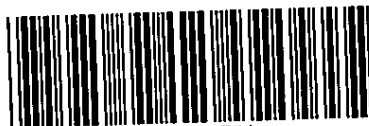


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Annual report
and accounts 2013

Bringing service to life

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Chairman's statement

The events of last year are well documented. In July the Secretary of State for Justice announced that an independent audit of the billing arrangements of the Electronic Monitoring contracts Serco operates had highlighted potential overbilling and in September, materials were provided to the Serious Fraud Office on this matter. In August, the Ministry of Justice (MoJ) and Serco made announcements regarding the referral to the City of London Police of the misreporting of data on the Prisoner Escort & Custody Services contract. The issues that were identified on these two contracts should never have happened and we have apologised unreservedly for them.

May I take this opportunity on behalf of the Board to make an equally fulsome apology to our shareholders. We are doing everything in our power to make sure that such issues cannot reoccur anywhere in our business around the world. Our objective continues to be the delivery of excellent public services with openness and transparency, and I believe the actions we have taken and are taking will support this now more than ever.

Twelve months ago I wrote "In all parts of Serco, when I visit our contracts I meet people who have the same commitment to service, to making a difference through helping those with whom they work, whilst at the same time delivering against our promises." I still believe that at the core of Serco is a combination of a strong ethos of public service with a real entrepreneurial drive to succeed and deliver against commitments, inside and outside the company. The independent reviews that we have performed of our culture and systems confirmed a high commitment to client service with no evidence of a corrupt culture, and key procedures and controls that were adequate but could be improved. However the reviews also demonstrated the need for attitudinal change, a change I, our Board, and Ed Casey, our Acting Group Chief Executive, are committed to implementing. The reviews showed that culturally there was a drive to succeed and deliver that could lead our people at times to make decisions that prioritised commercial objectives over ethical behaviour. Also, whilst our systems and controls formed a solid basis for a management framework, there was a lot more we could do to ensure that if there are issues, they are identified early, acted upon, and lessons learned.

I recognise that such inappropriate actions and decisions undermine the confidence people have in us. Our company relies upon the confidence of our customers and the confidence of the public, and anything that damages that, damages us. But it is not just our company, the whole industry relies on such confidence. If it is damaged, we lose the opportunity to show the difference outsourcing can make and we lose the ability to show how the private sector and competition can contribute to excellent, efficient, low-cost public services. This is why your Board has taken these matters so seriously.

I was very pleased to reach a settlement with the UK Government prior to the end of the financial year, in respect of issues arising on the Electronic Monitoring contract. The separate audits of our other MoJ contracts and the Cabinet Office's wider review across our other major UK Central Government contracts also concluded by the end of the year, with

no further material issues raised. During the fourth quarter of last year, we developed and set in train a comprehensive programme of corporate renewal. At its heart this programme aims – through leadership, training, guidance, and appropriate performance management – to change the balance of drivers within our business, such that the commitment to do what is right and to deal with our customers fairly and transparently always transcends that sustained drive to outperform. This will be supported by the right management structures and controls and best-in-class lines of assurance, to ensure that through early identification of risks and issues and their swift resolution, we never again compromise on our values and ethics. I was very pleased that at the end of January, the Cabinet Office published a positive assessment of our programme and, as a consequence, Serco can now be considered on an equal basis to other suppliers for the award of new contracts.

It is hard for those outside the company to appreciate how disruptive were the events of last year to the normal conduct of our business. Not only was our pipeline of contracts with the UK Government impacted by the suspension of awardability last summer, but the associated reputational damage also adversely affected our ability to win contracts with the private sector. We have made significant management changes at the most senior level, with new people, sometimes in an acting capacity, needing to assimilate their responsibilities and determine how to take forward their parts of the business. Absolutely correctly management has focused on the development and implementation of our programme of corporate renewal, diverting focus from where they would otherwise be concentrating their efforts to make our business more efficient, extend existing lines and explore new ones. The inevitable consequence has been a material loss of momentum, particularly in the UK, which translates itself into lower organic revenue growth and profitability than we would otherwise have aimed to achieve in 2014. In addition, 2014 will be impacted heavily by a major change of government policy affecting one of our largest contracts – that for the Australian Department of Immigration and Border Protection, whilst there is also a greater known impact of attrition from lost contracts such as Electronic Monitoring.

Our experience at Forth Valley and other UK hospitals helped us to win the contract at Fiona Stanley hospital in Perth, Western Australia.

It is essential that we take the steps now that are necessary to put Serco onto a sound basis for future growth, even if to do that means a degree of reversal of past growth. Key to that is strong effective leadership and I am very pleased to be able to announce that Rupert Soames OBE has accepted the Board's invitation to take the role of Group Chief Executive. He will start with us on 1 June. He has an outstanding track record as chief executive of a FTSE 100 company, having created very significant value for shareholders during his long tenure at Aggreko plc. I would like to take this opportunity to express my great appreciation on behalf of the Board of the work of Ed Casey, in taking the helm in the most difficult of circumstances and providing great leadership to get the company back on track.

I would also repeat my thanks to Chris Hyman for his enormous contribution to Serco over 19 years. As CEO since 2002, he took Serco from a predominantly UK business with a turnover of £1.3bn to the £5bn international services business it is today.

In thinking about the potential of the business for the future, Serco has a unique combination of capabilities with international reach. No other company has the breadth across both frontline and middle and back office services. No other company can apply the experience and track-record that we have in one of our markets in the UK, Europe, the Americas, the Middle East, Asia Pacific or Australia to support the winning of new contracts in another geography.

We would not have won the Fiona Stanley hospital in Perth, Western Australia if we had not achieved what we have at Forth Valley and elsewhere in hospitals in the UK. We would not have won Mt Eden prison in New Zealand had we not achieved what we have in prisons in the UK and Australia. We would not have won the Virginia Department of Transportation contract without our traffic management experience in the UK and Hong Kong.

One should not lose sight of what the business did achieve in 2013, despite the issues in our relationship with UK Central Government. We were awarded contracts to a value of £3.7bn and achieved organic revenue growth of 6%, albeit with a somewhat lower operating margin.

Chairman's statement

Continued

that left Adjusted pre-tax profits at £254m, 6% lower than 2012. Particularly gratifying was the progress achieved in the Americas where in 2012 we had experienced the toughest trading conditions, with new contract awards being constrained by the inability to agree a US Federal Budget. Despite this uncertainty continuing during 2013, we won new contracts with the United States Department of Health and Human Services' Centers for Medicare & Medicaid Services to provide processing support for new health benefit exchanges, worth potentially US\$1.25bn, and with the Virginia Department of Transportation to manage traffic in the state of Virginia worth US\$355m. In Canada we were successful in the rebid of our contract to provide driver examination services in the state of Ontario for a further ten years, worth C\$500m.

Furthermore, we celebrated Serco's 25 years as a listed company, with our staff undertaking phenomenal challenges to raise more than £400,000 for charities all around the world.

I am delighted to welcome three new non-executive directors to our Board. They add to our diversity of thought and experience, as we consider how best to take the business forward. Mike Clasper has a strong reputation as both executive and non-executive. Latterly in his executive career he was CEO of BAA, whilst as a non-executive he was Chairman of HMRC and is senior independent director at ITV and Chairman of Coats. He will join the Audit, Corporate Responsibility and Nomination Committees. Rachel Lomax will join the Audit Committee and will become the Chair of the newly formed Corporate Responsibility Committee. This committee will have

responsibility for the ethical and governance oversight of the Group, as well as taking over from the main Board detailed consideration of the company's health and safety, environmental and risk policies and management. Rachel is a past Deputy Governor of the Bank of England, and has been Permanent Secretary at both the Department of Work and Pensions and the Department for Transport. She is currently Chairman of the Conduct & Values Committee of HSBC. Tamara Ingram is currently an executive vice president of WPP and last year rotated after nine years from being a non-executive director of the Sage Group. She will join both the Remuneration and Corporate Responsibility Committees.

In conclusion I would like to say thank you on behalf of the Board to all those of our management and staff who have worked so hard over the last 12 months, both to deliver our promises on our contracts and to address the challenges that have faced us. It is very hard maintaining one's energy and commitment working for a company that is in the news for the worst of reasons; the determined response of our people over this period stands testament to the strong foundations of Serco and gives confidence in our ability to realise our full potential. This confidence supports the Board's decision to maintain the final dividend payment resulting in a total dividend for the year of 10.55p, an increase of 4.5%.

Alastair Lyons CBE
 Chairman

We were awarded the contract at Mt Eden prison in New Zealand because of our achievements at the prisons we run in the UK and Australia.

What we do

We deliver services that make a positive difference to people's lives

Our customers are local, state and national governments and major private companies

They face an increasingly complex and competitive world. People and communities have rapidly changing needs and expect the services they use to make a positive and tangible difference to their lives.

The organisations that serve them – our customers – have limited resources. Many are having to do more with less. Delivering service, and doing it well, is more difficult than ever. To overcome these challenges, our customers want a partner who can improve the quality and efficiency of their services and help them keep their promises to their own customers and citizens.

All of this means that service has never been more important or more challenging. It needs a specialist approach.

We specialise in service delivery

Serco has specialised in service delivery for more than 50 years. The combined capabilities we offer, across frontline, middle and back office services, are unique.

Our customers know what outcome or service they want to deliver and we find new and more effective ways to achieve it for them. Together, we make a difference to the lives of millions of people around the world.

Our people are always looking for ways to improve our service delivery. We transfer our skills, insights and ideas from one sector or region to another, so we can meet new challenges for customers. Drawing on this broad experience is at the heart of what makes us different. It ensures we deliver well today and use what we learn to anticipate our customers' needs tomorrow. It transforms good service into great.

Great service can look different from sector to sector and from country to country, but the values and capabilities it needs are broadly the same. Our service specialism means our customers can focus their time and people on what they do best, confident that our experience, innovation and scale will deliver the business and customer benefits they want.

Our capabilities allow us to work around the world on behalf of defence, transport, justice, health, and state and local government customers in the public sector, and to provide customer contact and business process activities for private sector customers in finance, retail, travel and telecommunications.

We have a strong service ethos

Our people have a strong service ethos and a real desire to deliver the promises we make to our customers.

We value working with our customers in a collaborative, flexible and imaginative way. We understand the principles and passions that motivate public sector managers and we seek to share their ethos and standards of conduct. We encourage social responsibility and try to treat people in the way we would wish to be treated. Our most powerful tool in improving performance is to instil a more stimulating culture, where people feel they can personally make a difference. We have honed this tool into four Governing Principles: we foster an entrepreneurial culture, we enable our people to excel, we deliver our promises, and we build trust and respect.

Following the challenges of 2013, we launched an independent review of our culture and ethics, and were reassured to find a workforce that believes strongly in Serco's commitment to service excellence. Our employees spoke openly and candidly, with the clear intent of providing constructive feedback to senior leadership as to how to restore Serco's good name. The events of 2013 were painful and embarrassing for our people, who care deeply about Serco and the customers it serves. There was no evidence that Serco has a corrupt culture or that the Company knowingly encourages improper or unethical behaviour. What was identified was an environment in which Serco employees could make inappropriate decisions to achieve commercial success, and it is this environment that we are committed to change as a fundamental part of our corporate renewal.

How we performed in 2013

A challenging 2013 and near-term outlook, markets remain attractive

Revenue growth of 5.6% for the Group, growth of 5.9% on an organic basis

- UK & Europe organic growth of 3%, driven by first half growth from new contracts won in the previous year
- Americas held steady with new health and transport contract wins despite a challenging US federal market
- AMEAA organic growth of 18%, supported by increased volume of work in immigration services
- Global Services organic growth of 5%, with strong first half from previous awards partially offset by a weaker second half of the year

Reduced profit and cash generation

- Adjusted operating margin from ongoing activities declined to 5.6%, driven in particular by higher BPO bid investment and fewer contract awards in the year
- Adjusted earnings per share (basic) of 39.53p, a decline of 2.1% at constant currency
- Net exceptional charge of £90.5m, reflecting principally the Electronic Monitoring settlement and one-off costs together with an estimated £21.0m of other indirect costs in relation to the UK Government reviews
- Operating profit of £143.8m, a decline of 44.6% at constant currency

- Earnings per share (basic) of 19.51p, a decline of 58.0% at constant currency
- Free cash flow declined to £84.8m, after BPO working capital investment and other adverse timing effects

Increased total dividend for the year and robust financing position

- Proposed final dividend held at 7.45p, total dividend for the year of 10.55p, up 4.5%, ongoing transition to higher payout ratio
- Group recourse net debt of £725m, sufficient financing headroom maintained

Further progress on contract awards and strategic positioning

- £3.7bn of contract awards, order book of £17.1bn as at 31 December 2013
- New US contract awards successfully broadened the Americas portfolio
- Non-core disposals reflected ongoing assessment of operations against their fit to Group strategy

Challenging near-term outlook

- 2014 faces above-average contract attrition, reduced volume of work in Australian immigration services and lower expected growth from new contracts awarded

- As previously disclosed, a mid-single digit organic revenue decline and a 50-100 basis points reduction in Adjusted operating margin is anticipated
- Of 2014 revenue, order book visibility of 77%, rebid/extension revenue still to secure of 8%

Securing Serco's position in large and growing markets

- Equal bidding basis for current UK Central Government work restored following corporate renewal positive assessment, settlement reached with UK Ministry of Justice (MoJ), conclusion of UK Government audits and reviews
- Comprehensive programme of corporate renewal, to ensure consistency of appropriate behaviours and improve operations across the Group
- Ongoing demand for efficient, high-quality and innovative service provision from public and private sector customers around the world
- Pipeline of new bid decisions over next two years valued at approximately £12bn or aggregate annual revenue of approximately £1.4bn
- As announced recently, Rupert Soames OBE appointed as Group Chief Executive with effect from 1 June 2014, currently Group Chief Executive of Aggreko plc, the FTSE 100 support services company

Notes and definitions

2012 is restated for changes to accounting standards IAS 19 Revised (Employee Benefits) and IFRS 11 (Joint Arrangements)

Adjusted measures include Serco's proportional share of joint ventures. Adjusted operating profit and Adjusted profit before tax are before amortisation of intangibles arising on acquisitions, transaction-related costs and exceptional items, as shown on the face of the Group's consolidated income statement and the accompanying notes. They are also before management's estimate of indirect costs incurred and allocation of expenses in relation to the UK Government reviews. The Adjusted earnings per share measure also takes account of the tax effect of these adjusting items. Adjusted net debt includes Serco's proportional share of joint venture net cash. Reconciliations to GAAP measures, together with descriptions of each adjusting item, are included in the Finance Review on pages 42 to 51 and the income statement is presented on page 113.

Change at constant currency has been calculated by translating non Sterling revenue and earnings for 2013 into Sterling at the average exchange rates for 2012.

Ongoing activities measures exclude the financial results of subsidiaries and operations disposed of in 2013 (being the UK occupational health business and the UK transport maintenance and technology business) and in 2012 (being nuclear consulting services, defence-related German operations, education software and UK data hosting operations).

Organic revenue growth is the change at constant currency in Adjusted revenue from ongoing activities (thereby excluding disposals) and also excludes incremental revenue from acquisitions completed in the current or prior financial year.

Free cash flow is from subsidiaries and dividends received from joint ventures, and is reconciled to recourse net debt in Section 6 of the Finance Review and to the movement in cash and cash equivalents, including the share of joint venture cash movements, in Section 3 of the Finance Review.

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

The total opportunity pipeline is the estimated value of all future potential new expansion, rebid and extension opportunities that are clearly defined and identifiable, including the estimate of any proportional share of future joint venture arrangements. The pipeline of new bid decisions over the next two years is the aggregate value of potential new contracts that are anticipated to be bid in the near term, where annual revenue for each is estimated to be in excess of £10m and where the estimated total contract value of each is capped at £1bn.

Adjusted Revenue***£5,143.9m**

2012 £4,913.0m

+4.7%**Revenue****£4,288.1m**

2012 £4,060.1m

+5.6%**Adjusted operating profit*****£292.0m**

2012 £314.1m

(7.0%)**Operating profit****£143.8m**

2012 £272.2m

(47.1%)**Adjusted profit before tax*****£254.4m**

2012 £271.6m

(6.3%)**Profit before tax****£106.6m**

2012 £281.1m

(62.1%)**Adjusted earnings per share*****39.53p**

2012 41.55p

(4.9%)**Dividend per share****10.55p**

2012 10.10p

+4.5%**Free cash flow****£84.8m**

2012 £181.2m

(£96.4m)

*Adjusted measures include Serco's proportional share of joint ventures and are before amortisation of intangibles arising on acquisition, transaction related costs, a pre-tax net exceptional charge of £90.5m (2012 net exceptional profit of £51.7m) and management's estimate of indirect costs incurred and allocation of expenses in relation to the UK Government reviews of £21.0m. Ongoing activities exclude the financial results of disposals. Notes and definitions are provided on page 6. Reconciliations and descriptions of costs are included in the Finance Review on pages 42 to 51 and the income statement is presented on page 113.

Our business

In 2013 we delivered our services through four divisions, as described below. More information on our divisions and their performance in the year can be found in the Divisional Reviews on pages 24 to 41.

In October 2013, we announced our intention to separate the UK & Europe division into two, with one business focused on our UK Central Government customer and the other on our wider UK public sector activities. This new structure came into effect on 1 January 2014.

UK & Europe

2013 Adjusted revenue from ongoing activities

£2,514m

+3%

2012 £2,436m

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

Americas

2013 Adjusted revenue from ongoing activities

£765m

+1%

2012 £753m

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

AMEAA

2013 Adjusted revenue from ongoing activities

£1,050m

+19%

2012 £883m

AMEAA consists of our operations in Australasia, the Middle East, Asia and Africa. We provide a range of frontline services including transport, justice, immigration, health, defence and other direct services, such as facilities management.

Global Services

2013 Adjusted revenue from ongoing activities

£772m

+10%

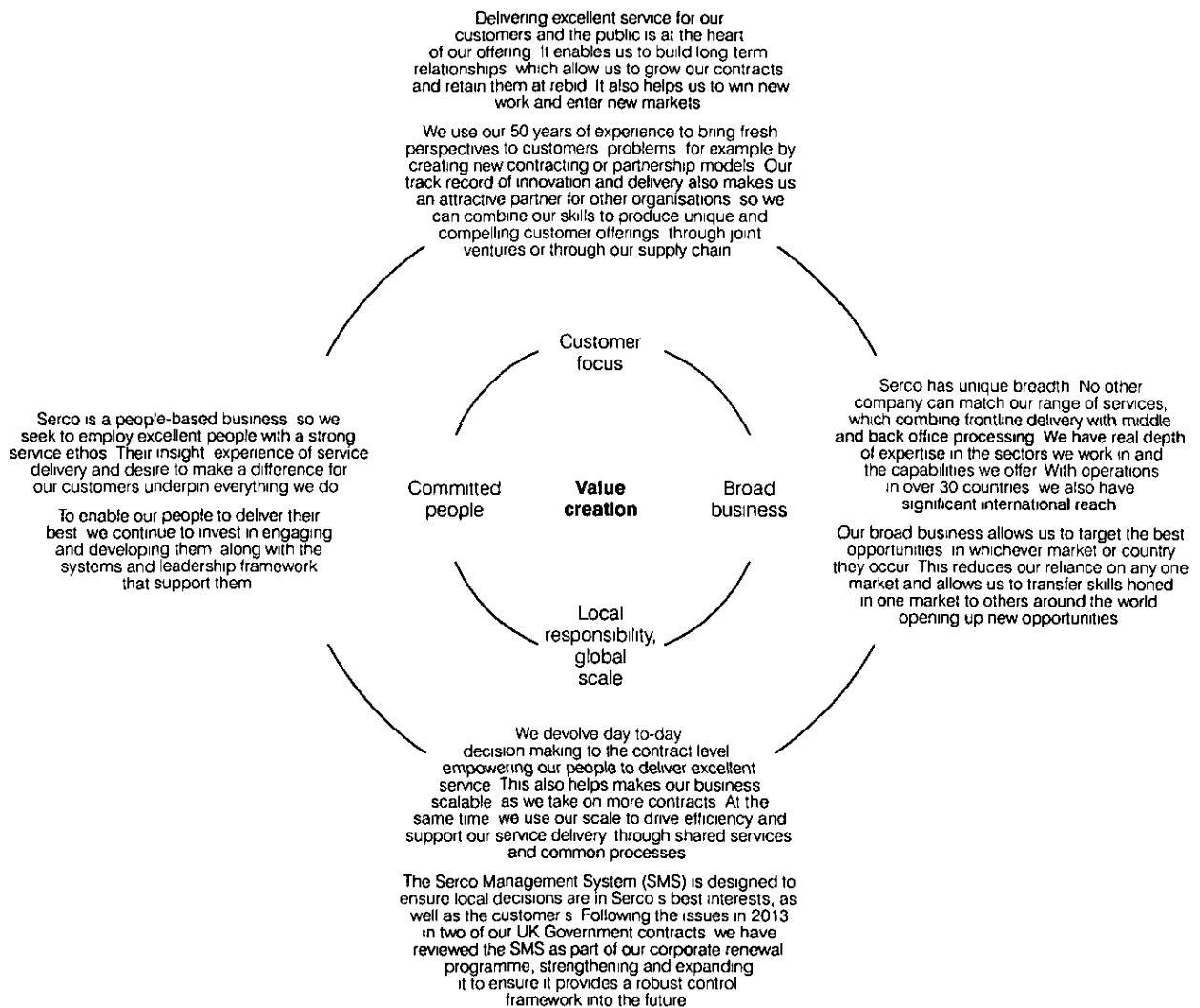
2012 £702m

Our Global Services division provides business process outsourcing (BPO) services to both the private and public sectors, bringing together Serco's middle and back office skills and capabilities across customer contact, transaction and financial processing, and related consulting and technology services.

Our business model

Our business model is built on a set of key strengths, which enable us to compete effectively and create value for our shareholders and other stakeholders. These competitive advantages derive from our focus on delivering the best service for our customers, the unique breadth of our business, our structure and our people.

Our strategy (see pages 10 to 11) builds on and reinforces these strengths.



The competitive environment

Competition is necessary for our markets to operate, as it encourages customers to put services out to tender, provides a benchmark to ensure they are getting best value and drives innovation.

Our business breadth means we have many competitors for both public and private sector contracts. These competitors are primarily companies but for government contracts they can include public sector and voluntary bodies.

As we enter new markets, we meet competitors who specialise in those areas. While we see effective competitors in every market, no organisation competes with us in all of them and only a few operate in more than one.

The overall level of competition is rising in our markets and customers are increasingly seeing assured service delivery as a prerequisite, rather than as a differentiator. They want providers that bring confidence, experience and insight, and who can partner with them to deliver

something different, including anticipating their changing needs and working with them to drive innovation.

Our business model makes us a strong competitor in our markets and allows us to target opportunities where we can differentiate ourselves from other providers, for example through innovation, the depth of our expertise and the breadth of our capabilities.

Our strategy

Setting our strategic direction

Although Serco faces its own challenges and there are some uncertainties in both developed and emerging economies, our markets are growing and we see that continuing. This growth is driven by economic and demographic fundamentals, which have strengthened over the last few years. Citizens are demanding more and better services within constrained public sector budgets. There is a desire for new public services in countries where the size and wealth of the population is growing. Demographic shifts continue to underpin demand, with more and more pressure being put on physical and social infrastructure, especially healthcare, social services, transport and immigration.

Despite the specific challenges Serco faced in 2013, our strategic approach remains centred on organic growth, while also emphasising the factors that will support that growth – service quality, efficiency and people development. Where it is valuable to add capabilities that complement our existing service offering, or we want to establish a presence in new markets that offer opportunities for our existing service lines, we will consider acquisitions to take our strategy forward.

Our Group strategy

Our strategy is focused on three key pillars: building a balanced portfolio, driving improved service and margin, and enhancing our people, systems and brand.

Strategy

Building
a balanced
portfolio

Driving
improved
service
and margin

Enhancing
our people,
systems
and brand

Description

Our strategy aims to build a balanced portfolio across developed and emerging markets – frontline and BPO services – and public and private sectors

This reduces our exposure to market fluctuations, enables us to select the best opportunities wherever they arise – and allows us to transfer expertise from one market to another

To support our organic growth – we consider acquisitions and strategic partnerships – which add to the depth of capabilities we can take to our customers – or enable us to enter new markets for existing service lines

Our proactive portfolio management also involves ongoing assessment of our contracts and businesses for strategic fit – expected performance and risk-adjusted returns. This results in our exit from markets no longer core to the Group's future development

Underpinning our strategy is our ability to consistently deliver efficient and high-quality services across the world. As Serco grows – we increasingly look for opportunities to transfer our capabilities across geographies – so that more of our capabilities are available to more of our customers

Growth allows us to drive economies of scale – providing the opportunity to support our portfolio with shared services – processes and platforms. These also help bind teams and businesses across sectors and countries

We therefore continue to develop and share global best practices and aim to maximise the efficiency of our operations

Our people are our greatest asset – so getting our people strategy right is essential to meeting our strategic goals. Our people strategy therefore aims to drive the right behaviours – capabilities – structures and incentives. Our focus is on further developing our leaders – equipping our staff to deliver the very best to our customers and having employee engagement processes designed to make Serco a great place to work

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

Key achievements in 2013

We delivered Adjusted revenue growth of 4.7%

We saw strong organic growth in our AMEAA division and held our Americas revenues steady despite a further year of shrinkage in the US Federal outsourcing market. New contracts supporting US healthcare eligibility and state transportation services have successfully broadened our portfolio in this region

Growth was also achieved in the UK and in our Global Services division. Reviews such as that covering UK clinical health have led to decisions to exit early from certain contracts

In 2013, we divested some operations that had become non-core including UK transport maintenance and operational health services

In 2013 – we experienced significant issues with two contracts for the UK Ministry of Justice (MoJ). Audits of all our other MoJ contracts and reviews of all our major UK Central Government contracts concluded to our customers' satisfaction. Our corporate renewal programme will also support further service improvement alongside changing attitudes

2013 was an important year for transitioning operations on major contracts such as Shop Direct Group and Fiona Stanley Hospital – as well as starting new, large operations such as those for the US Department of Health and Human Services – Centers for Medicare & Medicaid Services and Virginia Department of Transportation

Our margin declined in 2013. The principal drivers of margin reduction included – increased cost investment in contract bidding and new market development in Global Services – reduced discretionary and project work, and the general challenge Serco faced in progressing UK contract awards given the issues with our UK Government customer. In addition there were other margin mix effects – such as lower margins on the initial stages of new contracting areas and the start of the new five-year pricing period at the Atomic Weapons Establishment

In 2013 we developed a new leadership model which covers everyone in Serco and will be launched in 2014 (see page 53)

We continued to focus on driving engagement. Our annual Viewpoint survey highlighted a generally positive culture but overall levels of engagement declined slightly in the last 12 months – in part reflecting the challenging environment Serco has faced

We also continued to enhance our MyHR human resources system, positioning us to add new functionality which will support our people strategy (see pages 53-54)

Following the events of 2013 – we recognise the need to rebuild our relationships and reputation with our UK Government customer and the public at large – and have started a programme of reputation recovery

Within our programme of corporate renewal, which was developed during the last quarter of 2013 and is now being implemented – we are working to embed a change in our approach to doing business and to enhance our framework of reporting, systems and controls

Principal risks and uncertainties

Principal risks

The Group Risk Register identifies the principal risks facing the business as a whole, including those that are managed directly at Group level. These are managed through a formal process. More information on our risk management framework can be found on pages 70 to 73.

The Group's key stakeholders include, but are not limited to, customers, shareholders, suppliers, staff, trade unions, government, regulators, banks and insurers. The way we operate as a responsible company recognises the interests of the community in areas such

as social, environmental and ethical impact as described within the Corporate Responsibility section.

The most significant risks relate to our reputation, and to operational and financial performance, which are all direct threats to the achievement of our strategic objectives. Summarised on the following pages are the key risks we have identified that could have a material impact on our reputation, our operations or our financial performance. A number of our other risks reflect social and ethical issues.

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

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

Group risks and mitigating actions overview

Market risks

Risk | Change in the political environment

Description / Comment	Impact	Mitigation
<p>As a major proportion of Serco's customers are governments and governmental agencies, a substantial part of the business is dependent on government policies, budget priorities and regulatory or political constraints, in particular those regarding maintaining and improving public infrastructure, which could have a significant impact on the size, scope, timing and duration of contracts and orders under them and therefore on the level of business that we may win. As such, these businesses are susceptible to changes in government, government policy, budget allocations and the political environment, primarily in the UK, Australia and the US. Any reduction in such government expenditure and funding could result in a suspension, cancellation, termination or non-renewal of contracts. Revenues may also be adversely affected by changes to the UK Government's, US Government's or Australian Government's policy in respect of outsourcing.</p> <p>Failure to understand and manage the consequences of changes in the political environment, adverse changes in political stability, political leadership, policy and economic conditions will often negatively affect current and future business. The sustainability of Serco's business with governments is dependent on normal, stable government and a favourable policy climate to outsourcing. The policy environment may change and favourable markets may become hostile, leading to loss of business and reduced opportunities.</p>	<ul style="list-style-type: none"> • Reduction in market opportunities • Changes to terms of existing or new contracts • Failure to meet growth or profit expectations 	<ul style="list-style-type: none"> • Business strategy • Diverse business across geographies and markets • Dedicated teams regularly monitor the political landscape and government activities, reporting on government policy changes and the political environments where we are operating. We continue to develop expertise and capability in new markets and geographies.

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

Description / Comment

Failure to win material bids or renew material contracts could restrict growth opportunities for the future or have an adverse impact on Serco's business financial condition and results of operations. Further, a significant number of Serco's contracts with the UK Government, the US Government and other public sector customers including renewals and extensions of previous contracts are awarded through formal competitive bidding processes. Competitive bidding processes present a number of risks including substantial cost and management time and effort to prepare bids and proposals for contracts that may not be won. In addition, there is often a long period between a successful competition tender offer and entering into definitive contractual documentation and financial close and in some cases financial close may not occur.

If Serco does not continue to be competitive, show entrepreneurial spirit and deliver our promises, it may result in our failing to win material bids or renew material contracts which could restrict growth opportunities for the future or have an adverse impact on Serco's business financial condition and results of operations. We will become increasingly less competitive and our growth will stagnate. Margins will remain at current levels or reduce impacting on share price and making us an increasingly less attractive prospect for investors. Serco will also suffer from losing money due to the financing of unsuccessful bids.

Impact

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

Mitigation

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

Risk | Failure to effectively manage brand / reputation

Description / Comment

The economic value of our business is significantly impacted by our reputation reflected in our share price, rating, ability to attract and retain talent, win business, attract finance and maintain our licence to operate. That reputation is held in the minds of others and broadly consists of their attitudes towards our Company and the actions they subsequently take. Reputation counts. Our future success will not just depend on rational factors such as price, pay levels or contractual performance but also emotional attitudes towards the Company and the contracting market as a whole. We will need to decide how we wish to define and be seen by the full spectrum of customers – from the economic buyers to the actual end users and beneficiaries of the services we provide – and other stakeholders.

The events of last year relating to two UK government contracts have negatively impacted Serco's reputation and brand including our ability to bid for and win UK Government business during the second half of 2013.

Impact

- Failure to meet growth or profit expectations
- Significant financial loss or cost overrun
- Loss of contract revenue related to operations and service charges
- Could impact share price
- Inability to attract the human and financial capital necessary to grow or expand into new markets
- Damage to reputation resulting in loss of existing or new business
- Impact on strategic objectives

Mitigation

- Governance structure managed through Investment and Ethics Committee, Programme and Project Boards and Divisional and Contract Boards
- An effective risk issues and controls structure identifies potential reputational impacts allowing effective management and oversight
- Customer engagement and employee engagement strategies
- Relationship management and communication with external stakeholders

Principal risks and uncertainties

Operational risks

Risk | Major information security breach

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

Governance risks

Risk | Significant incident of bribery or corrupt practice

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

People risks

Risk | Failure to retain / attract key leadership talent

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

Finance risks

Risk | The impairment of goodwill could adversely impact reported results

Description / Comment	Impact	Mitigation
Goodwill accounted for 45% of Serco Group's recorded total assets as at 31 December 2013. Serco evaluates goodwill for impairment annually or more frequently when evidence of potential impairment exists. Any decrease in expected cash flows or deterioration in market conditions could require Serco to record impairment charges that could have a material impact on the financial position and results of operations.	<ul style="list-style-type: none"> ● Inability to meet profit expectations ● Potential for breach of financial covenants ● Damage to reputation and shareholder confidence ● Impact on strategic objectives 	<ul style="list-style-type: none"> ● Internal board and governance structure ● Strategic plans ● Business plans ● Business Lifecycle Governance process ● Financial review and reporting

Key performance indicators

In 2013, we used the key performance indicators (KPIs) below to monitor our performance. They are split between financial and non-financial measures.

As part of our corporate renewal programme, we are reviewing our KPIs. This will ensure we

have a balanced set of metrics that gives appropriate emphasis to both the financial and non-financial aspects of our performance, and will include customer satisfaction, people engagement and contract compliance indicators.

Financial

Adjusted revenue (£m)

Definition

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

Relevance to strategy

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

Performance

Growth of 4.7% year on year was a good performance considering the issues in the UK encountered in the second half of the year. Growth was driven primarily by contract awards in the previous year and high levels of organic revenue in AMEAA.

Adjusted operating profit (£m)

Definition

Adjusted operating profit is before amortisation of intangibles arising on acquisitions, transaction-related costs and exceptional items, as shown on the face of the Group's consolidated income statement and the accompanying notes. In 2013, it is before management's estimation of other costs in relation to the UK Government reviews.

Figures for 2009-2012 have been restated for changes in accounting policies.

Relevance to strategy

Adjusted operating profit reflects the ability to win and retain contracts with appropriate margins, sustaining or improving margin through efficient operations and proactive portfolio management to ensure appropriate performance and returns.

Performance

The decline of 7.0% represents a decrease in margin from 6.4% to 5.7%, reflecting the increased investment in market development activity in the Global Services division, reduced project work and the general challenge faced in the latter part of the year and other margin mix effects.

Adjusted earnings per share (EPS) (p)

Definition

Adjusted earnings per share is calculated on the basis of earnings before amortisation of intangibles arising on acquisitions, transaction-related costs and exceptional items, as shown on the face of the Group's consolidated income statement and the accompanying notes. It is also before management's estimation of other costs in relation to the UK Government reviews. In addition, Adjusted earnings per share takes account of the tax effect of these adjusting items.

Figures for 2009-2012 have been restated for changes in accounting policies.

Relevance to strategy

Adjusted EPS reflects the ability to grow both revenue and Adjusted operating profit margin together with the strength of funding and overall financial position.

Performance

The decline of 4.9% reflects the challenges faced in the second half of the year.

Group free cash flow (£m)

Definition

Group free cash flow is the free cash flow generated by our subsidiaries plus the dividends we receive from joint ventures.

Relevance to strategy

Group free cash flow reflects our ability to generate funds to invest in our future growth and strategic development.

Performance

The reduction in Group free cash flow principally reflected the increase in the level of working capital relating to the timing difference between the period when costs are incurred in the delivery of the contract and the period when we can contractually bill our customer and lower dividends from joint ventures.

Non-financial

Major reportable Incident rate (per 100,000 employees)

Definition

Major injuries 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. The rate measures our success in providing a safe and secure working environment and excludes joint ventures.

Relevance to strategy

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

Performance

The number of major reportable incidents fell by 45% to 33 in 2013, resulting in a rate of 33.4 per 100,000 employees. This was well ahead of our target of 57 and the UK Health and Safety Executive Total Service Industries benchmark of 91.5.

Carbon emissions headcount intensity (tonnes of CO₂e per FTE)

Definition

We report our greenhouse gas emissions as tonnes of CO₂e per full-time equivalent (FTE) employee. This normalises our emissions to the size of our business. In 2013, we adopted ISO 14064-1:2012 to ensure we meet greenhouse gas reporting requirements and provide a fair and transparent picture of our greenhouse gas emissions. This has resulted in us capturing far more comprehensive data than in previous years. As a result, we are using 2013 as the baseline for future reporting.

2013

4.04

Relevance to strategy

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

Performance

Our emissions in 2013 were 4.04 tonnes of CO₂e per FTE.

Investment in society (£m)

Definition

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

Relevance to strategy

Strong community relationships help us to win and retain contracts and to engage our people, as well as directly benefiting the lives of the people we assist.

Performance

We invested £2,575,029 through donations of money, assets and time to community projects and charities, representing 1% of our Adjusted pre-tax profit.



For more on our non-financial KPIs see the Corporate Responsibility section on pages 52 to 57 and greenhouse gas emissions on pages 58 to 59.

Chief Executive's statement

Ed Casey, Acting Group Chief Executive, said "We have been through a difficult year and there remains much to be done to ensure the agreed programme of corporate renewal is successfully implemented. However, the work we have completed and the undertakings we have made demonstrate our commitment to achieving this

"The events of 2013 absorbed management's focus and, therefore, interrupted the normal process of improving efficiency and developing our business into new areas. Over the second half of 2013 and until the end of January 2014, we were not able to be awarded new contracts by UK Central Government, which also had an impact on the development of our business in certain other sectors

"Our focus is clear to ensure that the Group has stable operations, appropriate operational controls and differentiated capabilities, to make the most of the breadth of our offering across frontline and middle and back office services, and our referenceability from one country to another. I am confident that these attributes will enable Serco's return to growth, in what remain fundamentally attractive service markets around the world."

2013 has brought significant challenges, in particular from certain contract issues with the UK Ministry of Justice. Organic revenue growth was 5.9% driven principally from contract awards in the previous year. Profitability declined due to less work with UK Central Government and fewer wins in the BPO market. Net exceptional charges, reflecting principally the Electronic Monitoring settlement, totalled £90.5m, with other indirect costs and charges related to the effects the UK Government reviews had on the business estimated by management at £21.0m. Adjusted EPS, before these exceptional charges and costs, were 39.53p, a decline of 2.1% at constant currency. Free cash flow also declined in the year. The dividend payment is increasing reflecting our ongoing transition to a higher payout ratio. The Group maintains a robust financing position.

The value of contract awards totalled £3.7bn in the year, with further progress made on the strategic positioning of our portfolio. The outlook for 2014 remains challenging, with lower profits anticipated. We will continue our efforts to rebuild the confidence of our UK Government customer and strengthen the Group as a whole, through the comprehensive corporate renewal programme. There is ongoing demand in large and growing markets for our services, with a pipeline of opportunities to take the business forward.

Organic revenue growth of 5.9% for the Group

Adjusted revenue from ongoing activities was £5.1bn, a growth of 7.8% at constant currency. Excluding incremental revenue from acquisitions, our portfolio across multiple markets and varied conditions delivered organic revenue growth of 5.9%.

In the UK & Europe division, organic revenue growth was 3% in 2013. This was driven by the additional revenue in the first half from previous new contracts in their initial year of operation, including community healthcare in Suffolk, the Northern Isles ferry services in Scotland, and asylum applicant accommodation and transport services in North West England and Scotland & Northern Ireland. The Electronic Monitoring (EM) and Prisoner Escort & Custody Services (PECS)

contract issues impacted the second half of the year, whilst we worked to regain eligibility for new UK Central Government contract awards. Good progress continued to be made on extending existing contracts in areas such as environmental services, non-clinical health operations and defence training and support.

In the Americas division revenue held steady, a positive outcome given the third year of a declining and uncertain US federal contracting market, driven by government budget and funding issues. Momentum was achieved in the second half of the year, through the start of major new contracts in healthcare eligibility processing and state government transportation support.

The AMEAA division achieved organic revenue growth of 18%. A significant proportion of this was due to an increased volume of work providing immigration services in Australia. This contract, having grown to be the largest within the Group, began to see lower volume levels by the end of the year, following significant changes to government policies that are expected to continue to reduce the size of the contract in 2014. Numerous new contract developments were achieved in other parts of the region, particularly the Middle East.

The Global Services division, representing Serco's BPO middle and back office skills and capabilities, achieved organic revenue growth of 5% in 2013. After a strong first half, which included the first year of operation of previous new relationships such as Shop Direct and AEGON UK, the second half saw performance weaken. There was a lower level of work with UK Central Government customers and fewer major private sector bids were won than in 2012.

Reduced profit and cash generation

Adjusted operating profit from ongoing activities was £285.4m, representing a 2.3% decline at constant currency and a margin decline to 5.6% compared to 6.3% in 2012. The principal drivers of the margin reduction included increased investment in contract bidding and new market development activity in the Global Services division, reduced discretionary and ad hoc project work and the general challenge

We operate the national network of immigration centres for the Australian Department of Immigration and Border Protection.

Serco faced in progressing UK contract awards over the latter part of the year, and other margin mix effects, such as lower margins on initial stages of new contracts or from related operational issues, and the start of the new five-year pricing period at the Atomic Weapons Establishment (AWE)

Adjusted profit before tax was £254.4m and Adjusted earnings per share were 39.53p, declining by 3.6% and 2.1% respectively at constant currency

The Group incurred a net exceptional charge of £90.5m in the year. This reflected principally the settlement reached with the UK Ministry of Justice in respect of the issues arising on

the Electronic Monitoring contract, as well as the direct one-off costs regarding the UK Central Government audits and reviews, and the development of Serco's corporate renewal programme. In addition, there were an estimated £21.0m of other related costs

Group free cash flow declined to £84.8m compared with £181.2m in the previous year. There was an anticipated incremental working capital investment in BPO activities and lower dividends from joint ventures. There was a greater adverse timing impact that reduced cash flows on certain contracts, including some delays to customer payments and some timing differences of cash costs incurred compared to our contractual customer invoicing profile

Earnings, cash flow, financing and related matters are described fully in the Finance Review on pages 42 to 51

Increased total dividend for the year and robust financing position

The Board has proposed an increase of 4.5% to 10.55p in the total dividend for the year, holding the 2013 final dividend at last year's 7.45p. This reflects our ongoing transition to a higher payout ratio. Based on Adjusted basic earnings per share of 39.53p, the dividend represents a payout of 27% (2012: 24%), or dividend cover of 3.75x (2012: 4.11x). The Board set out in 2013 the intention to move to dividend cover of 2.5-3x over time, beyond which point it would expect to revert to increasing the total dividend

Chief Executive's statement

Continued

each year in line with the increase in underlying earnings. The final dividend will be paid, subject to shareholder approval, on 14 May 2014 to shareholders on the register on 14 March 2014.

Serco also maintains sufficient and suitable financing strength and funding arrangements for anticipated corporate purposes. Adjusted total net debt has increased from £581m to £701m, principally as a result of the cash payments related to the exceptional charges. The Group's financial leverage ratio remains, however suitably below our credit facility financial covenants.

Further progress on contract awards and strategic positioning

Contract awards in 2013 totalled £3.7bn, representing signed contracts valued at £3.5bn and preferred bidder appointments of a further £0.2bn. Our order book stood at £17.1bn at 31 December 2013 (£19.1bn at 31 December 2012). Wins included smaller and medium-sized awards which are important to growth, as well as significant rebids, extensions, expansions and new contracts. Of the total contract award value, approximately 40% reflected services newly contracted with Serco, with approximately 60% being rebids or extensions.

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

- Build and operate additional capacity at HMP Thameside (£120m over 22 years)
- Operation of the Docklands Light Railway in London (£100m over 18 months)

- Environmental services for various UK councils (£100m over four-to-eight year terms)
- Non-clinical support services for Plymouth Hospitals NHS Trust (£40m over three years)
- Multi-engine pilot training at RAF Cranwell (£36m over five years)
- Parking enforcement services for London borough councils (£30m over five years)
- European Space Agency operational IT support for satellite infrastructure (£30m over five years)
- Defence Science and Technology Laboratory (Dstl) procurement services (£15-25m over seven years)
- Barclays Cycle Hire phase 3 expansion in London (£15m over three years)
- European Parliament telephony and communication equipment support (£17m over six years)
- Pre-deployment training for the UK's Ministry of Defence (£10m over one year)
- US healthcare eligibility processing support (excluding optional tasks, US\$600m over five years)
- Driver examination services in Ontario, Canada (C\$500m over ten years)
- Virginia Department of Transportation (VDOT) operational services (US\$355m over six years)
- US IDIQ task orders – across areas including IT systems and services, human capital management, engineering support, logistics and programme management – totalling over US\$180m
- Systems engineering and technical assistance for US intelligence community (US\$40m over five years)
- City of Colorado Springs fleet management and maintenance services (US\$35m over five years)
- Dubai Metro operation and maintenance (£355m over five years)
- Australian immigration detention services (volume-related value over six months)
- Hong Kong road transportation management, operation and maintenance (£80m over six years)
- Facilities management services in the United Arab Emirates (£30m over six years)
- Iraq air traffic control services, training and support (£24m over 18 months)
- Tramway operation and maintenance in Dubai (£18m over five years)
- Middle East logistics and base support for the Australian Defence Force (£18m over one year)
- Healthcare support services in Abu Dhabi (£5m over three years)
- Procurement, finance and accounting services for an NHS Hospital Trust (£112m over four years)
- UK Central Government BPO services including Child Maintenance Group (£100m over three years)
- Customer management services for UK leading high street retailer (£50m over ten years)
- Public sector shared services for the United Arab Emirates (£24m over four years)
- Citizen contact services and ICT support for UK councils (totalling £20m over five years)
- BPO services for Indian banking, energy and telecom customers (totalling £20m over three years)

During 2013, we delivered the expansion of Barclays Cycle Hire to western boroughs of London.

More details of some of these awards are in the Divisional Reviews, with further information and other smaller and medium-sized awards described in the contract news updates and announcements on www.serco.com

New contract awards in the Americas division are broadening our portfolio in this region. We successfully leveraged Serco's global capabilities to achieve growth in the transportation market: the VDOT contract deepens our credentials further and the successful rebid of driver examination services in Canada strengthens our managed service capability. The award by the United States Department of Health and Human Services' Centers for Medicare & Medicaid Services (CMS), where Serco is providing eligibility processing support for the new federally-facilitated marketplace, is a significant development for our involvement in US healthcare and expands our customer reach in an attractive market.

Our proactive portfolio management involves an ongoing assessment of operations against their fit to the Group's strategy. This has resulted in further disposals – principally our UK occupational health and UK transport maintenance and technology businesses – which had become non-core to Serco's future development in the health and transportation markets. While remaining primarily focused on organic growth, we would consider potential infill acquisitions that bring additional skills, capabilities or market access to enhance the portfolio. We will also continue to evaluate the potential for further non-core disposals.

Challenging near-term outlook

As previously disclosed, our business plans reflect specific challenges that lead us to expect a further reduction in profits in 2014. At the same time, we are working to secure Serco's position in large and growing markets to strengthen our performance in the longer term.

In 2014, the level of contract attrition will have a greater impact than the Group has faced in the past. The incremental revenue contribution from new contract awards is not

expected to fully offset the attrition, with this in part a consequence of the issues faced in the latter part of 2013. The most significant factor is that following recent immigration policy changes, lower volumes of work in Australia are anticipated to reduce Group revenue further, our operations which grew to over £450m of revenue in 2013 could reduce up to 50%, though the nature of this work makes it difficult to forecast. These factors are each described more fully in the Divisional Reviews.

Serco's revenue visibility from its order book as at the start of this year was 77% for 2014 and 52% for 2015. This reflects the progress made during 2013 in securing rebids and extensions, as well as the contribution of new wins. Recurring task orders, project work and additional services for existing customers typically add a further 5-10% to the Group's total visibility in individual years. There is additional revenue that can be secured through known near-term extension and rebid processes, amounting to 8% of anticipated Group revenue in 2014 and 19% in 2015. Major contracts due for extension or rebid, with their approximate contribution to Group revenue in 2013 and existing contract end date, are as follows:

- Australian immigration detention services (9%, December 2014)
- Northern Rail franchise in the UK, operated in partnership with Abellio (6%, April 2014)
- Defence garrison support services in Australia, operated in partnership with Sodexo (2%, June 2014)
- Operation of the Docklands Light Railway in London (2%, September 2014)
- Systems engineering and technical assistance contracts for a US intelligence agency (1%, 2014)

Serco's internal forecasts for 2014 imply a mid-single digit percentage decline in terms of Group organic revenue. This takes into account the above factors, including assumed success in securing rebids and extensions, as well as

assumed incremental revenue contribution from successful outcomes of current bid opportunities. Compared to £5.1bn of Adjusted revenue from ongoing activities in 2013, for 2014 we anticipate £4.7-4.9bn at constant currency.

Our internal forecasts for 2014 also imply a further reduction in the Group's Adjusted operating margin of 50-100 basis points. This takes into account the impact on the average margin of the above-mentioned revenue factors, together with the ongoing incremental cost of corporate renewal programme delivery estimated at approximately £10m.

Based on the above, the Group's Adjusted operating profit in 2014 would be approximately £220-250m at constant currency. This compares to £285.4m Adjusted operating profit from ongoing activities for 2013.

Adjusted net finance costs are anticipated to be approximately £40m. The Adjusted effective tax rate and weighted average number of shares are also expected to be broadly unchanged. This would result in Adjusted EPS of 28-33p at constant currency. As previously announced, a restructuring charge estimated at £10-15m will be incurred in 2014 to implement further reductions in headcount and related costs, and one-off costs to implement the corporate renewal programme are estimated at £15m.

Our constant currency forecasts assume the average exchange rates in 2013 prevail through 2014. The Group has approximately half of its revenue in non-sterling currencies, therefore if the sterling average rate were stronger in 2014 than the Group's results in reported currency terms would reduce – and vice versa.

Free cash flow in 2014 is anticipated to be higher than 2013, reflecting lower working capital investment in BPO activity and some reversal of the adverse timing impacts experienced in 2013. Net debt at the end of the year is expected to be broadly unchanged from that at the end of 2013. The Group anticipates that sufficient financing headroom would be maintained.

From left
With our partner Abellio we run Northern Rail
the UK's largest train franchise

In Hong Kong we are market leader in managing
operating and maintaining road tunnels, bridges
and related tollway infrastructure

Chief Executive's statement

Continued

Securing Serco's position in large and growing markets

The focus of 2014 will be to take the actions necessary to return the business to longer term growth in revenue and profitability. Whilst Serco has strong foundations in its breadth of proven capabilities across frontline, middle and back office services, its long history of delivering excellent service and its geographical reach, there is much to do in 2014. We must stabilise those UK operations impacted by the events of 2013, implement the plan of corporate renewal, re-establish our momentum within our markets, particularly in the UK and the private sector, and ensure we continue to build differentiated capabilities that will secure the Group's future progress in large and growing markets.

Our various public service operations for UK Government make it collectively our single largest customer, with 2013 and 2014 involving substantial effort to rebuild confidence in Serco. There have been three main areas of activity. Firstly, we cooperated fully with the detailed independent forensic audit of the EM contract, the separate audits of our other MoJ contracts and the Cabinet Office's wider review across our other major UK Central Government contracts. Beyond the EM and PECS issues that had previously been identified, no further material issues were raised and the audits and reviews were, therefore, concluded satisfactorily by the end of 2013.

Secondly, Serco agreed a settlement with the MoJ in respect of the issues arising on the EM contract. The settlement reflected the difference in interpretation regarding billing arrangements for the EM contract since 2005, together with a repayment of an element of past profit

earned on the contract interest and the UK Government's costs of the audits and reviews.

Thirdly, Serco has developed and is now in the process of implementing the comprehensive programme of corporate renewal that we outlined in our announcement in January 2014, to ensure consistency of behaviours and strengthen operations across the Group. Our plan was assessed externally by an Oversight Group of Government non-executive directors, with independent advisers appointed by the Government to review our progress against agreed milestones. In January 2014, a positive assessment was provided on our programme, confirming Serco's consideration on an equal basis to other suppliers for current Central Government contract awards.

