid opportunities due for decision within the next 24 months includes a broad spread of defence support functions, transport operations including air traffic control support, and in areas of Citizen Services case management and processing.

Divisional Reviews continued

AsPac

19% of Group revenue
£548.2m (2017: £577.5m)

Operations in the Asia Pacific division include Justice, Immigration, Defence, Health, Transport and Citizen Services in Australia, New Zealand and Hong Kong. Serco's operations in Australia are by far the largest element of the division; the country represents approximately 19% of total Revenue for the Group.

Revenue for 2018 was £548.2m (2017: £577.5m), a decline of 5%. In Australian dollars, the main currency for operations of the division, revenue for the period was equivalent to approximately A\$980m, flat on the prior year. The strengthening of Sterling reduced revenue by £31m or 5%; the acquisition of the other 50% of a small defence services joint venture added 1% to revenue; the organic change at constant currency was therefore a decline of 1%, or £6m. This net reduction included a £31m impact from the Armidale Class Patrol Boats (ACPB) and Western Australia Court Security & Custodial Services (WACSCS) contracts, both of which ended in the first half of 2017, which was largely offset by growth in our Citizen Services business which provides contact centre and processing support services, and a small increase in workload in Immigration Services. While there was a small organic decline for the year as a whole, there was organic growth of 10% in the second half.

Underlying Trading Profit was £26.8m (2017: £22.3m), representing a margin of 4.9% (2017: 3.9%). There was profitable growth from the new Citizen Services work, a number of non-recurring commercial settlement benefits and good progress on transformation savings and other cost efficiencies; these more than offset other areas of margin pressure and the adverse currency impact of £1.6m. Within Underlying Trading Profit there was £5m of OCP utilisation (2017: £9m), significantly reduced following the end of the ACPB contract.

Contract & Balance Sheet Review adjustments resulted in a £13.7m credit (2017: £11.4m), principally reflecting the release of the remaining OCP balance on the ACPB contract following the expiry of all warranty periods, together with the successful recovery of an insurance claim related to one of the ACPB vessels. After these credits, Trading Profit was therefore £40.5m (2017: £33.7m).

AsPac represented around £0.5bn or 20% of the Group's order intake. The largest new award was to provide for Victoria Police contact centre services for non-urgent incidents. Other similar awards in our Citizen Services business have included contact services for Australia's National Disability Insurance Scheme, and further expanding operations supporting the Department of Human Services. In Hong Kong, we won a new contract to manage, operate and maintain two new tunnels that will form part of a major road link project in the region.

The signing of the National Garrison Health Services (NGHS) contract in February 2019 is an extremely important event for our Australian business. Valued at around £560m over the initial six-year term, under this contract we will work as a sub-contractor to Bupa sourcing and managing more than 1,000 professional staff who will support the delivery of an integrated health care system to over 80,000 Australian Defence Force members and reservists, and we expect this contract to make a noticeable contribution to revenues in 2019 and profits from 2020.

Of existing work where an extension or rebid will be required at some point before the end of 2021, there are 14 contracts with annual revenue of over £5m within the AsPac division; in aggregate, these represent well over half of the current level of annual revenue for the division; this high proportion reflects that the Australia onshore immigration services contract requires rebid or extension at the end of 2019, with this accounting for around 30% of current divisional revenue. Also in 2019 our contract for South Queensland Correctional Centre will require further extending or rebidding, along with Traffic Camera Services in Victoria and some of our Hong Kong transport management services. Others that will require extending or rebidding in 2020 are the Australian Tax Office framework contract, while Fiona Stanley Hospital and Acacia Prison become potentially due in 2021.

As set out above, the largest opportunity in our pipeline of major new bid opportunities at the start of the new year has already been won – NGHS for the Australian Defence Force. Others due for decision within the next 24 months include a relatively broad spread across Defence support and in our Justice & Immigration, Citizen Services, Transport and Health sectors.

12% of Group revenue
£342.3m (2017: £352.6m)

Middle East

Operations in the Middle East division include Transport, Defence, Health and Citizen Services, with the region accounting for approximately 12% of the Group's total revenue.

Revenue for 2018 was £342.3m (2017: £352.6m), a decrease of 3%. The strengthening of Sterling reduced revenue by £13m or 4%; the organic change at constant currency was therefore growth of 1%. The increase included some volume growth of transport operations, with other expanding or new work, such as the fire and rescue services in Saudi Arabia, broadly offsetting other small areas of attrition or reductions in scope or volumes.

Underlying Trading Profit was £21.5m (2017: £17.3m), representing a margin of 6.3% (2017: 4.9%). The improvement in profitability was due in large part to the non repeat of the heavy costs of bidding the rail tenders experienced in the prior year, together with some progress on other cost efficiencies; the profitability of the MELABS contact was also higher in its final year of the previous terms ahead of rebid; these together more than offset other areas of margin pressure, attrition and a £1.0m adverse currency movement. There are no OCP contracts in the division and therefore no OCP utilisation within Underlying Trading Profit. There were no Contract & Balance Sheet Review adjustments in the latest or prior year, therefore no difference between Underlying Trading Profit and Trading Profit.

The Middle East represented around £0.4bn or 15% of the Group's order intake. Included is a letter of intent from the customer for Serco to continue operating the Dubai Metro for a further two years through to September 2021. The MELABS defence base logistics and support services contract was successfully rebid, though as previously described the new contract will significantly reduce the Middle East division's profitability in 2019; other existing work secured included facilities management for Abu Dhabi Global Market Square, and air navigation services and training in Iraq; Serco was unsuccessful in its bid to continue providing air navigation services in Bahrain. The largest new contract was with Dammam Airports Company (DACO) for the provision of fire and rescue services at King Fahd International Airport (KFIA), the first Saudi airport to leverage an international service provider's expertise in firefighting systems; other new contracts included integrated facilities management for Aldar commercial properties in Abu Dhabi.

Of existing work where an extension or rebid will be required at some point before the end of 2021, there are 12 contracts with annual revenue of over £5m within the Middle East division; in aggregate, these represent well over half of the current level of annual revenue for the division. There are a number of smaller integrated facilities management contracts due for rebid or extension during the course of 2019. From early 2020, our contracts for air navigation services in both Dubai and Iraq become due, together with the Saudi rail and a number of other operations. The relatively high proportion of current annual revenue on a cumulative three-year basis reflects that the Dubai Metro contract is anticipated to become due again in September 2021.

Our pipeline of major new bid opportunities in the region reduced very significantly in 2017 following the outcome of the light rail and tram bids. The current pipeline has some other smaller opportunities in integrated facilities management, and effort is ongoing to rebuild a stronger pipeline across other sectors.

In April 2019, Phil Malem will become the divisional Chief Executive Officer of Serco Middle East. Phil joins from Atkins, one of the world's leading design, engineering and project management consultancies, where he was Managing Director for its transportation and infrastructure business, Middle East & Africa.

Corporate costs

Corporate costs relate to typical central function costs of running the Group, including executive, governance and support functions such as HR, finance and IT. Where appropriate, these costs are stated after allocation of recharges to operating divisions. The costs of Group-wide programmes and initiatives are also incurred centrally.

Benefiting from actions to deliver savings and improve efficiencies of our central functions, corporate costs in 2018 reduced by 4% to £40.1m (2017: £41.6m).

Finance review



Angus Cockburn
Group Chief Financial Officer

Revenue of £2,837m declined 4% over the full year, though grew in the second half. Underlying Trading Profit of £93.1m increased by 34% as a result of a strong operating performance, further good progress on transformation savings and other cost efficiencies, as well as some non-recurring trading items.

For the year ended 31 December 2018	Underlying £m	Non underlying items £m	Trading £m	Amortisation and impairment of intangibles arising on acquisition £m	Statutory pre exceptional £m	Exceptional items £m	Statutory £m
Revenue	2,836.8	–	2,836.8	–	2,836.8	–	2,836.8
Cost of sales	(2,570.2)	23.6	(2,546.6)	–	(2,546.6)	–	(2,546.6)
Gross profit	266.6	23.6	290.2	–	290.2	–	290.2
Administrative expenses	(202.3)	–	(202.3)	(4.3)	(206.6)	(31.9)	(238.5)
Share of profits in joint ventures and associates, net of interest and tax	28.8	–	28.8	–	28.8	–	28.8
Profit before interest and tax	93.1	23.6	116.7	(4.3)	112.4	(31.9)	80.5
<i>Margin</i>	3.3%		4.1%		4.0%		2.8%
Net finance costs	(13.9)	–	(13.9)	–	(13.9)	7.5	(6.4)
Profit before tax	79.2	23.6	102.8	(4.3)	98.5	(24.4)	74.1
Tax charge	(20.6)	8.7	(11.9)	3.1	(8.8)	2.1	(6.7)
Effective tax rate	(26.0%)		(11.6%)		(8.9%)		(9.0%)
Profit / (loss) for the period	58.6	32.3	90.9	(1.2)	89.7	(22.3)	67.4
Minority interest	0.0	–	0.0	–	0.0	–	0.0
Earnings / (loss) per share – basic (pence)	5.36		8.31		8.20		6.16
Earnings / (loss) per share – diluted (pence)	5.21		8.08		7.97		5.99

For the year ended 31 December 2017 (restated*)	Underlying £m	Non underlying items £m	Trading £m	Amortisation and impairment of intangibles arising on acquisition £m	Statutory pre exceptional £m	Exceptional items £m	Statutory £m
Revenue	2,950.9	–	2,950.9	–	2,950.9	–	2,950.9
Cost of sales	(2,686.4)	(24.2)	(2,710.6)	–	(2,710.6)	–	(2,710.6)
Gross profit	264.5	(24.2)	240.3	–	240.3	–	240.3
Administrative expenses	(222.2)	–	(222.2)	(4.4)	(226.6)	(19.6)	(246.2)
Share of profits in joint ventures and associates, net of interest and tax	27.0	–	27.0	–	27.0	–	27.0
Profit before interest and tax	69.3	(24.2)	45.1	(4.4)	40.7	(19.6)	21.1
Margin	2.3%	–	1.5%	–	1.4%	–	0.7%
Net finance costs	(11.2)	–	(11.2)	–	(11.2)	–	(11.2)
Other gains	–	0.7	0.7	–	0.7	–	0.7
Profit before tax	58.1	(23.5)	34.6	(4.4)	30.2	(19.6)	10.6
Tax charge	(20.2)	5.0	(15.2)	1.6	(13.6)	(5.0)	(18.6)
Effective tax rate	(34.8%)		(43.9%)		(45.0%)		(175.5%)
Profit / (loss) for the period	37.9	(18.5)	19.4	(2.8)	16.6	(24.6)	(8.0)
Minority interest	0.3		0.3		0.3		0.3
Earnings / (loss) per share – basic (pence)	3.45		1.75		1.50		(0.76)
Earnings / (loss) per share – diluted (pence)**	3.36		1.70		1.45		(0.76)

* Results for the year ended 31 December 2017 have been restated to reflect the adoption of IFRS15 with effect from 1 January 2017. See note 2 to the Financial Statements.

** Earnings per share is not diluted on a statutory basis

Alternative Performance Measures (APMs) and other related definitions

Overview

APMs used by the Group are reviewed below to provide a definition and reconciliation from each non-IFRS APM to its IFRS equivalent, and to explain the purpose and usefulness of each APM.

In general, APMs are presented externally to meet investors' requirements for further clarity and transparency of the Group's financial performance. The APMs are also used internally in the management of our business performance, budgeting and forecasting, and for determining Executive Directors' remuneration and that of other management throughout the business.

APMs are non-IFRS measures. Where additional revenue is being included in an APM, this reflects revenues presented elsewhere within the reported financial information, except where amounts are recalculated to reflect constant currency. Where items of profits or costs are being excluded in an APM, these are included elsewhere in our reported financial information as they represent actual profits or costs of the Group, except where amounts are recalculated to reflect constant currency. As a result, APMs allow investors and other readers to review different kinds of revenue, profits and costs and should not be used in isolation. Other commentary within the Strategic Report, including the other sections of this Finance Review, as well as the Consolidated Financial Statements and their accompanying notes, should be referred to in order to fully appreciate all the factors that affect our business. We strongly encourage readers not to

rely on any single financial measure, but to carefully review our reporting in its entirety.

The methodology applied to calculating the APMs has not changed during the year for any measure other than the APM for earnings per share which has changed to be with reference to the diluted weighted average number of shares rather than the basic weighted average number of shares.

The basis of the change is due to the fact that:

- the Group has made a statutory profit and therefore unvested options reduce earnings per share, whereas unvested options could not have been included in prior years as their conversion would have reduced loss per share; and
- more options are expected to vest and are therefore relevant in assessing the expected earnings per share.

Earnings per share on both a basic and diluted basis has been presented to illustrate the impact of the change.

The comparative numbers within this Finance Review have been restated to reflect the impact of IFRS15 as disclosed within note 2 on page 157. The restated balances are as previously included within the Group's Financial Statements for the 6 months to 30 June 2018 with an additional adjustment relating to the adoption of IFRS15 as set out in note 2 of the Financial Statements which had no net impact to the income statement or balance sheet.

Finance review continued

Alternative revenue measures

Reported revenue at constant currency

Reported revenue, as shown on the Group's Consolidated Income Statement on page 151, reflects revenue translated at the average exchange rates for the period. In order to provide a comparable movement on the previous year's results, reported revenue is recalculated by translating non-Sterling values for the year to 31 December 2018 into Sterling at the average exchange rate for the year ended 31 December 2017. All revenue in 2018 arose from continuing activities.

For the year ended 31 December	2018 £m
Reported revenue at constant currency	2,902.0
Foreign exchange differences	(65.2)
Reported revenue at reported currency	2,836.8

Organic Revenue at constant currency

Reported revenue may include revenue generated by businesses acquired during a particular year from the date of acquisition and/or generated by businesses sold during a particular year up to the date of disposal. In order to provide a comparable movement which ignores the effect of both acquisitions and disposals on the previous year's results, Organic Revenue at constant currency is recalculated by excluding the impact of any relevant acquisitions or disposals.

There are three acquisitions excluded for the calculation of Organic Revenue in the year to 31 December 2018.

- The acquisition of 50% of the issued share capital of Serco Sodexo Defence Services Pty Ltd (SSDS) on 24 August 2017, resulting in full control being obtained. SSDS was previously a 50% owned joint venture accounted for on an equity accounting basis and therefore no revenues had previously been recorded in the Group's results.
- The acquisition of 100% of the issued share capital of BTP Systems, LLC (BTP) on 26 January 2018.
- The acquisition of six UK health facilities management contracts which were transferred from Carillion plc between June 2018 and August 2018.

An adjustment is required for the two disposals outlined below:

- The disposal of contracts within the Anglia Support Partnership on 31 October 2018.
- The disposal of the remaining element of the UK private sector BPO business, consisting of a single contract, sold on 3 July 2017. This business was previously reported within discontinued operations but included as continuing in 2017 as it did not have a material impact on the Group's results.

The Group disposed of Service Glasgow LLP on 1 December 2017, which also consisted of a single contract. However, this disposal arose as a result of normal contract attrition rather than as a result of the disposal of a wider business and hence this is not excluded for the Organic Revenue calculation.

Organic Revenue growth is calculated by comparing the current year Organic Revenue at constant currency exchange rates with the prior year Organic Revenue at reported currency exchange rates.

For the year ended 31 December	2018 £m
Organic Revenue at constant currency	2,838.2
Foreign exchange differences	(64.2)
Organic Revenue at reported currency	2,774.0
Impact of any relevant acquisitions or disposals	62.8
Reported revenue at reported currency	2,836.8

For the year ended 31 December	2017 (restated*) £m
Organic Revenue at reported currency	2,929.7
Impact of any relevant acquisitions or disposals**	21.2
Reported revenue at reported currency	2,950.9

* Results for the year ended 31 December 2017 have been restated to reflect the adoption of IFRS15 with effect from 1 January 2017. See note 2 to the Financial Statements.

** Impact of relevant acquisitions and disposals has been restated for comparison purposes.

Revenue

Reported revenue, as shown on the Group's Consolidated Income Statement on page 151, reflects only that from continuing operations. In prior reporting periods an alternative measure to include discontinued operations has been used for the benefit of consistency with previously reported results and to reflect the overall change in scale of the Group's operations. The alternative measure allows the performance of the discontinued operations themselves, and their impact on the Group as a whole, to be evaluated on measures other than just the post tax result. No operations were classified as discontinued in 2018 and in 2017. In 2017 there was a single remaining business as at 1 January 2017 which generated insignificant revenue and profit up to the date of disposal of 3 July 2017 which related to the UK private sector BPO business which had previously been disclosed as a discontinued operation.

Revenue plus share of joint ventures and associates

Reported revenue, as shown on the Group's Consolidated Income Statement on page 151, excludes the Group's share of revenue from joint ventures and associates, with Serco's share of profits in joint ventures and associates (net of interest and tax) consolidated within Reported Operating Profit as a single line further down the Consolidated Income Statement. The alternative measure includes the share of joint ventures and associates for the benefit of reflecting the overall change in scale of the Group's ongoing operations, which is particularly relevant for evaluating Serco's presence in market sectors such as Defence and Transport. The alternative measure allows the performance of the joint venture and associate operations themselves, and their impact on the Group as a whole, to be evaluated on measures other than just the post tax result.

For the year ended 31 December	2018 £m	2017 (restated*) £m
Revenue plus share of joint ventures and associates	3,211.9	3,307.3
Exclude share of revenue from joint ventures and associates	(375.1)	(356.4)
Reported revenue	2,836.8	2,950.9

* Results for the year ended 31 December 2017 have been restated to reflect the adoption of IFRS15 with effect from 1 January 2017. See note 2 to the Financial Statements.

Alternative profit measures

For the year ended 31 December	2018 £m	2017 (restated*) £m
Underlying Trading Profit	93.1	69.3
Non-underlying items:		
Include OCP charges and releases	12.8	(27.4)
Include other Contract & Balance Sheet Review adjustments and one-time items	10.8	3.2
Total Non-underlying items	23.6	(24.2)
Trading Profit	116.7	45.1
Include operating exceptional items	(31.9)	(19.6)
Include amortisation and impairment of intangibles arising on acquisition	(4.3)	(4.4)
Operating profit	80.5	21.1

* Results for the year ended 31 December 2017 have been restated to reflect the adoption of IFRS15 with effect from 1 January 2017. See note 2 to the Financial Statements.

Underlying Trading Profit (UTP)

The Group uses an alternative measure, Underlying Trading Profit, to make adjustments for unusual items that occur and remove the impact of historical issues. UTP therefore provides a measure of the underlying performance of the business in the current year.

Charges and releases on all Onerous Contract Provisions (OCPs) are excluded in the current and prior years. OCPs reflect the future multiple year cost of delivering onerous contracts and do not reflect only the current cost of operating the contract in the latest individual year. It should be noted that, as for operating profit, UTP benefits from OCP utilisation of £51.8m in 2018 (2017 restated: £64.6m) which neutralises the in-year losses on previously identified onerous contracts, therefore it is only charges or releases of OCPs that are adjusted for.

Revisions to accounting estimates and judgements which arose during the 2014 Contract & Balance Sheet Review are separately reported where the impact of an individual item is material. Items in 2018 which were recorded within this category included a release of a provision made during the 2014 Contract & Balance Sheet Review following a change in the Group's obligations and a settlement received.

Both OCP adjustments and other Contract & Balance Sheet Review and one-time items are identified and separated from the APM in order to give clarity of the underlying performance of the Group and to separately disclose the progress made on these items.

Underlying trading margin is calculated as UTP divided by revenue from continuing and discontinued operations.

The non-underlying column in the summary income statement on page 34 includes the tax impact of the above items and tax items that, in themselves, are considered to be non-underlying. Further detail of such items is provided in the tax section below.

Trading Profit

The Group uses Trading Profit as an alternative measure to operating profit, as shown on the Group's Consolidated Income Statement on page 151, by making two adjustments. Trading Profit is a metric used to determine the performance and remuneration of the Executive Directors.

First, Trading Profit excludes exceptional items, being those considered material and outside of the normal operating practice of the Group to be suitable of separate presentation and detailed explanation.

Second, amortisation and impairment of intangibles arising on acquisitions are excluded, because these charges are based on judgements about the value and economic life of assets that, in the case of items such as customer relationships, would not be capitalised in normal operating practice.

Finance review continued

UTP at constant currency

UTP disclosed above has been translated at the average foreign exchange rates for the year. In order to provide a comparable movement on the previous year's results, UTP is

recalculated by translating non-Sterling values for the year to 31 December 2018 into Sterling at the average exchange rate for the year ended 31 December 2017.

For the year ended 31 December	2018 £m
Underlying Trading Profit at constant currency	97.1
Foreign exchange differences	(4.0)
Underlying Trading Profit at reported currency	93.1

Alternative Earnings or Loss Per Share (EPS) measures

For the year ended 31 December	2018 pence	2017 (restated*) pence
Underlying EPS, basic	5.36	3.45
Net impact of non-underlying items and amortisation and impairment of intangibles arising on acquisition	2.84	(1.95)
EPS before exceptional items, basic	8.20	1.50
Impact of exceptional items	(2.04)	(2.26)
Reported EPS, basic	6.16	(0.76)

* Results for the year ended 31 December 2017 have been restated to reflect the adoption of IFRS15 with effect from 1 January 2017. See note 2 to the Financial Statements.

For the year ended 31 December	2018 Pence	2017 (restated*) pence
Underlying EPS, diluted	5.21	3.36
Net impact of non-underlying items and amortisation and impairment of intangibles arising on acquisition	2.76	(1.91)
EPS before exceptional items, diluted	7.97	1.45
Impact of exceptional items	(1.98)	(2.20)
Remove impact of loss	–	(0.01)
Reported EPS, diluted	5.99	(0.76)

* Results for the year ended 31 December 2017 have been restated to reflect the adoption of IFRS15 with effect from 1 January 2017. See note 2 to the Financial Statements.

EPS before exceptional items

EPS, as shown on the Group's Consolidated Income Statement on page 151, includes exceptional items charged or credited to the income statement in the year. EPS before exceptional items aids consistency with historical results and is a metric used in assessing the performance and remuneration of the Executive Directors.

Underlying EPS

Reflecting the same adjustments made to operating profit to calculate UTP as described above, and including the related tax effects of each adjustment and any other non underlying tax adjustments as described in the tax charge section below, an alternative measure of EPS is presented. This aids consistency with historical results, and enables performance to be evaluated before the unusual or one-time effects described above. The full reconciliation between statutory EPS and Underlying EPS is provided in the summary income statements on page 34.

Alternative cash flow and Net Debt measures

Free Cash Flow (FCF)

We present an alternative measure for cash flow to reflect net cash inflow from operating activities before exceptional items, which is the measure shown on the Consolidated Cash Flow Statement on page 155. This IFRS measure is adjusted to include dividends we receive from joint ventures and associates and deducting net interest paid and net capital expenditure on tangible and intangible asset purchases. FCF is considered relevant to reflect the cash performance of business operations after meeting usual obligations of

financing and tax. It is therefore a measure that is before all other remaining cash flows, being those related to exceptional items, acquisitions and disposals, other equity-related and debt-related funding movements, and foreign exchange impacts on financing and investing activities. FCF is therefore a measure to assess the cash flow generated by the business and aids consistency for comparison to historical results. FCF is a metric used to determine the performance and remuneration of the Executive Directors.

For the year ended 31 December	2018 £m	2017 (restated*) £m
Free Cash Flow	25.0	(6.7)
Exclude dividends from joint ventures and associates	(29.7)	(28.2)
Exclude net interest paid	16.1	17.0
Exclude capitalised finance costs paid	2.0	–
Exclude purchase of intangible and tangible assets net of proceeds from disposal	29.5	30.1
Cash flow from operating activities before exceptional items	42.9	12.2
Exceptional operating cash flows	(40.2)	(32.5)
Cash flow from operating activities	2.7	(20.3)

* Results for the year ended 31 December 2017 have been restated to reflect the adoption of IFRS15 with effect from 1 January 2017. See note 2 to the Financial Statements.

UTP cash conversion

FCF as defined above, includes interest and tax cash flows. In order to calculate an appropriate cash conversion metric equivalent to UTP, Trading Cash Flow is derived from FCF by excluding tax and interest items. UTP cash conversion

therefore provides a measure of the efficiency of the business in terms of converting profit into cash before taking account of the impact of interest, tax and exceptional items.

For the year ended 31 December	2018 £m	2017 (restated*) £m
Free Cash Flow	25.0	(6.7)
Add back:		
Tax paid	10.6	11.4
Non-cash R&D expenditure	0.1	0.2
Net interest paid	16.1	17.0
Capitalised finance costs paid	2.0	–
Trading Cash Flow	53.8	21.9
Underlying Trading Profit	93.1	69.3
Underlying Trading Profit cash conversion	58%	32%

* Results for the year ended 31 December 2017 have been restated to reflect the adoption of IFRS15 with effect from 1 January 2017. See note 2 to the Financial Statements.

Finance review continued

Net Debt

We present an alternative measure to bring together the various funding sources that are included on the Group's Consolidated Balance Sheet on page 154 and the accompanying notes. Net Debt is a measure to reflect

the net indebtedness of the Group and includes all cash and cash equivalents and any debt or debt like items, including any derivatives entered into in order to manage risk exposures on these items.

For the year ended 31 December	2018 £m	2017 £m
Cash and cash equivalents	62.5	112.1
Loans receivable	–	25.7
Loans payable	(239.5)	(271.5)
Obligations under finance leases	(14.8)	(20.2)
Derivatives relating to Net Debt	3.8	12.8
Net Debt	(188.0)	(141.1)

Pre-tax Return on Invested Capital (ROIC)

ROIC is a measure to assess the efficiency of the resources used by the Group and is a metric used to determine the performance and remuneration of the Executive Directors. ROIC is calculated based on UTP and Trading Profit using the

Income Statement for the year and a two point average of the opening and closing balance sheets. The composition of Invested Capital and calculation of ROIC are summarised in the table below.

For the year ended 31 December	2018 £m	2017 (restated*) £m
Non-current assets		
Goodwill	579.6	551.3
Other intangible assets	67.3	66.7
Property, plant and equipment	64.8	61.3
Interest in joint ventures and associates	20.6	19.7
Trade and other receivables	30.3	57.3
Current assets		
Inventory	22.9	17.4
Trade and other receivables	543.8	512.0
Total invested capital assets	1,329.3	1,285.7
Current liabilities		
Contract liabilities, trade and other payables	(494.0)	(472.9)
Non-current liabilities		
Contract liabilities, trade and other payables	(109.9)	(112.0)
Total invested capital liabilities	(603.9)	(584.9)
Invested Capital	725.4	700.8
Two point average of opening and closing Invested Capital	713.1	721.9
Trading Profit	116.7	45.1
ROIC%	16.4%	6.2%
Underlying Trading Profit	93.1	69.3
Underlying ROIC%	13.1%	9.6%

* Results and balances for the year ended 31 December 2017 have been restated to reflect the adoption of IFRS15 with effect from 1 January 2017. See note 2 to the Financial Statements.

Overview of financial performance

Revenue

Reported Revenue declined by 3.9% in the year to £2,836.8m (2017 restated: £2,950.9m), a 1.7% reduction in constant currency.

No revenue arose in 2018 (2017: nil) from operations classified as discontinued.

Commentary on the revenue performance of the Group is provided in the Chief Executive's Review and the Divisional Reviews sections.

Trading Profit

Trading Profit for the year was £116.7m (2017 restated: £45.1m).

Commentary on the trading performance of the Group is provided in the Chief Executive's Review and the Divisional Reviews sections.

Underlying Trading Profit

UTP was £93.1m (2017 restated: £69.3m), up 34%. At constant currency, UTP was £97.1m, up 40%.

Commentary on the underlying performance of the Group is provided in the Chief Executive's Review and the Divisional Reviews sections.

Excluded from UTP were net releases from OCPs of £12.8m (2017 restated: net charges of £27.4m) following the detailed reassessment undertaken as part of the budgeting process. Also excluded from UTP were net releases and additional profits of £10.8m (2017 restated: net releases of £3.2m) relating to other provisions and accruals for items identified during the 2014 Contract & Balance Sheet Review and other one-time items.

The cumulative to date improvement to Trading Profit as a result of OCP charges and releases and adjustments to items identified during the 2014 Contract & Balance Sheet Review is £44.5m (2017: £19.3m). This represents 6% of the 2014 total charge to Trading Profit arising from the Contract & Balance Sheet Review.

The tax impact of items in UTP and other non underlying tax items is discussed in the tax section of this Finance Review.

Discontinued operations

There were no operations classified as discontinued in 2018 or 2017.

Joint ventures and associates – share of results

In 2018, the most significant joint ventures and associates in terms of scale of operations were AWE Management Limited and Merseyrail Services Holding Company Limited, with dividends received of £20.0m (2017: £17.1m) and £8.7m (2017: £7.3m) respectively. Total revenues generated by these businesses were £1,024.7m (2017 restated: £951.8m) and £160.8m (2017 restated: £155.1m) respectively.

While the revenues and individual line items are not consolidated in the Group Consolidated Income Statement, summary financial performance measures for the Group's proportion of the aggregate of all joint ventures and associates are set out below for information purposes.

The increase in revenue and profits on the prior year is due to the improved operating performance of the Group's material joint ventures.

For the year ended 31 December	2018 £m	2017 (restated*) £m
Revenue	375.1	356.4
Operating profit	34.6	34.1
Net investment finance costs	0.3	(0.1)
Income tax expense	(6.1)	(7.0)
Profit after tax before exceptional charge	28.8	27.0
Exceptional pension charge (see exceptional items below)	(0.3)	–
Profit after tax	28.5	27.0
Dividends received from joint ventures and associates	29.7	28.2

* Results for the year ended 31 December 2017 have been restated to reflect the adoption of IFRS15 with effect from 1 January 2017. See note 2 to the Financial Statements.

Finance review continued

Exceptional items

Exceptional items are items of financial performance that are outside normal operations and are material to the results of the Group either by virtue of size or nature. As such, the

items set out below require separate disclosure on the face of the income statement to assist in the understanding of the performance of the Group.

For the year ended 31 December	2018 £m	2017 £m
Exceptional items arising		
Exceptional (loss)/profit on disposal of subsidiaries and operations	(0.5)	0.3
Other exceptional operating items		
Restructuring costs	(32.3)	(28.6)
Increase in onerous lease provision	(1.8)	–
Costs associated with UK Government review	0.4	(0.4)
Release of UK frontline clinical health contract provisions	–	0.4
Settlement of defined benefit pension obligations	–	10.3
Reversal of impairment of interest in joint venture and related loan balances	0.8	4.5
Reversal of impairment on loan balances	13.9	–
Impairment of AsPac customer lists	–	(6.1)
Cost of Guaranteed Minimum Pension equalisation	(9.6)	–
Increase in other provisions	(2.8)	–
Other exceptional operating items	(31.4)	(19.9)
Exceptional operating items	(31.9)	(19.6)
Exceptional finance income	7.5	–
Exceptional tax	2.1	(5.0)
Total operating and financing exceptional items net of tax	(22.3)	(24.6)

Exceptional profit on disposals

There were no material disposals of continuing operations in 2018 (2017: none).

historically been treated as exceptional and consistent treatment is applied in 2018. The credit reflects the recovery of costs from the Group's insurance providers.

Other exceptional operating items

The annual impairment testing of CGUs in 2018 has identified no impairment of goodwill.

An exceptional charge of £9.6m (2017: nil) has been recorded in the Group's income statement for the year ended 31 December 2018. This is to recognise the Group's obligations associated with equalising the Guaranteed Minimum Pension (GMP) payments between male and female employees for the Group's defined benefit pension schemes following the High Court ruling made in October 2018. The Serco Pension and Life Assurance Scheme (SPLAS) recorded the largest charge being £9.0m. Included in the £9.6m charge is £0.3m related to the Group's share of the GMP cost in one of the Group's Joint Ventures. This has been recorded as exceptional to ensure consistent treatment of all items in 2018 related to the cost of equalising the GMP payments within the Group's pension schemes. The impact of GMP equalisation is not currently estimated to have a material impact in future years.

The Group is incurring costs in relation to restructuring programmes resulting from the Strategy Review. These costs include redundancy payments, provisions (including onerous leases), external advisory fees and other incremental costs. Due to the nature and scale of the impact of the transformation phase of the Strategy Review, the incremental costs associated with this programme are considered to be exceptional. Costs associated with the restructuring programme resulting from the Strategy Review must meet the following criteria: that they are directly linked to the implementation of the Strategy Review; they are incremental costs as a result of the activity; and they are non business as usual costs. In 2018, a charge of £32.3m (2017: £28.6m) arose in relation to the restructuring programme resulting from the Strategy Review. The Strategy Review is discussed in more detail in the Strategic Report on page 18. Non-exceptional restructuring charges are incurred by the business as part of normal operational activity, which in the year totalled £6.3m (2017: £11.1m) and were included within operating profit before exceptional items. We expect exceptional restructuring costs of approximately £20.0m will be incurred in 2019, which we expect to be the final year.

An additional charge of £2.8m has been recorded in respect of an existing legal case in the Group's North American Division. The treatment of this additional amount as exceptional is consistent with the recognition of the original charge associated with the same legal matter.

There was an exceptional credit totalling £0.4m (2017: charge of £0.4m) associated with the UK Government reviews and the programme of Corporate Renewal. These costs have

In 2016, a review of a joint venture's cash flow projections led to the impairment of certain equity interests and associated receivables balances, totalling £13.9m. The impairment was outside of the normal course of business and of a significant value, and was therefore considered to be an exceptional item. In the year ended 31 December 2018 payments of £0.8m (2017: £4.5m) were received against the impaired loan.

Other exceptional operating items continued

An exceptional profit of £13.9m (2017: nil) has been recognised for the settlement of consideration associated with the sale of Serco GmbH in 2012 through the offsetting of outstanding loan balances, the receivable of which had been impaired. An exceptional loss on disposal of £27.7m was recorded in 2012 in respect of the sale.

An exceptional charge of £10.7m arose in 2016 in respect of the bulk transfer of a number of employees that are being transferred from SPLAS to the Principal Civil Service Pension Scheme. This transfer was legally agreed in December 2016 at which point all obligations of SPLAS to pay retirement benefits for these individuals were eliminated and as a result, a settlement charge of £10.7m arose, for which a provision was made. In 2017 a new agreement was reached with the UK Government to transfer out the scheme members on an individual basis and the 2016 legal and commercial arrangements were cancelled by consent of all parties. As a result of the changes, the impact of the transfer was treated as an experience gain adjustment through other comprehensive income and the majority of the provision made in 2016 was reversed, resulting in a £10.3m credit to exceptional items in 2017. A cost of this nature did not reoccur in 2018.

In 2017 there were releases of provisions £0.4m which were previously charged through exceptional items in relation to the exit of the UK frontline clinical health contracts. As a result of contracts coming to the end of their natural lives and no significant new contracts being awarded by the customer, the remaining customer relationship intangible assets of the DMS Maritime Pty Limited business acquired in 2012 were impaired in 2017, totalling £6.1m.

Exceptional finance costs

Part of the consideration for the sale of the Group's private sector BPO business in 2015 was a loan note with a face value of £30m accruing compound interest of 7%. The receivable associated with this loan note was recorded at a fair value of £19.5m. The discount on the loan note has been unwinding through the Group's net finance cost on an annual basis. During October 2018, the Intelenet business was sold and therefore repayment of the loan note was triggered resulting in a gain of £7.5m. As this gain is outside the normal financing arrangements of the Group and significant in size it has been recorded as exceptional investment income.

Exceptional tax

Exceptional tax for the year was a tax credit of £2.1m (2017: £5.0m charge) which arises on exceptional items within operating profit.

No net tax credit arises on the exceptional charge associated with GMP equalisation (further detail on this charge is included in the "Other exceptional operating items" section above). The credit that arises on the deferred tax movement associated with this charge is netted with an equal and opposite charge that arises on the associated reduction in the deferred tax asset in order to retain the net deferred tax position as supported by future forecast profits.

Remaining exceptional costs excluding the pension charge (£14.8m) only gave rise to a credit of £2.1m, as the majority of these costs were incurred in the UK where they only impact our unrecognised deferred tax in relation to losses.

Pre exceptional finance costs and investment revenue

Investment revenue of £4.3m (2017 restated: £8.0m) includes interest accruing on net retirement benefit assets of £0.8m (2017: £3.8m), interest earned on deposits and other receivables of £2.3m (2017: £2.6m), interest arising on customer contracts £nil (2017: £0.4m) and the movement in discounting of other receivables of £1.2m (2017: £1.2m).

Finance costs of £18.2m (2017: £19.2m) includes interest incurred on the USPP loans and the Revolving Credit Facility of £13.8m (2017: £14.0m), facility fees and other charges of £3.1m (2017: £3.0m), interest payable on finance leases of £0.6m (2017: £1.3m), the movement in discount on provisions of £0.5m (2017: £1.3m) and a loss for foreign exchange on financing activities of £0.2m (2017: £0.4m credit).

Other gains

On 24 August 2017 the Group acquired 50% of the issued share capital of Serco Sodexo Defence Services Pty Ltd for £1.6m, obtaining full control. Serco Sodexo Defence Services Pty Ltd was previously a 50% owned joint venture accounted for on an equity accounting basis. As a result of the increase in ownership from 50% to 100%, the Group fair valued the existing 50% shareholding and the resulting uplift in value of £0.7m was recorded in other gains, outside of operating results.

There were no other gains recorded in the year to 31 December 2018.

Tax

Tax charge Underlying tax

In 2018 we recognised a tax charge of £20.6m on underlying trading profits after finance cost. The effective tax rate (26.0%) is lower than in 2017 (34.8%). This is mainly due to a fall in the rate of tax incurred by our overseas operations, primarily driven by the fall in US tax rate, together with lower underlying UK tax losses on which no accounting tax credit is available which is only partially offset by a lower adjustment in respect of prior years.

Finance review continued

Pre exceptional tax

We recognised a tax charge of £8.8m (2017: £13.6m) on pre-exceptional profits which includes underlying tax (£20.6m), tax impact of amortisation on intangibles arising on acquisition of £3.1m credit and £8.7m credit on non-underlying items. Of the £3.1m credit, £2.3m arises on balancing the UK deferred tax asset to the level supported by forecasts due to the recognition of a deferred tax liability on customer lists arising on the acquisition of the Carillon plc healthcare facility management contracts. This deferred tax liability was recognised against goodwill arising on the acquisition. The £8.7m credit consists of the tax impact on contract and balance sheet review adjustments and other material one-time items (non-underlying items) together with tax items that are in themselves considered to be non-underlying:

- The tax on non-underlying items during the period totalled a debt of £3.2m reflecting the impact of current or future tax charges.
- During the current period we have recognised an additional £2.9m of deferred tax asset in relation to UK losses to reflect the improved forecast taxable income of our UK operations.
- Generally movements in the valuation of the Group's defined benefit pension schemes and the associated deferred tax impact are reported in the Statement of Comprehensive Income (SOCi) and do not flow through the income statement, therefore do not impact profit before tax or the tax charge. However, the net amount of deferred tax recognised in the balance sheet relates to both the pension accounting and other timing differences, such as recoverable losses. As the net deferred tax balance sheet position is at the maximum level supported by future profit forecasts, the increase in the deferred tax liability associated with the pension scheme (with the benefit reported in the SOCi) leads to a corresponding increase in the deferred tax asset to match the future profit forecasts. Such an increase in the deferred tax asset therefore leads to a credit to tax in the income statement. Where deferred tax charges or releases are the result of movements in the pension scheme valuations rather than trading activity, these are excluded from the calculation of tax on underlying profit and the underlying effective tax rate, with the prior periods being restated to reflect this. These amounted to £9.0m credit for 2018 (2017: £1.9m charge).

The tax rate on profits before exceptional items on continuing operations, at 8.9% is lower than the UK standard corporation tax rate of 19%. This is due to the credits in relation to pensions and the acquisition and additional recognition of deferred tax assets noted above, together with the impact of our joint ventures whose post-tax results are included in our pre-tax profit which is only partially offset by the impact of higher rates of tax on profits arising on our international operations, together with the absence of any deferred tax credit for current year losses incurred in the UK (which includes the result of UK divisions and the majority of corporate costs). Our tax charge in future years will continue to be materially impacted by our accounting for UK deferred taxes.

To the extent that future UK tax losses are incurred and are not recognised, our effective tax rate will be driven higher than prevailing standard corporation tax rates. When our UK business returns to sustainable profitability our existing UK tax losses will be recognised or utilised, and the effective rate will be reduced.

Exceptional tax

Analysis of exceptional tax is provided in the Exceptional items section above.

Contingent tax assets

At 31 December 2018, the Group has gross estimated unrecognised deferred tax assets of £1.1bn (£211m net), which are potentially available to offset against future taxable income. These principally relate to tax trading losses of £852m. Of these tax losses, £717m have arisen in the UK business (net £122m).

A £20.3m UK tax asset has been recognised at 31 December 2018 (2017: £17.4m) on the basis of forecast utilisation against future taxable income.

Taxes paid

Net corporate income tax of £10.6m was paid during the year, relating primarily to our operations in AsPac (£8.7m), Europe (£4.1m) and Middle East (£1.1m). The Group's UK operations have transferred tax losses to its profitable joint ventures and associates giving a cash tax inflow in the UK of £3.3m. A cash tax refund in Canada on the carry back of prior year losses has broadly equalled cash tax paid in the US such that the net cash tax outflow for North America was nil.

The amount of tax paid (£10.6m) differs from the tax charge in the period (£20.6m) mainly due to the effect of future expected cash tax outflows for which a charge has been taken in the current period. In addition, taxes paid/received from Tax Authorities can arise in later periods to the associated tax charge/credit and also there is a time lag on receipts of cash from joint ventures and associates for losses transferred to them.

Further detail is shown below of taxes that have been paid during the year.

Total tax contribution

Our tax strategy of paying the appropriate amount of tax as determined by local legislation in the countries in which we operate, means that we pay a variety of taxes across the Group. In order to increase the transparency of our tax

profile, we have shown below the cash taxes that we have paid across our regional markets. In total during 2018, Serco globally contributed £568m of tax to government in the jurisdictions in which we operate.

Taxes by category

For the year ended 31 December 2018	Taxes borne £m	Taxes collected £m	Total £m
Corporation tax	15.9	–	15.9
VAT and similar	8.2	157.1	165.3
People taxes	104.4	274.3	378.7
Other taxes	7.2	0.8	8.0
Total	135.7	432.2	567.9

Taxes by region

For the year ended 31 December 2018	Taxes borne £m	Taxes collected £m	Total £m
UK & Europe	82.8	240.3	323.1
AsPac	26.2	113.7	139.9
Americas	24.2	73.8	98.0
Middle East	2.5	4.4	6.9
Total	135.7	432.2	567.9

Corporation tax, which is the only cost to be separately disclosed in our Financial Statements, is only one element of our tax contribution. For every £1 of corporate tax paid directly by the Group (tax borne), we bear a further £7.53 in other business taxes. The largest proportion of these is in connection with employing our people.

In addition, for every £1 of tax that we bear, we collect £3.18 on behalf of national governments (taxes collected). This amount is directly impacted by the people that we employ and the sales that we make.

Dividends

The Board is not recommending the payment of a dividend in respect of the 2018 financial year. The Board's appraisal of the appropriateness of dividend payments takes into account the Group's underlying earnings, cash flows and financial leverage, together with the requirement to maintain an appropriate level of dividend cover and the prevailing market outlook. Although the Board is committed to resuming dividend payments as soon as judges it prudent to do so, in assessing whether we should resume dividend payments in respect of 2018, we have been mindful of the fact that 2019 is the last year of significant outflows of cash related to OCPs and exceptional costs, which together will mean that net debt is likely to increase again in 2019, albeit modestly. The Board will continue to keep the dividend policy under careful and regular consideration as we progress with completing the transformation stage and driving forward with the growth stage of our strategy.

Share count and EPS

The weighted average number of shares for EPS purposes was 1,094.4m for the year ended 31 December 2018 (2017: 1,089.7m) and diluted weighted average number of shares was 1,125.4m (2017: restated 1,120.6m).

Basic EPS before exceptional items was 8.20p per share (2017 restated: 1.50p); including the impact of exceptional items, Basic EPS was 6.16p (2017 restated: loss of 0.76p). Basic Underlying EPS was 5.36p per share (2017 restated: 3.45p).

Diluted EPS before exceptional items was 7.97p per share (2017 restated: 1.45p); including the impact of exceptional items, Diluted EPS was 5.99p (2017 restated: loss of 0.76p). Diluted Underlying EPS was 5.21p per share (2017 restated: 3.36p).

Finance review continued

Cash flows

The UTP of £93.1m (2017 restated: £69.3m) converts into a trading cash inflow of £53.8m (2017: £21.9m). The improvement in 2018 cash conversion was primarily driven by margin growth, largely arising from cost efficiencies and additionally the settlement of a long outstanding legal matter. In 2018, the working capital outflow was £21.6m (2017 restated: £14.3m) and the OCP utilisation is £51.8m (2017 restated: £64.6m).

The table below shows the operating profit and FCF reconciled to movements in Net Debt. FCF for the year was an inflow of £25.0m compared to an outflow of £6.7m in 2017. The improvement in FCF is largely as a result of improved operating profit before exceptional items to £112.4m in 2018 from a restated balance of £40.7m in 2017, partially offset by net provision releases in FY18 of £7.9m, compared to net

charges of £37.2m in 2017 (restated). In addition, the utilisation of the OCP's in 2018 of £51.8m was lower than the previous year (2017 restated: £64.6m) through better contract performance and some onerous contracts ending.

The movement in Net Debt is an increase of £46.9m in 2018, a reconciliation of which is provided at the bottom of the following table. The movement includes a net outflow of £29.3m, excluding transaction costs of £0.6m, arising on the acquisition of BTP Systems, LLC and the acquisition of Six Carillion plc healthcare facilities management contracts, as well as both cash and non-cash exceptional items of £20.8m (FY17 restated: £32.5m) and adverse foreign currency exchange movements of £22.2m (2017: £17.4m gain).

For the year ended 31 December	2018 £m	2017 (restated*) £m
Operating profit on continuing operations	80.5	21.1
Remove exceptional items	31.9	19.6
Operating profit before exceptional items	112.4	40.7
Less: profit from joint ventures and associates	(28.8)	(27.0)
Movement in provisions	(68.1)	(33.6)
Depreciation, amortisation and impairment of property, plant and equipment and intangible assets	43.2	46.6
Other non-cash movements	16.5	11.4
Operating cash inflow before movements in working capital, exceptional items and tax	75.2	38.1
Working capital movements	(21.6)	(14.3)
Tax paid	(10.6)	(11.4)
Non-cash R&D expenditure	(0.1)	(0.2)
Cash flow from operating activities before exceptional items	42.9	12.2
Dividends from joint ventures and associates	29.7	28.2
Interest received	0.6	0.5
Interest paid	(16.7)	(17.5)
Capitalised finance costs paid	(2.0)	–
Purchase of intangible and tangible assets net of proceeds from disposals	(29.5)	(30.1)
Free Cash Flow	25.0	(6.7)
Net cash (outflow) acquisition and disposal of subsidiaries	(31.3)	(5.6)
Other movements on investment balances	(0.3)	0.2
Capitalisation and amortisation of loan costs	1.3	(0.8)
Unwind of discounting and capitalisation of interest on loans receivable	3.0	3.4
New, acquired and disposed finance leases	(3.4)	(4.7)
Exceptional items	(19.2)	(32.5)
Cash movements on hedging instruments	0.2	(2.5)
Foreign exchange gain / (loss) on Net Debt	(22.3)	17.4
Movement in Net Debt	(46.9)	(31.8)
Net Debt at 1 January	(141.1)	(109.3)
Net Debt at 31 December	(188.0)	(141.1)

* Results for the year ended 31 December 2017 have been restated to reflect the adoption of IFRS15 with effect from 1 January 2017. See note 2 to the Financial Statements.

Net Debt

As at 31 December	2018 £m	2017 £m
Cash and cash equivalents	62.5	112.1
Loans receivable	–	25.7
Loans payable	(239.5)	(271.5)
Obligations under finance leases	(14.8)	(20.2)
Derivatives relating to Net Debt	3.8	12.8
Net Debt	(188.0)	(141.1)

Average Net Debt as calculated on a daily basis for the year ended 31 December 2018, was £234.9m (2017: £184.3m), compared with the opening and closing positions of £141.1m and £188.0m respectively. Peak Net Debt was £306.9m (2017: £242.7m).

Treasury operations and risk management

The Group's operations expose it to a variety of financial risks that include liquidity, the effects of changes in foreign currency exchange rates, interest rates and credit risk. The Group has a centralised treasury function whose principal role is to ensure that adequate liquidity is available to meet the Group's funding requirements as they arise and that the financial risk arising from the Group's underlying operations is effectively identified and managed.

Treasury operations are conducted in accordance with policies and procedures approved by the Board and are reviewed annually. Financial instruments are only executed for hedging purposes and speculation is not permitted. A monthly report is provided to senior management outlining performance against the Treasury Policy and the treasury function is subject to periodic internal audit review.

Liquidity and funding

As at 31 December 2018, the Group had committed funding of £492m (2017: £741m), comprising £242m of private placement notes and a £250m revolving credit facility (RCF), which was undrawn. In addition, the Group had a receivables financing facility of £30.0m which was unutilised at the year-end (2017: unutilised of £30.0m).

On 3 December 2018 the Group completed the refinancing of its RCF with a syndicate of banks. Serco's RCF provides funds for general corporate and working capital purposes, and the ability to issue bonds to support the Group's business needs. The previous facility of £368m was due to mature in April 2020. The new facility provides £250m of committed funding for five years; the lower amount reflecting the much reduced need for debt in the business. The terms and conditions of the new facility are substantially unchanged from the prior facility.

Interest rate risk

Given the nature of the Group's business, we have a preference for fixed rate debt to reduce the volatility of net finance costs. Our Treasury Policy requires us to maintain a minimum proportion of fixed rate debt as a proportion of overall Net Debt and for this proportion to increase as the ratio of EBITDA to interest expense falls. As at 31 December 2018, more than 100% of the Group's Net Debt was at fixed rates. Interest on the revolving credit facility is at floating rate, however it was undrawn.

Foreign exchange risk

The Group is subject to currency exposure on the translation to Sterling of its net investments in overseas subsidiaries. The Group manages this risk where appropriate, by borrowing in the same currency as those investments. Group borrowings are predominantly denominated in Sterling and US Dollar. The Group manages its currency flows to minimise foreign exchange risk arising on transactions denominated in foreign currencies and uses forward contracts where appropriate to hedge net currency flows.

Credit risk

Cash deposits and in-the-money financial instruments give rise to credit risk on the amounts due from counterparties. The Group manages this risk by adhering to counterparty exposure limits based on external credit ratings of the relevant counterparty.

Finance review continued

Debt covenants

The principal financial covenant ratios are consistent across the private placement loan notes, receivables financing facility and revolving credit facility, with a maximum Consolidated Total Net Borrowings (CTNB) to covenant EBITDA of 3.5 times and minimum covenant EBITDA to net finance costs of 3.0 times, tested semi-annually. A reconciliation of the basis of calculation is set out in the table below.

Following the refinancing in December 2018, the debt covenants have been amended to include the impact of IFRS15. The covenants continue to exclude the future impact of IFRS16 on the Group's results.

For the year ended 31 December	2018 £m	2017 (restated*) £m
Operating profit before exceptional items	112.4	40.7
Remove: Amortisation and impairment of intangibles arising on acquisition	4.3	4.4
Trading Profit	116.7	45.1
Exclude: Share of joint venture post-tax profits	(28.8)	(27.0)
Include: Dividends from joint ventures	29.7	28.2
Add back: Net non-exceptional charges to OCPs	–	27.4
Add back: Depreciation, amortisation and impairment of property, plant and equipment and non acquisition intangible assets	38.9	42.2
Add back: Foreign exchange credit on investing and financing arrangements	(0.2)	0.4
Add back: Share based payment expense	14.7	11.4
Other covenant adjustments to EBITDA	–	3.6
Covenant EBITDA	171.0	131.3
Net finance costs	13.9	11.2
Exclude: Net interest receivable on retirement benefit obligations	0.8	3.8
Exclude: Movement in discount on other debtors	1.2	1.2
Exclude: Foreign exchange on investing and financing arrangements	(0.2)	0.4
Add back: Movement in discount on provisions	(0.5)	(1.3)
Other covenant adjustments to net finance costs	–	0.4
Covenant net finance costs	15.2	15.7
Recourse Net Debt	188.0	141.1
Exclude: Disposal vendor loan note, encumbered cash and other adjustments	2.3	30.3
Covenant adjustment for average FX rates	(8.8)	7.8
CTNB	181.5	179.2
CTNB / covenant EBITDA (not to exceed 3.5x)	1.06x	1.36x
Covenant EBITDA / covenant net finance costs (at least 3.0x)	11.2x	8.4x

* Results for the year ended 31 December 2017 have been restated to reflect the adoption of IFRS15 with effect from 1 January 2017. See note 2 to the Financial Statements.

Net assets summary

As at 31 December	2018 £m	2017 (restated*) £m
Non-current assets		
Goodwill	579.6	551.3
Other intangible assets	67.3	66.7
Property, plant and equipment	64.8	61.3
Other non-current assets	51.0	80.7
Deferred tax assets	60.9	59.7
Retirement benefit assets	85.8	41.8
	909.4	861.5
Current assets		
Inventories	22.9	17.4
Contract assets, trade receivables and other current assets	551.5	522.3
Current tax assets	7.3	11.2
Cash and cash equivalents	62.5	112.1
Total current assets	644.2	663.0
Total assets	1,553.6	1,524.5
Current liabilities		
Contract liabilities, trade payables and other current liabilities	(497.7)	(474.0)
Current tax liabilities	(29.2)	(25.3)
Provisions	(120.1)	(146.3)
Obligations under finance leases	(5.7)	(8.5)
Loans	(21.9)	(31.8)
Total current liabilities	(674.6)	(685.9)
Non-current liabilities		
Contract liabilities, trade payables and other non-current liabilities	(109.9)	(112.0)
Deferred tax liabilities	(21.4)	(20.4)
Provisions	(119.3)	(174.0)
Obligations under finance leases	(9.1)	(11.7)
Loans	(217.6)	(239.7)
Retirement benefit obligations	(14.9)	(15.5)
	(492.2)	(573.3)
Total liabilities	(1,166.8)	(1,259.2)
Net assets	386.8	265.3

* Balances for the year ended 31 December 2017 have been restated to reflect the adoption of IFRS15 with effect from 1 January 2017. See note 2 to the Financial Statements.

At 31 December 2018 the balance sheet had net assets of £386.8m, a movement of £121.5m from the restated closing net asset position of £265.3m as at 31 December 2017. The increase in net assets is mainly due to the following movements:

- An increase in the net retirement benefit assets of £44.6m as a result of changes in the financial assumptions underpinning the defined benefit obligation associated with SPLAS, predominantly an increase in the discount rate which is based on UK corporate bond yields, specifically those with a credit rating of AA. The increase in corporate bond yields reflects the broad rise in global corporate bond yields, with macro factors such as the Federal Reserve tightening monetary conditions by raising interest rates, the ongoing trade tensions and heightened political risk – particularly in the UK with Brexit – all contributing to the rise in corporate bond yields.
- A decrease in provisions of £80.9m. Further details on provision movements is provided below.
- Net Debt increased by £46.9m. Further details of these movements are provided in the cash flow and Net Debt sections above.
- An increase in goodwill of £28.3m, caused by the acquisitions of BTP Systems, LLC and the UK health facilities management contracts of Carillion plc, as well as the movements in foreign exchange rates.

The triennial valuation of SPLAS is in the process of being completed with funding arrangements being agreed with the scheme's trustees. As at 31 December 2018 the estimated actuarial deficit of the SPLAS scheme is £27.8m (2017: £33.7m).

Finance review continued

Provisions

The total of current and non-current provisions has decreased by £80.9m since 31 December 2017, on a restated basis. The movement is predominantly due to:

- A decrease in onerous contract provisions of £64.5m.
- An £8.1m release of other provisions following changes in the Group's obligations, £7.5m of which was excluded from UTP as the provision was made during the Contract & Balance Sheet Review.
- A final settlement during the period of £8.3m for the Docklands Light Railway defined benefit pension scheme.

Movements in onerous contract provisions since the 31 December 2017 balance sheet date on a restated basis, are as follows:

	Onerous Contract Provisions £m
At 1 January 2018 (restated*)	146.6
Charged to the income statement during the year – trading	3.4
Released to the income statement – trading	(16.2)
Utilisation during the year	(51.8)
Unwinding of discount	0.5
Foreign exchange	(0.4)
At 31 December 2018	82.1

* Results for the year ended 31 December 2017 have been restated to reflect the adoption of IFRS15 with effect from 1 January 2017 and a brought forward reclassification of £1.5m. See notes 2 and 27 to the Financial Statements.

The balance of OCPs at 31 December 2018 was £82.1m (2017 restated: £146.6m). OCP balances are subject to ongoing review and a full bottom-up assessment of the forecasts that form the basis of the OCPs is conducted as part of the annual budgeting process. The net non-exceptional release to OCPs was £12.8m in 2018 (2017 restated: £27.4m charge) and utilisation was £51.8m (2017 restated: £64.6m).

In 2018, the net release in OCPs is reflective of the Group's ability to forecast the final years of contracts which are nearing completion, the expiry of contractual obligations and relief of obligations through commercial settlement or sale of contracts such as the Anglia Support Partnership. Additional charges of £3.4m (2017 restated: £61.9m) have been made in respect of future losses on existing onerous contract provisions to reflect the updated forecasts as settlements are agreed and contracts near completion.

Acquisitions

On 26 January 2018, the Group acquired 100% of the issued share capital of BTP Systems, LLC (BTP). The acquired business contributed £12m of revenue and £1.9m of operating profit before exceptional items to the Group's results during year to 31 December 2018. The net cash outflow as a result of the acquisition was £13.2m, being £1.2m cash acquired less £14.4m consideration paid.

BTP provides satellite communications (SATCOM), radar modernisation, operations and maintenance and sustainment services that enable customers to extend the lives of existing systems and achieve phased upgrades with new technology to enhance operational capability. BTP specialises in areas including obsolescence engineering, systems engineering services, test equipment and design, and field engineering services, and maintains a near-field and compact antenna test range at their Ludlow, MA headquarters. BTP's expertise spans shipboard and submarine SATCOM antenna systems, Military Strategic & Tactical Relay command post antennas and radar antennas.

As explained in note 7 of the Group's Consolidated Financial Statements, the Group acquired Carillion plc's facilities management contracts at six major NHS hospital sites over the period from June 2018 to August 2018: Great Western Hospital in Swindon; Darent Valley Hospital in Dartford; James Cook University Hospital in Middlesbrough; Harplands Hospital in Stoke-on-Trent; The Langlands Unit of Queen Elizabeth University Hospital in Glasgow; and Addenbrooke's Treatment Centre in Cambridge.

The total annual revenue of all six contracts is expected to be around £70m and the estimated operating profit before exceptional items, including an appropriate allocation of charges for shared support services and other incremental overheads, will be approximately £4m, the aggregate consideration payable is approximately £18m. The acquired contracts contributed £30.3m of revenue and an operating loss before exceptional items of £2.1m to the Group's results during year to 31 December 2018 due to the transition costs incurred.

IFRS15

The Group has restated all comparative amounts within the Consolidated Financial Statements to align with IFRS15. The impact on opening retained earnings as at 1 January 2017 was a reduction of £49.3m and the impact on the opening OCP balance as at 1 January 2018 was a reduction of £20.5m. Underlying Trading Profit decreased by £0.5m and Trading Profit decreased by £8.9m for the year ended 31 December 2017. This low adjustment is reflective of the prudent accounting practices adopted by the Group following the Contract & Balance Sheet Review undertaken in 2014 and the repeat nature of the services provided. Further detail on the adjustment is provided in note 2 of the Group's consolidated financial statements.

IFRS16

A new leasing standard, IFRS16 'Leases', is effective for the Group from 1 January 2019.

A number of options are allowed under IFRS16 in relation to the adoption of the new standard. The Group will adopt the modified retrospective approach for calculating all right of use assets as at 1 January 2019. This approach is more closely aligned to the full retrospective transition, without the need to recalculate all lease liabilities assuming IFRS16 had always been adopted by the Group.

The Group has also adopted the exemptions allowable under IFRS16:

- all leases with an end date before 31 December 2019 are not subjected to transition to IFRS16.
- all short dated leases with a term of less than twelve months or a cost from new of less than £5,000 are not capitalised on the balance sheet and the associated lease expense is recognised through operating costs.

A project relating to the implementation of IFRS16 included a review of the transition options to be adopted and a robust data capture exercise. The Group has assessed its lease portfolio under the principles included within IFRS16 where the consideration of whether a lease exists has changed from risks and rewards to one of control. As a result of this assessment there have been no changes to the lease assessments made under IAS17.

The expected impact of IFRS16 on the opening balance sheet of the Group as at 1 January 2019 is a £24.6m reduction in opening retained earnings and a £118.0m increase in Net Debt. As the modified retrospective approach is being adopted, the comparative information for 2018 will not be restated.



Angus Cockburn

Group Chief Financial Officer
20 February 2019

Risk Management

Risk management approach

We have a structured framework identified in our Serco Management System ("SMS") to support our management of risks. Our Group standard, which we require all our Divisions and Functions to follow, consists of six key processes forming the risk management life cycle. This enables a consistent approach to identifying, analysing, monitoring and reporting risks and a mechanism for providing assurance that the risk mitigation in place is effective.

We seek to identify, review and report risks at all levels of our business, reflecting the nature of the activities being undertaken at those levels, the business and operational risks, and the level of control considered necessary to protect our interests and those of our stakeholders.

We recognise that our management and internal control systems can only seek to manage and not eliminate our risks, as any system can only provide reasonable, not absolute, assurance against material misstatement or loss.

Management oversight

We have a systematic approach to our risk oversight, with nominated members of senior management tasked to ensure that the risk management framework is understood and implemented. This allows for a robust reporting structure, both top-down and bottom-up, with a current focus on better aligning the Business and Divisional risks to our principal risks, and vice versa.

For our principal risks, we have Subject Matter Experts ("SMEs") and a nominated Executive Committee member allocated to each, supporting their review and management. Detailed reviews of these risks are carried out on a rolling basis and contribute to the risk reporting at the Group Risk Committee ("GRC"). As well as individual 'deep-dives' carried out on each of our principal risks during the year, our divisional CEOs provide a 'deep-dive' of one of their material risks providing the opportunity for the GRC to challenge risks at Divisional level and to stress test our Group principal risks (see pages 91 to 93 for the detailed Corporate Governance Report).

Risk management life cycle



This year we have enhanced our risk overviews with the introduction of a Key Risk Indicator dashboard. This enables the GRC to see 'at a glance' progress to our mitigation plans, our tolerance levels and other risk indicators such as outcomes relating to our three lines of defence activity. The dashboard has been refined during the year, and this is expected to continue as our maturity regarding indicators and performance measures increases.

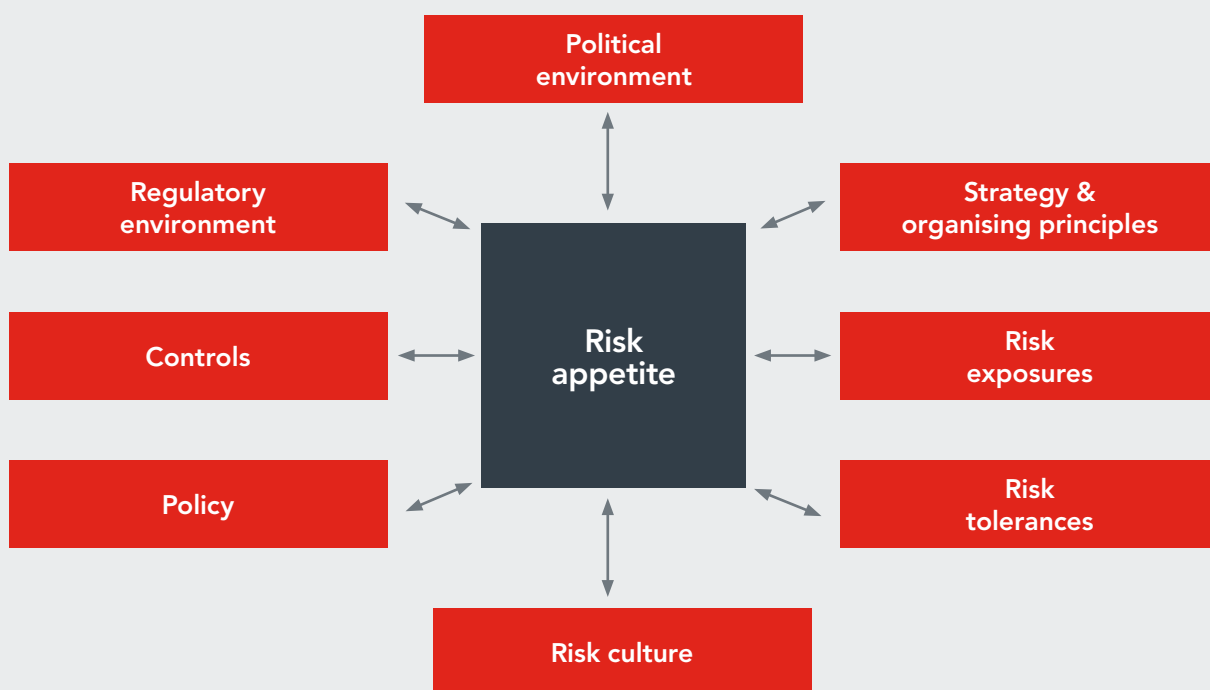
Risk appetite

Our objective is to be a trusted partner of governments, delivering superb public services that transform outcomes and make a positive difference for our fellow citizens. As such, we have a relatively low risk appetite to ensure that we can deliver on the wider value that we want to bring to governments, public services and to society.

The Board considers the risk appetite of the Group in the context of the factors outlined in the diagram below. Different risks will attract different levels of risk appetite, and the use of 'heat maps' help us to prioritise our risks using a combination of agreed impact and likelihood criteria.

Each of our principal risks has an appetite statement to determine the nature and amount of risk that the Group is willing to accept as well as informing our decision-making as to the level of resource required to mitigate the principal risks. These statements are aligned to our Values, Code of Conduct and other ethical requirements to support and drive the right risk culture within the Group.

Risk appetite factors



Principal Risks and Uncertainties

Review of principal risks and wider horizon scanning

Our Executive Committee reviews the principal risks facing the Group, taking into consideration the various Divisional risk registers and any emerging risks that would threaten the execution of Serco's strategy, business model, future performance, solvency and liquidity.

We also assess our external and internal environment to anticipate both risks and opportunities and to increase our ability to pre-empt, convert or exploit them. Material risks are covered at the GRC meetings.

This year, emerging risks specifically included reviews on:

- The changes in perception for outsourcing and changes in government, inflation, other external cost pressures and Brexit.

We make specific reference below to the UK's proposed withdrawal from the European Union ("Brexit") and our current assessment of its impact on Serco.

We recognise that significant uncertainty will remain until any Brexit proposal is fully agreed and understood, and as such our understanding of potential risks and impacts are being regularly reviewed and assessed. We have, for example, reviewed the potential impact of Brexit, including adverse economic consequences, on our existing contract base, workforce, bidding activities and supply chain. Reiterating our CEO's comment in last year's Annual Report, we do not believe that Serco will be materially affected by the UK withdrawing from the European Union. This is based on the following key points:

- For our UK and EU contracts, operations are generally delivered locally in-country and are not critically dependant on a cross-border supply chain or workforce.
- By operating many contracts, Serco has a natural hedge from material Brexit risks that may therefore arise on a limited number of contracts only.
- Many of our existing contracts have provisions which allow for inflationary adjustments to fees charged by us.
- A 'hard' Brexit without a transition period and/or an orderly withdrawal may cause regulatory and compliance uncertainty on some limited UK contracts that require performance under EU regulation, bodies and/or standards; however, we believe such uncertainties will be addressed under proposed new UK regulations following any withdrawal.
- Tariffs will only affect a small number of UK contracts that require imported goods that cannot be procured locally.

- For our European business, Serco conducts business through locally established companies in EU states and by way of a branch of Serco Limited which allows Serco to continue to operate subject to the freedoms and rules of the Internal Market.
- Public procurement and bidding processes will remain broadly unaffected as local laws will continue to apply post-Brexit.
- We recognise that Brexit may delay existing public sector outsourcing contracts and/or reduce pipeline opportunities while the UK Government and the Civil Service focus on implementing Brexit withdrawal.
- We are not critically reliant on our workforce having to travel extensively between the EU and UK, or the need to source EU workers on UK contracts – any such requirements that do arise will raise a manageable administrative workload only.
- We are conducting a critical supply chain review, and to date we are broadly comfortable with our key UK suppliers' ability to maintain the provision of goods and services on key UK contracts.

Our principal risks and emerging risks are constantly monitored at the appropriate level within the organisation. However, whilst we may have refined our risk drivers and controls during the year, these considerations have not materially affected the principal risks as reported in our 2017 Annual Report.

The resulting principal risks, as described below, have been reviewed by the Executive Committee, GRC and the Board. Each risk is classified as a strategic, financial, operational, people, hazard, or legal and compliance risk. The risks are described on the following pages, together with the relevant strategic business objectives, key risk drivers, the Group-wide material controls which have been put in place to mitigate the principal risks and the mitigation priorities going forward to improve the effectiveness of the controls. This year we have included the residual risk trend indicator for each risk, together with a brief commentary to contextualise these trends.

The risks are considered over the same three-year timeframe as the Viability Statement set out on pages 64 and 65, which takes account of the principal risks in its assessment.

In addition to the principal risks and uncertainties listed below, there may be other risks, either unknown, or currently believed to be immaterial, which could turn out to be material. These risks, whether they materialise individually or simultaneously, could significantly affect the Group's business and financial results.

Summary of principal risks

Strategic risks	Failure to grow profitably	Failure to manage our reputation	Failure to deliver expected benefits from Transformation
Financial risks	Financial control failure		
Operational risks	Major information security breach	Contract non-compliance, non-performance or misreporting	Failure of business critical partner, supplier or sub-contractor
People risks	Failure to act with integrity		
Hazard risks	Catastrophic incident		
Legal and compliance risks	Material legal and regulatory compliance failure		



Winning good business



Executing brilliantly

A place people
are proud to work

Profitable and sustainable



Increasing risk



Decreasing risk



No change

The trend indicator depicts the trend of our residual risk rating internally over the course of 2018.

STRATEGIC RISKS

Failure to grow profitably

Failure to win material bids or renew material contracts profitably, or a lack of opportunities in our chosen markets, will restrict growth and may have an adverse impact on Serco's long-term financial viability.

Our business is linked to changes in the economy, fiscal and monetary policy, political stability and leadership, budget priorities, and the perception and attitude of governments and the wider public to outsourcing, which could result in decisions not to outsource services or lead to delays in placing work.

Market conditions continue to be challenging in a number of our sectors and geographies, though our diversity and focus on business development has enabled us to retain important re-bids and gain sufficient new business to stabilise our revenue. With a reasonable pipeline of opportunities ahead, further opportunity for margin improvement and our access to a wide variety of markets, we consider this risk to be stable.

Key risk drivers:

External factors reducing the pipeline of opportunities

– political and policy changes in our markets (such as changes in views about the private provision of public services, changes following elections in federal or state governments, or decisions such as Brexit) may make it more difficult for us to win in some geographies or result in fewer opportunities.

Failure to be competitive – lack of appropriate references and value propositions for the markets in which we compete, or an insufficient understanding of our competitive environment may put us at a disadvantage to our competitors.

Inability to meet customer and solution requirements during design, implementation and delivery – executing our bids in an unsatisfactory manner by not understanding the strategic needs of the customer, mispricing bids, developing inefficient or non-innovative solutions and misunderstanding risks, may prevent us from achieving our growth ambitions.

Ineffective business development – poor account management, market shaping, proposition development and visibility of pipeline opportunities may affect our ability to set and meet targets for growth as well as drive process improvements.

Failure to obtain or capitalise on benefits from our Transformation Programme – (See 'Failure to deliver expected benefits from Transformation Programme').

Material controls:

- Serco Group and Divisional Strategy including annual strategy reviews, ensuring focus on and resource allocation to specific markets and geographies with the greatest growth potential.
- Serco Operating Model.
- Investment Committee.
- Serco Management System ("SMS").
- Sector-specific Centres of Excellence ("CoEs") and Value Propositions.
- Newly relaunched Serco Institute to develop thought leadership and innovation for our markets.
- Business Life cycle Review Team ("BLRT") Process.
- Pipeline and Business Development ("BD") spend reviews to ensure efficient deployment of resources.
- Divisional Performance Reporting ("DPR") process.
- Annual Performance Reviews, Talent Reviews and Succession Planning processes.
- Ensure that the divisional and business unit BD leadership and resources are appropriate for the delivery of our growth strategy.

Mitigation priorities:

- Review pipeline opportunities to ensure all market activity is accurately captured and that budgets are allocated accordingly.
- Review portfolio for new attractive organic expansion areas.
- Continue to improve leveraging of Serco best practice and innovation, as well as refine bid solution processes and SME resources to ensure our propositions remain competitive.
- Continue to adopt a robust qualification processes so that Business Development resources are focused on the most attractive opportunities.
- Refinement of BLRT process to ensure lessons learnt and price-to-win competitive analysis are formally embedded in the solution process.
- Continued focus on account management for major bids, as well as re-bids to ensure existing clients are experiencing good service from Serco and fully understand the value and quality of our services.
- Continuation of changes to Group and Divisional overhead and Shared Services' structures as part of the Transformation Programme to ensure we remain cost competitive.
- Review and consider appropriate inorganic growth opportunities as the market continues to develop.

Risk trend:



Principal Risks and Uncertainties continued

STRATEGIC RISKS CONTINUED

Failure to manage our reputation

Failure to manage our reputation will mean that customers will be less likely to give us new business or renew existing business. It will also impact our ability to attract and retain high-quality people and may lead to reduced share price and the related consequences of a reduced valuation of the business.


We have maintained a continued focus on Operational Excellence and have made a positive contribution to the debate around public sector outsourcing.

Key risk drivers:	Material controls:	Mitigation priorities:	Risk trend:
<p>Failure to clearly define what Serco stands for and how we wish to be seen – may result in inconsistent communication and misunderstanding by our key stakeholders.</p> <p>Not understanding our customers' and stakeholders' expectations – may result in a failure to recognise changes in our business environment or our customers' priorities.</p> <p>Insufficient focus on articulating and evidencing the benefits of private provision of public services – may result in an imbalanced public discourse and a misunderstanding of what Serco contributes to customers and service delivery.</p> <p>Failure to manage incidents appropriately – may result in us not responding in a collaborative manner with our customers or not communicating in an open and ethical manner to key stakeholders.</p>	<ul style="list-style-type: none"> Serco Values clearly defined and understood. Group Reputation, Brand and Communication Standard. Customer and stakeholder relationship, communication and engagement programmes. Proactive engagement with the media and continual media monitoring. Media training and understanding of reputational issues for senior management. Incident management processes and crisis management plans. 	<ul style="list-style-type: none"> Continual refinement and improvement of existing communication and marketing controls and approaches. Continued and heightened efforts to explain and evidence the benefits and innovations that Serco brings to the provision of public services. Recently relaunched Serco Institute to trial and publish innovative thinking in public service delivery. 	

Failure to deliver expected benefits from Transformation

If components of the Transformation Programme do not deliver the anticipated benefits, then we will not achieve the efficiency savings needed to become a sufficiently profitable and growing business.

Early momentum on key projects delivery at the end of 2017 (eg. UK divisions consolidation) meant benefits flowed early in 2018, this established momentum for the rest of the year. The full-year target was achieved by July which meant residual risk in-year was minimal.


Key risk drivers:	Material controls:	Mitigation priorities:	Risk trend:
<p>Non-delivery of required benefits – we fail to achieve the expected benefits due to ineffective portfolio management and governance.</p> <p>Severe disruption to the business – we fail to coordinate and prioritise the various programme objectives due to poor integration across activities and inadequate programme management, and we negatively impact on 'Business As Usual' activities.</p> <p>Failure of the businesses to understand the imperative to change – due to ineffective communication from the leadership teams.</p> <p>Failure to comply with new operating model – due to ineffective enforcement of the model and changes not embedded into the business.</p> <p>Failure to communicate the change and impact of the change to clients – potentially causing opposing short-term drivers.</p>	<ul style="list-style-type: none"> Serco Target Operating Model and design principles. Portfolio programme management process. Stakeholder engagement and communication plans. Benefits management process. 	<ul style="list-style-type: none"> Key benefits embedded in 2019 budgets to further increase focus on delivery and achievement of benefit outcomes at all levels. Further refinements to benefits tracking and reporting including differentiation between budget supporting and budget enhancing benefits. Additional delivery assurance and supplier management activities built into portfolio and delivery management processes. 	

FINANCIAL RISKS

Financial control failure

Financial control failure may result in: an inability to accurately report timely financial results and meet contractual financial reporting obligations; a heightened risk of error and fraud; poor quality data leading to poor business decisions, or an inability to forecast accurately; the failure to create a suitable capital structure, and an inability to make critical financial transactions, leading to financial instability, potential business losses, and negative reputational impact.

During 2018, the Finance Transformation Programme has been completed for both our UK and AsPac Divisions. Finance Centres of Excellence were created for both Divisions which are now in a stabilisation phase. Finalising the transformation phase has significantly reduced our financial control risk exposure, and stabilisation will continue to reduce this exposure further.

Key risk drivers:	Material controls:	Mitigation priorities:	Risk trend:
<p>Not setting the right tone from the top – if we do not set the right tone from the top, we may fail to embed finance policy, processes and controls.</p> <p>Poor financial processes – if processes are poorly designed, then inaccuracies and fraud may occur.</p> <p>Inadequate financial controls within the business – if controls are inadequate, we may fail to provide adequate protection from sabotage of systems, fraud and error.</p> <p>Impact of Finance Transformation Programme activities – programme activities may lead to poor change control or an unstable financial control environment due to an increased workload on the finance community.</p> <p>Failure of Finance Transformation Programme – we do not transform the finance processes and controls and fail to deliver expected benefits.</p>	<ul style="list-style-type: none"> • Group Governance and finance strategy. • Finance Transformation Programme governance. • Serco Management System ("SMS") – finance processes and controls. • Standardised reporting, forecasting and financial processes. • Standardised financial systems and data structures. • Skilled and adequately trained finance staff. 	<ul style="list-style-type: none"> • Deliver on final components of finance transformation. • Embed transformed finance function and monitor delivery and risks of outsourced Finance Centre of Excellence. • Continuously improve forecasting and reporting processes and outputs to deliver better insight into contract operations. • Deliver global finance process improvement and efficiency through automation and robotics. • Establish billing assurance programme. • Ensure talent is retained within the finance function through initiatives such as opportunities for personal development and improved training. 	

Principal Risks and Uncertainties continued

OPERATIONAL RISKS

Major information security breach

A major information security breach resulting in the loss or compromise of sensitive information (including personal or customer) or wilful damage resulting in the loss of service, causing significant reputational damage, financial penalties and loss of customer confidence.

Whilst our ongoing mitigation measures continue to deliver clear benefits, the external threats continue to evolve in complexity and sophistication, resulting in a steady state view of the overall risk.

Key risk drivers:	Material controls:	Mitigation priorities:	Risk trend:
<p>Non-compliant systems – if our systems are non-compliant with Serco policies and standards and regulatory requirements for the protection of sensitive information, we are susceptible to breaches and penalties.</p> <p>Non-compliance with policies and standards – if staff do not comply with Serco policies and standards, then they may accidentally release sensitive information to third parties.</p> <p>Vulnerability of systems and information – if we do not identify sensitive information and protect and test the vulnerability of our systems, then we are potentially exposed to a breach.</p> <p>Unauthorised use of systems – if we do not implement effective personnel vetting and access restriction processes and controls, then unauthorised use of our systems may occur.</p> <p>Inadequate incident monitoring and response – if we do not monitor our systems and remediate and repel attacks, then we may fail to minimise the impact of any breach.</p>	<ul style="list-style-type: none"> Enterprise Architecture Boards & Solution Review meetings. Serco Management System (“SMS”). IT security infrastructure, processes and controls. Privileged User Management and Two Factor Authentication for our centralised managed systems. External assessments. Third-party due diligence checks for key suppliers. Active monitoring by our Security Operations Centres and Computer Security Incident Response Team processes. Standardised HR processes. Cyber security awareness training part of our Serco Essentials training programme. Regular Phishing training exercises. 	<ul style="list-style-type: none"> Routine vigilance and proactive vulnerability identification coordinated through our Security Operations Centres. Embed third-party due diligence checks for key suppliers. Embed the use of global key security risk indicators to support mitigation priorities. 	

Contract non-compliance, non-performance or misreporting

Failure to deliver contractual requirements or to meet agreed service performance levels and report against these accurately may lead to significant financial penalties, legal notices, onerous contract provisions or ultimately, early termination of contracts.


The reporting structure, the systems and the monthly business performance review which is conducted at contract, Business Unit and Division level across our business provides a rigour that allows senior management visibility of contract performance or compliance issues early. We have seen no major failures in 2018.

Key risk drivers:	Material controls:	Mitigation priorities:	Risk trend:
<p>Poor understanding of contract obligations – may result in staff failing to acknowledge and act on obligations or a failure to provide adequate resources to deliver against contractual obligations.</p> <p>Poor systems/IT – unreliable or incorrectly configured systems may result in late or incorrect data being produced.</p> <p>Lack of process and controls – poorly documented or poorly communicated processes may lead to deliberate or unintentional misreporting or contract non-compliance.</p> <p>Ineffective assurance and human error – insufficient oversight and assurance of contract performance, could lead to contract non-compliance, non-performance or a misreporting of performance.</p> <p>Poor leadership and culture – if our leaders do not align with our Values, and staff feel under pressure to meet challenging operational targets and/or performance indicators, then deliberate misreporting may occur.</p>	<ul style="list-style-type: none"> Contract Management Application (“CMA”). Contract governance including Monthly Contract Reviews, Business Unit reviews and Divisional Performance Reporting (“DPR”) process. Business Life cycle Review Team (“BLRT”) process. Serco Management System (“SMS”). Leadership Development Programme and Contract Manager training. Communication of Our Values and Code of Conduct. Speak Up process (“Ethicspoint”). 	<ul style="list-style-type: none"> Contract Management training (Global and Divisional). Development and global roll-out of contract performance dashboard (“Gauge”). Improve consistency of approach to risk assessment and controls across all divisions. Divisional operational excellence improvement plans. 	

Failure of business-critical partner, sub-contractor or supplier

As a result of the failure of a business-critical¹ partner, sub-contractor or supplier to deliver and/or perform to the required standard, Serco may be unable to meet its customer obligations or perform critical business operations which could result in a financial, operational or reputational impact on Serco.

An extensive exercise to identify business-critical suppliers across all divisions was concluded in Q3, and the trend is steady while controls are implemented and systematically tested. This trend will remain the case while we focus on our highest risk suppliers and test the effectiveness of controls implemented.

Key risk drivers:	Material controls:	Mitigation priorities:	Risk trend:
<p>Ineffective procurement and supply chain governance – resulting from non-compliance to standards and lack of consequence management.</p> <p>Identification of significant suppliers – a failure to identify our critical suppliers may result in lack of focused oversight and understanding of the impacts on Serco should they fail to deliver our customer critical services.</p> <p>Limited oversight – resulting in poor sourcing, contracting and monitoring of business-critical business partners, sub-contractors and suppliers as well as the potential for engaging in ineffective or onerous contracts with suppliers or sub-contractors.</p> <p>Lack of resilience in the supply chain – exposing us to potential service provision or financial losses should they have ineffective Business Continuity and Disaster Recovery plans.</p>	<ul style="list-style-type: none"> • Serco Management System ("SMS") – Procurement policy, standards and procedures. • Sourcing standards and procedures in each region. • Identification and maintenance of business-critical partner, sub-contractor and supplier list. • Contracts with appropriate KPIs/SLAs etc. • Financial health checks and monitoring in the UK, North America and AsPac. 	<ul style="list-style-type: none"> • Focus on highest-rated business-critical suppliers for roll-out and testing of controls. • Develop proposition for formal supplier and contract management framework. • Audit business-critical sub-contractor and supplier business continuity plans. • Risk assessment and mitigation of business-critical suppliers through the Sales and Bidding cycle. 	

1. A partner, sub-contractor or supplier on whom Serco depends to deliver customer critical services or perform critical Serco business operations and therefore ability to earn revenue.

Principal Risks and Uncertainties continued

PEOPLE RISKS

Failure to act with integrity

Being found to have engaged in a significant corrupt or dishonest act (bribery, fraud, misreporting, cheating and lying) leads to customers being reluctant to do business with such organisations. Such behaviour might arise through the actions of rogue employees or as a result of pressures individuals feel they are being placed under (culture). Such acts might lead to: the loss of existing business; restrictions on our ability to bid or win new business; our ability to attract high-quality people or partners; or may impact shareholder, investor and financial institutions' confidence in Serco.

We have continued to entrench our values through explicit leadership behaviours and communications and celebration through the Pulse Awards.

Our key controls have been further embedded, including those for our due diligence processes and ethical risk assessment.

We have strengthened and further clarified our expected behaviours through updates of Code of Conduct and associated training.

Key risk drivers:	Material controls:	Mitigation priorities:	Risk trend:
<p>Failure to communicate – if we do not define and communicate our Values and expected standards adequately, our staff and third parties will fail to understand these, which may result in inappropriate leadership actions and low engagement with our values.</p> <p>Our ways of working do not align with our Values – staff or third parties being unaware of and/or not reflecting our Values may result in poor decision-making, unacceptable business conduct, and unethical or illegal behaviour bringing our operations into disrepute.</p> <p>Direct or indirect contribution to human rights abuse – staff either directly or indirectly contributing to human rights (including slavery and forced labour) abuses may result in a breach of laws/regulations.</p>	<ul style="list-style-type: none"> • Top-level commitment/tone from the top. • Strong, meaningful and understood Values. • Code of Conduct. • Corporate Governance with oversight by the Corporate Responsibility Committee ("CRC"). • Delegated Authority Matrix ("DAM"). • Serco Management System ("SMS"). • Financial controls and processes, with segregation of duties for core financial controls. • Gifts and Hospitality process and registers. • Risk management procedures. • Third-party due diligence. • Leadership Academy. • People development and remuneration. • Corporate investigations. • Speak Up process ("Ethicspoint"). 	<ul style="list-style-type: none"> • Adoption of online Conflict of Interest registers. • Refinement of divisional ethics and compliance risk assessments. • Review of due diligence processes. • Continued refresh of Serco Essentials training. • Evaluate effectiveness of internal culture assessment processes. 	

HAZARD RISKS

Catastrophic incident

An event (incident or accident) as a result of Serco's actions or failure to effectively respond to an event that results in multiple fatalities, severe property/asset damage/loss or very serious long-term environmental damage.

Significant activity completed – frontline operational controls collated and self-assessed. Second line (insurance and contractual risk allocation) under review and improved.

Key risk drivers:	Material controls:	Mitigation priorities:	Risk trend:
<p>Factors resulting in unsafe conditions – a lack of identification and assessment of risks, sudden equipment failure or inadequate security may result in poor mitigation of and/or response to a serious event.</p> <p>Ineffective or inadequate policies, standards and procedures – if procedures/systems are not aligned with industry standard or customer expectations, an unacceptable level of safety management may occur.</p> <p>Lack of capability and experience – if resources lack current competency in specialist/regulatory requirements this may result in a serious event.</p> <p>Lack of safety cultural alignment – a safety culture which does not reflect our Values and fails to engage our staff and work safely may result in a serious event.</p> <p>Insufficient safety management oversight – devolved compliance of regulations to sector-specific Subject Matter Experts without appropriate safety management oversight may result in safety management systems which are not fit for purpose.</p> <p>Inadequate response to a catastrophic event – if our contingency plans do not provide an adequate response to an event then escalation of an event or prolonged disruption may occur.</p>	<ul style="list-style-type: none"> • Serco (Health, Safety and Environmental) HSE Strategy. • Effective and engaged safety culture. • Regular safety communications and maintenance of safety awareness. • Competency-based recruitment programme. • Role description and competency definition. • Serco Essentials training. • Safety training and individual development plans and process based on role and operational risk. • Access to subject matter expertise. • Safety Management System (policy and procedures). • Planned and preventative inspections, maintenance and repair programmes. • Third-party ethical due diligence process. • Assure – Serco's incident and compliance reporting system. • Incident/Near-miss investigations. • Business Life cycle Review Team ("BLRT") process. • Divisional Performance Reporting ("DPR") process. • Crisis and incident emergency response plans and testing. • Business Continuity plans and testing. • Adequate risk transfer via contract, insurance. 	<ul style="list-style-type: none"> • Adoption of updated health and safety strategy. • Ensure strategy workplans have specific focus on Catastrophic risk. • Improve understanding through training in insurance and contractual risk management. • Complete second line controls review and alignment of insurance. • Review levels and adequacy of compliance assurance. 	

Principal Risks and Uncertainties continued

LEGAL AND COMPLIANCE RISKS

Material legal and regulatory compliance failure

Failure to comply with laws and regulations may cause significant loss and damage to the Group including exposure to regulatory prosecution and fines, reputational damage and the potential loss of licences and authorisations, all of which may prejudice the prospects for future bids. Defending legal proceedings may be costly and may also divert management attention away from running the business for a prolonged period. Uninsured losses or financial penalties resulting from any current or threatened legal actions may also have a material adverse effect on the Group.

Various laws and regulations that apply across the business continue to be subject to increased focus and attention, including anti-bribery and corruption laws, Market Abuse Regulations, data and privacy laws, modern slavery, trade compliance and human rights.

Our GDPR implementation programme continues to support the business and help drive increased focus on data protection laws.

Key risk drivers:	Material controls:	Mitigation priorities:	Risk trend:
<p>Lack of governance and oversight – may result in a failure to identify potential or actual legal or regulatory breaches resulting in a failure to respond appropriately or confirm compliance with legal and regulatory requirements.</p> <p>Failure to comply with the SMS and contractual obligations – may result in compliance failures for Group-wide material legal and regulatory requirements.</p> <p>Failure to identify and respond to material changes in legal and regulatory requirements – may result in key subject matter experts within the business not remaining up to date and failure to comply with material legal and regulatory obligations.</p> <p>Lack of awareness by employees of the legal and regulatory requirements placed upon them and the business – may result in lack of identification and subsequent compliance to requirements.</p> <p>Inadequate provision of systems and tools – may result in ineffective methods to support the management and reporting of legal and regulatory compliance.</p> <p>Legal or regulatory compliance failure by a third-party supplier/agent/partner – may result in Serco being held responsible for their failure under customer contracts.</p>	<ul style="list-style-type: none"> Automated alerts on material legal and regulatory obligations and changes. Legal and contracts experts aligned to various specialist areas across the business. Investment Committee and Business Life cycle Review Team (“BLRT”) bid process and governance. Third-party ethical and general due diligence on all suppliers. Serco Management System (“SMS”) including various policies and operating procedures guiding and regulating conduct. Case management software and analytics. Legal training. Serco Essentials training. External and Internal audits. Regular reporting to Board and Executive Committee on legal issues and new laws across the Group. Speak Up process and case management system (“Ethicspoint”). Serco Trading Principles promoting consistency across the Group on bid risk. 	<ul style="list-style-type: none"> Horizon scanning on key potential new laws and regulations, including Brexit. Greater use of data and trend analysis to inform Key Risk Indicators. Launch of new Conflicts Group Standard Operating Procedure. Ongoing compliance activity. Refreshing Serco Essentials training programmes. Continuing key contract and compliance assurance reviews on legal compliance. Developing and embedding Serco Trading Principles. 	

SFO investigation

We remain under investigation by the UK Serious Fraud Office ("SFO") which commenced in December 2013. We are cooperating fully with the SFO's investigation, but it is not possible to predict the outcome and timing. No conclusion has yet been reached. However, in the event that the SFO decides to prosecute, the range of possible adverse outcomes is any one or a combination of the following:

- that the SFO prosecutes the individuals and/or the Serco Group companies involved, who may defend the action successfully or be convicted. This may result in significant financial penalties, an impact on existing contracts and Serco being subject to a period of discretionary debarment from future contracts with government entities; or
- that the SFO and the relevant Serco entities enter into a deferred prosecution agreement ("DPA") – which may result in significant financial penalties, a potential impact on existing contracts and a period of discretionary debarment from future contracts with government entities. Such debarment would be discretionary in the sense that a contracting authority may consider it not to be relevant to a given bid or re-bid, or that Serco has provided sufficient evidence that it has addressed any issues identified in a DPA or be limited in time under the terms of the Public Contract Regulations 2015.

Upon any such conviction or DPA, the amount of additional work given to the Group may be reduced, and the Group may be subject to enhanced scrutiny with respect to its other contracts and further actions beyond those being implemented under the Corporate Renewal Programme may need to be taken.

If the Group faces any criminal convictions, debarment consequences or enters into a DPA, any such outcome could result in significant fines, a potential impact on existing contracts and have a material adverse impact on the Group's ability to contract with the government and on its reputation, which would, in turn, materially adversely affect its business, financial condition, operations and prospects.

In addition, a criminal conviction of a Serco entity or of one or more of the Group's current or former employees would in certain circumstances allow the Ministry of Justice to re-open the £64.3m settlement agreed and paid in 2013 in respect of certain issues arising under the Electronic Monitoring Contract. In those limited circumstances, the UK Government may seek additional payments from Serco.

We will continue to cooperate with the SFO's investigation.

Viability Statement

In accordance with provision C2.2 of the UK Corporate Governance Code published by the Financial Reporting Council in April 2016, the Directors have assessed the prospects of the Group over the three-year period to 31 December 2021.

The Directors believe that a three-year period is appropriate since it reflects the fact that:

- The Group has limited visibility of contract bidding opportunities beyond three years.
- Approximately 50% (2017: 58%) of the current year revenue relates to contracts where the contract term potentially comes to an end within three years.
- There is currently significant political uncertainty in the United Kingdom, United States, Saudi Arabia, Qatar and Australia.

The strategic plan set out in March 2015 significantly changed the direction of the Group as explained in previous shareholder communications. This plan is still being executed with the Group preparing an updated five-year business plan each year to establish whether it is on target to achieve its long-term goals. However, the financials for the last three years of this period are largely extrapolations of key assumptions used in the budget process. Given the difficulties of forecasting over a long time period it would be inappropriate to draw conclusions on the future prospects of the Group and for developing sensitivities and mitigation strategies. Therefore, whilst the Five-year business plan continues to be developed, it remains a goal for the Group and is not a forecast based on known assumptions; this makes assessing the longer term viability a challenge.

Good progress has been made on the strategic plan and the Directors expect this to deliver the growth targets which have been set. Although in the early stages of growth, the ability of the Group to harvest the benefits of the transformation are only just starting to be realised. We have previously highlighted the dependence on the external market and our ability to win new contracts whilst reducing the cost base. Market rates of growth have slowed in recent years and while we expect strong growth in the next two years due to our new contract wins and order book, thereafter revenue growth is more difficult to assess, but margins will increase from cost reduction and improved efficiencies. Importantly in 2018, we have refinanced the Group's bank debt, and the new Five-year funding will provide the financial platform to continue to invest in the growth of the Group.

The Board and the Group Risk Committee continue to monitor the principal risks facing the Group, including those that would threaten the execution of its strategy, business model, future performance, solvency and liquidity. Management and mitigations of those principal risks have been taken into consideration when considering the future viability of the Group. The Group's principal risk review, as set out on pages 52 to 63, considers the impact of these principal risks and the mitigating controls that are in place.

In assessing the prospects of the Group over the three-year period, the Directors have also considered the Group's current financial position as well as its financial projections in the context of the Group's debt facilities and associated covenants. These financial projections are based on a bottom up Budget exercise for 2019 and 2020 which has been approved by the Board, and an extrapolation to 2021 using higher level assumptions based on local market growth rates and identified opportunities.

The Group's covenant net debt balance at 31 December 2018 is £181.5m. The Group's base projections indicate that debt facilities and projected headroom are adequate to support the Group over the next three years. The Group's financial plan has been stress-tested against key sensitivities which could materialise as a result of the crystallisation of one or a number of the principal risks, the objective being that the future viability of the Group is tested against severe but plausible scenarios. The sensitivities tested include a reduction in the win rates for rebids, extensions and the Pipeline of new opportunities, a delay in delivering margin improvements and a potential penalty arising from risks such as contract non-compliance, major information security breach or a material legal and regulatory compliance failure. A reverse stress test of the Group's profit forecast has been completed using different assumptions of new business and rebid win rates and the Group's profit margin. This analysis shows that the Group can afford to be unsuccessful on 50% of its target new business and rebid wins, or it can be unsuccessful on 25% of its target new business and rebid wins combined with a profit margin 100 basis points below the Group's forecast, before the Group's borrowing facility covenants are breached in 2021. As context, rebids have a more significant impact on the Group's revenue than new business wins, as contracts accounting for 50% of total revenue are expected to be rebid in the next three years. The Group's rebid win rate has been in excess of 90% over the last two years. While these sensitivities will change in line with Group's order book and contract performance going forward, including the impact of new contract wins and losses, the ability for the Group to absorb sensitivities of this scale within its existing financing arrangements drove the assumptions below which the Directors felt appropriate to disclose in making this viability statement.

It is unlikely, but not impossible, that the crystallisation of a single risk would test the future viability of the Group; however, unsurprisingly, and as with many companies, it is possible to construct scenarios where either multiple occurrences of the same risk, or single occurrences of different significant risks, could put pressure on the Group's ability to meet its financial covenants.

At this point, the Group would look to address the issue by exploring a range of options including, amongst others, a temporary or permanent renegotiation of the financial covenants, disposals of parts of the Group's operations to reduce net debt and/or raising additional capital in the form of equity, subordinated debt or other such instruments.

Subject to these risks and on the basis of the analysis undertaken, the Directors have a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over the three-year period of their assessment. In doing so, it is recognised that such future assessments are subject to a level of uncertainty that increases further out in time and, therefore, future outcomes cannot be guaranteed or predicted with certainty. The Directors have made the following key assumptions in connection with this assessment:

- there is no significant unexpected contract attrition of existing work that becomes due for extension or rebid over the next three years;
- there is no significant reduction in scale of existing contract operations as a result of customer policy or other changes;
- there is no significant deterioration in new bid and rebid win rates from those anticipated;
- the Group is able to complete the execution of its strategy, including further transformation in 2019, and making progress to revenue growth and further margin improvement from 2019 onwards; and
- the Group is not subject to any significant penalties or direct and indirect costs and/or debarment from bidding for new contracts from the current SFO investigation, nor does the investigation adversely impact on existing contracts.

Corporate Responsibility

As a private sector company with global presence and a strong public sector bond, taking responsibility defines what we do and how we do it. We serve society on behalf of governments who trust us to provide public services, and citizens who trust us to take care of them in diverse circumstances. In this we are also trusted to serve as a responsible employer, partner, neighbour and investment.

Being a responsible business is about more than just meeting our minimum obligations. It is how we contribute and create sustainable value. It is the outcomes that define us, and how we achieve them. It is recognising that, to best protect the interests of any one group of stakeholders, we must determinedly embrace our responsibilities to all stakeholders.

From the boardroom to the frontline, we seek out opportunities to make a meaningful difference. Not because we are required to, but because it makes good business sense; because we are in a good position to make that difference; and because it is in our nature as a team of more than 50,000 people who share the same values and sense of purpose.

Externally, the focus on what it means to be a responsible and sustainable business has continued to grow, expanding in scope and driving increased scrutiny and rigour.

In the past 12 months, for example, we have commenced measuring and reporting our Gender Pay Gap and supplier payment performance in the UK, aligned our social responsibility governance with the Corporate Social Responsibility Act in the United Arab Emirates, and worked on implementation of the new Modern Slavery Bill in Australia.

Alongside our customers and other stakeholders, we see industry-shaping potential in these developments: to drive transparency, accountability and improved governance further and deeper across the public service landscape. For Serco, these changes complement our existing endeavours and are welcome opportunities to share our performance more widely and inclusively whilst helping our key stakeholders become better and more objectively informed.

Through our corporate responsibility framework, we address the most pressing needs of our key stakeholder groups. Our efforts are not limited to these items, but this is where we focus our attention and ambitions most closely.

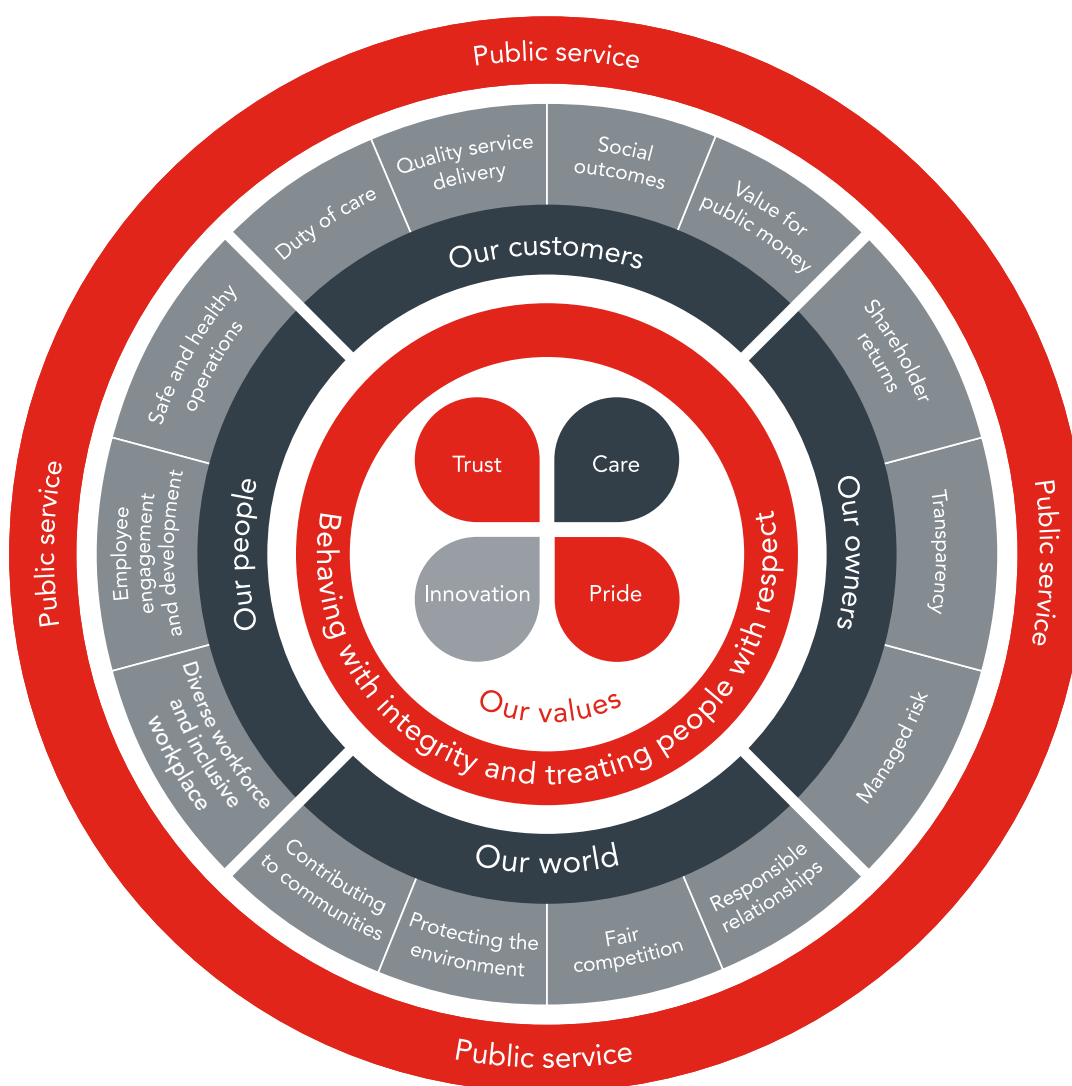
Beyond this report, our organisation is alive with leadership and action. Each component in our framework represents a continuously improving system of people, projects and processes – managed by global teams and fulfilled by our employees, touching the lives of countless service users every day. In our report we celebrate examples of exceptional contributions around the world. Harder to share is all that exists behind the scenes, enabling them to make a difference. Nonetheless, we all stand on the shoulders of our colleagues, atop a solid foundation of shared strategy, policy and governance.

We believe Serco to be a responsible business, well-positioned not only to deliver quality services and value for money, but also to promote higher standards in public services. We are not perfect, nor are we immune to mistakes, but we do not hide our imperfections, just as we do not hide our efforts to overcome them and the strengths with which we strive to improve.

We define our responsibilities by our principal stakeholder groups, and the strength of these relationships is the true test of our progress and performance. In this report we summarise how we are learning from them and responding to their needs whilst living the values that underpin our approach.

Further information is available in the Corporate Responsibility Committee Report on page 102 and in our full Corporate Responsibility Report which is available on the Company's website.

Our corporate responsibility framework below defines our principal areas of responsibility and helps to guide practice and behaviour whilst facilitating measurement of our performance.



Our customers
We are driven by our public service ethos to help our customers create positive outcomes for society.

P72 See page 72 for information on our customers

Our people
We are committed to enabling the development, wellbeing and safety of our people.

P75 See page 75 for information on our people.

Our world
We strive to manage our impact on the communities, economies and environments in which we operate responsibly.

P77 See page 77 for information on our world.


















Our owners
We are determined to protect our shareholders' interests and create long-term, sustainable value for them.

P79 See page 79 for more information on our owners.

Corporate Responsibility

Our commitment

We have continued to build momentum in long-term objectives for sustainable improvement: consolidating progress and maintaining key strategies.

Our CR categories	Next steps identified in our 2017 report	Progress in 2018
Behaving with integrity and treating people with respect	Develop a condensed Code of Conduct for temporary workers.	
	Complete our global review of Anti-Bribery and Corruption (ABC) 'adequate procedures'.	
	Apply elements of the UK ABC assessment toolkit in other Divisions.	
Our customers	Relaunch the Serco Institute.	
	Explore opportunities to measure and report performance for our responsibilities to our customers at Group level.	
Our people	Develop and deploy a 'just' health and safety culture framework.	
	Deploy our safety culture assessment tool globally.	
	Replicate our new global aviation safety forum in other safety critical areas.	
	Complete a formal review of our online incident management tool.	
	Improve 'near-miss' incident reporting.	
	Continue working to improve our leadership gender balance.	
Our world	Relaunch the Serco Foundation.	
	Refresh and refocus our environment strategy.	
	Launch our refreshed fair competition training for managers and our new conflicts of interest register.	
	Improve guidance for ethical and human rights due diligence in new geographies and partner selection and appointment.	
	Deploy our new Supplier Relationship Management solution.	
	Explore opportunities to address Tier 2 suppliers in high-risk areas.	

For progress and priorities relating to our responsibilities to our owners, see our Strategic Report (specifically: Key Performance Indicators, pages 9 to 11; Chief Executive's Review, pages 20 to 27; and Principal Risks and Uncertainties, pages 54 to 63).


Our priority next steps

- Develop a Group business ethics and human rights dashboard.
- Further review the legislative standards for Modern Slavery that apply in each Division to ensure all local requirements are met.

 Completed

 In progress

 Under review

 Ongoing (target for 2020 achieved and revised upwards)

- Continue to explore opportunities to measure and report performance for our responsibilities to our customers at Group level.
- Continue to drive a range of initiatives across our custodial, health and transport operations to address increasing violence.
- Better coordinate and share insight from our Divisional customer surveys.

- Build respect for the new Serco Institute and deploy its capabilities to the maximum through developing strategic partnerships.
- Embed our new Communities of Practice.
- Continue to develop and promote our proposed four principles for governing outsourced public service delivery in the UK.

- Finalise and deploy our 'just' health and safety culture framework.
- Act on our safety culture assessment results.
- Continue our work to improve 'near-miss' incident reporting.
- Drive employee wellbeing forward as a strategic priority.
- Launch our new cross-Divisional oversight groups for safety-critical areas.

- Formulate and deliver Corporate and Divisional action plans to improve employee engagement in response to our 2018 survey.
- Respond to Provision Five of the 2018 UK Corporate Governance Code.
- Promote our staff inclusion networks at both the Divisional and Group levels.
- Launch our new employer brand.
- Launch an annual People Report for internal and external publication.

- Formally relaunch the Serco Foundation externally.
- Improve community investment reporting.
- Roll out our new environmental strategy across our Divisions.
- Commence reporting in line with The Companies (Directors' Report) and Limited Liability Partnerships (Energy and Carbon Report) Regulations 2018.
- Incorporate risk tolerance variation into our due diligence process.

- Complete the launch of our new conflicts of interest register and Group Standard Operating Procedure for conflicts of interest; develop and deploy new fair competition training for high-risk roles.
- Publish new guidance for ethical and human rights due diligence in new geographies and partner selection and appointment.
- Trial our new Tier 2+ supply chain questionnaire.

Corporate Responsibility

Our commitment continued

Our approach to corporate responsibility is structured around our key stakeholders, focusing on how we create or contribute sustainable value whilst protecting their interests and meeting their needs with accountability and transparency.

Our stakeholder engagement

We are committed to proactively and regularly engaging our stakeholders in open, honest dialogue that enables effective collaboration, service and management. We want to understand their priorities and points of view, communicate our own and determine how we can best define and fulfil our responsibilities.

We actively manage our relationships with our stakeholder groups, maintaining various formal and informal means of engagement at local, regional and Group levels.

Our customers

We recognise our customers to be those we serve – the public – and the governments and other organisations who engage us to provide public services. We maintain service-specific feedback channels for service users, such as dedicated customer service personnel and surveys, and follow formal processes for engaging with our contract customers, including contract bidding and performance review. Individual contract customer relationships are managed by our business leadership from Contract Directors to our Group CEO. We also engage customers in our industry research through the Serco Institute.

Our people

Effective leadership and line management are our principal means of engaging our employees. Building trust and relationships and communicating effectively are key competencies in our Leadership Model. We also invite employee feedback via: Viewpoint, our employee engagement survey; Speak Up, our whistleblowing process; and Yammer, our internal social media platform. We also maintain various employee-led networks at all organisational levels and strong relationships with our recognised trade unions.

Our world

At Contract and Business Unit levels we maintain relationships with specific non-governmental organisations (NGOs) with whom we consult or collaborate for delivery of service outcomes. We also engage with NGOs and charities in the regions where we operate through the Serco Foundation, an independent charitable organisation established specifically for that purpose.

Our engagement with communities – those we serve and those where we operate – is at two levels: business-led and employee-led. We are committed to proactive dialogue with representative bodies to understand and manage our impact; and facilitating employee participation in community initiatives and charitable giving, which also applies to the regional causes our employees choose to support.

We maintain strong, collaborative relationships with our suppliers and strategic partners, both centrally and locally, engaging them regularly in strategy and performance review meetings, management forums and site visits.

Our owners

See 'Our owners: Transparency' on page 79 for more information.

Our Serco Management System

The Serco Management System (SMS) is our management framework. It describes how we do business and defines the rules governing how we operate, behave and deliver our strategy, including all areas covered by our CR framework.

At the heart of the SMS are:

- 16 Group policy statements, owned by Group Functional Directors, signed by the Group Chief Executive and approved by the plc Board. They define our strategic commitments and apply across the Group.
- 24 Group standards, approved by the Executive Committee. They define the minimum standards we must achieve, focusing on mandatory requirements applicable across the Group.
- 45 Group Standard Operating Procedures, owned by functional subject matter experts and approved by the Executive Committee. They provide consistent procedures to address key areas of control that are applied across the Group.

Country, Divisional and Local operating procedures build on these foundations, complying with relevant laws and regulations and sensitive to local customs, traditions and cultures.

All elements of the SMS are subject to a schedule of regular review to ensure they meet our needs and are up-to-date, relevant and appropriate.

Employee and manager responsibilities regarding SMS compliance are clearly defined and all employees complete appropriate SMS, Code of Conduct and Values training on joining Serco and periodically during their employment.

Our Code of Conduct

Our Code of Conduct applies to everyone who works for and on behalf of Serco, helping to drive continuous and consistent responsibility and behaviours across our organisation. Based on our Values, it forms part of the SMS, clearly and concisely defining our expectations of operational and behavioural compliance.

In 2018 we developed a version for short-term temporary workers; revised our Supplier Code of Conduct, reinforcing our expectations of compliance regarding modern slavery in our supply chain; and developed the first in a series of short briefing videos on elements in our Code.

In 2019 we will review the impact, effectiveness and accessibility of our current Code of Conduct materials and refresh our approach to Code of Conduct training.

Our Values

Our culture is based on a set of four Values – Trust, Care, Innovation and Pride – that shape our individual behaviours and hence the way the Company behaves. They help to ensure we are all working from a commonly understood base that can be consistently applied across our organisation.

Our Values are incorporated into the Serco Management System, our Code of Conduct and all existing channels, publications and resources.

Our Viewpoint Culture Index comprises engagement levels for each of the four Values and, alongside our 'Speak Up' whistleblowing process, enable us to regularly assess and reinforce our culture. Culture Index results inform annual engagement action planning and our Values strategy.

In addition to the ways in which our Values are embedded and reinforced continuously through Group systems and processes, each Division is responsible for the ongoing promotion of our Values at the local level, driving them through employee communications, recognition schemes and engagement initiatives.

Our 2018 employee engagement survey results indicate that employee perceptions of our Values remain similar to last year. For more information, see our full Corporate Responsibility Report.

In 2019 we will continue to actively and regularly promote and reinforce our Values throughout the business whilst monitoring employee understanding and perceptions of how well they are lived. As required, we will respond with specific, focused and appropriate interventions.

Behaving with integrity and treating people with respect

Across all our regions, we aim to meet the high moral and ethical standards we have set ourselves, within the bounds of expected individual and corporate behaviour, with regard for relevant laws and regulatory requirements, with sensitivity to local cultures and with respect for human rights.

We have zero tolerance for any form of bribery and corruption or any activities that break any law relating to human rights, either directly or indirectly, anywhere in the world. We will not engage in any form of human trafficking or use forced, bonded, illegal or child labour, nor knowingly work with anyone who does; this commitment recognises all applicable modern slavery legislation. We use international human rights standards as a framework to assess, monitor, mitigate and remedy any actual or potential adverse human rights impacts that may affect our business.

In 2018 we developed our UK Anti-Bribery and Corruption (ABC) assessment tool into a Group ABC Risk Indicator Questionnaire, embedding it in our SMS self-assessment tool, completed annually by contracts across all Divisions.

We also delivered the following in all Divisions:

- a review of ABC adequate procedures and our Speak Up (whistleblowing) programme;
- assessment of ethics, regulatory compliance and human rights risks; new modern slavery awareness training for managers; and
- continued promotion of Speak Up to increase trust in the process, whilst reviewing it for improvement.

In 2019 we will:

- continue to monitor and work actively to mitigate our ethics, regulatory compliance and human rights risks;
- review data and internal reporting to develop an effective dashboard;
- continue to raise awareness of Speak Up and review how we monitor live cases to ensure optimal case management and closure; and
- further review the legislative standards for modern slavery that apply in each Division to ensure all local requirements are met.



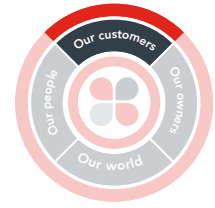
For more information, see our annual Modern Slavery Statement at www.serco.com/slaverystatement.



See also: Fair competition, page 78; Responsible relationships, page 78.

Corporate Responsibility

Our customers



Duty of care

We place the health, safety and wellbeing of the public at the heart of service design and delivery.

We strive to prioritise, protect and promote the health, safety and wellbeing of the recipients of our services, whether they are those for whom we are directly responsible, such as individuals in our prisons or travelling on our transport, or those who are the direct beneficiaries of our services, such as patients in the hospitals that we clean and maintain.

We design and deliver services in ways that focus on the needs and experiences of service users and enable and enhance service-related outcomes. We work to ensure that service users are treated with consideration, courtesy, compassion and respect, and that our provisions and interactions exemplify our Value of Care.

In 2018 we:

- made use across our service delivery of Serco's ExperienceLab – which specialises in citizen-centric design;
- embedded our Serco Cares programme to improve patient experience – training 3,000 hospital colleagues;
- continued to implement a broad range of coordinated, mutually supporting initiatives to address prison violence, e.g. key worker training, five-minute interventions, improved intelligence, social responsibility units and body cameras;
- established a security working group across our Health business to review security and address issues of increased violence in hospitals;
- actively worked with UK police authorities to tackle increased violence on trains; and
- deployed our Centres of Excellence (CoEs) to focus on end user experience and outcomes.

In 2019 we will:

- continue to support our contracts, Divisions and CoEs in delivering all objectives relating to duty of care, directly or indirectly;
- continue to explore opportunities to measure and report our duty of care performance at a Group level; and
- continue to drive a range of initiatives across our custodial, health and transport operations to address increasing violence.

Quality service delivery

We draw on our international best practice, cross-sector experience and our ability to innovate in order to help governments raise standards of public service.

Providing reliable and high-quality products and services that meet customer and service user needs is important to us. To the best of our abilities, aligned to helping customers achieve value for money, we seek to deliver services that are as high-quality as possible and subject to appropriate focus on continuous improvement.

We work closely with our customers, striving to:

- anticipate, understand and meet their needs and expectations;
- deploy quality systems that deliver excellent service usability for service recipients;
- invest in public service research and development and innovate quickly and proactively, testing new ways of doing things and improving continuously throughout the lifetime of our contracts;
- develop scalable, customisable solutions; and
- transfer best practice and experience internationally and cross-sector.

In 2018 we:

- worked to improve the relationship between suppliers and contractors through our development of the 'Four Principles' on how to better govern public services, which should help strengthen delivery of outsourced services across the sector;
- continued to develop how we bring various different elements of management information together to enable us to focus management attention to address potential issues and opportunities;
- ran customer insight surveys in each of our regions;
- strengthened operational delivery further – achieving win rates of around 50% for new bids and around 90% for rebids and extensions;
- relaunched the Serco Institute which sources crowd thinking for innovation in public service delivery; and
- deployed our Centres of Excellence to enhance best practice and product development.

In 2019 we will:

- continue working to develop and promote our proposed four principles for governing outsourced public service delivery in the UK;
- better coordinate and share insight from our Divisional customer surveys;
- build respect for the new Serco Institute and deploy its capabilities to the maximum through developing strategic partnerships; and
- commence the contract managers' development programme with Oxford Saïd Business School. For more information, see: Employee engagement and development on page 75.

Social outcomes

We aim to enhance social outcomes by designing and delivering frontline public services that make a real difference to people's lives. We believe that the provision of public services around the world – for us, for our customers and for society – requires commitment to a social as well as a commercial contract. We strive to maintain our public service ethos and aspiration to do the best for citizens, not only for our customers.

Aligned to our ambition for quality service delivery, we design citizen-centred public service solutions whilst maintaining a focus on delivering particularly complex and transformational services that are critical to the functioning of society.

In 2018 we:

- developed and agreed a new strategy for the Serco Foundation, focused on supporting non-profit organisations engaged in enhancing public service outcomes;
- made use across our service delivery of Serco's ExperienceLab – which specialises in citizen-centric design;
- more generally:
 - **Justice:** we have helped to safeguard society and reduce reoffending through the provision of prison management, police support and prisoner escorting services.
 - **Immigration:** we have helped to protect borders and manage immigration through the provision of border control, detention centre and asylum seeker housing and welfare services.
 - **Citizen Services:** we have contributed to local community wellbeing through the provision of leisure facilities and waste management services.
 - **Health:** we have helped to enhance patient experiences and maintain safer environments in hospitals through the provision of facilities management services.
 - **Defence:** we have contributed to the protection of national and international security through the provision of critical support services to defence organisations.
 - **Transport:** we have helped to facilitate national travel, enabling local and regional economies and societies to function through the provision of air, sea, road and rail services.

In 2019 we will:

- formally relaunch the Serco Foundation and increase further its charitable support and impact on social outcomes; and
- continue to explore potential criteria with which to more precisely define and measure our contribution to social outcomes through our operations.

Duty of care

IN ACTION

See our full Corporate Responsibility Report to find out about:

- our work with the Texas Department of Transportation, helping citizens travel safely;
- the He Waka Angamua staff network at Kohuora Auckland South Corrections Facility, supporting better outcomes for Maori;
- our focus on improving patient care through employee engagement, at the GCC Patient Experience Summit in Abu Dhabi; and
- our UK colleague who cared for an asylum seeker with terminal cancer.

Quality service delivery

IN ACTION

See our full Corporate Responsibility Report to find out about:

- our awards for industrial security excellence from the US Department of Defense;
- our Australian immigration detention team who secured and protected several hundred detainees during a category two cyclone and evacuation;
- our Transport Solutions Provider of the Year Award from the United Arab Emirates Transport Community; and
- our UK custodial team who helped to restore prison operations in the Caribbean.

Social outcomes

IN ACTION

See our full Corporate Responsibility Report to find out about:

- our work with the US Navy to help Reservists and their families access psychological healthcare;
- our team in Melbourne, Australia who worked at night to reclaim Princes Park from vandalism ahead of a 30,000-strong public vigil;
- our team in Baghdad who kept Iraqi airspace open during a local strike; and
- our UK Leisure team who helped a girl with a tracheostomy learn to swim.

Corporate Responsibility

Our customers continued

Value for public money

Along with quality of delivery, we aspire to greater efficiency in public services and in enabling governments to deliver better for less.

We are committed to enabling governments to achieve the best value for money for the public services we deliver.

To deliver efficiency to our customers, we strive to:

- select and bid for opportunities where we can achieve optimal balance of value creation for our stakeholders;
- manage our business with commercial rigour;
- innovate at both the contract and corporate level;
- fully utilise our economies of scale and our international, transferable expertise; and
- drive a cost-effective supply chain.

In 2018 we:

- launched Communities of Practice (CoPs) which are international fora to develop, enhance and share best practice in specific capability or competencies – including contract efficiency;
- found significant efficiencies for our customers on several next generation contracts including our MELABS contract with the Australian Defence Force in the Middle East and our CMS health insurance eligibility support contract in the US;
- further rolled out formal Operational Excellence training and activities across all our Divisions to help run continuous improvement exercises and improve the efficiency of our operations; and
- reduced our overhead costs thereby enabling us to be more efficient in our delivery to customers.

In 2019 we will:

- embed the CoPs and consider extending them to additional competencies;
- continue to review the efficiency of our contract delivery, including through the continued use of Operational Excellence; and
- improve our measurement of the value of outsourced services to the public.

Value for public money

IN ACTION

See our full Corporate Responsibility Report to find out about:

- our Premier Supplier Excellence Award from Raytheon;
- a report from the Australian Federal Human Services Minister, highlighting cost-effective high performance from Serco Citizen Services; and
- our London Cycle Hire mechanics who generated significant efficiency gains and helped increase bike availability for the public.

Corporate Responsibility

Our people



Safe and healthy operations

Our vision is zero harm. Wherever we work, we are committed to the promotion of wellbeing and the prevention of injury and ill health. We recognise that our commitment to a vision of zero harm is a challenging, long-term aspiration that will take continuous concerted effort if it is ever to be achieved given our operational risks. Our Health, Safety and Environment (HSE) strategy is designed to help clarify our next steps on our journey.

We strive to:

- identify, assess and actively manage the hazards, impacts and risks arising from our operations, investigating incidents and monitoring performance and systems;
- actively encourage input from employees and others to build sustainable solutions;
- promote a 'just' health and safety culture based on active and caring leadership and mutual trust, innovation and pride; and
- regularly review, learn and identify opportunities for continual improvement at all levels of governance.

In 2018 we refreshed our Group HSE strategy in response to evolving risks and opportunities and the continuous improvement of our health and safety governance, oversight and risk assessment capability. The new strategy reinforces our existing principles and priorities whilst introducing a more prominent focus on employee wellbeing and increased emphasis on shared ownership, 'just' culture and preventive awareness.

We also:

- developed a 'just' health and safety culture framework for adoption across the business and incorporated this in our online incident management tool;
- rolled the Health and Safety Laboratory (HSL) Safety Climate culture assessment tool out across all Divisions with favourable results;
- enhanced our safety management system by introducing functionality to facilitate identification and management of operational safety hazards and improve line of sight for new or changing risks; and
- completed a formal review of our online incident management tool against market leaders, identifying opportunities for future improvement.

In 2019 we will:

- act on the findings from the culture assessment tool;
- finalise and deploy our 'just' health and safety culture framework;
- build on current work to improve near-miss reporting and safety observations;
- drive employee wellbeing forward as a strategic priority, building on everything we already have in place;
- launch new cross-Divisional oversight groups to drive and coordinate our continued focus on improvement in the following safety-critical areas: Rail, Marine and Physical Assaults;
- complete our systems review to better align the management of safety, compliance, environment, risk and insurance and better inform risk management by providing an holistic view of data and performance; and
- explore potential longer-term future performance trend indicators.

Employee engagement and development

We are committed to fostering professional development and positive working environments that enable our people to be highly engaged, capable, passionate about public service and motivated to achieve personal success.

We regularly review and strive to improve levels of employee engagement and performance, including the development of their skills to meet current and future business needs and addressing any behaviour identified as negatively impacting engagement. We provide relevant training and development where necessary to enable individuals to perform their duties within role.

In 2018 we began to develop our approach to engagement beyond a traditional annual survey by introducing a stronger and more versatile survey capability (through our new engagement partner, Glint), which will enable us to engage with employees more closely and regularly throughout the employee lifecycle.

Safe and healthy operations

IN ACTION

See our full Corporate Responsibility Report to find out about:

- our new C5ISR 'Safety Blitz' hazard and incident reduction programme;
- our participation in the Sustaining Resilience at Work research trial, focused on preventing occupational stress;
- our new virtual portals providing 24/7 medical support for our employees in the Middle East; and
- our UK colleagues recognised for health and safety excellence by the Royal Air Force and the Ministry of Defence.

Employee engagement and development

IN ACTION

See our full Corporate Responsibility Report to find out about:

- our 'Job Rotation' programme, enabling our high potential US and Canadian colleagues to expand their skill sets through alternative role assignments;
- our Asia Pacific 'Emerge' programme, developing our managers for internal career progression;
- our programmes for engaging and developing National Emirati interns, graduates and management talent; and
- our Large Apprentice Employer of the Year Award in the UK.

Corporate Responsibility

Our people continued

We also:

- supported our leaders in owning and driving their career and personal development, continued to involve leaders in our business plans and strengthened leadership communications;
- supported our managers through interventions focused on building capability and pride;
- supported all employees through stronger promotion of taking action to build engagement locally;
- reinforced engagement as a strategic priority by incorporating it as a performance measure into our Performance Share Plan Awards, made to our Executive team and senior leaders globally;
- continued to build and strengthen our system of Group and regional development programmes;
- delivered our Oxford Management Programme for a further 120 members of our global management population, bringing the cumulative total to 328; and
- opened the Management Programme to a broader population of management roles across the business whilst introducing an ongoing curriculum of virtual education for programme alumni.

In 2019 we will:

- continue working to deliver our 2020 employee engagement target of 70 points or above, as defined in our Group performance framework;
- formulate and deliver Corporate and Divisional action plans to improve employee engagement in response to our 2018 survey; and
- explore our options for enhancing how employee interests are factored into Board decision-making in order to respond to Provision Five of the 2018 UK Corporate Governance Code.

Diverse workforce and inclusive workplace

Our business thrives because of our talented and diverse workforce, for which we must continually challenge ourselves to ensure diversity and inclusion (D&I) are embedded in our culture and ways of working.

We strive to:

- attract, develop and retain employees from the broadest possible talent pool;
- proactively manage and regularly analyse the diversity of our workforce; and
- promote equality of opportunity and create an inclusive and enabling environment in which all our people are treated fairly and with respect, dignity and zero tolerance for any form of discrimination.

Diverse workforce and inclusive workplace

IN ACTION

See our full Corporate Responsibility Report to find out about:

- our listing in Forbes' America's Best Employers for Women 2018;
- our annual celebrations of diversity in Australia, New Zealand and Hong Kong;
- the appointment of Ayesha Sultan to our Middle East Executive Management Team as Managing Director for Growth; and
- our UK work to drive equality in recruitment and the advances in diversity and inclusion led by our LGBT+ and BAME networks.

In 2018 we:

- achieved our 2020 target of a minimum 25% women in leadership roles, and revised our target to 35% by 2025;
- recognised four official global focus areas (gender, disability, BAME and LGBT+), assigning each an Executive Committee Sponsor;
- refreshed and refined our Divisional D&I strategies in response to progress made since 2016, key organisational changes and the new global focus areas;
- continued taking action in our Divisions to deliver regional D&I objectives; and
- reported our Gender Pay Gap for 2017 in April (12.9%) and prepared our 2018 Gender Pay Gap report (11.9%).

In 2019 we will work to:

- create excitement around staff inclusion networks both within our Divisions and across the Group;
- ensure each Division sets stretching ambitions around the short and medium term;
- launch our new employer brand to attract and recruit a more diverse workforce; and
- launch an annual People Report which we will share both internally and externally to keep momentum and focus.

Corporate Responsibility

Our world



Contributing to communities

Through our business operations we contribute to local employment, small-medium enterprises, communities and economies. Beyond this, we encourage and facilitate community initiatives and charitable giving both from colleagues and from the Serco Foundation.

We strive to:

- work closely with communities to make a positive difference and partner with local governments in order to best contribute to local economies;
- employ people from our local communities where possible; encourage and participate in charitable activity that aligns with our Values; and
- ensure small firms, voluntary and community organisations, and social enterprises are actively encouraged to be members of Serco's supply chain.

In 2018 we:

- strengthened our governance relating to community initiatives and charitable giving, requiring more robust due diligence in the consideration of any sponsorship opportunity or charitable contribution;
- developed a new strategy for the Serco Foundation which has now been agreed by all Trustees. Its refreshed mission is to support non-profit-making organisations in the delivery of public services through awarded grants and the secondment of Serco employees. It has already started supporting charitable causes under this new mission. See our full Corporate Responsibility Report for more details; and
- strengthened executive oversight and facilitation of our social responsibility agenda in the Middle East in response to new legislation in the UAE which is withdrawing legacy restrictions, promoting corporate action and introducing formal reporting requirements.

In 2019 we will:

- continue to reinvigorate our governance for charitable and community contributions, focusing on the improvement of community investment reporting across the business. We recognise significant levels of local activity by our operations and our employees in all regions, but also recognise challenges in capturing the full extent of our commitment. We will engage with the business in order to identify and implement improvements that will enable us to resume reporting our global community investment performance; and
- formally relaunch the Serco Foundation externally and build real momentum in its activities.

Protecting the environment

We are committed to limiting the impact our operations have on the environment through more sustainable business practice.

We strive to:

- identify and assess the hazards, impacts and risks that arise from our activities and services, investigating incidents and monitoring performance and systems;
- minimise adverse environmental impact through the implementation of environmental management systems that are proportional to each contract, aligned to customer specification and contractual requirements, and underpinned by the SMS;
- actively encourage input from employees and others to build sustainable solutions;
- promote a commitment to the environment based on active and caring leadership and mutual trust, innovation and pride; and
- regularly review, learn and identify opportunities for continual improvement at all levels of governance.