A stronger Serco will be positioned to benefit from the ongoing demand for efficient, high quality and innovative service provision, from public and private sector customers around the world. In each of our major markets – the UK, the US and the countries in which we operate within the AMEAA region – there is substantial spend by governments that is expected to continue to generate long-term growth in each of our main areas of service provision: Transport, Defence, Home Affairs (including justice, borders and welfare services), Health, and other areas of integrated facilities management. Our latest assessment of the total addressable market spend in these areas is equivalent to over £150bn of annual spend.

In overall terms, total government expenditure that has been outsourced to date as service contracts is estimated at 10-20%, with policy development suggesting that governments will continue to expand this proportion. In developed economies, the primary driver remains fiscal pressure on government spending, while the established presence that Serco also has in developing economies adds further opportunity, given the likely continued higher growth in demand for new or significantly improved services for citizens. Meanwhile, the global BPO market is both large and continues to grow, and Serco will look to further develop its strategic positioning with both private sector and public sector customers in this market.

We are tracking a total opportunity pipeline valued at an estimated £29bn. Versus a year ago, the reduction from approximately £31bn reflects where we have won, lost or taken the decision to withdraw from bidding. Over the next two years, our pipeline of new bids, which excludes the value of rebids and potential extensions, has an estimated total value of £12bn, or aggregate annual revenue of approximately £1.4bn. This near-term pipeline consists of approximately 40 opportunities that each have anticipated annual revenue of at least £10m and are at a relatively advanced stage of tendering. Described in more detail in the Divisional Reviews, examples of notable opportunities include those for:

- UK Defence Infrastructure Organisation (DIO)
- UK Magnox nuclear site decommissioning activities
- UK transport operations, such as the Caledonian Sleeper rail service and Clyde & Hebrides ferry services
- UK military air traffic management support services
- UK NHS trust integrated facilities management
- UK local council environmental services opportunities
- US Navy systems and engineering services
- US Patent & Trademark Office citizen services
- US Department of State passport services
- US state transportation operations
- Australia new-build prison in Victoria
- Sydney North West Rail link and light rail opportunities in the region
- Middle East air navigation and other transport systems operation

We run lifeline passenger and freight ferry services to the Northern Isles in Scotland.

- Private sector customer contact, account management and multi-channel support services bids
- Public sector citizen contact and other BPO support

Serco's portfolio of operations and opportunities around the world continues to provide elements of both resilience and future growth potential. Whilst the Group has a challenging near-term outlook, and successful delivery of corporate renewal is required, our position should be restored to one of strength in what remain large and growing markets. There exists a balance of risks and opportunities, but the Board is confident in the potential for Serco's long-term growth. While we will strategically review our involvement in certain markets, and continue our proactive portfolio management, the Group's strategy remains to operate a strong and diverse contract portfolio, reducing our exposure to market fluctuations, enabling us to select the best opportunities where they arise and allowing us to transfer expertise and insight across sectors and geographies.

Ed Casey
Acting Group Chief Executive

From left
We are a major supplier of support services to UK hospitals

The Middle East is home to some of Serco's longest standing air traffic control contracts

Divisional reviews

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

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

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

UK & Europe

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

Transport & Local Direct Services

We are a key provider of transport services in the UK. With our partner Abellio, we run both Northern Rail, the UK's largest train franchise, and Merseyrail, the UK's most punctual train operator. In London, we run the Docklands Light Railway and the Barclays Cycle Hire scheme, supporting growth in regular journeys as well as major events such as the London Marathon, the Diamond Jubilee and the 2012 Olympic Games. During 2013, we also provided traffic management operations and local authority parking enforcement in the capital. In Scotland, Serco runs lifeline passenger and freight ferry services to the Northern Isles.

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

Defence & Science

Serco works for the Royal Air Force, the Army Air Corps and the Royal Navy's Fleet Air Arm, providing services such as training, engineering or operational support.

We also support the Royal Navy's three main UK bases and operate and maintain strategic assets such as secure satellite communications, the Defence Academy of the United Kingdom, the Emergency Planning College on behalf of the Cabinet Office and the UK's ballistic missile early warning system.

We provide systems engineering, safety assurance and risk management services, and support the essential research carried out at the Defence Science and Technology Laboratory (Dstl). Our joint venture with Lockheed Martin and Jacobs Engineering manages the Atomic Weapons Establishment (AWE), which provides the warheads for the UK's nuclear deterrent.

Home Affairs

Serco is a leading custodial accommodation provider, operating six adult prisons in England and Scotland. These include HMP & YO1 Doncaster, which has been piloting Payment by Results, and HMP Thameside, one of the world's most technologically advanced prisons. We also run the secure training centre at Hassetfield in County Durham, for young people aged between 12 and 17 years who are either awaiting trial or serving sentences.

From left
We extended our Multi Activity Contract at RAF Brize Norton during 2013

In 2013, we achieved all-time high performance at the Docklands Light Railway in London

From left
We operate HMP Thameside one of the world's most technologically advanced prisons
Our operations for Sandwell Metropolitan Borough Council saw the opening of a new £10m waste transfer station handling 1 700 tonnes of waste and recycling each week

Divisional reviews

UK & Europe

Continued

During 2013 we have provided prisoner escort and custody services in London and the South East of England, and electronically monitored defendants and offenders subject to home curfew. In partnership with the London Probation Trust, we have delivered Community Payback, which requires offenders to do unpaid work for the community. On behalf of the Home Office we run two immigration removal centres and provide technology services for border control and security. We also provide accommodation and transport services for asylum applicants in the North West of England, Scotland and Northern Ireland.

As part of the Department for Work & Pensions' Work Programme, Serco and its partners are placing thousands of jobseekers into sustainable employment. A Serco-led consortium also operates the National Citizen

Service in six regions across the country, enabling 16 and 17-year-olds to develop skills through projects that contribute to society.

Health

Serco delivers GP out-of-hours services in Cornwall and provides a comprehensive range of clinical services in the community in Suffolk. We are the largest independent provider of custodial health services. We are also a major supplier of support services to a number of UK hospitals. GSTS Pathology, our joint venture with two major NHS teaching hospitals, is the UK's leading independent pathology services provider.

UK & Europe – 2013 review

Adjusted revenue from ongoing activities grew by 3% to £2,514m (2012: £2,436m), and represented 49% of the Group (2012: 51%). On an organic basis, revenue also grew by 3%. Adjusted operating profit from ongoing operations declined by 8% to £150.7m (2012: £163.4m), with the margin declining to 6.0% (2012: 6.7%). Including the impact of disposals, Adjusted revenue was broadly flat at £2,557m (2012: £2,561m) and Adjusted operating profit declined by 11% to £157.3m (2012: £177.1m).

Whilst the first half of 2013 grew strongly, driven principally by the additional revenue of the new contracts that started in the second half of 2012, as well as additional project-based work on certain contracts, the issues that arose with the UK Government impacted our business in

the second half of the year. As a consequence, revenue in the second half declined against the comparable period in 2012, given the lower contribution from new contract starts and less discretionary and ad hoc project work.

The margin reduction reflected the initial stages of the major new contract starts, which tend to involve greater upfront investment, the effect of the new five-year pricing period for our management and operation of AWE and the lower margin on managing capital projects for certain customers.

Transport & Local Direct Services

Operations across Transport & Local Direct Services accounted for approximately 40% of UK & Europe Adjusted revenue from ongoing activities.

At Northern Rail, in the most recent National Passenger Survey (NPS), overall customer satisfaction was broadly level on a year earlier. We continue to invest in areas that will improve our customers' experience with us, including the upkeep of our trains and keeping passengers informed. The challenge of increasing capacity will be a major focus for the successor franchise, which we would anticipate bidding on during 2015, ahead of its start in February 2016. At Merseyrail, we are very pleased that it has continued to be ranked top in the NPS for overall customer satisfaction. At the Docklands Light Railway, all-time high performance metrics were achieved in the year and an

From left

We provide a comprehensive range of community health services in Suffolk.

Merseyrail is the UK's most punctual train operator and continues to be ranked top for overall customer satisfaction in the National Passenger Survey.

We support the Royal Navy's Fleet Air Arm at RNAS Yeovilton

18-month extension was signed with a value of approximately £100m

Ferry services to the Northern Isles of Scotland completed their first full year under Serco's management. This has seen the refurbishment of all three passenger vessels and numerous other improvements delivered to assist increasing usage of the lifeline freight and passenger services. In similar operations Serco and its local joint venture partner Stromma Turism & Sjöfart AB were selected during the year to manage and operate four ferries currently carrying over two million passengers annually in Stockholm.

Serco delivered the phase 3 expansion of Barclays Cycle Hire for Transport for London, adding approximately 5,600 new docking points and 2,400 new bikes to western boroughs. Serco was also awarded an innovative new contract to provide end-to-end on-street parking enforcement for the West London Alliance, a partnership between Ealing, Hounslow and Brent borough councils.

In Local Direct Services, Serco successfully extended or rebid its contracts for environmental services for Canterbury City Council, Welwyn Hatfield Borough Council and Breckland Borough Council, valued in total at over £100m. Our operations for Sandwell Metropolitan Borough Council saw the opening of a new £10m waste transfer station in Tipton, handling more than 1,700 tonnes of waste and recycling each week.

Defence & Science

Operations across Defence & Science accounted for approximately 30% of UK & Europe Adjusted revenue.

Our management and operation of AWE, as part of a joint venture with Lockheed Martin and Jacobs Engineering, began the next five-year pricing period in April 2013. Strong operational performance and programme delivery has continued. Projects that became fully operational in the period included Orion, AWE's new laser facility, which is now one of the world's most powerful lasers and of immense interest both internationally and to the wider academic community working in areas such as fusion energy and astrophysics. Meanwhile, at Serco's strategic partnership with Dstl, further target service options such as procurement have been added to the existing prime contract.

In our support services for the Armed Forces, Serco extended and then subsequently rebid successfully its Multi-Engine Pilot Training contract at RAF Cranwell, valued at approximately £36m over five years. Serco provides up to 5,500 flying hours annually in the King Air B200 aircraft, as well as up to 2,700 aircraft simulator hours. Other extended contracts included maintenance for the Search and Rescue fleet of Sea King aircraft, our Multi-Activity Contract at RAF Brize Norton and our Air Traffic Services at Wattisham, for the British Army's Apache helicopter fleet. In related services for the private sector, Serco has rebid

and expanded its services to Airbus for air traffic control, manoeuvring area safety training, air traffic engineering and facilities management services. We also successfully rebid our support to the United States Air Force in Europe, which provides transportation, supply and facilities management. For the British Army, our pre-deployment training Contemporary Operating Environment Force contract was extended for a further year.

Operations in Europe have similarly been successfully rebid during 2013. Serco will continue to manage the European Space Agency's operational control centre infrastructure and tracking stations network, under a five-year contract worth over €30m. We rebid our contract providing telephony, videoconferencing and cabling support across European Parliament sites, and expanded it further to cover TV distribution, in a new contract valued at approximately €17m over a maximum of six years.

Home Affairs

Operations across the Home Affairs market accounted for approximately 20% of UK & Europe Adjusted revenue.

During the year a detailed independent forensic audit of our Electronic Monitoring (EM) contract was completed with Serco's full cooperation, with the audit identifying issues with billing. A settlement of £64.3m with the MoJ reflected the difference in contract interpretation.

From left

Our Defence Business Services contract for the Ministry of Defence was our first pure back-office contract in the UK public sector.

Our joint venture continues to achieve strong operational performance and programme delivery at the Atomic Weapons Establishment.

Divisional reviews

UK & Europe

Continued

regarding the billing arrangements since 2005, together with a repayment of past profit earned on the contract, interest and the UK Government's costs of the audits and reviews. The difference in contract interpretation led to instances of daily charges being applied when there was an open Court Order but where no active monitoring was taking place. The settlement was full and final in respect of contractual claims, with the proviso that additional payments might be sought in limited circumstances, such as if criminality were to be established. Serco continues to cooperate fully with the ongoing investigations by the Serious Fraud Office. The settlement was included as an exceptional cost in the year. The EM contract underwent an accelerated transition to the new service provider, with the associated costs of this reflected within management's estimate of other costs in relation to the UK Government reviews.

A second significant contract issue also arose during the year. Serco and the MoJ jointly referred misreporting of data on the Prisoner Escort & Custody Services (PECS) contract to the City of London Police. Under the contract, Serco is required to deliver defendants to Court with performance measured against the defendant being 'Designated Ready and Available for Court Time' (DRACT). Serco identified misreporting of DRACT data locally, such that performance reported to the customer was overstated. A settlement of £2.0m was reached in repayment of profit earned since the contract was renewed in 2011; this was included as an exceptional cost in the year. Significant cost was incurred to deliver service improvements that enabled the MoJ to confirm that Serco could retain this contract whilst forgoing any future profits; this cost is included within management's estimate of other indirect costs in relation to the UK Government reviews.

Separate audits of all of our MoJ contracts, as well as the Cabinet Office's wider review across the range of our other major UK Central Government contracts, concluded in December 2013. Beyond the EM and PECS contracts, no further material issues were raised.

Within our custodial operations, at HMP Thameside, Her Majesty's Chief Inspector of Prisons and more recently the Independent Monitoring Board have recognised the progress that has been made since the prison first opened, which has included a number

of health and welfare initiatives to improve operational performance at this new London prison. Supporting the MoJ's programme to modernise the UK prison estate, we are increasing the capacity of HMP Thameside with a contract expansion valued at £120m over 22 years, which includes a £36m 18-month construction phase. During the year, Serco transitioned HMP & YOI Ashfield from being a Young Offender Institution to being an Adult Male prison. At HMP & YOI Doncaster, our payment by results pilot programme saw significant improvement in reoffending rates for prisoners serving less than 12 months; this work and our London Community Payback contract will conclude by the end of 2014 in order for them to be rolled into the Government's new Transforming Rehabilitation programme, where Serco will look at opportunities to support others in the development of the new probation services market.

As reported by the National Audit Office in January 2014, our contract under the Home Office's COMPASS programme to provide accommodation and support services to almost 10,000 asylum applicants in the North West of England and in Scotland and Northern Ireland, has experienced a challenging transition since taking over the service in late 2012. Whilst the report recognised that Serco had worked hard to raise standards, there remains scope for further improvement and we are committed to working with our customer and our partners in local government, the NHS and the voluntary sector to achieve that.

At HMP Thameside we are supporting the Ministry of Justice's programme to modernise the UK prison estate.

In the welfare market, Government statistics for the Work Programme show that the national picture is improving and that Serco continues to achieve good results in its two contracts. To date, we have helped 20,000 long-term unemployed people into employment across the South Yorkshire and West Midlands regions. The NCS Network, a partnership of Serco Catch22, the National Youth Agency, UK Youth and vInspired, is delivering the National Citizen Service across six regions in the UK. More than 10,000 young people have completed the programme in the first year, gaining skills useful for their future working lives.

Health

Operations across Health accounted for approximately 10% of UK & Europe Adjusted revenue.

Core to our strategy in the UK is providing healthcare organisations with integrated facilities management. For example, Serco signed an extension to continue providing support services to Plymouth Hospital's NHS Trust, valued at approximately £40m over three years. Our UK skills and capabilities in this sector have also continued to be important references for contracts won in other regions.

Operations at certain clinical health contracts have proven challenging in 2013. Our management of Braintree Hospital has been impacted by lower levels of patient referrals than predicted, with Serco's ability to improve utilisation of the hospital being limited. At our Cornwall GP out-of-hours contract, overall patient feedback is positive and the Care Quality Commission's report noted the improvements made and that essential standards of quality and safety were being fully met. However, the implementation of the NHS Pathways IT system during the year proved an additional challenge for a contract that Serco has acknowledged publicly that it has not delivered as successfully as it should have. As announced in December 2013, Serco will end these two contracts early.

Serco began a significant new contract for the NHS in Suffolk in October 2012, providing a wide range of community health services. The contract is one of the first of its kind and runs for three years. Serco has delivered some early benefits in 2013, such as reducing the length of stay in community hospitals by around a week and improving access to the service by

establishing a 24-hour care coordination centre. However, demand on the service has increased and it is taking longer than anticipated to bring about the operational performance levels that are expected. At all times, Serco has ensured that the service is properly resourced to deliver a safe, quality service and will continue to do so. Serco remains committed to the community healthcare market and to the service in Suffolk.

Provisions for estimated losses in future years on the Suffolk and Cornwall contracts, together with provisions against the underlying assets of the Braintree contract, led to a non-cash exceptional charge of £17.6m in the year.

UK & Europe – future developments

The 2014 financial year will be impacted by a greater level of attrition, which includes the ending of contracts such as the Electronic Monitoring service and the anticipated transition of the management and operation of the UK's National Physical Laboratory. These two significant contracts together have previously accounted for around 5% of divisional revenue. The overall level of attrition is expected to have a greater impact on profitability. A reduced level of project-related work is also anticipated compared to 2013.

Over the next two years, significant Serco contracts that require extending or rebidding include:

- Northern Rail, where the existing contract is due to expire in April 2014 and revenue in 2013 was approximately 13% of the UK & Europe division. Serco is in advanced stages of agreeing an extension to continue operations through to early 2016, at which point the franchise would be retendered.
- Docklands Light Railway, where the existing contract is due to expire in September 2014 and revenue in 2013 was approximately 3-4% of the UK & Europe division. Serco is currently one of three shortlisted parties bidding for the next contract.

Future growth is expected to be driven by competitive outsourcing continuing to support the UK Government's aim of achieving savings, whilst improving services and social outcomes. The reform of public services provision is an ongoing process, with the Cabinet Office and spending departments continuing to bring

new opportunities to market. Bids and market development in other areas continue to be pursued, including direct services for local government, non-clinical and community healthcare services, and other frontline support to organisations in the UK and Europe. In addition, middle and back office opportunities for local and central government will be pursued, in conjunction with the skills and capabilities of our Global Services division.

New bid opportunities that are expected to be decided over the next two years include:

- Strategic partner to the MoD to deliver further efficiencies to the Defence Infrastructure Organisation.
- Management of decommissioning activities at 12 UK nuclear sites, in partnership with CH2M HILL and AREVA.
- Operational and engineering support for the Defence Fire and Risk Management Organisation.
- Transport operations including the Caledonian Sleeper rail service and Clyde & Hebrides ferry services.
- Operational support for Programme GATEWAY at RAF Brize Norton.
- Engineering and support services to UK military air traffic management.
- Non-clinical health support services to an NHS trust.
- Numerous environmental and integrated waste management services for local councils.

As previously noted, from 2014 the operations of this division will split into two, with a separate division for our UK Central Government work to achieve a focus on government as a collective customer.

From left
Our community health services contract in Suffolk is one of the first of its kind.

Serco continues to deliver good results in its two Work Programme contracts.

Divisional reviews

Americas

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

For nearly two decades, Serco has served as one of the largest systems engineering and technical assistance contractors in US Air Force Space Command, supporting a wide range of military satellite systems, missile defence systems, command and control systems and mission essential networks and IT systems worldwide. We install and test communications and data networking systems for shore, ship and submarine installations for the US Navy. We also assist a major intelligence agency to acquire next generation IT systems.

Serco provides personnel and family support services to over two million military personnel and their families. Serco has processed and assigned appropriate US and international classifications for over 2.3 million US patent applications. In 2013, we implemented the Cooperative Patent Classification system, a global classification system for patent documents. We manage air traffic control services at 64 towers across the US, ensuring the safe transport of nearly nine million commercial aircraft passengers a year.

Under our contract with the Virginia Department of Transportation, we are integrating and operating the State's five transportation operation centres. Serco has responsibility for managing the services of the Safety Service Patrol Operations, Transportation Operations Centres, Floor Operations and ITS Maintenance, overseeing 57,000 miles of roadway.

Through a new Department of Health and Human Services contract, Serco supports the US Federal Government's newly created health benefit exchanges. We manage over 3,500 staff, who provide the routing, processing, reviewing and troubleshooting of applications. Serco also designed and implemented the technology infrastructure and workflow management system that support this work.

In Canada, we provide driver examination services at approximately 100 locations across Ontario and provide complete base operations services, including facilities maintenance, fire protection, and air traffic control, at the Canadian Air Force base in Goose Bay.

Americas – 2013 review

Adjusted revenue from ongoing activities on a reported currency basis grew by 1% to £765m (2012: £753m) and represented 15% of the Group (2012: 16%). On a constant currency basis, before the effect of a marginal strengthening of the average US dollar rate, organic growth held steady. Adjusted operating profit from ongoing activities grew by 7% on a reported currency basis to £58.8m (2012: £55.2m), with the margin increasing to 7.7% (2012: 7.3%).

Challenging conditions have continued for US federal contractors. During 2013, both the Department of Defense and civilian agencies had to implement automatic spending cuts known as 'sequestration'. Failure to reach

From left
Serco delivers all non military services at the
Goose Bay Canadian Armed Forces Base

We provide personnel and career transition support
to US soldiers and their families

From left
We oversee driver knowledge and road tests across
Ontario Canada

Serco produces deployable medical systems for
global disaster relief operations

Divisional reviews

Americas

Continued

a budget agreement resulted in a US Federal Government shutdown lasting several weeks in October. Additionally, 'small business set asides' have restricted our ability to compete as the prime contractor in some cases, and government emphasis on lowest price solutions versus best value has remained a significant pressure.

In the third year of a US federal contracting market reducing in size, Serco's performance of holding organic revenue steady was a good outcome. Growth was achieved in the second half of the year through the start of major new contracts for the United States Department of Health and Human Services' Centers for Medicare & Medicaid Services (CMS) and Virginia Department of Transportation (VDOT). The increase in margin includes the benefit of higher margin project work performed during

the year, further cost reduction activity and a leverage effect of returning back to growth in the second half of 2013.

Reflecting a significant development in our strategy to broaden the Americas portfolio, Serco was awarded a major new contract by CMS. Since July 2013, Serco has been providing processing support for applications submitted for enrolment into a Qualified Health Plan and for insurance affordability programmes. The contract had an initial one-year base period valued at approximately US\$115m with four one-year options, with a potential total contract value of approximately US\$1.25bn, including all option periods and optional tasks. Following a modification to the contract, the value has increased to US\$202m in the first year. Serco has set up four facilities and hired over 3,000 staff and subcontractors, who are processing paper applications and working with consumers seeking healthcare coverage through the federally-facilitated marketplace. Future operational levels will be dependent on funding and policy development of the Affordable Care Act, which legislated for the development of the services Serco is supporting.

Serco was awarded a new contract for the VDOT, with this further significant portfolio development building on the skills and capabilities that we deliver in other parts of the Group around the world. Serco is integrating and operating VDOT's transportation operations

centres, managing the Safety Service Patrol, and implementing a state-wide advanced traffic management system that oversees 57,000 miles of roadway. The contract has a six-year base period valued at US\$355m and three two-year option periods. Also in the transportation market, Serco successfully rebid its Driver Examination Services contract for the Ontario Ministry of Transportation in Canada. Serco is providing these vital services as part of a ten-year partnership, with estimated revenue to Serco of approximately C\$500m over the contract term. Serco is responsible for overseeing approximately 575,000 knowledge tests and 675,000 road tests annually, at 95 testing centres across Ontario, and the new contract is expanded to include upgrading and enhancing information technology solutions.

Existing Sea Enterprise and HRsolutions IDIQ frameworks generated wins, modifications and extensions worth US\$139m during the year. This includes integrating and upgrading IT systems for the US Navy and human resource services for the US Army. Task orders valued at US\$22m were awarded under the Alliant IDIQ, through which Serco provides a full range of integrated information technology solutions to federal civilian agencies and the Department of Defense. Serco is the sole provider on the C412TSR IDIQ, which supports the US Air Force Space Command's command and control systems, with this generating task orders valued at US\$25m in 2013. Serco also provides systems engineering and technical assistance.

From left
We process documents to assist US consumers seeking federally facilitated healthcare coverage

Serco utilises logistics supply operations to keep US Navy assets mission-capable

In Virginia, Serco operates transportation operation centres, manages the road-side Safety Service Patrol and is developing a single advanced, stateside solution that oversees 57,000 miles of roadway

to the US intelligence community, and signed a five-year extension to one of its contracts valued at approximately US\$40m

Americas – future developments

The 2014 financial year will be impacted by the ending of certain areas of work for the US Federal Retirement Thrift Investment Board the Department of Veteran Affairs and the US Army. Together, these contracts have previously accounted for around 8% of divisional revenue and a greater proportion of profits. The level of higher margin project work experienced in 2013 is not expected to repeat. The annualisation of the CMS and VDOT new contract awards should substantially offset the revenue impact.

Over the next two years, significant Serco contracts that require extending or rebidding include:

- IT support services for a US intelligence agency, where the existing contracts expire at various points in 2014 and revenue in 2013 was approximately 9% of the Americas division
- Contracts for the US Department of Homeland Security supporting the United States Citizenship and Immigration Services where the contracts are due to expire in November and December 2014 and revenue in 2013 was approximately 5% of the Americas division
- Support to the Department of State's

National Visa Center and Kentucky Consular Center where the contracts are now expected to be extended to January 2015 and revenue in 2013 was approximately 5% of the Americas division

- C4I2TSR services for the US Air Force, where the existing IDIQ contract vehicle is due to expire in 2014 and revenue in 2013 was approximately 4% of the Americas division

Future growth within the federal government services market will continue to be a challenge in the short term. While the US Federal Government is funded through to September 2014, questions still remain on what the overall impact will be on specific programmes and contracts. In the longer term, the market remains attractive in size and growth.

Following the progress in 2013 in broadening the Americas portfolio within sectors where Serco has strong global capabilities, we continue to pursue opportunities in our established core market segments which include acquisition and programme management, defence readiness, aviation and air traffic management, C4ISR, citizen services, and facilities and asset management. We will pursue further growth opportunities in government health services and other healthcare support and in surface transportation. With this market segment approach to growing the business, the Americas division has recently realigned its

organisational structure and adjusted growth investment to support its strategy going forward.

New bid opportunities that are expected to be decided over the next two years include:

- A significant number of task orders under the Sea Enterprise IDIQ, for US Navy network services
- Data capture, processing and document management for the US Patent & Trademark Office
- Processing and case management for the Department of State Passport Support Services
- Expanded IT and support services for the US intelligence community
- Management of state transportation operations centres
- Support to state-based exchanges for health insurance

From left
Serco manages airport traffic control towers across North America, to ensure the safety of our skies

We maintain satellite communication systems for the US Air Force, to ensure data sharing around the world

Divisional reviews

AMEAA

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

In Australia, Serco offers systems integration and complex project management, as a key provider for the Australian Defence Force. Our marine arm, DMS Maritime, makes us one of the country's largest marine services providers. Our work in justice and corrections, focused on reducing reoffending, was again publicly recognised by further awards in 2013. In health, we have taken over responsibility for Western Australia's flagship Fiona Stanley hospital site where we are integrating facilities management and support services. We also provide medical logistic services to the military. We operate the national network of immigration centres for the Australian Department of Immigration and Border Protection. In transport, our services range from operating customer services and processing information to developing and maintaining infrastructure. Serco also owns Great Southern Rail, which operates Australia's iconic trains, the Indian Pacific and the Ghan.

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

In Hong Kong, we are the market leader in managing, operating and maintaining road tunnels, bridges and related tollway infrastructure. We provide domestic and transportation services to two major hospitals, and in 2013 we commenced our first contract

to provide road and parking facilities management services at the Hong Kong International Airport.

The Middle East is home to some of Serco's longest standing air traffic control contracts. We are also the region's largest international operator in urban surface transport. Most notably, we operate the Dubai Metro, the world's longest and most-advanced driverless light rail system. Our technology business serves the telecommunications, marine and biomedical sectors, and we provide integrated facilities management to the education and commercial sectors.

In India, Serco operates and maintains the new Bus Rapid Transit System, in the city of Indore in the state of Madhya Pradesh. We have implemented a pilot project for electronic road toll collection with ICICI Bank, intended to pave the way for a long-term partnership and nationwide implementation.

AMEAA – 2013 review

Adjusted revenue from ongoing activities on a reported currency basis grew by 19% to £1,050m (2012: £883m), and represented 21% of the Group (2012: 18%). On a constant currency basis, before the effect of local currency weakness against the average sterling rate, growth was 22%. Excluding the contribution from the prior year's acquisition of the remaining 50% equity stake in DMS Maritime, organic growth was 18%. A significant

From left

During 2013, management of the Fiona Stanley hospital site passed to Serco. By early 2015, we will be managing more than 1,000 non-clinical staff at the hospital.

Our work in justice and corrections was again publicly recognised by awards in Australia in 2013.

From left
Our portfolio of air traffic control contracts includes Baghdad International Airport, Iraq

We are one of Australia's largest marine services providers

Divisional reviews

AMEAA

Continued

proportion of this was due to the volume of our work providing immigration services in Australia, with other incremental revenue coming from growing our transport and health operations in the wider AMEAA region

Adjusted operating profit from ongoing activities grew by 28% on a reported currency basis to £82.1m (2012: £64.3m), with the margin increasing to 7.8% (2012: 7.3%). The increased margin reflects principally the beneficial effect of operational leverage, particularly in immigration services, and other cost management activity undertaken in the period.

In Immigration Services in Australia, a record number of people arrived by boat without a valid visa; over 20,000 individuals arrived in this manner in 2013 and the number of people in our care averaged 7,400. This increased the

volume of work carried out under contracts Serco has for the management and operation of the detention services and the related transport arrangements. This resulted in further growth in revenue to over £450m for the Group in 2013, and the employment of more than 3,000 people across Australia. Following significant changes to government policies, the population in our care declined to below 5,000 by the end of February 2014. A six month extension to 10 December 2014 was awarded for our main contract for the detention centres.

In justice services, operational improvements at Mt Eden Corrections Facility have continued to be recognised. A new performance grading of all prisons in New Zealand has placed Mt Eden in the 'exceeding' category. In Australia, Southern Queensland Correctional Centre was honoured with a prestigious Australian Business Award in the Innovation category, recognising a ground-breaking education project being trialled at the prison, with the ultimate aim of reducing reoffending.

Serco's pre-operational support for the Fiona Stanley hospital in Perth continued to build over 2013 and management of the site transferred to Serco in December. The hospital is the largest public tertiary health facility in Western Australia with Serco providing an extensive range of facilities management and support services. The first patients will be admitted in October 2014 and by early 2015 Serco will be managing more than 1,000 non-clinical staff required to operate the hospital.

Serco's presence in the health market elsewhere in the AMEAA region is developing well. Serco was awarded a new healthcare support services contract in the Middle East at Healthpoint in Abu Dhabi. Healthpoint is a fully integrated, primary care and multi-specialty hospital, offering a wide range of outpatient and inpatient services. In Hong Kong, where we currently employ more than 600 people in health-related businesses, we extended our facilities management services contract, covering four hospitals and one rehabilitation centre in the western districts.

Also in Hong Kong, Serco was awarded a new transportation management, operation and maintenance contract for the Tsing Sha Control Area, with a total estimated value to Serco of HK\$960m (approximately £80m) over the six-year base period. Our extensive air traffic control services in the region, while no longer serving Abu Dhabi, were strengthened with a new 18-month, £24m contract for the Iraq Civil Aviation Authority and a new framework contract for the Qatar Civil Aviation Authority.

During the year, Serco signed an extension to its contract with the Dubai Government Roads and Transport Authority (RTA) to operate and maintain the Dubai Metro. Serco has continued to deliver world class safety and operational standards, including 99.9% of trains on time while also expanding ridership to over 137 million journeys in 2013. The five-year extension is valued at approximately £355m, with an

From left
Serco operates the Dubai Metro – the world's longest and most-advanced driverless light rail system.

We manage Mt Eden Corrections Facility, which is currently New Zealand's only privately operated prison.

At HMAS Watson in Sydney, Australia, we apply the highest standards of engineering, software development and technical skills to simulator based maritime warfare training

opportunity to extend for a further two years to 2021. Also for the RTA, Serco signed a contract for the new Dubai Tramway valued at £18m over five years. Further extending our range of services in the region, a six-year contract valued at approximately £30m was awarded to provide facilities management services in the United Arab Emirates, and a contract for employment support and training services was awarded in the Kingdom of Saudi Arabia.

In defence services, Serco extended and expanded its contract with the Australian Defence Force (ADF) to provide logistics and base support services in the Middle East. Valued at approximately £18m for a further year, we continue to deliver fully integrated support for ADF bases, to ensure the provision of high-quality services in areas such as maintenance and accommodation, and will also assist through a complex programme of demobilisation from Afghanistan. We also secured our first direct contract to provide training services in the Middle East defence market in the period.

AMEAA – future developments

The 2014 financial year is expected to be significantly impacted by reduced activity levels for Serco's Immigration Services in Australia. Activity levels have proven unpredictable in the past due to a number of factors, however they have fallen following recent changes in government policy and we estimate that the contract could reduce by as much as

50% in 2014. As the Group's single largest operation, accounting for around 9% of Group revenue, and achieving a margin reflecting the complexity of the services involved, this is the single largest factor underlying the Group's anticipated reduction in financial performance for 2014. Having secured an extension through to December 2014, the operations are then subject to rebid.

Over the next two years the only other significant rebid in the AMEAA division relates to our various Australian regional defence garrison support services contracts, operated in partnership with Sodexo. These have accounted for approximately 8% of revenue of the AMEAA division, are due to expire in June 2014 and are under evaluation currently.

There remain significant market opportunities to achieve further growth in the AMEAA region. These include the justice market in Australia and New Zealand, non-clinical healthcare support services across the region, defence support services, and transport operations including the rail, bus and aviation sectors. Serco has strong skills and capabilities in each of these operational areas within the AMEAA region, and the ability to leverage referenceability from across the Group.

New bid opportunities that are expected to be decided over the next two years include:

- A new-build prison design, construct and operate contract in Victoria, Australia, with Serco's SecurePathways consortium, one of two shortlisted.
- Service operation of the Sydney North West Rail link, with Serco's TransForm consortium, one of two shortlisted for the proposed new rapid transport system.
- Operation and maintenance of public bus services in Bahrain.
- Oman air navigation services.
- Traffic management services in Abu Dhabi.
- Further support and operation of metro systems in the region, including the Sydney Light Rail project, with Serco's SydneyConnect consortium, one of three shortlisted.
- Non-clinical support services to health organisations in the Middle East.

From left

We operate and manage parking meters for 18,000 street parking spaces in Hong Kong.

Serco owns Great Southern Rail, which operates Australia's iconic trains, the Indian Pacific and the Ghan.

Divisional reviews

Global Services

Global Services brings together our customer contact, middle and back office skills, allowing us to provide broad end-to-end BPO services to public and private sector customers. Our combination of our BPO expertise and frontline services sets us apart from other providers.

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

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

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

Global Services – 2013 review

Adjusted revenue from ongoing activities on a reported currency basis grew by 10% to £772m (2012: £702m), and represented 15% of the Group (2012: 15%). On a constant currency basis, before the effect of local currency weakness against the average sterling rate, growth was 12%. Excluding the contribution from the prior year's Vertex acquisition, organic growth was 5%. Adjusted operating profit from ongoing operations on a reported currency basis declined by 35% to £39.9m (2012: £61.3m), with the margin declining to 5.2% (2012: 8.7%). Including the impact of disposals, Adjusted revenue on a reported currency basis increased by 8% to £772m (2012: £716m) and Adjusted operating profit declined by 36% to £39.9m (2012: £62.1m).

The major contract awards that began in the second half of 2012, including Shop Direct and AEGON UK, helped to drive strong revenue growth in the first half of 2013. However, performance weakened in the second half of the year. There was less success in winning new contract awards, and there was a lower level of UK Central Government discretionary and ad hoc project work. The significant margin reduction reflected increased costs of contract bidding and new market development activity, the reduced level of typically higher margin project work and the transitional stage of the major new contracts, which tend to involve greater upfront investment.

Global Services operates in more than 100 locations and employs 60 000 people.

Worldwide Global Services conducts more than 90 million multi-channel interactions in 20 languages each year

Divisional reviews

Global Services

Continued

In our first full year of providing all customer contact services across Shop Direct's brands, we have delivered our transformation plan for the rationalisation of UK operations, the delivery of new digital services from our centre in Cardiff and the establishment of offshore and nearshore locations in India and South Africa. This has included the transfer of around 2 000 Shop Direct employees to Serco, the introduction of three new sites and the closure of two legacy sites. Similarly with the transformation programme at AEGON UK, during our first year of operation we have successfully transitioned over 300 staff to Serco and have around 500 000 policies under management.

New contract awards in the year for private sector customers included providing a range of BPO services such as sales and payments

collection for a further leading UK high street retailer. The adoption of an integrated contact centre approach saw Serco transition customer services to our centre in Sheffield, as part of a ten-year contract worth approximately £50m. Of particular importance are Serco's capabilities in multi-channel contact, with specific developments for those customers who are using tablet or mobile devices for their shopping and account management needs.

At the Anglia Support Partnership (ASP) where we provide shared service support to NHS organisations, we have continued to see expansion of our platform and framework contract. A further contract was signed with a large NHS hospital trust, to provide strategic procurement and finance and accounting services, involving the transfer of the trust's systems to the ASP shared service platform. The four-year contract is expected to generate revenue of approximately £112m.

Serco secured extensions in the year for a number of UK Central Government BPO contracts valued at over £100m in total, with an average extension period of three years. The contracts include the provision of specialist complex case management services for the Child Maintenance Group at the Department for Work & Pensions (DWP), managing enquiries on behalf of Jobcentre Plus and the Universities & Colleges Admissions Service, supporting the delivery of the Department of Health's 'Healthy Start' programme and operating the Food

Standards Agency's emergency helpline. For our Child Maintenance Group operations, Serco won the 'Value for Money Award' at the DWP Supplier Excellence Awards 2013, recognising our continuous improvement ethos and innovative approaches to enhancing customer experience, whilst driving down costs for the DWP.

In our local authority strategic partnerships, at Hertfordshire County Council we continue to transform the way services are delivered. Expanded services have included a pioneering new telecare service for adults in receipt of social care. With an initial value of £12m over five years, there is potential for further growth as the service is extended to provide wider support. At Thurrock, Serco has introduced a new debt collection programme and is providing additional ICT support, as part of the council's wider transformation programme.

In an important development in our Middle East operations, Serco was awarded a new contract for shared services to over 50 government departments within the United Arab Emirates. Serco will initially provide citizen contact and issue resolution management regarding the supply of public services, with potential for the scope of the contract to be increased in the future to include other back office processing. Contact will be delivered on a unique multi-channel basis, including voice, email and web chat. As per the agreement, the contract will provide employment opportunity

We secured extensions for a number of UK Central Government BPO contracts in 2013 valued at over £100 million in total.

Serco is now the sole contact centre service provider for India's largest public sector bank

to only Middle Eastern nationals. The initial four-year contract is estimated to be valued at approximately £24m.

In India's banking and financial services market, Serco is now the sole contact centre service provider for the country's largest public sector bank. For India's largest private sector bank, additional work awarded has led to Serco now supporting more than 75% of the collections services and becoming the largest supplier supporting card issuance on behalf of the bank. Expanding our support to the Indian public sector, we were awarded a customer support contract for energy services in the state of Punjab. Amongst other rebids and contracts won, we successfully rebid a contract valued at approximately £14m, supporting a leading US credit bureau with customer services for mortgage-related queries.

Our network of BPO delivery centres saw, during 2013, the opening of our first centre in Cape Town, South Africa, to service both international and domestic customers. The opening of our centre in Teltow, Germany, is supporting major European customers such as Sky Deutschland. Meanwhile our workforce in Cardiff, where we support multi-channel customer contact for a number of well-known UK retail brands, has almost doubled in size.

Global Services – future developments

In the 2014 financial year, no significant attrition is anticipated from the ending of any individual contracts. Over the next two years there are also no significant contracts that require extending or rebidding. There are, however, ongoing pressures from terms renegotiations with existing customers, some reductions in activity levels as we move beyond the transition phases on previous major contract starts and the need to rebuild the pipeline, particularly after the lower level of contract awards in the second half of 2013, in part as a result of the UK Government issues.

Serco has important capabilities to offer in the attractive BPO market, with scale and depth to provide private and public sector customers with a range of end-to-end, integrated business services, as they seek to reduce costs and improve efficiencies by transforming their

operations. In particular, Serco has strength in offering a blend of onshore, nearshore and offshore service provision. We also have excellent capabilities in areas such as multi-channel customer contact services.

For the private sector, the Global Services division has added to and expanded the scope of existing customer relationships over time, and sees further potential to continue growing in this manner in the future. Referenceability and prospects are spread across large and diverse industry groups: Banking, Financial Services & Insurance, Travel, Hospitality & Transportation, Retail, Healthcare, Utilities & Manufacturing, and Telecom, Technology, Online Services & Media. With significant presence to build from in the UK and India domestic markets, we are also continuing to target opportunities in other geographies.

For the public sector, the Global Services division is working alongside the regional divisions in order to bid and deliver fully integrated solutions for their customers. The division provides bid support in areas relating to contact centre services, case management, identity verification, transaction processing, ICT human resources and payroll, finance and accounting, and any other middle or back office support function that is required. Central Government is expected to continue to develop opportunities for shared service centre support. UK strategic partnerships with local authorities to transform their services should also further develop as a market, with increasing potential to outsource non-core supporting operations. Expanding existing local authority relationships remains a key source of future growth, as does further developing the ASP shared service centre for the NHS and other health organisations.

Recognition of Serco's growing presence in the BPO market continues to build. For example, we have risen into the top three UK business process services providers, as compiled by leading software and IT services industry research company TechMarketView, in its 2013 UK Software and IT Services Rankings report. In a separate recent report regarding the public sector, TechMarketView acknowledged Serco's progress in transitioning from a pure IT

outsourcer to a BPO player, using technology to support innovation and transformation in the front and back office. We have also been recognised as a top tier BPO service provider by industry analysts and third party advisors such as Gartner, Everest, NelsonHall and HFS.

New bid opportunities that are expected to be decided over the next two years include:

- European telecom operator customer contact services and digitisation
- Expanded existing and new operations for life and pensions companies
- Retail multi-channel customer management services
- Lincolnshire County Council BPO support, covering finance, HR, ICT and citizen contact
- Further local authority opportunities, covering similar services

Finance review

Overview

Revenue grew by 5.6% to £4,288.1m and operating profit, after exceptional items, was £143.8m (2012 £272.2m). Adjusted revenue from ongoing activities was £5,101.3m, a growth of 7.8% at constant currency (5.9% organic). Adjusted operating profit from ongoing activities was £285.4m, representing a 2.3% decline at constant currency. Adjusted operating margin on an ongoing basis reduced to 5.6% compared to 6.3% in 2012, a decrease of 68 basis points (59 basis points decrease at constant

currency). Adjusted profit before tax declined by 6.3% to £254.4m (3.6% decline at constant currency). Group free cash flow was £84.8m, which reflected a decrease on the prior year principally as a result of working capital impacts of timing differences between the period when costs are incurred in the delivery of the contract and the period when we can contractually bill our customer, and lower dividends from joint ventures.

For 2014, we are forecasting a mid-single digit percentage organic revenue decline. This reflects the lower level of incremental work won across the Group to date, the attrition from contracts lost such as Electronic Monitoring, and our latest assessment of the impact of volume reductions in our Australian immigration detention services contract. The Adjusted operating margin is anticipated to decline by approximately 50 to 100 basis points. This takes account of the margins associated with the revenue reductions, together with the ongoing incremental costs of the agreed corporate renewal programme. Statutory operating profit margins before exceptional items are expected to decline but at a lesser rate, reflecting the lower levels of costs and charges expected to be incurred in relation to the impact of the UK Government reviews, together with a lower amount for amortisation of intangibles arising on acquisition.

Andrew Jenner
Group Chief Financial Officer

1 Income statement

The key lines of Serco's income statement for the year are summarised below and include analysis of revenue, operating profit, exceptional items, profit before tax and earnings per share. In the review of the business which follows, the statutory results have been adjusted to reflect proportional consolidation of the results of joint ventures, as these businesses form a fundamental part of the way the Group works to meet the demands of its customers.

The tables show separately Adjusted revenue and Adjusted operating profit of ongoing activities, which exclude the financial results of subsidiaries and operations disposed of during the year, in order to present more clearly the performance of the ongoing business. Measures of Adjusted operating profit, Adjusted profit before tax and Adjusted earnings per share are presented to assist the reader to understand the results of the underlying business and reflect the measures used by senior management to assess the performance of the business. Adjusted measures are also calculated before amortisation of intangibles arising on acquisition, transaction-related costs, exceptional items and management's estimate of other costs and charges relating to the impact of the UK Government reviews.

The prior year results have been restated following adoption of the revisions to IAS 19 Employee Benefits and IFRS 11 Joint Arrangements, and also to reflect the adjustment to prior year acquisitions for provisional acquisition accounting entries. The impact of these restatements is shown in note 4 to the financial statements and has reduced reported revenue by £852.9m, profit before tax by £20.9m and profit for the year by £4.9m.

1.1 Revenue

Year ended 31 December	2013 £m	2012 (restated) £m	Change	Change at constant currency
Adjusted revenue – ongoing activities	5,101.3	4,774.6	6.8%	7.8%
Adjusted revenue – disposed activities	42.6	138.4		
Adjusted revenue	5,143.9	4,913.0	4.7%	5.7%
Less: Share of joint venture revenue	(855.8)	(852.9)		
Revenue	4,288.1	4,060.1	5.6%	6.7%

Adjusted revenue from ongoing activities grew by 6.8% to £5,101.3m (7.8% growth at constant currency). Organic revenue, which excludes currency effects, acquisitions and disposals, increased by 5.9%, with the drivers of this revenue performance discussed in the preceding Divisional Reviews. Revenue for the year was up 5.6% at £4,288.1m.

1.2 Operating profit

Year ended 31 December	2013 £m	2012 (restated) £m	Change	Change at constant currency
Adjusted operating profit – ongoing activities	285.4	299.6	(4.7%)	(2.3%)
Adjusted operating profit – disposed activities	6.6	14.5		
Adjusted operating profit	292.0	314.1	(7.0%)	(4.7%)
Amortisation of intangibles arising on acquisition	(21.4)	(24.1)		
Transaction-related costs	(3.5)	(3.7)		
Share of joint venture tax and interest	(11.8)	(14.7)		
Management estimation of charges related to UK Government reviews	(21.0)	–		
Operating profit before exceptional items	234.3	271.6	(13.7%)	(11.2%)
Exceptional operating items	(90.5)	0.6		
Operating profit	143.8	272.2	(47.1%)	(44.6%)
Adjusted operating margin – ongoing activities	5.59%	6.27%	(68bps)	(59bps)
Adjusted operating margin	5.68%	6.39%	(71bps)	(62bps)

Costs estimated and allocated by management as relating to the impact of UK Government reviews on the business are in addition to those identified as exceptional items on the face of the income statement. Included in this amount are onerous contract charges incurred in the period on other Ministry of Justice contracts, an estimation of the costs incurred on the Electronic Monitoring and Prisoner Escort & Custody Services (PECS) contracts relating to supporting the review work, bid costs incurred on proposals where management believe the Cabinet Office reviews represented a significant reason why the Group was unsuccessful, the effect of accelerated transition to a new service provider of the Electronic Monitoring contract and other specific related costs.

Adjusted operating profit from ongoing activities decreased by 4.7% to £285.4m (2.3% decline at constant currency). This represents a margin of 5.6%, which is a 68 basis point decrease compared with the prior year. Drivers of the margin performance are discussed in the Divisional Reviews. Operating profit before exceptional items in the year to 31 December 2013 was £234.3m (2012: £271.6m) and operating profit, after exceptional items, was £143.8m (2012: £272.2m).

Finance review

1.3 Reportable segments and ongoing activities

The table below shows the segmental results split between ongoing activities, being the part of the business which will continue into 2014, and disposed activities being the part of the business which contributed to the 2013 and 2012 results but were disposed of during either year

Year ended 31 December 2013	UK & Europe £m	Americas £m	AMEAA £m	Global Services £m	Corporate £m	Total £m
Adjusted segment revenue						
Ongoing activities	2,514.3	765.3	1,049.5	772.2	–	5,101.3
Disposed activities	42.6	–	–	–	–	42.6
Adjusted revenue	2,556.9	765.3	1,049.5	772.2	–	5,143.9
Adjusted operating profit						
Ongoing activities	150.7	58.8	82.1	39.9	(46.1)	285.4
Disposed activities	6.6	–	–	–	–	6.6
Adjusted operating profit	157.3	58.8	82.1	39.9	(46.1)	292.0

Year ended 31 December 2012

Adjusted segment revenue						
Ongoing activities	2,436.4	753.4	883.0	701.8	–	4,774.6
Disposed activities	124.7	–	–	13.7	–	138.4
Adjusted revenue	2,561.1	753.4	883.0	715.5	–	4,913.0
Adjusted operating profit						
Ongoing activities	163.4	55.2	64.3	61.3	(44.6)	299.6
Disposed activities	13.7	–	–	0.8	–	14.5
Adjusted operating profit	177.1	55.2	64.3	62.1	(44.6)	314.1

1.4 Transaction-related costs

There were £3.5m of costs arising from transaction-related activity during the year (2012: £3.7m)

1.5 Management estimation of charges related to UK Government reviews

There were £21.0m (2012: £nil) of both costs estimated and allocated by management as relating to the impact of UK Government reviews on the business. These costs are in addition to those identified as exceptional items on the face of the income statement. Included in this amount are onerous contract charges incurred in the period on other Ministry of Justice contracts (£6m), an estimation of the costs incurred on the Electronic Monitoring and PECS contracts relating to supporting the review work (£2m), bid costs incurred on proposals where management consider the Cabinet Office reviews represented a significant reason why the Group was unsuccessful (£5m), the effect of accelerated transition to a new service provider of the Electronic Monitoring contract and other specific related costs (£8m).

1.6 Exceptional operating profit items

Year ended 31 December	2013 £m	2012 £m
Settlement relating to UK Government reviews	(66.3)	–
Costs associated with UK Government reviews	(11.6)	–
UK clinical health provisions	(17.6)	–
Restructuring costs	(14.9)	–
Asset impairment	(9.6)	–
Adjustment to deferred consideration relating to prior year acquisition	10.3	–
Charitable donation	–	(5.0)
Gain on disposal of UK transport maintenance business	23.2	–
Loss on disposal of UK occupational health business	(3.9)	–
Loss on disposal of Ascot College	(0.1)	–
Gain on disposal of nuclear consulting services business	–	57.6
Loss on disposal of German operation	–	(27.7)
Loss on disposal of UK data hosting operations	–	(11.5)
Loss on disposal of education software business	–	(12.8)
Net exceptional (costs)/income	(90.5)	0.6

Settlement amounts relating to UK Government reviews

In December 2013, following a review of the billing arrangements on the Electronic Monitoring contract by the Ministry of Justice, a settlement of £64.3m was reached in respect of the contractual claim. In addition, a £2.0m settlement was reached on the PECS contract which was also subject to Government review, to reflect repayment of past profit earned on this contract.

Costs associated with UK Government reviews

Since July 2013 there have been external adviser and other directly related incremental costs, including the exit costs of certain senior management, that amounted to £11.6m.

Onerous UK clinical health provisions

During the year we completed a comprehensive review of the clinical health operations in the UK. As a result we will exit two contracts early. These contracts, together with a third loss-making contract, require provisions for estimated losses in future years together with a provision against underlying assets, which in total amount to a non-cash exceptional charge of £17.6m. This has been treated as exceptional due to the non-recurring nature of the charge and its significant value.

Restructuring

As a result of a review of the cost structures in the UK businesses, a restructuring charge of £14.9m was taken and when complete will reduce headcount by approximately 400, split equally between UK & Europe and Global Services.

Asset impairment

As a result of a review of under-performing businesses and operations, an impairment charge of £9.6m was taken in relation to the carrying value of fixed assets in Great Southern Railway, a rail tourism business based in Australia, reflecting more challenging conditions in that market.