In 2018 we refreshed our Group Health, Safety and Environment strategy in response to evolving risks and opportunities and the continuous improvement of our environmental governance, oversight and risk assessment capability. The new strategy reinforces our existing principles and priorities whilst introducing a more prominent focus on specific customer priorities.

Contributing to communities

IN ACTION

See our full Corporate Responsibility Report to find out about:

- how our colleagues in North America challenge themselves in support of charitable causes and a culture of health and wellbeing;
- the commitment of our team at Fiona Stanley Hospital to making a positive difference to their communities;
- our contributions to colleagues and other stakeholders in the Middle East during Ramadan; and
- our partnerships with local suppliers and social enterprises across Scotland, supporting local communities whilst enhancing service user experiences.

Protecting the environment

IN ACTION

See our full Corporate Responsibility Report to find out about:

- our new, environmentally-responsible North American headquarters;
- our work with the Royal Australian Navy to monitor and manage a range of environmental incidents;
- our celebration of World Environment Day across Serco Middle East, focused on reducing plastic use and eliminating plastic waste; and
- our work to deliver environmentally-friendly leisure centres for Birmingham City Council, UK.

Corporate Responsibility

Our world continued

We also:

- shaped future environmental strategy and driven continuous improvement in our most energy and carbon intensive business units, including a programme of environmental and energy reviews in our UK Justice & Immigration business and a new Energy Management System for our UK Leisure business; and
- worked with an independent energy performance and carbon compliance consultancy to explore the opportunity for science-based carbon reduction targets aligned to Government requirements.

In 2019 we will:

- roll out our new environmental strategy across our Divisions to further embed a culture of environmental stewardship and drive improvements;
- commence reporting in line with The Companies (Directors' Report) and Limited Liability Partnerships (Energy and Carbon Report) Regulations 2018; and
- monitor Divisional action planning and delivery to ensure that Business Units continue driving improvement in their most energy and carbon intensive contracts.

Fair competition

We strive to compete legally, fairly and ethically, making sure we promote competition in business, protect our customers' interests and avoid situations that may, or may appear to, create a conflict of interest.

We strive to ensure we do not abuse any dominant market position we may have, obtain competitive intelligence through improper means, or enter into any agreements, arrangements or concerted business practices which appreciably prevent, restrict or distort competition. We are committed to engaging with competitors and trade associations with appropriate caution.

In 2018 we completed significant work to develop appropriate processes for capturing conflicts of interest. This has included redrafting operating procedures, developing an online tool and producing a short video explaining what a conflict of interest is and what to do about it.

In 2019 we will roll out and embed our new Group Standard Operating Procedure and register for Conflicts of Interest across the business. We will also develop and deploy targeted fair competition training for high-risk roles.

Responsible relationships

We build honest, respectful and transparent relationships with customers, partners and suppliers who share our ethical standards and who follow regulatory compliance.

We strive to:

- only work with customers, partners and suppliers who respect our Values and meet our standards of business conduct and ethics;
- complete legal, ethical and human rights due diligence on proposed key third parties and conduct ongoing monitoring throughout the lifetime of the relationship;
- complete robust analysis of requirements and establish a clear management structure for third-party arrangements considered necessary to meet contract requirements, including joint ventures, strategic partnerships and consortium arrangements;
- apply robust supplier sourcing and selection criteria; and
- monitor supplier performance to inform relationship management and identify opportunities for improvement.

In 2018 we strengthened the human rights elements in our Supplier Code of Conduct and developed a new questionnaire for enhanced supplier due diligence, focusing on how our Tier 1 suppliers manage modern slavery risks within their own supply chains. We also completed a review of our third-party due diligence process, including quality of reports and information provided.

We commenced reporting our supplier payment performance per new UK regulations introduced in 2017. In 2018, 83.09% of our supplier invoices were paid on time, putting Serco in the top quartile of reporting companies, but still with room for improvement.

In our 2017 report we advised that in 2018 we would deploy the Supplier Relationship Management solution previously piloted in the UK. This work has since been placed under review whilst other priorities have taken precedence.

In 2019 we will:

- publish new guidance on ethical and human rights due diligence for new geography entry and the selection and appointment of partners;
- review our third-party due diligence process to enable different risk tolerances to be applied at initial assessment and through ongoing monitoring; and
- trial our new Tier 2+ supply chain questionnaire for modern slavery due diligence.

Responsible relationships

IN ACTION

See our full Corporate Responsibility Report to find out about:

- our work with the Tasmanian Government and Australian Antarctic Division of the Department of the Environment to engage local industry support for the Icebreaker programme;
- driving total data transparency in medical insurance for our Middle East employees; and
- engaging our UK supply chain to help us minimise waste and avoid waste to landfill.

Corporate Responsibility

Our owners



Shareholder returns

We focus on creating long-term, sustainable value – protecting the interests of our owners alongside those of our employees, customers and the communities in which we operate.

We focus as much on the preservation and growth of the business as on the maximisation of shareholder value. We believe that in a free market system, and in the long-term, the two will automatically coincide, even if there is some short-term divergence. We will realise this by executing our strategy to achieve our purpose of becoming a trusted partner of governments, delivering superb public services that transform outcomes and make a positive difference for our fellow citizens.

As of 2018, an additional two performance measures for sustainable shareholder value generation have been included in relation to long-term incentives (alongside relative total shareholder return, earnings per share growth and return on invested capital), which take into account progress in the Group's employee engagement score and our order book.

As set out in our guidance and outlook, we expect to deliver further progress in 2019 with Revenue growth of 3-4% anticipated and Underlying Trading Profit forecast to increase to approximately £105m. Revenue growth is expected to accelerate to around 5% in 2020. In terms of our ambition of achieving margins of at least 5% over the longer term, we believe this is still achievable. We continue to deliver against our plans and make good progress against our strategy.



For more information and our progress and performance in 2018, as well as our guidance and outlook, see Key Performance Indicators on pages 9 to 11 and Chief Executive's Report on pages 20 to 27.

Transparency

With investors, as with customers, we seek long-term relationships based on transparency, honesty and clarity. We are therefore committed to open and regular engagement with our shareholders.

We strive to maintain open, meaningful dialogue with all our shareholders, and use a variety of communication means to update investors on performance and gain insight into shareholder views, including ensuring that Board members and the wider senior management team are available to address shareholder questions and views at our Annual General Meeting. We seek to: provide meaningful insight into our results and prospects; have management information systems that enable efficient and effective internal and external reporting; and base our approach to executive remuneration on a clear rationale in which the alignment of interests are recognisable and understandable.

In 2018, we delivered our annual schedule of external reporting and shareholder engagement, including additional trading and contract news updates to ensure transparency of performance and engaging with over 100 different institutional investment funds. We have again been recognised for our commitment to transparency with a 'Most Honoured Companies' award from Institutional Investor.

Managed risk

In order to achieve our strategic and business objectives, protect our stakeholder interests and maximise our returns, we seek to identify, manage and mitigate our exposure to risks through robust procedures and controls throughout the organisation.

We support informed risk-taking that promotes business growth and success whilst recognising the risks associated with key decisions, and embed systematic, structured and timely risk management in our organisational processes, linked to achievement of our objectives. We strive for early line of sight regarding increases in threat or exposure, and maintain a robust control environment that reduces negative impacts to our business performance.



For more information and our progress and performance in 2018, see: Principal risks and uncertainties on pages 54 to 63 and Group Risk Committee report on pages 91 to 93.

Corporate Responsibility

Key Performance Indicators

		2014	2015	2016	2017	2018	2017 vs 2018	Var %	Notes
Behaving with integrity and treating people with respect									
Viewpoint Index: Ethics and Integrity	14-17: % 18: Avg. score	70	69	69	69	73	-		1
Upheld cases of corrupt behaviour	Number	0	0	0	0	0	0	-	
Upheld cases of human rights violations	Number	0	0	0	0	0	0	-	
Speak Up cases:									
Investigated	%	95	96	97	90	94	4	4.4	2
Corrective action taken	%	56	63	53	42	54	12	28.6	
Disciplinary action taken against one or more individuals involved in a case	%	15	24	16	9	18	9	100.0	
Dismissal of one or more individuals involved in a case	%	9	6	6	5	11	6	120.0	
Closed within three months	%	70	48	64	89	75	-14	-15.7	
Our people									
Employee engagement and development:									
Employee engagement	14-17: % 18: Avg. score	51	53	54	56	67	-		1
People manager engagement	14-17: % 18: Avg. score	58	59	62	65	70	-		1
Leadership engagement	14-17: % 18: Avg. score	51	55	72	71	69	-		1
Viewpoint Index: Learning & Development	14-17: % 18: Avg. score	44	46	48	49	60	-		1
Inclusive workplace: 3									
Viewpoint Index: Diversity & Inclusion	14-17: % 18: Avg. score	75	67	69	70	74	-		1
Number of women: Serco Group plc Board	Number (%)	3 (30.0)	3 (30.0)	2 (22.2)	3 (30.0)	3 (33.3)	0	-	4
Number of men: Serco Group plc Board	Number (%)	7 (70.0)	7 (70.0)	7 (77.8)	7 (70.0)	6 (66.7)	-1	-14.3	4
Number of women: Executive Committee and Direct Reports	Number (%)	12 (16.2)	13 (16.7)	12 (17.1)	15 (21.7)	28 (31.8)	13	86.7	4
Number of men: Executive Committee and Direct Reports	Number (%)	62 (83.8)	65 (83.3)	58 (82.9)	54 (78.3)	60 (68.2)	6	11.1	4
Number of women: all other employee levels	Number (%)	23,157 (44.4)	21,165 (42.6)	18,798 (41.9)	18,129 (41.6)	18,960 (42.4)	831	4.6	
Number of men: all other employee levels	Number (%)	29,028 (55.6)	28,531 (57.4)	26,054 (58.1)	25,435 (58.4)	25,757 (57.6)	322	1.3	
Number of employees with disclosed disabilities	Number (%)	228 (0.7)	468 (1.3)	516 (1.2)	425 (1.0)	343 (0.8)	-82	-19.3	
Age profile: 3									
16-24	%	10.2	9.5	9.1	8.7	8.5	-0.2	-2.3	
25-40	%	35.2	35.9	35.7	38.8	38.7	-0.1	-0.3	
41-54	%	29.8	29.2	29.2	31.4	29.8	-1.6	-5.1	

		2014	2015	2016	2017	2018	2017 vs 2018	Var %	Notes
Our people - Age profile continued									
55-64	%	14.6	14.9	15.6	17.9	17.6	-0.3	-1.7	
65+	%	2.4	2.3	2.6	3.1	3.1	0	-	
Undisclosed	%	7.8	8.2	7.8	0.1	2.3	-2.2	-2,200.0	5
Staff turnover	%	31.0	32.8	33.8	30.6	27.0	3.6	11.8	
Proportion of days lost to sickness	%	3.3	3.2	3.2	3.1	12.3	-9.2	-296.8	6
Safe and healthy operations:									
Viewpoint Index: Safety	14-17: % 18: Avg. score	70	71	73	75	77	-		1
Lost Time Incident Frequency Rate	Per 1m hours worked	4.81	5.79	4.98	4.18	4.93	-0.75	-17.9	7 8
Lost Time Incident Severity Rate	%	17.53	19.10	22.96	23.68	26.14	-2.46	-10.3	9
Major Incident Frequency Rate	Per 1m hours worked	0.33	0.34	0.27	0.33	0.41	-0.08	-24.2	7
Physical Assault Frequency Rate	Per 1m hours worked	7.04	7.19	6.92	8.96	13.12	-4.16	-46.4	7 10
Serious Physical Assault Frequency Rate	Per 1m hours worked	0.38	0.49	0.93	0.89	1.37	-0.48	-53.9	11
Prosecutions	Number	0	1	0	0	0	0	-	12
Fines paid	£'000	50	200	0	116	0	-116	-	13
Our world									
Protecting the environment:									
14									
Carbon dioxide equivalent (Scope 1+2)	tCO ₂ e	343,717	298,986	291,883	253,655	259,814	6,159	2.4	
Scope 1 - Combustion of fuels and operation of facilities	tCO ₂ e	173,441	162,197	182,819	174,289	176,254	1,965	1.1	
Scope 2 - Grid electricity purchased for own use (location-based)	tCO ₂ e	170,276	136,789	109,064	79,366	83,560	4,194	5.3	15
Headcount intensity (Scope 1+2)	tCO ₂ e/FTE	6.32	5.16	5.98	5.56	5.53	-0.03	-0.5	
Carbon Disclosure Project	Score	97%	99%	B	B	C	-		16
Prosecutions	Number	0	0	0	0	0	0	-	
Fines paid	£'000	0	0	0	0	0	0	-	
Enforcement notices	Number	0	0	0	0	0	0	-	
Fair competition:									
Upheld cases of anti-competitive behaviour	Number	0	0	0	0	0	0	-	
Responsible relationships:									
Third-party due diligence screening									
17									
Third parties validated	Number	-	-	-	28,066	7,867	-20,199	-71.9	
Third parties pending review	Number	-	-	-	1,143	191	952	83.2	
Third parties disqualified	Number	-	-	-	3	1	2	66.6	18

Corporate Responsibility continued

Key Performance Indicators continued

Notes:

The performance analysis is based on data reported as at 20 February 2019, unless otherwise stated. Additional data may arise after this date. Where this occurs, numbers will be corrected in the following year report.

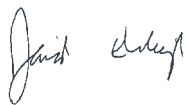
All data is for the total Group unless otherwise stated. All data excludes joint ventures and historical BPO data to enable like-for-like comparison. Our private sector offshore BPO business was sold in December 2015.

Current workforce KPI levels are in line with benchmark targets for the geographies and markets in which we operate. However, we continue to try to improve them.

Please refer to our full Corporate Responsibility Report for Group targets. Other annual targets are managed at local and regional levels.

1. Applies to all data from our 'Viewpoint' employee engagement survey. In 2018, our methodology for calculating employee engagement changed, aligned to our new survey provider. Pre-2018, engagement results represent the proportion of engaged employees expressed as a percentage. As of 2018, engagement scores represent the average response, with maximum potential scores of 100. It is not possible to adjust all our historic data to restate to the new methodology. However, analysis performed by our new survey provider indicates that engagement levels from 2017 to 2018 have remained broadly stable, with opportunity for improvement against new benchmarks. Regarding Viewpoint Index scores, an index comprises one or more related questions that cover a specific area of analysis.
2. Where anonymous cases provide insufficient information, we are unable to investigate.
3. Inclusive workplace and age profile figures are representative only of employees for whom relevant data is available.
4. From 2018, this data will be the same as that submitted to the annual Hampton-Alexander Review, UK. For 2018 the data was submitted on 30th June.
5. Reduction in 2017 reflects improvements in data availability resulting from new D&I strategy and focus on developing clear and robust data.
6. Increase in 2018 reflects introduction of new absence management system and subsequent planned improvement in absence capture.
7. 2017 numbers corrected following additional data due to reclassifications or delayed reporting.
8. Our lost time incident frequency rate in 2018, whilst an increase against 2017, reflects the five-year average baseline. One contributing factor is the increase reported in assaults. When these are removed the lost time incident frequency rate is brought down to 4.2. The main cause for non-assault incidents remains slips and trips and manual handling.
9. We have changed the way we report lost days. Lost days will now be reported so that days lost are allocated in the year they occur rather than the year the incident occurred in. Figures presented reflect this change. Adjustments have been made to 2016 and 2017 data to enable comparison of current performance.
10. 94% of assaults in 2018 relate to Justice and Immigration which has seen a 39% increase against 2017. This remains an area of significant management attention. We continue to deliver a programme of co-ordinated, mutually-supporting initiatives to manage this risk.
11. Clarification was sought from the UK Ministry of Justice regarding the inclusion of spitting and potting under serious assaults. They confirmed that these are not currently included in published statistics for Serious Assault. These have therefore been removed from the figures and the 2017 figure adjusted to reflect this change.
12. 2015 date relates to an incident in 2011.
13. Dubai Metro: February 2017 (500,000AED) public hazard relating to escalator maintenance by a sub-contractor – fine paid by sub-contractor and revised work instructions implemented; August 2017 (100,000AED) unsafe lifting operations relating to glass movement in station – revised work instructions implemented.
14. Please refer to our full Corporate Responsibility Report for a full breakdown of our environmental performance. Our reporting year for greenhouse gas emissions is one quarter behind our financial year, namely 1 October 2017 to 30 September 2018. We quantify and report to ISO 14064-1 2012, using an operational control approach to defining our organisational boundary. The classification of reporting boundaries is set out in detail in our Basis of Reporting document, available on our website, www.serco.com. We report all material emission sources for which we consider ourselves responsible and have set our materiality threshold at 5%. Units reported: tCO₂e = Tonnes Carbon Dioxide Equivalent; FTE = Full Time Employee.
15. Additional 9,512 tCO₂e due to inclusion of Middle East domestic accommodation in scope as per advice received from Carbon Credentials. Reductions from closure of Bolton and JD Williams offices (circa 1,000 tCO₂e). Reductions due to UK conversion factor (UK grid 19% less carbon intensive vs 2017). Conversion factors for Middle East and Australia slightly increased. Location-based electricity emissions are calculated using the electricity grid average emission factors.
16. New scoring mechanism introduced in 2015. We have continued to manage our carbon emissions in line with the legacy Carbon Disclosure Project criteria for a score of B (see our Carbon Disclosure Project scores for 2016-17). However, changes made by the Carbon Disclosure Project in 2018, including the introduction of new or intensified criteria in certain areas, have reset the baseline for all participants. We accept that, against the new criteria, our Carbon Disclosure Project score is C, and recognise that our existing plans are appropriate for driving improvement. Further information can be found in our full Corporate Responsibility Report and on the Carbon Disclosure Project website, www.cdp.net/en
17. 2018 numbers reflect business as usual addition of third parties following completion of initial due diligence review of all third parties completed in 2016 and 2017.
18. Additional organisations disqualified because they are no longer used by Serco or there is a gap of 2+ years in the relationship: 6,634 in 2017; 173 in 2018.

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



David Eveleigh

Group General Counsel and Company Secretary
20 February 2019

Corporate Governance

Corporate Governance

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Board of Directors



Sir Roy Gardner

Chairman



Appointed to the Board

June 2015 (Chairman since July 2015)

Skills and experience

Sir Roy Gardner is an experienced chairman with over 40 years' experience in both executive and non-executive roles in a variety of businesses in the services, energy, industrial, chemicals, electronics, insurance and leisure sectors. He is a Fellow of the Chartered Association of Certified Accountants, the Royal Aeronautical Society, the Royal Society of Arts and the City and Guilds Institute and has an Honorary Doctorate from Thames Valley University.

Previous roles

Chairman of Compass Group PLC, Connaught plc and Manchester United and Plymouth Argyle football clubs. Chief Executive of Centrica plc, Managing Director of GEC-Marconi Limited and a Director of GEC plc, Senior Independent Director of William Hill plc and a Non-Executive Director of Willis Group Holdings Limited and Laporte plc.

Chairman of the Advisory Board of the Energy Futures Lab at Imperial College London, the Apprenticeship Ambassadors Network and Mainstream Renewable Power Limited and Senior Adviser to Credit Suisse.

Current external commitments

Senior Independent Director of Mainstream Renewable Power Limited.



Rupert Soames OBE

Group Chief Executive Officer



Appointed to the Board

May 2014

Skills and experience

Rupert Soames is an experienced chief executive officer having held the role for nearly 20 years in other companies before joining Serco as Chief Executive in 2014.

He studied Politics, Philosophy and Economics at Oxford University, where he is now a visiting fellow, and was President of the Oxford Union.

Previous roles

Chief Executive of Aggreko plc, and the Banking and Securities Division of Misy plc.

Senior Independent Director and a member of the Remuneration, Nomination and Audit Committees of Electrocomponents plc.

Current external commitments

Non-Executive Director and a member of the Audit, Nomination and Remuneration Committees of DS Smith Plc.



Angus Cockburn

Group Chief Financial Officer



Appointed to the Board

October 2014

Skills and experience

Angus Cockburn is a chartered accountant with considerable experience gained in a variety of sectors before joining Serco in 2014. He has an MBA from the IMD Business School in Switzerland and is an Honorary Professor at the University of Edinburgh.

Previous roles

Chief Financial Officer and Interim Chief Executive of Aggreko plc, Managing Director of Pringle of Scotland and senior finance positions at PepsiCo Inc including Regional Finance Director for Central Europe. Non-Executive Director of Howdens Joinery Group plc and Senior Independent Director and a member of the Audit, Remuneration and Nomination Committees of GKN plc.

Current external commitments

Non-Executive Director and Chair of the Audit Committee and a member of the Nomination and Remuneration Committees of Ashted Group plc.



John Rishton

Senior Independent Non-Executive Director



Appointed to the Board

September 2016

Skills and experience

John Rishton has considerable experience in chief executive and chief financial officer roles gained from a variety of companies during a period of around 40 years.

He has a BA in Economics from Nottingham University and is a Fellow of the Chartered Institute of Management Accountants.

Previous roles

Chief Executive of Rolls Royce Group plc, Chief Executive and President of the Dutch international retailer, Royal Ahold NV (and prior to that, its Chief Financial Officer) and Chief Financial Officer of British Airways plc.

Current external commitments

Non-Executive Director and Chair of the Audit Committee of Unilever plc.

Non-Executive Director and Chair of the Audit Committee of Informa plc.

Non-Executive Director of Associated British Ports.



Kirsty Bashforth

Independent Non-Executive Director



Appointed to the Board

September 2017

Skills and experience

Kirsty Bashforth is an experienced board member within the construction, services and education industries, with expertise in change management, safety and risk management, organisational culture and leadership.

She has an MA (Cantab) in Economics from the University of Cambridge.

She has been running her own corporate advisory business, QuayFive Limited, since 2016.

Previous roles

Senior executive at BP plc having spent over 24 years with the company in a variety of commercial roles, including Group Head of Organisational Effectiveness, where she led BP's global agenda on culture, diversity and change management.

Governor of Leeds Beckett University and Ashville College.

Current external commitments

Non-Executive Director, Chair of Safety, Health and Environment Committee and a member of the Nomination, Remuneration, Risk Management and Audit Committees of Kier Group plc.

Independent Non-Executive Director, Chair of the Remuneration and People Committee and a member of the Audit & Risk and Reputation & Ethics Committees of GEMS Mensa Holdings Limited.

Director of QuayFive Limited.

Key to Committee membership (Red highlight denotes Chair)

- A** Audit Committee
- N** Nomination Committee
- R** Remuneration Committee
- C** Corporate Responsibility Committee
- GR** Group Risk Committee



Eric Born

Independent Non-Executive Director

A N R C GR

Appointed to the Board

January 2019

Skills and experience

Eric Born is an experienced chief executive officer with experience in the aviation services, logistics and retail sectors. He is currently Chief Executive Officer of Swissport International Limited which he joined in 2015.

He has an MBA from the University of Rochester, New York, and is a graduate of the University of Applied Sciences in Zurich.

Previous roles

Chief Executive Officer of Wincanton plc and Non-Executive Director and member of the Audit, Nomination and Remuneration Committees of John Menzies plc.

Current external commitments

Chief Executive Officer of Swissport International Limited.



Ian El-Mokadem

Independent Non-Executive Director

A N R C GR

Appointed to the Board

July 2017

Skills and experience

Ian El-Mokadem is an experienced chief executive officer with international experience in business transformation and in acquisitions and disposals.

He is currently Chief Executive Officer of V. Group which he joined in 2017.

He has a BSc (Hons) in Economics and Statistics from University College London and an MBA from INSEAD.

Previous roles

Chief Executive Officer of Exova Group plc, Group Managing Director, UK & Ireland of Compass Group plc and senior management positions with Centrica plc and the global management consultancy, Accenture.

Current external commitments

Chief Executive Officer of V.Group.



Rachel Lomax

Independent Non-Executive Director

A N R C GR

Appointed to the Board

March 2014

Skills and experience

Rachel Lomax has significant experience of government and economic policy.

She has an MA in History from Cambridge University and an MSc in Economics from the London School of Economics.

Previous roles

Deputy Governor, Monetary Stability, Bank of England, and a member of the Monetary Policy Committee, Permanent Secretary in the Department for Transport, Department for Work and Pensions and the Welsh Office, and senior posts at the Cabinet Office, HM Treasury and World Bank.

Senior Independent Director and Chair of the Conduct and Values Committee at HSBC Holdings plc and a Trustee/ Board Member of Imperial College, London.

Current external commitments

Non-Executive Director of Heathrow Airport Holdings Limited.
 Director of SETL Development Limited.
 Governor of the Ditchley Foundation.
 Member of the Board of Breugel.
 Deputy Chair of the British Council.



Lynne Peacock

Independent Non-Executive Director

A N R C GR

Appointed to the Board

July 2017

Skills and experience:

Lynne Peacock has over 25 years' senior management experience in a range of roles including brand development, mergers and acquisitions, change management and business transformation.

She has a BA (Hons) in Business Studies.

Previous roles

Non-Executive Chair of Standard Life Assurance Limited and Non-Executive Director and a member of the Nomination and Governance Committees of Standard Life Aberdeen plc.

Chief Executive of Woolwich plc and National Australia Bank Limited's UK businesses and a Non-Executive Director and Chair of the Audit Committee of Scottish Water.

Current external commitments

Senior Independent Director, Chair of the Remuneration Committee and member of the Audit, Risk and Nomination Committees of Nationwide Building Society.
 Non-Executive Director and a member of the Audit and Risk, Nominations and Remuneration Committees of Jardine Lloyd Thompson Group plc.
 Chair of Trustees of the Westminster Society for People with Learning Disabilities.

Corporate Governance Report

Chairman's governance overview



Sir Roy Gardner

Chairman

This report sets out how Serco is governed and the key activities of the Board of Directors in promoting effective governance during 2018. Further information on how the Company complied with the UK Corporate Governance Code during 2018 is set out on pages 104 and 105.

2018 Highlights

- Continued refreshment of the Board through the appointment of Eric Born following the resignation of Mike Clasper.
- Appointment of John Rishton as Senior Independent Director.
- Continued refreshment of Committee membership with changes to the Audit, Corporate Responsibility and Nomination Committees.
- Improvements to internal procedures to improve Board effectiveness following the internal Board evaluation undertaken in 2017.
- External Board evaluation undertaken by ICSA Board Evaluation Limited.

Dear Shareholders

I am pleased to present the Corporate Governance Report for 2018. The Board believes that good governance is key to the long-term success of the Group and is committed to achieving high standards of governance.

As in previous years, we report against the UK Corporate Governance Code published by the Financial Reporting Council on 27 April 2016 ("the Code"). I confirm that, during 2018, the Company has complied fully with the provisions of the Code. Details of how the Company has complied with the Code are set out on pages 104 to 105.

The Board has reviewed the UK Corporate Governance Code published in July 2018 by the Financial Reporting Council ("the 2018 Code") which applies to accounting periods beginning on or after 1 January 2019.

The Company already complies with the vast majority of the 2018 Code's provisions and, with some changes in processes and procedures and additional disclosure relating to existing processes and procedures, the Board believes that full compliance will be achieved and so reported in the annual report for the year ending 31 December 2019.

The most significant change is in respect of workforce engagement. The Company already enjoys good employee relations, the mechanisms for which are set out in the Directors' Report on pages 132 to 138, and to meet the requirements of the 2018 Code, the Company has appointed Kirsty Bashforth, one of our Non-Executive directors and the Chair of our Corporate Responsibility Committee, as the "lead" employee voice representative on the Board and the Group HR Director will take executive responsibility for activity that will ensure two-way communication. In addition, our current internal communication methods will be reviewed to support such a way of operating and amongst other changes, a forum comprising the nominated Non-Executive Director, the Group HR Director, the Group General Counsel and Company Secretary and a representative from each Division will be established to discuss a range of issues that have relevance to the Board agenda to ensure a two-way dialogue.

Effectiveness

As Chairman, I am responsible for providing leadership to ensure that the Board operates effectively. I have been supported in this by all the Directors, in particular Mike Clasper, our Senior Independent Director until his resignation on 31 December 2018. The annual reviews of Board effectiveness help the Board to consider how it operates and how its operations can be improved. This year, the review was externally facilitated by ICSA Board Evaluation Limited. The findings of this review have provided us with ideas to further improve the manner in which the Board operates, which, together with progress against recommendations from the previous internal evaluation, are set out on page 90.

Changes in the Board

The Board continued to review Board composition and succession planning with assistance from the Nomination Committee.

During the year, the Nomination Committee, as part of its routine business, reviewed the composition of the Board and, to ensure continued refreshment of the Board and the appropriate breadth of experience, recommended that an additional Non-Executive Director with international experience should be recruited.

Korn Ferry was appointed to assist with the recruitment process and several individuals were identified as suitable candidates, of whom five were interviewed by myself and by my executive and non-executive colleagues, following which Eric Born was invited to join the Board and become a member of the Audit and Corporate Responsibility Committees with effect from 1 January 2019.

Eric, who is currently Chief Executive Officer of Swissport International Limited, has considerable international, strategic and operational experience.

Mike Clasper, who joined the Board in May 2014, and who was the Senior Independent Non-Executive Director, stood down on 31 December 2018.

As a result of these changes to the Board, John Rishton, who was appointed as a Non-Executive Director in 2016, assumed the role of Senior Independent Director and joined the Nomination Committee on 1 January 2019. In addition, Kirsty Bashforth, who was appointed as a Non-Executive Director in 2017, replaced Mike Clasper as Chair of the Corporate Responsibility Committee on 1 January 2019.

Contract site visits

Non-Executive Directors are encouraged to continually increase their knowledge of the Company and its operations. This includes visits to contract sites which enables them to witness the excellent day-to-day service provided by our contract teams. The visits provide a deeper level of understanding of the risks and opportunities faced by our contract teams on a daily basis, together with the Group-wide challenges regarding the scale and variety of our operations. During the year, our Non-Executive Directors have visited sites operated within each of the Company's divisions including at HM Naval Base, Clyde ("Faslane"), Northlink Ferries, International Nuclear Services, Caledonian Sleepers, 'Compass' in Glasgow and Liverpool, Norfolk and Norwich Hospital, the Norfolk Naval Shipyard in Portsmouth, Virginia, the Federal Retirement Thrift Investment Board, Washington, Fiona Stanley Hospital, Western Australia, the Dubai Metro, HMAS Watson, Sydney, Brisbane Immigration Transit Centre, Fleet Marine Services, Southern Queensland Correctional Centre and Villawood Immigration Detention Centre.

Diversity

The Board is committed to ensuring the development of gender and ethnic diversity amongst Serco's senior management population and annually reviews its recommendations on gender and ethnic diversity for senior management roles.

More information is provided in the Nomination Committee Report on pages 100 to 101.

Shareholder engagement

The Board continued to engage in an open and meaningful way with its shareholders during the course of 2018. In addition, I attend the results announcements in the City and meet many of our stakeholders. I hope shareholders will take the opportunity to meet with Board members at the 2019 Annual General Meeting.



Sir Roy Gardner

Chairman
20 February 2019

Corporate Governance Report

Chairman's governance overview continued

What the Board has achieved in 2018

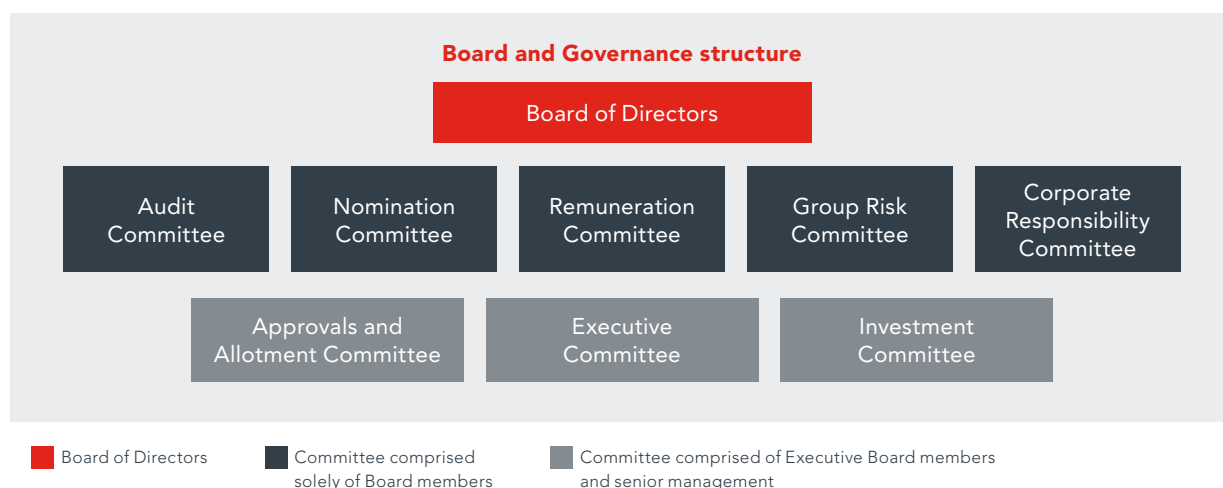
- Reviewed and challenged the strategy of the Group and supported the Executive management in the Group's strategic development.
- Received, discussed and reviewed regular reports from the Chief Executive and Chief Financial Officer.
- Regularly reviewed financial performance.
- Reviewed and agreed budgets.
- Focused on the ongoing performance of the Group.
- Reviewed employee engagement, as well as receiving regular People reports.
- Focused on further embedding the Corporate Responsibility Framework.
- Focused on further embedding the Corporate Renewal Programme.
- Reviewed and challenged management on the progress of the Group's business development pipeline.
- Received regular legal and governance reports, including diversity and governance developments and received training as a Board.
- Focused on and reviewed key individual material bids and acquisitions over the year.
- Continued to drive improvements in Health and Safety and, specifically, to challenge measures put in place to support the reduction in physical assaults in prisons.
- Changes to Board and Committee membership.
- Spent time with the Divisional management teams and met regularly with senior management responsible for the delivery of the Group's key opportunities and existing contracts, including a number of contract visits in the UK and overseas.
- Received operational 'deep dives' from across the Divisions.
- Reviewed the Operating Model and Finance Transformation plans.
- Reviewed and challenged the Centres of Excellence.
- Considered succession planning both for the Board and the senior management team, including diversity.
- Reviewed the Gender Pay position.
- Reviewed, challenged and refreshed the Tax and Treasury Policy.
- Engaged with the Company's stakeholders.
- Considered the UK political environment and its potential impact on the Company.
- Received regular reports from the Head of Investor Relations.
- Received regular reports on ethics, compliance and Health, Safety and Environment.
- Received detailed reports of the proceedings of each of the Board's Committees.
- Received a progress report on the implementation of General Data Protection Regulation.
- Continued enhancement of risk management.
- Considered and implemented recommendations arising from Board Regulation.

Board priorities for 2019

- Continue to assess and challenge the Group's strategy.
- Continue to support and challenge improvements in contract execution and cost efficiency, together with seeking to ensure the utilisation of capabilities across the Group.
- Ongoing review and challenge of the bid pipeline and new business opportunities, together with the development of the Centres of Excellence.
- Continued focus on enhancing risk management.
- Focus on Board and Senior Management succession planning, including diversity.
- Further embedding of the Serco Values within the culture of the Group.
- Further review of Divisional operations and ensuring the ongoing transformation and strengthening of the Group.
- Support and challenge management on embedding the Group's transformation initiatives.
- Budget and financial performance reviews.
- Monitor changes to relevant legal, regulatory and governance areas.
- Continue to oversee employee engagement.
- Continued focus on governance developments and training.
- Continue to oversee ethics, compliance and Health, Safety and Environment.
- Implementation of recommendations arising from Board evaluations.

Board and Governance

The Board has a comprehensive corporate governance framework, with clearly defined responsibilities and accountabilities to safeguard long-term shareholder value, which provides an effective platform to realise the Group's strategy.



The Company's governance structure is illustrated above. There is a schedule of matters reserved for the Board which is available on the Company's website. The Board has delegated certain of its responsibilities to the Audit, Corporate Responsibility, Group Risk, Nomination and Remuneration Committees, the terms of reference of each of which are also available on the Company's website. In addition, there is a Disclosure Group which meets to consider the disclosure of information to meet legal and regulatory obligations under Market Abuse Regulation.

The Executive Committee is chaired by the Group Chief Executive and additionally comprises the Group Chief Financial Officer, Divisional Chief Executives, the Group General Counsel and Company Secretary, the Group HR Director and the Group Director of Strategy and Communications. 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 Investment Committee comprises the Group Chief Executive, the Group Chief Financial Officer, the Group General Counsel and Company Secretary, and other members of the management team. It acts on behalf of the Board to review, monitor and approve bids, mergers, acquisitions and disposals and other corporate activity within specific authority limits delegated by the Board.

The Approvals and Allotments Committee comprises the Group Chief Executive, the Group Chief Financial Officer and the Group General Counsel and Company Secretary. This Committee acts on behalf of the Board between Board meetings in respect of matters not specifically reserved to the Board, including the approval of documentation for shareholders and the allotment of shares.

The table below gives details of attendance of Board and Committee meetings during 2018:

	Board	Audit	Corporate Responsibility	Group Risk	Nomination	Remuneration
Sir Roy Gardner ¹	8/8	–	2/3	–	4/4	4/4
Rupert Soames	8/8	–	3/3	–	–	–
Angus Cockburn	8/8	–	–	–	–	–
Kirsty Bashforth	8/8	–	3/3	–	–	4/4
Mike Clasper ²	7/8	5/6	3/3	3/4	2/4	–
Ian El-Mokadem	8/8	–	3/3	4/4	–	–
Rachel Lomax	8/8	6/6	–	4/4	–	–
Lynne Peacock ³	7/8	5/6	–	–	4/4	4/4
John Rishton	8/8	6/6	–	4/4	–	4/4

1. Sir Roy Gardner was unable to attend the Corporate Responsibility Committee meeting on 12 December 2018 due to illness.
2. Mike Clasper was unable to attend the Nomination Committee meeting on 10 September 2018 due to illness. He was also unable to attend meetings of the Board and the Audit, Group Risk and Nomination Committees held on 31 October/1 November 2018 since he was recuperating following an operation.
3. Lynne Peacock was unable to attend meetings of the Board and the Audit Committee which were rescheduled to 11 December 2018, a date on which she already had prior commitments.

Corporate Governance Report

Board and Governance continued

Board evaluation

During 2018, in response to recommendations arising from the internal Board evaluation undertaken in 2017, a number of improvements were made to internal procedures to improve Board effectiveness. Progress was made in the following areas specifically noted for improvement:

- **Strategy.** Briefing documentation was circulated to the Board in advance of the annual strategy meeting and several Non-Executive Directors met with Management and the consultants who assisted with the strategy review before it took place. Following the strategy review, there were opportunities for follow up discussion at subsequent board meetings.
- **Succession planning.** Detailed succession plans were discussed by the Board with particular reference to the assumption of responsibilities previously held by the Chief Operating Officer who left the Company on 31 December 2017.
- **Shareholder engagement.** Engagement with shareholders has been discussed on a regular basis by the Board and additionally the Remuneration Committee.
- **Board training.** Although a number of initiatives were introduced or re-introduced, further consideration will be given to the training opportunities to be made available to Directors.

As indicated in the 2017 Annual Report, the external evaluation of the Board and its Committees, which it had been intended to undertake during 2017, was deferred to provide an opportunity for the Non-Executive Directors who were appointed in 2017 to settle into their roles.

An external evaluation was duly undertaken in 2018 by Geoffrey Shephard of ICSA Board Evaluation Limited which has no other connection with the Company. This evaluation, acknowledging progress on areas of improvement identified in previous internal evaluations, concluded that the Board continued to operate effectively, but that it would benefit from several changes of a procedural nature which would improve the overall performance of the Board and go some way to helping the Board achieve its strategic goals. In particular:

- More detailed reporting of the appraisals of Non-Executive Directors and the Chief Executive.
- More frequent review of processes, procedures and policies.
- A broader role for the Nomination Committee.

The recommendations made in the report will be implemented during the course of 2019.

Appointment, induction and training

The Chairman is responsible for ensuring that an appropriate induction is provided to new Board members. The induction programme is specifically tailored to the needs of the incoming Director and includes circulation of the Board policies and procedures, meetings with senior management and contract site visits.

During 2018, the Directors received advice and training on a number of areas, including:

- General Data Protection Regulation.
- Regulatory developments and changes to the UK Listing Rules and Corporate Governance.
- Market Abuse Regulation.
- Anti-bribery and corruption.
- Money laundering.
- Crisis management.
- New accounting standards.

External directorships

The Company has a policy which allows the Executive Directors to accept directorships of other quoted companies and to retain the fees paid, provided that they have obtained the prior permission of the Chairman. In accordance with the Code, no Executive Director would be permitted to take on more than one Non-Executive Directorship in a FTSE 100 company or the Chairmanship of such a company.

Angus Cockburn was a Non-Executive Director of GKN plc (Senior Independent Director from 20 February 2018) until his resignation on 19 April 2018 following the acquisition of GKN plc by Melrose Industries plc. He was appointed as a Non-Executive Director, Chair of the Audit Committee and a member of the Nomination and Remuneration Committee of Ashted Group plc on 9 October 2018.

Rupert Soames has been appointed as a Non-Executive Director and a member of the Audit, Nomination and Remuneration Committees of DS Smith Plc with effect from 1 March 2019.

Conflicts of interest

Every Director has a duty to avoid a conflict between their personal interests and those of the Company. The provisions of Section 175 of the Companies Act 2006 and the Company's Articles of Association permit the Board to authorise situations identified by a Director in which he or she has, or may have, a direct or indirect interest that conflicts, or may conflict, with the interests of the Company. The Board continues to undertake regular reviews of the external positions and interests or arrangements with third parties held by each Director and, where appropriate, to authorise those situational conflicts following consideration. Notwithstanding the above, each Director is aware of his or her duty to notify the Board should there be any material change to their positions or interests during the year. Directors do not participate in Board discussions or decisions which relate to any matter in which they have, or may have, a conflict of interest.

Group Risk Committee Report

Group Risk Committee members

Rachel Lomax (Chair)
Ian El-Mokadem
John Rishton

Dear Shareholders

The Committee has continued to oversee the Group's efforts to enhance its risk management capability and the way that the Risk Management Framework has been embedded at Divisional level. During its regular reviews of principal risks, it has paid particular attention to the monitoring of progress in constructing and implementing effective risk management plans.

The Committee has focused on:

- conducting 'deep dives' with each Division, considering and challenging their approach to their material risks, and gaining a deeper understanding of the management approach to risk management generally;
- challenging divisional risk registers to ensure they are aligned to the Group's principal risks; and
- satisfying itself that Divisions have adequate capability to implement the Group's Risk Management Framework.

A Key Risk Indicator Dashboard has been introduced to help improve oversight and visibility of the effectiveness of our risk management approach.

The Dashboard includes indicators such as tolerance levels, progress in implementing mitigation plans, leading and/or lagging indicators and results from our three lines of defence activity for each principal risk.

These improvements in reporting, process and structure, have generated a greater understanding and confidence in our management of risk, and the progress that is being made towards achieving target outcomes.

Following a review and horizon scanning exercise by the Executive Committee, it was agreed that there were no material changes to our principal risks since our 2017 report.

I would like to thank Mike Clasper for his contribution to the work of the Committee since its creation, and welcome Kirsty Bashforth who is joining the Committee later this year.



Rachel Lomax
Chair of the Group Risk Committee
20 February 2019

Corporate Governance Report

Group Risk Committee Report continued

Committee's responsibilities

The Committee advises the Board on the Group's overall risk appetite, tolerance and strategy, taking account of the current and prospective macroeconomic and financial environments. The key responsibilities of the Committee are:

- overseeing the effectiveness of the Group's risk management framework, including the assessment of all 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;
- challenging and advising the Board on the current risk exposures facing the Group, future risk strategy and reviewing regular risk management reports which enable the Committee to consider the process for risk identification and management;
- assessing how key Group risks are controlled and monitored by management;
- in conjunction with the Audit Committee, reviewing the Group's risk assessment processes, and ensuring both qualitative and quantitative metrics are used to inform the Board's decision-making; and
- reviewing the Group's capability to identify and manage emerging risks, in conjunction with the other Board Committees as appropriate.

The Terms of Reference for the Committee are available on the Company's website.

Membership and attendees

The Committee is comprised solely of independent Non-Executive Directors. The Board considers that each member of the Committee is independent within the definition set out in the UK Corporate Governance Code ("the Code"). Biographical details for each member of the Committee are provided on pages 84 and 85. The Committee met four times during the year and details of Committee membership and attendance at meetings are set out on page 89 and Committee meetings are held in advance of Board meetings, with the Committee Chair updating the Board directly on the outcomes of each meeting. Meetings of the Committee were attended by the Chief Executive, the Group General Counsel and Company Secretary and the Group Risk and Compliance Director.

Activities of the Committee during 2018

During the year the Committee's key activities included:

- receiving updates regarding the Group's principal risks, detailing key changes and trends, and emerging risks;
- undertaking, as planned, an in-depth review ("deep dives") of the following risks: Failure to manage our reputation, Financial control failure, Failure to deliver expected benefits from Transformation, Contract non-compliance, non-performance or misreporting, Catastrophic incident, Material legal and regulatory compliance failure, Failure of business critical partner, supplier, sub-contractor and Major information security breach. Failure to grow profitably was reviewed specifically at our October Board meeting following an initial review of the content by the Committee. Failure to act with integrity was reviewed by our Corporate Responsibility Committee;
- receiving presentations, as planned, from all four Divisional CEOs covering their Divisional Risk Management process, alignment of their risks to the Group Risk Register and a selected 'deep dive' on one of their principal risks. These included a review on a Major information security breach from Serco Americas, Failure to convert sufficient profitable business by 2019 to achieve 2021 Plan from Serco Asia Pacific, Contract non-compliance, non-performance or misreporting from Serco UK and Failure to grow profitably from Serco Middle East;
- refining the risk review process at Leadership level, resulting in 'deep dive' reviews for certain risks to be discussed in more detail by appropriate Committees. For example, the 'deep dive' on Failure to act with integrity risk was carried out with the Corporate Responsibility Committee;
- reviews on potential cost pressures in the UK, Brexit and other matters. Refer to page 54 for more details on emerging risks; and
- on-going challenge and support of the Group Risk and Compliance Director to improve, enhance and embed the risk management framework.

2019 priorities and focus

During 2019, the Committee will continue their focus on undertaking detailed 'deep dive' reviews into Group principal risks, which may not be classified as such but none the less warrant review and discussion at Committee level. Meetings with the Divisional teams will also continue. Focus will remain on the progression of mitigation actions and their effectiveness in driving the Risk Management Agenda.

We will continue to refine our Key Risk Indicators, Corporate Risk Management Tool and the supporting policies, standards and reporting.

Serco's approach to managing business risks and internal control

Serco's internal control framework includes financial, operational, compliance and risk management controls. These are designed to manage and minimise risks that would adversely affect services to our customers and to safeguard shareholders' investments, our assets, our people and our reputation (collectively "business risks").

Internal controls and key processes are defined within the Serco Management System ("SMS"). To provide management assurance that these controls are effective, we use a 'three line of defence' compliance assurance model to test business compliance.

The Executive Committee is responsible for providing oversight, challenge and direction across the first and second lines of defence, including the review of the Group Risk Register and individual risks as required.

The Board has overall responsibility for risk management and internal control and formally reviews the findings of the overall Internal Audit programme. It is supported in these duties by the Group Risk and Audit Committees.

The Board confirms that there has been a focus on the three lines of defence for the year under review and up to the date of approval of the 2018 Annual Report and Accounts.

First line of defence – Contract Managers, Business and Function leaders within the Group are responsible for identifying and managing risks and for implementing associated processes and controls.

We endeavour to ensure that appropriate processes and controls are in place through the implementation of our SMS and that suitably trained staff seek to ensure that customer, legal and regulatory requirements are adhered to.

We conduct an annual SMS self-assessment which is completed by our Contract Managers and other Leaders across the Group. This process enables a deeper understanding of SMS compliance levels and helps drive improvements. Progress against actions identified through this self-assessment is monitored by senior management. We recognise that whilst the SMS controls can provide reasonable assurance against misstatement or loss, this cannot be absolute.

Second line of defence – The Group Risk and Compliance Function is responsible for the development and implementation of policies and standards associated with Risk Management and Compliance Assurance. It is the custodian of the Group Compliance Assurance Programme ("CAP") and the Principal Risk Register, providing management oversight, assurance and challenge.

The CAP aims to ensure we have a consistent approach to compliance assurance across all Divisions, with direction provided by Group around minimum requirements based upon our principal risks.

Third line of defence – The Group Head of Internal Audit reports functionally to the Audit Committee Chair and is responsible for the delivery of the Internal Audit programme.

Together with external audits undertaken across the Group, Internal Audit provides an independent assessment of the design and operating effectiveness of the Group's governance, risk management and control frameworks in place to manage risk.

The Internal Audit team carries out an annual programme of risk-based audits reporting findings to the Audit Committee. The audit programme is approved by the Audit Committee. The in-house Internal Audit team uses PwC as a co-sourced resource, where appropriate.

Corporate Governance Report

Audit Committee Report

Audit Committee members

John Rishton (Chair)
Eric Born
Rachel Lomax
Lynne Peacock

Dear Shareholders

I am pleased to present the Committee's report for the year ended 31 December 2018 and to welcome Eric Born, who was appointed a Non-Executive Director on 1 January 2019, as a member of the Committee. The Audit Committee has a fundamental role to play in reviewing, monitoring and challenging the effectiveness of the Group's financial reporting and internal control processes. Details of the work carried out by the Committee and in addressing significant issues during 2018, which are reported to the Board as a matter of course, are described in this report.

In 2019, the Committee will continue to focus on the critical accounting judgements made, financial controls and the operating performance of the new finance operating structure and emerging risks arising from it.



John Rishton
Chair of the Audit Committee
20 February 2019

Committee's responsibilities

The Committee supports the Board in fulfilling its responsibilities in respect of: overseeing the Group's financial reporting processes; reviewing, challenging and approving significant accounting judgements proposed by management; the way in which management ensures and monitors the adequacy of financial and compliance controls; the appointment, remuneration, independence and performance of the Group's External Auditor; and the independence and performance of Internal Audit.

The Terms of Reference for the Committee are available on the Company's website.

Membership and attendees

The Committee is comprised solely of Independent Non-Executive Directors. The Board considers that each member of the Committee is independent within the definition set out in the UK Corporate Governance Code ("the Code") and that, between them, the members of the Committee bring strong international, service and public sector expertise and experience which is highly relevant to the Company. John Rishton is a Fellow of the Chartered Institute of Management Accountants and has served as Chief Executive and Chief Financial Officer of large businesses, providing assurance to the Board that at least one member of the Committee has recent and relevant financial experience, as required by the Code. Biographical details for each member of the Committee are provided on pages 84 and 85.

The Committee met six times during the year and details of Committee membership and attendance at meetings are set out on page 89. In addition to the members of the Committee, the Chief Financial Officer, the Director of Finance, the Head of Internal Audit, the Group General Counsel and Company Secretary and representatives of the Company's External Auditor, KPMG LLP, attended and received papers for each meeting. The Committee retain time at the end of each meeting to meet separately without management present and invite the Head of Internal Audit and KPMG LLP to attend for part of this session. The Committee also meets privately with the Chief Financial Officer.

Performance review

The Audit Committee's performance was assessed as part of the Board's annual effectiveness review. In terms of enhancement to the Committee's overall effectiveness, it was felt that the Committee worked effectively but should reflect further on annual training needs and continue to visit contracts to help improve business understanding.

Activities of the Committee during the year

The Committee has an annual agenda plan developed from its Terms of Reference with standing items considered at each meeting in addition to any specific matters arising and topical business or financial items on which the Committee has chosen to focus. The work of the Committee in 2018 principally fell into three main areas:

Accounting, tax and financial reporting

- Reviewing the integrity of the half-year and annual financial statements and the associated significant financial reporting judgements and disclosures;
- Considering the liquidity risk and the basis for preparing the half-year and annual financial statements on a going concern basis, and reviewing the related disclosures in the Annual Report and Accounts;
- Considering the provisions of the Code regarding going concern and viability statements and reviewing emerging practice and investor comment;
- Reviewing updates on accounting matters and new accounting standards, including the new accounting standards on financial instruments (IFRS9), revenue (IFRS15) and leasing (IFRS16); and
- Reviewing the processes to assure the integrity of the Annual Report and Accounts as well as reviewing:
 - the management representation letter to the External Auditor;
 - the findings and opinions of the External Auditor;
 - the disclosures in relation to internal controls and the work of the Committee in discharging its responsibilities;
 - that the information presented in the Annual Report and Accounts, when taken as a whole, is fair, balanced and understandable and contains the information necessary for shareholders to assess the Group's position and performance, business model and strategy;
 - the effectiveness of the disclosure controls and procedures designed to ensure that the Annual Report and Accounts complies with all relevant legal and regulatory requirements; and
 - the process designed to ensure the External Auditor is aware of all 'relevant audit information', as required by Sections 418 and 419 of the Companies Act 2006.

Internal controls

- Assessing the effectiveness of the Group's internal control environment and making recommendations to the Board;
- Receiving presentations from the Chief Financial Officers of each division regarding the controls and risks in each of the Divisions;
- Assessing the findings and directing the work of the Group's financial assurance function;
- Receiving reports from Internal Audit on the audit programme and resulting recommendations. Where relevant, divisional and business unit management were invited to the Audit Committee to discuss the findings from Internal Audit reviews;
- In conjunction with the Group Risk Committee, considering the level of alignment between the Group's key risks and Internal Audit programme;
- Reviewing the proposed 2019 Internal Audit plan;
- Reviewing the adequacy of resources of the Internal Audit function and considering and approving the scope of the Internal Audit programme; and
- Considering reports from the External Auditor on their assessment of the control environment.

External auditor

- Considering and approving the audit approach and scope of the audit undertaken by KPMG LLP as External Auditor and their fees;
- Agreeing reporting materiality thresholds;
- Reviewing reports on audit findings;
- Considering and approving letters of representation issued to KPMG LLP;
- Considering the independence of KPMG LLP and their effectiveness, taking into account:
 - non-audit work undertaken by the External Auditor;
 - feedback from a survey targeted at various stakeholders; and
 - the Committee's own assessment.
- Making a recommendation to the Board on the appointment of the External Auditor.

Corporate Governance Report

Audit Committee Report continued

Financial controls and significant financial judgements

The Group aims to have a strong and well-monitored control environment that minimises financial risk and, as part of the Committee's responsibilities, it reviews the effectiveness of systems for internal financial control and financial reporting. Where relevant, the Committee also works with the Group Risk Committee to consider financial risk management.

Financial control risk is monitored through one of the Group's Principal Risks, 'financial control failure'. The Committee has reviewed this risk during 2018 and has focused in particular on:

- The impact of the Group's Finance Transformation programme and risks associated with the delivery of financial information under the new operating model, with briefings received from Management;
- Updates to the risk mapping framework to document key financial control risks being managed by the Divisions and Business Units and the assurance activity undertaken to mitigate those risks;

- The output from key risk indicators associated with the risk of financial control failure; and
- Management's review of the output and adequacy of the Group's finance function first and second lines of defence, with a focus to deliver better assurance through system controls and data analytics.

Following review and challenge, the Committee believes that, to the best of their knowledge and belief, the financial control framework and the monitoring of this framework has worked effectively during the year, and that in cases of non-compliance, the Group has not been exposed to critical, severe or significant risk. The Committee was also encouraged to note that where weaknesses in the financial control framework were identified they continued to be addressed.

Issue and significance	How the Committee addressed this	Comments and conclusion
Contract performance, including Onerous Contract Provisions (OCPs)		
<p>As part of the 2014 Strategy Review, the Contract & Balance Sheet Review led to the establishment of material OCPs.</p>	<p>The Committee has regularly reviewed and challenged Management's assumptions and main areas of judgement in relation to the performance of the Group's key contracts.</p> <p>The Audit Committee gives particular focus to material OCP positions and, with the support of the External Auditor, agreed that, while accounting for OCPs remained an area of judgement, the view formed by Management regarding each individual material OCP and the aggregate view was considered reasonable. As part of their review, the Committee also considered how the assessment of OCPs reflected other key judgements made by Management in respect of asset impairments, deferred tax asset recognition and future liquidity and viability.</p>	<p>The Committee agreed with Management and the External Auditor that the overall level of provision was appropriate when taking into account the range of possible outcomes.</p> <p>The Committee also concluded that the assumptions and judgements made by Management in the calculation of OCPs were consistent with those prepared by Management for forecasting future profitability and cash flows, and that adequate consideration was given to contracts with low margins to assess whether any additional OCPs were required to be recorded.</p>
Finance Transformation programme		
<p>Management has completed the transition to the new finance operating model developed through the Group's Finance Transformation programme in the UK and AsPac. The operating model requires the new outsourced service provider to deliver the initial output of the finance function through greater leverage of its centres of excellence, where processes can be standardised and their efficiency improved.</p>	<p>The Committee has been kept informed of the progress through the Finance Transformation Programme and is being briefed on any risks and issues arising while the model is being embedded.</p> <p>Through its oversight of the Finance Transformation programme the Committee has considered the potential risks associated with the new finance operating model and challenged Management on the processes and controls put in place to mitigate those risks.</p>	<p>The Committee concluded that the new finance operating model was appropriate and progress was in line with expectations.</p> <p>The Committee was satisfied that Management has taken sufficient steps to mitigate the risks associated with the Finance Transformation programme and the ongoing management of the new structure.</p>

Issue and significance	How the Committee addressed this	Comments and conclusion
Use of Alternative Performance Measures (APMs)		
<p>The Group's performance measures continue to include some metrics which are not defined or specified under IFRS. In particular, following its introduction in 2015, Management continued to use Underlying Trading Profit, as a key measure to review current performance against the prior year by removing the impact of adjustments to OCPs, material charges and releases of other items identified during the 2014 Contract & Balance Sheet Review, together with other significant non-trading items.</p>	<p>The Committee considered whether the performance measures used by Management provided a meaningful insight into the results of the Company for its shareholders.</p> <p>The Committee reviewed the treatment of items considered as being exceptional and requiring separate disclosure.</p> <p>The Committee also reviewed the proposed disclosure of APMs in both the 2018 Half and Full Year results and the 2018 Annual Report ahead of their approval by the Board.</p>	<p>The Committee agreed with Management that Underlying Trading Profit continued to be a reasonable basis for the comparison of the performance of the business.</p> <p>The Committee also continued to support the judgements made by Management regarding the items considered as being exceptional and requiring separate disclosure. The Committee concluded that, in relation to the Half and Full Year 2018 results and the 2018 Annual Report, clear and meaningful descriptions had been provided for the APMs used. It was also concluded that the relationship between these measures and the statutory IFRS measures was clearly explained and supported the understanding of the financial statements.</p>
The Adoption of New Accounting Standards in 2018		
<p>During the year the Group's Financial Statements were prepared under IFRS9 and IFRS15.</p> <p>IFRS9 has not had a material impact on the Group's financial statements.</p> <p>Management performed a detailed assessment of the impact of IFRS15 and restated its prior 2017 numbers to reflect the change in accounting standards.</p> <p>Management updated the Group's revenue recognition policies for long-term contracts to align with IFRS15.</p> <p>Management has implemented a new piece of software and developed processes to manage the Group's lease data and enable the Group to account for leases under IFRS16 from 1 January 2019.</p>	<p>The Committee challenged the policy choices made that determine how revenue is recognised under IFRS15 and transition methods adopted in detail with Management and the External Auditor.</p> <p>The Committee have been briefed on the expected impact of IFRS16 and the project undertaken to prepare the Group for the new accounting standard.</p> <p>Due to the significance of IFRS16, as with the adoption of IFRS15, the Committee members took part in an IFRS16 education session held with the External Auditors and senior members of the Group Finance team.</p>	<p>The Committee were satisfied that the adoption of IFRS9 and IFRS15 have been appropriately reflected in the Financial Statements for the current year and the prior year restatement.</p> <p>The Committee are comfortable with the policy choices made and the approach taken by Management in respect of the adoption of IFRS16.</p> <p>The impact of IFRS16 is disclosed within note 2 of the Financial Statements.</p>
Goodwill Impairment		
<p>A key area of judgement made by Management in recent years has been in the assessment of the holding value of goodwill. In 2014, 2015 and 2016 Management proposed impairment charges and core to the assessment of the value of goodwill is Management's estimate of future cash flows. This estimate is dependent on circumstances both within and outside of their control, and discount rates that are adjusted to reflect the risks specific to individual assets. No impairment of goodwill has been identified in 2018.</p>	<p>The methodology and the results of the impairment testing were presented to the Committee and were subject to scrutiny and review. The Committee placed particular focus on the discount rates applied and ensuring that the underlying cash flows are consistent with the Board-approved forecasts.</p> <p>The Committee also reviewed the disclosures included in the financial statements to ensure that they provide an appropriate level of information to users.</p>	<p>The Committee were satisfied that the assumptions underlying the impairments made in the year were appropriate.</p> <p>Following review of the disclosures in the financial statements, the Committee concluded that the disclosures were transparent, appropriate and in compliance with financial reporting requirements.</p>

Corporate Governance Report

Audit Committee Report continued

Issue and significance	How the Committee addressed this	Comments and conclusion
Defined Benefit Pension Schemes		
The Group's defined benefit pension scheme obligations are an area of Management focus, in particular regarding the identification of obligations arising from customer contracts and the calculation of financial impact of any such liabilities.	The Committee considered both the process undertaken by Management to finalise the assumptions for the main schemes, including the additional liability associated with obligations in respect of the equalisation of Guaranteed Minimum Pensions, and how these assumptions benchmark against the market. Advice was taken from independent actuaries on the appropriateness of the assumptions used.	Following review, the Committee concluded that the process followed was appropriate and the resulting conclusions reached and calculations performed were appropriately balanced.
Exceptional Items		
The Group has undergone a significant restructuring programme as a result of the Strategy Review undertaken in 2014. As a result of this the Group incurred significant restructuring costs associated with changes made to the strategy, organisational structure and underlying infrastructure required to support the future growth in revenues and profit margins.	The Committee has scrutinised and challenged Management on the items recognised as exceptional during the year to ensure consistent application of the Group's policy, which is in line with FRC guidance, and the controls in place to ensure that appropriate restructuring costs are charged as exceptional items.	The Committee concluded that the items recorded as exceptional were appropriate and that appropriate review controls were in place to ensure that costs which should be recorded within Underlying Trading Profit were not instead recorded as exceptional.

Viability Statement

In October 2018, the FRC 'Business model reporting; Risk and viability reporting' study was issued. The Committee has reviewed the 2018 Viability Statement in light of this study and believe that the Group's Viability Statement is appropriate and balanced in respect of highlighting the risks the Group is exposed to and the assumptions being made in assessing its viability.

The Viability Statement is set out on pages 64 and 65.

Independent assurance

The Group's Independent assurance structure is formed of Internal Audit and External Audit.

Internal Audit

Internal Audit acts as a 'third line of defence' providing independent assurance to the Board, Audit Committee and management, and in particular:

- Provides objective, independent assurance and advice to management and the Audit Committee on the design and operating effectiveness of the governance and internal control processes in place to identify and manage business risks;
- Delivers an annual programme of risk-based internal audits, reporting findings and recommendations for management actions to improve governance, risk management and controls to each Audit Committee meeting; and
- Reviews the annual Internal Audit programme regularly throughout the year to ensure it remains focused on key risks, recommending changes to the Audit Committee for their approval.

Internal Audit gives particular regard to the ongoing evaluation of the efficacy of the Group's financial controls and reporting processes. Internal Audit is headed by the Group Head of Internal Audit who reports functionally to the Chair of the Audit Committee ensuring independence is maintained. Internal Audit work with a co-sourced partner, PwC, to supplement and enhance in-house skills and resources where required. During 2018, Internal Audit has delivered a full programme of audits making recommendations to management for improvements to risk, governance and controls. Reports have been discussed with the parts of business they relate to and management actions agreed have been tracked for progress. Key themes and management action progress have been included in regular written updates to the Audit Committee. Internal audits may focus on individual contracts, processes, functions or risk themes.

The 2019 Internal Audit programme will continue to focus on the key risks across the business.

External Auditor

The Audit Committee manages the relationship with the Company's External Auditor on behalf of the Board. In 2017, KPMG LLP were appointed by the Board as the Company's external auditor for the 2016/17 audit and have served as the Company's auditor for two years. John Luke was appointed as audit partner in 2018. In accordance with the Revised Ethical Standard 2016, the Company will continue the practice of the rotation of the audit engagement partner at least every five years.

The Committee evaluates the effectiveness of the external audit annually, using feedback obtained from management associated with audits undertaken in Group Finance and in the Divisions and by assessing the performance of the External Auditor against a range of criteria including calibre of the audit team, knowledge of the Group, and the quality of planning, review, testing, feedback and reporting. The feedback received was reviewed by management and reported to the Committee. After taking these reports into consideration, the Committee concluded that the auditor demonstrated appropriate qualifications and expertise and remained independent of the Company, and that the audit process was effective.

During the year, the FRC Audit Quality Review (AQR) team completed a review of KPMG's audit of Serco Group plc's 2017 financial statements. The Committee considered the findings of the review and discussed them with KPMG, and the Chairman of the Committee also discussed the findings with the FRC's AQR team. Whilst none of the findings were regarded by the Committee as significant, some matters were identified as requiring improvement and we are satisfied with the responses implemented by KPMG in the audit of the Group's 2018 financial statements.

The Committee also reviewed the External Auditor's engagement letter and determined the remuneration of the External Auditor in accordance with the authority given to it by shareholders. The Committee considered the External Auditor's remuneration to be appropriate.

It is proposed that KPMG LLP be re-appointed as External Auditor of the Company at the next AGM in May 2019 and, if so appointed, that they will hold office until the conclusion of the next general meeting of the Company at which accounts are laid. Further details are set out in the Notice of Annual General Meeting which is available on the Company's website.

The Independent Auditor's Report to shareholders is set out on pages 140 to 150.

Non-audit fees

The Committee limits the non-audit work undertaken by the External Auditor and monitors the non-audit fees paid during the year. For the financial year ended 31 December 2018, the non-audit fees paid to KPMG LLP were £0.1m (2017: £0.1m). The majority of the fees relate to the UK Government review where KPMG LLP is being used for continuity given the complex nature of the work performed, with their services in respect of the review commencing prior to KPMG LLP's appointment as External Auditor. These services predominantly relate to data extraction under instruction from the Group's external lawyers and will end when the UK Government review is concluded. An analysis of fees paid in respect of audit and non-audit services provided by the external auditor for the past two years is disclosed on page 185. The Committee regularly reviews the nature of non-audit work performed by the External Auditor and the volume of that work. Focus is given to ensuring that engagement for non-audit services does not: (i) create a conflict of interest; (ii) place the auditor in a position to audit their own work; (iii) result in the auditor acting as a manager or employee; or (iv) put the auditor in the role of advocate for the Company.

Having undertaken a review of the non-audit services provided during the year, the Committee is satisfied that these services were provided efficiently by the External Auditor as a result of their existing knowledge of the business and did not prejudice their independence or objectivity.

Corporate Governance Report

Nomination Committee Report

Nomination Committee members

Sir Roy Gardner (Chair)
Lynne Peacock
John Rishton

Dear Shareholders

During the year, the Committee reviewed the balance of skills on the Board to identify where additional skills would be beneficial, reviewed the annual plan of agenda items to ensure all those matters required to be addressed by the Committee were fully discussed and confirmed the renewal of appointments for further terms of three years for those Non-Executive Directors whose three year terms of appointment were due for renewal.

As part of the Committee's objective to ensure the Board is continually refreshed, the Committee recommended that an additional Non-Executive Director with international experience should be recruited. Following a selection process more fully described later in this report, Eric Born was appointed as Non-Executive Director and a member of the Audit and Corporate Responsibility Committees on 1 January 2019.

Mike Clasper, who was the Senior Independent Non-Executive Director, stood down on 31 December 2018 following which John Rishton was appointed as Senior Independent Director and a member of the Nomination Committee and Kirsty Bashforth was appointed Chair of the Corporate Responsibility Committee.



Sir Roy Gardner
Chair of the Nomination Committee
20 February 2019

Committee's responsibilities

The Board values diversity and when recruiting new Board members the issue of diversity is addressed by the Committee, with particular regard to the percentage of women on the Board (which currently stands at 33% (2017: 33%).

The key responsibilities of the Committee are:

- Reviewing the size, structure and composition of the Board and identifying candidates for appointment to the Board;
- Recommending membership of Board Committees;
- Undertaking succession planning for Directors and other senior executives and ensuring that the leadership needs of the organisation continue to be met; and
- Reviewing induction and training needs of Directors.

The Terms of Reference for the Committee are available on the Company's website.

Membership and attendees

The Committee is comprised solely of independent Non-Executive Directors. The Board considers that each member of the Committee is independent within the definition set out in the UK Corporate Governance Code. The Committee met four times during the year and details of Committee membership and attendance at meetings are set out on page 89. Meetings of the Committee are normally attended by the Group Chief Executive, the Group HR Director and the Group General Counsel and Company Secretary. Biographical details for each member of the Committee are provided on pages 84 and 85.

Activities of the Committee during 2018

During the year the Committee's key activities included:

- The appointment of a non-executive director
As part of the ongoing process of ensuring the Board's continuing refreshment, the Committee recommended that an additional non-executive director with, in particular, international experience should be recruited to join the board. Korn Ferry, which has no other connection with the Company, was appointed to identify potential candidates to match the specification prepared by the Committee.

Following the identification of several potential candidates, a shortlist of candidates was prepared by the Committee and members of the Committee and other executive and Non-Executive Directors interviewed these shortlisted candidates.

Following these interviews, the Committee recommended to the Board that Eric Born should be appointed as a Non-Executive Director and a member of the Audit and Corporate Responsibility Committees.

Eric, who was duly appointed with effect from 1 January 2019, has attended meetings with members of the Executive Committee and other key senior managers as part of a comprehensive induction programme which will also include meetings with the Company's advisers and visits to contract sites.

- Changes to Committee membership

Mike Clasper, who was the Senior Independent Director, stood down as a Non-Executive Director on 31 December 2018, which created opportunities for some further refreshment of roles on the Board and the Company's Committees. John Rishton replaced him as Senior Independent Director and as a member of the Nomination Committee and Kirsty Bashforth took his place as chair of the Corporate Responsibility Committee.

- Developing the Board Diversity Policy

Serco strongly supports the principle of boardroom diversity and values the benefits that diversity of thought can bring to its Board and throughout Serco. We believe that a mix of expertise, experience, skills and backgrounds (including age, ethnicity, disability, gender, sexual orientation, religion, belief, culture, education and professional backgrounds) allows Serco to deliver a great service that is valued by our customers and meets the needs of those who use the services we provide. Serco will always seek to appoint Board members and senior management on merit against objective criteria, including diversity. In developing the Board Diversity Policy, the Committee considered the voluntary recommendations provided in the Hampton-Alexander Review on Women in Leadership Positions and the Parker Report into Ethnic Diversity and recommended that the Board commit to improving gender and ethnic diversity on the Board and in the senior management roles within Serco. The Nomination Committee reviews and assesses the Board Diversity Policy annually and recommends any revisions to the Board for approval. Details of the Group's Gender Diversity Policy and how we support development of female talent within Serco are provided on page 76. The Board Diversity Policy is available on the Company's website.

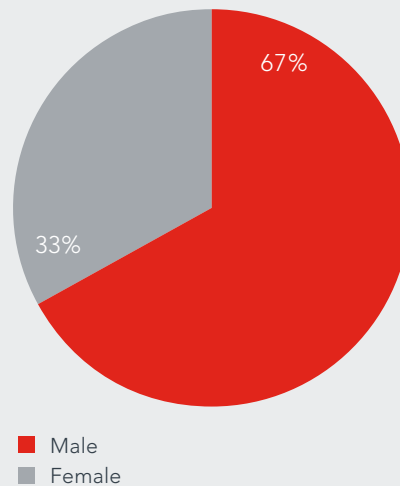
Performance review

The Committee's performance was assessed as part of the Board's annual effectiveness review. Although it was felt that the Committee worked effectively, it was agreed that the Committee should have a broader role and the general observation that changes of a procedural nature, including the more frequent review of processes, procedures and policies, would improve overall performance was considered appropriate to the Committee as well as the Board and will be implemented.

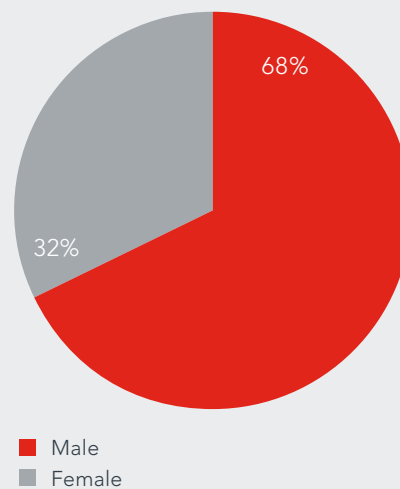
2019 priorities and focus

During 2019, the Committee will continue to focus on developing its approach to succession planning for the Board, its Committees and the wider management team.

Gender diversity: Board



Gender diversity: Senior Management



Corporate Governance Report

Corporate Responsibility Committee Report

Corporate Responsibility Committee members

Kirsty Bashforth (Chair)
Eric Born
Ian El-Mokadem
Sir Roy Gardner
Rupert Soames

Dear Shareholders

It has been three years since the new Corporate Responsibility Committee separated from the Group Risk Committee to focus on the continuation of our corporate renewal whilst driving the maturity and strategic alignment of our corporate responsibility agenda. In that time, we have witnessed the business transformation gather pace, building on the foundations laid in 2014-15 and underpinning Serco's future growth.

The Corporate Renewal Programme has been a core element of our stabilisation, but it represents more than just a milestone in Serco's history. Through the steps we have taken and the lessons we have learned, the principles of corporate renewal have become, and must continue to be, embedded in our culture, our ways of working and our relationships with stakeholders.

Alongside other key components in our corporate strategy today, the momentum and direction of our corporate responsibility agenda is an important outcome of our renewal and ongoing development. Intensifying external scrutiny and focus on responsible business practice continues to challenge all organisations globally and we are proud that the business continues to respond with drive and commitment.

As Serco moves from renewal towards growth, the Committee's agenda evolves and so too does its membership. Mike Clasper, Chair of the Committee since 2016, left with his departure from the Board at the end of the year. I would like to thank Mike for his contribution to developing the Committee and clarifying its focus. I would also like to welcome Eric Born to the Committee, who has joined us following his appointment to the Board.

I was honoured to be asked to chair the Corporate Responsibility Committee. The Committee's remit, including oversight of ethics and business conduct, culture and employee engagement, approach to stakeholder relationships and ongoing corporate renewal activity, provides an ideal arena for assuring the integrity of the business and its approach to responsible operation and growth. The next phase in Serco's evolution and performance promises to be the most engaging yet and, together with my fellow Committee members, I look forward to overseeing and reporting our progress.



Kirsty Bashforth

Chair of the Corporate Responsibility Committee
20 February 2019

Committee's responsibilities

The Committee is responsible for overseeing and considering the Group's current and future approach regarding all aspects of corporate responsibility as defined by the Corporate Responsibility Framework.

The Committee also reviews and scrutinises the Group's continued approach to corporate renewal.

The Terms of Reference for the Committee are available on the Company's website.

Membership and attendees

The Committee is comprised of both Executive and Non-Executive Directors and biographical details for each member of the Committee are provided on pages 84 and 85.

The Committee met three times during the year and details of Committee membership and attendance at meetings are set out on page 89. Meetings of the Committee are normally attended by the Group General Counsel and Company Secretary, the Group HR Director, the Director, Business Compliance and Ethics, and the Managing Director, Group Operations.

Activities of the Committee during 2018

Key activities included:

- supporting the embedding of the Serco Corporate Responsibility Framework whilst ensuring it remains integral to the Group's public purpose and responsibilities;
- monitoring and reviewing the progress of the Corporate Renewal Programme, including: the findings of the annual SMS self-assessment process and compliance assurance programme; ongoing contract management performance and reporting; and in-depth analysis of progress in our Americas and Asia Pacific Divisions;
- ratification of the refreshed Group Health, Safety and Environment (HSE) strategy and monitoring and reviewing the Group's HSE performance, including: lessons learnt and action plans from specific incidents, an overview of HSE governance and oversight, specific initiatives to drive continuous improvement and in-depth analysis of marine safety and physical assaults;
- monitoring and reviewing the Group's Ethics and Speak Up performance, including: trends, resolution times, investigation outcomes, lessons learnt and specific initiatives to drive continuous improvement;
- reviewing the culture of the Group through analysis of the Culture Index generated by the annual 'Viewpoint' employee engagement survey;
- in-depth analysis of the Group principal risk, failure to act with integrity;
- preparation of the Group's annual Corporate Responsibility Report and Modern Slavery Statement; and
- changes to Committee membership – Kirsty Bashforth was appointed Chair of the Committee following Mike Clasper's decision to stand down from the Board, with effect from 1 January 2019. Newly-appointed Non-Executive Director, Eric Born was also appointed to the Corporate Responsibility Committee with effect from 1 January 2019.

2019 priorities and focus

During 2019, the Committee will:

- continue to undertake deep dives into key areas within its remit to ensure appropriate focus, control and rigour throughout the Group, including a review of Corporate Renewal Programme progress in our Middle East and UK & Europe Divisions;
- continue to support embedding the Serco Corporate Responsibility Framework whilst ensuring it remains integral to the Group's public purpose and responsibilities;
- review the Committee's position, focus and approach regarding corporate renewal and corporate responsibility to ensure they remain appropriate, embedded in the business and conducive to the ongoing delivery of the Group strategy;
- oversee the implementation of the Group's Business Integrity Compliance Plan and continue to challenge the integrity and effectiveness of Speak Up, including the strengthening of trust in the process;
- oversee the effective implementation of the refreshed Group HSE strategy; and
- review the approach adopted to further ensure workforce engagement in accordance with the provisions of the 2018 UK Corporate Governance Code.

Corporate Governance Report

Compliance with the UK Corporate Governance Code

This section of the Corporate Governance Report describes how the Company has complied with the principles of the UK Corporate Governance Code ("the Code") published by the Financial Reporting Council on 27 April 2016 and which is available at www.frc.org.uk. It should be read in conjunction with the Corporate Governance Report as a whole, set out on pages 83 to 103.

The Company has complied in full with the Code during 2018.

A. Leadership

A.1 The Role of the Board

The Board is collectively responsible to the Company's shareholders for promoting the long-term success of the Company and the operation of effective governance arrangements. It oversees and agrees the Group's strategy and ensures that necessary resources are available, and that the appropriate risk management controls, processes and culture are in place to deliver it. As well as oversight, responsibility for financial performance, internal control and risk management of the Group, there is a schedule of matters reserved to the Board.

The Board meets formally on a regular basis. All Directors are expected to attend all Board and relevant Committee meetings in addition to general meetings of the Company, including the Annual General Meeting ("AGM"). Details of the number of Board and Committee meetings held during 2018 and the Directors' attendance are shown on page 89.

A.2 Division of responsibilities

The roles and responsibilities of the Chairman and Chief Executive are separate and are clearly defined, documented and approved by the Board.

Sir Roy Gardner, the Chairman, leads and is responsible for the operation of the Board. Rupert Soames, the Group Chief Executive, leads the business to develop and deliver the Group's strategy and business plans as agreed with the Board.

A.3 The Chairman

The Chairman, in consultation with the Company Secretary, sets the Board's agenda. Meetings are arranged to ensure sufficient time is available for the discussion of all matters, in particular strategic issues. The Chairman encourages open and constructive dialogue during the meetings. The Chairman was independent on appointment.

A.4 Non-Executive Directors

Non-Executive Directors are urged to challenge constructively and help develop proposals on strategy, scrutinise the performance of management in meeting agreed goals and objectives, and monitor the reporting of performance. As part of the business planning process, all Directors attend the annual Board Strategy Day at which the future direction of the Company is considered.

The Senior Independent Director is available to address shareholders' concerns regarding governance. He is also available to address concerns on other issues as an alternative contact to the Chairman, Group Chief Executive or Group Chief Financial Officer. A description of the key responsibilities of the Senior Independent Directors is available on the Company's website.

The Chairman meets with the Non-Executive Directors without the Executive Directors present. At least annually, the Non-Executive Directors, led by the Senior Independent Director, meet without the Chairman present.

During the year, the Directors had no unresolved concerns about the running of the Company or any proposed action. It is Company policy that any such unresolved concern would be recorded in the Board minutes.

B. Effectiveness

B.1 Composition of the Board

As at the date of this report, there are six Non-Executive Directors, in addition to the Chairman and two Executive Directors on the Board.

During the year, the Board reviewed the overall balance of skills, experience, diversity, independence and knowledge of Board and Committee members and concluded that the Board was of an appropriate size to meet the requirements of the business.

In accordance with the Code, the Board undertakes an annual review of the independence of its Non-Executive Directors. The Board considers each of the Non-Executive Directors to be independent and free of any business relationships that could compromise the exercise of independent and objective judgement.

B.2 Appointments to the Board

The Nomination Committee, which is chaired by the Company's chairman, leads the process for Board appointments, with the assistance of an external search company, and makes recommendations to the Board. All appointments are made on merit against objective criteria. Non-Executive Directors are appointed for periods of three years and any term beyond six years would be subject to rigorous review. All Directors submit themselves for re-election at each annual general meeting.

Eric Born was appointed as Non-Executive Director on 1 January 2019. Full details regarding the appointment process are given in the Nomination Committee report.

B.3 Commitment

The time commitment of Non-Executive Directors is defined on appointment and regularly evaluated. The Board is satisfied that each of the Non-Executive Directors is able to devote sufficient time to the Company's business. Executive Directors are encouraged to take on non-executive roles to broaden their experience, subject to the Board's approval and the time commitment required. Angus Cockburn is a non-executive director, Chair of the Audit Committee and a member of the Nomination and Remuneration Committee of Ashted Group plc. Rupert Soames has been appointed as a non-executive director and a member of the Audit, Nomination and Remuneration Committees of DS Smith Plc with effect from 1 March 2019.

B.4 Development

A full, formal and tailored induction programme is provided to all Directors appointed to the Board, which takes into account their qualifications and experience.

The Chairman reviews and agrees Directors' training and development needs.

During the year, the Board received briefings from advisers on relevant topics designed to update Directors' skills and knowledge in particular areas. A number of the Non-Executive Directors also visited contract sites and attended Divisional management meetings to broaden familiarity with the Group's operations. Reports of such visits are shared with all Board members.

B.5 Information and support

The Directors have access to independent professional advice at the Company's expense as well as to the advice and services of the Company Secretary who advises the Board on corporate governance matters.

The Company Secretary ensures that information is received by the Board and its committees on a timely basis for them to review prior to meetings and ensures that board procedures are followed and that the Company and the Board operate within applicable legislation. The Company Secretary is also responsible for facilitating Directors' inductions, assisting with identifying and enabling appropriate training and board performance evaluation.

The appointment and removal of the Company Secretary is a matter for the Board as a whole.

The Chairman, in conjunction with the Company Secretary, ensures that all Board members receive timely, accurate and effective information.

B.6 Evaluation

The evaluation of the Board is externally facilitated every three years and in 2018 an external performance evaluation was undertaken by ICSA Board Evaluation Limited. Full details are given on page 90.

The Chairman reviews the performance of Non-Executive Directors annually and the Non-Executive Directors, led by the Senior Independent Director, are responsible for the Chairman's annual performance review.

Following the evaluation, the Directors concluded that the Board and its Committees operated effectively and that each Director contributes effectively and demonstrates commitment to their role.

B.7 Election/Re-election

Each Director is subject to election at the first AGM following their appointment, and re-election at each subsequent AGM. All Directors will stand for election or re-election at the 2019 AGM. Full biographical details for all Directors are on pages 84 and 85.

C. Accountability

C.1 Financial and business reporting

A statement of the Directors' responsibilities regarding the financial statements, including the status of the Company as a going concern, is set out on page 138 with an explanation of the Group's strategy and business model together with the relevant risks and performance metrics set out on pages 15 to 63.

A further statement is provided on page 138 confirming that the Board considers that the Annual Report and Accounts, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group's position and performance, business model and strategy.

The Audit Committee report on pages 94 to 99 sets out the details of the Committee's responsibility for ensuring the integrity of the financial reporting process and the key matters considered during the year in respect of its oversight of financial and business reporting.

C.2 Risk management and internal control

The Board, through the Group Risk and Audit Committees, has carried out a robust assessment of the principal risks facing the Company, including those that would threaten its business model, future performance, solvency or liquidity. Further details about these risks and how they are

managed and mitigated can be found on pages 54 to 63. The Viability Statement on pages 64 to 65 explains how the Directors have assessed the prospects of the Company and concluded that they have a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment.

The Board determines the Company's risk appetite and has established risk management and internal control systems. At least annually, the Board undertakes a review of their effectiveness. Further details are set out on pages 52 to 63 and 91 to 93.

C.3 Audit Committee and Auditors

The Audit Committee report on pages 94 to 99 sets out details of the composition of the Committee, including the expertise of members, and outlines how the Committee discharged its responsibilities during the year.

The Board has delegated a number of responsibilities to the Audit Committee, including oversight of the Group's financial reporting processes and management of the External Auditor. Full details are set out in the terms of reference of the Committee, which are available on the Company's website.

D. Remuneration

D.1 The level and components of remuneration

The Remuneration Report on pages 106 to 131 outlines the activities of the Committee during the year and sets out the Directors' Remuneration Policy table, including relevant remuneration components and how they support the achievement of the strategic objectives of the Group. The Annual Remuneration Report outlines the implementation of remuneration during the year (including salary, bonus and share awards).

D.2 Procedure

The Board has delegated a number of responsibilities to the Remuneration Committee, including the setting of the Group's overall remuneration policy and strategy, as well as the remuneration arrangements for the Executive Directors and the Executive Committee. Full details are set out in the terms of reference of the Committee which are available on the Company's website.

No Director is involved in setting his or her own remuneration.

E. Relations with shareholders

E.1 Dialogue with shareholders

The Board recognises that meaningful engagement with its institutional and retail shareholders is integral to the continued success of the Group. The Executive Directors and the Investor Relations team regularly meet with analysts and major investors to maintain effective dialogue. The Chairman is available and has met with a number of major investors. There has been active engagement with shareholders through meetings, presentations and roadshows throughout the year.

E.2 Constructive use of General meetings

At general meetings, proxy appointment forms enable shareholders to vote in favour of or against resolutions, or to withhold their vote. Proxy forms and announcements of results of votes make clear that votes withheld are not counted when calculating the results of the vote since they are not a vote in law.

All valid proxy appointment forms are recorded and counted and, after a vote has been counted, information regarding the proxy votes is given at the meeting and published on the Company's website.

Separate resolutions are proposed at general meetings on substantially separate issues.

Should a significant proportion of votes be cast against a resolution, the Company would explain, when announcing the result, what action it intends to take to understand the reasons behind the result.

Notice of general meetings is despatched to shareholders at least 14 working days in advance and, in the case of annual general meetings, at least 20 working days in advance.

All directors are required to attend annual general meetings and the chairs of each of the Board Committees are available to answer relevant questions.

The AGM will be held on Thursday 9 May 2019 and is an opportunity for shareholders to vote in person on certain aspects of Group business. The Board values the AGM as an opportunity to meet with those shareholders able to attend and to take their questions. The Notice of AGM is made available to all shareholders either electronically or, where requested, in hard copy and is available on the Company's website.

Remuneration Report

Report On Directors' Remuneration

Remuneration Committee members

Lynne Peacock (Chair)
Kirsty Bashforth
Sir Roy Gardner
John Rishton

Reward aligned to performance

Dear Shareholders

On behalf of the Board, I am pleased to present the Directors' Remuneration Report ("the Report") for Serco Group plc for the year ended 31 December 2018. The 2018 Report sets out how the Directors' Remuneration Policy ("the Policy"), approved at the 2018 AGM, has been implemented for 2018 and how the Policy will be implemented in 2019. No changes to the Policy are proposed for the coming year. A summary of the approved Policy is reproduced here for reference and the full Policy can be found in our 2017 Directors' Remuneration Report which is available on the Company's website.

This report has been drafted in compliance with the disclosure requirements of the UK Corporate Governance Code and the requirements of the UKLA Listing Rules. This Report also complies with the provisions of the Companies Act 2006 and the Large and Medium-sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013.

Context to the Committee decisions

Since the arrival of our current Executive Directors in 2014, the business has been through a major transformation, with the setting of a new business strategy, a Rights Issue, disposal of several businesses, rationalisation of the portfolio and mitigation of loss-making contracts. It is now a much stronger business, with a solid balance sheet and a restored reputation with customers.

As reported by the Chairman in his introduction to this year's Annual report, 2018 has been another successful year as we continued through the transformation phase of the 2015 plan and began to see the return to growth.

Despite market challenges, particularly in the UK, the management team has delivered a strong trading result, above that expected at the start of the year. Although bolstered by some non-recurring items, the strong profit growth in 2018 and increased margins also reflect both significant improvements in operational performance and cost reduction delivered through the transformation of the business to date. Order intake of £2.9bn has delivered a book-to-bill ratio of over 100%. Progress on delivering transformation savings and other cost efficiencies will continue into 2019, however 2018 marked the start of the delivery of the third phase of our corporate strategy, growth.

Implementing the Remuneration Policy approved in 2018

The Committee values its relationship with, and continued support from, shareholders and we were pleased to receive strong support for our new Directors' Remuneration Policy at the 2018 AGM. Through the new Policy we refreshed the focus on value creation and share ownership, and reinforced the alignment of the high calibre executives (appointed in 2014) with the completion of the transformation and the delivery of the outcomes previously committed to shareholders. The Policy, which is supported by our Executive Team, aims to ensure remuneration remains aligned with our key corporate goals and shareholders' expectations, and that it motivates and compensates senior management fairly for their contribution to the business.

During 2018 we have achieved simplification of our long-term incentive arrangements, with the removal of the Deferred Bonus Plan, which also resulted in a significant reduction in remuneration opportunity for both the Chief Executive Officer (CEO) and Chief Financial Officer (CFO). Good practice measures have also been introduced in 2018, including the mandatory 3 year deferral into shares of any bonus earned over 100% of salary in respect of performance over 2018 (these bonuses are disclosed in the report that follows).

As previously communicated, the last award under the legacy Deferred Bonus Plan was made to the Executive Directors in 2018 in respect of the deferral of part of the bonuses earned against performance in 2017 and in line with the Remuneration Policy approved by Shareholders in respect of remuneration for that financial year.

Summary of key decisions taken in 2018

- Confirmation of 2018 vesting of the 2015 Performance Share Plan (PSP) awards which vested at 66.67% and the 2015 Deferred Bonus Plan (DBP) Matching Share Awards which vested in full.
- Determination of vesting of the 2014 PSP and Recruitment Awards granted to the CEO and CFO that were subject to Absolute Share Price performance conditions assessed during the year. The Absolute Share Price elements did not vest as the minimum performance was not achieved.
- Assessment of performance for the 2018 Annual Bonus. It was determined that the CEO should receive a bonus of 77.1% of maximum and the CFO a bonus of 75.6% of maximum.
- Assessment of performance for the 2014 PSP Awards five year EPS element, 2016 DBP and 2016 PSP Awards (EPS and ROIC tranches) with performance periods ending in FY18 and vesting in 2019.
- Determination of DBP Matching Share Awards granted in connection with the deferral of 2017 bonuses under the 2017 Remuneration Policy, and awards granted under the PSP in June 2018.
- Determination of a nil salary increase for the CEO and a 2% increase for the CFO in 2019.
- Review of the TSR performance condition and peer group used in the PSP awards and confirmation that this appropriately aligns the PSP awards with shareholder experience.
- Preparation of new share plan rules including the determination of a revised list of triggers for both malus and clawback to be applied in line with the approved Policy reflecting current market practice and the latest Corporate Governance Code Guidance.

Remuneration linked to delivery of the strategic plan – 2018 variable pay outcomes

Overall, the Company's strong performance has delivered the incentive outcomes in 2018 summarised below.

KPI	Plan	2018 performance	2018 incentive outcome
Trading Profit	Annual Bonus	£105.9m ¹	●
Revenue	Annual Bonus	£2,902.0m ¹	●
Free Cash Flow	Annual Bonus	(£25.0m) ¹	●
Relative TSR	PSP	Below Median	●
Average ROIC	PSP	11.7%	●
Aggregate EPS	PSP & DBP	17.58p	●

1. At constant currency.

- Below Threshold
- Between Threshold and Target
- Between Target and Max

Remuneration Report continued

Report On Directors' Remuneration continued

In addition to these specific performance targets, the Committee also considered the Company's performance as a whole when deciding on levels of payout for the Annual Bonus and PSP, as well as when determining any salary increases for the coming year, to ensure that the overall remuneration packages continue to reflect Company performance.

Annual bonus payments are based on a combination of financial targets (70% weighting) and personal objectives linked to the delivery of the Group's operational and strategic priorities (30%). The strong financial performance in the year saw significant increases to trading profit in 2018 with trading profit for bonus purposes assessed to be £105.9m, and the achievement of positive Free Cash Flow of £25m for the first time in four years. The Committee also considered the performance of each Executive Director against his personal objectives and, taking into consideration all factors, it was agreed that bonuses of 77.1% and 75.6% of maximum should be awarded to the CEO and CFO respectively. These bonuses, to the extent they are over 100% of salary, are subject to mandatory deferral into shares for three years, therefore 26% of the bonus awarded to the CEO and 15% of the bonus awarded to the CFO will be deferred. Full details of the annual bonus outcomes are set out on pages 116 to 118.

Long term incentives with performance periods ending in 2018 were determined to have mixed vesting outcomes reflecting the challenges faced by the Group since the awards were granted. In particular, it was determined that the final tranche of the 2014 PSP awards (subject to a five year EPS condition and due to vest in 2019) will not vest. This means that overall 0% of the 2014 annual PSP award, granted to the Executive Directors, vested. The performance period for the TSR tranche of the 2015 PSP award ended in 2018. Despite the recent financial performance of the Group, over the relevant performance period the minimum TSR required for vesting was not met. When combined with the EPS and ROIC tranches of the 2015 PSP awards, which were disclosed in the 2017 DRR, the overall vesting outcome was 66.67% which the Committee agreed was an appropriate outcome. Of the annual PSP and DBP awards granted in 2016, which will vest in 2019, the performance period for the EPS (both PSP and DBP) and ROIC (PSP only) tranches has now completed. On assessment of the financial performance, the maximum EPS and ROIC targets were exceeded. The Committee determined that it was appropriate for these tranches to vest in full recognising the achievements made by the Executive team and senior management in transforming the business. The long term incentive outcomes are discussed further on pages 119 to 120.

Implementation of the remuneration policy in 2019 Salary

Base salaries for the CEO and CFO were set in a way which reflected the needs of the business at the time they were recruited in 2014, and the experience they both brought to the roles. Given the circumstances at the time, and their positions as experienced leaders of a FTSE 100 business, the Committee recognised that it would have to pay highly (relative to FTSE 250 companies) to attract them to what was then a business with a number of very significant challenges to face. Shareholders gave overwhelming support to their appointment and subsequently to their remuneration.

Following the departure of the Chief Operating Officer (COO) at the end of 2017, the key duties he fulfilled have been shared amongst the remaining Executive Directors and the Executive Committee. Recognising the additional responsibilities taken on following the departure of the COO, the key role the CFO has played in the transformation of Serco and the value he continues to bring to the business, the Committee has determined to increase his base salary in 2019 by 2%. This is in line with the increase for the wider workforce. This is the first increase in base salary for the CFO since joining Serco in 2014. No increase to base salary is proposed for the CEO, for the fifth successive year.

Bonus

Bonus targets are set to reflect the opportunities and challenges that the Company is likely to face in the coming year, and are based on trading profit, cash and revenue, together with key operational and strategically aligned personal objectives. Any bonus earned over 100% of salary will continue to be subject to compulsory deferral into shares for three years.

LTIP

In line with the policy approved in 2018, long-term incentive awards will be granted to Executive Directors with a combination of financial measure (85% of the award split equally between EPS, TSR and ROIC) and strategic objectives (15% of the award split equally between employee engagement and order-book goals). The Committee has determined that these measures remain aligned with the strategic plan and targets will be set taking into consideration the challenging market conditions and market consensus.

Consideration of wider workforce remuneration

Whilst the Committee's primary purpose is the governance of pay for Executive Directors, we continue to exercise oversight of remuneration for senior management and take into consideration pay policy across the wider workforce as part of our decision-making process. The Committee also reviews the gender pay gap reporting requirements (for which the 2018 report may be found on our website) and the remuneration practices across the Group. To further support our decision making and the alignment of executive pay with the wider workforce, we are incorporating more detailed updates from management on the pay and working practices across the workforce into our annual programme of work. This will be supported by the developments to our 'employee voice' mechanism through which we will improve the clarity and extent of the feedback from this key stakeholder group.

Shareholder engagement

Further to the 2017/18 consultation with our main shareholders and investor agencies on our new remuneration Policy, we contacted our top shareholders to share updates and invite feedback on how that Policy had been implemented during 2018, and the implementation plans for 2019, which are shared here in more detail. In addition, our Investor Relations team are in regular contact with our shareholders and share any feedback or queries on remuneration throughout the year so that we can maintain an ongoing dialogue.

Concluding comments

On behalf of my colleagues on the Committee, we appreciate the input and support we have received on the implementation of our Policy in 2018. The Committee believes that the Policy has, and will continue to, ensure that our executive management team are rewarded for and incentivised to achieve completion of the Transformation phase and the continued delivery of the Growth phase of our strategy.

On behalf of the Board:



Lynne Peacock

Chair of the Remuneration Committee
20 February 2019

Remuneration Report continued

The Remuneration Committee

The role of the Committee is to determine and recommend to the Board a fair and responsible remuneration framework that aligns the executive management team to shareholders' interests and is designed to reward and incentivise them appropriately for their contribution to Group performance. The Committee's primary focus is to ensure a clear link between reward and performance. This means ensuring that the policy, structure and levels of remuneration for Executive Directors reinforce the strategic aims of the business and are appropriate given the market context in which Serco operates and the reward strategy throughout the rest of the business.

The Committee's composition, responsibilities and operation comply with the principles of good governance as set out in the UK Corporate Governance Code, with the Listing Rules and with the Companies Act 2006. The Terms of Reference of the Committee are available on the Company's website.

Members of the Committee and attendees

All members of the Committee are independent, Non-Executive Directors of the Group, initially appointed for a three-year term. That appointment may be terminated on three months' written notice. Lynne Peacock joined the Committee on 1 July 2017 and has been Chair of the Remuneration Committee since 15 September 2017. Sir Roy Gardner, John Rishton and Kirsty Bashforth have been members of the Remuneration Committee since 1 June 2015, 13 September 2016 and 15 September 2017 respectively.

In addition, the following individuals attended the Remuneration Committee meetings during the year:

	Position	Comments
Rupert Soames	CEO	Attended by invitation
Anthony Kirby	Group HR Director	Attends as an executive responsible for advising on the People Strategy
Nigel Crossley	Group Financial Controller	Attended by invitation
Tara Gonzalez	Group Reward Director	Attends as an executive responsible for advising on the Remuneration Policy
Lianne Dance from December 2018	Group Head of Reward	
David Eveleigh	Group General Counsel & Company Secretary	Attends as the secretary to the Committee
Chandrika Kher until February 2018/ Stuart Haydon from May 2018 as Interim	Deputy Company Secretary	Attends as the secretary to the Committee
PricewaterhouseCoopers LLP	External advisers to the Remuneration Committee	Attend when required as the independent advisers to the Committee

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

Summary of the Committee's activities during the financial year

Meeting	Regular items
February	Considered feedback from the shareholder consultation on the 2017 Policy Review; agreed new Remuneration Policy to be put to shareholders at the 2018 AGM; considered base pay of Executive Directors and members of the Executive Committee; considered performance against 2017 targets and confirmation of 2017 bonus payable; reviewed achievement of performance conditions for the long term incentives vesting in respect of awards granted in 2015; set performance targets and objectives for 2018; reviewed and approved the 2017 Remuneration Report; received an update on the 2017 UK Gender Pay Report; and received an update on draft remuneration related amendments to the UK Corporate Governance Code.
May	Considered administrative changes to the PSP Rules and the Share Dealing Code; considered AGM voting outcomes; confirmed the TSR vesting outcome for the relevant tranches of PSP and Recruitment Awards granted in 2014; approved the rules to support the new compulsory bonus deferral; considered the pay philosophy and principles relating to members of the Executive Committee and the approach to benchmarking the remuneration for these roles; received a market practice and Corporate Governance update regarding executive remuneration; and considered the forward agenda and timing of meetings for 2019.
September	Reviewed progress of Executive Directors against annual bonus targets and objectives; considered share based reward policy below main Board considering market trends and corporate governance updates with a view to preparing new plan Rules for 2019; considered shareholder engagement; received and discussed remuneration related governance updates in respect of the Directors' Remuneration Report, UK Corporate Governance Code and BEIS 'Delivering on Fair pay' recommendations; received an update on the review of the wider senior management team at Serco; and considered the review of the TSR comparator group following a review to ensure it remains appropriate.
December	Reviewed the proposed approach to the structure of the Remuneration Report; reviewed the Committee's annual programme of work; considered base pay of Executive Directors and Executive Committee members for 2019; considered the grant policy to apply to annual long-term incentive awards in 2019; received an update on in-flight share awards and performance tracking for these; considered the detail for the 2018 UK Gender Pay Report; reviewed new share plan Rules for 2019; and received an update on the global review of senior management and considered the proposed reward strategy, remuneration framework and incentive recommendations from this.

Advisers to the Remuneration Committee

The Committee has been advised during the year by PricewaterhouseCoopers LLP (PwC). PwC were selected as advisers to the Committee through a competitive tendering process in 2012 and no conflicts of interest were identified. PwC have provided advice throughout the year mainly around the following key executive reward areas:

- support in reviewing the Directors' Remuneration Report;
- design of performance conditions;
- informing the Committee on market practice and governance issues; and
- assistance with general and technical reward queries.

Fees paid to PwC as advisers to the Committee during the year totalled £42,100. Fees are charged on an hourly rate basis.

PwC are members of the Remuneration Consultants' Group, which oversees the voluntary code of conduct in relation to executive remuneration consulting in the UK.

The Committee reviews the objectivity and independence of the advice it receives from PwC each year. It is satisfied that PwC is providing robust and professional advice. In the course of its deliberations, the Committee considers the views of the CEO on the remuneration and performance of the other members of the Executive Committee.

Remuneration Report continued

At a glance: implementation of Remuneration Policy for 2019

There are no changes proposed to the Policy approved by shareholders at our 2018 AGM, a summary of which is set out at the end of this report. Our pay structure which will continue to apply in 2019 is summarised as follows:

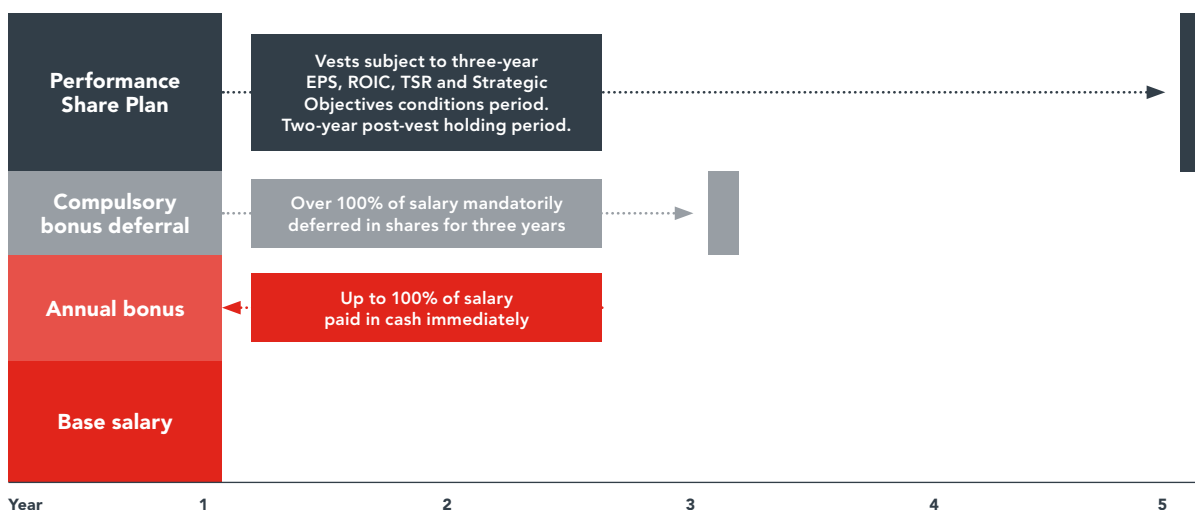


Chart is illustrative and is not to scale. Details of Executive Director remuneration for 2019 may be found on page 114. A summary of the Executive Remuneration Policy that was approved by shareholders at the 2018 AGM can be found on pages 126 to 131, the full approved 2018 Directors' Remuneration Policy is set out in the 2017 Director's Remuneration Report which is available via our website.

How our variable pay structure aligns to the core KPIs for 2019

Our aspiration is to be the best managed company in our sector. To achieve this we concentrate on doing four things really well; winning good business, executing brilliantly, being a place people are proud to work and being profitable and sustainable. Our variable pay for 2019 aligns to this through the targets set against a number of our core KPIs, each of which has an important role in realising this aspiration. Total Shareholder Return aligns variable pay with value created for shareholders.

Core KPIs		Annual bonus	PSP
Financial	Non-financial		
Trading Profit		✓	
Revenue		✓	
Free Cash Flow		✓	
	In-year non-financial objectives	✓	
Relative TSR			✓
Average ROIC			✓
Aggregate EPS			✓
	Growth-aligned strategic objectives		✓

The following charts illustrate the value that may be delivered to Executive Directors under different performance scenarios for the year ending 31 December 2019.



The scenarios in the above graphs are defined as follows:

- Fixed elements of remuneration:
 - base salary as applicable from 1 April 2019;
 - estimated value of benefits to be provided in 2019 in line with the Remuneration Policy (based on the value of actual benefits provided in 2018); and
 - pension contribution/cash supplement equal to 30% of salary.
- Annual bonus and Performance Share Plan participation as set out in the Policy table. In all cases, target performance results in delivery of 50% of maximum opportunity. The Performance Share Plan values reflect the 'face value' at grant of shares that could be received for target and maximum performance. The Performance Share Plan value under the maximum scenario is also shown assuming 50% share price appreciation over the performance period.

Remuneration Report continued

Implementation of Remuneration Policy for 2019 – Executive Directors

Element	CEO (Rupert Soames)	CFO (Angus Cockburn)
Base salary from 1 April 2019 ¹	£850,000	£510,000
Pension*	30% of salary	30% of salary
Annual bonus	Max 175% of salary On-target 87.5% of salary	Max 155% of salary On-target 77.5% of salary
	Compulsory three-year deferral into Serco shares of bonus over 100% of salary	
Annual bonus measures ²		
Performance Share Plan (PSP)	Maximum 200% of salary	Maximum 175% of salary
PSP measures ³ Assessed over the three-year performance period	<p>Awards granted under the PSP in 2019 will be subject to Group performance over a three-year period ending 31 December 2021.</p> <p>For 2019, 85% of the award will be based on financial measures split equally between:</p> <ul style="list-style-type: none"> Aggregate EPS – Statutory Earnings Per Share (EPS) before exceptional items (adjusted to reflect tax paid on a cash basis), measured as an aggregate over the performance period. Relative TSR – Total Shareholder Return (TSR) when ranked relative to companies in the FTSE 250 (excluding investment trusts). Average ROIC – Pre-tax Return on Invested Capital (ROIC), measured as an average over the performance period. <p>For 2019 the remaining 15% will be based on Strategic Objectives – performance targets for the awards granted in 2019 will be based on improvements in order book and employee engagement, which are critical to delivering the business strategy over the next three years. The Committee has concluded that a weighting of 15% for strategic measures and 85% for financial measures is an appropriate balance.</p>	
Holding requirement	Vested shares from the PSP must be held for two years post-vesting (after payment of tax).	
Shareholding guideline	200% of salary	150% of salary
Malus and clawback	Malus provisions and clawback provisions apply to PSP awards during the three-year performance period prior to vesting and the two-year post-vesting holding period, respectively. Clawback provisions apply to the annual bonus plan.	

- Following the resignation of the Chief Operating Officer at the end of 2017, the CFO took on additional responsibilities. He has also been instrumental in the delivery of the transformation to date and therefore it was agreed to award him a 2% increase for 2019 in line with the increases to be given to the wider workforce. This is the first increase in base salary for the CFO since joining Serco in 2014. No increase to base salary is proposed for the CEO for the fifth successive year.
- The Committee deems the specific details of the performance measures and targets to be commercially sensitive as they are intrinsically linked to the forward-looking strategic plans of the business. Full disclosure will be provided in the Annual Report on Remuneration for the year in which final performance is assessed provided these details are no longer considered sensitive.
- The Committee sets the performance targets in respect of the PSP immediately prior to the grant of the award and therefore these are not yet determined. Details of the performance targets will be disclosed in the Annual Report on Remuneration for the year in which the awards are made to the extent that they are not deemed commercially sensitive at that time. Full retrospective disclosure will be made of any details that are withheld once this information is no longer deemed commercially sensitive by the Committee.

* the pension contribution rate for any new directors is set as a maximum of 20% of salary

Implementation of Remuneration Policy for 2019 – Non-Executive Directors

Following changes to the Non-Executive Directors and their committee memberships a review of the fees for Non-Executive Directors was undertaken. In line with the approved Non-Executive Directors' Remuneration Policy, the fees for the period from 1 January 2019 will be as follows.

	Base fee to apply from 1 January 2019 £	Base fee 1 April 2018 £	Change £
Element – Annual Board and Committee fees			
Chairman	250,000	250,000	No change
Senior Independent Director	15,000	25,000	(10,000)
Board fees	53,000	50,000	3,000
Audit Committee Chairmanship	12,500	12,500	No change
Audit Committee membership	5,000	5,000	No change
Corporate Responsibility Committee Chairmanship	12,500	No fee payable	New fee
Corporate Responsibility Committee membership	5,000	5,000	No change
Group Risk Committee Chairmanship	12,500	15,000	(2,500)
Group Risk Committee membership	5,000	8,000	(3,000)
Remuneration Committee Chairmanship	12,500	10,000	2,500
Remuneration Committee membership	5,000	5,000	No change
Element – travel allowance			
Allowance for travel to international meetings	No longer available	5,000	Removed

The fees for Non-Executive Directors were last reviewed with effect from 1 April 2018 when a membership fee of £5,000 per annum for the Corporate Responsibility Committee was introduced. No fee, however, was introduced for chairing this Committee as this was chaired by the Senior Independent Director who was already in receipt of an additional fee. Following changes to the roles held by Non-Executive Directors a fee has been introduced for chairing the Corporate Responsibility Committee and the Senior Independent Director fee has been reduced.

No additional fee is payable for the Chair or membership of the Nomination Committee.

The Chairman does not receive any additional fees for his committee memberships nor do the Executive Directors where they sit on Board committees.

Dates of Directors' service contracts/letters of appointment

Directors who served on the Board during the financial year ended 31 December 2018.

Director	Date of appointment to the Board
Rupert Soames	8 May 2014
Angus Cockburn	27 October 2014
Sir Roy Gardner	1 June 2015
Mike Clasper ¹	3 March 2014
Rachel Lomax	3 March 2014
John Rishton	13 September 2016
Lynne Peacock	1 July 2017
Ian El-Mokadem	1 July 2017
Kirsty Bashforth	15 September 2017

Notes:

1. Mike Clasper resigned on 31 December 2018.

Each Director is subject to election at the first AGM following their appointment and re-election at each subsequent AGM.

Remuneration Report continued

Annual Report on Remuneration

The implementation of the Remuneration Policy for year ended 31 December 2018

The Remuneration Policy applied for the year ended 31 December 2018 was consistent with the Policy approved by shareholders at the AGM in 2018.

Single Figure – Directors' remuneration (audited information)

Executive Directors' single figure

The following table shows a single total figure of remuneration in respect of qualifying services for 2018 for each Executive Director, together with comparative figures for 2017. Details of Non-Executive Directors' fees are set out in the next section.

All figures in £	Rupert Soames		Angus Cockburn	
	2018	2017	2018	2017
Salary	850,000	850,000	500,000	500,000
Taxable benefits ¹	38,865	40,232	53,889	63,317
Pension ²	255,000	255,000	150,000	150,000
Total fixed remuneration	1,143,865	1,145,232	703,889	713,317
Bonus ³	1,146,863	956,505	585,900	489,580
Long term incentives ^{4,5}	2,187,373	1,579,261	1,120,493	543,399
Total variable remuneration	3,334,236	2,535,766	1,706,393	1,032,979
Total	4,478,100	3,680,998	2,410,282	1,746,296

Notes:

- The taxable benefits relate to the provision of independent financial advice, a car or car allowance (fully inclusive of all scheme costs including insurance and maintenance), health care and private medical assessments, as well as taxable business expenses. Where Serco settles the PAYE and NIC liability in respect of benefits provided, the value of the benefit has been grossed up at the individual's marginal tax rate. Rupert Soames' 2018 taxable benefit includes £23,367 company car benefit. Angus Cockburn's 2018 taxable benefit includes £21,716 (on a grossed up basis) for travel between his home, in Scotland, and London. The 2017 taxable benefit values have been restated to include taxable benefits provided in the period but not previously disclosed.
- The pension amount includes payments made in lieu of pension, calculated as a percentage of base salary, from which the Executive Directors make their own pension arrangements.
- Performance bonuses earned in the period under review, but not paid until the following financial year. For 2018 this figure includes £296,863 of Rupert Soames' and £85,900 of Angus Cockburn's 2018 bonuses which will be subject to mandatory deferral into Serco shares for a three year period at the point the bonuses are paid in 2019. During the year Rupert Soames participated in the DBP for the last time, voluntarily deferring 25% of his 2017 bonus paid in 2018 via the purchase of Investment Shares.
- This is the estimated or actual value of long-term incentives for which the performance period ended in the year. The 2014 PSP Awards and 2014 Recruitment Awards granted to Rupert and Angus that were subject to an Absolute Share Price performance condition, and the 2015 PSP Awards that were subject to TSR performance (for which the performance period in each case ended 22 February 2018) did not meet the minimum criteria for each condition and therefore these awards lapsed in full. The 2014 PSP Awards granted to Rupert and Angus that were subject to a five year EPS performance condition (for which the performance period ended 31 December 2018) did not meet the minimum criteria and therefore these awards will also lapse in full in 2019. The 2016 PSP Awards that were subject to EPS and ROIC performance, and the 2016 DBP Awards subject to EPS performance, for which the performance periods ended 31 December 2018, are reported for 2018 on an estimated basis. Further details are provided on pages 119 to 120.
- The long-term incentive values reported for 2017 have been restated to reflect the actual share price at the relevant vest dates for the Awards.

Variable pay outcomes (audited information)

Performance-related annual bonus

For 2018, the Executive Director bonus was based on achieving a mix of financial and non-financial objectives which were weighted 70:30 respectively. The financial measures were based on Trading Profit (40%), Free Cash Flow (40%) and Revenue (20%) and the non-financial measures were individually set and based on key strategic goals. Payments under the 2018 annual bonus were subject to an Underlying Trading Profit underpin (after adjustment for in-year Onerous Contract Provisions (OCP) items) of £89.5m at constant currency rates.

The Remuneration Committee reviewed the achievements against the targets for the year and the proposed annual incentive payments for the Executive Directors. The tables below show the achievement against the financial and non-financial measures.

Financial performance

Performance measure	Weighting for 2018 (% maximum bonus opportunity)	Threshold target (£m)	Target (£m)	Maximum target (£m)	Actual Performance ¹ (£m)	Achievement against measure (% maximum opportunity for this measure)
Revenue	14%	£2,970	£3,127	£3,283	£2,902.0	0%
Free Cash Flow	28%	£(6.4)	£9.2	£25.0	£25.0	100%
Trading Profit	28%	£89.5	£94.0	£107.5	£105.9	95%

- At constant currency.

Non-financial performance

Weighting for 2017 (% maximum opportunity)	30%	
	Rupert Soames	Angus Cockburn
Achievement against measure (% maximum opportunity for this measure)	75.0%	70.0%

Overall 2018 bonus outcome

	Rupert Soames	Angus Cockburn
Total bonus payable as % of maximum	77.1%	75.6%
Bonus opportunity as % of salary	175%	155%
Bonus amount achieved as % of salary	134.9%	117.2%
Bonus amount earned	£1,146,863	£585,900

Financial performance for 2018 has been strong; both Trading Profit and Free Cash Flow performance exceeded the stretching targets set by the Committee at the beginning of the year, with significant growth in the Underlying Trading Profit and positive Free Cash Flow achieved for the first time since 2014. Therefore, these components were determined to pay out at 95% and 100% of maximum respectively. The level of Revenue achieved over the period was below threshold and as such none of this component of the bonus was awarded.

The financial bonus outcomes have been calculated after appropriate adjustments, which were agreed at the beginning of the year as part of the target-setting process and in line with the approach disclosed in respect of 2016. The Committee has once again spent considerable time reviewing the Trading Profit calculation for bonus purposes, initially working with management to determine a robust approach to decision-making, informed by a review of each individual contract and with cross-referencing to information shared with the Audit Committee. The Company's external auditors verified the extraction of figures appearing in the accounts and those tabled for bonus purposes, followed by a formal sign-off by the Audit Committee on the numbers used to determine bonus payments prior to decisions being made by the Committee. As a result of the rigour applied to this process, the Committee is satisfied that the annual bonus out-turn fairly reflects management performance in the year.

Trading Profit of £116.7m is adjusted by the Committee to arrive at a figure for Trading Profit for bonus purposes; shareholders were consulted on the principles behind these adjustments in early 2015, and the bonus outcomes for 2015, 2016 and 2017 reflected these principles, the purpose of which is to ensure that management are measured against their in-year performance and are not given credit for gains for which they have not materially influenced. The Committee has applied 2018 in a consistent manner to the principles established in 2015, 2016 and 2017.

The first adjustment is to put Trading Profit into constant currency, so that it is consistent with the targets set at the beginning of the year; this is a +£4.4m increase. The Committee then considers items to properly reflect management effort and in-year operational performance. The Committee has concluded that a total of -£15.2m should be deducted from Trading Profit in constant currency to arrive at a calculation of Trading Profit for bonus purposes in 2018; this compares with +£23.6m which was added to Trading Profit in 2017. The main difference between the two years is that in 2018 there was a +£13.0m net credit to Trading Profit related to Onerous Contract Provisions charges and releases which was excluded from Trading Profit for bonus purposes, whilst in 2017 there was a net charge of -£19.5m, similarly excluded.

For the purposes of comparison, the table below sets out the adjustments made by the Committee between Trading Profit and Trading Profit for bonus purposes in 2015, 2016, 2017 and 2018.

£'m	2018	2017	2016	2015
Trading Profit	116.7	54.0	100.3	137.6
Constant currency adjustment	4.4	(6.8)	(5.7)	7.7
Trading Profit at constant currency	121.1	47.2	94.6	145.3
Adjustment for bonus purposes	(15.2)	23.6	(20.9)	(32.9)
Trading Profit for bonus purposes	105.9	70.8	73.7	112.4
Underlying Trading Profit at constant currency	97.1	63.4	73.4	95.9

Remuneration Report continued

Rupert Soames

Rupert's objectives included:

- Improving Business Development performance to rebuild the pipeline, with focus on both new business wins and total wins including re-competes and extensions.
- Supporting the delivery of the Global Transformation.
- Promote Serco Thought Leadership around UK Government contracting practices and support the launch of the Serco Institute.

The Committee deemed performance to be very strong overall. Rupert has continued to show highly effective and visible leadership throughout 2018 and over the course of the last 12 months has achieved significant further progress in delivering the plan set out in 2015. He has delivered further transformation of the business, removing over £20m of costs in 2018, and has started to deliver against the third phase of the plan - growth. The Group signed contracts with a total value of £2.9bn during the year delivering a strong performance with our closing order book at its highest level since 2013 at £11.5bn. Over 40 contract awards in 2018 were worth more than £10m each. In addition, in the first 6 weeks of 2019 we signed our largest ever contract (AASC – accommodation and asylum services) in the UK, and a significant contract in Australia (NGHS – defence healthcare provision in Australia), on the back of significant efforts made during 2018. Rupert has delivered thought leadership around UK Government contracting practices, which is particularly important in the wake of the challenges facing our market, and the Group has successfully launched the Serco Institute which is a platform for all interested parties to share ideas regarding the delivery of public services. The Committee continue to monitor the successful embedding of values through the annual employee engagement survey "Viewpoint". Engagement in 2018 remained broadly the same as in 2017 when the Group recorded its highest score since the survey began in 2011; engagement is a key determinant of the future success of the business. Based on Rupert's achievement the Committee has awarded an above target but below maximum performance for the non-financial element relating to these objectives.

Angus Cockburn

Angus's objectives included:

- Improving Business Development performance to rebuild the pipeline, with focus on both new business wins and total wins including re-competes and extensions.
- Delivery of a refinancing strategy.
- Completion of the Global Finance Transformation with a number of key milestones agreed at the start of the year which built on progress made in the previous year.

Overall, the Committee deemed Angus's performance to be very strong against his objectives. Angus has made a significant contribution to the delivery of the strong performance in 2018 with significant growth in profits, net debt lower than we expected, positive free cash flow for the first time since 2014, and strong order intake. These are significant achievements in the current, challenging market in which Serco operates. Contract and Balance Sheet Onerous Contract Provision liability now stands at £79m, down from £146m in 2017 and £447m in 2014. Net debt reduced from £745m at the end of 2013 to £188m at the end of 2018, with Net Debt:EBITDA at 1.2x which is well within our medium-term target range of 1-2x. Angus delivered a successful refinancing of the Group's Revolving Credit Facility towards the end of 2018 providing £250m of committed funds for 5 years on substantially unchanged terms from the prior facility and at a lower amount (previously £368m) reflecting the much reduced need for debt in the business. The Global Finance Transformation has completed and Angus has delivered against the key milestones agreed at the start of the year. In terms of the Transformation Plan, operating costs reduced again in 2018 with a further £20m of costs removed from the business, which together with the strong profit performance resulted in margins expanding from 2.3% to 3.3%. Based on Angus's achievement the Committee has awarded an above target but below maximum performance for the non-financial element relating to these objectives.

Note:

1. Bonuses earned over 100% of salary are subject to mandatory deferral into Serco shares for 3 years.

Long term incentives

The long term incentives amount included in the 2018 single total figure of remuneration includes the following Performance Share Plan, Deferred Bonus Plan and Recruitment Awards.

Performance Share Plan (PSP)

A number of Performance Share Plan awards are included in the 2018 single figure of remuneration for the Executive Directors:

- the Absolute Share Price element of the 2014 Performance Share Plan (PSP) awards with a performance period ending on the announcement of the Company's 2017 results on 22 February 2018;
- the five year EPS element of the 2014 PSP awards with a performance period ending 31 December 2018;
- the TSR element of the 2015 PSP awards with a performance period ending on the announcement of the Company's 2017 results on 22 February 2018; and
- the elements of the 2016 PSP awards subject to EPS and ROIC performance in the period to 31 December 2018.

The above awards were granted in the form of nominal cost options.

The performance assessment and vesting outcome for each award is as follows:

Award	Performance condition	Relative weighting	Threshold* – 25% vesting	Maximum – 100% vesting	Actual	Percentage of max achieved
2014 PSP	Absolute Share Price	1/3	£4.50	£6.00	£0.91	0%
2014 PSP	Five year EPS	1/6	30.0p	35.0p	9.1p	0%
2015 PSP	Relative TSR ¹	1/3	Median ranking	Upper quartile ranking	Below median	0%
2016 PSP	Aggregate EPS ²	1/3	7.5p	9.1p	17.58p	100%
2016 PSP	Average pre-tax ROIC ³	1/3	8.4%	10.2%	11.7%	100%

Notes

1. The Company's TSR performance was assessed relative to the constituents of the FTSE 250, excluding investment trusts, over the period starting on the completion of the Rights Issue in 2015 and ending on 22 February 2018 with the announcement of the Company's results for the 2017 financial year.
2. The financial outturns supporting the three year aggregate EPS performance of 17.58p reflect reported values; being pre-IFRS 15 for 2016 and 2017, and post IFRS 15 for 2018. A separate internal assessment for the impact of IFRS 15 on Trading Profit was undertaken to support the Committee's assessment that the EPS performance related element of the 2016 PSP award should vest in full. The impact of IFRS 15 was determined to be relatively minor, and did not impact the vesting level of 100% for the EPS tranche of the 2016 PSP award.
3. ROIC targets for the 2016 PSP award were also set pre IFRS 15. The financial outturn above reflects the average of reported ROIC; being pre IFRS 15 for 2016 and 2017, and post IFRS 15 for 2018. As for the EPS vesting outcome, an adjusted calculation was also performed to assess the impact of IFRS 15 on the vesting outcome, and the impact on ROIC performance was determined to be minor, not affecting the vesting outcome.
4. In all cases 25% of the award vests at threshold performance, rising on a straight-line basis to 100% vesting at maximum performance.

Executive Director	Award	Date of grant	No. of shares awarded	No. of shares vesting	Vesting date	Share price at vest	Value of vesting	Value attributable to share price appreciation
Rupert Soames	2014 PSP (Abs SP)	27 June 2014	192,132 ¹	0	27 June 2018	£1.0080	£0	n/a
	2014 PSP (5yr EPS)	27 June 2014	96,066 ¹	0	27 June 2019	£0.9471 ²	£0	n/a
	2015 PSP (TSR)	29 May 2015	413,927	0	29 May 2018	£0.9670	£0	n/a
	2016 PSP (EPS)	6 April 2016	589,970	589,970	6 April 2019	£0.9471 ²	£546,958	£(7,909) ³
	2016 PSP (ROIC)	6 April 2016	589,970	589,970	6 April 2019	£0.9471 ²	£546,958	£(7,909) ³
Angus Cockburn	2014 PSP (Abs SP)	31 October 2014	121,747 ¹	0	31 October 2018	£0.9610	£0	n/a
	2014 PSP (5yr EPS)	31 October 2014	60,891 ¹	0	31 October 2019	£0.9471 ²	£0	n/a
	2015 PSP (TSR)	29 May 2015	213,051	0	29 May 2018	£0.9670	£0	n/a
	2016 PSP (EPS)	6 April 2016	303,661	303,661	6 April 2019	£0.9471 ²	£281,522	£(4,071) ³
	2016 PSP (ROIC)	6 April 2016	303,661	303,661	6 April 2019	£0.9471 ²	£281,522	£(4,071) ³

1. The number of shares under award was adjusted on the Rights Issue in 2015. These are the adjusted number of shares awarded.
2. As these awards are still to vest at the time of reporting the share price used (£0.9471) is the Q4 average closing share price to 31 December 2018.
3. The value included in the single figure reflects a small depreciation in the share price from that at grant (£0.9605) to the estimate of the share price at vest (based on the 2018 Q4 average share price).

Remuneration Report continued

Deferred Bonus Plan (DBP)

The performance period for the 2016 Deferred Bonus Plan (DBP) Matching Share Award (a conditional share award) wholly subject to EPS performance ended on 31 December 2018. 25% of this award vests for threshold performance of an Adjusted EPS of 7.5p rising on a straight-line basis to 100% vesting for at or above maximum performance of an Adjusted EPS of 9.1p measured as an aggregate over the three-year performance period. The Adjusted EPS for the period was measured as 17.58p therefore the 2016 DBP Matching Share Award will vest in full.

Executive Director	Date of grant	No. of shares awarded	No. of shares vesting	Vesting date	Share price at vest	Value of vesting	Value attributable to share price appreciation
Rupert Soames	3 May 2016	1,154,540	1,154,540	3 May 2019	£0.9471 ¹	£1,093,458	£(9,672) ²
Angus Cockburn	3 May 2016	588,589	588,589	3 May 2019	£0.9471 ¹	£557,449	£(4,931) ²

Notes:

- As these awards are still to vest at the time of reporting the share price used is the Q4 average closing share price to 31 December 2018.
- The value included in the single figure reflects a small depreciation in the share price from that at grant (£0.9555) to the estimate of the share price at vest (based on the 2018 Q4 average share price).

Recruitment Awards

The 2018 LTI value includes the element of the Recruitment Awards (in the form of nominal cost options) with performance periods ending in the relevant year which were granted in 2014 to Rupert Soames and Angus Cockburn subject to an Absolute Share Price performance condition. For the Absolute Share Price element, 25% of the award would vest for an average closing share price over the 30 days following the announcement of the Company's 2017 results of £4.50 rising on a straight-line basis to 100% vesting for an average closing share price of £6.00. The share price assessed at the end of the performance period was £0.91 which is below that required for threshold vesting and therefore this element lapsed in full.

Executive Director	Performance condition and relative weighting	Date of grant	No. of shares awarded ¹	No. of shares vesting	Vesting date	Share price at vest	Value of vesting
Rupert Soames	Absolute Share Price (40%)	27 June 2014	153,953	0	27 June 2018	£1.0080	£0
Angus Cockburn	Absolute Share Price (40%)	31 October 2014	112,714	0	31 October 2018	£0.9610	£0

Note:

- The number of shares under award was adjusted on the Rights Issue in 2015. These are the adjusted number of shares awarded.

Single Figure – Non-Executive Directors' remuneration (audited information)

Non-Executive Directors' remuneration consists of cash fees paid monthly with increments for positions of additional responsibility. In addition, an inter-continental travel allowance and 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.