Adjustment to prior year acquisition

On assessment against earn-out criteria, an adjustment was made to the accrual for deferred consideration arising on the 2011 Intelenet acquisition of £10.3m.

Exceptional net profit on disposal of subsidiaries and operations

On 27 November 2013 the Group disposed of its UK transport maintenance and technology business for consideration of £44.9m, which resulted in a gain of £23.2m. The disposal on 4 October 2013 of the occupational health business resulted in a loss of £3.9m.

1.7 Exceptional other gain

Year ended 31 December	2013 £m	2012 £m
Gain on step acquisition accounting of joint venture	–	51.1

The exceptional other gain in 2012 represents the non-cash gain arising from the step acquisition accounting of the DMS joint venture where the original 50% shareholding was restated to fair value.

1.8 Net finance costs

Year ended 31 December	2013 £m	2012 (restated) £m	Change	Change at constant currency
Adjusted net finance costs	(37.6)	(42.5)	(11.5%)	(11.8%)
Less: Share of joint venture net interest costs	0.4	0.3		
Net finance costs	(37.2)	(42.2)	(11.8%)	(12.1%)

Adjusted net finance costs decreased £4.9m to £37.6m (2012: £42.5m). The principal reason for this was the non-recurrence of additional costs in the prior year relating to re-financing the revolving credit facility.

Finance review

1 9 Profit before tax

Year ended 31 December	2013 £m	2012 (restated) £m	Change	Change at constant currency
Adjusted profit before tax	254 4	271 6	(6 3%)	(3 6%)
Amortisation of intangibles arising on acquisition	(21 4)	(24 1)		
Transaction-related costs	(3 5)	(3 7)		
Share of joint venture tax	(11 4)	(14 4)		
Management estimation of charges related to UK Government reviews	(21 0)	–		
Profit before tax and before exceptional items	197 1	229 4	(14 1%)	(11 1%)
Exceptional items	(90 5)	51 7		
Profit before tax	106 6	281 1	(62 1%)	(59 7%)

Adjusted profit before tax decreased by 6 3% to £254 4m (3 6% decrease at constant currency). Profit before tax and before exceptional items was 14 1% lower than the prior year, with the reduction following the decrease in operating profits as described above. Profit before tax was £106 6m, a reduction of 62 1% on the prior year.

1 10 Tax

Year ended 31 December	2013 £m	2012 (restated) £m	Change	Change at constant currency
Adjusted tax	(61 1)	(66 9)	8 7%	6 0%
Tax on amortisation of intangibles arising on acquisition	5 5	5 4		
Tax on transaction-related costs	–	0 5		
Share of joint venture tax	11 4	14 4		
Tax on management estimate of charges related to UK Government reviews	4 2	–		
Tax before exceptional items	(40 0)	(46 6)	14 2%	10 5%
Tax on exceptional items	28 8	6 5		
Tax	(11 2)	(40 1)	72 1%	68 2%
Adjusted effective tax rate	24 0%	24 6%		

The Adjusted effective tax rate was 24 0% (2012: 24 6%). The movement reflects changes in the mix of taxable profits in different jurisdictions and the reduction in the UK headline tax rate from 24% to 23% from 1 April 2013.

1 11 Earnings per share (EPS)

Year ended 31 December	2013 Pence	2012 (restated) Pence	Change	Change at constant currency
Adjusted earnings per share (basic)	39 53	41 55	(4 9%)	(2 1%)
Amortisation of intangibles arising on acquisition	(3 25)	(3 81)		
Transaction-related costs	(0 72)	(0 65)		
Management estimate of charges related to UK Government reviews	(3 43)	–		
Earnings per share before exceptional items (basic)	32 13	37 09	(13 4%)	(10 5%)
Exceptional items	(12 62)	11 85		
Earnings per share (basic)	19 51	48 94	(60 1%)	(58 0%)

Adjusted EPS declined by 4 9% to 39 53p (2 1% decline excluding currency effects). EPS before exceptional items declined by 13 4% to 32 13p, while EPS declined 60 1% to 19 51p. EPS and Adjusted EPS are calculated on a basic weighted average share base of 489 0m (2012: 491 2m).

2 Dividend

Year ended 31 December	2013 Pence	2012 Pence	Change
Dividend per share	10 55p	10 10p	4 5%

The Board has proposed a final dividend for 2013 held at 7 45p, bringing the total dividend for the year to 10 55p which is an increase of 4 5%. This reflects our ongoing transition to a higher payout ratio. Based on Adjusted basic earnings per share of 39 53p, the dividend represents a payout of 27% (2012: 24%), or dividend cover of 3 75x (2012: 4 11x). The Board set out in 2013 the intention to move to dividend cover of 2 5-3x over time, beyond which point it would expect to revert to increasing the total dividend each year in line with the increase in underlying earnings. The final dividend will be paid, subject to shareholder approval, on 14 May 2014 to shareholders on the register on 14 March 2014.

3 Cash flow

The Group generated a free cash inflow of £84.8m (2012 £181.2m), the decrease arising principally as a result of incremental working capital and lower dividends from joint ventures

Year ended 31 December	2013 £m	2012 (restated) £m
Adjusted operating profit excluding joint ventures	233.1	236.9
Non cash items	53.0	56.0
Adjusted EBITDA excluding joint ventures	286.1	292.9
Working capital movement	(144.0)	(47.2)
Adjusted operating cash flow excluding joint ventures	142.1	245.7
Interest	(38.2)	(44.6)
Tax	(18.8)	(33.6)
Net expenditure on tangible and intangible assets*	(51.8)	(66.9)
Dividends from joint ventures	51.5	80.6
Free cash flow	84.8	181.2
Acquisition of subsidiaries net of cash acquired	(18.6)	(141.8)
Disposal of subsidiaries and operations net of cash disposed	40.6	131.0
Transaction-related costs	(2.8)	(3.9)
Purchase of own shares and issue proceeds of share capital	(14.9)	(10.3)
Financing**	73.2	(152.0)
Management estimation of charges related to UK Government reviews	(9.2)	-
Other exceptional items***	(83.7)	(5.0)
Special pension contribution	(19.7)	-
Dividends paid	(51.5)	(41.9)
Group net decrease in cash and cash equivalents	(1.8)	(42.7)
Adjustment to include joint venture cash impacts	(5.6)	(4.5)
Net decrease in cash and cash equivalents before exchange loss	(7.4)	(47.2)
Exchange loss	(15.9)	(9.0)
Net decrease in cash and cash equivalents	(23.3)	(56.2)

Notes

* Net expenditure on tangible and intangible assets excludes assets funded under finance lease arrangements

** Financing is stated net of directly reimbursed capital expenditure

*** Exceptional items include an amount of £22m due to the UK Government that was satisfied through a net settlement in relation to receipts on billed amounts due from the same customer

3.1 Adjusted operating cash flow excluding joint ventures

Adjusted operating cash flow excluding joint ventures was £142.1m (2012 £245.7m)

The movement in working capital of £144.0m (2012 £47.2m) principally relates to timing differences between the period when costs are incurred in the delivery of the contract and the period when we can contractually bill our customer. Examples of this include Shop Direct where we have undertaken transition services in the first two years of the contract which may only be billed and recovered from the customer over a longer period. Defence Marine Services (DMS) in Australia, where there has been significant vessel maintenance in the year, with recovery spread over a longer period and Fiona Stanley Hospital, where there has been spend related to the start of the contract which will be billed and recovered in a later period. There have additionally been outflows from the decline in the accelerated payment cycle from some of our customers in 2013 and delays to receipts from certain customers in AMEAA.

3.2 Interest

Net interest paid decreased to £38.2m (2012 £44.6m), principally due to the payment in 2012 of £5.6m of facility fees relating to the refinancing of the revolving credit facility.

3.3 Tax

Tax paid was £18.8m (2012 £33.6m). Cash tax remains below the equivalent charge in the income statement, principally as a result of the availability of accelerated capital allowances and other timing differences, together with the impact of tax relief on exceptional items primarily in the UK.

3.4 Net expenditure on tangible and intangible assets

Net expenditure on tangible and intangible assets was £51.8m (2012 £66.9m). This represents 1.2% of revenue (2012 1.6%).

3.5 Dividends from joint ventures

Dividends received from joint ventures totalled £51.5m (2012 £80.6m), with the decline reflecting lower profits from joint ventures and from the impact of the former DMS joint venture, which became a wholly owned subsidiary in late 2012.

Finance review

3.6 Purchase of own shares and issue proceeds of share capital

The net £14.9m cash outflow in the year related to a £16.0m outflow (2012: £16.0m) for the Employee Share Ownership Trust (ESOT) in order to satisfy options granted under the Group's share option schemes and £1.1m (2012: £5.7m) of proceeds from the issue of share capital and exercise of share options.

3.7 Financing

The inflow from financing of £73.2m (2012: outflow of £152.0m) is primarily due to additional private placements taken out in the year. Further details on sources of funding are included in section 8 below.

3.8 Management estimation of charges related to UK Government reviews

There was cash spend of £9.2m (2012: nil) in relation to management's estimation of the charges related to the UK Government reviews.

3.9 Other exceptional items

There was spend of £83.7m (2012: £5.0m) in relation to other exceptional items. This included the agreed settlement paid on 23 December 2013 to the UK Central Government of £66.3m, together with related VAT of £5.8m in relation to the Electronic Monitoring and PECS contracts. There was also £11.6m of spend in relation to restructuring and the direct costs associated with the UK reviews.

3.10 Special pension contributions

The special pension contributions of £19.7m relate to a £16.8m payment to fund the deficit on the Vertex pension fund, prior to its transfer into the Group's largest defined benefit scheme, Serco Pension and Life Assurance Scheme (SPLAS), and £2.9m in relation to deficit recovery funding of the Walsall defined benefit pension scheme. The Vertex payment enabled its separate defined benefit scheme to be closed and thereby reduces ongoing administration costs.

3.11 Reconciliation of free cash flow

The table below reconciles the net cash from operating activities in the consolidated cash flow statement to the free cash flow at the beginning of section 3 of the Finance Review.

Year ended 31 December	2013 £m	2012 £m
Operating activities		
Net cash inflow from operating activities before cash spend on special pension contribution and other exceptional items	111.3	225.9
Investing activities		
Net cash inflow/(outflow) from investing activities	14.2	(4.0)
Less: Increase in security deposits	0.2	–
Less: Proceeds on disposal of subsidiaries and operations	(40.6)	(131.0)
Less: Acquisition of subsidiaries, net of cash acquired	18.6	141.8
Financing activities		
Interest paid	(40.8)	(47.1)
Management estimation of charges related to UK Government reviews	9.2	–
Transaction-related costs	2.8	3.9
Directly reimbursed capital expenditure and other financing items	9.9	(8.3)
Free cash flow	84.8	181.2

4 Acquisitions

Deferred consideration payments in relation to acquisitions totalled £18.6m (2012: £141.8m). This represented £11.9m in relation to the acquisition of Intelnet and £6.7m in relation to the acquisition of The Listening Company.

5 Disposals

The table below shows the net cash proceeds from the disposal of businesses and operations, reflecting the cash proceeds less any cash and cash equivalents disposed and disposal costs paid in the year.

Year ended 31 December	2013 £m	2012 £m
UK transport maintenance and technology business	40.2	–
UK occupational health business	2.2	–
Ascot College	0.7	–
Nuclear consulting services business	–	129.8
German operation	–	(3.5)
Education software business	–	4.7
UK data hosting operations (disposal cash costs)	(2.5)	–
Net cash proceeds	40.6	131.0

6 Net debt

At 31 December	2013 £m	2012 £m
Group – cash and cash equivalents	125.1	142.8
Group – loans	(782.2)	(699.5)
Group – obligations under finance leases	(68.0)	(50.2)
Group recourse net debt	(725.1)	(606.9)
Group non-recourse debt	(20.3)	(25.1)
Net debt	(745.4)	(632.0)

Adjusted net debt, which includes the proportional share of joint venture net cash of £44.2m, is £701.2m (2012: £580.7m). A reconciliation of net debt is present in section 6.3 below.

6.1 Group recourse net debt

Group recourse net debt increased by £118.2m to £725.1m (2012: £606.9m). Sources of funding are described in section 8 below.

Cash and cash equivalents include encumbered cash of £10.2m (2012: £7.5m). This is cash relating to customer advance payments.

6.2 Group non-recourse debt

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

Group non-recourse debt decreased by £4.8m to £20.3m. The decrease is mainly due to the final repayment of debt on our Driver Examination Services contract in Canada.

Finance review

6.3 Reconciliation of free cash flow to recourse net debt

The tables below reconcile free cash flow at the beginning of section 3 of the Finance Review to the movement in Group recourse net debt and net debt

Year ended 31 December	2013 £m	2012 £m
Free cash flow	84.8	181.2
Acquisition of subsidiaries net of cash acquired	(18.6)	(141.8)
Disposal of subsidiaries and operations net of cash disposed	40.6	131.0
Transaction-related costs	(2.8)	(3.9)
Purchase of own shares and issue proceeds of share capital	(14.9)	(10.3)
New loans on acquisition of subsidiaries	-	(15.2)
Repayment of non-recourse loans	(10.2)	(8.7)
New and acquired finance leases	(33.0)	(26.1)
Management estimation of charges related to UK Government reviews	(9.2)	-
Other exceptional items	(83.7)	(5.0)
Special pension contribution	(19.7)	-
Dividends paid	(51.5)	(41.9)
Other financing items including foreign exchange	-	3.6
Movement in Group recourse net debt	(118.2)	62.9
Recourse net debt at 1 January	(606.9)	(669.8)
Recourse net debt at 31 December	(725.1)	(606.9)

Year ended 31 December	2013 £m	2012 £m
Repayment of non-recourse loans	10.2	8.7
Non-recourse loan advances	(5.3)	(18.4)
Foreign exchange	(0.1)	0.1
Movement in non-recourse debt	4.8	(9.6)
Non-recourse debt at 1 January	(25.1)	(15.5)
Non-recourse debt at 31 December	(20.3)	(25.1)

Year ended 31 December	2013 £m	2012 £m
Movement in total net debt	(113.4)	53.3
Net debt at 1 January	(632.0)	(685.3)
Net debt at 31 December	(745.4)	(632.0)

7 Pensions

The Group is a sponsor of a number of defined benefit schemes and defined contribution schemes. At 31 December 2013, the net retirement benefit asset included in the balance sheet arising from our defined benefit pension scheme obligations was £42.7m (2012: £26.1m). The pension scheme asset base is £1.4bn.

Defined benefit pension schemes

At 31 December	2013 £m	2012 (restated) £m
Group schemes – non contract specific	58.4	45.5
Contract specific schemes	(5.5)	(13.8)
Net retirement benefit asset	52.9	31.7
Intangible assets arising from rights to operate franchises and contracts	1.0	3.2
Deferred tax liabilities	(11.2)	(8.8)
Net balance sheet asset	42.7	26.1

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

- Non contract specific – schemes which do not relate to specific contracts or franchises. For these schemes we charge the actuarial gain or loss for the period to the consolidated statement of comprehensive income (the SOCI), and
- Contract specific – schemes relating to specific contracts or franchises, where the deficit will pass back to the customer or on to the next contractor at the end of the contract. For these schemes, we charge the actuarial gain or loss on our share of the deficit for the period to the SOCI, recognise a recoverable intangible asset on the balance sheet at the start of the contract or franchise and amortise the intangible asset to the income statement over the contract or franchise life. Serco has limited commercial risk in relation to the contract specific schemes because the deficit will, in general, pass back to the customer or on to the next contractor at the end of the contract.

Amongst our non contract specific schemes, the largest is the Serco Pension and Life Assurance Scheme (SPLAS). At 31 December 2013, SPLAS had a surplus of £64.2m (31 December 2012: surplus of £69.7m). This is calculated under IAS 19 Revised using market-derived rates at 31 December 2013. It therefore reflects the effect of the market conditions on investment returns in the period.

The estimated actuarial deficit of SPLAS, calculated using prudent Trustee assumptions, as at 31 December 2013 was approximately £13m (2012: £11m). The value calculated in the latest triennial review was a deficit of £24m at 5 April 2012. We continue to review the level of benefits and contributions under the scheme in the light of our business needs and changes to pension legislation.

8 Treasury

The Group has a five-year multi-currency revolving credit facility of £730m (31 December 2012: £730m). This five-year multi-currency revolving credit facility, which was signed on 28 March 2012, matures in March 2017. As at 31 December 2013, £175m had been drawn (31 December 2012: £178m).

In addition to the bank facility, Serco has US private placements totalling £575m (31 December 2012: £461m) which will be repaid between 2014 and 2024, with £23m maturing in 2014. This includes \$240.0m of new notes issued in May 2013.

The above facilities are unsecured and have financial and non-financial covenants and obligations typical of these arrangements. The principal financial covenants (as defined) require leverage not to exceed 3.5 times EBITDA and EBITDA to cover interest at least 3.0 times. As at 31 December 2013 these ratios were 2.3 times and 8.8 times respectively.

9. Going concern

In order to satisfy ourselves that we have adequate resources for the future, the Directors have reviewed the Group's committed funding and liquidity positions, and our ability to generate cash from trading activities. The Directors have also reviewed our strategy and the principal risks we face. Whilst the current economic environment continues to contain uncertainties, our revenues are largely derived from long-term contracts and our contract portfolio is of sufficient diversity that a downturn in any particular market sector or geography has a diluted effect on the Group as a whole.

The Group's principal funding is through a revolving credit facility and US private placements. As at 31 December 2013, the Group had £1,305m of committed credit facilities and headroom of £555m. The revolving credit facility matures in March 2017 whilst repayments of the US private placements occur between 2014 and 2024, with a scheduled repayment of £23m in August 2014. The Group fully expects to meet these repayments through operational cash flows.

Based on the information set out above, 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.

Andrew Jenner
Group Chief Financial Officer

Corporate responsibility

The issues we faced in the second half of 2013 have only served to reinforce our view that for Serco to be successful and sustainable, we have to work in the right way. This means living up to our responsibilities to our customers, the public, our employees, partners, suppliers, communities and the environment.

Being a responsible business means ensuring that we

- always do the right thing
- are open and transparent with our customers, our people and the societies we serve
- deliver on our commitments and comply with the law
- engage with and motivate our people
- act safely and with respect for the environment and those with whom we work
- minimise business risks
- achieve appropriate financial returns, and
- develop and safeguard our reputation and brand

By being responsible, we will enhance our financial performance and create sustainable value for our shareholders. The importance of corporate responsibility (CR) means that we have built it into the way we operate, embedding it in all aspects of the Serco Management System (SMS). The SMS defines the rules that govern the way we behave, operate and deliver our strategy. It encompasses a set of Group-wide policies and standards, covering subjects ranging from health, safety and the environment (HSE) to procurement and supply chain. During 2014, we will further develop the SMS, including our values and code of conduct as part of our corporate renewal programme. More information on the key components of the programme can be found on page 60.

The way we manage our responsibilities and our performance in the year are summarised below. We also publish a fuller CR report online, which is available at www.cr2013-serco.com.

Managing corporate responsibility

Our CR framework encompasses our people, health and safety, communities, the environment, our marketplace, which covers our relationships with our customers, suppliers and other parties, and our commitment to ethics and business conduct.

The Serco Group plc Board has ultimate responsibility for our Group business strategy and therefore approves our Group CR strategy. One of our non-executive directors is the Board sponsor for CR and chairs the CR Committee.

In October 2013, we announced that we would establish a Board committee for CR, to take oversight of our approach to ethics, the structure of governance, risk management and HSE matters. This committee, which met for the first time in February 2014, will meet quarterly to receive formal progress reports against each element of the CR framework. More information on the CR Committee can be found in the Corporate Governance Report on page 81.

The Chief Executive is a member of the CR Committee and is responsible for promoting the Group's CR strategy and

its effective implementation across the Group. The Executive Committee is responsible for implementing our Group CR objectives.

Our people need to feel confident that there is somebody they can turn to discuss potential ethical conflicts that may arise during bidding or when transitioning or operating contracts, so the matter can be discussed openly and we can take authoritative decisions. Towards the end of 2013, we therefore appointed an ethical lead in each division, who will be answerable to a divisional ethics committee, which has now been established.

Developing our CR strategy

Each element of CR has its own strategy, which we develop as follows:

- The Group HR Director sponsors our people strategy, which is developed through the Global HR Directors Forum. The forum includes divisional HR directors and other senior corporate function members.
- The Group Director of Risk and Acquisitions sponsors our HSE strategy. This is based on our divisional strategies and the Group's evolving HSE risk profile. The HSE Oversight Group is made up of senior corporate function members and divisional HSE leads. It agrees the HSE strategy before submitting it to the Group Risk Management and Safety Committee (GRMSC). The GRMSC reviews the HSE strategy and monitors performance at its quarterly meetings. The chair of the GRMSC reports and presents the HSE strategy to the Executive Committee.
- Our community strategy is developed through a CR Oversight Group. The Executive Committee then reviews and monitors our community strategy.
- Serco operates across many countries, jurisdictions and cultures, so we adopt a flexible approach to the marketplace. This includes actively engaging our stakeholders, so we can take account of their views when we make decisions. This process is embedded in our overall business strategy.

Serco is one of the UK's top 100 employers of apprentices.

- The Director of Business Compliance and Ethics has responsibility for the Group's Code of Conduct. Our Code and matters pertaining to our ethical position will be reviewed and monitored by the CR Committee. We are clear on the ethical standards we expect from all employees and this is communicated through the Code which all employees receive. This is supported by training on the Code for all employees. As part of the corporate renewal programme, we have refreshed our Code, which will be relaunched in 2014.
- Each division has a CR strategy, which is owned by the divisional CEO and monitored by the divisional board. Our contracts develop CR initiatives that fit their divisional strategies, their business and their local communities. The contract director is responsible for delivering these initiatives.
- Our CR activities also reflect our people's passionate involvement in local causes, which often involve them volunteering to raise money or provide direct help.

People

We depend on our people's skills and commitment to deliver the services our customers expect. Our people contribute directly to our reputation and ability to grow.

Our human resources activities are designed to create a robust and sustainable organisation, which can operate effectively in a complex environment. To do this, we follow a clear people strategy, as described in the strategy section on page 11.

For 2013, we set the following objectives in relation to our people:

Objective 1 To continue to develop leaders who are fit for the future by embedding the talent review and succession planning process across a wider proportion of our management population

During the year, we embedded our talent management processes around the Group and focused on consistently improving them. We are now linking these processes to our

wider leadership agenda. This has seen us carry out a significant piece of work with our leaders around the world, to determine what we expect from leaders in Serco.

This work has allowed us to create a new leadership model, which we will roll out in 2014. Our aim is to identify people who have the desire and capability to be leaders at all levels in the organisation and to help them fulfil their potential. Whether people are interested in developing their skills, managing a small group or taking on wider responsibilities, the model will enable them to understand what capabilities they need to develop and demonstrate, so they can progress to the next level of leadership. It will also help to communicate and embed our values throughout the organisation.

Objective 2 To improve our overall employee engagement levels by focusing on the top engagement drivers across Serco

Each year, we undertake a global employee survey called Viewpoint. This gives us important insights into how we can improve the working experience at Serco. In 2013, we achieved a response rate of 82%. The survey showed that overall levels of engagement declined slightly in the last 12 months, in part reflecting the specific challenges Serco faced in 2013. However, it also identified a generally positive corporate culture, with most employees feeling they have good working relationships with colleagues, that their contract provides a high level of customer service and that Serco values diversity.

The results analysis also identifies the drivers that will most improve engagement if we take action. To optimise engagement, we therefore need to focus on what we do with the survey results. In 2014, the Executive Team will be senior sponsors of employee engagement and personally commit to three actions. These are:

- 1 Engaging the leadership team. Leadership engagement is critical to the business and improving the overall engagement of employees. Our actions will include focus groups with the leadership team in all regions, 'listening sessions' with the

Chief Executive and Executive Committee, and aligning engagement and leadership development.

- 2 Bringing to life the strategic narrative for Serco. For employees, feeling part of Serco is the top driver to improve in this year's results. To close the gap, we need to clarify the role Serco plays in supporting great service delivery, to enable our people to realise their service vocation. This effort will be linked to other elements of corporate renewal, such as our review of our values and our new leadership model. It will include a broader range of communication channels and greater recognition of best practice and individual achievements.
- 3 Developing employee engagement as a strategic priority. To meet our strategic objectives, we need to focus on engaging our people and using engagement data as a predictive indicator of ethics and compliance risks. We will create a set of global employee wellbeing principles, with resources for all regions, and continue our focus on performance-related processes, such as setting objectives and reviews.

During the year, we also continued to support Engage for Success, an independent and voluntary group of leaders, managers, trade unionists, engagement practitioners and experts, who all want to highlight the importance of employee engagement.

Objective 3 To continue to implement MyHR – our single HR programme and common core processes – throughout the business

MyHR provides a range of self-service tools for both managers and employees. It gives managers better visibility and control of their team information, the ability to carry out people management activities online, and access to reports to support planning and decision making. The system also makes HR processes easier for employees – for example by allowing them to maintain their personal information or book annual leave online.

We depend on our people's skills and commitment to deliver the services our customers expect.

Corporate responsibility

Continued

Implementation has taken place across a complex global environment which presented us with a number of technical and organisational challenges. We resolved these in the first half of the year and put in place improved processes for dealing with issues as they emerge.

We continued to develop the system during the year, including better forms and training managers in using MyHR Online and our people management processes. We now intend to move to the next stage of development, adding more functionality to MyHR to include learning, reward and performance management. It will also help us to deploy training and compliance programmes to all our people, for example around our Code of Conduct.

During the year, we transferred HR processing for our Middle East business to our transaction centre in Delhi.

2014 objectives

Our people objectives for 2014 are to

- roll out our new leadership model
- continue to build on best practices in engagement, and
- add new functionality to MyHR and use the system to improve our efficiency

Diversity

Serco is an inherently diverse business. However, we still need to promote diversity and ensure that all our employees are able to be successful and happy at work, regardless of their background. We therefore have a global diversity strategy, based on a set of global principles, details of which can be found on our website, www.serco.com.

At 31 December 2013, the numbers of men and women employed by Serco were as follows

	Number		Percentage	
	Male	Female	Male	Female
Directors	5	1	83.3%	16.7%
Senior managers	56	8	87.5%	12.5%
Employees*	77,780	41,020	65.5%	34.5%

* At 31 December 2013, we had 120,535 employees of which we had gender information on 118,800

On 3 March 2014 we announced the appointment of three new non-executive directors. At the date of this report, we therefore had nine directors of whom three are female.

Human rights

Respecting human rights is an important principle for us but it is not a significant issue for our business.

We recognise and apply the principles in the Universal Declaration on Human Rights. Our Governance, Conduct and Ethics policy requires us to respect the human rights and dignity of individuals and to not take part in, or benefit from, any activity that breaks any law relating to human rights or that supports or encourages the abuse of human rights. We also have a human rights 'decision tree', which we use to assess the potential human rights issues associated with contracts for which we are thinking of bidding.

Health and safety

Our aspiration is zero harm. Nothing is so urgent or important that we cannot do it safely. A strong HSE performance ensures the safety of our people and protects our reputation. Wherever they work and whatever their role, our people must adhere to stringent health and safety procedures. These procedures are embedded in the SMS and are the minimum standards that apply.

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

For 2013, we set the health and safety objectives below. Definitions of these metrics are contained in our CR report.

Objective 1 A lost time incident (LTI) rate of 573 per 100,000 employees, representing a 5% reduction against the 2012 baseline.

The LTI rate fell from 611 in 2012 to 505 in 2013, a reduction of 17%. All our divisions improved their performance during the year.

Slips, trips, falls and manual handling are the biggest contributors to LTIs, so we have implemented risk reduction initiatives, including staff awareness and training.

More specifically, the UK & Europe division took a risk based approach to safety critical areas, with initiatives including improved governance.

Nothing is so urgent or important that we cannot do it safely and we have a strong controls framework for managing our HSE responsibilities.

to provide oversight and challenge, consistent processes and toolsets across the division, and a core curriculum of online safety training. Our Americas division took prompt action to address a spike in LTIs in its Engineering business unit, with a focus on injury prevention awareness.

We also made organisational changes across AMEAA, to create a single HSE delivery function supported by a centre of excellence that directs policy, systems, processes and reporting. Global Services identified fatigue as the root cause of some incidents at the start of the year. We issued global guidance on fatigue risk assessment and management to all divisions.

Objective 2 A major reportable incident rate of 57 per 100,000 employees, representing a 15% reduction against the 2012 baseline

The number of major reportable incidents fell by 45% to 33 in 2013, resulting in a rate of 33.4 per 100,000 employees. This was well below our target of 57 and the UK Health and Safety Executive Total Service Industries benchmark of 91.5.

One third of the major reportable incidents related to road traffic incidents in Global Services towards the beginning of 2013, which were addressed through the global guidance on fatigue discussed above. AMEAA has seen a significant reduction in major incidents as a result of our safety initiatives over the last 18 months. We also closely monitored major reportable incidents in our UK & Europe division, resulting in a continued reduction in the incident rate throughout 2013.

Objective 3 A physical assault rate of 528 per 100,000 employees, representing a 15% reduction against the 2012 baseline

No employee should be subjected to either physical or verbal abuse. The physical assault rate fell by 23% to 482 in 2013, beating our target by 9%.

The risk of physical assault is highest in our UK & Europe and AMEAA divisions, reflecting

the nature of some of their contracts including prisons and immigration work. AMEAA has reduced the potential for assaults through controls such as intelligence reports and surveillance, training our people in de-escalation and situational response, and a violence reduction strategy in our New Zealand justice and corrections business. UK & Europe has continued to raise awareness of reporting requirements and liaised with national HSE groups which focus on this topic. We continue to review and implement specific control measures across the contracts.

2014 objectives

For 2014, we have set the following health and safety targets:

- an 8.5% reduction in the LTI rate to 462
- to sustain a major reportable incident rate under 40, and
- a 4.6% reduction in the physical assault rate to 460

Community

Our communities are primarily the people who live and work around our contracts but our definition extends to include the third-sector organisations we partner with, to deliver a number of our contracts.

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

For 2013, we set the following objectives:

Objective 1 To continue to invest 1% of Adjusted pre-tax profits into wider society

We invested £2,575,029 into society, through donations of money, assets and time. This represented 1% of our Adjusted profit before tax.

The chart below shows the activities that made up this total:

Objective 2 To promote and support the Serco Foundation

2013 marked Serco's 25th anniversary as a listed company. In preparation for this milestone, we had established the Serco Foundation in the UK during the previous year.

Our employees voted for "children" to be the Foundation's cause for fundraising support. In response, the Foundation created the global "Every Child, Everywhere" initiative, a three-year commitment based on a belief that children everywhere deserve the best possible start in life.

During the year, the Foundation engaged our people and our communities to support nine child-related charities around the world. Some incredible individual and team achievements raised more than £400,000 for the chosen charities.

Working with our communities contributes directly to our business success and gives us a better understanding of their needs.

Corporate responsibility

Continued

Objective 3 To use the Serco25 campaign to encourage our people to raise money for charities

We wanted Serco25 to enable our employees to make a difference in our local communities, encouraging them to take part in numerous fundraising and other community events during 2013. These ranged from ultramarathons to volunteering days to helping communities affected by natural disasters.

To showcase their efforts, we created a dedicated website so our people could see what their colleagues around the world were doing. The site had 220,000 visits, 14,444 registrations and more than one million page views.

As part of the Serco25 campaign, our people not only raised over £400,000 for our nine child-related charities, but also raised more than £200,000 for other charities of their own choice.

2014 objectives

For 2014, we have set the following community objectives:

- to continue to invest 1% of Adjusted pre-tax profits into wider society
- to promote and support the Serco Foundation and
- to recognise exceptional contributions made by our people to the communities in which they live and work

Environment

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

Although Serco's activities are typically managed at a local level, we are united in our strategy of measuring our impact and reducing our environmental footprint. This supports many initiatives in our operations around the world. We also have contracts that help our customers to improve their environmental performance. For example, Serco provides environmental services to UK local authorities, which help our customers to reduce the volumes of waste sent to landfill sites.

For 2013, we set the following environmental objectives:

Objective 1 To reduce our carbon emissions headcount intensity rate by 3% to 1,967 tonnes of CO₂e equivalent (CO₂e) per 1,000 employees

During the year, we changed the basis on which we calculate our carbon emissions, in order to meet the UK's new regulations on greenhouse gas reporting. We adopted ISO 14064-1:2012 – *Specification with guidance at the organisation level for quantification and reporting of greenhouse gas emissions and removals*, which resulted in us collecting a far more comprehensive data set across all our operations globally.

The profile of our business has also changed. For example, 2013 included a full year of the Northlink Ferries contract, which we took over in July 2012, and DMS Maritime, which we took full ownership of towards the end of 2012. This had a significant impact on our emissions, as these two operations make up around one fifth of the Group's total.

As a result of these factors, our emissions performance for 2013 of 4.04 tonnes of CO₂e per full time equivalent (FTE) is not comparable

to previous years. We will therefore use 2013 as the baseline for future reporting.

We have calculated our emissions using a materiality threshold of 5%, meaning we are confident that our emissions are within 5% of the total stated. These calculations have been verified by Carbon Credentials, an independent sustainability services provider. More information on our greenhouse gas emissions can be found on pages 58 to 59. We have also published a detailed 'basis of reporting' document on our website www.serco.com.

We continue to contribute to the Carbon Disclosure Project. In 2013, Serco achieved a score of 92% (18th equal in the FTSE 350) placing us into the Carbon Disclosure Leadership Index.

Objective 2 Zero environmental prosecutions, fines and enforcement notices from our activities

We once again received no environmental prosecutions, fines and enforcement notices.

2014 objectives

For 2014, we have set the following environmental targets:

- to improve the materiality threshold of our greenhouse gas emissions reporting for all divisions to 5%
- to reduce our carbon emissions intensity (tonnes of CO₂e per FTE) by 3% and
- to agree targets for divisional environmental initiatives, so we can monitor their impact

Marketplace

Customers

Developing and improving long-term relationships with our customers is central to our business. The events of the last year have demonstrated that being clear and transparent with our customers is fundamental to maintaining trusting relationships. While day-to-day responsibility for meeting our customers' needs lies with our contract directors, our

2013 marked Serco's 25th anniversary as a listed company and we used our Serco25 campaign to enable our people to make a difference in our communities.

corporate renewal plan aims to increase the frequency and transparency of our customer engagement. This will help to ensure we identify and respond promptly to their concerns. We are also placing customer satisfaction at the core of our management reporting and incentive structures, so we are fully focused on ensuring our customers receive the high-quality services they deserve from us.

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

Our reputation with our existing customers is also vital to our success and to our prospects of future growth. Many factors influence our reputation, including:

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

Suppliers

Effective procurement helps us to achieve our vision and deliver high-quality service to customers. We aim to be professional in all our dealings with suppliers and to establish mutually beneficial relationships. We have a Procurement and Supply Chain function, which is responsible for putting this approach into practice. Each division has its own dedicated procurement business partner embedded within the divisional management team.

Our businesses have many common purchasing needs which we strive to fulfil with preferred suppliers, enabling us to achieve better terms and conditions and make the most of our scale.

Serco works with thousands of small and medium-sized (SME) suppliers and we continue to improve our interaction with them. Our Small Business Advisory Body in the UK is made up of representatives of SMEs from across the business. The Body guides us on our communications with and support to SMEs. In the US, we have a supplier mentor programme, which provides guidance to small businesses on key matters such as growing their businesses and creating budgets.

In June 2013, we launched a supplier code of conduct. This sets out the principles and standards we expect from those we work with to ensure we operate not just legally, but ethically and fairly.

Joint venture partners

Serco has many joint ventures with commercial partners and customers. Strong relationships, based on mutual trust and respect and clarity of roles, are essential ingredients if a joint venture is to deliver excellent customer service.

Our divisional management teams are responsible for relationships with our joint venture partners, supported by members of the Group Executive Committee and Board as appropriate. This includes holding regular strategy and review meetings with our partners.

Strategic partners

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

Our values and the open and honest way in which we work also make us an attractive partner for voluntary sector organisations, who often lack the scale and experience to access major government programmes. Responsibility for relationships with our strategic partners lies with the relevant contract and divisional management.

Serco provides environmental services to UK local authorities which help our customers to reduce the volumes of waste sent to landfill.

Greenhouse gas emissions

This section includes our mandatory reporting of greenhouse gas emissions, as required by Section 7 of the Companies Act 2006 (Strategic Report and Directors' Report) Regulations 2013 ("the Regulations")

Emissions from	Tonnes of CO ₂ e
Combustion of fuel and operation of facilities	187 217
Electricity heat steam and cooling purchased for our own use	211 302
– Emissions reported above, normalised to tonnes of CO ₂ e per FTE	4 04

Reporting year

Our reporting year for greenhouse gas emissions is one quarter behind our financial year, namely 1 October 2012 to 30 September 2013. We have established this reporting year to ensure that the emissions information we obtain from supplier invoices is complete.

Global greenhouse gas emissions data

For the period 1 October 2012 to 30 September 2013

Reporting boundary and responsibility

We report our emissions data using an operational control approach to defining our organisational boundary. This follows the greenhouse gas protocol and defines how we meet the Regulations' requirements in respect of the emissions we are responsible for.

We have reported all material emission sources for which we consider ourselves responsible and have set our materiality threshold at 5%. These sources align with where we consider we have operational control.

We do not have responsibility for any emission sources that are beyond our operational control. For example, business travel other than by vehicles under our control (including, for example, commercial air travel) is not within our operational control and, therefore, is not considered to be our direct responsibility.

We anticipate reporting accurate and verified scope 3 emissions data in the 2013-14 report.

Methodology

Serco quantifies and reports to ISO 14064-1:2012. We have used the Department for Environment, Food and Rural Affairs (DEFRA) 2013 conversion factors within our reporting methodology. We have also opted to use operational control as the consolidation approach, due to the nature of our business, with employees who are often on customer sites where no operational control is possible. As this approach is inconsistent with the financial statements, we have described the classification of reporting boundaries in detail in our Basis of Reporting document, which is available on our website, www.serco.com.

In some cases, we have estimated emissions based on similar facilities. This is done, for example, where our staff work on leased premises but have no access to actual consumption figures. In other cases, we have extrapolated total emissions by using available information from part of the reporting period and extending it to apply to the full reporting year. This has occurred where some information was

not recorded at the start of the reporting period and before the regulations came into force

The sum of all estimated emissions is below 3.15% of our global emissions, so we consider the potential error to be immaterial

Scope of reported emissions

We have reported emissions data for our operations in the following countries

Division	Country
AMEAA	Australia Bahrain Hong Kong India New Zealand UAE
Americas	USA Canada
Global Services	Australia India Ireland UK
UK & Europe	UK

The emissions that have not been included in this year's report relate to refrigerant gases from air conditioning and refrigeration outside the UK. After analysis, we believe these emissions are immaterial. However, we are implementing processes to capture such data for future reporting.

For countries where we have very limited operations, such as Djibouti, Dominican Republic and Virgin Islands, where we have fewer than ten employees, or where our staff work in facilities where we do not have operational control, we have undertaken a materiality assessment and consider that the related emissions are not material. Emissions from these operations are therefore excluded from our reported emissions.

While we have used a materiality threshold of 5%, we have reported emissions for a number of sites that fall below this threshold.

Intensity ratio

To express our annual reported emissions in relation to the scale of our activities, we have used full time equivalents (FTE) as our intensity ratio. This is the most relevant indication of our growth and provides the best comparative measure over time.

Emissions reported have been normalised to 4.04 tonnes CO₂e per FTE.

Baseline

The data for 2012-13 forms the baseline for subsequent periods. Although Serco has previously reported on emissions, it is not appropriate to use these reports as baseline years due to the differing methodologies used.

Reducing carbon and waste

Across more than two thirds of our business, we are working on our customers' premises and are therefore not in direct control of the environment in which we operate. That is why collaborative working with our customers

on environmental issues is important. Serco recognises its responsibility to ensure that any adverse impact on the environment is reduced, or where possible, eliminated by applying the most appropriate management systems at contract level – whether designed by our customers or by us.

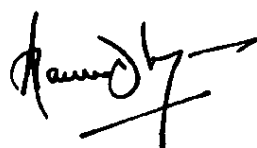
Where we are not in control of the working environment, we support our customers in applying their own environmental management systems and objectives.

Initiatives and progress

In line with our energy and environmental management targets, we have implemented a number of initiatives and made solid progress. Examples of current initiatives include:

- Introducing enhanced monthly reporting for divisional executive teams, to drive operational performance improvement across the business, in line with global and divisional targets.
- Developing a Strategic Energy Improvement Plan for 2014, which aims to reduce carbon emissions at our largest facilities. This approach is enhanced across our wider portfolio of facilities by real-time monitoring and tactical interventions where electricity and gas consumption is outside defined parameters.
- Developing a comprehensive employee engagement programme for 2014. This programme aims to ensure all employees are fully aware of their environmental responsibilities and the role they play in supporting the delivery of our energy and environmental management targets.

Our 2013 Strategic Report from page 2 to page 59, has been reviewed and approved by the Board of Directors on 3 March 2014.



Alastair Lyons CBE
Chairman

Corporate Governance Report

Chairman's Letter

Dear Shareholder

At Serco, we are committed to achieving high standards of corporate governance, integrity and business ethics in all our activities around the world. Governance is not an exercise in compliance nor is it a specific form of management. For Serco, our framework of governance is how we ensure the best interests of all our stakeholders – our customers, our employees, our shareholders, and the societies and communities of which we are a part – are uppermost in all our minds as we go about our business, and that where these interests are not directly aligned, we make decisions on the basis of what is right: this is an essential part of our public service ethos. During 2013, we found ourselves challenged at the heart of the way in which we do business. A number of individuals were found to be acting outside our values as epitomised by our Governing Principles and our framework of governance had not identified sufficiently clearly the root causes that had allowed this to happen. This challenged the trust in which we are held by our customers, our employees, and society at large. In response, the Company has designed and implemented a comprehensive programme of corporate renewal to ensure we respond appropriately to these root causes and put in place the actions, systems and processes to deliver stronger, more effective governance, organisational change and operational resilience across the Group.

In the following pages, we describe what we are doing in this programme of corporate renewal, and outline the work of the Board and the governance framework we have designed to meet the current needs of our businesses around the world. We also explain how we have applied the Main Principles of the UK Corporate Governance Code in the financial year. To illustrate how our governance arrangements work in practice, we have redesigned this Corporate Governance Report around the key elements of the Board's role: leadership, effectiveness, accountability and engaging with shareholders.

Board focus

In my Chairman's Statement I speak about the independent reviews of our culture and systems that we commissioned last year to understand the root causes of the issues that had arisen. It was these reviews that informed the design of our programme of corporate renewal, the key components of which are as follows:

- Commitment by our leadership throughout the business to 'do what is right' by always dealing with customers fairly and placing this above any other conflicting drivers for success
- Revising Serco's Code of Conduct, Values Statement and Governing Principles, backed up by training, induction and performance management
- Strengthening contract level governance, including improved contract bid processes to ensure appropriate levels of operational resource and the delivery of sustainable performance
- Enhancing transparency and access, with robust reporting of operational and financial contract KPIs, and greater engagement of customers at contract and departmental level
- Creating a separate division for our UK Central Government work to achieve both focus and openness for Government as a collective customer
- Developing our management system to include more prescriptive guidance on required operational processes and procedures, supported by strengthened risk management and internal audit processes and capabilities
- Appointing three additional Board Non-Executive Directors, one of whom will chair a new Corporate Responsibility Committee to formalise the process of guidance and decision making on ethical issues – more detail of this new Committee can be found on page 81
- Establishing formal Ethics Committees and Ethics Officers in each division, accompanied by the redesign of our whistle-blowing process to the highest international standards, and
- Measuring the progress of attitudinal change throughout the organisation with ongoing independent culture and ethics reviews

Our Board established a Committee of the Board (the Board Oversight Committee) to oversee the programme. The various reviews and audits undertaken by the UK Government were completed during the year and found no further evidence of wrongdoing or malpractice. Lord Gold was appointed as an independent third-party member of this Committee. The full and effective implementation of this programme is fundamental to our future success as a company that seeks to work in partnership with its customers around the world delivering services to taxpayers. It is management's top priority, something that will be appropriately reflected in the structure of management incentivisation. I am pleased to say that to date they are on plan to achieve their various milestones and that the plan to implement this programme has received a positive assessment by the Government Oversight Group, with the input of the independent advisers appointed by the UK Government who will continue to monitor the Company's implementation against the agreed milestones.

Going forward, through leadership, training and guidance, and appropriate incentivisation, we will change the balance of drivers within our business such that the commitment to do what is right and to deal with our customers fairly and transparently always transcends that sustained drive to succeed. This will be supported by the right management structures and controls and best-in-class lines of assurance to ensure that through early identification of risks and issues and their swift resolution we never again compromise on our values and ethics.

In summary, this plan seeks to ensure that never again does someone amongst our 120,000 people do the wrong thing because they do not want to fail to meet their commercial objectives. And if they do the wrong thing, we will have the controls in place to make sure the problem is identified at an early stage, acted on, and the lessons learned.

Despite the exceptional events of last year that required my and my colleagues' absolute focus and that dominated our agenda for the second half of 2013, the Board has continued its programme of meeting local management with the Board conducting some of its meetings at operational sites. A number of Board members also undertook tours of international sites to deepen Non-Executive Directors' understanding of the day to day activities of the business.

Board skills and diversity

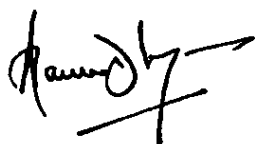
After 10 years service, David Richardson stood down from the Board at the Company's Annual General Meeting held on 15 May 2013. We are grateful to David for his contribution to the Company as both Senior Independent Director and Chairman of the Audit Committee. Malcolm Wyman, who joined the Board in January 2013, succeeded David in these roles. Malcolm's significant financial and international business experience makes him well placed to make a strong contribution.

In last year's report, I outlined our approach to Board diversity with particular reference to the Lord Davies of Abersoch's report 'Women on Boards,' and emphasised our commitment to boardroom diversity, of which gender is one of several aspects. We also stated an aim to achieve appropriate diversity across all elements of Serco's management. I am delighted that since I last wrote to you, in addition to Malcolm, we have secured the services of three new Non-Executive Directors, who bring a broad range of skills and experience to complement our current Board, and of whom two are female. Each has a great track-record in their particular field of expertise and will add much to the debate around our board table. More information on all members of the Board can be found on pages 62 to 64.

With these appointments, a third of the Board is female but these are all non-executive members. I believe there is an increasing recognition that the real issue is not Board composition but the balance of women in senior executive positions. It is this that will provide the opportunity for talented women to become directors, both executive and non-executive, and it is here that, in my view, we should be focusing. Within Serco we are, therefore, maintaining our focus on diversity across our management team. At present, 12.5% of our senior managers are female and we will be seeking to increase this over time.

Leadership and effectiveness

As you can see from the above there was considerable change during 2013 to our company and our Board. With the appointments announced today around half our directors will be new during 2014. Given this extent of change during, and the exceptional events of last year which in turn caused Board activity that was abnormal both in quantum and nature, I decided that it would not be constructive to undertake our normal annual internal review of Board effectiveness. I have mentioned above the reviews that we undertook during 2013 into our culture and systems of control. These extended to the Board and the Board discussed their findings which in turn has resulted in changes to our governance framework, including our Board composition.



Alastair Lyons CBE
Chairman

Compliance statement

Throughout the financial year ended 31 December 2013, Serco Group plc complied fully with all relevant provisions of the UK Corporate Governance Code (the Code) with the exception of membership of the Audit Committee as explained in the Audit Committee Report on pages 75 to 79 and undertaking a formal internal review of the effectiveness of the Board, its committees and individual members in accordance with Code B 6.1. The Code can be found on the Financial Reporting Council's website at frc.org.uk.

Corporate Governance Report

Meet the Board

Alastair Lyons CBE (60)

Role Chairman

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

Responsibilities Alastair is responsible for the effective operation of the Board and oversight of corporate governance. He is Chair of the Nomination Committee

Experience In his executive career Alastair was Group Finance Director and subsequently Chief Executive of the National & Provincial Building Society. When the society was acquired in 1996 by Abbey National, he joined the Abbey National main Board as Managing Director of its Insurance Division. In 1997 he became Chief Executive of the pensions specialist

NPI where he led its demutualisation and acquisition by AMP subsequent to which he joined NatWest in 1999 as Director of Corporate Projects. A chartered accountant with an MA in economics from Trinity College Cambridge, Alastair has been a non-executive director of, successively the Department for Work & Pensions and the Department for Transport

External appointments Alastair has been Chairman of Admiral Group plc, the direct motor insurer since 2000. In 2008 he was appointed deputy Chairman of Bovis Homes Group PLC, one of the UK's leading quoted house-builders. In February 2011 he was appointed Chairman of the Towergate Insurance Group. He retired in October 2013 from the role of Senior Independent Director and Audit Chair at the Phoenix Group

Edward J Casey, Jr (55)

Role Acting Group Chief Executive

Appointment Ed was appointed to the Board of Serco Group plc in October 2013

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

Experience Ed has been with the Company since 2005 and until recently was CEO of our Americas division. He is also part of the Executive Committee. Under Ed's leadership the Americas business tripled in size with US\$1.2bn of revenue and now has over 10,000 employees. Ed was responsible for the integration of SI International and RCI, two major acquisitions of the Company. Prior to this he spent a decade on Wall Street and a decade in the energy sector

External appointments None

Andrew Mark Jenner (45)

Role Group Chief Financial Officer

Appointment Andrew was appointed Group Chief Financial Officer in May 2002

Responsibilities Andrew is responsible for the Group's financial strategy and management including reporting, forecasting, treasury, tax and governance. He shares responsibility with the Chief Executive for our relationship with shareholders and the City

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

External appointments Andrew is a non-executive director of Galliford Try plc, one of the UK's leading construction and house-building groups and is Chair of its Audit Committee

Mike Clasper (60)
Role Non-Executive Director

Appointment Mike joined Serco as a Non-Executive Director in March 2014

Responsibilities Mike is a member of the Corporate Responsibility, Audit and Nomination Committees

Experience Mike was previously the Group Chief Executive of BAA plc from 2003 to 2006 and Chairman of Her Majesty's Revenue and Customs from 2008 to 2012. Mike was previously the Senior Independent Director at ITV PLC from which he stepped down on 31 December 2013 after eight years on the ITV Board

External appointments Mike is currently Chairman of Coats plc and Which? Limited and is a non-executive director of Guinness Peat Group plc. Mike has also been appointed President Elect of the Chartered Management Institute (CMI) where he will succeed the current President in October 2014

Ralph D Crosby, Jr (66)
Role Non-Executive Director

Appointment Ralph joined Serco as a Non-Executive Director in June 2011

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

the Graduate Institute of International Studies, Switzerland, and a BSc from the United States Military Academy at West Point, NY

External appointments Ralph is a non-executive director of American Electric Power Co. Inc. and Airbus Group NV

Tamara Ingram (53)
Role Non-Executive Director

Appointment Tamara joined Serco as a Non-Executive Director in March 2014

Responsibilities Tamara is a member of the Corporate Responsibility and Remuneration Committees

Experience Tamara is currently a Trustee of Save the Children (UK). In 2013 she stepped down after completing nine years as a non-executive director of The Sage Group plc. Previously, Tamara chaired the Board of Visit London (formerly the London Tourist Board) from 2001 to 2011

External appointments Tamara is Executive Vice President at WPP, where she is Managing Director at Grey Group and CEO, Team P&G

Rachel Lomax (68)
Role Non-Executive Director

Appointment Rachel joined Serco as a Non-Executive Director in March 2014

Responsibilities Rachel is Chair of the Corporate Responsibility Committee and a member of the Audit Committee

Experience Rachel was Deputy Governor of the Bank of England from 2003 to 2008 and has been Permanent Secretary at both the Department for Transport and the Department for Work and Pensions

External appointments Rachel is currently a non-executive director of HSBC Holdings plc where she is also Chair of the Conduct & Values Committee. Rachel is also a non-executive director at The Scottish American Investment Company PLC and Heathrow Airport Holdings Limited

Corporate Governance Report

Meet the Board

Angie Risley (55)

Role Non-Executive Director

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

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

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

Previously Angie was Group Human Resources Director of Lloyds Banking Group plc, serving as a member of the Lloyds Banking Group Executive Committee

with responsibility for developing group-wide people practices. Until May 2007 she was an executive director of Whitbread PLC having joined the Whitbread Group in 1989. She has also been a member of the Low Pay Commission, and a non-executive director of Biffa plc and Arriva plc

External appointments Angie is Group Human Resources Director of J Sainsbury plc

Malcolm Wyman (67)

Role Non-Executive Director

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

Responsibilities Malcolm is Senior Independent Director and Chair of the Audit Committee. He is also a member of the Remuneration and Nomination Committees

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

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

Gender Diversity

Male	6
Female	3

Board Tenure

1 < One year	4
2 One and three years	3
3 > Three years	2

Our governance framework

Our governance structure has been developed over several years to meet the increasing span and complexity of our businesses. We have clearly defined roles and responsibilities at Board level and below it, to seek to ensure that decisions throughout the organisation are soundly based and risks are appropriately controlled and monitored.