	Board fee (including Chairmanship fees) (£)		Taxable benefits ⁸ (£)		Total (£)	
	2018	2017	2018	2017	2018	2017
Sir Roy Gardner ¹	250,000	250,000	19,004	1,688	269,004	251,688
Mike Clasper ²	88,000	92,603	–	–	88,000	92,603
Rachel Lomax ³	70,000	70,000	–	–	70,000	70,000
John Rishton ⁴	75,500	75,227	2,520	3,468	78,020	78,695
Ian El-Mokadem ⁵	61,750	29,000	–	–	61,750	29,000
Lynne Peacock ⁶	65,000	31,468	–	–	65,000	31,468
Kirsty Bashforth ⁷	57,917	16,151	1,973	426	59,889	16,577
Total	668,167	564,449	23,497	5,582	691,663	570,032

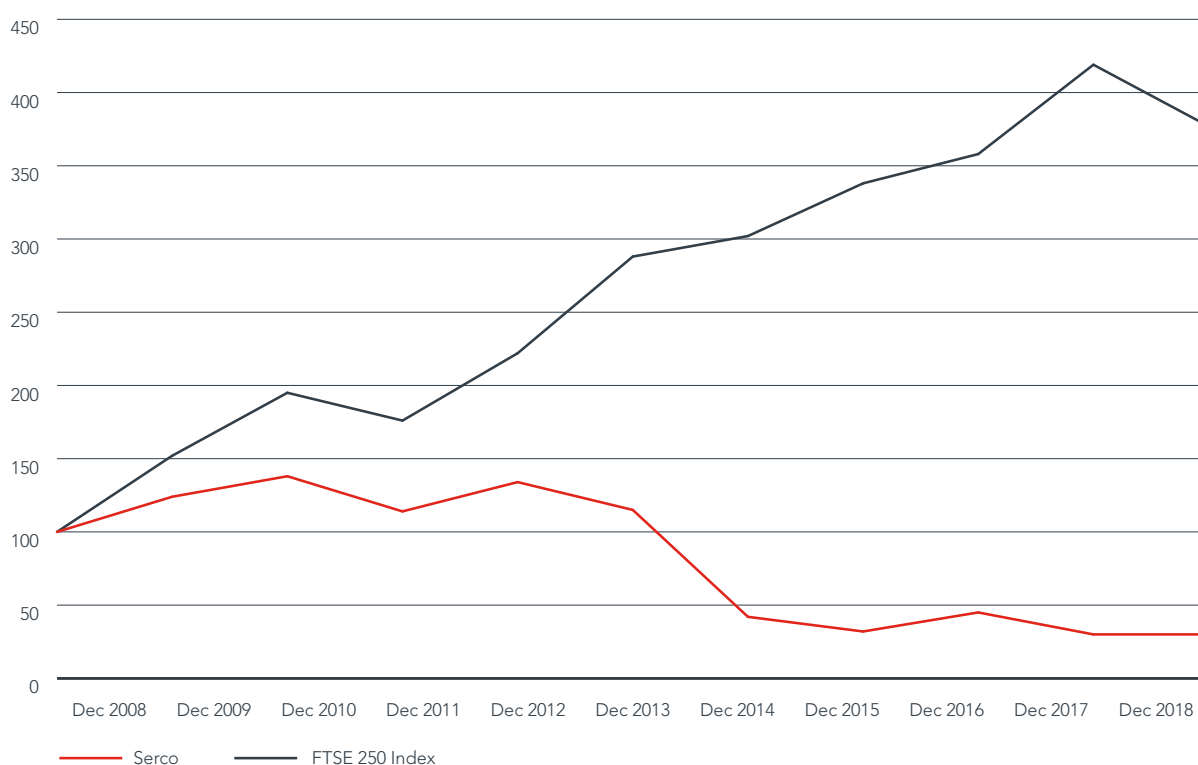
Notes to the Non-Executive Directors' Single Figure table:

1. Sir Roy Gardner is Chairman of the Board, Chairman of the Nomination Committee and a member of the Remuneration and Corporate Responsibility Committees.
2. Mike Clasper was Senior Independent Director, Chairman of the Corporate Responsibility Committee and a member of Audit, Nomination and Group Risk Committees. He resigned on 31 December 2018.
3. Rachel Lomax is Chairman of the Group Risk Committee and a member of Audit Committee.
4. John Rishton is Chairman of the Audit Committee and a member of the Remuneration and Group Risk Committees. His 2017 fees have been restated to show fees actually received in respect of that financial year.
5. Ian El-Mokadem is a member of the Group Risk and Corporate Responsibility Committees.
6. Lynne Peacock is Chairman of Remuneration Committee and a member of the Audit and Nomination Committees.
7. Kirsty Bashforth is a member of the Remuneration and Corporate Responsibility Committees.
8. Taxable benefits in 2017 and 2018 relate to reimbursed taxable travel and subsistence business expenses. Sir Roy Gardner's taxable benefit value in 2018 includes £11,666.67 of taxable business expenses relating to 2017 which were reimbursed in 2018.

Performance graph and table

This graph shows the value as at 31 December 2018, of a £100 investment in Serco on 31 December 2008 compared with £100 invested in the FTSE 250 index 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. The Company chose the FTSE 250 index as the comparator for this graph as Serco has been a constituent of that index throughout the period.

Serco performance graph



Remuneration Report continued

CEO's pay in last ten financial years

Year ended 31 December	Group CEO	CEO single-figure remuneration (£)	Annual bonus outcome (as % of maximum opportunity)	LTI vesting outcome (as % of maximum opportunity)
2009	Christopher Hyman	3,625,830	90%	295%
2010	Christopher Hyman	2,646,894	91%	169%
2011	Christopher Hyman	2,826,038	81%	80%
2012	Christopher Hyman	2,582,185	72%	64%
2013	Christopher Hyman	893,451	n/a	0%
	Ed Casey	294,782	74%	0%
2014	Ed Casey	1,605,064	71%	0%
	Rupert Soames	747,655	0%	n/a
2015	Rupert Soames	2,255,493	87%	100%
2016	Rupert Soames	2,216,566	82%	24%
2017	Rupert Soames	3,804,924	75%	91%
2018 ¹	Rupert Soames	4,478,100	77%	73%

1. The 2018 single figure of remuneration for the CEO reflects the new approved Remuneration Policy which gave the CEO a higher maximum opportunity but which will be subject to compulsory deferral above a threshold. As set out in the notes to the single figure table, LTI awards with performance periods ending in 2018 include a number of shares under awards reportable in 2018 which did not (or will not) vest. The single figure also includes an amount in respect of past DBP awards which are no longer part of the current Policy. In line with our TSR performance relative to the FTSE 250, our awards subject to TSR have consistently not vested.

Percentage change in CEO's remuneration

The table below shows the percentage change in the salary, benefits and bonus of the CEO compared to that for the average UK employee. The UK employee sub-set of the Company's global employee population has been chosen as the group which provides the most appropriate comparator; this comprises some 20,000 of the 50,000 individuals Serco employs worldwide. Inflation and local pay practices form a key driver in the salary and benefits provided in each location, and as the CEO is based in the UK we have chosen employees within the same country.

	Salary	Benefits ²	Bonus ³
CEO	0%	-3%	20%
Average change for all other UK employees	1.18% ¹	-1%	-8%

1. This represents the average pay increase for all UK employees that was applied in the 2018 annual pay review cycle.
2. The nature of benefits provided to the CEO and to employees in 2018 compared to 2017 remains the same. The percentage change between 2017 and 2018 reflects the reduction in the costs incurred in providing those same benefits.
3. The bonus element is shown for those employees eligible for such payments. The figures shown here relate to a calculation of the bonus earned, but not yet paid, related to performance in 2018 compared to the 2017 bonuses paid in April 2018. The reduction in the average employee bonus is due to the different performance outcomes at Divisional and Business Unit levels compared to 2017 which impacts the bonuses for the comparator population. The increase in the CEO's bonus is due to the change in opportunity in line with the approved Remuneration Policy and the performance outcomes compared to 2017. The CEO's 2018 bonus over 100% of salary is subject to compulsory deferral for three years into shares.

Relative importance of spend on pay

The table below details the percentage change in 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 for the business.

	2018 vs 2017	2018	2017
Dividend per share	0%	nil	nil
Overall expenditure on wages and salaries	-4.9%	£1,438.7m	£1,513.6m

Dividend per share, and overall expenditure on wages and salaries have the same meaning as in the notes to the Company Financial Statements.

Pensions (audited information)

As at 31 December 2018, there were no Executive Directors actively participating in, or accruing additional entitlement in, the Serco Pension and Life Assurance Scheme which is a defined benefits scheme.

Payments for loss of office (audited information)

No payments for loss of office were made in the year.

Payments to past Directors (audited information)

No payments to past Directors were made in the year.

Awards made in 2018

Performance Share Plan (PSP) (audited information)

In 2018 the CEO received awards equivalent to 200% of salary, and the CFO received awards equivalent to 175% of salary.

The awards will vest at the end of the performance period, if the Executive Directors are still in employment with Serco and to the extent that the performance conditions have been met as measured over the three-year performance period ending 31 December 2020.

Performance measure	Weighting of measure	Performance target
Aggregate EPS	28.33%	Statutory Earnings Per Share (EPS) before exceptional items (adjusted to reflect tax paid on a cash basis) of 13.7p (threshold, 25% vesting) to 16.7p (maximum, 100% vesting), measured as an aggregate over the three-year performance period.
Relative TSR	28.33%	Total Shareholder Return (TSR) of median (threshold, 25% vesting) to upper quartile (maximum, 100% vesting) when ranked relative to companies in the FTSE 250 (excluding investment trusts), measured over the three year performance period.
Average ROIC	28.33%	Pre-tax Return on Invested Capital (ROIC) of 9.9% (threshold, 25% vesting) to 12.2% (maximum, 100% vesting), measured as an average over the three-year performance period.
Order book	7.50%	Book-to-bill ratio of 100% (threshold, 50% vesting) to 105% (maximum, 100% vesting), measured as an average over the three-year performance period.
Employee engagement	7.50%	Employee engagement of 56% (threshold, 50% vesting) to 60% (maximum, 100% vesting), measured via the Serco Employee Engagement Survey in the final year of the performance period.

The structure for vesting is the same for all measures, with straight-line vesting between threshold and maximum, and no shares vest where performance is below threshold. In determining the extent to which these awards will vest the Committee will consider the Group's underlying performance (with input from the Group Audit and Risk Committees as appropriate) and external market reference points to ensure that outcomes are fair and reflect the underlying performance of the Group.

Each element of the PSP award is subject to a post-vesting holding requirement that takes the total term of the award (ie. performance period plus holding period) to a minimum of five years. Pre-vesting malus and post-vesting clawback is also applicable to these awards.

Directors	Type of interest awarded	Basis of Award (% salary)	Grant date	Market price at award (p) ¹	Face value (£) ²	Percentage vesting at threshold performance	Number of shares	Performance period end date
Rupert Soames	Nominal cost option	200%	25 June 2018	96.95	1,700,000	25%	1,753,481	31 December 2020
Angus Cockburn	Nominal cost option	175%	25 June 2018	96.95	875,000	25%	902,527	31 December 2020

Notes:

1. Closing share price on 22 June 2018 (being the last trading day prior to the grant).
2. Calculated using the closing share price on the trading day immediately prior to the grant date.

Remuneration Report continued

Deferred Bonus Plan (DBP) (audited information)

The table below summarises the Matching Share Awards granted to Executive Directors in 2018 in relation to their participation in the DBP in respect of their 2017 bonuses paid in 2018.

Executive Directors received a Matching Share Award (in the form of a conditional share award) on a 2:1 basis in respect of their gross bonus deferred (ie. for each Investment Share that could have been purchased from the gross bonus deferred, two Matching Shares are granted). Matching Share Awards granted in 2018 vest subject to Aggregate EPS over the three-year performance period ending 31 December 2020. 25% of the Matching Share Award will vest for threshold performance (Aggregate EPS of 13.7p), rising on a straight-line basis to 100% vesting for maximum performance (Aggregate EPS of 16.7p or above).

The definition of EPS is statutory Earnings Per Share before exceptional items (adjusted to reflect tax paid on a cash basis).

Directors	Basis of Award (% salary)	Grant date	Face value (£) ¹	Percentage vesting at threshold performance	Number of shares	Performance period end date
Rupert Soames	56%	23 August 2018	478,252	25%	488,418	31 December 2020

Note:

- The face value has been determined using the share price on 22 August 2018 of 97.92p per share (being the price paid by the Director to acquire the Investment Shares in connection with this award of DBP Matching Shares). This share price was used to determine the number of shares granted under the Matching Share Award.

Pre-vesting malus and post-vesting clawback is applicable to these awards.

Statement of voting at the general meeting

At the previous AGMs, votes on the Remuneration Report were cast as follows:

	Year of AGM	For % Number	Against % Number	Withheld % Number ¹
2017 Remuneration Policy	2018	88.51% 756,102,233	11.49% 98,143,929	n/a 61,479
2017 Annual Report on Remuneration	2018	86.95% 742,773,852	13.05% 111,481,844	n/a 51,945
2016 Remuneration Policy	2017	93.39% 736,257,238	6.61% 52,086,742	n/a 29,512
2016 Annual Report on Remuneration	2017	96.30% 759,195,936	3.70% 29,155,876	n/a 21,680
2015 Annual Report on Remuneration	2016	96.68% 814,337,337	3.32% 27,947,300	n/a 610,006
2014 Annual Report on Remuneration	2015	98.87% 760,294,709	1.13% 8,671,241	n/a 24,080
2013 Annual Report on Remuneration	2014	99.61% 367,080,126	0.39% 1,442,674	n/a 2,302,116
2013 Remuneration Policy	2014	98.08% 358,418,242	1.92% 7,033,412	n/a 5,373,262
2012 Remuneration Report	2013	95.82% 346,071,397	4.18% 15,084,901	n/a 5,923,160
2011 Remuneration Report	2012	93.72% 351,474,463	6.28% 23,547,217	n/a 8,299,355

Note:

- 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.

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.

During the year Angus Cockburn also served as a Non-Executive Director, and was appointed the Senior Independent Director from 20 February 2018, of GKN plc until his resignation on 19 April 2018 following the acquisition of GKN by Melrose Industries plc. He retained the fee payable of £63,000 per annum as a Non-Executive Director and £10,000 per annum as Senior Independent Director (pro-rated for the period served in role). Angus was appointed as a Non-Executive Director and Chair of the Audit Committee of Ashted Group plc with effect from 9 October 2018 in respect of which he retained the total fee payable of £75,000 per annum (£60,000 per annum as a Non-Executive Director and £15,000 per annum as Chair of the Audit Committee).

No other fee-paying external positions were held by the Executive Directors during the year ended 31 December 2018.

Directors' shareholding and share interests (audited information)

Current shareholdings are summarised in the table below. Shares are valued for shareholding guideline purposes at the year-end price, which was £0.9560 per share at 31 December 2018 (being the last trading day of the financial year).

Executive Directors

Name	Share ownership requirements (% of salary) ¹	Number of shares owned outright (including connected persons) at 31 December 2018 (or date of cessation) ²	Value invested ³ (£)	Shares		Share options ⁵		Total share interests at 31 December 2018 (or date of cessation) ²
				Subject to performance conditions ⁴	Subject to performance conditions ⁶	Exercised during the year ⁷		
Rupert Soames	200%	2,272,945	£2,942,628	2,516,884	5,123,882	827,855	9,913,711	
Angus Cockburn	150%	733,132	£811,599	1,030,059	2,648,737	426,101	4,411,928	

Notes:

- The CEO, Rupert Soames, and CFO, Angus Cockburn, have both met their contractual investment commitments of investing 200% and 150% of salary, respectively. The CEO has also met his shareholding guideline.
- Includes shares owned by connected persons. There were no changes in Directors' interests in the period 1 January 2019 and the date of this report.
- Based on the share price at the point of acquisition of each tranche of shares held outright at 31 December 2018 by the Executive Director and/or their connected persons.
- Includes awards made to Rupert Soames and Angus Cockburn under the Deferred Bonus Plan. All awards are in the form of conditional share awards. There are no interests in the form of conditional share awards that are not subject to performance conditions.
- All options are in the form of nominal cost options subject to a 2p per share exercise price. There are no interests in the form of share options that are not subject to performance conditions, nor are there any share options that are vested but unexercised.
- Includes awards under the Performance Share Plan that were made to Rupert Soames and Angus Cockburn in compensation for performance-based awards that were forfeited in connection with them joining Serco (as disclosed in the 2014 DRR). These are all nominal cost options with a 2p per share exercise price.
- Rupert Soames and Angus Cockburn exercised vested options in respect of their 2015 PSP awards that were subject to EPS and ROIC performance conditions tested at the end of 2017 and which vested during 2018.

Remuneration Report continued

Non-Executive Directors

Non-Executive Directors do not participate in any share-based incentives and do not hold any interests in shares other than shares owned outright.

Name	Number of shares owned outright (including connected persons) at 31 December 2018 (or date of resignation) ¹
Sir Roy Gardner	100,000
Mike Clasper	56,000
Rachel Lomax	40,000
John Rishton	43,086
Ian El-Mokadem	50,000
Lynne Peacock	15,000
Kirsty Bashforth	10,000

Notes:

1. Includes shares owned by connected persons. There were no changes in Directors' interests in the period 1 January 2019 and the date of this report. Non-Executive Directors do not have shareholding guidelines and there are no interests in shares held by Non-Executive Directors where the individual does not own those shares outright.

Other shareholding information

Shareholder dilution

Awards granted under the Company 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 Investment Association (formerly the ABI) 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 2018, our dilution level was within these limits.

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.

The Trust held 8,728,497 and 3,527,740 ordinary shares at 1 January 2018 and 31 December 2018 respectively.

Summary of the approved Remuneration Policy for Executive Directors

The 2018 Directors' Remuneration Policy ("the Policy") took effect following shareholder approval at the 2018 Annual General Meeting (held on 10 May 2018). The full Policy may be found on the Company's website. A summary of the approved policy for Executive Directors' is provided below. This summary does not replace or override the full approved policy which is available on our website within the 2017 Annual Report and Accounts.

Serco's Remuneration Policy supports the achievement of the Group'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 executives with the required skills and experience in all our chosen markets; and
- be based on a clear rationale which participants, shareholders and other stakeholders are able to understand and support.

We approach Executive Directors' remuneration on a total reward basis to provide the Remuneration Committee with a holistic view of total remuneration rather than just the competitiveness of the individual elements. Analysis is conducted by looking at each of the different elements of remuneration (including salary, annual bonus, performance share plan and pension) in this context. This ensures that in applying the Remuneration Policy executive pay is sufficient to achieve the goals of the Remuneration Policy without paying more than is necessary. The balance of fixed to variable pay also ensures that significant reward is only delivered for exceptional performance.

This remuneration framework is echoed throughout the organisation with the approach to pay for the wider workforce reflecting these core principles.

How the element supports our strategic objectives	Operation	Opportunity	Performance framework
<p>Base salary</p> <p>To recognise an individual's experience, responsibility and performance of the role, and by providing the basis for a competitive remuneration package; to help recruit and retain executives of the necessary calibre to execute Serco's strategic objectives.</p>	<p>Pay levels are designed to attract and retain experienced, skilled executives reflecting the skills and role of the individuals.</p> <p>Base salaries are set by reference to:</p> <ul style="list-style-type: none"> • the relevant experience and time in role of the individual; • individual performance; • compensation of similarly situated executives of companies in an appropriate peer group; and • the wider economic environment. <p>In some circumstances an executive may start on a lower salary than would be competitive in the market, with a phased increase applying depending on performance in role and individual ability.</p> <p>Salaries are normally reviewed annually and any changes are usually effective from 1 April. Salary reviews take account of the individual's performance and contribution to the Company during the year.</p>	<p>Whilst there is no prescribed, formulaic maximum, over the policy period, base salaries for Executive Directors will be set at an appropriate level within the peer group and will normally increase at no more than the greater of inflation and salary increases made to the general workforce in the jurisdiction the Executive Director is based in.</p> <p>Higher increases may be made in exceptional circumstances. Such cases would include where there has been a significant change in role size or complexity which has resulted in the salary falling below a market competitive level given the enhanced responsibilities of the role.</p>	<p>Review takes account of individual performance and contribution to the Company during the year.</p>

Remuneration Report continued

How the element supports our strategic objectives	Operation	Opportunity	Performance framework
<p>Benefits</p> <p>To provide a competitive level of benefits.</p>	<p>A range of benefits may be provided to Executive Directors. These include, but are not limited to, company car or car allowance, private medical insurance, permanent healthcare insurance, life cover, annual allowance for independent financial advice, and voluntary health checks every two years.</p> <p>Relocation benefits will be provided in a manner that reflects individual circumstances and Serco's relocation benefits policy. For example, relocation benefits could include temporary accommodation for the executive and dependents, education costs for dependents and tax equalisation.</p> <p>Benefits are reviewed annually against market practice and are designed to be competitive.</p>	<p>The maximum opportunity for benefits is defined by the nature of the benefits and the cost of providing them. As the cost of providing such benefits varies based on market rates and other factors, there is no formal maximum monetary value.</p>	<p>None</p>

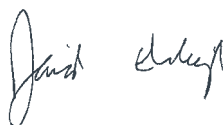
How the element supports our strategic objectives	Operation	Opportunity	Performance framework
<p>Annual bonus</p> <p>Incentivise executives to achieve specific, predetermined goals that are aligned to the business strategy during a one-year period.</p> <p>Compulsory deferral into shares increases alignment of the short-term incentive with shareholders.</p> <p>Reward ongoing stewardship and contribution to core values.</p>	<p>The Committee sets objectives and their weightings at the start of each performance year. The annual performance measures and objectives are determined with reference to the Group's overall strategy and annual business plan and priorities for the year. At the end of the performance year the bonus result is determined by the Committee based on performance against the objectives and targets set.</p> <p>Annual bonuses are paid after the end of the financial year to which they relate. There is compulsory deferral into shares vesting after three years of any bonus earned over 100% of salary. The Committee has discretion to permit a dividend equivalent to accrue during the vesting period. Dividend equivalents are delivered to participants in the form of additional shares or cash to the extent that the award vests.</p> <p>Awards made to Executive Directors are subject to malus and clawback provisions.</p>	<p>Maximum bonus opportunity is 175% of salary for CEO and 155% of salary for other Directors. This represents the maximum bonus payable for exceptional/'stretch' performance.</p>	<p>Performance is assessed annually.</p> <p>Both financial and non-financial measures are used, with a weighting of no less than 70% financial. Financial measures are based on the Company's Key Performance Indicators (KPIs) for the year such as Trade Profit, Cash Flow and Revenue and take into consideration analyst consensus and the Company's forecasts. Non-financial measures are based on personal performance against key strategic objectives for that year.</p> <p>Awards for on-target performance are 50% of the maximum opportunity. At minimum (threshold) performance the award that may be received is 0% of the maximum opportunity.</p> <p>All bonus payments are ultimately at the discretion of the Committee, taking into consideration the Director's personal contribution to business performance over the relevant year and leadership behaviours demonstrated in making that contribution.</p> <p>Performance conditions do not apply to the deferred element.</p>

Remuneration Report continued

How the element supports our strategic objectives	Operation	Opportunity	Performance framework
<p>Performance Share Plan (PSP)</p> <p>Recognises achievement against the longer-term objectives linked to the Group's strategy and aligns incentives with shareholder value creation.</p>	<p>Awards under the PSP are usually made in the form of nominal cost options or conditional share awards, but may also take the form of nil-cost options or market value share options.</p> <p>Awards are normally granted on an annual basis. However, the Committee will consider awards under the PSP twice a year.</p> <p>Awards will be subject to performance conditions.</p> <p>Awards are typically settled in Ordinary Shares however, at the discretion of the Board, awards may be converted to a cash equivalent based on the value of the shares at the vesting date (in cases where due to local law it is not possible to deliver shares), or subject to net settlement.</p> <p>The Committee has discretion to permit a dividend equivalent to accrue during the vesting period. Dividend equivalents are delivered to participants in the form of additional shares or cash to the extent that the award vests.</p> <p>Shares are subject to a two year post vesting holding period. During this time the shares must be retained but are not subject to forfeiture provisions. Shares may be sold in order to satisfy tax or other liabilities as a result of the vesting of the award.</p> <p>Awards made to Executive Directors are subject to malus and clawback provisions.</p>	<p>Maximum annual award of up to 200% of base salary for the CEO and 175% for other Directors.</p>	<p>Performance measures and weightings will be set by the Committee at the start of the three year performance period on the basis of the Group's strategic plan. At least 75% of the vesting of the LTIP is dependent on two or more financial performance conditions chosen from:</p> <ul style="list-style-type: none"> • EPS • TSR • ROIC <p>The Remuneration Committee has discretion to introduce additional financial measures aligned to the Group's strategy.</p> <p>In addition, up to 25% of the LTIP vesting may be based on the achievement of strategic measures. The Remuneration Committee has discretion to restrict the vesting against the non-financial element if, on assessment of the Company's performance as a whole including the financial performance, the formulaic outcome of the non-financial measures is not reflective of this.</p> <p>25% of the award vests for threshold performance rising on a straight-line basis to full vesting for maximum performance.</p> <p>The Committee (with input from the Audit and Group Risk Committees as appropriate) considers Serco's underlying performance and external market reference points as well as performance against the specific targets set in determining the overall outcome of the PSP.</p>

How the element supports our strategic objectives	Operation	Opportunity	Performance framework
<p>Pension</p> <p>To provide pension-related benefits to encourage executives to build savings for retirement.</p>	<p>Executive Directors may participate in the Group defined contribution pension plan (or overseas Serco pension plan as appropriate).</p> <p>Employer contributions are reviewed against local market practices annually.</p> <p>Executive Directors may choose to receive some or all of their employer pension contribution in cash to invest as they see fit.</p>	<p>Employer pension contributions (or the equivalent), and/or combined with a cash supplement, of up to 30% of base salary.</p> <p>The maximum employer pension contribution (or the equivalent), and/or combined with a cash supplement, for new Executive Directors will be up to 20% of base salary.</p>	None
<p>Shareholding guidelines</p> <p>To support long-term commitment to the Company and the alignment of employee interests with those of shareholders.</p>	<p>The Committee reviews the shareholding guideline with the Policy review to ensure the guidelines remain in line with market and best practice.</p> <p>Unvested awards that are subject to performance conditions are not taken into account in determining an Executive Director's shareholding for these purposes. Share price is measured as at end of the relevant financial year.</p> <p>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 guideline.</p>	<p>The shareholding guidelines are 200% of salary for the CEO, and 150% of salary for other Executive Directors.</p> <p>The Committee has the discretion to increase the shareholding guideline of the Executive Directors.</p>	None

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



David Eveleigh

Group General Counsel and Company Secretary
20 February 2019

Directors' Report

Annual Report and Accounts

The Directors present the Annual Report and Accounts of the Group for the year ended 31 December 2018. Comparative figures used in this report are for the year ended 31 December 2017 unless otherwise stated. The Corporate Governance Report, including the Remuneration Report, set out on pages 83 to 131, forms part of the Directors' Report.

The Chairman's Statement on pages 6 to 8 and the Chief Executive's Review and Divisional Reviews on pages 20 to 33 report on the activities during the year 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.

Articles of Association

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.

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 ("AGM").

At the Annual General Meeting in May 2018, pursuant to Section 570 of the Companies Act 2006, shareholders approved the issue of shares for cash up to 5% of the existing issued share capital and an additional 5% (only to be used in connection with an acquisition or specified capital investment) in each case without the application of pre-emption rights. The authority will expire at the conclusion of the 2019 AGM, at which a resolution will be proposed for its renewal, or, if earlier, 30 June 2019.

Rights attaching to shares

Each ordinary share of the Company carries one vote at general meetings of the Company. There are no restrictions on the transfer of ordinary shares in the capital of the Company other than certain restrictions which may from time to time be imposed by law.

The Company is not aware of any agreement between shareholders that may result in restrictions on the transfer of securities and/or voting rights.

Authority for the purchase of shares

At the Annual General Meeting in May 2018, the Company was granted authority by shareholders to purchase up to 109,856,423 ordinary shares (10% of the Company's issued ordinary share capital as at 28 March 2018). This authority will expire at the conclusion of the 2019 AGM, at which a resolution will be proposed for its renewal, or, if earlier, 30 June 2019.

Dividends

No interim dividends were paid during the financial year ended 31 December 2018 (2017: nil). The Directors are not recommending a final dividend be paid for 2018 (2017: nil).

Directors

The current members of the Board, all of whom served throughout the year with the exception of Eric Born who was appointed on 1 January 2019, are set out on pages 84 and 85.

Mike Clasper resigned as a Director on 31 December 2018.

Eric Born, having been appointed as Director since the previous AGM, will resign and offer himself for election at the AGM on 9 May 2019 in accordance with the Articles of Association.

In accordance with the UK Corporate Governance Code, 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 of control conditions are included in the Executive Directors' service contracts, which provide for compensation or reduction of notice periods in the event of a change of control of the Company.

Details of the Directors' interests in the ordinary shares and options over the ordinary shares of the Company as at 31 December 2018 are set out in the Remuneration Report on pages 125 and 126. Between 1 January 2019 and the date of this report there were no changes in the Directors' interests in ordinary shares and options over ordinary shares.

Directors' indemnities

The Company maintains Directors' and Officers' liability insurance. As permitted under the Articles of Association and in accordance with best practice, deeds of indemnity have been executed indemnifying each of the Directors and the Company Secretary of the Company in respect of their positions as officers of the Company as a supplement to the Directors and Officers insurance cover. The indemnities, which constitute a qualifying third party indemnity provision as defined by Section 234 of the Companies Act 2006, remain in force for all current Directors and the Company Secretary of the Company.

Branch offices

In certain jurisdictions, the Group operates through a branch of one of its subsidiary companies. These include the following countries: Abu Dhabi, Afghanistan, Bahrain, Belgium, Dubai, France, Guam, Iraq, Italy, Luxembourg, Netherlands, Qatar and Singapore.

Significant agreements that take effect, alter or terminate upon a change of control

Given the business-to-government nature of many of the services provided by the Company and its subsidiaries, many agreements contain provisions entitling the other parties to terminate them in the event of a change of control, which can be triggered by a takeover of the Company. The following agreements are those individual agreements which the Company considers to be significant to the Group as a whole that contain provisions giving the other party a specific right to terminate if the Company is subject to a change of control:

Material contracts

- **Clarence Correctional Centre:** On 14 June 2017, NorthernPathways Project Trust (of which Serco Australia Pty Limited is a member) entered into a Project Deed with the Australian State of New South Wales to design, construct and operate a new build prison named the New Grafton Correctional Centre, the name of which has subsequently been changed to Clarence Correctional Centre. The prison is expected to become operational in 2020. Also, on 14 June 2017, Serco Australia Pty Limited entered into an operator sub-contract with NorthernPathways. The operator sub-contract will expire 20 years from the date of acceptance of the completed Clarence Correctional Centre by the State. Both the project deed and the operator subcontract contain change of control provisions that provide that any change of control to an unrelated third-party that has not been approved by the State of New South Wales would be a major default. A major default under either the project deed or operator sub-contract, if not cured, could result in a termination of that contract.
- **Australian Immigration Services:** On 11 December 2014, Serco Australia Pty Limited entered into a contract with the Commonwealth of Australia (acting through the Department of Immigration and Border Protection) for the provision of detention services at all onshore immigration facilities in Australia. The contract has an initial five-year term, with two two-year extension options available. In the event of a change in control or ownership of Serco Australia Pty Limited, which in the reasonable opinion of the Commonwealth adversely affects the Company's ability to perform the services, the contract may be terminated by the Commonwealth.
- **AWE:** Serco Holdings Limited is a shareholder in AWE Management Limited ("the AWE JV"). Serco Holdings Limited's joint venture partners and the other shareholders in the AWE JV are UK subsidiary companies of Lockheed Martin Corporation and Jacobs Engineering Group. The AWE JV oversees the design, development, maintenance and manufacture of warheads for the UK's strategic nuclear deterrent. This work is carried out by the AWE JV under a management and operation contract with the Secretary of State for Defence ("the AWE Contract"). The AWE Contract was entered into on 1 December 1999 and has a 25-year term. Under the terms of the AWE Contract, any change in shareholding or the identity of a shareholder in the AWE JV requires the consent of the Secretary of State for Defence. In the event that there is a change of control of Serco Holdings Limited, it is required to transfer its entire shareholding in the AWE JV to the Serco Group or another wholly owned subsidiary of the Serco Group prior to such change of control. In the event that there is a change of control of Serco Holdings Limited without its entire shareholding in the AWE JV first being transferred to another member of the Serco Group or if there is a change of control of the Serco Group then the other shareholders in the AWE JV are entitled (subject to the approval of the Secretary of State and applicable regulatory approvals) to purchase the AWE JV shares and loans held by Serco Holdings Limited and any other member of the Serco Group.
- **CMS Eligibility Support Services:** In June 2018, Serco Inc. was awarded a follow-on contract with the United States of America (acting through the Centers for Medicare and Medicaid Services (CMS)) for the provision of support for the Exchanges implemented to provide affordable health insurance and insurance affordability programmes. The contract had an initial base term of one year, with four options of one year each. In the event of a change in control or ownership of Serco Inc., which in the reasonable opinion of the U.S. Government adversely affects the Company's ability to perform the services, the contract may be terminated by the U.S. Government.
- **Special Security Agreement:** In order to bid and perform on certain classified contracts involving US national security, Serco Inc. was required to mitigate its foreign ownership through a Special Security Agreement between the US Government, Serco Inc. and Serco Group plc. The effective date of the SSA is 18 June 2008. The U.S. Department of Defense may terminate Serco's SSA in the event of the sale of the Corporation to a company or person not under Foreign Ownership, Control or Influence (FOCI).
- **Asylum Accommodation and Support Services Contract ("AASC"):** On 8 January 2019 Serco Limited entered into contracts with the Secretary of State for the Home Department (acting through its UK Home Office Visas and Immigration department) for two regions of the new AASC, being the North West of England and the Midlands & East of England. Under AASC, Serco will be responsible for the provision of properties for initial and dispersed accommodation requirements, for transportation to and from properties, and for a range of other services to support the welfare of asylum seekers. In the two regions for which Serco has been selected, there are currently approximately 20,000 asylum seekers living in more than 5,000 properties. The AASC Contract becomes operational on 1 September 2019. In the event of a change of control or ownership of Serco Limited, which in the reasonable opinion of the Authority adversely affects Serco's ability to perform the services, the contract may be terminated by the Authority.

Directors' Report continued

Financing facilities

- Revolving credit facility: the Company has a £250,000,000 revolving credit facility dated 3 December 2018 (amended with a syndicate of banks). The facility provides funds for general corporate and working capital purposes, and bonds to support the Group's business needs. The facility agreement provides that in the event of a change of control of the Company each lender may, within a certain period, call for the prepayment of the amounts owed to it and cancel its commitments under the facility.
- US notes: the Company has notes outstanding under three US Private Placement Note Purchase Agreements (the 'USPP Agreements') dated 9 May 2011, 20 October 2011 and 13 May 2013 respectively. The total amount of the notes outstanding under the three USPP Agreements was \$309,264,151 at 31 December 2018, and their maturity is between 20 October 2019 and 14 May 2024. Under the terms of the USPP Agreements, if a change of control of the Company occurs it is required to offer to prepay the entire principal amount of the notes together with interest to the prepayment date but without payment of any make-whole amount.

Share plans

- The Company's share plans contain provisions in relation to a change of control. Outstanding options and awards may vest and become exercisable on a change of control of the Company, in accordance with the rules of the plans.

Annual General Meeting

The Annual General Meeting of the Company will be held at Clifford Chance LLP, 10 Upper Bank Street, Canary Wharf, London E14 5JJ on Thursday 9 May 2019 at 11.00am.

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 202 to 208.

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 policies and principles.

Diversity

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 diversity, respect for human rights, and equality of opportunity regardless of gender, sexual orientation, age, marital status, disability, race, religion or other beliefs and ethnic or national origin.

The Group promotes diversity so that all employees are able to be successful regardless of their background. 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 recognises the importance of protecting human rights. We seek to respect and uphold the human rights of individuals in all aspects of our operations wherever we operate. Our Human Rights Group Standard demonstrates this commitment and the significance of human rights for a diverse global organisation. It also sets out expectations for individual and corporate behaviour across our business in regards to human rights. We use International Human Rights Standards such as the United Nations Guiding Principles on Business and Human Rights (2011) (UN Guiding Principles) as frameworks to assist our decision-making and constructive engagement; to identify, assess, and manage adverse human rights impacts; and to integrate and act on findings, track responses, monitor effectiveness and communicate how impacts are addressed.

Employee Engagement

The Group is proud of its record of managing employee relations and believes 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 employment terms and conditions. Where employees choose not to belong to a trade union, employee communication forums such as works councils exist to ensure involvement of staff within the business. The Group has been proactive in providing employees with information on matters of concern to them as employees and employee feedback is invited through Viewpoint, our employee engagement survey. These mechanisms ensure employees' views are considered in decision-making and that they have a common awareness of Group strategy, matters of concern to them and the financial and economic factors affecting the performance of the Company.

Participation by staff in the success of the Group is encouraged by the availability of long-term incentive arrangements for senior management, which effectively aligns their interests with those of shareholders by requiring that Company-level financial performance criteria are achieved as a condition of vesting.

Corporate responsibility

As a provider of public services, the Group is committed to operating with a public service ethos and recognises its responsibilities. The Company's approach to corporate responsibility is structured around our key stakeholders, focusing on how we work to add sustainable value whilst delivering their requirements with accountability and transparency. Our corporate responsibility framework defines our principal areas of responsibility and helps to guide practice and behaviour whilst facilitating measurement of performance. More information on Corporate Responsibility, including greenhouse gas emission reporting, can be found in the Strategic Report on pages 66 to 82.

Political donations

During the year neither the Company nor the Group made political donations and they intend to continue with this policy. However, it is possible that certain routine activities may unintentionally fall within the broad scope of the Companies Act provisions relating to political donations and expenditure. As in previous years, a resolution will therefore be proposed that the authority granted at the AGM in May 2018 regarding political donations be renewed. Details will be included in the Notice of AGM.

Within the US business there exists a Political Action Committee (PAC), which is funded entirely by employees. The Serco PAC and its contributions are administered in strict accordance with regulatory requirements. Employee contributions are entirely voluntary and no pressure is placed on employees to participate. Under US law, an employee-funded PAC must bear the name of the employing company.

Financial statements

At the date of this report, as far as each Director is aware, there is no relevant audit information of which the Group's Auditor is 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 Auditor is aware of that information.

Auditor

The Audit Committee has considered the reappointment of KPMG LLP as auditor and recommended it to the Board. The Board recommends the reappointment of KPMG LLP to shareholders at the AGM to be held on 9 May 2019.

Going concern

In assessing the basis of preparation of the financial statements for the year ended 31 December 2018, the Directors have considered the principles of the Financial Reporting Council's 'Guidance on Risk Management, Internal Control and Related Financial and Business Reporting, 2014; namely assessing the applicability of the going concern basis, the review period and disclosures. The Group's current principal debt facilities at the year-end comprised a £250m revolving credit facility, and £242m of US private placement notes. As at 31 December 2018, the Group had £492m of committed credit facilities and committed headroom of £308m.

The Directors have undertaken a rigorous assessment of going concern and liquidity taking into account financial forecasts. In order to satisfy themselves that the Company has adequate resources for the future, the Directors have reviewed the Group's existing debt levels, the committed funding and liquidity positions under our debt covenants, and our ability to generate cash from trading activities.

In undertaking this review the Directors have considered the business plans which provide financial projections for the foreseeable future. For the purposes of this review, we consider that to be the period ending 30 June 2020. The Directors have also reviewed the principal risks considered on pages 52 to 63 and taken account of the results of sensitivity testing.

The Directors have a reasonable expectation that the Company and the Group will be able to operate within the level of available facilities and cash for the foreseeable future and accordingly believe that it is appropriate to prepare the financial statements on a going concern basis.

Directors' Report continued

Interests in voting rights

At 31 December 2018, the Company had been notified under Rule 5 of the Disclosure and Transparency Rules of the Financial Conduct Authority of the following interests in voting rights over the issued share capital of the Company:

Notifying person	Number of shares at date of notification	% held at date of notification	Nature of Holding
BlackRock Inc	34,854,885	3.17	Indirect
	5,571,238	0.51	Securities Lending
	45,278,466	4.12	Contract for difference
	85,704,589	7.80	Total
FIL Limited	73,169,712	6.66	Indirect
	156,204	0.01	Stock Loan
	73,325,916	6.67	Total
Lancaster Investment Management LLP ¹	70,030,527	6.37	Swap
Marathon Asset Management LLP	58,353,594	5.31	Indirect
Majedie Asset Management Limited	55,965,452	5.09	Direct
Azvalor Asset Management S.G.I.I.C., S.A ²	54,936,411	5.00	Direct
MSD Partners, L.P.	54,563,815	4.97	Indirect
Orbis Group	54,510,229	4.96	Indirect
Tameside MBC re: Greater Manchester Pension Fund	34,127,885	3.11	Direct

Notes:

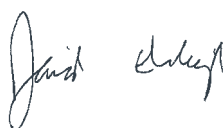
1. On 11 January 2019, Lancaster Investment Management LLP notified the Company that their interest in voting rights had been reduced to 5.98%.
2. On 15 February 2019, Azvalor Asset Management S.G.I.I.C., S.A notified the Company that their interest in voting rights had been reduced to 4.95%.

Index of Directors' Report disclosures

The information required to be disclosed in the Directors' Report can be found in this Annual Report on the pages listed below. Pursuant to Listing Rule 9.8.4C, the information required to be disclosed in the Annual Report under Listing Rule 9.8.4R is marked with an asterisk (*).

Amendment of the Articles	Page 132
Appointment and replacement of Directors	Page 132
Board of Directors	Pages 84 and 95
Change of control	Pages 133
Community	Page 77
Corporate responsibility	Pages 66 to 82
Directors' insurance and indemnities	Page 132
Directors' inductions and training	Page 90
Directors' responsibilities statement	Page 138
Disclosure of information to Auditor	Page 149
Diversity	Page 76 and 101
Dividends	Pages 8 and 132
Employee involvement	Page 75 and 86 and 134
Employees with disabilities	Page 134
Financial risk management	Pages 202 to 209
Future developments of the business	Page 12 to 19
Going concern	Pages 135 and 156
Greenhouse gas emissions]	Page 81
Independent Auditors' Report	Pages 140 to 150
Long-term incentive plans under Listing Rule 9.4.3*	Pages 119 to 124
Political donations	Page 135
Powers for the Company to issue or buy back its shares	Page 132
Powers of the Directors	Page 104
Research and development activities	Page 135
Restrictions on transfer of securities	Page 132
Rights attaching to shares	Page 132
Risk management and internal control	Pages 52 to 63 and 93
Share capital	Page 132
Significant agreements	Pages 133
Significant related party agreements*	Page 219 and 220
Significant shareholders	Page 136
Statement of corporate governance	Pages 104 and 105
Strategic Report	Pages 3 to 82
Viability Statement	Page 64 and 65
Voting rights	Page 132

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



David Eveleigh

Group General Counsel and Company Secretary
20 February 2019

Directors' Report continued

Directors' Responsibility Statement

The Directors are responsible for preparing the Annual Report and the Group and Company financial statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare Group and Company 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 applicable law, and have elected to prepare the Company financial statements in accordance with UK accounting standards, including FRS 101, Reduced Disclosure Framework. Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Group and Company and of their profit or loss for that period.

In preparing each of the Group and Company financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable, relevant, reliable and prudent;
- for the Group financial statements, state whether they have been prepared in accordance with IFRSs as adopted by the European Union;
- for the Company financial statements, state whether applicable UK accounting statements have been followed, subject to any material departures disclosed and explained in the Company financial statements;
- assess the Group's and Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and
- use the going concern basis of accounting unless they either intend to liquidate the Group or the Company or to cease operations, or have no realistic alternative but to do so.

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 its financial statements comply with the Companies Act 2006. They are responsible for such internal controls as they determine are necessary to enable the preparation of the financial statements that are free from material misstatement, whether due to fraud or error, and have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

Under applicable law and regulations, the Directors are also responsible for preparing a Strategic Report, Directors' Report, Directors' Remuneration Report and Governance Statement that complies with that law and those regulations.

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

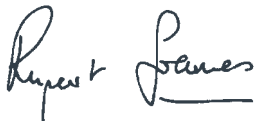
Responsibility statement of the Directors in respect of the Annual Report and Accounts

We confirm that to the best of our knowledge:

- the financial statements, prepared in accordance with the applicable set of accounting standards, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Company and the undertakings included in the consolidation taken as a whole; and
- the Strategic 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.

We consider the Annual Report and Accounts, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group's position and performance, business model and strategy.

By order of the Board:



Rupert Soames
Group Chief Executive
20 February 2019



Angus Cockburn
Group Chief Financial Officer
20 February 2019

Financial Statements

Financial Statements

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Independent Auditor's Report

to the members of Serco Group plc

Our opinion is unmodified

We have audited the financial statements of Serco Group plc ("the Company") for the year ended 31 December 2018 which comprise the Consolidated Income Statement, the Consolidated Statement of Comprehensive Income, the Consolidated and parent Company Statement of Changes in Equity, the Consolidated and parent Company Balance Sheet, the Consolidated Cash Flow Statement, and the related notes, including the accounting policies in notes 2 and 39.

In our opinion:

- the financial statements give a true and fair view of the state of the Group's and of the parent Company's affairs as at 31 December 2018 and of the Group's profit for the year then ended;
- the Group financial statements have been properly prepared in accordance with International Financial Reporting Standards as adopted by the European Union;
- the parent Company financial statements have been properly prepared in accordance with UK accounting standards, including FRS 101 Reduced Disclosure Framework; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities are described below. We believe that the audit evidence we have obtained is a sufficient and appropriate basis for our opinion. Our audit opinion is consistent with our report to the audit committee.

We were appointed as auditor by the directors on 27 May 2016. The period of total uninterrupted engagement is for the three financial years ended 31 December 2018. We have fulfilled our ethical responsibilities under, and we remain independent of the Group in accordance with, UK ethical requirements including the FRC Ethical Standard as applied to listed public interest entities. No non-audit services prohibited by that standard were provided.

Key audit matters: our assessment of risks of material misstatement

Key audit matters are those matters that, in our professional judgement, were of most significance in the audit of the financial statements and include the most significant assessed risks of material misstatement (whether or not due to fraud) identified by us, including those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. We summarise below the key audit matters (amended since 2017 to include The impact of uncertainties due to Britain exiting the European Union on our audit and Classification of Exceptional Items and to remove Retirement Benefit Surplus to reflect the reducing level of judgement involved), in arriving at our audit opinion above, together with our key audit procedures to address those matters and our findings from those procedures in order that the Company's members as a body may better understand the process by which we arrived at our audit opinion.

These matters were addressed, and our findings are based on procedures undertaken, in the context of, and solely for the purpose of, our audit of the financial statements as a whole, and in forming our opinion thereon, and consequently are incidental to that opinion, and we do not provide a separate opinion on these matters.

The impact of uncertainties due to UK exiting the European Union on our audit

A new key audit matter identified in 2018. Refer to page 54 (principal risks)

The risk	Our response
<p>Unprecedented levels of uncertainty</p> <p>All audits assess and challenge the reasonableness of estimates, in particular as described in Recoverability of group goodwill and of parent's investment in subsidiaries below, and related disclosures and the appropriateness of the going concern basis of preparation of the financial statements (see below). All of these depend on assessments of the future economic environment and the Group's future prospects and performance.</p> <p>In addition, we are required to consider the other information presented in the Annual Report including the principal risks disclosure and the viability statement and to consider the directors' statement that the annual report and financial statements taken as a whole is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group's position and performance, business model and strategy.</p> <p>Brexit is one of the most significant economic events for the UK and at the date of this report its effects are subject to unprecedented levels of uncertainty of outcomes, with the full range of possible effects unknown.</p>	<p>We developed a standardised firm-wide approach to the consideration of the uncertainties arising from Brexit in planning and performing our audits. Our procedures included:</p> <ul style="list-style-type: none">• Our Brexit knowledge: We considered the directors' assessment of Brexit-related sources of risk for the Group's business and financial resources compared with our own understanding of the risks. We considered the directors' plans to take action to mitigate the risks.• Sensitivity analysis: When addressing <i>Recoverability of group goodwill and of parent's investment in subsidiaries</i> and other areas that depend on forecasts, we compared the directors' sensitivity analysis to our assessment of the full range of reasonably possible scenarios resulting from Brexit uncertainty and, where forecast cash flows are required to be discounted, considered adjustments to discount rates for the level of remaining uncertainty.• Assessing transparency: As well as assessing individual disclosures as part of our procedures on <i>Recoverability of group goodwill and of parent's investment in subsidiaries</i> we considered all of the Brexit related disclosures together, including those in the strategic report, comparing the overall picture against our understanding of the risks. <p>Our findings</p> <p>As reported under <i>Recoverability of group goodwill and of parent's investment in subsidiaries</i>, we found the resulting estimates and related disclosures of the carrying value of goodwill and disclosures in relation to going concern to be balanced. However, no audit should be expected to predict the unknowable factors or all possible future implications for a Group and this is particularly the case in relation to Brexit.</p>

Independent Auditor's Report continued

to the members of Serco Group plc

Revenue and margin recognition

Revenue £2,836.8m (2017 restated: £2,950.9m), **operating profit £80.5m** (2017 restated: £21.1m) and **Onerous Contract Provisions of £82.1m** (2017 restated: £148.1m)

Assessment of risk vs. prior year: Unchanged

2017 balances have been restated for the adoption of IFRS 15 Revenue from Contracts with Customers. Refer to page 97 (Audit Committee Report), pages 157 to 161 and 163 to 164 (accounting policy), page 171 (key judgements), pages 196 to 197 (contract assets, trade and other receivables note in the financial statements) and page 200 (provisions note in the financial statements)

The risk	Our response
<p>Subjective estimate</p> <p>The contractual arrangements that underpin the measurement and recognition of revenue by the Group can be complex, with significant judgements involved in the assessment of current and future financial performance of those contracts. The key judgements impacting the recognition of revenue and resulting operating profit include:</p> <ul style="list-style-type: none"> • Interpretations of terms and conditions in relation to the required service obligations in accordance with contractual arrangements; • The identification of performance obligations within contracts and the allocation of revenue and costs to performance obligations where multiple deliverables exist; • Assessment of stage of completion and cost to complete, where percentage completion accounting is used; • Consideration of the Group's performance against contractual obligations and the impact on revenue and costs of delivery; and • The recognition and recoverability assessments of contract related assets, including those recognised as direct incremental costs prior to service commencement. <p>Where an onerous contract provision is required, judgement is required in assessing the level of provision, including estimated cost to complete taking into account contractual obligations to the end of the contract, extension periods and customer negotiations.</p>	<p>Our procedures included:</p> <p>Contracts were selected for substantive audit procedures based on qualitative factors, such as commercial complexity, and quantitative factors, such as financial significance and profitability that we considered to be indicative of risk. Our audit testing for the contracts selected included the following:</p> <ul style="list-style-type: none"> • Assessing policy application: We inspected the contract agreements to challenge the method of revenue recognition in accordance with IFRS 15 adopted by the Group including, where relevant, the allocation of revenue across contractual obligations and compared the specific method used to Group policy. • Independent reperformance: Where percentage of completion is used, we re-calculated the stage of completion on the basis of actual costs and latest cost forecasts to inform our assessment of the appropriate amount of revenue and profit to recognise and compared this to the amounts recorded by the Group. • Accounting analysis: We assessed whether the revenue recognition methodology applied was consistent with IFRS 15 accounting standard, including restated balances in prior year. We also inspected and challenged accounting papers prepared by the Group to understand the support and corroborate the position provided in respect of key contract judgements and onerous contract provisions. • Tests of details: We inspected a sample of correspondence with customers and third parties, in instances where contractual variations and claims have arisen, to inform our assessment of the revenue and costs recorded up to the balance sheet date. • Site visits: We visited key contract locations and attended a sample of monthly Divisional and Business Unit Performance Reviews used to assess business performance to inform our assessment of operational and financial risks. <p>For onerous and potentially onerous contracts identified through application of quantitative selection criteria, our procedures also included:</p> <ul style="list-style-type: none"> • Benchmarking assumptions: We compared contract level forecast revenues and costs to Group budgets and forecasts approved by the directors. We challenged key assumptions made by the Group in preparing these forecasts, including those in relation to revenue growth and cost reductions, checking to external evidence where possible and obtaining supporting plans where appropriate. • Our sector experience: We assessed the contractual terms and conditions to identify the key obligations of the contract to inform our challenge of completeness of forecast costs and cost accruals recorded at the balance sheet date.

The risk	Our response
<p>The effect of these matters is that, as part of our risk assessment, we determined that onerous contract provisions has a high degree of estimation uncertainty, with a potential range of reasonable outcomes greater than our materiality for the financial statements as a whole, and possibly many times that amount.</p>	<ul style="list-style-type: none"> • Historical comparisons: We compared the contract forecasts to historic and in year performance to assess the historical accuracy of the forecasts. • Tests of details: We assessed the mathematical accuracy of the models used to forecast contract revenues and costs. • Independent reperformance: We compared the forecast margin to the cumulative margin recognised up to the balance sheet date to assess whether provisions for loss-making contracts had been appropriately recorded and, in the case of profitable contracts, that margin recognised to date did not exceed the forecast. <p>For selected contract related assets, representing capitalised bid and phase in costs, our procedures included:</p> <ul style="list-style-type: none"> • Assessing application: We assessed whether these had been recognised in accordance with the Group's accounting policy and relevant accounting standards. • Comparing valuations: We inspected actual and forecast contractual cash flows and profits to assess whether these supported the carrying value of the assets. • Historical comparisons: We inspected the underlying contracts to inform our assessment of the forecast cash flows, and compared actual cash flows to forecasts to assess reasonableness. • Independent reperformance: We compared the amortisation period with the duration of the contract and checked that the amortisation had been calculated correctly. <p>Assessing transparency: We also assessed whether the Group's disclosures about the estimates and judgements applied reflected the risks related to revenue and margin recognition.</p> <p>Our findings</p> <p>In determining the application of the Group's revenue recognition policy, there is room for judgement and we found that within that, the Group's judgement for revenue recognised was balanced based on our analysis of the level of prudence within the key contract judgements and the impact of those judgements on the financial statements across the portfolio.</p>

Independent Auditor's Report continued

to the members of Serco Group plc

Recoverability of group goodwill and of parent's investment in subsidiaries

Group: £579.6m (2017: £551.3m); parent Company: £2,021.7m (2017: 2,010.5m)

Assessment of risk vs. prior year: Unchanged

Refer to page 97 (Audit Committee Report), page 165 (accounting policy), page 166 (key judgements) and pages 191 to 193 (Goodwill note in the financial statements)

The risk	Our response
<p>Forecast-based valuation</p> <p>Goodwill in the Group and the carrying amount of the parent Company's investments in subsidiaries are significant and at risk of irrecoverability due to Brexit uncertainty regarding contract attrition, new contract wins and extension rates, and the impact of the Group's transformation programme to reduce operating costs.</p> <p>The estimated recoverable amount of these balances through value in use calculations is subjective due to the inherent uncertainty involved in forecasting and discounting future cash flows.</p> <p>The cash generating units (CGUs) which were most sensitive to a deterioration in the division's projections or an increase in discount rate were the Health CGU and Direct Services CGU. As at year end 31 December 2018, the Health CGU has headroom of £65m and Direct Services has headroom of £42m.</p> <p>The effect of these matters is that, as part of our risk assessment, we determined that the value in use of goodwill is £1,444m and value in use of investments in subsidiaries is £1,996m. Both goodwill and investments in subsidiaries have a high degree of estimation uncertainty, with a potential range of reasonable outcomes greater than our materiality for the financial statements as a whole, and possibly many times that amount. The financial statements (note 18) disclose the sensitivity for goodwill estimated by the Group.</p>	<p>Our procedures included:</p> <ul style="list-style-type: none"> • Identification of CGUs: We assessed whether management's identification of CGUs, and the group of CGUs to which goodwill has been allocated for impairment purposes, is consistent with the level at which performance is monitored for internal management purposes following the reorganisation of the Group's organisational structure and the requirements of IAS 36. • Benchmarking assumptions: With the assistance of our valuation specialists, we challenged the growth rate and discount rate for each CGU used in the value in use calculation by comparing the Group's assumptions to external data. We challenged forecast assumptions around new contract wins or extensions, contract attrition, cost reductions and the allocation of central costs. • Historical comparisons: We compared current actual cash flows to historic forecasts to assess the historical accuracy in the impairment model and we have also reviewed forecast cash flows against budgets. • Sensitivity analysis: We tested the sensitivity of impairment calculations to changes in key underlying assumptions, which were discount rate and terminal growth rate for all CGUs. For CGUs that had the lowest headroom, which were: Health and Direct Services, we sensitised the five year cash flow forecasts by eliminating new wins within the pipeline. • Comparing valuations: We considered whether the forecast cash flow assumptions used in the value in use calculation were consistent with the assumptions used to calculate the expected loss on onerous contract provisions, the recognition of deferred tax assets and the Directors' assessment of going concern and viability. The value in use derived was compared to the appropriate goodwill and investments carrying value to identify any impairment. • Assessing transparency: We also assessed whether the Group's and parent Company's disclosures about the sensitivity of outcomes reflected the risks inherent in the valuation of goodwill and investment in subsidiaries. <p>Our findings:</p> <p>We found the Group's assumptions applied for the purposes of estimating recoverable amount of Group goodwill and of parent's investment in subsidiaries to be balanced with a recoverable amount exceeding the book value by £820m and £766m respectively. Our independent assessment of the growth assumptions indicates sufficient headroom when sensitised for new contract wins later in the forecast period. We found that the disclosures describing the inherent degree of subjectivity in the estimates and the potential impact of reasonably possible changes in key assumptions to be proportionate.</p>

Classification of Exceptional Items £31.9m (2017: 19.6m)

Assessment of risk vs. prior year: increased

A new key audit matter identified in 2018. Refer to page 98 (Audit Committee Report), page 172 (key judgements) and pages 183 to 184 (Exceptional items note in the financial statements)

The risk	Our response
<p>Presentation appropriateness</p> <p>Significant judgement is involved in determining the classification of exceptional items in the financial statements, and accurately identifying specific elements for inclusion within exceptional items. Accordingly we consider this area to be particularly susceptible to the risk of management bias.</p>	<p>Our procedures included:</p> <ul style="list-style-type: none">• Accounting analysis: We assessed whether the accounting policy applied is consistent with guidance issued from the Financial Reporting Council (FRC). We also inspected accounting papers prepared by the Group to understand the support provided in respect of key judgements taken and assumptions made.• Assessing policy application: We inspected the classification of items adopted by the Group including, where relevant, the identification of specific cost items within the overall classification and compared the specific method used to Group policy.• Tests of details: We inspected a sample of items included within exceptional items to ensure recognition is in line with Group policy. This included, amongst others, sample testing items included under restructuring to check that these are wholly and exclusively incurred for the purposes of the Transformation Programme.• Consistent application: We compared the classification of exceptional items where these relate to, or bear similar characteristics to, historical items to check that these are treated in a consistent manner.• Assessing transparency: We also assessed whether the Group's disclosures regarding the classification of exceptional items appropriately reflects the judgements made. <p>Our findings:</p> <p>In determining the treatment of profit or loss items under the Group's accounting policy, there is room for judgement. We found that the Group's judgement was balanced.</p>

Independent Auditor's Report continued

to the members of Serco Group plc

The risk

Our application of materiality and an overview of the scope of our audit

Our response

Materiality

Materiality for the Group financial statements as a whole was set at £5 million (2017: £5 million), determined with reference to a normalised benchmark of Group Profit Before Tax and Exceptional Items taking into account historical financial performance and the Group's current profit margins in light of the Group's ongoing Strategy Review. The group team performed procedures on the items excluded from normalised group profit before tax. This materiality represents 5.1% (2017: 12.9%) of Group Profit Before Tax and Exceptional Items of £98.5 million (2017: £38.7 million as originally reported in that year).

Materiality for the parent company financial statements as a whole was set at £4.5 million (2017: £4.5 million), determined with reference to a benchmark of company total assets of £2,449.9 million (2017: £2,457.0 million), of which it represents 0.2% (2017: 0.2%).

We agreed to report to the Audit Committee any corrected or uncorrected identified misstatements exceeding £0.25 million (2017: £0.25 million), in addition to other identified misstatements that warranted reporting on qualitative grounds.

Scope of our audit

Of the Group's 10 (2017: 8) reporting components, we subjected 10 (2017: 6) to full scope audits for Group purposes.

These 10 (2017: 6) components represent approximately 100% (2017: 99.8%) of the Group's Revenue, 100% (2017: 99.4%) of Group profit before tax and 100% (2017: 98.4%) of Group total assets.

The Group audit team instructed component auditors as to the significant areas to be covered, including the relevant risks detailed above and the information to be reported back. The Group team approved component materiality levels, which ranged from £2.0 million to £3.6 million (2017: £2.0 million to £3.6 million) having regard to the mix of size and risk profile of the Group across the components. The work on 4 of the 6 components (2017: 4 of the 6 components) was performed by component auditors and the rest, including the audit of the parent company, was performed by the Group team. The Group team visited all (2017: all) component locations to assess the audit risk and strategy and also performed reviews over all file reviews at year end. Video and telephone conference meetings were also held with these component auditors. At these visits, the findings reported to the Group team were discussed in more detail, and any further work required by the Group team was then performed by the component auditor.

The Group operates a shared service centre in India, the outputs of which are included in the financial information of the reporting components it services and therefore it is not a separate reporting component. The shared service centre is subject to specified risk-focused audit procedures, predominantly the testing of transaction processing and review controls. Additional procedures are performed at certain reporting components to address the audit risks not covered by the work performed over the shared service centre.

The risk**We have nothing to report on going concern****Our response**

The Directors have prepared the financial statements on the going concern basis as they do not intend to liquidate the Company or the Group or to cease their operations, and as they have concluded that the Company's and the Group's financial position means that this is realistic. They have also concluded that there are no material uncertainties that could have cast significant doubt over their ability to continue as a going concern for at least a year from the date of approval of the financial statements ("the going concern period").

Our responsibility is to conclude on the appropriateness of the Directors' conclusions and, had there been a material uncertainty related to going concern, to make reference to that in this audit report. However, as we cannot predict all future events or conditions and as subsequent events may result in outcomes that are inconsistent with judgements that were reasonable at the time they were made, the absence of reference to a material uncertainty in this auditor's report is not a guarantee that the Group and the Company will continue in operation.

In our evaluation of the Directors' conclusions, we considered the inherent risks to the Group's and Company's business model and analysed how those risks might affect the Group's and Company's financial resources or ability to continue operations over the going concern period. The risks that we considered most likely to adversely affect the Group's and Company's available financial resources over this period were:

- The impact of a significant reduction in contract profitability arising from the one, or a combination of, the principal risks outlined in the Group's strategic on page 54, including the early termination of contracts; and
- The impact of a material legal and regulatory compliance failure.
- As these were risks that could potentially cast significant doubt on the Group's and the Company's ability to continue as a going concern, we considered sensitivities over the level of available financial resources indicated by the Group's financial forecasts taking account of reasonably possible (but not unrealistic) adverse effects that could arise from these risks individually and collectively and evaluated the achievability of the actions the Directors consider they would take to improve the position should the risks materialise. We also considered less predictable but realistic second order impacts, such as the impact of Brexit and political and policy changes in Serco's markets.

Based on this work, we are required to report to you if:

- we have anything material to add or draw attention to in relation to the directors' statement in note 2 to the financial statements on the use of the going concern basis of accounting with no material uncertainties that may cast significant doubt over the Group and Company's use of that basis for a period of at least twelve months from the date of approval of the financial statements; or
- the related statement under the Listing Rules set out on page 137 is materially inconsistent with our audit knowledge.

We have nothing to report in these respects, and we did not identify going concern as a key audit matter.