At a glance

Board

Audit Committee	Nomination Committee	Remuneration Committee	Corporate Responsibility Committee	Approvals and Allotments Committee
Pages 75 to 79	Page 80	Pages 82 to 105	Page 81	Page 67

Executive Management

Group Chief Executive

Executive Committee

Composition
Group Chief Executive
Group Chief Financial Officer
Divisional Chief Executives
Group Functional Heads

Sub-Committees
Executive Remuneration
Group Risk Management and Safety
Investments and Ethics
Nomination

Divisional Chief Executives

Divisional Boards

Composition
Divisional Chief Executives
Divisional Finance Directors
Senior Independent (Internal)

Sub-Committees
Audit and Risk
Operating & Financial Review
Remuneration
Ethics

The role of the Board

The Board drives the development and performance of the Group to deliver sustainable shareholder value over the long term, by setting the entrepreneurial and governance framework that supports the achievement of the Group's strategic objectives within an acceptable risk profile. It is responsible for setting the Group's ethical compass and its risk appetite, balancing risks and reward in the interests of shareholders having regard to the implications for other stakeholders, in particular customers and employees, and for achieving the Group's commercial potential, whilst effectively addressing the Group's weaknesses. It is responsible for oversight and review of the way in which the Group does business, of the Group's performance in meeting its commitments to customers, shareholders, and its employees, of the contribution of the Group's executive management, of the Group's principal risks, and of its internal control and risk management processes.

Serco's business culture and standards of conduct are established and monitored by the Board to ensure that the Group's goals are achieved in a manner that also benefits society as a whole. The Corporate Responsibility Report is available online at www.serco.com and illustrates how Serco's approach to corporate assurance and responsibility translates from the Board into everyday working practices.

Chairman and Group Chief Executive

The roles of the Chairman and the Group Chief Executive are separately held and the division of their responsibilities is clearly established, set out in writing, and agreed by the Board. The Chairman leads the Board and ensures that it operates effectively and the Group Chief Executive has primary responsibility for the development and delivery of strategy and the operational performance of the Group. This separation of the two central board roles safeguards plurality and a balance of viewpoints on the Board, which promotes better decision-making.

Senior Independent Director

This role is set out under written terms available on the Company's website www.serco.com. The Senior Independent Director provides an alternative point of contact to the Chairman, both for shareholders and other directors, should the need arise. The role would also deputise for the Chairman should the need arise.

Corporate Governance Report

Non-Executive Directors

Although the Chairman and Non-Executive Directors do not carry any executive responsibilities, together with the Executive Directors they are collectively responsible for the Company's direction. In particular, Non-Executive Directors apply their skills, experience and independent judgement to constructively challenge and contribute to the development of the Group's strategy and business plans, and to hold management to account for Group performance.

Company Secretary and independent advice

The Company Secretary is responsible for advising the Board on all corporate governance matters, assisting the Chairman in ensuring that all Board procedures are followed and that there are good information flows, together with facilitating induction programmes for newly appointed directors. All directors have access to the advice and services of the Company Secretary.

The Board has approved a procedure for directors to take independent professional advice, if necessary, at the Company's expense.

Key Roles and Responsibilities

Chairman

Leads the Board and ensures that it is effective in all aspects of its role

- Takes a leading role in determining the structure and composition of the Board, and its capabilities
- Manages the business of the Board, ensuring that it facilitates the Board to fulfil its role and function and, in doing so, ensuring that:
 - the directors receive timely, accurate, concise and clear information, and
 - the Board invests sufficient time on each matter for effective consideration and decision-making, in keeping with the relative importance of each matter and especially for complex or strategically important issues
- Provides appropriate counsel and support to the Group Chief Executive whilst respecting executive responsibility
- Takes a leading role in the development and succession needs of the Board and the effective performance of each director, including:
 - promoting the effective contribution of the non-executive directors
 - ensuring that new directors receive an effective induction, and
 - assisting directors in determining individual training needs and ensuring that they update as appropriate their knowledge and capabilities
- Takes a leading role in the performance evaluation of the Board and its Committees
- Promotes the highest standards of corporate governance
- Ensures that the Board has effective channels of communication with shareholders and that the views of principal shareholders on significant matters are taken into account

Senior Independent Director

- Acts as a sounding board for the Chairman and assists him in the delivery of his objectives as requested
- Provides an alternative point of contact for principal shareholders if they have any concerns that are unresolved through normal channels of communication
- Seeks to maintain a balanced understanding of the views and concerns of principal shareholders
- Takes a leading role in the performance evaluation of the Chairman
- Should it become necessary, leads an orderly succession process for the Chairman
- In the unlikely event that there is a serious failure in Board governance, or where normal Board functioning is seriously impaired or the Chairman is unable to act:
 - will act as an intermediary where necessary,
 - will intervene to resolve the issues and restore the Board to effective functioning

Group Chief Executive

Leads the business to develop and deliver the Group's strategy and business plans as agreed with the Board

- Provides inspirational leadership across the Group, setting the tone from the top to promote the Company's values and the highest ethical behaviour by all employees
- Develops, motivates and retains a strong, professional and internationally-minded senior management team capable of meeting the challenges associated with the Company's long-term growth strategy
- Identifies strategic opportunities to enable the Group to grow and differentiate itself, and agrees with the Board a roadmap to realising those opportunities
- Accountable for the Group's performance and operational management, including its:
 - operational governance
 - ethical compass
 - profitability,
 - competitive market position, and
 - risk management and internal control systems
- Maintains a close relationship of trust with the Chairman, seeking appropriate counsel and support whilst preserving executive responsibility
- Leads the executive team, setting a personal example, building team spirit, ensuring clear lines of communication, developing individual and team capabilities, and ensuring that robust succession planning processes are in place
- Acts as an effective ambassador for the Group, developing and maintaining strong relationships with current and potential customers, and key stakeholders
- Proactively promotes the Group's investment case to investors and listens to the views of major shareholders on key issues affecting the Group
- Communicates both internally and externally the Group's culture and values, key strategic imperatives and performance of the business, ensuring that a clear sense of purpose is conveyed

Non-Executive Directors

- Constructively challenge and contribute to the development of the Group's strategy and business plans
- Ensure that the Group upholds high standards of integrity and probity with appropriate oversight over the effective embedding of the agreed culture, values and ethical compass
- Maintain effective oversight and review of the Group's performance against agreed goals and objectives, and of the performance of the executive management
- Maintain an effective understanding and oversight of the Group's principal risks
- Satisfy themselves as to:
 - the integrity of the financial statements and all other formal announcements
 - whether, taken as a whole, the annual report and accounts is fair, balanced and understandable
 - whether the Group's risk management and internal control processes, including those relating to the financial reporting process, are robust and defensible, and
 - whether the Board has robustly assessed the solvency and liquidity risks faced by the Group
- Taking primary roles in:
 - appointing and, if necessary, removing Executive Directors, and in Board succession planning,
 - the Board's determination of remuneration policy for the Chairman, the Executive Directors, the Executive Committee members and the Company Secretary

Conflicts of interest

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

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

How the Board operates

The Board and its Committees

Currently the Board has nine members: the Chairman, two Executive Directors and six Non-Executive Directors. The Board organises itself with clear divisions of responsibility so that no individual or group of individuals has unfettered powers of decision-making. Whilst each constituent of the Board carries out distinct but complementary roles and responsibilities, collectively all directors work for the long-term success of the Company.

Many key board responsibilities are referred to four standing board committees: the Audit, Nomination, Remuneration and Corporate Responsibility Committees. This structure is recommended under the Code as best practice for UK quoted companies and allows particularly detailed or complex matters to be given special scrutiny and oversight. The Board has a fifth committee, the Approvals and Allotments Committee, which comprises the Executive Directors and the Company Secretary, which meets on an ad hoc basis to approve proposals that have more operational significance but do not merit full Board consideration. Except where decisions are specifically delegated, each committee reports and submits recommendations back to the Board for its review and, where necessary, decision. Each committee operates within clearly defined terms of reference, which are reviewed annually by the respective committees and, if necessary, approved by the Board, to ensure they remain appropriate and reflect any changes in good practice and governance. These are available online at www.serco.com.

Committees are authorised to obtain outside legal or other independent professional advice if they consider it necessary.

The Board and the four standing committees meet with sufficient frequency to fulfil their respective responsibilities, using structured but flexible agendas to ensure that regular matters are addressed properly, while allowing time to discuss significant new issues. More information on the work and performance of the Board can be found in the following pages. Separate reports describing the activities of the Audit, Nomination, Corporate Responsibility and Remuneration Committees are presented on pages 75 to 81.

Conduct of meetings

Board meetings are scheduled six times a year, of which two are held over three days at a time, two over two days and two meetings are held for one day each. The directors receive meeting packs in paper and electronic form ahead of each meeting. Board meetings are structured to allow open discussion of the strategy and trading and financial performance of the Group. To facilitate a proper understanding of the Group's businesses, Board and Committee meetings are held at varying locations and the opportunity is used to combine the formal business of the Board with site visits and divisional presentations and discussions. Additional Board meetings are held as required.

Board decisions are usually taken by consensus. Exceptionally, if a decision is to be taken by vote, the Chairman does not have a second or casting vote.

Reserved matters

There is a formal schedule of matters reserved to the Board. This schedule, which is reviewed annually, includes approval of

- The Group strategy
- Annual financial and operating plans
- Major capital expenditure, acquisitions or divestments
- Annual and half-year financial results and satisfying itself as to the integrity of financial information
- The Company's dividend policy
- Ensuring there are adequate succession plans for the Board and senior management
- Appointing and removing directors, the Company Secretary and committee members
- Setting and reviewing risk management and treasury policies
- Setting levels of operational delegated authorities
- Agreeing the Group's culture, values, and ethical compass
- Reviewing the Group's overall governance arrangements, and
- Reviewing the effectiveness of the Group's system of internal control and risk management processes

Other specific responsibilities are delegated to Board Committees which operate within clearly defined terms of reference. Details of the responsibilities delegated to the Committees are given on pages 75 to 81. Each Committee has an appropriate balance of skills, experience, independence and knowledge of the Group.

Corporate Governance Report

The work of the Board

At each Board meeting, the Group Chief Executive presents a comprehensive update on the strategy and business issues across the Group together with an update on transformation and portfolio management activity. The Group Chief Financial Officer presents a detailed analysis of the financial performance, both at Group and divisional levels. Senior executives below Board level attend relevant parts of the Board meetings in order to inform the Board of developments and activities in their areas of responsibility. This provides the Board with access to a broader group of executives and helps Directors make assessments of the Group's emerging talent as succession to senior management roles – this was an agreed action arising from the 2012 Board evaluation. During the year, the Board held some of its meetings at divisional locations and conducted in depth reviews of operations and strategy as well as gaining more presence and visibility amongst management and staff. Individual Board members also conducted several visits to contract sites in the UK and internationally.

At its meetings during the year the Board discharged its responsibilities and, in particular, reviewed the following areas. In addition the Board gave specific focus to the issues that arose in 2013 in relation to certain of its contracts with the UK Government, reviewing their root causes and agreeing the resulting programme of corporate renewal and the restoration of the Group's relationship with government.

Strategy and transformation	The Group and divisional corporate strategies, transformation plans, portfolio management and the Group's health and safety strategy
Investor relations	Investor feedback and analyst meetings following the release of the full year 2012 and half year 2013 annual results
Business performance	The operational performance of each of the divisional businesses, and periodic updates presented by the divisional management teams
Governance	Review of the Group's Treasury policy, risk appetite, work undertaken with regard to the corporate renewal programme referred to above and in particular forming the Corporate Responsibility Committee of the Board and the recruitment of three Non-Executive Directors
Financial and risk management	The Group's business plans, presentations on the Group risk register and significant areas of risk
Diversity, talent and succession	Presentation from Group Human Resources and Talent Directors on talent management and development across the Group

Board effectiveness

Balance

To be effective, the Board must understand the dynamics of Serco's rich mix of complex businesses across its many diverse markets, including the issues and factors upon which sustained success depends. A balance of experience, skills and viewpoints within the Board promotes overall Board effectiveness and enhances Company performance in the long term. The directors are drawn from different backgrounds and industries, and each has extensive experience of other international businesses in sectors that help inform and augment Board debate.

Induction, training and ongoing development

On joining the Board, each director receives a personalised induction programme including:

- An overview of the Group's businesses, risks, governance arrangements and relations with investors
- Structured meetings with a range of relevant senior managers from across the Group
- Meetings with key advisors and shareholders as appropriate to the director's role
- Site visits to gain first-hand insight into operational contracts with major customers

Legal and regulatory updates are essential for good governance, to ensure that directors understand the operational environment of the business. The Board and Committee meetings incorporate briefings periodically on changes to the business, legislative and regulatory environment, and on other relevant topics, such as changes to the corporate and remuneration reporting landscape in 2013.

As part of its annual evaluation process, the Board considers the training needs of the directors and the Company Secretary. Development needs fall within the remit of the Chairman, who reviews and agrees these with each individual. All Board members are encouraged to attend relevant external training courses at the Company's expense. More information on Board evaluation can be found on page 69. An induction programme for Malcolm Wyman was successfully completed on his appointment and a programme for Mike Clasper, Tamara Ingram and Rachel Lomax, who joined the Board on 3 March 2014, is already underway and includes site visits and meetings with senior executives of, and advisers to, the Group. The Chairman continues to undertake an extensive programme of contract visits.

Board independence

The Board considers all of the Non-Executive Directors to be independent. In coming to this conclusion, it has determined that each Non-Executive Director is independent in character and judgement and there are no relationships or circumstances that are likely to affect, or could appear to affect, the directors' judgements. In particular, they are independent of management and have no cross-directorships or significant links that could materially interfere with the exercise of their independent judgement.

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

All Non-Executive Directors are appointed for an initial term of three years. Thereafter, subject to satisfactory performance, they may serve one or two additional three-year terms.

The Board considered the Chairman to be independent on his appointment in 2010. The Nomination Committee keeps the Board's diversity, balance and independence under review, the details of which can be found on page 80.

The terms and conditions of the appointment of the directors are summarised in the Directors' Remuneration Report on page 93 and are available on request from the Company Secretary.

Re-election of directors

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

Notwithstanding the above, in accordance with provisions contained within the UK Corporate Governance Code, all directors retired and stood for re-election at the 2013 Annual General Meeting and will do so on an annual basis at each annual general meeting. Their names are set out in the Notice of Annual General Meeting.

Time commitment and external directorships

As part of the Board evaluation process, the available time and commitment of each director is considered. The Board considers that the Executive Directors can gain valuable experience and knowledge through appropriate and limited non-executive appointments in other listed companies or independent sector organisations. The Board is careful to ensure that any such appointments do not present any material conflicts of interest to Serco or compromise the effective management of the Group, and these are approved in advance of any appointments being taken up. Details of the fees received by executive directors for external appointments can be found in the Remuneration Report on page 102.

Alastair Lyons is non-executive Chairman of Admiral Group plc and of the Towergate Insurance Group and Deputy Chairman of Bovis Homes Group PLC.

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

Board attendance

Board meetings were held on a bi-monthly basis with ad hoc meetings in between as required. The frequency and content of Board meetings are reviewed by the Board annually.

The attendance of the individual Directors at Board and Committee meetings of which they were members during 2013 was as follows:

	Board	Audit	Remuneration	Nomination	Corporate Responsibility
No. Held	6	3	11	5	0
Alastair Lyons	6	2/3	9/11	5	–
Christopher Hyman	5(5)	n/a	n/a	–	n/a
Andrew Jenner	6	3	n/a	n/a	n/a
Edward J. Casey, Jr	1/(1)	n/a	n/a	–	–
David Richardson	2/(2)	1/(1)	5/(5)	2/(2)	n/a
Angie Risley	6	3	11	5	n/a
Ralph D. Crosby Jr	6	n/a	n/a	n/a	n/a
Malcolm Wyman	6	3	11	5	n/a

Notes

- 1 The table excludes attendances of directors who attended committee meetings by invitation only.
- 2 Where a number is given in brackets against a director's attendance, this is the number of meetings which took place during their tenure.
- 3 The Corporate Responsibility Committee was designed during 2013 but not formally constituted until 2014.
- 4 As well as meetings detailed above, 14 additional Board meetings were held during the year, to discuss issues highlighted on the previous pages principally around the Corporate Renewal Programme.

Performance evaluation

This year the Board did not undertake a formal internal review of the effectiveness of the Board, its committees and individual members and did not, therefore, comply with Code B 6.1. The Board last carried out an externally facilitated review with CTMC&A Limited in 2011. CTMC&A Limited has no connection with Serco other than facilitating Board-level performance evaluations. In line with the Code, the next external review will take place in 2014.

In addition, an evaluation of the Chairman's performance led by the Senior Independent Director (taking into account the views of both the non-executive and executive directors) was carried out during the year. It is considered that the Chairman continues to provide strong leadership of the Board, and there is a good level of trust between him and the Acting Group Chief Executive. The Chairman's commitment to contract and site visits, and the value derived from these by the business, was also acknowledged. His very well informed view of the Group's operations also enables him to provide a strong sounding board for the executive directors.

Corporate Governance Report

Financial reporting process

The Company has a thorough assurance process in place in respect of the preparation, verification and approval of periodic financial statements. The process includes:

- The involvement of qualified, professional employees with an appropriate level of experience in Group Finance and across the divisions
- Formal sign-offs from divisional Chief Executive Officers and Finance Directors
- Comprehensive review and, where appropriate, challenge from key internal Group functions
- A transparent process to ensure full disclosure of information to the external auditors. Engagement of a professional and experienced firm of external auditors
- Oversight of the Audit Committee, involving amongst other duties:
 - A detailed review of key financial reporting judgements which have been discussed by management
 - Review and, where appropriate, challenge on matters including the consistency of, and any changes to, significant accounting policies and practices during the year, significant adjustments resulting from an external audit, the going concern assumption, and the Company's statement on internal control systems, prior to endorsement by the Board

The above process and the review by the Audit Committee of a comprehensive note from management that sets out the details of the preparation, internal verification and approval process for the Annual Report and Accounts, provides comfort to the Board that the Group has undertaken an appropriate process to include the necessary information for it to consider 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 Company's performance, business model and strategy.

During the year, as part of our programme of corporate renewal, the reporting lines of divisional and business unit finance executives were changed such that these now have a direct reporting relationship to the Group Chief Financial Officer whilst also remaining a part of the divisional and business unit management teams.

Managing business risks and internal control

Serco has a system of internal control, including financial, operational and compliance controls and risk management, designed to safeguard shareholders' investments, our assets and our reputation. The various reviews and audits undertaken by the UK Government which were completed during the year found no further evidence of wrongdoing or malpractice.

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

Risk management is fundamental to how we manage the business, it informs decision making and aligns to the organisation's strategic objectives. The systems and processes we have developed to identify and manage the key risks facing each of our businesses and the Group as a whole and the resources that are committed to risk management, were reviewed during the year as part of the corporate renewal programme and a series of actions identified to further develop and strengthen our structure of internal control and risk management having regard to the breadth and depth of the Group's activities. All parts of the business have appropriate crisis management plans that meet defined policy standards.

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

Our risk management policies, systems and processes align to the guidance contained within the UK Corporate Governance Code and form part of the Serco Management System (SMS).

Such systems and processes, however, can only be designed to mitigate, rather than eliminate the risk of failure to achieve business objectives, and can only provide reasonable and not absolute assurance against misstatement or loss. The Board confirms that this process has been in place for the year under review and up to the date of approval of the 2013 Annual Report and Accounts.

Our approach to risk within the Serco Management System

The Serco Management System (SMS) sets out policy standards, systems and processes that identify, review and report risks at all levels of our business and in the Group as a whole, that impact upon strategic objectives, with the aim of safeguarding our shareholders' investments, the Group's assets and its reputation. At each level within our business, risk management processes reflect the nature of the activities being undertaken and the business and operational risks inherent in them, and therefore the level of control considered necessary to protect our interests and those of our stakeholders.

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

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

Risk identification

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

Once identified, we document risks in risk registers, which are maintained at contract, programme, business unit, divisional and Group levels. These risk registers change as new risks emerge and existing risks diminish, so that the registers reflect the current threats to the relevant strategic objectives. We review the Group and Divisional Risk Registers at least quarterly and more frequently as required. The GRMSC reviews the Group Risk Register quarterly ahead of formal review by the Corporate Responsibility Committee.

Risk assessment

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

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

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

Risk planning and control

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

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

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

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

Risk monitoring

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

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

Managing and mitigating risk

The objective of our risk management process is to provide a governance overview of our operational risk profile. Operational risk can never be eliminated; risks are necessary to achieve targeted benefits (risk management informs decisions). However, while risk is necessary, we seek to minimise the probability and impact of threats through the consistent implementation of the SMS, ensuring that appropriate infrastructure, controls, systems, staff and processes are in place. A comprehensive review of the SMS forms part of the corporate renewal programme in order to address those areas identified by the 2013 independent review of systems and controls as having contributed to the issues that arose last year on contracts with the UK Government.

Corporate Governance Report

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

- Our operating processes reflect the principles of clear delegation of authority and segregation of duties
- The GRMSC meets quarterly to ensure that risks, internal control and business assurance are effectively managed and reviewed
- Our processes of business review are intended to ensure that we meet customer expectations, regulatory requirements and performance criteria, including operational effectiveness, investment returns, cash flow requirements and profitability. The effectiveness of these processes has been the subject of particular focus as part of our programme of corporate renewal
- The business recognises the importance of relevant key performance indicators to provide an analysis of business performance and variances from plan, occupational health and safety incidents, and error and exception reporting
- Selective recruitment, succession planning and other human resource policies and practices ensure that staff skills are aligned with Serco's current and future needs
- We maintain insurance policies against losses arising from circumstances such as damage or destruction of physical assets, theft, legal liability for third-party loss and professional advice
- We review the adequacy of our insurance cover at regular intervals
- The Investment and Ethics Committee meets regularly to ensure appropriate governance and the management of risk associated with larger or higher risk bids, acquisitions, disposals and areas of significant capital expenditure
- We apply robust project management and change implementation disciplines to all major projects, including new contract transitions, acquisitions, new technology applications, change programmes and other major initiatives
- The Strategic Report describes our approach to health, safety and environmental protection. Qualified and experienced staff in each business unit provide advice and support on health, safety and environmental issues and undertake regular audits
- We have safety specialists in our aviation, rail, defence, nuclear and marine businesses that report to the Board, and maintain and further develop the very high standards expected in these industries
- A Chief Information Officer is responsible for ensuring that systems and processes are in place to ensure the confidentiality, integrity and availability of sensitive information and the associated information systems that support our business activities
- Our Corporate Responsibility Committee has responsibility for the review of ethical issues that may arise from our current and future activities
- The Company Secretary manages a confidential reporting service, to which staff can report illegal, dangerous, dishonest or unethical activities
- We have crisis and business continuity plans in place to manage crisis events, both within Divisions and the Group
- All Divisional Chief Executives are required to self-certify their Division's compliance to the SMS at half and end-of-year points
- As mandated by the SMS, throughout the business lifecycle of all our bids and contracts independent reviews (such as Black Hats and Gate Reviews) are required to provide an appropriate standard of assurance and governance across the business

Group risk function

The Group risk function forms part of the overall risk management process. While line managers are responsible for identifying and managing all risks within their risk appetite and tolerance limits, in line with the policies and standards set within the SMS, the Group risk function (reporting to the Director Risk and Acquisitions) is responsible for the development and implementation of risk management policy, strategy and governance. In addition to this, the function provides assurance over the business providing risk management oversight, assurance and challenge as well as managing the Serco Group overall risk profile.

Internal audit

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

During 2013, there was a change in administrative reporting lines of the Group Head of Internal Audit from the Group Chief Financial Officer to the Group Chief Executive. Functionally, the Group Head of Internal Audit reports to the Chair of the Audit Committee and is responsible for delivery of the internal audit programme, ensuring that it is risk-based and aligned with the overall strategy of the Group. Internal audit is delivered at Group and divisional levels, using a mix of co-sourced and in-house resources, with each division operating an Audit and Risk Committee which reviews the results of relevant internal audits three times a year. The findings of the overall internal audit programme are reported directly to the Board's Audit Committee. The effectiveness and resourcing of our internal audit capability has been specifically reviewed as part of our programme of corporate renewal.

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

Management assurance

Management assurance is part of the business assurance process. Each division is required to carry out a programme of management assurance to provide comfort that the division is managing its risks effectively and in compliance with the SMS. The results of the programme are reviewed by the divisional Audit and Risk Committees.

Business conduct

Serco Group operates within a management system that defines the policies, standards and processes to be applied wherever we operate. Integral to this is our policy on Business Conduct and Ethics that applies to all business divisions, operating companies and business units throughout the world. This policy outlines the Group's position on a wide range of ethical and legal issues including conflicts of interest, financial inducements, human rights and legal and regulatory compliance. It applies to directors and to all employees regardless of their position or location. Recognising that ethical dilemmas may arise in a growing company, the Group has an ethics consultation process that is to be followed to determine the Group's position on particular issues. To support this process the Investment and Ethics Committee, comprising members of the Executive Team with a quorum of three and chaired by the Director, Risk and Acquisitions, meets as required. As the leadership of the Company, the Executive Team will make judgements about what it considers acceptable.

Under the Corporate Renewal Programme we have established the Corporate Responsibility Committee of the Board to take the lead in determining the Group's ethical compass, supported by the creation of formal Ethics Committees and the appointment of Ethics Officers in each division. We have also redesigned our whistle-blowing process, with input from the Institute of Business Ethics, to benchmark against the highest international standards.

Serco's outsourced Ethics Hotline operated throughout the year, which enabled employees to report any concerns, or report any wrongdoing, that they did not feel able to raise with their line manager, human resources colleagues or through other reporting channels. In addition to the Hotline, which is available 24 hours a day toll-free worldwide in several languages, employees can also make reports via email or the internet. The Company Secretary independently investigates, with external specialist support where required, any issues raised and reports back to the Audit Committee and, as appropriate, the Board.

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

The Board confirms that the actions it considers necessary are being taken to remedy the failings and weaknesses which it has determined to be significant from its review of the internal controls across the Group.

Going concern

The Directors have acknowledged the guidance 'Going Concern and Liquidity Risk: Guidance for Directors of UK Companies 2009' and 'An update for Directors of Listed Companies: Responding to increased country and currency risk in financial reports', published by the Financial Reporting Council in October 2009 and January 2012 respectively. This is discussed in the Finance Review starting on page 42.

Corporate Governance Report

How we engage with shareholders

Serco uses a variety of means to gain insight into the views of shareholders and other stakeholders, and the Board is regularly briefed on the feedback received through these engagement channels

Primary responsibility for engaging with shareholders rests with the Chairman, Group Chief Executive and Group Chief Financial Officer. In addition, the Senior Independent Director is available to shareholders should these normal communication channels fail to resolve an issue, or are inappropriate for any reason.

We have formal arrangements for engaging with shareholders, including those described below.

Investor meetings

The Executive Directors and the Investor Relations team regularly meet with analysts and major investors to maintain effective dialogue. The Chairman also offers to meet with the Company's largest institutional investors each year.

The Board reviews an investor relations report each quarter. This highlights share price movements, changes in the share register, the Company's recent and planned investor relations activities, analyst recommendations, and significant news from the market and the support services sector. This report significantly contributes to the Board's understanding of investors' views.

Annual General Meetings (AGMs)

The AGM provides an opportunity to communicate with all shareholders, especially our private shareholders. Individual shareholders have the opportunity to question the Chairman and, through him, the Chairs of the various Board committees and other directors. The Notice of Meeting sets out the resolutions being proposed at the AGM to be held on 8 May 2014. It is the Company's policy at present to take all resolutions at a general meeting on a poll. A poll reflects the number of voting rights exercisable by each member and is considered by the Board to be a more democratic method of voting. Shareholders are advised of the total number of votes lodged for each resolution, in the categories "for" and "against" together with the number of "votes withheld". This information is also posted on the Group's website www.serco.com.

Formal consultations

When a material change in remuneration policy is being considered, the Chairman of the Remuneration Committee consults with major investors and seeks their views. From time to time, we seek the views of major shareholders on other Company proposals.

Direct communications initiated by shareholders and representative bodies

From time to time, we receive enquiries and circulars directly from major shareholders and representative bodies, such as the Association of British Insurers, the National Association of Pension Funds and Pensions Investment Research Consultants. We also review the various environmental, social and governance reports published about us annually and consider whether any changes are needed to respond to any specific comments.

External advisors

Legal, financial, remuneration and communications advisors gain insights into shareholder attitudes in the course of conducting specific research or through their work with other clients. Relevant insights are shared when the Board or its Committees are considering important issues and external advice has been sought.

Corporate website

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

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



John Hickey
Secretary
3 March 2014

Audit Committee Report

Annual statement by the Chairman of the Audit Committee

During the year, the Audit Committee continued with the provision of its effective governance over the appropriateness of the Group's financial reporting, adequacy of related disclosures, effectiveness of the internal control systems, and overseeing the external and internal audit functions. A number of reviews into certain contracts with Government departments were undertaken by the Cabinet Office and the Ministry of Justice as mentioned on pages 2 to 4. The Committee has devoted significant time to monitoring and reviewing the process and outcome of these reviews as well as engaging regularly with management, Internal Audit and the external auditors.

Membership and meetings

The Audit Committee consists solely of independent Non-Executive Directors.

The Committee welcomed the appointments of Mike Clasper and Rachel Lomax to the Committee from March 2014 and the broad range of skills and experience they bring to complement the current Committee. In addition to Mike and Rachel, the Committee now comprises of Malcolm Wyman, who chairs the Committee, and Angie Risley. Following the sad and untimely passing of Paul Brooks, a Non-Executive director, in January 2012, membership of the Committee had been reduced below the level required by the Code. The Board considered it appropriate to pend increasing the membership of the Committee until new Non-Executive directors, with the right balance of skills were appointed to the Board and this has now been addressed. The Company Chairman, who is himself a qualified accountant and an Audit Committee chairman, attended the majority of meetings in the year and the Board considers that appropriate representation was maintained as a consequence.

Malcolm Wyman, who joined the Committee on his appointment to the Board on 1 January 2013, took over as Chairman of the Committee on the retirement of David Richardson at the close of the Company's 2013 Annual General Meeting and has recent and relevant financial experience. The Audit Committee met three times during the year. At the invitation of the Committee, the Group Chief Financial Officer, the Group Head of Internal Audit, KPMG LLP (the Group's internal audit providers) and Deloitte LLP (the external auditors) attend meetings. The Committee meets with each of KPMG LLP the external auditors and the Group Head of Internal Audit separately at least once a year. The minutes of the Audit Committee meetings are circulated to all directors.

Responsibilities of the Audit Committee

The Board has delegated to the Committee responsibility for assisting the Board in maintaining the integrity of the Company's financial information and ensuring that the internal controls are robust and defensible, and for making recommendations to the Board in relation to the re-appointment of the Company's external auditors. The principal responsibilities of the Audit Committee are:

- To monitor the integrity of the financial statements of the Company, including Interim Management Statements, and any formal announcements relating to the Company's financial performance, and reviewing significant financial reporting judgements contained therein.
- To review, approve and monitor the internal audit programme to ensure that the internal audit function is adequately resourced and has appropriate standing within the Company, and to assess the effectiveness of the internal audit function.
- To maintain oversight of the external audit activities including discussing with the external auditors before the audit commences, the nature and scope of the audit and to review the auditors' quality control procedures and steps taken by the auditors to respond to changes in regulatory and other requirements.
- To review management's and the internal auditors' reports on the effectiveness of systems for internal controls, and financial reporting.
- To consider the appointment, re-appointment or removal of the external auditors, and assess their independence and objectivity, ensuring that key partners are rotated at appropriate intervals and relevant UK professional and regulatory requirements are taken into account.

Additionally, in accordance with the UK Corporate Governance Code, the Committee is responsible for overseeing a formal whistle-blowing policy and procedures which apply throughout the Group. This responsibility will be transferred to the newly formed Corporate Responsibility Committee during 2014. Responsibility for the operation of this policy has been delegated to the Company Secretary.

Members of the Audit Committee have received updates on accounting standards and generally accepted accounting practice on a quarterly basis as part of the Group Chief Financial Officer's report to the Board and also on a half-yearly basis from the external auditors.

A copy of the Committee's full terms of reference are available online at www.serco.com.

Audit Committee Report

Principal activities during the year

During 2013 the Audit Committee discharged fully its responsibilities listed above and, in doing so, considered the following key matters

- Monitored the integrity of the financial statements of the Company including the Corporate Governance Report and statement of Directors' Responsibilities for inclusion in the 2012 and 2013 Annual Report and Accounts, the 2013 Half Year Report and Auditors' Report thereon and the Interim Management Statements issued during the year
- Accounting issues, judgements and information to support the statements including but not limited to going concern revenue recognition, impairments and exceptional items and disclosure of that information to the auditors
- The annual audit plan of the external auditors and the 2013 external audit fees
- Pre-approving any fees in respect of non-audit services provided by the external auditors and ensuring that the provision of non-audit services did not impair the external auditors' independence or objectivity
- Review of the whistle-blowing process and significant reports from that process
- Evaluation and independence of the Audit Committee and its members
- The continuing independence of the external auditors and the effectiveness of the external audit process
- The 2013 internal audit programme, the proposed 2014 programme and a review of the restructuring of roles and responsibilities of the Internal Audit function
- Reviewing the internal control environment processes and systems in the light of the outcome of the reviews into certain contracts with Government departments undertaken by the Cabinet Office and the Ministry of Justice
- The Committee's work plan for the year ahead and a review of its achievement against the Committee's terms of reference

At its meeting in February 2014, the Committee reviewed and discussed a comprehensive paper prepared by the Group Chief Financial Officer, which set out the Group's accounting policies and basis of preparation, gave consideration to a number of key accounting judgements associated with financial reporting, set out the Group's financial control procedures, and considered the impact of new accounting developments. The Audit Committee also reviewed and discussed a paper prepared by the external auditors which included significant reporting and accounting matters. The Committee pays particular attention to matters which it considers to be important as a result of their impact on the Group results and remuneration of management, or the level of complexity, judgement or estimation in their application on the preparation of the Company's financial statements.

In considering the Financial Statements for the year ended 31 December 2013, the Committee discussed with the auditors and management all areas of risk it identified during both the audit planning process and year end audit. In the Committee's judgement, these areas are usual for a company of Serco's size and business model.

The significant issues considered by the Committee during the period were as follows

Significant issues considered by the Committee

- 1 Onerous contracts – Provisions for future losses on onerous contracts require an estimate to be made of the future performance of the given contract. This is based on various interdependent factors, often outside the direct control of the Group.

How the issue was addressed by the Committee

Documentation regarding the UK clinical health contracts was presented to, and approved by, the Committee. This outlined the key decisions, both operational and financial, and the proposed accounting decisions. Following this report, the Committee agreed the provision made of £17.6m and concluded that due to the material size and nature of this charge, that it be treated as an exceptional item.

Management prepared a separate paper which included support for the £9.1m provision for other onerous contracts made in the year. The Committee challenged the amounts provided for and whether all contracts requiring provision had been covered.

Following the process outlined above, the Committee was satisfied that the Group's provision for onerous contracts is appropriate.

- 2 Goodwill and intangibles impairment – The judgements in relation to goodwill impairment testing relate to the assumptions applied in calculating the value in use of the operating companies being tested for impairment.

The key assumptions applied in the calculation relate to the future performance expectations of the business. Business plans prepared by management supporting the future performance expectations used in the calculation were approved by both the Executive Committee and the Board. The Audit Committee received a detailed report on the outcome of the impairment review performed by management. The impairment review was also an area of focus for the external auditors, who reported their findings to the Committee.

The Committee concluded that the intangible assets were not impaired and approved the disclosures in the Financial Statements.

- 3 Defined benefit pension schemes – Changes in the assumptions applied to the calculation of the defined benefit retirement scheme balances can have a material impact on the Financial Statements.

The costs, assets and liabilities of the Group's defined benefit retirement schemes are considered together with the key assumptions underlying their calculation. In addition, advice is sought from independent actuaries and discussions are held with the external auditors.

The Committee is satisfied that the assumptions made are appropriate.

- 4 Exceptional items – Certain items of income and expenditure require separation from statutory operating profit, to assist the reader of the Financial Statements to assess the quality of the profits of the Group. Determining the treatment of such items requires a level of judgement.

Management prepared documentation in support of the treatment applied in these Financial Statements, which was reviewed and challenged by the Committee. This treatment was considered in light of the guidance issued by the Financial Reporting Council in December 2013.

The Committee also considered detailed reporting from, and discussions with, the external auditors on this matter, and concluded that the items included as "exceptional" are needed to provide clear and useful information about the trends in the components of the results of the Group.

- 5 Disposal accounting – There were three disposals in the year and the profit/loss on disposal for each of these were identified as exceptional items in the Income Statement.

The Committee considered the accounting for the businesses disposed in the year. This included the judgement made in allocating goodwill to these disposals, associated disposal costs and a review of the disclosure of these items as exceptional items in the Income Statement.

- 6 Intangible assets capitalised – There were additions to intangible assets of £27.8m in the year covering a number of software projects and internal development projects, particularly in Global Technology Delivery.

The Committee reviewed the material items of intangible spend in the year and assessed whether these had been correctly judged to have met the capitalisation criteria of IAS 38. This involved a review of the expected economic benefits.

Audit Committee Report

Internal audit

The Audit Committee has oversight responsibility for the Internal Audit function, and reviews and approves the internal audit programme. It also reviews and assesses all reports issued, together with management's actions to respond to findings and recommendations. The Group Head of Internal Audit, who functionally reports directly to the Chairman of the Audit Committee, is invited to and attends the Audit Committee meetings and is also presented with the opportunity to meet privately with the Audit Committee without any members of management present.

During 2013, a strategy for strengthening Internal Audit was developed and presented to the Audit Committee and this led to a number of changes in the Internal Audit function, designed to further enhance the delivery of internal audit and its standing within the Group. Key changes have been implemented already including the formulation of a single Global Internal Audit team, changing of reporting lines, the rollout of a standard internal audit methodology, approval of an updated internal audit charter which outlines the objectives, authority, scope and responsibilities of the new group internal audit function, and the change in administrative reporting lines of the Group Head of Internal Audit to the Group Chief Executive.

External auditors

The Audit Committee has responsibility for making a recommendation on the appointment, re-appointment and removal of external auditors. Deloitte LLP were re-appointed auditors of the Group at the Annual General Meeting held in May 2013. During the year, the Committee received and reviewed audit plans and reports from the external auditors. The external auditors also met privately with the Audit Committee without any member of management or the Executive Directors being present.

Non-audit services

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

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

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

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

The Group has complied with the policy throughout the year. Where appropriate, non-audit services have been provided by companies other than Deloitte LLP to safeguard auditor objectivity and independence. The fees paid to Deloitte for audit, audit-related and non-audit services for 2013 can be found in Note 12 to the Consolidated Financial Statements. The principal areas of engagement of Deloitte for audit-related and non-audit services were commissioned in full compliance with the above policy and a formal tender exercise was undertaken. The services principally related to taxation advice, IT advisory work and due diligence and other corporate finance advisory services.

Effectiveness of external auditors

During the year, the Audit Committee reviewed the effectiveness of the external audit process. An assessment of the process was undertaken by each member of the Committee with input received from management associated with the audits undertaken (Group Finance and Divisional Finance Directors). The assessment covered all aspects of the audit service provided by the audit firm. The Committee also obtained a report on the audit firm's own internal quality control procedures and consideration of audit firms' annual transparency reports.

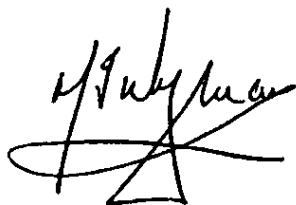
Audit tendering

The Audit Committee has noted the changes to the Code, the recent findings of the Competition Commission and the Guidance for Audit Committees issued by the Financial Reporting Council, each in the context of the tendering by audit firms for the external audit contract at least every ten years.

The independence, objectivity and effectiveness of the external auditors have been examined by the Committee and discussions were held regarding their terms of engagement and remuneration. The Senior Statutory Auditor is Richard Knights, who was appointed to the role at the beginning of 2011. There are no contractual obligations that restrict the Company's current choice of external auditor. Following an assessment of the independence, objectivity and effectiveness of Deloitte LLP, the Committee recommended to the Board that Deloitte LLP be proposed for reappointment at the forthcoming 2014 Annual General Meeting. This recommendation has been accepted by the Board and will be proposed to shareholders.

The Committee will consider a formal tender process in accordance with the provisions of the UK Corporate Governance Code 2012. It will comply with the Competition Commission Order relating to the statutory audit market for FTSE 350 companies, which is expected to come into effect from 1 October 2014. Under the transitional arrangements, the Committee expects a formal tender process to be held no later than two years from the end of the current audit engagement partner rotation period. As partner rotation is due in the year ended 31 December 2015, a tender process is expected to commence no later than 2016.

The Committee notes and continues to monitor the further developments from the EU Commission in respect of audit regulations that will need to be reflected in UK law in the next few years. These rules will require listed companies to change auditors after ten years, with the possibility of keeping the same firm for an additional ten years if the work has been put out to tender.



Malcolm Wyman
Chairman of the Audit Committee
3 March 2014

Nomination Committee Report

Annual statement by the Chairman of the Nomination Committee

The Nomination Committee is responsible for identifying and nominating, for the approval of the Board, candidates to fill Board vacancies as and when they arise. Before making an appointment, the Committee will evaluate the balance of skills, knowledge and experience on the Board and, in the light of this evaluation, prepare a description of the role and capabilities required for a particular appointment. The Committee will also make recommendations to the Board concerning the appointment of any Director or the Company Secretary to the Board and give full consideration to succession planning in the course of its work, taking into account the challenges and opportunities facing the Company and the necessary skills and expertise required on the Board.

Where an external recruitment is appropriate, or to benchmark a suitable internal candidate, the Committee will engage the services of an independent search consultant. In consultation with the chosen search consultant, specifications are drawn up for the roles and for those personal attributes and experience that are felt to be essential for the effective performance of any new appointment, including for Non-Executive Directors what would be considered appropriate in terms of time commitment.

The Committee is responsible for a number of other matters relating to the composition of the Board and its committees. In particular it is responsible for:

- Making a statement in the annual report and accounts about its activities, the process used for appointments, the membership of the Committee, number of Committee meetings held and attendance over the course of the year
- Ensuring that on appointment to the Board, Non-Executive Directors receive a formal letter of appointment setting out clearly what is expected of them in terms of time commitment, Committee service and involvement outside Board meetings

A copy of the Committee's full terms of reference are available online at www.serco.com

Membership and meetings

The Nomination Committee consists of Executive and independent Non-Executive Directors. The majority of members are independent Non-Executive Directors.

The Committee welcomed the appointment of Mike Clasper to the Committee from March 2014 and the broad range of skills and experience he brings to complement the current Committee. In addition to Mike, the Committee currently comprises Alastair Lyons, who chairs the Committee, Malcolm Wyman, Angie Risley and Ed Casey. The Committee met five times during 2013.

The minutes of the Committee meetings are circulated to all directors.

Principal activities during the year

At its meetings during the year, the Committee discharged its responsibilities as outlined above. In particular, one of the key areas of focus in the 2012 Board effectiveness review was to enhance the profile of the Board through greater diversity. During the year, the Committee conducted a thorough process of search to identify three additional Non-Executive Directors, in order to complement the existing non-executive members of the Board and these were proposed for appointment and approved by the Board in 2014. With these appointments, a third of the Board is now female.

The Committee also dealt with succession planning for the role of Group Chief Executive following Christopher Hyman's resignation from the Board in October. This completed with the announcement of Rupert Soames' appointment in February 2014.

The Committee engaged the Zygos Partnership, an independent external executive search consultancy, for the recruitment of the new Non-Executive Directors, and for the position of Group Chief Executive. The Board confirms the Zygos Partnership is not connected with the Company in any way.

Diversity

The Board strongly supports the principle of boardroom diversity, recognises the benefits of having diversity across all areas of the Group and believes this adds to Serco's continued success and advantage. The Board will always seek to appoint on merit against objective criteria, including diversity. When considering the optimum composition of the Board, the benefits of diversity of the Board are appropriately reviewed and balanced where possible, including in terms of differences of skills, industry experience, approach, gender, race, age, nationality, background and other contributions that individuals may bring. The Committee continues to focus on encouraging diversity of thought and experience, recognising that Directors with diverse skill sets, capabilities and experience gained from different geographic and cultural backgrounds enhance the Board. In addition to Board diversity, the Company believes in promoting diversity at all levels of the organisation and has stated an aim to achieve appropriate diversity across all elements of Serco's management. As highlighted earlier in the Corporate Governance Report, the Board has an increased focus on the balance of women in senior executive positions in the organisation, in order to provide opportunities for talented women to become directors, both executive and non-executive. At present 12.5% of our senior managers are female and the Board will be seeking to increase this over time.



Alastair Lyons CBE
Chairman of the Nomination Committee
3 March 2014

Corporate Responsibility Committee

Under the Corporate Renewal Programme, the Board committed to establish a Corporate Responsibility Committee which will be responsible for overseeing the Company's approach to all aspects of Corporate Responsibility, including its ethics and business conduct, the structure of governance its approach to health and safety its contribution to the communities in which its people live and work, its impact on the environment in which the Company operates its approach to managing its relationships with customers, suppliers and other parties, and its risk management framework. The terms of reference for the Committee were designed during 2013 and formally approved in February 2014.

The full terms of reference of the Committee are available online at www.serco.com

Membership and meetings

The Corporate Responsibility Committee consists of Executive and independent Non-Executive Directors. The majority of members are independent Non-Executive Directors.

The Committee welcomed the appointment of Mike Clasper, Tamara Ingram and Rachel Lomax to the Committee from March 2014 and the broad range of skills and experience they bring to it. Rachel chairs the Committee and in addition to Mike and Tamara, the Committee comprises of Alastair Lyons and Ed Casey. The Committee will meet not less than four times a year. The Committee did not meet during 2013.

The minutes of the Committee meetings will be circulated to all directors.

Principal activities during the year

The Committee held its first meeting in February 2014, which was chaired by Alastair, at which the terms of reference were approved and formally presented to the Board.

Remuneration Report

Dear Shareholder

On behalf of your Board, I am pleased to present our Directors' Remuneration Report for the year ended 31 December 2013

The Remuneration Committee continues to recognise the clear link between pay and performance and provides information on this in the Report by way of additional disclosures on our reward and on our remuneration decisions in line with the recommendations 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 (Regulations)

We have structured the Report into two sections

- 1 Directors' Remuneration Policy setting out all elements of our Company's remuneration policy and the key factors that were taken into account in setting that policy. This policy is subject to a binding shareholder vote at this year's General Meeting on 8 May and thereafter at least every third year
- 2 Annual Report on Remuneration setting out payments and awards made to our directors and details on the link between Company performance and remuneration for the financial year covered by the accounts. This report on remuneration together with this letter is subject to an advisory shareholder vote at the General Meeting on 8 May

2013 Overview

As reported in the Strategic Review (pages 2 to 59), we have been through a very difficult and extremely unusual period since July of last year, which has had a major impact on the Company by reducing near-term growth, diverting management focus, and adding costs in order to strengthen the business. Whilst the impact will continue to be significant in 2014 as we implement the programme of corporate renewal and rebuild our UK pipeline, the notification by the UK Government in January that a positive assessment has been made of our corporate renewal plan will now allow the business to begin to emerge in a stronger position to compete in its large and growing markets and rebuild value for shareholders. Recognising the need for strong and effective leadership, I am delighted with the appointment of Rupert Soames as our new Group Chief Executive with effect from 1 June 2014. Also the range of skills and experience of our current Board will be complemented by the addition of three new Non-Executive Directors one of whom, Tamara Ingram, will join the Remuneration Committee.

Remuneration outcomes in respect of 2013

During 2013 Christopher Hyman resigned as Group Chief Executive and Ed Casey took on the role of Acting Group Chief Executive. As communicated at the time, and as described elsewhere in this Report, Chris only received his contractual entitlement of 12 months payment in lieu of notice, paid on a phased basis and subject to mitigation. He was allowed to retain the 2011 Performance Share Plan (PSP) and Deferred Bonus Plan (DBP) awards that were due to vest within his notice period. However, as the threshold performance conditions for these awards were not met, they lapsed entirely and so no payment was made.

Ed was appointed Acting Group Chief Executive in October 2013 on a salary of USD1,046,000, with a pension supplement of 30% of salary. His short and long-term incentives are in line with our normal policy for the Group Chief Executive. His bonus for the period since his appointment in October 2013 has been based on a combination of financial KPIs, in large part reflecting the performance of our US business which he had led for 10 months of the year, alongside non-financial objectives relating to his role as Acting Group Chief Executive. Our US business has had a strong year and Ed has made an outstanding contribution as Acting Group Chief Executive, rapidly getting to grips with our corporate renewal plan, demonstrating strong leadership in a time of great instability, and showing great personal flexibility. On the basis of this performance, a bonus award of 111% has been determined for him for his period since appointment in October 2013. Andrew Jenner, our Group Chief Financial Officer, has elected not to take a bonus in respect of 2013 in recognition of the significant impact of events during the year on Serco's performance and share price. Serco's financial performance for the year is described in more detail in the Strategic Report starting on page 2.

As a consequence of our financial performance falling short of where we wanted it to be, the long-term incentive awards made under the PSP and DBP in 2011, and due to vest in 2014 based on 2013 results, will lapse as we were below median against our peer group on a relative Total Shareholder Return basis and EPS growth fell short of the threshold of 9% pa compound.

These outcomes clearly demonstrate that our remuneration policy is effective in aligning pay with performance.

Remuneration for 2014

The Committee conducted its regular annual review of salaries of the Executive Directors, taking into account the challenges that have faced the business last year, their performance, the competitiveness of their remuneration against the UK market and the current economic climate. The Committee also has regard to the overall pay decisions for employees across the Group as a whole. With effect from 1 April 2014, the salaries for the Executive Directors will increase by 1.5% to USD1,061,690 for the Acting Group Chief Executive and £463,855 for the Group Chief Financial Officer.

Rupert Soames has been appointed on a base salary of £850,000 with a first review date of 1 April 2016, and will receive a pension supplement of 30% of salary. His incentives are in line with our current remuneration policy, as set out in this Report, and which will be put to shareholders for approval under the binding vote at the 2014 General Meeting. In order to compensate him for awards he will forgo at Aggreko as a result of joining Serco, Rupert will also receive an initial one-off long-term incentive award of 150% of salary under the PSP and an award of shares vesting over the period to 1 April 2017. The performance conditions on the one-off PSP award will be relative TSR, Share Price (both tested following the announcement of the 2016 results) and strategic objectives. Any Aggreko awards that have performance conditions attached will be replaced with Serco awards with performance conditions.

Under our corporate renewal plan, we have committed to review the Group's variable incentivisation structures for the leadership such that they support the process of behavioural change and ensure there is a commitment to do what is right and to deal with our customers fairly and transparently beyond merely the achievement of financial measures. Changes to our leadership bonus plan have already been agreed for 2014 to reflect this objective. For 2014 performance measures in respect of the bonus for Executive Directors will be based 50% on financial metrics and 50% on non-financial metrics related to implementing our corporate renewal plan, stabilising our business and providing clarity of leadership and direction. For the 2014 policy, we have decided to make the following changes to improve the alignment of our remuneration with long-term shareholder interests and sustained performance:

- We have introduced a two-year holding period post-vesting for shares under the PSP, and
- We have introduced malus provisions pre-vesting for the PSP and DBP, and claw back during the holding period for PSP awards.

We will keep our remuneration under review to ensure it remains strongly linked to the strategy and we will, therefore, during 2014 conduct a fuller review of incentives and of our remuneration policy. It is, therefore, possible that changes will be made for 2015, and a further binding policy vote in 2015 may be required.

Shareholder engagement

The Committee will engage as appropriate with our shareholders and key shareholder bodies during any policy review undertaken during 2014. In the short term we will also be consulting on the appropriate targets to apply to our long-term incentives for 2014 awards ahead of the Annual General Meeting.

I, and the Committee believe it is important to continue to maintain effective channels of communication with our shareholders. The Committee takes the views of shareholders very seriously and these views have been influential in shaping our policy and practice.

The voting outcome at the 15 May 2013 General Meeting in respect of the Directors' Remuneration Report for the year ending 31 December 2012 is set out on page 102 and reflected very strong shareholder support for the Company's remuneration policy.

We welcome shareholder feedback on any aspects of executive remuneration.

In summary, it has been an extraordinarily difficult time for Serco over the last 8 months. I believe that in making the necessary decisions the Remuneration Committee has rigorously sought to ensure that reward is clearly linked to performance and shareholder interests, that no payment is made for failure or loss of office, and that the reward for Rupert Soames as our new Group Chief Executive is positioned appropriately to attract someone of his leadership capability and commercial track-record, both of which are critical for Serco's future success.



Angie Risley
Chair of Remuneration Committee
3 March 2014

Remuneration Report

At a glance. Implementation of remuneration policy for 2014 and key decisions for 2013

The table below summarises how key elements of the remuneration policy will be implemented in 2014 and key decisions taken by the Remuneration Committee in relation to base pay and incentives for Executive Directors in respect of 2013 year-end. EPS targets will be determined before the General Meeting on 8 May 2014 and following consultation with Serco's major investors

Element	Acting CEO (Ed Casey)	CFO (Andrew Jenner)															
Base salary from 1 April 2014	\$1,061,690	£463,855															
Pension	30% of salary including cost of participation in US 401K plan	33% of salary															
Annual bonus	Max 150% of salary On-target 75% of salary	Max 130% of salary On-target 65% of salary															
Annual bonus measures	<ul style="list-style-type: none">50% financial targets including revenue, PBT, Free Cash Flow50% non-financial targets from programme of corporate renewal. The weighting has been increased to reflect the importance of the corporate renewal priorities for 2014																
Deferred Bonus Plan (DBP)	Maximum of 50% of earned bonus can be deferred to purchase investment shares, each individual investment share purchased will be matched (on a gross investment basis) by a maximum of two 'matching' shares																
DBP measures	EPS is the sole measure to determine the vesting of matching shares measured over three years																
Performance Share Plan (PSP)	Maximum 200% of salary	Maximum 175% of salary															
PSP measures	<p>Measured over three years with one-third each on</p> <ul style="list-style-type: none">relative TSR measured against the companies in the FTSE 51 to 130 (excluding investment trusts),2016 EPSShare Price <p>Relative TSR will be measured from a base-point of the average over the 30 days to 4 March 2014 and the end point for both Relative TSR and Share Price will be measured over the 30 days following announcement of the 2016 results</p> <table><tr><th>Performance</th><th>Vesting</th><th>Relative TSR</th><th>2016 EPS</th><th>Share price</th></tr><tr><td>Threshold</td><td>25%</td><td>Median</td><td></td><td></td></tr><tr><td>Maximum</td><td>100%</td><td>Upper Quartile</td><td>Targets to be confirmed ahead of General Meeting</td><td></td></tr></table>		Performance	Vesting	Relative TSR	2016 EPS	Share price	Threshold	25%	Median			Maximum	100%	Upper Quartile	Targets to be confirmed ahead of General Meeting	
Performance	Vesting	Relative TSR	2016 EPS	Share price													
Threshold	25%	Median															
Maximum	100%	Upper Quartile	Targets to be confirmed ahead of General Meeting														
Holding requirement	Vested shares from the PSP to be held for two years post vesting (after payment of tax)																
Shareholding requirement	200% of salary	150% of salary															
Malus and clawback	<ul style="list-style-type: none">Malus provisions will apply to PSP and DBP awards during the three-year performance period prior to vestingClawback provisions will apply during the two-year post-vesting holding period to shares arising from PSP awards																
Changes in policy from 2013	<ul style="list-style-type: none">Weighting of non-financial targets increased from 20% to 50%Two-year holding period introduced on PSP awardsPre-vesting malus introduced for PSP and DBPPost-vesting claw-back introduced for the two year holding on PSP																

Year-end decisions made

Executive Directors

1 April 2014 salary review	1.5%	1.5%
2013 Bonus outcome		
• Currency value	\$216,734	Bonus waived
• % of salary	111%	Nil
• % of maximum	74%	Nil
2011 LTIP vesting	Nil	Nil
2011 DBP vesting	N/A	Nil

Non-Executive Directors

Non-Executive Directors Fees	Chairmanship	Membership
Audit Committee	£12,500 (no change)	£5,000
Corporate Responsibility Committee	£15,000	£8,000
Nomination Committee	-	-
Remuneration Committee	£10,000 (no change)	£5,000

Directors' Remuneration Policy

The following report details the remuneration policy and the decisions on remuneration of the Directors of the Group for the year ended 31 December 2013. 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 (Regulations).

The remuneration policy report is subject to a binding vote at the 2014 AGM and if approved will take effect from 8 May 2014 and will apply until Shareholders next consider and vote on the Policy.

The directors' remuneration policy will be displayed on the company's website, in the investor area, after the 2014 AGM.

Remuneration Policy

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

- Support Serco's long-term future growth, strategy and values
- Align the financial interests of executives and shareholders
- Provide market competitive reward opportunities for performance in line with expectations and deliver significant financial rewards for sustained out-performance
- Enable Serco to recruit and retain the best with the required skills and experience in all our chosen markets
- Be based on a clear rationale which participants, shareholders and other stakeholders are able to understand and support

Remuneration Report

Future policy table

The remuneration package for Executive Directors consists of base salary, annual bonus, long-term share-based incentives, pension and other benefits. The Company's policy is to ensure that a significant proportion of the package is related to performance.

The following table sets out each element of reward and how it supports the Company's short and long term strategic objectives. Whilst the table is focused on Executive Directors, the table set out on page 90 provides further information of how pay policies are set for the broader employee population.

How the element supports our strategic objectives	Operation of the element	Maximum potential value and payment at threshold	Performance metrics used, weighting and time period applicable
Base Salary To help recruit and retain executives of the necessary calibre to execute Serco's strategic objectives and to recognise an individual's experience, responsibility and performance. To ensure base salaries are competitive in the market in which the individual is employed.	Pay levels are designed to be competitive and fair and reflect the skills and performance of individuals. Salaries are benchmarked from time to time against salaries for the Company's relevant peer group, with the market positioning dependent on the scale of challenges intrinsic to the individual's role and individual's ability, experience and role. In some circumstances there may be phased movement to that positioning. Salaries are reviewed annually and any changes are effective from 1 April in the financial year.	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. Higher increases may be made in exceptional circumstances, for example when there is a change in role or responsibility.	None
Benefits To provide a competitive level of benefits.	Serco pays the cost of providing the benefits on a monthly basis or as required for one-off events such as receiving financial advice. These include but are not limited to car allowances, private medical insurance, permanent healthcare insurance, life cover, annual allowance for independent financial advice, and voluntary health checks every two years. 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 and tax equalisation. Benefits are reviewed annually against market practice and are designed to be competitive.	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.	None

How the element supports our strategic objectives	Operation of the element	Maximum potential value and payment at threshold	Performance metrics used, weighting and time period applicable
<p>Annual Bonus</p> <p>Incentivise executives to achieve specific predetermined goals during a one-year period</p> <p>Reward ongoing stewardship and contribution to core values</p>	<p>Bonus result is determined by the Committee after the year end, based on performance against objectives and targets</p> <p>Annual bonuses are paid after the end of the financial year end to which they relate. There is an optional deferral of 50% of the total earned bonus into Serco shares</p> <p>On change of control the Remuneration Committee may pay bonuses on a pro-rata basis measured on performance up to the date of change of control</p>	<p>Maximum bonus opportunity</p> <p>150% of salary for CEO</p> <p>130% of salary for CFO</p> <p>On-target bonus</p> <p>75% of salary for CEO</p> <p>65% of salary for CFO</p> <p>Threshold bonus is 20% of maximum bonus opportunity</p>	<p>Bonus is earned on the basis of achievement of a mix of financial and non-financial objectives of which at least 50% are financial</p> <p>Financial measures are based on the Company's Key Performance Indicators (KPIs) and the non-financial measures are based on key strategic objectives</p> <p>Performance is measured over the financial year</p> <p>The Committee has discretion to vary the weighting of performance metrics over the life of this remuneration policy. Also the Committee has discretion in exceptional circumstances to vary performance measures part-way through a performance year if there is a significant event (such as a major transaction or transition in role) which causes the Committee to believe the original performance conditions are no longer appropriate</p>
<p>Deferred Bonus Plan ("DBP")</p> <p>This plan is to incentivise executives to achieve superior returns for shareholders and to align executives to shareholder interests</p>	<p>Executive Directors can elect to defer, for three financial years, up to 50% of their annual bonus by purchasing investment shares</p> <p>Each individual investment share purchased will be matched (on a gross investment basis) by a maximum of two 'matching' shares</p> <p>Dividends are reinvested and distributed only in respect of shares that vest at the end of the performance period</p> <p>The Committee, at its discretion may attach a post-vesting holding period for awards</p> <p>In circumstances such as fraud, misconduct and/or misstatement by a participant, the Company will be entitled to withhold before the vesting date the value of any shares to be released or the payment of cash equivalents under the DBP</p> <p>On a change of control awards vest pro-rata for time and performance up to the date of change of control unless the Committee decides otherwise</p> <p>As provided in the plan rules approved by shareholders, the Committee has discretion to adjust awards in the event of, for example corporate restructuring or capital events</p>	<p>For maximum performance, each investment share is matched by two matching shares</p> <p>For threshold performance each investment share is matched by half a matching share</p>	<p>Earnings Per Share ("EPS") is the sole measure to determine the vesting of matching shares</p> <p>The performance condition is measured over three years</p> <p>In exceptional circumstances the Committee retains discretion to change performance measures and targets and the weightings attached to performance measures part-way through the performance period if there is a significant event (for example a major transaction) which causes the committee to believe the original measures, weightings or targets are no longer appropriate</p> <p>The Committee has discretion to vary the proportion of awards that vest, to ensure that the outcomes are fair and appropriate and reflect the underlying financial performance of the Group</p>

Remuneration Report

How the element supports our strategic objectives

Performance Share Plan ("PSP")

To drive achievement of longer term objectives, increase shareholder value aligned closely to creating shareholders' interests

Operation of the element

Awards of nominal cost options/conditional shares made annually
 Dividends are reinvested and distributed only in respect of shares that vest at the end of the performance period

The Committee, at its discretion, may attach a post-vesting holding period for awards

In circumstances such as fraud, misconduct and/or misstatement by a participant the Company will be entitled to withhold before the end of the holding period the value of any shares to be released or the payment of cash equivalents under the PSP

On a change of control awards vest pro-rata for time and performance up to the date of change of control unless the committee decides otherwise

As provided in the plan rules approved by shareholders, the Committee has discretion to adjust awards in the event of, for example, corporate restructuring or capital events

Maximum potential value and payment at threshold

Face value on grant of 200% of base salary for the CEO and 175% for the CFO

25% of the award vests for threshold performance

Performance metrics used, weighting and time period applicable

Vesting is dependent on at least two performance conditions chosen from

- EPS
- Relative TSR
- Share Price or absolute TSR

The measures are independent, and are measured over three years. The weighting of each is determined prior to award. The Remuneration Committee has discretion to adopt other measures following consultation with major shareholders.

In exceptional circumstances the Committee retains discretion to change performance measures and targets and the weightings attached to performance measures part-way through the performance period if there is a significant event (such as a major transaction) which causes the committee to believe the original measures, weightings or targets are no longer appropriate.

The Committee has discretion to vary the proportion of awards that vest, to ensure that the outcomes are fair and appropriate and reflect the underlying financial performance of the Group.

Pension

To provide funding for retirement

Executive Directors may participate in tax-approved pension plans operated by the Company

A cash allowance is available for those not participating in a pension scheme or whose participation exceeds one or more tax allowances

Since 2010, Andrew Jenner ceased accruing benefits in the pension scheme and has been in receipt of a cash allowance equal to 33% of base salary in lieu of further pension provision

Andrew remains entitled to lump sum and widow's pension benefits should he die before retirement and while still employed by Serco

Ed Casey participates in the US 401k pension and receives a cash allowance in lieu of pension equal to 30% of base salary less the cost of participation in the US 401k plan

None

Shareholding Requirement

To support long-term commitment to the Company and the alignment of employee interests with those of shareholders

Unvested performance shares or options are not taken into account. Share price is measured at end of each financial year

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

CEO – 200% of salary

CFO – 150% of salary

The Committee has the discretion to increase the shareholding requirements of the Executive Directors

None

Notes to the policy table:

Performance measures and targets

The table below sets out a rationale for the performance conditions chosen for annual bonus, Deferred Bonus Plan and Performance Share Plans and how targets were set

Element	Performance measures and rationale	How targets are set
Annual bonus	<ul style="list-style-type: none"> ● Financial and non-financial performance measures ● The Committee selected the financial measures based on the Company's Key Performance Indicators (KPIs) and the non-financial measures were individually set and based on key strategic goals 	<ul style="list-style-type: none"> ● The performance targets are determined annually by the Committee taking into account analyst consensus and the Company's forecasts
Deferred Bonus Plan	<ul style="list-style-type: none"> ● EPS is the sole measure to determine the vesting of matching shares ● The Committee selected EPS as it is a key performance indicator both for the Company and its major shareholders ● The Committee believes EPS can be directly influenced by executive decision-making while also reflecting shareholder value 	<ul style="list-style-type: none"> ● EPS targets are set in reference to analyst forecasts, Company business plans and levels of EPS required to support our share price goals
Performance Share Plan	<ul style="list-style-type: none"> ● EPS, Relative TSR and Share Price or absolute TSR ● As set out above EPS is an important measure of shareholder value which can also be influenced by executive decision making ● Relative TSR reflects our performance relative to other companies in which investors could choose to invest ● The rationale for the share price measure is explicitly to recognise the recent falls in share price and to ensure that the full award is not delivered unless shareholders benefit from a significant recovery in value over the next three years 	<ul style="list-style-type: none"> ● Share price targets will be set to reflect what the Committee determines as stretching, taking into account the recent fall in share price and historic share price levels, but also what is realistic and consistent with achievable levels of financial performance ● The Committee consults with a selection of the largest shareholders and the voting guidance services when determining targets for the Company's LTI arrangements

Remuneration Report

Remuneration policy for other employees

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

Element	Difference in remuneration policy for other employees
Base salary	The same principles and considerations that are applied to Executive Directors are, as far as possible, applied to all employees.
Benefits	Serco also has provisions for market aligned benefits for all employees.
Pension	The Group operates a number of defined benefit schemes and defined contribution schemes. Individuals who have exceeded certain tax allowances may be offered cash allowances in lieu of pension benefits.
Annual bonus	Approximately 600 members of the Global Leadership Team are eligible for a bonus award under The Leadership Team Bonus Scheme.
Deferred Bonus Plan ('DBP')	Members of the Executive Committee are invited to participate in the DBP on the same terms as the Executive Directors.
Performance Share Plan ('PSP')	The PSP is awarded to approximately 600 employees in the Global Leadership Team.
Sharesave	An all-employee scheme. Options are normally granted at a discount of 10% to the market value and have no performance conditions. The Executive Directors do not participate in Sharesave.

Considerations of conditions elsewhere in the Group

Although the Committee does not consult directly with employees on the Directors' Remuneration Policy, the Committee does consider the general base salary increase, remuneration arrangements and employment conditions for the broader employee population when determining the remuneration policy for the Executive Directors.

Illustrations of application of the Remuneration Policy

The charts illustrate the composition and value of the different elements of remuneration that the Executive Director's will receive for below threshold target and maximum corporate performance

The graphs show an estimate of the remuneration that could be received by Executive Directors under the Policy set out in this Report. Each of the bars is broken down to show how the total under each scenario is made up of fixed elements of remuneration, the annual bonus and share-based incentives

The charts indicate that a significant proportion of both target and stretch pay is performance-related. For target performance – variable pay accounts for nearly two-thirds of total pay for the Acting Group Chief Executive, and over half for the Group Chief Financial Officer

	Below Threshold	Target performance	Maximum performance
Fixed elements of remuneration	Base salary as at 1 April 2014 Estimated value of benefits provided under the remuneration policy Cash allowance in lieu of pension 33% of salary for CFO Cash allowance in lieu of pension 30% of salary for Acting CEO less the cost of participation in the US 401k plan Ed Casey's fixed elements of pay are converted into GBP with an exchange rate of GBP1 = USD1.609		
Annual bonus (payout as a % of salary)	0%	75% Acting CEO 65% CFO	150% Acting CEO 130% CFO
Deferred Bonus Plan	Nil	1.1 Matching Shares ¹	2 Matching Shares ¹
Performance Share Plan (as a % of face value)	Nil	50% ¹	100% ¹

¹The LTI values reflect target and maximum vesting of the proposed 2014 award. Share price movement or dividend equivalent has not been incorporated into the above figures

Remuneration Report

Approach to Recruitment Remuneration

Serco operates in diverse markets and geographies and many of its competitors for talent are outside the UK. In the event of hiring a new Executive Director, the Committee will typically align the remuneration package with the above Remuneration Policy, which provides for a maximum total incentive under bonus, PSP and DBP combined of 500% of salary in any one year (assuming maximum bonus, maximum investment in the DBP and maximum achievement of all performance conditions). This is the maximum level of incentives excluding buy-outs that will apply to new recruits. Different performance conditions may apply for new recruits from those set out in the policy, depending on the particular circumstances at the time (which could, for example, include the appointment of an interim Executive Director).

In determining appropriate base salary on hiring a new Executive Director, the Committee will take into account all factors it considers relevant including their experience and calibre, current total remuneration, levels of remuneration for companies in the Committee's chosen peer group, and the remuneration required to attract the best candidate for Serco. The Committee will seek to ensure that the arrangement is in the best interests of the Company and its shareholders without paying more than is necessary. New promotes or recruits to the board may on occasion have their salaries set below the targeted policy level while they become established in their role. In such cases, salary increases may be higher than inflation or the general UK workforce increase until the targeted market positioning is achieved.

Where it is necessary to compensate a candidate for entitlements and/or unvested long-term incentive awards from an existing employer that are forfeited, the Committee will seek to match the quantum, structure and timeframe of the award with that of the awards forfeited. In determining the form and quantum of replacement awards, the Committee will consider whether existing awards are still subject to performance requirements and the extent to which those are likely to be met, with the aim of providing an opportunity of broadly equivalent value. The principle will be to seek to replace awards that remain significantly at risk for performance at the candidate's current employer with awards subject to performance at Serco and to seek to make any other replacement awards in the form of Serco shares, subject to appropriate vesting or holding requirements. Any compensation for awards forfeited is not taken into account in determining the maximum incentive award level.

The recruitment policy also includes the additional provision of benefits in kind, pensions and other allowances, such as relocation, education and tax equalisation in line with Serco policies as may be required in order to achieve a successful recruitment. The policy for recruitment also includes benefits that are either not significant in value or are required by legislation. It is anticipated that any new Executive Director would be offered a pension allowance equal to 30% of base salary in lieu of pension.

Where a new Executive Director is an internal promote, the Committee reserves discretion to allow the new Executive Director to continue to benefit from existing awards granted, or benefit entitlements (such as pension) prior to appointment to the Board.

The policy on the recruitment of new Non-Executive Directors is to apply the same remuneration elements as for the existing Non-Executive Directors. It is not intended that day rates or benefits in kind be offered, although in exceptional circumstances such remuneration may be required in currently unforeseen circumstances.

The Committee will include in future Annual Reports details of the implementation of the Policy in respect of any such recruitment to the Board.

Element of remuneration	Maximum percentage of salary
Maximum variable pay normally comprising	500%
● Annual bonus	150%
● Long-term incentives	350%
Pension allowance	30% cash allowance in lieu of pension

Note Maximum percentage of salary for annual bonus and long-term incentives excludes compensation for awards forfeited.

Service contracts and loss of office payments

The policy for service contracts for new Directors is shown in the table below. Existing Directors have service contracts entered into before 27 June 2012 which have aspects that differ from policy as highlighted underneath the table. The Committee may under this policy at any time, with the agreement of a Director, alter aspects of their existing contracts so that they are in line with the policy for new Directors. Copies of the directors' service contracts and letters of appointment are available for inspection at the Company's registered office. The date of appointment for each Director is shown in the table below.

Provision	Detailed terms
Notice period	<ul style="list-style-type: none"> ● 12 months' notice from the Company ● 12 months' notice from the Director
Termination payment	<ul style="list-style-type: none"> ● Payment in lieu of notice comprising <ul style="list-style-type: none"> ● Base salary ● Pension allowance ● Selected benefits ● All of the above would be paid in instalments in accordance with the Director's contractual payment schedule, subject to an obligation on the part of the Director to mitigate his loss such that payments will either reduce or cease completely, in the event that the Director gains new employment/remuneration. In the event of a compromise or severance agreement, the Committee may make payments it considers reasonable in settlement of potential legal claims. It may include in such payments reasonable reimbursement of professional fees incurred by the Director in connection with such agreements and reasonable payments in respect of restrictive undertakings. ● The Remuneration Committee may agree that if a Director steps down from the Board then for a transitional period notice (including payment in lieu of notice) would continue to be based on the equivalent of up to twelve months' notice based on their rate of salary and benefits while a Director payable in instalments and subject to mitigation. ● The reimbursement of repatriation costs or fees for professional or outplacement advice may also be included in the termination package, as deemed reasonable by the Committee, as may the continuation of benefits for a limited period.
Treatment of annual bonus on termination under plan rules	<ul style="list-style-type: none"> ● No payment unless employed on date of payment of bonus except for 'good leavers' defined as death, disability, redundancy and other circumstances at the Committee's discretion. ● 'Good leavers' are entitled to a bonus pro-rated to the period of service during the year, subject to the outcome of the performance metrics and paid at the usual time. ● The Committee has discretion to reduce the entitlement of a 'good leaver' in line with performance and the circumstances of the termination.
Treatment of unvested performance shares or options and unvested matching deferred share awards on termination under plan rules	<ul style="list-style-type: none"> ● All awards lapse except for 'good leavers' ill-health, injury or disability, death, redundancy, retirement, change of control (as defined in the plan rules) and other circumstances at the Committee's discretion (to the extent that they allow 'good leaver' treatment for particular awards). ● For 'good leavers' vesting is pro-rated on a time basis and is dependent on the achieved performance over the performance period. ● The Committee has the discretion to vary the level of vesting to reflect the individual performance, and may, depending on the circumstances of the departure allow some awards to vest while lapsing others.
Change of control	<ul style="list-style-type: none"> ● Where the Director leaves the Company following a change of control, whether or not he is dismissed or he elects to leave on notice, he will be entitled to receive a payment equivalent to up to one year's remuneration.
Exercise of discretion	<ul style="list-style-type: none"> ● Intended only to be used to prevent an outcome that is not consistent with performance. The Committee's determination will take into account the particular circumstances of the Executive Director's departure and the recent performance of the Company.
NEDs	<ul style="list-style-type: none"> ● Appointed for initial three-year term ● Appointment may be terminated on three months' written notice ● All NEDs are subject to annual re-election ● No compensation or other benefits are payable on early termination

Notes

Contractual terms for current Directors existing before 27 June 2012 and not subsequently amended have principal areas that deviate from the policy above as follows:

- In respect of Andrew Jenner, the notice period from the Director is six months and in the event of Change of Control notice reduces to one month in the six months following the date of the Change of Control.

- In respect of Ed Casey, the notice period is six months from the Company and two weeks from the Director.

- In respect of Andrew Jenner and Ed Casey, there are no clauses for termination payments to be paid in instalments or for such payments to be mitigated.

Whilst unvested Awards will normally lapse, the Committee may in its absolute discretion allow for Awards to continue until the normal vesting date and be satisfied subject to achievement of the performance conditions. In such circumstances, Awards vesting will normally be pro-rated on a time apportioned basis, unless the Committee determines otherwise.

Any such discretion in respect of leavers would only be applied by the Committee to 'good leavers' where it considers that continued participation is justified, for example by reference to past performance to the date of leaving, or by the requirement to achieve an orderly transition. The claw back provisions would continue to apply in the event that such discretion were exercised.

Service contracts outline the components of remuneration paid to the individual but do not prescribe how remuneration levels may be adjusted from year to year.

Remuneration Report

The Chairman and Non-Executive Directors' Fees

In accordance with the Company's policy, the fees of the Chairman and the Non-Executive Directors, which are determined by the Board, are set at a level which is designed to attract individuals with the necessary experience and ability to make a substantial contribution to the Group's affairs

How the element supports our strategic objectives	Operation of the element	Maximum potential value and payment at threshold	Performance metrics used, weighting and time period applicable
To attract Non-Executive Directors with the necessary experience and ability to make a substantial contribution to the Group's affairs	<p>The fees of the Chairman are determined and approved by the Remuneration Committee (excluding Chairman) and fees of the Non-Executive Directors, are determined and approved by the Board as a whole</p> <p>The Chairman receives a base fee</p> <p>The following fees are paid to Non-Executive Directors in addition to their base fee</p> <ul style="list-style-type: none"> ● SID fee ● Committee Chairmanship fee ● Committee membership fee <p>Fees are reviewed on an annual basis against a relevant peer group and taking into consideration market practice</p> <p>An allowance is payable to directors for attendance at meetings outside their country of residence where such meetings involve inter-continental travel</p> <p>In addition, reasonable travel and business related expenses are paid</p> <p>Non-Executive Directors are not entitled to receive incentives and pension</p> <p>Non-Executive Directors are encouraged to hold shares in the Group but are not subject to a shareholding requirement</p>	<p>Over the policy period, base fees for current Non-Executive Directors will be set at an appropriate level within the peer group and increases will typically be broadly in line with market</p> <p>The base fees or fees for specific Non-Executive Directors roles may be reviewed at any time based on the anticipated responsibility and time commitment involved</p> <p>Current fee levels are shown in the section on implementation of policy</p>	Non-Executive Director fees are not performance related

Dates of Director's Service Contracts/Letters of Appointment

Director	Date of appointment to the Board
Ed Casey	24 October 2013
Andrew Jenner	3 May 2002
Alastair Lyons	16 March 2010
Angie Risley	1 April 2011
Ralph D. Crosby Jr	30 June 2011
Malcolm Wyman	1 January 2013
Mike Clasper	3 March 2014
Tamara Ingram	3 March 2014
Rachel Lomax	3 March 2014

Notes

All directors are put forward annually for re-election at the AGM

Christopher Hyman was appointed to the Board on 1 April 1999 and ceased to be a director on 25 October 2013

Annual Report on Remuneration

Statement of Implementation of Remuneration Policy for year ended 31 December 2013

The remuneration policy for the year ended 31 December 2013 was consistent with the policy on which shareholders will vote at the 2014 AGM apart from the following that are being implemented for 2014

- Malus and clawback provisions did not apply under the Deferred Bonus Plan and Performance Share Plan for awards prior to 2014
- A holding period did not apply to the Performance Share Plan after the vesting period for awards prior to 2014
- Committee membership fees were not paid to Non-Executive Directors prior to 2014

Single Figure – Directors' remuneration (audited information)

Executive Director's single figure

The following table shows a single total figure of remuneration in respect of qualifying services for the 2013 financial year for each Executive Director, together with comparative figures for 2012. Details of NEDs' fees are set out in the next section

	Ed Casey		Christopher Hyman		Andrew Jenner	
	2013 £	2012 £	2013 £	2012 £	2013 £	2012 £
Salary and fees	121,113	N/A	626,977	744,500	452,750	436,750
Taxable benefits ¹	2,634	N/A	59,572	77,254	72,553	77,755
Bonus ²	134,701	N/A	–	812,250	–	412,984
LTI ³	–	N/A	–	701,435	–	359,725
Pension ⁴	36,334	N/A	206,902	245,685	149,408	144,128
Total	294,782	N/A	893,451	2,581,124	674,711	1,431,342

Notes

1 The value of the taxable benefits relate to the provision of independent financial advice, car allowance (fully inclusive of all scheme costs including insurance and maintenance), health care and private medical assessments

2 The bonuses shown include performance bonuses earned in the period under review but not paid until the following financial year

3 The value of shares vested in the year is based on an average market value over the last quarter of the financial year. The vesting date for the PSP is 31 March 2014 and the DBP is 4 April 2014, however these awards did not reach minimum vesting level so lapsed in full

4 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 and which do not include the value of accrued pension under the DB scheme

5 The 2012 LTI figures have been updated to reflect the actual share price on the date of vesting. The share price on 29 March 2013 when the DBP vested was 632p and on 8 April when the PSP vested it was 611.5p

6 Ed Casey's remuneration is paid in US dollars and relates to the period (25 October to 31 December 2013) in the role of Acting Group Chief Executive for the purpose of the single figure £1 = USD 1.609

7 Christopher Hyman's remuneration is prorated to 25 October 2013

Remuneration Report

The annual base salaries of the Executive Directors for the year ended 31 December 2013 were

Director	Base salary	Effective Date	Increase
Ed Casey	\$1,046,000	25 October 2013	N/A
Christopher Hyman	£779,000	1 April 2013	3.86%
Andrew Jenner	£457,000	1 April 2013	3.86%

Variable pay outcomes (audited information)

Performance-related annual bonus

For 2013, the Group Chief Financial Officer's bonus was on achieving a mix of financial and non-financial objectives which were weighted 80% and 20% respectively. The financial measures were based on the Company's Key Performance Indicators (KPIs) and the non-financial measures were individually set and based on key strategic goals.

Andrew Jenner asked not to be considered for a bonus payment in 2013.

For 2013, Ed Casey's bonus for the period (25 October to 31 December) he was Acting Group Chief Executive was based on achieving a mix of financial and non-financial objectives. The financial measures were based on the Company's Key Performance Indicators, in large part reflecting the performance of our US business which he had led 10 months of the year alongside non-financial objectives relating to his role as Acting Group Chief Executive. Our US business has had a strong year and Ed has made an outstanding contribution as Acting Group Chief Executive, rapidly getting to grips with our corporate renewal plan, demonstrating strong leadership in a time of great instability, and showing great personal flexibility. On the basis of this performance, a bonus award of 111% has been determined for him for his period since appointment in October 2013.

Christopher Hyman asked not to be considered for a bonus payment in 2013.

Deferred Bonus Plan (DBP)

The LTI amount included in the 2013 single total figure of remuneration includes the DBP matching share award which was awarded in 2011. For matching awards which completed their performance period on 31 December 2013, achievement against the measure is shown in the table below.

Performance condition	Weighting	Threshold – 25% vesting	Maximum – 100% vesting	Actual	Percentage of max achieved
EPS compound growth. For threshold performance each invested share is matched by half a share rising to a match of two shares at maximum performance.	50%	9%	14%	7.69%	No shares vest
Relative TSR. For median performance each invested share is matched by half a share rising to a match of two shares for upper quartile performance.	50%	Median	Upper quartile	Below median	No shares vest
Total					0%

For awards made in 2012 onwards, EPS is the sole performance measure.

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

The awards made to the Executive Directors were as follows

2011 DBP Matching share awards	No of shares awarded	No of shares vesting	Vesting date	Value of vesting £
Christopher Hyman	173,898	0	4 April 2014	0
Andrew Jenner	88,033	0	4 April 2014	0

Note

1 Ed Casey did not participate in the DBP in 2011

Performance Share Plan (PSP)

The LTI amount included in the 2013 single total figure of remuneration includes the PSP award which was awarded in 2011. Face value awards on grant were 200% of base salary for the Group Chief Executive and 175% for the Group Chief Financial Officer. For the PSP awards which completed their performance period on 31 December 2013, achievement against the measure is shown in the table below

Performance condition	Weighting	Threshold – 25% vesting	Maximum – 100% vesting	Actual	Percentage of max achieved
EPS growth. For threshold performance 25% of the award vests rising on a straight line basis to 100% at maximum performance	30%	9%	14%	7.69%	No shares vest
Relative TSR. For median performance each invested share is matched by half a share rising to a match of two shares for upper quartile performance	70%	Median	Upper quartile	Below median	No shares vest
Total					0%

For awards made in 2012 onwards the EPS weighting was increased from 30% to 50% and the TSR weighting was reduced from 70% to 50%

The awards made to the Executive Directors were as follows

2011 PSP share awards	No of shares awarded	No of shares vesting	Vesting date	Value of vesting £
Ed Casey	73,899	0	31 March 2014	0
Christopher Hyman	247,568	0	31 March 2014	0
Andrew Jenner	127,652	0	31 March 2014	0

Note

1 Ed Casey's PSP award was made prior to him being appointed to the Board

Remuneration Report

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) £ 2013	Board fee (including Chairmanship fees) £ 2012	Allowances £ 2013	Allowances £ 2012	Total £ 2013	Total £ 2012
Alastair Lyons Chairman, Chairman of Nomination Committee and Member of Remuneration Committee	267,500	257,500	10,000	5,000	277,500	262,500
Angie Risley Chairman of Remuneration Committee, Member of Audit and Nomination Committees	60,000	56,666	–	5,000	60,000	61,666
Ralph D Crosby Jr	50,000	50,000	30,000	25,000	80,000	75,000
Malcolm Wyman Chairman of Audit Committee, SID, Member of Nomination and Remuneration Committees	64,250	N/A	–	N/A	64,250	N/A
Total	441,750	364,166	40,000	35,000	481,750	399,166

Notes

1. Fees paid to the Chairman were increased from £260,000 to £270,000 with effect from 1 April 2013.
2. £5,000 is payable for each occasion that requires inter-continental travel outside of the director's country of residence.

Annual NED Fees

Role	Base fee 1 April 2013 £	Base fee 1 April 2012 £	Percentage increase
Chairman	270,000	260,000	3.8%
Senior Independent Director	10,000	10,000	0%
Board fees	50,000	50,000	0%
Audit Committee Chairmanship	12,500	12,500	0%
Remuneration Committee Chairmanship	10,000	10,000	0%
Travel to international meetings	5,000	5,000	0%

Performance graph and table

This graph shows the value as at 31 December 2013, of a £100 investment in Serco on 31 December 2008 compared with £100 invested in the FTSE250 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.

CEO's pay in last five financial years

Year ended 31 December	Group CEO	2009	2010	2011	2012	2013
CEO single figure remuneration (£)	Ed Casey	–	–	–	–	294,782
	Christopher Hyman	3,625,830	2,646,894	2,826,038	2,582,185	893,451
Annual bonus outcome (as % of maximum opportunity)	Ed Casey	–	–	–	–	74%
	Christopher Hyman	90%	91%	81%	72%	N/A
LTI vesting outcome (as % of maximum opportunity)	Ed Casey	–	–	–	–	0%
	Christopher Hyman	295.42%	168.77%	80%	63.60%	0%

Percentage change in CEO's remuneration

In the year ended 31 December 2013 Christopher Hyman received a 3.86% salary increase, no increase in taxable benefits and 100% less in bonus than the equivalent amounts for the year ended 31 December 2012. The average percentage changes for employees in the leadership team were 2%, 0% and a 39.3% reduction respectively.

Relative importance of spend on pay

The chart 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.

"Dividend", and "Overall Expenditures on Staff Pay" have the same meaning as in the preparation of the accounts of the company.

Remuneration Report

Pensions (audited information)

As at 31 December 2013, 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)

Christopher Hyman ceased to be a director of the Company on 25 October 2013 and left employment of the Company on 8 November 2013, he was paid £47,430 during this period

The principle adopted by the Committee when calculating his loss of office payment was to pay contractual entitlements and to allow a retention of awards that would have vested during his twelve months notice period had he served such notice. All other unvested awards were forfeited

Christopher Hyman's compensation payment

12 months	£
Salary	779,000
Pension benefit*	257,070
Other benefits**	73,754
Total	1,109,824

* The pension benefit is a cash allowance equal to 33% of base salary in lieu of pension contributions

** Private medical, permanent health insurance, life cover, financial advice, health checks and the provision of a car allowance

Vesting of LTI awards

The awards granted to Christopher Hyman in 2011 under the PSP and the DBP would have vested on the usual vesting dates (31 March 2014 and 4 April 2014 respectively) to the extent that the relevant performance conditions have been met. These would have been reduced pro-rata to reflect the proportion of the performance period which had elapsed at the date of cessation of employment. However, the performance conditions were not met and so these awards lapsed

Share awards	Performance achieved	Shares vested	£
2011 DBP award (173,898 shares)	Minimum vesting level not achieved	No shares vest	0
2011 PSP award (247,568 shares)	Minimum vesting level not achieved	No shares vest	0
Value of shares vesting			0

Christopher Hyman has six months from the date of ceasing employment to exercise his previously vested outstanding options under the Serco Group plc 2005 Executive Share Option Plan, 2006 Long Term Incentive Plan and Performance Share Plan

Payments to Past Directors

No payments were made in the year to past directors other than the payments made to Christopher Hyman on him ceasing to be a director

Awards made in 2013

Deferred Bonus Plan (DBP) (audited information)

In 2013 both the CEO and the CFO elected to defer 50% of their earned bonus into the DBP

For matching share awards made in 2013 EPS growth was the sole performance measure. The range for the three-year performance period was set at annual compound EPS growth of 5.5% at threshold to 10.5% at maximum. No matching shares will vest where performance is below threshold. For threshold performance, each invested share will be matched by half a matching share. For maximum level performance each invested share will be matched (on a gross investment basis) by two shares. For performance between threshold and maximum, the number of matching shares will be determined on a straight line basis.

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

Directors	Scheme	Basis of Award (% of salary)	Award date	Market price at award (p) ¹	Face value £	Percentage vesting at threshold performance	Number of shares	Performance period end date
Christopher Hyman	Deferred Bonus Plan (conditional share award)	108.3%	3 May 13	625	812,044	25%	129,927	31 Dec 2015
Andrew Jenner	Deferred Bonus Plan (conditional share award)	93.86%	3 May 13	625	412,875	25%	66,060	31 Dec 2015

Notes

- 1 The market price at award was the purchase price of the investment shares.
2 Ed Casey did not defer his 2012 earned bonus into the Deferred Bonus Plan.

Performance Share Plan (PSP) (audited information)

In 2013 the Executive Directors received awards equivalent to 200% of salary for the Group Chief Executive and 175% for the Group Chief Financial Officer.

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

The structure for vesting is the same for both measures and no shares vest where performance is below Threshold.

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

Directors	Scheme	Basis of Award (% of salary)	Award date	Market price at award (p) ¹	Face value £	Percentage vesting at threshold performance	Number of shares	Performance period end date
Ed Casey ²	Performance Share Plan (conditional share award)	130%	15 Apr 13	618	468,203	25%	75,761	31 Dec 2015
Christopher Hyman	Performance Share Plan (nominal cost options)	200%	15 Apr 13	618	1,501,209	25%	242,914	31 Dec 2015
Andrew Jenner	Performance Share Plan (nominal cost options)	175%	15 Apr 13	618	770,621	25%	124,696	31 Dec 2015

Notes

- 1 The market price at award was the preceding days MMO.
2 Ed Casey's conditional share award under the Performance Share Plan was made prior to him being appointed as Acting CEO and a director and was equivalent to 130% of salary.

Remuneration Report

Statement of voting at the general meeting

At the last annual general meeting votes on the Remuneration Report were cast as follows

	For % number	Against % number	Withheld % number*
2012 remuneration report	95.82% 346,071,397	4.18% 15,084,901	N/A 5,923,160
2011 remuneration report	93.72% 351,474,463	6.28% 23,547,217	N/A 8,299,355
2010 remuneration report	92.98% 298,080,103	7.02% 22,494,102	N/A 54,392,029

* 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

The disclosure in the 2014 Remuneration Report will include details of the binding shareholder vote at the 2014 AGM on directors' remuneration policy

External appointments

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

Andrew Jenner served as a non-executive director of Galliford Try plc during the year. Fees payable in the year were £40,400.

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

Directors' shareholding and share interests (audited information)

Current shareholdings are summarised in the table below. Shares are valued for these purposes at the year-end price, which was £4.992 per share at 31 December 2013.

	Share ownership requirements (% of salary)	Number of shares required to hold	Number of shares owned outright (including connected persons)	Vested unexercised share options	Restricted share awards subject to performance conditions	Share ownership requirements met	Weighted average exercise price of vested options	Weighted average period to vest of restricted share awards
Ed Casey	100%	130,227	17,626	87,738	200,136	No	0	0
Christopher Hyman	200%	312,099	526,387	794,090	421,466	Yes	306	0.02
Andrew Jenner	150%	137,320	464,861	618,937	633,123	Yes	204	0.02
Alastair Lyons	N/A	N/A	33,600	N/A	N/A	N/A	N/A	N/A
Angie Risley	N/A	N/A	5,967	N/A	N/A	N/A	N/A	N/A
Ralph D Crosby Jr	N/A	N/A	–	N/A	N/A	N/A	N/A	N/A
Malcolm Wyman	N/A	N/A	–	N/A	N/A	N/A	N/A	N/A

Notes

1. Ordinary shares are beneficial holdings which include the Directors' personal holdings and those of their spouses and minor children.
2. 122,990 of Christopher Hyman's and 65,386 of Andrew Jenner's shares are held in trust on their behalf under the terms of their participation in the Deferred Bonus Plan. Provided such shares remain in trust for three years and subject to certain performance conditions, they are also granted an award over matching shares equivalent to two times the gross bonus initially used for the share purchase.
3. Security has been granted to Christopher Hyman's bank over 85,564 ordinary shares held in his name.

Gain on exercise of share awards

	Number of options exercised	Exercise price	Market value on exercise (p)	Gain on exercise of share option/ award £
Ed Casey	26,611	-	608	161,662
Christopher Hyman	59,832	-	605	361,954
	289,515	153	605	1,308,462
Andrew Jenner	30,549	-	605	184,806
	173,709	153	605	785,077
Aggregate gain on exercise of shares awards				2,801,961

Note

1 The awards that Ed Casey exercised during the year were granted prior to him being appointed to the Board

Other Shareholding information (audited information)

Shareholder Dilution

Awards granted under the Serco Group plc share plans are met either by the issue of new shares or by shares held in trust when awards vest. The Committee monitors the number of shares issued under its various share plans and their impact on dilution limits. The relevant dilution limits established by the Association of British Insurers in respect of all share plans is 10% in any rolling ten-year period and in respect of discretionary share plans is 5% in any rolling ten-year period. Based on the Company's issued share capital at 31 December 2013, our dilution level was 6.83% against all share plans and 4.54% against discretionary share plans.

The Group has an employee share ownership trust which is administered by an independent trustee and which holds ordinary shares in the Company to meet various obligations under the share plans. In June 2013 a loan of £16 million was made to the Employee Trust in order to finance the purchase of shares to satisfy the ongoing liabilities under the Company's employee share plans.

The Trust held 10,174,594 and 11,883,973 ordinary shares at 1 January 2013 and 31 December 2013 respectively.

Remuneration Report

The Remuneration Committee

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

Terms of reference

The terms of reference of the Committee, a copy of which can be found on the Group's website, are reviewed annually to ensure that they remain appropriate. Details of the Directors' attendance at meetings of the Committee can be found in the Corporate Governance Report on page 69.

Members of the Committee

All members of the Committee are independent. Non-Executive Directors of the Group are initially appointed for a three-year term and that appointment may be terminated on three months' written notice.

Remuneration Committee members and attendees (the Committee met 11 times during 2013)

Remuneration Committee members	Position	Comments
Angie Risley	Chairman of Remuneration Committee	
Alastair Lyons	Member from 10 May 2011	
David Richardson	Member from 2 June 2003	Retired from the Board at the conclusion of the Company's 2013 AGM on 15 May 2013
Malcolm Wyman	Member from 1 January 2013	
Tamara Ingram	Member from 3 March 2014	
Christopher Hyman	Group Chief Executive	Attended by invitation
Andrew Jenner	Group Chief Financial Officer	Attends by invitation
Geoff Lloyd	Group HR Director	Attends as an executive responsible for advising on the remuneration policy
Cathy Aldwinckle	Group Head of Reward	Attends as an executive responsible for advising on the remuneration policy
John Hickey	Company Secretary	Attends as the secretary to the Committee

Meeting	Regular items	Ad hoc items
February	Consider salary review proposals for the Executive Directors, members of the Executive Committee and the Company Secretary, review of achievement of performance conditions for LTI vesting review final draft of the remuneration report	
March	Confirmation of bonus payable, approve the salary increases for the Executive Directors, members of the Executive Committee and the Company Secretary, review bonus objectives, approve LTI awards, finalisation of remuneration report	
May	Review the share scheme performance	
August	Review performance of the Executive Directors against bonus objectives, review the share scheme performance, review of Remuneration Committee advisors	
November	Review the Committee Terms of Reference, review the share scheme performance	Finalisation of termination package for Christopher Hyman, Consideration of remuneration package for Ed Casey

Advisors to the Remuneration Committee

The Committee has been advised during the year by PricewaterhouseCoopers LLP ('PwC'). PwC were selected as advisors 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:

- Benchmarking the Chairman and Non-Executive Director fees
- Benchmarking the Board and Executive Committee total remuneration
- Support in reviewing the DRR
- Advice in relation to design of remuneration arrangements and treatment of leavers and joiners
- Responding to general and technical reward queries

A representative from PwC attends each meeting of the Remuneration Committee. Consulting services have also been provided to the Group by the advisors in relation to retirement benefits and pay data, accounting and taxation services.

Fees paid to PwC as advisors to the Committee during the year totalled £144,600, 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 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 Group Chief Executive on the remuneration and performance of the other members of the Executive Committee. The Committee have also received legal advice from Linklaters LLP and Clifford Chance LLP during the year.

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



John Hickey
Secretary
3 March 2014

Directors' Report

Annual Report and Accounts

The Directors have pleasure in presenting the Annual Report and Accounts of the Group for the year ended 31 December 2013. Comparative figures used in this report are for the year ended 31 December 2012. The Corporate Governance Report set out on pages 60 to 74 forms part of the Statutory Directors' Report.

The Chairman's Statement and the remainder of the Strategic Report on pages 2 to 59, provide a description of the business model and report on the activities during the year, post balance sheet events, and likely future developments.

Share capital

The issued share capital of the Company, together with the details of shares issued during the year is shown in note 35 to the Consolidated Financial Statements.

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

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

Dividends

An interim dividend of 3.10p (2012: 2.65p) per ordinary share was paid on 18 October 2013. The Directors recommend a final dividend of 7.45p (2012: 7.45p) per ordinary share which, if approved by shareholders at the Annual General Meeting, will be paid on 14 May 2014 to those shareholders on the register at the close of business on 14 March 2014.

Interests in voting rights

As at 3 March 2014* the Company had been notified under Rule 5 of the Disclosure Rules and Transparency Rules of the Financial Conduct Authority of the following holdings of voting rights in its shares:

	Number of shares (millions)	% held
Invesco Limited	71.8	14.37
The Capital Group Companies, Inc	24.7	4.96
UBS Investment Bank	29.1	5.90
Morstan Nominees Limited	25.1	5.11
AXA S.A.	24.4	4.95
Fidelity International Limited	24.5	4.90
Baillie Gifford & Co	24.0	4.92
FMR LLC	24.3	4.86
Newton Investment Management Limited	23.6	4.85
BlackRock Inc	24.1	4.82
HBOS plc	20.5	4.22

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

Directors

The current members of the Board together with biographical details of each Director are set out on pages 62 to 64.

On 25 October 2013, the Company announced the appointment of Edward J Casey Jr as an Executive Director of the Company with effect from the same date. On 3 March 2014 the Company announced the appointments of Mike Clasper, Tamara Ingram and Rachel Lomax as Non-Executive Directors of the Company with effect from the same date. Mike will serve as a member of the Audit, Corporate Responsibility and Nomination Committees. Tamara will join the Remuneration and Corporate Responsibility Committees. Rachel will Chair the Corporate Responsibility Committee and serve as a member of the Audit Committee. Ed, Mike, Tamara and Rachel will all stand for election at the Company's AGM on 8 May 2014.

As in previous years, and 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 in control conditions are included in the service contracts of Directors which provide compensation or reduction of notice periods in the event of a change in control of the Company.

Details of the Directors' interests in the ordinary shares and options over the ordinary shares of the Company are set out in the Remuneration Report on page 102.

Annual general meeting

The Annual General Meeting of the Company will be held at the offices of Clifford Chance LLP, 10 Upper Bank Street, London E14 5JJ on 8 May 2014 at 11 00am

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

Financial risk policies

A summary of the Group's treasury policies and objectives relating to financial risk management, including exposure to associated risks, is shown on pages 152 to 157

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.

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. Further information on gender breakdown is provided in the Strategic Report at pages 54.

The Group recognises and applies the principles in the Universal Declaration on Human Rights. These are embedded in the Company's policies and standards and considered when reviewing business opportunities. Further information on Human Rights is provided in the Strategic Report at page 54.

The Group remains proud of its record of managing employee relations and continues to believe that the structure of individual and collective consultation and negotiation is best developed at a local level.

Over the years, the Group has demonstrated that working with trade unions and creating effective partnerships allows improvements to be delivered in business performance as well as in terms and conditions of employment. Where employees choose not to belong to a trade union, employee communication forums such as works councils exist to ensure involvement of staff within the business.

Participation by staff in the success of the Group is encouraged by the availability of sharesave schemes, a share option scheme, and long term incentive arrangements for senior management, which effectively align their interests with those of shareholders by requiring that performance criteria are achieved prior to exercise.

Corporate Responsibility

The Group maintains a focus on corporate responsibility through a model that is applied across the business focusing on our people, safety, the environment and the communities we serve. This model forms an integral part of our Management System and is supported by defined policies in all of the areas it covers. More information on Corporate Responsibility, including Greenhouse Gas Emission reporting, can be found in the Strategic Report on pages 52 to 59.

Political Donations

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

Financial statements

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

Auditors

Deloitte LLP have expressed their willingness to continue in office as auditors and a resolution to reappoint them will be proposed at the forthcoming Annual General Meeting.

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



John Hickey
Company Secretary
3 March 2014

*As at 25 March 2014 the Company had not been notified of any changes or additions to these interests.