Independent Auditor's Report continued

to the members of Serco Group plc

The risk	Our response
We have nothing to report on the other information in the Annual Report	<p>The directors are responsible for the other information presented in the Annual Report together with the financial statements. Our opinion on the financial statements does not cover the other information and, accordingly, we do not express an audit opinion or, except as explicitly stated below, any form of assurance conclusion thereon. Our responsibility is to read the other information and, in doing so, consider whether, based on our financial statements audit work, the information therein is materially misstated or inconsistent with the financial statements or our audit knowledge. Based solely on that work we have not identified material misstatements in the other information.</p> <p>Strategic report and directors' report</p> <p>Based solely on our work on the other information:</p> <ul style="list-style-type: none">• we have not identified material misstatements in the strategic report and the directors' report;• in our opinion the information given in those reports for the financial year is consistent with the financial statements; and• in our opinion those reports have been prepared in accordance with the Companies Act 2006. <p>Directors' remuneration report</p> <p>In our opinion the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006.</p> <p>Disclosures of principal risks and longer-term viability</p> <p>Based on the knowledge we acquired during our financial statements audit, we have nothing material to add or draw attention to in relation to:</p> <ul style="list-style-type: none">• the directors' confirmation within the Viability Statement on page 64 that they have carried out a robust assessment of the principal risks facing the Group, including those that would threaten its business model, future performance, solvency and liquidity;• the Principal Risks and Uncertainties disclosures describing these risks and explaining how they are being managed and mitigated; and• the directors' explanation in the Viability Statement of how they have assessed the prospects of the Group, over what period they have done so and why they considered that period to be appropriate, and their statement as to whether they have a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions. <p>Under the Listing Rules we are required to review the Viability Statement. We have nothing to report in this respect.</p> <p>Our work is limited to assessing these matters in the context of only the knowledge acquired during our financial statements audit. As we cannot predict all future events or conditions and as subsequent events may result in outcomes that are inconsistent with judgements that were reasonable at the time they were made, the absence of anything to report on these statements is not a guarantee as to the Group's and Company's longer-term viability.</p>

The risk	Our response
<p>We have nothing to report on the other information in the Annual Report <i>continued</i></p>	<p>Corporate governance disclosures</p> <p>We are required to report to you if:</p> <ul style="list-style-type: none"> we have identified material inconsistencies between the knowledge we acquired during our financial statements audit and the directors' statement that they consider that the annual report and financial statements taken as a whole is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group's position and performance, business model and strategy; or the section of the annual report describing the work of the Audit Committee does not appropriately address matters communicated by us to the Audit Committee. <p>We are required to report to you if the Corporate Governance Report does not properly disclose a departure from the eleven provisions of the UK Corporate Governance Code specified by the Listing Rules for our review.</p> <p>We have nothing to report in these respects.</p>
<p>We have nothing to report in respect of the matters on which we are required to report by exception</p>	<p>Under the Companies Act 2006, we are required to report to you if, in our opinion:</p> <ul style="list-style-type: none"> 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. <p>We have nothing to report in these respects.</p>
<p>Respective responsibilities</p>	<p>Directors' responsibilities</p> <p>As explained more fully in their statement set out on page 150, the directors are responsible for: the preparation of the financial statements including being satisfied that they give a true and fair view; such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; assessing the Group and parent Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and using the going concern basis of accounting unless they either intend to liquidate the Group or the parent Company or to cease operations, or have no realistic alternative but to do so.</p> <p>Auditor's responsibilities</p> <p>Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or other irregularities (see below), or error, and to issue our opinion in an auditor's report. Reasonable assurance is a high level of assurance, but does not guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud, other irregularities or error and are considered material if, individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.</p> <p>A fuller description of our responsibilities is provided on the FRC's website at www.frc.org.uk/auditorsresponsibilities.</p>

Independent Auditor's Report continued

to the members of Serco Group plc

The risk	Our response
Respective responsibilities continued	<p>Irregularities – ability to detect</p> <p>We identified areas of laws and regulations that could reasonably be expected to have a material effect on the financial statements from our general commercial and sector experience, through discussion with the directors and other management (as required by auditing standards), and from inspection of the Group's regulatory and legal correspondence and discussed with the directors and other management the policies and procedures regarding compliance with laws and regulations. We communicated identified laws and regulations throughout our team and remained alert to any indications of non-compliance throughout the audit. This included communication from the Group to component audit teams of relevant laws and regulations identified at Group level.</p> <p>The potential effect of these laws and regulations on the financial statements varies considerably.</p> <p>Firstly, the Group is subject to laws and regulations that directly affect the financial statements including financial reporting legislation (including related companies legislation), distributable profits legislation and taxation legislation and we assessed the extent of compliance with these laws and regulations as part of our procedures on the related financial statement items.</p> <p>Secondly, the Group is subject to many other laws and regulations where the consequences of non-compliance could have a material effect on amounts or disclosures in the financial statements, for instance through the imposition of fines or litigation or the loss of the Group's licence to operate. We identified the following areas as those most likely to have such an effect: anti-bribery, employment law, and certain aspects of company legislation. Auditing standards limit the required audit procedures to identify non-compliance with these laws and regulations to enquiry of the directors and other management and inspection of regulatory and legal correspondence, if any. These limited procedures did not identify actual or suspected non-compliance.</p> <p>Owing to the inherent limitations of an audit, there is an unavoidable risk that we may not have detected some material misstatements in the financial statements, even though we have properly planned and performed our audit in accordance with auditing standards. For example, the further removed non-compliance with laws and regulations (irregularities) is from the events and transactions reflected in the financial statements, the less likely the inherently limited procedures required by auditing standards would identify it. In addition, as with any audit, there remained a higher risk of non-detection of irregularities, as these may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal controls. We are not responsible for preventing non-compliance and cannot be expected to detect non-compliance with all laws and regulations.</p>
The purpose of our audit work and to whom we owe our responsibilities	<p>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 and the terms of our engagement by the Company. 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 the further matters we are required to state to them in accordance with the terms agreed by the Company 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.</p>



John Luke (Senior Statutory Auditor)
for and on behalf of KPMG LLP, Statutory Auditor
Chartered Accountants
15 Canada Square, London, E14 5GL
20 February 2019

Consolidated Income Statement

For the year ended 31 December

	Note	2018 £m	2017 (restated*) £m
Continuing operations			
Revenue	9	2,836.8	2,950.9
Cost of sales		(2,546.6)	(2,710.6)
Gross profit		290.2	240.3
Administrative expenses			
Other general and administrative expenses		(202.3)	(222.2)
Exceptional profit on disposal of subsidiaries and operations	8	(0.5)	0.3
Other exceptional operating items	10	(31.4)	(19.9)
Other expenses - amortisation and impairment of intangibles arising on acquisition		(4.3)	(4.4)
Total administrative expenses		(238.5)	(246.2)
Share of profits in joint ventures and associates, net of interest and tax	6	28.8	27.0
Operating profit		80.5	21.1
Operating profit before exceptional items			
		112.4	40.7
Investment revenue	13	4.3	8.0
Finance costs	14	(18.2)	(19.2)
Exceptional finance income	10	7.5	-
Total net finance costs		(6.4)	(11.2)
Other gains		-	0.7
Profit before tax		74.1	10.6
Profit before tax and exceptional finance income			
		66.6	10.6
Tax on profit before exceptional items	15	(8.8)	(13.6)
Exceptional tax	15	2.1	(5.0)
Tax charge		(6.7)	(18.6)
Profit/(loss) for the year		67.4	(8.0)
Attributable to:			
Equity owners of the Company		67.4	(8.3)
Non controlling interests		-	0.3
Earnings per share (EPS)			
Basic EPS	17	6.16p	(0.76p)
Diluted EPS	17	5.99p	(0.76p)

* Results for the year ended 31 December 2017 have been restated to reflect the adoption of IFRS15 with effect from 1 January 2017. See note 2.

Consolidated Statement of Comprehensive Income

For the year ended 31 December

	Note	2018 £m	2017 (restated ^{***}) £m
Profit/(loss) for the year		67.4	(8.0)
Other comprehensive income for the year:			
Items that will not be reclassified subsequently to profit or loss:			
Net actuarial (loss)/gain on defined benefit pension schemes*	31	52.1	(106.5)
Actuarial (loss)/gain on reimbursable rights*	31	(0.2)	(0.6)
Tax relating to items not reclassified*	15	(9.2)	18.1
Share of other comprehensive income in joint ventures and associates	6	2.0	0.9
Items that may be reclassified subsequently to profit or loss:			
Net exchange (loss)/gain on translation of foreign operations**		(5.3)	(14.6)
Fair value (loss)/gain on cash flow hedges during the year**		0.6	(0.2)
Total other comprehensive income for the year		40.0	(102.9)
Total comprehensive income for the year		107.4	(110.9)
Attributable to:			
Equity owners of the Company		107.3	(111.0)
Non controlling interest		0.1	0.1

* Recorded in retirement benefit obligations reserve in the Consolidated Statement of Changes in Equity.

** Recorded in hedging and translation reserve in the Consolidated Statement of Changes in Equity.

*** Results for the year ended 31 December 2017 have been restated to reflect the adoption of IFRS15 with effect from 1 January 2017. See note 2.

Consolidated Statement of Changes in Equity

	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 shareholders' equity £m	Non controlling interest £m
At 1 January 2017 (restated*)	22.0	327.9	0.1	49.3	(91.1)	82.9	(52.1)	24.6	363.6	1.4
Total comprehensive income for the year (restated*)	-	-	-	(7.5)	(89.0)	-	-	(14.5)	(111.0)	0.1
Shares transferred to option holders on exercise of share options	-	-	-	-	-	(6.0)	6.0	-	-	-
Expense in relation to share based payments	-	-	-	-	-	11.4	-	-	11.4	-
Change in non controlling interest	-	-	-	-	-	-	-	-	-	(0.2)
At 1 January 2018 (restated*)	22.0	327.9	0.1	41.8	(180.1)	88.3	(46.1)	10.1	264.0	1.3
Total comprehensive expense for the year	-	-	-	69.3	42.7	-	-	(4.7)	107.3	0.1
Shares transferred to option holders on exercise of share options	-	-	-	-	-	(28.0)	27.4	-	(0.6)	-
Expense in relation to share based payments	-	-	-	-	-	14.7	-	-	14.7	-
Change in non controlling interest	-	-	-	-	-	-	-	-	-	-
At 31 December 2018	22.0	327.9	0.1	111.1	(137.4)	75.0	(18.7)	5.4	385.4	1.4

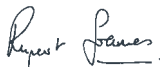
* Balances and results for the year ended 31 December 2017 have been restated to reflect the adoption of IFRS15 with effect from 1 January 2017. See note 2.

Consolidated Balance Sheet

	Note	At 31 December 2018 £m	At 31 December 2017 (restated*) £m	At 1 January 2017 (restated*) £m
Non current assets				
Goodwill	18	579.6	551.3	577.9
Other intangible assets	19	67.3	66.7	83.6
Property, plant and equipment	20	64.8	61.3	67.2
Interests in joint ventures and associates	6	20.6	19.7	20.1
Trade and other receivables	22	30.3	57.3	44.4
Derivative financial instruments	30	0.1	3.7	14.2
Deferred tax assets	16	60.9	59.7	55.3
Retirement benefit assets	31	85.8	41.8	150.4
		909.4	861.5	1,013.1
Current assets				
Inventories	21	22.9	17.4	22.4
Contract assets	22	244.3	239.6	254.6
Trade and other receivables	22	299.5	272.4	290.8
Current tax assets		7.3	11.2	11.0
Cash and cash equivalents	23	62.5	112.1	177.8
Derivative financial instruments	30	7.7	10.3	4.9
		644.2	663.0	761.5
Total assets		1,553.6	1,524.5	1,774.6
Current liabilities				
Contract liabilities	24	(74.3)	(64.3)	(71.5)
Trade and other payables	24	(419.7)	(408.6)	(469.8)
Derivative financial instruments	30	(3.7)	(1.1)	(0.6)
Current tax liabilities		(29.2)	(25.3)	(25.9)
Provisions	27	(120.1)	(146.3)	(160.3)
Obligations under finance leases	25	(5.7)	(8.5)	(12.3)
Loans	26	(21.9)	(31.8)	(9.7)
		(674.6)	(685.9)	(750.1)
Non current liabilities				
Contract liabilities	24	(86.6)	(83.3)	(85.5)
Trade and other payables	24	(23.3)	(28.7)	(16.8)
Deferred tax liabilities	16	(21.4)	(20.4)	(30.5)
Provisions	27	(119.3)	(174.0)	(202.9)
Obligations under finance leases	25	(9.1)	(11.7)	(15.9)
Loans	26	(217.6)	(239.7)	(290.2)
Retirement benefit obligations	31	(14.9)	(15.5)	(17.7)
		(492.2)	(573.3)	(659.5)
Total liabilities		(1,166.8)	(1,259.2)	(1,409.6)
Net assets		386.8	265.3	365.0
Equity				
Share capital	32	22.0	22.0	22.0
Share premium account	33	327.9	327.9	327.9
Capital redemption reserve		0.1	0.1	0.1
Retained earnings		111.1	41.8	49.3
Retirement benefit obligations reserve		(137.4)	(180.1)	(91.1)
Share based payment reserve		75.0	88.3	82.9
Own shares reserve		(18.7)	(46.1)	(52.1)
Hedging and translation reserve		5.4	10.1	24.6
Equity attributable to owners of the Company		385.4	264.0	363.6
Non controlling interest		1.4	1.3	1.4
Total equity		386.8	265.3	365.0

* Balances as at 31 December 2017 and 1 January 2017 have been restated to reflect the adoption of IFRS15 with effect from 1 January 2017. See note 2.

The financial statements were approved by the Board of Directors on 20 February 2019 and signed on its behalf by:



Rupert Soames

Group Chief Executive Officer



Angus Cockburn

Group Chief Financial Officer

Consolidated Cash Flow Statement

For the year ended 31 December

	Note	2018 £m	2017 (restated*) £m
Net cash inflow from operating activities before exceptional items		42.9	12.2
Exceptional items		(40.2)	(32.5)
Net cash inflow/(outflow) from operating activities	37	2.7	(20.3)
Investing activities			
Interest received		0.6	0.5
(Decrease)/increase in security deposits		(0.3)	0.2
Dividends received from joint ventures and associates		29.7	28.2
Proceeds from disposal of property, plant and equipment		5.3	1.5
Proceeds from disposal of intangible assets		0.5	0.1
Net cash inflow/(outflow) on disposal of subsidiaries and operations	8	1.5	(7.1)
Acquisition of subsidiaries, net of cash acquired	7	(32.8)	1.5
Proceeds from loans receivable		29.9	0.6
Exceptional finance income received		7.5	-
Purchase of other intangible assets		(8.9)	(18.4)
Purchase of property, plant and equipment		(26.4)	(13.3)
Net cash inflow/(outflow) from investing activities		6.6	(6.2)
Financing activities			
Interest paid		(16.7)	(17.5)
Capitalised finance costs paid		(2.0)	-
Repayment of loans		(31.3)	(3.8)
Capital element of finance lease repayments		(8.7)	(12.6)
Cash movements on hedging instruments		0.2	(2.5)
Net cash outflow from financing activities		(58.5)	(36.4)
Net decrease in cash and cash equivalents		(49.2)	(62.9)
Cash and cash equivalents at beginning of year		112.1	177.8
Net exchange (loss)		(0.4)	(2.8)
Cash and cash equivalents at end of year	23	62.5	112.1

* Results for the year ended 31 December 2017 have been restated to reflect the adoption of IFRS15 with effect from 1 January 2017. See note 2.

Notes to the Consolidated Financial Statements

1. General information

Serco Group plc (the Company) 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 comprise the Company and its subsidiaries (together referred to as the Group) and are presented in pounds Sterling because this is the currency of the primary economic environment in which Serco operates. All amounts have been rounded to the nearest one hundred thousand pounds, foreign operations are included in accordance with the policies set out in note 2.

2. Significant accounting policies

Basis of accounting

These consolidated financial statements on pages 140 to 233 have been prepared in accordance with International Financial Reporting Standards adopted for use in the European Union (IFRS) and therefore comply with the requirements set out in 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. Historical cost is generally based on the fair value of the consideration given in exchange for goods and services. The following principal accounting policies adopted have been applied consistently in the current and preceding financial year except as stated below.

Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Company and entities controlled by the Company up to 31 December each year. Control is achieved when the Company:

- (i) has power over the investee;
- (ii) is exposed, or has rights to variable returns from its involvement with the investee; and
- (iii) has the ability to use its power to affect the returns.

The Company reassesses whether or not it controls an investee if facts and circumstances indicate that there are changes to one or more of the three elements of control listed above.

The results of subsidiaries 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 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 profits or losses and net assets in subsidiaries that is not held by the Group and is presented within equity in the consolidated balance sheet, separate from equity of shareholders of Serco Group plc.

Going concern

The Directors have a reasonable expectation that the Company and the Group will be able to operate within the level of available facilities and cash for the foreseeable future and accordingly believe that it is appropriate to prepare the financial statements on a going concern basis.

In assessing the basis of preparation of the financial statements for the year ended 31 December 2018, the Directors have considered the principles of the Financial Reporting Council's 'Guidance on Risk Management, Internal Control and Related Financial and Business Reporting, 2014'; namely assessing the applicability of the going concern basis, the review period and disclosures. The Directors have undertaken a rigorous assessment of going concern and liquidity, taking into account financial forecasts, which indicate sufficient capacity in our financing facilities and associated covenants to support the Group. In order to satisfy themselves that they have adequate resources for the future, the Directors have reviewed the Group's existing debt levels, the committed funding and liquidity positions under our debt covenants, and our ability to generate cash from trading activities and working capital requirements. The Group's current principal debt facilities at the year-end comprised a £250m revolving credit facility, and £242m of US private placement notes. As at 31 December 2018, the Group had £492m of committed credit facilities and committed headroom of £308m.

On 3 December 2018 the Group completed the refinancing of its RCF with a syndicate of banks. Serco's RCF provides funds for general corporate and working capital purposes, and the ability to issue bonds to support the Group's business needs. The previous facility of £368m was due to mature in April 2020. The new facility provides £250m of committed funding with a maturity date of December 2023; the lower amount reflecting the much reduced need for debt in the business. The terms and conditions of the new facility are substantially unchanged from the prior facility.

In undertaking this review the Directors have considered the business plans which provide financial projections for the foreseeable future. For the purposes of this review, we consider that to be the period ending 30 June 2020. The Directors have also reviewed the principal risks considered on pages 54 to 63 of the Strategic Report and taken account of the results of sensitivity testing.

Adoption of new and revised standards

IFRS9 *Financial Instruments* (effective 1 January 2018) replaces IAS39 and introduces new requirements for classifying and measuring financial instruments and puts in place a new hedge accounting model that is designed to be more closely aligned with how entities undertake risk management activities when hedging financial and non-financial risk exposures.

The impact of IFRS9 on the regular trading activities of the Group is immaterial. The key areas of focus for the Group under IFRS9 are:

- External loan receivables, including those from equity accounted entities.
- Debt refinancing not accounted for as a significant modification under IAS39.
- Expected credit losses being recognised on trade debtors and contract assets recognised under IFRS15.
- Intercompany loan recoverability.

IFRS9 replaces the 'incurred loss' model in IAS39 with an 'expected credit loss' model. The new model applies to financial assets that are not measured at FVTPL (fair value through profit and loss), including loans, lease and trade receivables, debt securities, contract assets under IFRS15 and specified financial guarantees and loan commitments issued. It does not apply to equity investments.

Under the expected credit loss model, the Group is required to calculate the allowance for credit losses by considering on a discounted basis the cash shortfalls it would incur in various default scenarios for prescribed future periods and multiplying the shortfalls by the probability of each scenario occurring. The allowance is the sum of these probability weighted outcomes. Because every loan and receivable carries with it some risk of default, it is expected that every such asset has a loss attached to it from the moment of its origination.

The financial assets held on the balance sheet have been reviewed in order to determine whether any loss is required to be recorded based on these expected credit losses. However, given the fact that the Group's customers are governments it is unlikely that there will be a default as a result of credit risk. In most cases, each amount receivable has specific risk attached to recoverability which is most likely based on the services provided under the terms of the contract and, given the majority of receivables are backed by organisations with a sovereign credit rating, the counterparty credit risk is not considered to be material.

Prior year restatement for the impact of IFRS15 *Revenue from Contracts with Customers*

IFRS15 *Revenue from Contracts with Customers* (effective 1 January 2018), provides a single, principles-based five step model to be applied to all sales contracts, based on the transfer of control of goods and services to customers. It replaces existing revenue recognition guidance for goods, services and construction contracts currently included in IAS11 *Construction Contracts* and IAS18 *Revenue*.

Under the transition rules, IFRS15 has been applied retrospectively to the prior period in accordance with IAS8 *Accounting Policies, Changes in Accounting Estimates and Errors*, subject to the following expedients:

- contracts completed prior to 1 January 2017 or that begin and end within the same annual reporting period have not been restated;
- for contracts that have variable consideration and which completed prior to 1 January 2018, the revenues recognised reflected the actual outcome, rather than being estimated and trued up; and
- the disclosures required for comparative periods in respect of amount of revenue allocated to the remaining performance obligations, and an explanation of when that amount is expected to be recognised, will not be made in the financial statements for the year ended 31 December 2018.

There was no material impact of applying the practical expedients noted above.

The cumulative effect of initial application of the standard has been applied as an adjustment to brought forward retained earnings as at 1 January 2017.

Notes to the Consolidated Financial Statements continued

2. Significant accounting policies continued

The following table details the specific areas impacted as a result of the adoption of IFRS15 and cross-referenced below the table are Serco's policies in adopting the requirements of the standard. The restated balances are as previously included within the Group's Financial Statements for the 6 months to 30 June 2018 with one additional balance sheet reclassification relating to the adoption of IFRS15, which had no net impact on the income statement or balance sheet. The impact of the additional adjustment on the balance sheet for the year ended 31 December 2017 was to reduce provisions by £9.7m and to increase deferred income by the same amount with £1.0m being current and the remaining £8.7m being non-current. A reclassification was also made to the balance sheet for the year ended 31 December 2016. This adjustment reduced provisions by £15.7m, increased non-current deferred income by £11.7m and reduced unbilled receivables by £4.0m.

Impact on retained earnings as at 1 January 2017 and the consolidated income statement for the year ended 31 December 2017	Retained earnings £m	Revenue £m	Operating profit before exceptional items £m
As previously stated	83.1	2,953.6	49.6
IFRS15 adjustments:			
(i) Declining unit prices	(14.7)	5.4	5.0
(ii) Upfront fees	(2.7)	0.9	0.8
(iii) Transition, transformation and other mobilisation activities	(4.3)	2.2	(1.7)
(iv) Asset maintenance and replacement, including vessel dry docking	(11.8)	1.3	(4.3)
(v) Pass through revenues and procurement arrangements	–	(12.5)	–
(vi) Consideration payable to a customer	–	(0.5)	(0.4)
(vii) Percentage of completion accounting	(0.3)	0.5	0.1
(viii) OCP charges and releases	–	–	(8.4)
As restated	49.3	2,950.9	40.7

The Group's accounting policy for the items above are covered in the Group's revenue recognition policy below this restatement section. The reason the adjustments noted above arise is:

- (i) Declining unit prices. Where unit prices have been set to decline over the future periods, revenue recognised in prior years for these contracts has been deferred under IFRS15 in order to recognise revenue consistently in line with output received by the customer.
- (ii) Upfront fees. In some instances upfront fees were recognised as revenue under IAS18 but are deferred under IFRS15 where no separate performance obligation exists relating to these fees.
- (iii) Transition, transformation and other mobilisation activities. In some instances revenue recognised under IAS18 has been deferred under IFRS15 where no separate performance obligation exists.
- (iv) Asset maintenance and replacement, including vessel dry docking. Adopting IFRS15 has resulted in the deferral of revenue recognised under IAS18 on certain contracts as a result of changing to the appropriate revenue recognition method.
- (v) Pass through revenues and procurement arrangements. For certain procurement arrangements the Group does not have control prior to transfer, but does have a level of risk associated with the activity, therefore these arrangements are recognised on a net basis under IFRS15 instead of the gross basis under IAS18 due to the Group acting as agent rather than principal in these transactions.
- (vi) Consideration payable to a customer. Under IFRS15 all amounts payable to a customer (including all payments to the customer and all reductions to amounts paid by the customer) are recorded as a reduction in revenue. In 2017, an element of reductions have been recorded as costs.
- (vii) Percentage of completion accounting. Changes to the Group's current accounting policy arise when the percentage of completion model under IAS11 is replaced by the output method of accounting. The output method is used where the customer simultaneously receives and consumes the benefits in direct proportion to the deliverable performed rather than the level of expense incurred to date.
- (viii) OCP charges and releases. Where an adjustment is required by IFRS15 and the relevant contract is loss making, the deferral of revenue from prior years can result in a decrease in the level of OCP needed under IFRS15, as future losses will reduce by the level of deferred revenue. During the second half of 2017, one contract recorded a release against the OCP balance held under current accounting standards. As a result of IFRS15, revenues on this contract have been deferred, reducing the opening OCP balance, increasing deferred revenue and therefore the release of the relevant OCP balance is lower under IFRS15.

	Year ended 31 December 2017 as previously stated £m	Adjustment £m	Year ended 31 December 2017 as restated £m
Impact on consolidated income statement			
Revenue	2,953.6	(2.7)	2,950.9
Cost of sales	(2,704.7)	(5.9)	(2,710.6)
Gross profit	248.9	(8.6)	240.3
Administrative expenses			
General and administrative expenses	(222.2)	–	(222.2)
Exceptional profit on disposal of subsidiaries and operations	0.3	–	0.3
Other exceptional operating items	(19.9)	–	(19.9)
Other expenses – amortisation and impairment of intangibles arising on acquisition	(4.4)	–	(4.4)
Total administrative expenses	(246.2)	–	(246.2)
Share of profits in joint ventures and associates, net of interest and tax	27.3	(0.3)	27.0
Operating profit	30.0	(8.9)	21.1
Operating profit before exceptional items	49.6	(8.9)	40.7
Investment revenue	7.6	0.4	8.0
Finance costs	(19.2)	–	(19.2)
Net finance costs	(11.6)	0.4	(11.2)
Other gains	0.7	–	0.7
Profit before tax	19.1	(8.5)	10.6
Tax on profit before exceptional items	(14.0)	0.4	(13.6)
Exceptional tax	(5.0)	–	(5.0)
Tax charge	(19.0)	0.4	(18.6)
Profit/(loss) for the year	0.1	(8.1)	(8.0)
Earnings per share (EPS)			
Basic (EPS)	(0.02p)	(0.74p)	(0.76p)
Diluted (EPS)	(0.02p)	(0.74p)	(0.76p)
Impact on consolidated statement of other comprehensive income			
Profit for the year	0.1	(8.1)	(8.0)
Other comprehensive income for the year:			
Items that will not be reclassified subsequently to profit or loss:			
Net actuarial loss on defined benefit pension schemes	(106.5)	–	(106.5)
Actuarial loss on reimbursable rights	(0.6)	–	(0.6)
Tax relating to items not reclassified	18.1	–	18.1
Share of other comprehensive income in joint ventures and associates	0.9	–	0.9
Items that may be reclassified subsequently to profit or loss:			
Net exchange loss on translation of foreign operations	(14.6)	–	(14.6)
Fair value loss on cash flow hedges	(0.2)	–	(0.2)
Total other comprehensive income for the year	(102.9)	–	(102.9)
Total comprehensive income for the year	(102.8)	(8.1)	(110.9)

Notes to the Consolidated Financial Statements continued

2. Significant accounting policies continued

	As at 31 December 2017 as previously stated £m	Adjustment £m	As at 31 December 2017 as restated £m
Impact on consolidated balance sheet			
Non current assets			
Goodwill	551.3	–	551.3
Other intangible assets	66.7	–	66.7
Property, plant and equipment	65.2	(3.9)	61.3
Interests in joint ventures and associates	14.3	5.4	19.7
Trade and other receivables	57.3	–	57.3
Derivative financial instruments	3.7	–	3.7
Deferred tax assets	55.0	4.7	59.7
Retirement benefit assets	41.8	–	41.8
	855.3	6.2	861.5
Current assets			
Inventories	17.4	–	17.4
Trade and other receivables	506.5	5.5	512.0
Current tax assets	11.2	–	11.2
Cash and cash equivalents	112.1	–	112.1
Derivative financial instruments	10.3	–	10.3
	657.5	5.5	663.0
Total assets	1,512.8	11.7	1,524.5
Current liabilities			
Trade and other payables	(462.9)	(10.0)	(472.9)
Derivative financial instruments	(1.1)	–	(1.1)
Current tax liabilities	(25.3)	–	(25.3)
Provisions	(148.5)	2.2	(146.3)
Obligations under finance leases	(8.5)	–	(8.5)
Loans	(31.8)	–	(31.8)
	(678.1)	(7.8)	(685.9)
Non current liabilities			
Trade and other payables	(28.7)	(83.3)	(112.0)
Deferred tax liabilities	(20.4)	–	(20.4)
Provisions	(211.5)	37.5	(174.0)
Obligations under finance leases	(11.7)	–	(11.7)
Loans	(239.7)	–	(239.7)
Retirement benefit obligations	(15.5)	–	(15.5)
	(527.5)	(45.8)	(573.3)
Total liabilities	(1,205.6)	(53.6)	(1,259.2)
Net assets	307.2	(41.9)	265.3
Equity			
Share capital	22.0	–	22.0
Share premium account	327.9	–	327.9
Capital redemption reserve	0.1	–	0.1
Retained earnings	83.7	(41.9)	41.8
Retirement benefit obligations reserve	(180.1)	–	(180.1)
Share based payment reserve	88.3	–	88.3
Own shares reserve	(46.1)	–	(46.1)
Hedging and translation reserve	10.1	–	10.1
Equity attributable to owners of the Company	305.9	(41.9)	264.0
Non controlling interest	1.3	–	1.3
Total equity	307.2	(41.9)	265.3

Impact on components of the cash flow statement	Year ended 31 December 2017 as previously stated £m	Adjustment £m	Year ended 31 December 2017 as restated £m
Operating profit for the year	30.0	(8.9)	21.1
Adjustments for:			
Share of profits in joint ventures and associates	(27.3)	0.3	(27.0)
Share based payment expense	11.4	–	11.4
Exceptional impairment of intangible assets	8.9	–	8.9
Impairment and write down of intangible assets	(0.1)	–	(0.1)
Depreciation of property, plant and equipment	24.3	(3.4)	20.9
Amortisation of intangible assets	25.8	–	25.8
Exceptional profit on disposal of subsidiaries and operations	(0.3)	–	(0.3)
Loss on disposal of property, plant and equipment	0.3	–	0.3
Loss on disposal of intangible assets	0.3	–	0.3
Non cash R&D expenditure offset against intangible assets	(0.7)	–	(0.7)
Decrease in provisions	(56.0)	12.8	(43.2)
Other non cash movements	0.1	–	0.1
Total non cash items	(13.3)	9.7	(3.6)
Operating cash inflow before movements in working capital	16.7	0.8	17.5
Decrease in inventories	3.7	–	3.7
Decrease in receivables	12.6	0.4	13.0
Decrease in payables	(37.2)	(5.7)	(42.9)
Movements in working capital	(20.9)	(5.3)	(26.2)
Cash generated by operations	(4.2)	(4.5)	(8.7)
Tax paid	(11.4)	–	(11.4)
Non cash R&D expenditure	(0.2)	–	(0.2)
Net cash outflow from operating activities	(15.8)	(4.5)	(20.3)

New standards and interpretations not applied: IFRS16 Leases

IFRS16 Leases (effective 1 January 2019), specifies how to recognise, measure, present and disclose leases. The standard provides a single lessee accounting model, requiring lessees to recognise assets and liabilities for all leases unless the lease term is 12 months or less or the underlying asset is of a low value. Lessors continue to classify leases as operating or finance, with the IFRS 16 approach to lessor accounting remaining substantially unchanged from its predecessor, IAS 17.

Under the applicable transition rules a lessee shall either apply IFRS 16 with full retrospective effect or alternatively not restate comparative information but recognise the cumulative effect of initially applying IFRS 16 as an adjustment to opening equity at the date of initial application, subject to the Group's application of the following expedients:

- No reassessment is required as to whether a contract is, or contains, a lease at the date of initial application.
- No reassessment is required for:
 - leases with a lease term end date within one year of the date of initial application; or
 - leases for low value assets, which the Group considers to be those with an initial cost value less than £5,000 except for circumstances where those assets form part of a bundle of leased assets accounted for as a single lease contract.
- The Group has adopted the modified retrospective transition approach and as such the valuation of the right of use asset at 1 January 2019 is calculated as if the lease had always existed and hence the net book value of the asset on 1 January 2019 is based on the assumption of straight line amortisation.

The lease liability at 1 January 2019 is calculated as the present value of future payments in relation to the lease, discounted at the applicable incremental borrowing rate.

Below is set out the expected lease accounting policy under IFRS16 together with the estimated impact of adopting the standard.

Notes to the Consolidated Financial Statements continued

2. Significant accounting policies continued

Leases

A right of use asset is recognised as an asset of the Group at the present value of minimum lease payments determined at the inception of the lease, which is equal to the lease liability on inception. The corresponding liability to the lessor is included in the balance sheet as a 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 to the income statement, 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).

Leases for assets with an initial cost of less than £5,000 except for circumstances where those assets form part of a bundle of leased assets accounted for as a single lease contract, or with a lease term of less than 12 months, or both, are charged to the income statement on a straight-line basis over the term of the relevant lease.

Estimated impact of the adoption of IFRS16

The estimated impact for the Group of adopting IFRS16 is as follows:

	As at 1 January 2019 £m
Retained earnings at 31 December 2018	110.6
Lease liability recognised	(118.0)
Right of use asset recognised, net of impairments	88.0
Deferred tax asset recognised	5.4
Adjustment to retained earnings due to the implementation of IFRS16	(24.6)
Retained earnings at 1 January 2019	86.0

The Group will continue to work to design, implement and refine procedures to apply the new requirements of IFRS16 and to finalise accounting policy choices, including in its subsidiaries and joint ventures. As a result of this ongoing work, it is possible that there may be changes to the impact shown above prior to the 30 June 2019 results being issued. However, at this time these are not expected to be significant.

In calculating the lease liability to be recognised on transition, the Group used a weighted average incremental borrowing rate on 1 January 2019 of 3.50%. Applying this weighted average incremental borrowing rate to the operating lease commitments disclosed in note 28 gives a liability of £187.2m. This differs from the lease liability recognised as a result of transitioning to IFRS16 for the following reasons:

	As at 1 January 2019 £m
Operating lease commitments discounted at the weighted average incremental borrowing rate	187.2
Less: leases ending within 12 months of the transition date to IFRS16 covered by the practical expedient	(44.8)
Less: leases included in the operating lease commitment not meeting the recognition criteria of IFRS16	(24.4)
Lease liability on transition to IFRS16	118.0

The implementation of IFRS16 *Leases* has required the Group to make a number of judgements, the certainty of the exercise of termination options and estimates. The key judgements applied relate to the likelihood of lease extension options being exercised, the certainty of the exercise of termination options and the identification of leases embedded within other contracts. The key estimates used in assessing the impact of adopting the new standard are the incremental borrowing rates applied in calculating the present value of future lease payments to identify the lease liability at 1 January 2019.

In addition to the areas where a financial impact has been identified as a result of adoption of IFRS16 as identified above, there are certain accounting policies which are new or change existing policies applied by the Group and may have an impact on the future financial performance of the Group. The policies in these areas to be adopted by the Group are set out below:

- (i) Lease amendments. Where changes in a lease occur, this will trigger a reassessment of the lease liability. Changes in the lease liability will be recognised via an adjustment to the right of use asset. However, if the carrying amount of the right-of-use asset is reduced to zero and there is a further reduction in the measurement of the lease liability, any remaining amount of the remeasurement will be recognised in profit or loss.
- (ii) Lease incentives. Where a lease incentive is received prior to the commencement of a lease, the amount is offset against the right of use asset at inception. Where a lease includes a period or periods of reduced or free rentals, these are included in the calculation of the present value of the lease liability on inception.

- (iii) Variable lease payments. Where a contract to lease an asset has a pricing mechanism that allows for changes after the commencement date, other than those that change simply due to the passage of time, it is considered to have variable lease payments. These payments will depend on an index or rate and are included in the calculated lease liability at the lease commencement date according to the rate or index as at that date.
- (iv) Sub-leases. Where a Group entity leases an asset and this asset is subsequently leased to another entity, this is considered to be a sub-lease if the original head lease remains in place. In this instance the entity which has entered into the head lease is acting as both a lessee and a lessor simultaneously. As a result, the head lease is accounted for in accordance with the Group's lease accounting policy. When acting as a lessor, there is a requirement to determine whether the sub-lease is an operating lease or a finance lease, with the accounting following this determination.
- (v) Separate lease and non-lease components. Lease contracts can often contain elements related to the use of an asset and elements that are unrelated, for example where a property lease also includes a charge for insurance or maintenance. The lease component and the associated non-lease component are accounted for as a single lease component.

New standards and interpretations not applied: IFRIC23 *Uncertainty over Income Tax Treatments*

As an interpretation, IFRIC23 *Uncertainty over Income Tax Treatments* clarifies the application of the recognition and measurement criteria of IAS12 when there is uncertainty over income tax treatments yet to be accepted by tax authorities. The interpretation has an effective date of 1 January 2019 and is not expected to have a significant impact on the Group's financial statements.

Fair value

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between willing market participants at the measurement date, regardless of whether that price is directly observable or is estimated using another valuation technique. There are certain transactions in these financial statements which are similar to fair value, but are determined by the treatment set out in their respective standards. These are share based payment transactions that are within the scope of IFRS2 *Share Based Payment*, leasing transactions that are within the scope of IAS17 *Leases*, or the calculation of net realisable value under IAS2 *Inventories* or value in use under IAS36 *Impairment of Assets*.

Revenue recognition: Repeat service based contracts

The majority of the Group's contracts are repeat service based contracts where value is transferred to the customer over time as the core services are delivered and therefore in most cases revenue will be recognised on the output basis, with revenue linked to the deliverables provided to the customer. Where any price step downs are required in a contract accounted for under the output basis and output is not decreasing, revenue will require deferral from initial years to subsequent years in order for revenue to be recognised on a consistent basis.

There are certain contracts where a separate performance obligation has been identified for services where the pattern of delivery differs to the core services and which are capable of being distinct. In these instances, where the transfer of control is most closely aligned to our efforts in delivering the service, then the input method is used to measure progress, and revenue is recognised in direct proportion to costs incurred. Where deemed appropriate, the Group will utilise the practical expedient within IFRS15, allowing revenue to be recognised at the amount which the Group has the right to invoice, where that amount corresponds directly with the value to the customer of the Group's performance completed to date.

Under IFRS15, unless upfront fees received from customers including transition payments can be clearly attributable to a distinct service the customer is obtaining, then such payments do not constitute a separate performance obligation and instead are deferred and spread over the life of the core services.

Any changes to the enforceable rights and obligations with customers and/or an update to the transaction price will not be recognised as revenue until there is evidence of customer agreement in line with the Group's policies.

Any variable amounts will only be recognised where it is highly probable that a significant reversal will not occur.

Where the Group is required to assess whether it is acting as principal or as an agent in respect of goods or services procured for customers, the Group is acting as principal if it is in control of a good or a service prior to transferring to the customer and an agent where it is arranging for those goods or services to be provided to the customer without obtaining control.

Revenue recognition: Long-term project based contracts

The Group has a limited number of project based long-term contracts. Revenue associated with these contracts is recognised at the point in time when control over the deliverable is passed to the customer or where the Group has a legally enforceable right to remuneration for the work completed to date.

Notes to the Consolidated Financial Statements continued

2. Significant accounting policies continued

Revenue recognition: Contract modifications

When a modification to an existing contract is approved, the Group first assesses whether it adds distinct goods or services to the existing contract that are priced commensurate with the stand-alone selling prices for those goods or services. If this is the case then the modification is accounted for prospectively as a separate contract. If the pricing is not commensurate with the stand-alone selling prices for the goods or services and the new goods or services are not distinct from those in the original contract then this is considered to form part of the original contract. Pricing is updated for the entirety of the revised contract and any historic adjustments recognised as a result are recognised through opening retained earnings. If the pricing is not commensurate with the stand-alone selling prices for the goods or services and the new goods or services are distinct from those in the original contract then this is considered to represent the termination of the original contract and the creation of a new contract which is accounted for prospectively from the date of modification.

Revenue recognition: Other

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

The transaction price allocated to future performance obligations disclosed in the financial statements includes estimated variable income where the contractual agreement requires a stand ready obligation to provide future goods or services and no separate purchase decision is required based on the terms of the existing contract and customary business practices.

Interest income is accrued for 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 right to receive payment has been established.

The Group has no material exposure to returns or refunds.

Contract costs

Bid costs are capitalised only when they relate directly to a contract and are incremental to securing the contract. Bid costs are amortised over the duration of the contract to which they relate in equal annual instalments. Any costs which would have been incurred whether or not the contract is actually won are not considered to be capitalised bid costs.

Contract costs are charged to the income statement as incurred, including the necessary accrual for costs which have not yet been invoiced, unless the expense relates to a specific time frame covering future periods.

Contract costs can only be capitalised when the expenditure meets all of the following three criteria and are not within the scope of another accounting standard, such as inventories, intangible assets, or property, plant and equipment:

- The costs relate directly to a contract. These include: direct labour, being the salaries and wages of employees providing the promised services to the customer; direct materials such as supplies used in providing the promised services to a customer; and other costs that are incurred only because an entity entered into the contract, such as payments to subcontractors.
- The costs generate or enhance the resources used in satisfying performance obligations in the future. For initial contract costs capitalised, such costs only fall into one of the following two categories: the mobilisation of contract staff, being the costs of moving existing contract staff to other Group locations; or directly incremental costs incurred in meeting contractual obligations incurred prior to contract delivery, which are required to ensure a proper handover from the previous contractor. Redundancy costs are never capitalised.
- The costs are expected to be recovered, i.e. the contract is expected to be profitable after amortising the capitalised costs.

Operating profit

Operating profit is not a measure defined by IFRS and the Group considers this to include the profits and losses from continuing operations prior to corporation tax, interest revenue and finance costs.

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. 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 through the consolidated statement of comprehensive income (SOCI).

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

Such translation differences are recognised as income or expenses in the period in which the operation is disposed of. Goodwill and fair value adjustments arising on the acquisition of a foreign entity are treated as assets and liabilities of the foreign entity and translated at the closing rate.

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 IFRS3 (2008) *Business Combinations* are recognised at their fair value at the acquisition date, except where a different treatment is mandated by another standard.

Investments in joint ventures and associates

A joint venture is an arrangement whereby the owning parties have joint control and rights over the net assets of the arrangement. The Group's investments in joint ventures are incorporated using the equity method of accounting.

Under the equity method, an investment in an associate or a joint venture is initially recognised in the consolidated balance sheet at cost and adjusted thereafter to recognise the Group's share of the profit or loss and other comprehensive income of the associate or joint venture. Any excess of the cost of acquisition over the Group's share of net fair value of the identifiable assets, liabilities and contingent liabilities of the joint venture recognised at the date of acquisition is recognised as goodwill. Goodwill is included within the carrying value amount of the investment and is assessed for impairment as part of that investment. Any excess of the Group's share of the net fair value of the identifiable assets, liabilities and contingent liabilities over the cost of acquisition, after reassessment, is recognised immediately in profit or loss. Where the Group entity transacts with a joint venture, profits and losses are eliminated to the extent of the Group's interest in the arrangement.

Determining whether joint control exists requires a level of judgement, based upon specific facts and circumstances which exist at the year end. Details of the unconsolidated joint ventures are provided in notes 5 and 6.

An associate is an entity over which the Group has significant influence and that is neither a subsidiary nor an interest in a joint venture. Significant influence is the power to participate in the financial and operating policy decisions of the investee but is not control or joint control. The results and assets and liabilities of associates are also incorporated in these financial statements using the equity method of accounting.

Goodwill

Goodwill is measured as the excess of the fair value of purchase consideration over the fair value of the net assets acquired and is recognised as an intangible asset when control is achieved. Negative goodwill is recognised immediately in the income statement. Fair value measurements are based on provisional estimates and may be subject to amendment within one year of the acquisition, resulting in an adjustment to goodwill.

Goodwill itself does not generate independent cash flows and therefore, in order to perform required tests for impairment, it is allocated at inception to the specific cash generating units (CGUs) or groups of CGUs which are expected to benefit from the acquisition.

On the disposal of a business which includes all or part of a CGU, any attributable goodwill is included in the determination of the profit or loss on disposal. Where part of a CGU with goodwill is sold, the attributable amount is calculated based on the future discounted cash flows leaving the Group as a proportion of the total CGU future discounted cash flows.

The fair values associated with material business combinations are valued by external advisers and any amount of consideration which is contingent in nature is evaluated at the end of each reporting period, based on internal forecasts.

Other intangible assets

Material intangible assets are grouped into classes of similar nature and use and separately disclosed. Other intangible assets are amortised from the date of completion.

Notes to the Consolidated Financial Statements continued

2. Significant accounting policies continued

Other intangible assets continued

Customer relationships can arise on the acquisition of subsidiaries and represent the incremental value expected to be gained as a result of existing contracts in the purchased business. These assets are amortised over the average length of the related contracts.

Licences comprise premiums paid for the acquisition of licences, while franchises represent costs incurred in obtaining franchise rights arising on the acquisition of franchises. These are amortised on a straight-line basis over the life of the respective licence or franchise.

Software and IT represent computer systems and processes used by the Group in order to generate future economic value through normal business operations. The underlying assets are amortised over the period from which the Group expects to benefit, which is typically between three to eight years.

Development expenditure is capitalised as an intangible asset only if all of certain conditions are met, with all research costs and other development expenditure being expensed when incurred. The period of expected benefit, and therefore period of amortisation, is typically between three and eight years. The capitalisation criteria are as follows:

- 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.

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. Assets are grouped into classes of similar nature and use and separately disclosed except where this is not material.

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 assets	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. Given that there is limited history of material gains or losses on disposal of fixed assets, the level of judgement involved in determining the depreciation rates is not considered to be significant.

Asset impairment

The Group reviews the carrying amounts of its tangible and intangible assets (including goodwill) at each reporting period, together with any other assets under the scope of IAS36 *Impairment of Assets*, in order to assess whether there is any indication that those assets have suffered an impairment loss. As the impairment of assets has been identified as both a key source of estimation uncertainty and a critical accounting judgement, further details around the specific judgements and estimates can be seen in note 3.

If any indication of impairment exists, the recoverable amount of the asset is estimated in order to determine if there is any impairment loss. Goodwill is assessed for impairment annually, irrespective of whether there are any indicators of impairment. 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.

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 with reference to pre-tax discount rates that reflect the risks specific to the asset for which the estimates of future cash flows have not been adjusted.

If the recoverable amount is estimated to be less than the carrying amount of the asset, the carrying amount is impaired to its recoverable amount. Impairment losses recognised in respect of CGUs are allocated first to reduce the carrying amount of any goodwill allocated to the CGU and then to reduce the carrying amount of the other assets in the CGU 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 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 in prior years.

At each reporting date, the Group assesses whether there is an indication that a previously recognised impairment loss has reversed because of a change in the estimates used to determine the impairment loss. If there is such an indication, and the recoverable amount of the impaired asset, or CGU, subsequently increases, then the impairment loss is generally reversed.

Impairment losses and reversals are recognised immediately within administrative expenses within the income statement unless it is considered to be an exceptional item.

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 statement of comprehensive income.

Both current and past service costs are the amounts recognised in the income statement, reflecting the expense associated with the individuals. 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. Gains and losses on curtailments or settlements are recognised in the income statement 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 reduced by the fair value of scheme assets. Any asset resulting from this calculation is limited to the present value of available refunds (which is only recognised to the extent that the Group has an unconditional right to receive it) and reductions in future contributions to the scheme. To the extent that an economic benefit is available as a reduction in future contributions and there is a minimum funding requirement required of the Group, the economic benefit available as a reduction in contributions is calculated as the present value of the estimated future service cost in each year, less the estimated minimum funding contributions required in respect of the future accrual and benefits in that year.

Calculation of the amounts recognised in the consolidated financial statements in respect of defined benefit pension schemes requires a high level of judgement, as further explained in note 3.

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, 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 estimated amount of scheme deficit 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 within Other Comprehensive Income.

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 30.

Derivatives are initially recognised at fair value at the date a derivative contract is entered into and are subsequently re-measured to their fair value at each balance sheet date. 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 (fair value hedges) or hedges of highly probable forecast transactions or hedges of firm commitments (cash flow hedges).

Notes to the Consolidated Financial Statements continued

2. Significant accounting policies continued

Derivative financial instruments and hedging activities continued

At the inception of the hedge relationship, the Group 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. Both at the inception of the hedge and on a periodic basis, the Group assesses 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.

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. Derivatives, which mature within 12 months, are presented as current assets or current liabilities.

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 30.

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 de-designates 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 accumulated 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.

Hedge accounting is discontinued when the Group de-designates 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.

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 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, 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.

As an interpretation, IFRIC 23 *Uncertainty over Income Tax Treatments* clarifies the application of the recognition and measurement criteria of IAS12, when there is uncertainty over income tax treatments yet to be accepted by tax authorities. The interpretation has an effective date of 1 January 2019 and is not expected to have a significant impact on the Group's financial statements.

Share based payment

Where the fair value of share options requires the use of a valuation model, fair value is measured by use of Binomial Lattice, Black Scholes or Monte Carlo Simulation models depending on the type of scheme, as set out in note 35. The expected life used in the models has been adjusted, based on management's best estimate, for the effects of non transferability, exercise restrictions, and behavioural considerations. Where relevant, the value of the option has also been adjusted to take account of market conditions applicable to the option.

Inventories

Inventories are stated at the lower of cost and net realisable value and comprise service spares, parts awaiting installation and work in progress for projects undertaken for customers where payment is received on completion. Cost comprises direct materials and, where applicable, direct labour costs that have been incurred in bringing the inventories to their present location and condition.

Trade receivables

Trade receivables are recognised initially at cost (being the same as fair value) and subsequently at amortised cost less any provision for impairment, to ensure that amounts recognised represent the recoverable amount.

A provision for impairment arises where there is evidence that the Group will not be able to collect amounts due, which is achieved by creating an allowance for doubtful debts recognised in the income statement within administrative expenses. Determining whether a trade receivable is impaired requires judgement to be applied based on the information available at each reporting date. Key indicators of impairment include disputes with customers over commercial positions, or where debtors have significant financial difficulties such as historic default of payments or information that suggests bankruptcy or financial reorganisation are a reasonable possibility. The majority of contracts entered into by the Group are with government organisations and therefore historic levels of default are relatively low and as a result the risks associated with this judgement are not considered to be significant.

When a trade receivable is expected to be uncollectible, it is written off against the allowance for doubtful debts. Subsequent recoveries of amounts previously provided for or 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.

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 to the income statement, 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 the income statement on a straight-line basis over the term of the relevant lease.

Loans

Loans 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.

Notes to the Consolidated Financial Statements continued

2. Significant accounting policies continued

Borrowing costs

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

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

Provisions

Provisions are recognised when the Group has an obligation to make a cash outflow as a result of a past event. Provisions are measured at the best estimate of the expenditure required to settle the obligation at the balance sheet date when settlement is considered to be likely.

Onerous contract provisions (OCPs) arise when the unavoidable costs of meeting contractual obligations exceed the remuneration expected to be received. Unavoidable costs include total contract costs together with a rational allocation of shared costs that can be directly linked to fulfilling contractual obligations which have been systematically allocated to OCPs on the basis of key cost drivers except where this is impracticable, where contract revenue is used as a proxy to activity. The provision is calculated as the lower of the termination costs payable for an early exit and the expected net cost to fulfil the Group's unavoidable contract obligations. Where a customer has an option to extend a contract and it is likely that such an extension will be made, the expected net cost arising during the extension period, is included within the calculation. However, where a profit can be reasonably expected in the extension period, no credit is taken on the basis that such profits are uncertain given the potential for the customer to either not extend or offer an extension under lower pricing terms. Further details of the judgements can be seen in note 3.

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.

Dividends payable

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.

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 (CODM) in order to allocate resources to the segments and to assess their performance. The CODM is considered to be the Board of Directors as a body.

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 CODM.

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

3. Critical accounting judgements and key sources of estimation uncertainty

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. As described below, many of these areas of judgement also involve a high level of estimation uncertainty.

Key sources of estimation uncertainty

Provisions for onerous contracts

Determining the carrying value of onerous contract provisions requires assumptions and complex judgements to be made about the future performance of the Group's contracts. The level of uncertainty in the estimates made, either in determining whether a provision is required, or in the calculation of a provision booked, is linked to the complexity of the underlying contract and the form of service delivery. Due to the level of uncertainty and combination of variables associated with those estimates there is a significant risk that there could be material adjustments to the carrying amounts of onerous contract provisions within the next financial year.

Major sources of uncertainty which could result in a material adjustment within the next financial year are:

- The ability of the Company to maintain or improve operational performance to ensure costs or performance related penalties are in line with expected levels.
- Volume driven revenue and costs being within the expected ranges.
- The outcome of matters dependent on the behaviour of the customer, such as a decision to extend a contract where it has the unilateral right to do so.
- The outcome of open claims made by or against a customer regarding contractual performance.
- The ability of suppliers to deliver their contractual obligations on time and on budget.

In the current year, an amount of £3.4m was charged to historic provisions, and releases of £16.2m have been made. No charges have been made to new onerous contract provisions during the current year. Further details are provided in the Finance Review within the Strategic Report. All of these revisions have resulted from triggering events in the current year, either through changes in contractual positions or changes in circumstances which could not have been reasonably foreseen at the previous balance sheet date. To mitigate the level of uncertainty in making these estimates Management regularly compares actual performance of the contracts against previous forecasts and considers whether there have been any changes to significant judgements. A detailed bottom up review of the provisions is performed as part of the Group's formal annual budgeting process.

The future range of possible outcomes in respect of those assumptions and significant judgements made to determine the carrying value of onerous contracts could result in either a material increase or decrease in the value of onerous contract provisions in the next financial year. The extent to which actual results differ from estimates made at the reporting date depends on the combined outcome and timing of a large number of variables associated with performance across multiple contracts.

The individual provisions are discounted where the impact is assessed to be significant. Discount rates used are calculated based on the estimated risk free rate of interest for the region in which the provision is located and matched against the ageing profile of the provision. Rates applied are in the range of 0.72% and 1.24%.

Impairment of assets

Identifying whether there are indicators of impairment for assets involves a high level of judgement and a good understanding of the drivers of value behind the asset. At each reporting period an assessment is performed in order to determine whether there are any such indicators, which involves considering the performance of our business and any significant changes to the markets in which we operate.

We seek to mitigate the risk associated with this judgement by putting in place processes and guidance for the finance community and internal review procedures.

Determining whether assets with impairment indicators require an actual impairment involves an estimation of the expected value in use of the asset (or CGU to which the asset relates). The value in use calculation involves an estimation of future cash flows and also the selection of appropriate discount rates, both of which involve considerable judgement. The future cash flows are derived from approved forecasts, with the key assumptions being revenue growth, margins and cash conversion rates. Discount rates are calculated with reference to the specific risks associated with the assets and are based on advice provided by external experts. Our calculation of discount rates are performed based on a risk free rate of interest appropriate to the geographic location of the cash flows related to the asset being tested, which is subsequently adjusted to factor in local market risks and risks specific to Serco and the asset itself. Discount rates used for internal purposes are post tax rates, however for the purpose of impairment testing in accordance with IAS36 *Impairment of Assets* we calculate a pre tax rate based on post tax targets.

A key area of focus in recent years has been in the impairment testing of goodwill as a result of the pressure on the results of the Group. However, no impairment of goodwill was noted in the year ended 31 December 2018.

Current tax

Liabilities for tax contingencies require management judgement and estimates in respect of tax audits and also tax exposures in each of the jurisdictions in which we operate. Management is also required to make an estimate of the current tax liability together with an assessment of the temporary differences that arise as a consequence of different accounting and tax treatments. Key judgement areas include the correct allocation of profits and losses between the countries in which we operate and the pricing of intercompany services. Where management conclude that a tax position is uncertain, a current tax liability is held for anticipated taxes that are considered probable based on the current information available.

Notes to the Consolidated Financial Statements continued

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

These liabilities can be built up over a long period of time but the ultimate resolution of tax exposures usually occurs at a point in time, and given the inherent uncertainties in assessing the outcomes of these exposures, these estimates are prone to change in future periods. It is not currently possible to estimate the timing of potential cash outflow, but on resolution, to the extent this differs from the liability held, this will be reflected through the tax charge/(credit) for that period. Each potential liability and contingency is revisited on an annual basis and adjusted to reflect any changes in positions taken by the Company, local tax audits, the expiry of the statute of limitations following the passage of time and any change in the broader tax environment.

On the basis of the currently available information, the Group does not anticipate a material change to the estimated liability in the short term.

Retirement benefit obligations

Identifying whether the Group has a retirement benefit obligation as a result of contractual arrangements entered into requires a level of judgement, largely driven by the legal position held between the Group, the customer and the relevant pension scheme. The Group's retirement benefit obligations and other pension scheme arrangements are covered in note 31.

The calculation of retirement benefit obligations is dependent on material key assumptions including discount rates, mortality rates, inflation rates and future contribution rates.

In accounting for the defined benefit schemes, the Group has applied the following principles:

- The asset recognised for the Serco Pension and Life Assurance Scheme is equal to the full surplus that will ultimately be available to the Group as a future refund.
- No foreign exchange item is shown in the disclosures as the non UK liabilities are not material.
- No pension assets are invested in the Group's own financial instruments or property.
- Pension annuity assets are remeasured to fair value at each reporting date based on the share of the defined benefit obligation covered by the insurance contract.

Critical accounting judgements

Use of Alternative Performance Measures: Operating profit before exceptional items

IAS1 requires material items to be disclosed separately in a way that enables users to assess the quality of a company's profitability. In practice, these are commonly referred to as 'exceptional' items, but this is not a concept defined by IFRS and therefore there is a level of judgement involved in arriving at an Alternative Performance Measure which excludes such exceptional items. We consider items which are material and outside of the normal operating practice of the Company to be suitable for separate presentation. Further details can be seen in note 10.

The segmental analysis of continuing operations in note 4 includes the additional performance measure of Trading Profit on continuing operations which is reconciled to reported operating profit in that note. The Group uses Trading Profit as an alternative measure to reported operating profit by making several adjustments. Firstly, Trading Profit excludes exceptional items, being those we consider material and outside of the normal operating practice of the Company to be suitable of separate presentation and detailed explanation. Secondly, amortisation and impairment of intangibles arising on acquisitions are excluded, because these charges are based on judgments about the value and economic life of assets that, in the case of items such as customer relationships, would not be capitalised in normal operating practice. The CODM reviews the segmental analysis for continuing operations together with discontinued operations.

Investigation by the Serious Fraud Office

In November 2013, the UK's Serious Fraud Office announced that it had opened an investigation, which remains ongoing, into the Group's Electronic Monitoring Contract.

We are cooperating fully with the Serious Fraud Office's investigation but it is not possible to predict the outcome and timing. However, disclosed in the Principal Risks and Uncertainties in this Report is a description of the range of possible outcomes in the event that the Serious Fraud Office decides to prosecute the individuals and/or the Serco entities involved.

Deferred tax

Deferred tax assets are recognised for unused tax losses to the extent that it is probable that taxable profit will be available against which the losses can be utilised. Significant management judgement is required to determine the amount of deferred tax assets that can be recognised, based upon the likely timing and the level of future taxable profits. Recognition has been based on forecast future taxable profits.

Further details on taxes are disclosed in note 16.

4. Segmental information

The Group's operating segments reflecting the information reported to the Board in 2018 under IFRS8 Operating Segments are as set out below.

Reportable segments	Operating segments
UK & Europe	Services for sectors including Citizen Services, Defence, Health, Justice & Immigration and Transport delivered to UK Government, UK devolved authorities and other public sector customers in the UK and Europe;
Americas	Services for sectors including Defence, Transport and Citizen Services delivered to US federal and civilian agencies, selected state and municipal governments and the Canadian Government;
AsPac	Services for sectors including Defence, Justice & Immigration, Transport, Health and Citizen Services in the Asia Pacific region including Australia, New Zealand and Hong Kong;
Middle East	Services for sectors including Defence, Transport and Health in the Middle East region; and
Corporate	Central and head office costs.

Each operating segment is focused on a narrow group of customers in a specific geographic region and is run by a local management team which report directly to the CODM on a regular basis. As a result of this focus, the sectors in each region have similar economic characteristics and are aggregated at the operating segment level in these financial statements.

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

Information about major customers

The Group has four major governmental customers which each represent more than 10% of Group revenues. The customers' revenues were £1,113.1m (2017: £1,104.3m) for the UK Government within the UK & Europe segment, £522.8m (2017: £571.1m) for the US Government within the Americas segment, £498.7m (2017: £523.5m) for the Australian Government within the AsPac segment and £232.9m (2017: £239.8m) for the Government of the United Arab Emirates within the Middle East segment. The amounts shown for 2017 have been restated to show the impact of applying IFRS15 *Revenue from Contracts with Customers*.

Notes to the Consolidated Financial Statements continued

4. Segmental information continued

The following is an analysis of the Group's revenue, results, assets and liabilities by reportable segment:

Year ended 31 December 2018	UK&E £m	Americas £m	AsPac £m	Middle East £m	Corporate £m	Total £m
Revenue	1,300.7	645.6	548.2	342.3	–	2,836.8
Result						
Trading profit/(loss) from continuing operations*	51.6	43.2	40.5	21.5	(40.1)	116.7
Amortisation and impairment of intangibles arising on acquisition	(0.5)	(3.2)	(0.6)	–	–	(4.3)
Operating profit/(loss) before exceptional items	51.1	40.0	39.9	21.5	(40.1)	112.4
Exceptional profit/(loss) on disposal of subsidiaries and operations	(0.5)	–	–	–	–	(0.5)
Other exceptional operating items**	(11.0)	(2.8)	(4.5)	–	(13.1)	(31.4)
Operating profit/(loss)	39.6	37.2	35.4	21.5	(53.2)	80.5
Investment revenue						4.3
Finance costs						(18.2)
Exceptional finance income						7.5
Profit before tax						74.1
Tax charge						(8.8)
Tax on exceptional items						2.1
Profit for the year from continuing operations						67.4

* Trading profit/(loss) is defined as operating profit/(loss) before exceptional items and amortisation and impairment of intangible assets arising on acquisition.

** Exceptional items incurred by the Corporate segment are not allocated to other segments. Such items may represent costs that will benefit the wider business.

Year ended 31 December 2018	UK&E £m	Americas £m	AsPac £m	Middle East £m	Corporate £m	Total £m
Supplementary information						
Share of profits in joint ventures and associates, net of interest and tax	28.6	–	0.2	–	–	28.8
Depreciation of plant, property and equipment	(11.4)	(3.3)	(2.5)	(0.7)	(1.6)	(19.5)
Impairment of plant, property and equipment	(0.7)	–	–	–	–	(0.7)
Total depreciation and impairment of plant, property and equipment	(12.1)	(3.3)	(2.5)	(0.7)	(1.6)	(20.2)
Amortisation of intangible assets arising on acquisition	(0.5)	(3.2)	(0.6)	–	–	(4.3)
Amortisation of other intangible assets	(0.4)	(1.5)	(4.9)	(0.3)	(11.5)	(18.6)
Impairment of other intangible assets	(0.1)	–	–	–	–	(0.1)
Total amortisation and impairment of intangible assets	(1.0)	(4.7)	(5.5)	(0.3)	(11.5)	(23.0)
Segment assets						
Interests in joint ventures and associates	19.6	–	0.6	0.4	–	20.6
Other segment assets***	487.6	426.4	222.1	123.4	135.0	1,394.5
Total segment assets	507.2	426.4	222.7	123.8	135.0	1,415.1
Unallocated assets						138.5
Consolidated total assets						1,553.6
Segment liabilities						
Segment liabilities***	(339.4)	(130.3)	(152.1)	(93.6)	(142.8)	(858.2)
Unallocated liabilities						(308.6)
Consolidated total liabilities						(1,166.8)

*** The Corporate segment assets and liabilities include balance sheet items which provide benefit to the wider Group, including defined benefit pension schemes and corporate intangible assets.

Year ended 31 December 2017 (restated***)	UK&E £m	Americas £m	AsPac £m	Middle East £m	Corporate £m	Total £m
Revenue	1,331.5	689.3	577.5	352.6	–	2,950.9
Result						
Trading profit/(loss) from continuing operations*	(4.1)	39.8	33.7	17.3	(41.6)	45.1
Amortisation and impairment of intangibles arising on acquisition	–	(3.0)	(1.4)	–	–	(4.4)
Operating profit/(loss) before exceptional items	(4.1)	36.8	32.3	17.3	(41.6)	40.7
Exceptional profit on disposal of subsidiaries and operations	0.3	–	–	–	–	0.3
Other exceptional operating items**	11.9	(0.3)	(7.4)	0.1	(24.2)	(19.9)
Operating profit/(loss)	8.1	36.5	24.9	17.4	(65.8)	21.1
Investment revenue						8.0
Finance costs						(19.2)
Other gains						0.7
Profit before tax						10.6
Tax charge						(13.6)
Tax on exceptional items						(5.0)
Loss for the year from continuing operations						(8.0)

* Trading profit/(loss) is defined as operating (loss)/profit before exceptional items and amortisation and impairment of intangible assets arising on acquisition.

** Exceptional items incurred by the Corporate segment are not allocated to other segments. Such items may represent costs that will benefit the wider business.

*** Results and balances for the year ended 31 December 2017 have been restated to reflect the adoption of IFRS15 with effect from 1 January 2017. See note 2.

Year ended 31 December 2017 (restated***)	UK&E £m	Americas £m	AsPac £m	Middle East £m	Corporate £m	Total £m
Supplementary information						
Share of profits in joint ventures and associates, net of interest and tax	26.3	–	0.8	–	(0.1)	27.0
Depreciation of plant, property and equipment	(12.3)	(3.2)	(3.2)	(0.8)	(1.4)	(20.9)
Reversal of impairment of plant, property and equipment	0.1	–	–	–	–	0.1
Total depreciation and impairment of plant, property and equipment	(12.2)	(3.2)	(3.2)	(0.8)	(1.4)	(20.8)
Amortisation of intangible assets arising on acquisition	–	(3.0)	(1.4)	–	–	(4.4)
Exceptional impairment and write down of intangible assets arising on acquisition	–	–	(6.1)	–	–	(6.1)
Amortisation of other intangible assets	(1.1)	(1.5)	(4.8)	(0.2)	(13.8)	(21.4)
Exceptional impairment of other intangible assets	–	–	–	–	(2.8)	(2.8)
Total amortisation and impairment of intangible assets	(1.1)	(4.5)	(12.3)	(0.2)	(16.6)	(34.7)
Segment assets (restated***)						
Interests in joint ventures and associates	18.9	–	0.4	0.4	–	19.7
Other segment assets****	452.4	387.6	225.2	113.7	133.2	1,312.1
Total segment assets	471.3	387.6	225.6	114.1	133.2	1,331.8
Unallocated assets						192.7
Consolidated total assets						1,524.5
Segment liabilities (restated***)						
Segment liabilities****	(407.5)	(124.9)	(161.3)	(86.2)	(142.0)	(921.9)
Unallocated liabilities, including liabilities held for sale						(337.3)
Consolidated total liabilities						(1,259.2)

*** Results and balances for the year ended 31 December 2017 have been restated to reflect the adoption of IFRS15 with effect from 1 January 2017. See note 2.

**** The Corporate segment assets and liabilities include balance sheet items which provide benefit to the wider Group, including defined benefit pension schemes and corporate intangible assets.

Notes to the Consolidated Financial Statements continued

5. List of principal undertakings

The following are considered to be the principal undertakings of the Group as at the year end:

Principal subsidiaries			2018	2017
United Kingdom	Serco Limited		100%	100%
Australia	Serco Australia Pty Limited		100%	100%
USA	Serco Inc.		100%	100%

Principal joint ventures and associates			2018	2017
United Kingdom	AWE Management Limited		24.5%	24.5%
United Kingdom	Merseyrail Services Holding Company Limited		50%	50%

A full list of subsidiaries and related undertakings is included in the Appendix on pages 228 to 230 which form part of the financial statements.

6. Joint ventures and associates

AWE Management Limited (AWEML) and Merseyrail Services Holding Company Limited (MSHCL) were the only equity accounted entities which were material to the Group during the year or prior year. Dividends of £20.0m (2017: £17.1m) and £8.7m (2017: £7.3m) respectively were received from these companies in the year.