Directors' responsibilities statement

The Directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and regulations

Company law requires the Directors to prepare financial statements for each financial year. Under that law the Directors are required to prepare the group financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union and Article 4 of the IAS Regulation and have elected to prepare the parent company financial statements in accordance with Financial Reporting Standard 101 Reduced Disclosure Framework. Under company law the Directors must not approve the accounts unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period.

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

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

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

- Properly select and apply accounting policies
- Present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information
- Provide additional disclosures when compliance with the specific requirements in IFRSs are insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance, and
- Make an assessment of the Company's ability to continue as a going concern

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

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

Responsibility statement

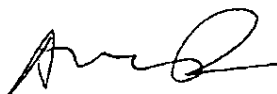
We confirm that to the best of our knowledge

- 1 The financial statements, prepared in accordance with International Financial Reporting Standards as adopted by the EU, 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
- 2 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, and
- 3 The annual report and financial statements, taken as a whole, are fair, balanced and understandable and provide the information necessary for shareholders to assess the Company's performance, business model and strategy

By order of the Board



Ed Casey
Acting Group Chief Executive
3 March 2014



Andrew Jenner
Group Chief Financial Officer
3 March 2014

Independent Auditor's Report

to the members of Serco Group plc

Opinion on financial statements of Serco Group plc

In our opinion

- the financial statements give a true and fair view of the state of the Group's and parent company's affairs as at 31 December 2013, and of the Group's profit for the year then ended,
- the consolidated financial statements have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union,
- the parent company financial statements have been properly prepared in accordance with the Financial Reporting Standard 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

The financial statements comprise the consolidated income statement, the consolidated statement of comprehensive income, the consolidated and company balance sheets, the consolidated cash flow statement, the consolidated statements of changes in equity, and the related notes 1 to 55. The financial reporting framework that has been applied in the preparation of the consolidated financial statements is applicable law and IFRSs as adopted by the European Union. The financial reporting framework that has been applied in the preparation of the parent company financial statements is applicable law and the Financial Reporting Standard 101 Reduced Disclosure Framework.

Going concern

As required by the Listing Rules we have reviewed the Directors' assessment included in the Finance Review section of the Strategic Report that the Group is a going concern. We confirm that

- we have concluded that the directors' use of the going concern basis of accounting in the preparation of the financial statements is appropriate, and
- we have not identified any material uncertainties that may cast significant doubt on the Group's ability to continue as a going concern.

However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the Group's ability to continue as a going concern.

Independent Auditor's Report

to the members of Serco Group plc

Our assessment of risks of material misstatement

The assessed risks of material misstatement described below are those that had the greatest effect on our audit strategy, the allocation of resources in the audit, and directing the efforts of the engagement team

Risk

Revenue and profit recognition

There are significant accounting judgements in applying the Group's revenue recognition policies to the contracts entered into by the Group

Revenue and profit recognition on contracts requires judgement over complex areas including assessment of stage of completion, consideration of onerous contract terms, recognition of pre-contract costs, and billing and cash flow arrangements. The Group's policy on revenue recognition is set out in note 2 to the Group financial statements

During the year 75% of the UK Central Government contracts were subject to an external review into operational and billing arrangements

Disclosure of items as exceptional

The Group has recorded exceptional income and expenditure in respect of one-off items and transactions that fall outside of the normal course of trading. In particular, the Group settled a material contractual dispute with the Cabinet Office in the year and disposed of certain non-core businesses as disclosed in note 11 to the financial statements

Exceptional items are not defined by IFRSs as adopted by the European Union. Therefore judgement is required by the Directors to identify such items as exceptional and to maintain comparability of the results with previous years

Goodwill and intangible assets

The assessment of the carrying value of goodwill and other intangible assets is a judgemental process which includes assumptions around future revenue growth and cash performance, together with the applicable discount rate

There are inherent uncertainties in forecast cash flow modelling which require the exercise of management judgement

Goodwill and intangible assets are material balances in the Group financial statements and the Group operates in various global markets which are susceptible to economic change. Group management's key judgements are disclosed in note 20 to the financial statements

Pension commitments

The actuarial assumptions used in the measurement of the Group's pension commitments involve management judgement in relation to mortality, price inflation, discount rates, and rate of pension and salary increases

Judgement is also exercised in determining whether a pension surplus should be recognised, and the extent of the Group's pension liability in respect of franchise and other contractual agreements

How the scope of the audit responded to the risk

We carried out tests relating to controls over revenue recognition, including the timing of, and the right to, recognise revenue. We also reviewed forecast costs to complete and profit recognition policies on those contracts where the requirement is to recognise revenue on a percentage of completion basis

We reviewed specific contract forecasts and historical operational costs to validate management's assessment of whether contracts are deemed to be onerous and reviewed provisions for anticipated losses

We also considered the results of the external forensic investigations in scoping the focus of our testing and work

We reviewed the nature of exceptional items, challenged management's judgements in this area and agreed the quantification to supporting documentation

In particular, we discussed with the Directors and the Audit Committee, the costs related to the Cabinet Office contractual dispute, and verified costs to appropriate audit evidence

On the Clinical Health onerous contracts and on the impairment of assets, we reviewed and challenged management's forecasts and underlying assumptions in determining the level of exceptional costs recorded

In respect of the sales of businesses in the year, we also tested the component parts of the profit on disposal calculation to source documentation including the proceeds received, the net assets disposed of and the costs associated with the disposal, including goodwill allocation to the disposed entities

We evaluated management's assumptions within the cash flow forecasts used in the value in use calculations for each Cash Generating Unit ("CGU") and other intangible assets as described in note 20 to the financial statements. These include CGU cash flow projections, growth rates and pipeline levels at each CGU

We have challenged the discount rate applied to the separate CGUs by utilising valuation experts, the prevailing Group cost of capital at the year end and our understanding of the future prospects of the Group. We have considered the level of risk adjustment applied to each of the CGUs

We have assessed management's sensitivities applied to the model. We have considered whether the Group's disclosure appropriately reflected the risks inherent in the valuation of goodwill assessed

We evaluated the appropriateness of the principal actuarial assumptions used in the calculation of the Group's pension commitments, using our own actuarial experts, and by making enquiries of the Group's external actuary as to the key assumptions made, and comparing these to our knowledge of market practice

As part of our work we evaluated the recoverability of pension surplus amounts and of contract specific pension commitments recorded franchise adjustments (notes 21 and 34)

The Audit Committee's consideration of these risks is set out on page 77

Our audit procedures relating to these matters were designed in the context of our audit of the financial statements as a whole, and not to express an opinion on individual accounts or disclosures. Our opinion on the financial statements is not modified with respect to any of the risks described above, and we do not express an opinion on these individual matters

Our application of materiality

We define materiality as the magnitude of misstatement in the financial statements that makes it probable that the economic decisions of a reasonably knowledgeable person would be changed or influenced. We use materiality both in planning the scope of our audit work and in evaluating the results of our work.

We determined materiality for the Group to be £12.5 million, which is below 6.5% of normalised pre-tax profit. Pre-tax profit has been normalised by adding back net exceptional costs of £90.5 million incurred in the year.

We agreed with the Audit Committee that we would report to the Committee all audit differences in excess of £200,000, as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds. We also report to the Audit Committee on disclosure matters that we identified when assessing the overall presentation of the financial statements.

An overview of the scope of our audit

Our group audit was scoped by obtaining an understanding of the Group and its environment, including group-wide controls, and assessing the risks of material misstatement at the group level. Based on that assessment, we focused our group audit scope primarily on the audit work at four operating divisions: UK & Europe, Global Services, Americas and AMEAA. Each of these was subject to a full audit. In the case of significant joint ventures, the Group audit team issues audit referral instructions to the auditors of these entities. In addition, certain central reporting entities and Group functions including those covering treasury, taxation and pensions and the parent company were subject to an audit. Our audit work at each division was executed at levels of materiality applicable to each individual entity which were lower than Group materiality.

At the parent entity level we also tested the consolidation process and carried out analytical procedures to confirm our conclusion that there were no significant risks of material misstatement of the aggregated financial information of the remaining components not subject to audit or audit of specified account balances.

The Group audit team follows a programme of planned visits to the operating locations of the Group that is designed to ensure the Senior Statutory Auditor or another senior member of the group audit team visits the principal locations at least once a year and remaining locations as part of our rotation strategy. For 2013 year end audit purposes the Senior Statutory Auditor or another senior member of the group audit team visited Washington DC, Dubai, Mumbai and Delhi. The Group audit team also holds detailed meetings with audit teams in the other locations.

Opinion on other matters prescribed by the Companies Act 2006

In our opinion:

- the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006, and
- the information given in the Strategic Report and the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which we are required to report by exception

Adequacy of explanations received and accounting records

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- we have not received all the information and explanations we require for our audit, or
- 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 are not in agreement with the accounting records and returns.

We have nothing to report in respect of these matters.

Directors' remuneration

Under the Companies Act 2006 we are also required to report if, in our opinion, certain disclosures of directors' remuneration have not been made or the part of the Directors' Remuneration Report to be audited is not in agreement with the accounting records and returns. We have nothing to report arising from these matters.

Corporate Governance Statement

Under the Listing Rules we are also required to review the part of the Corporate Governance Statement relating to the Company's compliance with nine provisions of the UK Corporate Governance Code. We have nothing to report arising from our review.

Independent Auditor's Report

To the members of Serco Group plc

Our duty to read other information in the Annual Report

Under International Standards on Auditing (UK and Ireland) we are required to report to you if, in our opinion, information in the annual report is

- materially inconsistent with the information in the audited financial statements or
- apparently materially incorrect based on, or materially inconsistent with, our knowledge of the Group acquired in the course of performing our audit, or
- otherwise misleading

In particular we are required to consider whether we have identified any inconsistencies between our knowledge acquired during the audit and the directors' statement that they consider the annual report is fair, balanced and understandable and whether the annual report appropriately discloses those matters that we communicated to the Audit Committee which we consider should have been disclosed. We confirm that we have not identified any such inconsistencies or misleading statements.

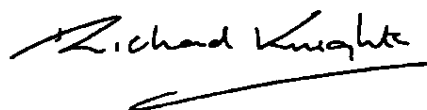
Respective responsibilities of directors and auditor

As explained more fully in the Directors' Responsibilities Statement, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors. We also comply with International Standard on Quality Control 1 (UK and Ireland). Our audit methodology and tools aim to ensure that our quality control procedures are effective, understood and applied. Our quality controls and systems include our dedicated professional standards review team, strategically focused second partner reviews and independent partner reviews.

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of whether the accounting policies are appropriate to the Group's and the parent company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the annual report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.



Richard Knights (Senior Statutory Auditor)
for and on behalf of Deloitte LLP
Chartered Accountants and Statutory Auditor
London
United Kingdom
3 March 2014

Consolidated Income Statement

For the year ended 31 December

		2013			2012 (restated)*		
		Before exceptional items £m	Exceptional items £m	Total £m	Before exceptional items £m	Exceptional items £m	Total £m
Continuing operations	Note						
Adjusted revenue		5,143 9	–	5,143 9	4,913 0	–	4,913 0
Less: Share of revenue of joint ventures		(855 8)	–	(855 8)	(852 9)	–	(852 9)
Revenue	10	4,288 1	–	4,288 1	4 060 1	–	4,060 1
Cost of sales		(3,788 9)	–	(3,788 9)	(3,576 5)	–	(3,576 5)
Gross profit		499 2	–	499 2	483 6	–	483 6
Administrative expenses		(287 1)	–	(287 1)	(246 7)	–	(246 7)
Other expenses – amortisation of intangibles arising on acquisition		(21 4)	–	(21 4)	(24 1)	–	(24 1)
Other expenses – transaction-related costs		(3 5)	–	(3 5)	(3 7)	–	(3 7)
Share of profits in joint ventures, net of interest and tax	7	47 1	–	47 1	62 5	–	62 5
Exceptional net profit on disposal of subsidiaries and operations	11	–	19 2	19 2	–	5 6	5 6
Other exceptional operating items	11	–	(109 7)	(109 7)	–	(5 0)	(5 0)
Operating profit		234 3	(90 5)	143 8	271 6	0 6	272 2
Investment revenue	14	5 2	–	5 2	6 4	–	6 4
Exceptional other gain	11	–	–	–	–	51 1	51 1
Finance costs	15	(42 4)	–	(42 4)	(48 6)	–	(48 6)
Profit before tax		197 1	(90 5)	106 6	229 4	51 7	281 1
Tax	16	(40 0)	28 8	(11 2)	(46 6)	6 5	(40 1)
Profit for the year		157 1	(61 7)	95 4	182 8	58 2	241 0
Attributable to							
Equity owners of the Company		157 1	(61 7)	95 4	182 2	58 2	240 4
Non-controlling interest		–	–	–	0 6	–	0 6
Earnings per share (EPS)							
Basic EPS	19	32 13p	(12 62)p	19 51p	37 09p	11 85p	48 94p
Diluted EPS	19	31 38p	(12 32)p	19 06p	36 23p	11 57p	47 80p

*Certain amounts shown here do not correspond to the 2012 financial statements and reflect adjustments made in respect of the retrospective application of new or revised standards and reallocation of costs. See note 4

Consolidated Statement of Comprehensive Income

For the year ended 31 December

	Note	2013 £m	2012 (restated) £m
Profit for the year		95 4	241 0
Other comprehensive income for the year			
Items that will not be reclassified subsequently to profit or loss			
Net actuarial gain/(loss) on defined benefit pension schemes ¹	34	30 3	(117 0)
Actuarial (loss)/gain on reimbursable rights ¹	34	(37 1)	34 3
Tax relating to items not reclassified ¹	16	3 0	23 0
Share of other comprehensive income/(expense) in joint ventures		3 9	(0 9)
Items that may be reclassified subsequently to profit or loss			
Net exchange loss on translation of foreign operations ²		(53 1)	(18 6)
Fair value loss on cash flow hedges during the period ²		(4 8)	(4 1)
Tax relating to items that may be reclassified ²	16	1 2	4 1
Share of other comprehensive expense in joint ventures		(1 8)	(0 4)
Total comprehensive income for the year		37 0	161 4
Attributable to			
Equity owners of the Company		37 0	160 8
Non-controlling interest		–	0 6

Notes

- 1 Recorded in retirement benefit obligations reserve in the consolidated statement of changes in equity
 2 Recorded in hedging and translation reserve in the consolidated statement of changes in equity

Consolidated Statement of Changes in Equity

For the year ended 31 December

	Share capital £m	Share premium account £m	Capital redemption reserve £m	Retained earnings £m	Retirement benefit obligations reserve £m	Share- based payment reserve £m	Own shares reserve £m	Hedging and translation reserve £m	Total equity £m	Non- controlling interest £m
At 1 January 2012	9.9	322.7	0.1	706.3	(92.0)	66.1	(48.2)	38.9	1,003.8	–
Changes in accounting policies (note 4)	–	–	–	(2.8)	13.1	–	–	(10.3)	–	–
At 1 January 2012 (restated)	9.9	322.7	0.1	703.5	(78.9)	66.1	(48.2)	28.6	1,003.8	–
Total comprehensive income for the year	–	–	–	239.1	(59.7)	–	–	(18.6)	160.8	0.6
Shares transferred to option holders on exercise of share options	0.1	3.8	–	–	–	(3.6)	5.4	–	5.7	–
Dividends paid	–	–	–	(41.9)	–	–	–	–	(41.9)	(0.4)
Expense in relation to share-based payments	–	–	–	–	–	12.1	–	–	12.1	–
Tax charge in relation to share-based payments	–	–	–	–	–	3.1	–	–	3.1	–
Purchase of own shares for Employee Share Ownership Trust (ESOT)	–	–	–	–	–	–	(16.0)	–	(16.0)	–
Change in non-controlling interest	–	–	–	–	–	–	–	–	–	1.1
At 1 January 2013	10.0	326.5	0.1	900.7	(138.6)	77.7	(58.8)	10.0	1,127.6	1.3
Total comprehensive income for the year	–	–	–	97.5	(3.8)	–	–	(56.7)	37.0	–
Shares transferred to option holders on exercise of share options	–	1.3	–	–	–	(4.5)	4.3	–	1.1	–
Dividends paid	–	–	–	(51.5)	–	–	–	–	(51.5)	(0.6)
Expense in relation to share-based payments	–	–	–	–	–	2.9	–	–	2.9	–
Tax credit in relation to share-based payments	–	–	–	–	–	(5.9)	–	–	(5.9)	–
Purchase of own shares for ESOT	–	–	–	–	–	–	(16.0)	–	(16.0)	–
Change in non-controlling interest	–	–	–	–	–	–	–	–	–	–
At 31 December 2013	10.0	327.8	0.1	946.7	(142.4)	70.2	(70.5)	(46.7)	1,095.2	0.7

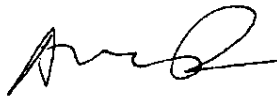
Consolidated Balance Sheet

	Note	At 31 December 2013 £m	At 31 December 2012 (restated) £m	At 1 January 2012 (restated) £m
Non-current assets				
Goodwill	20	1,270 8	1,312 1	1,253 9
Other intangible assets	21	185 7	215 7	180 4
Property, plant and equipment	22	176 8	176 9	174 4
Interests in joint ventures	7	8 1	11 9	36 1
Trade and other receivables	24	78 3	49 2	78 9
Retirement benefit assets	34	64 2	69 7	122 3
Deferred tax assets	17	57 9	40 1	25 0
Derivative financial instruments	33	–	0 1	1 1
		1,841 8	1,875 7	1,872 1
Current assets				
Inventories	23	49 4	53 1	47 9
Trade and other receivables	24	764 4	778 1	701 0
Current tax assets		19 5	24 6	9 2
Cash and cash equivalents	26	125 1	142 8	194 6
Derivative financial instruments	33	8 7	2 7	6 2
		967 1	1,001 3	958 9
Total assets		2,808 9	2,877 0	2,831 0
Current liabilities				
Trade and other payables	27	(644 1)	(757 3)	(679 7)
Current tax liabilities		(10 4)	(9 6)	(6 4)
Obligations under finance leases	28	(14 9)	(10 7)	(9 8)
Provisions	30	(26 2)	(11 5)	(10 4)
Loans	29	(52 2)	(64 0)	(204 1)
Derivative financial instruments	33	(20 2)	(13 8)	(12 3)
		(768 0)	(866 9)	(922 7)
Non-current liabilities				
Trade and other payables	27	(34 1)	(42 3)	(61 0)
Obligations under finance leases	28	(53 1)	(39 5)	(35 1)
Loans	29	(756 1)	(661 8)	(630 8)
Derivative financial instruments	33	(21 1)	(24 5)	(26 3)
Retirement benefit obligations	34	(11 3)	(38 0)	(75 8)
Provisions	30	(34 9)	(44 7)	(53 6)
Deferred tax liabilities	17	(34 4)	(30 4)	(21 9)
		(945 0)	(881 2)	(904 5)
Total liabilities		(1,713 0)	(1,748 1)	(1,827 2)
Net assets		1,095 9	1,128 9	1,003 8
Equity				
Share capital	35	10 0	10 0	9 9
Share premium account	36	327 8	326 5	322 7
Capital redemption reserve		0 1	0 1	0 1
Retained earnings		946 7	900 7	703 5
Retirement benefit obligations reserve	37	(142 4)	(138 6)	(78 9)
Share-based payment reserve	37	70 2	77 7	66 1
Own shares reserve	37	(70 5)	(58 8)	(48 2)
Hedging and translation reserve	37	(46 7)	10 0	28 6
Equity attributable to owners of the Company		1,095 2	1,127 6	1,003 8
Non-controlling interest		0 7	1 3	–
Total equity		1,095 9	1,128 9	1,003 8

The financial statements were approved by the Board of Directors on 3 March 2014 and signed on its behalf by



Ed Casey
Acting Group Chief Executive



Andrew Jenner
Group Chief Financial Officer

Consolidated Cash Flow Statement

For the year ended 31 December

	Note	2013 £m	2012 (restated) £m
Net cash inflow from operating activities before cash spend on special pension contribution and other exceptional items		111 3	225 9
Special contribution to defined benefit pension scheme		(19 7)	–
Other exceptional items		(83 7)	(5 0)
Net cash inflow from operating activities	40	7 9	220 9
Investing activities			
Interest received		2 6	2 5
Increase in security deposits		(0 2)	–
Dividends received from joint ventures	7	51 5	80 6
Proceeds from disposal of property, plant and equipment		4 6	20 9
Proceeds from disposal of intangible assets		0 4	0 1
Proceeds on disposal of subsidiaries and operations	9	40 6	131 0
Acquisition of subsidiaries, net of cash acquired (excluding transaction-related costs)	8	(18 6)	(141 8)
Purchase of other intangible assets		(27 8)	(49 9)
Purchase of property, plant and equipment		(38 9)	(47 4)
Net cash inflow/(outflow) from investing activities		14 2	(4 0)
Financing activities			
Interest paid		(40 8)	(47 1)
Dividends paid	18	(51 5)	(41 9)
Non-controlling interest dividends paid		(0 6)	(0 4)
Repayment of loans		(77 5)	(365 3)
Repayment of non recourse loans		(10 2)	(8 7)
New loan advances		176 5	216 3
Capital element of finance lease repayments		(4 9)	(2 4)
Purchase of own shares for Employee Share Ownership Trust (ESOT)		(16 0)	(16 0)
Proceeds from issue of share capital and exercise of share options		1 1	5 7
Net cash outflow from financing activities		(23 9)	(259 8)
Net decrease in cash and cash equivalents		(1 8)	(42 9)
Cash and cash equivalents at beginning of year		142 8	194 6
Net exchange loss		(15 9)	(8 9)
Cash and cash equivalents at end of year	26	125 1	142 8

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

2 Significant accounting policies

Basis of accounting

These financial statements on pages 113 to 169 have been prepared in accordance with International Financial Reporting Standards (IFRSs) adopted for use in the European Union and therefore comply with Article 4 of the EU IAS regulation.

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

As discussed in more detail in the Finance Review section of the Strategic Report, these financial statements have been prepared on the going concern basis.

Basis of consolidation

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

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 profit or loss and net assets in subsidiaries that is not held by the Group and is presented within equity in the consolidated balance sheet, separate from equity of shareholders of Serco Group plc.

Adoption of new and revised standards

The following accounting amendments, standards and interpretations became effective in the current reporting period:

- Amendments to IAS 1 *Presentation of Financial Statements: Presentation of Items of Other Comprehensive Income*
- IAS 19 *Employee Benefits* revised 2011
- IFRS 13 *Fair Value Measurement*

In addition, the Group has early adopted the following standards, which are endorsed by the EU but not effective until 1 January 2014:

- IFRS 10 *Consolidated Financial Statements*
- IAS 27 *Separate Financial Statements*
- IFRS 11 *Joint Arrangements*
- IAS 28 *Investments in Associates and Joint Ventures*
- IFRS 12 *Disclosure of Interests in Other Entities*
- IAS 36 *Impairment of Assets*

The nature and the impact of each of the new amendments, standards or interpretations which have a significant impact on the financial statements are described below:

- IFRS 10 *Consolidated Financial Statements* (IFRS 10) replaces the parts of the previously existing IAS 27 that dealt with consolidated financial statements. The new standard changes the definition of control such that an investor controls an investee when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to control those returns through its power over the investee. The adoption of IFRS 10 has had no impact on the consolidation of investments held by the Group.
- IFRS 11 *Joint Arrangements* (IFRS 11) removed the option for the proportional consolidation of joint ventures and instead requires equity accounting. A restatement of the 2012 results for these changes reduced statutory reported revenue by £852.9m and profit before tax by £15.1m.
- IFRS 12 *Disclosure of Interests in Other Entities* (IFRS 12) resulted in additional disclosures with respect to individual joint venture arrangements.
- IFRS 13 *Fair Value Measurement* (IFRS 13) establishes a single source of guidance under IFRS for all fair value measurements. IFRS 13 does not change when an entity is required to use fair value, but rather provides guidance on how to measure fair value under IFRS. IFRS 13 defines fair value as an exit price. As a result of the guidance in IFRS 13, the Group re-assessed its policies for measuring fair values, in particular, its valuation inputs such as non-performance risk for fair value measurement of liabilities. IFRS 13 also requires additional disclosures. Application of IFRS 13 has not materially impacted the fair value measurements of the Group.

2 Significant accounting policies (continued)

- *IAS 1 (amended) Presentation of Financial Statements* (IAS 1) increases the required level of disclosure within the statement of comprehensive income and clarified the requirements for comparative information. One impact of these amendments has been to analyse items within the statement of comprehensive income between items that may be reclassified subsequently to profit or loss and items that will not. The financial statements have also been amended to analyse income tax on the same basis. The amendments have been applied retrospectively, and hence the presentation of items of comprehensive income has been restated to reflect the change. The amendments also clarify that the opening statement of financial position (as at 1 January 2012 in the case of the Group) presented as a result of retrospective restatement or reclassification of items in the financial statements does not have to be accompanied by comparative information in the related notes. Other than the above mentioned presentation changes, the application of the amendments to IAS 1 do not result in any impact on profit or loss, comprehensive income and total comprehensive income.
- *IAS 19 (revised) Employee Benefits* (IAS 19) requires pension interest return to be calculated using the value of scheme assets multiplied by the discount rate rather than the expected rate of asset return. The Group has applied IAS 19 (revised) retrospectively and in accordance with the transitional provisions as set out in that standard. The impact of this change is to reduce pre tax profits by £5.8m and to reduce post tax profits by £4.9m. IAS 19 (revised) also introduces more extensive disclosures in the presentation of the defined benefit cost.
- *IAS 36 (revised) Impairment of Assets* (IAS 36). The amendments to IAS 36 enhance the disclosure requirements arising when recoverable amounts have been determined on the basis of fair value less costs of disposal. They also limit the requirement to disclose the recoverable amount of an asset or CGU to periods in which an impairment loss has been recognised or reverses. We have chosen to adopt the amendments early, as allowed by the standard, with effect from 1 January 2013.

New standards and interpretations not applied

At the date of authorisation of these financial statements, the following standards and interpretations which have not been applied in these financial statements were in issue but not yet effective or have not yet been adopted by the EU.

- *IFRS 9 Financial Instruments* (IFRS 9)
- *IAS 39 (revised) Financial Instruments: Recognition and Measurement* (IAS 39)

The Directors do not anticipate that the adoption of these standards will have a material impact on the Group's financial statements in the period of initial application except for IFRS 9, which will impact both the measurement and disclosures of financial instruments. However, it is not practicable to provide a reasonable estimate of the effect of this standard until a detailed review has been completed.

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 market participants at the measurement date, regardless of whether that price is directly observable or estimated using another valuation technique. In estimating fair value of an asset or liability, the Group takes into account those characteristics of the asset or liability market participants would consider when pricing the asset or liability. Fair value for measurement and/or disclosure purposes in these consolidated financial statements is determined on such a basis, except for share-based payment transactions that are within the scope of IFRS 2, leasing transactions that are within the scope of *IAS 17 Leases*, and measurements that have some similarities to fair value but are not fair value, such as net realisable value in *IAS 2 Inventories* or value in use in *IAS 36 Impairment of Assets*.

Revenue recognition

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

Revenue is deferred when the Group has received consideration under the terms of a contract in advance of performing the related service or delivering the associated goods. Deferred revenue is recognised as revenue in the income statement when the Group has fulfilled the relevant contractual commitment.

Revenue recognition: repeat service-based contracts

Revenue on repeat service-based contracts is recognised as services are provided. Where initial contract costs (phase-in costs) are paid for by the customer, revenue is recognised when the related costs are incurred.

Revenue recognition: long-term project-based contracts

The Group has a number of long-term contracts for the provision of complex, project-based services. Where the outcome of such long-term project-based contracts can be measured reliably, revenue and costs are recognised by reference to the stage of completion of the contract activity at the balance sheet date in accordance with *IAS 18 Revenue* and *IAS 11 Construction Contracts*. This is measured by the proportion of contract costs incurred for work performed to date compared to the estimated total contract costs.

Variations in contract work, claims and incentive payments are included to the extent that they have been agreed with the customer, or are virtually certain of being received.

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

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

Notes to the Consolidated Financial Statements

2 Significant accounting policies (continued)

Revenue recognition other

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

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

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

Bid costs and phase in costs

All bid costs are expensed through the income statement up to the point where contract award (or full recovery of costs) is virtually certain, being the point at which the Group is awarded preferred bidder status. Bid costs incurred after this point are then capitalised within trade and other receivables. On contract award these bid costs are amortised through the income statement over the contract period by reference to the stage of completion of the contract activity at the balance sheet date. Bid costs are only capitalised to the extent that it is expected that the related contract will generate sufficient future economic benefits to at least offset the amortisation charge.

Phase in costs that are incremental and directly related to the initial set up of contracts are capitalised within trade and other receivables and are recognised on a straight-line basis over the life of the contract, except where they are specifically reimbursed as part of the terms of the contract when they are recognised as revenue.

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 *IFRS 3 (2008) Business Combinations* are recognised at their fair value at the acquisition date, except where a different treatment is mandated by another standard.

Investments in joint ventures

A joint venture is an arrangement whereby the owning parties have joint control and rights over the net assets of the arrangement. Following adoption of IFRS 11, the Group's investments in joint ventures are no longer reported in the financial statements using the proportional consolidation method, but are instead incorporated using the equity method of accounting.

Under the equity method, investments in joint ventures are carried in the consolidated balance sheet at cost less any impairment. For investments held at the date of implementation, cost is deemed to be the aggregate of the carrying amounts of the assets and liabilities previously proportionately consolidated. 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 a Group entity transacts with a joint venture, profits and losses are eliminated to the extent of the Group's interest in the arrangement.

Goodwill

Goodwill arising on acquisition is recognised as an asset at the date that control is acquired. Goodwill is measured as the excess of the sum of the consideration transferred, the amount of any non-controlling interest and the fair value of any previously held equity interest in the acquired entity, over the net of the acquisition date amounts of the identifiable assets and liabilities acquired.

If, after reassessment, the Group's interest in the net fair value of the acquiree's identifiable net assets exceeds the sum of the consideration transferred, the amount of any non-controlling interest and the fair value of any previously held equity interest in the acquired entity, the excess is recognised immediately in the income statement.

2 Significant accounting policies (continued)

Goodwill which is recognised as an asset is reviewed for impairment at least annually. Any impairment is recognised immediately in profit or loss and is not subsequently reversed. For the purpose of impairment testing, goodwill is allocated to each of the Group's cash-generating units (CGUs) expected to benefit from the synergies of the combination. CGUs to which goodwill has been allocated are tested for impairment annually, or more frequently when there is an indication that the unit may be impaired. If the recoverable amount of the CGU is less than the carrying amount of the unit, the impairment loss is allocated first to reduce the carrying amount of any goodwill allocated to the unit and then to the other assets of the unit pro rata on the basis of the carrying amount of each asset in the unit. On disposal of a subsidiary, associate or jointly-controlled entity, the attributable amount of goodwill is included in the determination of the profit or loss on disposal.

Other intangible assets

Assets are grouped into classes of similar nature and use and separately disclosed except where this is not material.

Expenditure on research is recognised as an expense in the period in which it is incurred. Development expenditure is capitalised as an intangible asset only if all of the following conditions are met:

- an asset is created that can be separately identified, and which the Group intends to use or sell,
- the finalisation of the asset is technically feasible and the Group has adequate resources to complete its development for use or sale,
- it is probable that the asset created will generate future economic benefits, and
- the development cost of the asset can be measured reliably.

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

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

Licences comprise premiums paid for the acquisition of licences, while franchises represent costs incurred in obtaining franchise rights and franchise goodwill arising on the acquisition of franchises. These are amortised on a straight-line basis over the life of the respective licence or franchise.

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

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 building improvements	The higher of 10% or the rate produced by the lease term
Machinery	15%–20%
Motor vehicles	10%–50%
Furniture	10%
Office equipment	20%–33%
Leased equipment	The higher of the rate produced by the lease term or useful life

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

Impairment of tangible and intangible assets

Annually, the Group reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Where the asset does not generate cash flows that are independent from other assets, the Group estimates the recoverable amount of the CGU to which the asset belongs. A CGU is the smallest group of assets that generates cash inflows from continuing use that are largely independent of the cash flows of other assets or groups of assets. For the purpose of impairment testing, the goodwill acquired in a business combination is allocated to cash-generating units that are expected to benefit from the synergies of the combination.

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

Notes to the Consolidated Financial Statements

2 Significant accounting policies (continued)

If the recoverable amount of an asset (or CGU) is estimated to be less than its carrying amount, the carrying amount of the asset (or CGU) is reduced to its recoverable amount. An impairment loss is recognised as an expense immediately. Impairment losses recognised in respect of CGUs are allocated first to reduce the carrying amount of any goodwill allocated to the units and then to reduce the carrying amount of the other assets in the unit (group of units) on a pro rata basis.

An impairment loss in respect of goodwill is not reversed. In respect of other assets, impairment losses recognised in prior periods are assessed at each reporting date for indications that the loss has decreased or no longer exists. Where an impairment loss subsequently reverses, the carrying amount of the asset (or CGU) is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, had no impairment loss been recognised for the asset (or CGU) in prior years. A reversal of an impairment loss is recognised as income immediately.

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

Retirement benefit costs

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

For defined benefit pension schemes, the cost of providing benefits is determined using the projected unit credit actuarial cost method, with actuarial valuations being carried out at each balance sheet date.

Actuarial gains and losses are recognised in full in the period in which they occur. They are recognised outside the income statement and are presented in the SOCI. The current service cost represents the increase in the present value of the scheme liabilities expected to arise from employee service in the current period.

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

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

The economic benefit from refunds is only recognised to the extent that the Group has an unconditional right to receive a refund.

To the extent that an economic benefit is available as a reduction in contributions and there is a minimum funding requirement, the economic benefit available as a reduction in contributions is calculated at the present value of:

- a) the estimated future service cost in each year, less
- b) the estimated minimum funding contributions required in respect of the future accrual and benefits in that year.

Defined benefit obligations arising from contractual obligations

Where the Group takes on a contract and assumes the obligation to contribute variable amounts to the defined benefit pension scheme throughout the period of the contract, the Group's share of the defined benefit obligation less its share of the pension scheme assets that it will fund over the period of the contract is recognised as a liability at the start of the contract with a corresponding amount being recognised as an intangible asset. The intangible asset, which reflects the Group's right to manage and operate the contract, is amortised over the contract period. The Group's share of the scheme assets and liabilities is calculated by reducing the scheme assets and liabilities by a franchise adjustment. The franchise adjustment represents the amount of scheme deficit that is expected to be funded outside the contract period. Subsequent actuarial gains and losses in relation to the Group's share of pension obligations are recognised outside the income statement and are presented in the SOCI.

Multi-employer pension schemes

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

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 33.

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).

2 Significant accounting policies (continued)

At the inception of the hedge relationship, the entity documents the relationship between the hedging instrument and the hedged item, along with its risk management objectives and its strategy for undertaking various hedge transactions. 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 33.

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

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

Deferred tax liabilities are recognised for taxable temporary differences arising on investments in subsidiaries, 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.

Share-based payment

The Group makes equity-settled share-based payments to certain employees and operates an HMRC approved Save As You Earn (SAYE) share option scheme open to eligible employees which allows the purchase of shares at a discount. These are measured at fair value at the date of grant. The fair value is expensed on a straight-line basis over the vesting period, based on the Group's estimate of shares that will eventually vest. SAYE options are treated as cancelled when employees cease to contribute to the scheme, resulting in an acceleration of the remainder of the related expense.

Notes to the Consolidated Financial Statements

2 Significant accounting policies (continued)

Where the fair value of share options requires the use of a valuation model, fair value is measured by use of the Binomial Lattice or Monte Carlo Simulation models depending on the type of scheme, as set out in note 38. 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 fair value and subsequently measured at amortised cost using the effective interest method, less provision for impairment. A provision for impairment of trade receivables is established when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of the contract. Significant financial difficulties of the debtor, probability that the debtor will enter bankruptcy or financial reorganisation, and default or delinquency in payments are considered indicators that a trade receivable is impaired. The amount of the provision is based on management's best estimate of the recoverable amount. The carrying amount of the asset is reduced through the use of an allowance for doubtful debts and the amount of the loss is recognised in the income statement within administrative expenses. When a trade receivable is uncollectible, it is written off against the allowance for doubtful debts. Subsequent recoveries of amounts previously written off are credited against administrative expenses.

Cash and cash equivalents

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

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.

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

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

Dividends are recorded in the Group's consolidated financial statements in the period in which they are declared, appropriately authorised and no longer at the discretion of the Company.

2 Significant accounting policies (continued)

Segmental information

Segmental information is based on internal reports about components of the Group that are regularly reviewed by the Group's Chief Operating Decision Maker in order to allocate resources to the segments and to assess their performance.

Segmental revenue is analysed on an external basis. Inter-segment revenue is not presented as it is not significant in the context of revenue as a whole. Net finance costs are not presented for each operating segment as they are reviewed on a consolidated basis by the Group's Chief Operating Decision Maker.

Items excluded from segmental results comprise corporate expenses. Specific corporate expenses are allocated to the corresponding segments. Segment assets comprise goodwill, other intangible assets, property, plant and equipment, inventories, trade and other receivables (excluding corporation tax recoverable) and any retirement benefit asset. Segment liabilities comprise trade and other payables and retirement benefit obligations.

3 Critical accounting judgements and key sources of estimation uncertainty

Critical judgements in applying the Group's accounting policies

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

Revenue and profit recognition of long-term project-based contracts

Revenue and profit is recognised for certain long-term project-based contracts based on the stage of completion of the contract activity. The assessment of the stage of completion requires the exercise of judgement and is measured by the proportion of costs incurred to estimated whole life contract costs, except where whole life contract costs exceed the contract value, in which case the excess is expensed immediately.

Capitalisation of internally generated intangible assets

When the Group creates an intangible asset where the future economic benefits are greater than the expected costs, the development costs are capitalised if they meet the other requirements of *IAS 38 Intangible Assets* as set out in the accounting policies section above.

Separation of income statement items from underlying results

IAS 1 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 determining what to include in underlying profit. We consider items which are material, non-recurring and outside of the normal operating practice of the Company to be suitable for separate presentation.

Key sources of estimation uncertainty

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

Impairment of goodwill

Determining whether goodwill is impaired requires an estimation of the value in use of the cash-generating units to which goodwill has been allocated. The value in use calculation involves an estimation of the future cash flows of cash-generating units and also the selection of appropriate discount rates, which involves judgement, to calculate present values (see note 20). The carrying value of goodwill is £1,270.8m (2012 restated £1,312.1m) at the balance sheet date.

Retirement benefit obligations

The calculation of retirement benefit obligations is dependent on material key assumptions including discount rates, future returns on assets and future contribution rates (see note 34). The value of net retirement benefit obligations at the balance sheet date is an asset of £52.9m (2012 restated £31.7m). Details of the impact of changes in assumptions relating to retirement benefit obligations are disclosed in note 34.

Business combinations

The calculation of fair values associated with business combinations requires the use of judgement in determining the future economic inflows and outflows associated with the acquired assets and liabilities. This includes the estimation of contingent deferred consideration and intangibles arising on acquisition. As permitted by IFRS 3 (2008), provisional amounts are recognised for acquired net assets during the measurement period where complete information about facts and circumstances that existed at the acquisition date is not available at the reporting date.

Provisions for onerous contracts

Determining whether provisions are required for loss making onerous contracts requires an estimate to be made of the future profitability of the given contract, based on various interdependent factors. Historically these provisions have been rare, but in the current year an exceptional charge was made for onerous contracts, with further details provided in notes 11 and 30.

Notes to the Consolidated Financial Statements

4 Prior year restatement

Changes in accounting policies

IFRS 11 and the revisions to IAS 19 were adopted in 2013. IFRS 11 removes the option for proportional consolidation of joint ventures and instead requires equity accounting. The revisions to IAS 19 require the pension interest return to be calculated using the value of scheme assets multiplied by the discount rate rather than the expected rate of return. Both of these changes were applied retrospectively, with the date of initial application being 1 January 2012, in accordance with the transition provisions of the individual standards and IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

Reallocation of costs

In 2012 £114m of costs previously included in administrative expenses have been reallocated to cost of sales, as in the view of the Group, this classification better reflects the underlying nature of these items.

Acquisition adjustments

After a review of the provisional acquisition accounting for Vertex Public Services Limited and DMS Maritime Pty Limited recognised in the 2012 accounts, the comparative information in relation to these acquisitions has been adjusted retrospectively.

Impact of prior year restatement on summarised financial statements

Year ended 31 December 2012	As disclosed £m	Acquisition adjustments £m	Changes in accounting policies		Restated £m
			IFRS 11 £m	IAS 19* £m	
Income statement					
Revenue	4,913 0	-	(852 9)	-	4,060 1
Operating profit	287 6	-	(12 9)	(2 5)	272 2
Investment revenue	12 4	-	(2 7)	(3 3)	6 4
Exceptional other gain	51 1	-	-	-	51 1
Finance costs	(49 1)	-	0 5	-	(48 6)
Profit before tax	302 0	-	(15 1)	(5 8)	281 1
Tax	(56 1)	-	15 1	0 9	(40 1)
Profit for the year	245 9	-	-	(4 9)	241 0

* IAS 19 Revised adjustment after application of IFRS 11

Earnings per share	49 94p	-	-	(1 00)p	48 94p
Other comprehensive income for the year	(84 5)	-	-	4 9	(79 6)
Total comprehensive income for the year	161 4	-	-	-	161 4
Balance sheet					
Non-current assets	2,103 4	(0 7)	(227 0)	-	1,875 7
Current assets	1,143 7	-	(142 4)	-	1,001 3
Total assets	3,247 1	(0 7)	(369 4)	-	2,877 0
Current liabilities	(997 8)	-	130 9	-	(866 9)
Non-current liabilities	(1,120 4)	0 7	238 5	-	(881 2)
Total liabilities	(2,118 2)	0 7	369 4	-	(1,748 1)
Net assets	1,128 9	-	-	-	1,128 9
Equity	1,128 9	-	-	-	1,128 9
Cash flow					
Net cash inflow from operating activities	303 4	-	(82 5)	-	220 9
Investing activities	(89 2)	-	85 2	-	(4 0)
Financing activities	(261 4)	-	1 6	-	(259 8)
Net decrease in cash and cash equivalents	(47 2)	-	4 3	-	(42 9)
Net exchange loss	(9 0)	-	0 1	-	(8 9)

4 Prior year restatement (continued)

At 1 January 2012	As disclosed £m	Acquisition adjustments £m	Changes in accounting policies		Restated £m
			IFRS 11 £m	IAS 19 £m	
Balance sheet					
Non-current assets	2,053.1	–	(181.0)	–	1,872.1
Current assets	1,129.0	–	(170.1)	–	958.9
Total assets	3,182.1	–	(351.1)	–	2,831.0
Current liabilities	(1,061.6)	–	138.9	–	(922.7)
Non-current liabilities	(1,116.7)	–	212.2	–	(904.5)
Total liabilities	(2,178.3)	–	351.1	–	(1,827.2)
Net assets	1,003.8	–	–	–	1,003.8
Equity	1,003.8	–	–	–	1,003.8

5 Segmental information

Information reported to the Chief Operating Decision Maker for the purposes of resource allocation and assessment of segment performance focuses on the geographic spread of the business in order to gain advantage of local market and customer understanding. In addition, due to its strategic importance to the Group, the global Business Process Outsourcing (BPO) business is reviewed separately as a single unit. The Group's reportable operating segments under IFRS 8 Operating Segments are:

Reportable segments

UK & Europe

Americas

AMEAA

Global Services

Operating segments

UK and Europe frontline services in areas including home affairs, defence, health, transportation and local government direct services

US defence, intelligence and federal civilian agencies operations and Canadian operations

Frontline contracts in Australasia, Middle East, Asia (including Hong Kong and India) and Africa

Global BPO middle and back office services

The reportable segments will change in 2014 to reflect the separation of the UK & Europe segment into two new segments, UK Central Government and UK Local and Regional Government, and the existing segment will no longer exist.

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

Geographic information

Year ended 31 December	Revenue 2013 £m	Non-current assets* 2013 £m	Revenue 2012 (restated) £m	Non-current assets* 2012 (restated) £m
United Kingdom	2,071.5	784.1	2,008.7	781.2
United States	706.5	423.7	694.4	437.5
Australia	869.2	167.0	700.3	192.5
Other countries	640.9	406.5	656.7	421.7
Total	4,288.1	1,781.3	4,060.1	1,832.9

* Non-current assets exclude financial instruments, deferred tax assets and loans to joint ventures.

Revenues from external customers are attributed to individual countries on the basis of the location of the customer.

Notes to the Consolidated Financial Statements

5 Segmental information (continued)

Information about major customers

The Group has two major governmental customers which each represent more than 10% of Group revenues. The customers' revenues were respectively £1,807.0m (2012 restated £1,727.3m) across UK & Europe and Global Services and £643.2m (2012 restated £649.7m) within the Americas segment.

The following is an analysis of the Group's revenue, results, assets and liabilities by reportable segment.

Year ended 31 December 2013	UK & Europe £m	Americas £m	AMEAA £m	Global Services £m	Corporate £m	Total £m
Adjusted revenue	2,556.9	765.3	1,049.5	772.2	–	5,143.9
Less: Share of joint venture revenue	(770.8)	(0.7)	(84.3)	–	–	(855.8)
Revenue	1,786.1	764.6	965.2	772.2	–	4,288.1
Result						
Operating profit before exceptional items	133.4	47.5	77.8	25.5	(49.9)	234.3
Exceptional net profit on disposal of subsidiaries and operations	19.2	–	–	–	–	19.2
Other exceptional operating items	(92.3)	–	(10.1)	(6.0)	(1.3)	(109.7)
Operating profit	60.3	47.5	67.7	19.5	(51.2)	143.8
Investment revenue						5.2
Finance costs						(42.4)
Profit before tax						106.6
Tax						(11.2)
Profit for the year						95.4
Supplementary information						
Interest in the profit of joint ventures	42.7	–	4.4	–	–	47.1
Depreciation	(24.2)	(2.7)	(15.3)	(11.9)	–	(54.1)
Amortisation of intangibles arising on acquisition	(0.3)	(11.3)	(2.4)	(7.4)	–	(21.4)
Other amortisation	(2.9)	(1.3)	(5.3)	(13.2)	(5.2)	(27.9)
Total amortisation	(3.2)	(12.6)	(7.7)	(20.6)	(5.2)	(49.3)
Segment assets						
Interests in joint ventures	1.4	0.2	6.5	–	–	8.1
Other segment assets	636.5	558.3	418.7	846.7	126.0	2,586.2
Total segment assets	637.9	558.5	425.2	846.7	126.0	2,594.3
Unallocated assets						214.6
Consolidated total assets						2,808.9
Segment liabilities						
Segment liabilities	(229.2)	(70.3)	(147.7)	(180.5)	(61.3)	(689.0)
Unallocated liabilities						(1,024.0)
Consolidated total liabilities						(1,713.0)

5 Segmental information (continued)

Year ended 31 December 2012 (restated)	UK & Europe £m	Americas £m	AMEAA £m	Global Services £m	Corporate £m	Total £m
Adjusted revenue	2 561 1	753 4	883 0	715 5	–	4 913 0
Less: Share of joint venture revenue	(723 4)	(0 7)	(128 8)	–	–	(852 9)
Revenue	1,837 7	752 7	754 2	715 5	–	4,060 1
Result						
Operating profit before exceptional items	166 0	41 5	58 1	50 6	(44 6)	271 6
Exceptional net profit on disposal of subsidiaries and operations	31 0	–	–	(25 4)	–	5 6
Other exceptional operating items	–	–	–	–	(5 0)	(5 0)
Operating profit	197 0	41 5	58 1	25 2	(49 6)	272 2
Investment revenue						6 4
Exceptional other gain						51 1
Finance costs						(48 6)
Profit before tax						281 1
Tax						(40 1)
Profit for the year						241 0
Supplementary Information						
Interest in the profit of joint ventures	51 1	0 1	11 3	–	–	62 5
Depreciation	(19 7)	(2 9)	(5 7)	(17 7)	(0 1)	(46 1)
Amortisation of intangibles arising on acquisition	(0 4)	(13 7)	(0 3)	(9 7)	–	(24 1)
Other amortisation	(3 2)	(0 8)	(2 0)	(11 8)	(3 1)	(20 9)
Total amortisation	(3 6)	(14 5)	(2 3)	(21 5)	(3 1)	(45 0)
Segment assets						
Interests in joint ventures	4 4	0 3	7 2	–	–	11 9
Other segment assets	674 2	604 3	453 7	844 9	74 2	2,651 3
Total segment assets	678 6	604 6	460 9	844 9	74 2	2,663 2
Unallocated assets						213 8
Consolidated total assets						2 877 0
Segment liabilities						
Segment liabilities	(313 1)	(93 7)	(146 3)	(256 1)	(28 4)	(837 6)
Unallocated liabilities						(910 5)
Consolidated total liabilities						(1 748 1)

6 List of principal undertakings

The Company has taken advantage of the exemption under Section 410(2) of the Companies Act 2006 by providing information only in relation to undertakings whose results or financial position, in the opinion of the Directors, principally affected the financial statements

A complete list of subsidiary and associated undertakings will be attached to the next Serco Group plc annual return to Companies House

The percentage of equity capital held directly or indirectly by Serco Group plc is shown below, together with the location of incorporation and operation. The voting rights are the same as the percentage holding

Principal subsidiaries		2013	2012
United Kingdom	Serco Limited	100%	100%
	NPL Management Limited	100%	100%
Australia	Serco Australia Pty Limited	100%	100%
India	Serco BPO Private Limited	100%	100%
USA	Serco Inc	100%	100%
Joint venture undertakings		2013	2012
United Kingdom	AWE Management Limited	33%	33%
	Northern Rail Holdings Limited	50%	50%

All joint ventures are accounted for using the equity method, none have quoted shares and there are no significant restrictions on the ability of any of the joint ventures to pay dividends or repay amounts owed. All the subsidiaries of the Group have been consolidated

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

Notes to the Consolidated Financial Statements

7 Joint ventures

The Group has certain arrangements where control is shared equally with one or more parties. As each arrangement is a separate legal entity and legal ownership and control are equal with all other parties, there are no significant judgements required to be made.

Summarised financial information of the joint ventures which are material to the Group and an aggregation of the other joint ventures in which the Group has an interest is as follows:

31 December 2013

Summarised financial information	AWE Management Limited (100% of results) £m	Northern Rail Holdings Limited (100% of results) £m	Group portion of material joint ventures* £m	Group portion of other joint venture arrangements* £m	Group portion total £m
Revenue	1,023.6	650.4	666.4	189.4	855.8
Operating profit	77.7	33.6	42.7	16.2	58.9
Net investment revenue/(finance costs)	0.3	0.6	0.4	(0.8)	(0.4)
Income tax expense	(11.1)	(9.4)	(8.4)	(3.0)	(11.4)
Profit from continuing operations	66.9	24.8	34.7	12.4	47.1
Other comprehensive income	–	(2.6)	(1.3)	3.4	2.1
Total comprehensive income	66.9	22.2	33.4	15.8	49.2
Dividends received from joint venture	25.5	14.2	39.7	11.8	51.5
Non-current assets	454.2	12.0	157.4	20.1	177.5
Current assets	163.2	90.2	99.5	36.7	136.2
Current liabilities	(147.3)	(95.2)	(96.7)	(34.9)	(131.6)
Non-current liabilities	(453.6)	(9.2)	(155.8)	(18.2)	(174.0)
Net assets	16.5	(2.2)	4.4	3.7	8.1
Proportion of group ownership	33%	50%	–	–	–
Carrying amount of investment	5.5	(1.1)	4.4	3.7	8.1

Supplementary material	AWE Management Limited (100% of results) £m	Northern Rail Holdings Limited (100% of results) £m	Group portion of material joint ventures* £m	Group portion of other joint venture arrangements* £m	Group portion total £m
Cash and cash equivalents	39.3	49.0	37.6	12.7	50.3
Current financial liabilities excluding trade and other payables and provisions	(7.5)	(5.2)	(5.1)	(1.5)	(6.6)
Non-current financial liabilities excluding trade and other payables and provisions	–	(3.0)	(1.5)	(4.4)	(5.9)
Depreciation and amortisation	–	(3.4)	(1.7)	(3.3)	(5.0)
Interest income	0.3	0.4	0.3	0.1	0.4
Interest expense	–	–	–	(0.2)	(0.2)

* Total results of the joint ventures multiplied by the respective proportion of Group ownership.