Summarised financial information of AWEML and MSHCL and an aggregation of the other equity accounted entities in which the Group has an interest is as follows:

31 December 2018

Summarised financial information	AWEML	MSHCL	Group portion of material joint ventures and associates* £m	Group portion of other joint venture arrangements and associates* £m	Total £m
	(100% of results) £m	(100% of results) £m			
Revenue	1,024.7	160.8	331.5	43.6	375.1
Operating profit before exceptional items	100.4	17.1	33.2	1.4	34.6
Exceptional items	–	(0.6)	(0.3)	–	(0.3)
Operating profit	100.4	16.5	32.9	1.4	34.3
Net investment revenue/(finance costs)	0.6	0.2	0.2	0.1	0.3
Income tax charge	(18.6)	(3.3)	(6.2)	0.1	(6.1)
Profit from continuing operations	82.4	13.4	26.9	1.6	28.5
Profit from continuing operations before exceptional items	82.4	14.0	27.2	1.6	28.8
Other comprehensive income	–	4.1	2.0	–	2.0
Total comprehensive income	82.4	17.5	28.9	1.6	30.5
Non current assets	518.5	8.0	131.0	2.6	133.6
Current assets	210.1	45.7	74.3	15.4	89.7
Current liabilities	(190.6)	(28.0)	(60.7)	(12.5)	(73.2)
Non current liabilities	(517.6)	(0.8)	(127.2)	(2.3)	(129.5)
Net assets	20.4	24.9	17.4	3.2	20.6
Proportion of Group ownership	24.5%	50.0%	–	–	–
Carrying amount of investment	5.0	12.4	17.4	3.2	20.6

* Total results of the entity multiplied by the respective proportion of Group ownership.

	AWEML (100% of results) £m	MSHCL (100% of results) £m	Group portion of material joint ventures and associates* £m	Group portion of other joint venture arrangements and associates* £m	Total £m
Cash and cash equivalents	98.1	34.3	41.2	5.1	46.3
Current financial liabilities excluding trade and other payables and provisions	(9.7)	(2.0)	(3.4)	(0.2)	(3.6)
Non current financial liabilities excluding trade and other payables and provisions	–	–	–	(2.3)	(2.3)
Depreciation and amortisation	–	(2.0)	(1.0)	(1.0)	(2.0)
Interest income	0.6	0.2	0.2	0.1	0.3
Interest expense	–	–	–	–	–

* Total results of the entity multiplied by the respective proportion of Group ownership.

The financial statements of MSHCL are for a period which is different from that of the Group, being for the 52 week period ended 5 January 2019 (2017: 52 week period ended 6 January 2018). The 52 week period reflects the joint venture's internal reporting structure and is sufficiently close so as to not require adjustment to match that of the Group.

The cost associated with the Group's share of MSHCL's obligation in respect of the equalisation of guaranteed minimum pension (GMP) payments has been recorded as exceptional to ensure consistent treatment across all defined benefit pension schemes the Group is liable for. More information is provided in note 10.

Certain employees of the groups headed by AWEML and MSHCL are members of sponsored defined benefit pension schemes. Given the significance of the schemes to understanding the position of the entities the following key disclosures are made:

Main assumptions: 2018	AWEML	MSHCL
Rate of salary increases (%)	2.2%	3.1%
Inflation assumption (CPI %)	2.2%	2.2%
Discount rate (%)	3.0%	2.9%
Post-retirement mortality:		
Current male industrial pensioners at 65 (years)	23.0	N/A
Future male industrial pensioners at 65 (years)	25.6	N/A
Retirement benefit funding position (100% of results)	£m	£m
Present value of scheme liabilities	(2,030.4)	(290.3)
Fair value of scheme assets	1,512.8	193.3
Net amount recognised	(517.6)	(97.0)
Members' share of deficit	–	58.2
Franchise adjustment*	–	38.8
Related asset, right to reimbursement	517.6	–
Net retirement benefit obligation	–	–

* The franchise adjustment represents the amount of scheme deficit that is expected to be funded outside the contract period.

AWEML is not liable for any deficiency in the defined benefit pension scheme under current contractual arrangements. The deficit reflected in the financial statements of MSHCL covers only that portion of the deficit that is expected to be funded over the term of the franchise arrangement the entity operates under. In addition, the defined benefit position reflects an adjustment in respect of funding required to be provided by employees.

Notes to the Consolidated Financial Statements continued

6. Joint ventures and associates continued 31 December 2017 (restated**)

Summarised financial information	AWEML (100% of results) £m	MSHCL (100% of results) £m	Group portion of material joint ventures and associates* £m	Group portion of other joint venture arrangements and associates* £m	Total £m
Revenue	951.8	155.1	310.7	45.7	356.4
Operating profit	90.8	17.2	30.8	3.3	34.1
Net investment revenue/(finance costs)	0.2	(0.2)	(0.1)	–	(0.1)
Income tax (charge)/credit	(18.8)	(3.9)	(6.6)	(0.4)	(7.0)
Profit from continuing operations	72.2	13.1	24.1	2.9	27.0
Other comprehensive income	–	2.0	1.0	(0.1)	0.9
Total comprehensive income	72.2	15.1	25.1	2.8	27.9
Non current assets	665.6	8.7	167.5	2.2	169.7
Current assets	197.3	43.5	70.1	17.1	87.2
Current liabilities	(179.0)	(26.1)	(57.0)	(14.0)	(71.0)
Non current liabilities	(664.3)	(1.6)	(163.5)	(2.7)	(166.2)
Net assets	19.6	24.5	17.1	2.6	19.7
Proportion of Group ownership	24.5%	50.0%	–	–	–
Carrying amount of investment	4.8	12.3	17.1	2.6	19.7

* Total results of the entity multiplied by the respective proportion of Group ownership.

** Results and balances for the year ended 31 December 2017 have been restated to reflect the adoption of IFRS15 with effect from 1 January 2017. See note 2.

	AWEML (100% of results) £m	MSHCL (100% of results) £m	Group portion of material joint ventures and associates* £m	Group portion of other joint venture arrangements and associates* £m	Total £m
Cash and cash equivalents	77.2	33.6	35.7	5.5	41.2
Current financial liabilities excluding trade and other payables and provisions	(8.3)	(1.9)	(3.0)	(0.5)	(3.5)
Non current financial liabilities excluding trade and other payables and provisions	–	–	–	(2.7)	(2.7)
Depreciation and amortisation	–	(2.2)	(1.1)	(1.4)	(2.5)
Interest income	0.2	0.1	0.1	–	0.1
Interest expense	–	(0.3)	(0.2)	–	(0.2)

* Total results of the entity multiplied by the respective proportion of Group ownership.

Key disclosures with respect of the defined benefit pension schemes of material joint ventures and associates:

Main assumptions: 2017	AWEML	MSHCL
Rate of salary increases (%)	2.2%	3.1%
Inflation assumption (CPI %)	2.2%	2.2%
Discount rate (%)	2.6%	2.5%
Post-retirement mortality:		
Current male industrial pensioners at 65 (years)	22.9	N/A
Future male industrial pensioners at 65 (years)	25.2	N/A

	AWEML £m	MSHCL £m
Retirement benefit funding position (100% of results)		
Present value of scheme liabilities	(2,233.3)	(304.4)
Fair value of scheme assets	1,569.1	193.9
Net amount recognised	(664.2)	(110.5)
Members' share of deficit	–	44.2
Franchise adjustment*	–	66.3
Related asset, right to reimbursement	664.2	–
Net retirement benefit obligation	–	–

* The franchise adjustment represents the amount of scheme deficit that is expected to be funded outside the contract period.

AWEML is not liable for any deficiency in the defined benefit pension scheme under current contractual arrangements. The deficit reflected in the financial statements of MSHCL covers only that portion of the deficit that is expected to be funded over the term of the franchise arrangement the entity operates under. In addition, the defined benefit position reflects an adjustment in respect of funding required to be provided by employees.

7. Acquisitions

On 26 January 2018, the Group acquired 100% of the issued share capital of BTP Systems, LLC (BTP). The acquired business contributed £12m of revenue and £1.9m of operating profit before exceptional items to the Group's results during year to 31 December 2018. Having incorporated the assets, liabilities and operations of BTP into the Group, BTP Systems, LLC was liquidated on 26 January 2018.

BTP provides satellite communications (SATCOM), radar modernisation, operations and maintenance and sustainment services that enable customers to extend the lives of existing systems and achieve phased upgrades with new technology to enhance operational capability. BTP specialises in areas including obsolescence engineering, systems engineering services, test equipment and design, and field engineering services, and maintains a near-field and compact antenna test range at their Ludlow, MA headquarters. BTP's expertise spans shipboard and submarine SATCOM antenna systems, Military Strategic & Tactical Relay command post antennas and radar antennas.

The Group acquired Carillion plc's facilities management contracts at six major NHS hospital sites over the period from June 2018 to August 2018: Great Western Hospital in Swindon; Darent Valley Hospital in Dartford; James Cook University Hospital in Middlesbrough; Harplands Hospital in Stoke-on-Trent; The Langlands Unit of Queen Elizabeth University Hospital in Glasgow; and Addenbrooke's Treatment Centre in Cambridge.

The total annual revenue of all six contracts is expected to be around £70m and the estimated operating profit before exceptional items, including an appropriate allocation of charges for shared support services and other incremental overheads, will be approximately £4m, the aggregate consideration payable was £18.1m. The acquired contracts contributed £30.3m of revenue and an operating loss before exceptional items of £2.1m to the Group's results during year to 31 December 2018 due to the transition costs incurred.

	Fair value BTP £m	Provisional fair value Carillion Health contracts £m	Total £m
Goodwill	10.0	6.8	16.8
Acquisition related intangible assets	3.1	13.6	16.7
Property, plant and equipment	0.2	–	0.2
Inventories	0.3	–	0.3
Trade and other receivables	1.5	–	1.5
Cash and cash equivalents	1.2	–	1.2
Trade and other payables	(1.2)	–	(1.2)
Provisions	(0.7)	–	(0.7)
Deferred tax liability	–	(2.3)	(2.3)
Acquisition date fair value of consideration transferred	14.4	18.1	32.5
Satisfied by:			
Cash	14.4	16.1	30.5
Contingent consideration	–	2.0	2.0
Total consideration	14.4	18.1	32.5

Notes to the Consolidated Financial Statements continued

7. Acquisitions continued

The net cash outflow as a result of acquisitions completed during the year was £32.8m made up of £30.5m consideration paid on acquisitions made during the year, costs related to current year acquisitions of £0.6m, consideration related to historic acquisitions of £2.9m and £1.2m of cash acquired.

Goodwill on the Carillion Health contracts represents the premium associated with taking over contracts considered to have synergies with existing Health related contracts already being operated by the Group, and bring an established workforce able to deliver the services required under the contracts. The contracts acquired are considered to be accretive to the Group's financial performance. The contingent consideration payable on the Carillion Health contracts is contingent on the Group receiving certain indemnities in relation to the contracts acquired.

Goodwill on the acquisition of BTP represents the premium associated with enabling the Group to enter into new markets with a developed customer base and a series of established product and service offerings. These services complement Serco's capabilities in Command, Control, Communications, Computers, Combat Systems, Intelligence, Surveillance and Reconnaissance (C5ISR) services. Combining the skills of Serco and BTP Systems will enable the delivery of expanded C5ISR services supporting naval modernisation and sustainment for ship, shore and hardware integration projects.

Based on estimates made of the full year impact of acquisitions arising during the year, had the acquisitions taken place on 1 January 2018 Group revenue and operating profit before exceptional items for the period would have increased by £41.3m and approximately £6.2m respectively, taking total Group revenue to £2,878.1m and total Group operating profit before exceptional items to £118.6m.

The total impact of acquisitions to the Group's cash flow position in the period was as follows:

	£m
Net cash outflow on acquisition of BTP	(13.2)
Consideration paid in respect of Carillion contract acquisition completed including acquisition related costs	(16.7)
Deferred consideration paid in respect of historic acquisition:	
Anglia Support Partnership	(1.2)
Grafton Correctional Centre	(1.1)
Serco Sodexo Defence Services	(0.6)
Net cash outflow arising in the year on acquisitions	(32.8)

8. Disposals

A summary of the disposals taking place in the year ended 31 December 2018 were as follows:

Year ended 31 December 2018	Profit/(loss) on disposal £m	Cash flow £m
Disposal of the Anglia Support Partnership contract	(0.5)	(0.3)
Settlement of consideration for Service Glasgow LLP	–	1.8
	(0.5)	1.5

In October 2018 the Group's interest in the Anglia Support Partnership contract was disposed of, resulting in a net cash outflow of £0.3m with a loss on disposal of £0.5m. Further details are provided below.

	Anglia Support Partnership contract £m
Trade and other receivables	0.5
Trade and other payables	(0.6)
Net assets disposed	(0.1)

	Anglia Support Partnership contract £m
Consideration	–
Less:	
Net assets disposed	(0.1)
Disposal costs	(0.4)
Income statement impact of disposal	(0.5)

The net cash outflow arising on the disposal of the Anglia Support Partnership contract and the impact on Net Debt is as follows:

	Anglia Support Partnership contract £m
Consideration	–
Less: Disposal costs	(0.3)
Net cash flow on disposal and movement in Net Debt	(0.3)

9. Revenue from contracts with customers

Revenue

As a result of the adoption of IFRS15 all disclosures contained in this note are new or restated from that previously disclosed in the Group's financial statements.

Information regarding the Group's major customers, and a segmental analysis of revenue is provided in note 4.

An analysis of the Group's revenue from its key market sectors, together with the timing of revenue recognition across the Group's revenue from contracts with customers is as follows:

Year ended 31 December 2018	UK&E £m	Americas £m	AsPac £m	Middle East £m	Total £m
Key sectors					
Defence	260.2	338.3	56.2	40.8	695.5
Justice & Immigration	269.8	–	271.4	–	541.2
Transport	151.4	90.2	18.3	204.6	464.5
Health	231.8	–	89.1	28.5	349.4
Citizen Services	387.5	217.1	113.2	68.4	786.2
	1,300.7	645.6	548.2	342.3	2,836.8
Timing of revenue recognition					
Revenue recognised from performance obligations satisfied in previous periods	1.6	–	3.2	–	4.8
Revenue recognised at a point in time	38.9	–	1.8	–	40.7
Products and services transferred over time	1,260.2	645.6	543.2	342.3	2,791.3
	1,300.7	645.6	548.2	342.3	2,836.8
Year ended 31 December 2017					
Key sectors					
Defence	291.9	325.7	76.9	41.2	735.7
Justice & Immigration	258.0	–	303.0	–	561.0
Transport	153.0	86.5	32.5	204.9	476.9
Health	180.7	–	91.1	33.7	305.5
Citizen Services	447.9	277.1	74.0	72.8	871.8
	1,331.5	689.3	577.5	352.6	2,950.9
Timing of revenue recognition					
Revenue recognised from performance obligations satisfied in previous periods	0.2	–	–	–	0.2
Revenue recognised at a point in time	45.0	–	4.8	–	49.8
Products and services transferred over time	1,286.3	689.3	572.7	352.6	2,900.9
	1,331.5	689.3	577.5	352.6	2,950.9

Notes to the Consolidated Financial Statements continued

9. Revenue from contracts with customers continued

Transaction price allocated to remaining performance obligations

The following table shows the transaction price allocated to remaining performance obligations. This represents revenue expected to be recognised in subsequent periods arising on existing contractual arrangements. The Group has not taken the practical expedient in IFRS15.121 not to disclose information about performance obligations that have original expected durations of one year or less and therefore no consideration from contracts with customers is excluded from the amounts included below. Forecast variable revenue is included only to the extent that it is highly probable that a significant reversal will not occur.

	UK&E £m	Americas £m	AsPac £m	Middle East £m	Total £m
Within 1 year (2019)	1,138.3	424.8	497.0	241.1	2,301.2
Between 2 – 5 years (2020 – 2023)	2,962.6	162.9	724.8	144.1	3,994.4
5 years and beyond (2025+)	3,849.2	0.6	1,727.2	170.2	5,747.2
	7,950.1	588.3	2,949.0	555.4	12,042.8

Contract balance sheet items

The contract balances arising from contracts with customers are as follows:

	2018 £m	2017 £m
Contract assets		
Capitalised bid costs	4.9	6.2
Capitalised mobilisation and phase in costs	17.2	18.9
Accrued income and other unbilled receivables	222.2	214.5
	244.3	239.6

These amounts exclude Trade receivables disclosed separately in note 22. The key judgements relating to contract assets are described in note 22.

	2018 £m	2017 £m
Contract liabilities		
Deferred income	(160.9)	(147.6)

These amounts exclude Trade payables disclosed separately in note 24.

During the current year and the prior year, there have been no significant changes in contract assets or contract liabilities other than those arising in the normal course of business.

10. Exceptional items

Exceptional items are items of financial performance that are outside normal operations and are material to the results of the Group either by virtue of size or nature. As such, the items set out below require separate disclosure on the face of the income statement to assist in the understanding of the underlying performance of the Group.

Other exceptional operating items arising on continuing operations

For the year ended 31 December	2018 £m	2017 £m
Exceptional items arising		
Exceptional (loss)/profit on disposal of subsidiaries and operations	(0.5)	0.3
Other exceptional operating items		
Restructuring costs	(32.3)	(28.6)
Increase in onerous lease provision	(1.8)	–
Costs associated with UK Government review	0.4	(0.4)
Release of UK frontline clinical health contract provisions	–	0.4
Settlement of defined benefit pension obligations	–	10.3
Reversal of impairment of interest in joint venture and related loan balances	0.8	4.5
Reversal of impairment on loan balances	13.9	–
Impairment of AsPac customer lists	–	(6.1)
Cost of Guaranteed Minimum Pension equalisation	(9.6)	–
Increase in other provisions	(2.8)	–
Other exceptional operating items	(31.4)	(19.9)
Exceptional operating items	(31.9)	(19.6)
Exceptional finance income	7.5	–
Exceptional tax	2.1	(5.0)
Total operating and financing exceptional items net of tax	(22.3)	(24.6)

Exceptional profit on disposals

There were no material disposals of continuing operations in 2018 (2017: none).

Other exceptional operating items

The annual impairment testing of CGUs in 2018 has identified no impairment of goodwill.

The Group is incurring costs in relation to restructuring programmes resulting from the Strategy Review. These costs include redundancy payments, provisions (including onerous leases), external advisory fees and other incremental costs. Due to the nature and scale of the impact of the transformation phase of the Strategy Review, the incremental costs associated with this programme are considered to be exceptional. Costs associated with the restructuring programme resulting from the Strategy Review must meet the following criteria: that they are directly linked to the implementation of the Strategy Review; they are incremental costs as a result of the activity; and they are non business as usual costs. In 2018, a charge of £32.3m (2017: £28.6m) arose in relation to the restructuring programme resulting from the Strategy Review. The Strategy Review is discussed in more detail in the Strategic Report on page 18. Non-exceptional restructuring charges are incurred by the business as part of normal operational activity, which in the year totalled £6.3m (2017: £11.1m) and were included within operating profit before exceptional items. We expect exceptional restructuring costs of approximately £20.0m will be incurred in 2019, which we expect to be the final year.

There was an exceptional credit totalling £0.4m (2017: charge of £0.4m) associated with the UK Government reviews and the programme of Corporate Renewal. These costs have historically been treated as exceptional and consistent treatment is applied in 2018. The credit reflects the recovery of costs from the Group's insurance providers.

An exceptional charge of £9.6m (2017: nil) has been recorded in the Group's income statement for the year ended 31 December 2018. This is to recognise the Group's obligations associated with equalising the Guaranteed Minimum Pension (GMP) payments between male and female employees for the Group's defined benefit pension schemes following a High Court ruling made in October 2018. The Serco Pension and Life Assurance Scheme (SPLAS) recorded the largest charge being £9.0m. Included in the £9.6m charge is £0.3m related to the Group's share of the GMP cost in one of the Group's Joint Ventures. This has been recorded as exceptional to ensure consistent treatment of all items in 2018 related to the cost of equalising the GMP payments within the Group's pension schemes. The impact of GMP equalisation is not currently estimated to have a material impact in future years.

Notes to the Consolidated Financial Statements continued

10. Exceptional items continued

An additional charge of £2.8m has been recorded in respect of a legal dispute in the Group's North American Division. The treatment of this additional amount as exceptional is consistent with the recognition of the original charge associated with the same legal matter.

In 2016, a review of a joint venture's cash flow projections led to the impairment of certain equity interests and associated receivables balances, totalling £13.9m. The impairment was outside of the normal course of business and of a significant value, and was therefore considered to be an exceptional item. In the year ended 31 December 2018 payments of £0.8m (2017: £4.5m) were received against the impaired loan.

An exceptional profit of £13.9m (2017: nil) has been recognised for the settlement of consideration associated with the sale of Serco GmbH in 2012 through the offsetting of outstanding loan balances, the receivable of which had been impaired. An exceptional loss on disposal of £27.7m was recorded in 2012 in respect of the sale.

An exceptional charge of £10.7m arose in 2016 in respect of the bulk transfer of a number of employees that are being transferred from SPLAS to the Principal Civil Service Pension Scheme. This transfer was legally agreed in December 2016 at which point all obligations of SPLAS to pay retirement benefits for these individuals were eliminated and as a result, a settlement charge of £10.7m arose, for which a provision was made. In 2017 a new agreement was reached with the UK Government to transfer out the scheme members on an individual basis and the 2016 legal and commercial arrangements were cancelled by consent of all parties. As a result of the changes, the impact of the transfer was treated as an experience gain adjustment through other comprehensive income and the majority of the provision made in 2016 was reversed, resulting in a £10.3m credit to exceptional items in 2017. A cost of this nature did not reoccur in 2018.

In 2017 there were releases of provisions £0.4m which were previously charged through exceptional items in relation to the exit of the UK frontline clinical health contracts. As a result of contracts coming to the end of their natural lives and no significant new contracts being awarded by the customer, the remaining customer relationship intangible assets of the DMS Maritime Pty Limited business acquired in 2012 were impaired in 2017, totalling £6.1m.

Exceptional finance income

Part of the consideration for the sale of the Group's private sector BPO business in 2015 was a loan note with a face value of £30m accruing compound interest of 7%. The receivable associated with this loan note was recorded at a fair value of £19.5m. The discount on the loan note has been unwinding through the Group's net finance cost on an annual basis. During October 2018, the Intelenet business was sold and therefore repayment of the loan note was triggered resulting in a gain of £7.5m. As this gain is outside the normal financing arrangements of the Group and significant in size it has been recorded as exceptional investment income.

Exceptional tax

Exceptional tax for the year was a tax credit of £2.1m (2017: £5.0m charge) which arises on exceptional items within operating profit.

No net tax credit arises on the exceptional charge associated with GMP equalisation (further detail on this charge is included in the "Other exceptional operating items" section above). The credit of £1.6m that arises on the deferred tax movement associated with this charge is netted with an equal and opposite charge that arises on the associated reduction in the deferred tax asset in order to retain the net deferred tax position as supported by future forecast profits.

Remaining exceptional costs excluding the pension charge (£14.8m) only gave rise to a credit of £2.1m, as the majority of these costs were incurred in the UK where they only impact our unrecognised deferred tax in relation to losses.

11. Operating profit

Operating profit is stated after charging/(crediting):

Year ended 31 December	2018 £m	2017 £m
Research and development costs	0.6	1.7
Exceptional impairment of intangible assets	–	8.9
Loss on disposal of property, plant and equipment	0.5	0.2
Loss on disposal of intangible assets	1.5	0.3
Depreciation and impairment of property, plant and equipment*	20.2	20.8
Amortisation and impairment of intangible assets – arising on acquisition	4.3	4.4
Amortisation, write down and impairment of intangible assets – other	18.7	21.4
Exceptional net (loss)/gain on disposal of subsidiaries and operations (note 8)	0.5	(0.3)
Staff costs (note 12)	1,453.4	1,525.0
Allowance for doubtful debts charged/(credited) to income statement	(1.0)	0.7
Net foreign exchange charge	0.4	1.2
Movement on non-designated hedges and reclassified cash flow hedges	0.2	(0.2)
Lease payments recognised through operating profit	152.2	99.6
Operating lease income from sub-leases	(1.7)	(2.4)

* Results for the year ended 31 December 2017 have been restated to reflect the adoption of IFRS15 with effect from 1 January 2017. See note 2.

Amounts payable by the Company and its subsidiary undertakings in respect of audit and non-audit services to the Company's Auditor are shown below.

Year ended 31 December	2018 £m	2017 £m
Fees payable to the Company's Auditor for the audit of the Company's annual accounts	1.0	1.0
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	0.2	0.2
Total audit fees	1.2	1.2
– Audit-related assurance services	0.1	0.1
– Other services	0.1	0.1
Total non-audit fees	0.2	0.2

Fees payable to the Company's Auditor 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 Audit Committee Report on page 99. No services were provided pursuant to contingent fee arrangements.

Notes to the Consolidated Financial Statements continued

12. Staff costs

The average number of persons employed by the Company (including Executive Directors) was:

Year ended 31 December	2018 number	2017 number
UK & Europe	20,307	21,222
Americas	6,091	7,421
AsPac	8,851	8,739
Middle East	4,185	4,428
Unallocated	950	954
	40,384	42,764

The average number of persons employed includes all permanent employees and those with fixed term contracts. It excludes self-employed contractors and other casual workers.

Aggregate remuneration of all employees based on the average number of employees reported above was:

Year ended 31 December	2018 £m	2017 £m
Wages and salaries	1,251.7	1,326.5
Social security costs	95.3	102.9
Other pension costs (note 31)	91.7	84.2
	1,438.7	1,513.6
Share based payment expense (note 35)	14.7	11.4
	1,453.4	1,525.0

13. Investment revenue

Year ended 31 December	2018 £m	2017 (restated*) £m
Interest receivable on other loans and deposits	2.3	2.6
Net interest receivable on retirement benefit obligations (note 31)	0.8	3.8
Interest arising on customer contracts	–	0.4
Movement in discount on other debtors	1.2	1.2
	4.3	8.0

* Results for the year ended 31 December 2017 have been restated to reflect the adoption of IFRS15 with effect from 1 January 2017. See note 2.

14. Finance costs

Year ended 31 December	2018 £m	2017 £m
Interest payable on obligations under finance leases	0.6	1.3
Interest payable on other loans	13.8	14.0
Facility fees and other charges	3.1	3.0
Movement in discount on provisions	0.5	1.3
	18.0	19.6
Foreign exchange on financing activities	0.2	(0.4)
	18.2	19.2

15. Tax

15 (a) Income tax recognised in the income statement

Year ended 31 December	Before exceptional items 2018 £m	Exceptional items 2018 £m	Total 2018 £m	Before exceptional items 2017 (restated*) £m	Exceptional items 2017 £m	Total 2017 (restated*) £m
Current income tax						
Current income tax charge/(credit)	23.6	(1.4)	22.2	14.6	(2.4)	12.2
Adjustments in respect of prior years	(0.9)	–	(0.9)	(0.8)	–	(0.8)
Deferred tax						
Current year (credit)/charge	(13.8)	(0.7)	(14.5)	1.7	7.4	9.1
Adjustments in respect of prior years	(0.1)	–	(0.1)	(1.9)	–	(1.9)
	8.8	(2.1)	6.7	13.6	5.0	18.6

* Results for the year ended 31 December 2017 have been restated to reflect the adoption of IFRS15 with effect from 1 January 2017. See note 2.

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

Year ended 31 December	Before exceptional items 2018 £m	Exceptional items 2018 £m	Total 2018 £m	Before exceptional items 2017 (restated***) £m	Exceptional items 2017 £m	Total 2017 (restated***) £m
Profit before tax	98.5	(24.4)	74.1	30.2	(19.6)	10.6
Tax calculated at a rate of 19.00% (2017: 19.25%)	18.7	(4.6)	14.1	5.8	(3.8)	2.0
Expenses not deductible for tax purposes*	5.3	–	5.3	5.9	0.3	6.2
UK unprovided deferred tax**	(7.5)	3.5	(4.0)	(3.0)	2.9	(0.1)
Other unprovided deferred tax	2.5	–	2.5	2.3	0.1	2.4
Effect of the use of unrecognised tax losses	(0.3)	–	(0.3)	(1.2)	(0.5)	(1.7)
Impact of changes in statutory tax rates on current income tax	1.7	–	1.7	1.4	(2.2)	(0.8)
Change in deferred tax as a result of legislative changes	–	–	–	–	(8.8)	(8.8)
Overseas rate differences	7.3	(0.7)	6.6	9.2	(0.8)	8.4
Other non taxable income	(2.5)	(0.4)	(2.9)	(0.9)	(0.5)	(1.4)
Adjustments in respect of prior years	(1.0)	–	(1.0)	(2.9)	–	(2.9)
Adjustments in respect of deferred tax on pensions	(10.1)	–	(10.1)	2.2	18.3	20.5
Adjustments in respect of equity accounted investments	(5.3)	0.1	(5.2)	(5.2)	–	(5.2)
Tax charge	8.8	(2.1)	6.7	13.6	5.0	18.6

* Relates to costs that are not allowable for tax deduction under local tax law

** Arises due to timing differences between when an amount is recognised in the income statement and when the amount is subject to UK tax. In the current year, the Group has received tax deductions for amounts which have been charged to the income statement in previous periods in connection with items such as fixed assets. Additional tax is recognised in relation to brought forward losses as shown in the deferred tax note below. UK unprovided deferred tax in relation to exceptional items relates to amounts which have been charged to the income statement in the current period for which no tax deduction has yet been taken, for items such as restructuring costs.

*** Results for the year ended 31 December 2017 have been restated to reflect the adoption of IFRS15 with effect from 1 January 2017. See note 2.

The income tax charge for the year is based on the blended UK statutory rate of corporation tax for the period of 19.00% (2017: 19.25%). Taxation for other jurisdictions is calculated at the rates prevailing in the respective jurisdictions.

Notes to the Consolidated Financial Statements continued

15. Tax continued

15 (b) Income tax recognised in the SOCI

Year ended 31 December	2018 £m	2017 £m
Current tax		
Taken to retirement benefit obligations reserve	–	–
Deferred tax		
Relating to cash flow hedges	–	–
Taken to retirement benefit obligations reserve	(9.2)	18.1
	(9.2)	18.1

16. Deferred tax

Deferred income taxes are calculated in full on temporary differences under the liability method using local substantively enacted tax rates.

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

	2018 £m	2017 (restated*) £m
At 1 January – asset	(39.3)	(24.8)
Income statement charge/(credit)	(14.7)	7.2
Items recognised in equity and in other comprehensive income	9.2	(18.1)
Arising on acquisition	2.3	(1.0)
Exchange differences	3.0	(2.6)
At 31 December – asset	(39.5)	(39.3)

* Results for the year ended 31 December 2017 have been restated to reflect the adoption of IFRS15 with effect from 1 January 2017. See note 2.

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	OCPs £m	Tax losses £m	Other temporary differences £m	Total £m
At 1 January 2018 (restated*)	25.8	(12.2)	2.5	(7.9)	(18.7)	(28.8)	(39.3)
(Credited)/charged to income statement (note 15a)	(4.7)	(1.8)	(1.7)	0.8	(1.9)	(5.4)	(14.7)
Items recognised in equity and in other comprehensive income (note 15b)	–	–	9.2	–	–	–	9.2
Arising on acquisition	2.3	–	–	–	–	–	2.3
Exchange differences	1.2	0.3	(0.1)	(0.3)	–	1.9	3.0
At 31 December 2018	24.6	(13.7)	9.9	(7.4)	(20.6)	(32.3)	(39.5)

* Results for the year ended 31 December 2017 have been restated to reflect the adoption of IFRS15 with effect from 1 January 2017. See note 2.

Of the amount credited to the income statement, £0.1m (2017: charge of £0.1m) has been taken to cost of sales in respect of the R&D Expenditure credit. Other temporary differences include a deferred tax asset of £nil in respect of derivative financial instruments (2017: £nil).

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	OCPs £m	Tax losses £m	Other temporary differences £m	Total £m
At 1 January 2017 (restated*)	36.5	(12.0)	17.6	(17.8)	(10.3)	(38.8)	(24.8)
(Credited)/charged to income statement (note 15a)	(6.7)	0.3	2.8	9.2	(8.4)	10.0	7.2
Items recognised in equity and in other comprehensive income (note 15b)	–	–	(18.1)	–	–	–	(18.1)
Arising on acquisition	(0.1)	(0.9)	–	–	–	–	(1.0)
Exchange differences	(3.9)	0.4	0.2	0.7	–	–	(2.6)
At 31 December 2017	25.8	(12.2)	2.5	(7.9)	(18.7)	(28.8)	(39.3)

* Results and balances for the year ended 31 December 2017 have been restated to reflect the adoption of IFRS15 with effect from 1 January 2017. See note 2.

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:

	2018 £m	2017 (restated*) £m
Deferred tax liabilities	21.4	20.4
Deferred tax assets	(60.9)	(59.7)
	(39.5)	(39.3)

* Balances for the year ended 31 December 2017 have been restated to reflect the adoption of IFRS15 with effect from 1 January 2017. See note 2.

As at the balance sheet date, the UK has a potential deferred tax asset of £168.8m (2017: £177.0m) available for offset against future profits. A deferred tax asset has currently been recognised of £20.3m (2017: £17.4m). Recognition has been based on forecast future taxable profits. No deferred tax asset has been recognised in respect of the remaining asset (net £148.5m) based on current forecasts; additional asset recognition is contingent on further improvement in the UK profit forecast. Measures enacted during 2016 cut the future tax rate from April 2020 from 19% to 17%. These measures will reduce the Group's future current tax charge accordingly. The deferred tax balance at 31 December 2018 has been calculated reflecting the reduced rate.

Losses of £0.2m (2017: £0.1m) expire within 5 years, losses of £0.1m (2017: £0.1m) expire within 6-10 years, losses of £0.7m (2017: £4.1m) expire within 20 years and losses of £1,015.2m (2017: £998.4m) may be carried forward indefinitely.

Notes to the Consolidated Financial Statements continued

17. Earnings per share

Basic and diluted earnings per ordinary share (EPS) have been calculated in accordance with IAS33 *Earnings per Share*.

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

Number of shares	2018 millions	2017 (restated*) millions
Weighted average number of ordinary shares for the purpose of basic EPS	1,094.4	1,089.7
Effect of dilutive potential ordinary shares: Share options	31.0	30.9
Weighted average number of ordinary shares for the purpose of diluted EPS	1,125.4	1,120.6

* The number of dilutive ordinary shares has been restated to ensure that the calculation is consistent with the method used for the current financial year. This does not impact the diluted earnings per share for 2017 as the Company was in a loss making position.

At 31 December 2018 options over 145,238 (2017: 236,616) shares were excluded from the weighted average number of shares used for calculating diluted earnings per share in accordance with IFRS2 *Share Based Payments* because their exercise price was above the average share price for the year and they were, therefore, anti-dilutive.

Earnings per share

	Earnings 2018 £m	Per share amount 2018 pence	Earnings 2017 (restated*) £m	Per share amount 2017 (restated*) Pence
Basic EPS				
Earnings for the purpose of basic EPS	67.4	6.16	(8.3)	(0.76)
Effect of dilutive potential ordinary shares	–	(0.17)	–	–
Diluted EPS	67.4	5.99	(8.3)	(0.76)
Basic EPS excluding exceptional items				
Earnings for the purpose of basic EPS	67.4	6.16	(8.3)	(0.76)
Add back exceptional items	24.4	2.23	19.6	1.80
Add back tax on exceptional items	(2.1)	(0.19)	5.0	0.46
Earnings excluding exceptional operating items for the purpose of basic EPS	89.7	8.20	16.3	1.50

* Results and balances for the year ended 31 December 2017 have been restated to reflect the adoption of IFRS15 with effect from 1 January 2017. See note 2.

18. Goodwill

	Cost £m	Accumulated impairment losses £m	Carrying amount £m
At 1 January 2017	926.5	(348.6)	577.9
Exchange differences	(48.5)	21.9	(26.6)
At 1 January 2018	878.0	(326.7)	551.3
Exchange differences	24.4	(12.9)	11.5
Acquisitions	16.8	–	16.8
At 31 December 2018	919.2	(339.6)	579.6

Movements in the balance since the prior year end can be seen as follows:

	Goodwill balance 1 January 2018 £m	Additions 2018 £m	Exchange differences 2018 £m	Impairment 2018 £m	Goodwill balance 31 December 2018 £m	Headroom on impairment analysis 2018 £m	Headroom on impairment analysis 2017 £m
UK & Europe	177.5	6.8	–	–	184.3	593.6	427.7
Americas	253.0	10.0	15.9	–	278.9	159.4	151.8
AsPac	110.8	–	(4.9)	–	105.9	307.8	231.6
Middle East	10.0	–	0.5	–	10.5	57.9	145.6
	551.3	16.8	11.5	–	579.6	1,118.7	956.7

Included above is the detail of the headroom on the CGUs existing at the year-end which reflects where future discounted cash flows are greater than the underlying assets and includes all relevant cash flows, including where provisions have been made for future costs and losses.

Late in 2017, the Group amalgamated its Central Government and Local and Regional Government divisions into a combined UK & Europe division led by a single management team. Within the UK & Europe division, there are a number of business units, each individually representing a cash generating unit, three of which have an amount of goodwill allocated to them. Following the combination of divisions in 2017, the management structure across the UK & Europe division has been aligned to the management structure across other divisions with divisional resources and certain operational decisions being considered on a division-wide basis. The UK & Europe division now represents the lowest level at which goodwill is monitored for internal management purposes and as a result goodwill will be tested for impairment across the group of CGUs that make up the division.

Notes to the Consolidated Financial Statements continued

18. Goodwill continued

Had the movements and headroom for the year ended 31 December 2018 been prepared on a basis consistent with the year ended 31 December 2017, the result would have been:

	Goodwill balance 1 January 2018 £m	Additions 2018 £m	Exchange differences 2018 £m	Impairment 2018 £m	Goodwill balance 31 December 2018 £m	Headroom on impairment analysis 2018 £m	Headroom on impairment analysis (restated*) 2017 £m
UK & Europe							
Justice & Immigration	49.6	–	–	–	49.6	188.4	127.4
Health	60.6	6.8	–	–	67.4	64.9	19.4
Direct Services & Europe	67.3	–	–	–	67.3	41.6	71.5
Americas	253.0	10.0	15.9	–	278.9	159.4	151.8
AsPac	110.8	–	(4.9)	–	105.9	307.8	231.6
Middle East	10.0	–	0.5	–	10.5	57.9	145.6
	551.3	16.8	11.5	–	579.6	820.0	747.3

* Within the Group's restructuring activities late in 2017, the historic Citizen Services business unit was amalgamated with Direct Services, meaning that no separate financial information is available for 2018. As a result, the headroom on the impairment analysis for 2017 has been restated, increasing by £1.2m, to reflect the value in use calculation of the Citizen Services business unit as at 31 December 2017.

Headroom under the revised approach used in 2018 is greater than that which would have existed under the 2017 approach due to the fact that there are additional business units to which no goodwill was previously allocated which form part of the UK & Europe group of CGUs.

The key assumptions applied in the impairment review are set out below:

	Discount rate 2018 %	Discount rate 2017 %	Terminal growth rates 2018 %	Terminal growth rates 2017 %
UK & Europe	10.0	10.8	2.0	2.0
Americas	10.6	10.5	2.4	2.4
AsPac	10.0	9.7	2.4	2.4
Middle East	11.8	10.8	2.5	2.5

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 reviewed annually with external advisers and are adjusted for risks specific to the market in which the CGU operates.

Short term growth rates

The annual impairment test is performed immediately prior to the year end, based initially on five year cash flow forecasts approved by senior management. Short term revenue growth rates used in each CGU five year plan are based on internal data regarding our current contracted position, the pipeline of opportunities and forecast growth for the relevant market.

Short term profitability and cash conversion is based on our historic experiences and a level of judgement is applied to expected changes in both. Where businesses have been poor performers in recent history, turnaround has only been assumed where a detailed and achievable plan is in place and all forecasts include cash flows relating to contracts where onerous contract provisions have been made.

Terminal growth rates

The calculations include a terminal value based on the projections for the fifth year of the short term plan, with a growth rate assumption applied which extrapolates the business into perpetuity. The terminal growth rates are based on long term inflation rates of the geographic market in which the CGUs operate and therefore do not exceed the average long term growth rates forecast for the individual markets. These are provided by external sources.

Sensitivity analysis

Sensitivity analysis has been performed for each key assumption, a 1% movement in discount rates and a 1% movement in terminal growth rates are considered to be reasonably possible. No impairment results from these changes being made to the key assumptions either individually or in combination. When reviewing the cash generating units in a manner consistent with 2017, it was noted that a reduction of £6.9m in the terminal year cash flows for the Health CGU would lead to the recoverable amount no longer exceeding the carrying value. Having reviewed the forecast cash flows associated with the group of CGUs making up UK and Europe the required reduction in terminal year cash flows, which would result in an impairment of goodwill, was considered an unlikely scenario.

19. Other intangible assets

	Acquisition related		Other		Total £m
	Customer relationships £m	Licences and franchises £m	Software and IT £m	Internally generated development expenditure £m	
Cost					
At 1 January 2018	65.1	0.2	122.8	56.6	244.7
Arising on acquisition	16.7	–	–	–	16.7
Eliminated on disposal	(3.9)	–	(7.0)	–	(10.9)
Additions from internal development	–	–	6.5	–	6.5
Additions from external acquisition	–	–	2.4	–	2.4
Disposals	(27.7)	–	(5.0)	–	(32.7)
Reclassification from property, plant and equipment	–	–	3.4	–	3.4
Exchange differences	1.5	–	–	0.1	1.6
At 31 December 2018	51.7	0.2	123.1	56.7	231.7
Accumulated amortisation and impairment					
At 1 January 2018	58.5	0.1	75.8	43.6	178.0
Brought forward reclassification	–	–	1.2	–	1.2
Arising on acquisition	–	–	–	–	–
Eliminated on disposal	(3.9)	–	(7.0)	–	(10.9)
Impairment charge	–	–	0.1	–	0.1
Amortisation charge – internal development	–	–	10.8	5.6	16.4
Amortisation charge – external	4.3	–	2.2	–	6.5
Disposals	(27.7)	–	(3.0)	–	(30.7)
Reclassification from property, plant and equipment	–	–	2.4	–	2.4
Exchange differences	1.0	–	0.3	0.1	1.4
At 31 December 2018	32.2	0.1	82.8	49.3	164.4
Net book value					
At 31 December 2018	19.5	0.1	40.3	7.4	67.3

Notes to the Consolidated Financial Statements continued

19. Other intangible assets continued

	Acquisition related		Other		Total £m
	Customer relationships £m	Licences and franchises £m	Software and IT £m	Internally generated development expenditure £m	
Cost					
At 1 January 2017	67.6	0.3	120.6	55.7	244.2
Arising on acquisition	0.9	–	0.9	–	1.8
Eliminated on disposal	–	–	(1.2)	–	(1.2)
Additions from internal development	–	–	9.9	0.9	10.8
Additions from external acquisition	–	–	7.6	–	7.6
Disposals	–	(0.1)	(13.4)	(0.1)	(13.6)
Reclassification from/(to) other intangible asset categories	–	–	0.2	(0.2)	–
Reclassification to property, plant and equipment	–	–	0.4	–	0.4
Research and development expenditure credit	–	–	–	0.7	0.7
Exchange differences	(3.4)	–	(2.2)	(0.4)	(6.0)
At 31 December 2017	65.1	0.2	122.8	56.6	244.7
Accumulated amortisation and impairment					
At 1 January 2017	50.4	0.3	71.6	38.3	160.6
Arising on acquisition	–	–	0.9	–	0.9
Eliminated on disposal	–	–	(1.1)	–	(1.1)
Impairment charge	6.1	–	2.8	–	8.9
Amortisation charge – internal development	–	–	11.8	5.7	17.5
Amortisation charge – external	4.4	–	3.9	–	8.3
Disposals	–	(0.1)	(13.0)	(0.1)	(13.2)
Reclassification to property, plant and equipment	–	–	0.4	–	0.4
Exchange differences	(2.4)	(0.1)	(1.5)	(0.3)	(4.3)
At 31 December 2017	58.5	0.1	75.8	43.6	178.0
Net book value					
At 31 December 2017	6.6	0.1	47.0	13.0	66.7

Included in Software and IT and other internally generated development expenditure is an amount of £3.6m (2017: £6.1m) in respect of leased intangibles.

Customer relationships are amortised over the average length of contracts acquired. The Group is carrying £19.5m (2017: £6.6m) in relation to Customer relationships. Amortisation of intangibles arising on acquisition consists of amortisation in relation to Customer relationships and Licences and franchises and totals £4.3m (2017: £4.4m).

The net book value of internally generated intangible assets as at 31 December 2018 was approximately £7.4m (2017: £13.0m) in development expenditure and £28.0m (2017: £34.3m) in software and IT.

20. Property, plant and equipment

	Freehold land and buildings £m	Short- leasehold assets £m	Machinery, motor vehicles, furniture and equipment £m	Total £m
Cost				
At 1 January 2018 (restated*)	4.6	30.3	186.4	221.3
Arising on acquisition	–	0.1	0.1	0.2
Eliminated on disposal	–	–	(1.9)	(1.9)
Additions	–	6.5	23.5	30.0
Reclassification to other intangible assets	–	–	(3.4)	(3.4)
Disposals	–	(7.2)	(31.2)	(38.4)
Exchange differences	–	0.6	0.2	0.8
At 31 December 2018	4.6	30.3	173.7	208.6
Accumulated depreciation and impairment				
At 1 January 2018 (restated*)	2.7	23.8	133.5	160.0
Brought forward reclassification	–	–	0.3	0.3
Eliminated on disposal	–	–	(1.9)	(1.9)
Charge for the year – impairment	–	–	0.7	0.7
Charge for the year – depreciation	0.2	2.6	16.7	19.5
Reclassification to other intangible assets	–	–	(2.4)	(2.4)
Disposals	–	(7.0)	(25.6)	(32.6)
Exchange differences	–	0.1	0.1	0.2
At 31 December 2018	2.9	19.5	121.4	143.8
Net book value				
At 31 December 2018	1.7	10.8	52.3	64.8
2017				
	Freehold land and buildings £m	Short- leasehold assets £m	Machinery, motor vehicles, furniture and equipment £m	Total £m
Cost				
At 1 January 2017 (restated*)	4.0	32.4	202.3	238.7
Arising on acquisition	–	–	0.4	0.4
Additions*	0.5	2.0	15.7	18.2
Reclassification to other intangible assets	–	(0.4)	–	(0.4)
Disposals*	–	(2.5)	(29.8)	(32.3)
Exchange differences	0.1	(1.2)	(2.2)	(3.3)
At 31 December 2017	4.6	30.3	186.4	221.3
Accumulated depreciation and impairment				
At 1 January 2017 (restated*)	2.5	22.8	146.2	171.5
Arising on acquisition	–	–	0.4	0.4
Charge for the year – impairment	–	–	(0.1)	(0.1)
Charge for the year – depreciation*	0.2	3.2	17.5	20.9
Reclassification to other intangible assets	–	(0.4)	–	(0.4)
Disposals*	–	(1.0)	(28.9)	(29.9)
Exchange differences	–	(0.8)	(1.6)	(2.4)
At 31 December 2017	2.7	23.8	133.5	160.0
Net book value				
At 31 December 2017 (restated*)	1.9	6.5	52.9	61.3

* Balances for the year ended 31 December 2017 have been restated to reflect the adoption of IFRS15 with effect from 1 January 2017. See note 2.

The carrying amount of the Group's Machinery, motor vehicles, furniture and equipment includes an amount of £23.4m (2017: £23.4m) in respect of assets held under finance leases.

The carrying amount of the Group's Short-leasehold assets includes an amount of £0.1m (2017: £0.1m) in respect of assets held under finance leases.

Notes to the Consolidated Financial Statements continued

21. Inventories

	2018 £m	2017 £m
Service spares	14.9	13.0
Parts awaiting installation	2.7	1.9
Work in progress	5.3	2.5
	22.9	17.4

22. Contract assets, trade and other receivables

	2018 £m	2017 (restated*) £m
Contract assets: Current		
Accrued income and other unbilled receivables	222.2	214.5
Capitalised bid and phase in costs	22.1	25.1
	244.3	239.6

* Balances for the year ended 31 December 2017 have been restated to reflect the adoption of IFRS15 with effect from 1 January 2017. See note 2.

The Group has capitalised bid costs of £4.9m (2017: £6.2m) and phase in costs of £17.2m (2017 restated*: £18.9m) that are realised as a part of the normal operating cycle of the Group. These assets represent up-front investment in contracts which are recoverable and expected to provide benefits over the life of those contracts. Bid costs are capitalised only when they relate directly to a contract and are incremental to securing the contract. Any costs which would have been incurred whether or not the contract is actually won are not considered to be capitalised bid costs.

Contract costs can only be capitalised when the expenditure meets all three criteria identified in note 2.

Movements in the period were as follows:

	2018 £m	2017 (restated*) £m
Capitalised bid and phase in costs		
At 1 January	25.1	27.0
Additions	3.9	5.0
Amortisation	(5.5)	(6.8)
Reclassified to contract asset	(1.2)	–
Exchange differences	(0.2)	(0.1)
At 31 December	22.1	25.1

* Balances for the year ended 31 December 2017 have been restated to reflect the adoption of IFRS15 with effect from 1 January 2017. See note 2.

Total trade and other receivables held by the Group at 31 December 2018 amount to £329.8m (2017: £329.7m).

	2018 £m	2017 £m
Trade and other receivables: Non current		
Loans receivable (note 26)	–	25.7
Other investments	9.9	10.0
Other receivables	20.4	21.6
	30.3	57.3

	2018 £m	2017 (restated*) £m
Trade and other receivables: Current		
Trade receivables	227.1	188.8
Prepayments	51.2	48.4
Amounts owed by joint ventures and associates	0.7	0.6
Security deposits	0.2	0.3
Other receivables	20.3	34.3
	299.5	272.4

* Results for the year ended 31 December 2017 have been restated to reflect the adoption of IFRS15 with effect from 1 January 2017. See note 2.

The Group has a receivables financing facility of £30.0m (2017: £30.0m), which was un-utilised at 31 December 2018 (31 December 2017: £nil utilised).

The management of trade receivables is the responsibility of the operating segments, although they report to Group on a monthly basis on debtor days, debtor ageing and significant outstanding debts. The average credit period taken by customers is 29 days (2017: 23 days) and no interest is charged on overdue amounts.

Each customer has an external credit score which determines the level of credit provided. However, the majority of our customers have a sovereign credit rating as a result of being government organisations. Of the trade receivables balance at the end of the year, £88.7m is due from agencies of the UK Government, the Group's largest customer, £34.8m from the Australian Government, £64.9m from the Government of the United Arab Emirates, and £13.4m from the US Government. There are no other customers who represent more than 5% of the total balance of trade receivables. Of the trade receivables balance at the end of 2017, £54.1m was due from agencies of the UK Government. 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.

As at 31 December 2018, a total of £0.8m (2017: £1.6m) of trade receivables held by the Group 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 total amount of the provision for the Group was £2.8m as of 31 December 2018 (2017: £3.6m). The Group does not have any impairments associated with expected credit losses.

	2018 £m	2017 £m
Ageing of trade receivables		
Neither impaired nor past due	168.2	144.3
Not impaired but overdue by less than 30 days	35.2	29.6
Not impaired but overdue by between 30 and 60 days	9.6	8.2
Not impaired but overdue by more than 60 days	16.1	8.7
Impaired	0.8	1.6
Allowance for doubtful debts	(2.8)	(3.6)
	227.1	188.8

Of the total overdue trade receivable balance, 50% (2017: 38%) relates to the UK, US or Australian governments, and a further 37% (2017: 38%) relates to the government of the United Arab Emirates. The total allowance for doubtful debts is greater than the assets identified as impaired due to provision being made for partial impairment of balances held within one of the ageing categories.

	2018 £m	2017 £m
Movements on the Group allowance for doubtful debts		
At 1 January	3.6	3.6
Net charges and releases to income statement	(1.0)	0.7
Utilised	0.2	(0.5)
Exchange differences	–	(0.2)
At 31 December	2.8	3.6

Included in the current other receivables balance is a further £5.6m (2017: £10.2m) due from agencies of the UK Government.

An amount of £nil (2017: £5.5m) is held within current other receivables in relation to insurance claims where it is probable that the Group will receive future payments.

Notes to the Consolidated Financial Statements continued

23. Cash and cash equivalents

	Sterling 2018 £m	Other currencies 2018 £m	Total 2018 £m	Sterling 2017 £m	Other currencies 2017 £m	Total 2017 £m
Customer advance payments*	–	1.0	1.0	–	0.2	0.2
Other cash and short-term deposits	38.7	22.8	61.5	79.6	32.3	111.9
Total cash and cash equivalents	38.7	23.8	62.5	79.6	32.5	112.1

* Customer advance payments totalling £1.0m (2017: £0.2m) 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.

24. Contract liabilities, trade and other payables

	2018 £m	2017 (restated*) £m
Contract liabilities: Current		
Deferred income	74.3	64.3
Contract liabilities: Non current		
Deferred income	86.6	83.3

* Balances for the year ended 31 December 2017 have been restated to reflect the adoption of IFRS15 with effect from 1 January 2017. See note 2.

Total trade and other payables held by the Group at 31 December 2018 amount to £443.0m (2017: £437.3m).

	2018 £m	2017 £m
Trade and other payables: Current		
Trade payables	67.4	78.4
Other payables	89.6	71.1
Accruals	262.7	259.1
	419.7	408.6

The average credit period taken for trade purchases is 30 days (2017: 33 days).

	2018 £m	2017 £m
Trade and other payables: Non current		
Other payables	23.3	28.7

25. Obligations under finance leases

	Minimum lease payments 2018 £m	Present value of minimum lease payments 2018 £m	Minimum lease payments 2017 £m	Present value of minimum lease payments 2017 £m
Amounts payable under finance leases				
Within one year	6.1	5.7	9.1	8.5
Between one and five years	8.6	8.2	11.0	10.4
After five years	0.9	0.9	1.4	1.3
	15.6	14.8	21.5	20.2
Less: future finance charges	(0.8)	–	(1.3)	–
Present value of lease obligations	14.8	14.8	20.2	20.2
Less: amount due for settlement within one year (shown within current liabilities)	(5.7)	(5.7)	(8.5)	(8.5)
Amount due for settlement after one year	9.1	9.1	11.7	11.7

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.

26. Loans

	Total 2018 £m	Total 2017 £m
Loans are repayable as follows:		
On demand or within one year	21.9	31.8
Between one and two years	6.4	19.7
Between two and five years	159.5	105.0
After five years	51.7	89.3
	239.5	245.8
Less: amount due for settlement within one year (shown within current liabilities)	(21.9)	(31.8)
Less: amounts shown in receivables (note 22)	–	25.7
Amount due for settlement after one year	217.6	239.7

	Carrying amount 2018 £m	Fair value 2018 £m	Carrying amount 2017 £m	Fair value 2017 £m
Other loans	239.5	229.9	271.5	263.1
Loan receivables	–	–	(25.7)	(25.7)
	239.5	229.9	245.8	237.4

The fair values are based on cash flows discounted using a market rate appropriate to the loan. All loans are held at amortised cost.

Notes to the Consolidated Financial Statements continued

26. Loans continued

Analysis of Net Debt

The analysis below provides a reconciliation between the opening and closing positions in the balance sheet for liabilities arising from financing activities together with movements in cash loan receivables and derivatives relating to the items included in Net Debt. There were no changes in fair value noted in either the current or prior year.

	At 1 January 2018 £m	Cash flow £m	Acquisitions* £m	Disposals £m	Exchange differences £m	Non cash movements £m	At 31 December 2018 £m
Loans payable	(271.5)	33.3	–	–	(12.9)	11.6	(239.5)
Obligations under finance leases	(20.2)	8.7	–	–	0.1	(3.4)	(14.8)
Liabilities arising from financing activities	(291.7)	42.0	–	–	(12.8)	8.2	(254.3)
Cash and cash equivalents	112.1	(50.4)	1.2	–	(0.4)	–	62.5
Loan receivables	25.7	(37.4)	–	–	–	11.7	–
Derivatives relating to Net Debt	12.8	–	–	–	(9.0)	–	3.8
Net Debt	(141.1)	(45.8)	1.2	–	(22.2)	19.9	(188.0)

	At 1 January 2017 £m	Cash flow £m	Acquisitions* £m	Disposals £m	Exchange differences £m	Non cash movements £m	At 31 December 2017 £m
Loans payable	(299.9)	3.8	–	–	25.4	(0.8)	(271.5)
Obligations under finance leases	(28.2)	12.6	–	–	0.1	(4.7)	(20.2)
Liabilities arising from financing activities	(328.1)	16.4	–	–	25.5	(5.5)	(291.7)
Cash and cash equivalents	177.8	(57.3)	1.5	(7.1)	(2.8)	–	112.1
Loan receivables	22.9	(0.6)	–	–	–	3.4	25.7
Derivatives relating to Net Debt	18.1	–	–	–	(5.3)	–	12.8
Net Debt	(109.3)	(41.5)	1.5	(7.1)	17.4	(2.1)	(141.1)

* Acquisitions represent the net cash/(debt) acquired on acquisition.

27. Provisions

	Employee related £m	Property £m	Contract £m	Other £m	Total £m
At 1 January 2018 (restated*)	55.7	13.6	148.1	102.9	320.3
Brought forward reclassification	–	–	(1.5)	–	(1.5)
Arising on acquisition	–	–	–	0.7	0.7
Eliminated on disposal of subsidiary	–	–	–	–	–
Charged to income statement – exceptional	2.8	1.8	–	2.8	7.4
Charged to income statement – other	14.3	2.1	3.4	3.3	23.1
Released to income statement – exceptional	(4.7)	–	–	(0.9)	(5.6)
Released to income statement – other	(0.7)	(2.1)	(16.2)	(12.0)	(31.0)
Utilised during the year	(7.9)	(2.9)	(51.8)	(13.2)	(75.8)
Reclassification	–	–	–	0.5	0.5
Unwinding of discount	–	–	0.5	–	0.5
Exchange differences	–	(0.1)	(0.4)	1.3	0.8
At 31 December 2018	59.5	12.4	82.1	85.4	239.4
Analysed as:					
Current	19.9	4.3	54.6	41.3	120.1
Non current	39.6	8.1	27.5	44.1	119.3
	59.5	12.4	82.1	85.4	239.4

* Balances for the year ended 31 December 2017 have been restated to reflect the adoption of IFRS15 with effect from 1 January 2017. See note 2.

Contract provisions relate to onerous contracts which will be utilised over the life of each individual contract. The present value of the estimated future cash outflow required to settle the contract obligations as they fall due over the respective contracts has been used in determining the provision. The individual provisions are discounted where the impact is assessed to be significant. Discount rates used are calculated based on the estimated risk free rate of interest for the region in which the provision is located and matched against the ageing profile of the provision. In 2018, additional charges have been made in respect of future losses on a number of onerous contracts totalling £3.4m. This increase related to revisions to existing OCPs of £82.1m at 31 December 2018. No new OCPs were created during the year.

A full analysis is performed at least annually of the future profitability of all contracts with marginal performances and of the balance sheet items directly linked to these contracts.

Due to the significant size of the balance and the inherent level of uncertainty over the amount and timing of the related cash flows upon which onerous contract provisions are based, if the expected operational performance varies from the best estimates made at the year end, a material change in estimate may be required. The key drivers behind operational performance is the level of activity required to be serviced, which is often directed by the actions of the UK Government, and the efficiency of Group employees and resources.

Employee related provisions are for long-term service awards and terminal gratuity 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. There are also amounts included in relation to restructuring. The provisions will be utilised over various periods driven by local legal or regulatory requirements, the timing of which is not certain.

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 generated in the future. The provision has been calculated based on the discounted cash outflow required to settle the lease obligations as they fall due, with the longest running lease ending in April 2039.

Other provisions are held for indemnities given on disposed businesses, legal and other costs that the Group expects to incur over an extended period, in respect of past events. These costs are based on past experience of similar items and other known factors and represent management's best estimate of the likely outcome and will be utilised with reference to the specific facts and circumstances. The timing of utilisation is dependant on future events which could occur within the next twelve months over a longer period with the majority expected to be settled by 31 December 2021.

28. Capital and other commitments

	2018 £m	2017 £m
Capital expenditure contracted but not provided		
Property, plant and equipment	0.8	0.9
Intangible assets	0.9	0.2

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:

	2018 £m	2017 (restated*) £m
Within one year	73.2	63.1
Between one and five years	95.1	122.0
After five years	22.1	33.6
	190.4	218.7

* Subsequent to issuing the annual report and accounts for the year ended 31 December 2017, a decision was made following a review of the terms and conditions associated with the commitments of the Group's contracts, to reclassify certain costs from operating lease charges to service costs and to remove costs beyond the expected termination date. There was no impact on classification in the income statement, however the reclassification meant that future costs relating to the service were no longer classified as operating lease commitments.

Notes to the Consolidated Financial Statements continued

29. Contingent liabilities

The Company has guaranteed overdrafts, finance leases, and bonding facilities of its joint ventures and associates up to a maximum value of £4.3m (2017: £4.3m). The actual commitment outstanding at 31 December 2018 was £4.3m (2017: £4.3m).

The Company and its subsidiaries have provided certain guarantees and indemnities in respect of performance and other bonds, issued by its banks on its behalf in the ordinary course of business. The total commitment outstanding as at 31 December 2018 was £225.3m (2017: £227.1m).

As we have disclosed before, we are under investigation by the Serious Fraud Office. In November 2013, the UK's Serious Fraud Office announced that it had opened an investigation, which remains ongoing, into the Group's Electronic Monitoring Contract.

We are cooperating fully with the Serious Fraud Office's investigation but it is not possible to predict the outcome and timing. However, disclosed in the Principal Risks and Uncertainties in this Report is a description of the range of possible outcomes in the event that the Serious Fraud Office decides to prosecute the individuals and/or the Serco entities involved.

The Group is also aware of other claims and potential claims which involve or may involve legal proceedings against the Group although the timing of settlement of these claims remains uncertain. 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.

30. Financial risk management

30 (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: Inputs derived from unadjusted quoted prices in active markets for identical assets or liabilities.

Level 2: Inputs are inputs, other than quoted prices included within Level 1, that are observable for the asset or liability, either directly or indirectly.

Level 3: Inputs are unobservable inputs for the asset or liability.

Based on the above, the derivative financial instruments held by the Group at 31 December 2018 and the comparison fair values for loans and finance leases, are all considered to fall into Level 2. Market prices are sourced from Bloomberg and third party valuations. The valuation models incorporate various inputs including foreign exchange spot and forward rates and interest rate curves. There have been no transfers between levels in the year.

The Group held the following financial instruments which fall within the scope of IFRS9 *Financial Instruments* at 31 December:

	Carrying amount (measurement basis)			Comparison fair value	Carrying amount (measurement basis)			Comparison fair value
	Amortised cost 2018 £m	Fair value – Level 2 2018 £m	Level 2 2018 £m		Amortised cost 2017 £m	Fair value – Level 2 2017 £m	Level 2 2017 £m	
Financial assets								
Financial assets – current								
Cash and bank balances	62.5	–	62.5		112.1	–	112.1	
Derivatives designated as FVTPL								
Forward foreign exchange contracts	–	2.4	–		–	4.5	–	
Derivative instruments in designated hedge accounting relationships								
Cross currency swaps	–	5.1	–		–	5.7	–	
Forward foreign exchange contracts	–	0.2	–		–	0.1	–	
Loans and receivables								
Trade receivables (note 22)	227.1	–	227.1		188.8	–	188.8	
Security deposits (note 22)	0.2	–	0.2		0.3	–	0.3	
Amounts owed by joint ventures and associates (note 22)	0.7	–	0.7		0.6	–	0.6	
Financial assets – non current								
Derivative instruments in designated hedge accounting relationships								
Cross currency swaps	–	–	–		–	3.6	–	
Forward foreign exchange contracts	–	0.1	–		–	0.1	–	
Loans and receivables								
Loan receivables (note 22)	–	–	–		25.7	–	25.7	
Other investments (note 22)	9.9	–	9.9		10.0	–	10.0	
Financial liabilities – current								
Derivatives designated as FVTPL								
Forward foreign exchange contracts	–	(3.7)	–		–	(1.1)	–	
Financial liabilities at amortised cost								
Trade payables (note 24)	(67.4)	–	(67.4)		(78.4)	–	(78.4)	
Loans (note 26)	(21.9)	–	(21.6)		(31.8)	–	(31.8)	
Obligations under finance leases (note 25)	(5.7)	–	(5.7)		(8.5)	–	(8.5)	
Financial liabilities – non current								
Derivative instruments in designated hedge accounting relationships								
Forward foreign exchange contracts	–	–	–		–	(0.1)	–	
Financial liabilities at amortised cost								
Loans (note 26)	(217.6)	–	(208.3)		(239.7)	–	(231.3)	
Obligations under finance leases (note 25)	(9.1)	–	(9.1)		(11.7)	–	(11.7)	

The Directors estimate that the carrying amounts of cash, trade receivables and trade payables approximate to their fair value due to the short-term maturity of these instruments.

The fair values of loans and finance lease obligations are based on cash flows discounted using a rate based on the borrowing rate associated with the liability.

The fair value of derivatives is calculated using a discounted cash flow approach applying discount factors derived from observable market data to actual and estimated future cash flows. Credit risk is considered in the calculation of these fair values.

Notes to the Consolidated Financial Statements continued

30. Financial risk management continued

ii) Fair value of derivative financial instruments

The fair valuation of derivative financial instruments results in a net asset of £4.1m (2017: net assets of £12.8m) comprising non current assets of £0.1m (2017: £3.7m), current assets of £7.7m (2017: £10.3m), current liabilities of £3.7m (2017: £1.1m) and non current liabilities of £nil (2017: £0.1m).

	1 January 2018 £m	Movement in fair value of derivatives designated in hedge accounting relationships £m	Movement in fair value of derivatives not designated in hedge accounting relationships £m	31 December 2018 £m
Currency swaps	9.3	(4.2)	–	5.1
Forward foreign exchange contracts	3.5	(4.5)	–	(1.0)
	12.8	(8.7)	–	4.1

	1 January 2017 £m	Movement in fair value of derivatives designated in hedge accounting relationships £m	Movement in fair value of derivatives not designated in hedge accounting relationships £m	31 December 2017 £m
Currency swaps	14.2	(4.9)	–	9.3
Forward foreign exchange contracts	4.3	(0.3)	(0.5)	3.5
	18.5	(5.2)	(0.5)	12.8

The fair value of financial liabilities at fair value through profit and loss is £3.7m (2017: £1.1m) and relates to derivatives that are not designated in hedge accounting relationships. The fair value of the derivatives and their credit risk adjusted fair value are not materially different, and are approximately equal to the amount contractually payable at maturity due to the short tenor of the instruments.

30 (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.

30 (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 2018 £m	Drawn 2018 £m	Utilised for bonding facility 2018 £m	Total facility available 2018 £m
Syndicated revolving credit facility	Sterling	250.0	–	–	250.0

	Currency	Amount 2017 £m	Drawn 2017 £m	Utilised for bonding facility 2017 £m	Total facility available 2017 £m
Syndicated revolving credit facility	Sterling	480.0	–	–	480.0

On 3 December 2018 the Group entered into a new £250m revolving credit facility with a maturity date of December 2023.

In addition to the banking facility, the Group has outstanding US private placements of £242.2m (2017: £260.7m) which will be repaid as bullet repayments between 2019 and 2024.

In addition to the bank and private placement facilities the Group has a £30.0m receivables financing facility (2017: £30.0m) of which £nil (2017: £nil) was drawn at year end.

ii) Maturity of financial liabilities

The Group's financial liabilities will be settled on both a net and a gross basis over the remaining period between the balance sheet date and 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
At 31 December 2018					
Trade payables (note 24)	67.4	–	–	–	67.4
Obligations under finance leases (note 25)	5.7	2.9	5.3	0.9	14.8
Loans* (note 26)	21.9	6.4	162.1	51.8	242.2
Future loan interest	12.6	11.6	20.5	1.3	46.0
Derivatives settled on gross basis:					
Outflow	467.5	–	–	–	467.5
Inflow	(471.8)	–	–	–	(471.8)
	103.3	20.9	187.9	54.0	366.1

* Loans are stated gross of capitalised finance costs.

	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
At 31 December 2017					
Trade payables (note 24)	78.4	–	–	–	78.4
Obligations under finance leases (note 25)	8.5	5.6	4.8	1.3	20.2
Loans* (note 26)	31.8	20.7	131.0	89.4	272.9
Future loan interest	12.3	22.4	20.6	1.2	56.5
Derivatives settled on gross basis:					
Outflow	897.8	22.1	–	–	919.9
Inflow	(907.1)	(26.0)	–	–	(933.1)
	121.7	44.8	156.4	91.9	414.8

* Loans are stated gross of capitalised finance costs.

Gross cash flows in the table above relating to forward foreign exchange contracts total £448.6m (inflow) and £449.8m (outflow) on demand or within one year and £nil (inflow) and £nil (outflow) between one and two years (2017: £875.5m (inflow) and £871.9m (outflow) on demand or within one year and £4.7m (inflow) and £4.4m (outflow) between one and two years).

Notes to the Consolidated Financial Statements continued

30. Financial risk management continued

30 (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 2018, there were no material unhedged non-functional currency monetary assets or liabilities, firm commitments or highly probable forecast transactions.

ii) Translational

Where possible the Group will raise external funding to match the currency profile of its foreign operations, in order to mitigate translation exposure. If matched funding is not possible, currency derivatives may be used to protect against movements in foreign exchange.

iii) Hedge accounting

For the purposes of hedge accounting, hedges are classified as either of fair value hedges, cash flow hedges or hedges of net investments in foreign operations. Details of the Group's accounting policies in relation to derivatives qualifying for hedge accounting under IFRS9 can be seen in note 2.

At 31 December 2018, the Group held cross currency swaps designated as cash flow hedges against \$28.5m of the US Dollar private placements. 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 in the current and prior year is as follows:

Maturity	2018 Receivable			2017 Receivable		
	Notional amount	US Dollar interest rate	Payable Sterling interest rate	Notional amount	US Dollar interest rate	Payable Sterling interest rate
	US Dollar m	%	%	US Dollar m	%	%
October 2019	28.5	3.8	4.1	28.5	3.8	4.1

The Group also held a number of forward foreign exchange contracts designated as cash flow hedges. These derivatives are hedging highly probable forecast foreign currency trade payments in the UK business. The net notional amounts are summarised by currency below:

	2018 £m	2017 £m
Sterling	(8.8)	(9.4)
US Dollar	1.7	0.6
Indian Rupee	7.7	9.2

All derivatives designated as cash flow hedges are highly effective and as at 31 December 2018 a net fair value loss of £0.1m (2017: £0.7m) has been deferred in the hedging reserve. During the course of the year to 31 December 2018, £0.6m (2017: £0.1m) of fair value gains were transferred to the hedging reserve and £0.1m (2017: £0.2m) reclassified to the consolidated income statement.

The Group has entered into a net investment hedge. This uses a portion of the USD denominated loans payable as a hedging instrument against movements in the value of the assets and liabilities of Serco North America (Holdings), Inc. All loans payable are recorded at amortised cost, and movements in value due to foreign exchange in the portion designated as hedging instruments are taken to reserves. The value of loans used in the hedging relationship at 31 December 2018 was £194.3m (2017: £151.8m).

iv) Currency sensitivity

The Group's currency exposures in respect of monetary items at 31 December 2018 that result in net currency gains and losses in the income statement and equity arise principally from movement in US Dollar and Euro exchange rates. The impact of a 10% movement is summarised below:

	Pre-tax profits gain/(loss) 2018 £m	Equity gain/ (loss) 2018 £m	Pre-tax profits gain/(loss) 2017 £m	Equity gain/ (loss) 2017 £m
US Dollar	–	(0.1)	–	(0.1)
Euro	0.1	–	–	–
Indian Rupee	–	(0.8)	–	(1.0)
	0.1	(0.9)	–	(1.1)

30 (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:

	Floating rate 2018 £m	Fixed rate 2018 £m	Weighted average interest rate 2018 %	Floating rate 2017 £m	Fixed rate 2017 £m	Weighted average interest rate 2017 %
Financial assets						
Cash and cash equivalents	62.5	–	–	112.1	–	–
Other loan receivables	–	–	–	–	25.7	7.0
				112.1	25.7	
Financial liabilities						
US Dollar loans	–	242.2	5.2	–	260.7	5.2
Other loans	–	–	–	12.2	–	–
		242.2		12.2	260.7	

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 £14.8m (2017: £20.2m) of amounts payable under finance leases, which are subject to fixed rates of interest.

ii) Interest rate sensitivity

The effect of a 100 basis point increase in LIBOR rates on the net financial liability position at the balance sheet date, with all other variables held constant, would have resulted in a decrease in pre-tax profit for the year to 31 December 2018 of £0.2m (2017: increase of £1.0m).

Notes to the Consolidated Financial Statements continued

30. Financial risk management continued

30 (f) Credit risk

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

Credit risk is the risk that a counterparty could default on its contractual obligations. In this regard, the Group's principal exposure is to cash and cash equivalents, derivative transactions and trade receivables.

The Group's contract asset and 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 has not recorded any impairments related to contract assets or trade and other receivables relating to credit risk during the year ended 31 December 2018 (2017: none).

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 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.

The Group's policy is to provide guarantees for joint ventures and associates only to the relevant proportion of support provided by the partners. At 31 December 2018, the Company has issued guarantees in respect of certain joint ventures and associates as per note 29.

30 (g) Capital risk

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 Group plans to maintain sufficient funds and distributable reserves to allow payments of projected dividends to shareholders.

The following table summarises the capital of the Group:

	2018 £m	2017 (restated*) £m
Cash and cash equivalents	(62.5)	(112.1)
Loans	242.2	272.9
Obligations under finance leases	14.8	20.2
Equity	386.8	265.3
Capital	581.3	446.3

* Balances for the year ended 31 December 2017 have been restated to reflect the adoption of IFRS15 with effect from 1 January 2017. See note 2.

31. Retirement benefit schemes

31 (a) Defined benefit schemes

i) Characteristics and risks

The Group contributes to defined benefit schemes for qualifying employees of its subsidiaries in the UK and Europe. The normal contributions expected to be paid during the financial year ending 31 December 2019 are £4.9m (2018: £7.1m).

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 5 April 2015 and resulted in an actuarially assessed deficit of £4.0m for funding purposes. Pension obligations are valued separately for accounting and funding purposes and there is often a material difference between these valuations. As at 31 December 2018 the estimated actuarial deficit of SPLAS was £27.8m (2017: £33.7m) based on the actuarial assessment on the funding basis whereas the accounting valuation resulted in an asset of £85.8m. The primary reason a difference arises is that pension scheme accounting requires the valuation to be performed on the basis of a best estimate whereas the funding valuation used by the trustees makes more prudent assumptions. A revised schedule of contributions for SPLAS was agreed during 2017, with employer contributions of 29.3% of pensionable salaries to be made up to 31 October 2018, dropping to 28.3% from 1 November 2018 to 31 December 2022. Additional shortfall contributions made up of four payments of £0.5m payable at the end of each April through to 2022 were also agreed. In addition to this agreement a decision was reached between the Group and the SPLAS trustees to make a one-off shortfall contribution of £4.0m during the year, with this payment being made in December 2018. It is anticipated that a revised Schedule of Contributions will be signed before 5 July 2019 following the finalisation of the 2018 SPLAS actuarial valuation.

The assets of funded schemes are held independently of the Group's assets in separate trustee administered schemes. The trustees of each pension scheme are required by law to act in the interest of the scheme and of all relevant stakeholders in the scheme. The trustees of the pension schemes are responsible for the investment policy with regard to the assets of the scheme. The Group's major schemes are valued by independent actuaries annually using the projected unit credit actuarial cost method for accounting purposes. This reflects service rendered by employees to the dates of valuation and incorporates actuarial assumptions including: discount rates to determine the present value of benefits; projected rates of salary growth; and life expectancy of pension plan members. Discount rates are based on the market yields of high-quality corporate bonds in the country concerned. Pension assets and liabilities in the different defined benefit schemes are not offset.

The schemes typically expose the Group to risks that impact the financial performance and position of the Group and may affect the amount and timing of future cash flows. The key risks are set out below:

- **Investment risk.** The schemes hold assets with which to discharge the future liabilities of these schemes. Any decline in the value of these investments directly impacts on the ability of the scheme to meet its commitments and could require the Group to fund this shortfall in future years. As a result of the SPLAS's investment strategy, which aims to reduce volatility risk by better matching assets to liabilities, 47% of the scheme's assets are annuity policies, 46% are Liability Driven Investments (LDIs) and the remainder is split between equities, bonds and cash or cash equivalents. The annuity policies result in an insurer funding the future benefit payments to the relevant members and therefore eliminate the risk of changes in the future value of the benefits to the scheme. The main asset classes that make up the LDI investments are gilts and corporate bonds with inflation and interest swap overlays and are therefore linked to the key drivers of the scheme's liabilities. The value of these investments vary in line with gilt yields, which have increased from 2.53% p.a. to 2.86% p.a. during 2018 resulting in a decrease in the value of these assets. SPLAS previously identified an investment strategy consisting of Multi-Asset Absolute Return (MAAR), Buy and Maintain credit (B&M) and LDI. This ensures that the scheme remains protected against changes to interest rates and long term inflation expectations, with the funding level therefore being relatively stable.
- **Interest risk.** The present value of the defined benefit schemes' liabilities are calculated using a discount rate determined by reference to high quality corporate bond yields and therefore a decrease in the bond interest rate will increase the schemes' liabilities. This will be partially offset by an increase in the return of the schemes' debt investments.
- **Longevity risk.** The present value of the defined benefit schemes' liabilities are calculated by reference to the best estimate of the mortality of the schemes' participants both during and after their employment. An increase in the life expectancy of the schemes' participants will increase the schemes' liabilities.
- **Salary risk.** The present value of the defined benefit schemes' liabilities are calculated by reference to the future salaries of the schemes' participants, as such, an increase in the salary of the schemes' participants will increase the schemes' liabilities.

Notes to the Consolidated Financial Statements continued

31. Retirement benefit schemes continued

The defined benefit schemes are grouped together as follows:

- **Contract specific.** 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 as defined by the contract and scheme rules. At rebid, any deficit or surplus would be expected to transfer to the next contractor. At the start of these relevant contracts the Group recognised the defined benefit obligation less the fair value of scheme assets with a corresponding amount recognised as an intangible asset. 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 initial term of the contracts with none remaining at the current or prior year end. Where the relevant scheme has a deficit which is not required to be fully funded by the Group an adjustment is made to limit the amount recognised in the Group's balance sheet by way of a 'franchise adjustment'. Under contractual arrangements the Group sponsors a section of an industry wide defined benefit scheme, the Railways Pension Scheme (RPS), paying contributions in accordance with a Schedule of Contributions. There is no residual liability to fund a deficit at the end of the franchise period and any costs are shared 60% by the employer and 40% by the members. The Group also makes contributions under Admitted Body status to a number of sections of the Local Government Pension Scheme for the period to the end of the relevant customer contracts. The Group will only participate in the Local Government Pension Schemes for a finite period up to the end of the contracts. The Group is required to pay regular contributions as decided by the respective Scheme Actuary and as detailed in each scheme's Schedule of Contributions. In addition, the Group may be required to pay some or all of any deficit (as determined by the respective Scheme Actuary) that is remaining at the end of the contract. In respect of this, the Group recognises a sufficient level of provision in these financial statements based on the IAS19 valuation at the reporting date and contractual obligations.
- **Non contract specific.** These do not relate to any specific contract and consist of two pre-funded defined benefit schemes and an unfunded defined benefit scheme. Any liabilities arising are recognised in full and the liabilities in relation to unfunded scheme amount to £0.4m (2017: £0.4m). The unfunded scheme is the only non UK scheme in which the Group participates. The funding policy for the pre-funded schemes is to contribute such variable amounts, on the advice of the actuary, as will achieve 100% funding on a projected salary basis. One of these schemes is SPLAS and the other is a non contract specific section of the RPS.

ii) Events in the year

During the year, the Group made two one-off contributions into the SPLAS scheme. In April 2018 a payment of £1.2m was made and this was followed by a payment for £4.0m in December 2018.

Also during the year, following a ruling in the High Court, the Group has recognised a past service cost for the impact of Guaranteed Minimum Pension equalisation. The total amount recognised by the Group is £9.6m and this has been treated as an exceptional item in the Income Statement.

iii) Values recognised in total comprehensive income in the year

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

	Contract specific 2018 £m	Non contract specific 2018 £m	Total 2018 £m
Recognised in the income statement			
Current service cost – employer	1.1	4.6	5.7
Past service cost	–	9.3	9.3
Curtailment gain recognised	–	–	–
Administrative expenses and taxes	–	3.9	3.9
Recognised in arriving at operating profit after exceptionals	1.1	17.8	18.9
Interest income on scheme assets – employer	(0.4)	(33.3)	(33.7)
Interest on franchise adjustment	(0.1)	–	(0.1)
Interest cost on scheme liabilities – employer	0.4	32.6	33.0
Finance income	(0.1)	(0.7)	(0.8)

	Contract specific 2018 £m	Non contract specific 2018 £m	Total 2018 £m
Included within the SOCI			
Actual return on scheme assets	(0.5)	40.7	40.2
Less: interest income on scheme assets	(0.4)	(33.4)	(33.8)
	(0.9)	7.3	6.4
Effect of changes in demographic assumptions	–	–	–
Effect of changes in financial assumptions	1.7	74.0	75.7
Effect of experience adjustments	–	(30.0)	(30.0)
Remeasurements	0.8	51.3	52.1
Change in franchise adjustment	–	–	–
Change in members' share	(0.3)	0.1	(0.2)
Actuarial profit/(loss) on reimbursable rights	(0.3)	0.1	(0.2)
Total pension gain recognised in the SOCI	0.5	51.4	51.9

	Contract specific 2017 £m	Non contract specific 2017 £m	Total 2017 £m
Recognised in the income statement			
Current service cost – employer	1.0	7.6	8.6
Past service cost	–	0.3	0.3
Curtailment loss recognised	–	(2.0)	(2.0)
Administrative expenses and taxes	–	5.3	5.3
Recognised in arriving at operating profit	1.0	11.2	12.2
Interest income on scheme assets – employer	(0.4)	(41.4)	(41.8)
Interest on franchise adjustment	(0.1)	–	(0.1)
Interest cost on scheme liabilities – employer	0.5	37.6	38.1
Finance income	–	(3.8)	(3.8)

	Contract specific 2017 £m	Non contract specific 2017 £m	Total 2017 £m
Included within the SOCI			
Actual return on scheme assets	11.0	(50.7)	(39.7)
Less: interest income on scheme assets	(0.4)	(41.4)	(41.8)
	10.6	(92.1)	(81.5)
Effect of changes in demographic assumptions	–	1.0	1.0
Effect of changes in financial assumptions	(10.3)	(21.3)	(31.6)
Effect of experience adjustments	0.8	4.8	5.6
Remeasurements	1.1	(107.6)	(106.5)
Change in franchise adjustment	(0.2)	–	(0.2)
Change in members' share	(0.4)	–	(0.4)
Actuarial losses on reimbursable rights	(0.6)	–	(0.6)
Total pension gain recognised in the SOCI	0.5	(107.6)	(107.1)

Notes to the Consolidated Financial Statements continued

31. Retirement benefit schemes continued

iv) Balance sheet values

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

	Contract specific 2018 £m	Non contract specific 2018 £m	Total 2018 £m
Scheme assets at fair value			
Equities	9.7	39.9	49.6
Bonds except LDIs	3.8	93.4	97.2
LDIs	–	580.7	580.7
Property	1.2	–	1.2
Cash and other	2.9	8.7	11.6
Private debt mandates	–	11.4	11.4
Annuity policies	–	600.2	600.2
Fair value of scheme assets	17.6	1,334.3	1,351.9
Present value of scheme liabilities	(23.8)	(1,263.2)	(1,287.0)
Net amount recognised	(6.2)	71.1	64.9
Franchise adjustment*	3.7	–	3.7
Members' share of deficit	2.3	–	2.3
Net retirement benefit asset	(0.2)	71.1	70.9
Net pension liability	(0.2)	(14.7)	(14.9)
Net pension asset	–	85.8	85.8
Net retirement benefit asset	(0.2)	71.1	70.9
Deferred tax liabilities	–	(9.9)	(9.9)
Net retirement benefit asset (after tax)	(0.2)	61.2	61.0

* The franchise adjustment represents the amount of scheme deficit that is expected to be funded outside the contract period.

	Contract specific 2017 £m	Non contract specific 2017 £m	Total 2017 £m
Scheme assets at fair value			
Equities	9.9	46.3	56.2
Bonds except LDIs	2.9	20.8	23.7
LDIs	–	709.8	709.8
Gilts	0.2	–	0.2
Property	1.6	–	1.6
Cash and other	2.8	3.2	6.0
Annuity policies	–	587.5	587.5
Fair value of scheme assets	17.4	1,367.6	1,385.0
Present value of scheme liabilities	(23.4)	(1,341.3)	(1,364.7)
Net amount recognised	(6.0)	26.3	20.3
Franchise adjustment*	3.6	–	3.6
Members' share of deficit	2.4	–	2.4
Net retirement benefit asset	–	26.3	26.3
Net pension liability	–	(15.5)	(15.5)
Net pension asset	–	41.8	41.8
Net retirement benefit asset	–	26.3	26.3
Deferred tax liabilities	–	(2.5)	(2.5)
Net retirement benefit asset (after tax)	–	23.8	23.8

* The franchise adjustment represents the amount of scheme deficit that is expected to be funded outside the contract period.

The SPLAS Trust Deed gives the Group an unconditional right to a refund of surplus assets, assuming the full settlement of plan liabilities in the event of a plan wind-up. Pension assets are deemed to be recoverable and there are no adjustments in respect of minimum funding requirements as economic benefits are available to the Group either in the form of future refunds or, for plans still open to benefit accrual, in the form of possible reductions in future contributions.

As required by IAS19, the Group has considered the extent to which the pension plan assets should be classified in accordance with the fair value hierarchy of IFRS13. Virtually all equity and debt instruments have quoted prices in active markets. Annuity policies, private debt mandates and property assets can be classified as Level 3 instruments, and LDIs are classified as Level 2.

	Contract specific £m	Non contract specific £m	Total £m
Changes in the fair value of scheme liabilities			
At 1 January 2017	12.0	1,418.0	1,430.0
Current service cost – employer	1.0	7.6	8.6
Current service cost – employee	0.4	–	0.4
Past service costs	–	0.3	0.3
Scheme participants' contributions	0.1	0.5	0.6
Interest cost – employer	0.5	37.6	38.1
Interest cost – employee	0.1	–	0.1
Benefits paid	(0.2)	(77.6)	(77.8)
Effect of changes in demographic assumptions	–	(1.0)	(1.0)
Effect of changes in financial assumptions	10.3	21.3	31.6
Effect of experience adjustments	(0.8)	(4.8)	(5.6)
Plan curtailments	–	(2.0)	(2.0)
Settlement payments from plan assets	–	(58.6)	(58.6)
At 1 January 2018	23.4	1,341.3	1,364.7
Current service cost – employer	1.1	4.6	5.7
Current service cost – employee	0.5	–	0.5
Past service costs	–	9.3	9.3
Scheme participants' contributions	0.1	0.2	0.3
Interest cost – employer	0.4	32.6	33.0
Interest cost – employee	0.1	–	0.1
Benefits paid	(0.1)	(80.7)	(80.8)
Effect of changes in financial assumptions	(1.7)	(74.0)	(75.7)
Effect of experience adjustments	–	30.0	30.0
At 31 December 2018	23.8	1,263.3	1,287.1
Changes in the fair value of scheme assets			
At 1 January 2017	5.8	1,550.7	1,556.5
Interest income on scheme assets – employer	0.4	41.4	41.8
Interest income on scheme assets – employee	0.1	–	0.1
Administrative expenses and taxes	–	(5.3)	(5.3)
Employer contributions	0.5	8.7	9.2
Contributions by employees	0.2	0.4	0.6
Benefits paid	(0.2)	(77.6)	(77.8)
Return on scheme assets less interest income	10.6	(92.1)	(81.5)
Settlement payments from plan assets	–	(58.6)	(58.6)
At 1 January 2018	17.4	1,367.6	1,385.0
Interest income on scheme assets – employer	0.4	33.3	33.7
Interest income on scheme assets – employee	0.1	–	0.1
Administrative expenses and taxes	–	(3.8)	(3.8)
Employer contributions	0.5	10.2	10.7
Contributions by employees	0.2	0.3	0.5
Benefits paid	(0.1)	(80.7)	(80.8)
Return on scheme assets less interest income	(0.9)	7.4	6.5
At 31 December 2018	17.6	1,334.3	1,351.9

Notes to the Consolidated Financial Statements continued

31. Retirement benefit schemes continued

Changes in the franchise adjustment	Total £m
At 1 January 2017	3.7
Interest on franchise adjustment	0.1
Taken to SOCI	(0.2)
At 1 January 2018	3.6
Interest on franchise adjustment	0.1
At 31 December 2018	3.7

v) Actuarial assumptions: SPLAS

The assumptions set out below are for SPLAS, which reflects 92% of total liabilities and 94% of total assets of the defined benefit pension scheme in which the Group participates. The significant actuarial assumptions with regards to the determination of the defined benefit obligation are set out below.

The average duration of the benefit obligation at the end of the reporting period is 16.1 years (2017: 17.9 years).

Main assumptions	2018 %	2017 %
Rate of salary increases	2.80	2.70
Rate of increase in pensions in payment	2.20 (CPI) and 3.00 (RPI)	2.30 (CPI) and 3.00 (RPI)
Rate of increase in deferred pensions	2.30 (CPI) and 3.30 (RPI)	2.30 (CPI) and 3.00 (RPI)
Inflation assumption	2.30 (CPI) and 3.30 (RPI)	2.20 (CPI) and 3.20 (RPI)
Discount rate	2.90	2.50

Post retirement mortality	2018 years	2017 years
Current pensioners at 65 – male	22.6	22.5
Current pensioners at 65 – female	25.1	25.1
Future pensioners at 65 – male	24.4	24.3
Future pensioners at 65 – female	27.0	26.9

Sensitivity analysis is provided below, based on reasonably possible changes of the assumptions occurring at the end of the reporting period, assuming all other assumptions are held constant. The sensitivities have been derived in the same manner as the defined benefit obligation as at 31 December 2018 where the defined benefit obligation is estimated using the Projected Unit Credit method. Under this method each participant's benefits are attributed to years of service, taking into consideration future salary increases and the scheme's benefit allocation formula. Thus, the estimated total pension to which each participant is expected to become entitled at retirement is broken down into units, each associated with a year of past or future credited service. The defined benefit obligation as at 31 December 2018 is calculated on the actuarial assumptions agreed as at that date. The sensitivities are calculated by changing each assumption in turn following the methodology above with all other things held constant. The change in the defined benefit obligation from updating the single assumption represents the impact of that assumption on the calculation of the defined benefit obligation.

(Increase)/decrease in defined benefit obligation	2018 £m	2017 £m
Discount rate – 0.5% increase	(102.8)	(107.9)
Discount rate – 0.5% decrease	112.2	122.0
Inflation – 0.5% increase	66.9	83.4
Inflation – 0.5% decrease	(64.7)	(78.0)
Rate of salary increase – 0.5% increase	2.4	3.6
Rate of salary increase – 0.5% decrease	(2.3)	(3.5)
Mortality – one year age rating	39.9	41.6

Management acknowledges that the method used of presuming that all other assumptions remaining constant has inherent limitation given that it is more likely for a combination of changes, but highlights the value of each individual risk and is therefore a suitable basis for providing this analysis.

Assumptions in respect of the expected return on scheme assets are required when calculating the franchise adjustment for the contract-specific plans. These assumptions 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 2018 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. The Group applies an equity risk premium of 4.6% (2017: 4.6%).

The overall expected return on assets is calculated as the weighted average of the expected returns for the principal asset categories held by the scheme.

31 (b) Defined contribution schemes

The Group paid employer contributions of £73.6m (2017: £75.0m) into UK and other defined contribution schemes and foreign state pension schemes.

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.

32. Share capital

	2018 £m	Number 2018 millions	2017 £m	Number 2017 millions
Issued and fully paid				
1,098,564,237 (2017: 1,098,564,237) ordinary shares of 2p each at 1 January	22.0	1,098.6	22.0	1,098.6
Issued on the exercise of share options	–	–	–	–
1,098,564,237 (2017: 1,098,564,237) ordinary shares of 2p each at 31 December	22.0	1,098.6	22.0	1,098.6

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

33. Share premium account

	2018 £m	2017 £m
At 1 January and 31 December	327.9	327.9

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.

Notes to the Consolidated Financial Statements continued

34. Reserves continued

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 2018, the ESOT held 3,527,740 (2017: 8,728,497) shares equal to 0.3% of the current allotted share capital (2017: 0.8%). The market value of shares held by the ESOT as at 31 December 2018 was £ 3.4m (2017: £8.6m).

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.

	Hedging reserve £m	Translation reserve £m	Total £m
At 1 January 2017	(0.5)	25.1	24.6
Total comprehensive income for the year	(0.2)	(14.3)	(14.5)
At 1 January 2018	(0.7)	10.8	10.1
Total comprehensive income for the year	0.6	(5.3)	(4.7)
At 31 December 2018	(0.1)	5.5	5.4

35. Share based payment expense

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

	2018 £m	2017 £m
Performance Share Plan	13.1	9.9
Deferred Bonus Plan	1.6	1.5
	14.7	11.4

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 2018 thousands	Weighted average exercise price 2018 £	Number of options 2017 thousands	Weighted average exercise price 2017 £
Outstanding at 1 January	93	4.16	93	4.16
Lapsed during the year	(38)	(0.28)	–	–
Outstanding at 31 December	55	3.88	93	4.16

Of these options, 54,545 (2017: 92,540) were exercisable at the end of the year, with a weighted average exercise price of £3.88 (2017: £4.16).

The options outstanding at 31 December 2018 had a weighted average contractual life of 0.37 years (2017: 0.87 years).

The exercise price for options outstanding at 31 December 2018 was £3.88 (2017: ranged from £3.88 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 £0.95 (2017: £1.17).

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 Plan during the year and all shares are now vested.

Performance Share Plan (PSP)

Under the PSP, eligible employees have been granted options with an exercise price of zero or two pence. Awards vest after the performance period of three to five years and are subject to the achievement of certain performance measures, with the exception of non-performance awards. These non-performance options are only subject to continued employment on vesting dates which vary from six months to three years after the grant dates.

On the performance related awards, the performance measures are Earnings per Share (EPS), Total Shareholder Return (TSR) and Return on Invested Capital (ROIC). Additional measures related to Strategic Objectives were introduced for new grants in 2018.

If the options remain unexercised after a period of ten years from the date of grant, the options expire.

	Number of options 2018 thousands	Weighted average exercise price 2018 £	Number of options 2017 thousands	Weighted average exercise price 2017 £
Outstanding at 1 January	41,001	0.02	34,485	0.02
Granted during the year	15,213	0.02	15,936	0.02
Exercised during the year	(4,445)	0.02	(1,123)	0.02
Lapsed during the year	(8,218)	0.02	(8,297)	0.02
Outstanding at 31 December	43,551	0.02	41,001	0.02

Of these options, 3,829,638 (2017: 1,040,066) were exercisable at the end of the year. The options outstanding at 31 December 2018 had a weighted average contractual life of 7.4 years (2017: 7.7 years).

In the year, fifteen grants were made, of which eight were non-performance conditional share awards and three non-performance nominal share awards. The remaining four performance based awards are with 85% of the award split equally between Earnings per Share (EPS), Total Shareholder Return (TSR) and Return on Invested Capital (ROIC) performance conditions and the remaining 15% based on Strategic Objectives based on improvements in order book and employee engagement. The options subject to market-based performance conditions (such as the TSR condition for these awards), were valued using the Monte Carlo Simulation model. For options subject only to non-market based performance conditions (such as the EPS and ROIC conditions) a Black-Scholes model has been used. This approach has also been used for the Awards made with no performance conditions attached to them.

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 Absolute Share Price or TSR based awards.

The Monte Carlo and Black-Scholes Models used the following inputs:

	2018
Weighted average share price	£0.97
Weighted average exercise price	0.02
Expected volatility	34.6%
Expected life	3
Risk free rate	0.79%

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 weighted average fair value of options granted under this scheme in the year is £0.87 (2017: £0.99).

Notes to the Consolidated Financial Statements continued

35. 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 this period, the shares are retained for that period and the performance measures have been met, the Group will make a matching share award, up to a maximum of two times the gross bonus deferred.

	Number of options 2018 thousands	Weighted average exercise price 2018 £	Number of options 2017 thousands	Weighted average exercise price 2017 £
Outstanding at 1 January	4,894	Nil	2,945	Nil
Granted during the year	956	Nil	2,549	Nil
Exercised during the year	(755)	Nil	–	Nil
Lapsed during the year	(74)	Nil	(600)	Nil
Outstanding at 31 December	5,021	Nil	4,894	Nil

None of these options were exercisable at the end of the year (2017: none). The options outstanding at 31 December 2018 had a weighted average contractual life of 1.2 years (2017: 1.6 years).

There were 955,582 new options granted under the Deferred Bonus Plan in the year, with 100% of the deferred bonus subject to the same EPS performance conditions as the PSP.

The portion subject to EPS 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 performance conditions are:

	2018
Weighted average share price	£0.99
Weighted average exercise price	Nil
Expected volatility	34.3%
Expected life	3 years
Risk free rate	1.01%

The weighted average fair value of options granted under this scheme in the year is £0.99 (2017: £1.20).

36. Related party transactions

Transactions between the Company and its wholly owned subsidiaries, which are related parties, have been eliminated on consolidation and are not disclosed in this note. Transactions between the Group and its joint venture undertakings and associates are disclosed below.

Transactions

During the year, Group companies entered into the following transactions with joint ventures and associates:

	Transactions 2018 £m	Current outstanding at 31 December 2018 £m	Non current outstanding at 31 December 2018 £m
Sale of goods and services			
Joint ventures	0.4	0.1	–
Associates	7.3	0.6	–
Other			
Dividends received – joint ventures	9.7	–	–
Dividends received – associates	20.0	–	–
Receivable from consortium for tax – joint ventures	4.8	5.3	–
Total	42.2	6.0	–

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. The only loan amounts owed by joint ventures or associates related to a single entity which have been provided for in full (see note 6).

	Transactions 2017 £m	Current outstanding at 31 December 2017 £m	Non current outstanding at 31 December 2017 £m
Sale of goods and services			
Joint ventures	0.5	0.1	–
Associates	7.1	0.5	–
Other			
Dividends received – joint ventures	11.1	–	–
Dividends received – associates	17.1	–	–
Receivable from consortium for tax – joint ventures	2.4	5.3	–
Total	38.2	5.9	–

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 IAS24 *Related Party Disclosures*:

	2018 £m	2017 £m
Short-term employee benefits	9.5	12.5
Share based payment expense	5.3	6.2
	14.8	18.7

The key management personnel comprise the Executive Directors, Non-Executive Directors and members of the Executive Committee (2018: 17 individuals, 2017: 23 individuals).

Notes to the Consolidated Financial Statements continued

36. Related party transactions continued

Aggregate directors' remuneration

The total amounts for directors' remuneration in accordance with Schedule 5 to the Accounting Regulations were as follows:

	2018 £m	2017 £m
Salaries, fees, bonuses and benefits in kind	4.0	5.5
Amounts receivable under long-term incentive schemes	3.1	6.3
Gains on exercise of share options	1.8	0.1
	8.9	11.9

None of the directors are members of the Company's defined benefit pension scheme.

One director is a member of the money purchase scheme.

Further information about the remuneration of individual directors is provided in the audited part of the Directors' Remuneration Report on pages 116 to 131.

37. Notes to the consolidated cash flow statement

Year ended 31 December	2018 Before exceptional items £m	2018 Exceptional items £m	2018 Total £m	2017 (restated*) Before exceptional items £m	2017 Exceptional items £m	2017 (restated*) Total £m
Operating profit for the year	112.4	(31.9)	80.5	40.7	(19.6)	21.1
Adjustments for:						
Share of profits in joint ventures and associates	(28.8)	–	(28.8)	(27.0)	–	(27.0)
Share based payment expense	14.7	–	14.7	11.4	–	11.4
Exceptional impairment of intangible assets	–	–	–	–	8.9	8.9
Impairment of property, plant and equipment	0.7	–	0.7	(0.1)	–	(0.1)
Impairment of intangible assets	0.1	–	0.1	–	–	–
Depreciation of property, plant and equipment	19.5	–	19.5	20.9	–	20.9
Amortisation of intangible assets	22.9	–	22.9	25.8	–	25.8
Exceptional loss/(profit) on disposal of subsidiaries and operations	–	0.5	0.5	–	(0.3)	(0.3)
Reversal of impairment on loan balances	–	(13.9)	(13.9)	–	–	–
Loss on disposal of property, plant and equipment	0.5	–	0.5	0.3	–	0.3
Loss on disposal of intangible assets	1.5	–	1.5	0.3	–	0.3
Exceptional Interest in JV	–	0.3	0.3	–	–	–
Non cash R&D expenditure offset against intangible assets	–	–	–	(0.7)	–	(0.7)
Decrease in provisions	(68.1)	(13.8)	(81.9)	(33.6)	(9.6)	(43.2)
Other non cash movements	(0.2)	–	(0.2)	0.1	–	0.1
Total non cash items	(37.2)	(26.9)	(64.1)	(2.6)	(1.0)	(3.6)
Operating cash inflow/(outflow) before movements in working capital	75.2	(58.8)	16.4	38.1	(20.6)	17.5
(Increase)/decrease in inventories	(5.0)	–	(5.0)	3.7	–	3.7
(Increase)/decrease in receivables	(22.9)	0.4	(22.5)	8.5	4.5	13.0
Decrease/(increase) in payables	6.3	18.2	24.5	(26.5)	(16.4)	(42.9)
Movements in working capital	(21.6)	18.6	(3.0)	(14.3)	(11.9)	(26.2)
Cash generated by operations	53.6	(40.2)	13.4	23.8	(32.5)	(8.7)
Tax paid	(10.6)	–	(10.6)	(11.4)	–	(11.4)
Non cash R&D expenditure	(0.1)	–	(0.1)	(0.2)	–	(0.2)
Net cash inflow/(outflow) from operating activities	42.9	(40.2)	2.7	12.2	(32.5)	(20.3)

* Results for the year ended 31 December 2017 have been restated to reflect the adoption of IFRS15 with effect from 1 January 2017. See note 2.

Additions to property, plant and equipment during the year amounting to £3.6m (2017: £4.7m) were financed by new finance leases.

38. Post balance sheet events

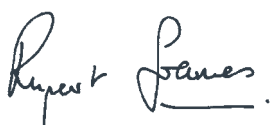
On 7 January 2019, the Group signed a contract with the UK Home Office Visas and Immigration department to run two regions of the new Asylum Accommodation and Support Services Contract (AASC). The Group continues to work through the anticipated financial impact that AASC will have on its results and financial position for 2019 and future years, particularly in relation to the lease of accommodation used to service the contract.

Company Balance Sheet

At 31 December	Note	2018 £m	2017 (restated*) £m
Fixed assets			
Investments in subsidiaries	40	2,021.7	2,010.5
Current assets			
Debtors: amounts due within one year	41	3.2	3.4
Debtors: amounts due after more than one year	41	381.0	291.2
Derivative financial instruments due within one year	45	–	10.1
Derivative financial instruments due after more than one year	45	7.5	3.6
Cash at bank and in hand		36.5	138.2
		428.2	446.5
Total assets		2,449.9	2,457.0
Creditors: amounts falling due within one year			
Trade and other payables	42	(60.6)	(50.9)
Borrowings	43	(21.9)	(31.8)
Provisions	44	(2.8)	(3.5)
Corporation tax liability		(0.1)	(0.2)
Derivative financial instruments	45	(3.7)	(1.0)
		(89.1)	(87.4)
Net current assets		339.1	359.1
Creditors: amounts falling due after more than one year			
Borrowings	43	(217.6)	(227.6)
Amounts owed to subsidiary companies		(1,130.3)	(1,106.0)
Provisions	44	(41.1)	(41.1)
		(1,389.0)	(1,374.7)
Total liabilities		(1,478.1)	(1,462.1)
Net assets		971.8	994.9
Capital and reserves			
Called up share capital	47	22.0	22.0
Share premium account	48	327.9	327.9
Capital redemption reserve		0.1	0.1
Profit and loss account	49	580.0	617.6
Share based payment reserve	50	60.7	74.0
Own shares reserve		(18.7)	(46.1)
Hedging and translation reserve	52	(0.2)	(0.6)
Total shareholders' funds		971.8	994.9

* Balances as at 31 December 2017 have been restated to reclassify net exchange gain/(loss) on translation of loans in respect of foreign operations from the hedging reserve to the profit and loss account. This adjustment has no impact on the net assets of the Company and the impact on net loss is a reduction of £6.7m.

The financial statements (registered number 02048608) were approved by the Board of Directors on 20 February 2019 and signed on its behalf by:



Rupert Soames
Group Chief Executive Officer



Angus Cockburn
Group Chief Financial Officer

Company Statement of Changes in Equity

	Share capital £m	Share premium account £m	Capital redemption reserve £m	Profit and loss account (restated*) £m	Share based payment reserve £m	Own shares reserve £m	Hedging and translation reserve (restated*) £m	Total shareholders' equity £m
At 1 January 2017	22.0	327.9	0.1	620.6	68.5	(52.1)	(0.7)	986.3
Total comprehensive income for the year	-	-	-	(3.0)	-	-	0.1	(2.9)
Shares transferred to option holders on exercise of share options	-	-	-	-	(6.0)	6.0	-	-
Options over parent's shares awarded to employees of subsidiaries	-	-	-	-	9.2	-	-	9.2
Expense in relation to share based payments	-	-	-	-	2.3	-	-	2.3
At 1 January 2018	22.0	327.9	0.1	617.6	74.0	(46.1)	(0.6)	994.9
Total comprehensive income for the year	-	-	-	(37.6)	-	-	0.4	(37.2)
Shares transferred to option holders on exercise of share options	-	-	-	-	(28.0)	27.4	-	(0.6)
Options over parent's shares awarded to employees of subsidiaries	-	-	-	-	11.2	-	-	11.2
Expense in relation to share based payments	-	-	-	-	3.5	-	-	3.5
At 31 December 2018	22.0	327.9	0.1	580.0	60.7	(18.7)	(0.2)	971.8

* Balances as at 31 December 2017 and 1 January 2017 have been restated to reclassify net gain/(loss) on translation of loans in respect of foreign operations from the hedging reserve to the profit and loss account. This adjustment has no impact on the net assets of the Company and the impact on net loss is a reduction of £6.7m.

Notes to the Company Financial Statements

39. Accounting policies

The principal accounting policies adopted are set out below and have been applied consistently throughout the current and preceding year.

Basis of accounting

The Company meets the definition of a qualifying entity under FRS 100 (Financial Reporting Standard 100) 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. The Company has not presented its own profit and loss account as permitted by Section 408 of the Companies Act 2006. The total loss for the year was £37.6m (2017 restated: £3.0m), and loss in total comprehensive income for the year was a loss of £37.2m (2017: loss of £2.9m).

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 goods and services. The principal accounting policies adopted are the same as those set out in note 2 to the consolidated financial statements, except as noted below.

Fixed asset investments

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

40. Investments held as fixed assets

Shares in subsidiary companies at cost	£m
At 1 January 2017	2,001.3
Options over parent's shares awarded to employees of subsidiaries	9.2
At 1 January 2018	2,010.5
Options over parent's shares awarded to employees of subsidiaries	11.2
At 31 December 2018	2,021.7

The Company directly owns 100% of the ordinary share capital of the following subsidiaries:

Name	% ownership
Serco Holdings Limited	100%

41. Debtors

Amounts due within one year	2018 £m	2017 £m
Other debtors	3.2	3.4
	3.2	3.4

Amounts due after more than one year	2018 £m	2017 £m
Amounts owed by subsidiary companies	381.0	291.2

42. Trade and other payables

	2018 £m	2017 £m
Amounts owed to subsidiary companies	42.5	35.6
Trade creditors	1.6	0.1
Accruals and deferred income	13.7	12.9
Other creditors including taxation and social security	2.8	2.3
	60.6	50.9

43. Borrowings

	2018 £m	2017 £m
Loans	239.5	259.4
Less: Amounts included in creditors falling due within one year – loans	(21.9)	(31.8)
Amounts falling due after more than one year	217.6	227.6
Loans:		
Within one year or on demand	21.9	31.8
Between one and two years	6.4	19.7
Between two and five years	159.5	118.6
After five years	51.7	89.3
	239.5	259.4

44. Provisions

	Employee related £m	Other £m	Total £m
At 1 January 2018	0.4	44.2	44.6
Released to income statement	(0.4)	(0.3)	(0.7)
At 31 December 2018	–	43.9	43.9
Analysed as:			
Current	–	2.8	2.8
Non-current	–	41.1	41.1
	–	43.9	43.9

Employee related provisions relate to restructuring. Other provisions are held for indemnities given on disposed businesses, legal and other costs that the Group expects to incur over an extended period, in respect of past events. These costs are based on past experience of similar items and other known factors and represent management's best estimate of the likely outcome.

45. Derivative financial instruments

	Assets 2018 £m	Liabilities 2018 £m	Assets 2017 £m	Liabilities 2017 £m
Currency swaps	5.1	–	9.3	–
Forward foreign exchange contracts	2.4	(3.7)	4.4	(1.0)
	7.5	(3.7)	13.7	(1.0)
Analysed as:				
Non current	–	–	3.6	–
Current	7.5	(3.7)	10.1	(1.0)
	7.5	(3.7)	13.7	(1.0)

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 30 of the Group's consolidated financial statements.

Notes to the Company Financial Statements continued

46. Deferred tax

The deferred tax asset not provided is as follows:

At 31 December	2018 £m	2017 £m
Depreciation in excess of capital allowances	0.3	0.3
Short-term timing differences	0.8	2.2
Losses	29.5	26.1
	30.6	28.6

47. Called up share capital

Issued and fully paid	2018 £m	Number 2018 millions	2017 £m	Number 2017 millions
1,098,564,237 ordinary shares of 2p each at 1 January and 31 December	22.0	1,098.6	22.0	1,098.6

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

48. Share premium account

At 1 January and 31 December	2018 £m	2017 (restated*) £m
	327.9	327.9

49. Profit and loss account

	2018 £m	2017 (restated*) £m
At 1 January	617.6	620.6
Loss for the year	(37.6)	(3.0)
At 31 December	580.0	617.6

* Balances as at 31 December 2017 have been restated to reclassify net exchange gain/(loss) on translation of loans in respect of foreign operations from the hedging reserve to the profit and loss account. This adjustment has no impact on the net assets of the Company and the impact on net loss is a reduction of £6.7m.

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. The total loss for the year was £37.6m (2017: £3.0m), and loss in total comprehensive income for the year was a loss of £37.2m (2017: loss of £2.9m).

50. Share based payment reserve

	2018 £m	2017 £m
At 1 January	74.0	68.5
Options over parent's shares awarded to employees of subsidiaries	11.2	9.2
Share based payment charge	3.5	2.3
Share options to holders on exercise	(28.0)	(6.0)
At 31 December	60.7	74.0

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

51. 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 2018, the ESOT held 3,527,740 (2017: 8,728,497) shares equal to 0.3% of the current allotted share capital (2017: 0.8%). The market value of shares held by the ESOT as at 31 December 2018 was £3.4m (2017: £8.6m).

52. Hedging and translation reserve

	2018 £m	2017 (restated*) £m
At 1 January	(0.6)	(0.7)
Fair value gain on cash flow hedges during the period	0.4	0.1
At 31 December	(0.2)	(0.6)

* Balances as at 31 December 2017 have been restated to reclassify net exchange gain/(loss) on translation of loans in respect of foreign operations from the hedging reserve to the profit and loss account. This adjustment has no impact on the net assets of the Company and the impact on net loss is a reduction of £6.7m.

53. Contingent liabilities

The Company has guaranteed overdrafts, finance leases, and bonding facilities of its joint ventures and associates up to a maximum value of £4.3m (2017: £4.3m). The actual commitment outstanding at 31 December 2018 was £4.3m (2017: £4.3m).

Both the Company and its subsidiaries have provided certain guarantees and indemnities in respect of performance and other bonds, issued by its banks on its behalf in the ordinary course of business. The total commitment outstanding as at 31 December 2018 was £207.0m (2017: £210.4m).

The Company also provides parent company guarantees in respect of trading performance and/or recovery of liabilities owed to customers by its subsidiaries. These are not expected to result in any material financial loss to the Company.

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.

54. 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 101 from disclosing related party transactions with entities that are 100% owned by Serco Group plc.

Appendix: List of subsidiaries and related undertakings

Company name	Serco Group interest	Registered office address
Aeradio Technical Services WLL ⁴	49%	Headquarters Building, Building # 1605, Road # 5141, Askar # 951, PO Box 26803 Manama, Kingdom of Bahrain
Antab Operations & Contracting LLC	60%	Office No. 31, 4th Floor, Amar 40 Building (No. 2444), 6987 King Abdulaziz Road, Al Masif, PO Box 50025, Riyadh 11523, Kingdom of Saudi Arabia
AWE Management Limited ³	24.5%	Atomic Weapons Establishment, Aldermaston, Reading, Berkshire, RG7 4PR United Kingdom
BAS-Serco Limited	10%	Clarendon House, 2 Church Street, Hamilton, HM11, Bermuda
CCM Software Services Ltd ²	100%	135 Hillside, Greystones, Co Wicklow 216410, Ireland
Confluent Innovations, LLC	49%	5880 Innovation Drive, Dublin, OH 43016, United States
Djurgardens Farjetrafik AB	50%	Svensksundsvagen 17, 111 49 Stockholm Sweden
DMS Maritime Pty Limited	100%	Level 24, 60 Margaret Street, Sydney NSW 2000, Australia
Equity Aviation Holdings (Pty) Ltd ²	50%	Block F, 1st Floor, Gilloolys View, Osborn Lane, Bedfordview, Johannesburg 2000, South Africa
Equity Aviation Investment Holdings (Pty) Ltd ²	50%	Block F, 1st Floor, Gilloolys View, Osborn Lane, Bedfordview, Johannesburg 2000, South Africa
Hong Kong Parking Limited	40%	Room 2601, World Trade Centre, 280 Gloucester Road, Causeway Bay, Hong Kong
Innu Serco Inc	49%	P.O. Box 1012, Station C, Happy Valley - Goose Bay, A0P 1C0, Canada
Innu Serco Limited Partnership	49%	P.O. Box 1012, Station C, Happy Valley - Goose Bay, A0P 1C0, Canada
International Aeradio (Emirates) LLC – Abu Dhabi	49%	Office No. 503, 5th Floor, Al Muhairy Building, Zayed The First Street, PO Box 3164 Abu Dhabi, United Arab Emirates
International Aeradio (Emirates) LLC – Dubai	49%	19th Floor, Rolex Tower, Sheikh Zayed Road, PO Box 9197 Dubai, United Arab Emirates
JBI Properties Services Company LLC	49%	Al Jazira Club, 303, Tower A, Muroor Road (4th Street), PO Box 63737 Abu Dhabi, United Arab Emirates
Khadamat Facilities Management LLC	49%	The United Arab Emirates University, Al Jamea Street, Al Maqam District, PO Box 15551 Al Ain, United Arab Emirates
LOGTEC Inc.	100%	Suite 1000, 1818 Library Street, Reston VA 20190, United States
Merseyrail Services Holding Company Limited ³	50%	Eversheds House, 70 Great Bridgewater Street, Manchester, Lancashire, M1 5ES United Kingdom
Northern Rail Holdings Limited	50%	Eversheds House, 70 Great Bridgewater Street, Manchester, Lancashire, M1 5ES United Kingdom
Northern Pathways Holding Pty Limited	10%	John Laing, Level 16, 15 Castlereagh St, Sydney NSW 2000, Australia
COMPASS SNI Limited	100%	Serco House, 16 Bartley Wood Business Park, Bartley Way, Hook, Hampshire, United Kingdom
Priority Properties North West Limited	100%	Serco House, 16 Bartley Wood Business Park, Bartley Way, Hook, Hampshire, United Kingdom
Serco (Jersey) Limited	100%	13 Castle Street St Helier Jersey JE4 5UT, Jersey
Serco Australia Pty Limited ³	100%	Level 24, 60 Margaret Street, Sydney NSW 2000, Australia
Serco Belgium S.A	100%	Avenue de Cortenbergh 60 – 1000 Brussels, Belgium
Serco Caledonian Sleepers Limited	100%	Basement And Ground Floor Premises, 1-5 Union Street, Inverness, IV1 1PP, Scotland, United Kingdom
Serco Canada Inc.	100%	330 Bay Street, Suite 400, Toronto, Canada M5H 2S8
Serco Citizen Services Pty Ltd	100%	Level 24, 60 Margaret Street, Sydney NSW 2000, Australia

Company name	Serco Group interest	Registered office address
Serco Corporate Services Limited	100%	Serco House, 16 Bartley Wood Business Park, Bartley Way, Hook, Hampshire, United Kingdom
Serco Defence Clothing Pty Ltd	100%	Level 24, 60 Margaret Street, Sydney NSW 2000, Australia
Serco Defence SA	100%	Avenue de Cortenbergh 60-1000, Brussels, Belgium
Serco Defence Services Pty Ltd	100%	Level 24, 60 Margaret Street, Sydney NSW 2000, Australia
Serco Environmental Services Limited	100%	Serco House, 16 Bartley Wood Business Park, Bartley Way, Hook, Hampshire, United Kingdom
Serco Ferries (Guernsey) Crewing Limited	100%	4th Floor, West Wing, Trafalgar Court, Admiral Park, St Peter Port, GY1 2JA, Guernsey
Serco Ferries (HR) Limited	100%	Serco House, 16 Bartley Wood Business Park, Bartley Way, Hook, Hampshire, United Kingdom
Serco Geografix Limited	100%	Serco House, 16 Bartley Wood Business Park, Bartley Way, Hook, Hampshire, United Kingdom
Serco Gestion de Negocios SL	100%	Calle Ayala, 13 1ºDr, 28001 Madrid, Spain
Serco Group (HK) Limited	100%	Suite No. 1, 11 F., Sino Plaza, 255-257 Gloucester Road, Causeway Bay, Hong Kong
Serco Group Consultants (Shanghai) Company Limited ²	100%	1206-A23, 12/F Shui On Plaza, No.333 Mid Huai Hai Road, Shanghai 200021, China
Serco Group Pty Limited	100%	Level 24, 60 Margaret Street, Sydney NSW 2000, Australia
Serco Holdings Limited ¹	100%	Serco House, 16 Bartley Wood Business Park, Bartley Way, Hook, Hampshire, United Kingdom
Serco Inc. ³	100%	c/o Corporation Services Company, 830 Bear Tavern Rd, West Trenton, NJ 08628, United States
Serco Insurance Company Limited	100%	Maison Trinity, Trinity Square, St Peter Port Guernsey
Serco Integrated Transport Private Limited	100%	Office# 431, Level 4, Augusta Point, Sector 53 Golf Course Road, Gurgaon 122002, India
Serco International Limited	100%	Serco House, 16 Bartley Wood Business Park, Bartley Way, Hook, Hampshire, United Kingdom
Serco International S.à r.l	100%	Estera, 7 rue Robert Stümper, L-2557 Luxembourg
Serco Leasing Limited	100%	Serco House, 16 Bartley Wood Business Park, Bartley Way, Hook, Hampshire, United Kingdom
Serco Leisure Operating Limited	100%	Serco House, 16 Bartley Wood Business Park, Bartley Way, Hook, Hampshire, United Kingdom
Serco Limited ³	100%	Serco House, 16 Bartley Wood Business Park, Bartley Way, Hook, Hampshire, United Kingdom
Serco Listening Company Limited	100%	Serco House, 16 Bartley Wood Business Park, Bartley Way, Hook, Hampshire, United Kingdom
Serco Luxembourg S.A.	100%	17 Boulevard Royal 17, L – 2449 Luxembourg
Serco Nederland B.V.	100%	Kapteynstraat 1, 2201 BB Noordwijk ZH, Netherlands
Serco New Zealand (Asset Management Services) Limited	100%	Level 4, KPMG Centre, 18 Viaduct Harbour Avenue, Auckland Central, Auckland, 1010, New Zealand
Serco New Zealand Limited	100%	Level 4, KPMG Centre, 18 Viaduct Harbour Avenue, Auckland Central, Auckland, 1010, New Zealand
Serco New Zealand Training Limited	100%	Level 4, KPMG Centre, 18 Viaduct Harbour Avenue, Auckland Central, Auckland, 1010, New Zealand
Serco North America (Holdings), Inc.	100%	Corporation Trust Center, 1209 Orange Street, Wilmington, DE 19801, United States

Appendix: List of subsidiaries and related undertakings continued

Company name	Serco Group interest	Registered office address
Serco North America Limited	100%	Serco House, 16 Bartley Wood Business Park, Bartley Way, Hook, Hampshire, United Kingdom
Serco Paisa Limited	50%	Surrey, Ci Tower, St. George's Square, New Malden, Surrey, KT3 4TE United Kingdom
Serco PIK Limited	100%	Serco House, 16 Bartley Wood Business Park, Bartley Way, Hook, Hampshire, United Kingdom
Serco Pension Trustee Limited	100%	Serco House, 16 Bartley Wood Business Park, Bartley Way, Hook, Hampshire, United Kingdom
Serco Projects LLC	49%	Global Business Centre 2, Second Floor, Al Hitmi Village Building, C-Ring Road, PO Box 25422 Doha, State of Qatar
Serco Regional Services Limited	100%	Serco House, 16 Bartley Wood Business Park, Bartley Way, Hook, Hampshire, United Kingdom
Serco Sarl	100%	15, rue Lumière 01630 Saint Genis Pouilly, France
Serco SAS	100%	15, rue Lumière 01630 Saint Genis Pouilly, France
Serco Saudi Arabia LLC	100%	Mazaya Tower, 1st Floor, King Saud Road, PO Box 366877, Riyadh 11393, Kingdom of Saudi Arabia
Serco Services GmbH	100%	Lise-Meitner-Strasse 10, 64293 Darmstadt, Germany
Serco Services Inc.	100%	Suite 1000, 1818 Library Street, Reston VA 20190, United States
Serco Services Ireland Limited	100%	29 Earlsfort Terrace, Dublin 2, Ireland
Serco Singapore Pte Limited	100%	38 Beach Road, #29-11 South Beach Tower, Singapore, 189767
Serco SpA	100%	Via Sciadonna 24/26, 00044 Frascati (Roma), Italy
Serco Switzerland SA	100%	86 bis Route de Frontenex, 1208 Geneva, Switzerland
Serco Traffic Camera Services (VIC) Pty Limited	100%	Level 24, 60 Margaret Street, Sydney NSW 2000, Australia
Serco-IAL Limited	100%	Serco House, 16 Bartley Wood Business Park, Bartley Way, Hook, Hampshire, United Kingdom
VIAPATH Group LLP	33%	Francis House, 9 King's Head Yard, London, SE1 1NA, United Kingdom

1. Serco Holdings Limited is directly owned by Serco Group plc. All other subsidiaries and associated undertakings are held indirectly via Group companies.
2. Companies in liquidation as at 31 December 2018.
3. Companies key to the consolidated numbers, all of which are engaged in the provision of support services.
4. Companies with a non controlling interest due to being consolidated in full as a result of considerations over control.

Appendix: Supplementary Information

Five-year record (unaudited)

	2018 £m	2017 (restated ^{***}) £m	2016 £m	2015 (restated ^{**}) £m	2014 £m
Adjusted Revenue	3,211.9	3,307.3	3,529	4,252	4,753
Less: Share of revenue of joint ventures and associates	(375.1)	(356.4)	(481)	(737)	(798)
Revenue	2,836.8	2,950.9	3,048	3,515	3,955
Underlying Trading Profit*	93.1	69.3	82.1	95.9	113.2
OCP and Contract and Balance Sheet Review adjustments	23.6	(24.2)	14.2	20.9	(745.3)
Include benefit from non-depreciation and amortisation of assets held for sale	–	–	0.5	11.7	–
Include other one-time items	–	–	3.5	9.0	–
Trading Profit/(Loss)*	116.7	45.1	100.3	137.5	(632.1)
Amortisation and impairment of intangibles arising on acquisition	(4.3)	(4.4)	(5.1)	(4.9)	(23.7)
Operating profit/(loss) before exceptional items	112.4	40.7	95.2	132.6	(655.8)
Exceptional profit/(loss) on disposal of subsidiaries and operations	(0.5)	0.3	0.1	2.8	(5.4)
Other exceptional operating items	(31.4)	(19.9)	(70.6)	(190.3)	(656.1)
Operating profit/(loss)	80.5	21.1	24.7	(54.9)	(1,317.3)
Net finance costs	(13.9)	(11.2)	(12.6)	(31.9)	(36.7)
Exceptional finance income/(costs)	7.5	–	(0.4)	(32.8)	–
Other gains	–	0.7	–	–	–
Profit/(loss) before tax	74.1	10.6	11.7	(119.6)	(1,354.0)
Tax (charge)/credit	(6.7)	(18.6)	(12.8)	(33.5)	6.9
Profit/(loss) after tax	67.4	(8.0)	(1.1)	(153.1)	(1,347.1)
Recourse Net Debt	(188.0)	(141.1)	(109.3)	(82.2)	(642.7)
Net Debt	(188.0)	(141.1)	(109.3)	(82.2)	(642.7)
	Pence	Pence	Pence	Pence	Pence
Earnings/(loss) per share before exceptional items	8.20	1.50	6.12	6.55	(107.43)
Basic (loss)/earnings per share	6.16	(0.76)	(0.11)	(15.47)	(205.66)
Dividend per share	–	–	–	–	3.10

* Included in 2014 Trading Loss were charges totalling £745.3m arising from the Contract and Balance Sheet Review undertaken in 2014, with £718.0m charged to Adjusted Operating Profit and £27.3m charged to Management estimate of items relating to UK Government reviews.

** The 2015 general and administrative expenses and net finance costs have been restated following the change in accounting policy regarding foreign exchange movements on investment and financing arrangements. No changes have been made to the comparative periods for 2014 and prior as it is impracticable.

*** Results for the year ended 31 December 2017 have been restated to reflect the adoption of IFRS15 with effect from 1 January 2017. See note 2. No changes were made to earlier periods, hence the results for the years ended 31 December 2016, 31 December 2015 and 31 December 2014 would need to be restated for the impact of IFRS9 and IFRS15 in order to be prepared in accordance with current International Financial Reporting Standards.

Shareholder Information

Our website

The Company's website, www.serco.com, provides access to share price information as well as sections on managing your shareholding online, corporate governance and other investor relations information.

Shareholder queries

Our share register is maintained by our Registrar, Equiniti. Shareholders with queries relating to their shareholding should contact Equiniti directly using one of the methods listed opposite.

American Depositary Receipts (ADRs)

Serco has established a sponsored Level I ADR programme. Serco ADRs are traded on the US over-the-counter market (SCGPY).

For queries relating to your ADR holding, please contact our ADR depositary bank, Deutsche Bank Trust Company Americas.

Managing your shares online

Shareholders can manage their holding online by registering to use our shareholder portal at www.shareview.co.uk. This free service is provided by our Registrar, giving quick and easy access to your shareholding.

Electronic communications

We encourage shareholders to consider receiving their communications electronically which means you receive information quickly and securely and allows us to communicate in a more environmentally friendly and cost-effective way. You can register for this service online using our share portal at www.shareview.co.uk

Duplicate documents

Some shareholders find that they receive duplicate documentation due to having more than one account on the share register. If you think you fall into this group and would like to combine your accounts, please contact our Registrar, Equiniti.

Changes of address

To avoid missing important correspondence relating to your shareholding, it is important that you inform our Registrar of your new address as soon as possible.

Sharegift

If you have a very small shareholding that is uneconomical to sell, you may want to consider donating it to Sharegift (Registered Charity no.10526886), a charity that specialises in the donation of small, unwanted shareholdings to good causes. You can find out more by visiting www.sharegift.org or by calling +44 (0) 207 930 3737.

Useful Contacts

Serco's registered office

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

Telephone +44 (0)1256 745 900
Email investorcentre@serco.com

Registered in England and Wales No. 2048608

Group General Counsel and Company Secretary

David Eveleigh

Registrar

Equiniti
Aspect House
Spencer Road
Lancing
West Sussex
BN99 6DA
United Kingdom

Telephone 0371 384 2932 (from within UK)
+44 (0)121 415 7047 (from outside UK)
Lines are open 8.30am to 5.30pm
Monday to Friday. (excluding public holidays
in England and Wales)

Website www.shareview.co.uk

Shareholders can securely send queries via the website using the 'Help' section.

ADR depositary bank

Deutsche Bank Trust Company Americas
c/o American Stock Transfer & Trust Company
6201 15th Avenue
Brooklyn NY 11219
USA

Telephone +1 866 249 2593 (toll-free within USA)
+1 718 921 8124 (from outside USA)

Website www.adr.db.com
Email db@astfinancial.com

Brokers

JP Morgan Cazenove
Bank of America Merrill Lynch

Auditor

KPMG LLP

Unsolicited mail and shareholder fraud

Shareholders are advised to be wary of unsolicited mail or telephone calls offering free advice, to buy shares at a discount or offering free company reports. For further information on how shareholders can be protected from investment scams visit www.fca.org.uk/consumers/scams/investment-scams/share-fraud-and-boiler-room-scams

Legal Disclaimer

This Annual Report and Accounts contains certain statements which are, or may be deemed to be, 'forward-looking statements'. By their nature, these forward-looking statements are subject to a number of known and unknown risks, uncertainties and contingencies, many of which are beyond Serco's control or influence, and actual results and events could differ materially from those currently being anticipated as reflected in such statements. For a description of certain factors that may affect Serco's business, financial performance or results of operations, please refer to the Principal Risks and Uncertainties set out in this Annual Report and Accounts on pages 54 to 63. These forward-looking statements speak only as of the date of this publication. Past performance should not be taken as an indication or guarantee of future results and no representation or warranty, express or implied, is made regarding future performance. Except as required by any applicable law or regulation, Serco expressly disclaims any

obligation or undertaking to release publicly any updates or revisions to any forward-looking statements contained in this publication to reflect any change in Serco's expectations or any change in events, conditions or circumstances on which any such statement is based. Accordingly, undue reliance should not be placed on any such forward-looking statements.

Any references in this publication to other reports or materials, including website addresses, are for the reader's interest only. Neither the content of Serco's website nor any website accessible from hyperlinks from Serco's website, including any materials contained or accessible thereon, are incorporated in or form part of this publication.

Serco is subject to the regulatory requirements of the Financial Conduct Authority of the United Kingdom.

Notes



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