The financial statements of Northern Rail Holdings Limited are for a period which is different from that of the Group, being for the 52 week period ended 4 January 2014. 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.

7 Joint ventures (continued)

Certain employees of the groups headed by AWE Management Limited and Northern Rail Holdings Limited are members of sponsored defined benefit pension schemes. Given the significance of the schemes to understanding the position of the joint ventures the following key disclosures are made:

	AWE Management Limited	Northern Rail Holdings Limited
Main assumptions 2013		
Rate of salary increases (%)	3.5	3.4
Inflation assumption (CPI, %)	2.7	2.7
Discount rate (%)	4.8	4.7
Post-retirement mortality		
Current male industrial pensioners at 65 (years)	22.7	N/A
Future male industrial pensioners at 65 (years)	24.5	N/A
Retirement benefit funding position (100% of results)	£m	£m
Present value of scheme liabilities	(1,416.3)	(770.8)
Fair value of scheme assets	962.7	564.2
Net amount recognised	(453.6)	(206.6)
Members' share of deficit	-	82.6
Franchise adjustments*	-	120.2
Related asset, right to reimbursement	453.6	-
Net retirement benefit obligation	-	(3.8)

* The franchise adjustment represents the amount of scheme deficit that is expected to be funded outside the contract period.

The Northern Rail defined benefit pension scheme uses a mortality rate multiplier of 98% based on the S1 normal males (heavy) table, adjusted for the geographic location of members.

AWE Management Limited is not liable for any deficiency in the defined benefit pension scheme under current contractual arrangements. The deficit reflected in the financial statements of Northern Rail Holdings Limited 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.

31 December 2012

Summarised financial information	AWE Management Limited (100% of results) £m	Northern Rail Holdings Limited (100% of results) £m	Group portion of material joint ventures* £m	Group portion of other joint venture arrangements* £m	Group portion total £m
Revenue	973.5	597.2	623.1	229.8	852.9
Operating profit	106.5	34.8	52.9	24.3	77.2
Net investment revenue/(finance costs)	0.6	0.4	0.4	(0.6)	(0.2)
Income tax expense	(17.4)	(5.4)	(8.5)	(6.0)	(14.5)
Profit from continuing operations	89.7	29.8	44.8	17.7	62.5
Other comprehensive income	-	4.8	2.4	(3.7)	(1.3)
Total comprehensive income	89.7	34.6	47.2	14.0	61.2
Dividends received from joint venture	30.9	17.1	48.0	32.6	80.6
Non-current assets	644.1	10.8	220.1	21.4	241.5
Current assets	175.5	87.1	102.1	40.3	142.4
Current liabilities	(149.5)	(92.7)	(96.2)	(34.7)	(130.9)
Non-current liabilities	(644.1)	(1.2)	(215.3)	(25.8)	(241.1)
Net assets	26.0	4.0	10.7	1.2	11.9
Proportion of group ownership	33%	50%	-	-	-
Carrying amount of investment	8.7	2.0	10.7	1.2	11.9

* Total results of the joint ventures multiplied by the respective proportion of Group ownership.

Notes to the Consolidated Financial Statements

7 Joint ventures (continued)

Supplementary material	AWE Management Limited (100% of results) £m	Northern Rail Holdings Limited (100% of results) £m	Group portion of material joint ventures* £m	Group portion of other joint venture arrangements* £m	Group portion total £m
Cash and cash equivalents	90.4	31.0	45.6	10.2	55.8
Current financial liabilities excluding trade and other payables and provisions	(9.3)	(5.6)	(5.9)	(2.8)	(8.7)
Non-current financial liabilities excluding trade and other payables and provisions	—	—	—	(6.5)	(6.5)
Depreciation and amortisation	—	(5.7)	(2.9)	(3.1)	(6.0)
Interest income	0.6	0.4	0.4	0.3	0.7
Interest expense	—	—	—	—	—

* Total results of the joint ventures multiplied by the respective proportion of Group ownership

The financial statements of Northern Rail Holdings Limited are for the 52 week period ended 5 January 2013

Key disclosures with respect of the defined benefit pension schemes of material joint ventures

Main assumptions 2012	AWE Management Limited	Northern Rail Holdings Limited
Rate of salary increases (%)	3.40	3.40
Inflation assumption (CPI, %)	2.20	2.20
Discount rate (%)	4.30	4.30
Post-retirement mortality		
Current male industrial pensioners at 65 (years)	22.6	N/A
Future male industrial pensioners at 65 (years)	24.4	N/A
Retirement benefit funding position (100% of results)	£m	£m
Present value of scheme liabilities	(1,494.9)	(782.3)
Fair value of scheme assets	850.9	506.6
Net amount recognised	(644.0)	(275.7)
Members' share of deficit	—	110.3
Franchise adjustments*	—	165.4
Related asset, right to reimbursement	644.0	—
Net retirement benefit obligation	—	—

* The franchise adjustment represents the amount of scheme deficit that is expected to be funded outside the contract period

The Northern Rail defined benefit pension scheme uses a mortality rate multiplier of 98% based on the S1 normal males (heavy) table, adjusted for the geographic location of members

IFRS 11 was adopted in 2013. IFRS 11 removes the option for proportional consolidation of joint ventures and instead requires equity accounting for such entities, which is applied retrospectively from 1 January 2012. A breakdown of the assets and liabilities of all joint ventures at 1 January 2012 is as follows

	£m
Non-current assets	220.4
Current assets	171.6
Current liabilities	(140.4)
Non-current liabilities	(215.5)
Net assets	36.1

8 Acquisitions

Prior year acquisitions

Deferred consideration payments in relation to prior year acquisitions were made in 2013 totalling £18.6m. This represented £11.9m in respect of Intelenet and £6.7m in relation to The Listening Company. During 2012, a cash payment of £6.6m was made in respect of deferred contingent consideration payable following the acquisition of The Listening Company Limited in 2011.

After a review of the provisional acquisition accounting for Vertex Public Services Limited as recognised in the 2012 accounts, the comparative information in relation to this acquisition has been adjusted retrospectively to increase the fair value of deferred tax assets by £2.3m offset by a decrease in goodwill of £2.3m. Following a review of the provisional acquisition accounting for DMS Maritime Pty Limited as reported in the 2012 accounts, the comparative information in relation to this acquisition has been adjusted retrospectively to reduce the fair value of intangible assets recognised by £7.9m, offset by an increase in goodwill of £7.2m and a decrease in the deferred tax liability of £0.7m. As a result of the failure to meet earn-out criteria, an adjustment was made to the deferred consideration arising on the Intelenet acquisition in 2011 of £10.3m.

A summary of the significant 2012 acquisitions, together with the other acquisitions in aggregate is as follows:

Fair value of net assets acquired

	Vertex Public Services Limited 2012 £m	DMS Maritime Pty Limited 2012 £m	Other acquisitions (in aggregate) 2012 £m	Total 2012 £m
Intangible assets	7.4	32.7	4.3	44.4
Property, plant and equipment	0.6	4.8	0.6	6.0
Inventories	–	5.5	–	5.5
Deferred tax asset	3.8	–	–	3.8
Trade and other receivables	27.8	10.0	2.1	39.9
Cash and cash equivalents	–	–	0.8	0.8
Trade and other payables	(23.3)	–	(1.2)	(24.5)
Tax liabilities	–	–	(0.1)	(0.1)
Deferred tax liability	–	(10.3)	–	(10.3)
Provisions	(4.9)	(0.4)	(0.7)	(6.0)
Loans	–	(14.8)	–	(14.8)
Bank overdraft	–	(0.4)	–	(0.4)
Retirement benefit obligations	(13.4)	–	–	(13.4)
Net (liabilities)/assets acquired	(2.0)	27.1	5.8	30.9
Gain on remeasurement to fair value	–	(51.1)	–	(51.1)
Goodwill	57.5	93.1	9.4	160.0
Total consideration	55.5	69.1	15.2	139.8
Satisfied by				
Cash	55.5	69.1	11.4	136.0
Contingent consideration	–	–	3.8	3.8
Total consideration	55.5	69.1	15.2	139.8
Net cash outflow arising on acquisition				
Purchase consideration	55.5	69.1	11.4	136.0
Cash and cash equivalents acquired	–	–	(0.8)	(0.8)
Net cash outflow arising on current year acquisitions	55.5	69.1	10.6	135.2
Consideration paid in respect of previous periods	–	–	–	6.6
Acquisition of subsidiaries, net of cash acquired	–	–	–	141.8

Notes to the Consolidated Financial Statements

9 Disposals

On 27 November 2013 the Group disposed of its London streets maintenance and UK transport technology business. On 4 October 2013, the Group disposed of its occupational health business. Details of these transactions are given below.

The net assets at the date of disposal were:

	Transport 2013 £m	Occupational health 2013 £m	Other 2013 £m	Total 2013 £m	Total 2012 £m
Goodwill	14.0	1.7	–	15.7	86.8
Other intangible assets	–	0.5	–	0.5	4.6
Property, plant and equipment	0.4	0.2	0.1	0.7	19.0
Inventories	0.3	–	–	0.3	–
Deferred tax asset	–	–	–	–	5.2
Trade and other receivables	7.5	3.0	0.5	11.0	53.7
Loans receivable	–	–	–	–	25.9
Cash and cash equivalents	–	–	–	–	1.4
Trade and other payables	(3.5)	(0.7)	–	(4.2)	(15.6)
Finance lease obligations	–	–	–	–	(6.2)
Bank overdrafts	–	–	–	–	(1.3)
Provisions	(0.3)	–	–	(0.3)	(0.1)
Other loans	–	–	–	–	(0.1)
Retirement benefit obligations	–	–	–	–	(50.5)
Deferred tax liabilities	–	–	–	–	(5.2)
Net assets disposed	18.4	4.7	0.6	23.7	117.6

The profit/(loss) on disposal is calculated as follows:

Cash consideration	44.9	3.5	0.8	49.2	141.6
Less:					
Net assets disposed	(18.4)	(4.7)	(0.6)	(23.7)	(117.6)
Disposal-related costs	(3.3)	(2.7)	(0.3)	(6.3)	(18.4)
Profit/(loss) on disposal	23.2	(3.9)	(0.1)	19.2	5.6

The net cash inflow/(outflow) arising on disposals is as follows:

Consideration received	44.9	3.5	0.8	49.2	141.6
Less:					
Deferred consideration	(2.3)	–	–	(2.3)	–
Cash and cash equivalents disposed	–	–	–	–	(1.4)
Disposal-related costs paid during the period	(2.4)	(1.3)	(2.6)	(6.3)	(9.2)
Net cash inflow/(outflow) on disposal	40.2	2.2	(1.8)	40.6	131.0

During the year, £2.5m of disposal costs in relation to a prior year transaction were cash settled.

10 Revenue

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

Year ended 31 December	2013 £m	2012 (restated) £m
Rendering of services	4,214.0	3,970.1
Revenue from long-term project-based contracts	74.1	90.0
Revenue as disclosed in the consolidated income statement	4,288.1	4,060.1
Investment revenue (note 14)	5.2	6.4
Operating lease income	1.0	0.9
Total revenue as defined in IAS 18	4,294.3	4,067.4

11 Exceptional items

Current year exceptional items

Exceptional items are non-recurring items of financial performance that are material to the results of the Group either by virtue of size or nature. We believe these items require separate disclosure on the face of the income statement to assist in the understanding of the underlying performance of the Group.

Net profit on disposal of subsidiaries and operations

Year ended 31 December	2013 £m
Gain on disposal of UK transport maintenance business	23.2
Loss on disposal of occupational health business	(3.9)
Loss on disposal of Ascot College	(0.1)
Net profit on disposal of subsidiaries and operations	19.2

In November 2013 the Group completed the sale of its London streets maintenance and UK transport technology business to Cubic Corporation which after disposal-related costs, resulted in a profit on disposal of £23.2m. This was offset by a loss on the disposal of the occupational health business in October 2013 of £3.9m and Ascot College of £0.1m, which was sold in December 2013.

Other exceptional operating items

During the year an investigation was undertaken by the Ministry of Justice (MoJ) into the billing practices in respect of our Electronic Monitoring (EM) contract. Additionally, the Cabinet Office undertook a wider review across other Serco contracts with UK Central Government. 48% of 2013 contract revenues in the UK & Europe division were covered by reviews undertaken by Central Government and the Ministry of Justice. Serco has also agreed with the UK Government to undertake a process of corporate renewal, to strengthen governance and transparency which includes the separation of the UK & Europe division into two. The audits, reviews and corporate renewal processes all incurred one-off costs that are deemed to be exceptional items, which are set out in the table below together with other items identified for separate presentation.

Year ended 31 December	UK Government review related Items 2013 £m	Other 2013 £m	Total 2013 £m
Settlement amounts relating to UK Government reviews	(66.3)	–	(66.3)
Costs associated with UK Government reviews	(11.6)	–	(11.6)
UK clinical health contract provisions	–	(17.6)	(17.6)
Restructuring	–	(14.9)	(14.9)
Asset impairment	–	(9.6)	(9.6)
Deferred consideration relating to prior year acquisition	–	10.3	10.3
Other exceptional operating items	(77.9)	(31.8)	(109.7)

Settlement amounts relating to UK Government reviews

In December 2013, following a review of the billing arrangements on the EM contract by the Ministry of Justice, a settlement of £64.3m was reached in respect of contractual claims. In addition, a £2.0m settlement was reached on the Prisoner Escort and Custody Services (PECS) contract which was also subject to Government review to reflect repayment of past profit earned on this contract. The settlement was full and final in respect of contractual claims with the proviso that additional payments might be sought in limited circumstances, such as if criminality were to be established. Serco continues to cooperate fully with the ongoing investigations by the Serious Fraud Office.

Costs associated with UK Government reviews

Since July 2013 there have been external adviser and other directly related incremental costs that amount to £11.6m.

UK clinical health contract provisions

During the year we completed a review of the clinical health operations in the UK. As a result, we will exit two contracts early. These contracts, together with a third loss-making contract, require contract provisions for estimated losses in future years and the impairment of operating assets which in total amounts to a non-cash exceptional charge of £17.6m.

Restructuring

As a result of a wider assessment of the Group's operations, a restructuring charge of £14.9m was taken, with £13.3m directly related to the corporate renewal process.

Asset impairment

As a result of a review of under-performing businesses and operations, an impairment charge of £9.6m was taken in relation to the carrying value of fixed assets in Great Southern Railway, a rail tourism business based in Australia, reflecting more challenging conditions in that market.

Adjustment to prior year acquisitions

On assessment against the earn-out criteria, an adjustment was made to the deferred consideration arising on the Intelnet acquisition in 2011 of £10.3m.

Notes to the Consolidated Financial Statements

11 Exceptional items (continued)

Tax impact of above items

The tax impact of these items was a tax credit of £28.8m

Prior year exceptional items

Net profit on disposal of subsidiaries and operations

Year ended 31 December	2012 £m
Net profit on disposal of subsidiaries and operations	5.6

During the prior year the Group disposed of its Technical Services business which provided consulting and project solutions, resulting in a profit of £57.6m. In addition, the German Serco business was sold as well as the UK data hosting operations and education software businesses, resulting in losses of £27.7m, £11.5m and £12.8m respectively.

Other exceptional operating items

Year ended 31 December	2012 £m
Exceptional donation to Serco Foundation	5.0

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

Exceptional other gain – gain on step acquisition accounting of joint venture

Year ended 31 December	2012 £m
Gain on step acquisition accounting of joint venture	51.1

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

Tax impact of above items

The tax impact of these items was a credit in the income statement of £6.5m.

12 Operating profit

Operating profit is stated after charging/(crediting)

Year ended 31 December	2013 £m	2012 (restated) £m
Research and development costs	20.0	23.5
Profit on disposal of property, plant and equipment	–	(0.9)
Loss on disposal of intangible assets	1.0	–
Depreciation and impairment of property, plant and equipment (note 22)	54.1	46.1
Amortisation of intangible assets – arising on acquisition (note 21)	21.4	24.1
Amortisation and impairment of intangible assets – other (note 21)	27.9	20.9
Staff costs (note 13)	1,999.2	1,911.9
Exceptional net profit on disposal of subsidiaries and operations (note 11)	(19.2)	(5.6)
Other exceptional operating items (note 11)	109.7	5.0
Allowance for doubtful debts charged/(credited) to income statement (note 24)	0.4	(0.8)
Net foreign exchange credit	(7.7)	(7.5)
Movement on non-designated hedges and reclassified cash flow hedges	6.6	7.1
Minimum lease payments recognised as an operating lease expense	117.6	101.5
Operating lease income from sub-leases (note 10)	(1.0)	(0.9)

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

Year ended 31 December	2013 £m	2012 £m
Fees payable to the Company's Auditor for the audit of the Company's annual accounts	1 1	0 9
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 8	0 8
Total audit fees	1 9	1 7
– Audit-related assurance services	0 2	0 1
– Taxation compliance services	0 1	0 3
– Other taxation advisory services	0 3	0 3
– Other services	0 3	0 4
Total non-audit fees	0 9	1 1

Fees payable to Deloitte LLP and their associates for non-audit services to the Company are not required to be disclosed separately because the consolidated financial statements are required to disclose such fees on a consolidated basis

Details of the company's policy on the use of auditors for non-audit services and how the auditor's independence and objectivity was safeguarded are set out in the Audit Committee Report on page 78. No services were provided pursuant to contingent fee arrangements

13 Staff costs

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

Year ended 31 December	2013 Number	2012 (restated) Number
UK & Europe	20,155	23,403
Americas	9,293	8,854
AMEAA	9,952	8,465
Global Services	55,464	48,672
Unallocated	116	141
	94,980	89,535

Aggregate remuneration comprised

Year ended 31 December	2013 £m	2012 (restated) £m
Wages and salaries	1,752 5	1,680 4
Social security costs	135 2	133 9
Other pension costs (note 34)	108 6	85 5
	1,996 3	1,899 8
Share-based payment expense (note 38)	2 9	12 1
	1,999 2	1,911 9

14 Investment revenue

Year ended 31 December	2013 £m	2012 (restated) £m
Interest receivable on other loans and deposits	2 4	2 5
Net interest receivable on retirement benefit obligations (note 34)	2 3	3 9
Movement in discount on other debtors	0 5	–
	5 2	6 4

Notes to the Consolidated Financial Statements

15 Finance costs

Year ended 31 December	2013 £m	2012 (restated) £m
Interest payable on non recourse loans	0.8	0.9
Interest payable on obligations under finance leases	2.5	2.8
Interest payable on other loans	31.5	30.8
Facility fees and other charges	6.1	12.2
Movement in discount on provisions and deferred consideration	1.5	1.9
	42.4	48.6

16 Tax

16 (a) Income tax recognised in the income statement

Year ended 31 December	Before exceptional items 2013 £m	Exceptional items 2013 £m	Total 2013 £m	Before exceptional items 2012 (restated) £m	Exceptional items 2012 £m	Total 2012 (restated) £m
Current income tax						
Current income tax expense	31.6	–	31.6	37.5	(5.1)	32.4
Adjustments in respect of prior years	(9.2)	(0.2)	(9.4)	(5.5)	–	(5.5)
Deferred tax						
Current year	19.7	(25.4)	(5.7)	9.5	(1.4)	8.1
Adjustments in respect of prior years	(2.1)	(3.2)	(5.3)	5.1	–	5.1
	40.0	(28.8)	11.2	46.6	(6.5)	40.1

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 2013 £m	Exceptional items 2013 £m	Total 2013 £m	Before exceptional items 2012 (restated) £m	Exceptional items 2012 £m	Total 2012 (restated) £m
Profit before tax	197.1	(90.5)	106.6	229.4	51.7	281.1
Tax calculated at a rate of 23.3% (2012: 24.5%)	45.9	(21.1)	24.8	56.2	12.7	68.9
Expenses/(income) not deductible for tax purposes	(0.5)	0.6	0.1	1.4	0.7	2.1
Unrelieved tax losses	2.9	–	2.9	3.6	–	3.6
Effect of the use of unrecognised tax losses	(0.1)	–	(0.1)	–	–	–
Unprovided deferred tax	0.9	–	0.9	0.8	–	0.8
Impact of changes in statutory tax rates	4.1	3.6	7.7	1.4	–	1.4
Overseas rate differences	10.9	(0.8)	10.1	2.7	–	2.7
Other non-taxable income	–	(2.4)	(2.4)	–	–	–
Step acquisition accounting of joint venture	–	–	–	–	(12.5)	(12.5)
Disposal of Serco GmbH	–	–	–	–	6.8	6.8
Statutory tax benefits	(1.8)	(5.3)	(7.1)	(3.7)	(14.2)	(17.9)
Adjustments in respect of prior years	(11.3)	(3.4)	(14.7)	(0.4)	–	(0.4)
Adjustments in respect of equity accounted investments	(11.0)	–	(11.0)	(15.4)	–	(15.4)
Tax charge/(credit)	40.0	(28.8)	11.2	46.6	(6.5)	40.1

16 Tax (continued)

16 (b) Income tax recognised in the SOCI

Year ended 31 December	2013 £m	2012 (restated) £m
Current tax		
Taken to retirement benefit obligations reserve	(1 1)	5 9
Deferred tax		
Relating to cash flow hedges	1 2	4 1
Taken to retirement benefit obligations reserve	4 1	17 1
	4 2	27 1

The income tax expense for the year is based on the blended UK statutory rate of corporation tax for the period of 23.3% (2012: 24.5%). The impact of changes in statutory tax rates relates principally to the reduction of the UK corporation tax rate from 24% to 23% from 1 April 2013, which was enacted on 17 July 2012. In addition, the UK corporation tax rate was reduced from 23% to 21% from 1 April 2014 and from 21% to 20% from 1 April 2015, which was enacted on 17 July 2013. These changes have resulted in a deferred tax charge arising from the reduction in the balance sheet carrying value of deferred tax assets to reflect the anticipated rate of tax at which those assets are expected to reverse.

16 (c) Tax on items taken directly to equity

Year ended 31 December	2013 £m	2012 £m
Current tax		
Recorded in share-based payment reserve	(0 1)	0 6
Deferred tax		
Recorded in share-based payment reserve	(5 8)	2 5
	(5 9)	3 1

17 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 deferred tax assets and liabilities during the year was as follows:

	2013 £m	2012 (restated) £m
At 1 January – asset	(9 7)	(2 9)
Income statement charge (note 16)	(11 0)	13 2
Acquisitions/disposals	–	3 5
Items recognised in equity and in other comprehensive income (note 16)	0 5	(23 7)
Exchange differences	(3 3)	0 2
At 31 December – asset	(23 5)	(9 7)

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17 Deferred tax (continued)

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

	Temporary differences on assets/intangibles £m	Share-based payment and employee benefits £m	Retirement benefit schemes £m	Derivative financial instruments £m	Other temporary differences £m	Total £m
At 1 January 2013 (restated)	21.3	(21.0)	6.3	(13.8)	(2.5)	(9.7)
(Credited)/charged to income statement	(9.9)	4.4	(1.2)	0.1	(4.4)	(11.0)
Items recognised in equity and in other comprehensive income	–	6.8	1.8	(1.2)	(6.9)	0.5
Exchange differences	(2.8)	0.4	–	(0.1)	(0.8)	(3.3)
At 31 December 2013	8.6	(9.4)	6.9	(15.0)	(14.6)	(23.5)

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

	Temporary differences on assets/intangibles £m	Share-based payment and employee benefits £m	Retirement benefit schemes £m	Derivative financial instruments £m	Other temporary differences £m	Total £m
At 1 January 2012	25.6	(23.8)	18.5	(9.1)	(17.1)	(5.9)
Changes in accounting policies	0.1	1.4	2.0	(0.6)	0.1	3.0
At 1 January 2012 (restated)	25.7	(22.4)	20.5	(9.7)	(17.0)	(2.9)
(Credited)/charged to income statement	(3.2)	3.6	0.7	–	12.1	13.2
Acquisitions/disposals	1.0	0.1	2.0	–	0.4	3.5
Items recognised in equity and in other comprehensive income	–	(2.5)	(17.1)	(4.1)	–	(23.7)
Exchange differences	(2.2)	0.2	0.2	–	2.0	0.2
At 31 December 2012 (restated)	21.3	(21.0)	6.3	(13.8)	(2.5)	(9.7)

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

	2013 £m	2012 (restated) £m
Deferred tax liabilities	34.4	30.4
Deferred tax assets	(57.9)	(40.1)
	(23.5)	(9.7)

At the balance sheet date, the Group did not recognise deferred tax assets of £9.4m (2012: £16.5m) which principally relate to unused tax losses of £40.2m (2012: £48.4m). Losses of £14.4m (2012: £11.8m) expire within five years, losses of £1.2m (2012: £24.4m) expire within six to ten years, losses of £7.0m (2012: £nil) expire within fifteen to twenty years, losses of £1.0m (2012: £nil) expire within twenty to twenty-five years and losses of £16.6m (2012: £12.2m) may be carried forward indefinitely.

18 Dividends

	2013 £m	2012 £m
Amounts recognised as distributions to equity holders in the year		
Final dividend for the year ended 31 December 2012 of 7.45p per share on 488.3 million ordinary shares (2012: Final dividend for the year ended 31 December 2011 of 5.9p per share on 490.2 million ordinary shares)	36.4	28.9
Interim dividend for the year ended 31 December 2013 of 3.10p per share on 486.9 million ordinary shares (2012: Interim dividend for the year ended 31 December 2012 of 2.65p per share on 488.2 million ordinary shares)	15.1	13.0
	51.5	41.9
Proposed final dividend for the year ended 31 December 2013 of 7.45p per share on 487.4 million ordinary shares (2012: 7.45p on 488.3 million ordinary shares)	36.3	36.4

The proposed final dividend for 2013 is subject to approval by shareholders at the Annual General Meeting and has not been included as a liability in these financial statements. A dividend waiver is effective for those shares held on behalf of the Company by its Employee Share Ownership Trust (note 37).

19 Earnings per share

Basic and diluted earnings per ordinary share (EPS) have been calculated in accordance with IAS 33 *Earnings per Share*.

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

	2013 Millions	2012 Millions
Number of shares		
Weighted average number of ordinary shares for the purpose of basic EPS	489.0	491.2
Effect of dilutive potential ordinary shares: share options	11.6	11.7
Weighted average number of ordinary shares for the purpose of diluted EPS	500.6	502.9

	Earnings 2013 £m	Per share amount 2013 Pence	Earnings 2012 (restated) £m	Per share amount 2012 (restated) Pence
Earnings per share				
Earnings before exceptional items	157.1	32.13	182.8	37.09
Exceptional items	(61.7)	(12.62)	58.2	11.85
Earnings for the purpose of basic EPS	95.4	19.51	241.0	48.94
Effect of dilutive potential ordinary shares	–	(0.45)	–	(1.14)
Diluted EPS	95.4	19.06	241.0	47.80

At 31 December 2013, options over nil (2012: nil) shares were excluded from the weighted average number of shares used for calculating diluted earnings per share because their exercise price was above the average share price for the year and they were, therefore, anti-dilutive.

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20 Goodwill

	£m
At 1 January 2012	1,259.0
Changes in accounting policies	(5.1)
At 1 January 2012 (restated)	1,253.9
Additions	167.5
Disposals	(86.8)
Exchange differences	(22.5)
At 1 January 2013 (restated)	1,312.1
Disposals	(15.7)
Exchange differences	(25.6)
At 31 December 2013	1,270.8

The goodwill acquired in business combinations is allocated, at acquisition, to the cash-generating units (CGUs) that are expected to benefit from that business combination.

The Group tests goodwill annually for impairment or more frequently if there are indications that goodwill might be impaired. The annual impairment test is performed immediately prior to the year end based on financial plans approved by senior management covering a five-year period. The recoverable amount of each CGU is based on value in use calculations derived from these plans. The plans include a terminal value based on the projections for the final year of that plan, with a growth rate assumption applied to subsequent periods. The results of the impairment test are further reviewed after the year end in light of any significant changes in the environment.

Key assumptions

The key assumptions affecting the CGUs within each operating segment are discussed below. The table shows the key assumptions applied in the impairment review across the CGUs. These assumptions are revised year on year in light of changes to the current economic environment.

	Discount rate 2013 %	Discount rate 2012 %	Terminal growth rates 2013 %	Terminal growth rates 2012 %	Goodwill 2013 £m	Goodwill 2012 (restated) £m
UK & Europe						
Health	9.1	8.4	2.2	2.5	79.5	81.2
Transport & Local Direct Services	9.1	8.4	2.2	2.5	116.9	130.9
Home Affairs	9.1	8.4	2.2	2.5	46.0	46.0
Germany	8.6	8.0	2.0	2.2	17.6	17.1
Global Services	12.5	10.5	4.0	5.0	513.3	513.5
Americas	10.5	9.5	2.4	2.7	385.9	393.2
AMEAA						
ASPAC	10.4	9.5	3.0	3.0	103.3	121.8
Middle East	8.6	7.3	3.0	3.5	8.3	8.4
At 31 December					1,270.8	1,312.1

Short-term growth rates

Short-term revenue growth rates used in each CGU five-year plan are based on internal data regarding the current pipeline of opportunities and published industry forecasts for the relevant market. Further discussion of the Group's order book and pipeline is provided in the Our business and Our performance sections.

Terminal growth rates

The cash flows subsequent to the five-year period are based upon management's estimate of the growth rates of the sectors in which the CGUs operate. Where possible these have been derived with reference to external sources.

These rates do not exceed the average long-term growth rates forecast for the individual market sectors.

Discount rate

Pre-tax discount rates, derived from the Group's post-tax weighted average cost of capital have been used in discounting the projected cash flows. These rates are adjusted for risks specific to the market in which the CGU operates, including but not limited to geographic and economic risks, contract length and customer type.

20 Goodwill (continued)

Sensitivity analysis

Sensitivity analysis has been performed for each key assumption and, except as noted below, the Directors have not identified any reasonably possible change in a key assumption that would cause the carrying value of net assets, including goodwill, to exceed the recoverable amount

Sensitivity analysis shows that a 1% increase in the discount rate would result in an impairment of the Americas CGU of £40m, the Health CGU of £3m and the Global Services CGU of £58m. A 1% increase in the discount rate would not cause the operating assets, including goodwill, to exceed their recoverable amount on any other CGU

Sensitivity analysis shows that a 1% decrease in the terminal growth rate would result in an impairment of the Americas CGU of £14m, the Health CGU of £1m and the Global Services CGU of £41m. A 1% decrease in the terminal growth rate would not cause the operating assets, including goodwill, to exceed their recoverable amount on any other CGU

If the short term growth rate were to equal the terminal growth rate applied to the Health CGU forecast this would result in an impairment of £20m

21 Other intangible assets

	Acquisition related		Other		Total £m
	Customer relationships £m	Licences and franchises £m	Software, IT and other development expenditure £m	Pension related intangibles £m	
Cost					
At 1 January 2013	147.2	72.0	208.6	15.7	443.5
Eliminated on disposal	-	-	(1.5)	-	(1.5)
Additions from internal development	-	-	27.8	-	27.8
Disposals	-	(71.1)	(16.7)	-	(87.8)
Reclassification (to)/from property, plant and equipment	-	(0.4)	8.1	-	7.7
Exchange differences	(10.0)	0.7	(5.9)	-	(15.2)
At 31 December 2013	137.2	1.2	220.4	15.7	374.5
Accumulated amortisation and impairment					
At 1 January 2013	56.4	66.4	92.5	12.5	227.8
Eliminated on disposal	-	-	(1.0)	-	(1.0)
Charge for the year – impairment (exceptional)	-	-	3.2	-	3.2
Charge for the year – amortisation	16.5	4.9	22.5	2.2	46.1
Disposals	-	(71.1)	(15.3)	-	(86.4)
Reclassification from property, plant and equipment	-	-	4.9	-	4.9
Exchange differences	(3.3)	0.6	(3.1)	-	(5.8)
At 31 December 2013	69.6	0.8	103.7	14.7	188.8
Net book value					
At 31 December 2013	67.6	0.4	116.7	1.0	185.7

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21 Other intangible assets (continued)

	Acquisition related		Other		Total £m
	Customer relationships £m	Licences and franchises £m	Software IT and other development expenditure £m	Pension related intangibles £m	
Cost					
At 1 January 2012	116.5	74.2	170.9	26.2	387.8
Changes in accounting policies	–	(2.2)	(0.8)	(12.4)	(15.4)
At 1 January 2012 (restated)	116.5	72.0	170.1	13.8	372.4
Arising on acquisition	36.8	–	1.1	–	37.9
Eliminated on disposal	–	–	(14.1)	–	(14.1)
Additions from internal development	–	0.7	49.2	–	49.9
Disposals	(0.4)	–	(2.5)	–	(2.9)
Reclassification from property, plant and equipment	–	0.9	6.4	–	7.3
Pension scheme franchise adjustment	–	–	–	1.9	1.9
Exchange differences	(5.7)	(1.6)	(1.6)	–	(8.9)
At 31 December 2012 (restated)	147.2	72.0	208.6	15.7	443.5
Accumulated amortisation					
At 1 January 2012	42.1	61.8	79.1	19.9	202.9
Changes in accounting policies	–	(1.7)	(0.3)	(8.9)	(10.9)
At 1 January 2012 (restated)	42.1	60.1	78.8	11.0	192.0
Arising on acquisition	–	–	0.3	–	0.3
Eliminated on disposal	–	–	(10.0)	–	(10.0)
Charge for the year	16.6	7.5	19.4	1.5	45.0
Disposals	(0.4)	–	(2.3)	–	(2.7)
Reclassification (to)/ from property, plant and equipment	(0.3)	0.5	6.3	–	6.5
Exchange differences	(1.6)	(1.7)	–	–	(3.3)
At 31 December 2012 (restated)	56.4	66.4	92.5	12.5	227.8
Net book value					
At 31 December 2012 (restated)	90.8	5.6	116.1	3.2	215.7

Included in Software IT and other development expenditure is an amount of £16.2m (2012: £9.7m) in respect of leased intangibles

Customer relationships are amortised over the average length of contracts acquired. The Group is carrying £67.6m (2012: £90.8m) in relation to Customer relationships. The remaining average life of the Customer relationship intangible assets is approximately four years (2012: five years).

Amortisation of intangibles arising on acquisition consists of amortisation in relation to Customer relationships and Licences and franchises and totals £21.4m (2012: £24.1m).

The Group is carrying £116.7m (2012: £116.1m) in relation to Software, IT and other development expenditure which includes assets relating to the Group's SAP related systems of £44.2m (2012: £59.4m). The average amortisation period of these assets has five years (2012: six years) remaining.

The value of internally generated intangible assets as at 31 December 2013 was approximately £64.4m (2012: £70.7m). Internally generated intangibles relate to development costs and software.

22 Property, plant and equipment

	Freehold land and buildings £m	Short- leasehold building improvements £m	Machinery, motor vehicles, furniture and equipment £m	Total £m
Cost				
At 1 January 2013	4 8	59 1	297 3	361 2
Additions	0 1	7 0	62 5	69 6
Reclassification from/(to) intangible assets	0 8	6 9	(15 4)	(7 7)
Disposals	–	(7 9)	(29 4)	(37.3)
Eliminated on disposal	–	(0 4)	(1 4)	(1.8)
Exchange differences	(0 3)	(3 3)	(14 6)	(18.2)
At 31 December 2013	5 4	61 4	299 0	365 8
Accumulated depreciation and impairment				
At 1 January 2013	1 9	32 1	150 3	184 3
Charge for the year – impairment (exceptional)	–	–	6 4	6.4
Charge for the year – depreciation and impairment	0 3	7 8	39 6	47 7
Reclassification from/(to) intangible assets	0 1	0 1	(5 1)	(4 9)
Disposals	–	(6 2)	(25 9)	(32 1)
Eliminated on disposal	–	(0 2)	(0 9)	(1 1)
Exchange differences	(0 2)	(1 7)	(9 4)	(11 3)
At 31 December 2013	2 1	31 9	155 0	189 0
Net book value				
At 31 December 2013	3 3	29 5	144 0	176 8

	Freehold land and buildings £m	Short- leasehold building improvements £m	Machinery motor vehicles, furniture and equipment £m	Total £m
Cost				
At 1 January 2012	7 0	59 0	339 6	405 6
Changes in accounting policies	–	(3 0)	(52 5)	(55 5)
At 1 January 2012 (restated)	7 0	56 0	287 1	350 1
Additions	1 2	4 9	75 1	81 2
Reclassification from/(to) intangible assets	1 5	8 3	(17 1)	(7 3)
Disposals	(0 6)	(1 9)	(43 4)	(45 9)
Arising on acquisition	–	1 4	22 4	23 8
Eliminated on disposal	(4 2)	(7 9)	(21 3)	(33 4)
Exchange differences	(0 1)	(1 7)	(5 5)	(7 3)
At 31 December 2012 (restated)	4 8	59 1	297 3	361 2
Accumulated depreciation and impairment				
At 1 January 2012	3 7	27 1	180 0	210 8
Changes in accounting policies	–	(1 3)	(33 8)	(35 1)
At 1 January 2012 (restated)	3 7	25 8	146 2	175 7
Charge for the year	0 3	8 6	37 2	46 1
Reclassification from/(to) intangible assets	0 2	3 4	(10 1)	(6 5)
Disposals	(0 1)	(1 1)	(24 7)	(25 9)
Arising on acquisition	–	1 3	16 5	17 8
Eliminated on disposal	(2 2)	(5 1)	(12 0)	(19 3)
Exchange differences	–	(0 8)	(2 8)	(3 6)
At 31 December 2012 (restated)	1 9	32 1	150 3	184 3
Net book value				
At 31 December 2012 (restated)	2 9	27 0	147 0	176 9

The carrying amount of the Group's Machinery, motor vehicles, furniture and equipment includes an amount of £57.0m (2012 £42.0m) in respect of assets held under finance leases

The carrying amount of the Group's Short-leasehold building improvements includes an amount of £0.4m (2012 £0.5m) in respect of assets held under finance leases

Notes to the Consolidated Financial Statements

23 Inventories

	2013 £m	2012 (restated) £m
Service spares	33.8	33.5
Parts awaiting installation	10.4	12.8
Work in progress	5.2	6.8
	49.4	53.1

24 Trade and other receivables

	2013 £m	2012 (restated) £m
Trade and other receivables non-current		
Amounts owed by joint ventures	9.5	9.2
Loans receivable (note 29)	3.3	0.1
Security deposits	0.6	0.3
Other receivables	64.9	39.6
	78.3	49.2

	2013 £m	2012 (restated) £m
Trade and other receivables current		
Trade receivables	210.7	275.0
Prepayments and accrued income**	431.1	330.7
Amounts recoverable on long term contracts* (note 25)	8.3	31.2
Amounts owed by joint ventures	0.4	1.4
Loans receivable (note 29)	2.5	1.1
Security deposits	0.2	7.8
Other receivables	111.2	130.9
	764.4	778.1

* In respect of 2012, an amount of £7.2m has been reclassified from work in progress within inventories to trade and other receivables in relation to long-term contract accounting

** Also in respect of 2012 an amount of £262m has been reclassified from trade receivables to accrued income in relation to unbilled receivables

As at 31 December 2013, trade receivables of £2.5m (2012: £12.3m) were considered to be impaired. Impairments to trade receivables are based on specific estimated irrecoverable amounts and provisions on outstanding balances greater than a year old unless there is firm evidence that the balance is recoverable. The amount of the provision was £4.7m as of 31 December 2013 (2012: £5.3m) primarily because our customers either have a sovereign credit rating being government organisations or are blue chip private sector companies.

Included within current other receivables are capitalised bid and phase in costs of £64.9m (2012: £64.9m) that are realised as a part of the normal operating cycle of the Group.

The Group has a non recourse receivables financing facility of £60m, of which £27.1m had been utilised at 31 December 2013 (31 December 2012: £32.5m utilised).

The ageing of trade receivables is as follows

	2013 £m	2012 (restated) £m
Neither impaired nor past due	125.3	150.9
Not impaired but overdue by less than 30 days	48.8	68.3
Not impaired but overdue by between 30 and 60 days	20.3	26.9
Not impaired but overdue by more than 60 days	18.5	21.9
Impaired	2.5	12.3
Allowance for doubtful debts	(4.7)	(5.3)
	210.7	275.0

24 Trade and other receivables (continued)

Movements on the Group allowance for doubtful debts are as follows

	2013 £m	2012 (restated) £m
At 1 January	5 3	6 3
Charged/(credited) to income statement	0 4	(0 8)
Utilised	(0 5)	0 1
Exchange differences	(0 5)	(0 3)
At 31 December	4 7	5 3

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.

25 Long-term contracts

	2013 £m	2012 (restated) £m
Contracts in progress at the balance sheet date		
Amounts due from long-term project-based contract customers included in trade and other receivables	8 3	31 2
Amounts due to long-term project-based contract customers included in trade and other payables	–	(0 9)
	8 3	30 3
Long-term project-based contract costs incurred plus recognised profits less recognised losses to date	239 7	727 0
Less progress payments	(231 4)	(696 7)
	8 3	30 3

As at 31 December 2013, £nil (2012: £nil) of advances received from customers were included within long-term project-based contract balances. As at 31 December 2013, the Group had £0.4m (2012: £1.3m) of contract retentions held by customers.

26 Cash and cash equivalents

	Sterling 2013 £m	Other currencies 2013 £m	Total 2013 £m	Sterling 2012 (restated) £m	Other currencies 2012 (restated) £m	Total 2012 (restated) £m
Customer advance payments*	–	10 2	10 2	–	7 5	7 5
Other cash and short-term deposits	28 5	86 4	114 9	33 0	102 3	135 3
Total cash and cash equivalents	28 5	96 6	125 1	33 0	109 8	142 8

* Customer advance payments totalling £10.2m (2012: £7.5m) are encumbered cash balances.

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

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27 Trade and other payables

	2013 £m	2012 (restated) £m
Trade and other payables current		
Trade payables	169.9	147.9
Amounts payable on long-term contracts	–	0.9
Other payables	128.9	147.1
Accruals and deferred income	345.3	460.0
Amounts owed to joint ventures	–	1.4
	644.1	757.3

The average credit period taken for trade purchases is 33 days (2012 restated 32 days)

	2013 £m	2012 (restated) £m
Trade and other payables non-current		
Other payables	34.1	42.3
	34.1	42.3

28 Obligations under finance leases

	Minimum lease payments 2013 £m	Present value of minimum lease payments 2013 £m	Minimum lease payments 2012 (restated) £m	Present value of minimum lease payments 2012 (restated) £m
Amounts payable under finance leases				
Within one year	16.9	14.9	11.8	10.7
Between one and five years	52.6	48.3	39.2	36.3
After five years	5.0	4.8	3.3	3.2
	74.5	68.0	54.3	50.2
Less: future finance charges	(6.5)	–	(4.1)	–
Present value of lease obligations	68.0	68.0	50.2	50.2
Less: amount due for settlement within one year (shown under current liabilities)	(16.9)	(14.9)	(11.8)	(10.7)
Amount due for settlement after one year	51.1	53.1	38.4	39.5

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

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

29 Loans

	Non recourse loans 2013 £m	Other loans 2013 £m	Total 2013 £m	Non recourse loans 2012 (restated) £m	Other loans 2012 (restated) £m	Total 2012 (restated) £m
Loans are repayable as follows						
On demand or within one year*	2 9	46 8	49 7	10 0	52 9	62 9
Between one and two years	3 0	20 7	23 7	2 4	37 8	40 2
Between two and five years	8 4	277 0	285 4	7 3	211 9	219 2
After five years	6 0	437 7	443 7	5 4	396 9	402 3
	20 3	782 2	802 5	25 1	699 5	724 6
Less: amount due for settlement within one year (shown within current liabilities)	(2 9)	(49 3)	(52.2)	(10 0)	(54 0)	(64 0)
Less: Amounts shown in receivables (note 24)	–	5 8	5 8	–	1 2	1 2
Amount due for settlement after one year	17 4	738 7	756 1	15 1	646 7	661 8

* Included in loans repayable on demand or within one year are loan receivable amounts of £2.5m (2012: £1.1m)

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

	Carrying amount 2013 £m	Fair value 2013 £m	Carrying amount 2012 (restated) £m	Fair value 2012 (restated) £m
Non recourse loans	20 3	20 4	25 1	26 6
Other loans	782.2	770 0	699 5	719 6
	802 5	790 4	724 6	746 2

The fair values are based on cash flows discounted using a market rate appropriate to the loan. All loans are held at amortised cost.

Analysis of net debt

	At 1 January 2013 £m	Cash flow £m	Acquisitions* £m	Disposals £m	Exchange differences £m	Non cash movements £m	At 31 December 2013 £m
Cash and cash equivalents	142 8	(1 8)	–	–	(15 9)	–	125 1
Non recourse loans	(25 1)	4 9	–	–	(0 1)	–	(20 3)
Other loans	(699 5)	(99 0)	–	–	16 3	–	(782 2)
Obligations under finance leases	(50 2)	4 9	–	–	0 3	(23 0)	(68 0)
	(632 0)	(91 0)	–	–	0 6	(23 0)	(745 4)

	At 1 January 2012 (restated) £m	Cash flow £m	Acquisitions* £m	Disposals £m	Exchange differences £m	Non cash movements £m	At 31 December 2012 (restated) £m
Cash and cash equivalents	194 6	(43 3)	0 8	(0 4)	(8 9)	–	142 8
Non recourse loans	(15 5)	(9 7)	–	–	0 1	–	(25 1)
Other loans	(819 4)	149 0	(30 4)	(24 4)	25 7	–	(699 5)
Obligations under finance leases	(44 9)	2 4	–	6 2	0 3	(14 2)	(50 2)
	(685 2)	98 4	(29 6)	(18 6)	17 2	(14 2)	(632 0)

* Acquisitions represent the net cash/(debt) acquired on acquisition

Notes to the Consolidated Financial Statements

30 Provisions

	Employee related £m	Property £m	Contract £m	Other £m	Total £m
At 1 January 2012 (restated)	12.5	8.8	26.1	16.6	64.0
Arising from acquisitions	1.0	1.6	6.4	0.1	9.1
Derecognised on disposal of subsidiary	(0.1)	–	–	–	(0.1)
Charged to income statement	1.4	0.1	–	8.9	10.4
Released to income statement	(0.4)	(0.7)	(5.7)	–	(6.8)
Utilised during the year	(0.6)	(1.7)	(11.3)	(4.7)	(18.3)
Unwinding of discount	–	0.2	0.3	–	0.5
Exchange differences	(0.5)	(0.4)	(0.9)	(0.8)	(2.6)
At 1 January 2013 (restated)	13.3	7.9	14.9	20.1	56.2
Derecognised on disposal of subsidiary	–	(0.3)	–	–	(0.3)
Charged to income statement	5.8	0.2	21.7	7.8	35.5
Released to income statement	–	(0.1)	(4.6)	(7.4)	(12.1)
Utilised during the year	(2.7)	(2.5)	(5.9)	(6.0)	(17.1)
Unwinding of discount	–	0.2	0.2	–	0.4
Exchange differences	(0.7)	(0.1)	(0.4)	(0.3)	(1.5)
At 31 December 2013	15.7	5.3	25.9	14.2	61.1
Analysed as					
Current	–	1.1	16.8	8.3	26.2
Non-current	15.7	4.2	9.1	5.9	34.9

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

Property provisions relate to leased properties which are either underutilised or vacant and where the unavoidable costs associated with the lease exceed the economic benefits expected to be received. Management has calculated the provision based on the discounted cash outflows required to settle the lease obligations as they fall due over the next ten years.

Contract provisions relate to provisions for loss making onerous contracts. Management has used the present value of the estimated future cash outflows required to settle the contract obligations as they fall due over the respective contracts in determining the provision.

Other provisions are held for legal and other costs that the Group expects to incur over an extended period. These costs are based on past experience of similar items and other known factors and represent management's best estimate of the likely outcome.

31 Capital and other commitments

	2013 £m	2012 (restated) £m
Capital expenditure contracted but not provided		
– Property, plant and equipment	30	11
– Intangible assets	103	77

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

	2013 £m	2012 (restated) £m
Within one year	741	668
Between one and five years	1721	1525
After five years	686	685
	3148	2878

Principal lease commitments are within the UK & Europe segment, with future minimum lease payments totalling £66.2m (2012 restated £74.4m). These leases relate primarily to administrative and operational buildings, track and rolling stock within the train operating companies. The length of the leases is concurrent with the period of the franchises and the terms of the leases are fixed during this period.

32 Contingent liabilities

The Company has guaranteed overdrafts, finance leases, and bonding facilities of its joint ventures up to a maximum value of £26.0m (2012 £27.2m). The actual commitment outstanding at 31 December 2013 was £22.6m (2012 £23.2m).

In addition to this, the Company and its subsidiaries have provided performance guarantees and indemnities relating to performance bonds and letters of credit issued by its banks on its behalf, in the ordinary course of business. These are not expected to result in any material financial loss.

The Group is aware of certain claims in respect of employee, insurance and pension related matters with a potential value of up to £40m. However, no provisions have been made in respect of these items as management's assessment is that the likelihood of such claims being successful is remote.

The Group is aware of other 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.

As discussed in note 11, the EM contract was referred by the Cabinet Office to the Serious Fraud Office for investigation. At this stage, the Group has not been informed of the outcome of this investigation.

Notes to the Consolidated Financial Statements

33 Financial risk management

33 (a) Fair value of financial instruments

i) Hierarchy of fair value

The classification of the fair value measurement falls into three levels, based on the degree to which the fair value is observable. The levels are as follows:

Level 1 derived from unadjusted quoted prices in active markets for identical assets or liabilities,

Level 2 derived from other observable market data for the assets or liabilities, and

Level 3 derived from valuation techniques using data that is not based on observable market data.

Based on the above, the derivative financial instruments held by the Group at 31 December 2013, are all considered to fall into Level 2. There have been no transfers between levels in the year.

The Group held the following financial instruments which fall within the scope of *IAS 39 Financial Instruments: Recognition and Measurement* at 31 December:

	Carrying amount (measurement basis)		Comparison fair value	Carrying amount (measurement basis)		Comparison fair value
	Amortised cost 2013	Fair value – Level 2 2013	Level 2 2013	Amortised cost 2012 (restated)	Fair value – Level 2 2012 (restated)	Level 2 2012 (restated)
	£m	£m	£m	£m	£m	£m
Financial assets – current						
Cash and bank balances	125.1	–	125.1	142.8	–	142.8
Derivatives designated as FVTPL						
Forward foreign exchange contracts	–	8.6	–	–	2.7	–
Derivative instruments in designated hedge accounting relationships						
Forward foreign exchange contracts	–	0.1	–	–	–	–
Loans and receivables						
Trade receivables (note 24)	210.7	–	210.7	275.0	–	275.0
Loan receivables (note 24)	2.5	–	2.5	1.1	–	1.1
Financial assets – non-current						
Derivative instruments in designated hedge accounting relationships						
Forward foreign exchange contracts	–	–	–	–	0.1	–
Loans and receivables						
Loan receivables (note 24)	3.3	–	3.3	0.1	–	0.1
Financial liabilities – current						
Derivatives designated as FVTPL						
Forward foreign exchange contracts	–	(6.8)	–	–	(2.8)	–
Derivative instruments in designated hedge accounting relationships						
Cross currency swaps	–	(0.3)	–	–	–	–
Forward foreign exchange contracts	–	(13.1)	–	–	(11.0)	–
Financial liabilities at amortised cost						
Trade payables (note 27)	(169.9)	–	(169.9)	(147.9)	–	(147.9)
Loans (note 29)	(52.2)	–	(59.3)	(64.0)	–	(68.7)
Obligations under finance leases (note 28)	(14.9)	–	(14.9)	(10.7)	–	(10.7)
Financial liabilities – non-current						
Derivatives designated as FVTPL						
Interest rate swaps	–	(0.1)	–	–	(0.1)	–
Derivative instruments in designated hedge accounting relationships						
Cross currency swaps	–	(0.3)	–	–	(0.6)	–
Forward foreign exchange contracts	–	(20.7)	–	–	(23.8)	–
Financial liabilities at amortised cost						
Loans (note 29)	(756.1)	–	(736.8)	(661.8)	–	(678.7)
Obligations under finance leases (note 28)	(53.1)	–	(53.1)	(39.5)	–	(39.5)

33 Financial risk management (continued)

33 (a) Fair value of financial instruments (continued)

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

ii) Fair value of derivative financial instruments

The fair valuation of derivative financial instruments results in a net liability of £32.6m (2012: £35.5m) comprising non-current assets of £nil (2012: £0.1m), current assets of £8.7m (2012: £2.7m), current liabilities of £20.2m (2012: £13.8m) and non-current liabilities of £21.1m (2012: £24.5m)

	1 January 2013 £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 2013 £m
Currency swaps	(0.6)	–	–	(0.6)
Forward foreign exchange contracts	(34.8)	1.0	1.9	(31.9)
Interest rate swaps	(0.1)	–	–	(0.1)
	(35.5)	1.0	1.9	(32.6)

	1 January 2012 (restated) £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 2012 (restated) £m
Currency swaps	0.8	(1.4)	–	(0.6)
Forward foreign exchange contracts	(31.5)	(0.3)	(3.0)	(34.8)
Interest rate swaps	(0.6)	0.6	(0.1)	(0.1)
	(31.3)	(1.1)	(3.1)	(35.5)

The fair value of financial liabilities at fair value through profit and loss is £6.8m (2012: £2.9m), 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 tenure of the instruments

33 (b) Financial risk

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

Notes to the Consolidated Financial Statements

33 Financial risk management (continued)

33 (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 2013 Millions	Drawn 2013 £m	Undrawn 2013 £m	Total facility 2013 £m
Syndicated revolving credit facility	GBP	730 0	175 0	555 0	730 0

	Currency	Amount 2012 Millions	Drawn 2012 £m	Undrawn 2012 £m	Total facility 2012 £m
Syndicated revolving credit facility	GBP	730 0	177 6	552 4	730 0

The £730 0m syndicated revolving credit facility was signed in March 2012 and matures in March 2017. It is unsecured and contains financial and non-financial covenants and obligations typical of these arrangements.

In addition to the banking facility the Group has outstanding US private placements of £574 8m, £46 4m of which will be repaid in equal instalments over 2014 and 2015, with the remaining £528 4m as bullet repayments between 2016 and 2024.

In addition to the bank and private placement facilities the Group has drawn receivable financing facilities of £27 1m (2012: £32 5m) and total facilities of £60m (2012: £60m).

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 2013					
Trade payables (note 27)	169 9	–	–	–	169 9
Obligations under finance leases (note 28)	16 9	19 9	32 7	5 0	74 5
Loans (note 29)	52 2	27 0	285 4	443 7	808 3
Future loan interest	24 8	23 0	60 7	59 8	168 3
Derivative financial liabilities	20 0	14 3	7 6	–	41 9
	283 8	84 2	386 4	508 5	1,262 9

	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 2012 (restated)					
Trade payables (note 27)	147 9	–	–	–	147 9
Obligations under finance leases (note 28)	11 8	12 2	27 0	3 3	54 3
Loans (note 29)	64 0	40 3	219 3	402 2	725 8
Future loan interest	22 5	19 6	49 1	54 6	145 8
Derivative financial liabilities	14 6	9 9	19 0	–	43 5
	260 8	82 0	314 4	460 1	1,117 3

33 Financial risk management (continued)

33 (c) Liquidity risk (continued)

The Group's derivative financial liabilities are settled on both a net and gross basis depending upon the terms of each derivative financial instrument. The maturity of the Group's undiscounted derivative financial liabilities is as follows:

	Cross currency swaps £m	Forward foreign exchange contracts £m	Interest rate swaps £m	Total £m
At 31 December 2013				
On demand or within one year	(0 2)	(19 7)	(0 1)	(20 0)
Between one and two years	(0 4)	(13 9)	–	(14 3)
Between two and five years	–	(7 6)	–	(7 6)
	(0 6)	(41 2)	(0 1)	(41 9)
At 31 December 2012				
On demand or within one year	–	(14 6)	–	(14 6)
Between one and two years	–	(9 8)	(0 1)	(9 9)
Between two and five years	(0 7)	(18 3)	–	(19 0)
	(0 7)	(42 7)	(0 1)	(43 5)

33 (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 2013, 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 fair value hedges, cash flow hedges or hedges of net investments in foreign operations. Pages 122 to 123 detail the Group's accounting policies in relation to derivatives qualifying for hedge accounting under IAS 39.

At 31 December 2013, the Group held two cross currency swaps designated as cash flow hedges against the 2003 US Dollar private placement. Fixed interest cash flows denominated in US Dollars are exchanged for fixed interest cash flows denominated in Sterling. The profile of these cross currency swaps held by the Group is as follows:

Maturity	Notional amount USD m	2013 Receivable USD interest rate %	Payable GBP interest rate %	Notional amount USD m	2012 Receivable USD interest rate %	Payable GBP interest rate %
August 2015	22 0	5 7	5 7	33 0	5 7	5 7

The Group also held a number of forward foreign exchange contracts designated as cash flow hedges. The net notional amounts are summarised by currency below:

	2013 £m	2012 £m
Sterling	(99 7)	(176 3)
US Dollar	4 9	(47 2)
Euro	4 5	9 5
Indian Rupee	93 5	190 7

All currency derivatives designated as cash flow hedges are highly effective and as at 31 December 2013 a net fair value loss of £33.2m (2012: £29.7m loss) has been deferred in hedging reserve. During the course of the year to 31 December 2013, £14.5m (2012: £13.8m) of fair value losses were transferred to the hedging reserve, and £9.7m (2012: £9.7m) reclassified to the consolidated income statement.

iv) Currency sensitivity

The Group's currency exposures in respect of monetary items at 31 December 2013 that result in net currency gains and losses in the income statement and equity arise principally from movement in US Dollar and Indian Rupee exchange rates. At 31 December 2013, if both had weakened by 10% against Sterling, with all other variables held constant, post-tax profit for the year would have increased by £0.6m (2012: £0.6m increase), comprising USD £0.2m and INR £0.4m and equity would have decreased by £13.1m (2012: £9.1m increase), comprising USD £0.9m and INR £12.2m.

Notes to the Consolidated Financial Statements

33 Financial risk management (continued)

33 (e) Interest rate risk

The Group's policy is to minimise the impact of interest rate volatility on earnings to provide an appropriate level of certainty to cost of funds. Exposure to interest rate risk arises principally on changes to US Dollar and Sterling interest rates.

i) Interest rate management

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

Financial assets

	Floating rate 2013 £m	Fixed rate 2013 £m	Weighted average fixed interest rate 2013 %	Floating rate 2012 £m	Fixed rate 2012 £m	Weighted average fixed interest rate 2012 %
Cash and cash equivalents	125.1	–	–	142.8	–	–
Other loan receivables	1.1	4.7	3.30	1.2	–	–
	126.2	4.7		144.0	–	

Financial liabilities

	Floating rate 2013 £m	Fixed rate 2013 £m	Weighted average fixed interest rate 2013 %	Floating rate 2012 £m	Fixed rate 2012 £m	Weighted average fixed interest rate 2012 %
Non recourse Canadian Dollar loans	–	–	–	–	7.5	5.27
Non recourse Sterling loans	–	20.3	3.62	–	17.6	3.64
Sterling loans	200.1	33.2	2.30	97.2	49.8	3.23
US Dollar loans	1.5	541.6	4.09	26.5	411.0	4.16
AU Dollar loans	–	–	–	79.4	–	4.49
Other loans	11.6	–	–	36.8	–	4.38
	213.2	595.1		239.9	485.9	

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 £68.0m (2012: £50.2m) of amounts payable under finance leases, which are subject to fixed rates of interest.

ii) Interest rate swaps

Interest rate swaps outstanding at 31 December 2013 relate to interest rate risk management on debt held locally within the Group.

Maturity	Notional Value 2013 USD m	Payable USD interest rate 2013 %	Receivable USD interest rate 2013 %	Receivable JPY interest rate 2013 %
March 2014	0.5	6.89	–	3 month JPY LIBOR + 1.0
January 2015	2.5	6.30	3 month USD LIBOR + 2.0	–

Maturity	Notional Value 2012 USD m	Payable USD interest rate 2012 %	Receivable USD interest rate 2012 %	Receivable JPY interest rate 2012 %
March 2014	2.1	6.89	–	3 month JPY LIBOR + 1.0
January 2015	3.8	6.30	3 month USD LIBOR + 2.0	–

The interest rate swaps were not designated as cash flow hedges. The fair value loss of £0.1m has therefore been recorded in the income statement (2012: £0.1m loss).

iii) 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 reduction in post-tax profit for the year to 31 December 2013 of £0.7m (2012: £0.7m).

33 Financial risk management (continued)

33 (f) Credit risk

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

Credit risk is the risk that a counterparty could default on its contractual obligations. In this regard, the Group's principle exposure is to cash and cash equivalents, derivative transactions and trade receivables

The Group's trade receivables credit risk is relatively low given that a high proportion of our customer base are government bodies with strong sovereign, or sovereign like, credit ratings. However, where the assessed credit worthiness of a customer, government or non government, falls below that considered acceptable, appropriate measures are taken to mitigate against the risk of contractual default using instruments such as credit guarantees

The Group's Treasury function only transacts with counterparties that comply with Board policy. The credit risk is measured by way of a counterparty credit rating and as a minimum any counterparty must have a long term public rating of 'Single A' from any two recognised rating agencies. Pre-approved limits are set based on a rating matrix and exposures monitored accordingly. The Group also employs the use of set-off rights in some agreements.

33 (g) Capital risk

The Group defines capital as equity, loans and borrowings and cash and cash equivalents. The Articles of Association of Serco Group plc require that the net borrowings of Serco Group plc and its subsidiary undertakings shall not at any time without the previous sanction of an ordinary resolution exceed three and a half times adjusted capital and reserves. The Group does not have any externally imposed requirements for managing capital, other than those imposed by its debt covenants and Company Law.

The Board's objective is to maintain a capital structure that supports the Group's strategic objectives, including but not limited to reshaping the portfolio through mergers, acquisitions and disposals. In doing so the Board seeks to manage funding and liquidity risk, optimise shareholder return and maintain an implied investment grade credit position. This strategy is unchanged from the prior year.

The Board reviews and approves at least annually a treasury policy document which covers inter alia, funding and liquidity risk, capital structure and risk management. This policy details targets for committed funding headroom, diversification of committed funding and debt maturity profile. All targets were met throughout the financial year.

The Group ensures that sufficient funds and distributable reserves are held to allow payments of projected dividends to shareholders and it intends to pursue a policy of dividend growth that broadly reflects the increase in underlying earnings of the business.

The following table summarises the capital of the Group

	2013 £m	2012 £m
Cash and cash equivalents	(125.1)	(142.8)
Loans	802.5	724.6
Obligations under finance leases	68.0	50.2
Equity	1,095.9	1,128.9
Capital	1,841.3	1,760.9

Notes to the Consolidated Financial Statements

34 Retirement benefit schemes

The Group has accounted for pensions in accordance with *IAS 19 Employee Benefits*. The Group operates a number of defined benefit schemes and defined contribution schemes. The pension charge for the year ended 31 December 2013 excluding joint ventures, was £108.6m (2012: £85.5m).

34 (a) Defined benefit schemes

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

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

The schemes in the UK typically expose the Company to actuarial risks such as: investment risk, interest rate risk, longevity risk and salary risk.

● Investment risk

The present value of the defined benefit schemes' liability is calculated using a discount rate determined by reference to high quality corporate bond yields; if the return on plan assets is below this rate, a deficit will be created.

● Interest risk

A decrease in the bond interest rate will increase the scheme liability but this will be partially offset by an increase in the return of the plan's debt investments.

● Longevity risk

The present value of the defined benefit plan liability is calculated by reference to the best estimate of the mortality of plan participants both during and after their employment. An increase in the life expectancy of the plan participants will increase the plan's liability.

● Salary risk

The present value of the defined benefit scheme liability is calculated by reference to the future salaries of plan participants; as such, an increase in the salary of the plan participants will increase the plan's liability.

i) Balance sheet values

The amounts recognised in the balance sheet 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. At rebid, any deficit or surplus would transfer to the next contractor. The Group has recognised as a liability the defined benefit obligation less the fair value of scheme assets that it will fund over the period of the contracts with a corresponding amount recognised as intangible assets at the start of the contracts. Subsequent actuarial gains and losses in relation to the Group's share of the pension obligations have been recognised in the SOCI. The intangible assets are amortised over the term of the contracts.

Non contract specific

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

ii) Triennial funding valuation

Among our non contract specific schemes, the largest is the Serco Pension and Life Assurance Scheme (SPLAS). The estimated actuarial deficit of SPLAS as at 31 December 2013 was approximately £13.0m (2012: £10.9m). The most recent full actuarial valuation of this scheme was undertaken as at 5 April 2012 and resulted in an actuarially assessed deficit of £24m. Following this review, the Group agreed with the Trustees to make a small increase in contributions, bringing cash contributions of up to 33% of members' pensionable salaries until 2021. The level of benefits and contributions under the scheme is kept under continual review in light of the needs of the business and changes to pension legislation.

34 Retirement benefit schemes (continued)

34 (a) Defined benefit schemes (continued)

The assets and liabilities of the schemes at 31 December are

	Contract specific 2013 £m	Non contract specific 2013 £m	Total 2013 £m
Scheme assets at fair value			
Equities	93 4	36 0	129 4
Bonds except LDI	40 6	13 7	54 3
Liability driven investments (LDI)	13 6	1,048 9	1,062 5
Gilts	42 5	–	42 5
Property	9 1	–	9 1
Cash and other	25 9	25 0	50 9
Annuity policies	2 1	22 3	24 4
Fair value of scheme assets	227 2	1,145 9	1,373 1
Present value of scheme liabilities	(267 8)	(1,091 2)	(1,359 0)
Net amount recognised	(40 6)	54 7	14 1
Members' share of deficit	–	3 7	3 7
Franchise adjustment*	35 1	–	35 1
	(5 5)	58 4	52 9
Analysed as			
Net pension liability	(5 5)	(5 8)	(11 3)
Net pension asset	–	64.2	64 2
Related assets			
Intangible assets (note 21)	1 0	–	1 0

* The franchise adjustment represents the amount of scheme deficit that is expected to be funded outside the contract period

	Contract specific 2012 (restated) £m	Non contract specific 2012 (restated) £m	Total 2012 (restated) £m
Scheme assets at fair value			
Equities	83 2	58 9	142 1
Bonds except LDI	50 9	11 9	62 8
Liability driven investments (LDI)	15 9	982 6	998 5
Gilts	23 7	20 9	44 6
Property	7 5	0 4	7 9
Cash and other	17 1	58 6	75 7
Annuity policies	–	22 5	22 5
Fair value of scheme assets	198 3	1 155 8	1,354 1
Present value of scheme liabilities	(280 4)	(1,115 3)	(1,395 7)
Net amount recognised	(82 1)	40 5	(41 6)
Members' share of deficit	–	4 1	4 1
Franchise adjustment*	68 3	–	68 3
Effect of IFRIC 14	–	0 9	0 9
	(13 8)	45 5	31 7
Analysed as			
Net pension liability	(13 8)	(24 2)	(38 0)
Net pension asset	–	69 7	69 7
Related assets			
Intangible assets (note 21)	3 2	–	3 2

* The franchise adjustment represents the amount of scheme deficit that is expected to be funded outside the contract period

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34 Retirement benefit schemes (continued)

34 (a) Defined benefit schemes (continued)

Liabilities in relation to unfunded schemes included above amount to £0.3m (2012: £0.2m)

Certain of the Group's non contract specific schemes have a Liability Driven Investment (LDI) strategy which aims to reduce volatility risk by better matching assets to liabilities. The main asset classes that make up the LDI investments are gilts and corporate bonds with inflation and interest swap overlays. The assumed expected rate of return is taken to be gilts +0.8% (2012: gilts +0.8%)

Virtually all equity and debt instruments have quoted prices in active markets. Annuity policies and property assets can be classified as Level 3 instruments.

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

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

	Contract specific 2013 £m	Non contract specific 2013 £m	Total 2013 £m
Recognised in the income statement			
Current service cost – employer	9.3	10.8	20.1
Past service cost	–	–	–
Curtailment gain	–	(2.4)	(2.4)
Settlement gain	–	(0.1)	(0.1)
Administrative expenses and taxes	0.9	3.2	4.1
Recognised in arriving at operating profit	10.2	11.5	21.7
Interest income on scheme assets – employer	(9.2)	(48.0)	(57.2)
Interest on franchise adjustment	(2.4)	–	(2.4)
Interest cost on scheme liabilities – employer	11.9	45.4	57.3
Finance income	0.3	(2.6)	(2.3)
Included within the SOCI			
Actual return on scheme assets	20.0	22.0	42.0
Less: interest income on scheme assets	(9.2)	(48.8)	(58.0)
	10.8	(26.8)	(16.0)
Effect of changes in demographic assumptions	8.8	(9.2)	(0.4)
Effect of changes in financial assumptions	12.5	(9.1)	3.4
Effect of experience adjustments	8.8	34.5	43.3
Remeasurements recognised in the SOCI	40.9	(10.6)	30.3
Change in IFRIC 14	–	(0.9)	(0.9)
Change in franchise adjustment	(35.6)	–	(35.6)
Change in members' share	–	(0.6)	(0.6)
Actuarial gains on reimbursable rights	(35.6)	(1.5)	(37.1)
Total pension cost recognised in the SOCI	5.3	(12.1)	(6.8)

34 Retirement benefit schemes (continued)

34 (a) Defined benefit schemes (continued)

	Contract specific 2012 (restated) £m	Non contract specific 2012 (restated) £m	Total 2012 (restated) £m
Recognised in the income statement			
Current service cost – employer	7.3	11.9	19.2
Past service cost	–	1.1	1.1
Curtailment gain	–	(6.1)	(6.1)
Administrative expenses and taxes	0.7	1.3	2.0
Recognised in arriving at operating profit	8.0	8.2	16.2
Interest income on scheme assets – employer	(7.9)	(50.3)	(58.2)
Interest on franchise adjustment	(2.1)	–	(2.1)
Interest cost on scheme liabilities – employer	10.3	46.0	56.3
Interest on effect of asset ceiling	–	0.1	0.1
Finance income	0.3	(4.2)	(3.9)
Included within the SOCI			
Actual return on scheme assets	14.3	39.3	53.6
Less interest income on scheme assets	(8.0)	(51.4)	(59.4)
	6.3	(12.1)	(5.8)
Effect of changes in demographic assumptions	(2.2)	–	(2.2)
Effect of changes in financial assumptions	(31.5)	(96.0)	(127.5)
Effect of experience adjustments	3.6	14.9	18.5
Remeasurements recognised in the SOCI	(23.8)	(93.2)	(117.0)
Change in IFRIC 14	–	8.4	8.4
Change in franchise adjustment	23.8	–	23.8
Change in members' share	–	2.1	2.1
Actuarial gains on reimbursable rights	23.8	10.5	34.3
Total pension cost recognised in the SOCI	–	(82.7)	(82.7)

Changes in the fair value of scheme liabilities are analysed as follows

	Contract specific £m	Non contract specific £m	Total £m
At 1 January 2012 (restated)	209.1	1,001.3	1,210.4
Current service cost – employer	7.3	11.9	19.2
Current service cost – employee	–	0.2	0.2
Past service costs	–	1.1	1.1
Scheme participants' contributions	0.8	0.6	1.4
Interest cost – employer	10.3	46.0	56.3
Interest cost – employee	–	0.9	0.9
Benefits paid	(3.8)	(38.4)	(42.2)
Effect of changes in demographic assumptions	2.2	–	2.2
Effect of changes in financial assumptions	31.5	96.0	127.5
Effect of experience adjustments	(3.6)	(14.9)	(18.5)
Plan curtailments	–	(6.1)	(6.1)
Arising on acquisition of a subsidiary	26.6	69.9	96.5
Eliminated on disposal of a subsidiary	–	(51.6)	(51.6)
Exchange differences	–	(1.6)	(1.6)
At 31 December 2012 (restated)	280.4	1,115.3	1,395.7
At 1 January 2013	280.4	1,115.3	1,395.7
Current service cost – employer	9.3	10.8	20.1
Current service cost – employee	–	0.2	0.2
Scheme participants' contributions	0.7	0.8	1.5
Interest cost – employer	11.9	45.4	57.3
Interest cost – employee	–	1.0	1.0
Benefits paid	(4.4)	(37.8)	(42.2)
Effect of changes in demographic assumptions	(8.8)	9.2	0.4
Effect of changes in financial assumptions	(12.5)	9.1	(3.4)
Effect of experience adjustments	(8.8)	(34.5)	(43.3)
Plan curtailments	–	(2.4)	(2.4)
Plan settlements	–	(25.9)	(25.9)
At 31 December 2013	267.8	1,091.2	1,359.0

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34 Retirement benefit schemes (continued)

34 (a) Defined benefit schemes (continued)

Changes in the fair value of scheme assets are analysed as follows

	Contract specific £m	Non contract specific £m	Total £m
At 1 January 2012 (restated)	152.8	1,065.3	1,218.1
Interest income on scheme assets – employer	7.9	50.3	58.2
Interest income on scheme assets – employee	0.1	1.1	1.2
Administrative expenses and taxes	(0.7)	(1.3)	(2.0)
Employer contributions	13.6	29.8	43.4
Contributions by employees	0.6	0.6	1.2
Benefits paid	(3.8)	(38.4)	(42.2)
Return on scheme assets less interest income	6.3	(12.1)	(5.8)
Arising on acquisition of a subsidiary	21.5	61.6	83.1
Eliminated on disposal of a subsidiary	–	(1.1)	(1.1)
At 31 December 2012 (restated)	198.3	1,155.8	1,354.1
At 1 January 2013	198.3	1,155.8	1,354.1
Interest income on scheme assets – employer	9.2	48.0	57.2
Interest income on scheme assets – employee	–	0.8	0.8
Administrative expenses and taxes	(0.9)	(3.2)	(4.1)
Employer contributions	13.4	34.0	47.4
Contributions by employees	0.8	0.9	1.7
Benefits paid	(4.4)	(37.8)	(42.2)
Return on scheme assets less interest income	10.8	(26.8)	(16.0)
Plan settlements	–	(25.8)	(25.8)
At 31 December 2013	227.2	1,145.9	1,373.1

Employer contributions for non contract specific schemes in 2013 include a £19.7m (2012: £nil) special contribution. The special pension contributions of £19.7m relate to a £16.8m payment to fund the deficit on the Vertex pension fund prior to its transfer into the Group's largest defined benefit scheme Serco Pension and Life Assurance Scheme (SPLAS), and £2.9m in relation to deficit recovery funding of the Walsall defined benefit pension scheme. The Vertex payment enables their separate defined benefit scheme to be closed and thereby reduces ongoing administration costs.

The normal contributions expected to be paid during the financial year ending 31 December 2014 are £27.3m (financial year ended 31 December 2013: £32.3m).

The average duration of the benefit obligation at the end of the reporting period is 17.8 years (2012: 17.5 years).

Assumptions in respect of the expected return on scheme assets are based on market expectations of returns over the life of the related obligation. Due consideration has been given to current market conditions as at 31 December 2013 in respect of inflation, interest, bond yields and equity performance when selecting the expected return on assets assumptions.

The expected yield on bond investments with fixed interest rates is derived from their market value. The yield on equity investments contains an additional premium (an 'equity risk premium') to compensate investors for the additional anticipated risks of holding this type of investment, when compared to bond yields. Management have concluded that an appropriate equity risk premium is 4.6% (2012: 4.6%).

34 Retirement benefit schemes (continued)

34 (a) Defined benefit schemes (continued)

The overall expected return on assets is calculated as the weighted average of the expected returns for the principal asset categories held by scheme

	2013 %	2012 %
Main assumptions		
Rate of salary increases	3 20	3 40
Rate of increase in pensions in payment	2 50 (CPI) and 3 30 (RPI)	2 20 (CPI) and 3 00 (RPI)
Rate of increase in deferred pensions	2 60 (CPI) and 3 40 (RPI)	2 20 (CPI) and 3 00 (RPI)
Inflation assumption	2 60 (CPI) and 3 40 (RPI)	2 20 (CPI) and 3 00 (RPI)
Discount rate	4 60	4 30
	2013 Years	2012 Years
Post-retirement mortality		
Current pensioners at 65 – male	22 5	21 0
Current pensioners at 65 – female	24 9	23 5
Future pensioners at 65 – male	24 2	22 5
Future pensioners at 65 – female	26 9	24 6

Management considers the significant actuarial assumptions with regards to the determination of the defined benefit obligation to be the discount rate, inflation the rate of salary increases and mortality

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 2013 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 2013 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.

	Assumption	Change in assumption	Change in present value of scheme liabilities
Discount rate	4 6%	+0 5% (0 5%)	(9%) +10%
Inflation	2 4% (CPI) 3 4% (RPI)	+0 5% (0 5%)	+9% (8%)
Rate of salary increase	3 2%	+0 5% (0 5%)	+1% (1%)
Mortality	20 7 – 27 8*	Increase by one year	+2%

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

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 suitable basis for providing this analysis.

34 (b) Defined contribution schemes

The Group paid employer contributions of £86 9m (2012: £69 3m) into UK and other defined contribution schemes and foreign state pension schemes.

Pre-funded defined benefit schemes treated as defined contribution

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

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35 Share capital

	2013 £m	Number 2013 Millions	2012 £m	Number 2012 Millions
Issued and fully paid				
498,462,508 (2012: 497,327,070) ordinary shares of 2p each at 1 January	10.0	498.5	9.9	497.3
Issued on the exercise of share options	–	0.8	0.1	1.2
499,328,896 (2012: 498,462,508) ordinary shares of 2p each at 31 December	10.0	499.3	10.0	498.5

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

During the year 866,388 (2012: 1,135,438) ordinary shares of 2p each were allotted to the holders of share-based awards or their personal representatives using newly listed shares

36 Share premium account

	2013 £m	2012 £m
At 1 January	326.5	322.7
Premium on shares issued	1.3	3.8
At 31 December	327.8	326.5

37 Reserves

37 (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

37 (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

37 (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 2013, the ESOT held 11,883,973 (2012: 10,174,594) shares equal to 2.4% of the current allotted share capital (2012: 2.0%). The market value of shares held by the ESOT as at 31 December 2013 was £59.3m (2012: £54.4m)

37 (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

38 Share-based payment expense

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

	2013 £m	2012 £m
Long Term Incentive Scheme and Plan	0.1	0.8
Transformational Share Scheme	–	0.1
Performance Share Plan	1.5	9.9
Deferred Bonus Plan	(0.9)	1.1
Sharesave 2012	2.2	0.2
	2.9	12.1

38 Share-based payment expense (continued)

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 2013 Thousands	Weighted average exercise price 2013 £	Number of options 2012 Thousands	Weighted average exercise price 2012 £
Outstanding at 1 January	2,472	2 56	3 389	2 49
Granted during the year	–	–	–	–
Exercised during the year	(797)	1 58	(759)	2 29
Lapsed during the year	(206)	1 53	(158)	2 22
Outstanding at 31 December	1,469	3 24	2,472	2 56

Of these options 1 468,534 (2012: 2,471,696) were exercisable at the end of the year with a weighted average exercise price of £3 24 (2012: £2 56).

The options outstanding at 31 December 2013 had a weighted average contractual life of 2 0 years (2012: 2 0 years).

The exercise prices for options outstanding at 31 December 2013 ranged from £2 17 to £4 55 (2012: £1 39 to £4 55).

The weighted average share price at the date of exercise approximates to the weighted average share price during the year, which was £5 73 (2012: £5 50).

The fair value of options granted under the EOP is measured by use of the Binomial Lattice model. The Binomial Lattice model is considered to be most appropriate for valuing options granted under this scheme as it allows exercise over a longer period of time between the vesting date and the expiry date.

There were no new options granted under Executive Option Plans during the year.

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

Awards made to eligible employees under the above schemes are structured as options with a zero exercise price. The extent to which an award vests (and therefore becomes exercisable) is measured by reference to the growth in the Group's earnings per share (EPS) or total shareholder return (TSR) over the performance period or service period conditions.

If the options remain unexercised after a period of ten years from the date of grant, the options expire. Furthermore, options may be forfeited if the eligible employee leaves the Group before the options vest. Details of the movement in all LTIS and LTIP options are as follows:

	Number of options 2013 Thousands	Weighted average exercise price 2013 £	Number of options 2012 Thousands	Weighted average exercise price 2012 £
Outstanding at 1 January	917	Nil	2,638	Nil
Granted during the year	62	Nil	218	Nil
Exercised during the year	(332)	Nil	(247)	Nil
Lapsed during the year	(159)	Nil	(1,692)	Nil
Outstanding at 31 December	488	Nil	917	Nil

Of these options, 425,953 (2012: 521,459) were exercisable at the end of the year. The options outstanding at 31 December 2013 had a weighted average contractual life of 2 38 years (2012: 3 92 years).

There was one grant of LTIP options during the year. The fair value is considered to be their face value less the present value of any dividend payments not paid over the vesting period. The weighted average fair value of options granted under this scheme in the year is £6 22.

Notes to the Consolidated Financial Statements

38 Share-based payment expense (continued)

Transformational Share Scheme

Awards made to eligible employees under the Transformational Share Scheme are structured as options with a £nil exercise price and are exercisable after the third anniversary of the grant

The employee must exercise the options no later than 30 days after the vesting date. Furthermore, if the eligible employee leaves the Group before the options vest, the options may be forfeited

	Number of options 2013 Thousands	Weighted average exercise price 2013 £	Number of options 2012 Thousands	Weighted average exercise price 2012 £
Outstanding at 1 January	33	Nil	86	Nil
Granted during the year	–	Nil	–	Nil
Exercised during the year	(26)	Nil	(53)	Nil
Lapsed during the year	(7)	Nil	–	Nil
Outstanding at 31 December	–	Nil	33	Nil

None of these options were exercisable at the end of the year (2012: none). The options outstanding at 31 December 2013 had a weighted average contractual life of 0 years (2012: 0.2 years).

Performance Share Plan (PSP)

Under the PSP, eligible employees have been granted options with an exercise price of two pence. Awards vest after the performance period of three years and are subject to the achievement of two performance measures. The primary performance measure is TSR and the second performance measure is based on EPS growth.

	Number of options 2013 Thousands	Weighted average exercise price 2013 £	Number of options 2012 Thousands	Weighted average exercise price 2012 £
Outstanding at 1 January	10,084	0.02	7,426	0.02
Granted during the year	4,399	0.02	4,104	0.02
Exercised during the year	(535)	0.02	(125)	0.02
Lapsed during the year	(3,477)	0.02	(1,321)	0.02
Outstanding at 31 December	10,471	0.02	10,084	0.02

Of these options 292,203 (2012: 148,830) were exercisable at the end of the year.

The options outstanding at 31 December 2013 had a weighted average contractual life of 8.37 years (2012: 8.45 years).

In the year, four grants were made with 50% of the options granted subject to TSR performance conditions and 50% subject to EPS growth performance conditions.

The options subject to TSR performance conditions were valued using the Monte Carlo Simulation model. The options subject to EPS growth performance conditions were deemed to have fair values equal to their face value less the present value of any dividend payments not received over the vesting period.

The Monte Carlo Simulation model is considered to be the most appropriate for valuing options granted under schemes where there are changes in performance conditions by which the options are measured, such as for the TSR based awards.

The inputs into the Monte Carlo Simulation model for options granted during the year with TSR performance conditions are:

	2013	2012
Weighted average share price	618p	540p
Weighted average exercise price	2p	2p
Expected volatility	22.5%	22.7%
Expected life	3 years	3 years
Risk free rate	0.2%	0.3%

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.

38 Share-based payment expense (continued)

The assumptions for options granted during the year with EPS growth performance conditions are

	2013	2012
Weighted average share price	618p	540p
Weighted average exercise price	2p	2p
Expected volatility	N/A	N/A
Expected life	3 years	3 years
Risk free rate	N/A	N/A

The weighted average fair value of options granted under this scheme in the year is £4.83

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 two performance measures (which are the same as the PSP scheme, being TSR and EPS growth) have been met, the Group will make a matching share award. For shares purchased by employees in 2011, the match was on a basis of two times the gross bonus deferred.

	Number of options 2013 Thousands	Weighted average exercise price 2013 £	Number of options 2012 Thousands	Weighted average exercise price 2012 £
Outstanding at 1 January	1,058	Nil	750	Nil
Granted during the year	390	Nil	519	Nil
Exercised during the year	(91)	Nil	(107)	Nil
Lapsed during the year	(532)	Nil	(104)	Nil
Outstanding at 31 December	825	Nil	1,058	Nil

None of these options were exercisable at the end of the year (2012: none). The options outstanding at 31 December 2013 had a weighted average contractual life of 1.2 years (2012: 1.6 years).

In the year, one grant was made with 100% of the deferred bonus subject to EPS growth performance conditions.

The portion subject to EPS growth performance conditions was deemed to have a fair value equal to their face value less the present value of any dividend payments not received over the vesting period.

Expected volatility was determined by calculating the historical volatility of the Group's share price over the previous three years. The expected life used in the model has been adjusted, based on management's best estimate, for the effects of non-transferability, exercise restrictions and behavioural considerations.

The assumptions for options granted during the year with EPS growth performance conditions are

	2013	2012
Weighted average share price	623p	515p
Weighted average exercise price	Nil	Nil
Expected volatility	N/A	N/A
Expected life	3 years	3 years
Risk free rate	N/A	N/A

The weighted average fair value of options granted under this scheme in the year is £6.23

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38 Share-based payment expense (continued)

Sharesave 2012

The Sharesave 2012 scheme provides for a purchase price equal to the daily average market price on the date of grant less 10%. The options can be exercised for a period of six months following their vesting. Details of the movement in Sharesave 2012 options are as follows:

	Number of options 2013 Thousands	Weighted average exercise price 2013 £	Number of options 2012 Thousands	Weighted average exercise price 2012 £
Outstanding at 1 January	6,012	5.14	–	–
Granted during the year	–	5.14	6,074	5.14
Exercised during the year	(23)	5.14	–	5.14
Lapsed during the year	(857)	5.14	(62)	5.14
Outstanding at 31 December	5,132	5.14	6,012	5.14

Of these options, none (2012: none) were exercisable at the end of the year. The options outstanding at 31 December 2013 had a weighted average contractual life of 2.4 years (2012: 3.4 years). Given that options granted under the Sharesave plan can be exercised at any time after vesting, management consider the Binomial Lattice model to be appropriate to value the options granted under this scheme. The Binomial Lattice model allows exercise over a window in time, from vesting date to expiry date and assumes option holders make economically rational exercise decisions.

39 Related party transactions

Transactions between the Company and its wholly owned subsidiaries, which are related parties, have been eliminated on consolidation and are not disclosed in this note. Transactions between the Group and its joint venture undertakings are disclosed below.

Trading transactions

During the year, Group companies entered into the following material transactions with joint ventures:

	2013 £m	2012 £m
Royalties and management fees receivable	2.1	2.3
Dividends receivable	51.5	80.6
	53.6	82.9

The following receivable balances were held relating to joint ventures:

	2013 £m	2012 (restated) £m
Current		
Loans and other receivables	0.4	1.4
	2013 £m	2012 (restated) £m
Non-current		
Loans and other receivables	9.5	9.2

Joint venture receivables and loan amounts outstanding have arisen from transactions undertaken during the general course of trading, are unsecured and will be settled in cash. Interest arising on loans is based on LIBOR, or its equivalent, with an appropriate margin. No guarantee has been given or received. No provisions are required for doubtful debts in respect of the amounts owed by the joint ventures.

39 Related party transactions (continued)

Remuneration of key management personnel

The Directors of Serco Group plc had no material transactions with the Group during the year other than service contracts and Directors' liability insurance

The remuneration of the key management personnel of the Group is set out below in aggregate for each of the categories specified in IAS 24 *Related Party Disclosures*

	2013 £m	2012 £m
Short-term employee benefits	10.9	9.4
Post-employment benefits	0.1	0.4
Share-based payment (credit)/charge	(0.7)	1.8
	10.3	11.6

The key management personnel comprise the Executive Directors, Non-Executive Directors and members of the Executive Committee (2013: 16 individuals; 2012: 17 individuals)

40 Notes to the consolidated cash flow statement

Reconciliation of operating profit to net cash inflow from operating activities

Year ended 31 December	2013 £m	2012 (restated) £m
Operating profit for the year	143.8	272.2
Adjustments for:		
Share of profits in joint ventures	(47.1)	(62.5)
Share-based payment expense	2.9	12.1
Exceptional impairment of intangible assets and property, plant and equipment	9.6	–
Depreciation and impairment of property, plant and equipment – other	47.7	46.1
Amortisation of intangible assets	46.1	45.0
Exceptional profit on disposal of subsidiaries and operations	(19.2)	(5.6)
Loss on disposal of intangible assets	1.0	–
Profit on disposal of property, plant and equipment	–	(0.9)
Increase/(decrease) in provisions	7.4	(19.4)
Release of deferred consideration in relation to prior year acquisition – exceptional	(10.3)	–
Other non-cash movements	(6.2)	(2.8)
Operating cash inflow before movements in working capital	175.7	284.2
Decrease/(increase) in inventories	7.2	(2.2)
Increase in receivables	(66.0)	(61.1)
(Decrease)/increase in payables	(90.2)	33.6
Cash generated by operations	26.7	254.5
Tax paid	(18.8)	(33.6)
Net cash inflow from operating activities	7.9	220.9

Additions to fixtures and equipment during the year amounting to £23.1m (2012: £14.4m) were financed by new finance leases

Financial statements

Company Balance Sheet

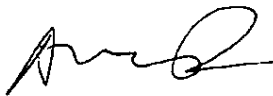
At 31 December

	Note	2013 £m	2012 £m
Fixed assets			
Investments in subsidiaries	42	815 5	811 8
		815 5	811 8
Current assets			
Debtors amounts due within one year	43	17 3	6 0
Debtors amounts due after more than one year	43	1,174 0	1,222 1
Deferred tax	47	2 9	5 9
Derivative financial instruments due within one year	46	2 9	0 7
Cash at bank and in hand		0 7	5 6
		1,197 8	1 240 3
Total assets		2,013 3	2,052 1
Creditors amounts falling due within one year			
Trade and other payables	44	(142 0)	(249 4)
Borrowings	45	(99 7)	(106 2)
Derivative financial instruments	46	(6 6)	(2 6)
		(248 3)	(358 2)
Net current assets		949 5	882 1
Creditors amounts falling due after more than one year			
Borrowings	45	(726 5)	(615 0)
Amounts owed to subsidiary companies		(352 0)	(385 3)
Derivative financial instruments	46	(0 3)	(0 6)
		(1,078 8)	(1 000 9)
Total liabilities		(1,327 1)	(1 359 1)
Net assets		686 2	693 0
Capital and reserves			
Called up share capital	48	10 0	10 0
Share premium account	49	327 8	326 5
Capital redemption reserve		0 1	0 1
Own shares reserve	50	(70 5)	(58 8)
Share-based payment reserve	51	55 3	57 7
Hedging and translation reserve	52	(0 2)	1 9
Profit and loss account	53	363 7	355 6
Total shareholders' funds		686 2	693 0

The financial statements (registered number 02048608) were approved by the Board of Directors on 3 March 2014 and signed on its behalf by



Ed Casey
Acting Group Chief Executive



Andrew Jenner
Group Chief Financial Officer

Notes to the Company Financial Statements

41 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.

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.

42 Investments held as fixed assets

	£m
Shares in subsidiary companies at cost	
At 1 January 2012	816.6
Options over parent's shares awarded to employees of subsidiaries	7.2
Disposals	(12.0)
At 1 January 2013	811.8
Options over parent's shares awarded to employees of subsidiaries	3.7
At 31 December 2013	815.5

Full details of the principal subsidiaries of Serco Group plc can be found in note 6 to the Group's consolidated financial statements. The Company directly owns 100% of the ordinary share capital of the following subsidiary.

Name	% ownership
Serco Holdings Limited	100%

43 Debtors

	2013 £m	2012 £m
Amounts due within one year		
Corporation tax recoverable	13.8	3.6
Other debtors	3.5	2.4
	17.3	6.0
Amounts due after more than one year		
Amounts owed by subsidiary companies	1,165.4	1,212.1
Amounts owed by joint ventures	4.0	4.1
Other debtors	4.6	5.9
	1,174.0	1,222.1
	1,191.3	1,228.1

Notes to the Company Financial Statements

44 Trade and other payables

	2013 £m	2012 £m
Amounts owed to subsidiary companies	128.1	231.5
Trade creditors	0.2	0.3
Accruals and deferred income	10.7	15.7
Other creditors including taxation and social security	3.0	1.9
	142.0	249.4

45 Borrowings

	2013 £m	2012 £m
Loans	826.2	721.2
Less: amounts included in creditors falling due within one year – loans	(23.2)	(27.0)
Less: amounts included in creditors falling due within one year – bank loans & overdrafts	(76.5)	(79.2)
Amounts falling due after more than one year	726.5	615.0

Loans

Within one year or on demand	99.7	106.2
Between one and two years	23.2	23.4
Between two and five years	265.6	54.2
After five years	437.7	537.4
	826.2	721.2

46 Derivative financial instruments

	Assets 2013 £m	Liabilities 2013 £m	Assets 2012 £m	Liabilities 2012 £m
Currency swaps	–	(0.6)	–	(0.6)
Forward foreign exchange contracts	2.9	(6.3)	0.7	(2.6)
	2.9	(6.9)	0.7	(3.2)
Analysed as				
Non-current	–	(0.3)	–	(0.6)
Current	2.9	(6.6)	0.7	(2.6)
	2.9	(6.9)	0.7	(3.2)

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 33 of the Group's consolidated financial statements.

47 Deferred tax asset

	2013 £m	2012 £m
Capital allowances in excess of depreciation	0.2	0.1
Short-term timing differences	2.7	5.8
	2.9	5.9

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

	2013 £m	2012 £m
At 1 January	5.9	4.9
(Credited)/charged to profit and loss account	(1.8)	0.8
Items taken directly to equity	(1.2)	0.2
At 31 December	2.9	5.9

48 Called up share capital

	2013 £m	Number 2013 Millions	2012 £m	Number 2012 Millions
Issued and fully paid				
498,462,508 (2012: 497,327,070) ordinary shares of 2p each at 1 January	10.0	498.5	9.9	497.3
Issued on the exercise of share options	–	0.8	0.1	1.2
499,328,896 (2012: 498,462,508) ordinary shares of 2p each at 31 December	10.0	499.3	10.0	498.5

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

During the year 866,388 (2012: 1,135,438) ordinary shares of 2p each were allotted to the holders of share-based awards or their personal representatives using newly listed shares

49 Share premium account

	2013 £m	2012 £m
At 1 January	326.5	322.7
Premium on shares issued	1.3	3.8
At 31 December	327.8	326.5

50 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 2013, the ESOT held 11,883,973 (2012: 10,174,594) shares equal to 2.4% of the current allotted share capital (2012: 2.0%). The market value of shares held by the ESOT as at 31 December 2013 was £59.3m (2012: £54.4m).

51 Share-based payment reserve

	2013 £m	2012 £m
At 1 January	57.7	49.1
Options over parent's shares awarded to employees of subsidiaries	3.7	7.2
Share-based payment (credit)/expense	(0.8)	4.8
Share options to holders on exercise	(4.5)	(3.6)
Tax (credit)/charge on items taken directly to equity	(0.8)	0.2
At 31 December	55.3	57.7

Details of the share-based payment disclosures are set out in note 38 of the Group's consolidated financial statements

52 Hedging and translation reserve

	2013 £m	2012 £m
At 1 January	1.9	1.9
Fair value loss on cash flow hedges during the period	(1.0)	–
Net exchange loss on translation of foreign operations	(1.1)	–
At 31 December	(0.2)	1.9

Notes to the Company Financial Statements

53 Profit and loss account

	2013 £m	2012 £m
At 1 January	355.6	288.9
Profit for the year	59.6	108.6
Equity dividends	(51.5)	(41.9)
At 31 December	363.7	355.6

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

54 Contingent liabilities

The Company has guaranteed overdrafts, finance leases and bonding facilities of its joint ventures up to a maximum value of £26.0m (2012: £27.2m). The actual commitment outstanding at 31 December 2013 was £22.6m (2012: £23.2m).

The Company has provided certain financial guarantees and indemnities in respect of the loans, overdraft and bonding facilities, and other financial commitments of its subsidiaries. The total commitment outstanding as at 31 December 2013 was £145.0m (2012: £151.0m).

In addition to this, the Company and its subsidiaries have provided performance guarantees and indemnities relating to performance bonds and letters of credit issued by its banks on its behalf, in the ordinary course of business. These are not expected to result in any material financial loss.

The Group is aware of claims and potential claims which involve or may involve legal proceedings against the Group. The Directors are of the opinion, having regard to legal advice received and the Group's insurance arrangements, that it is unlikely that these matters will, in aggregate, have a material effect on the Group's financial position.

55 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.

Supplementary information

Five-year record (unaudited)

		2013	2012 (restated)	2011 (restated)	2010 (restated)	2009 (restated)
Adjusted revenue	£m	5,144	4,913	4,646	4,327	3,970
Revenue*	£m	4,288	4,060	3,827	3,533	3,184
Adjusted operating profit*	£m	292.0	314.1	289.0	257.6	228.7
Adjusted operating margin*	%	5.68%	6.39%	6.22%	5.95%	5.76%
Adjusted profit before tax*	£m	254.4	271.6	252.6	226.3	200.5
Group free cash flow	£m	84.8	181.2	168.3	185.8	137.3
Group recourse net debt	£m	(725.1)	(606.9)	(669.8)	(303.6)	(387.7)
Adjusted net debt	£m	(701.2)	(580.7)	(633.9)	(261.2)	(358.5)
Adjusted earnings per share*	p	39.53	41.55	38.14	33.96	30.39
Dividend per share	p	10.55	10.10	8.40	7.35	6.25

* Restated for IFRS 11 and IAS 19R where appropriate

Directors, Secretary and Advisors

Chairman

Alastair Lyons CBE

Directors

Malcolm Wyman* ^
Edward J Casey Jr
Andrew Jenner
Ralph D Crosby Jr*
Angie Risley*
Rachel Lomax*
Mike Clasper*
Tamara Ingram*

Secretary

John Hickey

* Non-Executive Director

^ Senior Independent Director

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Serco Group plc is registered in
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EC2Y 5AJ

Bank of America Merrill Lynch
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EC1A 1HQ

Principal Bankers

HSBC Bank PLC
8 Canada Square
London
E14 5HQ

Solicitors

Clifford Chance LLP
10 Upper Bank Street
London
E14 5JJ

Registrars

Equiniti
Aspect House
Spencer Road
Lancing
West Sussex
BN99 6DA

Shareholder information

Group website

Go to www.serco.com to catch up on the current share price, latest news in the investors section and read the Annual report and accounts

Registrars

Administrative enquiries about the holding of Serco Group plc shares and enquiries in relation to the Serco Dividend Re-investment Plan (DRIP) should be directed to

Equiniti
Aspect House
Spencer Road
Lancing
West Sussex
BN99 6DA

Tel 0871 384 2932

There is a text phone available on 0871 384 2255 for shareholders with hearing difficulties

Calls cost 8p per minute plus network extras

Callers from outside the UK should use + 44 (0) 121 415 7047

Telephone lines are open 8.30am to 5.30pm Monday to Friday

Dividend re-investment plan

You can elect to receive future dividends as shares rather than cash by participating in the DRIP. To register, request further information, or to obtain a copy of terms and conditions booklet and mandate form please contact Equiniti on 0871 384 2932. Alternatively, these can be downloaded from the website www.shareview.co.uk by choosing the Dividend Investment Plan heading within the Product Centre section

Dividends paid direct to your bank account

- Avoid the risk of cheques being lost in the post
- No need to present cheques for payment
- Dividend credited to your account on payment date

To set up a dividend mandate or change your existing mandated details please register with the Shareholder Centre via the Shareview website or contact Equiniti on the number provided above

Global payment services

For overseas shareholders in certain countries Equiniti offers an Overseas Payment Service by arrangement with Citibank Europe PLC. This service offers shareholders the ability to have their dividend converted into their local currency and sent electronically to their local bank account. To sign up for this service, please contact Equiniti on 0871 384 2932 (+ 44 (0) 121 415 7047 if calling from outside the UK). Alternatively you can download an application form and terms and conditions from the website www.shareview.co.uk

Electronic communication

You can register for electronic communications by visiting www.shareview.co.uk you will need your shareholder reference number to sign up. After you have registered you will receive emails alerting you to communications as they become available

Share dealing

Serco does not endorse any one service for the buying and selling of its shares. However, arrangements have been made with the following independent share dealing provider to offer all shareholders competitive charges

Alternatively if shareholders hold a share certificate they can also use any bank, building society or stockbroker offering share dealing facilities. Shareholders in any doubt about buying or selling their shares should seek professional financial advice

Stocktrade

We have arranged a telephone sharedealing service with Stocktrade for purchases/sales of Serco Group plc shares. You should call +44 (0)131 240 0414 between 8.00am and 4.30pm, Monday to Friday and quote Low Co 330. Commission is charged at 0.5% on amounts to £10,000 and 0.2% on the excess thereafter subject to a minimum charge of £17.50. Further details and other dealing options can be found at www.stocktrade.co.uk/serco. This service is not available to US residents

Please note that UK share purchases will be subject to 0.5% stamp duty

Shareholder profile

The range and size of ordinary shareholding as at 31 December 2013 is set out below

	Number of shareholders	%	Number of shares	%
1 – 1,000	4,428	53.48	1,754,387	0.35
1,001 – 5,000	2,626	32.09	5,567,119	1.11
5,001 – 10,000	415	5.00	2,782,599	0.56
10,001 – 100,000	484	5.95	15,413,813	3.09
100,001 – 500,000	162	1.99	40,586,900	8.13
500,001 – 1,000,000	48	0.60	34,748,478	6.96
1,000,001 – 10,000,000	60	0.75	161,184,275	32.28
10,000,001 and above	11	0.14	237,291,325	47.52
Total	8,234	100	499,328,896	100

Financial calendar

2013 Full Year Results Announcement	4 March 2014
Ex-dividend date for 2013 final dividend	12 March 2014
Record date for 2013 final dividend	14 March 2014
Deadline for DRIP mandates	22 April 2014
AGM and Interim Management Statement	08 May 2014
Payment date for 2013 final dividend	14 May 2014
Pre-close statement	27 June 2014
2014 Half Year Results announcement	* 12 August 2014
Ex-dividend date for 2013 interim dividend	* 3 September 2014
Record date for 2014 interim dividend	* 5 September 2014
Deadline for DRIP mandates	* 26 September 2014
Payment date for 2014 interim dividend	* 17 October 2014
Interim Management Statement	* 18 November 2014
Pre-close statement	* 19 December 2014

* Provisional and/or subject to shareholder approval

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